

# **ECONOMIC CONVERSION: WHAT SHOULD BE THE GOVERNMENT'S ROLE?**

*A Special Study*

January 1980



**CONGRESSIONAL BUDGET OFFICE  
U.S. CONGRESS  
WASHINGTON, D.C.**

**ECONOMIC CONVERSION:  
WHAT SHOULD BE THE GOVERNMENT'S ROLE?**

**The Congress of the United States  
Congressional Budget Office**

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PREFACE

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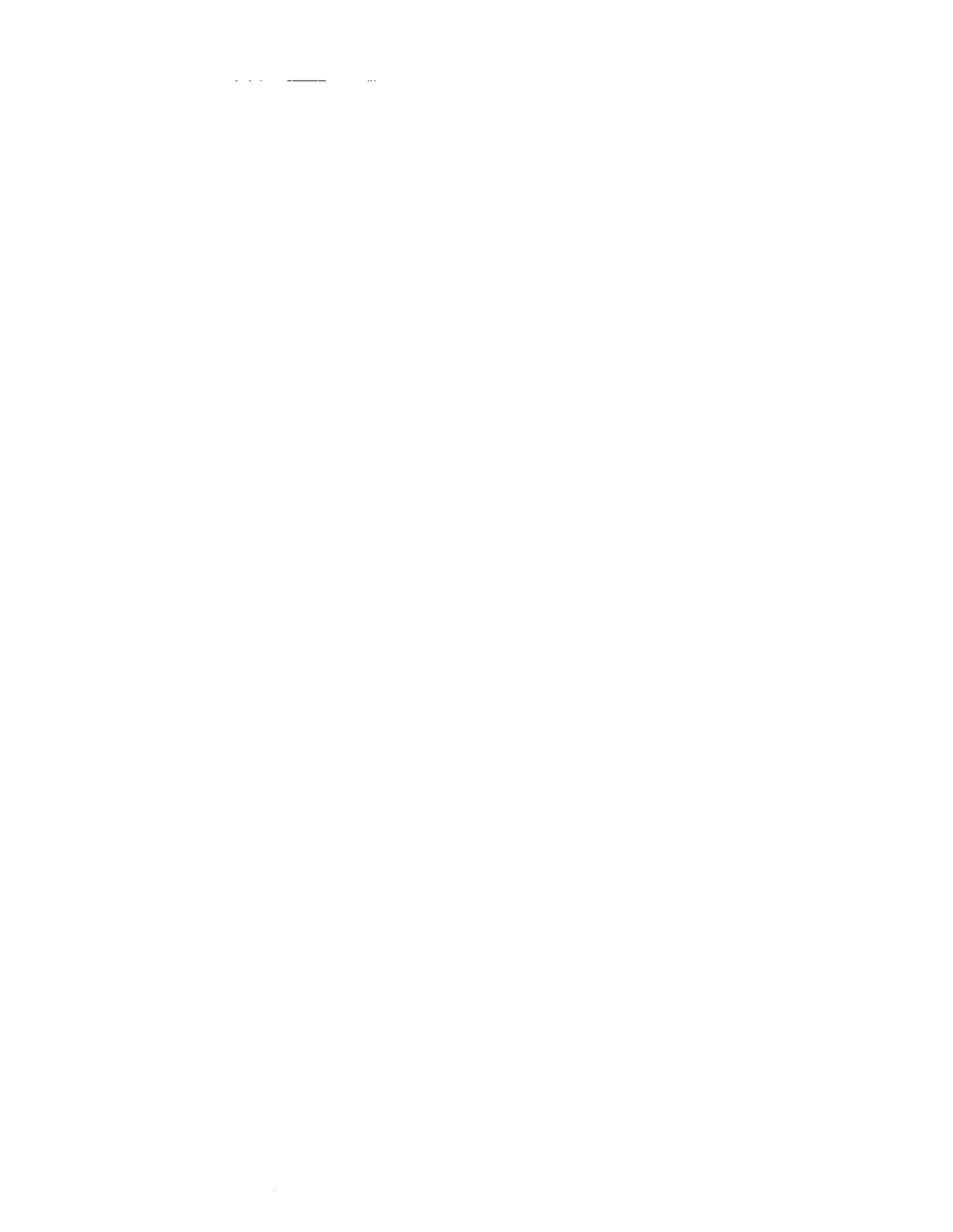
Members of the Congress have taken great interest in how labor and capital move to new and more productive pursuits in response to sudden declines in the demand for their services--for example, when a military base closes or when imports undercut a domestic industry. Many observers term this movement of resources "economic conversion."

To examine the government's role in assisting economic conversion, the Congressional Budget Office (CBO) organized a working conference at the request of Senator Edmund S. Muskie, Chairman of the Senate Committee on the Budget, and Senator Alan Cranston, at the time a member of the Budget Committee. The conference was held in Washington in July 1978, with representatives of labor, business, and government invited to present their views. Drawing on their experience, the participants discussed the possible role of government in providing adjustment assistance, the efficacy of current programs, and what changes might be appropriate. Special thanks are due to the participants for contributing to this review of the economic conversion problem.

Although the conference was held more than a year ago, the issues raised still bear on Congressional consideration of the conversion problem. This Special Study is organized in two parts. Part I, a summary of conference proceedings, presents synopses of the conference participants' remarks. Part II is a draft paper prepared by CBO staff members to provide a basis for discussion at the conference. The synopses and background materials were prepared under the supervision of David S.C. Chu, drawing on contributions by Jane D'Arista, Everett M. Ehrlich, Virginia G. France, Richard A. Hobbie, H. Marshall Hoyler, Rosemary E. Minyard, and Carl R. Neu, of CBO. Johanna Zacharias edited the paper with the assistance of Mary A. Anders, and Nancy H. Brooks prepared it for publication. In keeping with CBO's mandate to provide objective analysis, this paper offers no recommendations.

Alice M. Rivlin  
Director

January 1980



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The first portion of this CBO Special Study contains a summary of the remarks given at the conference on economic conversion held on July 18, 1978. Senator Alan Cranston chaired the conference, and the eight participants, listed here in the order in which they spoke, were:

Frederick W. Garry  
Chairman and  
Chief Executive  
Rohr Industries

T. A. Wilson  
Chairman and  
Chief Executive  
Boeing Aircraft  
Corporation

Eugene I. Casraiss, Jr.  
Legislative Representative  
International Union  
United Automobile, Aerospace  
and Agricultural Implement  
Workers of America

Rudolph A. Oswald  
Director of Research  
American Federation  
of Labor-Congress of  
Industrial Organiza-  
tions

Lester C. Thurow  
Professor of Economics  
Massachusetts Institute  
of Technology

Con Howe  
Executive Director  
Massachusetts Govern-  
ment Land Bank

David S.C. Chu  
Assistant Director for  
National Security and  
International Affairs  
Congressional Budget Office

Jerry Jasinowski  
Assistant Secretary  
for Policy  
United States Depart-  
ment of Commerce



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## SUMMARY

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Dislocation is a fact of economic life. In response to dislocation, resources--labor and capital--ought to move to more productive pursuits. This movement is the process called "economic conversion." The conference, held by CBO in July, 1978, focused on three aspects of the economic conversion problem:

- o What should the role of government be in assisting economic conversion?
- o How well do the current programs work?
- o What changes in government policies should be considered?

Each of the conference participants addressed these questions from the perspective of his professional experience. Mr. Garry and Mr. Wilson used the recent history of their companies to illuminate how government might better assist in the conversion problem. Both highlighted the difficulties that occur when there are sudden, sharp shifts in the demand for a company's products. To the extent that such shifts reflect the vagaries of government policy (as they did for several years in the mass transit area, for example), more consistent policies--with changes made gradually rather than suddenly--would assist the business community in achieving smooth transition. Mr. Wilson suggested that, when major economic contractions do occur, particular attention be paid to those workers with long-time ties to the communities they live in--perhaps by providing a stronger link between length of employment and the extent of employment benefits.

Both Mr. Casraiss and Mr. Oswald advocated a general and more organized economic conversion program than Mr. Garry or Mr. Wilson seemed to favor. They stressed the importance of labor participation in planning for change, citing "prenotification" (advance warning) as an essential ingredient in economic conversion. Both Mr. Casraiss and Mr. Oswald felt that the current ad hoc assortment of programs was inadequate, and that the United States could benefit from the European experience in designing new programs. Both urged that unemployment benefits be improved, that more pensions be made portable from job to job, and that transitional health insurance be provided to cover displaced workers while they seek employment.

