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A BETTER GLOBALISATION FUND

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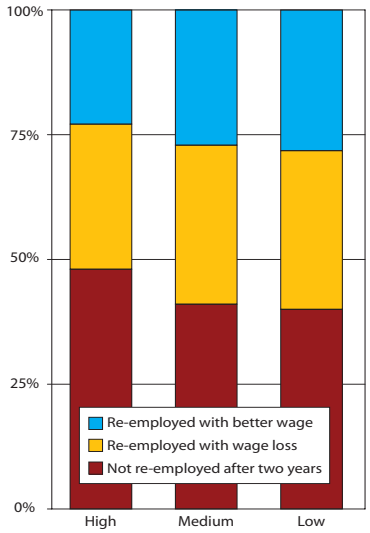
SUMMARY The recently adopted European Globalisation Adjustment Fund (EGF) is an EU response to the challenge of globalisation. It is to spend up to €500m annually supporting active labour market policies in Member States targeting workers affected by trade-induced (mass) layoffs. In principle, this EU effort to help trade-displaced workers makes sense since trade policy is also decided at EU level. In practice, EGF rules leave too much room for discretionary decisions, exposing it to political posturing and lobbying. During its critical first few years, **sound precedents must be established, eligibility rules should be strengthened, and rigorous evaluation should be built into the programme**. Otherwise, the EGF may come to be regarded as a political gimmick instead of a useful European response to globalisation.

Situation of manufacturing workers 24 months after redundancy in EU15



Prior employment in manufacturing grouped by intensity of import competition

Source: see Table 2

POLICY CHALLENGE

Displaced workers often face unemployment, a lower-paying job, or a new job far from home. Of these, the unemployed typically receive most public support. We propose that the EGF address this by focusing its limited funds on two simple active labour market schemes: wage insurance and mobility allowance. Wage insurance could offer workers whose pay was cut after displacement a top-up for up to two years amounting to half the difference between the old and the new wage. Those moving for a new job would receive a lump-sum mobility allowance equal to two months' gross pay in the previous job (four months for cross-border moves). These schemes should be scientifically evaluated to decide on the extension of the EGF when it expires in 2013.

THE political sustainability of globalisation is under threat. On both sides of the Atlantic, global economic integration is seen as one core factor in poor economic outcomes for below-average earners. Public opinion in France, the US, and Germany – in this order – favours keeping existing trade barriers, even if it might result in slower growth (see Figure 1). In the same poll, around 60 percent of respondents in both Europe and the US saw the rise of China as a threat; only one third saw it as an opportunity.

One of the underlying reasons for the fragility of globalisation is that globalisation creates large net gains, but some lose out and many more feel at risk. And in many OECD countries, those who lose out or who feel at risk already find themselves in the bottom half of the income distribution. To accommodate this distributional impact of globalisation, democratic societies have to perform a delicate balancing act involving redistribution between winners and losers[1].

In the EU context, this raises the question to what extent European instruments can usefully support these balancing acts by Member States. The European Globalisation Adjustment Fund (EGF), scheduled to be operational from early 2007, can be viewed as a litmus test in this respect[2]. Endowed with €500m per year until 2013, it will fund active labour market policies in Member States which target workers affected by trade-induced collective redundancies (see Box 1). The proposed fund has some similarities with the US Trade Adjustment Assistance (TAA), first introduced by the Kennedy administration in 1962, the expansion of which is being discussed in the US[3].

