



EUROPEAN SOCIAL POLICY NETWORK (ESPN)

# Financing social protection

## Sweden

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**European Social Policy Network (ESPN)**

**ESPN Thematic Report on  
Financing social protection**

**Sweden**

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The European Social Policy Network (ESPN) was established in July 2014 on the initiative of the European Commission to provide high-quality and timely independent information, advice, analysis and expertise on social policy issues in the European Union and neighbouring countries.

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# Contents

SUMMARY .....	4
1 CURRENT LEVELS AND PAST CHANGES IN FINANCING FOR SOCIAL PROTECTION .....	5
1.1 Overall expenditure and funding pattern.....	5
1.2 Pensions.....	7
1.3 Healthcare.....	7
1.4 Survivor benefits.....	8
1.5 Disability .....	8
1.6 Family.....	8
1.7 Unemployment insurance .....	9
1.8 Housing .....	9
1.9 Social exclusion.....	9
1.10 Main reforms and their impact .....	9
2 CURRENT MIX AND PAST CHANGES IN THE SOURCES OF FINANCING FOR SOCIAL PROTECTION .....	12
2.1 The Swedish model and its financing structure .....	12
2.2 Current issues.....	14
3 STRENGTHS AND WEAKNESSES OF THE EXISTING MIX OF FINANCING OPTIONS AND POTENTIAL FUTURE SOURCES OF FINANCING - NATIONAL DEBATE ON THE TOPIC.....	17
3.1 Strengths and weaknesses .....	17
3.2 Policy recommendations.....	18
REFERENCES .....	22

## Summary

The level of social protection expenditure in Sweden remained unchanged at around 29.5 per cent of GDP between 2005 and 2016. These levels were above EU average, but the differential reduced in size. Net social protection expenditure in Sweden was 25.9 per cent of GDP in 2015, just below EU average, partly due to comparatively high taxes on social insurance payments and modest levels of tax expenditure.

There was no deficit in either the social protection system or the public finances during the period examined. The structure of financing for social protection in Sweden follows a certain logic. Universal benefits such as child benefits and the guarantee pension are paid out of general taxation. Social insurance-type benefits are paid for by employer social security contributions (in the old-age pension system these are supplemented by contributions by insured people). Benefits in kind, (i.e. healthcare and other social services) are mainly funded by local taxes with subsidies from central state taxes as well as user charges. By and large, this formal structure remained intact during 2005-2016. The actual flows of money for different sources varied between individual years, mainly related to underlying changes in the economy and needs of the population.

The challenge for the financing system is simply to raise enough resources (by taxes and contributions) to sustain adequate levels of services and provision – in a world where not only is population ageing putting increased pressure on social protection funding, but also tax bases are becoming more mobile. Yet, at least in the Swedish case, the nature of this challenge varies between different branches of social protection due to, among other things, its financial structure. The pension system has a solid financial set-up on the basis of the defined contributions principle (DC) but the adequacy of benefits in the future will require a more rapid move to longer working lives and/or higher contributions. Healthcare services, as well as the other social services, are challenged by increased levels and variations in needs across the nation, as well as the fact that the present system is surrounded by political conflict. The challenge of the increased costs of the system of personal assistants for disabled persons (LSS) is a special case and involves tensions around the level of costs and the quality of services, but also the division of labour between the state and the municipalities.

Given all this, the differences in the system between 2005 and 2016 may seem small. However, developments over these years illustrate that there is space for action and room for political values to play a role. The centre-right government (2006-2014) reduced overall taxation levels and reduced the generosity of a number of social insurance benefits. It introduced an earned income tax credit (*jobbskatteavdraget*) to incentivise employment growth. The red-green government that came into power in 2014 restored the generosity of some of the social insurance programmes, but adequacy issues remain in a number of branches. Employment continues to grow, which broadens the tax base.

Policy recommendations about the financing of social protection should be guided by an idea of what is to be achieved. In the future, higher employment is the only way to avoid an exclusive reliance on increases in tax or social security contribution rates. This requires investments in education and labour market training, but also access to social services for families so that they can combine caring responsibilities with paid work. This has been the Swedish model, but there are cracks in this policy strategy in terms of maintaining adequate protection, services and investment. The model will collapse if it does not provide proper incentives for people to engage in paid employment. Some of the inadequacies in the system have more to do with the division of labour between the statutory and occupational programmes, but here incentives issues are not important as such. Two important government commissions in 2019 will bring proposals to the table that provide ample opportunities to deal with two of the most pressing financial issues. One is about the 'levelling out' of conditions for the municipalities to deal with variations in needs and resources. The other concerns the LSS, which is about values but also about properly designing cost controls for a system that is going through a maturing process.

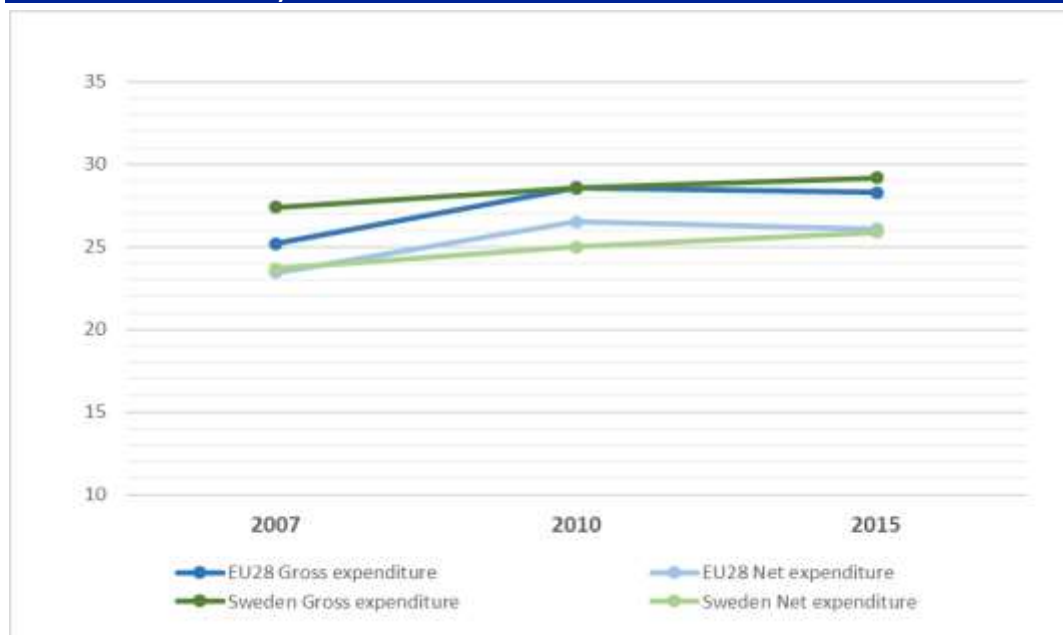
# 1 Current levels and past changes in financing for social protection

## 1.1 Overall expenditure and funding pattern

In Sweden, the increase in gross expenditure on social protection between 2005 and 2016 was negligible, from 29.5 to 29.6 per cent of GDP (Table 1b in ESSPROS<sup>1</sup>). This stability hides some notable changes that took place over the period: from 2005 to 2008 expenditure actually fell by 1.6 per cent of GDP but then increased, not only during the crisis years but actually up until 2013, when they peaked at 30.2 per cent. In real terms, expenditure increased continuously (with one exception in 2007), and overall by almost 25 per cent (Table 1b in ESSPROS), which was driven by strong economic growth during the period (except for the drastic drop of 5 per cent of GDP in 2009; cf. Palme, 2019). Social protections a percentage of GDP was about the same in 2016 (29.6) as in 2005 (29.5) with some fluctuations over time and 2007 being the lowest point (27.4).