Mr. Thurow also supported integrating the separate programs that now exist into a general program--a comprehensive "safety net" under workers who are laid off--although he questioned the applicability of European experience with conversion aid to the United States. He stressed that the importance of this safety net would fluctuate with the business cycle, assuming greater significance during periods of high unemployment. Mr. Chu noted that, provided labor and capital markets worked reasonably well, a comprehensive safety net might actually retard adjustment to changed circumstances, by sharply reducing the incentive for workers and entrepreneurs to seek new activities. Mr. Thurow argued, however, that imperfections in the marketplace--especially the marketplace for labor--are significant and that other government programs (for example, environmental protection regulations) require the counterbalance of conversion assistance to help markets adjust promptly.

Mr. Howe focused on the problems that state and local officials must solve when their communities confront sudden changes in the economic outlook. He stressed that local governments cannot move away from the problems the way workers can--Massachusetts cannot move to the Sunbelt. Mr. Howe emphasized that the conversion process was best managed by state and local governments. He felt that there was a need for a bridge between federal assistance and local officials, to be provided perhaps by the state itself or by state institutions.

Mr. Jasinowski offered a series of criteria for deciding whether federal assistance was warranted. He expressed sensitivity to the role of the marketplace as the normal vehicle for adjustment, and he cautioned that conversion programs ought not be used to address problems caused by cyclical fluctuations in the economy. Nor did he advocate the use of conversion assistance to counteract long-term economic decline in an area; that problem, he argued, is better handled by economic development programs. In general, Mr. Jasinowski urged a middle course between a general safety net and current ad hoc approaches in designing future programs to assist in economic conversion.

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SYNOPSIS OF REMARKS BY THE CONFERENCE PARTICIPANTS

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FREDERICK W. GARRY

Mr. Garry used Rohr Industries' recent experience in the transportation field as a basis for examining the economic conversion issue and the potential role of government assistance in ameliorating that problem.

Rohr entered the public transportation field in the late 1960s and early 1970s, when the federal government was encouraging the industry to expand. A number of companies stepped forward in anticipation of government funding. There were plans at that time to buy large numbers of buses; AMTRAK was to buy new rolling stock; and there was discussion of significant expansion in the nation's metropolitan rail transport system.

Responding to these governmental signs of interest to the private sector, Rohr geared up to enter the bus and rail car markets and began substantial research on future mass transit possibilities. Unfortunately, little of the anticipated government demand materialized. Moreover, some of the government demand that did materialize (for example, for buses to accommodate handicapped riders) was subject to frequent changes in design specifications. As a result, Rohr--like other companies in the industry--lost substantial amounts of money. Adjusting to the change in anticipated demand was difficult; many of the workers had specialized skills and hence were hard to absorb elsewhere in the company.

Mr. Garry did not attempt to blame changes in federal policy for all of Rohr's problems. Nor did he suggest that there were easy answers to the difficulties created by design changes in industries using new technology. But he emphasized that consistent government policies, with changes made gradually rather than suddenly, would enable the business community to anticipate and provide for future requirements rather than react hastily to surprise decisions. 1/ With such better planning, Mr. Garry

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1/ Mr. Howe seconded this point, noting that the need for gradual transition also applies to local governments' dealing with federal policy.

asserted, it might be possible to limit the need for explicit adjustment assistance programs.

T. A. WILSON

Mr. Wilson focused on the Boeing experience as an illustration of the complexities in providing adjustment assistance.

In the late 1960s, Boeing was expanding rapidly. The company had accelerated production of 707s and 727s to meet an air traffic growth rate of 15 percent per year. At the same time, it was also producing the Short Range Attack Missile and Minuteman Intercontinental Ballistic Missiles. And in December of 1966, Boeing had been awarded the Supersonic Transport (SST) prototype contract. To meet these commitments, the company increased its labor force from just under 50,000 in 1965 to just over 100,000 in 1968. With so hasty a buildup of personnel, labor productivity deteriorated.

Market conditions then changed very suddenly. In 1970, the commercial aircraft market dried up. In March 1971, the SST prototype was cancelled. Although foreign sales and military contracts acted somewhat as stabilizing influences, Boeing was compelled to cut its payroll sharply.

As is true in any company, Boeing had had large numbers of voluntary terminations in the 1960s, ranging from one-eighth to one-third of its labor force per year. But the large cuts that Boeing needed to make in 1971--to return to a labor force smaller than the company had in 1965--required substantial numbers of layoffs. Moreover, as it became clear to Boeing workers that new jobs would be hard to find in an increasingly tight local job market, the number of voluntary terminations fell sharply. Workers preferred to be laid off, since an array of benefit programs favored employees who were laid off over those who gave up their jobs voluntarily.

In contrast to the voluntary terminations of the 1960s, concentrated among employees who had been with Boeing only a short time, many of the involuntary terminations in the early 1970s involved employees who had been with the company for several years. Most of these people had strong ties to the community, remained in the Seattle area, and were eventually rehired by Boeing. Nonetheless, they suffered significant income losses and psychic costs.

What Boeing learned from this experience is never again to try to expand production as rapidly as the company attempted to do in the late 1960s. Labor productivity can fall sharply under these circumstances. Moreover, if the eventual price of rapid expansion is rapid contraction, the "normal" process for reducing the labor force--by attrition--can no longer be counted on.

The Boeing experience suggests that modest contractions can be handled by the normal workings of the labor market. But when a company is forced to make large cutbacks, involving layoffs that cannot be absorbed easily by the local labor market, adjustment assistance may be appropriate, especially if the workers who are laid off have long employment histories with the enterprise. This might suggest strengthening the relationship between the extent of employment benefits and duration of employment.

In the discussion of Mr. Wilson's remarks, the issue was raised whether government purchases--especially military purchases--are a source of instability. Although he acknowledged the counterexample of the B-1 bomber, Mr. Wilson argued that military demand is, in fact, relatively stable. Moreover, a high proportion of military contract work is done by large companies that can absorb cancellations. Government ownership of plants and equipment would not, in his view, be a useful way to help the conversion problem. In fact, he suggested, there is a stronger incentive for a company to work for effective conversion when it owns the plants and equipment than when the government is the owner.

#### EUGENE I. CASRAISS

Citing the plight of the worker injured by dislocation described in the CBO background material (see Part II of this paper), Mr. Casraiss argued that job insecurity is at the heart of the issue. To deal with the problem, the United Auto Workers (UAW) stresses prenotification--advance notice of layoffs and planning for alternative uses of the capital stock. The Environmental Protection Act was cited as a model, providing for notice years in advance. Labor sees this as an opportunity to explore problems before layoffs become necessary and thus obviate or at least minimize them. Decisions involving layoffs should not be strictly a management prerogative.

Mr. Casraiss criticized the present trade adjustment assistance program as inadequate. The program raises hopes that are

not fulfilled, he asserted, and is subject to unwarranted delays. Moreover, the program excludes those workers employed by suppliers and subcontractors who, in many cases, are producing the same part as the prime contractor.

Mr. Casraiss was also critical of proposals for Unemployment Insurance reform that did not improve the equity of benefits. A national system that resulted in higher benefits in some states and lower ones elsewhere would constitute income transfers from one group of the poor to another. Reform proposals should seek to raise unemployment compensation to livable levels for all. In Mr. Casraiss' view, such provisions as short-workweek benefits, job-search allowances, and relocation provisions should be recognized as essential. Computerized employment services should maintain lists of job vacancies for every city and town in the nation. Meaningful reform of the federal unemployment compensation system should include continued medical insurance payments and continued employers' Social Security contributions for laid-off employees.

Mr. Casraiss offered several specific suggestions for future programs. He urged the establishment of a three-part commission representing industry, labor, and government to study economic dislocation and to recommend conversion programs, with the Congress setting objectives for the commission. As a general principle, the need for labor involvement in discussions of dislocations should be recognized.

Mr. Casraiss argued that the Trade Act of 1974 (Public Law 93-618), the Redwoods Act of 1978 (Public Law 95-250), authority for AMTRAK, and similar legislation set precedents for the federal government's assuming at least partial responsibility for dislocations caused by its actions. Given these particular decisions, Mr. Casraiss indicated, it is reasonable to extend assistance to all Americans who are dislocated as a result of government action.

