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Trade Adjustment Assistance: Past Issues, Current Concerns, and a Possible Solution

Mike Hanson

ABSTRACT. Compensating workers who are displaced by trade provides a key political tool for advancing the cause of free trade. Since 1962 the United States has provided such compensation through Trade Adjustment Assistance. Throughout much of the program's relatively short life, there has been much criticism of its effectiveness. However, converting the program to one that provides earnings insurance rather than income replacement would greatly improve the program by providing strong incentives to find work.

I. Introduction

The protests at the WTO summit in Seattle late last year demonstrated that the benefits of free trade are largely unknown, misunderstood, or unacceptable to many people. Some of the basic benefits of free trade are increased competition, lower prices for consumers, and easier access to technology. While these benefits will have positive effects for the vast majority of people in the United States, it should also be said that there will be people who lose. As trade theory predicts, unskilled labor may be subject to import competition and some Americans will most likely lose their jobs. Industries who feel they are susceptible to foreign competition often lobby against the opening of U.S. borders claiming they are fighting to save American jobs. Recently, the Clinton Administration raised tariffs on certain steel imports and used the "saving jobs" argument as the reason for doing so [Cooper, 2000, A36]. On the same day, the AFL-CIO announced it was donating \$40 million to the Democratic party to help Al Gore win the presidency and help the party win back control of Congress [AP, 2000, C5]. The tariffs implemented are passed on to the consumer in the form of higher prices, all for the supposed saving of 4,000 American jobs [Cooper, 2000, A36].

A way to curb protectionist pressure within the United States, then, is to compensate workers who do lose their jobs due to increased imports and increased foreign competition. Such a program does exist. It is

called Trade Adjustment Assistance. While the program is very attractive politically, economic analysis shows that it has been ineffective in assisting the adjustment of workers who are displaced by trade. Currently the program focuses primarily on earnings replacement and secondly on job retraining. However, Trade Adjustment Assistance would be most effective in getting displaced workers to reenter the workforce quickly if it were converted to an earnings insurance program.

While the effects of job loss or layoff to the displaced worker can be extreme, the fact is that only a small percentage of the American workforce is in competition with foreign workers. According to Daniel T. Grisswold from the Cato Institute, in 1998, 108.7 million Americans worked in essentially non-tradable sectors while 19 million were employed in mining and manufacturing, sectors that are traditionally against freer trade. Excluding agriculture, this means that 85 percent of the workforce is immune to import competition [1999, 4]. A closer look at the manufacturing sector reveals that even fewer American jobs are at stake. The official definition of an import sensitive industry is one that has a four-digit Standard Industrial Classification number where imports totaled at least 30 percent of new supply. Using data from 1994, of the more than 450 separate manufacturing sectors with four-digit SIC numbers, only 66 were found to have import penetrations greater than 30 percent. The clothing industry is in the most potential danger, as imports accounted for more than one third of new supply. Employment in the clothing industry was 559,400 in 1994. Total employment in import sensitive industries reveal that nearly 2.2 million people have legitimate cause for concern about their jobs. However, employment in import sensitive industries accounts for only two percent of the entire U.S. workforce and twelve percent of the entire U.S. manufacturing sector [Grisswold, 1999, 5-6]. The vast majority of Americans will, therefore, not be hurt from free trade. While not discounting the hardships that will be endured from those who lose their jobs, protectionism is not in the best interest of the United States.

II. A Brief History

The idea of providing assistance to those directly affected by trade is not a new one. David McDonald of the United Steelworkers Union first proposed it to the Randall Commission in 1953, which was established by

President Eisenhower to give advice on future trade policy. The proposal was defeated 16 to 1 by the commission, but was picked up by Democratic senators. In 1962, it was included in the Kennedy administration's Trade Expansion Act. The political logic of the time was such that it offered a middle course of action, particularly for liberal Democrats. The legislation supported free trade, which would help the economy become more efficient, and satisfied organized labor by allowing for compensation to displaced workers [Destler, 1998, 391]. In reality, however, the so-called victory of the legislation proved to be in principle only. Because eligibility for the workers' compensation was so severely restricted by Section 302, the U.S. Tariff Commission rejected all applicants through fiscal year 1969. Section 302 limited trade adjustment assistance in two ways. Workers first had to show that their job was lost due to an increase in imports. Next they had to show that the increase in imports was due to a specific change in U.S. trade policy. By 1974, less than 50,000 workers had won benefits. Because of the ineffectiveness of the program, the AFL-CIO switched its stance on free trade and sought aggressively for protectionist measures [Destler, 1998, 392].

