The Stockholm School in a New Age – Erik Lundberg and the Swedish Model*

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Abstract. The Stockholm-school member Erik Lundberg is the economist who devoted most attention to the economic theory and policy of the Swedish postwar model. The established view is that Lundberg was a steadfast opponent of the so-called Rehn-Meidner model, an economic and wage policy program developed by two Swedish trade-union economists in the early postwar years. The model recommends fiscal policies in the medium term, extensive labor market programs and wage policies of solidarity to simultaneously obtain price stability, full employment, income equality and high growth. This article maintains that Lundberg shared many of the premises of the Rehn-Meidner model already at the beginning of his debate with Gösta Rehn in the early 1950s. Furthermore, in their debate, Lundberg approached Rehn’s policy program and underlying theory of the working of the Swedish economy. Despite his ideological qualms, Lundberg’s ambiguous attitude to the Rehn-Meidner model turned into a complete adoption of the model in the 1960s. By highlighting the innovative nature of the Rehn-Meidner theory, Lundberg also correctly downplayed the impact of the Stockholm School.

Keywords: Swedish model; Rehn-Meidner model; Stockholm School; Economic policy; Wage policy of solidarity; Labor-market policy

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1. Introduction

Swedish economics experienced a golden age in the interwar period while the Swedish model had its golden years after World War II. The ‘Stockholm School of Economics’ encompassed a group of Swedish economists loosely connected by their Wicksellian reference points, sequential analysis of cumulative real processes and belief in the necessity of fiscal or monetary policies to stabilize the economy. The label ‘the Swedish model’ is often used to depict the country’s introduction, especially after World War II, of generous social insurance systems and of universal welfare programs financed by (progressive) taxes. But the concept of the Swedish model is also used, and earmarked in this paper, for a specific economic- and wage-policy program developed in Sweden in the early postwar years by two trade-union economists, the so-called Rehn-Meidner model. At the time, Gösta Rehn (1913-1996) and Rudolf Meidner (1914-2005) were both employed by the LO, the Swedish Confederation of Trade Unions (organizing blue-collar workers).\footnote{In the 1950s, Rehn primarily served as an expert on Swedish public committees. In 1959-1962, he headed the economic division of the Swedish Department of Finance. In 1962-1974, Rehn directed the Manpower and Social Affairs Committee of the OECD. Meidner was the head of the LO research department from 1945 until 1966.} The established literature on the Stockholm School of Economics does not count Rehn and Meidner as members, or at least not as core members, of the school (Jonung, 1991).

The relation between the Stockholm School and the Rehn-Meidner model is analyzed in Erixon (2011) and Trautwein (2011). The modelling, evaluation and partial adoption of the Rehn-Meidner ideas by Bent Hansen, a third-generation representative of the Stockholm School, are examined in Erixon (2013). However, by his central position after World War II as an evaluator of Swedish economic policy and by his close affiliation to the founders of the Swedish model, Erik Lundberg (1907-1987) was the economist who paid the most attention to the model’s theory and policy. Lundberg belonged to the second generation of Stockholm-School economists. His doctoral dissertation on the business cycle from 1937 was generally seen, \textit{inter alia} by Paul Samuelson and Joseph Schumpeter, as a pioneering contribution to dynamic analysis (Samuelson, 1939, p. 78; Schumpeter, 1954, pp. 1173-1174; Henriksson, 1996, pp. 141-148).
In the early 1950s, Lundberg was involved in a vivid debate with Rehn about the validity and desirability of the Rehn-Meidner model. Rehn had developed the model’s stabilization policy and underlying theory.² By his economic education, general skill and contacts with prominent Stockholm-School economists, Rehn was a well-equipped discussant of macroeconomic issues. The Lundberg-Rehn controversy in the first half of the 1950s was seen in immediate retrospect, especially by political scientists, as a highlight in the debate on Swedish economic policy (Lewin, 1967, p. 371). There is probably no reason to revise this assessment in light of the debates in later decades.

The overall aim of this article is to assess the heritage of the Stockholm School by a close look at Lundberg’s review of and attitude to the Rehn-Meidner model. Lundberg’s painstaking analysis of the model is of interest per se. But it can also shed light on the links between the Stockholm School and the Swedish postwar model. The political and also theoretical heterogeneity in some respects of the Stockholm School makes it difficult to draw general conclusions about these links. Yet, Lundberg’s comments to the Rehn-Meidner model allow some tentative conclusions about the impact of the Stockholm School and the uniqueness of the model’s theory and policy.

Lundberg’s view of the Rehn-Meidner model has been surveyed by other scholars (see, inter alia, Ullenhag, 1971, Öhman, 1974 and Lindbeck, 1975). The surveys make a reasonable distinction between Lundberg’s economic and ideological objections. Furthermore, the inference by scholars that Rehn won the battle over Lundberg in the medium term but Lundberg won it in the long term is sensible (see Nycander, 2005, p. 147). The Rehn-Meidner model was largely applied in Sweden from the late 1950s to the early 1970s. There have been clear departures from the model’s economic and wage policy since then. What is more, when the golden days of the Rehn-Meidner model were over, leading Swedish economists including Lundberg made the model partly responsible for the decline in profits’ share of GDP and the negative profitability trend in the Swedish business sector from the 1950s to the 1980s; a squeeze of profit margins is an essential element of the model (Lundberg, 1985, p. 26, 29-30 and 1996b [1981], p. 56; Lindbeck, 1997, pp. 1291-1292). Moreover, Lundberg’s concern already in the 1950s about a strong state run by selfish and short-sighted politicians was shared from

² Rehn was also responsible for putting the theoretical and political pieces of the Rehn-Meidner model together. Meidner contributed to the model by his work on wage policies, labor mobility and disorganization problems in an overheated economy (Meidner, 2003, p. 218).
the 1970s by other influential Swedish economists and also confirmed by new hegemonic thinking in economics.

Despite the merits of earlier analyses of Lundberg’s relation to the Swedish model, there are some gaps in the pertinent literature. Previous works conceal Lundberg’s ambiguous attitude to the Rehn-Meidner model culminating with his surrender to the model during its heydays. The conclusion by scholars that Lundberg was the tireless main opponent of the model rests on an unqualified and too static view of Lundberg’s position. This article contributes to the literature on the Stockholm School and the Swedish model by emphasizing Lundberg’s ambivalence towards the Rehn-Meidner model, his partial assimilation of the model already in the early 1950s and his full adoption of it in the 1960s. The article also elucidates Lundberg’s growing conviction of the model’s uniqueness, thus downplaying, *inter alia*, any direct influence from the Stockholm School.

Chapter 2 provides a brief survey of the Rehn-Meidner model. Chapter 3 recapitulates and evaluates the Lundberg-Rehn controversy in the early 1950s. Lundberg’s adoption of the Rehn-Meidner model and his emphasis on the model’s originality in the 1960s and early 1970s is described in Chapter 4. Chapter 5 summarizes the main conclusions of the article.

### 2. The Rehn-Meidner model

The main economic-policy challenge in Sweden in the first postwar years was to combine full employment with low inflation. Monetary policies prioritizing permanently low interest rates in combination with expansionary fiscal policies during an unexpectedly strong export recovery led to low unemployment but also, especially during the Korean War, to high inflation. Swedish governments tried to combat inflation or current-account deficits by lingering war regulations, investment and export fees, profit freezes, exchange-rate policies, price controls and by appeals to central trade unions for wage restraint. In the postwar period, Sweden was governed by the Social Democrats until 1976 although in coalition with *Bondeförbundet* (the Agrarian Party) 1951-1957.

In the late 1940s, Rehn and Meidner wrote articles in social democratic and trade-union journals underscoring the difficulties in fighting inflation when full employment is
attained by high aggregate demand. In particular, wage moderation by central trade
unions cannot prevent wage drift, that is, nominal-wage increases for scarce labor
exceeding the rates of central agreements. In due course, wage drift because of high
aggregate demand will elicit wage-wage(-price) spirals. Pay rises for wage earners
favored by high labor demand will provoke other wage-earners (within or outside the
wage-drifting sector) to demand similar wage increases. Furthermore, wage earners try
to compensate themselves for demand-induced increases in consumer prices. Prices may
then rise again through markup pricing or supply constraints in the economy (Meidner,
1952 [1948], pp. 18-20; Rehn, 1952a [1948], pp. 38-43). Rehn and Meidner also
thought that firms are suffering in an inflationary economy from disorganization
symptoms and excessive labor turnover having a negative effect on their productivity
performance (Meidner 1952 [1948], pp. 22-23; Rehn, 1952a [1948], pp. 35-36).

