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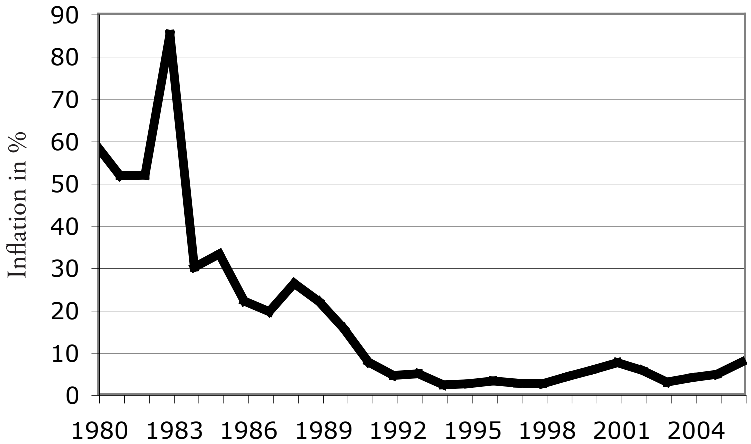
The Icelandic Model:
Neither Scandinavian Nor Anglo-Saxon

Commentators on current affairs sometimes distinguish between Anglo-Saxon and Scandinavian models of welfare capitalism. The former is said to be characterised by an entrepreneurial spirit, extensive economic freedom, low taxes, a rather unequal distribution of income and limited welfare benefits, allocated on the basis of need rather than as a right. The US, Canada, Ireland (although historically Celtic) and the UK would be typical such societies. The latter model is defined by an open economy, considerable economic freedom, high taxes, a relatively equal distribution of income and generous welfare provisions for all. Examples would be the three Scandinavian countries, Sweden, Norway and Denmark (Esping-Andersen, 1990). Where is the place of Iceland in this scheme? In 1991-2007, a comprehensive programme of stabilisation, liberalisation, privatisation and tax cuts was implemented in Iceland. While nobody denies that the reforms were economically successful, their critics claim that, because of them, Iceland has moved, at least some of the way, from the superior Scandinavian model to the inferior Anglo-Saxon one. The reforms mainly benefited the rich, the critics argue, as the distribution of income became more unequal, while poverty remains greater than

Figure 1
Inflation (Invisible Taxation) Going Down



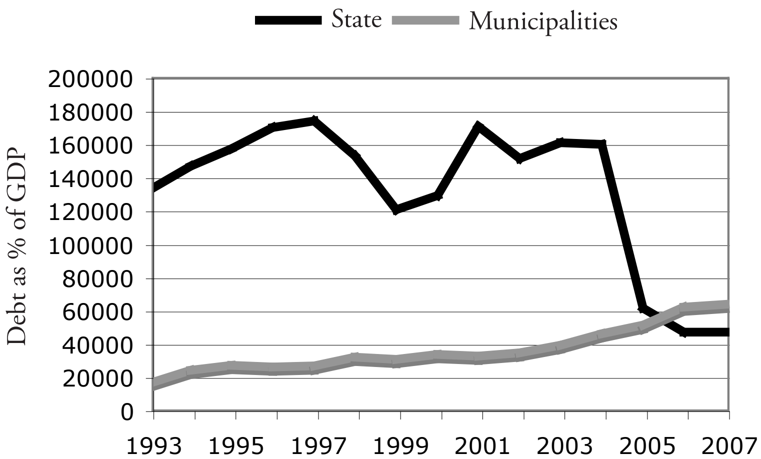
Source: Iceland Statistics

in the three Scandinavian countries (Olafsson and Sigurdsson, 2000; Olafsson, 2006a and 2006b; Gylfason, 2006). In this paper, those claims will be examined.