The following year Trade Adjustment Assistance (TAA) benefits became more available and President Ford authorized "expedited adjustment assistance" in the wake of escape clause petitions issued by industries attempting to induce protection. Under the escape clause the President can authorize temporary protection against imports that are found to cause "serious injury" to a domestic industry [Burtless, 1998, 138]. Like the earlier Kennedy administration, Ford found adjustment assistance an attractive solution to appease the interests of organized labor and maintain open borders [Destler, 1998, 392]. By 1980, program spending on TAA had reached \$1.6 billion. With its newfound size the program came under much criticism. There was doubt as to why workers displaced by trade should be treated differently from workers displaced by other factors.

Although money was now being provided to the displaced workers, the effectiveness of the compensation was also being questioned. Studies found little evidence to support the claim that TAA encouraged labor market adjustment [Aho, 1984, 170]. Because the benefits of TAA were generous relative to that of regular unemployment compensation and retraining opportunities were scarce, the program mostly encouraged

trade displaced workers to remain unemployed in hopes of getting their old job back [Destler, 1998, 393]. These charges nearly brought an end to the TAA program in 1981 when President Reagan instituted a series of budget cuts. Benefits were limited to that of regular unemployment insurance and would not be made available until regular unemployment insurance benefits had been exhausted. Nevertheless, the program stayed afloat and even expanded benefits slightly in 1991 [Destler, 1998, 394]. Since 1995, annual expenditures on trade adjustment assistance have been about \$350 million [Bohanon and Flowers, 1998, 66].

III. Predictions and Results

Trade theory predicts that the opening up of borders will increase the return to the abundant factor of production and decrease the return to the scarce factor of production. According to the Heckscher-Ohlin theorem, a country will import the goods that use the scarce factor of production intensively and export goods that use the abundant factor intensively. As domestic production of the scarce factor good decreases, demand for that factor will decrease. When demand for the scarce factor decreases, the return to the scarce factor will also decrease. The converse is true for the abundant factor of production. Demand for the abundant factor good will increase, which increases demand for the abundant factor of production, which increases the return to the abundant factor of production [Yarbrough, 1997, 88]. Within the United States, the theory predicts that the return on skilled labor (and capital) will increase while the wages of unskilled workers will decrease.

Studies of the impact of trade on the unskilled have produced conflicting conclusions. A study done by Richard Freeman and Lawrence Katz suggests that if an industry experiences a 10 percent increase in imports, employment is reduced by 5 percent and wages are reduced by up to 0.64 percent [Kletzer, 1998, 427]. Gene Grossman finds that out of nine manufacturing industries during the period 1969-1979, only one experienced significant employment effects due to declining import prices. In a separate study, Grossman argues that employment reductions in the steel industry were due to the appreciation of the dollar and not increasing foreign competitiveness. On the other hand, Ana Revenga concludes that for a sample of manufacturing industries from 1977-1987, changes in import prices did lead to a sizeable effect on employment,

though less so on wages [Kletzer, 1998, 429]. The point is that the true impact of trade on employment and wages is not yet fully understood. Although it seems logical that trade is a possible explanation for wage stagnation for unskilled workers and the increasing wage gap between high- and low-skilled workers in the U.S., there is simply not enough evidence to merit the claim that trade alone is responsible.

IV. The Current TAA Program

The modern TAA program has four main components. The first is a cash payment to the dislocated worker after the six-month limit on regular unemployment insurance (UI) expires, which is available for up to one year after UI is exhausted. After the 1988 amendments to the TAA program, enrollment in some form of job training is required to receive the cash payment [Decker, 1995, 759]. The others are forms of in-kind transfers that include job search assistance and compensation for relocation expenses.

While it is fairly well understood which sectors are most susceptible to trade, studies on the demographics of the workers in those sectors have not produced consistent results. Some show workers in highly import sensitive industries tended to be younger, less educated, and less experienced than workers in low to medium import sensitive industries. Real weekly earnings and health care benefits for workers in highly import sensitive industries tended to be significantly lower than their counterparts [Kletzer, 1998, 450]. Other studies show that TAA recipients were paid better wages than workers displaced for other reasons. Such studies also show that TAA recipients were more likely to have health insurance, belong to a union, and have more job tenure [Decker, 1995, 761]. Finally, a report issued by the U.S. Department of Labor and Office of the Inspector General reveals that the "average" TAA recipient "was 43 years old, had an eleventh grade education, worked 10.6 years with the adversely affected employer, and made an average weekly wage of \$440 [1993, 46]."

