Welfare Policy and Income Distribution: the Finnish Experience in the 1990s

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■ Introduction

Economic and social goals often compete with each other and their relationship can be tense. It is not rare that the creation and the distribution of welfare are seen as separate issues, even to the extent that the promotion of one is claimed to have a negative effect on the other.

After a long period of economic growth, Finland was hit by a severe economic crisis at the beginning of the 1990s. Social goals buckled under economic worries, and the start of the decade was marked by efforts to balance public finances. Since then, questions pertaining to economic policy have been the key political priority for governments.

Since the recession Finland has experienced rapid economic growth but also enduring high unemployment. In this situation, balancing the goals of economic, employment and social policies has represented a big challenge. The governments have wanted to ease people off social security and into work, while at the same time the prevention of exclusion has been a major concern.

This article deals with the tension that occurs when the emphasis shifts between economic and social goals. First, we shall situate Finland on the map of Europe based on social expenditure and poverty. Then, we shall document the main economic, employment and social policy aims of Finnish governments in the 1990s and bring forward some of the essential modifications made to the income transfer system. Finally, we shall ask how the political choices can be seen in the development of income differences and poverty. Before closing, we shall evaluate the room for further modifications in the incentive system.

■ The role of the welfare state in alleviating poverty

In international connections, the Nordic countries – including Finland – are considered to be countries that place a high value on the equality of results.

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and not only on the equality of opportunity. The so-called “Nordic (or Scandinavian) model” refers not only to a large public sector (which can be seen, for example, in high tax rates and elevated social expenditure) but also to such outcomes as even income distribution, gender equality and low poverty rates. The large comparison of OECD countries carried out by Atkinson et al. (1995) using material from the 1980s offered proof of this claim: among industrialized countries, the Nordic countries had the smallest income differences and poverty rates. When the data on social expenditure and poverty rates were cross-tabulated, many studies told the same story: the more a country has invested in social security, the lower the poverty rate (Mitchell, 1991, Atkinson, 1998).

These types of macro-level input-output analyses have been criticized for many different reasons. First, the same amount of money can be used in various ways with differing consequences (Esping-Andersen, 1990). Second, social expenditure can vary not only due to policy orientation but also due to demands caused by population and employment structures. Third, social expenditure has often been proportioned to the gross domestic product, which can fluctuate considerably. The fourth problem is that the social expenditure statistics do not usually take into account the taxation of benefits (Adema, 2001). It has also been maintained that the living conditions of citizens are strongly affected, in addition to direct income transfers, by other aspects of welfare policy, such as education, pay and housing policy (e.g. Castles and Mitchell, 1990). Thus the relationship between social protection expenditure and poverty should be taken with some caution. Co-variation is not enough to suggest a causal relationship.

Even though social expenditure as a policy measure can be legitimately criticized, it should be kept in mind that the visible political battles are usually about money and often also about poverty. Given this, we use data on the social expenditure share of GDP and on the poverty rate as a rough picture of the priorities in different countries and as a starting point for in-depth analysis.

The comparative data on poverty Atkinson et al. used came from LIS-database, but unfortunately the data from this source is not very up-to-date. Most recent data on social protection and poverty comes from Eurostat. However, due to different approaches to the measurement of poverty and perhaps also for political reasons (see the discussion in Atkinson et al., 2002), Eurostat now uses the notion “at-risk-of-poverty” instead of poverty. Basically, we are still talking about those whose income falls below a certain limit. Yet it is not just a change of terminology we are witnessing. The change of concept reflects not only an answer to criticism against the poverty concept (“not all below the poverty line are truly poor”), but also includes a recommendation concerning the way the phenomenon is calculated. The at-risk-of-poverty threshold has been raised and the equivalence scale has become less generous for child families. Eurostat’s at-risk-of-poverty rate is defined as the share of people with an equivalized income below 60 per cent of the national median.
equivalized disposable income. The scale used is the OECD modified scale, where the first adult gets the weight 1, the second adult the weight 0.5 and children the weight of 0.3.

