**Rising inequality in the UK and the political economy of Brexit: lessons for policy**

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Acknowledgements: This paper is based on based on Guschanski and Onaran, **The causes of falling wage share and prospects for growth with equality in a globalised economy, (forthcoming) as part of a Project funded by INET**. The usual disclaimers apply.

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**Rising inequality in the UK and the political economy of Brexit:**

**lessons for policy**

The EU Referendum in the UK on 23 June laid bare long existing divisions in the country. Various Brexit campaigns scapegoated immigrants and created an illusion that conditions can only improve if Britain takes control of its borders. According to survey evidence, fears of immigration are more pronounced among voters in a more vulnerable position in the labour market, and in the post-industrial north-eastern towns (Hobolt, 2016; Ashcroft, 2016; Burn- Murdoch, 2016). While there is consensus that the result is linked to globalisation and inequality (e.g. Resolution Foundation; Pimco; Bank of America; Hermes; Standard Life, reported by Allen, 2016 and Farrell, 2016), the impact of migration on inequality is contested. Our recent research shows that inequality in the UK increased not because of migration, i.e. the mobility of labour, but because of the increased fallback options of capital related to increased capital mobility in the form of FDI and financialisation; declining fallback options of labour related to the decline in collective bargaining power, deregulation of the labour market, austerity, and rising household debt, which itself is linked to financialisation. In fact, migration does not have a negative impact on the share of wages in total income and real wages even in the service sectors predominantly hiring low-skilled labour, which also employ a large share of migrants. Linking immigration to inequality, without adequately decomposing the impact of all other factors, misses the point that correlation is not causation. This debate on migration based on myths also misses how migrants contribute to overcoming the care deficit in an ageing society, an especially striking fact given that a majority of voters over 65 years voted to leave (Ashcroft, 2016). Indeed, migrants are net contributors to the social security system. Migrants are visible, while the activities of big businesses, the City’s financial firms and offshore tax havens are less visible and comprehensible. The real solution to inequality requires regulating the corporate governance of corporations, taming capital mobility, increasing public investment in social infrastructure and housing, regulating the labour market and improving the legislation to increase the voice of trade unions and collective bargaining coverage. In an alternative economy where the balance of power shifts in favour of labour and unions have a strong voice, if migrants come to work, it is possible for labour to set their own terms and working conditions. Conversely, in the current situation, high capital mobility and low wages elsewhere in Eastern Europe and the world will mean the firms will relocate or offshore parts of their production abroad, even if migration can be limited after Brexit.

Below we summarise the results of our econometric research on the causes of the rise in inequality and the fall in the wage share (labour compensation as a ratio to value added) in the UK using sectoral data with country specific estimations (Guschanski and Onaran, 2016, forthcoming[[1]](#footnote-1)). We pay special attention to the issue of migration.

***What happened to working peoples’ income share in the UK?***

There has been a significant decline in the share of wages in GDP in the UK since the 1980s. This was accompanied by greater inequality in personal income distribution, particularly by increases in income shares of the top 1% of the distribution. Figure 1 shows the wage share in different sectors. In the UK services sectors using predominantly low-skilled labour, the wage share experienced a steady reduction since the mid-1990s and is 5 percentage-points lower in

2009 than it was in 1981. Other sectors experienced an equivalent decline in the wage share which is now between 4 and 10 percentage-points lower than in the 1980s.

The decline in the wage share was accompanied by a strong decline in union density for all industries in the UK. Union density in aggregate in the UK decreased by 24.4 percentage points from 49.9% in 1981 to 25.4% in 2013. Similarly, collective bargaining coverage has seen the strongest decline in the UK, from its peak of 80% in 1979 to 31.2% in 2011.

Financial activities and the prominence of financial institutions gained momentum since the 1980s. Similar to globalisation, this process of financialisation has increased the fallback options for capital which can now be more easily invested in various financial assets. Furthermore, financialisation changed industrial relations and led to a ‘shareholder value orientation’ as a consequence of hostile takeovers of listed companies. Financialised firms adopt a ‘downsize and distribute’ strategy, which reduces prospects for labour to agree on a beneficial compromise. Financialisation, coupled with house price bubbles, has also had important impacts on households, above all through a remarkable rise in household debt. We conduct econometric to determine what has caused the decline of the share of wages in GDP.