It is for many reasons important to calculate social protection expenditure net of the taxes and social security contributions that benefit recipients pay (back) on their benefits. For one thing, it gives a more comparable assessment of the cost of social protection. Net social expenditure is substantially lower than gross expenditure in Sweden (Figure 1), but Sweden's rank order among EU countries does not change on this measure. In terms of both gross and net spending, Sweden was in the upper half of the EU distribution, but fairly close to the average (Table 5 in ESSPROS). Nevertheless, the size of the tax 'claw back' in Sweden was among the biggest in the EU throughout the period 2007-2015 even if it declined slightly (Table 6 in ESSPROS).

**Figure 1. Gross and net social protection expenditure, as percentage of GDP, Sweden and EU28, 2007-2015**



Source: Spasova and Ward (2019), Annex ESSPROS tables, Table 1b.

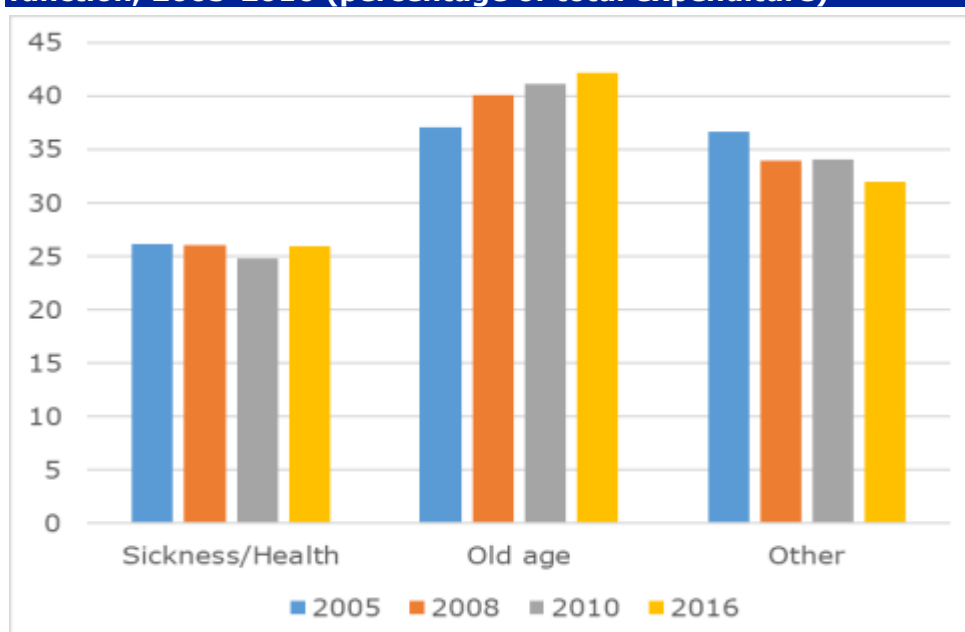
Other important but often neglected components of social expenditure are those associated with 'tax expenditure'. These may come in different forms and serve different purposes, ranging from family support to old age security. In Sweden, the most

<sup>1</sup> European System of integrated Social PROtection Statistics. All references to ESSPROS tables are to the annex ESSPROS tables in Spasova and Ward, 2019.

important tax expenditure is linked to collectively bargained occupational pension plans (Kangas & Palme, 1996; Palme & Sundén, 2014) (in ESSPROS labelled 'mandatory private expenditure') and the net tax expenditure on these plans is 0.3 per cent of GDP in 2013 (Table 7 in ESSPROS).

In terms of the different 'functions' or components of social protection spending, the main ESSPROS categories are 'sickness/health', 'old age' and 'other'. In Sweden old-age spending as a share of total spending rose gradually over the 2005-2016 period: this followed the EU pattern. The share was lower than the EU average in 2005 (37.1 per cent against 38.6 per cent) but had overtaken it by 2008 (40.1 per cent as against 39.4 per cent) (Figure 2 shows data for Sweden). Expenditure on sickness/health was stable at around 26 per cent of the total. The share of the 'other' category fell from 36.7 per cent in 2005 to 32.0 per cent in 2016 (Figure 2).

**Figure 2. Breakdown of gross expenditure on social protection in Sweden by function, 2005-2016 (percentage of total expenditure)**

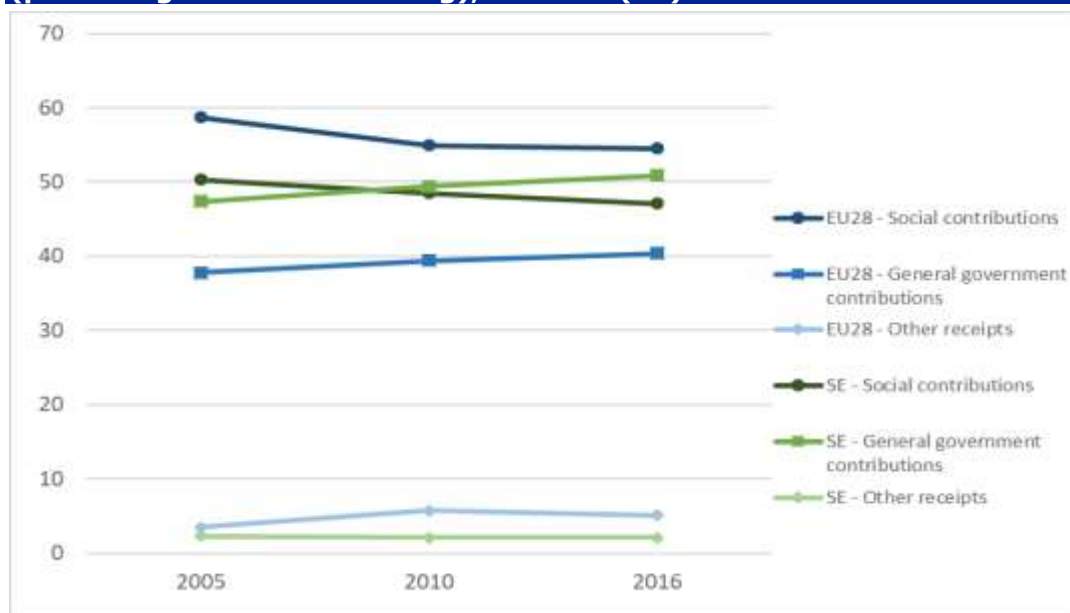


Source: Spasova and Ward (2019), Annex ESSPROS tables, Table 3a.

In terms of the overall funding of the system, Sweden followed the general EU trend during the 2005-2016 period, whereby the importance of social security contributions declined in importance and that of general taxation increased. In 2005, general taxation covered 47.4 per cent of total financing in Sweden – a share that had grown to 50.9 per cent by 2016. Social security contributions in Sweden continued to play a less important role than in the rest of EU – 47.1 per cent compared with 54.5 per cent in 2016 (Figure 3 below, and Table 2a in ESSPROS).



