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## **Special Report: In the shadow of prosperity - Trade's victims; Trade's victims**

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**Full Text** (2162 words)

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Hard truths about helping the losers from globalisation

NESTLED among the wooded Blue Ridge mountains in Virginia's far south-west, Galax is a town of bluegrass music, barbecue and hardscrabble living. It is home to an annual fiddlers' convention and, less happily, a huddle of textile and furniture factories. Over the past few years, globalisation has hit hard.

Unable to compete with Mexican and then Chinese competition, the town's old industries have withered, taking thousands of jobs with them. Last year brought the biggest single blow. Three big factories closed their doors within months. More than 1,000 people, around one-sixth of the town's workforce, lost their jobs.

Galax then acquired an "Economic Crisis Strike Force" for displaced workers, sent in by Virginia's governor, Tim Kaine. Housed behind a liquor store in an old strip mall, the Strike Force helps people apply for Trade Adjustment Assistance (TAA), the government support America offers to those deemed to have lost their jobs to global competition. TAA includes up to two years of unemployment benefits while retraining, temporary subsidies to help pay medical insurance and, for those over 50, a short-term top-up to any lower-paying new job. The centre also co-ordinates more basic help, from child care to food banks run by private charities.

Thousands of people have walked through its doors in the past nine months, many several times. Around one-third of those laid off last year are being retrained. Many others have found new jobs. At 6%, Galax's unemployment rate is twice Virginia's average, but no higher than it was a year ago.

For some, particularly those in their 50s, the future looks bleak. At 59, Paul Rotan sees little chance of finding another job with health insurance, but he is still six years away from qualifying for Medicare, the government health plan for the old. He is terrified of what will happen in June when the temporary public subsidies for his health insurance end.

But other, mainly younger, workers are already better off. After 19 years in a textile factory, Bobby Edwards has retrained as a radiologist. Brian Deaton has set up a thriving picture-framing business and has started selling gourmet coffee. Few of these people are enthusiastic about globalisation. "No one trusts China around here," is a common refrain. But government help has cushioned the shock. "I'd be lost if they weren't here," says Mr Rotan, nodding towards the centre's staff.

In the neat world of economics text-books the downside of globalisation looks much like Galax. Low-skilled workers in a rich country, such as America, suffer when trade expands with a poorer country with plenty of much cheaper low-skilled workers, such as China.

If labour markets are efficient in the rich country the displaced workers should find new jobs, but their wages will probably fall. Although the country overall gains handsomely, these people are often worse off. Hence the case for redistributing some of trade's gains and compensating the low-skilled losers. Traditionally, trade-displaced workers have also tended to be older and less educated than typical workers, and to have worked in only one industry. They take longer than average to find another job and, when they find one, are more likely to see their wages fall.

In America, where labour markets are flexible, the impact is felt on wages more than employment. In Europe fewer trade-displaced workers find new jobs quickly, but those who do take less of a pay cut. One study suggests that, during the 1980s-90s, 65% of manufacturing workers in America who lost their jobs to freer trade were employed two years later, but most took a pay cut. A quarter suffered pay losses of more than 30%. In Europe during the 1990s, in contrast, less than 60% of workers in the same situation had found a new job, but only 7% saw their pay fall more than 30%.

How much to spend?

Nonetheless, help for displaced workers has always been modest compared with the gains from trade. In America, where the social safety net is thinner than in other rich countries, those officially deemed hurt by trade are singled out. Their unemployment assistance lasts four times longer than ordinary workers', and they get more retraining. The United States spends around \$1 billion a year on helping trade-displaced workers. But the economy overall, by one estimate, gains \$1 trillion a year from freer trade.

In Europe overall public safety nets are far more generous, although in many countries they are being scaled back. European governments also spend much more money than America's on training and other "active" help for all workers. In this more comfortable environment, globalisation's losers have never been singled out.

That may be changing. Public scepticism about trade is rising in both rich countries and poor. A host of big economic shifts, such as rising income inequality, are blamed on global integration. The Doha round of trade talks has long been stalled. America's elections last November brought in a clutch of lawmakers deeply opposed to freer trade. To control this backlash, globalisation's champions are keen to appear more sensitive to the losers.

Already, some shifts are evident. One of the first bills introduced in the Democrat-controlled Senate is a big expansion of TAA, covering not merely manufacturing workers but also service workers whose jobs have been "offshored", and offering help not just to individual factories, but to whole industries.

Introduced by President Kennedy in 1962 to shore up support for tariff cuts, TAA has long been used to buy congressional support for trade deals. It was expanded as part of the North American Free Trade Agreement in 1993 and again in 2002 when George Bush asked Congress for special negotiating authority to pursue trade deals. The fate of the current bill is uncertain, but the Democrats have stressed that their support for future trade agreements depends on more help for workers who lose out.

In Europe the political pressure is similar. As Italy's shoemakers protest about Chinese competition and Germany's car-workers worry about "offshoring" to cheaper eastern Europe, the European Union has recently created a euro500m (\$650m) Globalisation Adjustment Fund to offer job counselling, training and other help when more than 1,000 people in a firm or industry lose their jobs because of "structural changes in world trade patterns".

