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ABSTRACT

Who is Afraid of Globalization? The Challenge of Domestic Adjustment in Europe and America*

The Paper examines why 'globaphobia' seems to be more prevalent among labour in the United States than in Europe. It argues that globalization has generated more wealth, but also more income inequality and adjustment problems, in America than in Europe. In the United States, the median voter has lost wages and experienced rising job insecurity due to globalization. By contrast, in Europe, the welfare state has largely insulated the median voter from the pains of globalization. The Paper also examines international labour mobility, the grand absentee of the current wave of globalization. Here it finds that phobia runs higher in Europe than in America. It claims that the relative generosity of Europe's welfare state makes it less open to migration than the United States.

JEL Classification: F02, F13, F22, J60
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NON-TECHNICAL SUMMARY

The emergence of ‘One World’, where goods, services and capital flow almost freely, thanks to the elimination of regulatory barriers and the advent of the ‘information revolution’, has brought unprecedented wealth to Europe and America. At the same time, however, labour has fared relatively poorly on both sides of the Atlantic: declining wages and rising job insecurity in America, and growing unemployment in Europe. Whereas economists continue to argue about whether trade or technological change is the main culprit behind the waning fortune of labour, ordinary citizens tend to see the two as simply different facets of ‘globalization’. To them, it makes no difference whether economists label flows of goods or services as ‘trade’ and flows of ideas passing through the Internet or multinational corporations as ‘technological change’. Both constitute globalization.

The potential costs to labour from trade liberalization are of two kinds: permanent income loss and temporary adjustment costs. The extent of these costs depends on the degree of trade openness and the nature of trade, on labour market institutions, and on the availability of redistribution and adjustment mechanisms.

The Paper shows that there are important differences between the United States and Europe with respect to the degree of trade openness and the nature of trade. There are also important differences in labour market institutions. But the main difference between the two sides of the Atlantic lies in the type of redistribution and adjustment mechanisms.

In the United States, various programs have been established, over the years, in response to the fear of trade liberalization voiced by labour. The Trade Adjustment Assistance (TAA) program, originally established in 1962, is the federal entitlement program for workers affected by trade liberalization. It offers a variety of benefits and reemployment services to assist workers adversely affected by increased imports. In 1993, when the North American Free Trade Agreement was approved by the US Congress, the NAFTA-Transitional Adjustment Assistance (NAFTA-TAA) program was introduced to provide benefits to workers negatively affected not only by imports from Canada or Mexico, but also by the relocation of plants to these countries. Despite TAA, US organized labour is becoming more and more opposed to globalization. The Paper argues that the main reason is that TAA only tackles temporary adjustment costs, whereas globalization is seen by labour as a cause of permanent income losses. In other words, TAA solves an *efficiency* problem, where labour perceives issues of *equity*.

In Europe, there is no program resembling TAA. More broadly, there is no EU social program specifically designed to deal with the fears and costs of trade liberalization. The main reason is all EU countries have large welfare states.

The welfare state in Europe is not only much larger than in the United States, it is also more equity-oriented, but less efficiency-oriented, than in the US. Unquestionably, Europe's social policy has been much more effective than America's in limiting income inequality and poverty. In the mid-1990s, the ratio between the share of income accruing to the highest decile and the share earned by the lowest decile was equal to 17 in the United States, compared to an EU average of 8. On the other hand, America's social policy has certainly been much more successful than Europe's in ensuring an efficient use of labour. In the late 1990s, income *per capita* in the United States was 50% higher than in the EU, not because of higher labour productivity, but because of a higher employment rate – the result of lower youth unemployment and higher participation of older workers.

The second part of the Paper focuses on the political economy of migration in Europe, another aspect of globalization where the welfare state plays a central role. It examines the link between migration and unemployment, but instead of adding to the literature on the effects of migration on labour markets, the Paper examines a novel topic: the different incidence of unemployment among national and foreign workers across countries. The emphasis is on EU member countries, but some discussion of the situation in the United States, Australia and Canada is also included.

The Paper finds that the ratio of the unemployment rate for non-EU foreigners to the total unemployment rate varies considerably across countries. In 1995–98, there were three categories of countries: those with high ratios (3 or above): the Netherlands, Belgium, Denmark, with Sweden not far behind; those with low ratios (around 1): Ireland, Italy and Spain; and those with average ratios (between 1.5 and 2.5): France, Finland, Germany, Portugal, Austria, the United Kingdom and Greece. These groupings suggest that countries with the most generous welfare state may also be those where the unemployment rate of non-EU foreigners exceeds the highest total unemployment rate. There may be two reasons for a relationship between the welfare state and the relative unemployment rate of non-EU foreigners. First, countries with generous welfare states may be those which most attract secondary migrants, i.e. family members of immigrant workers. Whereas primary migrants, usually settled guest-workers, may be expected to have unemployment rates no higher than those of nationals, the same may not be true of their relatives, for a variety of reasons. Second, countries with generous social transfers are also likely to have large public sectors, where employment is typically restricted to nationals or EU foreigners.

The use of multi-factor regression analysis, confirms that the unemployment rate among non-EU foreigners (relative to the total unemployment rate) increases according to the generosity of the welfare state, and to the importance of secondary or second-generation migrants. This finding is not evidence that migrants tend to go to countries with generous welfare systems, since this issue is not investigated. It is simply stating that cross-country differences in the unemployment rate among migrants tend to be positively correlated with cross-country differences in welfare generosity. The Paper argues that the appropriate response to this situation is a greater effort on the part of Europe to integrate its immigrant population.

The Paper concludes by asking whether current responses to the challenge of globalization can be sustained. In America, the challenge is to ensure a better distribution of income and a decrease in poverty. In Europe, the challenge is to prevent the demise of welfare states that are confronted with rising demands and dwindling resources. A broad consensus in Europe agrees that the welfare state must be reformed, not only for efficiency, but also budgetary reasons. Aging and further economic integration in Europe are both expected to increase the gap between social expenditures and revenue, if present benefit levels and eligibility rules remain unchanged. Demographic scenarios forecast a dramatic increase of the ratio of pensioners to workers during the next 50 years in Europe. In a shorter horizon, Economic and Monetary Union (EMU) is also likely to increase the demand for social transfers – through greater competition in product and capital markets, and, ultimately, greater pressure on labour markets – and to reduce the collection of taxes needed to finance them, due to greater mobility of financial and human capital. Given the current high level of taxation in Europe, raising taxes is probably not a politically viable option. This leaves two options. One is to adjust social expenditures downwards. The other is to employ more migrant workers, either by attempting to lower the unemployment rate among the current immigrant population, or by importing new permanent or temporary foreign workers. Either option would require difficult choices on the part of EU governments.

Who Is Afraid of Globalization?
The Challenge of Domestic Adjustment in Europe and America

André Sapir

The political problem of mankind is to combine three things: Economic Efficiency, Social Justice, and Individual Liberty. [J.M. Keynes (1926)].

1. Introduction

Imagine the following situation. On the one hand, the sole political super-power, and the biggest and most dynamic economy on earth. On the other, a collection of fifteen countries, struggling to attain international political status, and to cure a serious, lasting case of Eurosclerosis. It would seem natural to think that the former, a "new economy", should gleefully embrace the current wave of globalization, whereas the latter, an "old economy" with a per capita GDP lower by one-third, should resist it forcefully. Yet, it is America, more than Europe, that appears to ponder about whether globalization has gone too far,[1] and to suffer from globaphobia.[2]

The main opposition to globalization in the United States, and also in Europe, comes from labor, which claims that international economic integration is largely responsible for the recent deterioration of its economic and social condition. Since the mid-1970s, the United States, where wages are relatively flexible, have seen rising wage disparity between skilled and unskilled workers, and falling real wages for large segments of the labor force. Between 1973 and 1997, the median real weekly earnings of male full-time workers fell from \$700 to \$600 in constant 1997 dollars.[3] By contrast, Europe, where wages are relatively rigid, has undergone rising unemployment, with little or no downward pressure on wages (except in the United

[1] Rodrik (1997).
[2] Burtless et al. (1998).
[3] Council of Economic Advisers (1998).

Kingdom). Between 1973 and 1997, the unemployment rate in the European Union (EU-15) jumped from less 3% to nearly 11%.[4]

Trade economists have examined two channels through which globalization might affect labor market conditions in the United States and Europe: one is increased competition with low-wage countries, resulting in lower demand for unskilled labor; the other is increased international competition in product and capital markets, resulting in more elastic labor demand.

