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Reassessing Wage-Led Growth in Europe: Some sceptical notes

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Abstract

This comment critically examines the recent claim by Alcobia and Barradas that the European Union follows a wage-led growth regime, warranting pro-labour policy intervention. While their findings support a clear policy stance, closer inspection reveals significant methodological and empirical shortcomings, including data limitations, panel heterogeneity, and questionable assumptions about causality. The paper challenges the robustness of their conclusions and questions whether functional income distribution can be effectively influenced by policy. It argues for greater theoretical caution and contextual sensitivity in policy recommendations, particularly given the unresolved ambiguities surrounding the wage-led/profit-led growth framework in diverse European economies.

JEL codes: C23, D33, E12, O47

Key words: Post Keynesian economics, functional income distribution, wage-led regime research

1. Introduction

Mature capitalist economies are characterised by two prominent phenomena: a tendency toward low and declining GDP growth rates[1], and a rise in income inequality[2]. Naturally, this raises questions about correlation and causality: does income inequality affect GDP growth — and if so, positively, as supply-side economics would suggest, or negatively, as demand-oriented economics would argue? Or does causality run in the opposite direction, with sluggish economic growth impacting income distribution?

Over the past two decades, a vibrant post-Keynesian research tradition has emerged that places these questions at the centre of its investigation. The wage-led/profit-led regime approach, rooted in Marxian-Kaleckian theory, posits that changes in income distribution causally affect GDP growth[3]. In this framework, income distribution refers to *functional* income distribution, in contrast to the focus on *personal* income distribution in most mainstream studies[4]. Functional distribution concerns the division of income between the factors of production — wages and profits — as shaped by social conflict embedded in societal (i.e. legal, institutional, and cultural) structures. This distribution is argued to have a significant impact on economic growth.

However, one of the main challenges of this approach is the ambiguity surrounding the direction of the effect: does rising income inequality — reflected in a falling wage share (or, conversely, a rising profit share) — lead to lower GDP growth, as in wage-led regimes, or to higher growth, as in profit-led regimes? In wage-led economies, the restrictive effect of a declining wage share on consumption demand is thought to outweigh the potentially expansionary effect of rising profits on investment demand. In profit-led economies, the reverse is believed to hold true.

From a policy perspective, this ambiguity presents a serious problem. For most countries, it remains empirically unsettled whether they operate under a wage-led or a profit-led regime. As a result, it is unclear whether pro-labour or pro-capital economic policies are appropriate.

A new study by João Alcobia and Ricardo Barradas (2025; hereafter A&B) appears to provide an empirical resolution to some of the longstanding uncertainties — at least in the context of the European Union (EU): "(B)y performing a panel data econometric analysis of all EU countries from 1981 to 2021" (A&B, p. 331) — a period during which "the wage share registered a sustained fall and economic growth was rather dismal in the majority of EU countries" (A&B, p. 332) — the authors claim to show "that the EU countries follow a wage-led growth model in a context in which the decline of the wage share has represented one of the main growth constrainers in all EU countries and, particularly, in the euro area countries" (A&B, p. 332).

[1] There is a long-standing research tradition arguing that highly developed—or mature—capitalist economies are facing a secular decline in growth prospects (see, e.g., Eichengreen 2015; Steindl 2018).
[2] See e.g. OECD (2008), OECD (2011), Chancel/Piketty/Saez/Zucman et al. (2021).
[3] The list of relevant references is too extensive to present in full here, but it would be remiss not to mention the seminal contribution by Bhaduri and Marglin (1990).
[4] See e.g. Alesina/Rodrik (1994), Persson/Tabellini (1994), Aghion/Caroli/Garcia-Penalosa (1999), Cingano (2014).

Moreover, they conclude: “Our estimates also suggest that the policymakers in EU countries should adopt pro-labor policies instead of pro-capital policies in order to reverse the decreasing (increasing) trend of the labor (profit) share and to avoid the consolidation of a prolonged period of sluggish growth in Europe. This should involve the abandonment of Reaganomics and Thatcherism by refocusing policies on demand-side economics and full employment goals” (A&B, p. 332).

