

Approaches to Social Investment and Their Implications for Poverty in Sweden and the European Union

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The concept of social investment has gained increasing traction among European Union policymakers, as a strategy to reconcile the goals of employment, growth, and social inclusion. In recent years, however, scholars have criticized the social investment approach for not being able to achieve its intended distributional consequences and have raised doubts about whether the goals of increasing employment and decreasing poverty are reconcilable.

This paper argues that distinguishing between the 'Nordic approach' and the 'Third Way approach' to social investment is key both for describing policy developments and for understanding the relationships between social investment policies, employment and poverty.

Based on an exploration of recent trends in social investment policies, employment and poverty in Sweden, we propose that the recent noticeable increase in poverty can best be accounted for by changes in social insurance policy and tax policy that represent a shift from the Nordic approach to the Third Way approach, whereas an 'employment vs. poverty' trade-off is mitigated by the sustained presence of a compressed wage structure. A set of panel data analyses on 24 European countries over the last decade provide preliminary evidence that these mechanisms extend also beyond Sweden.

1. Introduction

Over the past 15 years, the concept of ‘social investment’ has gradually gained traction among European Union policymakers. Central strategies and policy agendas, such as the Lisbon Agenda of 2000, the Europe 2020 strategy of 2010 and the Social Investment Package of 2013, are all manifestations of this. Here social investment oriented policies aimed at enhancing the productive capacity and employment of the population have been identified as key elements in a strategy to increase growth and competitiveness as well as to reduce poverty and social exclusion.

The extent to which a social investment approach has been adopted “varies very widely” across the EU Member States (Bouget et al., 2015: 6). What is clear, however, is that in recent years, the approach has attracted much scholarly attention, including criticism from a number of perspectives. Perhaps most notably, analysts have questioned whether social investment oriented policies achieve their intended distributional consequences, and have raised doubts about the idea underpinning the approach, i.e. that the goals of increasing employment and reducing poverty are reconcilable (Cantillon, 2011; Corluy and Vandenbroucke, 2014).

The purpose of this paper is to scrutinize the feasibility of the social investment approach as a strategy of promoting employment and poverty reduction. This will be done in three steps: In the first step (section 2), we revisit the critique of the social investment approach and explore how it applies differently to two different versions of the social investment approach identified in the previous literature (e.g. Morel et al., 2012); the ‘Nordic approach’ (cf. Esping-Andersen et al, 2002) and the ‘Third Way approach’ pioneered by Giddens (1998). The two approaches vary not only in their historical roots but also in some central values and policy prescriptions. Therefore, it is argued, it is important to distinguish between them, when describing and explaining social investment policy developments as well as when assessing the achievements and shortcomings of the social investment approach.

In the second step (section 3), we demonstrate the usefulness of this distinction not only for characterizing recent developments of social investment oriented policies in Sweden but also for understanding the relationship between social investment policies, employment and poverty.

The section includes an empirical analysis of Sweden where we review recent trends in social investment policies, employment, and poverty. Although the past decade has seen increases in both employment and poverty, we question the notion of an ‘employment vs. poverty’ trade-off in the Swedish context of a relatively high degree of wage compression. Rather, we argue, the increase in poverty is best explained by precisely those policy changes which represent a *shift* from the Nordic approach of social investments to the Third Way approach; namely retrenchments in the social insurance systems and the introduction of a broad earned income tax credit (EITC).

In a third step (section 4), we analyze a short panel data set on at-risk-of-poverty rates in 24 European countries to make a first assessment of whether our arguments are transferrable outside the Swedish context. Our estimations suggest, in line with our argument, that employment is positively related to poverty *only* in the context of low wage bargaining centralization (implying a low degree of wage compression). We also find that poverty is negatively related to the replacement rate of unemployment benefits and unrelated to incremental changes in social investment expenditure.

In the concluding ‘Discussion’ we highlight the potential merits of social investments by pointing to the critical elements of such as strategy and what it requires in terms of institutional complementarities.

2. Approaches to social investment, and the critique

In this section, which draws heavily on Cronert and Palme (forthcoming), we elaborate on the distinction between the two versions of the social investment approach, and we begin by tracing its historical roots.

2.1 The origins of the Nordic approach to social investment

The origins of the social investment approach can be traced back to the 1930s, to the Great Depression, and to the falling birth rates – that in Sweden came to be labelled the ‘Crisis of the Population Question’. In the midst of these crises, Alva and Gunnar Myrdal began to develop an approach to social policy aimed at supporting production and reproduction, which opened up for an investment perspective on social policy (Morel et al., 2012).

Falling fertility was seen as an economic problem, in the context of increasing costs for households raising children, and with social consequences for those who could not afford to have children. Myrdal and Myrdal advocated policies that would combine direct economic support to families with children with indirect support for housing, as well as the provision of opportunities for female labor force participation. The population question was formulated not only in terms of the “quantity” but also in terms of the “quality” (health and education) of the population, i.e. the social conditions for human capital formation.

The Myrdals were also concerned with economic growth and productivity. This is true also for the post-World War II continuation of the social investment approach in Sweden. Part of this continuation is closely intertwined with the Myrdal agenda, even if the actual policy implementation came with a delay of (about four) decades. Another part of it developed in a different context and was influenced by other actors in the labor movement, namely the trade union economists Gösta Rehn and Rudolf Meidner (Morel et al., 2012). The Rehn-Meidner Model of economic policy was designed to support a kind of Schumpeterian creative destruction and transformation of the economy, while at the same time promoting ‘social construction’ with selective but massive encompassing active labor market policy (ALMP) measures, including re-training of the labor force to make workers fit for the new economic structures (cf. Bonoli, 2010). These investments in education and training of the labor force can no doubt be labelled as ‘social’ due to their distributional properties and inclusive effects (cf. Nelson and Stephens, 2012). The Rehn-Meidner Model was also underpinned by a centralized, egalitarian wage policy, meant to shift resources towards the more productive sectors of the economy while stimulating consumer demand and, in turn, labor demand and employment.

The expansion and universalization of the education system which began in the late 1950s and continued gradually throughout the post-war period were also clearly ‘social’ in nature (Lindensjö and Lundgren, 2014). Next, beginning in the 1960s, the approach was complemented with adult education under the label ‘life-long education’. This further geared the regular education systems towards combining social and economic objectives.

While Keynesianism grew in importance and dominated as an economic paradigm in the Western hemisphere until the late 1970s, it may be argued that following Keynes’ primary concerns, the function of public spending was mainly a macroeconomic balancing mechanism rather than an instrument for reducing inequalities (cf. Sen, 2009) or an instrument for ‘social investment’. The focus on female labor market participation and gender equality is something which belongs to the Myrdal imprint on the Swedish version of Keynesianism rather than (male) mainstream Keynesianism (Hobson, 2006). From the 1970s, the various components of what can be labelled the ‘dual-earner model’ gradually came into place; including separate taxation of spouse income to improve incentives for a second earner, and expansion of cradle-to-grave social services enabling women to combine family responsibilities with paid work in the expanding public sector as well as in the private sector. These services were vital to enable individuals and society to harvest the investment in women’s human capital that had taken place during the first post-war decades and that would continue to expand (Palme, 1999).

