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Policy Brief

A Brexit deal that minimizes damage for working people?

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Abstract: In this brief we discuss the impact on the economy through five channels via the effects of Brexit on trade, migration, budget deficit, private investment, and the depreciation of the pound. Moving forward, a Brexit deal that minimizes damage for working people would require minimum distortion to the relationship with Europe. This requires negotiating membership to the customs union as well as access to the single market.

Keywords: UK Referendum, Brexit, Europe, inequality, wages, globalization, migration, capital mobility,

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A Brexit deal that minimizes damage for working people?

Brexit has left Britain with a very uncertain future and it is not the best starting point for progressive transformation. In the following we first discuss the expected economic effects of Brexit. This makes it clear that there is not much silver lining in Brexit from a progressive point of view, and the best we can achieve is damage minimisation. The people have voted for Brexit and this decision has to be respected. We have to be also clear that the political impact of Brexit is more important than the economic one. But what can be done given the circumstances to address the burning problems of our time for the working people? In the final section we conclude with the best option that working people can expect, or in other words the red lines for the 99%.

1. Expected economic effects of Brexit

The economy will be affected through five channels via the effects of Brexit on trade, migration, budget deficit, private investment, and the depreciation of the pound.

1.1Trade

The exact magnitude of the effects via changes in exports and imports depends on the type of post-Brexit trade deal with the EU. Almost half of UK's trade is with the EU. The effect is likely to be minimal, if access to the single market is maintained. But given the current position of the government to push for hard Brexit, and prioritise migration controls and free trade deals with non-EU countries over access to the European single market or customs union with the EU, which may imply going back to WTO rules with tariffs, we may experience relatively higher negative effects on growth and employment.

The hope of offsetting the impact of loss in exports to the EU via free trade agreements with non-EU countries is wishful thinking, as distance matters for trade, even in services as much as in manufacturing. Furthermore new free trade agreements may also lead to job losses as imports replace domestic production. Different from the effect of continuing both exports to and imports from the EU, new imports from new partners may replace some domestic production, and net effect on employment may be negative.

1.2 Migration

If the government opts for a hard Brexit, and prioritises substantial migration controls, the effects of this on growth, productivity and budget balance will be largely negative. In very diverse professions ranging from health and social care, to science, engineering, food, agriculture, or retail, firms are worried that they may experience labour shortage. A substantial fall in migration is a big risk in our ageing society.

Rising inequality was a strong concern for people who voted for Brexit, but our recent research (Onaran and Guschanski, 2016; Guschanski and Onaran 2016) shows that migration has not been a cause of rising inequality, and it does not have a negative impact on either the share of wages in total income or real wages even in the service sectors predominantly hiring low-skilled labour, which also employ a large share of migrants. Inequality increased because of the increased fallback options of capital related to increased imports (in particular import of intermediate inputs, i.e. offshoring), capital mobility in the form of outward FDI and financialisation, along with declining fallback options of labour related to the decline in collective bargaining power of trade unions, deregulation of the labour market, zero hours contracts and false self-employed contracts, austerity, housing crisis and rising household debt. This is not a new phenomenon but a process that gained momentum since the 1980s. The quick conclusions related to the impact of immigration on inequality, without adequately decomposing the impact of all other factors, misses the point that correlation is not causation. The simultaneous rise in immigration and inequality does not mean that the former causes the latter (Onaran and Guschanski, 2016).

Mostly the debate about migration is taking place without any reference to a progressive approach to trade. In principle free trade as such without conditions is not what progressives praise. Now that our trade with Europe has been liberalised for decades, jobs here depend on trade so we need to maintain the access to the single market. But then we also need to avoid asymmetry with labour mobility. Migrants are visible to the people, but imports or relocating firms also cause job losses, but this is less visible than migrants. The problem is not labour mobility but uncontrolled capital mobility, the asymmetry between the options and power of labour and capital, exploitative employers, unorganized migrants as well as local workers, and lack of public spending in infrastructure to mitigate the impact of rising population. We understand peoples' concerns, but the real solution to these concerns requires tackling the real causes of inequality and disempowerment. If the balance of power shifts in favour of labour and unions have a strong voice, when migrants come to work, it is possible to set the terms and conditions under which they work (Onaran and Guschanski, 2016). Conversely, if migrants will not be allowed to come, firms will go to where cheap labour is in the current situation free with capital mobility and low wages elsewhere in Eastern Europe and the world. It is a lot harder to set the conditions of work abroad to avoid a global race to the bottom in wages than organizing both local and migrant workers at home.