Rehn and Meidner’s alternative economic policy worked out in the late 1940s was
presented in a report to the 1951 LO Congress. The two LO-economists argued for a
restrictive fiscal policy in the medium term primarily through indirect taxes. They were
not opponents of counter-cyclical fiscal and monetary policies. But they favored a
medium-term strategy to avoid capricious stop-go actions. Expansionary fiscal
measures should be reserved for a deep recession (LO, 1953 [1951], pp. 84, 90-93).\(^3\)

A larger public share of total saving (see the restrictive fiscal policy in the medium
term) is an intermediate goal in the Rehn-Meidner model to satisfy industrial-policy
ambitions and alter wealth distribution. However, the main objective of the tight
macroeconomic policy, in conjunction with the policy of full employment (see below),
is to control wage drift by a reduction of profit margins. Rehn and Meidner assumed
that wage drift is stimulated by higher profit margins and that profit margins, inter alia,
are a positive function of aggregate demand. A rise in profit margins will enhance
firms’ ability to self-finance investment having a positive effect on demand for scarce
labor. Moreover, high profit margins make firms more easy-going in wage negotiations
and also more financially capable of satisfying claims for higher wages. The prime
objective of the profit-margin pressure on firms in general in the Rehn-Meidner model
is to impede wage drift. But Rehn and Meidner emphasized, especially in the 1960s,
that a reduction of profit margins in the business sector would stimulate labor

\(^3\) See also Rehn (1952b [1950], pp. 75-76) and (1953, pp. 285-286, 289).
productivity growth by speeding up structural change and by encouraging labor substitution, rationalization and the introduction of (labor saving) new technologies (Rehn, 1949, p. 466 and 1969, pp. 151-152, 169-170).

A tendency towards ‘islands of unemployment’ will appear in the wake of the restrictive macroeconomic policy. Active labor market policy (ALMP) is the most important mean in the Rehn-Meidner model to sustain low rates of unemployment. Demand-oriented ALMP measures should have a selective character, thus, be directed towards specific regions, wage-earner groups and industries. ALMP programs should also improve the matching process on the labor market and increase occupational and regional mobility by generous subsidies for relocation, vocational training, etc (LO, 1953 [1951], pp. 92-93). Matching- and supply-oriented measures to enhance labor mobility are given precedence over other ALMP means in the Rehn-Meidner model; the ALMP programs are expected not only to sustain full employment but also to contribute to low inflation, structural change and wage equalization for similar jobs.

Wage policy of solidarity is the third pillar of the Rehn-Meidner policy program. Wage-earners with similar work shall receive the same pay irrespective of the profitability of firms and industries. Rehn and Meidner were convinced that the large wage differentials needed to create incentives for labor mobility are difficult to realize and also inflationary by leading to wage-wage(-price) spirals. The Rehn-Meidner model does not exclude wage differentials for dissimilar jobs. But wage gaps must reflect differences in working conditions and work content (LO, 1953 [1951], pp. 25-26, 34-35).

According to Rehn and Meidner, equal pay for equal jobs puts an additional pressure on firms and plants with low productivity. Firms and industries have to become more efficient and innovative to survive. If they fail, their death will free resources for the expansion of firms and industries with higher productivity levels and growth. At the same time, the strengthening of the profit-margin advantage for the most profitable industries and firms through the wage policy of solidarity is supposed to stimulate productivity by encouraging investment embodying new technologies and mergers facilitating the use scale advantages (LO, 1953 [1951], pp. 24-25, 34-35, 96-97). Solidaristic wage policy may also accelerate structural change by widening the profit-margin gap between sectors and between firms (Rehn, 1953, p. 280).
Wage policy of solidarity is presumed in the Rehn-Meidner model to contribute not only to wage equality and productivity growth but also to low inflation. The policy is meant to restrict wage increases in the most productive firms and industries. The creation of a ‘fair’ wage structure is further supposed to mitigate wage-wage races (LO, 1953 [1951], pp. 89-91, 95-96, 99).

The Rehn-Meidner model is based on four policy goals – full employment (defined as 2-3 percent open unemployment), low inflation, income and wealth redistribution and high growth. The three means - ALMP programs, tight macroeconomic policies and wage policies of solidarity – have more than one purpose. Incomes policy, that is, price controls and wage restraint (either compulsory or voluntary as in Sweden) is a subordinate (and criticized) measure in the model. However, to prevent profit margins (and the profit share of GDP) from falling below a critical value for private investment (despite the access to public saving), central trade unions must take responsibility for that wage increases are in line with the pace of productivity growth. The 1951 LO report recommended a constant profit share in the long run after the fall of this share to a lower level in the medium term (LO, 1953 [1951], pp. 93-94, 99).

Interactions between the policy means are important in the Rehn-Meidner model. I will give some examples. Solidarity wage policy will not lead to low inflation and structural change without the economic policy squeezing profit margins in general and the mobility-oriented ALMP programs reallocating labor to dynamic sectors and occupations. ALMP measures are also necessary to prevent profit margins from recovering by endogenous reductions in nominal wages. The assurance of full employment acts as a wage floor in the economy. Furthermore, full employment (and central wage coordination) is necessary to make the trade unions strong enough to implement the wage policy of solidarity.

3. The Lundberg-Rehn controversy

3.1. Lundberg’s economic critique

The article by Rehn in Tiden 1948 was commented by Lundberg in Ekonomisk Tidskrift 1950. Rehn replied to Lundberg in the same journal the same year. All articles and comments were published in English (as Meidner’s article in Tiden 1948) in an anthology 1952 edited by Ralph Turvey. Lundberg wrote an introduction to the Turvey

The Lundberg-Rehn discussion was held in a respectful atmosphere. The participants were conscious of the difference between economic and ideological arguments but also of the difficulty to draw a clear line between these arguments. In retrospect, Lundberg’s critique of Rehn’s economic theory and policy appeared to be modest and nuanced. Lundberg’s sympathetic attitude partly reflected that he shared many of the premises of the Rehn-Meidner model and, further, that he was influenced by Rehn in their controversy (see Section 3.4 below). Without crossing any line of propriety, Rehn had a more offensive and antagonistic strategy in the debate largely reflecting his underdog and outsider position in academic circles.

Lundberg was well acquainted with the ideas of Rehn and Meidner and vice versa. In the 1930s, Lundberg had been a lecturer of courses and leader of seminars at *Stockholms Högskola* (Stockholm University) attended by Rehn and Meidner. Moreover, Meidner was employed by Lundberg at *Konjunkturinstitutet* 1938-1940. Lundberg was also Meidner’s advisor at *Konjunkturinstitutet* 1950-1951 when the latter was on leave from LO to write his PhD thesis. In 1947-1948, Rehn worked at *Konjunkturinstitutet* under Lundberg’s supervision. Lundberg was also an advisor and examiner when Rehn in 1957 became a licentiate of economics, an academic degree below the PhD level.

The Lundberg-Rehn controversy was based on a consensus about some crucial features of the Swedish economy in the early postwar period. To a great extent, Lundberg accepted Rehn’s view of the determination of inflation and wages. Steady increases in

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4 *Konjunkturinstitutet* (The National Institute of Economic Research) is a Swedish public authority making business-cycle forecasts and policy evaluations. Lundberg was the head of *Konjunkturinstitutet* 1937-1955.

5 Lundberg told later that he examined Rehn during a walk under the false impression that they would only have a talk on economic issues. Rehn was a brilliant scholar, but he was suffering from exam anxiety and too engaged in daily political matters to strive for academic excellence. Back in his office, Lundberg approved Rehn’s licentiate degree after having put the latter’s contributions to their debate together with a staple. Rehn never presented a PhD thesis.
productivity after World War II were not associated with price reductions and constant nominal wages in line with the so-called Davidson rule. Instead, periods of productivity increases coincided with increasing prices, profit inflation and investment through forced saving leading to higher employment and, with a delay, to nominal wage increases exceeding the size of the increase in (physical) productivity (Lundberg, 1952a, pp. 3-4, 11-15, 1953, p. 312 and 1957 [1953], pp. 233, 247, 254-255).

However, Lundberg raised some objections to Rehn’s theory of the functioning of the Swedish economy. (I ignore here Lundberg’s emphasis on the practical difficulties in achieving macroeconomic stability with the Rehn-Meidner means.) He underlined that labor-market conditions (the degree of labor scarcity) might be decisive for the pace of wage increases, not the profits of firms (Lundberg, 1952b [1950], p. 60 and 1957 [1953], p. 258). Accordingly, Lundberg suggested, as also Bertil Ohlin had done in the late 1940s, that the policy for full employment should be less ambitious than that in the Rehn-Meidner model (Ohlin (1949, pp. 3-12; Lundberg, 1952b [1950], p. 70 and 1957 [1953], p. 255, 262-263).

Furthermore, Lundberg feared already in the beginning of the 1950s that private investment may be hampered by the Rehn-Meidner reduction of profits (ex ante and ex post) having a negative effect on economic growth (Lundberg, 1952b [1950], p. 67). Nor was Lundberg convinced that a profit-squeezing policy would moderate wage demands or make firms more unwilling to accept higher wage claims (Lundberg, 1952b [1950], pp. 59-60 and 68-69). And price increases due to higher indirect taxes may lead to wage-earner claims for compensation and also reduce the propensity of firms to resist these claims (Lundberg, 1952b [1950], pp. 57-60, 65-66).

Lundberg further maintained that consumption taxes will only hit consumption industries, not export and investment-good industries which generally are leaders of the Swedish business cycle (Lundberg, 1952b [1950], pp. 61-64, 66-67). Export-led wage increases are better prevented by currency appreciation offsetting the tendency to higher profits and labor demand in the exposed sector. And depreciations (or devaluations) may be needed in a slump or to maintain the competitiveness of the exposed sector if the wage pressure (and indirect taxes) of the Rehn-Meidner model becomes a reality.

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6 Both Rehn and Lundberg had resisted the removal of consumption taxes in the overheated Swedish economy of 1946-1947.
(Lundberg, 1952b [1950], pp. 63-64). At the end of the day, incomes policy may be needed to prevent wage inflation in the aftermath of a fall in the exchange rate (Lundberg, 1952b [1950], p. 68).