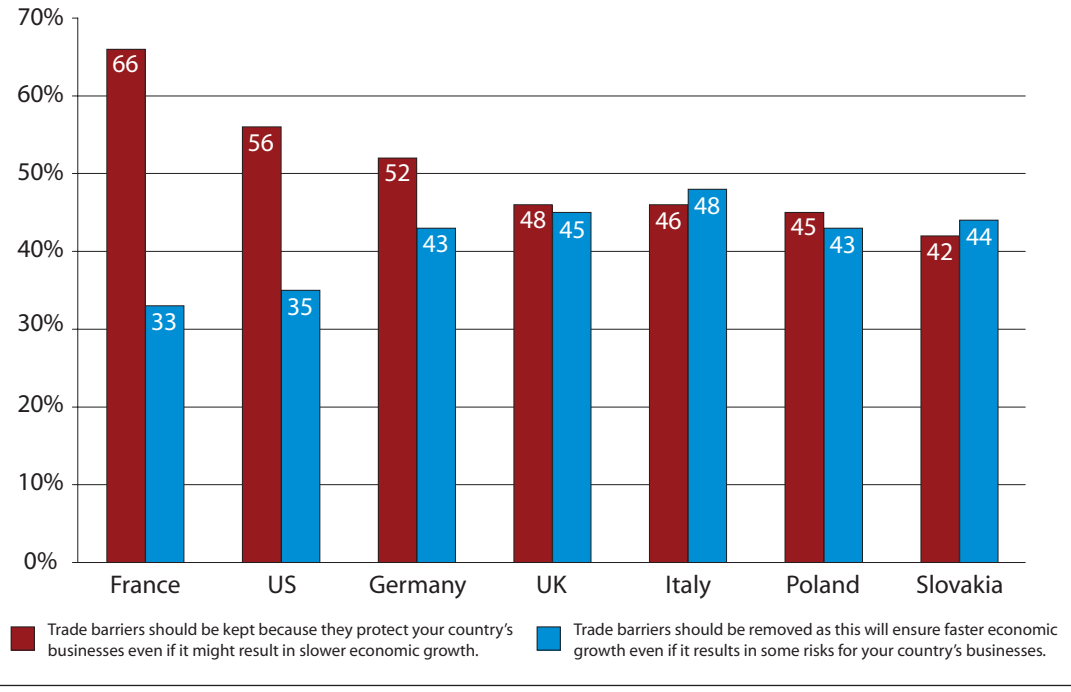
Section 1 provides the political context by summarising key arguments leading up to the establishment of the EGF in December 2006. In Section 2, the basic facts regarding displaced and trade-displaced workers in particular are presented. Section 3 discusses the advantage of sharp-edged rules for the EGF as opposed to discretionary allocation. In Section 4, concrete policy recommendations are made on how to strengthen the rules of the EGF.

1. RETRACING THE PROS AND CONS

The displacement of workers due to trade, technological progress, geographic shifts in economic activity and other shocks is an age-old phenomenon. And it is also widely accepted that national governments have a leading role to play in assisting displaced workers with their individual efforts to cope and to find a new job. Therefore, when the Barroso Commission proposed specifically to target workers displaced as a result of trade-related mass redundancies using European funds, this immediately raised some serious concerns.

A number of net contributor countries including Germany and Sweden did not originally want to pay for an EU adjustment mecha-

Figure 1: Public opinion in France, US, Germany favours existing trade barriers



Source: German Marshall Fund (2006)

[1] e.g. Frieden (2007).

[2] Direct EU support to individual trade displaced workers had already been proposed in Sapir et al. (2003).

[3] Kletzer and Rosen (2005); Brainard et al. (2005).

BOX 1

THE BASIC RULES GUIDING THE EGF

Size of Fund: The expenditure of the EGF may not exceed a maximum annual amount of €500 million (current prices) from 2007 to 2013.

Coverage: Support can be provided where changes in world trade patterns result in:

(a) at least 1 000 redundancies over a period of 4 months in an enterprise in a Member State, including workers made redundant in its suppliers or downstream producers, or

(b) at least 1 000 redundancies, over a period of 9 months, particularly in small or medium-sized enterprises, in a sector in one region or two contiguous regions.

In small labour markets or in exceptional circumstances, duly substantiated by the Member State(s) concerned, an application for a contribution from the EGF may be considered admissible even if the conditions laid down in subparagraphs (a) and (b) are not entirely met, when redundancies have a serious impact on employment and the local economy.

