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EU Trade Policy: Challenges and Opportunities

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Abstract

Trade has become a much higher profile policy area for the European Union following the decision by the Trump Administration to pursue a more protectionist trade policy and US questioning of multilateral cooperation and the WTO, and the rising concern in the EU regarding the competitive implications of China's industrial policies. Designing appropriate responses to trade tensions will be one of the challenges confronting the new Commission. Responding to protectionism abroad with protectionism at home is not the answer; maintaining an open policy stance is important for economic growth prospects. As the world's largest trading power, the EU should ramp up efforts to revitalize the WTO and deepen trade cooperation with like-minded countries to discipline the use of globally welfare-reducing trade and investment policies. Further improving transparency and monitoring the implementation of trade policy is needed to address legitimacy concerns and ensure the political sustainability of the EU's trade strategy.

Introduction*

The EU is the world's largest trading power, accounting for 16.7 percent of the global trade in goods and services. External trade in goods and services accounts for 35% of the EU's GDP.¹ One in seven jobs in the EU depends on exports.² Imports provide EU firms with access to inputs that help them to compete in the marketplace by improving productivity and reducing overall production costs and they give EU consumers the ability to buy a wide variety of goods and services that satisfy their preferences.

The Common Commercial Policy (CCP) allows the EU to speak with one voice on matters of trade policy and to leverage the single market to improve access to foreign markets for EU companies through the negotiation of trade and investment agreements. The World Trade Organization (WTO) is the most important of such agreements. By reducing uncertainty about the conditions for competition in foreign markets, the rules-based trade order embodied in the WTO supports investment and job creation. WTO rules and principles also provide the foundation for EU negotiations of deeper trade agreements with trading partners.

The rules-based multilateral trading system is under intense pressure. The United States is seeking trade concessions from its trading partners, including the EU, through a strategy of aggressive unilateralism that violates the spirit if not the letter of WTO rules. Large emerging economies are implementing more trade-distorting measures that adversely affect the ability of EU companies to export to their markets and reduce domestic support for maintaining the liberal EU trade regime. Research suggests that foreign trade-distorting measures implemented since 2009 have reduced EU export growth by 10-20 percentage points.³ Many of the instruments involved are only partially subject to WTO rules, which indicates a need to both update and strengthen the multilateral rulebook. In addressing these developments, the EU faces internal constraints which are reflected in opposition to its trade policy by some civic interest groups and political parties in several member states. The underlying concerns differ across groups but they include competition concerns and the protection of regulatory standards.

EU trade policy therefore faces major challenges, both internal and external. To successfully address them will be critical, both because of the importance of trade for growth and jobs in the EU and because of the role trade can play in raising real incomes and stimulating sustainable development in neighbouring countries, Europe's partners in Africa and other developing regions. The most urgent matter is to avoid a full-scale trade war, which would be very costly.⁴ The challenges go beyond the need to respond to the current US administration's shift towards protectionism and the competitive pressures arising from the rapid growth of China. It is equally important to ensure trade policy is fit for purpose for a European economy that is increasingly centred around services, as opposed to agriculture and manufacturing, and to address the concerns of many voters regarding the effects of globalization. European leadership in the trade area is urgently needed to reverse global trends towards protectionism, prevent a collapse of the multilateral trading system and support work to negotiate a framework of rules that addresses the sources of current trade conflicts. The US has made it clear it will not provide such leadership; nor will China.

* We are grateful to the participants at a December 2018 EUI workshop for their helpful comments on an initial draft. The project leading to this paper has received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No 770680.

¹ European Commission, DG Trade Statistical Guide, June 2018.

² I. Arto and others, EU export to the World effects on employment and income, European Commission, 2015.

³ S. Evenett and J. Fritz, *Europe Fettered: The impact of crisis-era trade distortions on exports from the European Union*, CEPR Press 2017.

⁴ IMF, OECD and academic research concludes that a 10% increase in the cost of imports (due to higher tariffs) will reduce global trade volumes by 15% and output (GDP) by 1 to 2%. A major trade war would reduce EU GDP by 4%. See M. Demertzis and G. Fredriksson, The EU Response to US Trade Tariffs. *Intereconomics*, 2018, pp. 260-68.

