

BREXIT HURTS UK WAGES AND TRAINING: how the post-referendum depreciation of sterling is hitting the labour market

Far from helping to tackle the UK's longstanding challenges of stagnant productivity growth and real wages, the vote to leave the European Union (EU) has led to falling wages and training in industries hit by the rise in intermediate import prices resulting from sterling's depreciation.

That is the central finding of research by **Rui Costa**, **Swati Dhingra** and **Stephen Machin**, to be presented at the annual congress of the European Economic Association in Manchester in August 2019. They conclude that the deskilling that has followed the unexpected result of the Brexit referendum poses a long-term threat to human capital, worker earnings and productivity.

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In the 24 hours around the previously unexpected vote by the UK electorate to leave the EU, the value of sterling fell massively against other currencies. The researchers' empirical analysis makes use of this currency depreciation and its variation by the different structure of trade partners across industries to look at the impact of trade on wages and future earnings potential as measured by job-related education and training.

The key results are that wages and training fell for workers employed in sectors where the price of intermediate imports rose by more as a result of the sterling depreciation. A 1% increase in the price of intermediate imports, which arose due to the vote-induced sterling depreciation, led to a reduction of between 0.35% and 0.55% in hourly wages and cutbacks in the proportion of workers receiving job-related education and training of between 0.5% and 0.7%.

After the referendum, real wage growth was weak and turned negative in the aggregate. This was more the case for workers in sectors where the exchange rate depreciation bit hardest and raised the cost of intermediate imports.

Figure 1 uses data from the UK's Labour Force Survey to show the evolution of wages from the third quarter of 2012, 16 quarters before the referendum, to the second quarter of 2018. Workers in sectors that faced an above median intermediate imports weighted depreciation saw their wages grow 2.7% less compared with workers in sectors with below median depreciation.

Calibrating the estimated wage elasticity with respect to intermediate import prices to theory uncovers evidence of complementarity between workers and intermediate imports in production. This provides new direct evidence that in the modern world of global value chains, changes in the cost of intermediate imports increasingly act as a driver of the impact of globalisation on worker welfare. Thus, the cost shock that made intermediate imports more expensive required an adjustment by employers: workers bore the pain in the form of lower wages and training.

The finding of falls in wages and training after the Brexit vote offers poignant new evidence on how the recent surge in economic nationalism is taking its toll by adversely affecting workers.

At the very least, the results show that trade is no longer dominated by final demand, and that in the modern world of global value chains, the way in which trade affects worker welfare does not fit traditional conclusions.

To reiterate, in a classic setting with just trade in final goods, the depreciation of sterling after the Brexit vote would be expected to benefit UK exporters and increase demand for domestic workers. Instead, exports in sectors with a larger currency depreciation do not show greater uptake.

The sterling depreciation seems to have had a relatively deskilling impact on workers in industries that rely on specific foreign sources for their intermediate inputs, and it is this effect that dominates. This has scope to translate into a long-term negative impact on human capital, worker earnings and productivity – quite the opposite of what some expected a vote to leave the EU to deliver.

The relative decline in the real earnings of workers has acted to reinforce trends in real wage stagnation that were already particularly marked for UK workers over the past decade.

Coupled with the deskilling resulting from training cutbacks, UK workers have not fared well since the referendum. Over and above the Brexit noise, and the key issues of the future of trade, these findings add to widely expressed and growing concerns about poor productivity performance relating to skills and to patterns of real wage stagnation that are plaguing contemporary labour markets.

ENDS

'Trade and Worker Deskilling' by Rui Costa, Swati Dhingra and Stephen Machin

