Towards a new model of welfare mix?
Discussion about the reform of legal conditions for private providers within the Swedish welfare state

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Summary

In Sweden, welfare services for which the state is responsible are increasingly being supplied by private providers rather than by state institutions, and these private companies often generate above-average profits and returns on investment. This has sparked political and public debate on the role of these providers within the welfare state. The present expertise looks back on this debate and examines the reform proposals which, as a result, have been presented in a comprehensive report prepared by an independent expert commission of the Swedish government (SOU 2016:78). The following points need to be emphasized on the subject of this reform debate:

- The New Public Management reforms of the 1990s, which allowed a massive entry of private providers into the social services systems of many European welfare states, continue to be the subject of intense discussion among experts. However, the debate on the legal conditions under which private providers operate within the welfare state has never taken place as intensely at the political, institutional and social level of any EU Member States as is currently the case in Sweden.

- The objective of the reform proposals suggested by the expert commission is to ensure that the public funds invested in welfare state activities are used for their intended purposes. The proposals are also meant to encourage diversity among the providers operating within the welfare state system and foster the financial stability of both new and existing providers.

- The reform proposals include, inter alia, limiting the operating result of companies in publicly-funded welfare sectors and facilitating market entry for new providers as a means of encouraging diversity among service providers.

- According to the legal appraisal of the expert commission, there are no breaches of EU law.

- Despite official opinion polls indicating majority approval for limiting corporate profits in publicly-funded welfare sectors, the reform proposals are unlikely to be introduced in the current legislative period (2014-2018). The Swedish parliament is expected to vote on them in early 2018. Assuming that, as expected, the measures would be rejected in parliament, however the reforms are likely to play an important role in the 2018 national election campaign.
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1 Introduction

By international standards, Sweden’s policies regarding social and health care services have traditionally been considered very effective and demand-oriented, so that they are often cited as models for the development and design of social policies in other European countries (cf., for instance, Sustainable Governance Indicators, Pierre/Jochem/Jahn 2016). Sweden’s approaches, discourses and practices regarding welfare state services are therefore of great interest to specialists everywhere. At the same time, those have evolved and changed over the last decades. As a shining example of Sweden’s social democratic welfare state system, social services in Sweden have traditionally been provided by state institutions. Since the decade of the 2000s, however, there has been a strong trend towards marketization of social services and thus a massive entry of private companies and investors in welfare sectors. The tendering procedures for social services in the Swedish welfare state are currently among the most flexible in Europe (Schön 2016).

In recent years, therefore, private enterprises have gained in importance within the Swedish welfare state. Two developments have triggered the debate on their role and legal conditions: on the one hand the large and rapidly growing market share of private providers in publicly-funded welfare sectors, and on the other the above-average return on investment that these providers have been achieving over the last few years. At the same time, there is no systematic evidence in the literature regarding the impact of this marketization trend on either the cost or the quality of the services (Petersen/Hjelmar 2014; SOU 2016). Against this background, the current government has commissioned the Swedish Government Reports Office (Statens offentliga utredningar, SOU) to conduct a systematic examination of the role and market position of private providers in welfare sectors and to present a reform proposal for the new legal conditions under which private providers of welfare state services operate.

A commission of experts was appointed to this effect, and in 2016 it published the report “Order and Savings in Welfare” (Ordning och reda i välfärden SOU 2016:78) as well as its continuation “Quality in Welfare – better contracting and control” (Kvalitet i välfärden – bättre upphandling och uppföljning SOU 2017:38). The present short expertise is based on the report of the expert commission (SOU 2016:78); it looks at the development of the Swedish welfare state in terms of provider landscape, at the reasons behind the current debate and at the most important goals of the reform proposals made by the expert commission.

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1 “Social democratic” is one of the three welfare state types postulated by Esping-Andersen (1990). The other two types are “liberal” and “conservative”. The three types differ in terms of degree of demand orientation and market orientation of welfare systems, as well as degree of state involvement in the provision and financing of welfare state services.

2 In the present paper, the terms “welfare sectors” and “welfare state services” refer to publicly-funded social and health services as well as education.
2 Why a debate about the role and legal conditions of private providers in the Swedish welfare state?