A key question for the next Commission leaders is whether they will be willing to invest the political capital needed to provide credible leadership on trade, given that this calls for robust engagement with both the US and China.

Internal challenges

Eurobarometer data indicate that over 70% of Europeans support the CCP and consider free trade to be positive.⁵ At the same time, many European citizens also consider globalisation a threat to employment and a source of rising inequalities. This helps explain the increased prominence of trade policy in domestic political debates and activity. Examples include the negative result of the Dutch advisory referendum on the ratification of the EU-Ukraine Association Agreement, large demonstrations in some member states – notably Germany – against the Transatlantic Trade and Investment Agreement (TTIP) with the US and opposition to the Comprehensive Economic and Trade Agreement (CETA) with Canada.

A distinct feature of opposition to trade negotiations with Canada and the US was the prominence of regulatory concerns as opposed to fears connected to loss of jobs.⁶ Concerns centre on the implications of trade agreements for regulatory powers, their salience in addressing non-economic concerns such as protection of the environment and labour standards and, in the case of neighbouring countries, fears that trade agreements may be a first step towards possible accession to the EU. Worries about the ability to regulate were at the heart of the debates surrounding the chapters in trade agreements on investment protection.⁷ Many of the concerns reflected misunderstanding of what a trade agreement does. Others – notably with regard to investor protection – resulted in the adoption of a new approach to adjudicating investment-related disputes. Managing and addressing the concerns of EU citizens regarding the potential consequences of trade agreements is important for the EU. They are a major external policy tool. They are also a key mechanism with which to respond to greater recourse to protectionism by the US and large emerging economies as a backstop in case efforts to revitalize the WTO fail.

It remains uncertain what the exit of the UK from the Union (Brexit) will entail. The current UK official position is that it will leave the customs union and the single market. If so, the EU will need to renegotiate its commitments to the WTO, establish preferential rules of origin that will apply to goods originating in the UK post-Brexit and determine the scope for commitments on services that go beyond those granted to other trading partners.⁸ Given the importance of satisfying regulatory requirements for both goods and services, a key element of any future trade relationship with the UK will revolve around putting in place measures to minimize regulatory trade costs.

⁵ European Commission, Standard Barometer 89: Spring (March 2018); European Commission, Special Eurobarometer 461.

⁶ See: Germany and the United States: Reliable Allies, but Disagreement on Russia, Global Leadership and Trade, Pew Research, 2015; German survey by TNS, 2015; European Commission, Special Eurobarometer 357 on International Trade, 2010.

⁷ Commission staff working document, Report on the online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the TTIP Agreement, SWD(2015) 3 final, 13 January 2015. It should be noted that although a very large majority of responses to the consultation on ISDS were negative, most of these were identical and reflected a successful social media campaign by opponents. Of the 150,000 submissions to the EU's ISDS consultation, 97% were collectively pre-formatted submissions from interest groups (L. Eliasson, *The Transatlantic Trade and Investment Partnership: Interest groups and public opinion*, 2015. Available at <http://aei.pitt.edu/79006/1/Eliasson.1.pdf>).

⁸ See Carmen-Cristina Cîrlig and Laura Puccio, *Future EU-UK Partnership: Agreeing the framework for the future EU-UK relations*, EPRS in-depth analysis, September 2018.

External challenges – and opportunities

The pursuit of ‘America first’⁹ policies has included US unilateral protectionist measures, including global safeguard actions against imports of washing machines and solar panels and national-security-motivated import restrictions on steel and aluminium. A broad range of imports from China have been subjected to additional tariffs in retaliation for alleged unfair Chinese trade practices. These measures have led to retaliatory actions against US exports. EU countermeasures affect US exports of cereals, juices, tobacco, apparel, iron and steel products, motorcycles and boats. The EU has also launched a safeguard action to prevent diversion of steel from the US to the EU and has challenged the legality of US protectionist measures before the WTO. In reaction to the countermeasures, the US initiated a national security investigation on imports of automobiles. Increasing the tariffs on imports of automotive products would have a substantial negative effect on EU producers. If sustained, the resulting escalating trade war can only have detrimental consequences for the world economy.