Two other important features of the Nordic approach to social investment are the idea that widespread employment and decent wages are the best guarantees for avoiding poverty and other socio-economic ills, and the notion of complementarities between ‘demanding’ and ‘enabling’ social policies to this end. Thus, clarifying the responsibility for individuals to search for, move to, and take up new employment (i.e. ‘demanding social policies’) became integral to the Nordic social investment approach as a complement to education and training programs (‘enabling social policies’) (Palme, 1999). In the realm of labor market policy, the basic formula, at least before the crisis of the 1990s, was to allocate 75 percent of the overall expenditure to ‘active’ labor market measures (ALMP) and 25 percent to ‘passive’ measures (unemployment benefits) (OECD, 2016a). Still, social transfers were acknowledged as a potential productive factor and an important tool for preventing poverty and inequality as well as depletion of human capital, and it was recognized that unemployment benefits may serve to reward formal labor force attachment, improve matching, cater to macroeconomic stabilization and promote economic restructuring (Palme et al., 2009). Family-related benefits are important for reducing child

poverty, and are even a precondition for social investments oriented towards children; parental leave insurance provides a second income for families with infants, and child care benefits allow for a second earner also in families with small children (Ferrarini, 2006).

The social policy agenda that was formulated in Sweden, starting in the 1930s and continuing in the post-war period, was based on the core assumption that the trade-off between equality and efficiency can be bridged by social policies that also have economic objectives and by economic policies that also have social objectives. Thus, fighting poverty was about enhancing the productivity and employment of the population, and counter-cyclical policies were about fighting poverty and inequality. Redistribution was seen as an irrigation system (G. Myrdal), not a leaky bucket (Okun) (cf. Korpi, 1985). The goal was equality and not mere poverty reduction (Erikson, 1993), and equality not only between social classes but also between the two genders. The means were *universal and life-long education, cradle-to-grave social services* (particularly *child care*, but also *elderly care*), *active labor market policy* (particularly *training and mobility grants*), combined with *earnings-related sickness insurance and parental leave benefits*, as well as *unemployment benefits* to avoid human capital depletion and cushion job transitions, and *centralized wage bargaining* to promote wage compression. At this point, however, it should be noted that wage bargaining structures do not figure as prominently as they deserve in the social investment literature. In this paper, we take steps in the direction to remedy this omission.

2.2. The Nordic approach meets the Third Way

The description above serves to facilitate the distinction between the Nordic approach to social investment and the so called 'Third Way' approach to welfare reform, pioneered by Anthony Giddens (1998). The Third Way approach was developed around the same time that the concept of social investment started to gain traction at the EU-level in connection to the development of the Lisbon Agenda of the year 2000, and to some extent in parallel to the work of Esping-Andersen and colleagues who were inspired by the Nordic approach. This resulted in a report to the Belgian Presidency of the EU during the fall of 2001, later to be published with the title: *Why We Need a New Welfare State* (Esping-Andersen et al., 2002). This is of relevance

not only because of the many similarities between the approaches, not least the focus on the supply side of the labor market and on investments in skill formation, but also because of their important differences.

More specifically, the approaches differ in their understanding of *what constitutes productive and unproductive social expenditures*, in the roles they ascribe to *social policy* and to *civil society actors*, in their *view of equality*, and how they appear to want to strike a balance between *rights and responsibilities* (Morel et al., 2012; cf. Andersson, 2009). Where Giddens emphasizes the moral hazards and unproductive character of unemployment benefits and similar cash transfers, Esping-Andersen sees the productive values of such programs. Where Giddens values the incentives created by inequalities, Esping-Andersen problematizes the effects of lack of equality. Where Giddens promotes a 'positive welfare society', the Nordic approach emphasizes the role of the state. On a discursive level and with respect to rights and responsibilities, Andersson (2009) identified illuminating differences between the two approaches by comparing Swedish Social Democrats and New Labour in the United Kingdom. One way to interpret her rich analysis is to say that whereas New Labour, inspired by the Third Way, tilted the balance between rights and responsibilities in the direction of responsibilities, in Sweden that kind of tilt did not occur until the Social Democrats lost the election in 2006¹.

Precisely because the polysemic nature of the concept of 'social investment' (Jenson, 2010) has enabled it to accommodate these rather different approaches to social and labor market policy reform, it is important for researchers to keep the two apart analytically. This is true not only when describing and explaining policy developments, but also when assessing the achievements and shortcomings of the social investment approach. In what follows, we elaborate further on this point.

1 This being said, New Labour achieved a number of significant real world policy advancements by investing in education and in expanding child care programs which facilitated female employment (Stewart, 2009; Stewart and Obolenskaya, 2016). But in contrast to the 'Nordic Model', traditional social insurance programs were left on a minimal level (Palme et al, 2009) and a wage formation model that would directly prevent in-work-poverty was also lacking (see below).

2.3. Social investment, redistribution and the trade-off between employment and equality

In recent scholarly debates on the merits of the social investment approach, it is the distributive consequences of its policy recipe, in particular its consequences for poverty, which have received the most skepticism². A number of factors have been brought up, which might have a detrimental effect on poverty, and which are typically held to be intrinsic to the social investment approach. However, some of these concerns primarily have bearing on either the particular principles or policy prescriptions linked to the Third Way approach or the consequences of ‘activation’ reforms introduced across Europe over the past two decades; most of which have had very little investment content³ (De la Porte and Jacobsson, 2012).

First, it has been suggested that because the consumption of those public services associated with the social investment approach are typically work-related and earnings-related, such services have a less redistributive profile than traditional cash transfers, giving way to ‘Matthew effects’ and increasing inequalities in social investment oriented states (Cantillon, 2011). Second, it has been suggested that the shift on the political agenda from passive income support policies to active investment policies has resulted in a reallocation of resources away from the more redistributive policy areas to the less so. Third, it has been argued that the discursive emphasis on ‘making work pay’ has justified, and perhaps even necessitated, a re-commodification of citizens by means of retrenchment of benefits, with detrimental consequences for the more vulnerable (Vandenbroucke and Vleminckx, 2011). Fourth, it has been argued that while on an aggregate level these consequences could have been mitigated in case the policies were successful in moving unemployed people into employment, the proportion of people living in jobless households

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2 Two other important strands of criticism concern its (lack of) commitment to equalizing power relations between women and men (see e.g. Jenson, 2009) and its inherent trade-off between imposing negative economic incentives and establishing a close monitoring of people’s willingness to work (see Vandenbroucke and Vleminckx, 2011).

3 To be sure, some concerns have also been raised about the Nordic approach in particular; primarily with regard to its economic and political sustainability. We briefly address these issues in the ‘Discussion’ section of this paper.

has hardly decreased in the EU in the wake of the employment and inclusion strategies, despite rising overall employment rates. This has raised doubts about whether the goals of increasing employment and decreasing poverty underpinning the social investment approach are reconcilable (Cantillon, 2011; Corluy and Vandenbroucke, 2014; de Beer, 2007).

Turning first to the *distributive profile of the services*, most evidence so far seems to suggest that on an aggregate level, social investment oriented services are redistributive in an egalitarian direction – although findings vary with respect to the extent. For instance, Esping-Andersen and Myles (2009: 654) found that services are generally redistributive but less so than some cash transfers, whereas Verbist and Matsaganis (2014) found that the poverty-reducing effect of services is much larger than the one of cash transfers to the working age population. Using concentration coefficients, they show that this is because although the *design* of cash transfers in most cases make them more oriented toward lower income groups, services are much more important in *size*. Nelson and Stephens (2012) find that a range of social investment oriented services are positively related to the consequent level of general skills – especially in the bottom half of the skill distribution – and to both the employment levels in general and employment in knowledge-intensive services.