This clear and uncompromising policy orientation will undoubtedly resonate with those who have long been skeptical of the supply-side politics associated with Thatcherism and Reaganomics — among them many heterodox economists, including myself. However, such strong claims in ideologically contested policy areas require watertight analysis and careful interpretation of empirical findings. It is here that I wish to pour a little water into A&B’s wine.

My critical remarks will address several areas. Principally — as has been argued elsewhere (see Heise 2020) — the wage-led/profit-led regime research appears unpromising due to its theoretical weaknesses and empirical inconclusiveness. While A&B do not offer any theoretical advancement, they claim to have empirically resolved — at least for the EU — the sign of the distributional effect on GDP growth and, by extension, the nature of the distributional regime facing the EU. I will therefore critically assess their interpretation of the empirical evidence, the methodology used to derive it, and, finally, the validity of the conclusions they draw.

2. “The wage share registered a sustained fall” – really?

The first critical point to make is that A&B’s empirical analysis lacks replicability due to insufficiently disclosed data sources. Although they cite databases such as the World Bank, AMECO, BIS, OECD, and “World Inequality” (A&B, p. 318), it is unclear what specific datasets or variables were used — particularly the vague reference to “World Inequality,” which is not clearly defined. As a result, we are left to rely on visual evidence where it is provided. This includes Figure 1 in A&B’s article, which displays the adjusted wage share in each EU country and is intended to support the “widely acknowledged” (A&B, p. 307) stylised fact that all — or at least the majority of — EU countries have experienced “a sustained fall in their wage shares” (A&B, p. 332), allegedly due to a pro-capital policy orientation dating back to the Thatcher-Reagan era of the early 1980s.

However, whether Thatcherism and Reaganomics appropriately characterise policy regimes beyond the year 2000 is debatable, especially given the shift in economic policy focus prompted first by globalisation and later by a series of external shocks — including the 9/11 attacks in 2001, the Global Financial Crisis after 2007, and the Covid-19 crisis from 2020 onwards[5]. That said, it has been argued that neoliberalism, encompassing a range of pro-capital policy measures — what Lavoie and Stockhammer (2012, p. 6) termed “neoliberalism in practice” — continued to dominate much of this period (see e.g. Crouch 2011; Schmid and Thatcher 2013).

[5] More recent literature asserts a shift in policy regime by the 2010s at the latest, see e.g. Laybourn-Langton/jacobs (2018), Macfarlane/Laybourn-Langton/Jacobs (2019).

A closer look at Table 1 undermines A&B's interpretation of wage share trends in the EU. Only 7 out of 28 EU countries provide data covering the full 1981–2021 period, and while 6 of these 7 do show a declining wage share, this represents a very limited sample. From 1995 onward, data is available for all 28 EU countries[6]. During this more consistent and recent period, only 7 countries experienced a decline in the wage share, while 14 saw a clear increase, and in 7 others, the wage share either stagnated or increased in trend slightly. Focusing on the four largest EU economies — France, Germany, Italy, and the United Kingdom, which together account for roughly 55% of total EU employment — the wage share either stagnated or clearly increased between 1995 and 2021.

Similarly, among the 12 'core' highly developed EU countries — Sweden, Finland, Denmark, Germany, the Netherlands, Belgium, Luxembourg, France, Austria, Italy, the United Kingdom, and Ireland — only two (Belgium and Ireland) experienced a falling wage share over the same period. In four countries (the UK, Austria, Luxembourg, and Sweden), the wage share clearly increased, while in the remaining six, it either stagnated or rose slightly. These patterns cast serious doubt on A&B's generalised claim of a sustained, EU-wide decline in the wage share[7].