Discussion about the first channel usually starts from the observation that the demand for unskilled labor has fallen considerably on both sides of the Atlantic since the mid-1970s, a phenomenon attributed either to competition from unskilled labor-abundant developing countries (one of the facets globalization), or to skill-biased technological progress, both of which have undergone rapid increase during the past two decades. All trade economists agree that both factors have played a role in the demise of unskilled workers, but most conclude that the latter is far more important. The common wisdom is that trade accounts for about 20 percent of the rising wage inequality in the United States,[5] and roughly the same percentage of the increasing unemployment in Europe.[6] There are, however, dissenting voices claiming that technological change cannot be treated entirely independently from trade, and, therefore, that trade accounts for a bigger fraction of the deterioration in labor's condition than is usually assumed.[7]

But the plight of labor in the United States and in Europe is not limited to unskilled workers, and, moreover, globalization encompasses other aspects of international economic integration, besides trade, in particular international

[4] European Commission (2000).
[5] See Cline (1997).
[6] See Dewatripont, Sapir and Sekkat (1999).
[7] In particular, Wood (1995) and Rodrik (1997).

investment. Hence the second channel. The story told, convincingly, by Rodrik (1997) is that increased trade and capital mobility make the demand for the services of immobile workers more elastic. In his words (p.4), “the services of large segments of the population can be more easily substituted by the services of other people across national boundaries.” In this view, globalization implies that workers lose bargaining power, and incur, at least in the United States, where labor markets are flexible, greater instability in earnings and hours worked in response to shocks. As Rodrik (1997, p. 27) puts it: “For those [in America] who lack the skills to make themselves hard to replace, the result [of globalization] is greater insecurity and a more precarious existence.”

So, there is *prima facie* academic evidence in support of the popular view that globalization, i.e. increasing international economic integration of product and capital markets, contributes to the waning fortune of American and European workers: declining wages and rising job insecurity in flexible America, and growing unemployment under rigid European labor market conditions.[8]

The difference of economic environment between Europe and the United States, “social protection versus economic flexibility”,[9] provides a potential clue to the puzzling divergent attitude of American and European labor towards increased international economic integration. In the United States, declining wages and rising job insecurity have clearly produced an anxious “median voter”. By contrast, in Europe, the “median voter” has been largely spared from growing unemployment, the

[8] Although admittedly oversimplified [see Nickell (1997)], the distinction between labor markets that are flexible in the US, but rigid in Europe, is common throughout the literature on globalization and labor.
[9] This is the title of a book edited by Blank (1994).

burden falling mainly on the young and women, while older workers have exited the labor market thanks to generous early retirement programs.[10]

The first part of the paper examines whether, indeed, the European social protection system can take the credit for having largely insulated much of the European citizenry from the negative impact of globalization. Three issues are analyzed: the nature of globalization in Europe; the European social policy in relationship to economic integration, and its contrast with the trade adjustment assistance programs operated in the United States along with trade liberalization initiatives; and the sustainability of the European model in the face of increasing international economic integration.

The second part of the paper shifts the focus to international labor mobility, the grand absentee of the current wave of globalization.[11] Here is a topic where phobia runs high on both sides of the Atlantic, with probably a clear advantage this time to Europe. The fear of the American median voter towards immigration is probably rooted in the same cause as his globaphobia: declining wages and rising job insecurity. By contrast, Europeans seem ready to accept increasing international economic integration of product and capital markets, as long as labor mobility is kept out of the picture.[12] One reason may be precisely the European social protection system, which helps cushion against the negative impact of globalization, but might be seen as unsustainable in the case of massive labor flows. Two issues are analyzed

[10] In 1997, the unemployment rate of young persons (aged under 25) in EU-15 was 21.1%, compared to a total unemployment rate of 10.6%. At the same time, the employment rate for men aged 25-54 was 86% (versus 89% in the US), compared to 37% for individuals aged 15-24 (vs. 52% in the US), and to 36% for individuals aged 55-64 (vs. 57% in the US). The employment rate for women aged 25-54 was 63% (vs. 74% in the US).

[11] This is in sharp contrast with the earlier wave of globalization which took place during the 40 years or so before World War One.

[12] This is very clear in the on-going debate about the Eastern enlargement. The EU public opinion remained largely indifferent to the free trade agreements with Central and Eastern European countries (CEECs). On the other hand, it is voicing profound dissatisfaction about the possibility of free labor movement.

in this part: the policy of European countries towards labor migration, and its relationship to social protection; and the lessons of European integration in the liberalization of services involving the movement of natural persons (i.e. temporary labor movement), a matter of great interest to developing countries with respect to the forthcoming negotiations of the General Agreement on Trade in Services (GATS).

2. Trade

Let me start with a *mea culpa*. I am just as guilty as any other trade economist for having a tendency to concentrate on the "gains from trade", and simply ignoring that some individuals, usually workers, may also incur "pains from trade". The potential costs to labor from trade liberalization are of two kinds: permanent income loss, and temporary adjustment costs. The extent of these costs depends on the source of gains from trade (comparative advantage or economies of scale), and on labor market institutions.

Consider first the effect of trade on labor's income. Under perfect competition in all product and factor markets, and with different factor endowments across countries, the analysis of Stolper and Samuelson shows that trade liberalization is likely to be detrimental to (unskilled) workers in industrial countries, where (unskilled) labor is relatively scarce. However, since countries enjoy overall gains from trade, there is the possibility of winners compensating losers, which raises the crucial issue of redistributional mechanisms. By contrast, if countries are sufficiently similar and there are important scale economies, so that lowering trade costs gives rise to increased intra-industry trade, both scarce and abundant factors are likely to gain from trade.[13]

[13] See Helpman and Krugman (1985), ch. 9.

These results may not hold if labor markets are distorted by relative wage rigidity, or monopoly power on the part of labor. The impact of wage rigidity on labor depends on whether trade is inter- or intra-industry. In the comparative advantage case, rigid wages imply that trade integration has little or no effect on relative output prices[14], which translates into little or no Stolper-Samuelson effect, and a fall in employment.[15] By contrast, in the intra-industry trade situation, even if wages are totally rigid, every factor could still gain from trade liberalization, and employment could remain unaffected.

The impact of union monopoly power on wages also depends on the nature of trade. Naylor (1999a, 1999b) constructs a model which shows that the direction of the effects of falling trade costs on wages varies according to whether trade is inter- or intra-industry. With inter-industry trade, a fall in the costs of international trade leads unions to reduce wage demands. On the other hand, when trade is primarily intra-industry, increased trade make unions more assertive in bargaining for higher wages.

The effect of trade on labor adjustment costs is closely related to the previous discussion. When economic integration leads to an expansion of intra-industry trade, labor faces relatively few adjustment costs, since there is no sectoral, and probably little geographical, reallocation of resources. On the other hand, when the lowering of trade costs generates inter-industry trade, labor needs to be reallocated across sectors, and across regions, since many sectors tend to be geographically concentrated. Obviously, the greater the rigidity of wages, the lower the reallocation of labor across sectors and regions, hence the lower the adjustment cost, but the higher the cost of unemployment.

[14] The effect on relative prices depends on the extent of wage rigidity. Relative prices are constant if relative wages are fixed.
[15] Krugman (1995).

The general message of the preceding discussion is that the cost to labor from increased international economic integration is likely to vary across countries depending on three factors: the nature of trade, the type of labor market institutions, and the kind of redistribution and adjustment mechanisms. In the remainder of the section, I will attempt to show that, despite similar increases in the degree of international economic integration, the United States and the European Union differ sufficiently in all three dimensions to explain the different reactions of labor to globalization.

Trade openness and nature of trade

Exposure to trade has always been far greater in Europe than in the United States. Already in 1960, the degree of trade openness (exports plus imports divided by GDP)[16] stood between 20 and 30 percent in France, Germany, Italy and the United Kingdom (UK), the four largest European economies, with considerably higher levels in smaller countries. By contrast, in the United States, international trade amounted to barely 7 percent of GDP. In the next forty years, exposure to trade increased significantly on both sides of the Atlantic, reaching between 40 and 50 percent in the large European countries, and nearly 20 percent in the United States. The main driving force behind this dramatic change was the steady removal of trade barriers not only through successive GATT/WTO negotiations, but also through regional efforts both in Europe (with the widening[17] and deepening[18] of the EU, and the spread of

[16] I agree with Dick Cooper that this traditional measure of trade openness is open to criticism.
[17] There have been 4 enlargements of the EU: 1973 (Denmark, Ireland, and the UK), 1981 (Greece), 1986 (Portugal, and Spain), and 1996 (Austria, Finland, and Sweden).
[18] Especially the completion of the Single Market in 1993.

regional trade arrangements between the EU and its neighbors[19]) and in America (with the formation of CUFTA/NAFTA).

Behind the apparent similarity of Europe and the United States in the rise of trade openness, there are, in fact, two important differences in the nature of the process of international economic integration between the two areas. First, as Figure 1 demonstrates, the increase of trade openness in France and Germany, between 1960 and 1998, was entirely an intra-EU phenomenon.[20] At the end of the 1990s, the exposure of these two countries to trade with countries outside the group of 15 nations that constitute, today, the European Union was, in fact, the same as it had been in 1960.[21] A similar picture holds for the other countries of the European Union. For EU-15 as a whole, trade openness has increased from 30 to 50 percent between 1960 and 1998, with the share of extra-EU trade in GDP remaining constant around 20 percent.[22] However, it is important to note that the trend changed during the 1990s. Between 1993 and 1998, the degree of trade openness in France (and also in the EU-15 as whole) increased by 8 percentage points, of which 5 points came from increased intra-EU trade (completion of the Single Market Program, and enlargement), and 3 from increased extra-EU trade (especially with the countries of Central and Eastern Europe). At the same time, trade openness increased by 10 points in Germany, with an equal contribution of intra- and extra-trade (this reflects the fact that Germany is, by far, the main trading partner of the countries of Central and Eastern Europe).