Eligible Measures: Active labour market measures designed to reintegrate redundant workers into the labour market are eligible for support, including: job-search assistance, occupational guidance, (re-)training, certification of acquired experience, outplacement assistance, entrepreneurship self-employment promotion, job-search allowances, mobility allowances or allowances for lifelong learning and training activities, and measures to stimulate the return to work of disadvantaged or older workers. Preparation, management, publicity, and control actives for the implementation of such programmes are also eligible. However, passive social protection measures are explicitly excluded from funding.

Legal Basis: Regulation (EC) No 1927/2006 of 20 December 2006.

nism, especially as they felt that they already had sufficiently developed national programmes to deal with adjustment issues. A related concern was that Member States slow to implement painful structural reforms might profit unduly from the proposal, as their restructuring backlog could be expected to draw disproportionate benefits from EGF.

Some critics argued that the proposal was primarily an expensive and self-serving public relations exercise of the Commission, without any compelling economic rationale. Other critics felt that, even as a public relations strategy, the EGF might backfire since its establishment would be an implicit acknowledgement of the adverse consequences of globalisation.

There were fears that the EGF might be a slippery slope towards an expensive and bureaucratic European welfare state run by the European Commission. Others felt that the EGF would be too small to be effective, in particular because it would be neither possible nor necessarily desirable to distinguish between the relatively few workers displaced by trade and the many displaced by other shocks[4]. So why was it that, in spite of these serious issues, the EGF (see Box 1) was adopted by the European Parliament and the Council of Ministers?

'The good cop/bad cop division of labour between Member States and the European Commission had perhaps been pushed too far.'

In addition to the complex *quid pro quo* considerations that are an integral part of almost any political decision-making process, one political and one economic argument in favour of the EGF seem particularly noteworthy. Politically, a number of Member States must have felt that the 'good cop/bad cop' division of labour between them and the European Commission had been pushed too far, and that this may have contributed to the stalling of the EU Constitution. According to that view, the division of labour – with the EU often in charge of efficiency-enhancing but unpopular moves towards greater liberalisation and globalisation, and Member States in charge of protecting their citizens from the adverse effects – needed to be adjusted in the enlightened self-interest of Member States. The EGF might have been a welcome opportunity to do just that.

From an economic perspective, the focus of the EGF on workers displaced by trade could be justified by the fact that trade policy has in effect been delegated to the European level, while Member States retain control rights to block decisions. Consider the hypothetical example of full trade liberalisation in textiles which would have greatly asymmetric effects between, say, Sweden, with hardly any textile industry, and Portugal with a substantial one. Sweden would be a key

[4] The archive of the news service Euractiv (www.euractiv.com) provides a good overview of the various points of view in this discussion, especially around the Hampton Court Summit in October 2005, which prepared the decision to establish the EGF.

beneficiary while the case would be somewhat less clear cut for Portugal, owing to the expected large number of displaced workers. Through the EGF, part of the cost of helping displaced textile workers in Portugal would be borne by Sweden, thereby making full trade liberalisation a more likely prospect. And although Sweden would be a net contributor to the EGF in that example, it might well be a net beneficiary of the arrangement as a whole. While, theoretically, such an unblocking of trade could be achieved through a web of bilateral transfer arrangements, in practice such transfers hardly ever take place and potential gains from opening up may fail to materialise.

Thus, in principle, an economic case could be made for EU involvement in assisting trade-displaced workers. But does this justify the EGF in practice? In this brief, we argue for a streamlined and, we believe, better EGF that could considerably strengthen the case for it.