In formulating future assistance programs, the United States may be able to benefit from the experience of other countries, Mr. Casraiss noted. The UAW has studied economic conversion programs in Sweden, Germany, and other European countries and has prepared a report on the subject. 2/

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2/ Economic Dislocation: Plant Closings, Plant Relocations and Plant Conversion, Joint Report of Labor Union Study Tour Participants (May 1979).

Finally, Mr. Casraiss indicated his strong disagreement with the statement by Mr. Garry that, with better planning, it might be possible to limit the need for explicit adjustment assistance programs. Insofar as planning prevents dislocation, planning would limit the use of adjustment assistance programs, he argued, but in no way would it diminish the need for such programs to exist.

He also suggested that the federal government be authorized to buy plants, acquire shares in companies, and offer guidance to management, with the understanding that private ownership could be reestablished over time at the government's option. The purpose of federal involvement would be to assist in transition toward alternative uses of existing facilities. The government should also take responsibility for inserting provisions in defense contracts to ensure protection for defense workers and the communities they live in. As an example, Mr. Casraiss suggested that the government could require defense contractors to offer portable pension plans.

#### RUDOLPH A. OSWALD

Mr. Oswald argued that the United States is far behind other developed countries in accepting responsibility for economic change. Almost all European countries require that workers be notified in advance of major employment reductions. In contrast, in the United States, even when corporation managers know that contracts are running out, there is no requirement that workers be notified of pending layoffs.

Retirement of defense workers represents a special problem. Although defense contracts and subcontracts often shift from one employer to another, the same workers are generally involved. Few defense contractors, however, have portable pension plans. When a defense worker changes companies, therefore, he is likely to lose his pension rights. To remedy this situation, Mr. Oswald suggested pooling the pension plans of defense contractors; he further proposed that government take specific responsibility in this area.

In European countries, social security laws and benefits encourage shifts to early retirement as a tool in assisting economic conversion. U.S. law, however, is inflexible and tends to discourage workers' acceptance of early retirement. Greater flexibility might help older workers deal with economic dislocation.

Because health insurance is usually an employment benefit, an additional effect of economic dislocation is less health care for jobless workers and their families. In the absence of national health insurance, Mr. Oswald proposed that the government maintain coverage for dislocated workers, citing European countries that have assumed more responsibility in this area. Improved unemployment insurance system would better cushion the impact of job loss generally, as well as the specific losses associated with economic conversion.

Mr. Oswald cited the Armour case in the early 1960s as a successful experience in economic conversion. <sup>3/</sup> Armour's success was the result of considerable planning, made possible by advance notice, the involvement of business, labor, and government, and the use of such tools as retraining and early retirement.

Economic conversion, in Mr. Oswald's view, is a government responsibility, and the European experience affirms that this approach can work. The United States has accepted its responsibility only in part, and its experience to date has been marred by frequent delays. He criticized existing trade adjustment assistance programs as slow to resolve the issues. Thus, workers and specific industries bear too much of the burden of adjusting to changes in trade relations. There is a need for negotiation of fairer trading relationships, for countervailing duties, and for recognition of the effects of sudden shifts in trade.

In a discussion of Mr. Casraiss' and Mr. Oswald's remarks, Mr. Jasinowski agreed that prenotification is an attractive proposal, but he foresaw difficulties in establishing a level of projected layoffs that would trigger prenotification. Moreover, given the constant labor turnover in industry, it is not easy to know how government should intervene. Finally, for firms known to be in trouble, prenotification might only compound their problems by undermining their status in the credit markets.

Mr. Thurow noted that the European system was not really tested until the 1974 recession. Moreover, there is a class of workers--migrants from poorer countries--that receives only limited benefits from the host governments of the countries they work

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<sup>3/</sup> Because of changes in the meatpacking industry, Armour closed several plants in 1959-1962. Assistance was provided to affected workers through joint labor/management committees.

in, and the limit on benefits given these workers strengthens the position of indigenous labor. This is also true in Japan, where, although all workers are indigenous, there are large numbers of temporary workers, and only around 60 percent of the labor force has "conversion rights." Moreover, when recession occurs, female employees in Japan are encouraged to drop out of the labor force.

Mr. Oswald replied that Germany does indeed provide advance notice to migrant workers and sends them home only at the ends of contracts. Mr. Thurow stated that, while migrant workers are under contract, temporary workers are not; they can be fired overnight. He indicated that many European employers, fearing another recession, are now hiring temporary employees only.

#### LESTER C. THUROW

Mr. Thurow suggested that the importance of conversion programs might change over the course of the business cycle. In a prosperous economy, a high rate of voluntary terminations makes economic contraction easier; whereas, in a recession, a high unemployment rate inevitably lowers the rate of voluntary terminations and makes adjustment more difficult.

Mr. Thurow supported integration of the current separate conversion programs (see Part II of this paper) into one general program. The evidence indicates that a worker who loses his job during a base closing or during a time of massive layoffs by a firm is hurt in much the same way as a worker laid off for any other reason. The design of current unemployment programs is complicated by a host of other factors related to how dislocation can hurt a worker--regional complexities, the state of the economy, the age and other characteristics of the worker, and his previous employment experience. Because of these factors, Mr. Thurow supported a general safety-net approach, rather than one based on causal criteria.

Mr. Thurow offered several arguments against the laissez-faire approach. He noted that the market cannot be expected to adjust when the government changes the rules of the game, as in the urban transportation case cited by Mr. Garry or in the case of new environmental regulations. Major changes in the economy likewise cause problems for the marketplace. Mr. Thurow pointed out that Adam Smith's "invisible hand" is all thumbs in the labor market: a worker cannot always get a job by lowering his wage demands.

Mr. Thurow discounted the possibility of relying on planning without also having income-support programs, and he questioned whether an income-support program could be designed to separate transient workers from those with strong ties to a particular area. Mr. Thurow indicated that he favored the concept of planning but noted that there are always random errors and shocks that cannot be anticipated. The government must become involved when it is the employer, when it changes its mind about what it wants to buy or alters its policies in other ways. The government must also become involved when the private sector sustains shocks to which private employers cannot readily adjust. When government is the direct cause of dislocation, the degree of government involvement should be greater. In planning conversion projects, particular care should be taken to avoid discouraging innovative responses to the underlying problem.

Mr. Thurow noted that in environmental cases compensation may have a role in preventing projects (such as power plants) from becoming hopelessly delayed. Compensating parties or groups who are blocking an action could result in substantial savings in interest payments and could avoid the increased construction costs that result from postponements.

In the discussion of Mr. Thurow's remarks, Mr. Jasinowski questioned the practicality of a general safety-net program. He not only doubted that such a net could be designed; he also pointed out that there was political support for differentiating by cause of impact. Mr. Thurow replied that he was providing an economic argument for a general program, while Mr. Jasinowski was offering a political argument for a differentiated approach. Mr. Jasinowski suggested that a mixture of economic and political criteria was the best guide in deciding policy.

#### DAVID S.C. CHU

If markets work fairly well, Mr. Chu argued, government intervention requires a strong justification. <sup>4/</sup> He distinguished among several cases for government intervention even when markets do work well, however:

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<sup>4/</sup> Mr. Chu was asked to present the conservative "Chicago school" point of view, undertaking a defense of the laissez-faire position. His statement does not necessarily represent his own views or those of CBO.

- o When the government itself creates instability. In such instances, the issue is whether such instability has been anticipated by the market. Are wages higher in industries that must cope with government-caused instability? Results of a recent paper by James Smith and Finis Welch suggest that the workers involved are already being reimbursed for the instabilities they risk. 5/
- o When the government must overcome definite obstacles to change. Job searches may involve unusual expenses. Or workers may want to move, but they may be reluctant to absorb losses of equity in their homes because of a depressed local housing market.
- o When political factors are involved. Even though a group may have been compensated for a dislocation by market mechanisms, the group may seek additional compensation through the political process if it has the leverage to obstruct change and the incentive to use that leverage.

Mr. Chu noted that one of the problems with conversion programs or other safety-net schemes is that they may act as disincentives to seeking new jobs quickly, especially if doing so involves relocation. Long-term employment insurance may have this effect, as it is alleged to have had in the case of the Detroit auto workers during the 1974-1975 recession.

