Associazione Studi e Ricerche
Interdisciplinari sul Lavoro

Working Paper n° 34/2018

THE REHN-MEIDNER MODEL OF WAGE AND PRODUCTIVITY POLICY. A SRAFFIAN ANALYSIS

Zoltàn Pogàtsa

Anno 2018

ISSN 2280 – 6229 -Working Papers - on line

ASTRIL (Associazione Studi e Ricerche Interdisciplinari sul Lavoro)

I Working Papers di ASTRIL svolgono la funzione di divulgare tempestivamente, in forma definitiva o provvisoria, i risultati di ricerche scientifiche originali. La loro pubblicazione è soggetta all'approvazione del Comitato Scientifico.

Per ciascuna pubblicazione vengono soddisfatti gli obblighi previsti dall'art. l del D.L.L. 31.8.1945, n. 660 e successive modifiche.

Comitato Scientifico

REDAZIONE:

ASTRIL
Università degli Studi Roma Tre
Via Silvio D'Amico, 77 - 00145 Roma
Tel. 0039-06-57335751; 06-57335723
E-mail: astril@uniroma3.it
http://host.uniroma3.it/associazioni/astril

Dr. Zoltán Pogátsa
University of West Hungary

The Rehn-Meidner model of wage and productivity policy – A Sraffian analysis

The mainstream neoclassical school treats labour as any other commodity, where demand and supply meet on a voluntary and equal basis. It also assumes that the best method for its allocation is open market coordination. The paper first outlines the epistemological faults in this model.

It then continues to discuss the alternative model, as charted by two Swedish economists, Gösta Rehn and Rudolf Meidner. This model is built on the assumption that the average productivity of a sector remains low if the minimum wage is eliminated (or is inflated). This is due to the fact that capital can chose to either invest in new technology to decrease production costs, or it can rely on low wages in order to maintain its margins. The second option is cheaper, as it requires no immediate expenditure. As many firms will opt for this second option, investment into productivity (technology and related skills) will fall behind, especially in comparison to similar industries abroad. The consequence of such policies is the gradual loss of competitiveness.

In the Rehn-Meidner model the actors must consciously raise the lowest wage payable in order to prevent firms from choosing the second option of relying on low wages, and forcing them to compete with the “high road” of technological improvements. This might be achieved through industry level wage bargaining by trade unions and employers for industrial wage floors, or it might be implemented through a statutory minimum wage determined by the state. Job losses resulting from the rise in the minimum wage are seen in this model positively, in terms of freeing up labour for active labour market policies, retraining for higher value added jobs as the value added range of the economy moves gradually upwards.

This logic runs contrary to the neoclassical theory, which (correctly) sees productivity as a limiting factor for wages, but does not have a theory for why entrepreneurs would prefer technological improvements to relying on low wages.

One of the main elements of neoliberalism ((Mirowski 2014) (Mirowski és Plehwe 2009) (Konings 2015)) is the deterioration or outright elimination of wage bargaining, together with the false ideology (Solow 2000) of flexible labour markets. This ideology was transferred to Eastern Europe during transition from state socialism to capitalism, resulting in extremely weak trade union competencies, as well as an absence of wage bargaining as it had existed in the West in prior decades. The ideology is also used to suppress wage bargaining in crisis countries in the South of Europe after 2008 by the Troika, of which the European Commission is a member, in spite of its verbal commitment to the idea of a ‘Social Europe’. It has also also contributed to the rolling back of the welfare state model in many Western European countries, not insignificantly in Germany (Streeck 2014) (Streeck 2009).

Labour in neoclassical economics is treated as any other commodity. Marginal theory declares that factors of production receive the value of their marginal contribution to output in perfectly competitive markets.

Neoclassical theory imagines that labour can be treated just like any other commodity. Higher wages will elicit a higher supply of labour, while reducing wages will reduce the supply of labour.

However, labour is *not* like any other commodity. Labour is not *produced for profit.* Therefore the market for labour is unlike any other commodity. The demand for labour is not determined by consumers: it is determined by producers and their decision to produce output for sale. The supply of labour is not determined by producers: it is determined by consumers, that is workers, based on their preferences between income and leisure time. These peculiarities of the labour market complicate the usual downward sloping demand and upward sloping supply curves of neoclassical economics.

