Winning Over Globalization's Losers

Etienne Wasmer and *Jakob von Weizsäcker*

On both sides of the Atlantic, many view economic globalization as a threat to below-average earners. According to a recent poll by the German Marshall Fund, majorities in France, Germany, and the United States favor maintaining existing trade barriers, even if doing so hampers economic growth. Clearly, the large net gains from global economic integration are not enough to convince those who have lost their jobs and the many others who feel at risk.

The recently established European Globalization Adjustment Fund (EGF) is an EU-wide response to this challenge. The EGF can spend up to €500 million annually in EU member states on workers affected by trade-induced layoffs. But sharing the benefits of globalization with the losers is traditionally regarded as a national responsibility. For example, the inspiration for the EGF, America's Trade Adjustment Assistance, introduced by the Kennedy administration in 1962, is a purely national scheme. Is EU involvement really justified?

The economic case for a European globalization fund is that trade policy has been delegated to the European level, while Union members retain control rights to block decisions. Consider the hypothetical example of full trade liberalization 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 clear beneficiary while Portugal would be hit hard, owing to the large number of displaced textile workers.

The negative impact of such redundancies is serious. OECD statistics show that 40% to 50% of displaced manufacturing workers in the EU15 remain without a job 24 months after becoming unemployed. Around 30% work in a job that pays less than the previous one. Only around one-quarter are re-employed with a wage at or above the previous level (see chart).

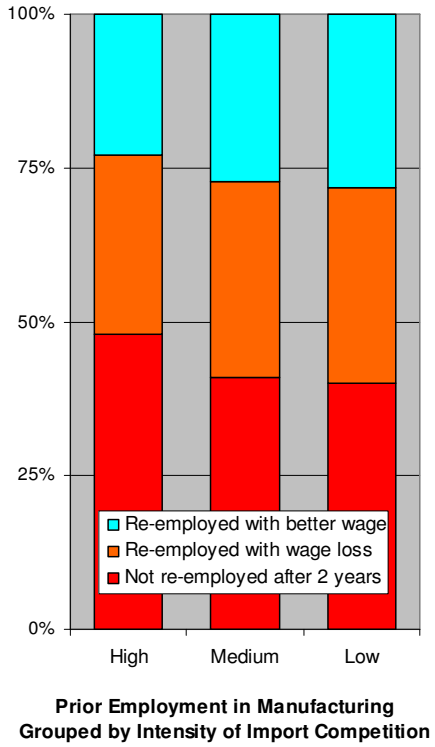

Chart: **Manufacturing Workers 24 Months after Layoff in the EU15**
Source : OECD

Through the EGF, part of the cost of helping displaced textile workers would be borne by all EU countries, thereby making wider trade liberalization a more likely prospect. Although Sweden, for example, would be a net contributor to the EGF, it might well be a net beneficiary of the arrangement as a whole. In principle, a web of bilateral transfer arrangements could achieve such an unblocking of trade. In practice, however, such transfers hardly ever take place, so the potential gains from opening trade may fail to materialize.

Nevertheless, the EGF's rules need to be tightened, lest the scheme comes to be regarded as a political gimmick. The current setup leaves too much room for discretion, as neither necessary nor sufficient conditions for aid are clearly spelled out. This will expose the EGF to wasteful political posturing and lobbying by countries and sectors. The EGF's rules should be amended to ensure that governments and trade-displaced workers receive transparent, visible, and reliable assistance, as well as to spread best practice in active labor market policy.

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. To address this distortion head on, and to provide clarity concerning the allocation of funds, the EGF should focus its limited funds on two simple active labor market programs: wage insurance and mobility allowance.

Wage insurance could offer workers whose pay was cut after displacement compensation for up to two years amounting to half the difference between the old and the new wage. The mobility allowance could offer those moving for a new job a lump-sum payment of two months' gross pay in the previous job, or four months' pay for cross-border moves. The very simplicity of this scheme will likely ensure high visibility and reasonable take-up rates.

The downside of such a focused approach is also clear: the margin of choice for EU members about how EGF funds are to be spent in their country would be minimal. In view of the likely advantages, this might be acceptable if member states could be assured that, if the schemes work, it will be expanded. This can be done as part of a reform of the European Social Fund, which has an annual budget of around €10 billion – twenty times the current funding of the EGF.

If the EGF does not prove effective, the money can simply be given back to the EU budget or to member states. But if the EGF does work, the benefits would far outweigh the costs.

Etienne Wasmer is Professor of Economics at Sciences-Po and OFCE in Paris. Jakob von Weizsäcker is a research fellow at Bruegel, a Brussels-based think tank.