An Outline of the 1991-2007 Economic Reforms

In the early 1980s, free market ideas made a strong impact on a group of young intellectuals in the Independence Party—Iceland's largest political party, usually supported by about 35-40% of the voters. The Nobel Laureates Friedrich A. Hayek, James M. Buchanan and Milton Friedman all visited Iceland, and their works were translated and widely discussed. One member of this group was David Oddsson who, only 43 years old, became leader of the Independence Party and Prime Minister in 1991. He moved swiftly to abolish some government investment funds which had been used by his predecessors to sustain inefficient enterprises, often in the name of job creation or regional policy. Thus, Oddsson practically emptied his waiting room. The next step was monetary and fiscal stabilisation. Inflation had for dec-

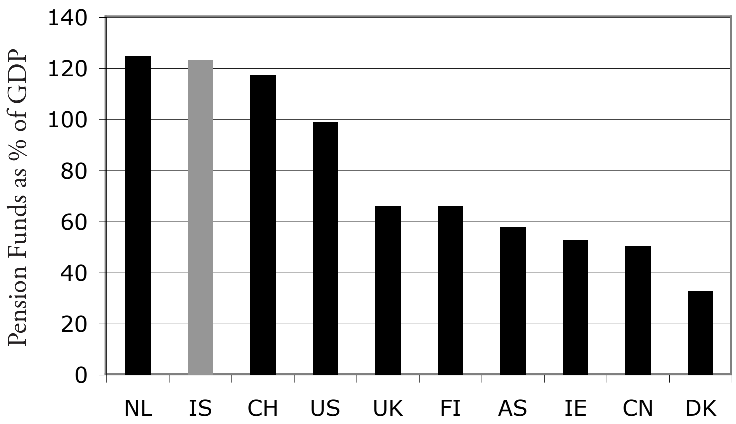
Figure 2
Government Debt (Invisible Taxation) Going Down



Source: Icelandic Ministry of Finances

ades been much higher in Iceland than in the neighbouring countries. As shown in Figure 1, it fell rapidly after 1991, not primarily by increasing restraint in collective wage bargaining (although it certainly helped), but by monetary constraints imposed by an increasingly independent central bank. The government deficit was slowly turned into a surplus, and the public debt was greatly reduced so that in 2007 it had become practically non-existent, as shown in Figure 2 (whereas the municipalities, the biggest of whom was controlled by a left-wing coalition from 1994, accumulated debt). In 2007, interest payments to government are for the first time in a long time estimated to exceed interest payments from government. Both the reduction of inflation and the disappearance of the public debt amounted to tax cuts: inflation is an invisible and involuntary tax on those who hold money, and debt accumulation is (in many cases) a tax deferred, hitting coming generations. The Oddsson government's third step was market liberalisation, facilitating trade and capital transfers between Iceland and other countries. An important part of this was mem-

Figure 3
Ten Strongest Pension Systems in OECD



Source: OECD, 2006

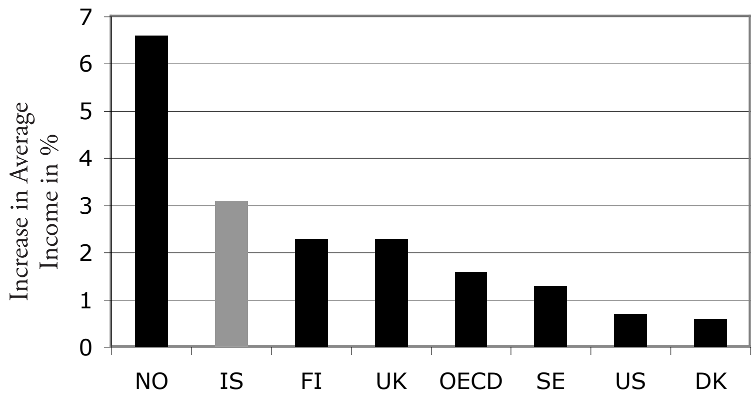
bership from 1994 in the European Economic Area, EEA, which opened the expanding European market to Icelandic products. Fearful of losing control of its fertile fishing grounds, Iceland has however chosen to remain outside the EU. In 2007, the only members of the EEA which are not also members of the EU are Iceland, Norway and Liechtenstein.

