



# **More Selectivity in Unemployment Compensation in Finland: Has it Led to Activation or Increased Poverty?**

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## **Contents**

Abstract.....	v
1. Introduction .....	1
2. Background: employment and labour market policy development in Finland .....	1
2.1 From “right to work” towards recession .....	2
2.2 The labour market context of the 1990’s .....	8
3. The 1994 Reform .....	10
3.1 What was proposed .....	10
3.2 What became of the reform .....	12
4. Data .....	13
4.1 Register information of labour market support .....	14
5. General developments .....	15
6. Activation .....	18
6.1 Active labour market policy measures .....	18
6.2 Activation in general .....	19
7. Poverty-related issues.....	21
8. Conclusion.....	26
References .....	31
Appendices .....	33
Appendix 1. The Data and variables in Figure 2 and Table 3 .....	33
Appendix 2. Unemployment benefit types in Finland, 1986-2001 (shares counted from annual averages) .....	34
Appendix 3. People on labour market support (stock = unemployed or in active measures at the end of the year) by age and labour market policy status .....	35

## **List of tables**

Table 1. Participation in active labour market policy measures (APM) 1990-1998.....	10
Table 2. Labour market support stock at the end of the year (1995 and 1997, including those in APM): share of those who actually received support on the following year.....	15
Table 3. Stock of unemployed and those in active labour market measures at the end of the year: shares of unemployment type, and shares of people on labour market support and receivers of social assistance by unemployment type .....	24

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### **List of Figures**

Figure 1. Gross domestic product (in 1995 prices) and the amount of employed persons (aged 15-64, annual average) in Finland 1989-2001. Index, 1989=100.....	4
Figure 2. Unemployment types of labour force (annual flow) 1990-1998 .....	8
Figure 3. Unemployed people in Finland by benefit type 1986-2001 (annual averages).....	16
Figure 4. People on labour market support (stock = unemployed or in active measures at the end of the year) by age and labour market policy status .....	17
Figure 5. Share of people in active labour market policy measures (APM) of those unemployed or in APM at the end of the year .....	19
Figure 6. Share of those active at the end of the following year of those who were unemployed or in APM at the end of the year .....	20
Figure 7. Absolute numbers and shares of social assistance recipients in different groups of people unemployed or in APM at the end of the year.....	23

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## Abstract

Until 1994, besides an unemployment insurance system, a universal unemployment allowance existed in Finland. In the mid-1990's, two reforms of unemployment security were carried out. A new, more selective, flat rate benefit ("labour market support") was introduced and the employment condition to qualify for insurance benefit was tightened. The aim was to activate the unemployed in a situation of persistent unemployment after a grave recession.

Obviously, the two reforms have decreased universality in the Finnish social security model. Nowadays, only about a half of the unemployed receive insurance benefit. Focusing mainly on the 1994 reform, we will discuss whether the reforms led to activation of the unemployed or rather to increased poverty and dependence of social assistance. Our conclusions are based on a preliminary analysis of a large register-based panel data, which covers the years 1987-2000.



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## 1. Introduction

This is a work-in-progress, only at a starting phase. It is a part of a larger long-term project of the authors, dealing with the analysis of the role of labour market and social policies and their reforms for the development of the unemployment problem and poverty related to it. The analysis and conclusions are preliminary and incomplete.

Our aim in this paper is to analyse the consequences of a reform of the unemployment compensation system targeted to labour market entrants and those who have received the maximum length of unemployment insurance benefit: the introduction of labour market support in 1994 in Finland. Other reforms relevant in this context, notably the abolishment of employment obligation of the public authorities in 1993 and tightening of the unemployment insurance conditions in 1996, are also considered.

First we review the development of employment and unemployment as well as of labour market policies in Finland since the 1980s.

In Section 3, we present the background, goals and contents of the 1994 reform in detail. Section 4 presents the data of our empirical analysis.

In Section 5 we analyse the general consequences of the reform and the expansion and structure of the recipients of the new benefit. The goal of the reform was to support the activation of the unemployed; in Section 6 we analyse how far this goal has been realized. In Section 7, we try to measure if the reform has had an impact on the incidence of poverty among the unemployed.

In Section 8, we draw some preliminary conclusions of our analysis.

## 2. Background: employment and labour market policy development in Finland

In the ideology of the Finnish welfare state, the pursuit towards full employment has always been ranked high. The employment law of 1971 obliged

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the state to promote the demand for labour and implement labour market policy measures that help the demand and supply of labour to balance. In 1972, the Finnish Constitution was amended as follows: “if needed, it is the task of the state authorities to arrange an opportunity to work for the citizens of Finland ”. In spite of this, the Finnish state, in practice, was not as committed to achieving full employment as were the other Nordic countries. In the 1980s, however, this commitment became clearly stronger, which can be seen both in the legislation and in practice.

## **2.1 From “right to work” towards recession**

The employment law of 1987 defined full employment as the goal of the state, and made public authorities responsible for arranging training or subsidized employment (typically for six months) for the young unemployed and the long-term unemployed (this was named as employment obligation). Thus, a kind of universal social right to (temporary) employment was created. As a consequence, long-term unemployment (unemployment spells longer than 12 months) became a rarity in Finland.

Quite soon, however, a considerable revision of the principles of the Finnish labour market policies was started. An important background to these changes was the severe recession that hit Finland in the early 1990s. It was deeper than in any industrialized country in any period covered by OECD-statistics. In 1991-93, gross domestic product (GDP) fell by 13 per cent and total domestic demand with 25 per cent. Employment rate decreased substantially and unemployment rate skyrocketed. In

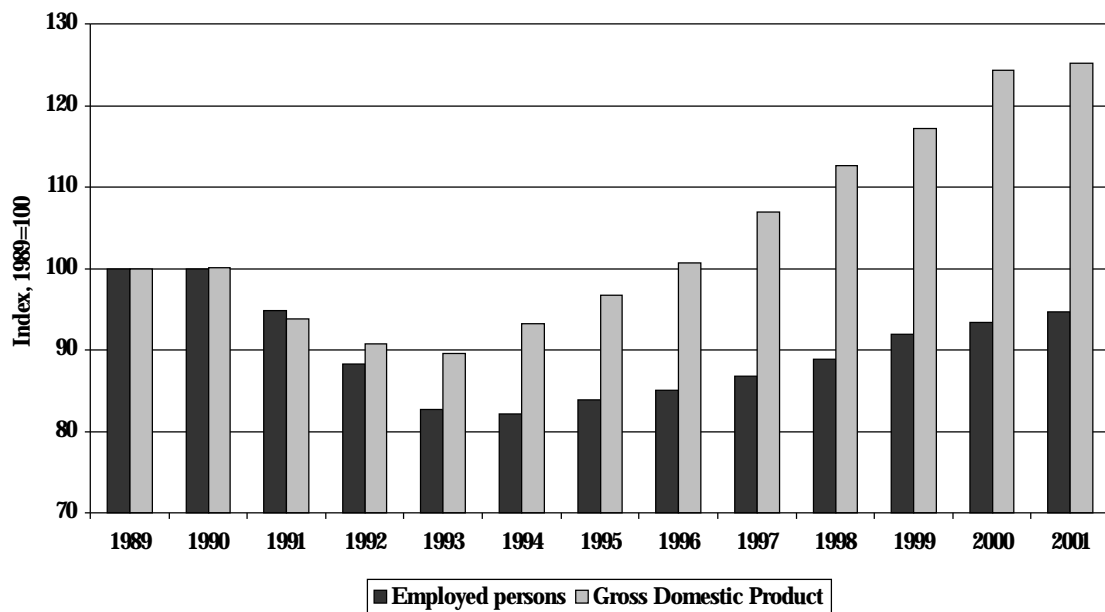


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Figure, we see the development of GDP and employment.

With the fast-increasing unemployment, it became impossible (both financially and practically) to fulfil the employment obligation, and it was mitigated in 1992 and abolished in 1993. The opportunity to participate in active labour market policy measures (APM) was no more offered to all whose unemployment prolonged, and long-term unemployment started to grow rapidly. This had long reaching consequences in relation to the income security of the unemployed.