[19] See Sapir (forthcoming).

[20] The same holds for Italy and the United Kingdom, and also for the smaller EU countries. These countries are not shown in Figure 1 in the interest of clarity.

[21] About 15% in France, and 20% in Germany.

[22] I.e. the evolution of trade openness for EU-15 (not shown in Figure 1) is almost the same as for Germany. There was, however, a major difference in the decline of trade exposure following German re-unification. Trade openness decreased from 52% in 1989 for West Germany to 37% in 1993 for unified Germany (see Figure 1), but only from 47% for EU-15 (exc. East Germany) to 40% for EU-15 (incl. East Germany).

Second, and related to the previous point, the increase in trade openness of European countries has generally resulted in intra-industry trade (IIT) specialization. I have computed an index of IIT for EU-15, France, Germany and the United States, based on the work of Grubel and Lloyd (1975). All data used for the calculation of the indices are at the 3-digit Standard International Trade Classification (SITC-Rev. 3) level, and are subsequently aggregated using the procedure of Grubel and Lloyd in order to obtain country indices. Only trade in manufactured goods (SITC 5-8, minus 68) is taken into consideration. The index can vary between zero and one. A value of zero would suggest that there is no intra-industry trade, whereas as value of one would indicate that all trade is intra-industry. .

Table 1 reports values of the IIT index computed for EU-15, France, Germany and the United States, with respect to different trading partners and for the period 1989-1998. It is immediately apparent that, in Europe, the level of IIT is significantly and consistently larger with respect to intra- than extra-EU trade. This, obviously, reflects the fact that factor endowments are much more similar within the EU than between the EU and third countries. Since, between 1960 and 1998, most of the increase in trade openness of France, Germany, and EU-15 in general, was accounted for by intra-EU trade, the IIT indices suggest that the trade liberalization has been relatively painless for EU countries. This message echoes the early work of Balassa (1966), which had found that the establishment of the Common Market resulted primarily in intra-industry trade, where "the income redistributional effects…are expected to be smaller than in the traditional [inter-industry] case." [Balassa (1966), p. 472)]. By contrast, trade liberalization may have been more painful during the 1990s, when a significant portion of the increase in trade openness was taken by extra-EU transactions, particularly to and from Central and Eastern European countries (CEECs).

In the United States, the level of IIT is generally fairly high as well, about half-way between the levels recorded in Europe for intra- and extra-EU trade. It is unlikely, therefore, that the difference in IIT accounts for a sizeable share of the different reactions to globalization between Europe and America.

Labor market institutions

There is little need to dwell here on the fact that labor markets are more rigid in Europe than in the US, given the plethora of writings on the subject. A useful summary of the literature is provided by Buti, Pench and Sestito (1998), who examine the role of labor market institutions in some detail. Using data from various OECD studies, the authors plot, for each OECD country, the combination of employment protection legislation (EPL) strictness, and unemployment benefit (UB) generosity, on what they refer to as the "workers protection" space. They observe that all EU countries (with the exception of the UK) choose a much higher degree of protection than the other OECD countries, with the United States ranking last on both dimensions. At the same time, they find that different groups of EU countries choose different combinations of EPL strictness and UB generosity in order to achieve similar levels of workers protection. Scandinavian countries tend to go for liberal labor market regulations and generous unemployment compensation, whereas Mediterranean countries tend to choose the opposite combination; France, Germany, and the other EU countries occupy an intermediate position.

One of the features that distinguish European from US labor market institutions is the centralization of wage bargaining, which results in the compression of relative wages across skills, sectors, and regions. With rigid wages, a shift in demand, such as globalization that favors skilled workers, new sectors, or perhaps new regions, tends to produce unemployment among unskilled workers, and in older sectors and regions. It also means that insufficient resources are shifted between sectors and regions. A clear indication of Europe's problem can be seen from data on sectoral specialization. There is a significant gap between the EU and the US in the share of employment in services. In 1997, services accounted for 73 percent of US employment, but only 65 percent in the EU.[23] By contrast, industry absorbed 30 percent of those employed in the EU, against only 24 percent in the US.[24] Moreover, within the manufacturing sector, compared to the United States, Europe tends to specialize much more in traditional areas, characterized by relatively low demand, and much less in the more dynamic, information and communication technology (ICT) sectors.[25]

Adjustment and redistribution mechanisms

The previous discussion suggests that globalization may have affected labor somewhat more in America than in Europe due to differences in the nature of trade and in the type of labor market institutions. Ultimately, however, the (real or perceived) cost of globalization borne by labor is also a function of the availbale adjustment and redistribution mechanisms.

In the United States, various programs have been established, over the years, in response to the fear of trade liberalization voiced by labor. The Trade Adjustment Assistance (TAA) program, originally established under the Trade Act of 1962

[23] The gap is even more striking if public administrations are excluded from services. In this case, the share of employment in services is 69% in the US, and only 58% in EU-15.
[24] European Commission (1999).

authorizing the US Administration to participate in the Kennedy Round, is the federal entitlement program for workers affected by trade liberalization. Initially meant to provide income support to those who lose their jobs due to *trade negotiations*, it was amended by the Trade Act of 1974 to aid workers who lose their jobs or whose hours of work and wages are reduced as a result of *increased imports*. The TAA program offers a variety of benefits and reemployment services to assist workers, who have been certified by their local state labor department as having been adversely affected by increased imports, to prepare for and obtain alternative employment. In 1993, when the North American Free Trade Agreement was approved by the US Congress, the NAFTA-Transitional Adjustment Assistance (NAFTA-TAA) program was introduced to provide benefits to workers negatively affected not only by imports from Canada or Mexico, but also by the relocation of plants to these countries.

The stated purpose of TAA and NAFTA-TAA is to assist certified individuals to return to 'suitable employment', which is defined as work of a substantially equal or higher skill level than, and which pays not less the 80 percent of, the person's previous employment. In other words, the programs aim at reducing *temporary* adjustment costs incurred in the generally efficient US labor market, not at compensating (possibly) *permanent* income losses. Thus, the activities of TAA/NAFTA-TAA focus on career counseling, training, job search, and relocation. Income support, known, in both programs, as trade readjustment allowances, is available for 52 weeks after a worker's unemployment compensation benefit is exhausted (at the end of the 26th unemployment week) and while the worker participates in an approved full-time training program.

[25] In 1997, the EU accounted for 40% of the EU-Japan-US triad GDP, but only 26% of the production of ICT goods. See OECD (1999a).

Given the role of NAFTA in the US public debate on globalization, it is useful to focus for a moment on NAFTA-TAA. According to Hinojosa-Ojeda et al. (2000), roughly 240 thousand workers had been certified under NAFTA-TAA by July 1999, resulting in an average of less than 4 thousand workers per month over 65 months. While this figure is certainly small judging from the size of the US labor force (over 110 million workers), or even in comparison with the total number of long-term displaced workers (estimated at about 175 thousand per month in the mid-1990s), its potential impact on the public debate should not be underestimated for several reasons. First, the number of certified workers is only a fraction of the number of workers who filed a petition for NAFTA-TAA. Second, labor unions play an important role in the process of petition and certification. Hinojosa-Ojeda et al. (2000) report that unionization is a factor that increases the probability that an adverse NAFTA-related impact will result in a NAFTA-TAA application. The authors note that, given the advocacy role of unions, it is not surprising to observe the high percentage of union involvement in NAFTA-TAA certifications: union petitions made up 22 percent of all the petitions that were certified, but accounted for 31 percent of certified workers, a far higher union rate that prevails generally in the United States. Finally, the US Department of Labor, which administers the program, is probably adding fuel to the public debate with a NAFTA-TAA fact sheet posted on its web-site proclaiming that: “If Imports from Canada or Mexico Cost You Your Job…Apply for NAFTA-Transitional Adjustment Assistance”. The exact same remarks hold for the TAA program, which currently certifies about two-third as many workers as NAFTA-TAA.[26]

[26] According to Samuel et al. (nd), the number of workers certified for benefits in 1997 was 60 thousand under TAA and 90 thousand under NAFTA-TAA. The actual number of benefit recipients is far lower than these figures because workers were either able to obtain alternative employment very rapidly, or were did not meet eligibility requirements.

It may seem paradoxical that, despite the existence of trade adjustment programs which it promotes and helps to implement, US organized labor is strongly opposed to globalization. I propose the following explanation. When the TAA program was created, the United States traded very little internationally, and imported virtually no manufactured goods from low-income countries. In those days, trade liberalization imposed little cost on labor. Import surges were mainly cyclical phenomena, only giving rise to temporary adjustment costs. And, indeed, until 1981, TAA provided mainly income support to workers on temporary layoff (usually in the steel sector), who eventually returned to work with their previous employer. As the degree of trade openness of the United States increased, and trade-induced layoffs became more permanent, TAA evolved into a program aiming at finding jobs in other sectors and regions. Accordingly, in the late 1980s, training became required for certified workers to receive extended income support, a condition also found in the NAFTA-TAA program introduced in 1994.[27] During the 1990s, trade openness and manufactured imports from low-income countries increased substantially, thereby adding permanent income losses to temporary adjustment costs. Yet, TAA remains the only response.