The distributional profile of services seems to depend on the design of specific policies, the context in which they are introduced, and how they are combined to achieve institutional complementarities. With respect to childcare policies, this is the conclusion from, for instance, studies by Vaalavuo (2011) and Van Lancker and Ghysels (2012). With respect to ALMP, Gingrich and Ansell (2015) as well as Cronert (2017) argued that these do not have pre-defined distributional profiles, but can be targeted at different groups by different actors. Moreover, in order to understand the distributional effects of services, we also need to consider the revenue side of the programs in the analysis, as was observed by Åberg (1989), illustrated by Rothstein (1998) and more recently emphasized by Whiteford (2008).

In sum, existing evidence seems to suggest that in general, the distributional profile of social investment oriented services, as defined in the previous section, is a function of their content and

targeting, and of the national context in which they are implemented, but that their potential is there.

The second and the third concerns, labelled *resource competition* and *re-commodification* by Vandenbroucke and Vleminckx (2011), warrant a recollection of the distinction between the Nordic and the Third Way approaches to social investment. Whereas for Giddens (1998), welfare state restructuring is indeed about achieving a *shift* from ‘passive’ to ‘active’ social policies, the Nordic approach stresses that ‘social promotion’ must be *combined* with ‘social protection’ (Hemerijck, 2012b). Thus, on an ideational basis, the resource competition and re-commodification critiques are primarily relevant to the Third Way approach⁴.

Turning to the empirical thrust of this critique, Vandenbroucke and Vleminckx (2011) concluded in their analysis of change in social expenditure over two decades in 14 countries, that pressure on social budgets came from healthcare and pensions rather than from social investment programs. Along the same lines, the results from Nikolai’s (2012) and Vandenbroucke and Diris’ (2014) studies of long-term social expenditures contradict the idea of a shift from passive to active spending. Vandenbroucke and Vleminckx (2011) did not rule out, however, that given the context of relatively tight budgetary constraints for many European governments, the ‘making work pay’ component of social investment may have justified and reinforced pressures for retrenchment in the field of unemployment benefits in order to strengthen work incentives. We agree, but suggest that such a justification would necessarily hinge on a selective reading of the social investment approach as outlined in this paper, given the important productive role it assigns to unemployment benefits.

When addressing the fourth concern, regarding the *poverty-reducing capacity of social investment policies*, specifically the ‘employment vs. poverty trade-off’, it is again important to distinguish between the Nordic and the Third Way approaches

4 That being said, we acknowledge that both approaches explicitly favor labor market participation over (long-term) de-commodification. Orloff’s (1993: 318) remark that “For many women and others excluded from paid labor, commodification – that is, obtaining a position in the paid labor force – is in fact potentially emancipatory” illustrates this reasoning.

to social investment. We agree that an even distribution of work is key to poverty reduction (Corluy and Vandenbroucke, 2014). Indeed, this is another reason to stress the importance of including the provision of enabling services such as child care to households with low work intensity. However, that might not be enough to escape the trade-off. Atkinson (2010) outlines two potential strategies for achieving high employment among workers with low productivity: 1) lowering the cost of job creation (which generally requires mobilization of public resources) and 2) reducing reservation wages by reducing the generosity of social protection. While the second strategy is less expensive, it may come at the cost of increasing the number of working poor, i.e. if reservation wages are set below the poverty line⁵.

Posed with Atkinson’s dilemma, most proponents of social investment would probably argue that the trade-off can be mitigated to the extent that investments in human capital in universal education systems, combined with targeted ALMP, succeed in raising productivity in the lower end of the distribution. Second, proponents of the Nordic approach would go on to point out that the extent to which increased employment leads to increased poverty is likely to depend on the degree of wage compression. If statutory or collectively bargained entry-level wages are high relative to the median wage the prevalence of *in-work* poverty is likely to be limited. Whereas the influential ‘Trilemma of the Service Economy’ (Iversen and Wren, 1998) suggests that, in the post-industrial era, wage compression *inhibits* employment growth in the first place, proponents of the Nordic approach would tend to agree more with Wren’s et al. revised version of the trilemma, which suggests that “[t]he possibility exists for high productivity, internationally traded service sectors to take over from manufacturing sectors as the dynamic drivers of employment expansion in the post-industrial economy, reducing the need to rely on low relative wages at the bottom of the earnings distribution to

5 This can be illustrated by the German experience with the Hartz reforms and the expansion of low-paid ‘mini-jobs’ in the first half of the 2000s. Between 2000 and 2010, employment in the ages 20-64 increased by a notable 6.1 percentage points (Eurostat, 2016b). In 2010, however, the overall at-risk-of-poverty rate at 50 % (60 %) of the median income was 9.6 % (16.4 %), which amounts to a 26 % (29 %) increase over said period (LIS, 2015).

facilitate private service employment expansion” (2013: 109). Our main point here is that *to the extent* that employment increases, it should primarily fail to reduce poverty if taking place in a context of high wage dispersion. This point, we argue, is important to bear in mind when analyzing and making inferences to the recent trends in social investment oriented policies, employment and poverty in Sweden, which are in focus in the empirical section that follows.

3. Social investment, employment and poverty: Revisiting the relationships in the Swedish case

In this section, we review recent trends in social investment policies, employment, and poverty in Sweden, and argue that the recent increase in poverty is best explained by precisely those policy changes which represent a *shift* from the Nordic approach of social investments to the Third Way approach.

3.1. Social investment trends in Sweden: From the Nordic approach to the Third Way?

In the mid-1980s, around the time that our historical outline of the development of the Nordic approach to social investment ends, Sweden was clearly the most social investment oriented country in Europe, judging from OECD social expenditure data for that period, (OECD 2016a). These data show that compared to the EU-15 average, Sweden spent over three times more of its GDP on what can be labelled ‘new’, or social investment oriented, policy areas; i.e. parental leave, elderly care and childcare services, and active labor market policy (Meeusen and Nys, 2012). In what follows, we look closer at the developments in these and other relevant policy fields that have taken place in Sweden over the three decades that followed. In brief, our mapping suggests that gradually over the period, and more distinctly during the last decade, Sweden has turned away from the Nordic approach, towards a Third Way approach.

Consider first Figure 1, which tracks social expenditure developments over the past three decades for the seven policy areas which Meeusen and Nys (2012) classify as ‘old’ (health care, old age benefits, and other benefits) and ‘new’ (parental leave, elderly care, child care, and ALMP), respectively.

At a first glance, the story to be told about social

expenditure in Sweden over these years seems to be one of overall stability rather than one of important change. The 25-year period between 1985 and 2011 saw one marked increase in total spending in the early 1990s. This increase coincided with the onset of the severe economic crisis in 1992. It was understandably driven more by the fact that GDP decreased in 1991, 1992 and 1993 than by any intentional increase in ‘welfare state effort’ (even though it is evident that the increased number of unemployed spurred expenditure expansion in real terms both for cash transfers and for ALMP). There is a similar, although smaller, bump at the end of the period, as Sweden saw a negative GDP growth in both 2008 and 2009, in the wake of yet another global financial crisis. Seen over the full period, the overall change is a modest 5 percent increase in social expenditure, up from 28.7 percent of GDP in 1985 to 30.2 percent in 2011. Expenditure on education is not included in Figure 1 because comparable data are only available from 1997 to 2011. These reinforce the pattern of overall stability. With no discernible trend, expenditure fluctuated around a mean of 4.1 (± 0.3) percent of GDP for primary and secondary education, and 1.6 (± 0.1) percent of GDP for tertiary education.