Figure 1. Gross domestic product (in 1995 prices) and the amount of employed persons (aged 15-64, annual average) in Finland 1989-2001. Index, 1989=100



Note: The scale has been cut. Source: Statistics, Finland.

Finland has traditionally had a dual unemployment compensation system, consisting of an earnings-related (average replacement rate about 60 per cent of earlier earnings) unemployment insurance and a means-tested flat-rate (quite low) unemployment allowance paid totally by the state. The conditions of entitlement to insurance benefit are membership in an unemployment fund (typically associated with labour unions) and at least six months employment during the past 12 months (until 1996, see below). Those who do not qualify are entitled to state allowance.

In 1994, the unemployment compensation system was reformed by introducing a new form of benefit, called a “labour market support”, for those not fulfilling the employment condition for unemployment insurance or having received the maximum period of unemployment benefit. The new benefit has similar characteristics as the traditional state allowance and has largely replaced it. This reform is in detail examined in this paper.

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The employment obligation used to give an opportunity to qualify and re-qualify for earnings-related benefit. The abolishment of the obligation led to the situation where this was no more automatically possible, and the reforms in 1996 (see below) made it even more difficult. As a consequence, increasing proportion of the unemployed lost their right to insurance benefit, or could not fulfil the employment condition in the first place.

While high unemployment turned out to remain persistent despite the considerable economic growth from 1994 onwards, “benefit dependency” and “incentive traps” became soon big political issues for the Government trying to find means to decrease unemployment. In 1996, the Government implemented a programme of small reforms in various social security systems, social assistance norms, income taxation, and children’s public day-care-fee policy in order to make employment - even temporary or low-income - always profitable in comparison with living on social security.

The employment condition of unemployment insurance was also tightened: it was raised to ten months employment during the last two years. This was motivated by the fact that especially subsidized employment in the public sector was not effective in facilitating later employment on the open labour market, but seemed rather often to be used as a means to gain or renew the right to the earnings-related unemployment benefit. After the reform, a single period of subsidized employment has alone not been sufficient in fulfilling the employment condition. Already from 1994 on, offering subsidized jobs for the young had increasingly been replaced by “labour market training with labour market support” (i.e. without wages and formal employment relationship). In addition, after the further reforms of 1996-97, the right to the labour market support for under 25-year-olds is gained only by applying for and starting, or completing, vocational education (Aho and Vehviläinen 1997).

The reform of public employment services in 1998 further increased the activation emphasis in the Finnish labour market policy (Räisänen and Skog

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1998).<sup>1</sup> The major elements of the reform were fixed-term interviews with job seekers, drawing up a job-search plan with the employment office, and supplying short training courses in the art of searching for a job extensively and intensively. A certain concern about the least employable persons was shown in that a new higher form of employment subsidy (called combined subsidy) was targeted to the group of those long-term unemployed who received labour market support. After partly critical evaluations (Aho et al., 2000; Arnkil et al., 2000; Malmberg-Heinonen and Vuori 2000; Tuomala 2000), a plan to continue and develop the reform has recently been published under the title “The Second Wave” by the Ministry of Labour (Työministeriö, 2001).

In general, what effects have the labour market policies and their changes had during the 1990s? Extensive subsidized employment and labour market training have no doubt decreased open unemployment; in the 1990s, the unemployment rate was 3 to 4 percentage points lower than it otherwise would have been (see Table, below). Evaluation studies have shown, however, that participation in the measures has not notably promoted later employment on the labour market, compared with the non-participated (Aho et al., 1999; Aho et al. 2001). According to evaluations, the service reform of the year 1998 did not have any significant impacts on employment either. (Aho et al., 2000; Malmberg-Heinonen and Vuori 2000; Tuomala 2000).

Evaluation reports on the reforms of 1996 conclude that they actually were successful in removing “incentive traps”. The employment impacts of these

<sup>1</sup> There has been an exception in the activation emphasis of the Finnish labour market policy: for the ageing unemployed, instead of active measures, an opportunity to early retirement has been provided through a rather generous unemployment pension system. Since 1990, unemployment (with some other conditions) at the age of 60 has given the right to retirement with unemployment pension (earlier the age limit was even lower). However, the conditions of this opportunity were also tightened after the recession. In 1994, those not qualified to unemployment insurance benefit (who did not fill the employment condition or who had received the maximum length of benefit) at the age of 55 lost their right to the unemployment pension; in 1997, the age limit was raised to 57. Recently, in order to decrease the attractiveness of the unemployment pension, the contributions of employers were increased when employees retired on the unemployment pension, and the unemployment pension was slightly cut. Also, activating measures should be re-targeted to the ageing, who earlier were largely left “inactivated” - which, however, seems not to have taken place (see Hytti, 1998; Aho and Österman 1999; Virjo and Aho, 2002)

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reforms were positive, although quite small. (Niinivaara, 1999; Laine and Uusitalo, 2001).

The commitment to provide an opportunity for employment to all citizens (in the form of a subsidized job period after a certain length of unemployment) of the 1980s was replaced during the recession with a pursuit to improve “the functioning of the labour market” (Räisänen and Skog, 1998; Työministeriö, 2001) and to activate the unemployed. In this respect, the Finnish welfare state has changed qualitatively. “Benefit dependence” has been repelled through tightened entitlement conditions and sanctions, and by removing “incentive traps” in a way that should promote casual employment as well. In 1995, the paragraph in the Constitution obliging the state to arrange an opportunity to work for the citizens was somewhat mitigated; it is no more “the task” but “a pursuit” of the public authorities “to secure everyone the right to work”.

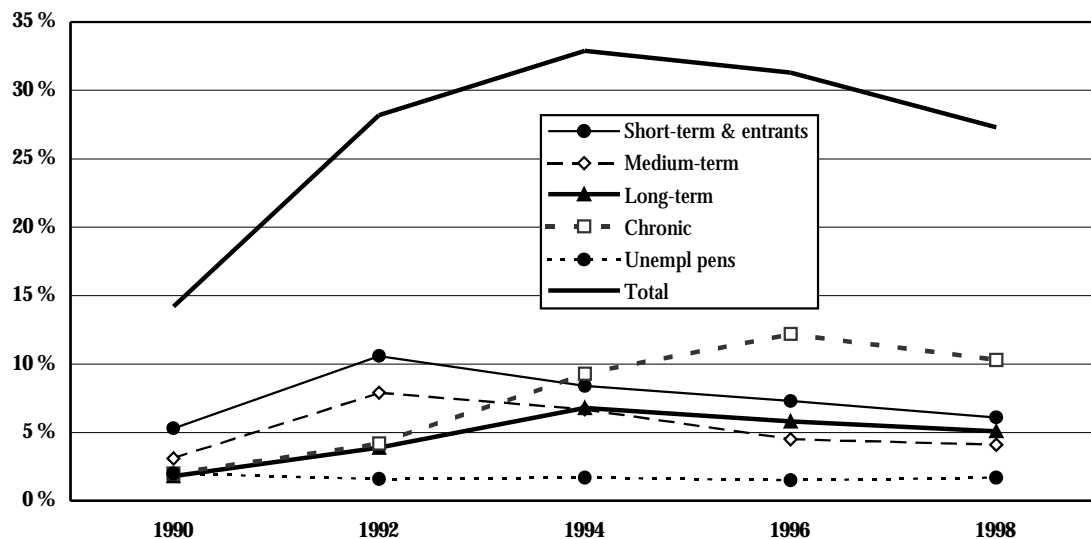
Nevertheless, extensive investment in activation has not significantly reduced the persistent structural long-term unemployment originated along with the recession. There is no reason to expect that the impact of this policy would improve later either. If the demand for low-skilled labour is structurally low, as is the case in Finland, any temporary subsidized employment and conventional vocational courses seem unable to provide the crucial remedy for the problem of persistent unemployment.

