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DOES “BASIC INCOME” HAVE NEGATIVE INCENTIVE EFFECTS ON THE YOUNG?

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Some of the work presented here has been planned together with senior researcher Simo Aho

1 INTRODUCTION / ABSTRACT

The (dis)incentive effects of unemployment security are often regarded as self-evident. In Finland, there has been much discussion about the future of the benefits. Reforms and motions for reforms have often been based on the possibility to counteract the disincentive effects. For instance, it has been suggested that the minimum unemployment benefit, labour market support (LMS)¹ should have a maximum length – at least when the unemployed person does not participate in any active labour market policy measures. (Työllisyystyöryhmän loppuraportti 2003, Hallituksen strategia-asiakirja 2003, Rakennetyöttömyyden purkaminen 2003, Työttömyysturvatyöryhmä 2001).

For the sake of argument, we can say that LMS acts as a kind of “basic income system” (BI) for the unemployed. Obviously, there are limitations: only the unemployed can receive the benefit, and in some cases, it is means-tested (for conditions, see Table 1). Still, the benefit is flat rate and has no maximum length, and the general level of monitoring and sanctioning is low.

Upon a closer look, there seems to be quite little research about the incentive effects of unemployment benefits in Finland. The research that has been done is mostly economic and econometric, and

¹ LMS = Labour market support. For explanations of the Finnish unemployment security system (incl. abbreviations), please refer to Table 1.

most of it is based purely on mathematical calculations and models with little or no empirical data. In any case, the results that have been produced by different lines of research and different studies contradict with each other. What is lacking is social scientific research with hard empirical evidence.

In this paper, some previous research is presented and summarised. Then, an ongoing project aiming at studying the phenomenon sociologically with longitudinal register data is presented. One part of the project is to study, what effects a maximum duration of the minimum unemployment benefit could have. As it is difficult to study phenomena that do not exist, we focus here on a reform that had this kind of contents.

In 1997, those under 25 years of age without occupational training (with only primary education or A-levels) were denied labour market support unless they were “active”². In a way, they lost their right to a basic income. The method of studying the effects of this reform is presented along with some preliminary results. The results indicate that the reform achieved some of its goals: open unemployment among those affected decreased rapidly, and employment increased. However, it seems that some of the people that fell out of unemployment security, fell through the entire safety net of the welfare state. The take-up / reciprocity of the selective last-resort social assistance has decreased with the reform. Some, but not all, of this can be accounted to the increased employment.

Overall, it seems that the reform did not have very drastic effects on the average well being of those affected. However, when interpreting the results, one must keep in mind that the targets of the reform were young people who lack occupational training. It would thus be hazardous to conclude that a similar reform for all people on minimum unemployment benefit would have a similar outcome. Most people on minimum unemployment benefit are long-term unemployed, and taking up occupational education with the small study allowance that is available is not a real alternative for them. Furthermore, we must consider that the analyses conducted comprise a period of a strong economic upturn, when unemployment overall decreased rather rapidly. It is likely that in a wider population, a larger share of people would fall on social assistance. The selective nature of the assistance and non-take-up issues would then probably lead to a situation where many would live completely outside the welfare state – and others would be tagged as “welfare cases”.

² Being “active” was at first a matter of interpretation. Now, there are clear criteria. One must either engage in labour market training, or try to come into at least three educational alternatives. If one does not come in, one must be prepared to take left-over education alternatives. (See Table 1).

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Table 1 The Finnish Unemployment Security System

Unemployment Insurance (UI)

- 121 600 people (annual average 2003, source: www.mol.fi), 42.1 per cent of all unemployed
- Roughly 60% of earlier earnings (or less, if salary has been high). Increased if supporting a minor.
- Maximum duration: 500 working days = roughly 2 years
 - Age-specific extension: if the 500 days have not passed when a person turns 57, he/she can get extension until 60, when they get unemployment pension.
 - Until 1996, the age limit was 55.
 - Those born in 1950 and after have an age limit of 59. They do not get unemployment pension (which will be abolished), but can get extension until old-age pension (at 62-65 years).
- Preconditions: 43 weeks (10 months) employment during the last 24 months (= "employment condition").
- Membership in an unemployment insurance fund, at least 10 months prior to unemployment
 - Until 1996, employment condition was 6 months during the last 24, and the membership condition was 6 months as well.
 - From 2003, employment condition is 10 months during the last 28 months for labour market entrants and 8 / 24 months for those who have previously been on UI benefit for the maximum amount

Unemployment Allowance (UA)

- 19 100 people, 6.6 per cent
- Flat-rate benefit, increased if supporting a minor.
- Roughly 20% of mean earnings
- Maximum duration 500 working days, roughly 2 years – the same age-specific extension as in UI
- Preconditions: the same employment condition as UI, no membership condition.

Labour Market Support (LMS)

- 144 400 people, 50.0 per cent
- People who receive this benefit have either received the max amount of UI or UA, or have not ever fulfilled the employment condition.
- Flat-rate benefit, the same amount as UA, but means-tested (other household income). Also reduced if living with parents.
- Not means-tested for 180 working days after maximum amount of UI or UA, nor for persons at least 55 years of age
- Not means-tested during labour market training with LMS, during which there is also a small increase of the benefit
- No maximum duration
- Labour market entrants, who have not ever fulfilled the employment condition, must wait for five months until receiving the benefit.
- In 1996, people under 20 with only basic education got the following restrictions to their right to LMS
- From 1997, the restrictions have applied to people under 25 without occupation (that is, with only basic or A-level education):
 - The person must actively try to get into education. If one fails, one is obliged to start an education ordered by the administration. Otherwise, the right to the benefit is lost until the person has been employed for 5 months, got an occupation or turned 25.
 - Obligation to participate in labour market training with LMS. During the training, the benefit is not means-tested, and even people who have lost their right to it as mentioned above can receive it.

2 RESEARCH ON THE INCENTIVES OF UNEMPLOYMENT BENEFITS

In this section, some of the research that has been done in Finland concerning the incentive effects of unemployment security is presented and summarised. The research is divided into four areas, which, of course, are partly overlapping. As the evaluation of the 1997 reform is done in the context of a larger research project dealing with the incentive effects of unemployment benefits, not all of the research presented here is directly relevant to the reform.