For four years, from 1991, the Social Democratic Party was the junior coalition partner of the Independence Party, to be replaced in 1995 by the Progressive Party (which has a mostly rural electoral basis). The economic programme, however, remained the same. The sixteen years from 1991 to 2007 saw massive privatisation. Government enterprises, including large fish processing plants, an investment fund, two commercial banks and the telephone company, were sold for about 2 billion US dollars. (This would be tantamount, in its economic impact, to the US government selling assets for 2 trillion dollars.) Since their privatisation, the banks have expanded enormously. The largest Icelandic bank, Kaupthing, was in 2006 one of the world's 200 largest banks, with more than 70% of its operations abroad. It greatly facilitated the rapid growth of the economy that a turnover tax was abolished and that the corporate income tax was gradually cut from 45 to 18 per cent. In those sixteen years, another kind of privatisation also took place: individual and transferable rights to harvest the valuable fish stocks in the Icelandic waters, already partly in place, were developed further: these are the so-called individual transferable quotas, ITQs. This meant that a fertile natural resource which had been ownerless, unregistered, unusable as a collateral and neither divisible nor transferable, and therefore not worth much, became a registered, divisible, transferable capital good in the hands of those who hold quotas. A third important reform was that the pension system was made fully-funded, and partly privatised. As shown in Figure 3, it has become one of the world's strongest pension systems (OECD, 2005). In a sense, this amounted to yet another tax cut because in many other countries where pension systems are not fully funded they constitute an obligation on future taxpayers. Since the turn of the century, Iceland—formerly mostly reliant on its fisheries—has become somewat of a financial centre, and Icelandic companies have invested a lot abroad. The sources of the Icelanders' new-found capital are not mysterious. They are mainly three: the added value of the privatised enterprises on the one hand and the fish stocks on the other hand and, thirdly, the strong pension funds (Kristinsson, 2006).

The Reforms Benefited All Income Groups

In 1991-2007, it was not only the taxes on business—the turnover tax and the corporate income tax (and a special tax on commercial housing)—which were cut: the personal income tax was cut by 8 per cent, from about 31 per cent in 1997 to about 23 per cent in 2007; a special surcharge on high income was abolished; the wealth tax was abolished and the estate tax was lowered. After an adjustment period of about four years, 1991-5, where some companies went bankrupt because they no longer enjoyed direct or indirect government subsidies, at the same time as total allowable catches in some Icelandic fish stocks had temporarily to be reduced, the economy began to grow. Its annual growth between

Figure 4
Increase in Income of 20% Poorest in Nordic and Anglo-Saxon Countries 1995-2000

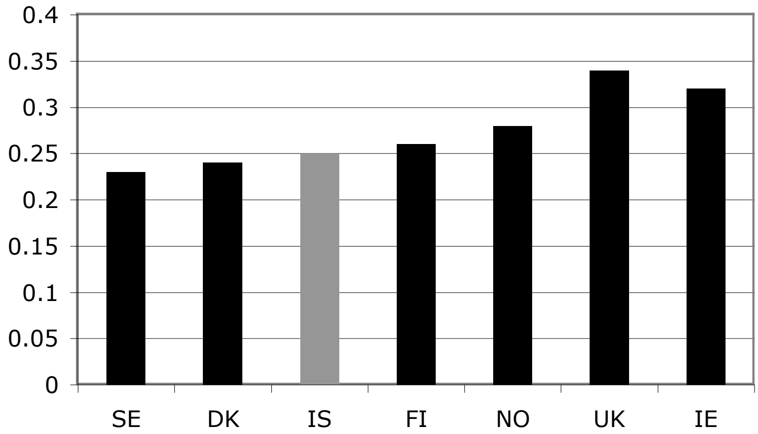


Source: Olafsson, 2006

1995 and 2005 was on average 4.3 per cent (OECD, 2007). In 2007, Iceland is one of the world's richest countries in terms of GDP per capita, being in the same league as Norway, the US, Ireland and Switzerland (whereas, traditionally, Luxembourg always occupies the first place on the list). But how have the benefits of economic growth been distributed? According to one of the most vocal critics of the economic reforms, sociologist Stefan Olafsson (2006b), all income groups benefited from the rapid economic growth, but the rich much more than the poor. In the years 1995-2004, the disposable income (after tax) of the 10 per cent lowest-income group increased by 27 per cent, and of the 10 per cent highest-income group by 78 per cent. On average, the disposable income of all increased by 48 per cent. Olafsson believes that the changes in the tax structure mainly favoured the higher-income groups, not least the reduction of the personal income tax and of the estate tax, the abolition of the wealth tax and of the special high-income surcharge, and the relatively low rate—10 per cent—of the capital income tax.

