

The effects of an experiment exempting employers from social security contributions

This audit examined the effects of an experiment that was conducted in 2003-2005, in which employers in northern Lapland and certain island municipalities were exempted from social security contributions, on employment and job creation. Twenty municipalities were included in the experiment.

The aid received by employers in the form of the exemption was *de minimis* aid, which means that it could not exceed 100,000 euros during a three-year period. Exempted contributions could not exceed 30,000 euros per wage-payment year. The experiment was financed by increasing social security contributions for employers outside the area covered by the experiment. The managing authorities in the experiment were tax offices. The Ministry of Social Affairs and Health was responsible for coordinating the experiment and controlling and evaluating results.

The audit evaluated the success of the experiment in terms of the achievement of objectives. On the basis of the control and evaluation of results, the audit examined the effects of the experiment and factors that influenced the experiment's results. The audit also examined problems related to the managing and control of the experiment as well as risks involved in continuing the experiment.

The municipalities in Eastern Finland that joined the experiment at a later date were excluded from the audit. Compliance with *de minimis* regulations in the Kainuu region, where a similar experiment is being conducted in 2005-2009, was examined for 2005 and 2006. Otherwise the audit did not cover the experiment in the Kainuu region.

The audit found that the number of undertakings that used the exemption in northern Lapland and island municipalities was about 38% lower than the objective. The total amount of exemptions in 2003-2005 was about 15.9 million euros, which was about 34% lower than the estimate given in the Government bill (120/2002).

The average exemption per employee was 2,423 euros a year. The exemption was used most by undertakings in the hotel and restaurant field. The municipalities where the exemption was used most were Inari, Kittilä, Sodankylä and Kemijärvi.

In northern Lapland only 32-35 employers used the maximum exemption of 30,000 euros a year in 2003-2005. This was less than 2% of all the undertakings that used the exemption in northern Lapland. In applying de minimis aid it was necessary to exclude certain sectors according to Commission Regulation 69/2001. This had a significant effect in northern Lapland. The experiment did not include reindeer herding, transport or the production, processing and marketing of agricultural or fish products.

Some forms of aid that are used by undertakings are mutually exclusive, in which case employers have had to choose between different forms of aid. This may have significance for the achievement of the experiment's quantitative objectives. It could explain the low number of undertakings that have used the exemption, for instance. Labour-intensive undertakings remained outside the experiment to a large degree.

According to an evaluation of the experiment that was completed in 2005, the exemption did not have a statistically significant effect on undertakings' employment in the area covered by the experiment. The lowering of labour costs that resulted from the exemption was offset by a rise in wages.

The audit indicated that the low number of undertakings that used the exemption partly explains the poor employment effects of the experiment. Since the experiment typically affected small undertakings, the small reduction in employers' costs was not a strong enough reason to hire new employees. The temporary nature of the experiment may have also reduced employers' motivation to hire additional labour.

In the light of employment statistics, the experiment did not have any clear regional effects on employment in 2003-2005. The lowering of the average unemployment rate in northern Lapland followed the general economic trend in the country as a whole. The average unemployment rate in the island municipalities was higher in 2003-2005 than in 2002, before the experiment.

At the municipal level the unemployment rate rose annually in about a third of the municipalities in the experiment. In all the is-

land municipalities and 64% of the municipalities in northern Lapland, the unemployment rate rose at least one year during the experiment.

Migration statistics indicate that the experiment did not have clear positive effects on migration from northern Lapland. In all the municipalities in northern Lapland net migration was negative in 2003-2005. Before the experiment started, migration from municipalities in northern Lapland had slowed, but in 2004 and 2005 migration from municipalities speeded up and net migration turned slightly up. In 2005 net migration in northern Lapland was on the same level as in 2002, before the experiment started. Only one municipality, Kittilä, recorded an increase in its population and positive net migration each year during the experiment. Net changes in island municipalities' populations were small, owing to the low number of people who live there. On the basis of migration statistics it is not possible to verify any curbing effect on migration of the rise in wages that was observed in the evaluation report.

It is impossible to draw conclusions from statistics on the business effects of the experiment in individual undertakings. Changes in the number of persons an undertaking employs are influenced by broader economic trends. Furthermore other supporting measures have also been carried out in the area covered by the experiment, and it is difficult to separate their effects from the effects of the experiment.