2.1 Incentive Traps

Incentive and unemployment traps have been the targets of a wide range of research. An “incentive trap” refers to a situation, where the net income of a person/household would not grow (at all or significantly) even if the gross income did. An “unemployment trap” refers to a situation, where the available net income of an unemployed person or his/her household would not grow even if the person received a job.

The research on this area mainly began in Finland in the mid-1990’s, when a public awareness about this problem arose. The government nominated a working group to counteract the traps (Kannustinloukkutyöryhmä 1996). Many of the group’s suggestions were carried out, and evaluations show that the system now has fewer traps than before (Niinivaara 1999).

However, this line of research shows that there are still situations where additional income and/or a job would not increase the net income. The problem is especially prominent with the receivers of means-tested social security, such as LMS, social assistance, and general housing subsidy. (Hiilamo et al. 2004).

Recent research also has come to a couple of interesting conclusions. Parpo (2004) experiments with different kinds of calculations and concludes that if major structural reforms are not undertaken, the Finnish social security remains contradictory. It is impossible to have a system, which is both entirely free from incentive traps and at the same time guarantees a humane basic security for all. One must compromise between the goals of encouragement and equality. In the context of this Congress, it is worth noting that Parpo experimented with changes to the existing benefits, not with major structural changes, such as the introduction of a BI system.

Hiilamo et al. (2004) show that “bureaucratic traps” might be a larger problem than the traditional incentive ones. Because of administrative delays, temporary employment for e.g. a month may swing the income of the household very drastically up and down over a long period in a way that is hardly predictable to the recipients of social security. This is because people receive multiple benefits that have different administrative delays. He concludes that even if the “bottom line” shows a small increase in net income, the uncertainty caused by the situation might scare people away from taking up temporary employment. Social caseworkers themselves have also pointed out this problem (Karjalainen et al. 2003).

There are some general problems when interpreting the results of the trap studies, though. For instance, the calculations are (and have to be) based on an assumption that an individual constantly optimises his/her behaviour in order to achieve the maximum economic gain. For instance, it is assumed that people always apply for and receive all the benefits they mathematically are entitled to. Sociology and economics seem to have a rather different approach to the question “why do people work?” (cf. Hiilamo 2003).

To summarise, the research on this area shows that there are both incentive and unemployment traps in the system – even though they are fewer than before. It also seems to be so that the traps are virtually impossible to eliminate within the frames of the current system.

2.2 Search Theory / Threshold Wages

Another major relevant research area is the theory of job search. In this research tradition, the job search activity and intensity of an unemployed person is modelled in different ways. In short, the idea is that the individual optimises his/her search intensity along with the expected gain, which is of course related to (among other things) the level of unemployment benefits. The idea of a “threshold wage” is somewhat related – the minimum acceptable wage is supposed to be optimised in relation to the level of benefits and the situation in the labour market.

An interesting variation of this research is offered by Tatsiramos (2004). He shows – with empirical data – that even though generous benefits tend to decrease re-employment probability, they simultaneously have the effect that the subsequent employment becomes more stable and long lasting. This is explained by people being able to find a job that suits them better, as they are not forced to take the first offer because of economic circumstances.

Again, this kind of research relies strongly to the rationality / optimisation assumption. The unemployed person is supposed to constantly calculate the best utility for him/her at the current moment. Risk aversion is not often prominently taken into account; a person is supposed to think e.g. *“I will not take this job offer now, because it will be more profitable to accept it after two more months of unemployment”*. In reality, of course, the individual probably assumes that the job offer might not be there after two more months of unemployment.

Research of this kind tends to conclude that in order to achieve optimal job search intensity, unemployment benefits should decrease over time. Similarly, the unemployed person is expected to drop his/her threshold wage when the benefits decrease. (Sinko 2001) However, the results are very dependent on the assumptions made – under different conditions, one may get the result that benefits should instead increase during unemployment (Hassler and Mora 2002).

Moreover, some elements of the existing unemployment security are hard to take into account in these kinds of models. For instance, Sinko (2001) points out that the basic result is valid when there is no maximum duration for the benefit. In a system – such as the Finnish – where the UI benefit has a maximum duration, but re-qualification is possible, the situation is more complicated when employment also comprises an option to a renewed period on UI.

Furthermore, even though the risk for losing the UI benefit is at its smallest at the beginning of an unemployment spell, the search intensity is then at its highest (as shown empirically in e.g. Virjo and Aho 2001) – even though search theory would traditionally hypothesize otherwise. One of the biggest flaws in many search theoretical models is that they do not in any way account for the re-employment probability of unemployed people. Re-employment probability is presumed to rise when search intensity rises, but the relation is not necessarily so straightforward. In any case, re-employment probability decreases significantly even after quite short unemployment. In such a situation, it is in its place to wonder about the causality between re-employment probability and search intensity.

2.3 Macroeconomic Models

One line of research that makes claims about unemployment benefits is macroeconomic research. Incentives of unemployment security are not the main focus of this kind of research, but from time to time you can read results about the optimal level of benefits. When studying “equilibrium unemployment” models etc., values for the maximum duration and level of unemployment security are

often included – along with such variables as interest rate and economic growth. Then, equations are created with different coefficients in order to explain, for instance, past unemployment rates on the macro level. When the models are able to satisfactorily explain past developments, the values of the variables are changed (e.g. the mean replacement rate of unemployment security is increased in the equation), and conclusions are drawn of the results received. Here are a couple of examples of such conclusions:

- Decreasing the replacement rate of unemployment security by ten percentage points would lower unemployment by two percentage points. The same effect would be accomplished by cutting the maximum benefit period by half. (Holm et al. 1999).
- “Political parameters”, such as unemployment benefits, social costs for the employers and the price of layoffs, account for 70 per cent of Finnish unemployment rate. (Ibid.)
- The replacement rate of unemployment security accounts for about one percentage point of Finnish unemployment in the 1990’s. However, the confidence interval for this result is very wide (from about 0 to 3 percentage points.) (Kiander and Pehkonen 1998).