However, some important changes in the composition of social expenditure deserve attention. First, taken together, ‘new’ or social investment oriented, expenditure has increased by one third since the mid-1980s (up from 6.1 percent of GDP to 8.2 in 2011), whereas expenditure on “other benefits”, i.e. unemployment compensation, early retirement, social assistance, paid sick leave, family allowances etc., is down 25 percent since 1985 and more than 50 percent since its peak in 1993. Second, among the ‘new’ policy areas, parental leave, elderly care and childcare has increased whereas ALMP has seen a steady and sizeable drop. Third, a decomposition of the ALMP expenditure, not visible in Figure 1, tells of a profound shift of focus of the ALMP portfolio, from skill formation to employment assistance (or ‘work first’). Training programs, which in 1985 amounted to 0.7 percent of GDP (or 35 percent of ALMP), were down to 0.1 percent of GDP (or 8 percent of ALMP) in 2011. By contrast, employment incentives and labor market services – aimed at promoting labor market entry – *increased* from 0.6 to 0.9 percent of GDP over the period, and now accounts for 75 percent of the ALMP portfolio.

Expenditure on a social policy program can be

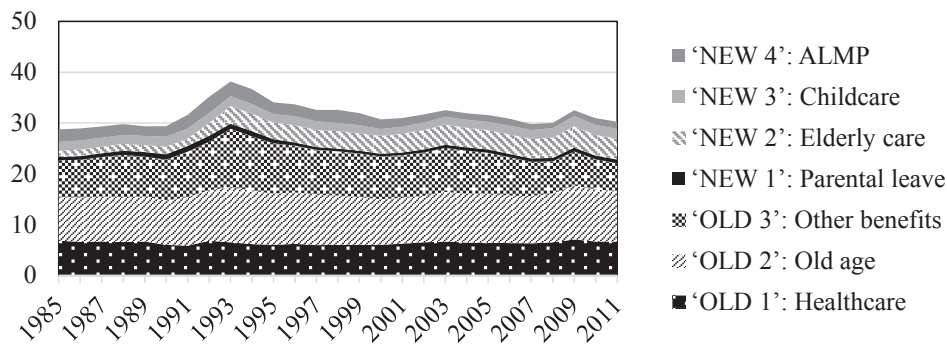


Figure 1. Social expenditure on “old” and “new” social policy areas, Sweden, 1985 – 2011. Public and private social expenditure as percentage of GDP. The categorization follows the framework developed by Meeusen and Nys (2012). Source: OECD (2016a).

divided into two components; the average number of beneficiaries and the average expenditure per beneficiary. And to the extent that the latter indicator can be seen as a proxy for policy ‘effort’, the picture of the investment content in the social expenditure becomes somewhat gloomier. Figure 2 plots the average public expenditure as the *share of one ppm of GDP per beneficiary* in seven policy areas over the periods that the available data permit. When it comes to education, preschool (age 1–6) and compulsory school (age 7–15) are the only schooling types that have not seen a drop in expenditure per pupil since the mid-1990s. Upper secondary school has seen gradually decreasing expenditure per student throughout the studied period and a more marked dilution has taken place in tertiary education. The only schooling type that has seen a slight increase since the mid-2000s is municipal higher education, yet expenditure per student was still lower in 2012 than in the mid-1990s.

The increase and subsequent sharp decrease in ALMP expenditure per program participant during the 2000s is paradoxical given the gradual overall decrease displayed in Figure 1. The bulk of the increase in the per-program-participant expenditure can be accounted for by two expensive programs – a subsidized sabbatical year (*Friår*) and a job creation scheme (*Plusjobb*). These were enacted by the social democratic government in 2005–2006, and immediately revoked by the center-right government that came into power following the 2006 election. The introduction of these programs coincided with an economic upturn during which the overall number of ALMP program participants

dropped; hence the relative stability of total ALMP expenditure during those years.

With regard to public expenditure on unemployment benefits, Figure 2 demonstrates that the drop in total expenditure on “other benefits” displayed in Figure 1 is not only a matter of shrinking numbers of benefits claimants, but that public expenditure per unemployed has decreased sharply since the early 2000s. Further, it can also be noted in this context that the adequacy rate of social assistance benefits has lagged behind the real growth of the economy. In the early 1990s it used to be close to 60 percent of the median income; by 2009 it had dropped below 50 percent (Kuivalainen and Nelson, 2010).

Three developments that are not reflected in the expenditure data are worth mentioning here. First, whereas the *enabling* dimension of the Swedish active labor market policy regime, expressed, for instance, in terms of the share of the ALMP portfolio that is devoted to labor market training programs, has clearly been pulled back, its *demanding* dimension, that is, the requirements placed on jobless individuals, has been strengthened. Overall, early enrolment into ALMP programs, notably in low-cost job search assistance programs but also in more costly wage subsidy programs has increased. The overall share of registered employed who are enrolled in a program was up from 42 percent in 1999 to 60 percent in 2013 (Cronert, 2015). In addition, the strictness of the sanctions imposed on unemployment benefit recipients if they fail to comply with the program requirements

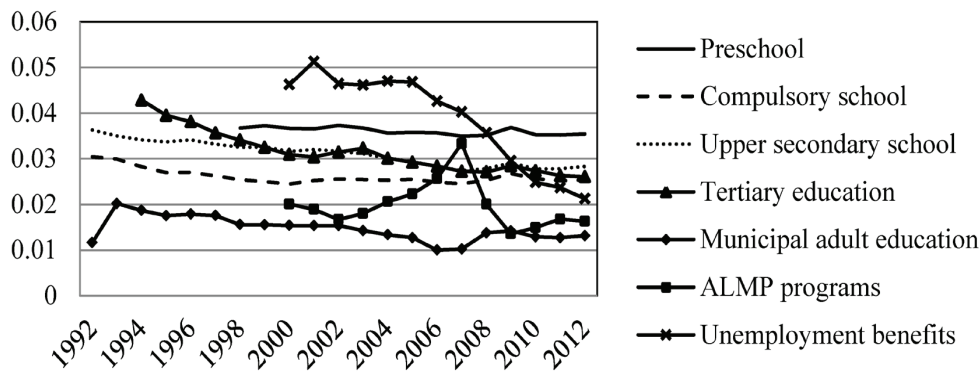


Figure 2. Public expenditure per beneficiary in seven policy areas, Sweden, 1992 – 2012. Public expenditure expressed as share of one part per million of GDP per beneficiary. For tertiary education, the average cost for a full time, fully performing student in a technical track is presented. For ALMP programs, average cost per participant and year is presented. Costs and participants for programs for disabled individuals are omitted. For unemployment benefits, average cost per unemployed and year is presented. The indicator includes public expenditures related to unemployment insurance and ‘activity support’.

Sources: Arbetsförmedlingen (2000–2012; 2014), Swedish National Agency for Education (2014), Swedish Association of University Teachers (2012).

or reject a suitable job offer have been increased stepwise since the mid-1990s (Knotz, 2016).