Given this empirical evidence, it is, first of all, difficult to understand why the period from 1981 to 2021 was chosen - unless one were to assume that the period was deliberately chosen in order to maximize the likelihood of confirming the working hypothesis[8]. Moreover, 1981 marked a year of deep recession in many Western European EU countries following the second oil price shock, which makes the choice of this starting point methodologically even more questionable[9]. In this light, the period 1981–2021 appears far from neutral. If we instead focus on the more consistent and data-rich period from 1995 to 2021, there is clearly no evidence of a sustained decline in the wage share across the EU, nor among its core countries[10].

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[6] In their Figure 1, A&B give the impression that data in Austria, Bulgaria, Croatia, Cyprus, Czechia, Estonia, Hungary, Latvia, Lithuania, Luxembourg, Malta, Poland, Romania, Slovakia and Slovenia is only available after 2000. This is not correct.

[7] These doubts are hardly alleviated by the fact that the assumption of a trend decline in the wage share is likewise adopted, or reiterated, in other contributions. The frequently appended qualification "since the early 1980s" (see e.g. Karabarbounis/Neiman 2014, p. 61) suggests, however, that the purported trend may be contingent on the period of observation, and could appear quite different if a longer—or indeed shorter—time horizon were considered. This is of particular importance if the development of the wage share is subject to a long-term cycle, as more recent studies suggest (see Charpe/Bridji/McAdam 2019). Some commentators, in case the datasets used by A&B are not trusted, refer instead to the European Union's Ameco database, which records a decline in the wage share from 57.8 in 1995 to 55.5 in 2021. Yet, when the fluctuating trajectory of the wage share over the entire period is taken into account, this can hardly be characterized as a "sustained fall in the wage share".

[8] The justification provided in the study ("We collected annual data for all EU countries from 1981 to 2021 . . . This represents the time span and the frequency for which all data were available" A&B, p. 317) is untenable, since not all data for all countries were in fact available from 1981 onward — comprehensive coverage is only achieved from 1995.

[9] It should also be noted that in many Western EU countries — especially in Germany but also in France and the UK (see e.g. Charpe/Bridji/McAdam 2019, p. 13) — 1981 marked the end of a continuous rise in the wage share during the 1970s, a development that was rather exceptional in the long-term trend of the wage share since the end of World War II. For that reason, choosing 1981 as the starting point of the analysis could be distorting.

[10] In their Figure 2, A&B (p. 310) present a clearly declining trend in the wage share for the EU. I can only attribute this result to the – admitted – fact that all countries were included in the calculations without any weighting, and that the high number of observations from those countries for which data is available for the entire period is particularly reflected in this outcome.

Table 1: Direction of long-term change of wage share in 28 EU countries

Country	*Direction of change (1981 – 2021)*	*Direction of change (1995 – 2021)*
Austria	n.d.	+
Belgium	n.d	-
Bulgaria	n.d.	+
Croatia	n.d.	-
Cyprus	n.d.	-
Czech Republic	n.d.	+
Denmark	n.d.	=
Estonia	n.d.	+
Finland	-	=
France	-	=
Germany	n.d.	=/+
Greece	n.d.	+
Hungary	n.d.	-
Ireland	-	-
Italy	-	=
Latvia	n.d.	+
Lithuania	n.d.	+
Luxembourg	n.d.	+
Malta	n.d.	+
Netherlands	-	=
Poland	n.d.	+
Portugal	n.d.	-
Romania	n.d.	=/+
Slovakia	n.d.	+
Slovenia	n.d.	+
Spain	n.d.	-
Sweden	-	+
United Kingdom	+	+

Notes: n.d. means 'no data available for entire period'; + means 'increase in trend in wage share'; - means 'fall in trend in wage share'; = means 'wage share remained roughly constant'; =/+ means 'wage share increased or stayed at least roughly constant'
Source: A&B, p. 309

What does this imply? Does it mean that, at least since 1995, pro-capital economic policies have not been pursued anymore? Or rather, that pro-capital policies have failed to suppress wage bargaining effectively? A&B do not raise these questions and, as a result, provide no answers. In any case, if there is no common and sustained decline in the wage share across EU member states, it is difficult to see how this variable could explain the widely observed trend of slowing GDP growth as a stylised fact.