A couple of years ago it seemed that the government had surrendered in front of the structural unemployment problem. An indication of this was the revision of the strategy of the Ministry of Labour, which gave priority to “fulfilling the demand for labour”. About unemployment, it states that attempts will be made “to shorten the average duration of unemployment” and “to reduce the flow to long-term unemployment” - not ambitious goals when nearly 10 per cent of the labour force is suffering of long-term unemployment. (Työministeriö, 2001.) However, recently more resources have been targeted to the measures for the least employable persons. Also, structural employment has been taken to the agenda of political debate again, seemingly because the time of the next parliament elections (spring 2003) is coming closer.

## 2.2 The labour market context of the 1990's

Although the economic recovery 1994-2000 was remarkable in comparison to the development in other countries, it was not sufficient to repair the employment losses of the recession, especially when the parallel increase in labour supply is considered. For the understanding of the context of the 1994 reform, it is essential to consider that (in addition to the dramatic increase in the unemployment level) the recession was followed by a change in the unemployment structure, when long-term and repeated unemployment became essentially more common. Conventional unemployment statistics do not provide any clear information on the extent of the problem, because subsidized employment etc. cut unemployment spells, which thus become shorter than the actual time without open-market employment. Figure is based on Aho's calculations, where the annual flow of the unemployed (those having at least some unemployment experience during the current year) has been categorized on the basis of four previous years' work and unemployment history (on the data and classification criteria, see Appendix).

Figure 2. Unemployment types of labour force (annual flow) 1990-1998



Source: Aho's calculations. Typology is based on employment histories during previous four years. (See Appendix).

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In 1990, unemployment concerned directly 14 per cent of the labour force (the combined proportion of the unemployed during the year and those on unemployment pension). In the worst year of unemployment in 1994, the corresponding proportion was as high as 33 per cent. In 1998, the proportion had decreased to 27 per cent, approximately to the level of the year 1992. Short- and medium-term unemployment increased naturally fast during the recession years, but had by 1998 gradually decreased back to the level only a little higher than in 1990. However, some victims of the recession were not able to re-establish their position on the labour market and became persistently unemployed. Even after the recession, the flow to long-term unemployment has been high among elderly employees. A major question to be analysed is, if the long-term unemployment is mainly a “shadow of the recession” or if there is constantly new flow into chronic unemployment. We can already say that this flow has clearly continued from the elderly work force and on the other hand, a considerable share of the long-term unemployed is not elderly (Virjo and Aho, 2002).

The added proportion of the long-term and chronically unemployed reached its peak - 18 per cent of the labour force - in 1996, and has decreased slowly since; in 1998 it was 15 per cent of the labour force, which was four times higher than in 1990. When the proportion of unemployment pensioners (about two per cent through the period) is added to these figures, we get an estimate of structural unemployment in Finland.<sup>2</sup>

Thus, there are not only more unemployed in Finland now than before the recession, but also the majority of them seem to be more or less permanently excluded from the open labour market. The problem does not seem to be disappearing despite the improved employment situation.

It is also important to consider that in dealing with the unemployment problem, the role of active labour market policy has traditionally been quite strong

<sup>2</sup> We are currently updating the analysis to the year 2000, and it seems that the trends shown in 1996-98 are continuing without any significant turn. Since 2000 Finland is experiencing slowing economic growth.

in Finland. The measures include e.g. labour market training and subsidized jobs in the public and private sectors, and start-up grants for the unemployed starting their own business. During the 1990s, their annual volume was approximately doubled and reached its peak 1997; it has been slowly decreasing since. Table shows how significant the role of these measures has been.

Table 1. Participation in active labour market policy measures (APM) 1990-1998

	1990	1992	1994	1996	1998
Participants of the labour force					
- at the end of the year	2%	3%	3%	4%	3%
- during the same year	5%	8%	9%	10%	10%
- during the past four years	9%	12%	17%	20%	20%
Participants of the unemployed					
- during the same year	32 %	27 %	29 %	32 %	33 %
- during the past four years	44 %	38 %	46 %	52 %	56 %

Source: Aho's calculations based on register data, see Appendix.

### 3. The 1994 Reform

The main focus of this paper is the 1994 reform, even though it is obvious that when evaluating Finnish labour market developments on the whole, we have to take into account the other reforms mentioned above. In this chapter, the quite radical Bill of the Government is introduced in detail together with the actual outcome of the legislative process.

#### 3.1 What was proposed?

In 1993, the Finnish Government (Bill 235/1993) proposed a major reform to unemployment security and labour market policy. According to the Bill, the basic flat rate benefit would only be paid to those who fulfil the six-month employment condition. The benefit would also have a maximum length of 500 working days instead of having unlimited duration. On the other hand, the benefit would no longer be diminished due to spouse's income. The main arguments for the proposal were as follows:



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Employment condition: People from other countries of the EES would not instantly qualify for Finnish unemployment security. Furthermore, it was the Government's idea that unemployment security should only apply to people who had been employed. This way, unemployment benefits would not be an economic incentive for young people to remain unemployed instead of studying.

Maximum duration: This was supposed to activate the unemployed. It was also considered principally wrong, if unemployment security formed a permanent alternative to paid labour.

No means testing: Before the reform, many people who had been employed for long periods, but didn't have a voluntary unemployment insurance (or belong to a trade union), did not receive any benefit at all because of their spouse's income. This resulted in increased inequality between the sexes and worked against the right to an individual income. Because the benefit would be for a limited time and demand fulfilment of stricter conditions, it was considered financially possible to abolish the means testing.

For those who would not qualify for the new stricter conditions of the basic benefit, a new benefit form was suggested, namely "labour market support". In monetary terms, it would be as high as the basic flat rate benefit, but without increases due to child custody. It would be means-tested (though not for those who had received basic benefit for 500 days) and limited to 300 working days.

In the Bill, it was clearly stated that labour market support would form an activation benefit for young people entering the labour market. They would have the right to it only after a four-month wait (though for those who had vocational training, there would be only a very short self-risk time), and those living with their parents would receive a heavily decreased benefit. Means testing, the four-month-wait, and the decrease for those living with their parents would be lifted for the time when the person would take part in labour market training. The main point with labour market support would be that the unemployed on the benefit could be forced into labour market training without increasing the level of the benefit. The central point of concern was the young: when becoming unemployed, they should immediately become targets of a very diligent activation policy. The

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fact that even those who had received 500 working days of the basic benefit would fall onto labour market support was considered almost as a curiosity.

Even here the argument for the time-limitation of the support is that it should not be an alternative to paid labour. Furthermore, it is not the practise in other countries, either, to pay unemployment-based benefits to people who have been without paid labour for a very long time. Instead, they should be clients of the municipal social assistance. In the Government's proposal, it was stated that those who had received the maximum amount of labour market support and were not employed, would become social welfare cases.

### **3.2 What became of the reform?**

After a long discussion, the Bill was accepted with some major changes. The changes were not due so much to the parliament opposing the Bill - even though opposition was strongly against the reform, the Government had a clear majority - than to the fact that some parts of the Bill were considered constitution-level legislation. The right to basic income is guaranteed by the constitution, and any changes that would decrease it "substantially" would demand a very large majority in the parliament. Consequently, these parts of the Bill were changed accordingly. So, the waiting time was changed from four to three months, and even labour market support included increases for the custody of minors. Most importantly, labour market support was to be paid for an unlimited time.

Because the above-mentioned changes had to be made due to Constitution, they were compensated for in monetary terms by increasing means testing of the benefit. It would be means-tested for everyone except

- § during the first 180 working days for those, who had previously lifted regular unemployment benefit;
- § for those over 55 years old who had been employed previously; and
- § during labour market training.

Because of these changes, the reform that was meant to be very radical came to have a more ideological and rhetorical nature than a practical one. The name

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and nature of the new benefit emphasized activation, but for most people, it would be similar to the old basic flat rate benefit. The major practical changes concerned the young and the introduction of labour market training with the support.