We also control for the effects of globalisation and technological change.

Table 1 in the Appendix summarises the estimation results for the wage share, and real wage (labour compensation as a ratio to people engaged). Our results for the UK show that there is a robust and strong positive effect of collective bargaining coverage as well as union density on the wage share, which is clearly driven by high and low-skilled manufacturing sectors.[[2]](#footnote-2)

Additionally, our results show that social government spending (in health, education, social care) has a strong positive impact on the wage share, pointing towards the negative consequences of austerity policies and decreasing fallback options of labour.

We also find a negative impact of personal income inequality on the wage share in the UK. The rise in personal income inequality, in particular, the income share of the top percentile reflects the impact of political capture and the control over resources by a narrow elite circle.

We find a robust negative effect of household debt and financial payments of non- financial corporations (dividends and interest) on the wage share in both manufacturing and service sectors alike.[[3]](#footnote-3) This finding complements recent research that finds a negative impact of financialisation on investment of non-financial companies (Tori and Onaran, 2015). Financial income of non-financial corporations, has a positive impact in some specifications.

Globalisation and technological change have been strongly emphasised in the debates about the determinants of the wage share. While we control for both phenomena by the inclusion of intermediate imports (as a ratio to domestic demand), outward Foreign Direct Investment (FDI, as a ratio to the number of employees) and the share of Information and Communication Technology capital services, we do not find a robust significant impact on the wage share in the UK. However, there is some evidence for a negative effect of outward FDI on the wage share driven by manufacturing and service sectors alike.[[4]](#footnote-4)

*Migration*

The impact of labour migration on wages depends on whether migrant labour substitutes the domestic workers and pushes down wages, or acts as a complement to labour being performed locally. The channels through which migration affects wages could, very broadly, be differentiated between the impact of migration on productivity and employment. Previous research has shown that migration is related to increased innovation, and is therefore positively linked to productivity in the UK, and that migrants to the UK are higher educated than the average British worker (Rolfe, et al. 2013; Saleheen, and Shadforth, 2006). Depending on the nature of the technological change and the bargaining power of labour this could lead to an increase in both wages and the wage share. Turning to the effect on employment, technological advancement and new business opportunities might also increase labour demand for domestic workers. Furthermore, migrants often bring in knowledge about markets and economies of their home countries and therefore open the possibility for expansion of the business activities via new export markets, which might have a positive impact on the wage share (Huber, et al. 2010; Rolfe, et al. 2013). Even migrants with low skills do not always substitute domestic labour, if their labour supply as well as demand is increasing the overall demand for labour in the economy.

The share of foreign workforce (by nationality) in total workforce increased from 2.8% in 1984 to 7.6% in 2010. We find a robust positive impact of this measure on the wage share as well as real wages in both manufacturing and service sectors. Contrary to political propaganda from several parties prior to the Brexit debate, the impact is significant and positive in the low- skilled service sectors, again on both wages and the wage share. There is need for more research on the reasons why increased immigration is associated with a higher wage rate as well as the impact of migration on different types of native workers, not just using sectoral average wage data but also individual household labour force survey data. We would rather not derive too strong conclusions regarding the positive impact of migration on wages in particular; however on a cautious note evidence based on our results as well as the literature indicate that more migration need not lead to lower wages, lower wage share and worse working conditions if unions and regulations are strong.

***Lessons for policy in the UK and Europe***

Since the 1980s, and in a more accelerated way after the Great Recession, the UK been the leader of damaging austerity, low-wage and precarious employment practices in the name of flexibility and financialisation.

It is, however, also true that despite the rights secured by the European trade union movement in the last decades, the labour market policies in the EU Member States (MS) have been far from rosy (Onaran, 2016). Individual EU MS and the European Commission (EC) have long encouraged wage moderation, explicitly recommending real wage growth below productivity growth to increase the international competitiveness of the countries. Furthermore, there is still much to do in tackling the policy flaws and democratic deficit in the EU institutions. However, let us be clear: these policies have not been imposed on the UK by the EC; the UK has been the leader of anti-labour low road labour market policies, and used globalisation as a pretext to implement them and to claim that there is no alternative.

