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# The Rehn-Meidner model and its role in the Swedish economic policy

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**ABSTRACT**

This paper aims to describe the Swedish Rehn-Meidner model, the cause of its creation, its features and the reasons for changes in the Swedish economic policy over several decades. The model was developed by two Swedish economists in 1951 and it impacted the economic policy over the following decades. It was intended to facilitate achieving the goals of full employment, price stability, economic growth and equality in a redistribution of income through the policies of solidarity wage, restrictive economy, active labour market and marginal employment. The model was designed as a solution to the "overheating" of the Swedish economy in the 1950s. The implementation of the model initially proved to be successful. However, in the 1970s the economic policy began to be more influenced by trade unions, acting mainly in their own interest. Due to the growing globalisation other external factors, such as oil crises and negative demand shocks, started to have an increasing impact on Sweden. It was when economic decisions started to shift away from the recommendations of the model, and the "golden age" of the 1950s and 1960s came to an end.

The following analysis intends to explain what was the model characterisation, how it influenced Sweden's development, and why the country economic policy has changed over time. It also states that despite changes in the economy, certain elements of the model have remained valid until today.

**Key words:** Rehn-Meidner model, Lars Gösta Rehn, Rudolf Meinder, Sweden, ALMP, welfare state

## Introduction

Sweden is often brought up as an example of a country where social welfare is one of the leading goals of its social and economic policy. The "golden age" of the Swedish welfare state began in the 1950s and lasted for about two decades. The Sweden we know today was to a great extent developed during this period. It was a result of the policies implemented by the *Socialdemokraterna* party which ruled for the better part of the century, and of high public support towards the concept of *welfare*. Many Swedish economists, led by Lars Gösta Rehn and Rudolf Meidner, contributed to this significantly.

Although ideas put forward by the economists were not innovative as such, it was their combination that set a new path for economic policy-making. It began to be carried out in the 1940s in anticipation of the looming post-war crisis. As it did not happen, the implemented solutions proved to be inadequate and ineffective for the development of the state. Thus, a decision was made to implement the model suggested by the above-mentioned economists, Rehn and Meidner – solidarity wage policy, strict economic policy and active labour market policy programmes, and subsidies for marginal employment. The goal was to achieve full employment, reduction of wage gaps, and expansion of the *welfare state* system. This meant that all residents were to be covered by benefits, such as comprehensive social security systems.

While the 1950s and 1960s are referred to as Sweden's "golden age", later times brought new challenges to the economy. During the 1970s, global problems, such as the oil crises and increasing international competition, reached the country. At the same time, the importance of trade unions continued to grow. The unions were primarily concerned with their own interests and thus put strong pressure on the economic policy. The government began to shift away from the recommendations of the Rehn-Meidner model more and more; yet many of its elements have still been taken into account in making decisions that would shape the economy of modern Sweden. This can be seen even in the 21$^{st}$ century.

**Sweden's post-war economic policy**

After the end of the World War II, the Swedish Social Democrats planned for a stabilisation policy, while looking ahead towards the inevitable crisis. Swedes expected reforms leading to an improvement in the standard of living of the people. Prime Minister Per Albin Hansson began spreading the idea of *folkhemmet* – the state is a common home, therefore everyone is equally responsible for it – which has become central to modern Sweden. *Folkhemmet* comes down to a sense of community and equality. It lies at the heart of the Swedish *welfare state*, it's justifying tax burdens, reliefs and benefits. While it took time for the idea to take root in the Swedish mentality, changes in the Swedish domestic policy since the 1930s have been influenced by it. The government began to build a system of social welfare based on universal health care, education, and social benefits. A nationalisation of basic branches of industry and financial institutions was advocated, investments were centrally planned, and the government was given a leading role in the transformation of the domestic industry. Most importantly, however, the state was made responsible for achieving and maintaining the goal of full employment [Meidner 1993, p. 212].