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; Huber, et al. 2010). 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 (Onaran and Guschanski, 2016). More migration need not lead to lower wages, lower wage share and worse working conditions if unions and regulations are strong and the positive benefits of migration on productivity as well as tax revenues are shared across the country.

1.3 Public sector budget deficit

If migration falls following Brexit, we will have a large increase in the government's budget deficit as migrants are net contributors to the budget. Improvements to the budget via cancelling the contribution to the EU budget in the event of a hard Brexit will be small and are likely to be dwarfed by effects on growth and tax revenues. Given the government's track record about their policy of managing the deficit so far, it is likely that the poor, women, and disabled will be hit hardest via further cuts to benefits. This alone will dwarf any benefit to low paid workers might expect from lower immigration.

Furthermore, a permanent access to the single market in the event of a soft Brexit or transitionary access until a new trade deal can be agreed with the EU will require continuity of the UK contributions to the EU budget.

1.4. Private investment

Uncertainty about the future of access to the single market and migrant labour force as well as political risks have already started to hit private investment plans and is likely to have further negative impacts on investment in the future. Indeed this negative impact on private investment is the biggest economic risk of Brexit.

Meanwhile, under a hard Brexit scenario, private firms are likely to lose their access to the European Investment Bank (EIB) loans, or at best the amount of these loans will decrease, which will further have a negative impact on growth, employment and productivity.

1.5. Depreciation

There has been already a substantial fall in the value of the pound. A depreciation of the pound will have sadly little impact on the trade balance. Although depreciation makes exports more competitive, imports become more expensive. With the UK manufacturing being largely reliant on importing raw and intermediate inputs, this curbs export competitiveness as well. Overall, trade deficit does not improve or even increases.

Even if the net effect of depreciation on exports may be slightly positive, this is unlikely to lead to a rise in investment in the export industry given the drag by higher uncertainty about the future of access to the single market. Without investment the overall impact of depreciation on competitiveness is low.

The other negative impact of depreciation in a highly import dependent country like the UK is that it will lead to inflation. The current slow increase in inflation is not a cause for celebration, but rather a reflection of firms' hesitance to pass rising import costs to prices in an environment of uncertainty and low demand. Inflation is expected to increase substantially in 2017, and real wages are likely to start falling in 2017. This is a rather bleak prospect for working people given that they are still about 7% lower than in 2007.

1.6. Policy reaction?

Can we expect economic policy response by the government to offset these? Unfortunately policy relies still substantially on monetary policy, which is not very effective when interest rates are already very low, banks are reluctant to lend and firms are unwilling to invest. In terms of fiscal stimulus, while there is acceptance that austerity is paused, there is no clear commitment to a substantial investment plan and industrial policy. There are likely promises of sweeteners, as has become clear in the case of Nissan, but no systematic details have been outlined, and policies are likely to be limited to socializing the costs of Brexit while avoiding a comprehensive strategy.

2. The best Brexit option for working people?

The Leave campaigners in the government would like to have a Brexit deal to ‘free’ us from the EU regulations protecting workers and the environment, and to strike new free trade deals without any standards that would open the door to the privatisations of our public services. This is an employers' Brexit not what people had in mind when voting for Brexit. Ryan Bourne (2016), the director of the Institute of Economic Affairs, sees Brexit as a chance to achieve freedom from EU regulations regarding employment, finance, environment, to focus on the comparative advantage of services, and to abolish taxes on profits to attract FDI. City economists are weighing the gains of freedom from the EU regulations regarding financial transactions tax and cap on bonus against the risks of loosing passport.

The EU, despite its flaws, had served as a moderating influence on extreme neoliberal UK government. In negotiating for the terms for Brexit, we should make sure that all existing employment rights underpinned by EU legislation are protected, such as the Working Time Directive, paid annual leave and rest times, maternity leave, the rights of part-time or agency workers, health and safety regulations, protections for workers if companies sold off, the right to strike and the protection against unfair dismissal. It is crucial that this legislation is retained in the long-term and not reversed once it has been transposed into UK law through the ‘Great Repeal Bill’.

Moving forward, a Brexit deal that minimizes damage for working people would require minimum distortion to the relationship with Europe. This requires negotiating membership to the customs union as well as access to the single market via the European Economic Area (EEA). This is a similar position to Norway who has access to the single market as an EEA member; however Norway is not a member of customs union. This option would involve the UK to comply with the Single Market regulations, and implementing new ones, despite being unable to influence their content, free movement of people and continue to make some contributions to the European Union budget.