In conclusion, the reform was tailored for young people coming to the labour market. They should not be able to lift benefits easily - instead, they should be activated to employment, labour market training or vocational training. Even though the above-mentioned changes to the Bill mostly concern long-term unemployed who have previously been employed, they were done merely because of constitutional reasons. It was not considered likely that the support would become a major benefit form for others than entrants to the labour market. For example, relying to statistics from 1993, the Government stated that it was “highly unlikely” that anyone would be unemployed for more than 800 days. Furthermore, the Government was optimistic about the new support, since it stressed activation, and therefore the periods on labour market support would probably be shorter than corresponding periods would be on basic flat rate benefit. It was predicted that more than 60 % of the receivers of labour market support would be less than 25 years old.

#### **4. Data**

Data have been created in Statistics Finland by combining information from various administrative registers. The data include large representative samples of the population of the years 1990 (5 per cent), 1994 (5 per cent), and 1997 (8.6 per cent) and rich yearly data covering the period 1987-99. All individuals in each sample can be followed up through the whole period.

The main sources of data used in this analysis are the following. Information on employment has been taken from the registers of employment pension funds (this insurance is compulsory and all employment relationships as well as entrepreneurial activity are registered). Information about unemployment and participation in active labour market policy measures comes from the register of labour administration (public employment services). In addition, various registers concerning education have been used.

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If the source of figures in a table or graph is not presented, the calculations are based on the above-mentioned data.

#### **4.1 Register information of labour market support**

In our data, we have information about the labour market policy –based right to receive labour market support (LMS) on a day-to-day-basis. This information is available until the year 2000. In addition, we have information from Social Insurance Institution about the amount of benefit that was actually paid until the year 1998. People who have had the labour market policy right to receive LMS may in many cases not actually have received any benefit at all because of many reasons. The labour market policy statement reads, “there is no labour market policy - based obstacle for paying LMS”. Even though there is no such obstacle, there may be other obstacles, most importantly the three-month wait period and means-testing. In a small number of cases, a person might have been on the support for such a short time that s/he has received less than FIM 500, which is registered as zero, because the statistical unit is one thousand FIM.

In the following, there is a comparison between the labour market policy right to receive LMS and the actual payment of it. The support can be paid due to two reasons: either the person has never qualified for the employment condition (DNQ), or s/he has received the maximum amount of regular (earnings-related or basic flat-rate) benefit (MAX).

The design in Table gives us a clear result of the share of people who do not receive any benefit despite their labour market policy right to it. Those, who were unemployed or in active measures at the end of the year, should have an entry of paid support during the following year if they have received any benefit. This is because the benefit is paid retrospectively. In 1995, about 15 per cent of both groups with the right to LMS did not receive any benefit. In 1997, there is a clear difference between the groups: over 20 per cent of those who have never qualified for regular benefit did not receive any LMS, when the corresponding share in the other group was only half as high. The probable explanations for the two groups

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differ as well: in the group that has received maximum amount of regular benefit, means testing is the most probable possible explanation for not receiving LMS.

In the other group, most non-receivers are probably those who have left unemployment during the three-month waiting period, and the share of those who did not receive benefit because of means testing is probably considerably smaller. In a small number of cases, refusing to take a job or enter an APM can also be the reason for not receiving any benefit. After 1996, people less than 25 years of age without vocational education, who refuse to apply for education, make up a (probably quite small) group of non-receivers.

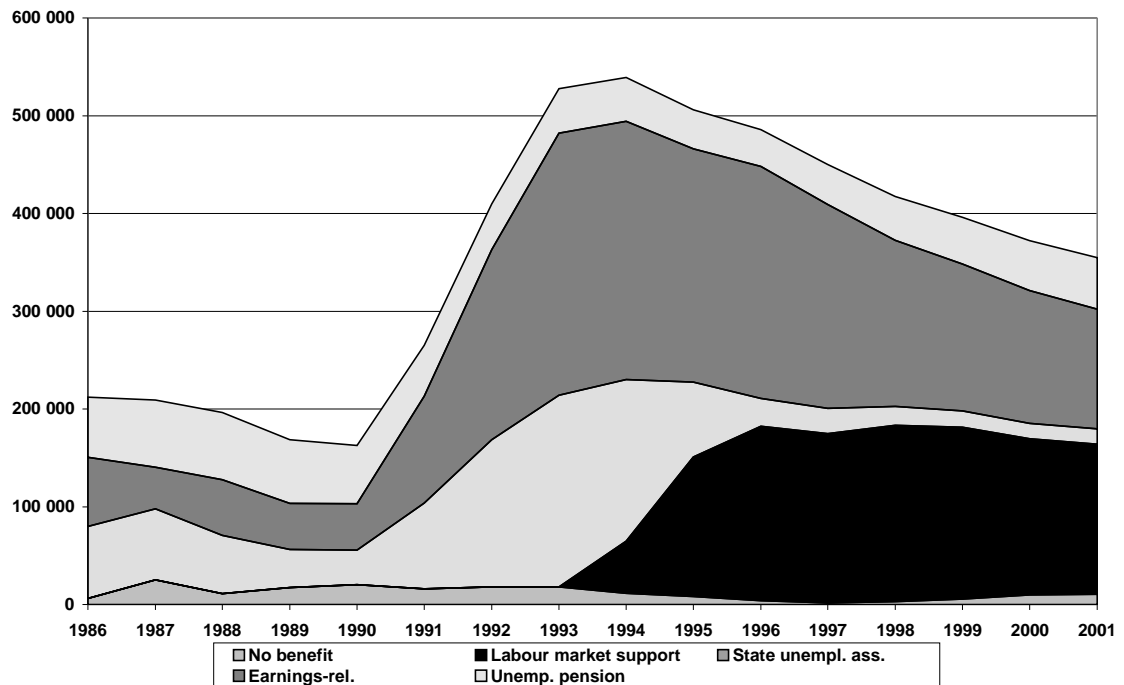
Table 2. Labour market support stock at the end of the year (1995 and 1997, including those in APM): share of those who actually received support on the following year

Year, basis for labour market policy right to LMS	Did actually receive labour market support on the following year
1995, DNQ	84 %
1995, MAX	85 %
1997, DNQ	78 %
1997, MAX	89 %

## 5. General developments

In Figure 3., we see the development of unemployment in Finland with the 1990's crisis. The remarkable trend in the figure is that from 1994 to 1996, the amount of people on labour market support increased rapidly to about 200,000. After that, the number has remained quite stable even though unemployment in general has decreased remarkably. This means that even though LMS at first did seem to replace merely basic flat rate benefit, its share has later grown at the expense of earnings-related benefit as well. This development can be seen even more clearly in Appendix 2. In 2001, almost half of all unemployed were on LMS. The group "no benefit" almost disappeared after 1994. This can be explained by the fact that those registered in the LMS group might receive little or no benefit because of means testing.

Figure 3. Unemployed people in Finland by benefit type 1986-2001 (annual averages)