3. "Panel data econometric analysis allows the collection of more observations and larger samples with higher heterogeneity that contribute to more consistent and more efficient estimates" – really?

A&B (p. 331) state their intention to "assess the relationship between functional income distribution and economic growth by performing a panel data econometric analysis of all EU countries from 1981 to 2021." Collecting data for 28 countries over four decades yields a potentially large sample of 1,148 observations. However, no single country has complete data for all years and all variables. In fact, as previously shown, even for the key explanatory variable—the wage share — consistent data across all countries is only available from 1995 onwards. As a result, A&B's final dataset contains just 724 usable observations, with 424 observations — roughly 59% of the full sample — missing.

Although there is no universally accepted threshold for the ratio of missing to available data beyond which panel results should be rejected, it is clear that results from such a heavily unbalanced panel may be biased in favour of countries that contribute more observations. In this case, 7 countries alone account for 287 out of the 724 available observations — almost 40% of the total. Six of these 7 countries show a clear decline in the wage share over the full 1981–2021 period, though only one maintains that decline over the more recent 1995–2021 sub-period.

Moreover, A&B (p. 327ff.) acknowledge that the 28 EU countries are highly heterogeneous — not only in terms of their economic structures, institutions, and cultures, but also in their stage of development. Some are mature, highly developed economies (essentially the 'core EU countries'), others are catching up (largely the Southern EU countries), and some are transitioning from planned to market economies (primarily the Eastern EU countries). These countries also differ significantly in their degree of openness and global economic integration.

A&B treat this heterogeneity as an advantage, suggesting that it contributes "to more consistent and more efficient estimates" (p. 308). Yet heterogeneous panels still require a degree of homogeneity to avoid becoming methodologically unreliable. A&B attempt to resolve this by assuming that there are "no significant differences among EU countries with regard to their long-term drivers of economic growth" (p. 322). But this amounts to assuming what needs to be demonstrated — namely, that growth drivers, and particularly the role of the wage share, are comparable across all EU countries. Dividing the sample into subgroups and replicating the results does little to resolve this issue if the subgroups themselves remain internally heterogeneous — which, as far as I can see, they do.

To clarify this point further, consider A&B's most homogeneous subsample: the 'core countries' (consisting of Austria, Belgium, Denmark, Finland, Germany, and Sweden; see A&B, p. 327). In theory, this subsample could yield 246 observations, but A&B manage to construct only 206, with 40 observations (16%) missing. Only two countries — Finland and Sweden — provide complete data for the entire period, making up nearly 40% of this subsample's available observations. Both show a clear decline in the wage share over the full period, but from 1995 to 2021, that trend either flattens (Finland) or reverses into an increase (Sweden). Of the remaining four countries, only Belgium shows a falling wage share during the later period, while the other three exhibit either stability or increases.

Despite this, A&B report (pp. 323 and 330) that for the 'core countries', the wage share declined significantly and had a statistically significant — though modest — negative effect on economic growth. I find this conclusion unconvincing, both on empirical and methodological grounds.

Table 2: Interrelation between economic growth and functional distribution in Germany, 1995 - 2021

Dependent variable	*GDP growth rate*	*GDP growth rate*	*Wage share*
Independent variable:			
Wage share (t)		-0,643**	
Wage share (t-1)	-0,020		
GDP growth rate			-0,277**
Adjusted R^2	-0,043	0,144	0,162
F statistic	0,0036	5,20	5,64
DW	1,74	1,642	0,27

Notes: DW means 'Durbin-Watson test', ** means statistically significant at the 5% level, (t-1) means a time lag of one period (year).
Source: AMECO data (current version 25-05-19 11:00); Wage Share: adjusted Labour Share (AMECO Online - AMECO Online (Current Version 2025-05-19 11:00) | Arbeitsblatt - Qlik Sense), World Bank; GDP growth rate: GDP per capital growth (annunal %) (GDP per capita growth (annual %) - Germany | Data)