**Figure 3. Division of financing for social protection by main source, 2005-2016 (percentage of total financing), Sweden (SE) and EU28**



Source: Spasova and Ward (2019), Annex ESSPROS tables, Table 2a.

## 1.2 Pensions

An examination of national data (Pensionsmyndigheten, 2019a) allows us to analyse expenditure on different components of the pensions system. The most important trend was that the contributory income pension (*inkomstpension*) increased in importance, in both relative and absolute terms. Between 2005 and 2016, the guarantee pension declined in importance both in terms of the number of recipients and level of expenditure. In 2016, total expenditure on income pensions (including the funded component) was 292 billion SEK (29.2 billion EUR) and expenditure on guarantee pensions was 14 billion SEK (1.4 billion EUR). Housing allowances for pensioners declined in relative terms but were fairly stable in real terms. In 2016, total expenditure on housing allowances amounted to 8 billion SEK (0.8 billion EUR). The old-age income support payment (*äldreförsörjningsstöd*), for new residents who have not qualified for a guarantee pension, increased somewhat following increased refugee migration, reaching 904 million SEK (90.4 million EUR) in 2016. However, the increase had tapered off by 2018 and increases are projected to be rather modest over the coming years. Projections also suggest that the diverging trends for other kinds of benefits will continue (Pensionsmyndigheten, 2019b). The changes on the expenditure side are also reflected on the financing side, with the increased importance of social security contributions for funding following the increasing importance of income pensions. This is something which we will return to in Section 2 below.

## 1.3 Healthcare

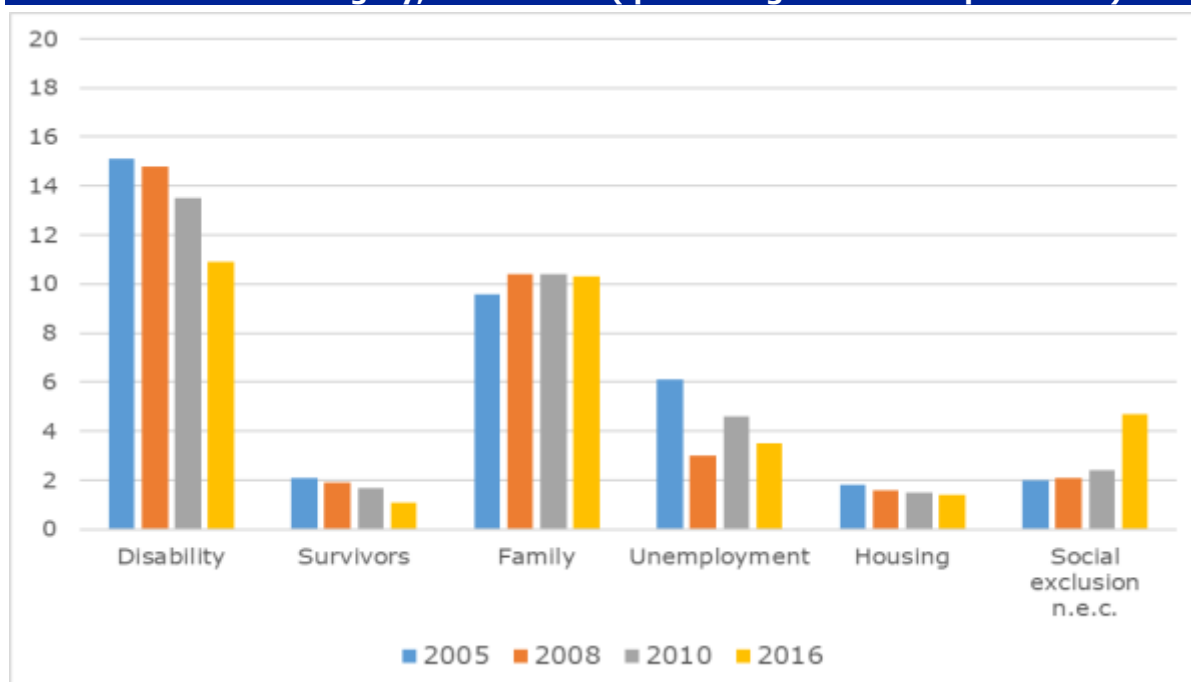
As noted above, the share of total spending going on sickness/health was stable if we compare 2016 with 2005. However, the sickness/health component in the ESSPROS system does not include all healthcare expenditure related to disabled and old people: if this is added, total healthcare expenditure in Sweden was around 11 per cent of GDP in 2016, which was higher than the EU average. Sweden allocates a lower percentage of healthcare spending to inpatient care than many other EU countries and has the lowest number of hospital beds in the EU in relation to population size (Agerholm & Fritzell, 2018; OECD, 2018). The number of physicians and nurses is slightly higher compared with the EU average (Agerholm & Fritzell, 2018).

Out-of-pocket payments are around 3 per cent of household consumption and around 15 per cent of total health expenditure, which is slightly lower than the EU average (Agerholm & Fritzell, 2018). The degree of out-of-pocket payments in dental care is high, which has obvious implications for equality. The Commission for Equity in Health (SOU 2017:47) has proposed that the dental care system should be incorporated in the financial regulations of the general healthcare system. Earlier this year, the government therefore commissioned an official inquiry, with the mission to propose reforms to the dental care system with a special focus on tackling inequalities. The final report of that inquiry will be delivered in 2020 (cf. Agerholm & Fritzell, 2018).

#### 1.4 Survivor benefits

Expenditure on survivor benefits in Sweden fell from 2.1 to 1.1 per cent of total social expenditure between 2005 and 2016 (Figure 4). This is what would be expected following the pension reform in 1989, which implied that the widow pension would be gradually replaced by a temporary unisex survivor benefit (six months that can be extended to 12 months). The costs of that programme are modest and will continue to be so (at least in the absence of further reforms). In 2016, total expenditure amounted to 12.5 billion SEK (1.25 billion EUR) (Pensionsmyndigheten, 2019b).

**Figure 4. Breakdown of gross social protection expenditure in Sweden by function in 'other' category, 2005-2016 (percentage of total expenditure)**



Source: Spasova and Ward (2019), Annex ESSPROS tables, Table 3b.

#### 1.5 Disability

Expenditure on disability fell as a share of total social protection spending, from 15.1 per cent in 2005 to 10.9 per cent in 2016. As will be discussed in Section 2 below, this decline was driven by a decline in expenditure on cash benefits, with expenditure on in-kind benefits increasing somewhat (SCB, 2019a and Figure 4).

#### 1.6 Family

Family support includes both in-cash and in-kind benefits. The relative size of total expenditure remained largely unchanged over the period. It started at 9.6 per cent in 2005, reached 10.4 per cent in 2010 and ended at 10.3 per cent in 2016 (Figure 4). These total figures hide an increased relative share for in-kind benefits.

## 1.7 Unemployment insurance

Spending on unemployment varied more over the period than the other components of social protection spending. In 2006, its share of total expenditure was 6.1 per cent. It then declined to 3.0 per cent in 2008, but increased to 4.6 per cent in 2010 following increased unemployment. By 2016 it had declined to 3.5 per cent (Figure 4).