Since 1974, nearly two million people have qualified for TAA, though only a portion of them ever received benefits as some found reemployment before they became entitled to the benefits [Burtless, 1998, 141]. It is also important to note that only workers in manufacturing and mining industries have qualified for TAA [Jacobson, 1998, 486]. Paul

Decker and Walter Corson find that workers in clothing and extraction (oil and gas) industries are most likely to receive TAA benefits [1995, 761]. The main criticism of the TAA cash payment (along with many other forms of cash transfers) is that it provides a disincentive to work and slows down the adjustment process. The median duration of unemployment among TAA recipients was 55 weeks, compared to a median of 39 weeks for other unemployed persons [Decker, 1995, 764]. The slowing of the adjustment process is significant because it has been found that the length of unemployment influences the chances of reemployment. Employers tend to discount the qualifications of a job applicant more the longer the applicant has been out of work [Burtless, 1998, 142].

Of the remaining three components of TAA, the two most widely used are job retraining and job search assistance (JSA). The most effective of the two seems to be JSA, not so much for its successes but relative to the failure of job retraining. Many studies support this claim, at least to the point of showing the lack of success for retraining. Duane Leigh concludes in his book, *Does Training Work for Displaced Workers?*, by saying that:

Evidence...indicates that classroom training fails to have a sizeable incremental effect on earnings and employment above that of JSA...It certainly does not appear to be the case that the additional effect of classroom training is large enough to compensate for its higher cost [1990, 47]

A later study by Paul Decker and Walter Corson reach similar results. They found that workers who choose to participate in TAA sponsored training earned *less* than those who choose not to participate in training, at least for the first three years. In cases where training participants earned more than non-participants the differences were attributed to individual characteristics such as age, level of education, or motivation [1995, 768-9].

There are distinct advantages to JSA over job retraining. It is more flexible than retraining because it is not dependent on the classroom skills of adults who have been out of school for many years. Another negative aspect of job retraining is that it requires job openings to match a narrow set of skills. This can leave successful "graduates" of retraining programs

without a training-related job. In addition, highly tenured dislocated workers will mostly likely have rusty job seeking skills. The use of an expert to assist them in finding reemployment can often result in better matches than if the worker acted alone [Jacobson, 1998, 508].

A recent article in *The Wall Street Journal* describes how a \$45 million grant awarded to El Paso, Texas, has had limited results. The grant was intended to help some 4,500 workers, mostly from the garment industry, find jobs after theirs had been exported to Mexico in the wake of NAFTA. The program was labeled the Proactive Reemployment Project (PREP) and began in June of 1998. Only 375 workers have been placed in new jobs since then and nearly \$25 million has been spent. The main criticisms of the PREP are that the local institutions have been understaffed to meet the demands of the participants. Ironically, a much smaller jobs program in El Paso that focuses on developing skills for factory jobs has been able place 80 percent of its participants in basic factory jobs within five months [Templin, 2000, B1].

Although the concept of trade adjustment assistance seems reasonable, it is not without its share of controversy. As mentioned earlier, some critics contend that it is unfair to offer special or separate compensation for workers displaced by trade. Their main contention is that trade is just one of many factors that force economic adjustment and should be treated no differently than advances in technology or shifting demand. The point is contestable. Assistance can be justified from a policy standpoint because free trade is for the benefit of society and those who are adversely affected can be compensated without destroying all of the gains from trade [Jacobson, 1998, 474]. It is also attractive politically in that by aiding those industries adversely affected, there will be a decrease in the opposition to free trade. Another criticism of the TAA program is that it only covers those who are directly affected by imports. It offers nothing to help secondary or tertiary firms or workers who are dependent on the livelihood of the adversely affected source [Jacobson, 1998, 486]. Along similar lines, TAA is criticized because it does not offer compensation to workers that produce export goods. If an exporting firm chooses to close its facilities and relocated across borders, those workers would not be eligible for TAA benefits [Morra, 1993, 144]. Finally, another argument against TAA is that it has, for the most part, been ineffective in the adjustment process.