2.1 Background of the debate – the evolution of private service provision within the Swedish welfare state

At present, private companies play a central role in the provision of social services within the Swedish welfare state. The proportion of profit-oriented companies within welfare services providers operating in Swedish welfare state sectors is larger than in any of the other Scandinavian welfare states (Sivesind 2017; SOU 2016). The literature shows a clear trend towards marketization in the Swedish welfare state that began in the 1990s and continued exponentially in the decade after the year 2000.

The marketization of social services in Sweden was made possible by a Swedish law on local administration structures that was passed in 1991. This law shifted administrative responsibility for care from Sweden’s 21 provinces (Län) to the country’s 290 municipalities and gave them the legal basis needed to outsource – marketize – the provision of certain social services (Brennan et al., 2012). The first municipalities to do so argued that this would give users a broader range of services, and that the new organization forms would promote innovation in the welfare sector. In particular, they argued that outsourcing social services would save costs and improve quality. This argument was not based on empirical foundations, however, but rather on the ideological orientation of the political parties in office at the time (cf. Suzuki 2002; Green-Perdersen 2002; Sivesind 2017).

Another important building block on the way to the current level of private enterprise within the Swedish welfare state was the introduction of the Freedom of Choice Act (LOV 2008:962) in 2008. According to this law, institutions that meet certain minimum standards should be granted access to public funding if they are selected by users who are legally entitled to the services being provided. However, municipalities are not obligated to apply the Freedom of Choice Act. At the moment, the Freedom of Choice Act applies in half of Swedish municipalities, most often in those where population density is highest (Svallfors/Tyllström 2017).

This legislative development has allowed private enterprise to become an integral part of the Swedish welfare state. At the moment, private companies provide about a fifth of publicly-funded welfare services in Sweden. The ratio of private-sector employees to the totality of employees in all welfare sectors has increased steadily since 2000 (see Figure 2). By contrast, non-profit organizations provide only a marginal share – approximately three per cent – of all welfare state services.
The marketization of welfare state services in favour of private companies has been particularly conspicuous in the area of social services. The ratio of employees in private companies to the total workforce across the entire range of social services doubled between 2007 and 2013 (cf. Table 1). This large increase in the market share of profit-oriented companies implies a sharp decline in numbers of public providers. The share of employees working for public providers of social services fell by just under 10 per cent during this period, from 82.1 to 72.3 per cent. Although the proportion of employees working for not-for-profit providers\(^3\) has not experienced such a drastic decline, it has remained marginal.

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\(^3\) The terms *non-profit* and *not-for-profit* refer to the same type of organizations. The term *not-for-profit* is a more accurate one: these organizations are allowed to generate profits, but profit maximization may not be their primary goal. Any profits are reinvested for organizational purposes and not distributed.
Table 1: Number of employees per welfare sector in Sweden (2007 - 2013)

<table>
<thead>
<tr>
<th>Sector</th>
<th>2007 Number of employees</th>
<th>Share in %</th>
<th>2013 Number of employees</th>
<th>Share in %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>Non-profit</td>
<td>22,284</td>
<td>4.9</td>
<td>24,660</td>
</tr>
<tr>
<td></td>
<td>For-profit</td>
<td>42,754</td>
<td>9.5</td>
<td>68,175</td>
</tr>
<tr>
<td></td>
<td>Public sector</td>
<td>385,757</td>
<td>85.6</td>
<td>388,547</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>450,795</td>
<td>100.0</td>
<td>481,382</td>
</tr>
<tr>
<td>Health</td>
<td>Non-profit</td>
<td>3,768</td>
<td>7.2</td>
<td>2,485</td>
</tr>
<tr>
<td></td>
<td>For-profit</td>
<td>46,168</td>
<td>14.8</td>
<td>56,456</td>
</tr>
<tr>
<td></td>
<td>Public sector</td>
<td>262,770</td>
<td>84.0</td>
<td>242,411</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>312,706</td>
<td>100.0</td>
<td>301,352</td>
</tr>
<tr>
<td>Social services</td>
<td>Non-profit</td>
<td>12,173</td>
<td>3.1</td>
<td>12,006</td>
</tr>
<tr>
<td></td>
<td>For-profit</td>
<td>58,691</td>
<td>14.8</td>
<td>111,788</td>
</tr>
<tr>
<td></td>
<td>Public sector</td>
<td>324,985</td>
<td>82.1</td>
<td>323,884</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>395,849</td>
<td>100.0</td>
<td>447,678</td>
</tr>
</tbody>
</table>


