A Report on "Removing Welfare Traps: Employment Responses in the Finnish Basic Income Experiment" by Verho et al. (2022)

Reviewer 2

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> I am wiser than this person; for it is likely that neither of us knows anything fine and good, but he thinks he knows something when he does not know it, whereas I, just as I do not know, do not think I know, either. I seem, then, to be wiser than him in this small way, at least: that what I do not know, I do not think I know, either.
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> Plato, *The Apology of Socrates*, 21d

> To err is human. All human knowledge is fallible and therefore uncertain. It follows that we must distinguish sharply between truth and certainty. That to err is human means not only that we must constantly struggle against error, but also that, even when we have taken the greatest care, we cannot be completely certain that we have not made a mistake.
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> Karl Popper, 'Knowledge and the Shaping of Reality'

Overview

Citation: Verho, J., Hämäläinen, K., and Kanninen, O. (2022). Removing Welfare Traps: Employment Responses in the Finnish Basic Income Experiment. *American Economic Journal: Economic Policy*. Vol. 14, No. 1, pp. 501–522.

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Abstract Summary: This paper analyzes the employment effects of the first nationwide randomized basic income experiment in an advanced economy, which replaced minimum unemployment benefits with a basic income of equal size for 2,000 benefit recipients in Finland. The study finds that replacing minimum unemployment benefits with a basic income of equal size has minor employment effects at best, despite a considerable increase in work incentives.

Key Methodology: Randomized controlled trial (RCT) using detailed administrative data and OLS estimation with covariates.

Research Question: What are the employment responses to replacing minimum unemployment benefits with a basic income of equal size in the Finnish Basic Income Experiment?

Summary

Is It Credible?

This article analyzes the Finnish Basic Income Experiment, a randomized control trial conducted in 2017–2018 involving 2,000 unemployed individuals. The authors' headline claim is that replacing minimum unemployment benefits with a partial basic income of €560 per month had "minor employment effects at best" (p. 501). Specifically, they report that in the first year—the only period unconfounded by other policy changes—the treatment effect was a statistically insignificant increase of 1.5 days of employment (p. 502). Based on this, they argue that the significant reduction in participation tax rates (PTRs) achieved by the reform failed to stimulate labor supply, suggesting that financial incentives may be an "ineffective policy tool for hard-to-employ populations" (p. 520).

The statistical evidence for the null result in the first year appears robust, and the authors are commendable for prioritizing the unconfounded 2017 data over the significant but contaminated 2018 results (p. 517). However, the interpretation of this null result as a failure of "basic income" or financial incentives generally is complicated by the experiment's specific design features. Most notably, the treatment was not a "pure" unconditional basic income for a large portion of the sample. The authors acknowledge that for 42 percent of the treatment group—primarily those with children—the basic income was lower than their previous benefits. To avoid income loss, these individuals applied for top-ups, which required them to "comply with the unemployment benefit rules" and remain registered job seekers (p. 507). Consequently, for nearly half the sample, the experiment did not actually remove conditionality or the threat of sanctions, effectively testing a different intervention than the one implied by the term "basic income."

Furthermore, the authors' conclusion that labor supply is unresponsive to incentives

is challenged by their own subgroup analysis. The article notes an "unexpected pattern" where the groups that saw the *largest* improvement in work incentives (those with the largest PTR decreases) actually showed negative or negligible employment effects, while those with *smaller* incentive improvements showed positive responses (p. 515; Online Appendix p. 33). This inverse relationship suggests that the Participation Tax Rate (PTR) mechanism—the primary theoretical channel through which the authors analyze the experiment—may not have been the dominant driver of behavior. If the group with the strongest financial incentive to work responded the least, it raises questions about whether other unobserved barriers or structural factors were more critical than the marginal tax rate.

Finally, the claim that participants were "reluctant to leave the usual reemployment services" despite the removal of obligations (p. 520) must be viewed in light of competing financial incentives. The authors admit that participating in active labor market programs (ALMPs) provided significant monetary supplements, amounting to a 13.7 percent increase in benefits (p. 519). This created a situation where the "old" system paid participants a bonus to stay engaged. While the control group faced sanctions for non-participation, the treatment group could opt out but would lose this financial bonus. Thus, the high rate of service use in the treatment group likely reflects rational income maximization—chasing the bonus payment—rather than a preference for bureaucracy or a failure of the basic income concept to reduce administrative dependence.