My skepticism deepens when exemplarily examining Germany – the biggest economy of the 'core countries' – during the period 1995–2021. As shown in Table 2, a simple OLS regression[11] does not reveal a statistically significant correlation between the lagged wage share and GDP growth. However, it does show a negative and statistically significant correlation between the

[11] Some commentators pointed out that this is a considerably less sophisticated econometric method than the one employed by A&B, and moreover concerns only a single country, making the analysis objectively inferior to that of A&B. Unfortunately, this line of argument misses the point: I am not attempting to provide an alternative explanation by means of the most advanced econometric techniques, but merely to demonstrate that even the simplest data analysis can cast doubt on the account presented by A&B.

unlagged wage share and GDP growth and, as a matter of course, a similarly significant correlation between the unlagged GDP growth rate and the wage share. This suggests that there is a statistically significant cointegration between economic growth and functional income distribution — possibly with the direction of influence running negatively from growth to the wage share[12]. Alternatively, this may indicate a spurious cointegration driven by a third, unobserved factor — an interpretation supported by the Durbin-Watson statistic, which shows strong residual autocorrelation[13].

In this interpretation, sluggish growth is accompanied by a high or rising wage share, either e.g. because wage income is less sensitive to the business cycle than profit income (suggesting a form of reverse causality), or because both variables are simultaneously determined by a third, unobserved factor — such as e.g. aggregate demand expectations.

4. Wage-led growth "suggest that policymakers in EU countries should adopt pro-labor policies instead of pro-capital policies" – really and how?

A clearly identified regime constellation in the EU — namely, a wage-led one — combined with a significant causal relationship to economic growth would seem to call for an equally clear policy recommendation: the adoption of pro-labour policies aimed at systematically increasing the wage share. Labour market policies, as well as labour and collective bargaining rights that strengthen the bargaining power of workers, are believed to support economic growth under such a regime (A&B, p. 332). However, despite the strong claims made, A&B make no attempt to demonstrate how pro-labour policies would, in practice, lead to a rising wage share.

Such an outcome — an increasing wage share — can only occur if real wages grow faster than labour productivity. This, in turn, is only possible if either: (a) workers have sufficient (market) power to push real wages above productivity growth; or (b) employment declines less sharply than the price level, *ceteris paribus*. The first scenario assumes that income distribution is shaped by the balance of power between labour and capital—i.e. by social conflict[14]. The second implies that functional (not personal) income distribution is endogenously determined, independent of distributional struggles or institutional interventions[15].

[12] There is evidence of cointegration between growth and the wage share, which points to a causal relationship running from growth towards the wage share (see Barrales-Ruiz et al. 2022). The sign of this relationship, however, may vary.

[13] None of the econometric tests applied by A&B addresses this problem, which therefore cannot be ruled out. In particular, the Hausman test—which one might consider relevant in this context and which is applied in the paper—only tests for the presence of time-invariant (i.e. fixed) effects, not for time-varying unobserved effects.

[14] This position is evidently advocated by the Marxian-Kaleckian approach within the post-Keynesian school. Stockhammer (2021, p. 164), a proponent of this approach, writes: "PKE (Post-Keynesian economics, A.H.) went beyond Keynes in three respects. First, the neo-Ricardian and Kaleckian streams drew on the tradition of classical political economy and its class analysis to interpret income distribution as the outcome of social struggles and power relations".

[15] This position is supported by the monetary or fundamentalist Keynesians within post-Keynesianism, as well as by Keynes himself; see e.g. Heise (2024a, p. 54ff.), Heise (2024b), Keynes (1936, p. 13ff.)