Second, the *Jobbskatteavdrag*, a general, non-means-tested earned income tax credit (EITC) first introduced in 2007, and expanded four times since, has substantially lowered income taxes for workers across the wage distribution⁶. In 2011, the average income tax rate for a single person at 67 % of average earnings with no child was 15 percent; that is 6.5 percentage points lower than in 2006 (OECD, 2014). While these tax reforms have increased disposable income for all working people, and arguably increased employment and extended the tax base⁷, they are “far from self-financed” in terms of their net effects on revenue and spending (Erickson et

6 Additional (though smaller) tax reductions come from the abolishment of the inheritance tax (2005), the wealth tax (2007), and the state-level real-estate tax (2008) (see Svallfors, 2016).

7 Simulations have estimated that the EITC has increased the number of working hours by between 1.5 and 2.5 percent (e.g. Ericson et al., 2009). Yet, these estimations could not be confirmed in an empirical evaluation by the Institute for Labour Market Policy Evaluation (IFAU) (Edmark et al., 2012). Also, public awareness of the EITC is poor, which implies that the theorized incentives might not live up to their full potential (Flood et al., 2013).

al., 2009: 1). As a result, resources available for public expenditure have significantly decreased. For 2014, the size of the EITC was 2.4 percent of GDP (SEK 95B; € 10.7B) (Regeringen, 2012; 2013). As an illustration, this amount is roughly equivalent to 3.5 times the budget devoted to ALMP programs (Regeringen, 2013).

The third development concerns minimum wages. In Sweden, these are not regulated by law, but subject to sector-specific negotiations between employers and trade unions. Settlements on minimum wages are found in the numerous collective agreements, which in total cover approximately 90 percent of the Swedish workforce⁸. Data for seven of the largest collective agreements signed by unions that make up about 74 percent of the total membership of the Swedish Confederation of Trade Unions (LO) indicate that, in each settlement, gross real minimum wages have grown faster than the real median disposable income over the past two decades. These data, compiled by Skedinger (2010) and completed by the authors, show a 2.3 percent

8 Whereas workers who are not covered by a collective agreement are typically not entitled to occupational pensions and other benefits, their wages tend to match collectively agreed levels.

annual growth rate of gross real minimum wages, averaged over the agreements for 1995 – 2011⁹. The corresponding figure for the real median disposable income is 1.5 percent (Statistics Sweden, 2016). What this implies is a reduction in the share of annual full-time work needed to yield a disposable income that exceeds the poverty line. For these seven sectors, our calculations show an average drop from 98 to 76 percent full-time work between 2000 and 2011¹⁰. In short; the wage developments, together with the aforementioned tax policy changes, have been ‘making work pay’.

To sum up this section, it has been shown that despite a largely unchanged scope of total social policy expenditure, Sweden has seen a clear recasting of its social and labor market policy portfolio. Policies to promote high labor force participation, such as childcare and elderly care services, employment assistance programs, benefit sanctions, and the EITC have been expanded, whereas the investment content of the policy portfolio has been diluted and the social protection systems for the working-age population have been dismantled. This can best be described as a movement away from the Nordic social investment approach that characterized Sweden in the post-war era, towards a Third Way approach to social investment. This shift, in turn, is important to keep in mind as we now turn to explore how employment, household work intensity and poverty in Sweden have developed in recent years.

3.2. Trends in employment and poverty in Sweden: Is there a trade-off?

Bearing in mind the policy changes described above, we now turn to explore trends in employment, household work intensity and poverty in Sweden between 2004 and 2014 (the full set of years for which comparable data are available). As a point

9 The reference ‘standardized’ worker is at least 20 years of age, has no work experience and works in an unskilled occupation in a non-metropolitan area. This worker is expected to earn the lowest minimum wage for an adult worker in each agreement (Skedinger, 2010).

10 We refer to the poverty line at 60 percent of the median equivalized disposable income (Statistics Sweden, 2016). Net wages are gross wages multiplied by $(1-t)$, where t is the sum of average income tax rate and average rate of employee’s social security contribution for a single person at 67% of average earnings with no child. Tax data come from OECD (2014).

of reference, we use the average for EU-27 from 2005 on. By comparing how the trends differ between groups and depending on where the poverty line is drawn, we come to suggest that the increase in poverty can be better accounted for by recent redistributive policy (taxes and transfers) changes than by the presence of an inherent trade-off between raising employment and decreasing poverty.

Poverty has many faces, and any attempt to define and measure it involves making difficult choices that necessarily involve value judgments (see Decancq et al. (2014) for an informed discussion on the available options). For the sake of comparability, we follow most poverty analyses for the EU by choosing *household income* as the metric of wellbeing, and by defining the poverty line in *floating, relative* and *national* terms (Decancq et al., 2014)¹¹. Unless otherwise noted, we apply the EU headline ‘at-risk-of-poverty’ indicator, which takes 60% of the median equivalized disposable household income as the poverty threshold.

Figure 3 compares the at-risk-of-poverty rate in Sweden to the average of EU-27; for the total population and for those 65 or older, and at the 50 and 60 percent of median income thresholds. The lower levels shown for Sweden at the beginning of the period are consistent with the stylized fact that the Swedish social investment oriented welfare state historically has performed better than the average EU Member State. However, the considerable 34 (47) percent increase in poverty at the 60 (50) percent threshold in Sweden between 2004 and 2014 calls for an explanation (we return specifically to the case of those 65 or older below).

Considering that statistics from Eurostat (2016b) indicate that the employment rate in Sweden (as well as the EU-27 average) has increased by 2.5 percentage points over the period, the data seem at first glance to support the notion that an ‘employment vs. poverty’ trade-off is in play. As mentioned above, this could occur either if the employment increase primarily takes place at wages that are below the poverty line or the previous out-of-work income packages, or if new jobs primarily

11 As noted by Decancq et al. (2014: 72), this approach differs from the American approach of setting a *fixed, absolute*, and *pan-U.S.* poverty line.

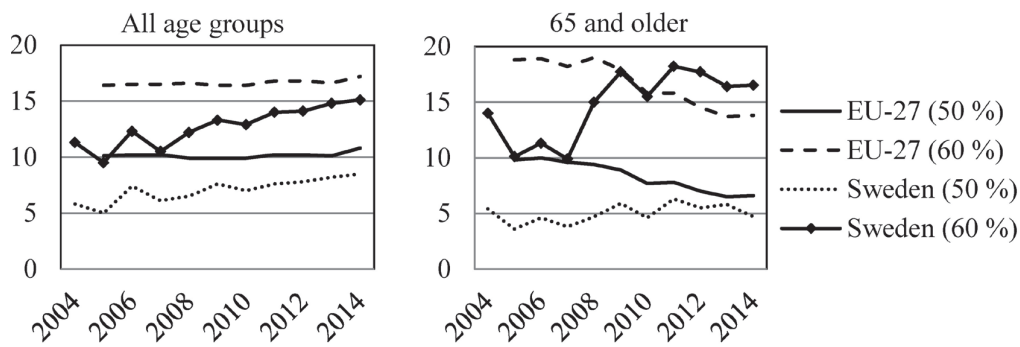


Figure 3. At-risk-of-poverty rate by age and threshold in Sweden and EU-27, 2004 – 2014. Percentage of population, by age. At-risk-of-poverty rate after social transfers. Thresholds: 50 and 60 percent of median disposable equivalized income. Source: Eurostat (2016a).