We also need an element of realism. Our partners in the EU, including the progressives, will not split four freedoms of movement of goods, services, capital and people. Martin Schulz, president of the European Parliament made clear that he refuses “to imagine a Europe where lorries and hedge funds are free to cross borders but citizens are not” (Rankin, 2016). They will also not split movement within one freedom such as free movement of cars but not for some other goods. A sector specific customs union is highly unlikely.

If post-Brexit Britain is to deliver for the working people and address the concerns of those who voted for Brexit, it has to be accompanied by an appropriate policy mix combining industrial policy, fiscal policy, labour market policy and international trade policy with complementary and consistent aims.

Industrial policy has to aim at multiple targets of creating decent jobs with decent incomes, a sustainable and equitable economy, and decreasing dependence on imports.

A substantial public investment programme linked to industrial policy targets need to ensure adequate supply of health, education, child care, social care, and housing to make sure that benefits of being part of the single market are equally shared across the country and any pressure on public services due to the rise in population due to migration is mitigated.

Progressives in the UK should also try to remove any unnecessary restraints of State Aid in a post-Brexit deal, and fight against any attempts to introduce forced privatisation and deregulation as part of a deal.

Ideally, the UK should also try to retain the UK's shareholding in the European Investment Bank. However, even under a soft Brexit deal, the UK's level of borrowing from the EIB may still be affected; hence extra public investment will become all the more important to offset this.

Similarly, preferential agreements to maintain access to EU research funds and student mobility programmes such as Erasmus are crucial, and there is some room to build on mutual interest.

Labour market regulation and new legislation to strengthen the trade unions to level the playing field is the key to manage globalization in a way that it delivers for all the working people. This requires redefining corporate governance to increase the voice of trade unions and have full collective bargaining coverage including also those with non-standard working times, as well as ending zero hours contracts making sure that all employees, migrant or native, have contracts with guaranteed minimum hours, ending practices of employing dependent employees as self employed, ensure equal rights for all workers including the migrants. These will put an end to conditions of work that give rise to a perception of native workers being undercut by migrant workers, as in reality it is the unchecked employers in a neoliberal labour market and not the migrants to erode the working conditions. As a negotiating point with the EU, the UK could ask to link migration to job offers (and family union), which implies accepting mobility of labour rather than people, but it is absolutely crucial that once migrants are in the country, they have the same rights as native workers, and if they lose their job with a permanent (non-fixed term) contract, they should be able to stay and look for another job for a period proportionate to the duration of their employment in the UK up to that point without their continued residence being tied to their employer's will; anything short of this will lower the bargaining power of the migrants and increase the likelihood of pressure on the working conditions of the locals as well. Being honest about the positive impact of migration and how labour markets need to be regulated to make work pay is likely to be more realistic in the long run rather than accepting the scapegoat rhetoric which is not based on facts and claiming that some permanent or temporary emergency measures to cap migration would solve the problems of the working people in Britain. Obviously there are also some simple measures that need to be taken care of when it comes to compiling the statistics about migration; e.g. a separate category of migration statistics should be reported which exclude overseas students in the headcount. Finally, any change in the freedom of movement of people within the European Single Market will not be just to create an exception for the UK; it can only be accepted by the EU Member States if any change is welcome and desired by all Member States.

Labour standards and protection for workers and the environment should also be at the core of any international trade agreements. Similarly any deals for Foreign Direct Investment inflows should come with terms and conditions consistent with industrial policy priorities, e.g. negotiating for joint ventures and minimum local content, and labour standards. This is a very different attitude of globalisation compared to the investor dispute schemes, which are aimed at protecting the multinational corporations against the public and workers, as is the case in TTIP.

A post-Brexit deal that promises the UK banks passporting rights and operations in the EEA should also come with conditions to redefine the role of financial services to make sure that they are paying their taxes and delivering the financial intermediation that investments including small businesses require.

We should not let the Brexit vote to stand in the way of international cooperation. As part of a European alliance of progressive forces, we can work for more coordination of investment, social and labour market policies, regulation of capital markets and finance, tax coordination, ecological standards far better than we could on our own. Negative effects of openness or global integration are not an unavoidable destiny, rather an outcome of policies and institutional factors. Openness and regional integration can be managed in a way to benefit both the richer and poorer partners if trade and investment flows are designed as part of an egalitarian international economic policy. There is a lot more scope for international cooperation, in case the coordination failure can be overcome.

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