Lundberg was critical to the one-sided emphasis on fiscal policy in the Rehn-Meidner model. He argued for monetary policy measures to stabilize the economy by both ideological and economic reasons. Stabilization policy relying on variations in tax rates provides large room for mistakes and political considerations. Lundberg (1957 [1953] stressed an embryonic argument in Lundberg (1952a and 1952 [1950]) that politicians are shortsighted and election oriented. For example, it is politically tempting to maintain the tax reductions and public transfers of a recession and to subsidize stagnating industries and public enterprises (Lundberg, 1952b [1950], pp. 69-71 and 1957 [1953], pp. 252 n1, 253-254, 255, 260). In addition, the implementation of fiscal policy is slow, requiring time-consuming discussions in Parliament, while monetary-policy decisions can be made immediately. However, in the debate with Rehn, Lundberg saw monetary policy as a complement, not as an alternative, to fiscal policy, a fact that is often ignored in the literature on their controversy (Lundberg, 1952b [1950], p. 70, 1953, p. 316 and 1957 [1953], p. 255).

In his reply to Rehn in 1950, Lundberg paid no interest to the wage policy of solidarity. However, in the introduction to the Turvey anthology in 1952, Lundberg objected to this wage policy. He expected that the wage share of GDP would be higher in an economy without solidarity wages – high productivity and profits in some industries would lead to high wage claims in a ‘free’ labor market. And firms in these industries are prone to satisfy these wage claims. Besides, many marginal firms cannot afford wages of solidarity (Lundberg, 1952a, pp. 5-7). Lundberg (1952a) also feared that equal wages for equal work would harm labor mobility between industries and between firms (ibid., pp. 7-8).

3.2. The ideological conflict

Lundberg was a liberal but he had no ambition like his Stockholm-School colleague Bertil Ohlin to pursue a political career (Ohlin was the chairman of the Liberal Party 1944-1967). Rehn was a social democrat who, *inter alia* through his close contacts with Gunnar Myrdal, became one of the coordinators of *Arbetarrörelsens efterkrigsråd* (The Postwar Committee of the Labor Movement). In 1944, the committee presented a
radical program for the Swedish labor movement to stabilize the economy, attain full employment and social welfare and make the private business sector more efficient. The so-called Postwar Program encompassed expansionary fiscal policies and the set-up of national cooperation bodies for the coordination of private investments and the modernization of inefficient industries (Erixon, 2011, pp. 98-99).

Lundberg’s main objection to the Rehn-Meidner model in the early 1950s was ideological, not theoretical, empirical or practical (Lundberg, 1952b [1950], pp. 69-70, 1953, p. 314 and 1957 [1953], pp. 252 n1, 263). He envisaged that public saving but also ambitious fiscal and employment-policy measures would lead to detailed state controls, power concentration and to lesser room for market incentives. Lundberg’s argument for monetary policy was largely based on his objections to fiscal policy on ideological grounds. Moreover, when arguing for a lower degree of employment (than that during the 1946-1951 years) Lundberg emphasized the evils of inflation rather the evils of unemployment (Lundberg, 1957 [1953], pp. 262-263).

In his critique of the ideology behind the Rehn-Meidner model, Lundberg was strongly influenced (like Ohlin) by Hayek’s *Road to Serfdom* (1944), see Lundberg (1985, pp. 14-15 and 1996b [1981], pp. 44-45). The Lundberg-Rehn discussion was held in the wake of an intense political debate on central planning before the 1948 election to Swedish Parliament (Lewin, 1967, pp. 373-374). The non-socialist parties, with Ohlin’s Liberal Party (*Folkpartiet*) in the lead, attacked the social democratic government for its planning ambitions. However, Lundberg always made a clear distinction between Rehn’s agenda and what he saw as an inevitable consequence of the latter’s policy program. Rehn’s early opposition to the maintainence of war regulations and his clear rejection of communism already in the 1930s made him a misguided target in the struggle against state planning (Erixon and Wadensjö, 2012, p. 72). In addition, at the time of the 1951 LO report, Rehn had toned down the industrial-policy arguments for a rise in public saving. Besides, he emphasized the disincentive effects of direct taxes already in the late 1940s (!), see Rehn (1952 [1948], p. 50).

3.3. Rehn’s defence

Throughout the debate with Lundberg, Rehn underlined the restriction of full employment in stabilization policy. According to Rehn, it is too easy to escape the inflation-unemployment dilemma by simply redefining the goal of full employment
Rehn (1952b [1950], pp. 72-73). Rehn also argued for high (indirect) taxes in the medium term rather than for flexible tax rates in order to stabilize the economy. He actually shared Lundberg critique of a fiscal policy relying on variations in tax rates. For example, Rehn recommended expansive fiscal policy measures in a deep recession only. Moreover, he did not expect that the fiscal restraint needed to stabilize the economy must imply a dominant position for public saving (Rehn, 1952b [1950], pp. 76-77).

Rehn met Lundberg’s argument that (indirect) taxes were slow and inefficient instruments to stabilize the economy by a counter-argument - monetary policy has similar weaknesses (Rehn, 1952b [1950], pp. 78-79 and 1953, p. 285). Rehn’s counter-argument was especially legitimate for the fixed exchange-rate system of the early postwar period in Sweden (Rehn, 1953, p. 289). Lundberg did not preclude the use of exchange-rate policies or various fiscal measures to affect the trade sector (Lundberg, 1952b [1950], pp. 66-64). But Rehn emphasized the pivotal role of a large public sector for the financing of export stimulus (Rehn, 1952b [1950], pp. 78-79) and also of a significant public saving to avoid current-account deficits (Rehn, 1953, pp. 289-290). Once again, the ideological aspect of the Lundberg-Rehn controversy was brought to the surface.

In his 1950 comment to Lundberg, Rehn also pointed to the role of fair wages as a necessary condition for wage stability (1952b [1950], pp. 74-75). This argument was later developed in LO (1951 [1953]). Moreover, Rehn underlined that the profit-squeeze policy of the Rehn-Meidner model would hit firms and industries in general while preserving a profit difference between firms and between industries and thus the incentives for structural change (Rehn, 1952b [1950], p. 77).

In his review of Lundberg (1957 [1953]), Rehn chiefly criticized Lundberg for having neglected that the ‘Schumpeterian’ dynamic process that the latter put in a favorable light will be obstructed by higher wages for progressive firms reducing or eliminating the temporary profits driving the process. Rehn noted with delight that Lundberg had eventually accepted the idea that (large) wage differentials are inflationary (see next section). However, Rehn maintained that Lundberg still disregarded that the wage policy of solidarity would offer a wage subsidy to dynamic firms and speed up structural change by widening the profit differentials between sectors and between firms.
(Rehn, 1953, pp. 280, 282). Furthermore, in his review, Rehn blamed Lundberg for ignoring that the solidarity wage policy cannot be realized unless profits are reduced in general by the combination of macroeconomic- and employment-policy measures and by monopoly controls (Rehn, 1953, p. 281).

A possible objection to Rehn in terms of his own theory is that the wage favor to dynamic sectors by the solidarity wage policy provides room for wage drift possibly initiating a wage-wage race; high profit margins lead to wage inflation in the Rehn-Meidner model. Besides, Rehn’s criticism of Lundberg for having neglected that the wage policy of solidarity would favor dynamic firms (by making their high profit margins even higher) was not right on target. Lundberg had accepted that solidarity wage policy would reduce wages in profitable firms. Rehn focused on a section in Lundberg (1957 [1953] emphasizing that a Schumpeterian transformation process requires measures to increase labor mobility. However, Lundberg did not argue here for larger wage differentials but for extensive ALMP programs.\(^7\) He was rather worried that the expansion of dynamic firms and industries would be restricted by state interventions to avoid open unemployment, for example, by the financing of public enterprises and subsidization of stagnating sectors. These government projects and measures make it difficult for the dynamic firms to obtain labor and capital (Lundberg, 1957 [1953], pp. 259-261).

Rehn (1953) insisted upon that the Rehn-Meidner model and “the modern line” in employment policy was favorable for dynamic firms and industries (Rehn, 1953, p. 287). Moreover, Rehn was optimistic about the capability of social engineers like himself to persuade politicians to conduct a flexible fiscal policy and to introduce government mandates in order to speed up the fiscal process. After all, extensive ALMPs must be complemented with expansionary fiscal policy measures in a deep recession (Rehn, 1953, pp. 288-289).

\(^7\) It is true that Lundberg argued for wage reductions for ‘low-grade’ labor (Lundberg, 1957 [1953], p. 261). However, wage differentials are compatible with the wage policy of solidarity provided that they can be justified on ‘objective” grounds, that is, by references to differences, *inter alia*, in education levels and work content.
3.4. Lundberg’s rapprochement

It is difficult and perhaps also politically biased and even unnecessary to proclaim the winner of the Lundberg-Rehn controversy in the short run; let us ignore here that the Rehn-Meidner model was actually applied in Sweden from the late 1950s. However, an immediate reflection is that Rehn stood up quite well in the discussion with his mentor and teacher. And as already mentioned, Lundberg buttressed Rehn’s description of the inflation process from the beginning. Lundberg wrote appreciatively about Rehn although excluding him from the group of professional economists: “Mr Rehn’s article seems to me to give a much more realistic treatment of the problem under discussion than do the writings of many economists, who only stress in a rather vague way the need for a restrained wage policy on the part of the trade unions.” (Lundberg, 1952b [1950], p. 55).