The observation that the trend towards marketization of welfare state services applies above all to the provision of social services is clearly observable in the care sector. From 2003 to 2010, the share of Swedish local authorities who outsourced their care services for the elderly increased from less than 5 per cent to more than 50 per cent (Rada 2014). Based on the example of elderly care, Figure 2 shows how public expenditure for not-for-profit providers has remained relatively stable while spending on profit-oriented providers has more than doubled. Two different periods can be observed: spending growth on for-profit providers remained moderate until 2007, but between 2008, when the Freedom of Choice Act (LOV 2008:962) was adopted, and 2014, it was very rapid – roughly 111 per cent.
2.2 Three concrete triggers to the debate from the perspective of the expert commission

In the context of the already significant and growing relevance of private providers operating within the Swedish welfare state, the expert commission’s report (SOU 2016) highlights the following three reasons why a debate about their legal conditions is needed.

1. Current obstacles to foster provider diversity in the field of social services

The expert commission sees the growing weight of private enterprise in publicly-funded welfare sectors as a risk of excessive concentration of private social services providers in the municipalities. As shown in section 2.1, the market share of private-commercial providers in publicly-funded welfare sectors is growing in comparison to the share of not-for-profit and public providers. In addition, individual companies in publicly-funded welfare sectors have been enjoying a significant increase of their market share, a trend that could create oligopolistic structures, especially in large cities or in regions with high population densities (Sivesind et al., 2017).

Paradoxically, one of the objectives of marketization for many municipalities was their desire to provide a broad and differentiated range of social services. The reforms introduced by the centre-right minority governments in the last two legislative periods between 2006 and 2014, including the adoption of the Freedom of Choice Act, aimed at reducing the predominance of the public sector in the provision of welfare state services by creating quasi-markets. The idea was that in these quasi-markets, i.e. markets designed and controlled by the public sector, users would be able to select social service providers according to their preferences. The aim of the reforms was to trigger a dynamic process in which poor-quality institutions would leave the market and good providers would remain. One consequence of this process, how-
ever, has been that many of the institutions that have remained in the market belong to a small number of corporate conglomerates, so that ultimately the diversity of the provider landscape is impaired. And because of information asymmetries, quasi-markets do not necessarily mean that offers are tailored to the interests and preferences of users (Sivesind et al., 2017).

Due to the smaller number of providers of social services, and because those that remain belong to a reduced number of investor and corporate groups, the expert commission believes that the concept of diversity among providers of social services and the breadth of services available to users are at risk.

2. Above-average profitability for providers of welfare service within the services sector: an issue of legitimacy

The second reason why this debate is relevant is the high return on investment. Companies operating in publicly-funded welfare sectors are significantly more profitable than many other companies operating in other areas of the services sector. The expert commission examined the economic situation of these companies over the past decade and published the following findings for 2014:

- Although the average operating profit margin for private enterprises operating in publicly-funded welfare sectors, at 5 per cent, is not unusually high in relation to Sweden’s services sector on the whole, their average return on total assets is 13.4 per cent, thus six percentage points higher than for the entire services sector (7.4 per cent). This means that capital invested in companies that operate in publicly-funded welfare sectors of the Swedish welfare state is particularly profitable. It also means that private providers of publicly-funded welfare sectors achieve high excess profits: in other words, they generate profits that are higher than their capital costs, i.e. interest expenses (borrowing costs) and dividends (cost of equity).

- At 27.3 per cent, the average return on equity of private providers of social services is also significantly higher than ROE figures for the overall services sector (14.3 per cent). This indicator suggests that equity investors, for instance shareholders or partners that invest capital in private providers operating in publicly-funded welfare sectors, achieve above-average returns on their investment in the services sector.