Figure 1 illustrates the relationship between social expenditure and at-risk-of-poverty. To some extent, it corroborates previous research results: the higher the relative social expenditure in a country, the less at-risk-of-poverty there is. In 1999, Sweden stood out as a country with high social expenditure and a low at-risk-of-poverty rate compared to other countries. Countries with relatively low social expenditure also had a higher at-risk-of-poverty rate. In the EU, these countries above all included South European countries and Ireland.

In Figure 1, the unweighted medians divide countries, on the one hand, to countries with higher or lower social expenditure than average, and on the other hand, to countries with higher or lower at-risk-of-poverty rates than average. Thus, the lower left-hand corner of the Figure would contain “effective” countries, in which lower than average expenditure generates lower than average at-risk-of-poverty rates. Luxembourg and Finland are
the closest examples. Many countries are situated in the lower right quadrant, where higher than average social protection expenditures yield lower than average at-risk-of-poverty rates.

If in the 1980s and in the mid-1990s there existed a high degree of similarity between the Nordic countries that distinguished them from rest of the industrialized countries, this appears to have disappeared by the end of the 1990s, at least when using the new European structural indicator “at-risk-of-poverty rate” instead of the “poverty rate”. In the light of this data, Finland, Denmark and Sweden still appeared reasonably close to each other, but their relative distance from other Western European countries was narrower compared with an analysis in which 50 per cent of the median is used as an indicator of poverty (Ritakallio, 2002). It is also the case that LIS data for Finland for the year 2000 continues to show a very low poverty rate (see www.lisproject.org).

While one can thus state that poverty continues to be infrequent in Finland by international standards, it is nevertheless the case that relative poverty increased in the latter part of the 1990s. And while income distribution is still rather even, income inequality has also increased. We now turn to assessing possible explanations for the growth of poverty and increasing income differences in Finland.

■ Economic and social goals: change in Finnish welfare policy in the 1990s

In the 1990s Finland was hit by a severe economic recession. As a result of this, for three consecutive years, the GDP decreased altogether by over ten per cent, the employment rate dropped by some ten per cent, and the unemployment rate grew fivefold from about three to fifteen per cent. This constitutes the deepest economic recession experienced in the industrialized countries since the Great Depression of the 1930s in the USA. So it is clear that economic, employment and social policy had to be adjusted to entirely new circumstances.

In the past twelve years, Finland has had three governments, each ruling for the entire four-year election cycle. In Finland, a government programme agreed on at the formation of the government sets the mid-term political agenda. A common feature of the three governments in the 1990s was their concern over the development of national economy and public finances. All governments emphasized the open sector and its international competitiveness. Securing economic growth and employment were also high on the
agenda. Another common feature was the conviction that employment can be improved by strong competitiveness, general economic policies and balanced public finances. Social policy included cuts, reviewing of policies and improving the operation and outcomes of social policy programmes and institutions. All governments tried to avoid tax increases, although tax increases were noteworthy in the first half of the decade.

While key aims show continuity, on closer examination one can observe that towards the latter half of the past decade the attitude towards employment and social policy gradually changed. In addition to established practice, the means of fighting social exclusion included two novel approaches. First, economic incentives were reviewed in order to increase employment and prevent poverty and exclusion. Taxation, social security benefits and service fees were co-ordinated so as to improve the economic incentives for seeking employment. The other high priority was activation, i.e. easing people off social security and into work by means of targeted administrative activities. Efforts were made to increase participation in working life through customer-oriented services and activities, active labour market policy, and individual solutions tailored for the long-term unemployed.

It is worth noting that, in Finland, by and large the same methods were used to develop the economy, improve employment and prevent exclusion. The main goal of economic policy was to improve employment by securing the preconditions for economic growth. Poverty and exclusion, on the other hand, were tackled primarily by directing attention to enhancing employment. On the level of actions this meant that social and employment policy goals or means for supporting them were not always easy to find in one particular policy sector. At first glance, it may seem odd that even though the prevention of exclusion was an essential goal for the government, virtually no concrete methods were introduced in the social policy part of the government programmes. The government’s concrete means to combat exclusion, i.e. reviewing incentives and increasing activation, were to be found within the methods of economic and employment policy.