Table 1

Very rough estimate of trade-related mass lay-offs

Category of annual job losses	Estimated number of job losses in the EU
Permanent job losses (rough estimate)	5.7 M
of which very roughly 10% trade related	570,000
of which very roughly 10% mass layoffs	57,000

Source: Bruegel estimates

2. DISPLACEMENT HITS HARD

The term 'displaced workers' typically refers to those workers whose working life has been seriously disrupted by a redundancy. Statistically, the number of workers displaced every year can be proxied by the number of permanent layoffs, namely the number of workers who do not find a new job within the same calendar year in which they lose their job. Extrapolating from EU15, we estimate that there are around 5.7 million permanent layoffs in EU27 per year[5].

Various studies and databases in both Europe and the US indicate that trade-related layoffs represent approximately 10 percent of all layoffs[6]. Furthermore, we observe that mass layoffs represent about 10 percent of all layoffs, according to the European Restructuring Monitor Database. On this basis, we arrive at a somewhat heroic estimate of 57,000 trade-related mass layoffs per year (see Table 1). This provides a very rough order of magnitude of how many eligible cases might be expected for the EGF. With an annual spending limit of €500m, and using this estimate,

Table 2

The cost of job displacements in the EU and the US

	Manufacturing	Non-Manufacturing	Manufacturing High import competition	Manufacturing Medium import competition	Manufacturing Low import competition
EU15 except Sweden 1994-2001					
Share re-employed after two years	57%	57%	52%	59%	60%
Re-employed: mean change in earnings	0%	7%	0%	-4%	3%
Share with no earning loss	46%	50%	44%	46%	47%
Share with losses greater than 30%	7%	8%	5%	7%	7%
US, 1979-99					
Share re-employed at survey date (+/- 24 mths*)	65%	69%	63%	65%	67%
Re-employed: mean change in wage	-12%	-4%	-13%	-13%	-9%
Share with no earning loss or earning more	35%	41%	36%	34%	38%
Share with losses greater than 30%	35%	29%	25%	25%	26%

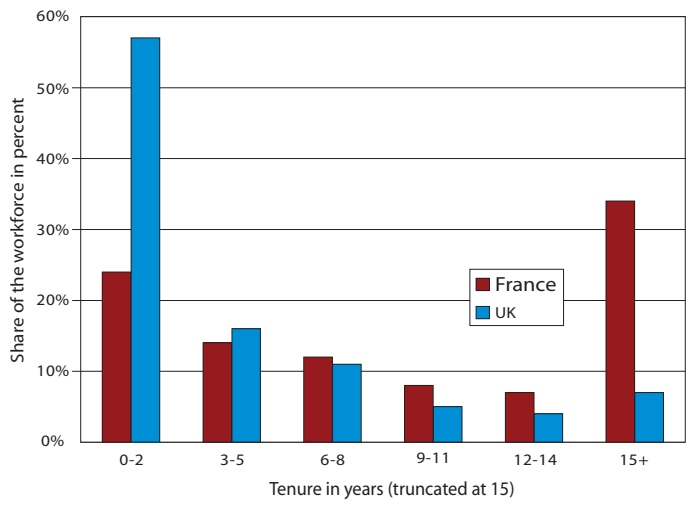
Source: Bruegel estimates based on Kletzer (2001) and OECD (2005).

(*) The re-employment rates are not directly comparable: the US data is based on retrospective questions, while EU data is based on a panel and thus follows more accurately a cohort of displaced workers.

[5] See Wasmer and von Weizsäcker (2007) for the technical underpinnings of this brief.

[6] This proportion may vary significantly depending on the definition used for trade-related redundancies.

Figure 2: Distribution of job tenures in France and the UK



Source: European Household Panel Database (European Commission)

the EGF might therefore be able to spend up to €9,000 per worker.

But how does this relate to the size of the typical economic loss that a displaced worker is expected to suffer? Statistically, this loss can be captured in two dimensions: the duration of unemployment (or the re-employment rate after a year), and the earnings gap compared to the previous job. The unemployment effect (especially in the EU) and the wage effect (especially in the US) can be serious. Evidence shows[7] higher non-employment rates after 12 months in continental Europe (45 percent in France, 40 percent in Germany) than in the US (24 percent) or the UK (12 percent). The re-employment rate after a year thus differs by up to 33 percentage points. The same source also indicates substantial wage losses for US and UK workers and no clear pattern in continental Europe.