In short, this kind of research reaches clear and consist results that are easy to put forward, and that may be why they are often used as arguments in political debate. However, the use of empirical data is quite rare, and the assumptions and simplifications made in order to make the models possible often seem quite hard to defend. For instance, in both of the above-quoted studies, a “mean replacement rate” of the unemployment benefit system is used in the calculations. The problem is that such a rate does not exist at all in reality – those on UI have a much higher rate than the average, and those on UA a clearly lower. Another simplification example is the assumption that Holm et al. (1999) make: all workers and workplaces are “compatible”, that is: any worker can take up any job that is open on the market. This comes very far from the reality of the Finnish labour market in the 1990’s.

Furthermore, the results of this research line contradict in many ways. Some of the research is even self-contradictory – for instance, the “political parameters” that are claimed to account for the major part of Finnish unemployment did not change significantly from the 80’s to the 90’s. At the same time, unemployment skyrocketed. More importantly, the studies cannot possibly all have the correct results, as the results are so different from each other.

2.4 Empirical Social Research

There has been a lot of research based on surveys and register data about unemployment and other issues relevant to this paper in Finland. As stated before, very few focus directly on the relation between employment and unemployment security. This observation was also made by Uusitalo and Moisala (2003). In the 1980's, the Finnish UI benefit had a statute that diminished the benefit after a certain unemployment period. Uusitalo and Moisala studied the effect of this system and the reform that abolished it with longitudinal data, but found no evidence that the "step" would have had incentive effects. Their results are compelling, but one cannot directly assume that the situation is similar today. Unemployment and long-term unemployment have become not only essentially more common, but probably even qualitatively different after the time in question.

One major finding in empirical social research is that the rationality assumption made in econometric studies about incentives and incentive traps often does not hold. We know that people not always apply for the benefits they might be entitled to (e.g. Virjo 2000), and that many people work even though they are in an unemployment trap, i.e. would receive the same amount or even more money if unemployed (Forssén and Hakovirta 1998, Holm and Kyrrä 1997, Pedersen and Smith 2001, Parpo 2004).

Furthermore, there is evidence that incentive traps, preference of more free time, low job search intensity and/or lack of willingness to work would be major factors behind the Finnish unemployment problem. (Virjo and Aho 2001, Aho et al. 2003, Martikainen 2003, Ervasti 2003). Of course, the incentives of the system may still constitute a major legitimacy issue.

2.5 Summary

The research concentrating directly on the incentives of unemployment benefits in Finland is both quite rare and one-sided. The most striking thing is the lack of research with empirical data. The results from the different lines of research are at least partly contradictory. Negative incentive effects are often considered self-evident, and the question that is posed is only how large an effect there is.

We do have very much information about the internal logic of the benefit system, e.g. from incentive trap research, but the behavioural effects of the system are largely an open question. We know that there are mathematical traps within the system, but we do not know if and how people react to

them. What we do know is that at least some people behave in a way that is not optimal according to the calculations.

Even internationally, the evidence of the incentive effects of unemployment benefits is somewhat contradictory (see Holmlund 2002 and Fredriksson and Holmlund 2003 for good reviews). Holmlund (2002) states that it is even theoretically clear that the results cannot be uniform, because the benefits have effects to opposite directions. While most of the research seems to point to the direction that generous benefits increase unemployment, it is not possible to say anything certain about the power of this effect. Furthermore, looking at the unemployment effects only does not give a sufficient picture of the effects of the system.

As Lilja (2002) points out, conclusions about the reforms needed in Finland should not be drawn on basis of research done on the Swedish (or any other than Finnish) labour market – no matter how good that research may be.

In addition to the above, far-fetching political conclusions are being made and reforms planned as we speak. Thus, it is clear that the situation calls for a large empirical research on the actual behaviour of actual human beings.

3 THE FINNISH SYSTEM AND THE REFORM ANALYSED

In Table 1, the Finnish unemployment security system is briefly presented. In addition to the benefits that are mentioned there, we have an “unemployment pension.” The people on it do not have the obligation to seek work, and they are not counted as officially unemployed. This system has been a matter of a wide debate (see e.g. Virjo and Aho 2002), and it will be gradually abolished. Instead, the age-specific UI benefit will be somewhat extended. Obviously, there are many smaller exceptions and special circumstances not presented in Table 1, but they are not discussed here.

Now, as we want to study the incentive effects of the system, we face some critical problems, two of which are above others. Firstly, many of the effects that we may find are most likely due to selection: people who end up on UI will most likely differ in many ways from those on UA, etc. Furthermore, the long-term unemployed are in many ways different from those who are re-employed in a short time. Thus, a major problem is how to isolate the effects of incentives from the effects of selection.

The second problem can be called “relevant research questions vs. the existing system”. Knowledge about the possible effects of different policy options, such as an UI benefit that decreases over time, is badly needed. Still, in empirical research it is only possible to study directly the kind of policies that exist.

The point of the system that is in focus in the empirical part of this paper is the minimum unemployment security of the young. For the proposals about maximum duration of LMS and/or the possibility to receive it only when “active” in labour market training, the young offer an interesting point of comparison. From 1997, a system roughly similar than the one recently proposed for all unemployed has been in force for those under 25 years of age without occupation. Even though we know that young people have different options in the labour market and may act differently from the rest of the population, studying the effects of the reform may give valuable information about the effects of the wider proposals.

4 DATA

The study is based on a large register-based panel data, which at present cover the years 1987-2001. The data set is a representative sample (8.6 per cent or 350 000 individuals) of the Finnish population aged 12-75 at the end of the year 1997. The data are continually updated and come mainly from the central job-seeker register, Social Insurance Institution, Finnish Centre for Pensions, and Statistics Finland. There are about 200 variables per individual per year. Most of them are comparable from one year to another. The data are compiled by Statistics Finland, where different registers are combined using the individuals’ social security code. Then, a random sample is picked, and for anonymity, the code is replaced with an observation number. The information combining observation numbers and social security codes is kept at Statistics Finland for updating purposes.