Mr. Chu suggested that the conversion problem appears less severe when viewed in the context of the economy as a whole than it does in particular industrial or local situations. Losses resulting from government action represent only a small percent of the Gross National Product (GNP) and therefore a relatively small number of workers. This should be contrasted with the 25 to 30 percent voluntary quit rate in the manufacturing work force during nonrecession years. Conversion assistance mechanisms might slow natural labor turnover in a manner that is detrimental to all.

In support of this point, Mr. Chu noted that only 1 percent of the civilian labor force is employed directly by the Department of Defense. Similarly, Defense Department contract cancellations

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5/ J.P. Smith and F.R. Welch, Black/White Male Earnings and Employment: 1960-1970, R-1666-DOL, (Santa Monica: The Rand Corporation, June 1975), p. 61.

represent only a small fraction of total defense procurement and an even smaller proportion of the GNP.

Mr. Chu suggested that a good deal of the interest in conversion assistance really reflects a concern with protecting the existing income distribution, rather than promoting the mobility of capital or labor. A large share of the funds for trade adjustment assistance, for example, have been spent on compensating losers to import competition; rarely has any money been spent on retraining. Wearing his Chicago hat, Mr. Chu expressed skepticism about income-support programs--and especially about long-term income support--because of the possible adverse effect on capital and labor mobility. He suggested instead that emphasis be given to improving the incentives for capital and labor to move quickly to new and more productive pursuits as the economy grows and undergoes changes.

Both Mr. Oswald and Mr. Casraiss took strong exception to certain of Mr. Chu's statements. Mr. Casraiss noted that, even if average wages are higher in an unstable industry, there are still individual winners and losers when change occurs. Moreover, he questioned whether workers should be encouraged to move quickly from an area that is losing jobs, in view of the effect on a community when large numbers of workers suddenly leave.

#### CON HOWE

Mr. Howe focused on what it is like to be a local political officeholder faced with the problem of economic dislocation. He offered a summary of the Massachusetts experience with military base closings as an illustration.

The two states hardest hit by the 1973 Defense Department base closings were Massachusetts and Rhode Island. Five bases were closed in Massachusetts, involving the direct loss of nearly 14,000 jobs (6,450 civilian, 7,400 military). An even larger number of workers--some 1,000 of whom were Massachusetts residents--were affected by the base closings in Rhode Island. Thousands of acres of federal property were declared surplus. In addition, the cutback in military spending caused a secondary employment loss of more than 1,200 Massachusetts jobs. Losses in state income and sales taxes were estimated at \$5.5 million per year, and the gross business volume loss was estimated at an annual \$270 million. Moreover, these base closings followed five years of continued cutbacks in defense contracts with Massachusetts firms.

Mr. Howe argued that local leaders cannot merely accept such events. While the benefits of base closings accrue to the entire nation, the costs are borne by local communities.

As a result of the 1973 experience, the Commonwealth of Massachusetts created a commission to act as an umbrella for local task forces made up of business, labor, and local officials. In the task forces' planning for redevelopment, the major problem was the inability to attract private investment because of the size and uniqueness of the properties, the long-term nature of the redevelopment, and the risks involved. The only solution that mitigated these problems appeared to be some public investment. Thus, the Massachusetts Government Land Bank was created with \$40 million in bonding authority to finance the acquisition of surplus property for economic redevelopment. Over the five-year period, a substantial amount of property and facilities were transferred to local communities for recreational and other public purposes. The greatest effort, however, has been directed toward producing new jobs. Of the 6,450 civilian jobs lost because of base closings, about 1,800 have been restored in two large industrial parks financed by the Land Bank.

Mr. Howe stressed the inability of state and local officials to deal effectively with this kind of dislocation. He held that it was necessary to differentiate between long-term deterioration and sudden, severe dislocations. Some of the Massachusetts military bases, he pointed out, had been in operation for 200 years. There could have been no expectation of change. The size of dislocation also was significant, causing great hardship to communities where 10 percent or more of the municipalities' land area was military base property. The towns, as is often typical of base communities, were very small and without diversified economies to absorb some of the shocks.

In addition, these base closings were the largest economic and land-use problems most of the local communities had ever faced. Most public officials in such communities are employed full time in other jobs and receive only part-time compensation for their public duties. Thus, managerial resources tend to be less than adequate.

Mr. Howe emphasized that, in deciding what the government can and should do, state and local officials have to pick up the pieces left by private and federal decisions. Officials cannot relocate their communities to escape the effects--Massachusetts cannot pick up and move to the Sunbelt. Thus, state and local

governments have a role in economic conversion because they have no choice. They should concentrate, therefore, on long-range planning and investment to assist adjustment. State purchases of surplus federal property do not take the place of private investment, but they should lead to it. The state's role is to break down the size and cost of investment in order to attract private investors and provide new private sector employment opportunities.

Mr. Howe suggested that federal compensation for base closings was necessary, but he was not optimistic that it would eliminate initial state and local opposition to base shutdowns. Such economic change inevitably creates much fear among the people to be affected, and the prospect of federal compensation seems too vague at the local level. What is needed is a bridge between federal assistance and local management of economic conversion. This bridge should facilitate a partnership in which local governments retain control of economic conversion within their jurisdictions, while the federal government provides such basic tools as grants for planning and capital improvements, public works, urban development funds, and so forth. In such partnerships, much of the economic recovery planning should be done by state governments, through intermediaries such as state development banks. The perspective of the federal government alone is too broad, and that of local governments is too narrow.

#### JERRY JASINOWSKI

According to Mr. Jasinowski, the CBO definition of economic conversion--a process that moves resources to more productive pursuits in response to dislocation--leaves several questions unanswered. Economic conversion can be interpreted in different ways. Senator George McGovern, who popularized the term, meant that major sectors of the economy would be converted from one general activity to another in response to shifting national priorities. These shifts would primarily involve a movement from defense to nondefense activities and would be quite massive.

On the other hand, the Commerce Department's experience with trade adjustment assistance suggests that conversion should take place in stages, depending on the severity of the problem. Mr. Jasinowski described four types of assistance: to management, workers, and communities, for revitalizing firms that can continue their present activities; to other firms and workers, to reorient them toward other activities; to communities, to attract new industry and help workers shift to new jobs or relocate in other

areas; and on an interim basis, to workers, in the form of compensation, while they are adjusting to and recovering.

Mr. Jasinowski also noted that the CBO definition of economic conversion could either be narrowed or broadened. It could focus only on government actions that cause significant dislocation. Or it could include dislocations caused by acts of God, major failure of the private market, or even the gradual deterioration of a particular firm or industry. Mr. Jasinowski noted, however, that a movement away from the former, more narrow, definition is a shift toward a comprehensive industrial policy for the United States.

Mr. Jasinowski suggested that, in deciding to intervene with conversion assistance, the following factors have to be weighed and balanced:

- o Market Superiority. Since the market naturally shifts resources to more productive uses without government aid, the private sector may be able to do the job better.
- o Avoiding Cyclical Dislocations. Government conversion aid cannot attempt to counter cyclical fluctuations.
- o Long-Term Economic Decline. Conversion programs are of little help to areas that are suffering long-term economic decline. Conventional economic development programs are more appropriate for such purposes.
- o Causes. Assistance should depend on the cause of dislocation. Government-caused dislocations can be categorized by function (trade regulation and base closings) and by their effects on economic activity (stimulating competition, imposing new costs, or withdrawing government demand). "Market failure" causes include the immobility of resources (for example, energy), the need to maintain competition (for example, the American Motors Corporation situation), and rapid changes in technology.
- o Severity. Three broad measures of severity of dislocation have to be considered--magnitude, suddenness, and duration (permanence or transience).
- o Likelihood of success or failure.

- o Political Considerations. What is fair assistance to the affected group? What broad benefits should be taken into account to offset the cost of assistance?
- o Budgetary Resources. Economic conversion occurs within the constraints of budgetary resources. The competition for funds is much greater with a tight budget than during times of budgetary abundance.

Mr. Jasinowski noted that, in deciding how the government intervenes, there can be major conflicts between equity and efficiency that have implications for program design. If equity is the major concern, the emphasis should be on providing unconditional cash payments to injured parties. But compensation alone does little to ensure that resources will be reallocated. If the emphasis is on efficiency, assistance should be tied to changes in economic behavior by workers, firms, and communities --increasing incentives for adjustment by tying payments to retraining, relocation, technical assistance to industry, and so forth. But asking the affected parties to change behavior makes adjustment less popular than compensation and less acceptable. This argues strongly for government insistence on adjustment where possible, to encourage needed changes.