Other findings (see Table 2) confirm that large income losses among those who take on a new job are much more prevalent in the US than in EU15, while the re-employment rate seems to be higher in the US.

Those workers who would have to accept a significant wage cut to find a new job are more likely to remain unemployed in Europe where welfare benefits are more generous. But beyond these regional differences, there is also considerable individual heterogeneity. Being older, having a lower level of education, longer tenure in the job and lower-level vocational skills makes it more difficult to cope with displacement.

As regards tenure, workers with more seniority are usually well protected and thus face a lower risk of being displaced but, when they are, they can be expected to suffer significantly larger wage losses. Average tenure differs widely across countries, as well as its distribution over the cross-section of the employed (see Figure 2). In the UK, there is an over-representation of tenures below three years and a small density of tenures above 15 years, while the opposite applies in France. This suggests that the social cost of displacement might be higher in a country like France than in a country like the UK.

The ability of workers ability to cope with structural change also depends on initial education, with longer and less specialised education reducing the cost of adjustment. Again, both the average number of years of education and the degree of specialisation of education vary significantly. In EU15, the average number of years of education is 11.6, which is about one year less than in the US (12.7) or Canada (12.9)[8]. Italy, Portugal, France, Spain and Greece have the shortest average number of years of education, between 10 and 11 years. The share of workers with vocational education is high in some countries (eg two thirds of the labour force in Poland) and moderate in others (34 percent in Estonia)[9].

In short, specialised labour has a lot to lose from displacement, either from long unemployment spells after displacement or wage losses. This also has political economy implications.

3. THE CASE FOR CLEARER RULES

First, note that there is hardly any difference in the fate of workers displaced by trade and workers displaced by other factors (see Table 2). So why provide additional support for trade-displaced workers and not, say, to those displaced by technological shocks?

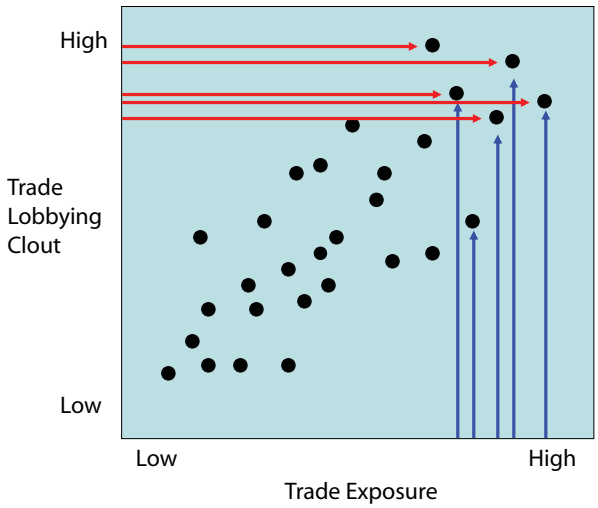
Support for displaced workers might simply be more effective at freeing up trade than at removing obstacles to the adoption of new technologies. It is striking how, in political decisions about trade liberalisation, the topic of displaced workers features prominently. By contrast, in political decisions about adoption of new technology, other considerations dominate: health, environmental and ethical concerns. Modern Luddites fighting new technology for reasons of job security hardly exist. Therefore,

[7] Kuhn (2002).

[8] Source: OECD (2004).

[9] Lamo et al. (2006).

Figure 3: Stylised correlation of lobbying clout and trade exposure



income support for those suffering from trade shocks might simply offer more 'bang for the buck' in political economy terms.