While some of Olafsson's statistics can been criticized (Gissurarson,

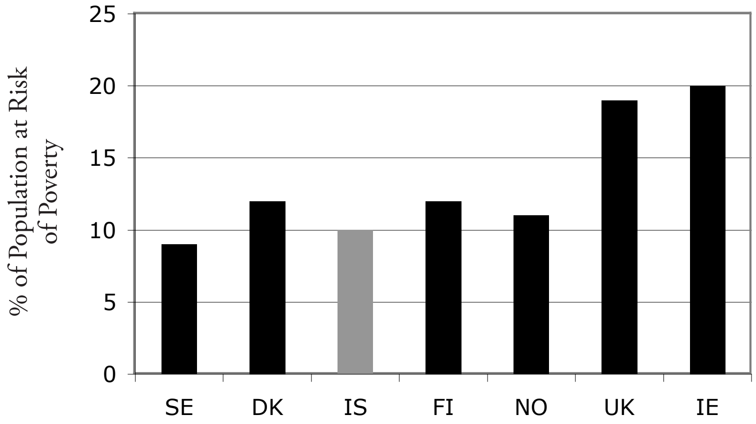
Figure 5
Gini-Coefficients for Nordic
and Anglo-Saxon Countries 2003-2004



Source: Eurostat and Icelandic Statistics

2007a), he is probably right that in 1995-2004 the higher-income groups in Iceland gained more than the lower-income groups and that the tax system has become less redistributive than it used to be in Iceland and still is in the other Nordic countries. But an important question is how the lower-income groups in Iceland have fared in comparison with similar groups in other countries. This is shown in Figure 4. In 1995-2000, the disposable income (after tax) of the 20 per cent lowest income group in Iceland increased by 3.1 per cent on average. In the same period, the disposable income of the same kind of group increased in the OECD by 1.6 per cent on average (Olafsson, 2006b). It is only in Norway, with its huge oil revenues, where the disposable income of the poorest has increased significantly more than in Iceland. In other words, if the increase in disposable income is treated as a gain from social cooperation, the poor in Iceland seem to have gained more from their rich than the poor in other countries have gained from their rich. Be that as it may, according to a 2007 EU study, the distribution of income is no less equal in Iceland than in the other Nordic countries. One way of measuring the distribution of income is by the so-called Gini-Coef-

Figure 6
Risk of Poverty in Nordic
and Anglo-Saxon Countries 2004



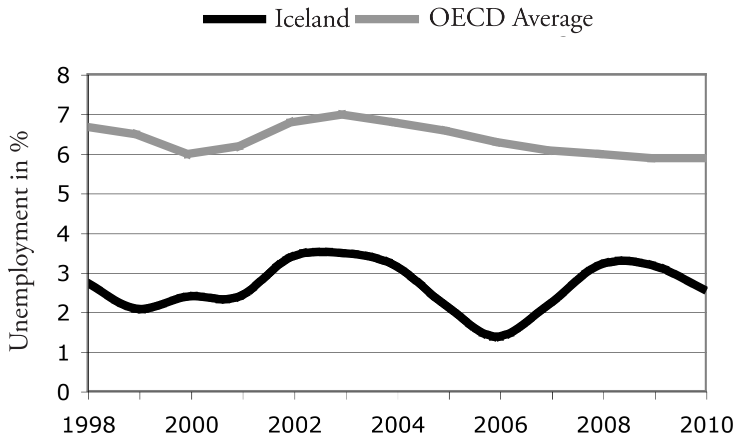
Source: Eurostat and Icelandic Statistics

ficient which is zero if all have equal income and one if one person only has all the income. The 2004 Gini-Coefficients for Iceland and the four other Nordic countries as well as two Anglo-Saxon countries, the UK and Ireland, are shown in Figure 5. Sweden and Denmark have a more equal distribution of income than Iceland, but Finland and Norway a less equal one. The UK and Ireland have a much less equal distribution of income (Eurostat, 2007). This result is remarkable in the light of the discussion about whether or not Iceland has abandoned the Scandinavian Model. At least the rapid economic growth of the recent years has not brought about an increase in inequality in Iceland such that it has ceased to be a typical Nordic country.