There are diverse background variables and pieces of information about household, spouse, income, etc. Most of the variables concern the individuals’ behaviour in the labour market, such as information about their unemployment and employment episodes as well as participation in active labour market policy measures. Some information about the employer is also included.

The advantages of register data in this kind of research are quite clear and substantial, because individuals can be followed up over long periods of time. In addition, the population sample is so large that it can truly be regarded as representative, and there is no risk of non-responding bias. Even

small fractions of the population include large numbers of observations; therefore making quite sophisticated distinctions and analyses possible.

Obviously, there are problems as well. For instance, the amount of information is vast, so it will be a challenge to be able to utilise it. Furthermore, not all things are registered, and this leads to two kinds of problems.

Firstly, some information must be deduced indirectly. For instance, we do not have direct information about the kind of benefit (UI/UA/LMS) a person receives during a particular unemployment spell. However, we do have the monetary amount of each benefit that the person has received during a year. Combining that information with the length of unemployment spells, we can deduce what benefit has been received under which period.

Secondly, there are non-registered things that affect selection to different statuses in the labour market. To put this problem in its extreme, we may have two people that are “identical twins” when it comes to registered variables, but the other one is employed after 50 days of unemployment and the other one is not. This is a problem we have to be aware of: even though we can control for many selection variables, there are always a number of things we cannot control for: personality, looks, etc.

5 EVALUATING REFORMS – METHODOLOGICAL ISSUES

As far as evaluating labour policy reforms is concerned, there are a few crucial methodological problems. First, the labour market changes all the time no matter what. Second, politicians tend to be very innovative and make reforms one after another. Third, groups affected by a reform can differ from those not affected. How can we then distinguish the effect of one particular reform from a) other developments in the labour market caused by economic trends, etc., b) the effects of other reforms and c) “effects” caused by selection to the groups affected?

Register data makes it possible to build time-series of several variables that include the year when the reform took effect. This way we can see if any changes occurred in the labour market at the time when the reform came into force. If there were changes occurring particularly in the distinct areas of the labour market that the reform deals with, they might be a result of the reform. Still, as pointed out earlier, they might be caused by other factors as well. How can we get around this problem?

The solution applied here, although thus far quite roughly and preliminarily, is to define groups of people and compare their status over the point of time when the reform took effect. The aim is to find at least two groups whose labour market status and behaviour were more or less similar before the reform and who were treated equally by the part of legislation to be reformed. After the reform, at least one of the groups was under a different kind of legislation, while at least one other group was not at all affected by the reform. For comparison, it is good to include a control group that is under different kind of legislation than the comparison groups or that reflects the general trend in the labour market during the period studied. Figure 1 presents a simple form of the research setting.

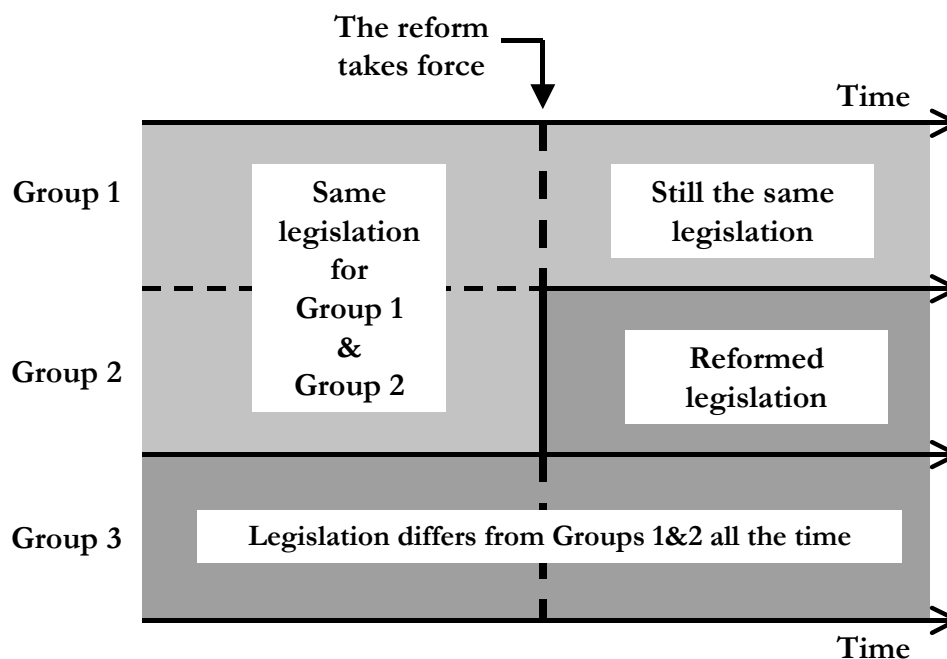


Figure 1 The research setting in a theoretical, simplified model.

By forming time-series (or statistical models) for these groups concerning different variables such as re-employment, economic situation and activation, we will get fairly clear results about whether there have been changes in the labour market, and more importantly, whether these have been caused by the reform. The idea is that the study groups not affected by the new legislation reflect a counterfactual situation in which the reform has not been carried out. Of course, when interpreting the results, we have to keep in mind that there is no ‘world without the reform’. There can be “spill-over” effects (cf. Larsson 2002, p. 106) on other groups than the one(s) directly affected.

When studying the effects of the LMS reform of 1997, the following study groups have been defined:

- a) 20-24-year-olds with no occupation (the group affected by the reform, cf. “Group 2” in Figure 1).
- b) 20-24-year-olds with an occupation
- c) 25-29-year-olds without an occupation (groups b and c can be seen to correspond with “Group 1” in Figure 1), and
- d) 25-29-year-olds with an occupation (cf. “Group 3”).

In short, the idea is to compare these groups over the time of the reform in several ways. In this case, one method will also be to study the “difference in differences” between e.g. groups a-b / c-d and a-c / b-d.