If indeed a focus on trade-displaced workers is justified in this way, the question remains how funds should ideally be allocated among the group of trade-displaced workers. From a social insurance perspective, those trade displaced workers hit the hardest should receive the most support. But from a trade liberalisation perspective, funds should be allocated in line with protectionist lobbying strength in order to achieve freer trade. Fortunately, these criteria are not necessarily incompatible. Other things being equal, those workers who have most to lose from trade liberalisation will have the greatest incentive to organise a protectionist lobby. However, the correlation is not perfect (see Figure 3 for an illustration), since there are other factors determining lobbying clout, such as geographic concentration.

'There is a clear advantage in allocating funds based on objective criteria: it reduces wasteful rent-seeking activity.'

Therefore, allocation of funds on the basis of competitive lobbying (indicated by the red arrows) and by objective criteria of trade exposure (indicated by blue arrows) while not yielding the same result, nevertheless produce a somewhat similar one. However, there is a clear advantage in allocating funds based on objective criteria: it reduces wasteful rent-seeking activity by affected regions and sectors. On balance, we would therefore favour allocation based on objective criteria of trade exposure.

Unfortunately, the current rules of the EGF leave a lot of room for discretionary decision-making and therefore competitive lobbying. The rules spell out neither necessary nor sufficient conditions for granting support. Decisions on whether funds will be granted, and how much, will be made on a case-by-case basis. A rather large range of applications from Member States has some chance of approval. But it is not clear in advance whether funds will be granted in any given case, or how much. Therefore, it would seem advisable to amend the EGF rules, so as to provide reliable necessary and sufficient criteria for the allocation of funds.

4. LESS IS MORE

Displaced workers are often faced with the unhappy choice between unemployment, or taking a new job that pays substantially less, or accepting a new job far away from home. But in the EU, those who become unemployed traditionally receive much more public support than those who take a substantial wage cut or those who agree to uproot themselves and move[10]. With the present stipulation of the EGF that funds must be spent on active labour market policy, Member States are implicitly acknowledging that national policies often suffer from this imbalance.

However, rather than attempting to spread best practice on how to address the imbalance, the present delimitation of the EGF to "active labour market policy" is vague. For example, under current EGF rules, unemployment benefits are not covered, but in most countries unemployment assistance comes with an active job-search requirement. Thus, there might be a temptation to label it as an active labour market policy. Other items such as entrepreneurial assistance and training schemes are difficult to monitor at EU level. In particular, the track record of training as an active job-market policy is mixed[11].

In view of these difficulties, we recommend to sharpen considerably the profile of the EGF, focusing its scarce resources on a limited number of particularly suitable active labour market policies. They should be effective and support displaced workers in line with their individual exposure. They should be transparent, simple and relatively easy to monitor and evaluate.

[10] Replacement rates have been on average around 25-30 percent in the US and the UK, and around 60 percent in many continental European countries such as France, Spain or Denmark (Nickell et al. 2005). Mobility rates are three times higher in the US than in Europe (eg Wasmer et al. 2007).

[11] See the excellent survey by Bassanini et al. (2007) who findlittle evidence of private returns to training on less skilled wokers, and the contrasting macro view in Bassanini and Duval (2006), emphasizing the negative correlations between public training expenditures and unemployment rates.

The downside of a more focused approach such as this is also clear: the choice of Member States on how EGF funds are to be spent in their country would be reduced. However, in view of the likely advantages, this might well be acceptable, especially if Member States could be assured of a rigorous scientific evaluation of the EGF's performance.

Specifically, we propose to support just two active labour market policies: wage insurance and mobility allowance. The wage insurance would help those displaced workers who accepted a pay cut in order to find a new job by paying them a wage top-up. And a mobility allowance would partially compensate workers for the private discomfort and expense of moving to find a new job. Both schemes directly signal the public interest in workers accepting a new job, rather than remaining unemployed, by providing a positive financial incentive.

Wage insurance

Wage insurance would be provided to every eligible displaced worker who was forced to accept a pay-cut in order to find a new job. We propose that the wage insurance programme would pay a top-up of between half and two thirds of the pay difference between the net salary of the old and the new job, for up to two years. This proposal is similar to the Alternative Trade Adjustment Assistance, one component of the US TAA. Indeed, a number of programmes providing sizeable wage complements, such as the Self-Sufficiency Program in Canada (SSP), have been shown to be effective labour market policies[12].