More specifically, Lundberg agreed with Rehn and Meidner that a profit squeeze might compel the firms to become more efficient (Lundberg, 1952b [1950], pp. 60-61 and 1957 [1953], p. 251). Like Rehn and Meidner, Lundberg also stressed the importance of ALMP programs. Swedish public committees and leading economists including Lundberg (and also the Postwar Program) had recommended both demand-stimulating and mobility-enhancing ALMP programs already before the birth of the Rehn-Meidner model. As a result, the National Labour Market Board (AMS) was established in 1948 (Öhman, 1974, pp. 9-15; Wadensjö, 2001, pp. 3-6).

The consensus between Rehn and Lundberg was consolidated during their debate. But Lundberg became more influenced by Rehn than the other way round. Lundberg’s growing support to the Rehn-Meidner thinking in the first half of the 1950s actually paved the way for his full approval of the model in the 1960s.

Lundberg was gradually convinced in the first half of the 1950s that the ALMPs must have a central role in stabilization policy. In the Rehn-Meidner model, ALMP measures, especially to speed up labor mobility, are strategic means to maintain full employment when fiscal policy is restrictive and also to achieve low inflation, high growth and wage equality for similar jobs. In addition, Lundberg came to use the distinction in Rehn and Meidner’s works between two kinds of wage increases, wage drift and central wage increases. Lundberg (1957 [1953]) referred to ‘wage slide’ but Lundberg would soon switch to ‘wage drift’ (löneglidning in Swedish), a notion probably invented by Rehn.
Lundberg assimilated the Rehn-Meidner idea that wage drift will fill up the room for wage increases when central trade unions endeavor to hold down the nominal wage-rate (Lundberg, 1957 [1953], p. 233). In fact, Lundberg came to agree with Rehn and Meidner that the willingness of the labor-market organizations to participate in wage-restraining programs is limited by sociological and psychological factors except in exceptional circumstances (Lundberg, 1957 [1953], pp. 233-235). Furthermore, in the early 1950s, Lundberg became more friendly to the Rehn-Meidner idea that a profit squeeze would reduce (trade-union) wage claims and make private employers more willing to resist demands for higher wages (Lundberg, 1957 [1953], pp. 257-258).

Moreover, Lundberg finally acknowledged that nominal wages will be higher in an economy without the wage policy of solidarity. In the absence of solidaristic wage policy, the pace of wage increases will not only be higher because of strong wage claims in profitable sectors (especially if markup pricing is possible). Wage hikes in these sectors can also start a wage-wage race. The more modest pay increases in profitable sectors with the wage policy of solidarity would weaken the wage claims by employees in other sectors (Lundberg, 1953, p. 313 and 1957 [1953], pp. 235-238).

Lundberg did qualify his newly acquired argument (by references to Swedish experiences) that wage differentials are inflationary - pay increases in low-wage sectors can induce compensatory wage claims by employees in high-wage sectors (1957 [1953], p. 237). However, already in 1948, Rehn had used exactly the same example of a wage-wage spiral when arguing for ‘fair’ wage differences, a strategic component of the wage policy of solidarity (Rehn, 1952a [1948], 41-42).

Furthermore, Lundberg (1957 [1953]) did not repeat the argument against the Rehn-Meidner model that indirect taxes will hit consumption industries only. And Lundberg here recapitulated only parenthetically the hypothesis that price increases through indirect taxes will lead to compensatory wage claims (ibid., p. 252).

At the end of his controversy with Rehn, Lundberg accepted the distinction between the two real alternatives in economic policy to achieve full employment without inflation clearly articulated in the 1951 LO report. One option represents an expansive (Keynesian) policy of full employment in combination with selective fiscal restraint and regulation, *inter alia*, voluntary wage moderation by central trade unions. The other
option is the Rehn-Meidner model. On purely economic grounds, Lundberg (1957 [1953]) actually leaned towards the latter strategy (ibid., pp. 246-247, 249, 251).

It is striking that Lundberg came to accept not only Rehn’s description of crucial driving forces and mechanisms in the Swedish economy, but also the central role of (restrictive) fiscal policy to combine full employment with price stability. Lundberg stated: “On the whole I agree with his picture of economic relationships and take the same view of the methods of operation of fiscal policy” (ibid., pp. 254-255).

Lundberg’s definition of the two alternatives of economic policy in the first half of the 1950s shall not obscure that he rather preferred a third option requiring a break with the political restrictions of the time (Lundberg, 1957 [1953], chapter XII). The recommendations of flexible monetary policies and also of deregulated capital markets (including the currency market) exemplify that Lundberg often went beyond the political restrictions of the time and that he in many respects was before his time. Sweden definitely abandoned the low interest-rate policy in 1957 but did not deregulate financial markets until the second half of the 1980s and did not switch to flexible exchange rates until 1992. The redefinition of full employment suggested by Lundberg was made in Sweden in the 1990s. By his position as a trade-union economist and perhaps also by his stronger skepticism towards economic theorizing, Rehn were more prone than Lundberg to accept the existing monetary and political institutions and the existing balance of power in politics and working life. In contrast, in the 1970s and 1980s, the Rehn-Meidner model was seen by leading Swedish politicians and economists including Lundberg as a break with the political and social realities of the time.

3.5. Rehn’s tenacity

There are few indications that Rehn was inspired by Lundberg in their 1950-1953 controversy. A reasonable hypothesis is that Rehn’s gradual acceptance of restrictive monetary policies as an alternative to indirect taxes to cool down the economy was a consequence of his discussion with Lundberg. But the influence from Lundberg shall not be overstated.

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8 Lundberg’s (and Ohlin’s) reference to the negative effects on productivity of high turnover rates and disorganization phenomena already in the late 1940s may have influenced the development of the Rehn-Meidner model with Meidner as an intermediary (Ohlin, 1949, pp. 12-13; Lundberg, 1952a, p. 9).
Firstly, in principle, monetary restraint can be used instead of fiscal policy to obtain the price-stability objectives of the Rehn-Meidner model (Rehn, 1953, pp. 286-287). The main aim of the model’s restrictive fiscal policies is to contribute to a profit-margin squeeze in the medium term. The net profit margins of the firms can be reduced by monetary policy. Already in the 1951 LO report, Rehn and Meidner put monetary restraint on an almost equal footing as a restrictive fiscal policy by indirect taxes.

Secondly, the influence of Lundberg on Rehn must be downplayed considering that Rehn still favored fiscal policy at the expense of monetary policy in the mid-1950s. He continued to argue for permanently low rates of interest to give a favor to and prevent the interruption of building programs (Rehn, 1953, pp. 288-289). Rehn’s resistance to monetary policy was eventually broken in 1957 when the low interest-rate policy was abandoned and monetary policy became counter-cyclical in Sweden.  

3.6. Some flaws in Lundberg’s interpretation and critique of the Rehn-Meidner model

The Rehn-Meidner ideas and the presentation of them in particular were preliminary and incomplete in the late 1940s. The 1951 LO report provided a fuller and more systematic and consistent description of the Rehn-Meidner model. For example, the report made clear that profit margins in the business sector should be reduced over the business cycle, thus, in the medium term (see LO (1953 [1951], pp. 90-93; see also Rehn (1952 [1950], pp. 75-76) and (1953, pp. 285-286, 289). The LO report also made clear that ALMP measures are necessary to obtain not only full employment but also a decline in profit margins. Lundberg’s interpretation of the Rehn-Meidner model was more accurate in Lundberg (1957 [1953]) that in Lundberg (1952a and 1952b [1950]). For example, he no longer asserted that the model is designed for a booming economy.

Rehn and Meidner never provided a detailed explanation of why a restrictive fiscal policy together with an upward wage pressure would lead to a decline in profit margins. Lundberg tried to fill this gap (Lundberg, 1952b, pp. 55-61) and (1957 [1953], pp. 248-250). He suggested that the negative effect on private consumption of the rise in consumer prices (see the increase in indirect taxes) would fully offset the positive effect on private consumption of the higher wages. Thus, private consumption may be

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9 It was easier to definitely abandon the low interest-rate policy when the Agrarian Party (named the Centre Party from 1957) left the coalition government together with the Social Democrats in 1957.
constant excluding a fall in total output. (Producer prices in contrast to consumer prices will be constant if private consumption is constant.) But profit margins will decline through the increase in nominal wages.

Lundberg’s account of Rehn and Meidner’s macroeconomic theory was not beyond all doubt. Rehn and Meidner took for granted that contractionary fiscal policies would depress inflation and profit margins by a reduction in aggregate demand. Lower aggregate demand may decrease the rate of inflation by reducing, for example, the number of firms operating on product markets with excess demand. (The reduction in the number of these firms may also reduce investments to increase the production capacity of the economy.) The drop in the rate of inflation through the lowering of aggregate demand (producer prices) is particularly important in the Rehn-Meidner model to counteract the positive effect on inflation of the guarantee of full employment leading to higher nominal wages.

According to the alternative interpretation of the Rehn-Meidner theory (in relation to Lundberg’s), the fall in aggregate demand (although not necessarily by indirect taxes) is associated with an increase in product real wages and a squeeze of profit margins (Erixon, 2018, pp. 668-669). The reduction of profit margins cannot be neutralized by lower nominal-wage growth; the guarantee of full employment will reinforce the wage floor in the economy. The economic policy of the Rehn-Meidner model resulting in lower profit margins in general will particularly hit firms and industries with low productivity or other characteristics making survival only possible in a boom.