The fundamental shortcoming of TAA/NAFTA-TAA identified here was already recognized by Burtless et al. (1998), who recommend that adjustment assistance should be complemented with an explicit compensation mechanism. The authors argue that the basis for compensation of trade-displaced workers should simply be the difference between what they earn in their new job and what they earned previously. Workers would be compensated for half their loss in earnings, and the compensation would last for a limited period (2-3 years). Although an

[27] See Schoepfle (2000).

improvement on TAA, the scheme of Burtless et al. (1998) is still far removed from full income compensation. Like TAA, it belongs more to the realm of *efficiency* than to sphere of *equity*.

In Europe, there is no program resembling TAA. More broadly, there is no EU social program specifically designed to deal with the fears and costs of trade liberalization. I see two reasons for this contrasting situation with the United States.

First, all EU members are countries with large welfare states. The welfare state in Europe is not only much larger than in the United States, it is also more equity-oriented, but less efficiency-oriented, than in the US. Unquestionably, Europe's social policy has been much more effective than America's in limiting income inequality and poverty. In the mid-1990s, the ratio between the share of income accruing to the highest decile and the share earned by the lowest decile was equal to 17 in the United States, compared to an EU average of 8.[28] At the same time, 17 percent of the US population lived in households with an income below the 50 percent median income level, whereas the equivalent proportion was generally less than 10 percent in the European Union.[29] On the other hand, America's social policy has certainly been much more successful than Europe's in ensuring an efficient use of labor. In the late 1990s, income per capita in the United States was 50 percent higher than in the EU, not because of higher labor productivity, but because of a higher employment rate – the result of lower youth unemployment and higher participation of older workers.

Second, the integrationist ideology of the European Union seems hardly compatible with having its executive body, the European Commission, proclaim on its web-site that: "If the Single Market Costs You Your Job…Apply for Trade Adjustment Assistance". Moreover, the 1957 Treaty of Rome, the founding document

[28] See World Bank (2000).

of the European Union, clearly recognized that the abolition, between member countries, of obstacles to freedom of movement for goods, services, capital and persons, needs to be accompanied by a number of common policies, including in the social field. The Treaty called for a two-pronged social policy: the approximation or harmonization of social provisions among member countries; and the establishment of a European Social Fund (ESF), designed to improve employment opportunities for workers in the Common Market, by increasing their geographical and occupational mobility.

The ESF has undergone many phases throughout its history. During the first phase (1958-1971), it provided grants for vocational training and resettlement to workers suffering a temporary drop in wages during restructuring operations of their enterprises. Although the texts made no explicit link between restructuring and the Common Market, the intention was clear. Thus, the ESF was rather like the TAA program in the United States, except that governments, rather than individuals, applied for funding. During this phase, the ESF had little role to play in the adjustment process since, as noted by Balassa (1966, p.472): "There are no examples of declining manufacturing industries in any of the member states, nor have they experienced a wave of bankruptcies. Indeed, the number of bankruptcies has fallen since the Common Market's establishment, and there is little evidence of frictional unemployment." The ESF budget, therefore, remained extremely modest during the initial phase. In latter periods, as the unemployment situation gradually deteriorated inside the EU, the Social Fund grew substantially, concentrating mostly on vocational training for young people. New changes were introduced in the late 1980s, after the entry of Portugal and Spain in the Community, and in 1995, after the accession of

[29] See OECD (1999b).

Austria, Finland and Sweden. Since the last enlargement, the ESF is allocated into six objectives, of which two (receiving 10% of the funds) are connected to industrial restructuring.[30] Wisely, I think, no distinction is made between the sources of restructuring. The purpose is to adapt to economic changes, regardless of whether the cause is (intra- or extra-EU) trade liberalization, or technological progress. Hence, trade adjustment assistance, as such, is totally absent from the current European landscape.

Regarding the regulatory dimension of EU social policy, I have examined, elsewhere, the relationship between trade liberalization and social harmonization during the process of European economic integration. In Sapir (1996), I showed that two periods can be distinguished. Before the mid-1980s, there was little or no demand for social harmonization between members states. The main reason was that the EC was fairly homogenous. Member countries had similar factor endowments, which meant that trade was mainly intra-industry, and adjustment costs were limited. Moreover, social policies were fairly similar across EC countries.

A clear shift in the direction of social harmonization occurred in the mid-1980s, as a result of three factors. The first, and foremost, was the enlargement of the EC to Portugal and Spain, two countries with substantially lower labor costs than the old members. The Southern enlargement raised the possibility of increased inter-industry trade, and rising adjustments costs; it also brought up the specter of "social dumping" in high-income, Northern countries. The second was the Single Market Program, which was designed to eliminate the remaining barriers to free circulation of products and factors within the EC. The last factor was the high unemployment and

[30] Since 1988, the 4 EU Structural Funds, account for one-third of the EU budget in the late 1990s. The ESF amounts to 30% of the Structural Funds, or 10% of the EU budget. With a total EU budget reaching about 1.2% of GDP, it means that the ESF amounts to 0.12% of EU GDP, certainly not a trivial figure.

stagnating real wages in the EC. Despite much efforts, however, little in the way of actual social harmonization was achieved.

3. Labor Mobility

There is an intense economic and political debate raging across Europe about migration policy. As The Economist succinctly put it in a recent issue (May 6th 2000): “Foreigners are streaming into the EU in search of jobs. They are often vilified, but they are increasingly necessary.”

During the 1960s and early 1970s, the six European Community (EC) countries opened their doors to large numbers of guest-workers, all from (Northern or Southern) Mediterranean countries. In 1970, Germany, alone, granted nearly 500 thousand work permits to recruits from Greece, Portugal, Spain, Turkey and Yugoslavia. The inflow was abruptly interrupted in 1973, in the wake of the oil crisis. Thereafter, virtually no new permits were awarded to foreign workers, but those who were in the EC were able to settle permanently, and to bring their relations. During the 1990s, the raising of the Iron Curtain and events in Yugoslavia unleashed a new flow of migrants into the EU, usually illegal workers or asylum-seekers.

Meanwhile, inside Europe, migration flows dwindled. When Greece acceded to the EC in 1981, and Portugal and Spain entered in 1986, high-income EC members feared that freedom of movement of workers, a principle enshrined in the Treaty of Rome, would result in large migratory movements from these traditional labor-sending countries. Consequently, the free movement of workers was banned during a transition period, which expired in 1988 for Greece, and in 1991 for Portugal and Spain. However, there was virtually no increase in migration from these countries after the transition period. I think that there are two principal reasons for the fall of migration within Europe, in spite of its enlargement to low-income countries.[31] The first is the rapid increase in income and employment opportunity in Southern Europe, partly aided by massive EU transfers, financed by the Structural Funds. The second factor is the increased generosity of the welfare state in these countries.[32]

The current debate on migration in Europe pits the vast majority of citizens, who tend to perceive immigrants as "welfare-scroungers, job-snatchers and threats to stability", against a small, enlightened group, which claims, like the recent cover page of The Economist, that: "Europe needs more immigrants". This positive attitude stems from the emphasis on two developments: the rapid aging of Europe's population; and growing labor shortages in specific activities and/or countries. Estimates by the United Nations' Population Division indicate that, at current birth and death rates, the European Union would need 1.6 million immigrants a year, in order to keep its working-age population stable in the next 50 years. Holding the ratio of workers to pensioners constant would require an additional inflow of 12 million a year. In addition to helping finance Europe's welfare state, immigrants would "inject into stale, ageing countries fresh vitality, fresh energy and an uncommon willingness to work hard at…the sorts of jobs Europeans are increasingly unwilling, or ill-equipped to do".[33]

Clearly, the welfare state plays a central role in the political economy of migration in Europe.[34] In reality, two economic factors are likely to shape the attitude of European citizens vis-à-vis migrants: whether they are substitutes or complements; and whether migrants are net contributors to or beneficiaries of the welfare state.

[31] See Braunerhjelm et al. (2000) for alternative explanations.
[32] Social transfers, as a percentage of GDP, increased, between 1970 and 1995, from 9 to 16% in Greece, 7 to 15% in Spain, and 4 to 15% in Portugal.
[33] All the citations in this paragraph are from The Economist, May 6th 2000.
[34] The link between the welfare state and migration is studied by Razin and Sadka (1997) and Wellisch and Walz (1998).

Divide European citizens into three categories: capital owners, skilled workers, and unskilled workers. And consider four types of immigrants: (1) unskilled guest-workers, i.e. temporary migrants without relatives; (2) unskilled permanent migrants, with relatives; (3) illegal unskilled workers; and (4) asylum seekers. We are now ready to examine how Europeans have reacted towards migrants during the past 40 years.

During the 1960s and early 1970s, migrants belonged entirely to category (1). They were complements to native capital owners and skilled workers, but substitutes for unskilled natives. However, the latter probably benefited from the fact that guest-workers were net contributors to the welfare state. Altogether, therefore, migration was relatively welcomed by all natives.

During the remainder of the 1970s and throughout the 1980s, migrants gradually shifted to category (2). Native capital owners were still better off with migrants, but the position of skilled and unskilled workers shifted compared to the earlier period. Unskilled workers were now clearly opposed to migrants, on economic grounds, as the latter were joined by their (relatively numerous) relations, and became net beneficiaries of the welfare state. The position of skilled workers was probably ambiguous. On the one hand, they were still complements to the migrants, on the other, they were feeling the pinch of social transfers.[35] Altogether, therefore, the attitude of natives towards migrants was probably divided.

