

Conclusions and recommendations of the National Audit Office

Preparation and implementation of the removal of incentive traps

The audit examined how various legislative measures have succeeded in removing incentive traps related to social security, enforcement, and taxation. The issues addressed in the audit included differences in the taxation of earned income and unemployment security as well as the combination of taxation and social security as an incentive to work. Information was also collected on the extent to which people are familiar with the incentives related to the taxation of earned income and on whether the recipients of unemployment security feel that these incentives have an impact on their willingness to take up work.

Incentive traps refer, for example, to cases where income earned from work does not significantly increase the disposable income or where the combination of earned income and benefit income requires a particular effort from the person concerned and may cause interruptions in income. In addition, people do not necessarily know how earned income and benefit income can be combined or how combining them affects their disposable income.

The audit focused on the success of two amendments to the legislation on unemployment security. One of the legislative amendments aimed at facilitating the reconciliation of earned income and unemployment security, while the other one was aimed at increasing the incentives for unemployed jobseekers to start a business. In addition, the audit focused on an amendment to the Enforcement Code concerning the right to a deferral of garnishment of wages or salary. The audit examined the appropriateness of the right to a deferral for increasing labour supply among long-term unemployed who are debtors in enforcement.

The National Audit Office decided to launch the audit because increasing the incentives to work through taxation, social security, and enforcement has been the goal of several governments. The audit is timely, as various incentives and incentive traps are also at the centre of the work of the parliamentary committee preparing the social security reform.

The audit provides new information on different ways to remove unemployment, income, bureaucracy, and information traps. The audit was unable to establish the impact of the legislative measures on employment. However, in order to assess their impact on employment, conclusions were drawn on the success of the measures and on the requirements for removing various incentive traps.

The delays in the payment of adjusted unemployment benefits have become shorter and fewer, but the overlapping earnings period and payment criteria pose a problem

The adjustment of unemployment benefits was reformed so that, instead of being based on the earnings period criterion, it is now based on the payment criterion. This has reduced and shortened the delays in the payment of benefits. The reform has had a greater impact on the adjustment of labour market subsidy and basic allowance than on earnings-related unemployment benefits. Although, as a rule, the adjustment is now based on the payment criterion, some adjustment cases are still resolved based on the earnings period criterion. Earnings-period-based consideration is also necessary in the monitoring of the fulfilment of the condition of previous employment and in the monitoring of working hours, which affects the availability of the adjusted benefit.

The overlaps between the payment and earnings period criteria increase the amount of administrative work, lead to complex situations that are open to interpretation, and make the system difficult for recipients of unemployment benefit to understand. In the opinion of the National Audit Office, it would be important to assess to which extent the payment criterion applied to the implementation of unemployment security could be clarified or expanded. This would also improve the usability of the Incomes Register.

The threshold for starting a business while receiving unemployment benefit has decreased, but the assessment of full or part-time nature of entrepreneurship remains ambiguous

The amendment to the Unemployment Security Act has made it easier to start a business while receiving unemployment benefit. As a result of the amendment, the full or part-time nature of entrepreneurship is not assessed at the start of the business but only after the first four months. This has lowered the threshold for trying out entrepreneurship. It has also increased the financial incentives to start a business, as the right to receive unemployment benefit remains for the first four months, even if the entrepreneurship is considered to be full-time in nature.

According to the audit, however, the basic problem with the reconciliation of unemployment benefit and entrepreneurship has remained unchanged, as there are still no clear criteria for assessing the full or part-time nature of entrepreneurship. The decisions made on the full or part-time nature of the activities vary considerably between different TE Offices. This means that the assessment of whether a client considering starting a business has the right to unemployment benefit is not made consistently in different parts of the country. Although incentives to start a business have increased, the ambiguity of the assessment of full or part-time nature of the activities may still cause uncertainty for those considering entrepreneurship.

Most of the applications for a deferral of garnishment are rejected

The amendment to the Enforcement Code aimed at increasing the incentives for debtors in enforcement to work. To this end, debtors in enforcement who have been unemployed for a long time were provided with the right to a deferral of garnishment of their wages or salary. The condition for the deferral is that the person is within the scope of income limit garnishment when he or she is employed and has received unemployment benefit for at least 258 days. A deferral may be granted for a maximum period of six months.

On the basis of the audit, the number of applications for a deferral has roughly corresponded to the estimates made in the preparatory phase. However, a significant number of the applications are rejected. This is probably explained by the fact that the legislation is ill-suited to the implementation of enforcement, the criteria are unclear to the applicants, and it is difficult to estimate the net income to be taken into account in enforcement.

In practice, however, the deferral is often automatic because information on employment reaches the enforcement authorities with a delay. The practical processes of garnishment of recurring income should be carefully considered in the preparation of the amendments to the Enforcement Code aiming at increasing the incentives for debtors to work.

Unemployment benefit recipients do not feel that the higher tax rate on unemployment security compared with that on earned income would affect their willingness to take up work

The tax rate applied to unemployment security is considerably higher than the one applied to earned income. This is primarily due to the credit for earned income, which is deducted automatically from taxes on income from work. One of the reasons for the higher tax rate on unemployment security is that the lower tax rate on work income is intended to encourage an unemployed person to find employment.

Based on the survey data collected as part of the Labour Force Survey of Statistics Finland, the difference between the taxation of unemployment security and earned income is not particularly well known. Unemployment benefit recipients do not feel that the difference in taxation affects their willingness to take up work. However, on the basis of the survey, more than half of the unemployed and those outside the labour force who receive unemployment benefit feel that they can accurately or fairly accurately assess the effects of employment on their disposable income.

The better the financial incentives are known, the better they can be expected to have an impact on people's choices. It might be easier to make an accurate assessment if there was an easy-to-use calculator that would take into account all aspects affecting the financial incentives. The audit provided indications that, as

an incentive to work, the tax credit for earned income is a costly measure from the perspective of central government finances. The high tax rate on unemployment security may, in turn, increase the need for social assistance.

Recommendations of the National Audit Office

The Ministry of Social Affairs and Health and the Ministry of Economic Affairs and Employment should

- pay particular attention to the implementation processes of legislation and make full use of the expertise of the implementers when preparing amendments to the unemployment security legislation to increase the incentives to work and start up a business. This would facilitate the implementation of the legislation, which could reduce the risk of bureaucracy and information traps.

The Ministry of Justice should

- in removing the incentive traps related to debt being enforced, develop solutions that speed up getting out of the debt,
- take full account of the implementation practices of garnishment when preparing reforms affecting the garnishment of recurring income, thus ensuring that the enforcement is as clear and easy-to-understand to the debtor as possible.

The Government should

- in the preparation of the social security reform, pay particular attention not only to unemployment and income traps but also to bureaucracy and information traps and any overlaps between the various incentive traps,
- ensure that, in reforms concerning incentive traps related to social security and taxation, the responsible ministries and the agencies in their sector ensure that the key target groups are informed sufficiently of the impacts of the reforms.