Lundberg did introduce some cases in which the increase in product wages and decline in profit margins through higher nominal wages will result in lower output, investment and employment, particularly in marginal industries and firms (Lundberg, 1952b [1950], pp. 60-61 and 1957 [1953], pp. 249-250). However, these cases were exceptions in Lundberg (1957 [1953]). And Lundberg still excluded the plausible assumption of price and profit-margin flexibility in connection with a decline in aggregate demand.

There were some other fallacies in Lundberg’s criticism of Rehn. His distinction between labor scarcity and profits as a source of wage increases is superseded by the Rehn-Meidner assumption that high actual profit margins can elicit wage increases by stimulating labor demand. Moreover, Rehn was probably right in claiming that the positive impact of consumption taxes on wage claims is a one-off effect (Rehn, 1953, p.
Lundberg’s argument in 1950 that indirect taxes will only reduce profits in the consumption sector can be met by references to the multiplier (encumbering the investment-goods sector as well).

3.7. The Stockholm-School connection

In his debate with Rehn, Lundberg did not explicitly underline the originality of former’s theory and policy. But nor did he trace the Rehn-Meidner ideas to works of the Stockholm school including his own. On the contrary, Lundberg seemed to have viewed the Rehn-Meidner model as a new insight and the Stockholm School as an irrelevant point of reference in the analysis of the model. In the 1950s, he was influenced by Rehn, but also by (other) economists outside the Stockholm School.

Studies of reinforcing cumulative processes are central in the Stockholm-School tradition. In his dissertation, Lundberg shed light on a multiplier-accelerator mechanism and formulated a business-cycle theory of cumulative processes and turning points based on some specifications of lags and parameter values (Lundberg, 1937; Berg, 1991). But Lundberg seems to have accepted Rehn and Meidner’s downplaying of the possibility that their demand- and profit-restricting economic policy would lead to vicious growth circles (Lundberg, 1957 [1953], pp. 250, 253).\textsuperscript{10} Rehn and Meidner referred to the limited scope of their austerity policy (see the notion of ‘islands of unemployment’), the reduction of production mainly through the elimination of low-productive firms and the need, after all, for profligate macroeconomic policy measures in a deep recession. In a recovery, cumulative processes are offset in the Rehn-Meidner theory by higher nominal wage growth (there is no positive relationship in the theory between the wage share of GDP and aggregate demand), lower productivity growth and, in an open economy, by price increases having a negative impact on the country’s competitive strength.

When defining a dynamic sector in which firms are appropriating ‘excess profits’, Lundberg (1957 [1953]) referred to Schumpeter and his Swedish followers, not to works by the Stockholm School. Lundberg also imported Schumpeter’s notion of

\textsuperscript{10} Moreover, Lundberg did not blame Rehn for the lack of any accelerator argument in his investment function (see Erixon, 2018, p. 672) or for ignoring that the multiplier can be a function of income distribution.
creative destruction (ibid., pp. 15-19, 259, 326). His Schumpeterian analysis was definitely in line with the Rehn-Meidner approach.

Nor did Lundberg relate the vintage perspective of the Rehn-Meidner model to the theories of the Stockholm-School economists. There is a vintage approach in some works by the Stockholm-School economists (and by Knut Wicksell).11 However, in the 1960s, Lundberg came to regard the model’s vintage theory as Rehn’s main contribution to economics. Furthermore, in the analysis of the positive effects of actual profits on nominal wages, not only Lundberg but also Bent Hansen referred to the Rehn-Meidner model, thus, not to works by established economists including the Stockholm-School members (Hansen 1958 [1955], pp. 368-370). Moreover, when portraying the Rehn-Meidner model, Lundberg used the notion of excess demand without mentioning its Stockholm-School origin.

The concept of excess demand can be derived from Lindahl’s disequilibrium analysis in the 1930s. Excess-demand or excess-supply conditions in the product market during a specific period reflect that the sales of firms with given prices do not match their sale plans (Trautwein, 2016, p. 364). Lundberg used an excess-demand concept in the 1940s (although by reference to Keynes) when determining inflationary gaps in the Swedish economy (Lundberg, 1982, pp. 47-48). In his analysis of the Rehn-Meidner policy, Lundberg cited Bent Hansen’s dissertation in which inflation pressure appears when either the product market or the labor market or both have excess demand instead of being in balance (Hansen, 1951). Lundberg dissected the effects of Rehn-Meidner policy by defining whether the product and labor markets are in equilibrium or not in the initial state. He assumed in the medium-term case that the contractionary fiscal policy is applied in an imaginary state of labor- and product-market equilibrium (Lundberg (1952b, [1950], pp. 60-61) and (1957 [1953], pp. 248-249).12

11 Lundberg could perhaps have referred to Ingvar Svennilson’s emphasis in the first half of the 1940s on the importance of embodied technological process for productivity growth (Svennilson, 1944). But Svennilson did not make the Rehn-Meidner assumption that productivity could increase through rationalization or the elimination of marginal firms. Besides, Svennilson assumed that the relation between aggregate demand and investment embodying new technologies is positive, not negative as in the Rehn-Meidner model (Erixon, 2011, pp. 101-102).

12 Let us ignore here that the disequilibrium perspective in the Rehn-Meidner model is fundamental with the alternative interpretation of the model (see Section 3.6 above). In Lundberg’s analysis of the Rehn-Meidner model, profit margins are an equilibrium concept whether the product and labor markets are in
However, Lundberg was right in his reluctance to derive the Rehn-Meidner ideas from the Stockholm School. Firstly, the paramount role of actual profit margins in the Rehn-Meidner analysis of inflation and growth was a valuable contribution to economics (Erixon, 2011, pp. 102-106). In the Rehn-Meidner model, the profit margin (and the profit share of GDP) is a strategic business-cycle indicator and determinant of wages, investment, structural change and productivity in the business sector. In particular, productivity and possibly also R&D investments are stimulated in the model by low profit margins, not by high profit (margins) as was generally assumed in the contemporary economic literature and in works by the Stockholm-School economists.

Secondly, the focus on excess-demand conditions and profits in some key sectors and labor markets (with strong repercussions on prices and wages in other parts of the economy) in the Rehn-Meidner inflation theory deviate from the aggregate perspective characterizing most Stockholm-School works. The Rehn-Meidner model is more akin to the theories of Hahn (1952) and Tobin (1972) than to the theories of the Stockholm School including those in Hansen’s dissertation. In fact, Hansen was inspired by the Rehn-Meidner model in his analysis of heterogeneous labor markets after his dissertation. By reference to the model, Hansen used the concept ‘asymmetric wage drift’ to describe a state of wage inflation where wage increases in some labor-market segments because of excess demand are not corresponded by wage decreases in labor markets with excess supply (because of downward wage rigidity). Higher aggregate demand eliminating all unemployment will generate wage drift by fostering or reinforcing excess-demand conditions in ‘intra-marginal’ labor markets (Hansen, 1958 [1955], pp. 347-350, 369). The Rehn-Meidner theory was also supported by Frank Hahn’s conclusion in his critical review of Hansen’s dissertation that general expansionary policy measures to sustain full employment, making it possible for marginal production to continue (and marginal firms to survive), will reinforce excess-demand conditions in other parts of the business sector (Hahn, 1952, p. 13).

Thirdly, by the goal of a public budget surplus in the medium, the Rehn-Meidner model goes beyond the recommendations of Stockholm School. Rehn and Meidner were more radical than Gunnar Myrdal who in an appendix to the Finance Bill of the Social equilibrium or not in the initial state. However, a reasonable assumption is that profit margins are in a disequilibrium state both before and after the implementation of the Rehn-Meidner policy.
Democrats in 1933 had demanded fiscal restrictions in a boom that were strong enough to create a balanced public budget over the business cycle.\(^{13}\)

Thus, Lundberg’s unwillingness to anchor the Rehn-Meidner model to the Stockholm School probably reflected the difficulty to actually find parallels to the model’s specific policy and theory in works by economists belonging to the school. Of course, no ideas in economics are developed in a scientific and social vacuum. Rehn and Meidner had close relations to Myrdal and Lundberg and also to Alf Johansson who was Rehn’s brother-in-law. The possibility of forced saving enabling firms to make additional investment by windfall profits was noticed by Swedish economists (including Wicksell and the Stockholm-School member Lindahl) before World War II (Trautwein, 2011, pp. 59, 72). But Rehn and Meidner rather referred to other Swedish economists and to foreign economists including Keynes.\(^{14}\) In the early 1980s, Rehn found a sanction for his profoundly critical view of incomes policy in *The General Theory* (Rehn, 1980, pp. 29). Besides, the Rehn-Meidner theory of inflation and investment, shedding light on the importance of unexpected windfall profits, is similar to Keynes’s theory in *A Treatise on Money* (1930). In particular, the distinction between profit inflation and income inflation (wage-price spirals) in *A Treatise on Money* has a clear parallel in the Rehn-Meidner theory. The dissertation by the Stockholm-School economist Dag Hammarskjöld focusing on dynamic economic processes was strongly affected by *A Treatise on Money*. Hammarskjöld actually emphasized, as Rehn and Meidner did later, that product and labor markets are heterogeneous, that wage increases are initiated by demand-induced increases in prices and windfall profits in leading sectors and that profit inflation may turn into income inflation (Hammarskjöld, 1933, p. 6 and chapter

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\(^{13}\) An article by Gunnar Myrdal in 1944 arguing for low interest rates and high taxes on profits is sometimes considered as an inspiration source of the Rehn-Meidner model. Myrdal opened up for the possibility of public saving if private saving was significantly reduced by the low interest rates of the decade (Myrdal, 1944). However, as typical for the time, Myrdal was primarily governed by industrial-policy ambitions and equity concerns while Rehn and Meidner first and foremost wished to squeeze profit margins in order to stabilize the economy (Erixon, 2011, p. 99).