A further consideration in deciding how government intervenes relates to whether an ad hoc approach or a general economic conversion program is better. The ad hoc approach operates without clear standards and may be neither efficient nor fair. The general approach offers a highly structured response to particular problems. Mr. Jasinowski questioned whether there is enough knowledge to make the latter approach successful. A need to find a middle ground exists.

#### GENERAL DISCUSSION

Dr. Rivlin summed up her impressions of the conference, noting that the problem is serious, however defined. Although there was evidently no consensus on what ought to be done, there was agreement that it is easier to achieve conversion in an expanding economy. The major issues reflected differences between people who view adjustment as a general problem relating to change within a free enterprise system and those who rely on the special aspects of a given situation for determining the appropriateness of intervention.

Dr. Rivlin suggested that a reasonable approach for the present might lie somewhere in the middle. This suggests a course of action that would

- o Not abandon the specific as the focus for federal responsibility in assisting conversion,
- o Push existing agencies to plan better and act faster, and
- o Improve existing social programs to ease conversion while enhancing mobility (that is, solving health insurance problems, providing pension mobility and vesting, giving advance notice, and offering protection for those with difficulties finding other jobs).

Dr. Rivlin also suggested that government do a better job of dealing with the effect of dislocation on local communities, perhaps by sending technical assistance teams to help organize local responses.



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PART II.           THE GOVERNMENT AND ECONOMIC CONVERSION--  
                  A DISCUSSION PAPER

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The chapters that follow were prepared as a background material paper for the conference summarized in Part I. The paper was designed to stimulate discussion of economic conversion issues and was used by the conference participants as a starting point for their remarks. It has been slightly edited since the conference took place.



Dislocation is a constant feature of economic life. Workers, firms, and communities are subject to a variety of hazards beyond their control that can endanger jobs, sales, or economic viability. The elements of risk include weather, government actions, foreign competition, and changes in tastes or technology. In response to such dislocations, resources must try to shift to other, more productive pursuits in a process termed "economic conversion."

Dislocation is often the result of government action. Even when the overall effect of a governmental action is beneficial to the economy, there can be adverse effects on particular groups or communities. Lowering a tariff--or failing to raise one--can benefit consumers of the product in question but can injure the firm or workers in the domestic producing industry. Closing an unneeded military base or phasing out an obsolete or ineffective weapons system can save federal money in the long run; but in the short run it will increase local unemployment. Similarly, regulations designed to avoid damage to the environment or to conserve energy can also have adverse economic effects on individuals, firms, or communities.

Often, the relatively small group injured by the dislocation can arouse enough sympathy or muster enough political clout to block an action that would benefit much larger groups of people. In principle, the large group that stands to gain can well afford to compensate the smaller group that loses; but in practice, there may be no mechanism by which the compensation can be carried out. If governmental aid for economic conversion were available to mitigate the harm done to injured groups, decision-makers might find it easier to press for the general benefit over the particular interest. There might be less tendency to argue the employment effects of defense spending, to protect inefficient industries, or to weaken needed environmental regulations.

Some economic conversion programs exist now. The Trade Act of 1974 (Public Law 93-618), for example, provides adjustment assistance for workers, firms, and communities that are adversely affected by increased imports. The Department of Defense offers some help to mitigate the hardships caused by base closings

and other cutbacks in military installations. In other cases--for example, the termination of a major weapons contract--there is little or no federal assistance available other than general programs such as unemployment compensation.

The purpose of this paper is to explore the concept of economic conversion, to review briefly the need for conversion programs, and to raise the question of whether new programs are necessary.

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## CHAPTER II. IS THERE A NEED FOR CONVERSION ASSISTANCE?

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Attitudes toward federal conversion assistance depend on the observer's view of the problem. Some question whether a problem exists, arguing that the laissez-faire workings of a free marketplace adequately compensate the victims of economic change and that the introduction of compensatory subsidies can undermine the incentives for resources to move quickly and efficiently. Critics of this position, however, cite instances in which special compensation to the economically injured represent the necessary price for effecting rapid change. In accordance with this latter view, decisions are more likely to be made in the general interest if a mechanism exists for enabling gainers to compensate losers; this may be particularly important when government is the agent of change. Advocates of a third approach would argue for much broader conversion assistance, contending that there are significant costs of moving resources from one use to another and that the costs--"economic friction"--may slow or even thwart the process of adjustment.

### THE FREE MARKET VIEW

If the free market system works well, economic activities subject to frequent dislocation will also benefit from disproportionately large rewards--higher profits to capital, higher wages to labor. These compensate for the greater risks of change. The more smoothly the market system works to absorb resources freed up by contraction of an activity, the smaller these premiums need be. Observers who believe that the free market system works well will therefore question the need for conversion assistance.

Moreover, advocates of the free market view would argue that there are inherent dangers in a conversion system. First, by guaranteeing relief from the adverse consequences of risky decisions, conversion aid can tempt firms, individuals, and communities to make unwise choices. Just as government-subsidized flood insurance encourages the location of homes and businesses on flood plains, conversion programs might encourage uneconomical investments by firms or failure of firms to diversify their activities in ways that would cushion their vulnerability to sudden shocks. Second, extended support to the victims of change

(long-term unemployment benefits, for example) may actually slow the process of adjustment. Workers who can look forward to 12 months' income that approximates their previous take-home pay may not energetically seek new jobs; also, they may not feel the need to move to regions where jobs are more plentiful.

#### THE POLITICAL CASE

Instances in which compensation to the victims of change was the necessary price of adjustment--for example, longshoremen who suffered from the introduction of containerized shipping, loggers who lost work in the recent expansion of the National Redwood Forest in California--come easily to mind. If there is no mechanism for those who benefit from certain kinds of action to compensate the potential losers, the losers may succeed in blocking the action. Trade adjustment assistance, for example, is sometimes referred to as the price of union support for free trade.

Mechanisms for the gainers to compensate the losers may be especially important when the gains and losses are caused by governmental--especially federal--action. Not only do governmental actions involve a consensual process, but also, their effects are usually much farther reaching. The decision of a private company to close a plant may affect only a small, local area; a decision by the Department of Defense to streamline its base structure may involve half the states in the nation. With so many parties affected, it may be much easier to organize a successful coalition to oppose change. 1/

Moreover, changes in government policy may be much harder for economic actors to foresee than changes in private policies. If so, cautious individuals and firms may demand much higher premiums for participation in activities that are affected by

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1/ It should be acknowledged that calls for compensatory assistance to counteract the effects of governmental action are asymmetrical. Assistance is often sought when the benefits accrue to the public at large and the losses are concentrated in particular groups. It is rare to hear demands for assistance when the benefits are concentrated in particular groups and the costs are borne by the general public (for example, price supports for sugar producers that result in higher sugar prices to consumers).

government policy changes and this could undermine the efficient working of the free market system. For example, firms may be reluctant to invest where the future course of government regulation is particularly uncertain.

Finally, there may be a moral motivation for conversion assistance to those who are injured by government actions. Presumably, such assistance should take into account the compensation already provided by the natural workings of market forces.

#### THE PROBLEM OF ECONOMIC FRICTION

For most victims of layoff, finding new jobs of equal value is not easy. Workers may have skills that are specific to a particular firm, and a new employee is unlikely to recognize fully the seniority rights of the employee at the old firm. Information about new jobs may be imperfect, and there are further demands on the resources of a worker who must travel to find another job. Moreover, relocating can impose substantial psychic costs on both the worker and his family.

Similar problems face the firm that has a contract cancelled or that loses its usual source of business. Bidding on a new contract takes time, money, and concerted effort. Such pecuniary and nonpecuniary costs tend to promote a course of inaction. This inertia is the basis of economic friction. To counter such inertia, conversion programs may create the incentives needed to ensure that the friction inhibiting movement away from the status quo does not impede general economic progress.

But are such programs feasible? How should "affected groups" be defined? How might they be helped? What difficulties are likely to arise? In particular, how can conversion assistance programs be implemented without eliminating legitimate business risk or encouraging inefficiency? The next chapter will attempt to answer some of these questions, while addressing the general issue of what the federal role might be.



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### CHAPTER III. ALTERNATIVE APPROACHES TO ECONOMIC CONVERSION

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A number of different approaches might be taken to the provision of conversion assistance--including doing nothing. Of course, the choice depends on what one perceives the problem to be, how severe it is, and what the role of government could be.