So, importantly, raising minimum security – a solution suggested by many for preventing poverty and exclusion – was not included in the goals. Indeed, this type of social policy was hardly in harmony with the other goals of the government, such as cutting back public spending, lowering the tax rate, reviewing incentives and emphasizing work. The tension between economic and social goals was eased by promoting the goals of social policy (preventing poverty and exclusion) in ways that differ from the traditional methods of social policy.

Thus, the focal points of policy seem to form a chain: economic policy deals with the economy and employment, while employment policy deals with employment and prevention of poverty. The same approach is reflected in the phrase often heard in Finland: treating unemployment is the best social policy. This reflects a commitment concerning the direction, but no specific
targets concerning rates of unemployment or poverty were set. From the point of view of the government, logical social policy solutions are those that reduce dependence on social security instead of increasing it.

### Changing income transfers

When we discuss the changes made in minimum security, one must know that, by the 1990s, Finland had established a comprehensive social security system of reasonably high quality. Thus, a security system is in place to ensure minimum subsistence, although opinions differ on how systematic it has been.

Finland has more than ten different benefit systems and more than a hundred forms of extra assistance to couple these. There is a residence-based basic security plus earnings-related benefits for those with a work history. In addition to these, local authorities provide last resort, temporary social assistance which is meant to complement the above-mentioned benefits in cases where the disparity between a person’s income and expenses is too large or there are delays in the payment of benefits. The subsistence system is further complemented by tax-financed social care and health services that are run by local authorities and available to all residents according to need.

![Levels of minimum security in Finland in 2002](image)

For net amounts, one needs to deduct Local Tax (municipal taxation on average 17.5%) and Church Tax (1.25%).

The economically most far-reaching changes in income transfers have been made to pension security, but in keeping with the topic, we shall discuss the changes to the benefits that are essential in preventing poverty. In the 1990s, important changes that affected minimum security and incentives were made to unemployment security, social assistance and housing allowance. The modifications usually weakened social security: increases in the level of benefits were omitted, and the terms for receiving social security were tightened. These measures aimed at cutting back public spending, but they also reflected value choices that emphasized the meaning of incentives for work. This set the aims of protecting minimum security and the aims of improving incentives for work on a collision course.

A more detailed examination of the development of minimum security in the 1990s shows how the selected policy especially affected the main sources of income of unemployed households. The most important changes to unemployment security aimed at tightening the terms for receiving unemployment security. Another common measure was to cut the increases in the level of unemployment security. The terms for receiving unemployment security were also tightened for people entering the labour market for the first time. A law was passed on means-tested labour market support that would be granted based on the need for financial assistance. More severe sanctions were also introduced for those refusing to work.

Increases in the level of social assistance were also omitted every now and again. Another change that affected incentives for work and tightened the terms of receiving benefits was the introduction of sanctions for refusing to work.

Housing allowance used to be subject to automatic income-related adjustments, the so-called inflation adjustments, but these were abolished in 1992. The compensation rate of housing allowance remained unchanged throughout the 1990s. Terms for receiving allowance were tightened for one and two-person households and increases in the level of rents that are taken into account have been omitted since 1996. As a result, the development of the housing allowance has lagged behind the increased costs of living.

The taxation of earned income was raised at the beginning of the 1990s. Families with children were affected by the abolition of child deductions and deductions for single parents, which, however, were partly compensated by increased child benefits. The employment pension contributions and unemployment pension contributions introduced in 1993 have also resulted in increased income taxation. Since 1990, the average municipal tax rate has grown every year. The state income tax scale was subsequently lightened, and the earned income deduction of the municipal tax increased. Employment pension contributions and unemployment pension contributions as well as health insurance contributions were reduced. The level of taxation is about the same now as it was at the beginning of the 1990s. As a
result of the changes in taxation and adjustments on income transfers, incentives for work are better now than they were in the mid-1990s.

**Economic and employment policies have been successful, but exclusion from the labour market remains unsolved**

The success of government policies can be looked at in the light of national economy, employment and economic indicators over three different periods: the bottom of the recession in 1990-93, the takeoff in 1993-96, and the recovery since 1996 (see Kautto, 2003).