benefit households which are already comparably ‘work-rich’, thus boosting the median income, while the number of ‘work-poor’ households as well as the income of those households remains stable (Cantillon, 2011; de Beer, 2007). However, the fact shown above, that the amount of minimum wage work required to reach out of poverty has decreased markedly since the turn of the century, suggests that no low-wage strategy seems to be in play that could account for this development.

intensities¹². The differences are particularly striking at the lower end of the distribution: In 2014, the probability of living in a household with low or very low work intensity was twice as high in the EU-27 as in Sweden for this age group. Moreover, while the data for the EU-27 confirm Cantillon’s (2011) finding about the overall lack of reduction in the number of work-poor households, Sweden stands out by seeing a sizeable 26 percent *reduction* in the share of households with very low work intensity, down

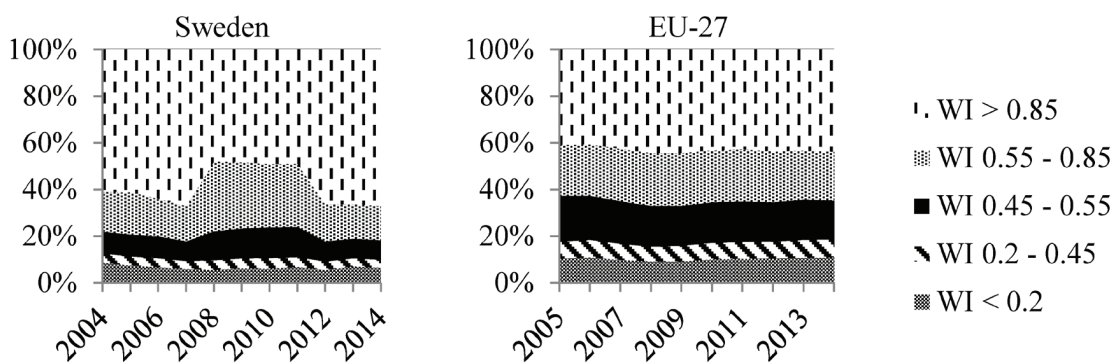


Figure 4. Distribution of population by work intensity of the household, 2004 – 2014. Refers to the population in the ages 0–59. For details regarding the calculation of work intensity (WI), see fn. 13. Source: Eurostat (2016a).

But what about the distribution of employment among work-rich and work-poor households? In congruence with expectations from the social investment approach, Figure 4 demonstrates that Sweden has a lower share of people in the ages 0–59 living in households with *very low* (<0.2), *low* (0.2–0.45), or *medium* (0.45–0.55) work intensity than the EU-27, and a higher share at the higher work

from 8.5 percent in 2004 to 6.3 percent in 2014. Lack

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12 Eurostat (2014) defines the work intensity of a household as “the ratio of the total number of months that all working-age household members have worked during the income reference year and the total number of months the same household members theoretically could have worked in the same period”.

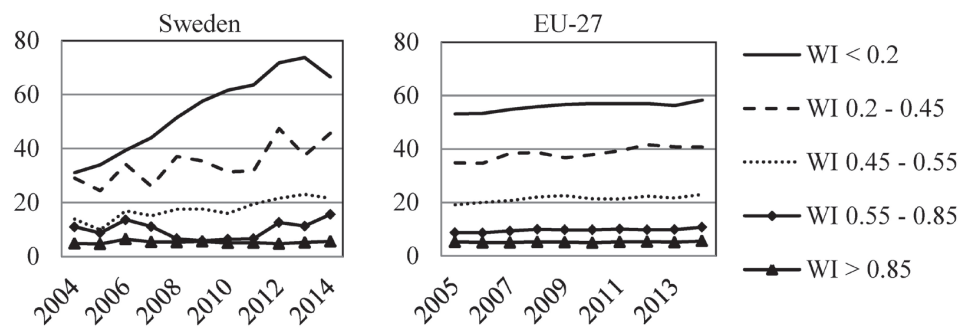


Figure 5. At-risk-of-poverty rate by work intensity of the household, 2004 – 2014. Refers to the population in the ages 0-59. For details regarding the calculation of work intensity (WI), see fn. 13. At-risk-of-poverty is at the 60 percent threshold. Source: Eurostat (2016a).

of data on flows prevents us from knowing if these households moved further up in the work intensity distribution than to the next level and how many of their members simply grew older than 59 and left the studied population; but there is little from our results to indicate that employment expansion in Sweden has primarily benefitted work-rich households. Indeed, according to estimates by Gabos et al. (forthcoming) for roughly the same period, the reduction of jobless households in Sweden has had a slight negative effect on the poverty rate. This suggests that the explanation of the increased poverty rate needs to be sought elsewhere.

Before continuing that search, let us turn to Figure 5, which disaggregates the at-risk-of-poverty rate by the level of work intensity of the household, for an illustration of the importance of high and evenly distributed employment for the prevention of poverty in Sweden. Considering the lower overall at-risk-of-poverty rate in Sweden as compared to the EU-27 reported in Figure 3 above, it is rather paradoxical to find that when decomposed by level of work intensity of the household, the at-risk-of-poverty rate in the population aged 0 to 59 years has now grown *higher* in Sweden than in EU-27 at four of the five levels of household work intensity reported by Eurostat (2016a) (only at WI 0.45–0.55 the poverty rate is still marginally lower in Sweden). One way to interpret the results in Figure 5, when paired with those for work intensity in Figure 4, is that the lower overall at-risk-of-poverty rate in Sweden, when compared to the EU-27, is at least partly due to Sweden's success in promoting employment at decent wages and in achieving a comparably even distribution of work across

households. Rather than there being a lower risk of poverty at any given level of work intensity, it seems to be the fact that a larger share of the Swedish population resides in households with higher levels of work intensity, which accounts for the lower overall at-risk-of-poverty rate in Sweden¹³.

Figure 5 also hints at what we suggest is one of the key explanations for the increase of poverty in Sweden during the period; namely the reductions in the level of protection provided by the unemployment insurance, sickness insurance and social assistance system, as discussed in section 3.1. The lower the work intensity of a household, the larger the share of the household's disposable income that comes from the social insurance systems tends to be, and the larger relative impact the reduction in benefit generosity should have on the at-risk-of-poverty¹⁴. And indeed, while the at-risk-of-poverty rate for Swedish households with a very low work intensity more than doubled between 2004 and 2014, from 31 to 66.5 percentage points,

13 A naïve calculation illustrates that if Sweden in 2014 would simply change its distribution of households across the work intensity intervals to that of the EU-27 (Figure 4), but retain the at-risk-of-poverty rate specific to each work intensity interval (Figure 5), the overall at-risk-of-poverty rate would be 49 percent higher for this age group (up from 13.4 to 19.9 percent).

14 For instance, the aforementioned reduction in the social assistance scale rate from 60 to less than 50 percent of the median wage implies that long-term recipients of social assistance are much more likely to show up as poor in the income data. This probably explains part of the recent increase in poverty at the 50 percent threshold shown in Figure 3 (Fritzell et al., 2013).