Like many other Western countries, Sweden shaped their economic policy programme according to the Keynesian theory, making full employment a priority. An expansionary fiscal policy was pursued. In 1947 the social democratic government abolished general sales taxes completely and implemented a monetary policy by setting low-interest rates as part of the stabilisation policy [Erixon 2010, pp. 686-687]. The ideas of Keynes and the Stockholm School, members of which included Nobel laureates Gunnar Myrdal and Bertil Ohlin, strongly influenced the post-World War II Swedish economic policy. They emphasised the need for implementation of the expansionary fiscal policy at a time of mass unemployment and argued for a countercyclical economic policy preventing cycle-induced fluctuations in GDP. The post-war programme was similar to, for example, the Beveridge Plan in Britain, recommending investment planning and regulation of the capital and product markets. This also meant some degree of nationalisation in order to maintain high levels of employment. The Beveridge Plan aimed at countering inflationary tendencies through price controls, domestic wage restrictions, and other regulations, rather than through restrictive economic policies contradicting full employment [Erixon 2011, p. 87]. Thus, the Social Democrats in Sweden began to build a welfare society inside a capitalist system by transferring to the state the responsibility for the redistribution of income and wealth. The trade unions had a large influence on the government's decisions because of their size and importance. The vast majority of the workforce were members of these unions. They were fighting for more labour rights, higher wages, and at some point, they started to expect more influence over company matters. Any policies were therefore negotiated with the unions at central, regional, and local-company levels [Czech 2013, p. 120].

In the 1950s. Sweden was still following the economic policy based on the Keynesian theory. The country's fiscal policy was countercyclical, as was its monetary policy in the second half of the decade [Erixon 2011, p. 89]. Various regulations were put in place to mitigate the inflationary effects and current account deficit tendencies. They were aimed at reducing a willingness to invest as well as at moderating prices and wage increases in over-active branches of the industry. The ideas that were effective in other Western countries, did not work out in Sweden though. A crisis similar to the one after World War I was being anticipated since the 1940s, but the rapid recovery of Europe resulted in an increasing demand for various raw materials and semi-finished products exported by Sweden. The expected crisis did not happen at all.

Increased exports, combined with high levels of domestic investments and suppressed demand for durable consumer goods and real estate, led to the "overheating" of the Swedish economy [Erixon 2010, pp. 679, 686-687]. The labour shortage caused an increase in wages that exceeded productivity growth, and thus, led to cost-push inflation. Various income policy measures were put in place, including a wage freeze in 1949–1950, but to no avail. These experiences showed that full employment and stability of prices were conflicting goals, and the government had to change its path. [Meidner 1993, p. 213]. The Swedish Trade Union Confederation (*Landsorganisationeni Sverige*, literally "National Organisation in Sweden") hired a group of economists to find the best way of moving forward. Two of them, Lars Gösta Rehn and Rudolf Meidner, came up with their new model of economic policy and wage policy in 1951. Rehn was responsible for the analysis of the stabilisation policy and Meidner was in charge of the wage policy. [Erixon, Wadensjö 2012, p. 75]. The report offered a detailed and structured plan on the conduct of the economic policy. Known in economics as the Rehn-Meidner model, it replaced the Keynesian-based policy and became the economic foundation of Sweden for the following decades, until the mid-1970s.

**Principles of the Rehn-Meidner model**

The Rehn-Meidner model was supposed to help overcome inflation and maintain low unemployment rates by achieving full employment, price stability, economic growth and equality in income redistribution. This was to be achieved through the solidarity wage policy, restrictive economic policy, active labour market policy and subsidies for marginal employment (short-term and low-wage), i.e. measures very different from the previously implemented ones [Czech 2008, p. 255]. Rehn and Meidner believed that their suggested model, focused on reducing aggregate demand, intensifying price competition, reducing profit margins, and increasing the efficiency of labour markets, was superior to the Keynesian approach to inflation operating in an economy approaching full employment, associated with expansionary macroeconomic policies and a primarily demand-stimulating fiscal policy [Erixon 2010, pp. 678-680]. The Keynesian programme of full employment created in 1944 did not work out. The expansionary policy led to high absence and turnover of workers, and full employment was dependent on inflation.

The new model marked a path that would ensure an increase in economic growth, purchasing power, employment, and income equality. Although the individual elements of the model were nothing new, combining them was a novel approach towards the conduct of the state economic policy. Even though the government was initially reluctant to accept it in full – even the finance minister at the time was openly against it – the plan was gradually implemented in its entirety.