\(^{14}\) Rehn and Meidner were probably influenced by Gustav Cassel’s and Gösta Bagge’s analysis of the wage policy of solidarity (Rehn, 1980, pp. 29-30; Erixon, 2011, pp. 96-97). Meidner shed light on the decisive influence of Hans Singer on the Rehn-Meidner model (Erixon, 2011, pp. 110-112). Rehn referred to Alvin Hansen when arguing that low profits are a necessary condition for the durability of full employment (Rehn, 1949, p. 465). He probably had in mind Hansen’s argument that the high profit rates (and profit margins) of the boom destabilizing the economy can be avoided by the high wages of an economy sustaining full employment (Hansen, 1947, pp. 254-256).
II.\textsuperscript{15} However, in the first place, Hammarskjöld (and later Lindahl) was here an intermediator between Keynes and Rehn-Meidner, not an independent forerunner of the Rehn-Meidner model. Besides, there are no indications that Rehn and Meidner ever read Hammarskjöld’s opaque and strenuous (but highly overlooked) dissertation or that they were familiar with his theory.

4. The Lundberg surrender

4.1. The application of the Rehn-Meidner model

In the mid-1950, the Social Democrats in Sweden came to support the Rehn-Meidner ideas. The government launched extensive ALMP programs in the 1957-1958 recession. ALMP expenditure rose steadily as a share of both central government expenditure and GDP from the late 1950s until the mid-1970s. Already in the mid-1960s, the amount of expenditure on ALMP measures was higher in Sweden than in other OECD countries. In line with the Rehn-Meidner model, measures to speed up occupational and regional mobility increased their share of total ALMP expenditure until the mid-1970s (Erixon, 2010, pp. 682, 706-708).

From the end of the 1950s until the early 1970s, fiscal and monetary policy was mainly counter-cyclical in Sweden though tighter on average than during the previous postwar years. Public saving increased to a high share of total saving by international standards. Consumption taxes were used again from 1960 after a long parenthesis since 1947, \textit{inter alia}, because of a resistance from the LO. And Sweden did not, like some competing countries, tackle current-account deficits during the second half of the 1960s by devaluation. Thus, social democratic governments did not react to external imbalances by using an efficient measure to elevate profits in the (wage-leading) exposed sector. The intermediate goal in the Rehn-Meidner model to obtain a significant decline in profits’ share of GDP was realized. Most OECD countries experienced a decline in

\textsuperscript{15} In his Bocconi lectures in 1981, Lundberg did not attribute the description of the inflation process in the Rehn-Meidner model (excess demand creates profit inflation resulting in investments and in due course to wage increases and possibly also to income inflation) to the founders of the model or even to Keynes or Hammarskjöld but to Lindahl (Lundberg, 1996b [1981], pp. 41-42). The article cited by Lundberg was written by Lindahl in 1957, thus, long after the birth of the Rehn-Meidner model (see Lindahl, 1957). Lindahl was probably influenced in the late 1930s by Keynes’s and Hammarskjöld’s analysis of a profit-led cumulative economic development (Trautwein, 2011, pp. 72-73). It seems, however, that the Rehn-Meidner model impelled Lindahl to return to this theory in the 1950s. Lindahl also followed Rehn and Meidner’s policy recommendations, \textit{inter alia}, to prioritize consumption taxes and forced public saving for the financing of private investment (Lindahl, 1957, pp. 33-34, 38-39).
profit shares until the 1980s. But the profit share (and profit rate) started to fall already in the beginning of the 1960s in Sweden (Erixon, 1987, p. 53).

From the late 1950s until the mid-1970s, Sweden succeeded in combining high growth and low unemployment with low inflation. The country was not exceptional here. But the fulfilment of macroeconomic goals was compatible with a radical wage equalization at the initiative of the Swedish Employers’ Federation (SAF), the LO and, from the late 1960s, of the central white-collar unions (Nycander, 2008, 141-146). Wage policy of solidarity was not only compatible with economic stability and growth but probably also an important factor behind the high Swedish productivity growth (especially in manufacturing) in the 1960s (Hibbs and Locking, 2000).

Indications that the Rehn-Meidner model was applied in Sweden in the 1960s and early 1970s are no evidence that political decision-makers were always guided by the model. Besides, wage equalization narrowed the gap not only for similar jobs but also for dissimilar jobs. Wage compression in general is only acceptable from a Rehn-Meidner viewpoint if wage gaps do not reflect ‘objective’ differences in working conditions and work content (Erixon, 2010, pp. 683). Anyway, the 1958-1972 period was the golden age of the Rehn-Meidner model in Sweden. Equally important, the Rehn-Meidner model then became a new hegemony in the Swedish economic-policy debate. Not only social democratic politicians and trade unionists but also representatives for the non-socialist parties gradually came to accept the goals and means of the model, especially the need for structural change and mobility-enhancing ALMP programs, and the underlying view of the working of the Swedish economy. Lundberg was more prepared than most other leading Swedish economists to regard the Rehn-Meidner model as a new hegemony. In the 1960s, he turned from being a benevolent critic into a follower of the model.

4.2. The Rehn-Lundberg article

In the 1960s, Lundberg was often a celebrated speaker in economic conferences abroad. There was then a growing interest in the Swedish ‘middle way’ in general and the Swedish postwar model in particular. In confidential conversations, Rehn and Meidner remarked ironically that Lundberg acted as a critic of the Swedish model on the domestic scene but as a traveling salesman or ambassador for the model abroad (see also Rehn, 1980, p. 69). Lundberg ambiguous view of the Rehn-Meidner model was
still obvious. But an article he wrote together with Rehn in 1963 was a clear sign of capitulation.\textsuperscript{16}

Rehn and Lundberg (1963) is divided into two parts. The second part describes the attempts by Swedish governments to move private investments from booms to recessions in the second half of the 1950s and the early 1960s by the help of an investment reserve-fund system in particular. This example of a ‘Stockholm-School’ stabilization policy was successful in the eyes of the authors and the evaluators of Swedish economic policy (\textit{inter alia}, the OECD) at the time. The first part of the Rehn-Lundberg article was nothing else than an uncritical description of the policy (including the use of indirect taxes), theory and performance of the Rehn-Meidner model. In fact, the authors complained that the ALMP programs, notwithstanding their rapid expansion, were yet too limited in scope (Rehn and Meidner, 1963, p. 8).

It is a remarkable fact in the history of Swedish economics that Lundberg wrote an article in the early 1960s that was a tribute to a state-interventionist and corporate social model that he feared was a threat to the free market and even to democracy. Besides, he wrote the article together with one of the founders of this model who also had been his main opponent in a debate with ideological dimensions ten years earlier (note also that Rehn was listed as first author). The Rehn-Lundberg article was particularly conspicuous considering that Lundberg had joined the Mont Pèlerin Society in 1958 and was still a member of the organization in the early 1960s (Offer and Söderberg, 2016, pp. 104-105 and 187). What is more, Lundberg’s surrender to the Rehn-Meidner model in the early 1960s was not a sudden impulse (see Lundberg, 1968, pp. 258-260).

Lundberg’s own explanations for his 1963 article together with Rehn can be found in a central paragraph surely written by Lundberg himself:

\begin{quote}
“The propelling force of the ideas came from the inner circles of social-democratic and trade union economists; the discussion was stimulated by opposition from more conservative circles inside and outside the social-democratic and trade union world. In the course of time, however, the
\end{quote}

\textsuperscript{16}Rehn and Lundberg were both skeptical towards abstract economic modelling and econometrics which, together with Lundberg’s open-minded personality and Rehn’s liberal (Rawlsian) orientation in the 1960s, facilitated collaboration. In the late 1950s, Rehn had begun to emphasize the importance of full employment (and mobility-enhancing ALMPs) for the strength of individual workers (not for the strength of trade unions), especially of workers with the weakest position on the labor market (Erixon, 2013, p. 95). It is more difficult to imagine a joint article by Lundberg and Meidner who was a radical socialist.
most important policy attitudes have come to be quite generally accepted, partly because of the strength of the arguments themselves, but chiefly because the recommended policy principles have to a considerable extent been applied in practice and gradually accepted as a matter of course.” (Rehn and Lundberg, 1963, p. 2).

Here, Lundberg reveals that he was anxious not to fall outside the Swedish discourse on economic policy by resisting a policy program that seemed to be the end of history. Thus, Lundberg wished to avoid his position in the economic-policy debate in the 1950s where he was accused (inter alia, by Rehn) of ignoring contemporary restrictions on economic policy. In the cited paragraph above, Lundberg also hinted a scientific and interdisciplinary explanation for his wholeheartedly support of the Rehn-Meidner model.