The US is actively renegotiating its existing trade agreements and has made it clear that it eschews multilateral cooperation – as is reflected in the decision to withdraw from the Trans-Pacific Partnership (TPP). The EU is actively negotiating with the US, including in talks on a bilateral agreement on industrial goods tariffs, re-visiting possibilities for sector-specific regulatory cooperation¹⁰ and a trilateral effort with Japan and the US focusing on common concerns regarding China’s trade-related policies. The EU is also engaging with the US over WTO reform.¹¹ In parallel, the EU has ramped up efforts to conclude trade agreements with major economies as a means of improving the governance of trade relations and expanding cooperation to policy areas that affect the ability of firms to compete fairly for markets.

Although the US remains a key EU trading partner, emerging economies have become more important. China ranks first as a source of EU imports and second as a destination for EU exports. Asian countries are the largest market for EU exports, accounting for a third of total merchandise exports, followed by North America (27 %) and non-EU European countries (23 %). The trade war between the US and China offers an opportunity for the EU to cooperate with China. There are long-standing talks on a Comprehensive Investment Agreement. Extending this to cover trade and address concerns that EU business has regarding competition-distorting policies in China while providing greater certainty regarding the ability of Chinese firms to export their goods and invest in the EU would be beneficial to both sides.¹²

Considering the importance of EU-China trade flows, a bilateral trade agreement could help offset the costs to both the EU and China should trade conflicts with the US continue to prevail. This could also allow the negotiation of provisions tackling the numerous issues that the EU has with China, such as with respect to public procurement, the treatment of EU investors and the activities of state-owned enterprises. Retreat from international cooperation and engagement by the US, if sustained, increases the salience of and potential payoff from engaging constructively with China, building on the extensive bilateral interactions and dialogues held in recent years.

⁹ C. Van Grassek, ‘Back to the Future: US Trade Policy under Trump’, in C. Braga and B. Hoekman, *Future of the Global Trade Order*, European University Institute, 2017.

¹⁰ European Commission, EU-U.S. Trade Talks: European Commission presents draft negotiating mandates, Press release, 18 January 2019.

¹¹ The EU and the US have agreed to work together with Japan and other countries to discuss WTO reform. The European Commissioner met with the USTR and the Japanese trade minister to discuss this matter in January 2019. See Joint EU-U.S. Statement following President Juncker’s visit to the White House, 25 June 2018; B. Baschuk, U.S. Rejects the EU’s Trade Reform Proposal, Putting WTO at Risk, Bloomberg, 12 December 2018; Joint Statement of the Trilateral Meeting of the Trade Ministers of the European Union, Japan and the United States, 9 January 2019.

¹² J. Pelkmans et al., *Tomorrow’s Silk Road: Assessing an EU-China Free Trade Agreement*. Brussels: CEPS, 2018.

A specific area where EU-China cooperation on trade and investment could be beneficial to both sides is China's Belt and Road Initiative (BRI). Launched in 2013, the BRI is a programme to invest over \$1 trillion in infrastructure linking China with Asia, Africa and Europe. The BRI presents an important opportunity to enhance connectivity and reduce trade costs. Given that Europe is at the other end of the 'silk road' to China, the EU has much to gain from the effective implementation of the initiative, including in terms of potential synergies in the sphere of EU development cooperation. While in some countries the BRI projects have been met with success, in other countries the cheap funding has resulted in financial sustainability problems and governance issues.¹³ Improving governance and access to and sustainability of finance are key objectives of the new Commission strategy on Connecting Europe and Asia.¹⁴ Another area of potential focus is procurement for BRI projects. Borrowing countries would benefit from the adoption of more competitive procurement practices that would open contracts to bids by European companies. This is something that China can decide to do unilaterally and could be part of a broader bilateral economic development cooperation agenda.¹⁵

Revitalizing the WTO

The WTO must be (and is) a central element of EU efforts to address US unilateralism and the more general rise in protectionism globally. The multilateral trading system is in crisis. Countries are increasingly adopting measures designed to advantage national industries. Policies to 'make it here' not 'in the world' are important drivers of current trade conflicts. Addressing the negative international spillover effects of the trade-distorting policies being used in several large countries – including India as well as China and the United States – requires revisiting the bargains struck when establishing the WTO (in 1995) and on China's accession (2001). The rules of the game date back to the 1980s or before. They have not kept up with a rapidly changing world economy. Following the failure to conclude the Doha Development Agenda, WTO members have not established a new work programme that spans both longstanding subjects such as agricultural support and new matters such as digital trade and forms of industrial policy not covered adequately, if at all, by the current rules, such as investment-related policies. Since 2016, the US has blocked new appointments to the WTO Appellate Body, reflecting dissatisfaction with the functioning of the dispute resolution mechanism. If sustained, this will make the WTO appeals system defunct and imply a reversion away from a rules-based trading system to one based on power.

