Brexit and Wage Inequality

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The vote to leave outcome of the EU referendum was in part shaped by issues of labour market inequality and the decision to leave has implications for what will happen to inequality in the future. In this piece, we discuss both of these, first showing some evidence that the spatial distribution of leave votes was correlated with low and stagnating real wage levels, and second considering some key areas of relevance of the vote outcome for some aspects of wage inequality.

The below Figure shows the first of these, plotting the percentage voting leave in the referendum against the median weekly wage in local authorities in England, Scotland and Wales.

The pattern shown by the Figure is not so surprising, but makes it evident that areas with relatively low median wages were substantially more likely to vote to leave. A negative pattern also arises
for wage growth since 1997. Real wages fell over this time in 62 out of 370 local authorities. It is
evident that in general worsening economic conditions for workers have proven important in
shaping moves in voting behaviour away from the main political parties for quite some time and
very markedly in the referendum to vote leave.

Given the referendum outcome, what are the likely implications for wages in the future?
Downward pressure on wages from the increased likelihood of a recession (or at least a negative
shock to the economy) that was predicted by almost all economists before the vote seems likely to
materialise. The key factor in this – as was highlighted in the pre-referendum economic research
on the likely outcomes from Brexit (see, for example, Dhingra et al, 2016) – will be the negative
trade shock from leaving the union. Also, reduced migration and capital flows are likely to impact
the structure of wages.

Where will the trade shock likely hit wages and income hardest? It seems that this will be the
places where globalisation has already had an impact, namely where manufacturing used to be
based prior to losing out because of cheaper imports, especially from China (see evidence on the
impact of increased trade with China in Bloom et al., 2016). The ray of hope to possibly offset
some of this is that, where exporters do still operate, the lower value of sterling enhances their
competitiveness. On balance, it does seem that the old industrial heartlands – who ironically voted
for the most part for Brexit – will be where downward pressures may well be more pronounced.

Reduced migration flows, if they occur, are likely to manifest themselves in at least two ways.
First, there is the question of EU students attending universities. Reductions in this may well have
ramifications for future graduate supply to the labour market. Second, at the bottom end of the
labour market the UK has been increasingly reliant over time – especially since the A8 accession
in 2004 – on migrant workers to do minimum wage jobs. If this supply falls, then there may be
pressure to raise the national minimum wage which, in a possible move into a recession, may have
harmful economic consequences on firms and workers.

The City of London’s finance operations are also likely to face a negative shock. It seems unlikely
that our EU partners will grant full access to the single market without the UK agreeing to
completely free movement of labour. Since this has seemingly already been ruled out by the
Government, there is likely to be a trade-off between access and labour mobility. The ability of
financial services firms to passport their services across the EU will surely be at least partially
removed. This is likely to reduce employment in finance – particularly in London. Ironically this
may well reduce income inequality - since the rise at the very top has been disproportionately
among such workers (see Bell and Van Reenen, 2013) – but as a result of reducing the overall pie.

Both the structure of wages and the strength/weakness of wage growth will likely change in
response to the UK leaving the EU. Here we have identified some factors that may exacerbate
already existing wage inequalities, and some that may reduce them. What is clear is that the labour market will need to learn to operate in a different way than it has in response to Brexit and that the consequences of this adaptation will alter the structure of wages in ways that will need to carefully monitored and studied in due course.

References