Either from the start or gradually, Lundberg had accepted many of the Rehn-Meidner ideas in the 1950s. However, in the 1960s, Lundberg was even more convinced, inter alia, by his own research, of the excellence of the Rehn-Meidner policy and theory. The Rehn-Meidner model was an alternative to “…the old-fashioned Keynesian approach” (Lundberg, 1968, p. 258). Lundberg was aware of the growing interest in the Swedish model among leading American and British economists. He was probably eager to keep up with and avoid being bypassed by the development of modern economics in which the Stockholm School played a marginal role. The international interest in the Rehn-Meidner model among leading economists was manifested, inter alia, in an international conference in 1966 celebrating Lundberg’s 60th anniversary.

4.3. The Lundberg conference

The conference in honor of Lundberg in Ulricehamn (a small Swedish town) was attended by prominent foreign economists such as Edward Denison, James Duesenberry, Nicholas Kaldor, Fritz Machlup, Charles Myers, Lloyd Reynolds, Paul Samuelson, James Tobin and Ralph Turvey. The Stockholm School was represented by Hansen, Myrdal, Ohlin and Ingvar Svennilson. Also Rehn and Meidner participated in the conference.

It is no exaggeration to say that Rehn and Meidner, not Lundberg or any other economist from the Stockholm School, were the main Swedish actors in the conference.
Meidner presented a paper on Swedish ALMPs (Meidner, 1969). And more importantly, Rehn was main speaker at two sessions entitled ‘Labour market policy and the Rehn model’ and ‘The relationship between productivity development and the state of overall demand’ (Rehn, 1969, pp. 151-152, 163-168). Kaldor claimed enthusiastically after one of Rehn’s speeches: “… I shall go away a wiser man – a breath of fresh air.” (Kaldor, 1969, p. 159). He referred to Rehn’s recommendation of wage pressure to speed up structural change by the elimination of inefficient firms in combination with extensive retraining programs. Ohlin complained at the seminar: “The fact that we have discussed so much the LO-Rehn model type of reasoning doesn’t mean that this is the only line along which thinking is going on in Sweden. There are all kinds of lines, and I’m quite sure that Swedish economists present here would represent quite a number of lines; there would be very considerable differences of opinion.” (Ohlin, 1969, p. 173). Despite the celebration of Lundberg’s birthday, no economist in the conference (including Lundberg himself and the other Swedes) referred to the Stockholm School. The political victory for and the intra-disciplinary attention to the Rehn-Meidner model did not disturb Lundberg as much as Ohlin. A few years after the conference, Lundberg recalled the strong interest in Rehn’s speeches and comments in the conference (Lundberg, 1972b, p. 13).

One explanation for the strong interest in Rehn-Meidner model in the Lundberg conference was the ambition among economists at the time to find plausible theories for the negative Phillips-curve correlation between the rate of unemployment and the rate of inflation (or the rate of nominal wage increases). An article by Rehn together with Bent Hansen in the 1950s was actually a forerunner of later works on the Phillips curve and especially of works within this field based on the notion of excess demand (Hansen and Rehn, 1957). Many economists, including the honorable participants in the Lundberg conference, suggested that the Phillips curve could be shifted downward by mobility-increasing ALMPs. Some economists including Lundberg also maintained that the profit-squeeze policy of the Rehn-Meidner model may have a similar function (Lundberg, 1969, p.14).

Lundberg contributed to the conference with a paper where the Rehn-Meidner model was not only the point of departure but also represented the new hegemony of economic policy in Sweden and even the state of the art in positive economics. He elucidated the model’s cost-push theory of productivity (both the within-firm and the industry-
composition effect). Lundberg also asserted by references to empirical studies that incomes policy (compulsory or voluntary) is an inefficient measure to solve problems of wage inflation; collective wage moderation cannot prevent wage drift and subsequent wage-wage races (Lundberg, 1969, pp. 12-13).

Lundberg found no evidence that the Swedish postwar model had resulted in too high nominal wages. He claimed in agreement with the Rehn-Meidner productivity theory that nominal-wages pressure and also fierce international competition and tight fiscal policy have enforced structural change and actions by firms to improve their productivity performance. Yet, Lundberg claimed that the full-employment policy and the indirect taxes might be a potential threat to the goals of low inflation and international competitiveness. Therefore, Lundberg provided space for incomes-policy arrangements including social contracts with the government as a third partner. He suggested an array of government interventions ranging from sanctions to compulsory directives (Lundberg, 1969, pp. 18-19).

Lundberg’s proposals for a change in Swedish policy to tripartite incomes policy seemed to be at odds with his ideological position but also with his acceptance of the economic theory underpinning the Rehn-Meidner policy. He still supported (as already mentioned) the Rehn-Meidner argument that the wage-moderating effects of incomes policy will be obstructed by market forces manifested by wage drift. Lundberg’s alternative economic policy in the 1960s had actually strong resemblances with the regulation strategy that he had already rejected in the debate with Rehn in the early 1950s. The proposals of compulsory state actions to control wage development in Lundberg (1969) also illustrated the tensions in Lundberg’s works on economic policy between a readiness to accept contemporary political realities and a temptation to violate the rules of the game (in Sweden, the Saltsjöbaden Agreement of 1938 keeping the state out of collective wage bargaining).

Lundberg’s argumentation in the 1960s for an alternative to the Rehn-Meidner policy was unconvincing and half-hearted. His alternative was not of the radical type that was

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17 Lundberg’s criticism of the Rehn-Meidner model in his conference paper was modest (Lundberg, 1969, pp. 15-17). He repeated his arguments from the 1950s that wage increases for unskilled labor can lead to wage-wage races (an argument hitting the practice rather than the theory of the model) and that higher indirect taxes may increase wages and prices in the long run. (Lundberg admitted that the indirect taxes in Sweden in the 1960s had dampened private consumption in the short run). By reference to econometric research, Lundberg also put some doubt again on the possibility of keeping down the pace of wage increases by squeezing profit margins.
waiting in the wings challenging not only the Rehn-Meidner model, but also the policy (and methodology) of the Stockholm School. It was too early for Lundberg to take a position on the new theories of rational expectations and natural rates of unemployment. In the meanwhile, he started to highlight the unique features of the Rehn-Meidner model.

4.4. Lundberg as a scientific messenger

In the late 1950s and the 1960s, Lundberg shared the growing interest in growth issues among mainstream economists. Schumpeter’s and Simon Kuznets’s analysis of structural change and Erik Dahmén’s Schumpeterian (institutional) analysis of Sweden’s economic development based on the notions of development blocks and structural tensions had a strong impact on Lundberg’s research (see Lundberg, 1957 [1953], pp. 15-19). The inspiration from these scholars was shown by his article for The Economic Journal in 1959 and his book Produktivitet och räntabilitet (Productivity and Profitability) published in 1961. Lundberg (1959) criticized the use of aggregate production functions in productivity studies for overestimating the importance of physical investment (ibid., p. 663). Lundberg (1961) underlined the pivotal role of structural change for productivity growth (ibid., pp. 39-46).

It is likely that the Rehn-Meidner model contributed to Lundberg’s early interest in economic growth and particularly to his emphasis on structural change and rationalization (see the so-called Horndal effect in Lundberg’s writings). Time was on Rehn and Meidner’s side which was displayed not only by the Phillips-curve discussion but also by the development of growth economics in the late 1950s and early 1960s. The vintage approach of Salter (1960), Solow (1960) and Hahn and Matthews (1964) was similar to that in the Rehn-Meidner model. Rehn and Meidner’s analysis of wage policy of solidarity was based on the assumptions of embodied technological progress, productivity differentials between firms (or plants) and limited labor substitution possibilities ex post (leading to the elimination of marginal firms and plants). Moreover, the Schumpeterian concept of creative destruction was easily incorporated in the Rehn-Meidner model, especially when the concept was broad enough to take account of the level and structure of profit margins and the influence of economic and wage policy.

In the 1960s, Lundberg began to promote the Rehn-Meidner model as an innovation in economics. In fact, his two articles for prestigious journals in the 1970s and the 1980s
were built on the Scandinavian inflation model developed by Norwegian economists in the 1960s (called the EFO model in Sweden) and especially on the Rehn-Meidner model (Lundberg, 1972a and 1985). In fact, Lundberg denied the importance of the Stockholm School for the postwar discussion of stabilization policy in Sweden (Lundberg, 1971, p. 15). At the end of his life he stressed, probably having Rehn in mind, that Swedish economists still made original contributions on the subjects of wage formation and labor-market policy in the 1960s, but the Stockholm School hardly played any part (Lundberg, 1995b [1987], p. 499).  

Lundberg’s growing conviction of the novelty of Rehn’s growth model (he did not yet refer to the Rehn-Meidner model) is exemplified by his reference to the Rehn-Salter model in Lundberg (1972a). He shed light on Rehn’s vintage theory by the use of a so-called Salter diagram with unit labor costs for different plants on the vertical axes and total output on the horizontal axes. A pressure on profit margins by economic policies or wage shocks will, given the wage policy of solidarity reinforcing the profit-margin gap between plants, increase productivity by five mechanisms (Lundberg, 1972a, pp. 470-474): marginal plants will eliminated (1), labor can then be transferred to plants with higher productivity (2) and firms will be more efficient by enforced reductions of X-inefficiencies (3); Lundberg once again emphasized the pioneering role of Rehn by referring to Leibenstein (1966). Moreover, the general squeeze of profit margins will not exclude investment embodying new technologies by firms with the most efficient plants (4). Finally, profit-margin differentials will speed up mergers making it possible to exploit scale advantages (5).