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4 Return on investment (ROI) is the ratio of pre-tax profit to total capital invested. As there are different types of capital, the term encompasses different types of ROI.

5 The operating profit margin is the ratio between the operating result – i.e. the difference between the value of the services provided (revenues) and their costs in any given period – and revenue.

6 Return on total assets (ROTA) is a ratio of pre-tax profit to total capital invested in a company (equity and debt capital). It indicates how profitably the capital invested in a company works.

7 Return on equity (ROE) is the ratio of pre-tax profit to total equity invested in a business. It roughly indicates how profitably the capital invested in a company works for the equity investors (the shareholders or partners).
- Companies operating in publicly-funded welfare sectors have a particularly high net working capital.\(^8\) Between 2005 and 2013, mean net working capital was 47 per cent. A high net working capital indicates a high financing surplus.

There is, however, a high degree of variance in all these indicators. While there are companies in welfare sectors that generate moderate profits and moderate returns on capital, others have extremely high profits and return on capital. From the point of view of the expert commission, this presents a legitimacy problem for private companies that are financed by public funds.

Not only are the above-average economic situation and profitability figures of private providers operating in publicly-funded welfare sectors viewed critically by the centre-left spectrum of the Swedish political landscape, but opinion polls conducted by the University of Gothenburg also show that they are viewed just as critically by a large majority of Swedish society: in 2013, about 69 per cent of Swedes were in favour of banning dividend distribution in welfare sectors, while only about 15 per cent disagreed with such a ban (cf. Figure 3). More opinion polls were published on this topic in 2016; this time, 80 per cent of the population supported limiting distributable dividends in welfare sectors, and 27 per cent went as far as to favour a total ban (Svallfors/Tyllström 2017).

**Figure 3: Public opinion on the statement “Dividends should be prohibited in publicly-funded education, health or care services” (2012-2015)**

![Graph showing public opinion on dividends](source: Svallfors/Tyllström (2017).

3. **Lack of systematic evidence on the efficiency and quality of the services**

A common argument for using private companies to provide social services is that this increases the efficiency and quality of the services. As mentioned above, in many Swedish municipalities this was a common argument in favour of the marketization of social services that took place in the early 1990s. However, the expert commission – much like the compre-—

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\(^8\) _Net working capital_ is a business indicator that represents the difference between current assets and short-term liabilities.
hensive analyses published in specialist literature (cf., for instance, Petersen/Hjelmar 2014) – points to the lack of systematic evidence regarding the efficiency or quality of outsourced social services. This is due, on the one hand, to the complexity of defining and measuring quality in the context of social services and, on the other, to the information asymmetries that exist between providers and users.

The expert commission even stresses the danger that private providers tend to cut back on staff and that many private providers’ business models are geared towards users who generate fewer costs. This is underpinned by empirical investigations conducted by the expert commission. These investigations show a lower staff ratio of some private providers as well as the segregating effects of some providers, because the socio-economic background of users differs depending on provider type.
3 Key components and objectives of the reforms being discussed in Sweden

The top priority of the reforms proposed by the expert commission is that any public funds invested in welfare state activities must be used for their intended purposes. The intended reforms consist of the following six measures:

3.1.1 Introducing compulsory licensing for entities financed through public funds

Private enterprises and non-profit organizations wishing to finance their operations through public funds should be subject to a licensing procedure. The first condition for private or non-profit organizations to qualify for licensing is that the services that they provide must be welfare state services. In addition, these organizations must also prove that the public funding they receive will be spent specifically on the provision of the intended welfare state services. This would allow investments by cross-sector conglomerates in publicly-funded welfare sectors to be monitored. However, this measure would not be retroactive: it would have no impact on existing procurement contracts between public authorities and providers of welfare state services.