1) Neoclassical theory assumes perfectly competitive markets. Assumptions are made to create an economic model. In order to approximate a model to reality, to apply the model to an actually existing situation, the assumptions have to be eased to make it possible to apply the model. In the real economy, markets are not competitive. Since the model assumes that factors of production are priced at the market value of the marginal products, when the marginal product decreases due to imperfect competition, the theory actually necessitates strong trade unions.

2) On the labour market, the individual or aggregate supply curves are *not necessarily upward sloping*. It is quite feasibly in fact that the supply curves might be downward sloping: workers might supply *less* labour as the wage rises, since a higher wage rate means that the same total wage income might be earned by working less hours! (On the labour market it does not make sense to decompose the change to income and substitution effects, i.e. income and leisure time, since for each worker a day consists only of 24 hours.)
   This means that on the labour market supply is just as likely to be upward sloping as downward sloping. At the aggregate level, accepting for the moment that a downward sloping demand curve is valid, the two curves can intersect at any number of points. This means that any number of "equilibrium" wage rates. This means that it does not hold that wages are determined by supply and demand. (It is also important to point out that neoclassical pronouncements about the ineffectiveness of minimum wage legislation, causing unemployment, are based on the laws of supply and demand applying to the labour market. Similarly, pronouncements about demand management not being able to alter the unemployment rate are also based on the same assumption. If the laws of supply and demand do not necessarily apply to the labour market, these pronouncements are baseless. In fact if labour supply and demand curves are both downward sloping, falling supply could be met by falling demand, resulting in ever increasing unemployment. Minimum wage legislation could halt this process and stabilise the labour market.

3.) Neoclassical macroeconomics assumes that the individual *supply* of labour works just like individual *demand* for two goods. There is a indifference between more leisure or higher wages. (Just like there is an indifference between two goods.)

There are a number of problems with this view. Firstly, the supply of, and the demand for hours of leisure is not infinite. There are only twenty-four hours in a day. Therefore on of the 'goods' in question is fixed. Also, there is a hidden assumption that the two goods are independent of each other: i.e. that one can enjoy leisure without wages. But this is not so. There are very few leisurely activities that do not cost anything. If we assume a positive relationship between wages and hours worked – the number of hours worked increases as the wage rate increases, and decreases as the wage rate decreases – then it follows that income disposable for leisure (which equals the number of hours worked times the hourly wage) falls even faster.

4.) Pierro Sraffa's critique of the aggregation of individual supply and demand curves (Sraffa 1926) is also very instructive. He has a broad and a narrow definition of aggregation. In the case of the labour market, it is clearly the broader definition that is applicable here, since the labour market encompasses the entire economy.

His critique is concentrated on the fact that there are 'aggregation problems' when we get from the micro level of individual wage-leisure choices to the macro level of the nation wide labour market. When wages rise in a certain industry, they have an affect on demand and therefore prices in other industries. Therefor the supply and demand curves in certain industry are not independent of each other. There are therefore no separate, independent supply and demand curves for a national labour market. These Marshallian tools are therefore inadequate for the analysis of wages and the labour market.

In addition to all of the above, it must be stressed that Pierro Sraffa had a broader criticism of the mainstream neoclassical theory of marginal productivity of labour and capital. In the famous *Cambridge Capital Controversy*, a debate between economists from Cambridge UK and MIT, he pointed out (Sraffa 1960) that capital in a firm cannot be aggregated, since it is impossible to know at what price dated capital has to be accounted for. In order to know the price of past capital, we would have to know the rate of profit on it. This relatively well known critique from Sraffa means that i) profits cannot be the marginal product of capital, ii) wages cannot be the marginal product of labour, iii) labour and capital have no independent marginal products, and therefore the entire neoclassical theory of marginal productivity theory of income distribution is refuted.