Since the early 1990s, all four categories of migrants are present in Europe. The main contingent belongs to category (2), but there are also some guest-workers, as well as large numbers of illegal workers and asylum-seekers, from Central and Eastern Europe. The impact of illegal workers on natives is the same as the impact of

[35] I am assuming that skilled workers contribute far more to the welfare state than capital owners.

guest-workers, save for two effects. First, their wages are lower, so they probably compete more fiercely with native unskilled workers than in the case of guest-workers. Second, they (and their employers) do not pay social security contributions. So, native unskilled workers are likely to be hurt by illegal unskilled workers on both counts. The impact of asylum-seekers is the same for all natives, since they are usually not allowed to work. They are simply social welfare recipients. All in all, therefore, these short-term economic considerations,[36] probably go a long way in explaining the majority opinion of Europeans that immigrants are "welfare-scroungers and job-snatchers".

In the remainder of this section, I examine two issues that figure prominently in the current debate on migration in Europe. The first is the link between migration and unemployment. The second is the question of temporary labor movements, an issue related to trade in services.

Migration and unemployment

There is a vast body of literature examining the impact of migration on wages and unemployment. Contrary to the literature on trade and labor discussed in the previous section, which is largely dominated by trade economists, studies about the effects of migration on domestic labor markets are written mostly by labor economists. In the United States, the leading contributor has repeatedly argued that massive immigration of unskilled workers depress the wages of native unskilled workers, and advocated both a reduction in the level of immigration and a shift in its composition towards more skilled workers.[37]

[36] Razin and Sadka (1998) show that, although they are net beneficiaries of the welfare state aFnd may induce adverse effects on natives in a static model, unskilled migrants are likely to benefit all natives in an overlapping generation model with pension.
[37] See, for instance, Borjas (1999).

In Europe, most of the empirical work on the effects of migration on domestic labor markets focuses on Austria and Germany, the two countries with the highest share of foreign workers in the labor force. Figure 2 indicates that, in 1998, foreign workers accounted for, respectively, 10 and 9 percent of the labor force in these two countries, compared to an average of roughly 5 percent for the EU-15. Moreover, the share of non-EU foreign workers in Austria and Germany was, respectively, 8 and 6 percent, compared to an EU average of only 3 percent. According to the literature summarized by Winter-Ebmer and Zimmermann (1999), immigration of non-EU nationals produces negative effects on native employment and wages in Austria, but has no significant effect on the German labor market.

In this section, I deliberately stay away from the discussion about the effects of migration on labor markets, and focus, instead, on a topic which, to my knowledge, has not been studied so far, namely the different incidence of unemployment among national and foreign workers. The emphasis will be on EU member countries, but some discussion of the situation in the United States, as well as Australia and Canada, will also be included.

Figure 3 presents publicly-available, but little-known data on unemployment rates in EU countries, for 1998, broken down between nationals, EU foreigners, and non-EU foreigners.[38] It reveals two important features. First, for the EU as a whole, the unemployment rate for non-EU foreigners was twice the unemployment rate for nationals or EU foreigners. By contrast, in the United States, the unemployment rate among persons born abroad was only 25 percent higher than the unemployment rate among those born in the country.[39] At the same time, however, the unemployment rate for blacks was twice that of whites, a constant feature of the US economy for many

[38] I am grateful to Eurostat, the Statistical Office of the European Commission, for providing the data.

years.[40] In part, the disparity among unemployment rates in the EU probably reflects differences in educational attainment between nationals and EU foreigners, on the one hand, and non-EU foreigners, on the other. However, in the same way that persistence of unemployment differentials among blacks and whites with similar levels of education suggests that racial discrimination may be at work in the US, the higher rate of unemployment among non-EU foreigners may reflect similar discrimination in EU labor markets.

The other central finding is the considerable variance of situations among EU countries. In Finland, Belgium, France and Sweden, the unemployment rate for non-EU foreigners was much above the EU average (30-45% versus 20%), but the unemployment rate for nationals was either slightly below or slightly above the EU average (8%-13% versus 10%). On the other hand, in Italy and Spain, and to a lesser extent in Greece and Ireland, unemployment rates were roughly similar for nationals and non-EU foreigners.

Figure 4 uses the ratio of the unemployment rate for non-EU foreigners to the total unemployment rate to tell the same story in a slightly different way. The ratio is presented for four sub-periods: 1983-86, 1987-90, 1991-94, and 1995-98. Clearly, there were three categories of countries: those with high ratios (3 or above): the Netherlands, Belgium, Denmark, with Sweden not far behind; those with low ratios (around 1): Ireland, Italy, and Spain; and those with average ratios (between 1.5 and 2.5): France, Finland, Germany, Portugal, Austria, the United Kingdom, and Greece. The figure also shows that the composition of the three categories has remained fairly stable throughout the period 1983-1998.

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[39] There are no statistics on unemployment rates broken down between nationals and foreigners for the US.

[40] See Council of Economic Advisers (1998).

The country grouping identified here suggests that countries with the most generous welfare state may also be those where the unemployment rate of non-EU foreigners exceeds the most the total unemployment rate. There may be two reasons for a relationship between the welfare state and the relative unemployment rate of non-EU foreigners. First, countries with generous welfare states may be those which most attract secondary migrants, i.e. family members of immigrant workers. Whereas primary migrants, usually settled guest-workers, may be expected to have unemployment rates no higher than those of nationals, the same may not be true of their relatives, for a variety of reasons. Second, countries with generous social transfers are also likely to have large public sectors, where employment is typically restricted to nationals or EU foreigners.

Figure 5 shows the relationship between the generosity of the welfare state (measured by the OECD index of unemployment benefit generosity, slightly modified by Buti, Sestito and Pench (1998)) and the unemployment rate for non-EU nationals relative to the total unemployment rate (average for 1995-1998). It plots values for all EU-15 countries (except Luxembourg), and the United States. The figure exhibits a clear positive relationship between welfare state generosity and the incidence of unemployment for non-EU foreigners. The coefficient of correlation between the two indicators equals 0.76 for the 14 EU countries, and increases slightly when the US is added to the sample.

In Table 2, I present regression results that confirm the relationship between the generosity of the welfare state (UBEN) and the unemployment rate for non-EU nationals relative to the total unemployment rate (UFT) in a multi-factor setting. I control for two factors. The first is the share of non-EU foreigners in the total population (FORRATE). This variable is meant to test the discrimination hypothesis that the higher the non-EU foreign population relative to the total population, the higher the incidence of unemployment rate among non-EU foreign workers relative to the total unemployment rate.[41] The second control variable is the participation rate (labor force divided by population) among non-EU foreigners (PARTRATE). The assumption is that the incidence of unemployment among non-EU foreigners is lower in countries where the participation rate is higher, i.e. when foreigners are mostly primary, rather than secondary, migrants.[42]

The regression results are surprisingly good, given that the sample includes only 14 observations. The main finding concerns the impact of the generosity of the welfare state on the unemployment rate for non-EU nationals relative to the total unemployment rate. The (highly significant) coefficient of UBEN indicates that a 10 percentage point increase in the index of benefit generosity results in an increase of 0.5 in the unemployment ratio (UFT). Adding Australia, Canada and the United States (ACU=1) to the sample does not affect the coefficient of UBEN.[43] There are, however, two important differences between the two sub-samples that show up in other coefficients. First, the constant is much lower for Australia, Canada and the US, reflecting the fact that UFT averages only about 1 for these countries, compared to 2 for the EU members. Second, the coefficient of FORRATE, the share of (non-EU) foreigners in the total population, is positive for the EU countries, but negative for Australia, Canada, and the US. This reflects two important differences between Australia, Canada and the US, on one hand, and the EU, on the other: the share of foreigners in the population (on average, 10 percentage points higher in Australia,

[41] FORRATE ranges from less than 1% in Finland, Ireland, Italy, Portugal and Spain to between 6 and 8% in Austria and Germany.
[42] PARTRATE ranges from about 40% in Belgium and the Netherlands to more than 75% in Austria and Sweden.
[43] ACU is a dummy variable, which is equal to one for Australia, Canada or the United States.

Canada and the US than in the EU); and skill composition of migrants (much more skilled in Australia, Canada and the US than in the EU).

To summarize, the unemployment rate among non-EU foreigners is significantly higher than the total unemployment rate in most EU countries, sometimes even by a factor 3 or 4. There is strong evidence that this situation is partly linked to the generosity of the welfare state, and to the importance of secondary or second-generation migrants. Let there be no misunderstanding: I am not saying that I find evidence that migrants tend to go to countries with generous welfare systems; as a matter of fact I do not investigate this issue at all. I am only claiming that cross-country differences in the unemployment rate among migrants tend to be positively correlated with cross-country differences in welfare generosity, partly, perhaps, because countries with generous welfare states have a large share of public jobs which are restricted to nationals. The response to this potentially politically and socially explosive situation is simple: Europe needs to make more efforts to integrate its immigrant population, and unleash its productive potential.