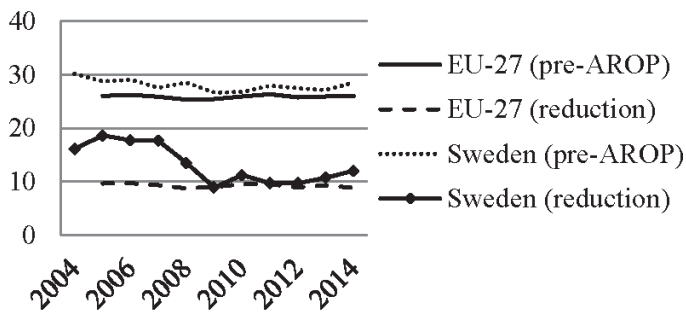


Figure 6. Pre-transfer at-risk-of-poverty rates, 2004 – 2014. Pre-AROP refers to at-risk-of-poverty rate (at 60%) before social transfers (excl. pensions). Reduction is pre-AROP less post-AROP (as shown in Figure 3). Source: Eurostat (2016a)

it has grown by no more than 17 percent, or 0.8 percentage points, for the households with very high work intensity (which in 2014 comprised 66 percent of the population aged 0–59). As shown in the right panel, for the EU-27 the relative increase in poverty has been much more evenly distributed across levels of work intensity (ranging from 10 to 20 percent).

Figure 6 above lends additional support to this interpretation. It plots the at-risk-of-poverty rate *before social transfers*, as well as the percentage point *difference* between the at-risk-of-poverty rates before and after social transfers (Eurostat, 2016a). Although the indicator of at-risk-of-poverty before transfers should be interpreted with caution, Figure 6 provides a basic indication that the increasing post-transfer poverty rates in Sweden reflect a decrease in the poverty-reducing capacity of the social transfers, rather than an increase in pre-transfer poverty rates, which would have been expected by those who believe in a trade-off between employment and poverty. Indeed, the before-transfer at-risk-of-poverty rate actually saw a slight decline over the period, which might be related to the fact that minimum wages have grown faster than median disposable income.

The second mechanism that we argue is particularly important for understanding the increased overall at-risk-of-poverty rate in Sweden is the introduction of the EITC (*Jobbskatteavdrag*) in 2007. This mechanism can be demonstrated by returning to the comparison of the at-risk-of-poverty rates at the 50 and 60 percent thresholds for people aged 65 or over, found in Figure 3 above. The comparison shows that the at-risk-of-poverty rate at the 60

percent threshold saw a remarkable increase after 2007, whereas the rate at the 50 percent threshold has been considerably more stable. This is puzzling, considering that the employment rate for people aged 65 or over has gradually increased (Eurostat, 2016b) and that no major changes have been made to the pension system during the period. Our conjecture is that this development largely reflects the fact that the nominal median disposable income grew by 7 percent in 2007 as compared to around on average 3 percent annually the decade before. This increase, in turn, was driven to a large extent by the introduction and stepwise expansion of the EITC, which by its design in the Swedish case increases income for all persons with earnings, including the median worker, but does not apply to income from pensions (or other social transfers). These changes have mechanically pushed a large group of retirees below the 60 % at-risk-of-poverty threshold, while the at-risk-of-poverty rate at the 50 % threshold has been considerably more stable over the period.

To sum up, the evidence put forward in this section, though certainly only correlational and with few alternative explanations discussed, is consistent with the following interpretation of the recent Swedish development. During the period studied here, Sweden has seen a modest increase in employment and a notable increase in poverty. However, the increases in employment have disproportionately occurred in households with lower degrees of work intensity, which is at odds with de Beer's (2007) and Cantillon's (2011) concern that social investments primarily benefit work-rich households. Moreover, minimum wages have grown faster than median wages, so the 'employment vs. equality' trade-off that

is arguably in play in post-Hartz Germany does not seem as applicable here. Instead, considering that the cut-backs in the social insurance system have primarily affected those with a high proportion of non-market income, and that the EITC only applies (but broadly so) to market income, these reforms appear as more plausible explanations for the increase in poverty. Granted that social protection retrenchments and in-work benefits are distinctive to the Third Way approach to social investment, it is not the social investment agenda *per se*, but the *shift* from the Nordic approach to the Third Way approach which seems apt to account for the rise in poverty.

4. A Europe-wide outlook

This subsection reports results from analyses of data for 24 European countries, to provide some preliminary evidence that the argument above, about social investments, employment, and poverty, extends outside Sweden. Consider first the three panels in Figure 7, which plots relationships between indicators averaged over the observed period for each of the 24 countries that go into our analyses¹⁵. From left to right, these graphs show (1) that a strong positive correlation ($r = 0.74$) exists between *Social investment expenditure* as share of GDP (Eurostat, 2016c; classified as in Meeusen and Nys, 2012) and the *Employment rate* in ages 15-64 (Eurostat 2016b), and that both (2) *Social investment expenditure* and (3) *Employment rate* are negatively correlated with the overall *At-risk-of-poverty rate* at the 60 percent threshold (Eurostat, 2016a) ($r = -0.56$ and -0.58). While these findings are merely correlational, they are consistent with Hemerijck's (2012a: 288) encompassing study, in which he concludes "that social investments are not successful merely in terms of stimulating employment participation, but also can actively keep social inequality at bay".

The critical accounts reviewed above do not question these cross-country relationships as much as the favorable relationships between social investments, employment and poverty within countries over time. Exploring such relationships requires econometric

analysis of panel data. The 24 country panels available here are short and unbalanced, which makes it difficult to estimate unbiased coefficients. Recent methodological advice on panels like these suggests applying a dynamic model with country-fixed effects and a lagged dependent variable (FE-LDV) and then using Kiviet's (1995) 'LSDVc' procedure to correct the biased coefficients from the FE-LDV model (Flannery and Hankins, 2013). Table 1 reports the results from three such LSDVc estimations, in which the dependent variable is the *At-risk-of-poverty rate* at the 60 percent threshold (Eurostat, 2016a). Each model has a control for the share of *Elderly* (aged 65 or above) in the population and *Real GDP growth* (Armingeon et al., 2015).

The results from Model 1 suggest, in line with the critical accounts, that there is, on average, a positive and significant within-country association between *Employment rate* and the *At-risk-of-poverty rate*. This result holds in Model 2, which includes two indicators on the *Replacement rate of unemployment insurance benefits* for a production worker with a dependent family (Scruggs et al., 2014) and *Social investment expenditure* as a share of GDP (Eurostat, 2016c).

However, the results from the full specification in Model 3 indicate rather – in line with our argument – that the effect of employment on poverty varies across countries depending on the wage structure of that country. This feature is modelled by means of including an interaction term between *Employment rate* and a measure of the *Centralization of wage bargaining (CWB)* (Visser, 2015), which, although a crude proxy for wage compression, is known to be negatively related to market income inequality¹⁶. The interaction coefficient is negative, and according to estimations plotted in Figure 8, the model suggests that the relationship between *Employment rate* and *At-risk-of-poverty* is positive and significant only in the context of *low Centralization of wage bargaining* (a CWB score of 2 or less; which is typically observed in the United Kingdom and in Central and Eastern Europe). When centralization is higher, which is the case for most of Europe, the association cannot be

15 The following 170 country-years are included: 2001–2011: NO; 2003–2011: AT, DK, IR; 2003–2010: BE; 2004–2011: FI, IT, PT, ES, SE; 2004–2010: EE, FR; 2004–2008: EL; 2005–2011: DE, NL; 2005–2010: CZ, HU, LT, LV, PL, SK, UK; 2006–2010: BG; 2007–2010: RO.

16 Based on 117 available observations from 18 OECD countries between 1967 and 2010, there is a -0.31 ($p = 0.007$) correlation between the Gini index on market income before taxes and transfers (Armingeon et al., 2015) and the CWB indicator (Visser, 2015).