Wages are therefore not determined 'meritocratically', by 'market mechanisms'. In fact Sraffa proves that the distribution of income to wages and profits is implemented according to the sheer bargaining power of employers and employees. This might happen in an organised manner, in regular and regulated wage bargaining rounds, or it might happened in an unregulated, unconscious manner. The former used to characterise Northern and Western Europe after the Second World War, and even much of Southern Europe. The system has been much weakened, especially in Southern Europe with the crisis, but still operates in Northern and Western Europe, although in a weakened form. The latter implies weak trade unions, sporadic strikes, etc., and characterises Eastern Europe after the transition from state socialism.

The most formalised theory of wages based on formal wage negotiations is the so-called Rehn-Meidner model, formulated by two Swedish trade union economists (Meidner és Rehn 1951). In fact it describes the model of wage negotiations that existed all over (Northern, Western and even Southern) Europe after WW2, but without any formalisation. It is the only model of setting wages that we have that does not rely on the flawed marginal productivity theory of income distribution, and is very practical.

The main tenets of the Rehn-Meidner model are the following:

1.) Employers and employees negotiate mid term wage increases based on a mutually shared, trust based assessment of productivity developments.
2.) Wages cannot increase faster than what productivity would allow, as this would result in the firm making a loss, jeopardising jobs. Thus wage increases must be set according to the levels allowed by productivity. (Note: *not the rate of growth* of productivity, but *levels* of productivity!)
3.) However, wages should not be too low either. Wages have an important (Keynesian) demand function, and when wages do not increase enough, there is a problem of underconsumption, weak demand, and therefore a lower employment performance than potential.
4.) The Rehn-Meidner model is built on the assumption that the average productivity of a sector remains low if the minimum wage is eliminated (or is inflated). This is due to the fact that capital can chose to either invest in new technology to decrease production costs, or it can rely on low wages in order to maintain its margins. The second option is cheaper, as it requires no immediate expenditure. As many firms will opt for this second option, investment into productivity (technology and related skills) will fall behind, especially in comparison to similar industries abroad. The consequence of such policies is the gradual loss of competitiveness.

   In the Rehn-Meidner model the actors must consciously raise the lowest wage payable in order to prevent firms from choosing the second option of relying on low wages, and forcing them to compete with the "high road" of technological improvements. This might be achieved through industry level wage bargaining by trade unions and employers for industrial wage floors, or it might be implemented through a statutory minimum wage determined by the state. Job losses resulting from the rise in the minimum wage are seen in this model positively, in terms of freeing up labour for active labour market policies, retraining for higher value added jobs as the value added range of the economy moves gradually upwards.

   This logic runs contrary to the neoclassical theory, which (correctly) sees productivity as a limiting factor for wages, but does not have a theory for why entrepreneurs would prefer technological improvements to relying on low wages.

From the above we conclude that according to the current state of economics as a science, the marginal productivity theory of income distribution is refuted, Marshallian demand and supply curves cannot and should not be used to analyse and conceptualise the labour market, and the Rehn-Meidner model is the only standing model we have of how wage setting should operate.

Bibliography

Konings, Martijn. *The Emotional Logic of Capitalism: What Progressives Have Missed.* Stanford: Stanford University Press, 2015.

Meidner, Rudolf, and Gösta Rehn. *Fackföreningsrörelsen och den Fulla Sysselsattningen .* Stockholm: LO, 1951.

Mirowski, Philip. *Never Let a Serious Crisis Go To Waste: How Neoliberalism Survived the Financial Meltdown.* London New York: Verso, 2014.

Mirowski, Philip, and Dieter Plehwe, . *The Road from Mont Pelerin: The Making of the Neoliberal Thought Collective.* Harvard University Press, 2009.

Solow, Robert M. *Unemployment in the United States and in Europe: A Contrast and the Reasons.* Munich: CESifo Working Paper Series No. 231, 2000.

Sraffa, Piero. "The laws of return under competitive conditions." *Economic Journal*, 1926: 36(144): 535-50.

—. *The Production of Commodities by Means of Commodities.* Cambridge: Cambridge Univsersity Press, 1960.

Streeck, Wolfgang. *Buying Time: The Delayed Crisis of Democratic Capitalism.* London: Verso Books, 2014.

—. *Re-Forming Capitalism: Institutional Change in the German Political Economy.* Oxford: Oxford University Press, 2009.