## 1.8 Housing

Expenditure on housing declined from 1.8 per cent of total social expenditure to 1.4 per cent over 2005-2016. Housing allowances were exclusively funded by the state during this period. Benefits are paid by the National Social Insurance Agency (following a reform in the early 1990s that transferred the responsibility for housing allowance from the municipalities to the state). The system is targeted at those on low incomes via means-testing (combined with a family size/square metre regulation). A separate means-tested housing allowance can be claimed by old-age pensioners and is paid by the Swedish Pension Agency.

## 1.9 Social exclusion

The 'last resort' social protection in Sweden is delivered by the municipalities, which provide both in-cash and in-kind benefits. Local taxes cover most of the costs but there is also a state subsidy. Cash benefits are means-tested and total spending on these remained the same between 2005 and 2016 at 0.3 per cent of GDP. In-kind provision by social services is directed to vulnerable groups that have needs that are not met by the universal or category-based programmes. The costs of these services were on a par with cash benefits, at 0.3 per cent of GDP in 2016 (SCB, 2019a). There is of course a large variation between different municipalities in the costs of both cash benefits and social services, depending on the socio-economic composition of the population. This is subject to cross-subsidies via the 'levelling-out system' (*utjämningssystemet*) and, as such, is politically controversial. The national data indicate unchanged relative expenditure on social services. The social exclusion component of the ESSPROS data includes expenditure related to the drastic increase in the number of asylum-seekers in 2015, and explains its increased share of total social expenditure, from 2.4 per cent in 2010 to 4.7 per cent in 2016.

Sweden diverges from the EU average pattern of an increasing relative share of means-tested expenditure in total social protection spending. The EU28 average share was 10.3 per cent in 2005, increasing to 12.1 per cent in 2016. In Sweden, the share was 2.9 per cent in 2005 and 2.4 per cent in 2016 (Table 4 in ESSPROS). No significant increase was recorded in Sweden even during the worst crisis years. This suggests that social insurance provision and universal benefits worked reasonably well as protection systems during the crisis, even after some retrenchments had been made (see below, Section 2), something that has been observed in other studies (Palme 2019).

To sum up, when we consider the shares of expenditure in Sweden over the period concerned for the components 'disability', 'survivors', 'family', 'unemployment', 'housing' and 'social exclusion n.e.c.', the ESSPROS figures indicate declining expenditure on disability, an increase in expenditure on unemployment (related to the Great Recession), and an increase also in expenditure on social exclusion in the aftermath of the refugee crisis in 2015. Expenditure on housing showed a small decline and on survivor benefits a more radical one (Figure 4).

## 1.10 Main reforms and their impact

The most important changes in taxation and welfare provisions in Sweden since 2006 can briefly be summarised as follows:

Starting in 2007, a number of earned income tax credits have been introduced (*jobbskatteavdrag*), meaning that income from work is taxed less than other types of

incomes. Since most social benefits (including pensions) are taxed, cutting tax on work incomes is seen as an important activation measure by improving incentives to find employment (e.g. Fritzell et al., 2018). The different taxation rules stemming from the earned income tax credits have led to increased AROP (at risk of poverty or social exclusion) rates for those aged 65 and above, and also for other workless households, by raising incomes for the working population and hence the threshold for the poverty line. More recently, the red-green government has made a series of changes to taxation rules so that the tax treatment of old-age pensioners is more similar to that for people who have income from work.

At the time when the earned income tax programme was initiated, the centre-right government (2006-2014) introduced substantial but differentiated insured persons' contributions to the unemployment insurance funds. Differentiation was intended to reflect unemployment rates in different branches, in order to punish excessive wage demands from the trade unions. Contributions were smaller than the tax cuts implied by the earned income tax credit but led to large-scale and unexpected exits from the unemployment insurance funds (Ferrarini et al., 2012). It was a very mixed group that decided not to pay the contributions, some of whom had virtually no unemployment risk, and others who had both low incomes and high unemployment risks but found the contributions unaffordable. Unfortunately, the drop in coverage of the fund (by about 10 percentage points of the employed labour force) coincided with the onset of the Great Recession. Gradually the centre-right government reversed their reform because of these unintended consequences for insurance coverage.

Starting in 2007, the eligibility criteria applied in the income-maintenance (social insurance) system were made stricter (Palme, 2019). Strict deadlines and time limits were introduced for both sickness cash benefits and unemployment benefits. The 2014-2018 red/green government deleted the time limit for sickness benefit with effect from 1 February 2016. Because of both decisions and non-decisions, the income ceilings (i.e. the maximum incomes for benefit purposes in the social insurance system) have been kept more or less constant over time. At the same time, the average income increase has been substantial. Consequently, the system has developed more into a flat-rate system and the relative income loss that most people experience has increased over time (Grees, 2015).

Economic conditions for the unemployed have changed quite dramatically during the past decade. The Swedish unemployment insurance programme has undergone changes concerning replacement rates, eligibility rules and benefit coverage (see further below and the Swedish ESPN thematic report on long-term unemployment (Fredriksson, Sirén & Fritzell, 2015)). One major change in the income support system in recent years was the relatively large increase in the ceiling for unemployment insurance that came to effect in September 2015 (Fritzell et al., 2018). Given that it was the first increase since 2002, it can be regarded as a substantial policy shift. Another recent change is the abolition of the maximum time period a person can receive sickness benefits. This change came into effect in February 2016. In 2016, the basic parental leave benefit, which is particularly important for those who do not qualify for the normal earnings-related parental leave, was raised from 180 SEK [19 EUR] per day to 250 SEK [26 EUR]. In March 2018, the universal child allowance was raised by close to 20 per cent. It was the first increase in over 10 years.

Activation and active labour market policy (ALMP) has long been an important element of the Swedish welfare state. The international discussion about activation and social investment often refers to Sweden as a possible way forward (Morel et al., 2012). Expenditure on ALMPs used to be around 2 per cent of GDP in Sweden, but is nowadays more commonly slightly above 1 per cent. In 2014, ALMP expenditure was 1.34 per cent of GDP. The OECD average was substantially lower, at 0.53 per cent. It has been argued (Cronert & Palme, 2017) that behind largely unchanged social protection expenditure there has been a recasting of the Swedish policy paradigm. Supply side policies have been expanded but the investment content of ALMP has been diluted. The earned income

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tax credit was not self-financed but it changed the fiscal conditions of the Swedish social protection system, which amounted to tax cuts 3.5 times the size of ALMP spending. Policy proposals in this area range from lower entry-level wages and tighter access to social protection, tax expenditures for certain jobs, an expansion of ALMP investment in language training and skills (or subsidised employment for that matter), and larger state grants to municipalities to meet increased demand for schools and housing.

## 2 Current mix and past changes in the sources of financing for social protection

### 2.1 The Swedish model and its financing structure

The Swedish system of funding should be seen in the light of the historical development of the different components of the country's system of social protection. This is particularly important in the context of this report, which to a large extent is guided by the ESSPROS reporting system, which does not fit with the Swedish system very well (cf. Box 1 and Palme, 2017). We consider separately in-cash and in-kind benefits, and distinguish between universal and social insurance benefits. We also highlight the role of municipalities in providing both last-resort cash benefits and services targeted at vulnerable groups.