According to the authors of this model, the income policy was unable to prevent inflation if full employment was achieved through the expansionary macroeconomic policy. Controlling prices and investments, collective wage restrictions and fiscal measures aimed at cooling overheated sectors were, according to Rehn and Meidner, not only ineffective in controlling inflation but also detrimental to structural changes, overall productivity growth and income redistribution [Erixon 2013, p. 76]. Instead, the solidarity wage policy should be adopted – striving for equal pay for equal work, regardless of the profitability of companies. The authors defined similar work positions in terms of objective criteria, such as required qualifications and working conditions. The solidarity wage policy, although it required coordination, would increase wages in the least profitable companies and industries. To survive, they would have to change their way of operating, for instance by deciding to introduce productivity-enhancing measures; if changes were to be ineffective, resources would be freed up for the use and development of other companies and industries. To avoid the emergence of structural unemployment (created by the discrepancy between labour demand and supply) the solidarity wage policy and the active labour market policy were to be combined. This would result in transferring the labour force to more dynamic and productive companies and industries [Erixon 2013, p. 81].

## Functioning of the model

The key part of the Rehn-Meidner model was for Sweden to maintain the active labour market policy as an instrument to ensure both full employment and a decline in profits under a restrictive macroeconomic policy environment. According to the authors, this decrease was not only intended to counter inflation; its task was also to increase a share of the labour force in the gross domestic product in a medium period and to cause economic growth by putting rationalisation pressures on enterprises [Erixon 2011, pp. 94-95]. The active labour market policy (ALMP) was formerly an element of the American New Deal programme in the 1930s; it comes down to a government intervention in order to help find jobs for the unemployed. In Sweden, this policy became an integral part of the state's economic policy in the 1950s, when various ALMP programmes were being initiated regularly. Moreover, the Rehn-Meidner model used high unemployment benefits as a way to encourage workers to risk changing jobs. The full employment policy and regulations on job security were also expected to encourage labour mobility. The ALMP programmes were essential to prevent not only the structural unemployment caused by strict macroeconomic policies but also that resulting from the solidarity wage policies. The Rehn-Meidner model aimed to avoid unemployment through selective incentives to induce labour demand and training and other programmes that would temporarily withdraw people from the labour market. A strengthening of the labour force, both individually and collectively, was to result in higher wages, but more importantly in a wage rigidity, not subject to arbitrary reductions by employers [Erixon 2016, pp. 7-9]. Even before the publication of the Phillips curve in 1960, the model pointed to a link between inflation and unemployment; an increase in the labour force, such as gained through induced low unemployment, would result in a higher nominal wage growth [Erixon 2011, p. 103].

Another important element of the model was the solidarity wage policy. It is based on the assumption that wage earners doing similar work must receive the same pay, regardless of the profitability of companies and industries employing them. This was intended to put pressure on companies and industries with relatively low-profit margins and productivity rates. They were to be faced with a choice between trying to increase their productivity or going out of business, thus freeing resources for the development of more dynamic companies and industries. Wage solidarity was to lead not only to equality and structural changes but also to price stability, by limiting the raising of actual wages above the agreed levels (e.g., by paying bonuses or paid overtime). A restrictive macroeconomic policy was necessary to ensure efficiency at the same time [Erixon 2011, pp. 95-96]. The wage equalisation policy was criticised for hindering the labour force mobility by not offering differences in wages that would serve as incentives for employees to change jobs. The equalisation of the wage structure and the disappearing of unprofitable firms, as argued, would allow the freed workforce to move to more profitable companies or be assisted by ALMP [Meidner 1993, pp. 216-217]. The ALMP programmes, combined with generous social assistance programmes, minimised the loss of income due to being laid off; even though the individual's employment was not itself secured, their position in the labour market was [Czech 2016, p. 110].