Poverty Negligible in Iceland

Why should we anyway be concerned about an unequal distribution of income? What many would find important is not whether the income of the Icelandic rich has increased more rapidly than that of other income groups in the country, but whether they have acquired their income in a legitimate and just way. No plausible

Figure 7
Less Unemployment = More Opportunities to Escape Poverty

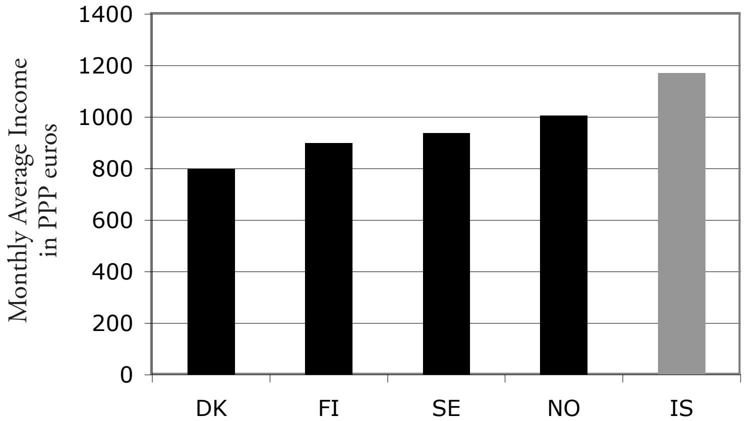


Source: Icelandic Statistics

argument has been made that this was not the case. Consider an opera singer performing in Reykjavik's largest theatre. Even though the tickets are expensive, the public flock to her concert, which they thoroughly enjoy. After the event, the opera singer is richer by 500,000 US dollars and her audience of 5,000 people are poorer by 100 dollars each. Where is the problem? It cannot be the opera singer and other high-income people unless they have somehow used unjustifable means to acquire their income (Nozick, 1974). There are plausible explanations for the sudden increase in wealth in Iceland, already mentioned, mainly the transformation of unregistered, untransferable and therefore almost worthless capital into registered and transferable capital (cf. de Soto, 2003). Instead of worrying about the rich, or about the distribution of income, some would rather be concerned about the poor. We should remember that their income—i.e. that of the 20 per cent Icelanders with the lowest income—increased, in 1995-2000, at almost the double rate of what is the average in OECD countries. Moreover, according to the aforementioned 2007 EU study, in Europe the "risk of poverty" rate—defined as the proportion of people with an income under 60 per cent of median income—is in 2004 lowest in two Nordic countries, Sweden, with 9 per cent, and Iceland, with 10 per cent, the country sharing that second place with the Czech Republic (Eurostat, 2007). This is shown in Figure 6. A more common concept of poverty, however, refers to the proportion of people with an income under 50 per cent of median income. In 2004, this was, according to the same study, 5.3 per cent. In 1997, the poverty rate defined in this way was found to be about 7-8 per cent (Olafsson and Sigurdsson, 2000). The conclusion is that not only is the poverty rate in Iceland one of the lowest in the world: it is also rapidly falling.

It should be noted that this is relative rather than absolute poverty: it is defined by how high the median income in the country itself is, not by the amount of Icelandic kronur or US dollars at the disposal of the poor. Since the GDP per capita in Iceland is one of the highest in the world, it is safe to assume that absolute poverty is also one of, if not the, lowest in the world. According to the 2007 study, the poverty threshold in Iceland in 2004 was 14,664 USD per year for an individual (at the average exchange rate of that year). The 5.3 per cent of the Icelanders counted as poor had an income below this level. In the same year, the absolute poverty threshold in the US was 9,645 USD per year (US Census, 2004). About 12 per cent of the US citizens had an income below this level. By definition, poverty is never pleasant. But all indicators show that there are fewer people poor in Iceland than in almost all other countries in the world and that the living standards of those few who count as poor are higher than elsewhere. Moreover, the question cannot be solely how bearable poverty is, but also how easy it is to get out of it. In the other Scandinavian countries and elsewhere in Europe, the main emphasis seems to be on making poverty more bearable, which creates the danger, of course, that people will remain poor. Iceland is like those countries following the Anglo-Saxon model, in that the emphasis is also on creating opportunities and incentives for the poor to leave poverty. Most importantly, unemployment is negligible in Iceland, as illustrated in Figure 7. Those who want to work, can—whereas in many