This implies that pro-labour policies can only achieve their intended effect — namely, raising the wage share and thereby fostering economic growth — if functional income distribution is indeed subject to social conflict and institutional influence. While such policies may certainly deliver other socially desirable outcomes — such as greater equality in personal income distribution, improved labour standards, or stronger co-determination rights — they may be ineffective, or even harmful (particularly to employment), if wage increases conflict with the price stability objectives of the central bank[16], and if functional income distribution lies beyond the influence of collective actors.

The point here is not to reject either theoretical perspective — whether functional income distribution is determined by social conflict or by endogenous structural forces — but rather to highlight the significance of model uncertainty. Under such uncertainty, empirical findings — no matter how persuasive — do not justify sweeping policy conclusions. Instead, they should serve to inform more cautious, context-sensitive, and model-specific recommendations.

5. Conclusion

The attempt by Alcobia and Barradas to empirically establish a wage-led growth regime for the European Union and to derive clear policy implications from it is both ambitious and politically resonant. Their findings align with a long-standing post-Keynesian concern about the adverse macroeconomic effects of falling wage shares and the dominance of neoliberal, supply-side economic policies. However, as this comment has sought to demonstrate, the strength of their conclusions rests on methodologically fragile ground.

First, the empirical foundation of their analysis is weakened by serious data limitations. The sample is highly unbalanced, with significant gaps that disproportionately weight the influence of a few countries. This alone casts doubt on the representativeness and robustness of the econometric findings. Furthermore, the claim of a sustained decline in the wage share across the EU is not supported when using the more consistent data available since 1995. Indeed, many countries – including the largest EU economies – have experienced stagnating or even rising wage shares during this period, undermining the assumption that a common distributional trend could explain the trend of sluggish growth.

Second, their treatment of the European Union as a relatively homogeneous economic entity for the purpose of panel estimation is highly problematic. The EU encompasses countries with fundamentally different economic structures, developmental stages, institutional settings, and exposure to global markets. The assumption that all countries share the same long-term growth drivers, particularly the same responsiveness of growth to changes in the wage share,

[16] Some commentators believe that this monetary policy reaction—if it could indeed be demonstrated—would necessarily be reflected in the data used by A&B and therefore could not be raised as a point of criticism. This, however, would only be the case if a corresponding wage policy had in fact been pursued during the underlying period—something to which A&B at least do not refer—and if the increase in the wage share, which can indeed be observed in many countries, at least temporarily, had actually been triggered by wage policy. The latter is not only questioned by myself but is also challenged in numerous studies that identify other determinants of the wage share (see, e.g. Bentolila/Saint-Paul 2003, Harrison 2002, Karabarbounis/Neiman 2014).

is both empirically unproven and theoretically unconvincing. Even within their own subsamples, heterogeneity remains a critical issue that is not sufficiently addressed.

Third, the econometric analysis, while technically competent, does not sufficiently distinguish between causality and correlation. In cases like Germany, for instance, the evidence suggests that any statistical association between the wage share and economic growth may reflect either reverse causality or spurious correlation due to omitted common factors such as aggregate demand dynamics. Residual autocorrelation and lack of robust causality tests further weaken the empirical claims.

Finally, the policy implications drawn by Alcobia and Barradas are overly confident given the underlying uncertainties. While pro-labour policies may be normatively appealing and have merit on grounds of equity and social justice, their macroeconomic effectiveness hinges on whether functional income distribution is in fact subject to change through social conflict and policy intervention. If, alternatively, functional income shares are largely endogenously determined by deeper structural or market forces, such policies may fail to raise the wage share or could even backfire under conditions of constrained monetary policy.

In light of these issues, the conclusion to be drawn is not that pro-labour policies should be rejected outright, but that they cannot be prescribed on the basis of the current empirical evidence alone. Any serious policy recommendation must grapple with the ambiguity of empirical findings, the contested theoretical foundations of the wage-led/profit-led regime framework, and the institutional and structural diversity of the EU. The more appropriate stance is one of methodological caution and theoretical openness: to advocate for policy measures that are responsive to context, attentive to distributional dynamics, and framed within a broader understanding of macroeconomic and institutional complexity.

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