In the early years of the model existence, Rehn and Meidner leaned toward its so-called "weak" version – income equalisation was not necessary for economic progress but was consistent with the pursuit of economic growth and preferable in terms of macroeconomic stability. They viewed their programme as an alternative to the strategy of growth based on large wage gaps and high profits, at the same time they were not questioning whether wage differences could promote structural change. Rehn and Meidner saw the solidarity wage policy, although still in combination with mobility-oriented ALMP, as a preferred alternative to the

Marshall mechanism. It assumed a movement of the labour force from stagnant to growing sectors and from low-paying to high-paying occupations stimulated by differences in wages. They did not challenge the theory that growth could be stimulated by high profits, but they argued that a profit-based growth path had undesirable effects on inflation and income distribution. It could be difficult to sustain, especially with political restrictions on maintaining full employment. It was not until the 1960s and 1970s that a refined, "strong" version of the model was developed; the economic and wage policies leading to margin declines and labour income equalisation would stimulate both productivity and structural changes [Erixon 2016, pp. 8-9]. Yet it was the 1950s and 1960s that are now referred to as the "golden age" of the Swedish social democracy; this period was characterised by full employment, an expansion of the welfare state that included various benefits, such as comprehensive social insurance systems covering all the population, and reduction in wage gaps.

**End of the "golden age" of the Swedish welfare state**

The 1970s brought difficulties coming not only from outside Sweden but also caused by internal problems. This is considered to be the end of the "golden age." The country suffered from the oil crises and negative demand shocks. At the same time, the international market for iron ore and steel products, exports of which were an important part of the economy, became more competitive. The state's economic policy changed through globalisation, and the Rehn-Meidner model began to be deviated from more and more. The model assumed a need to restore Sweden's competitive position by constantly increasing productivity and closing unprofitable businesses, thus freeing up workforce and capital for the use of other enterprises; simultaneously, due to the trade union demands, it became increasingly difficult to reduce employment costs and maintain profitability. The state was supposed to encourage new job-creating investments and match the means of production with specific tasks. But in time, many industries, such as mining and shipyards, began to receive financial support [Czech 2016, pp. 113-114]. The growing role of the state and its control over the economy started to influence the functioning of the mechanism of the competitive market. At the same time, oil crises caused stagflation, which Rehn and Meidner did not take into consideration; the international recessions increased the role of the labour market policy and changed its priorities. The emergence of large structural public deficits in the late 1970s, a phenomenon new to Sweden at the time, was the main explanation why bridging policies were not implemented in Sweden after the oil crises [Erixon 2010, p. 690]. After the first one striking, the Social Democrats abandoned the restrictive fiscal policy. As the situation began to change in the 1970s both in Sweden and globally, some of the concepts of the model did not fit the new reality anymore.

There was also contestation and disputes over the redistribution of income and wealth in Sweden, exaggerated demands of the unions, and sometimes disregard for economic rights [Czech 2013, p. 121]. Meidner himself believed that neither the unions should be blamed for their aggressive response nor market forces for acting accordingly when operating in a tight labour market with excessive profits and high liquidity. Although the government was responsible for ensuring economic stability and fighting inflation, it did not have the courage or strength to play that part; the foundations of the model were challenged by the occurrence of inflation [Meidner 1993, pp. 220-221]. The government's fiscal policy, against the model's recommendations, was overly expansionary. Especially during the economic boom of the second half of the 1960s, restrictions were introduced too late to keep inflation low and to improve the current account [Erixon 2010, p. 683].

Since the mid-1970s, Sweden's economic policy can be seenas a combination of the Keynesian, Rehn-Meidner and "neo-monetarist" model, with frequent ALMP use. [Erixon 2010, p. 704]. The adoption of new macroeconomic policy measures in the 1970s and 1980s was based on the experience of the previous years. The bridging policy of the mid-1970s, recommended by the OECD and leading Swedish economists, was to a large extent a Keynesian reaction to the Rehn-Meidner policy during the recession at the beginning of the decade. A new consensus was reached in the early 1980s stating that the bridging policy was a major contributor to inflation in Sweden and initiated a period of deficits in the public budget and current account. The deviation from the Rehn-Meidner model during this period was made easier by political changes. The Ministry of Finance, having a more positive attitude towards devaluation and with a stronger belief in ability of the collective bargaining system to contain wages than before, gained a stronger influence on the economic policy [Erixon 2010, p. 691].