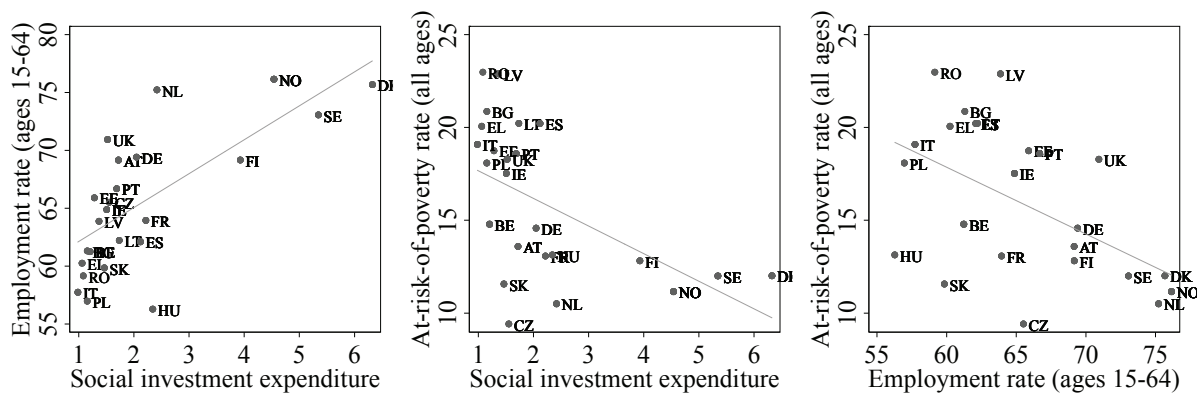


Figure 7. Cross-country correlations between social investment, employment, and poverty. Indicators averaged for various years; see fn. 16. Sources: Eurostat (2016a; 2016b; 2016c).

distinguished from zero. These findings are in line with our arguments above. Also consistent with our argument, both Models 2 and 3 report negative and significant coefficients for *Replacement rate of unemployment insurance benefits* and non-positive (but insignificant) coefficients for *Social investment expenditure*. However, these kinds of investment expenditures are likely to have effects primarily in the longer run (cf. Lindh and Palme, 2006, for an analysis and discussion of the long-term effects of education expenditures on economic growth).

5. Discussion

With regard to the ongoing discussion about the implications of social investments for employment

and poverty, the results presented in this paper highlight a number of important phenomena. By comparing countries and examining the Swedish development over time, it illustrates the relevance of distinguishing between different social investment approaches. The simultaneous examination of the development of the Swedish policy paradigm and the relationship between employment and poverty, pinpoints the importance of the wage formation system. The role of the wage formation process has not been adequately recognized in social investment literature, but we have tried to take steps in the direction to remedy this omission. Here we could observe that wage coordination also appears important in the wider European context. The analysis furthermore illustrated the importance of

	Model 1	Model 2	Model 3
Lagged dependent variable	0.47*** (0.09)	0.42*** (0.09)	0.41*** (0.09)
Employment rate	0.16*** (0.05)	0.14*** (0.05)	0.32*** (0.10)
Elderly population	0.42* (0.25)	0.40 (0.28)	0.39 (0.27)
Real GDP growth	-0.02 (0.02)	-0.03 (0.02)	-0.03 (0.02)
Replacement rate of UI benefits		-5.81*** (2.24)	-5.53** (2.17)
Social investment expenditure		-0.23 (0.48)	-0.05 (0.46)
Centralization of wage bargaining			6.17** (2.80)
Employment rate × CWB			-0.09** (0.04)
Observations (N = 24 countries)	147	147	147
Country-fixed effects	Yes	Yes	Yes

Table 1. Dynamic panel-data models of at-risk-of-poverty rates in Europe, ca. 2005 – 2011. Bruno's (2005) LSDVc estimator is applied. Bias correction initialized by Arellano and Bond estimator. Bootstrapped standard errors in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Bruno's (2005) estimator do not support clustered standard errors, but comparing clustered and non-clustered FE-LDV models, we find that clustering does not matter for the inferences.

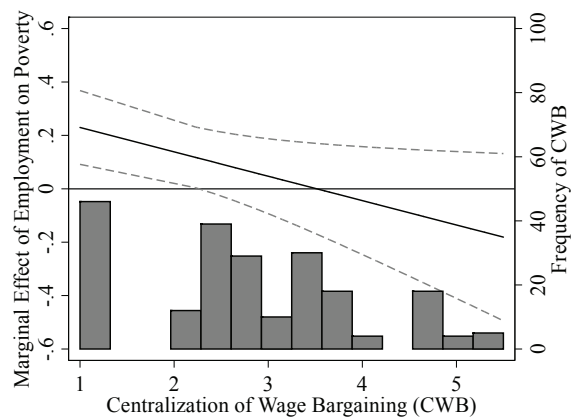


Figure 8. Interaction plot based on Model 3.
Dashed lines mark a 95 % confidence interval.

social insurance for reducing poverty. Behind a largely unchanged scope of total social policy expenditure, Sweden has seen a clear recasting of its policy paradigm. While supply side policies to promote labor force participation have been expanded, the investment content of the policy portfolio has been diluted and the social protection systems for the working-age population have been retrenched. We see this as a move away from the Nordic approach towards a Third Way approach to social investment. Still, a larger proportion of Swedes live in households with high employment intensity, which accounts for the lower overall poverty rate in Sweden. The dilution of social investment expenditures, in particular ALMP, might erode this formula. The policy shift is not reserved to social investment programs but can also be observed for the transfer programs. Increasing poverty rates in Sweden reflect a decrease in the poverty-reducing capacity of the social transfers, rather than an increase in pre-transfer poverty rates, which would have been expected by those who believe in a trade-off between employment and poverty. On the contrary, the before-transfer at-risk-of-poverty rate has actually slightly declined.

Our findings shed new light on a contested empirical issue concerning the social investment approach, at least with respect to the case of Sweden: the alleged trade-off between spending on social protection and social promotion, and the economic sustainability of the social investment state. The way that the EITC was introduced in Sweden in 2007 serves as an illustration. We observed that the EITC has been far from self-financed and that it is difficult to assess

with precision the importance of its expansion for increasing employment, preventing in-work poverty, and bolstering aggregate demand in Sweden. Yet it is in any event evident that the fiscal conditions of the Swedish public finances over the past ten years – marked by a severe financial crisis – did allow for planned tax revenue cuts amounting to 3.5 times the size of the national budget for ALMP. This, we suggest, indicates that the steps recently taken, away from the Nordic path of social investment towards the Third Way, are not singlehandedly a result of economic necessity or any inescapable trade-off between poverty reduction today and investments for tomorrow, but also a matter of political choice.

In an EU context, the scope for political choice is obviously more limited in countries in southern Europe, and Ireland for that matter, which have been experiencing a sovereign debt crisis in the wake of the global financial crisis. Coming years will tell how the scope of political choice in Sweden is affected by real or posed economic pressures resulting from the record high influx of migrants during 2014 and 2015. The ongoing debate features a wide array of policy proposals targeting the newly arrived migrants, ranging from lower entry-level wages and more restrictive access to social security benefits, to tax credits for certain service sector jobs, expansions of ALMP measures to promote language training and subsidized employment, and larger state grants to municipalities to meet increased demand for schools and housing. To judge from the results in this paper, it appears that this debate illustrates that Sweden is again at an important crossroads for its ‘strategy of equality’.

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