At the bottom of the recession, poor GDP, consumption and investment figures were very much in the foreground. Employment figures from this period look gloomy: employment deteriorated from year to year and unemployment rates went up. The number of long-term unemployed and the length of unemployment periods kept increasing and jobs were being lost. The distress was felt by the public economy as well: the state budget deficit increased and the public debt grew sharply.

The start of the takeoff was marked by an upturn in the open sector. This upturn can already be seen in the 1992 figures, which show a recovery in exports in particular but also in imports. The export-led economic growth could be seen as an increase in GDP after 1993. Consumption improved in 1994, followed by investments in 1995. The general upturn of the national economy could not be seen in employment until 1995, when unemployment started to decline slowly. There was also an increase in the number of vacant jobs. However, long-term unemployment did not take a turn for the better until after the middle of the decade when the average length of employment kept increasing. During the takeoff period, the deficit of public budgets started to diminish slowly. At the same time, however, the public debt continued to increase, although less sharply than before.

During the recovery from the recession, favourable economic development continued with a strong growth of GDP. Consumption, investments, exports and imports were also on the increase. The employment ratio was improving year after year, although the improvement was sluggish compared with the deterioration during the recession years. Unemployment was also falling. Moreover, the average length of unemployment was no longer growing and the number of long-term unemployed had turned down. After 1996, the public debt took a downward turn and the state budget already showed a surplus in 2000.

Even though the national and public economies have developed well, employment has not seen an equal amount of progress in Finland. The employment rate has been on the rise and has almost reached the goals set
by Prime Minister Lipponen’s second governmental programme. On the other hand, the unemployment rate has declined rather slowly (Figure 3).

Figure 3: Key figures of unemployment in Finland, 1990 to 2000

As reducing unemployment has proved difficult, the governments have faced an important social policy question: how to combat poverty and exclusion among those citizens who have not become employed, for one reason or another, despite the economic growth. Not all in risk groups will seek employment, no matter what is done with incentives or activation. Thus, the changes to incentives and the co-ordination of benefits may, in fact, have weakened the financial position of many. Next, we shall examine in more detail with national data how income distribution changed in Finland in the 1990s and how the above-mentioned policy changes have affected income distribution and the position of people with low income.
Income distribution and poverty

The reported results on income distribution and poverty are based on the income distribution statistics compiled by Statistics Finland. The main focus is placed on the distribution of disposable income. Disposable household income is comprised as follows. Earned income, entrepreneur’s income and property income constitute factor income. When these are combined with received income transfers, such as pensions, health insurance compensations and unemployment benefits, the result is gross income. When paid income transfers, i.e., direct taxes are deducted from gross income, we have disposable income.

The income comparison of households of different sizes and compositions is based here on the OECD’s original scale, in which the first adult is given the weight 1.0, the other adults the weight 0.7, and the children the weight 0.5. According to this scale, a family of two adults with two children needs a 2.7-fold income compared to a single person in order to achieve a similar level of subsistence. In order to study the distribution of income, the population is placed in ascending order according to income calculated by household consumption unit. This allows us to examine, among other things, the proportion of income that goes to the 10 per cent of Finns with the lowest income (the lowest income decile) and the proportion received by the 10 per cent with the highest income (the highest income decile). From a welfare point of view, it is justified to calculate the disposable income by consumption unit for each individual (thus the income is the same for all the members of a household), after which individuals are placed in ascending order based on their income. These methods are standard ones in income distribution research (see Kakwani, 1986).

We shall describe the development with the help of cross-section data on each year. This will reveal the change in the income level of a certain group as a whole, but will not specify what part of the change is due to households entering and leaving the group over the years and what part is due to changes in the income level of the households that have remained in the group.

Average development of household income

Figure 4 shows us how, on average, household income has developed during the recession. The figures have been calculated per household. Here, as well as in later Figures, euros have been presented according to the price level of the year 2000 using the cost of living index as deflator.

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1 Much of what follows was reported in Finnish in an article by Kautto et al., 2002.
The dual development of the 1990s can be clearly seen in the average household income development. Household factor income dropped by as much as 18 per cent between 1990 and 1994. This was compensated by an increase in income transfers so that the reduction in disposable income, under 10 per cent, was quite moderate considering the severity of the recession. The real growth of household income transfers was close to 40 per cent between 1990 and 1994. This was mainly caused by unemployment and unemployment security but also by pensions and social assistance. On the national economy level, the GDP share of social expenditure grew, which considerably eased the decline in household income.