6 RESULTS

Some basic analyses have been conducted, but at this point, it is important to point out that the results must be considered preliminary. It is my intention to both further the analyses presented here and to analyse factors that are absent in this article. The analyses presented here comprise of two kinds of findings: firstly, cross-sectional data for a series of years is presented. Secondly, a couple of cohort follow-ups are presented, where the same population is followed over a number of years.

6.1 The Aggregate Effects of the Reform

In Figure 2, we can see the overall development in the four study groups. In all groups, unemployment decreased over the period, which it did on the level of the whole population as well. In the younger groups, this development is more remarkable than in the older ones.

When looking only at the group affected by the reform (20-24-year-olds with no occupation), it looks like the reform would have been effective. Open unemployment has decreased heavily from 1996 onwards, and employment has increased. However, when comparing with the other young group, we see that there is little difference between these two groups. In the first group, the development is perhaps somewhat more coherent, but not much. In the two older groups, the development has not been as coherent, and 1997, when the reform came into force, marks no turning point whatsoever.

At first glance, then, we might conclude that either the reform has not had a large effect, or it has had a “spill-over” effect even on other young people than those directly affected – as the development in that group is very similar. Two more things are striking. The goal was to activate the unemployed and make the young people get themselves an occupation. The first goal seems to have been reached in the sense that employment has increased. However, active labour market policy measures have remained on a low level. Furthermore, the share of those studying has not increased but decreased in the group affected by the reform.³ This may be an effect of the economic upturn – when jobs are available, studying is not as popular an option as during a recession.

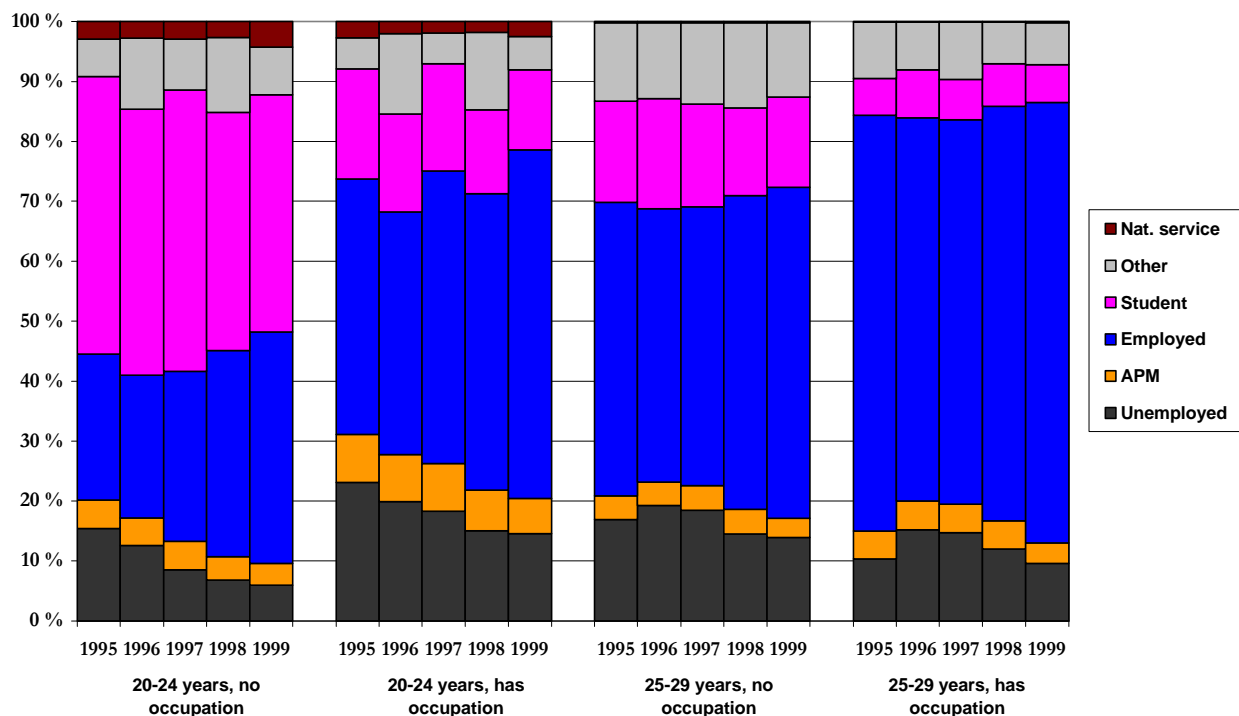


Figure 2 The main activity of the four study groups in 1995-1999. (Cross-sectional data from the end of the year in question). “APM” = Active labour market policy measure. “Nat. service” = either military or civil service.

What kind of effect did the reform have on reciprocity of social assistance? In Figure 3, cross-sectional data of this is presented. Students have been removed from the sample, because a) they are in a way “investing for the future” and thus commonly not considered as a problem group and b)

³ The share of students did increase temporarily in 1997, but since then it has decreased.

because those receiving study allowance normally do not have the same right to social assistance as others.⁴