#### LAISSEZ-FAIRE

Believers in the efficacy of the free market system would question whether any assistance is needed at all and warn that assistance would undermine the natural incentives that move resources from one economic activity to another. For example, trade adjustment assistance, as it is currently structured, provides an incentive for part-time work, since under some circumstances the worker can take home more than if he were employed full time. 1/ This situation might create an incentive to acquir-

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1/ Benefits are reduced by 50 percent of any wages that a worker earns from an alternate job, and by any unemployment benefits to which the worker is entitled. In addition, the total amount the worker receives from an alternate job, trade adjustment assistance, and unemployment insurance is subject to a ceiling (the lower of 80 percent of the worker's weekly wage, or 130 percent of the average weekly wage in manufacturing). Workers therefore have an incentive to seek new wages until they hit this ceiling--which tends to militate against full-time employment. (See Section 232 of Public Law 93-618.) Moreover, while earnings from an alternate job are taxable, adjustment assistance is not. Hence, under some circumstances an affected employee who works part time at an alternate job could take home more (from all sources combined) than one who works full time.

The practical effect of this incentive may be limited, however, since payments under the Act have often been severely delayed, and thus made retroactively. (See Subcommittee on Trade of the House Committee on Ways and Means, Background Materials on the Trade Adjustment Assistance Programs Under Title II of the Trade Act of 1974, May 10, 1977, p. 14.)

ing new skills through formal training programs while working part time; it might also simply delay the adjustment process. Although no evidence of the latter is available, 2/ the former does not appear to be the case either: less than 5 percent of the workers who received assistance in the first year of operation of the 1974 act were referred to training programs. 3/

#### AD HOC APPROACHES

Observers who believe that gainers from economic change must sometimes reimburse the losers, lest the losers thwart the process of adjustment, will tend to favor continuation or improvement of current federal policy--which takes an ad hoc approach. Moreover, ad hoc programs permit the tailoring of assistance to specific situations. The solution appropriate to dislocation caused by curbs on water pollution, for example, may be inappropriate to the dislocation caused by cancelling a major Defense contract. Moreover, with the current approach, innovative solution can be tried in small, ad hoc programs at relatively modest cost. If they work, they can be adapted to other programs; if they fail, they can be dropped.

#### A GENERAL ECONOMIC CONVERSION PROGRAM

The argument for a more comprehensive conversion program emphasizes the general problem of economic friction described

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2/ Since this paper was prepared, the authors have become aware of a recent paper by George R. Neuman, "The Direct Labor Market Effects of the Trade Adjustment Assistance Program" (Mimeograph, prepared for the U.S. Department of Labor Conference on Domestic Employment and Foreign Trade and Investment, Washington, D.C., December 2-3, 1976). Neuman estimates that adjustment assistance provided under the Trade Expansion Act of 1962 (Public Law 87-794), which provided less generous benefits than the 1974 act, increased the duration of unemployment of male beneficiaries by about two weeks. (Neuman, "Direct Labor Market Effects," p. 2.) The increased job search time paid off in increased earnings, however: males earned 5.4 percent more per week than would have been estimated in the absence of the program.

3/ House Ways and Means, Background Materials, pp. 13, 22.

earlier. According to this argument, it may be in the public interest to help victims of change make a smooth transition to other means of livelihood; the free market contains enough friction that the adjustment process will be slow and faulty. If so, the victims are more likely to seek removal of the cause of dislocation than to make the necessary adjustments to changed circumstances, and efforts to remove the cause of dislocation (by trade barriers, delay of environmental regulations, or retarding technological change, for example) can be costly to the rest of the country.

A comprehensive conversion program might either take an "economic planning" approach, or it could provide a series of general income-support programs for parties affected by dislocation. The planning approach assumes that the government is able to forecast accurately and that it understands how to encourage resources to move into suitable new activities. But past experience with economic planning and government management of business enterprise in the United States and abroad does not offer a convincing basis for these assumptions.

An income-support approach has three possible targets: workers, firms, and communities. To assist workers, the most attractive approach would appear to be a reform of the Unemployment Insurance system. This would result in a national system with uniform eligibility criteria and a consistent way of computing benefits, combined with training opportunities, improved job information, and relocation assistance.

If eligibility were confined to experienced workers (as it is under present Unemployment Insurance programs), total spending on income support related to economic conversion would not necessarily be much greater than under current programs. A uniform benefit formula would presumably raise benefits in some states and lower them in others, but it would not necessarily increase average benefits. More spending would be required to cover relocation allowances and additional employment services and training. Additional benefits might be made available to older workers or to those with a long attachment to a particular locality, on the grounds that they would have greater difficulty in relocating than would younger, more mobile workers. Alternatively, additional benefits or services might be made available to workers whose unemployment was caused by particular kinds of change (such as import competition or defense cutbacks). (Such special treatment is at variance with the idea of a general program, however, and would add greatly to the administrative complexity of the program.)

In contrast, aid to firms would probably have to be confined to companies that could prove themselves victims of some specific government action or major economic change beyond their power to control or predict. Otherwise, the program would become a general subsidy to inefficient firms. A firm that could establish its claim to special consideration would be granted either credit on favorable terms or technical assistance in finding and entering new markets.

Aid to communities could be based on the unemployment rate and a variety of other indicators of economic dislocation. The administrative choice would be between consolidation of existing programs of aid to distressed communities into a single agency or setting up a technical assistance agency (an expanded version of the Defense Department's Office of Economic Adjustment--OEA) that would assist communities in obtaining funds from other sources.

#### THE PROBLEMS OF DESIGNING A PROGRAM

Whether ad hoc or general, conversion programs must deal with three questions:

- o What event or action is causing injury?
- o Who gets help?
- o What kind of help do they get?

#### Defining the Cause of Injury

A narrow concept of conversion would limit assistance to those parties who were demonstrably injured by a specific governmental action such as the closing of a base, the termination of a contract, or the lowering of a tariff on a particular product. (One might wonder if the victims of government inaction were not equally worthy, but these losers are likely to be harder to identify.) Conceived along broader lines, a program might compensate parties injured by general import competition, the withdrawal of defense or other government contracts in an area, or simply by economic decline. Indeed, one might argue that a free enterprise system necessarily leaves innocent victims as firms move in and out of industries and localities in search of higher profits and that compensation to the victims is the price that has to be paid for preservation of the efficiencies of free enterprise.

## Who Gets Help

The case for helping a person who has lost his job directly because of a governmental action may seem clear, but what about the indirect victims--such as the landlord who loses rent when his tenants are out of work? Should special help be extended to older or less skilled workers because they are likely to experience greater difficulty in relocating? Aiding firms raises the same questions: Should aid be confined to the directly injured firm or extended to suppliers and subcontractors who may be indirectly injured? Should small firms be given more assistance than conglomerates with substantial resources to cushion blows? Extended aid to communities constitutes recognition of the claims of indirect as well as direct victims.

## Types of Aid

The type of aid to be extended depends in part on the objective of the program. If the goal is simply compensation for injury (that is, buying off the victims, as described above under "Ad Hoc Approaches"), a lump-sum payment may be most appropriate. But if the objective is to ease the transition to a new livelihood, the provision of particular services may be in order. Individuals may need a source of income while they look for another job (in other words, unemployment compensation), job placement services, retraining, travel funds to look for work elsewhere, or assistance in selling a house and relocating in a new community. Firms may need credit and technical assistance to convert to new product lines or move into new markets. And communities may need both funds and advice to attract new industry and rebuild a declining tax base.

The interests of the aid recipients may not coincide, however. If a plant closes down, it may be in the best interests of the workers to relocate in new communities with better job opportunities, but representatives of the old community will certainly prefer policies that hold onto taxpayers rather than move people out.

## FINAL COMMENTS

Some observers may believe the risks and costs of intervention to be sufficiently large that no program is justified and that, in fact, certain existing programs should be dismantled.

This paper attempts to point out some of those risks in a general way; it makes no effort to provide specific cost estimates for alternative programs. Neither does it try to provide a quantitative assessment of the possible benefits.

The paper also does not touch on the important issue of who should be responsible for a conversion program, if conversion is seen as a governmental responsibility and one or more programs are undertaken. Should the federal government take the lead? What role might local, state, and regional agencies play? And if nonfederal governments should be principally responsible, what, if anything, should the federal government do?