Universal benefits, such as child benefits and basic old-age pensions, are financed by general revenue (even though the basic old-age pension until the 1970s was assigned an earmarked tax with a ceiling). Earnings-related social insurance benefits are, on the other hand, financed by employer social security contributions without a cap. Pensions and sickness insurance (cash) benefits, as well as parental leave benefits, have all been mainly funded that way. The pension reform, fully implemented in 2003, included insured persons' contributions on the financing side. Insured persons pay contributions of 7 per cent of gross wages (up to the ceiling for benefit purposes), which are added to employer contributions of 10.21 per cent (without a cap). Although the unemployment insurance system has followed the 'Ghent system' of voluntary state-subsidised insurance managed by trade unions, nevertheless contributions from insured persons remain less important than funding from employer contributions.

Healthcare and social services in Sweden are financially separate from social insurance and other cash benefits. They are also separate in administrative terms, with the county municipalities handling healthcare and the local municipalities handling other social services. In financial terms, the county municipalities raise taxes for healthcare and the local municipalities raise taxes for other social services. There are, however, substantial central state tax subsidies to both kinds of municipalities, typically amounting to about 20 per cent of the total costs, but with a gradient depending on the needs and resources of each municipality. This means that this 'levelling-out' system (*utjämningssystem*) works as a redistribution mechanism. A system of user charges is in place for most services, including healthcare.

Targeted benefits are paid in two forms, as housing allowances and social assistance (*försörjningsstöd*). Housing allowances (*bostadsbidrag*), which used to be a municipality programme, have since the early 1990s been paid by the National Social Insurance Agency and funded by general revenue. Social assistance (*försörjningsstöd*) is funded and provided by the local municipalities and financing is primarily through local taxes, with additional state subsidies depending on the needs and resources of the population (*utjämningssystem*). This system is of fundamental importance for understanding not only the funding of the entire system of social services (including healthcare), but also the nature of the current and future economic and political challenges to it. This is elaborated on below.

A more detailed examination of who pays social security contributions in Sweden reveals that the share that employers pay is higher than the EU average; and even if it decreased over time (in particular between 2005 and 2008) it did not decrease as much as in the rest of EU. Employee social contributions are lower than the EU average, and in practice only fund the pensions system. Although contribution levels have remained the same, we shall come back (see below) to some changes that have taken place in unemployment insurance. Contributions paid by self-employed people are low compared with the rest of the EU, but this reflects the modest levels of self-employment in the

Swedish labour market (Palme & Ruhs, 2018). The level of contributions paid by self-employed people is by and large the same as for employees (Nelson et al., 2017). The contributions paid by benefit recipients are negligible (Table 2b in ESSPROS). There are no longer any earmarked taxes in Sweden (Table 2c in ESSPROS).

Regarding the pension system, social security contributions are clearly the dominant source of funding, and this has become accentuated over time (Table 8a in ESSPROS). The latter is a result not of changes in rules, but rather an effect of the fact that the oldest cohorts are replaced over time by younger cohorts with a higher labour force participation rate, and hence have earned higher contributory pensions. When it comes to the division between employer and employee contributions, no significant changes can be reported (Table 8a in ESSPROS), in the absence of any legislative changes.

Healthcare/sickness insurance is another important 'function' of social protection, but the lumping together in the ESSPROS system of in-kind and in-cash benefits is unfortunate, at least if one wants to understand the changes in the Swedish system. Healthcare is funded primarily by local taxes, but also by central government revenue, as well as a relatively modest contribution from user charges. Sickness cash benefits are funded primarily by social security contributions from employers, with self-employed people covering their own costs. Employees do not pay social security contributions towards sickness insurance (either benefits in cash or in kind). The changes observed between 2005 and 2008 (Table 9a in ESSPROS) were partly driven by the reduced number of sickness cash benefit recipients (this followed tighter rules for duration among other things; see Section 2 below), implying that the relative costs of contributory funded cash benefits declined.

The Swedish healthcare system is universal and financed primarily by taxation. This is true for the other social services, too. Despite the heavy reliance on taxes, there are out-of-pocket payments both within medical care and for drugs, as well for dental care – and here at a very high level.

Social security contributions played an increasing role over the period in funding survivor benefits. Employers also tended to increase their role as funders relative to the employees. This was a result of a very complex change pattern but nothing was related to reforms that took place during the 2005-2016 period, as opposed to older changes. In brief, what drove spending was the slow (and continuing) phasing out of the widow's pension system following a decision in 1989.

ESSPROS data for disability benefits suffer from the same problems as those for health/sickness, in terms of mixing in-cash and in-kind benefits. The trend over the period was for social security contributions (those entirely paid by employers) to decline in importance, contributing more than 50 per cent of the total in 2005 and less than 25 per cent in 2016. General revenue contributions increased in importance, providing more than two thirds of funding in 2016. These changes were, as in the case of health and sickness, driven by a relative decline in cash benefits and an increase in in-kind benefits, in particular expenditure on the programme of personal assistants for disabled persons (LSS). That service is paid for by municipalities up to 20 hours per week, and by the state for approved hours of assistance beyond that. What has driven the costs of the programme is primarily the number of hours of approved support per recipient, rather than the number of recipients, even though the latter also increased over the period (Försäkringskassan, 2017).

'Family support' is another ESSPROS function that mixes different sorts of cash benefits with in-kind benefits. While universal child benefits are covered by general revenue, parental leave benefits are typically covered by social insurance contributions (exclusively paid by employers). Family-related social services, primarily childcare provision, are paid for by local taxes with a state subsidy. The proportions paid by the different actors were more stable over the period than for the functions described above. In 2016 social security contributions make up 22 per cent and the direct share paid by general revenue stays around 70 per cent. A central state subsidy to municipalities makes up for the rest.

For the reasons outlined above, the financing of unemployment insurance changed during the period more than that of the other functions. There was a clear increase in the importance of social security contributions, from 87 per cent in 2005 to 98 per cent in 2008, followed by an almost equally large decline between 2010 and 2015. The share from government general revenue mirrored that development (in 2016 its share of financing was 12 per cent). The increase in social security contributions between 2005 and 2008 was due to the increase in contributions from employees, which went up from 6 per cent to 24 per cent. There was then a shift from employees to employers between 2008 and 2010, but the overall contribution rate remained the same.

### **Box 1: Methodological explanations, ESSPROS and MISSOC<sup>2</sup> data**

ESSPROS data have many advantages when it comes to describing overall social protection expenditure and financing, the most evident being that they produce comparable data for the EU Member States at a level of detail not found elsewhere. Another advantage is that they capture actual flows of money, which is a very important aspect of social protection systems where formal rules often do not reflect what is actually happening.

That said, there are also things that we cannot directly tell from the ESSPROS data. It is not possible to tell if a change is a consequence of changing needs or rules, to give one example (cf. Kangas & Palme 2007). Here, MISSOC can be helpful in identifying changes in rules. However, the description of the funding of healthcare and other social services (in general and each of the programmes), as well as the social assistance programme, is not complete enough to serve as a proper complement to the ESSPROS data. An example of this is the information about the financing of Swedish healthcare. While it is true that these services are mainly funded by local taxes, part of the funding (about 1/5) comes from central state revenue. If more detailed information on financing were made available through ESSPROS, this could be very useful for analytical purposes. As it stands, an opportunity has been missed in terms of casting new light on this important but often neglected dimension of social protection systems.