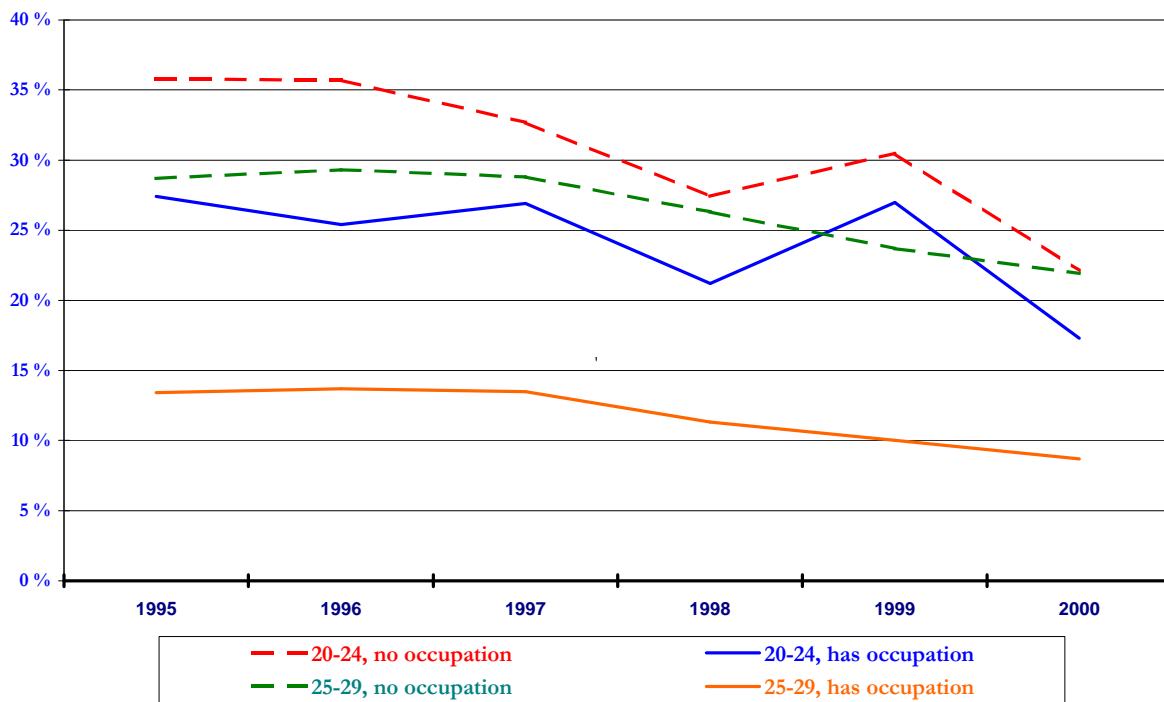


Figure 3 Those who have received social assistance during the year in the four groups. Note: Students have been removed from the analysis.

In all groups, the general trend is that the share of social assistance receivers decreases. The year 1999 marks an exception for the younger groups. However, the most striking result here is that if you are under 25, or under 30 and without an occupation and you are not a student, you run a very high risk of being dependent on social assistance. Between about 20-35 per cent of these groups have received social assistance during the years in question. The share is clearly lower for the older group that has an occupation. It is worth noting that the decrease in 1998 may partly be due to some changes in the social assistance legislation that occurred that year.

When comparing the group affected by the reform to others, there is a slight difference. Although the group has the largest share of social assistance recipients throughout the period, the share starts to decline compared to other groups in 1997, when the reform takes force. Thus, it seems that the reform may have slightly decreased the amount of social assistance receivers in the group. It is

⁴ Their government guaranteed study loan is counted as income when they apply for social assistance, even if they do not take up the loan.

worth noting, though, that from 1998 onwards the developments in the two younger groups are roughly similar.

If the reform did indeed have a decreasing effect on social assistance recipiency, how do we interpret this result? The most straightforward answer is that the effect is caused by increased employment in the group. However, this does not account for the difference between the two younger groups in 1997. Another explanation is that not all people who lose their right to LMS apply for or are eligible to receive social assistance. If this is so, then those people fall completely out of the safety net of the welfare state. Probably both explanations have some bearing.

6.2 Follow-up Analyses

In order to look at the effects of the reform more closely, some follow-up analyses were conducted. In all of these, the population to be followed is picked up at the end of 1995, and at the end of 1996. In order to have people who are affected or not affected by the reform, the four previous groups were restricted to single age classes: those who were 22 and those who were 25 years of age in those two years. Those who were 25, were obviously not affected by the reform at all. Those who were 22 in 1995 were only affected by the reform for a year (when they were 24 in 1997). Respectively, those who were 22 in 1996 were affected by the reform from the first follow-up year until they turned 25.

It must be noted, though, that the status of these people during the follow-up has not been controlled for. Some of them may have been or become eligible for the UI system by fulfilling the employment condition. Some may have completed occupational training and become eligible for unconditional LMS before they turned 25. These kinds of things are not accounted for, so the results are a bit rough and mainly give a picture of the aggregate effect of the reform.

