COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 01.03.2006
SEC(2006) 315

COMMISSION STAFF WORKING DOCUMENT

EUROPEAN GLOBALISATION ADJUSTMENT FUND REGULATION (EGF): RATIONALE FOR THE INTERVENTION CRITERIA

{COM(2006) 91 final}

COMMISSION STAFF WORKING DOCUMENT

EUROPEAN GLOBALISATION ADJUSTMENT FUND REGULATION (EGF): RATIONALE FOR THE INTERVENTION CRITERIA

This note explains the guiding principles, rationale and 9 key questions leading to the specific choice and balance of intervention criteria of the draft EGF Regulation.

Article 2 - Intervention criteria
A financial contribution from the Fund shall be provided where major structural changes in world trade patterns lead to serious economic disruption, notably a massive increase of imports into the EU or a progressive decline of the EU market share in a given sector or a delocalisation to third countries, and which results in:
(a) at least 1000 redundancies in an enterprise, including workers made redundant in its suppliers or downstream producers, in a region where unemployment measured at NUTS III level is higher than the EU or national average,
or
(b) at least 1000 redundancies, over a period of 6 months, in one or more enterprises in a sector, measured at NACE 2 level, which represents at least 1% of regional employment measured at NUTS II level.

1. WHAT PRINCIPLES AND RATIONALE GUIDED THE ESTABLISHMENT OF THE CRITERIA?

1. Subsequent to the proposal by President Barroso, the European Council agreed that: criteria must be **strict;** that the scope of intervention of the Fund must be dependent on the existence of **a link between the redundancies and changing world trade patterns**; and that the Fund's activation and eligibility must be specifically related to the **scale and the territorial impact** of the redundancies (i.e. without any pre-condition that would establish ex-ante priorities between Member States[1]).

2. A serious economic disruption due to changes in world trade patterns can occur in principle in all MS and regions. Therefore, a clear principle of intervention criteria is that they **should be open to workers in all Member States**, irrespectively of size or overall socio-economic situation; criteria should thus focus on the scale and impact of specific cases of economic disruption.

3. Similarly, assistance from the EGF should be available equally and under the same conditions to **workers of all sizes of enterprises**, since changes in world trade

[1] European Council conclusions: the Fund "*is designed to provide additional support for workers made redundant as a result of major structural changes in world trade patterns (...) Activation of the Fund should be subject to strict criteria relating to the scale of economic dislocation and its impact on local, regional or national economies*".

patterns affect multinational and national companies as well as small and medium sized ones (SMEs).

4. Within clear and transparent criteria, **the burden of proof on the fulfilment of intervention criteria must rest with the applicant Member State**, on grounds of subsidiarity (Member States are best placed to judge the situation on the ground), as well as efficiency and better regulation (the EGF should not be overburdened by excessive bureaucratic requirements or procedures).

5. In order to follow the approach of the European Council conclusions, the draft EGF Regulation should follow **a sequential set of intervention criteria**: firstly, evidence that redundancies result from major structural changes in world trade patterns; secondly, evidence of a significant impact on local, regional or national economies.

2. HOW TO DETERMINE THE LINK BETWEEN REDUNDANCIES AND WORLD TRADE PATTERNS?

Naturally, a fraction of redundancies in the EU are likely to be related to trade and investment liberalisation. However, evidence of a direct link between specific redundancies and changing trade patterns is practically impossible to establish in a mechanical or automatic manner.

In light of the above, taking into account the need for strict criteria, and at the same time the need for a margin of appreciation of applications, a Member State should realistically be able to provide evidence and justification of **at least one** of the three elements below, which are arguably the main indicators of structural changes in trade:

– *a massive increase of imports into the EU* - due to, e.g., a reduction or elimination of tariffs, removal of market supports, etc.; or

– *a progressive decline of the EU market share in a given sector* - shown e.g. by sectoral export statistics at NACE 2 level over a period of 5 years; or

– *an economic delocalisation to third countries* - shown by productive capacity ceasing within a region and moving outside the EU (trade policy being EU-wide, delocalisation between EU Member States would not fulfil this criteria).

These elements will be analysed by the Commission in consultation with the applicant Member State (as is the case for the Solidarity Fund).

In addition, on the basis of experience gained the Commission may issue guidance on them.