Temporary international labor movement

One of the important achievements of the Uruguay Round of trade negotiations was the extension of the system of multilateral rules to services. Article I of the General Agreement on Trade in Services (GATS) states that 'trade in services' covers international service transactions taking place through four 'modes of supply', including those requiring the temporary international movement of natural (as opposed to juridical) persons ('mode 4').

Many barriers restrict the movement of natural persons, including: quotas and/or economic needs test requirements; qualification and licensing requirements;

and visa formalities. While the GATS framework adequately addresses regulatory barriers that concern the movement of natural persons, the actual commitments to open markets with respect to mode 4 transactions have been very limited so far. There is widespread agreement that the Uruguay Round outcome in services was unbalanced. In particular, the liberalization of labor movement in services, like construction, which interest most the developing countries, was largely eschewed by the industrial countries. At the WTO Ministerial Conference held in Seattle, at the end of 1999, several developing country participants called on industrial countries to open up their markets to the movement of natural persons, a position supported by many economists for reasons of equity and efficiency.[44]

The purpose of this section is to analyze the EU experience concerning the temporary movement of labor in the context of international transactions in services, and to draw some lessons that may be relevant in the global context. I will concentrate exclusively on sectors like the construction industry, because this is where most of the controversy has occurred not only inside the EU, but also outside. I will, thus, ignore sectors which are intensive in human capital, because there is no controversy about the movement of highly skilled personnel within the EU. It must be stressed, however, that even here, there is strong resistance to open up the market to non-EU personnel, as illustrated by the recent outcry against the German plan to import of a few thousand Indian programmers ('Kinder statt Inder!' – children rather than Indians!),

The EC Treaty guarantees the freedom of movement of workers and the freedom to provide services between all EC countries. By implication, undertakings established in one EC country are free to "post workers" (that is, to send temporarily their employees) to any other EC member, in the context of the provision of services.

[44] See, for instance, Mattoo (2000) and Stiglitz (2000).

In other words, the freedom to provide services within the EC fully applies to mode 4 transactions.

The freedom to post workers within the EC did not raise any problem, until 1986, when Portugal, a country where the cost of labor was substantially below the level in old EC countries, joined the Community. Together with Spain, Portugal joined with a clause imposing a transition period of several years, during which the freedom of movement of workers was severely limited. By contrast, no such clause restricted the freedom to provide services between old and new EC members. The potential contradiction between the presence of restrictions on the movement of workers, on one hand, and the freedom to provide services, on the other, was considered by the European Court of Justice in the celebrated *Rush Portuguesa Lda v Office National d'Immigration* case of 1989.

Rush Portuguesa, an undertaking established in Portugal specializing in construction and public works, entered into a number of subcontracts with a French undertaking on several construction sites in France. In order to carry out the works, Rush brought a number of Portuguese workers from Portugal to France. It was penalized for doing so by the French authorities ('Office National d'Immigration'), on the grounds that the transition period introduced a derogation from the principle of freedom of movement for workers between the two countries. The European Court ruled, however, that despite the limitations imposed by the transition period, Portuguese undertakings could freely post workers in France, because they enjoyed unlimited freedom to provide services in the EC. The Court recognized that the purpose of the derogation was to prevent disturbances on the labor market of EC members, which could arise, following Portugal's accession, due to large and immediate movements of workers. It also accepted that the French authorities were authorized to check whether Portuguese undertakings were not circumventing the derogation “under the cloak of a provision in services”. But it concluded that “where there is a temporary movement of workers who are sent to another Member State to carry out construction work or public works as part of a provision of services by their employer,…such workers return to their country of origin after the completion of their work without at any time gaining access to the labor market of the host Member State”.[45]

Crucially, therefore, the Court considered that, as long as workers are posted abroad temporarily, they have no impact on the labor market of the host country. This liberal attitude of the Court greatly worried high-wage countries, such as France and Germany. These countries feared that unrestricted temporary labor movement from low-wage countries, such as Portugal, would impose undue consequences to their labor markets, especially in the construction sector. Several attempts were made by high-income countries to introduce EC legislation, which would allow EC countries to impose their domestic labor market regulations on workers posted within their territory. These attempts were fiercely opposed by low-income countries, which feared, in turn, that such legislation would curtail their comparative advantage in construction services. Finally, in December 1996, the EC introduced a legislation on “The Posting of Workers in the Framework of the Provision of Services” (96/71/EC) aiming at, *inter alia*, the “promotion of the transnational provision of services [in] a climate of fair competition”. It instructed countries to introduce, by December 1999, national legislation requiring that where an EC member state has certain minimum terms and conditions of employment, these must also apply to workers posted temporarily by their employer to work in that state.

[45] Case C-113/89. European Court Reports 1990 page I-1417.

It is clear, however, that this legislation has not put an end to the fight between low- and high-wage countries regarding the mobility of workers in the construction sector. The situation is especially acute in Germany, where more than 200 thousand workers posted by EC firms are said to be engaged on construction sites. After the introduction of the new legislation providing certain minimum terms and conditions of employment, including minimum wages, in the construction sector, a number foreign firms were accused of breaching the law, and fined. Some of these foreign companies decided to challenge the provisions of the new legislation, which they regard as an infringement of their right to provide services within the EC. Consequently, the legal and practical problems surrounding the status of posted workers inside the EU is still far from being resolved.

The EU experience demonstrates that there are real opportunities for trade in labor-intensive services, like construction, between high- and low-wage countries. At the same time, it shows that, even more than in the case of trade in goods or trade in services in other modes, mode 4 transactions between countries with important differences in economic conditions raise the specter of “unfair competition” and “social dumping”. In purely economic terms, it does not matter whether labor is embodied in products, or not. Whether I buy, in Brussels, Portuguese garments that embody Portuguese labor, or I purchase Portuguese construction services by having Portuguese workers come to Belgium and build my house is immaterial. In sociological terms, however, the two are not necessarily equivalent. Most Belgians readily accept that Portuguese workers in Portugal earn much less than workers in Belgium, and not simply because the cost of living is lower in Portugal. On the other hand, probably few Belgians would accept the idea that Portuguese workers in Belgium earn the same salary as Portuguese workers in Portugal, especially if they work alongside Belgian workers. This explains why Belgian workers do not seriously demand that minimum wages in Portugal be the same as in Belgium, but insist that minimum in wages in Belgium apply equally to all workers, including posted ones. Such considerations lead me to think that social norms must be part of the agenda of future GATS negotiations, if real progress is to be achieved in opening up markets to the movement of natural persons.

4. Conclusion

The emergence of "One World", where goods, services and capital flow almost freely, thanks to the elimination of regulatory barriers and the advent of the information revolution, has brought unprecedented wealth to Europe and America. At the same time, however, labor has fared relatively poorly on both sides of the Atlantic: declining wages and rising job insecurity in America, and growing unemployment in Europe. Whereas economists continue to argue about whether trade or technological change is the main culprit behind the waning fortune of labor, ordinary citizens tend to see the two as simply different facets of "globalization". To them, it makes no difference whether economists label flows of goods or services as "trade", and flows of ideas passing through the Internet or multinational corporations as "technological change". Both constitute globalization.

I have attempted to show that the political economy of domestic adjustment to globalization is different in Europe and America. In the United States, where markets operate efficiently, globalization generated more wealth, but also more income inequality and adjustment problems, than in Europe. The median voter lost wages and experienced rising job insecurity. Both resulted in fierce opposition of labor against globalization. In Europe, where the welfare state is more generous, and markets are less efficient, globalization generated less wealth, but also less income inequality and adjustment, than in the United States. The European median voter suffered relatively little. Unemployment increased, but its effect fell mainly on ‘outsiders’: the young, and the immigrants. Accordingly, European organized labor voiced less opposition against globalization than in America.

The essential question is: Can current responses to the challenge of globalization be sustained? In America, the challenge is to ensure a better distribution of income and a decrease in poverty. In Europe, the challenge is to prevent the demise of welfare states that are confronted with rising demands and dwindling resources. Possibly, both the United States and Europe have entered a new era, in which permanently higher GDP growth is, finally, reversing the decline of wages in America, and the fall in employment rates in Europe. If so, the question simply disappears. But what if the worst of globalization is not over, and trade and/or technological change continue to threaten the situation of the median voter in America, or the sustainability of the welfare state in Europe?

I will be silent on the problems of America, and concentrate on the situation in Europe. A broad consensus in Europe agrees that the welfare state must be reformed, not only for efficiency, but also budgetary reasons.[46] Aging and further economic integration in Europe are both expected to increase the gap between social expenditures and revenue, if present benefit levels and eligibility rules remain unchanged. Demographic scenarios forecast a dramatic increase of the ratio of pensioners to workers during the next 50 years in Europe.[47] In a shorter horizon, Economic and Monetary Union (EMU) is also likely to increase the demand for social transfers - through greater competition in product and capital markets, and, ultimately,

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[46] See Buti, Franco and Pench (1999), and the contributions therein.

greater pressure on labor markets -, and to reduce the collection of taxes needed to finance them – due to greater mobility of financial and human capital. Given the current high level of taxation in Europe, raising taxes is probably not a politically viable option. This leaves two options. One is to adjust social expenditures downwards. The other is to employ more migrant workers, either by attempting to lower the unemployment rate among the current immigrant population, or by importing new permanent or temporary foreign workers. Either option would require difficult choices on the part of EU governments.