Source: Finnish Labour Review, 2002, p. 2

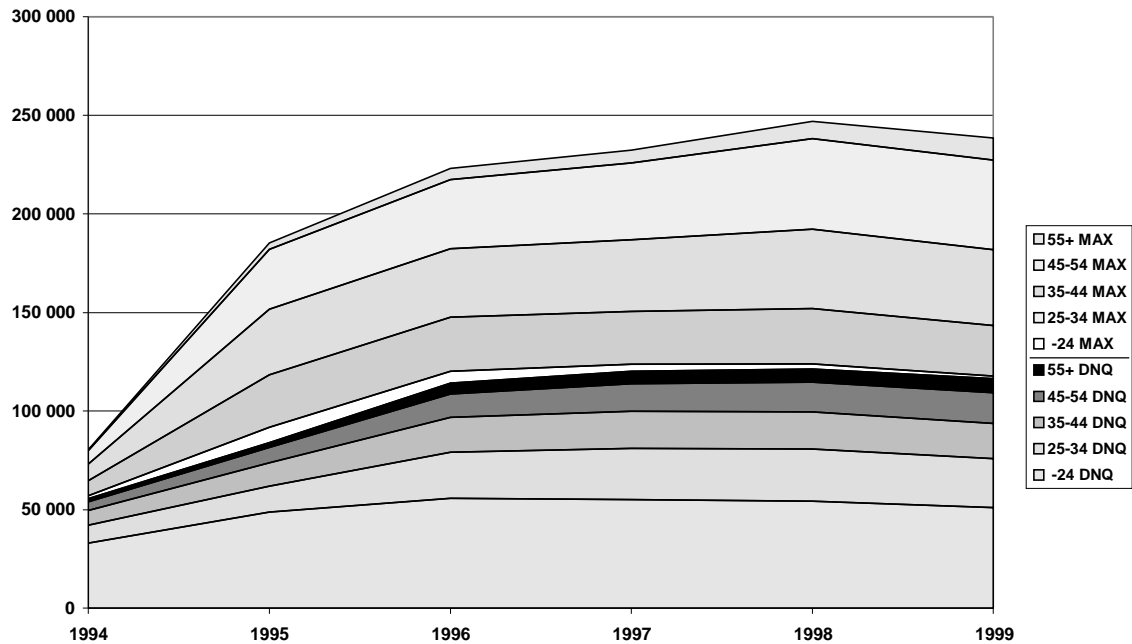
The Government intended labour market support as a temporary activation benefit for the young. In Figure 4., we see the amount of people on LMS by age. The totals are higher than in Figure 3. because they also include people in active labour market policy measures.

At first, most people on LMS came from the youngest age groups. As seen in Appendix 3, about 64 per cent of the people on LMS in 1994 were under 35 years and 43 per cent under 25 years old. Even this is less than the Government estimate that 60 per cent would be less than 25 years of age.

As the amount of people on LMS increased rapidly, the share of the youngest age classes decreased - in 1995, 52 per cent were under 35 and only 30 per cent under 25 years of age. After 1995, the trend continued but more slowly. In 1999, more than half of all people on LMS were at least 35 years old. Logically, the share of the younger age classes is larger in the group that has never qualified for regular unemployment benefit. In 1994, this group was remarkably larger than the

other group, mainly because people who had received basic flat rate benefit in the beginning of 1994 had a transition period right to receive it for 300 working days. After 1995, the people on LMS have been divided into halves when it comes to the labour market policy basis.

Figure 4. People on labour market support (stock = unemployed or in active measures at the end of the year) by age and labour market policy status



Note: DNQ = has never qualified for regular benefit, MAX = has received maximum amount of regular benefit.

The development cannot be described in any other way except that the Government heavily miscalculated the effects of the reform. Naturally, Government calculations were based on the Bill and not on the law that was passed, but still, it remains the fact that what was meant to be a temporary activation springboard for the young became the dominant benefit form for the majority of all unemployed. Many ageing long-term unemployed have been on LMS for years. One explanation for the miscalculation is that in the arguments for the Bill, the calculations were done based on the lengths of unemployment spells at the beginning of 1990's. At that time, the employment obligation was still in force, which in practise meant that unemployment spells were automatically cut by subsidized employment after a given length. In short, one could say that when

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making the calculations, the Government forgot that it had just abolished the employment obligation.

## **6. Activation**

One of the major arguments for the reform was that it would activate the unemployed. A new form of activation, labour market training with LMS and thus without pay or official employment contract, was introduced. In the following, we will see how this goal was achieved.

### **6.1 Active labour market policy measures**

In Figure 5., we see the share of people who were in active labour market policy measures at a given point in time. Because of the special arrangement for elderly unemployed entitled to regular unemployment benefit (“the unemployment pension tube”) and its policy implications, those at least 55 years of age have been distinguished from other unemployed than those on LMS. People on LMS do not have the right to enter the “tube”, so the distinction is not relevant to them.

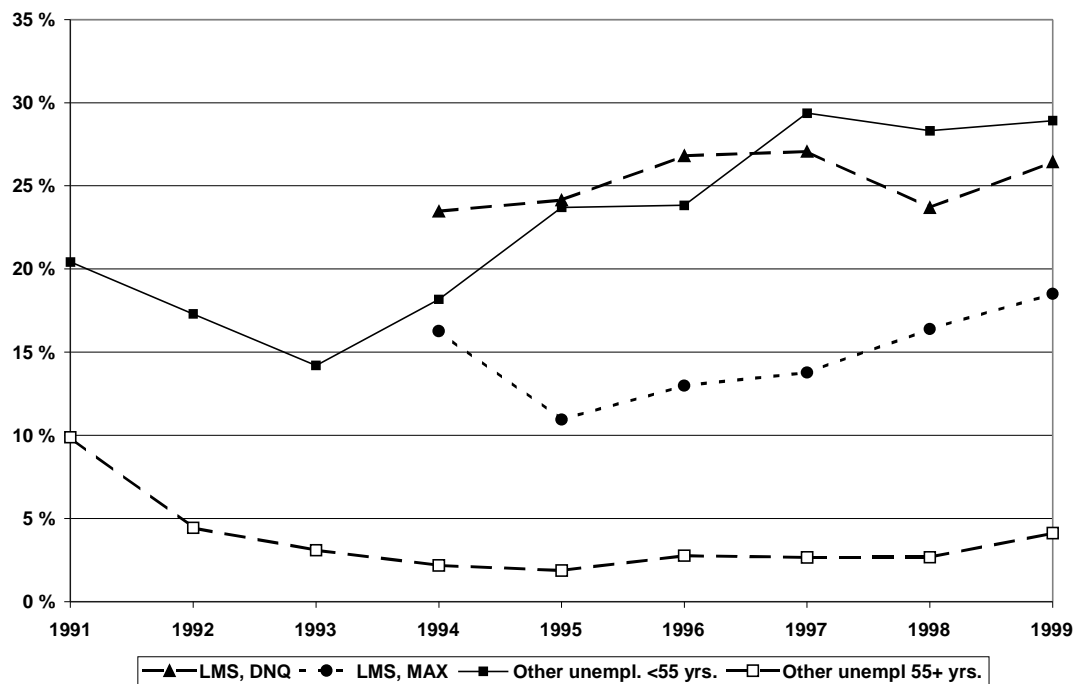
As can be seen, the distinction by age is very relevant: active measures are seldom targeted to elderly unemployed. When comparing the activation rate by benefit type we see that for those on LMS, who have never qualified for regular benefit, the rate does not differ very much from other unemployed. In 1994, their activation rate was a bit higher, but on the other hand it was clearly lower than that of the other unemployed in 1998-1999. The group that has received the maximum amount of regular benefit is activated remarkably less than other unemployed.

So, even here we can see that the goals of the reform have not been fulfilled. The DNQ group, which is clearly younger than the other group, has not been activated more than other unemployed, even though special emphasis was originally put on activation of the (young) people on LMS. The other group, whose large size was an unforeseen consequence of the reform in the first place,



has been activated considerably less than other unemployed. For the long-term unemployed, LMS is definitely not an activation springboard, even though the activation rate has increased slowly but steadily since 1995. This is due to the fact that the volume of APM has not decreased as fast as the general unemployment rate. Thus, even long-term unemployed on LMS inevitably come to take part in active measures more often than before. The same phenomenon can be seen in the case of elderly unemployed.