Since 1994, factor income has grown more rapidly than disposable income. This is partly caused by the fact that the amount of received income transfers has decreased slightly (because of reduced unemployment and cuts to social security). The main reason, however, is the continuing rise in direct taxes. The end result is that, since 1994, the yearly disposable household income has been on the increase and has already markedly exceeded the level of the beginning of the decade.

**Changes in income distribution**

Figure 5 illustrates the development of income shares for the different deciles in the 1990s. The line for the lowest income decile in Finland is at the
bottom, the line for the second lowest above it, etc. The highest line describes the income share of the highest income decile. These measures depict relative income differences, the share that each decile receives of the disposable income.

Figure 5: Income distribution between deciles in 1990-2000
(Disposable household income by consumption unit, person deciles)

Up to the year 1994, income distribution remained more or less unchanged. The recession years did not increase the income differences existing among Finns. The least affluent became poorer, but so did the affluent.

Since 1995, income differences have been on the rise. There are at least two underlying reasons for this. First, the growth in income differences is largely due to the increase in the income share received by the highest income decile. The reason for this is a sharp rise in property income and particularly in dividend yields and sales profits. More than half of property income is received by the highest income decile of Finns. In fact, of all income types, property income is the main responsible for the increase in income inequality in Finland in the late 1990s (Riihelä et al., 2001). The most recent data showed that income inequality decreased from 2000 to 2001 because of the decline of dividend yields and sales profits.

The other post-recession change has been smaller but significant from the point of view of low-income groups. The lowest-income half of Finns have lost ground in income distribution. This has been most evident in the case of the two lowest-income deciles. The relative position of low-income groups has thus deteriorated.
The redistribution effect of income transfers and taxation

The dual development of the 1990s raises questions about the role of social security and taxation and the changes made to them in evening income differences. Figure 6 illustrates the Gini coefficients of the distribution of factor income, gross income and disposable income.  

Direct taxation and social income transfers even out income differences. Because of received income transfers, the distribution of gross income is much more even than the distribution of factor income. The disposable income, on the other hand, is distributed more evenly than gross income, as direct taxes further even out income differences. The difference between disposable income and factor income reflects the joint effect of income transfers and direct taxes.

During the recession years, the inequality in the distribution of factor income grew sharply. This was caused mainly by rising unemployment. Since 1994, the growth of differences in factor income has slowed down significantly despite the fact that the rise in property income has increased the differences. The decline in unemployment has narrowed the differences and slowed down the increase of inequality.

The changes in the distribution of gross income followed the distribution of disposable income. This reflects the fact that there was little fluctuation in

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1 The Gini coefficient is a widely used measure of income distribution inequality. The more unequal the distribution, the higher the value.
the redistribution effect of direct taxes in the 1990s, at least compared to the effects of received income transfers.

Thus, changes in social security are of high importance. During the recession years, the importance of income transfers in household income formation grew. Although the trimming of social security benefits began in 1992, it did not restrain the growth of social expenditure and the resultant strengthening of redistribution. The redistribution effect of income transfers began to diminish from the year 1995. This was primarily caused by the reduced volume of social security and taxation in relation to GDP. There are various factors behind this. First, GDP has grown rapidly since the recession. Second, employment has improved, which has slowed down the growth of factor income differences while also reducing the need for social security. Third, the level of social security benefits has been raised moderately, and as mentioned before, the real level of certain benefits has even dropped or, at least, is lagging behind the progress in income levels.

**Trends in poverty**

There is no one official national poverty indicator in use in Finland. Figure 7 shows two indicators depicting poverty or subsistence difficulties. They tell a different tale. When poverty was measured relatively (as low income in relation to normal income in a society), the poverty rate among Finns remained unchanged or was even reduced during the recession. This was due to social security: despite social security cuts and unemployment, social security lifted a larger portion of the population than before above the poverty line. Since the recession, the relative poverty rate has been on the rise. This growth has slowed down in the past few years.