3. IS THERE A 'LEVEL PLAYING FIELD' ACROSS ALL MEMBER STATES?

Yes. The combination of the first criterion of Art. 2 (2a: territorially based), with the second one (2b: sector-based), is designed precisely to ensure that no Member State is *a priori* excluded from applying to the Fund, and that the impact and relevance of the various economic sectors is taken into account.

Furthermore, **the intervention criteria do not refer to Member States, but to regions**. Small Member States are not disadvantaged, since most small Member States are a single region, whereas Member States are divided into numerous regions[2].

<u>*NUTS* regions:*</u>

Level	Number of Regions	Population	
		Minimum	**Maximum**
NUTS 1	89	3 million	7 million
NUTS 2	254	800 000	3 million
NUTS 3	1214	150 000	800 000

* The Nomenclature of Territorial Units for Statistics (NUTS) was established by Eurostat more than 25 years ago in order to provide a single uniform breakdown of territorial units for the production of regional statistics for the European Union.

4. DO THE CRITERIA DISCRIMINATE AGAINST MEMBER STATES WITH LOW UNEMPLOYMENT RATES?

No. The EU unemployment level provides a measure of economic disruption, since where unemployment is very low the impact of redundancies is smaller. At the same time, sudden redundancies can occur everywhere: it would therefore be unfair to automatically exclude a priori from eligibility all Member States with a lower unemployment level than EU average, particularly those with marked <u>internal</u> regional unemployment disparities). Thus, the criteria include both the EU and national average unemployment levels, which makes all Member States eligible.

5. IS THE THRESHOLD OF 1000 REDUNDANCIES JUSTIFIED?

A quantitative threshold is designed to ensure that the Fund intervenes only when redundancies create serious economic disruption and have a significant impact. Determining the most appropriate quantity representing an economic impact at regional level across the EU is an extremely difficult exercise. On the other hand, a threshold in the form of a percentage instead of an absolute figure does not represent an operational solution (see point 6 hereafter). Furthermore, there are no reliable and pertinent data or comparable precedents (see point 8 below). In fact, to a great extent, as was the case with the US Trada Adjustment Assistance

2 Examples: **NUTS level I** territorial units: the German Länder, regions in Belgium, Ireland, Wales and Scotland. **NUTS II**: the autonomous regions in Spain, French regions and overseas departments (DOM), the Belgian and Dutch provinces, the Italian regions, the Austrian Länder. **NUTS III**: the Nomoi in Greece, the Maakunnat in Finland, the Län in Sweden, the Kreise in German, the French departments, and the Spanish and Italian provinces etc.

Act (see point 9 below), the most reliable indication of the appropriate thresholds will be the experience of the first year of operation of the Fund, after which the Regulation foresees the possibility of a revision (point 9 below).

The European Restructuring Monitor (ERM) reports of restructuring events, although only in companies of 100 or more employees in the EU, and without an indication of a link with globalization. These events appear to provide a broad indication that the threshold of 1000 redundancies could be the most pertinent, both for art. 2a and 2b, considering the objectives and the level of financial resources of the Fund.

More importantly perhaps, in order to take into account Member States and regions where there are few large and no very large companies, primary and secondary redundancies are taken into account in art. 2a): the 1000 threshold includes redundancies in the company that triggered the EGF intervention, but also in its direct suppliers and subcontractors if there is a demonstrable link.

Empirical evidence shows that, for every redundancy in a given company, there are at least two more in its suppliers and producers who would count towards the 1000 threshold; usually, these suppliers and producers are SMEs. Therefore, the actual number of redundancies in the single main affected enterprise **can be as low as approximately 300 redundancies**.

In sum, **the combination of a 1000 threshold in one single enterprise, plus the taking into account of its primary and secondary redundancies, plus the criterion 2b where the 1000 threshold is cumulative between several enterprises**, should allow a correct balance between flexibility and strict criteria.

6. SHOULD THE THRESHOLD BE A PERCENTAGE, RATHER THAN AN ABSOLUTE AMOUNT?

In order to take into account relative impact on large and small regions, the possibility of using criteria based on a percentage figure instead of an absolute one has been considered. In practice, this option would imply great complexity: it would require the introduction of several different ranges of population size, each with a different percentage to be applied. It would also introduce uncertainty, due to the use of an unknown variable - the employment level of the sub-region - for which there are no standardized statistics available (sub-regional employment figures are not maintained by Eurostat).