Figure 5. Share of people in active labour market policy measures (APM) of those unemployed or in APM at the end of the year

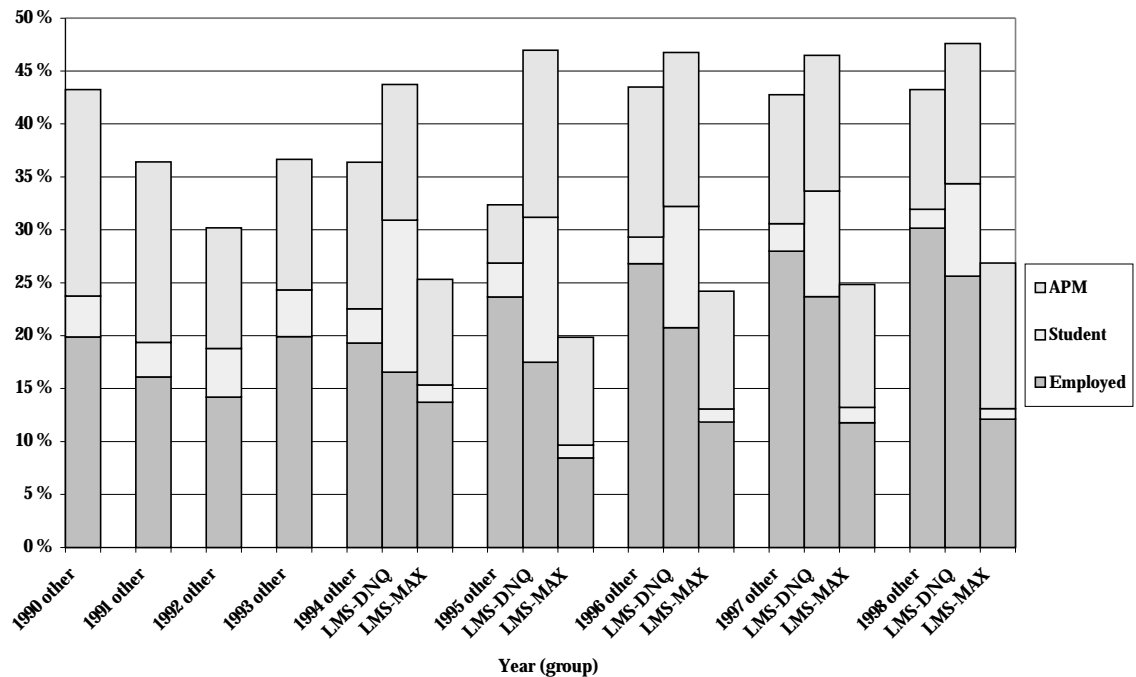


## 6.2 Activation in general

When considering activation consequences, it is clear that taking part in APM is not the only - and not the most relevant - indicator of activation. The politically preferred situation is of course that the unemployed person finds a job. For the young, (re-)entering vocational education can also be seen as a desirable consequence of labour market support. This was emphasized when planning the reform by the fact that the three-month wait period did not apply to those labour market entrants, who had graduated from vocational education. On the other hand,

it was considered to be of great importance that those without secondary education would get one. In 1996, this goal was enforced so that for under 25-year-olds without vocational education, it was obligatory to apply for education in order to receive LMS.

Figure 6. Share of those active at the end of the following year of those who were unemployed or in APM at the end of the year



In Figure 6., we see the share of all who were in one sense or the other “active” at the end of the following year. Here we can see that the DNQ group has the highest activation rates, mostly due to the fact that many of them have entered education. In this sense, LMS seems to have some activating effect on this group – even though it is quite clear that many people are in this group merely while waiting for their education to begin, which then can not be seen as an “activation” consequence. On the other hand, re-employment rates for those in the DNQ group are constantly lower than those of other unemployed, and lowest of all they are for the MAX group. As only a very small share of the MAX group has entered education during the year, their activation rates differ here even more dramatically from others than when considering only the role of active measures. The slow rise

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in activation rates can be seen for the MAX group here as well, but it does not depend on an increased re-employment probability.

It must be stressed here that the differences in re-employment probability between the three groups are dramatic, and they have constantly increased since 1994. Especially the MAX group's re-employment probability is in its own class. While it has remained very low, the two other groups' re-employment probability has constantly increased in 1994-1999. Active labour market policy measures have been targeted to long-term unemployed with the intent to level up the differences in employment chances, but as can be seen in Figure 5., the MAX group has a lower participation rate when it comes to APM, as well.

Even though there has been a clear increase in the re-employment probability of the DNQ group, their total activation rate has remained quite stable, as the share of those entering education has decreased simultaneously. This depends probably on two reasons: first, many people prefer employment to education, and more employment chances were created in the country during the period. Second, at better economic times, less people have unemployment spells between stages of education.

All in all, and even if we interpret the effects from a very optimistic viewpoint, it can be concluded that the activation effects of LMS are very limited. Even in the best year more than half of the DNQ group was not active at the end of the following year. In the other group, only about one-fourth was active at the end of the best year - and more than half of this was due to active labour market policy measures, not employment or education.

## **7. Poverty-related issues**

As a poverty indicator, we have used the reciprocity of last-resort social assistance. There are, of course, considerable problems when connecting poverty (only) with social assistance. For instance, it has been found that the commonly used poverty indicators correlate with social assistance reciprocity only to a rather small extent (Kangas and Ritakallio, 1996). It has also been stated that the

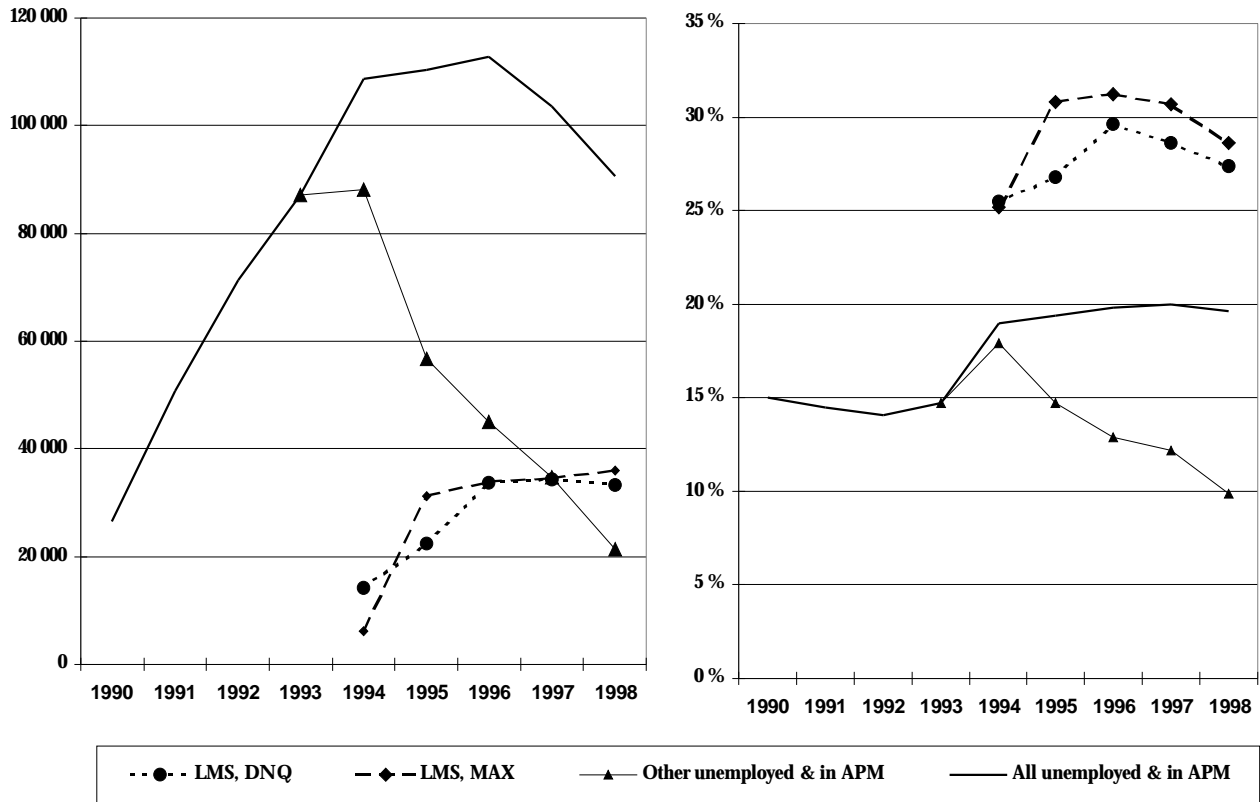
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relatively high level of social assistance norms in Finland kept official poverty figures from skyrocketing during the recession (Lehtonen and Aho, 2000). Furthermore, non-take-up of social assistance is obviously extensive, and the occurrence of non-take-up varies between different population groups (Virjo, 2000). Despite its problems, we can defend the use of this indicator by saying that we are not trying to establish “true figures of the number of poor ‘an sich’” - rather, we use social assistance reciprocity as an indicator of poverty trends within population and different groups. As such, it should give us decently reliable figures. It is also important that - being the last-resort system - social assistance reciprocity figures are a clear indication of the lacks in primary social security, such as unemployment benefits.