**Figure 7: Two poverty indicators**

![Two poverty indicators, 1990-2000](image)

1. The share of the poor in the population = the share of people living in households whose disposable income per consumption unit is less than half of the median of the population.
The share of social assistance recipients tells another story. Social assistance is paid by the municipality after a means test. In Finland, social assistance usually complements other social transfers. As all political-administrative poverty measures, its reliability can be questioned: the criteria of giving assistance may change over time; changes made to other benefits may affect entitlement to it; and local discretion may vary. During the recession years, the lowest income decile of Finns lost income, as did others. The increase in economic difficulties in households is reflected by the sharp rise in the share of the population receiving social assistance. The underlying reasons for the increase in subsistence difficulties are increased unemployment, decreased real income, debt and cuts in social security benefits. These together forced growing numbers of people to resort to social assistance. In 1997, the share of the population claiming social assistance took a downturn. Since then, the real income of low-income groups has improved somewhat.

■ Incentives

In the light of this development, it is appropriate to say a few words about incentives. Incentive traps are a result of unsuccessful co-ordination of earned income, income transfers and taxes. In Finland, traps are above all formed by links and overlaps between income transfers. The most important traps are the unemployment trap and the income trap. The unemployment trap is created when the income from social security is so high in relation to income from work that it does not encourage an unemployed person to accept work. This applies especially to the link between low-income work and the level of social security. The income trap is a situation in which, despite the rise in earned income, the person’s disposable income does not grow or grows very little. The root of the problem here is not the level of social security, but rather the co-ordination of social security and earned income: social security is reduced and taxation grows as earned income increases.

Income transfers causing incentive traps in Finland are, in particular, income taxation, unemployment security, general housing allowance and social assistance. A common feature of all these income transfers is that they are affected by income earned from work. Often, a household’s income formation is simultaneously affected by several income transfers. Incentive traps are thus not caused by one single income transfer, but rather by their joint effect. An income trap is usually created by two to four income transfers simultaneously affecting a household’s income formation. This makes it difficult to modify the incentives (Parpo, 2001).
Table 1: The shares of households in an income trap according to different background factors when the persons’ earned income increases by €84 per month (FIM500 per month), per cent

<table>
<thead>
<tr>
<th>Disposable income of the household, €</th>
<th>%</th>
<th>Age of the household</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 8 409</td>
<td>31.4</td>
<td>&lt; 30 years</td>
<td>54.0</td>
</tr>
<tr>
<td>8 409 &gt; 13 455</td>
<td>38.6</td>
<td>30-40 years</td>
<td>18.0</td>
</tr>
<tr>
<td>13 455 &gt; 18 501</td>
<td>16.7</td>
<td>40-50 years</td>
<td>18.6</td>
</tr>
<tr>
<td>18 501 &gt; 23 546</td>
<td>8.7</td>
<td>&gt; 50 years</td>
<td>9.4</td>
</tr>
<tr>
<td>23 546 &gt; 28 592</td>
<td>2.5</td>
<td>All</td>
<td>100.0</td>
</tr>
<tr>
<td>&gt; 28 592</td>
<td>2.1</td>
<td>All</td>
<td>100.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Socioeconomic position of the household</th>
<th>%</th>
<th>Life-phase of the household</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployed</td>
<td>45.2</td>
<td>Single parents</td>
<td>14.4</td>
</tr>
<tr>
<td>Pensioners</td>
<td>3.1</td>
<td>Couple with children</td>
<td>16.5</td>
</tr>
<tr>
<td>Students</td>
<td>20.8</td>
<td>Childless couple</td>
<td>5.8</td>
</tr>
<tr>
<td>Blue-collar workers</td>
<td>3.2</td>
<td>Singles</td>
<td>61.8</td>
</tr>
<tr>
<td>Lower white collar</td>
<td>5.5</td>
<td>Others</td>
<td>1.5</td>
</tr>
<tr>
<td>Upper white collar</td>
<td>1.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entrepreneurs</td>
<td>10.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>11.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All</td>
<td>100.0</td>
<td>All</td>
<td>100.0</td>
</tr>
</tbody>
</table>


According to a recent study made on incentive traps, the occurrence of traps depends on the amount of extra income (Parpo, 2001). Income traps are more widespread with minor income increases. Table 1 shows the occurrence of income traps for different households in a situation where earned income increases by 84 euros in a month. The effects were estimated with a micro-simulation model.