Progressive movements and trade unions in the UK should now work to lead high road labour market policies and a wage-led recovery and improve cooperation with pro-labour forces in Europe. We have [strong empirical evidence](http://gala.gre.ac.uk/14079/1/GPERC28_Onaran_ObstF.pdf) to reject the myth that we cannot have pro-labour policies in the age of globalisation. Both the UK and Europe as a whole is strong enough to pursue an egalitarian, wage-led growth strategy and would benefit from a coordinated boost to the wage share. As such, the UK and other progressives in Europe could, and should, take a step forward in terms of radically reversing the fall in the wage share globally.

Labour market policy is not the only issue where working people in the UK need to coordinate with the progressive forces in Europe. We should not let the Brexit vote to stand in the way of international cooperation. As part of a European alliance, we can work for financial regulation, tax coordination, ecological sustainability and [implement a](https://www.tuc.org.uk/international-issues/europe/eu-referendum/british-steel-why-brexit-won%E2%80%99t-save-our-steel) coordinated public investment policy far better together than we could on our own.

Figure 1



Source: See Guschanski and Onaran (2016, forthcoming) for data sources.

Appendix Table 1: Estimation results for the wage share in the UK

|  |  |  |
| --- | --- | --- |
| Dependent variable | Within Sector Wage Share | Within Sector Average Labour Compensation |
|  | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) |
| growth | -0.380\*\* | -0.333\*\* | -0.265\*\* | -0.275\*\* | -0.125\* | -0.117 | 1.060 | 1.064 | 12.988\*\* | 13.684\*\* |
|  | (0.014) | (0.009) | (0.015) | (0.012) | (0.098) | (0.114) | (0.891) | (0.712) | (0.027) | (0.021) |
| capital stock\_t-1 | 0.114\*\*\* | 0.130\*\* |  |  |  |  | -0.176 |  |  |  |
|  | (0.006) | (0.012) |  |  |  |  | (0.962) |  |  |  |
| int. imports\_t-1 | -0.259 | -0.113 |  |  |  |  | 3.266 |  |  |  |
|  | (0.330) | (0.622) |  |  |  |  | (0.796) |  |  |  |
| other imports\_t-1 | 0.044 | 0.143\*\*\* |  |  |  |  | 14.410\*\*\* |  |  |  |
|  | (0.399) | (0.004) |  |  |  |  | (0.001) |  |  |  |
| social government\_t-1 | 0.020\*\* |  | 0.001 |  | 0.020\* | 0.018\* | 3.639\*\*\* | 2.334\*\*\* | 1.103 | 0.870 |
|  | (0.010) |  | (0.801) |  | (0.052) | (0.061) | (0.002) | (0.000) | (0.292) | (0.398) |
| bargaining cov\_t-1 |  | 0.003 |  | 0.003\* |  |  |  |  |  |  |
|  |  | (0.123) |  | (0.079) |  |  |  |  |  |  |
| ICT capital\_t-1 |  |  | -0.002 | 0.019\*\* | -0.012 | -0.019 |  | 1.594\*\*\* | -10.578\*\*\* | -11.150\*\*\* |
|  |  |  | (0.802) | (0.045) | (0.706) | (0.584) |  | (0.005) | (0.000) | (0.000) |
| non-ICT capital\_t-1 |  |  | -0.033 | -0.062 | 0.058 | 0.064 |  | -17.071\*\*\* | 2.914 | 3.474 |
|  |  |  | (0.447) | (0.202) | (0.296) | (0.270) |  | (0.000) | (0.346) | (0.281) |
| outward FDI\_t-1 |  |  | 0.094 | 0.107 | -0.125\*\* | -0.118\*\* |  | 49.129\*\*\* | 19.148\*\* | 19.344\*\* |
|  |  |  | (0.578) | (0.520) | (0.017) | (0.020) |  | (0.000) | (0.022) | (0.021) |
| hh debt\_t-1 |  |  |  |  | -0.283\*\*\* | -0.268\*\*\* |  |  | 17.146\*\* | 18.304\*\* |
|  |  |  |  |  | (0.004) | (0.002) |  |  | (0.027) | (0.017) |
| fin. income\_t-1 |  |  |  |  | 0.030\* | 0.020\*\*\* |  |  | 3.540\*\*\* | 2.734\*\*\* |
|  |  |  |  |  | (0.055) | (0.001) |  |  | (0.003) | (0.000) |
| fin. payments\_t-1 |  |  |  |  | -0.102\*\*\* | -0.103\*\*\* |  |  | -5.117\*\*\* | -5.294\*\*\* |
|  |  |  |  |  | (0.000) | (0.000) |  |  | (0.000) | (0.000) |
| migration\_t-1 |  |  |  |  | 1.425\*\*\* | 2.080\*\*\* |  |  | 88.969\*\*\* | 146.114\*\*\* |
|  |  |  |  |  | (0.000) | (0.000) |  |  | (0.000) | (0.000) |
| gini\_t-1 |  |  |  |  |  | -0.008\*\* |  |  |  | -0.689\*\*\* |
|  |  |  |  |  |  | (0.028) |  |  |  | (0.001) |
| constant | 0.454\*\*\* | 0.493\*\*\* | 0.478\* | 0.350 | 1.873\*\*\* | 2.062\*\*\* | -17.252\* | -82.766\*\*\* | -104.494\*\*\* | -87.409\*\*\* |
|  | (0.000) | (0.000) | (0.065) | (0.207) | (0.000) | (0.000) | (0.051) | (0.000) | (0.000) | (0.001) |
| withR2 | 0.248 | 0.225 | 0.077 | 0.106 | 0.092 | 0.097 | 0.483 | 0.711 | 0.689 | 0.691 |
| F-test | 10.223 | 10.797 | 6.224 | 5.228 | 5561.640 | 1071.984 | 148.981 | 390.489 | 2286.033 | 1652.401 |
| obs | 182 | 182 | 266 | 266 | 132 | 132 | 184 | 265 | 125 | 125 |
| number of sectors | 11 | 11 | 18 | 18 | 18 | 18 | 11 | 18 | 18 | 18 |