From a Nordic perspective, the ESSPROS system seems to be well designed for monitoring continental European kinds of social protection system, where the boundaries between cash benefits and benefits in kind are less clear, which in turn makes the categorisation of 'functions' and 'components' meaningful. For monitoring and analysing the Nordic kind social protection system, the system has its problems. If the Commission is contemplating changes in MISSOC on the financing side, there are equally good reasons to pursue a more disaggregated and fine-grained approach in the ESSPROS system (separating benefits in cash and in kind): there would be synergies from making both these changes.

## **2.2 Current issues**

The coverage of contributions is in principle universal. Self-employed people essentially have to pay the same kinds of contributions as others, even if there are some differences at the margin (e.g. the option for self-employed people to choose the number of waiting days in sickness insurance, with a limited effect on contribution rates). This implies that, in principle, there are no exemptions from paying social security contributions. There are some qualifications, however. Workers over retirement age are exempt from contributions for benefits they cannot claim (for example unemployment benefits). There is also a cap on insured persons' contributions to the old-age pension system. There has been another interesting exemption from social security contribution during the observation period, in the partial exemption made for young people. This was introduced in 2007 in order to stimulate job growth in younger age groups. Eventually, these exceptions were abolished in 2016 after, among other things, their effectiveness had been questioned (IFAU, 2016). There are no other floors or caps in the present Swedish system, and there is no tradition of progressive contribution rates as against proportional ones. Proposals for differentiated contribution rates have virtually been absent from the public debate. This has probably to do with the fact that there are basic provisions in most programmes that deal with the redistribution aspect. Given the recognition of the

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<sup>2</sup> Mutual Information Systems on Social Protection.



importance of maintaining a substantial link between contributions and benefits, there has also been a strong reluctance to take measures that would weaken that link.

By and large, most changes in the financing mix during 2005-2016 were marginal. In the following, we will try to clarify how and to what extent there have been changes. Since so little has happened in terms of structural reforms, the description will be on a fairly detailed level. Apart from the interlude of increased insured persons' contributions to unemployment insurance (see above), it seems fair to argue that the most important changes have been about the *level of taxation*, although there are a number of changes in more structural aspects of the tax system as such that deserve to be mentioned and discussed. There have been no major changes in terms of widening social security coverage by extending social security contributions, and no creation of, or increase in, earmarked taxes.

Over the observation period, we have seen that when it comes to the flow of taxes and social security contributions there have been some shifts in both directions, but the causes of these shifts are more complicated than changes in regulations. Instead, it has more to do with shifts between different kinds of programme within a 'function' or 'component'.

The role of private and occupational welfare programmes is often referred to as the 'hidden welfare state' (Howard, 1997). The Swedish private welfare sector is quite substantial, and not least the occupational sector. For example, in 2016, the size of funds in occupational pension plans amounted to 2,576 billion SEK (258 billion EUR) and for private individual plans, funds amounted to 478 billion SEK (47.8 billion EUR).

**Table 1. Swedish public and private pensions 2016 (billions of SEK)**

	Premiums (% share)	Capital (% share)	(% share)	Disbursements (% share)
Income-based pension	297 (63)	2,346 (43)		289 (70)
Occupational pension	169 (36)	2,571 (48)		102 (25)
Private pension	5 (1)	478 (9)		22 (5)
<b>Total</b>	<b>471 (100)</b>	<b>5,395 (100)</b>		<b>413 (100)</b>

Source: Orange Report, 2017.

In both expenditure and revenue terms, the pension sector is the most important private programme and this is true for both the occupational and private individual parts. The importance of the occupational sector is connected to the high unionisation rate, and in practice more than 90 per cent of employees are covered by the four major plans (private blue-collar, private white-collar, state, municipalities). Contributions for old-age pensions range from 4.5 per cent, with much higher contributions being paid by those who have earnings above the ceiling for benefit purposes in the statutory system. A similar pattern can be observed for occupational sickness insurance (Grees, 2015). Parental leave benefits are in some sectors topped up by occupational plans, both by 10 per cent extra and special provision above the ceiling for benefits in the statutory system. Some trade unions also provide top-up unemployment benefits on a voluntary basis (Lindellee, 2018).

Tax exemptions for private individual pension contributions have been abolished. Such exemptions were reduced during the crisis of the 1990s, and were finally abolished by the last centre-right government in 2012. The motive for this was that private pension plans are a very expensive form of saving, due to the high fund-management and other administrative costs; but also the fact that the state should not subsidise programmes that may lead to a reduction in labour supply (pull effect from high private pensions).

In the Swedish case, it could be argued that there has been a deliberate deprioritising of social protection expenditure, in the sense that an increasing proportion of employer social security contributions (Table 2 below) has been used for spending purposes other

than the core social protection programmes. This was made possible when the cost of social protection programmes was declining faster than the reduction in contribution rates. This was not really about shifting to universal or targeted programmes when cuts in social insurance benefits are being made – it has more to do with the weak status of social security contributions in the public finances. Here the national data reveal some more peculiarities. Although the law stipulates specific contribution rates for a set of different social insurance programmes, these are in reality only nominal, and the programmes do not have independent funds within the state budget. (The only exception is the old-age pension system.) It is therefore not possible to identify surpluses or deficits in social protection schemes by function. What can be noted is that there is a trend towards an increasing 'general wage contribution' (*allmän löneavgift*) – that is, a contribution not tied to any specific form of insurance benefit – which is a sort of direct transfer from the social protection system to the general revenue, and an indication of a decrease in the importance of 'real' social security contributions.

**Table 2. Decomposition of employer social security contribution rates in Sweden 2005-2016, percentages**

Type of contribution	2005	2010	2011	2012	2013	2014	2015	2016
Old-age pension	10.21	10.21	10.21	10.21	10.21	10.21	10.21	10.21
Survivors	1.70	1.70	1.17	1.17	1.17	1.17	1.17	1.17
Sickness	10.15	5.95	5.02	5.02	4.35	4.35	4.35	4.85
Parental leave	2.20	2.20	2.20	2.60	2.60	2.60	2.60	2.60
Work injury	0.68	0.68	0.68	0.30	0.30	0.30	0.30	0.30
Labour market	4.45	4.65	2.91	2.91	2.91	2.91	2.64	2.64
General wage	3.07	6.03	9.23	9.21	9.88	9.88	10.15	9.65
Total	32.42	31.42	31.42	31.42	31.42	31.42	31.42	31.42

Source: Budgetpropositionen 2005, 2007, 2010, 2012, 2016.

This has some implications for what can be seen as feasible changes in the financing structure. A proposal put forward by a group of researchers (Sundén et al., 2014) in a report to SNS (*Studieförbundet Näringsliv och Samhälle* – a business-related think tank) was that one way of dealing with the rising costs of sickness insurance would be to give the finances for sickness insurance a more independent status in the state budget. By fixing the contribution rate, pressure would be put on the labour market partners to take more responsibility for cost developments (Sundén et al., 2014). However, this proposal was completely rejected by the Minister of Finance at the time, indicating that there is a strong resistance – not least from the Ministry of Finance – to putting any restrictions (on the Ministry of Finance and others) on how to handle the public finances from year to year.