Examined by socio-economic status, unemployed people find themselves in an income trap more often than others. A fifth of all the households in an income trap consists of students. Entrepreneur households are also caught in an income trap more often than others. To the extent that the primary challenge for the incentive system is participation in the labour market, the root of the problem lies first and foremost in the unemployed.

Examined by phase of life, people living alone are caught in an income trap more often than others, and couples without children less often than others. Examined by numbers, couples with children and single parents have the same chances of being in an income trap. It must be kept in mind, however, that the single parents group as a whole is smaller than the group of couples with children. Approximately seven per cent of single parents live in a situation where it is economically unprofitable to earn moderate extra income. Only two per cent of families with children are faced with an income trap.
In conclusion

Many Finnish social policy researchers have lamented the development of the welfare state in the 1990s. In our view, it would be too black-and-white to maintain that the welfare state has gone downhill ever since the recession years, at least when looking at the welfare state from the perspective of both its economical and social sustainability. From the perspective of economic development and public finances, the policy has been successful. The financial basis of the welfare state is now more solid, the rate of indebtedness is among the lowest in industrialized countries and the state budget shows a surplus. Debt has been paid back and debt interest costs have declined. A strong argument for strengthening the financial basis has been the need to prepare for costs caused by ageing. Protecting the future welfare state has thus been one argument for prolonged tight budgets.

In terms of employment goals, the assessment is not as unambiguous. Unemployment has declined sharply, albeit painfully slowly, from the worst recession years. Despite this positive trend, unemployment remains very high (at 9.1 per cent in 2002). However, the employment rate has grown steadily and, in this respect, Finland, with its current rate of 68 per cent, is among the leading countries in Europe – in full-time employment comparisons Finland ranks among the best countries.

On interpreting income distribution and developments in income differences, it should be kept in mind that there are marked differences between the actual recession years and the seven fat years following them. On account of these differences, in turn, the challenge is to be able to distinguish the impact of policies from other impacts. During the recession years, there were no major changes in income distribution among Finns. The subsistence of households was reduced from the turn of the decade, but it seems income decreases took place in essentially the same way in different income and population groups. The position of low-income groups deteriorated, as the narrow or non-existent economic freedom of action was reduced even more. However, the recession did not leave the well-off untouched either.

Income distribution remained fairly even due to social security: although inequality in the distribution of factor income increased, the redistribution effect of social income transfers was able to compensate for these changes. Thus, social security prevented the growth of income differences and the increase of relative poverty, although absolute poverty did grow to some extent.

The post-recession development has been different. Since 1995, income differences have been on the increase and the relative position of low-income groups has deteriorated. Furthermore, the relative poverty rate has increased since the recession, although not in the past two years. An important reason for this has been the strong growth in property income.
which has benefited mainly the rich. Another reason has been cuts in the social security system. We should, however, keep in mind that although cuts were a characteristic feature of the 1990s, pruning was not the only development in social policy. Income transfers and taxation continue to effectively even out income differences and reduce poverty, and in a comparative perspective Finland does not perform poorly.

Finally, we presented results from studies on incentives in order to assess how much modification is still required in the incentive system. The changes to the income transfer system carried out in the 1990s have alleviated income traps. Now, extra income more certainly means an increase in disposable household income. In addition to raising financial incentives, the changes to the income transfer system have proved to increase participation in working life. However, social security together with earned income taxation still forms a structure that, in some cases, has a negative effect on financial incentives for earning extra income.

Claims for reducing social security and lowering taxation can still be made, though not with as much conviction as before. The solutions to the problems are complicated because of their effect on poverty. Diminishing social security in the name of incentives has a flip side evidenced by increased poverty in the 1990s. In this new millennium, governments seeking to reduce unemployment by improving incentives to work – especially if carried out in a situation where demand for labour is not increasing – face the danger of increasing poverty instead of employment.
Literature