3.1.2 Limiting returns in publicly-funded welfare sectors

The expert commission has proposed a limitation of the operating result of companies in publicly-funded welfare sectors. The operating result is the difference between the value of the services provided (revenue or turnover) and the expenditure required to provide them in any given period. It is calculated prior to tax deductions or appropriations of funds (the latter could be, for instance, corporate allocations to subsidiaries in order to distribute the enterprise’s tax burden). The operating result is also calculated before capital costs, i.e. before interest expenses (borrowing costs) and dividends (cost of equity). This means that the operating result is a true indicator of the results of a company’s business operations and that it is not affected by the type or source of the company’s financing.

An alternative to limiting operating results would be to put a cap on dividends, i.e. limiting the portion of the profits (operating result after tax deductions) being distributed to the shareholders or partners of a company. As profits are either reinvested, distributed and/or used to cover interest expenses, limiting dividends would not discourage companies in publicly-funded sectors from seeking and achieving high profits. Such enterprises would still have incentives to earn high profits from their operations so that they could then invest these profits in their own company or in subsidiaries. Companies would also be free to take out large loans and cover their interest expenditure (borrowing costs) with their profits. Practices such as these would allow companies to distribute some of their profits in spite of the cap on dividends. As a result, limiting the operating result would therefore ensure that public funds are indeed spent on the provision of welfare state services, i.e. on the company’s primary business activity.
Limiting the operating result should, in the view of the expert commission, be calculated in relation to net working capital, i.e. in relation to the difference between current assets and short-term liabilities (cf. definition in footnote 8). The maximum permissible operating result would be calculated on the basis of the Swedish government bond rate – ranging between 0.35% and 0.6% since 2015 – taken into account as follows:

$$\text{maximum operating result} = (\text{government bond rate}_{5\text{ years}} + 7\%) \text{ net working capital}$$

The proposed cap on operating results is meant to ensure that the bulk of public funds is devoted to welfare state activities while still providing economic incentives for investors in publicly-funded welfare sectors.

3.1.3 Facilitating market entry and promoting financial flexibility

Another problem in connection with marketization in the Swedish welfare state is the lack of economic sustainability of some private providers. Many of these providers have become insolvent in recent years and have had to close. Cases like these, especially in education, have caused quite an uproar in the media. This is one of the reasons for the political importance of the debate on the legal conditions of private providers in the welfare state (Schön 2016).

In view of these circumstances, the reform proposals of the expert commission hope to contribute to the financial flexibility and stability of private providers. In concrete terms, companies should be allowed to offset the losses of up to three previous financial years in the annual financial statements of a financial year. This measure would also encourage new entrants into the quasi-markets of welfare state services and help new businesses overcome any accumulated losses.

3.1.4 Devising measures to prevent the circumvention of the reform proposals

With the aim of stopping providers from circumventing the reform proposals, the expert commission has proposed a ban on flows of funds to other companies above and beyond the maximum permissible operating result (see chapter 3.1.2).

However, this is often circumvented in actual practice, for instance when above-average wages are paid to employees or to close associates of the company or when premises are rented from close associates or associated companies at extremely high prices.
3.1.5 Ensuring that welfare state services are provided by distinct legal entities

If one and the same legal entity provides welfare state services while also carrying out other business activities, this increases the danger that public funds that have been allocated for welfare services might be used for other business activities. To ensure that providers are suitably licensed (cf. 3.1.1) and to simplify compliance procedures, the proposals would prohibit welfare state services from being provided by a legal entity that also carries out other business activities. However, carrying out different welfare state activities within the same legal entity would be legal.

The expert commission also proposes that only legal entities be licensed to provide welfare state services. This would exclude the provision of welfare state services by natural persons (for example in adult education).

3.1.6 Appointing competent authorities to monitor and determine any sanctions

The above measures would be managed and carried out by the national school inspectorate (Skolinspektionen) and by the national supervisory authority for health, nursing and care services (Inspektionen för vård och omsorg, IVO). Under the proposed reforms, the competence of the two national supervisory authorities would include the following tasks: ensuring that a company is suitably licensed (cf. 3.1.1), auditing the annual accounts – after their certification by chartered accountants – in order to ensure that the maximum permissible operating result has not been exceeded (cf. 3.1.2) and monitoring possible flows of funds to subsidiaries within corporate groups. Part of the resulting transaction costs for the Swedish supervisory authorities would be charged in the form of fees.