Even though the model is no longer a sole determinant of the state's policymaking, it has left a mark on the approach towards economic policymaking. The pursuit of full employment and wage equality remains an important part of the labour market in modern times. In the 21st century, the active labour market policy remains the most relevant of the principles proposed by Rehn and Meidner. During the financial crisis of 2008–2011, the ALMP programmes gradually became more important, the government increased the number of positions in upper vocational education and the number of positions in universities and colleges; all this was a result of a drive towards amore educated and specialised workforce. Today, Sweden faces different challenges than 70 years ago. The country's position on the international market has changed and so has its structure of society, which has had an impact on domestic politics. The labour market looks very different today than it did in the 1950s, and it brings many new challenges. Trends in the global economy also result in the state having less and less control over the market.

## Summary

After presenting and analysing the Rehn-Meidner model and its principles, it was confirmed that it had a significant impact on the development of Sweden and shaped its economy. The experience of both economic achievements and failures of the second half of the 20th century has shown what solutions should be introduced in the Swedish economic, political, and social realities. Although the "golden age" of Sweden is long gone, it is still considered to be a highly developed country with a strong economy. As a consequence, the state can provide its people with high standards of living and social security.

The Rehn-Meidner model is no longer a guideline on how the economic policy should be conducted – primarily because of massive changes in Sweden, but also globally. Despite this, some of its features remain relevant. The ALMP programmes are still an extremely important part of the labour market policy, and years of the solidarity wage policy have led to a reduction in social inequality. Undoubtedly, as changes occur in the global economy, also Sweden's current economic policy will be reformed again many times in the future. However, certain elements of the model developed in the 1950s will certainly remain valid. The failures, on the other hand, can be used as a warning against other concepts.

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## Model Rehna-Meidnera i jego rola w polityce gospodarczej Szwecji

### STRESZCZENIE

Celem artykułu jest przedstawienie szwedzkiego modelu polityki gospodarczej i płacowej Rehna-Meidnera, powodów jego powstania, jego cech, a także przyczyn zmian polityki gospodarczej Szwecji po kilkudziesięciu latach. Model ten, stworzony przez dwóch szwedzkich ekonomistów w 1951 r., stanowił podstawę polityki ekonomicznej przez kolejne dekady. Miał on ułatwić osiągnięcie celów pełnego zatrudnienia, stabilności cen, wzrostu gospodarczego i równości w redystrybucji dochodów poprzez politykę – solidarną płacową, restrykcyjną gospodarczą, aktywną na rynku pracy i marginalną w odniesieniu do zatrudnienia. Model został zaprojektowany z myślą o przegrzewającej się gospodarce, będącej problemem Szwecji w latach 50. Jego wdrożenie początkowo okazało się skuteczne, jednakże od lat 70. zaczęto coraz bardziej podporządkowywać politykę gospodarczą celom związków zawodowych, a wraz z postępującą globalizacją, coraz większy wpływ miały na Szwecję czynniki zewnętrzne, takie jak kryzysy naftowe i ujemne wstrząsy popytowe. Zaczęto wtedy odbiegać od zaleceń modelu przy podejmowaniu decyzji gospodarczych, a „złoty wiek" lat 50. i 60., dobiegł końca.

Niniejsza analiza prowadzi do zrozumienia, czym model się charakteryzował, jaki miał wpływ na rozwój Szwecji, oraz dlaczego polityka gospodarcza uległa tam z czasem zmianie. Wykazano także, iż pomimo zmian w gospodarce kraju, elementy modelu wciąż pozostają aktualne.

**Słowa kluczowe:** model Rehna-Meidnera, Gösta Rehn, Rudolf Meinder, Szwecja, ALMP, *welfare state*

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*Marta Sawer, mgr, absolwentka Skandynawistyki i Ekonomii Uniwersytetu Gdańskiego. Naukowo i zawodowo związana z krajami nordyckimi, specjalizuje się w polityce gospodarczej i społecznej, a szczególnie interesuje się zagadnieniem dobrobytu społecznego.*