### **3 Strengths and weaknesses of the existing mix of financing options and potential future sources of financing - national debate on the topic**

#### **3.1 Strengths and weaknesses**

There are good reasons to highlight and discuss a number of notable strengths and weaknesses in the present system of funding social protection in Sweden. In the following, we will base our assessment of the existing mix of financing on the analysis in Sections 1 and 2. Reference will also be made to relevant evaluations of national reforms.

With regard to the strengths of the system, we argue that the basic structure in place is sound and forms a solid platform for making desirable adaptations of various kinds in line with the fundamental goals of the model, including those suggested by our evaluation. There are, furthermore, programme-specific strengths that deserve mention.

For example, the financing of the pensions system has, with its DC framework, an obvious advantage in terms of cost control: expenditure will, in the medium to long term, not exceed contributions. Moreover, the incentive structure is sound because lifetime earnings as the basis for calculating pension levels encourage longer working lives, as does the ability to accrue pensions entitlements beyond normal retirement age. There is furthermore a trend for pension components other than the DC 'income pension' to decrease in importance and, since the non-contributory part of the pension systems are tax funded, this will lower the pressure on the tax system. This development is driven by the fact that recently retired cohorts have more extensive work records and have earned larger income pensions.

Universal benefits are funded by general taxes, which is straightforward from a social justice perspective and clarifies that some benefits are for all residents, and other (earnings-related/contributory) benefits are for workers. The fact that healthcare and social services are funded by a combination of local and central state taxes allows for equal treatment and local democratic influence at the same time, as long as there is a sufficient redistribution of resources from rich to poor regions. The same kind of argument can be made in respect of eldercare and childcare, as well as other social services.

With regard to the weaknesses of the system, there are number of ongoing or planned reforms and debates that can help to identify problems that ought to be addressed.

A major challenge comes from population ageing. This is a national phenomenon and will continue to put pressure on the public finances in general. It also implies problems when it comes to handling increasing variation in population ageing between different regions and municipalities. While there are different estimates concerning the future overall financing needs of the municipalities, there is a wide agreement that the needs are large. The Swedish Association of Local Authorities and Regions (SKL) estimates a future need by 2022 for more than 43 billion SEK (>4.3 billion EUR) to keep the current level of services (including schools). Estimates from the National Institute of Economic Research 2018b (*Konjunkturinstitutet*) are higher, suggesting 80 billion SEK (>8 billion EUR) to keep the current level of staffing by 2023. The demographic pressure on the municipality sector as a whole will continue to increase beyond these points in time, and so will the variation among municipalities.

As argued above, the levelling-out system is of fundamental importance for a universal but decentralised system of social protection, which is aimed at providing residents with equal social rights. It is also the most politically sensitive and difficult issue in the financing of the Swedish system for the coming decades, and thus warrants some further deliberations. The present system was set up in the early 1990s but has been the subject of several reforms and revisions since then. These changes have, however, not been enough to compensate for the differences in resources and needs between municipalities.

This is indicated not only by the variation in tax levels but also by a large number of reports across a wide range of social protection programmes on differences in the quality of services. The system consists of several components. Two of the main ones are the 'levelling-out of costs' (*kostnadsutjämningen*) and the 'levelling-out of income' (*inkomstutjämningen*). The system of levelling-out of costs aims to level out the estimated obligatory costs for the municipalities and is based on structural differences, such as demographics, geography and socio-economic variables. This part of the system is financed entirely by the municipalities with no external financing from the state. The system of levelling-out of income aims to level out the municipalities' gains from income taxation and is based on the taxable income of their inhabitants. This system is financed in part by the municipalities but mainly by the state (SOU 2019:2).

Despite the levelling-out system, there are currently large variations in municipal taxes in Sweden. The difference between the highest and the lowest municipal tax (which includes the county council tax) in 2019 is roughly 6 percentage points, varying between 29.2 per cent and 35.2 per cent (SCB, 2019b). This has prompted calls for new revisions of the system, and the government appointed a commission to review the levelling-out of costs system, which published its proposals in 2019. The main change suggested was greater compensation for rural geography, growing or shrinking populations, and socio-economic variables (including the number of refugees received).

The system of levelling-out of income has been criticised for reducing the municipalities' incentives to stimulate growth and get people out of social assistance dependency and into employment. The current system compensates the municipalities for reduction of their tax revenues up to 95 per cent, and the critics of the system argue that it simply makes well managed municipalities pay for the mistakes made by the mismanaged ones. A recent report from a think tank argued that it is desirable to have a system in place that can stimulate increased efficiency in the municipality sector (Mörk et al., 2019).

Since the implementation in 1994 of the LSS for disabled people, a steady increase in approved hours of support has resulted in increasing costs. It is believed that part of the cost increase was due to abuse of the system, and more than one report indicated that the sums were quite substantial. In 2007, an investigation estimated that as much as 11 per cent of total expenditure was misspent. In 2011, the programme's regulations were tightened, including increased control of the firms that were active in the area. A more recent investigation from 2018 estimated fraud in the system to be between 2 and 7 per cent.

This situation led the red-green 2014-2018 government to appoint a commission, which was given the task of reviewing the LSS and suggesting measures for increased cost control. Initiatives to control the system and reduce the number of approved hours have led to an intense political debate. This debate has been fuelled by the more restrictive procedures of the National Social Insurance Agency following a number of court decisions in the Administrative Courts, resulting in a more restrictive assessment of caring needs. In 2018, the government commission put forward a number of proposals for reform, including an increased role and level of discretion for the municipalities. Interest groups and a number of politicians have been very critical, claiming that the proposals would lead to a retrenchment of the system and problems of social justice. Point 64 in the 2019 agreement on a four-party coalition government (Fritzell & Palme, 2019) states that new terms of reference will be given to the government commission in order to pave the way for restoring some of the rights taken away. It also says that more commissions will be appointed to sort out the administrative issues, among other things around the responsibilities of the state vis-a-vis the municipalities.

### **3.2 Policy recommendations**

The policy recommendations that emanate from the present report are guided by the underlying logic of the Swedish model, as described above, in terms of both benefits and financing structure, with a view to sustaining social protection financing in future years.

### 3.2.1 Work incentives

The structure of work incentives is of critical importance for the economic sustainability of the Swedish model of social protection, with its strong reliance on high employment when it comes to be both awarding entitlements and financing. There are, however, some improvements to the adequacy of pensions and sickness insurance that could be made without any major implications for the incentive structure. Increasing the contributions for the income pension would mean higher pensions in the longer run and would also build on the substantial link between contributions and benefits (part of the underlying logic of the Swedish model), which appears to be a sustainable approach. To substantially increase the ceiling for benefit purposes in the sickness insurance system would mean higher contributions and higher labour costs under the statutory system. But it would just be about shifting the same burden that today is generated for employers by the occupational plans, which appear unproblematic from a work incentive point of view. Given the fact that there is a substantial non-take-up (despite their wide coverage) of occupational plans, there are some obvious gains when it comes to the distributional aspect of such a shift: what has been observed is that a fairly large proportion (more than 15 per cent) of those who are entitled to occupational top-up benefits do not actually get them (Grees, 2018).

The introduction and extension of the earned income tax credits (*jobbskatteavdraget*) should be seen in the context of promoting employment, and by increasing the labour supply responding to the increasing financial pressures from an ageing population. In effect they lowered the replacement rates of social insurance benefits, and thereby increased the economic gains from returning to paid employment.