Figure 8
Average Pension Income
in Nordic Countries 2004



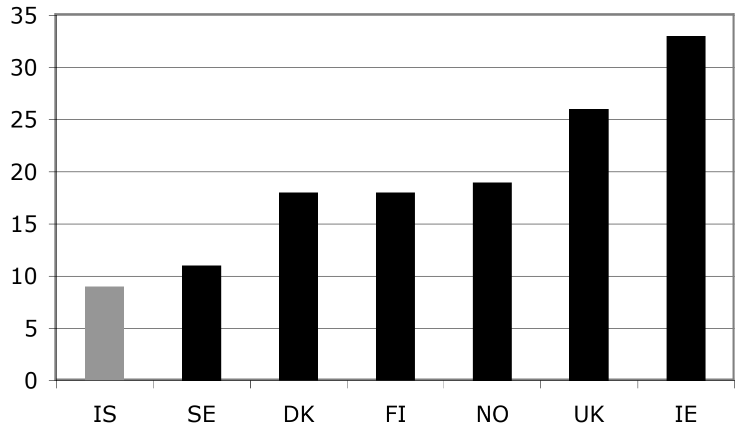
Source: Nososco, 2007

other OECD countries unemployment, especially amongst young people, is high, even 10-20 per cent.

Social Exclusion Negligible in Iceland

Unemployment is one of the worst forms of social exclusion. Another form of social exclusion is when people are forced to take early retirement. In Iceland people work on average longer than their contemporaries in the neighbouring countries. Of the 31,000 Icelanders 67 years and older in 2004, about 5,000 did not take a pension, since they were working full-time. According to a 2006 study, the pension income in Iceland was on average higher than in the four other Nordic countries, as shown in Figure 8 (Nososco, 2006). It is true that in Iceland pension payments per each individual 67 years or older were on average lower than in the other Nordic countries, but that was only because so many of them continued working full-time and did not therefore take pensions. Usually it is regarded as positive when the elderly are allowed to work longer: they then maintain a sense of belonging and meaning in their lives. It is clear, at least, that generally the Icelandic elderly do not have