'We propose to support just two active labour market policies: wage insurance and mobility allowance.'

Of course, even with a conceptually very simple programme like this, a number of complex technical questions would need to be addressed, taking the specificities of EU27 into account. For example, a workable and abuse-proof definition of the old and new net salary and rules for the portability of the wage insurance across EU member states would have to be agreed. A sound relationship would need to be organised between the proposed wage insurance and similar schemes that already exist in some member states[13]. Despite these difficult details, we are optimistic that not least the conceptual simplicity of the scheme would assure high visibility and reasonable take-up rates.

'Immobility is partly subsidised by unemployment insurance and other parts of the welfare state.'

Mobility allowance

Since immobility is partly subsidised by unemployment insurance and other parts of the welfare state, a subsidy for intra-EU mobility might be desirable to redress this distortion. In fact, without an additional subsidy for mobility, the proposed wage subsidy might even make this immobility distortion worse by inciting people to take on a lower paid (but subsidised) job in their home region instead of taking on a higher-paid (but unsubsidised) job in a different region or country.

Therefore, we propose to introduce a mobility allowance amounting to two months' previous gross pay for job-related moves of more than 50km. For cross-border moves, two extra months would be added to the allowance to encourage intra-EU mobility. Alternatively, a reimbursement of some fraction of the actual costs of moving might have been considered, but this would be much more bureaucratic without being much more precise. The reason is that the monetary costs of moving are often dwarfed by emotional and social costs, such as the lost support from social networks and the difficulties of dependants to re-adjust.

Budgetary considerations

This raises the question whether €500m could actually pay for the proposed measures. On the generous assumption that wage insurance would lead to an increase of the activity rate among eligible displaced workers from 57 percent to 75 percent, we estimate that around 150,000 displaced workers could fall within the scope of the scheme with the available funds, with a 50 percent wage insurance. Eligibility could thus probably be broadened by a factor three, compared to the current definition of mass displaced workers. Alternatively, benefits could be made more generous, for example by offering wage insurance up to two thirds of the difference between the previous and the new wage, effectively limiting its scope to about 120,000 displaced workers a year.

Scientific evaluation

Finally, a systematic ex-post evaluation of the use of the EGF should be undertaken after the first two years. For it to be scientific, individual data should be collected on workers receiving the subsidies, and on those not receiving it but with individual characteristics that are sufficiently close to those of aided groups. This was done for the Canadian Self-Sufficiency Program and careful evaluation on the basis of data col-

[12] See Michalopoulos et al. (2002).

[13] eg France: "Allocation temporaires dégressives" for firms with at least 50 employees and for which 10 employees or more or laid off; Germany: "Entgeltsicherung für ältere Arbeitnehmer" for older workers.

lected has led to a relative consensus on its pros and cons.

In the same way, systematic data collection should be made mandatory for the programmes supported by the EGF and those data be made available to the research community. The debate generated by the resulting independent academic studies would ensure tight control over the programme. In particular, such an evaluation would create a reassuringly solid basis for Member States to decide on the future of the EGF when its funding expires in 2013.

Outlook

In the coming years, the simple picture of who are likely winners and who are likely losers of globalisation may become ever-more fragmented due to increasing "trade in tasks"[14]. Such a development might also further complicate the delineation of trade-related and non-trade-related displacements of workers. If the EGF were to prove effective, it may therefore be conceivable to scale it up further to meet this challenge, not least in view of the inevitable debate on the reform of the much larger European Social Fund with an annual funding of approximately €10 billion (about 20 times as large as the EGF). And if the EGF does not prove effective, one should not hesitate to give the money back to the EU budget or to Member States.

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[14] See Grossman and Rossi-Hansberg (2006).

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