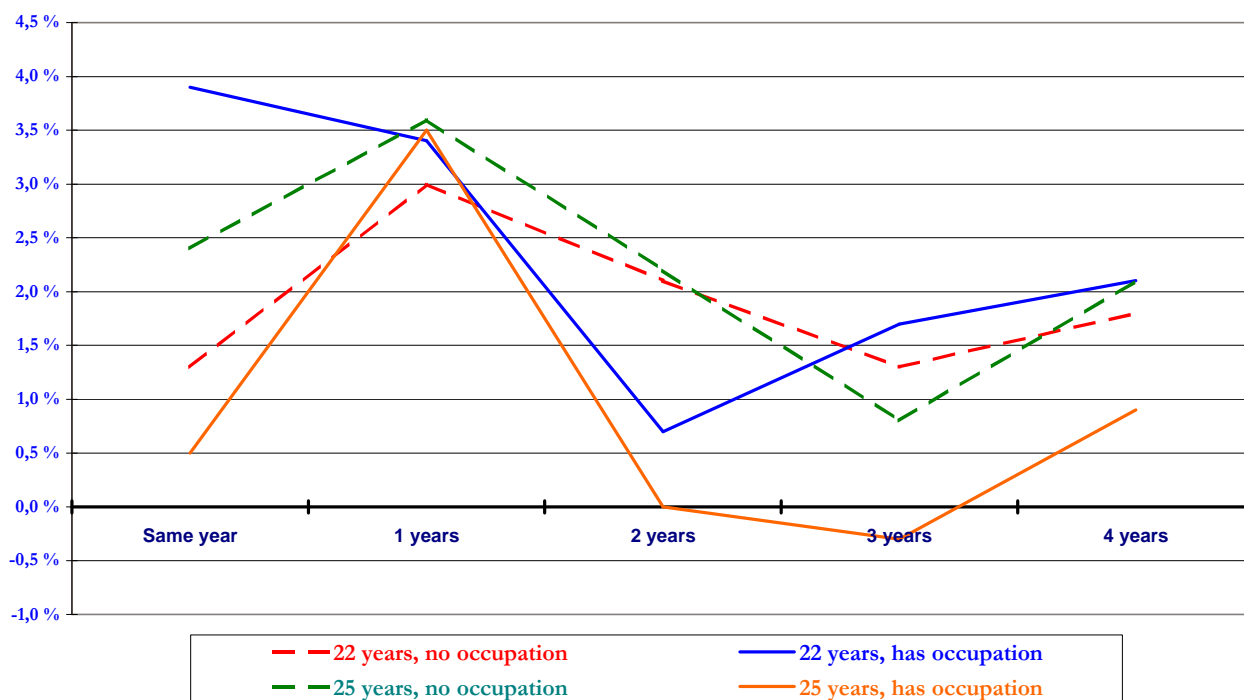


Figure 4 The change in "activity rate" from those picked up at the end of 1995 to those picked up at the end of 1996. "Activity" = employment, active labour market policy measure, studying, or military / civil service. Example: The activity of 22-year-olds who had occupation was about 4,0 percentage points higher at the end of 1996 than at the end of 1995.

In Figure 4, the differences of the cohort follow-ups have been calculated. As we can see, those picked up at the end of 1996 had a higher "activity rate" in almost all comparisons to those picked up a year earlier. The effect is highest in the first follow-up year for all except the young group not affected by the reform. Thus, there is a possibility that the reform increased the activity of the target group somewhat. On the other hand, their curve on the chart is very similar to the two older comparison groups, so it seems that the effect might more easily be explained by other developments in the labour market.

Furthermore, we must conclude that the overall changes in activity rates are not that big: a few percentage points at best. As all groups have these changes, it would be hasty to conclude that the reform is behind the risen activity rates.

6.3 Primary Education vs. A-levels

Lastly, some follow-ups were done comparing those who only have completed primary education to those who also have completed their A-levels. Both of these groups were affected by the reform at

least in principle. However, it has been previously concluded (Aho and Vehviläinen 1997) that those who have completed their A-levels have a strong orientation towards studying further, and thus will not be affected by incentives of the unemployment system. This is why it is in its place to compare these two groups. In these analyses, only 22-year-olds from 1995 and 1996 were compared.

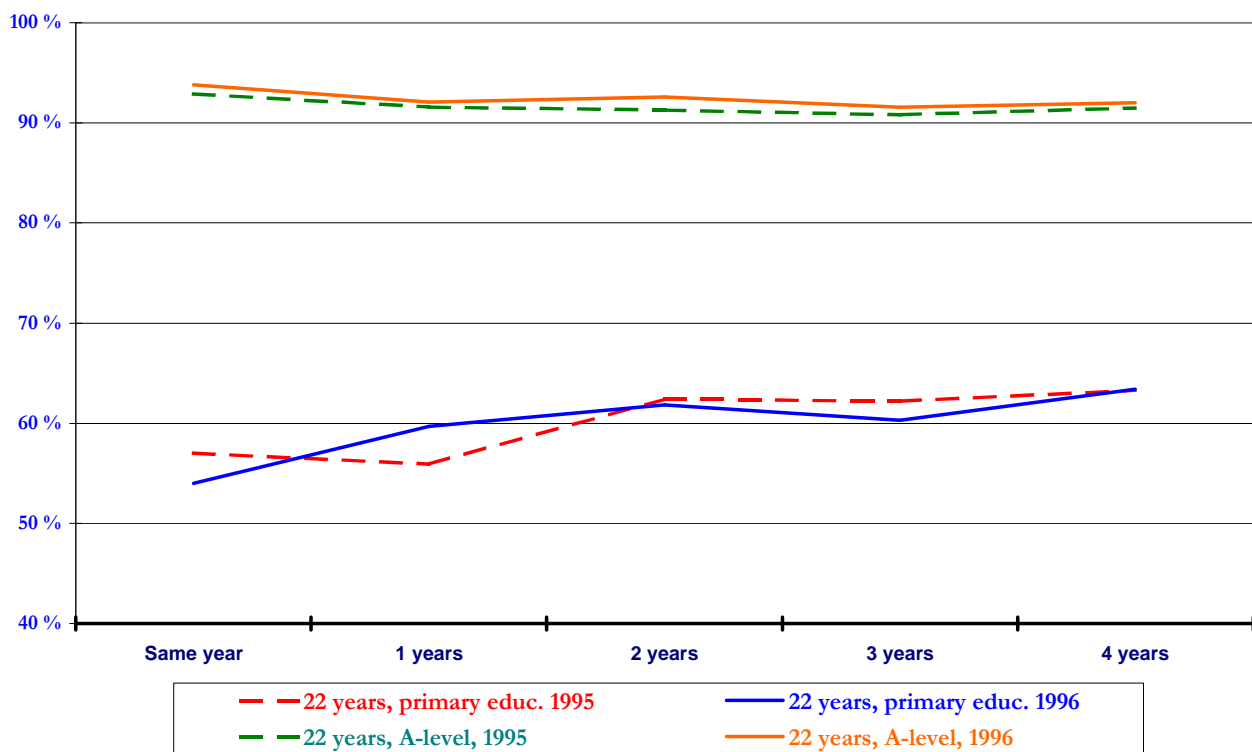


Figure 5 The "activity rate" of two groups of 22-year-olds, picked up at the end of 1995 and 1996, during five years.

In Figure 5, we see that the distinction between these two groups is very relevant. Firstly, those who have an A level exam have an activity rate of over 90 per cent. Secondly, the rate remains rather constant throughout the follow-up period and there is hardly any difference between the two cohorts.

Those with only primary education have a significantly lower activity rate, and some changes can be seen, too. In this follow-up there is again some indication that the reform may have increased the activity of those affected by it: the group picked up in 1996 has a higher activity rate after one year of follow-up. Still, this effect levels off quite soon and the differences are not drastic.