Figure 9
Risk of Poverty and Below in 65 Years and Older

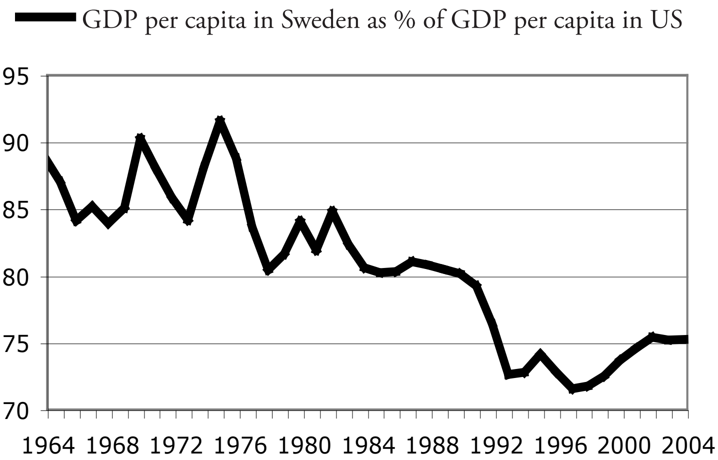


Source: Eurostat 2007

to work because they are desperately poor. According to the 2007 EU study, the risk of poverty rate for people at the pension age was in 2004 the lowest in Iceland in the whole of Europe, as illustrated in Figure 9 (Eurostat, 2007). In other words, although there are always sad exceptions, poverty amongst the elderly is probably less of a problem in Iceland than in any other country in world. Not only the strong pension system, but also the abolition of the wealth tax has benefited the elderly who often live in large flats or houses, while they do not always enjoy a correspondingly high income. (The wealth tax was therefore sometimes called the "widows' tax".) These results differ markedly, however, from what Icelandic critics of the economic reforms said in a recent report on poverty: "The relatively high degree of poverty amongst the elderly is in considerable contrast to the findings from the other Nordic countries, where poverty in this group has been greatly reduced, primarily by means of the welfare state" (Olafsson and Sigurdsson, 2000, p.116). Either the critics' figures were not correct, or the living standard of the elderly in Iceland has greatly improved in the years since 2000—or perhaps both.

The paradox of the Icelandic pension system is that total outlays

Figure 10
The Decline of Sweden Relative to US



Source: OECD 2007

per each person at pension age are lower than in the other Nordic countries, while the incomes of those who receive pensions are on average higher. The same can be said about child benefits in Iceland, but for a different reason: since child benefits are means-tested, total outlays per each child are lower than in the other Nordic countries, whereas the amount per child in low-income households is higher. In Sweden, for example, child benefits are equal for rich and poor. In Iceland, on the other hand, child benefits are low for the rich and high for the poor. Compare child benefits for a single parent in Iceland and Sweden, in 2006 (Tryggingastofnun, 2006, Forsakringskassan, 2006; USD at current rate):

Annual Parent Income	IS: 1 child younger than 7	SE: 1 child younger than 7	IS: 2 children, 1 younger than 7	SE: 2 children, 1 younger than 7
13,281	3,991	1,823	7,399	3,819
28,571	3,532	1,823	6,329	3,819
57,143	2,675	1,823	4,329	3,819
71,429	2,246	1,823	3,329	3,819

There is a fundamental difference between the two welfare systems. In Iceland, the assistance is based on need: in a world of scarce resources, it is possible to pay more to the poor, if less is paid to the rich. In Sweden, however, the assistance is based on what is seen as the right of the child, irrespective of whether its parent is rich or poor, which means that the poor get less than in Iceland (Gissurarson, 2007b).

A Unique Model

It is not clear that the Scandinavian model of welfare capitalism is superior to the Anglo-Saxon one, even from the point of view of the poor: while welfare provision are certainly more generous in Scandinavia, there are more opportunities to escape poverty in North America and on the British Isles, if only because of greater long-term economic growth. Figure 10 shows the decline of Sweden relative to the US in 1964-2004, measured in GDP per capita. But Iceland has not moved from the Scandinavian to the Anglo-Saxon model in the last sixteen years, as a result of its free-market reforms. Indeed, what has happened is that Iceland has developed its own unique and mixed model. It is Anglo-Saxon in that it is characterised by an entrepreneurial spirit, extensive economic freedom, relatively low taxes, and welfare benefits allocated on the basis of need rather than as a right. It is Scandinavian in that it is defined by an open economy, a relatively equal distribution of income and generous welfare provisions for those in need. The Icelandic model illustrates that tax cuts do not necessarily mean less welfare or worse public services. Instead, such tax cuts may stimulate more wealth creation which, in turn, increases the tax base. But of course, the more affluent the general population becomes and the more people there are migrating from low to high income groups, the less future need will there be for various welfare benefits. Why should rich old people or well-off parents receive public assistance? Switzerland has quite adequate welfare provisions even if the level of taxation, as a proportion of GDP, is only a little more than half of what it is in Sweden. If the corporate income tax is cut from 18 to 10 per cent, then Iceland will have great potential as a financial centre, with its direct access to the European market, strategic position in the middle of the North Atlantic Ocean, stable political structure, daily flights to many North American and European cities, and well-educated population. If the personal income tax is cut by, say, 6 per cent, then there would not be the same pressure to raise wages, in an inflationary process of collective wage bargaining. Despite the liberalisation programme of the last sixteen years, government is still too big in Iceland. To maintain the successful Icelandic model, it is necessary to reduce government, not least by radical tax cuts.

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