But cause and effect may not be so obvious. People filter in and out of employment in huge numbers all the time. In America around 20m jobs, or about one in seven, are lost involuntarily every year. Only a small fraction of those, some 2m-3m a year or 2% of all jobs, are permanent "displacements", where workers have little or no prospect of returning to their old industry. The displacement rates for Europe are broadly similar. And only a small share of these permanent job losses can be directly attributed to globalisation, rather than, say, to technological change.

One study by Lori Kletzer of the University of California, Santa Cruz found that only 14% of displaced manufacturing workers are in industries facing intense international competition. To judge by the number of people receiving TAA, the figure is even lower: fewer than 120,000 workers were deemed eligible for it in 2005. In the much bigger services sector, the share is lower still. For all the hoopla about offshoring, the best estimates suggest that only about 1m American service-sector jobs have actually moved overseas. In short, trade's role in job losses is much smaller than the public angst suggests.

Most economists have long held that technology, rather than globalisation, is the main cause of the rising gap between the pay of the high- and low-skilled. But some argue that the distinctions between trade and technology are increasingly irrelevant. Progress in information and communication technology means that traditional trade models, and their predictions of winners and losers by skill level, are becoming outdated (see page 90).

In the 21st century competition between firms and industries, such as Galax's furniture factories and their Chinese rivals, is becoming less important than competition between individual tasks within firms in different countries. Whether he is employed in a furniture company or a hospital, the American data-processor will be competing against

someone from Bangalore. Rather than affecting entire industries, or whole factories, global competition will affect individual jobs--skilled as much as unskilled.

Such a shift helps explain the popular nervousness about globalisation. Many more workers are worried that their jobs will be at risk. That, in turn, increases the political appeal of assisting trade's losers. But it also makes those losers even harder to identify. And it undermines at least one reason for offering them special help. When trade-displaced workers were older, less educated and hence less easily re-employable than others, helping to retrain them improved the economy's efficiency. But as potential job losses from trade shift up the skill ladder and across industries, those displaced by trade will look much like the rest of the workforce.

#### An alluring Danish model

As a result, it may be better to focus on policies which improve job prospects for all workers. In Europe, Denmark has led the way. The Danish system of "flexicurity" appears to offer the best of both worlds: dynamic labour markets and low unemployment coupled with generous support for those who lose their jobs.

Denmark has a long history of weak job protection. Employers hire and dismiss people at will. Around a quarter of the workforce is unemployed at some point in any year. But the jobless enjoy generous welfare benefits while they look for work, around 80% of their previous wage on average. To ensure this does not deter people from finding new jobs, the Danes oblige the unemployed to be trained and to look diligently for work.

The European Union is urging its members to follow the "flexicurity" model. Democratic wonks in America enthuse about it too. But Denmark's approach has evolved over decades and cannot easily be copied. Besides, it is extremely expensive. Although Denmark has an unemployment rate of under 5%, it spends more than 5% of GDP on the unemployed, including almost 2% of GDP on its "active" training and job-search programmes. It pays for it with one of the highest tax rates on labour income in the world--one many other European countries, with much higher unemployment rates, could not afford.

For America, which currently spends a mere 0.16% of GDP on such "active" labour-market policies, the idea of Danish-style "flexicurity" is more a slogan than a serious suggestion. Academics agree that employers are far better at training workers than the state. Few politicians in either party support a dramatic expansion of government training programmes.

An alternative approach is to give displaced workers a subsidy if they are forced into a lower-paid job. Such "wage insurance" already exists in a modest form on both sides of the Atlantic. Since 2003 Germany has a scheme where the government makes up 50% of the wages lost by people over 50 who are forced into a lower-paying job. France has a similar scheme with no age qualifications, but limits the subsidy to two years. Since 2002 America's TAA has offered wage insurance to any trade-displaced worker over 50: the government pays half the difference between the old and new wage for two years, up to a maximum of \$10,000.

#### Getting other things right

These experiments are too new to evaluate. But in theory wage insurance is appealing. It helps soothe workers' fears that they will suddenly lose income, but also keeps labour markets flexible by encouraging people to find a new job quickly. Many on America's centre-left see it as the key to maintaining political support for trade.

The proposed expansion of TAA would make any trade-displaced worker over 40 eligible for wage insurance. And more ideas are floating around Washington's think-tanks. One would restructure America's system of unemployment insurance so that the government focused less on smoothing the earnings of the temporarily unemployed and more on helping those who face a longer-term loss of wages. Another would simply expand the type of insurance in today's TAA to displaced workers. The cost, according to Howard Rosen of the Peterson Institute for International Economics, would be \$4 billion a year: still far less than the gains from trade.

As public fears of globalisation rise, so will the political appeal of these schemes. But they will have less impact than getting other, more basic, policies right. Globalisation underscores the need for a flexible, dynamic labour market and a well-educated, adaptable workforce. And a worker whose health care is not tied to his job will be less worried about trade than one for whom job loss also spells the loss of medical insurance. The tasks of freeing up labour markets (in Europe), reforming health care (in America) and improving education (everywhere) are far more important than any amount of experimentation with wage insurance or retraining schemes. If politicians really want to respond to the worries caused by globalisation, those are still the best places to start.

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