TRADE ADJUSTMENT ASSISTANCE 1/

Barriers to international trade impede the efficient allocation of resources and reduce the nation's real income. The lowering of tariffs and other trade barriers is a good example of a governmental action that is likely to benefit the country as a whole but that can seriously injure import-competing firms, their workers, and the communities in which they are concentrated.

Nevertheless, the extended U.S. effort to liberalize trade by negotiating reciprocal agreements with our trading partners that began with the Trade Agreements Act of 1934 did not involve any compensation to the victims of liberalization until 1962. Up to then, the only relief for injured industries was through invocation of the "escape clause," under which industries that could prove they had been adversely affected by prior tariff concessions could have the concessions reversed.

The Trade Expansion Act of 1962 (Public Law 87-794), which provided the basis for the Kennedy Round of tariff acts, also added a new dimension of relief: adjustment assistance for firms or groups of workers that could prove injury resulting from a tariff concession. The intention of the provision was to compensate both firms and workers for losses resulting from lowered trade barriers and to assist the losers in making the transition to new jobs or markets. Benefits to firms included technical assistance, loans and loan guarantees, and tax relief. Benefits to workers included readjustment allowances, additional assistance to cover expenses while participating in training, and relocation allowances to cover the costs of moving to take jobs in new locations.

Despite the worthy intentions, however, little assistance was granted under the 1962 act. Eligibility criteria were strict. The applicant had to prove injury whose "major cause" was an

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1/ This section draws heavily on Charles Frank, Foreign Trade and Domestic Assistance (Washington, D.C.: Brookings Institution, 1977).

increase in imports caused "in major part" by a trade concession. The procedure for establishing eligibility was lengthy and complex. Moreover, at the time the act was passed, there had been no recent tariff concessions. Substantial tariff concessions resulted from the Kennedy Round tariff cuts that began to take effect in 1968, but because of the adjustment assistance program's strict criteria and administrative complexity, it failed to provide more than trivial amounts of aid to injured parties.

Not until November 1969--seven years after enactment of adjustment assistance under the Trade Expansion Act--did the first group of workers succeed in establishing eligibility for aid. Between that time and April 1975, when the act expired, 36 firms and 110 groups of workers were certified as eligible. Only 35,000 workers actually received aid, many of them after long delays. Most eligible firms were manufacturers of women's shoes, electronic components, and radio, television, and related products.

The Trade Act of 1974 liberalized both the criteria for receiving adjustment assistance and the benefits themselves. To receive assistance under this act, it is only necessary to prove that increased imports contribute "importantly" to a loss of jobs or sales, not that increased imports result directly from a tariff concession or that these are the "major causes" of the injury.

Trade adjustment allowances for workers were raised by the 1974 act. Adjustment allowances are now 70 percent of a worker's average weekly wage but cannot exceed the average weekly manufacturing wage (\$229 in 1977). Benefit payments are reduced by 50 for \$1 of earned income up to the point at which either total income exceeds 80 percent of a worker's prior wage or 130 percent of the average weekly manufacturing wage, whichever is less. If a worker is older than 60 or is enrolled in training, he is eligible for an additional 26 weeks' benefits.

The 1974 act also improved the incentives for training and relocation. Training and employment services are provided through the normal network of programs, with workers on trade adjustment assistance eligible for supplemental subsistence payments up to \$15 per day, and reimbursement of transportation expenses at 12 per mile. Also, relocation allowances for 80 percent of transportation and moving expenses for the household, plus a lump sum payment of three times the worker's weekly wage up to \$500, are available and job search allowances of 80 percent of expenses, up to a maximum of \$500, have been instituted.

The procedures by which firms claim benefits were simplified by the 1974 act, although tax concessions were eliminated, and a new program of aid to adversely affected communities was added. Communities are eligible if a significant number or proportion of workers have lost their jobs or if sales and production in the area have declined and those losses or declines were associated with increases in imports or the relocation of local plants overseas. Once eligible, a community must submit a plan. When the plan is approved, two types of aid are available: for local governments, technical assistance and grants for acquiring and developing land and improving public works and services, and for private borrowers, loan guarantees for borrowing to finance plant construction or modernization and other activities designed to create more jobs in the area. Communities are also eligible for all services provided under the Public Works and Economic Development Act of 1965 (Public Law 89-136).

In view of the 1974 act's liberalized features, it is not surprising that in its first two years, petitions covering over 500,000 workers were received, four times as many as applied during the previous 12 years under the old Trade Expansion Act. By March 21, 1977, petitions covering nearly 200,000 workers had been certified, and petitions for nearly 250,000 had been denied. 2/

#### Administrative Problems

The Trade Act of 1974 requires an assessment of trade adjustment assistance in 1980 by the General Accounting Office (GAO). Before issuing its final report, GAO has planned a series of interim reports; one analyzes the first year of operation. 3/

GAO found that few nonunion laborers were aware of the trade adjustment assistance program. Also, only one fourth of the first-year petitions were processed within the legislatively required 60 days. Finally, the Department of Labor (DOL) has not established consistent criteria for determining eligibility.

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2/ Subcommittee on Trade of the House Committee on Ways and Means, Background Materials on the Trade Adjustment Assistance Programs Under Title II of the Trade Act of 1974, May 10, 1977, p. 25.

3/ GAO, Certifying Workers for Adjustment Assistance--The First Year Under the Trade Act, ID-77-28 (May 31, 1977), p. 5.

The practical difficulty of distinguishing unemployment caused by foreign trade competition from other types of unemployment is a major problem. GAO noted that about 63 percent of the average number of workers unemployed in the transport and equipment industry (primarily automobiles and parts) were covered by petitions for trade adjustment assistance in 1975. Since the recession hit the automotive industry particularly hard in that year, it is doubtful that the full 63 percent of the unemployment was caused by foreign trade alone. The act, however, requires only that increased imports be a "major factor." Such problems of distinction--the inability to distinguish unemployment caused by increased imports from cyclical unemployment--create a budgetary problem in the future.

#### Questions of Equity

If trade adjustment assistance can be made more effective and responsive, it may serve its original purpose of compensating the victims of trade liberalization and easing their transition to new jobs or markets. If it does, it may reduce protectionist pressures. Even if the program were truly succeeding, however, there would remain a substantial question of equity. Why should workers, firms, or communities be singled out for special help if their troubles stem from increased imports, while victims of other types of economic change (shifting tastes, technologies, resources, for example) are not accorded similar benefits?

#### SHARING THE COST OF ENVIRONMENTAL REGULATIONS

Many production processes cause environmental degradation, either by air or water pollution or by exposing workers or consumers to toxic substances. Corrective regulation of such hazards can have adverse effects on business: production costs can increase, marginal firms can be driven out of business, workers can lose jobs, and ultimately, whole communities can be affected. A case could be made for governmental assumption of all or part of these costs and for assistance to workers, firms, and communities harmed by environmental regulations.

In fact, however, recent environmental regulation has not generally provided "environmental adjustment assistance," perhaps because polluting firms have usually been viewed as transgressors against the public interest and have been expected to bear the

costs themselves (or pass the costs on to their customers). The Environmental Protection Agency (EPA) does keep track of economic effects and does provide assistance on an informal basis. According to EPA, plant closings brought about by environmental regulations have been relatively rare. Between 1971 and December 1977, 118 firms are reported to have been closed because of pollution control costs, terminating only 21,925 jobs. 4/ According to a Department of Commerce sample survey of actual closings in 1974 and planned closings in 1975, in four out of five cases other factors were also involved--principally age, obsolescence, or declining sales. 5/ Hence, the public has not seen environmental regulation as a major threat to jobs or to the economic security of communities.

In general, producers seem able to incorporate the costs of complying with environmental orders when provided with a phase-in period that enables them to plan for new uses for their plants. In this respect, large, diversified firms can make transitions to other sectors with greater ease.

#### Producers Initially Bear Environmental Costs

The usual pattern has been to require producers to carry the initial costs of environmental regulations and for the government to bear the cost only in isolated and unusual incidences. The assigning of costs to the producers is typified by the case of fluorocarbons in aerosol spraycans. When the production of fluorocarbon sprays was ordered stopped by the EPA, no special assistance was offered to fluorocarbon producers, although affected workers and communities are presumably eligible for benefits under existing programs of the DOL and the Economic Development Administration. Since most of the fluorocarbon producers are large, diversified firms (for example, Du Pont) that do not rely on fluorocarbon sales for their continued economic existence, the EPA decision is unlikely to result in their failure.