### 3.2.2 Distributive issues

The increasing gap between labour market insiders and outsiders that followed from the earned income tax credits has also been reinforced by direct cutbacks to social protection programmes since 2005, even if some of these cutbacks have since been reversed. This includes several government programmes for redistribution and income replacement; unemployment benefits, social assistance, child benefits, sickness benefits and pensions. Benefits and income-replacement policies have become less adequate due to insufficient updating of benefits, or of ceilings for benefit purposes, in line with the general earnings growth. Occasionally, changes have also been made to eligibility criteria, restricting access to the programmes. It is clear that the decline in the adequacy of cash benefits of different kinds has lowered the redistributive effect of the social protection system (Fritzell et al., 2018; Cronert & Palme, 2017).

The Swedish National Audit Office's latest audit suggested relaxing the rules for sickness benefits, so that more people could receive them. It said that the current rules are far too strict, given the negative consequences refusals have for individuals – both for their health and for their financial situation (Swedish National Audit Office, 2018).

In order to secure equal access to high-quality healthcare and related services, it would be desirable to increase central state funding. The alternative is to increase the 'levelling-out' system. To increase the state share of financing requires tax reforms, but that may be under way. To increase the central state share of financing for childcare (and education) to set priorities right also requires tax reforms (Mörk et al., 2019).

### 3.2.3 Labour costs

Labour costs have continued to increase as a result of continued growth of real wages, including for those on low wages. They were, however, not high enough to push inflation up to the Bank of Sweden's 2 per cent target during 2005-2016. The most recent figures from the Bank confirm the same situation (Riksbanken, 2019). Indirect labour costs (employer social security contributions) were lowered in 2009 by 1 per cent, from 32.42 per cent to 31.42 per cent. It should be noted here that most employers pay additional

contributions to occupational pension plans covering more than 90 per cent of employees, of at least 4.5 per cent of incomes.

### 3.2.4 Risk of evasion

In a high tax society like Sweden, tax evasion will always be an issue. One way of reducing evasion is to create incentives for people to pay contributions because their benefits will be higher than otherwise – and it is reasonable to argue that this has been the basic logic of the Swedish system. It can also be noted that the tax rebates on domestic services (RUT and ROT) not only appear to have lowered evasion but also created markets for these services. Nonetheless there is a trade-off, in the sense that these tax rebates disproportionately go to those on high incomes (Skatteverket, 2018a and Skatteverket, 2018b). A more recent problem has to do with the increased immigration of low-educated people, whose level of productivity does not correspond to the specialised Swedish labour market with high ‘minimum’ wages. This has been perceived as a major concern by the political parties as well as the labour market partners (Nordström et al., 2017). It can also be seen as a potential problem of tax evasion insofar as these workers may be priced out of the regular market and instead appear on the black market.

### 3.2.5 Administrative/collection costs

The administration and collection costs of the system do not appear to be perceived as a big issue in public debate, perhaps because the universal system allows the state to put constant pressure on the administration to be efficient, and has in fact done so for decades. Still, there is one area where administration costs have been an issue. This concerns the funded component of the pensions system, where the fund management costs of private providers have been at a level where they, eventually, adversely affect pension levels. However, here too, the state regulator has put pressure on the fund managers and administrative costs have been lowered. The costs of administering the income pension (*inkomstpension*) are deducted annually from pension balances. At current cost levels, the deduction will amount to approximately 1 per cent. The costs of administration and fund management in the premium pension system are deducted from premium pension capital. The present cost deduction will be an average about 9 per cent. Rebates of pension savers’ fund management fees are important, because without them pensions would be about 14 per cent lower (Orange Report, 2017). The National Board of Auditors (2018) have pointed to the unnecessarily high administrative costs and suggested ways of cutting them further, which there are good reasons to follow. This could be combined with an increased contribution rate to the pension system in order to raise pensions in the longer run. The cross-party agreement on pensions of December 2017 gave clear guidance when it comes to dealing with administrative issues in the funded part of the system, but also opens up a discussion about contribution rates (Fritzell & Palme, 2019).

One administrative aspect regarding the financing of social protection at the municipal level concerns the way the municipalities are organised. There has been some debate as to the suitability of the division of Sweden into 290 municipalities and 21 county councils/regions. Other Scandinavian countries, such as Denmark and Finland, have decided to reorganise their local divisions. In recent decades, the main focus in the Swedish debate has been a consolidation of county councils into a small number of larger regions. The idea is that these regions should have a more robust and stable tax base as well as being a more suitable basis for organising healthcare. Two government commissions a decade apart suggested new regional divisions (SOU 2007 and SOU 2016). The suggestions have not been implemented due to lack of political support, but we strongly recommend that such reforms be reconsidered.

### **3.2.6 Adaptability to demographic/economic swings**

During the Great Recession, the automatic balancing function of unemployment insurance was rediscovered in the EU, and also contributed to its increased legitimacy in Sweden. The pension system is equipped with mechanisms that are intended to absorb various kinds of economic and demographic shocks without immediately affecting the level of pensions even if the contribution rates are fixed. This shock absorption is mainly performed by the buffer funds. However, during the Great Rrecession, the funds were hit by an unprecedented decline at the same time as employment levels fell. This triggered the 'break' mechanism of the system and nominal pension levels were reduced. The cut took place after the recession, but indicated how the older population also is vulnerable to international economic volatilities. The National Institute of Economic Research (*Konjunkturinstitutet*, 2018a), despite finding that automatic balancing mechanisms have been stable at least since 2009, has raised the possibility of introducing a time variant component in unemployment insurance, in order to strengthen its automatic balancing function. This appears to be an interesting way forward and is recommended.

### **3.2.7 Vulnerability to structural changes in the labour market/new world of work**

The Swedish economy is export-oriented, and in many ways export-led. If we could talk about a common growth model or strategy for the future, it is certainly a continuation of that. This puts certain restrictions on what cannot be done without losing jobs. Total wage costs need to be competitive. More recently, concerns have been raised about the effects of artificial intelligence (AI) and machine learning, and the loss of routine manual and non-manual jobs that may come from that. That being said, it is clear the Swedish economy has been fuelled by domestic demand over the past decade, which contributed to the quick recovery after the Great Recession. An important component in the domestic-led economic boom is the population increase driven by mainly refugee-related migration (SCB, 2018). It should also be mentioned that Sweden has a special regime for temporary labour migration for third-country nationals that has contributed more workers in both low-skilled and high-skilled occupations (Calleman & Olsson, 2015).

### **3.2.8 Epilogue**

Finally, a few words are warranted about what not to do. During the economic crisis of the 1990s, a number of increases in user charges were made, aimed at saving a reasonable level of quality of social services of various kinds. Up to that point, user charges had primarily been used for steering and controlling consumption, and not for the actual funding of the operations. The unintended and negative effect was that an increasing proportion of the population reported that they had abstained from consuming public social services for economic reasons. The increases had thus created a 'regressive situation' where those on low incomes were contributing to social services by paying taxes, but did not use the services (Palme et al., 2003). This evidently raised strong political concerns and in the early years of the 21<sup>st</sup> century, a number of measures were taken to regulate the fees for, for example, childcare and elderly care, or completely abolish them as in the case of healthcare for children.

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