In the following calculations, household defines social assistance reciprocity. That is, if the person self or his/her spouse has a register entry of receiving any amount of social assistance during the year in question, s/he is counted as having received social assistance. This definition is, of course, rather coarse, since it does not tell us about the level of benefit dependency etc. The trends should still become clearly represented.

The absolute number of unemployed social assistance recipients grew rapidly at the beginning of the 1990's and did not start to decline until 1997. Even then, the share of unemployed people receiving assistance did not decline. There is a clear indication that the 1994 reform increased poverty among the unemployed: from 1993 to 1994, the share of unemployed receiving social assistance leaped from 15 per cent to 20 per cent. This is a remarkable change-taking place simultaneously with the reform, as the share of social assistance clients is rather stable both before and after this point in time. Moreover, we see that those on LMS have had a dramatically higher need of social assistance than other unemployed. A contradictory development for this interpretation is however that even among other unemployed than those on LMS, the share increased temporarily in 1994.

Figure 7. Absolute numbers and shares of social assistance recipients in different groups of people unemployed or in APM at the end of the year



In Table 3., we see the development inside different types of unemployment. As we can see, the share of people on labour market support has increased remarkably in almost every group. Simultaneously, the development concerning the share of people on earnings-related benefit has not been as consequent. In many groups, the share of people on earnings-related benefit has remained stable or even increased. The explanation for this is that as the shares of people on LMS grow, the shares of those on basic flat-rate benefit decrease. Still, a remarkable decrease in the share of people on earnings-related benefit can also be seen in some groups. So, LMS has mostly replaced the basic flat-rate benefit, but to some extent even earnings-related benefit.

When it comes to the poverty indicator, the most striking finding is that in most groups, there seems to be no correlation between unemployment benefit types and the reciprocity of social assistance. This is especially true if we look

only at the LMS figures. In two groups, namely “chronic” and “unemployment pension tube”, the poverty indicator seems to have some correlation with the share of people on earnings-related benefit. In most groups, the share of social assistance recipients has been rather stable throughout the period.

Table 3. Stock of unemployed and those in active labour market measures at the end of the year: shares of unemployment type, and shares of people on labour market support and receivers of social assistance by unemployment type

Unemployment type	Year	% of total unemployment	% on earnings-related benefit	% on LMS, DNQ	% on LMS, MAX	% living in households who received social assistance
Short term	1994	4.7	61	7	0	11
	1996	4.5	52	7	0	8
	1998	4.7	52	14	0	8
Students and entrants from education	1994	9.8	24	39	1	17
	1996	8.2	21	56	5	20
	1998	7.6	15	72	5	18
From outside the labour force (child care and others)	1994	4.0	22	41	1	29
	1996	5.1	19	59	2	31
	1998	3.6	17	68	7	30
Medium-term	1994	18.2	61	4	1	14
	1996	11.7	62	13	1	13
	1998	12.0	63	18	2	12
Long-term	1994	23.5	42	4	10	19
	1996	18.1	48	15	15	18
	1998	17.7	46	22	22	18
Chronic	1994	14.2	12	9	5	30
	1996	20.1	9	24	53	32
	1998	20.1	4	32	59	33
“Recycling”	1994	14.5	31	6	7	25
	1996	19.7	38	13	23	22
	1998	22.8	26	22	45	23
“Unemployment pension tube”	1994	11.1	70	0	0	7
	1996	11.9	87	0	0	4
	1998	11.5	91	0	0	3
Total unemployed and in active labour market policy measures	1994	100.0	41	10	4	19
	1996	100.0	41	20	19	20
	1998	100.0	37	26	27	20

So, even though we previously found that people on LMS rely on social assistance dramatically more often than people on earnings-related benefit, this effect seems to disappear when the type of unemployment is controlled for. In other words, it would seem that LMS itself does not produce poverty - it is the

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fact that a person has drifted to e.g. chronic unemployment that explains poverty. On the other hand, we cannot directly interpret this finding so that labour market support does not increase poverty. First, the system may have remarkable effects on the unemployment careers of people, and thus on what unemployment type they are classified to. As we have pointed out, the structure of unemployment has changed dramatically during the period in question. Second, there was a reform of social assistance in 1998, which resulted in less people on LMS having the right to social assistance. This is because most unemployed with low income also receive housing support, and in the reform the level of housing support was increased, and a self-risk for housing expenses was introduced to social assistance (Keskitalo et al., 2000). This results in that the figures from 1998 are lower than they would have been without the reform.

It is also clear that the changes of unemployment structure inside the unemployment types categorized in the table correlate with the share of social assistance receivers. For instance, inside the “short term” unemployment group, unemployment spells have become even shorter during the period in question, which clearly affects the need of social assistance - even though less people in the group have been on earnings-related benefit.

One very interesting finding that can be derived from the table is the remarkable difference of social assistance receivers’ share between the groups “chronic unemployment” and “recycling”. Both groups have been in practise completely without open-market employment, but the latter group has frequently participated in active labour market policy measures. It seems that even though the net effect of such measures on employment probability is virtually non-existent, they have a clear social function in preventing poverty. To a large extent, this is made possible because people have managed to renew their right to earnings-related benefit with the help of APM. Another explanation is that their income during APM is in most cases (all other measures except labour market training with LMS) substantially higher than during unemployment.

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## 8. Conclusion

The 1994 reform was much less radical than originally intended and the difference between the regular flat-rate benefit and LMS for most population groups was more of ideological than practical nature. Without the amendments made in the parliament, the impacts of the reform had been clearly more dramatic. When the amendments were made because of the demands of the Constitution, we can conclude that here the Constitution protected the weakest of society!

Despite this, the consequences are breathtakingly large and clearly unforeseen. This is mostly due to the fact that LMS was introduced shortly after the abolishment of the employment obligation.

As becomes clear in this paper, an ever-increasing share of the unemployed has been on LMS after it was introduced. Only a rather small share of them has been young, and the activation levels - however we measure them - are at best on the same level as those of the other unemployed, and then only for half of those on LMS, namely the group that has never qualified for regular benefit.

The large group that is on LMS because they have received the maximum amount of regular benefit is activated considerably less than other unemployed, and their re-employment chances are weak. Although the activation rate of this group seems to be increasing in recent years, it is not due to the LMS reform of 1994. Many people have been on the benefit for years, and there is cause to fear that especially ageing unemployed on LMS will remain on it for very long periods. This will most certainly cause poverty during unemployment, and even after it, since fragmentary employment history affects the level of their old-age pension.

So, when it comes to the first part of the question in this paper's title, we can clearly and definitely say that the reform has not resulted in increased activation of the unemployed. How about the other question then: did the 1994 reform itself increase poverty in society? First, it must be stated that the dramatic affects seen in



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Figure 7. are largely a consequent of the abolishment of employment obligation and the tightening of employment condition to qualify for earnings-related benefit. In other words, if the 1994 reform had not had taken place, but the two above-mentioned reforms would have, the poverty consequences would probably have been very similar.

That said, there are elements in the 1994 reform that seem to have directly increased poverty. These include stricter means-testing for some groups, lower benefit for those living with their parents, the fact that people on LMS do not qualify for “unemployment pension tube”, and the fact that labour market training with LMS - which does in most cases not increase income during the measure - has partly replaced other active labour market policy measures. Our results and other studies indicate that participation in active labour market policy measures decreases poverty. The LMS reform has probably weakened this effect for the reason mentioned above. Labour market training with LMS has later become the major measure for the young unemployed.

Our analyses of the poverty effects of the reform are by no means complete or totally consistent. Preliminarily, however, we can constitute that the 1994 reform did increase poverty in society to some extent. On the other hand, we have to conclude that other reforms have been much more important in this respect.