Notes: The dependent variable is the within sector average labour compensation in the UK as a ratio to total people engaged, adjusting for the labour income of the self-employed and the within sector average labour compensation in the UK as a ratio to total people engaged, adjusting for the labour income of the self-employed.. Estimation period is 1988-2008. All estimations exclude Agriculture, Hunting, Forestry and Fishing; and Mining and Quarrying sectors as well as public sectors (Public Administration and Defence; Compulsory Social Security; Education; Human Health and Social Work Activities). The estimation method is the within-estimator with standard errors robust to serial correlation within sectors, cross-sectional correlation between sectors as well as general heteroscedasticity. P-values below the estimation coefficients in parenthesis. \*, \*\*, \*\*\* denote statistical significant at the 1%, 5% and 10% level, respectively. See Guschanski and Onaran (2016, forthcoming) for data sources. The estimations for separate sector and skill groups are available upon request.

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1. We analyse the effects separately in manufacturing and service industries, and also distinguish between sectors using predominantly high and low-skilled labour. Our research also covers other selected OECD countries (Austria, Denmark, France, Germany, Italy, Spain, Sweden, the US). [↑](#footnote-ref-1)
2. Only results for all sectors (manufacturing and services) are included in this discussion note but estimations for sub-samples are available upon request. [↑](#footnote-ref-2)
3. Household debt appears to have a positive effect on wages as opposed to its negative effect on the wage share. However, given that lending to lower income households was much less aggressive in the UK than in the US, this finding most probably reflects the fact that low-income households are credit constrained. [↑](#footnote-ref-3)
4. Outward FDI has a positive impact on average wages, but the negative impact on the wage share indicates that the wage increases fall behind the rise in productivity. [↑](#footnote-ref-4)