Lundberg’s rendering of the Rehn-Meidner model was now very close to Rehn’s. Growth is stimulated by the interaction between a solidaristic wage policy and an economic policy (including a selective policy for full employment) aimed at squeezing profit margins. What is more, in his depiction of the model’s reduction of profit margins in general, Lundberg now leaned towards the price-flexibility approach suggested in Section 3.6 above. And he was finally aware of the importance of ALMP measures for the profit-margin decline in the medium term (Lundberg, 1972a, p. 479). In this time perspective, the negative labor-scarcity effect of the ALMPs on profit margins will

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18 Already in the early 1960s, Lundberg have questioned the empirical relevance of the Stockholm School (Lundberg, 1961, pp. 18-19). Furthermore, he was later convinced that Keynes’s static equilibrium model in *The General Theory* was superior to the Stockholm-School sequential analysis (Lundberg, 1996a [1981], p. 37).
outweigh the positive mobility-enhancing and labor-competence effects decisive in the short and long run (Erixon, 2018, pp. 668-670).19

Lundberg (1972a) also criticized a Keynesian economic policy for leading to excess demand for labor in some sectors and regions and hence to inflated profits and substantial wage drift inducing compensatory wage increases in other sectors and regions. Furthermore, he was now critical to empirical studies demonstrating that profits were less important than labor-market conditions for wages in Sweden. Lundberg referred, *inter alia*, to the ultimate importance of common determinants (Lundberg, 1972a, p. 472). In both respects, Lundberg was now very close to Rehn’s view.

Lundberg’s adoption to the Rehn-Meidner model shall not hide his critical remarks about the model in Lundberg (1972a). The transfer of saving to the public sector might increase “the degree of socialism” (Lundberg, 1972a, p. 472). He also feared that private investment and hence productivity growth would be reduced in Sweden if the cost and profit pressure of the 1960s became permanent (ibid., pp. 480-481). Lundberg also stressed, as in later publications, that the transfer of resources from manufacturing had primarily favored the expansion of the public sector (Lundberg, 1972a, pp. 481-482 and 1996b [1981], pp. 52-53). But the objections to the Rehn-Meidner model in (Lundberg, 1972a) were brief, modest and primarily formulated with an eye on the future. The article was profoundly a survey and support of the model emphasizing not only the model’s relevance in the analysis of Sweden’s economic development but also its innovative character.20

It is even reasonable to claim that Lundberg was too uncritical to the Rehn-Meidner model during the model’s golden era. There is a possible clash in the model between the goals of low inflation and growth in one respect – the increase in the profit margins of profitable firms by the wage policy of solidarity may stimulate growth but also boost inflation. Besides, there is a high risk that the collective wage favor to these firms will

19 However, Lundberg never adopted Rehn and Meidner’s conditional view of the wage policy of solidarity and the economic policy in their theory of inflation – a squeeze of profit margins in the medium term and a wage policy of solidarity are both necessary conditions for macroeconomic stability.

20 Lundberg had certainly the Rehn-Meidner model in mind when providing arguments for not focusing on short-term issues in his 1972 article: "It seems to me that interrelations between short-term stabilisation issues of employment and prices on the one hand and developments of productivity and profits on the other have been examined more closely in the policy debate in Sweden than in many other countries.” (Lundberg, 1972a, p. 65).
be eliminated by wage drift if we stick to the Rehn-Meidner theory about a positive relationship between profits and wages (see Section 3.3 and Erixon, 2018, pp. 680-681).

Lundberg continued to emphasize the innovative character of the Rehn-Meidner model after his 1972 article in *The Economic Journal*. As an evaluator when Rehn applied for a position as a professor in labor-market policy at Stockholm University, Lundberg had a new opportunity to express his high opinion of the model. In his evaluation report, Lundberg highlighted the central role of “the Rehn model” in the economic-policy debate, in education at different levels and in the international economic literature. He regarded Rehn as an ingenious creator of a new vision for economic policy and as a pioneer in the analysis of wage formation and the functioning of the labor market. Rehn had even established a new tradition in economics by his path-breaking theoretical and economic-political research. Lundberg made the addition (translated to English):

“Presumably, after the Heckscher-Ohlin theorem in trade economics, no other Swedish economists have formed a central branch of economic analysis and policymaking to the same degree as Gösta Rehn.” (Lundberg, 1972b, pp. 12, 18).

It is beyond the topic of this paper to explain why Lundberg ranked Rehn as only number three among the applicants (especially as Swedish economics was no longer in a golden age) and why he stated that Rehn was not even qualified for a professorship in economics. Lundberg considered Rehn as qualified for a professorship in labor-market policy, but Rehn was first and foremost a macroeconomist, not a labor economist. Before we insinuate a Mozart-Salieri relation between Rehn and Lundberg we must be reminded that the latter had contributed significantly to Rehn’s international fame. Lundberg also made clear in his evaluation report that Rehn’s academic merits were poor in a conventional sense. Rehn had not written any book, published any article for a scientific journal or made any in-depth evaluation of economic policy so far. Moreover, Lundberg rightly conjectured that the (marginal-productivity) theory in Rehn’s article together with Hansen had been formulated by the latter. However, Lundberg’s evaluation report on Rehn was written in agony and with awareness of the limitations of academic criteria in this case. As a post scriptum - Rehn was ultimately awarded the professorship in labor-market policy after a decision by the social democratic government.
5. Conclusions and comments

The controversy about economic policy between the Stockholm-School economist Erik Lundberg and his pupil, the trade-union economist Gösta Rehn, in the early 1950s is a well-known chapter in the history of Swedish economics. The subject of the dispute was the theory and policy program that Rehn had worked out together with Rudolf Meidner in the early postwar years. The conventionally view is that Lundberg was the main critic of the Rehn-Meidner model from the very beginning. This paper challenges this view by maintaining that Lundberg had largely accepted Rehn’s view of the functioning of the Swedish economy already before the debate and further, that he was strongly influenced by Rehn during their discussion. Moreover, the literature on the Lundberg-Rehn controversy ignores that Lundberg’s ambiguous attitude to the Rehn-Meidner model changed into a full absorption of the model in the 1960s. In fact, in the beginning of the decade, Lundberg was both a co-author along with Rehn of an article embracing the Rehn-Meidner model and a member of the Mont Pèlerin Society.

In the years of capitulation to the Rehn-Meidner model, Lundberg began to write articles for international journals bringing the novelty of the model in the light. He never, not even in the 1950s, suggested that the model was based on the insights (or methodology) of the Stockholm-School economists. There were other, probably more important, sources of inspiration for the Rehn-Meidner model. Lundberg was also right in pointing out the independent nature of the model. The founders combined a structural and vintage approach to growth studies with an analysis of macroeconomic stabilization based on a disaggregate notion of excess demand influencing Lundberg among others. Moreover, the emphasis on the importance of low profit margins for price stability, structural change and productivity growth was another major contribution by Rehn and Meidner to the analysis of the postwar economy. They also used the notion of wage drift to unveil in an independent way the tensions and relations between central wage agreements on the one hand and market- and firm-based changes in nominal wages on the other. The Rehn-Meidner policy program was unique by its medium-term perspective, multiple goals, combination of means and interaction between the means.

In the 1970s and the 1980s, Lundberg still had a respectful and benevolent attitude to the Rehn-Meidner model. In particular, he still expressed an admiration for the logic and originality of the model. And he still regarded the uniform wage for equal work as
an effective instrument for resource allocation (Lundberg, 1980, p. 78). In his critical review of the ‘old’ Swedish model, Lundberg focused on the expansion of the public sector, the rise in marginal taxes and the reduction of wage differentials in general, thus, on aspects of the Swedish model beyond the horizon of the Rehn-Meidner model (Lundberg, 1985, pp. 20, 24-29, 32-35 and 1995a [1981]). But he also recycled some of his old arguments against the model (Lundberg, 1985, pp. 19-20). Lundberg began to argue for high profits, especially in the exposed sector, and for internal saving as a source of investment (ibid., pp. 29-30). The days of surrender to the Rehn-Meidner policy were definitely over for Lundberg. A detailed scrutiny of his relation to the Swedish model after the model’s golden era remains to be done.

The conclusion by scholars that Lundberg won the battle over Rehn in the long run is, inter alia, vindicated by the fact that Lundberg had a stronger impact on Swedish economic policy than Rehn during the second half of the 1970s and the 1980s. Lundberg also retained a central position in Swedish economics as chairman of the Nobel Price committee in economics 1975-1979 (he had been a member of the committee since the start in 1968). However, the marginalization of Rehn in the Swedish economic-policy debate in the 1970s and 1980s shall not hide that the following decades witnessed a renaissance of his growth theory (see, inter alia, Acemoglu, 2010) and also of his medium-term approach to economic policy (see, for example, the Swedish fiscal rule since the late 1990s of a public-budget surplus over the business cycle). At the same time, the New Neo-Classical Synthesis in macroeconomics was a serious challenge to Lundberg’s discretionary Stockholm-School approach to economic policy. Perhaps paradoxically for some, by his penetrating analysis of the Rehn-Meidner policy and theory over four decades, Lundberg may have provided stronger arguments for the survival of the Swedish model than for the revival of the Stockholm School.

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