So, on the basis of preliminary analyses, our answer to the question presented in the title of this paper is as follows: no, more selectivity in unemployment security seems not to have increased activation of the unemployed. Yes, more selectivity (especially in the form of abolishing the employment obligation) has definitely led to increased poverty, but the 1994 reform has only a limited role in this development. In any case, we can conclude that the reform did not have the desired consequences. The intended “activation springboard for the young” became a “permanent livelihood for a majority of the long-term unemployed”.

Finally, we consider some general points for continuing this research.

Most importantly, the focus will be on taking into account the other reforms of the 1990's. As we see it, there are clearly two major policies. First, there is the

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abolishment of employment obligation, which can clearly be seen as merely coping with the situation that had emerged. In other words, it was a reform done almost in a panic situation in order to cut costs rapidly and get rid of the employment apparatus that had gained astronomical dimensions. Second, there is another line of policy starting from the 1994 reform. Many larger and smaller reforms have been carried out in line with this policy, and the same trend is clearly still going on. Even though cutting costs has been a major line of argument here, too, the main expressed emphasis is put on the activation of unemployed, removing incentive traps, and “making work pay”.

Generally, it has been all the time pointed out that the primary income source should be paid labour. When without paid labour, the obligations of the unemployed (to be an active job-seeker, to participate in active measures, to take up temporary or low-paid jobs etc.) have been emphasized at the expense of their rights. Another expressed goal of the labour market policy of the late 1990's has been to improve the dynamics of the labour market, reduce friction unemployment, the length of unemployment spells etc.

One central research question is, how do these policies and the reforms carried out interact with structural unemployment. It is easy to say that it is not a major social or political problem, if someone is unemployed for a week or two before getting a new job. The major challenge facing the Finnish society is the “hard core” of unemployment, those chronically unemployed. While unemployment rate decreases, it becomes increasingly difficult to reduce unemployment. Are the strategies applied recently relevant and sensible in this kind of situation? For example, there are many who think that inciting the unemployed in the way many reforms have thrived to has little or no effect on structural unemployment. Furthermore, the dynamics of the labour market may be as smooth as ever without having any effect on the main problem, as the demand for labour is directed towards other kind of people than the presently unemployed.

So, these are the questions, which have to be raised when doing further research on the labour market reforms. Even the research methods have to be improved from the preliminary analyses presented in this paper. To name one

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example, we intend to examine the poverty effects of the 1994 reform and other reforms with more valid indicators. As pointed out earlier, the indicator used in this paper is rather coarse, and it is problematic to equalize poverty with social assistance reciprocity. First, we intend to build a measure of the level of social assistance dependency by examining the share of income that the assistance constitutes. This is possible to do in an entirely valid way with our data. Second, we intend to develop one or two poverty indicators based on household income. Totally valid variables cannot, however, be constituted on the basis of our data while we do not have 100 per cent accurate information about the income and constitution of the entire household. Still, we believe that useful indicators can be developed, and used together with the social assistance - based indicator; we can create a clear picture of poverty trends in society and within different groups.



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## Appendices

### Appendix 1. The Data and variables in Figure 2 and Table 3

The annual flow of the unemployed consists of individuals who have at least some unemployment or participation in labour market policy measures during the given year. The labour force in Table 1 includes all individuals who have been in gainful employment during the given year, or belonged to the flow of the unemployed, or are retired with unemployment pension.

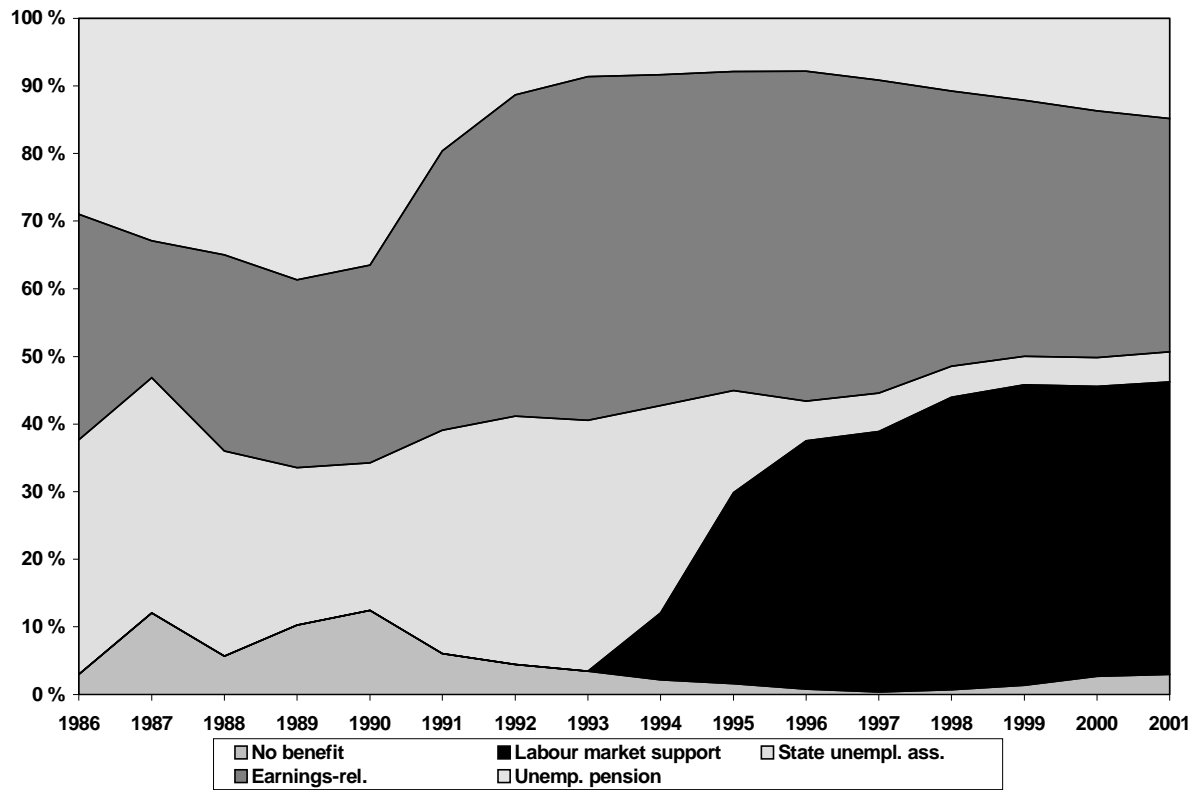
The variable in Figures 5 and 6, describing the type of unemployment is based on the employment and unemployment history of the past four years (e.g. for the year 1990, the variable is based on the labour market career of the years 1987-90). The categories are based on the time of belonging to the labour force (later TLF) during the four-year period, the proportion of open-market employment of TLF, and information on an eventual student status in secondary or tertiary education institutions. The categories are exclusive and based on the following criteria:

1. Short-term unemployment: proportion of employment 86-99 per cent of TLF.
2. Students or entrants from education: studied during the last year of the period.
3. Other labour market entrants: not belonged to the labour force during the previous year before the last year of the period (e.g. concerning the year 1990, not been in the labour force in 1989).
4. Medium-term unemployment: proportion of employment 50-85 per cent of TLF.
5. Long-term unemployment: proportion of employment 15-49 per cent of TLF.
6. Chronic unemployment: proportion of employment 0-14 per cent of TLF; or
7. Recycling: as chronic but participated in ALP at least twice during past four years.

8. Pension tube: entitled to earnings-related unemployment benefit until retirement with unemployment pension.
9. Unemployment pension: retired with unemployment pension during the last year of the period.

In Table 2, categories 1-3 and 6-8 are combined.

**Appendix 2. Unemployment benefit types in Finland, 1986-2001 (shares counted from annual averages)**



Source: Finnish Labour Review, 2002, p.2



**Appendix 3. People on labour market support (stock = unemployed or in active measures at the end of the year) by age and labour market policy status**



Note: DNQ = has never qualified for regular benefit, MAX = has received maximum amount of regular benefit.