The Bottom Line

The study provides credible evidence that this specific implementation of a partial basic income did not significantly increase employment among long-term unemployed people in Finland during its first year. However, the experiment was a "bundle of treatments" rather than a test of a purely unconditional benefit, as nearly

half the participants remained subject to job search conditions to maintain their income levels. Consequently, while the null result is statistically sound, it should be interpreted as a verdict on this specific, complex policy mix rather than a definitive refutation of the employment effects of a truly unconditional basic income.

Potential Issues

Confounded treatment design due to subgroup heterogeneity in conditionality: The experiment's ability to isolate the effect of a purely unconditional basic income is complicated by its design. For 42% of the treatment group—those with dependent children—the €560 basic income was lower than their previous unemployment benefits. To avoid this income loss, this subgroup could apply for a top-up payment, which required them to "comply with the unemployment benefit rules, and they had to be registered as job seekers" (p. 507). The authors are transparent about this, explicitly noting that the experiment is "best thought of as a bundle of treatments that varied across subgroups" (p. 516). This means the study is effectively a composite of two different treatments: one testing an unconditional benefit for 58% of the sample, and another testing a change in financial incentives while retaining conditionality for the other 42%. While the authors analyze this through subgroup analysis (Online Appendix Table B.1), the main pooled result remains an average of these distinct treatments.

Subgroup analysis shows an unexpected relationship with work incentives: The study's central premise is that basic income improves employment by lowering Participation Tax Rates (PTRs), thereby strengthening work incentives. However, the article's own subgroup analysis reveals a pattern that complicates this interpretation. The Online Appendix (Table B.2) shows that in both years of the experiment, the group with the *largest* improvement in work incentives (the 3rd tertile) showed negative, albeit statistically insignificant, changes in employment days. Conversely, the group with the *smallest* improvement in incentives (the 1st tertile) showed positive employment effects, which were large in the second year (+14.64 days). The authors acknowledge this "unexpected pattern" (p. 515; Online Appendix p. 33). While this provides a plausible explanation regarding demographics, it also suggests that the hypothesized incentive mechanism (PTR reduction) was not the dominant driver of

the observed employment effects within these subgroups.

Confounding financial incentives from active labor market programs: The experiment's design was implemented within an institutional context that provided a powerful financial incentive for participants to remain engaged with the public employment services that the basic income was intended to make voluntary. The article notes that participants in Active Labor Market Programs (ALMPs) receive benefit supplements and expense compensation, which provided an average 13.7 percent increase in unemployment benefits in 2017 (p. 519). This created a direct financial incentive that competed with the experimental treatment. While the control group was compelled to participate to avoid sanctions, the treatment group was incentivized to participate to capture this monetary bonus. The authors use this feature to explain why service use remained high in the treatment group, but this competing incentive makes it difficult to isolate the behavioral effect of the basic income itself regarding service use.

Potential confounding effect of an initial windfall payment: The analysis must contend with a one-time income shock delivered to the treatment group at the start of the experiment. The article reports that "nearly all treated persons received an extra benefit payment in January 2017, when they were paid both the first basic income payment and unemployment benefits owed from December" (p. 515). This windfall payment—a mechanical result of overlapping payment schedules rather than a design feature—contributed to an increase in total annual income for the treatment group. While the authors note that the basic income generally corresponded to the after-tax benefits of the control group (p. 505), this initial liquidity injection is not part of the theoretical basic income model being tested. It could have had its own behavioral effects, such as easing liquidity constraints and allowing for a longer or more selective job search, potentially suppressing short-term employment outcomes in a way that is distinct from the incentive effects of the basic income itself.

Future Research

Testing true unconditionality: Future experiments should ensure that the basic income amount is sufficient to replace existing benefits without requiring top-ups that reinstate conditionality. This would allow researchers to isolate the effect of removing job search obligations from the effect of changing financial incentives, a distinction that was blurred for the 42 percent of participants in this study who had dependent children.

Isolating service participation incentives: To determine whether unemployed individuals genuinely value public employment services or merely the financial supplements attached to them, future designs could decouple ALMP participation from additional benefit payments. Alternatively, a treatment arm could be included where the basic income is set high enough to exceed the combined value of unemployment benefits and ALMP supplements, thereby testing the willingness to engage with services when there is no immediate financial penalty for opting out.

Qualitative investigation of incentive heterogeneity: Given the counterintuitive finding that groups with the strongest financial incentives responded less than those with weaker incentives, future research should employ qualitative methods or more granular administrative data to identify non-financial barriers to employment. Understanding why the standard theoretical link between lower participation tax rates and higher labor supply broke down for specific demographic subgroups is essential for designing more effective activation policies.

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