The penalties for non-compliance with the reform proposals would range from fines to the withdrawal of a provider’s licence to apply for public funding.
4 Are reforms of this type EU-compliant?

In general, EU law gives EU Member States leeway in the organization of health, social and cultural services. According to Article 14 of the Treaty on the Functioning of the European Union (TFEU) as well as to Protocol 26 of this Treaty on services of general interest, EU Member States have a

“wide discretion (...) in providing, commissioning and organising services of general economic interest as closely as possible to the needs of the users”.

The EU Commission defines services of general interest as “services that public authorities of the Member States at national, regional or local level classify as being of general interest and, therefore, subject to specific public service obligations”. The term covers both economic activities and non-economic services (EU-COM 2013: 21). Services in the social or health sector, i.e. social services of general interest (SSGI), can be considered to be services of general economic interest (SGEI). SGEIs in sectors that are harmonized across the Union (for instance telecommunications, postal services and energy) are subject to EU law on competition policy, procurement procedures and state aid. Nevertheless, contract awards for welfare state services under the reform proposals being discussed – i.e. the marketization of these services – would not lead to discrimination or preferential treatment of particular companies. All forms of businesses could apply for public funding (see 3.1.1), including foreign companies. Limiting returns in publicly-funded welfare sectors (see 3.1.2) would not be based on distinctions in the form or origin of the companies. Nor would there be any distortion of competition due to discrimination or preferential treatment.

Applying EU law to national regulations in the field of education is easier. The European Commission views welfare state services in the field of education as “non-economic activities”; the Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01) states as follows (EU-COM 2016: 7):

“Public education organised within the national educational system funded and supervised by the State may be considered as a non-economic activity.”

For a non-economic activity, Article 2 of Protocol 26 to the TFEU applies as follows:

“The provisions of the Treaties do not affect in any way the competence of Member States to provide, commission and organise non-economic services of general interest.”

The reform proposals for the education sector would therefore be compliant with EU law.

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9 Article 77 of Directive 2014/24/EU on public procurement even allows not-for-profit providers in the social and health sectors to be commissioned without competition for a period of up to three years.
5 Outlook

Introducing the reform proposals presented in the report of the expert commission (SOU 2016) could be a pioneering step that would establish a model for many European welfare states. It would create a new type of mixed welfare economics, i.e. welfare pluralism, but also a system in which the earlier freedoms available for large, for-profit companies would be more strictly regulated. Such a policy would be in contrast to the legislative tendencies of the past two decades in EU Member States and EU institutions. Many challenges for Scandinavian welfare states that have developed in recent years became clear in the context of the discussion on the reforms proposed by the expert commission.

An analysis of these deficits in the Swedish welfare state can be made from two different perspectives. First, taxpayers want public funds to be used for their intended purposes – and this concerns the current organizational model of the Swedish welfare state and Swedish public procurement law, which is considered to be one of the most flexible in Europe and allows the distribution of high corporate profits. The proposed reform limiting operating results in publicly-funded welfare sectors could counteract this development. Secondly, from the point of view of the users, it would be good for the range of welfare services being provided to reflect increasing social heterogeneity. The proposed reforms would help prevent the formation of business groups holding large market shares – which would in turn ensure a more diverse range of services. However, limiting operating results could lead to the exact opposite of the desired effect. Suppliers would remain profit-driven in their efforts to reinvest their profits, thereby seeking to capture new market shares from other providers. Instead of competition for market shares among for-profit providers, a heterogeneous, need-based organizational landscape requires the development of socially oriented providers, and these are usually organizations that operate on a non-profit basis.

The political debate on legal conditions for private providers is relatively young. It was triggered by the Swedish Left Party during the 2010 Swedish national election campaign. At the moment, the social-democratic and left-wing/green parties that make up the minority Swedish government agree on the introduction of the reforms. However, they are expected to be rejected by parliament in early 2018. Given the results of official opinion polls indicating majority approval for limiting corporate profits in publicly-funded welfare sectors, the reforms could thus play an important role in the 2018 national election campaign.
6 References