According to interviews that were conducted in the audit, a positive effect of the experiment was that existing jobs were preserved in the undertakings that participated in the experiment. The increase in wages that was noted in the evaluation report was viewed as helping undertakings hold on to skilled labour. In the opinion of the National Audit Office, any strengthening of participating undertakings' competitive position or other business effects could be clarified by repeating the survey concerning employers' recruitment in northern Lapland, for example. The survey would be easy to repeat by sending questionnaires to the same target group as in the initial evaluation in the early stage of the experiment.

The audit observed problems in the tax administration's control system for the exemption, the control of de minimis aid and the checking of sector information. The control system lacked an alarm in case an employer exceeded the ceiling. The audit found 10 cases

in northern Lapland in 2003-2005 in which exempted contributions exceeded 30,000 euros a year. Altogether exempted contributions exceeding the ceiling totalled 150,000 euros. Undertakings in sectors that should have been excluded also took advantage of the exemption. As a result contributions totalling about 32,000 euros were erroneously exempted.

On the basis of the findings for northern Lapland, exemptions for municipalities in the Kainuu region in 2005 and 2006 were also examined. The audit found 13 cases in which ceilings were exceeded in Kainuu. Excesses totalled about 50,000 euros. Undertakings in sectors that should have been excluded also took advantage of the exemption in Kainuu.

In the opinion of the National Audit Office, contributions that were exempted on erroneous grounds should be recovered. According to the National Board of Taxes and the tax offices in the area that was covered by the experiment, steps have been taken to investigate and correct erroneous exemptions. The tax administration's control system has also been corrected on the basis of the audit findings.

One effect of the experiment that began in 2003 in northern Lapland and certain island municipalities is that the experiment has been extended up to the end of 2009 and the area covered by the experiment has been expanded to Kainuu and Eastern Finland.

In 2005 legislation concerning northern Lapland and island municipalities was expanded to include local authorities and parishes as well as private employers and unincorporated state enterprises. As a result the total amount of exempt contributions will rise, but the effect on employment will not be significant because of the *de minimis* condition.

Since the experiment was expanded, the total amount of exemptions in northern Lapland and island municipalities as well as municipalities in Kainuu and Eastern Finland is about 18 million euros a year.

Commission Regulation (EC) No 1998/2006 raised the *de minimis* ceiling to 200,000 euros during a three-year period. The Regulation applies from 1 January 2007 to 31 December 2013. Finnish legislation exempting employers from social security contributions has not been revised in this respect.

The total amount of exemptions depends on the degree to which labour-intensive undertakings use the exemption. Increasing the de minimis ceiling can have positive effects on employment if the de minimis condition has clearly kept labour-intensive undertakings from using the exemption. Positive effects on employment are expected to have multiplier effects, with employment growing in the service sector as well. Some forms of aid are mutually exclusive. Raising aid ceilings can also influence what forms of aid undertakings prefer to use.

During the first year of the experiment in Kainuu, exemptions were 60% higher than had been anticipated. According to the Ministry of the Interior, the effect of the experiment in Kainuu should be larger than in northern Lapland and island municipalities.

In the opinion of the National Audit Office, the costs of expanding the experiment have not been given adequate consideration. The increase in exemptions that may result from raising the de minimis ceiling will increase the need to raise social security contributions for other employers. Otherwise the risk in expanding the experiment and raising the de minimis ceiling is an increase in the Social Insurance Institution's deficit, which would not be in line with the experiment's objective. An efficient control system should also be created between authorities so that payments of de minimis aid can be fully monitored.

In the opinion of the National Audit Office, the experiment's final effectiveness evaluation should be conducted after 2009. Such an evaluation will be hampered by the difficulty of making the same comparisons that were used in the previous evaluation. The experiment has now been expanded to cover most of the area that was used for comparison. The lack of a comparison area may also make it more difficult to evaluate reliably the effects of raising the de minimis ceiling.

The new Regulation brought some changes in sectoral limitations. Finnish legislation exempting employers from social security contributions has not been revised in this respect either. In the opinion of the National Audit Office, as a result of changes in EU legislation, the need to revise Finnish legislation should be considered.