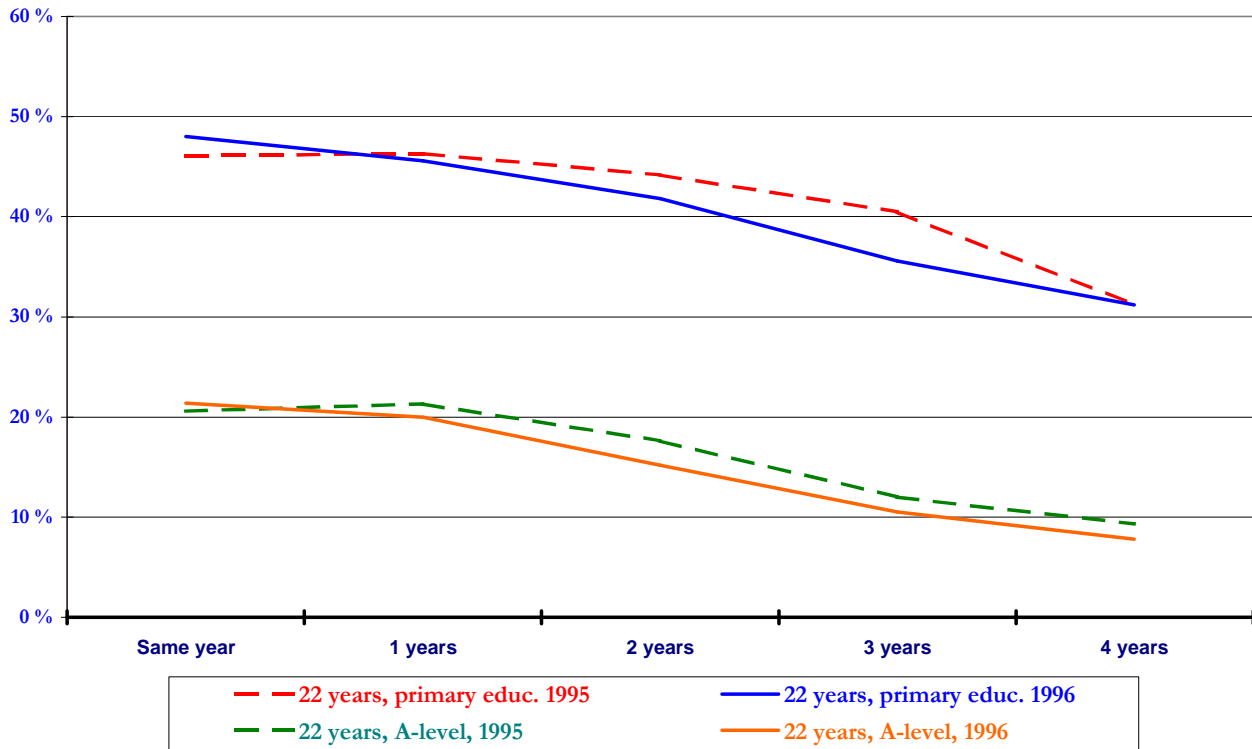


Figure 6 The share of those who received social assistance during the year in two groups of 22-year-olds, picked up at the end of 1995 and 1996, during five years.

When studying the recipiency of social assistance, we find – not surprisingly – that those with an A level exam have a significantly lower share of receivers. In Figure 6, the difference between the two cohorts is stronger than in Figure 5. The share of recipients falls over time in all of the groups, but in the primary education group picked up in 1995, the decrease is steeper, and the difference to the other cohort is larger.

Thus, this analysis strengthens the finding that the reform may have decreased the share of people on social assistance in the group affected.

7 PRELIMINARY CONCLUSIONS AND DISCUSSION

In this concluding section, the results presented in Chapter 6 are summarised, and some of their implications are discussed. Once again, it must be pointed out that the results are preliminary, as are the conclusions.

The evidence of the effects of the reform is somewhat contradictory. On one hand, the reform seems to have decreased unemployment, increased employment and decreased the share of receivers of

social assistance. On the other hand, many of these effects are very similar for the young people not affected by the reform, and thus one can ask if there is a “spill-over” effect or if the developments are caused by other labour market developments.

Overall, though, it can be concluded that the reform seems to have contributed to its primary goals: the open unemployment of those affected decreased rapidly and employment increased. However, the share of those getting themselves an education has not increased but decreased. Activation was one of the focuses of the reform, but the share of active labour market policy measures in the group affected remains low.

Further, there is some evidence that the reform has decreased the share of social assistance receivers. This is probably because of two reasons: firstly, employment has increased. Secondly, some of those who have fallen out of LMS have fallen directly out of social security because of the selective nature of social assistance and because of non-take-up effects. These people are most likely to be found among those with only primary education – there is a striking difference between them and those with an A level exam in many respects.

In summary, it is likely that taking away the “basic income” of these young people does “pull” a number of them into the labour market and into education. At the same time, it “pushes” a number of others out of the labour market, into social welfare or even outside it. At this point, it is impossible to say if the effects have decreased marginalisation more than increased it.

The most striking preliminary finding here is however that the reform did only have a very limited effect. In all analyses, the results – especially when compared to the other groups studied – do not point to any drastic effects of the reform. Thus, there seem to be no large effects on the overall well being of the target group (even though there most certainly are large effects on individuals).

As pointed out before, this reform can be seen as a “pilot” of the suggestions to introduce a maximum length of passive LMS for all unemployed. The overall picture points out, however, that it would be very hasty to make any far-fetching conclusions about these proposals based on the effects of the 1997 reform. At least the following serious reservations apply:

Firstly, the analyses conducted here comprise a period of strong economic upturn, when unemployment decreased overall. This has given people options to react to the negative incentives imposed on them.

Secondly, the target group of this reform consists of young people without occupational training. For them, studying with the small study allowance offered is a very real option when negative in-

centives are introduced. However, most of the people on LMS in Finland are long-term unemployed, and going (back) to school for years with a small allowance is not a realistic option for the majority of them.

Obviously, such a reform for all LMS receivers would have a positive incentive effect on some people. Still, it is likely that in a wider population, a major share of people would fall on social assistance because they would not have the option to work or study instead. This would be especially prominent in a state of economic downturn. The selective nature of social assistance and non-take-up issues would then probably lead to a situation where many would live completely outside the welfare state – and others would be stigmatised as “welfare cases”.

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