[47] From 0.4 in 2000, to 0.7 in 2050.

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Table 1
Intra-Industry Trade: France, Germany, and United States, with Various Partners, 1989 and 1998

	1989				1998			
Partner	France	Germany	EU-15	USA	France	Germany	EU-15	USA
Intra-EU	0.80	0.71	0.69	-	0.86	0.78	0.73	-
World	0.66	0.53	0.56	0.64	0.69	0.60	0.62	0.68
Rich neighbor	0.68	0.66	0.61	0.68	0.62	0.66	0.59	0.63
Poor neighbor	0.46	0.35	0.39	0.66	0.52	0.56	0.52	0.57
DAEs	0.33	0.30	0.31	0.37	0.44	0.44	0.42	0.48
China	0.11	0.10	0.10	0.11	0.23	0.22	0.21	0.12

Notes: 'world' is extra-EU for EU countries; 'rich neighbor' covers EFTA (Switzerland, Norway, Iceland, and Liechtenstein), for the EU, and Canada for the US; 'poor neighbor' includes Poland, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Albania, Latvia, Lithuania, Estonia, Slovenia, Croatia, Bosnia-Herzegovina, Serbia and FYROM, for the EU, and Mexico for the US; DAEs stands for Dynamic Asian Economies, and comprises of Singapore, Taiwan, Hong Kong, South Korea, Thailand, and Malaysia.

Table 2
Regression Analysis (OLS) of the Determinants of Unemployment Incidence Among Foreign Workers Relative to Total Labour Force, 1995-1998

$$UFT = \alpha + \beta UBEN + \gamma \log(FORRATE) + \delta \log(PARTRATE) + \varepsilon ACU + \phi ACU^{*} \log(FORRATE) + \eta$$

	14 EU Members	14 EU Members, plus Australia, Canada, and US	
α	1.225 (0.591) [0.065]	1.242 (0.713) [0.107]	1.226 (0.571) [0.055]
β	0.049 (0.011) [0.001]	0.040 (0.013) [0.008]	0.047 (0.011) [0.001]
γ	0.448 (0.099) [0.001]	0.409 (0.118) [0.005]	0.449 (0.096) [0.001]
δ	-2.171 (0.748) [0.016]	-2.374 (0.889) [0.020]	-2.338 (0.713) [0.009]
ε		-1.363 (0.452) [0.011]	-3.987 (1.014) [0.002]
ϕ			-1.472 (0.531) [0.018]
Adj. R^2	0.852	0.788	0.864
Obser.	14	17	17

Note: (standard errors) and [P-values] in parentheses.

Figure 1
Trade Openness: France, Germany, and United States, 1960-1998
(Exports plus imports as share of GDP)

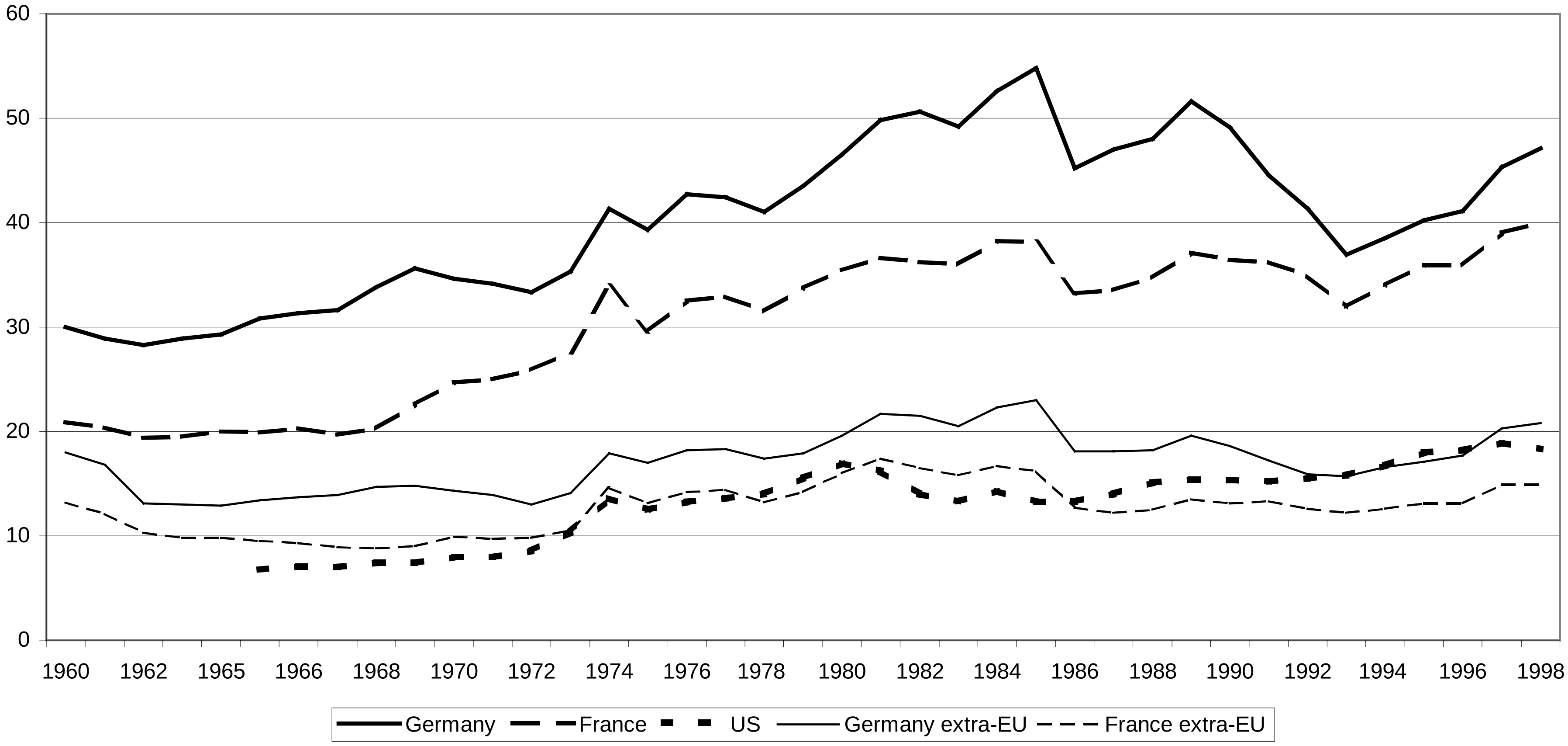

Figure 2
Share of (EU and non-EU) Foreign Workers in the Labor Force,
EU Total and Member States, 1998
(percentages)