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4/ Letter from EPA Administrator Douglas M. Costle to Secretary of Labor Ray Marshall, May 9, 1978.

5/ "The Closing of Production Facilities Due to Pollution Regulations," Survey of Current Business, July 1975, pp. 18-19.

Another example of costs borne by producers is found in the case of the contamination of Virginia rivers by the Allied Chemical Company with the highly toxic chemical, kepone. In this instance, costs were shifted from the public to the producer by a court decree that ordered Allied Chemical to pay the costs of cleanup and to compensate those persons directly affected economically by kepone (for example, fishermen). A similar case is now pending in New York regarding the alleged contamination of the Hudson River with polychlorinated biphenyl (PCB) by General Electric.

Attempts to impose costs upon producers often result in the costs ultimately being shifted elsewhere. Price increases, which shift the costs from producers to consumers, are one clear example. This type of shift would generally be regarded as desirable in the sense that consumers of a product should bear the full cost of its production, including the cost of producing it without damaging the environment. A less desirable example of shifting costs is the exportation to foreigners of unsafe products, materials, or processes. For example, the Occupational Safety and Health Administration (OSHA) determined that the health of asbestos workers was seriously affected by the asbestos production process and ordered the process terminated. In response to the OSHA action, U.S. asbestos producers have exported their technology and now employ the same process overseas. In such transnational efforts, certain costs are borne by foreign workers, who risk the health hazards of the banned processes; at the same time, other costs are borne by U.S. workers, whose employment is jeopardized by the ease with which producers can flee the United States rather than accommodate OSHA/EPA-mandated changes in their production techniques.

#### Governments Occasionally Bear the Costs

Occasionally, governments do offer "environmental adjustment assistance." Direct indemnification has sometimes been offered affected parties. In Mississippi, poultry farmers were indemnified by the government for losses suffered because of the ingestion of the chemical pesticide dieldrin by their chickens. The Department of Agriculture has also indemnified apiaries for bees killed by pesticides. In both cases, the indemnified enterprises are being compensated for costs for which they are not responsible. Yet such blanket indemnification serves to cloud the issue of properly ascribing the costs to the party that generated the problem--the dieldrin producer or the user.

Such ad hoc indemnification produces an equity problem. Contrast, for example, the experience of the indemnified poultry farmers with the treatment of Michigan cattle producers whose herds were infested with a fire retardant that was accidentally put into the cattle feed. Although the Michigan cattle were slaughtered, no indemnification was offered their owners. Thus, a policy of indemnification, when not universally applied, can arouse legitimate complaints of unfairness.

A related type of indemnification is embodied in the government's paying for the repair of environmental damage. Recently, the Congress decided to allocate \$4 million to the construction of a pretreatment plant for waste products of the Reserve Mining Company. The wastes emitted by Reserve into what was ultimately the drinking water supply of Duluth, Minnesota, were contaminated with asbestos, raising the possibility of carcinogens in Duluth's tap water. The Congress decided to intervene, however, only when it was clear that the time necessary to get a court decree ordering Reserve to treat its own wastes could be long enough to endanger the entire city.

A more general form of public sector assumption of environmental costs can be found in subsidies that facilitate compliance with environmental regulation. Environmentally mandated investments are subject to a special accelerated depreciation schedule for tax purposes. Similarly, the Small Business Administration provides loans, on favorable terms, for environmental investments by small businesses. Altogether, such loans totaled \$15.9 million in fiscal year 1977.

When contaminating products or processes are not banned, the environmental costs are usually borne by the public at large in the form of health and safety risks. In some cases, exemption from regulations may have its own rationale. For example, small businesses are exempted from many rulings issued under the Occupational Safety and Health Act (Public Law 91-596) and the Toxic Substances Control Act (Public Law 94-469). While costs may be exacted from the public as a result of such exemptions, the bureaucratic burden of detecting and correcting them may not justify their inclusion.

In sum, present policies with respect to the costs of environmental regulation vary greatly depending on the type of product, the economic structure of the industry, and political circumstances. A more consistent and equitable sharing of the burden would possibly lessen the fears and uncertainties associ-

ated with new laws and regulations designed to reduce environmental and health dangers.

#### DEFENSE CUTBACKS

Severe economic dislocations can occur in an area when a military base is closed, when a defense installation employing civilian workers is cut back or eliminated, or when a major defense contract with a private firm is terminated. These cases differ in the extent to which the affected employees are economically involved with the outside community. Various services (for example, retail outlets, medical care, police, and housing) are provided on-base for uniformed personnel. Such personnel and their families are sent from the community, with guarantees of employment elsewhere, when a base is closed. Civilian employees of the Defense Department are more heavily involved in the local community. They spend more of their pay in local stores, and they also require more local public services. In the event of layoffs, however, these employees are entitled to services at present unavailable to workers in the private sector. This privilege can mitigate some of the shocks caused by a cutback.

Several measures to assist in economic conversion are provided to individual civilian employees of the Defense Department. The department sometimes institutes a freeze on permanent job hirings at certain installations to make room for Defense employees affected by layoffs elsewhere. It has also provided a computerized job-vacancy information service for such workers. The jobs that this service enables these workers to find may eventually involve cuts in pay, but workers are guaranteed at least two years' work at their previous defense-related pay levels. In addition, the Defense Department may pay the costs of moves to new jobs. In some situations, it also provides for retraining. For individuals who do not move to new jobs, the department provides severance pay.

Additional federal programs available to individuals are designed to reduce the losses that may result when they have to sell their homes. Some involve either payments to Defense Department employees who own homes or assumption of their mortgages.

A second major category of economic programs is available to communities affected by closure or cutback of military installations. Provision of these programs is arranged by the Defense Department's Office of Economic Adjustment (OEA), which itself

provides planning assistance to communities. These programs include formal warning of possible closure actions when an installation is designated a candidate for closure, streamlined procedures for transferring surplus federal property to communities after a closure, and, under certain circumstances, continuation of federal "impact aid" to local school systems.

Other programs that OEA helps arrange can be used by communities affected by closure or cutback of military installations. One set of programs involves planning grants and other funds from the Department of Housing and Urban Development. Another set of programs involves manpower assistance, in the form of grants for retraining former defense workers. By far the most costly program is one that assists in capital improvements. These improvements are frequently made when a former base is converted into an industrial park; assisted projects include such undertakings as construction of roads and bridges and provision of water and/or sewage systems.

How well has economic conversion gone under the programs described? A 1970 study by the U.S. Arms Control and Disarmament Agency states that "in the great majority of cases. . . the transition is smoother than anticipated, and communities often find themselves better off with a more diversified and civilian-oriented set of replacement employers." <sup>6/</sup> Not all communities have expressed satisfaction, however. Cutbacks in Rhode Island and Massachusetts were the subject of bitter complaint by local leaders. This experience suggests that present conversion programs may not be adequate for all communities.

Conversion programs seem to have been reasonably successful in helping individuals when military installations are closed. Since 1969, 70 percent of the Defense Department workers laid off as the result of closures have been placed in jobs at other military installations. (There are several possible reasons why this figure is not 100 percent. Certain categories of workers--such as women, who may be secondary employees, older people nearing retirement, and younger workers less committed to career channels--are less likely to undertake a physical move to continue working for the government.)

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<sup>6/</sup> Graham T. Allison and others, Adjustments of the U.S. Economy to Reductions in Military Spending. Report prepared for the U.S. Arms Control and Disarmament Agency (Mimeo, 1979), p.22.

Assessment of the adequacy of present conversion programs when defense contracts are cut back is difficult. The evidence available suggests, however, that present conversion programs are less relevant to contract cutbacks. One reason may be, paradoxically, that even severe cutbacks have not caused so much damage to individuals and communities as anticipated. In Seattle, for example, as Boeing's troubles worsened in the early 1970s, consumption decreased less than was expected, in part because laid-off workers had been highly enough paid so that, even when unemployed, they could continue to consume out of savings. This suggests that wages in defense industries with unstable employment levels are high specifically in order to compensate for job insecurity. In addition, employment insurance and the rising incomes of those still employed helped to sustain the Seattle economy. 7/

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7/ R.B. Rainey and others, Seattle's Adaption to Recession, R-1352-NSF, (Santa Monica: The Rand Corporation, September 1973), p. v.