To illustrate the complexity of using percentages: in order to be sensitive to differences of size within NUTS III regions (i.e. between 150000 and 800000 population), the region should be sub-divided into at least 3 sub-regions. A different percentage should then be applied ,e.g.:

150000 to 250000 @ 0.4% = up to 1000

250001 to 650000 @ 0.15% = up to 975

650001 to 800000 @ 0.12% = up to 960

The end result would still be an absolute figure depending on the percentage applied. In addition, this would risk giving the impression of discrimination across regions.

More importantly perhaps, as the employment level varies, the denominator cannot be known in advance. Hence, the required number of redundancies could only be calculated after the fact. This would in practice render the Fund inoperable.

7. HOW TO TAKE INTO ACCOUNT THE IMPACT OF REDUNDANCIES IN A SECTOR? IS THE 1% THRESHOLD THE MOST APPROPRIATE ONE?

The criterion in Article 2b) is designed to address on the one hand, redundancies and significant economic damage in Member States or regions which do not have a sizeable number of big enterprises; on the other hand, redundancies accumulated in a number of small and medium enterprises (SMEs) within the same sector, particularly in sector-dependant regions.

The choice of NACE 2 sector level linked to NUTS II level (regions of 800.000 to 3 million people) is due to the fact that they are as close as possible to the ground, i.e. these are the lowest levels where data (from Eurostat) can be cross-tabulated.

The 1% regional employment threshold is designed to measure the level of regional dependence on a given economic sector. It appears to be the most balanced and adapted to the impact criteria indicated by the European Council. This threshold has been statistically tested against different levels of 0.5%, 1%, and 2%. As an indication of regional speciality, 30 manufacturing sectors were cross-tabulated with the 250 NUTS II level regions to determine 'sector X region density':

– with a 2% threshold, due to diffusion of economic activities (particularly manufacturing), in many regions no sector would be eligible;

– with a 1% threshold instead, all regions would be eligible to a greater or lesser extent, and the density of sectors per region would be 9 per region on average;

– with a 0.5% threshold, the density would be far greater: 15 sectors per region. Which would dilute the meaningfulness of the sectoral impact indicator.

8. IS THERE A PRECEDENT ON WHICH TO BASE THE EGF INTERVENTION CRITERIA?

There is no real precedent upon which to base the establishment of the EGF intervention criteria. In the EU, the closest available data are those of the European Restructuring Monitor (ERM) of the European Monitoring Centre on Change. However, the ERM provides a broad picture of the scale of the restructuring phenomenon in the EU, only in companies of more than 100 employees, and **not** of the link to globalisation or changing world trade patterns. Having said that, a sensitivity analysis of employment and unemployment rates by sector, Member State, NUTS III and NUTS II region has been carried out to determine the most relevant available level of comparable data.

Internationally, the closest example is the 40-year-long experience of the US Trade Adjustment Assistance programme (TAA), which has been thoroughly analysed in view of the establishment of the EGF criteria. The TAA indeed shows the difficulty of objectively identifying criteria and trade-related redundancies. Established in 1962, TAA intervention criteria were modified several times, mainly in accordance to changes in the evolution (and political impact) of world trade: from extremely stringent criteria initially (resulting in no workers being certified in the first years of its existence), to overly relaxed criteria resulting in a swelling of TAA spending to USD 1.6 billion in 1980 (when criteria were again tightened).

9. WILL THE CRITERIA REMAIN UNCHANGED FOR THE DURATION OF THE EGF REGULATION?

Not necessarily: **a review clause** in the Regulation (Art. 20) allows for adaptation of the criteria on the basis of the experience **of the first full year of activity** of the Fund.

The intervention criteria of Article 2 appear to be sufficiently strict, transparent and measurable to allow for objective selection of applications by the Commission. They should lead, in principle, to between 15 and 40 annual applications for assistance. However, these or other criteria (and their combination) have never been tested: it is impossible to predict with reliability whether they are too stringent (and therefore few or no applications could be introduced or accepted) or too wide (in which case a large number of applications would need to be refused for lack of funds).