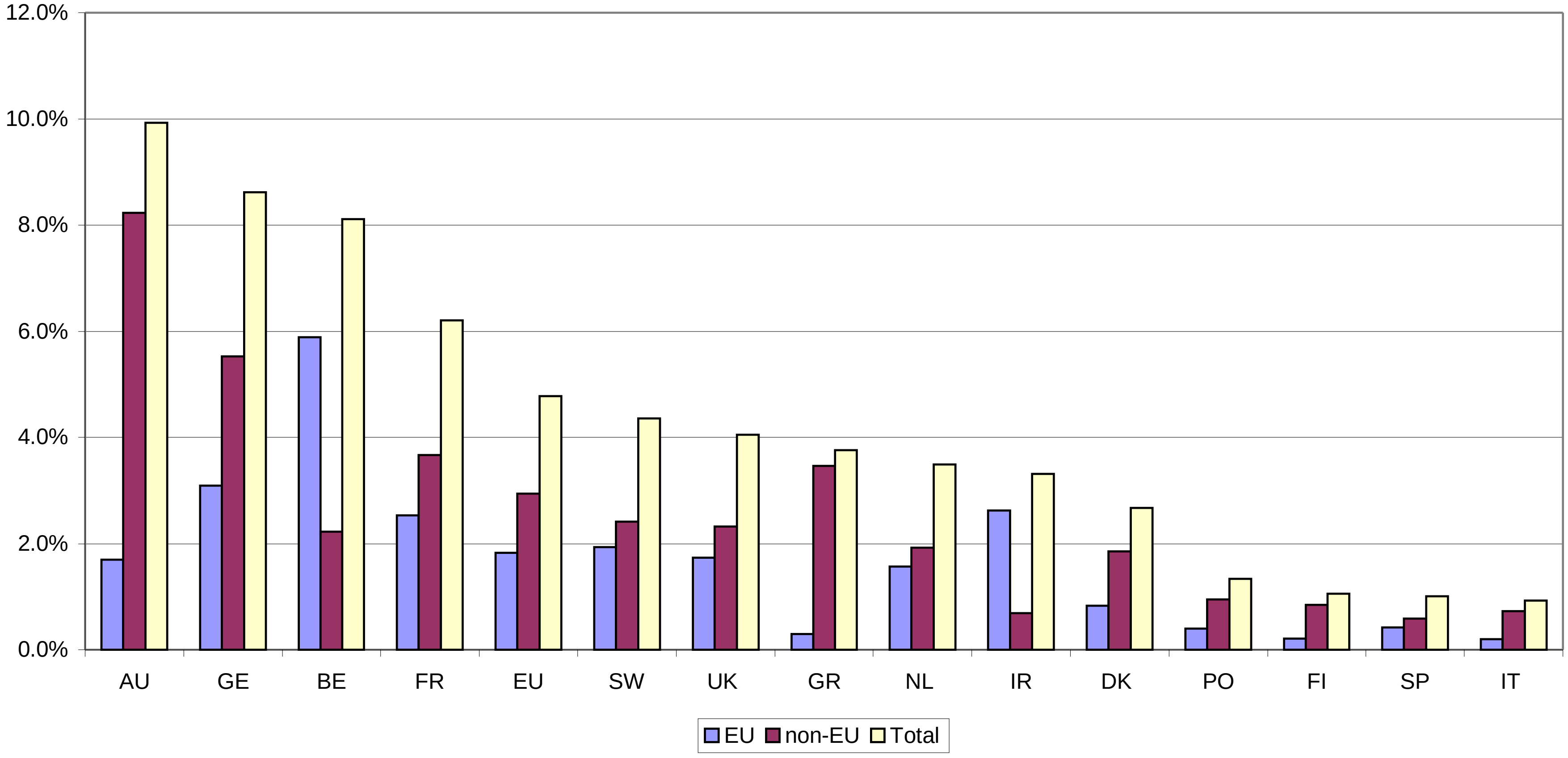

Figure 3
Unemployment Rates for (EU and non-EU) Foreigners and Nationals, EU Total and Member States, 1998
(percentages)

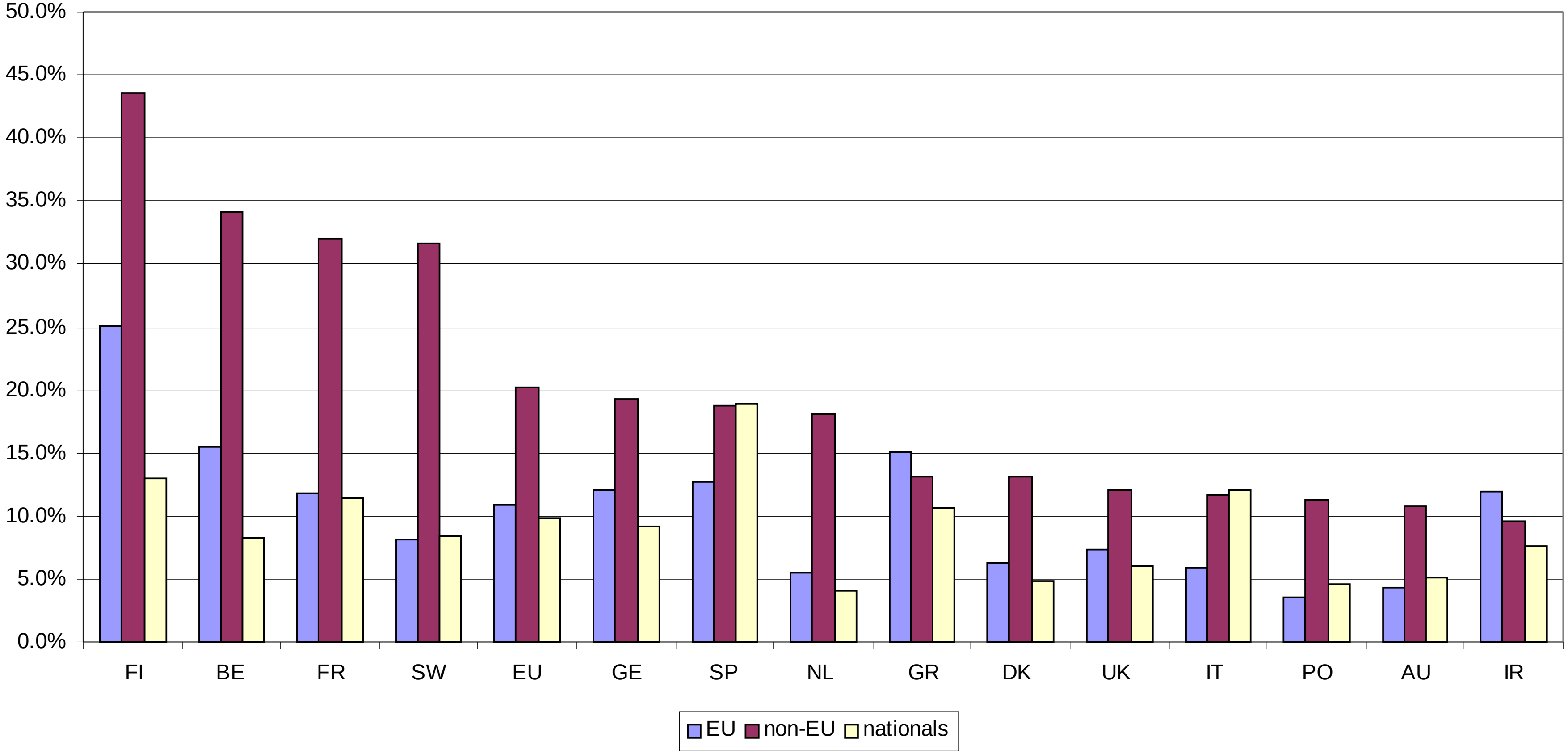

Figure 4
Unemployment Rates for Non-EU Foreigners Relative to Total Unemployment Rates, EU Member States,1983-98
(percentages)

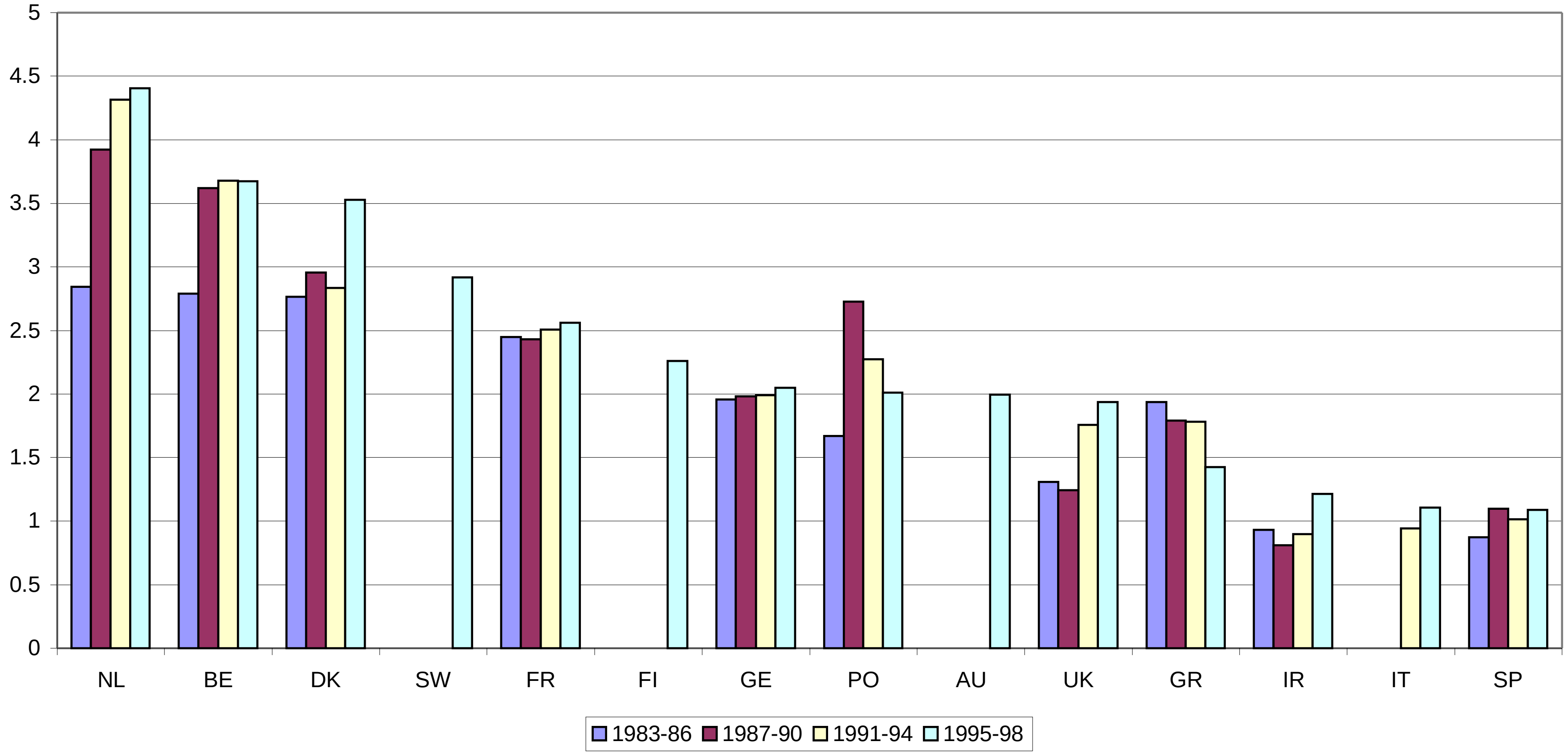

Figure 5
Relationship Between Generosity of the Welfare State and Unemployment Rates, mid-1990s