V. A Possible Alternative

Perhaps a more conceptually appealing approach to trade adjustment is an earnings insurance or subsidy. The main advantage of this type of program is that it provides no disincentive to work. The basic concept to earning insurance is paying out a percentage of the earnings differential of pre- versus post-displacement employment. Choosing a specific compensation percentage is somewhat arbitrary. While it is possible that the percentage would be the same for all displaced workers, there are legitimate reasons for not doing so. One case concerns providing more compensation to older displaced workers. Most likely older workers will have a harder time finding reemployment than their younger counterparts. It is also possible that older workers will take larger pay cuts when new work is found. A few other measures might be necessary. Limiting annual compensation makes sense since the payments are based on previous incomes. A highly paid worker displaced by trade most likely has greater savings, meaning displacement and adjustment will be less severe [Burtless, 1998, 144]. Limits on compensation would also reduce the costs of administering the program.

In a specific study, one possible program would pay 40 percent of previous earnings to dislocated workers that earned 30 percent or less of their pre-displacement earnings. As income increases above the 30 percent line, payments would be reduced by four-sevenths of a dollar for each additional dollar earned. As workers' earnings approached their pre-displacement levels, payments would decline and fall to zero when post-displacement earnings equal pre-displacement earnings [Jacobson, 1998, 514]. For example, assume a person was earning \$1000 a month before displacement. The worker then finds employment that pays only \$300 a month. TAA benefits would be \$400 for that worker that month. When the worker's earnings are \$1000 a month, TAA benefits are reduced to zero. Table 1 expands the example.

A prerequisite for receiving any TAA payment under this program is that the displaced worker must find employment before earnings supplementation begins. Along with the employment stipulation, the displaced worker would only be eligible for TAA compensation for a certain number of years after displacement. Combining the two eligibility clauses gives the displaced worker a double incentive to find employment.

TABLE 1

Pre-displacement Earnings	Post-displacement Earnings	TAA Benefits
\$1000/mo.	\$300/mo. (or less)	\$400/mo.
	400	342.86
	600	228.57
	700	171.43
	900	57.14
	1000	0

First, because payment cannot start until a new job is found, there is a reduced incentive to wait to get the old job back. Second, because the duration of payments is limited, greatest total compensation goes to the displaced worker who finds new employment the quickest [Burtless, 1998, 145].

The next critical question to be addressed is the cost of an earnings insurance program. If eligibility is limited to two years after displacement, it is estimated that the cost of such a program would roughly equal \$1 billion a year. While this is nearly three times the funding for the existing TAA program, it is only about five percent of the cost of unemployment insurance in recessionary years [Jacobson, 1998, 516]. One should also keep in mind the gains from trade that the U.S. will experience as our markets are opened up. By nearly all accounts, the costs of administering such a program would be small in comparison to the benefits to society of freer trade. States would administer the program, with funding for payments and administration costs coming from the federal government. The amount each displaced worker would receive would be based on pay stubs from current and previous employers [Burtless, 1998, 145]. One shortcoming of such a program is that when multilateral tariff reductions take place, it may become difficult to estimate the cost. Because such reductions will mostly likely affect a large number of industries, the potential number of displaced workers will

be extremely difficult to predict [Burtless, 1998, 147].

VI. Conclusion

Trade and globalization will most likely remain important political issues for the next few years, perhaps even longer. Although free trade will have beneficial effects for the majority of us, those who stand to lose will adamantly protest against it. The key for the United States is not to fall victim to protectionist pressures. While the adjustment process for those adversely affected will probably bring hardships, the gains from trade will more than offset the losses. Compensation for displaced workers will help to curb protectionist pressures and assist those who suffer for the benefit of society at large. While the current TAA system leaves much to be desired, slight modifications would bring vast improvements. The incorporation of earnings insurance would provide both monetary compensation as well as an incentive to find employment. Further investigation on how the government should finance the earnings insurance is necessary. There may be considerable debate on who exactly should pay for such a program. A broad-based tax may be a logical answer. This would diffuse the cost of the program and not have a significant effect on any one group. It is also necessary to gauge the political support for such a proposal. If the political arena shows no support for changing the status quo of TAA, it is probably not worth the time and effort to hammer out the details that such a bill would require.

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