The EU has long been a major proponent of the WTO and has a strong interest in an effective rules-based multilateral trade regime. Many of the foreign trade practices generating negative spillover effects are not unique to one country. Bilateral agreements cannot address them effectively – they offer only partial solutions to companies seeking disciplines on trade-distorting policies and to EU citizens concerned with ensuring that trade supports societal goals and sustainable development.

Action in the WTO is required on two fronts: (i) dealing with current conflicts between major trade powers through agreement on a new work programme and road map for the WTO; and (ii) improving the functioning of the WTO, including resolving the impasse on the operation of the WTO dispute settlement mechanism. Resolving trade tensions and revamping the WTO rulebook will require reform of the modus operandi of the organization. The EU has developed specific proposals and Canada has put forward a discussion paper outlining elements of a potential path forward. A recent report for the Bertelsmann Foundation proposes a number of specific actions for consideration by the WTO members. All these papers highlight the importance of launching a process of deliberation to define a new work

¹³ J. Hurley, S. Morris and G. Portelance, Examining the debt implications of the Belt and Road Initiative from a policy perspective, *CGD Policy Papers* 121, Center for Global Development, March 2018.

¹⁴ European Commission, Roadmap: elements for an EU Strategy on connecting Europe and Asia, 2018.

¹⁵ T. Ghossein, B. Hoekman and A. Shingal, "Public Procurement in the Belt and Road Initiative," MTI Discussion Paper No. 10. Washington, D.C.: World Bank, 2018.

programme, to reflect on WTO working practices and to grasp the opportunities that exist for a critical mass of countries to cooperate through open plurilateral initiatives.¹⁶ Vigorous engagement and support for a concerted effort to make the WTO a more effective forum for trade cooperation should be a central focus of the EU.

Achieving WTO reform will not be easy. Addressing the concerns and priorities of different countries may not be feasible. Many countries have become less willing to cooperate on trade- and investment-related policies. Major emerging economies such as China and India are pursuing ‘make it here’ policies and may not be willing to consider multilateral agreements to reduce the negative spillover effects of such policies. The same may be true for the United States. Thus, it is important for the EU to explicitly consider a ‘plan B’ in parallel with pursuing dispute-settlement action and efforts to agree on WTO reforms. Any such plan B will revolve around expanding the number and depth of trade agreements with major trading nations, something that is already a core element of the EU’s trade strategy. The focus here should be on Asia, the most dynamic region in the global economy, and Africa, a region that many EU countries have historical ties with and one that is both a future growth pole and a priority for EU development assistance.

A plan B should encompass engagement with the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). The EU already has trade agreements with or concluded negotiations with several CPTPP members (Canada, Chile, Japan, Mexico, Peru, Singapore and Vietnam) and is negotiating with others (Australia and New Zealand). CPTPP is an ambitious agreement that includes provisions on e-commerce and state-owned enterprises. Connecting to the CPTPP would reduce the fragmentation associated with bilateral agreements and deepen the economic relationship between the EU and Asia-Pacific nations. A first step should be an analysis of the feasibility of the EU joining the CPTPP and its compatibility with EU law and external policy objectives.

Sustaining openness to the world

A central focus of policy attention looking forward should be on ensuring that the CCP promotes EU welfare, economic growth prospects and the realization of EU core values. The gains from trade and technical change are inherently associated with some groups in society incurring adjustment costs. The EU collectively benefits from these adjustments and member states therefore have a responsibility to assist those who bear the burden. Effective social safety nets and active labour policies are critical to assist affected workers to move across industries and update their skills. An improved European Globalisation Adjustment Fund¹⁷ and the 2014 ‘smart specialisation’¹⁸ initiative in EU regional policy programmes are examples of EU programmes that complement the implementation of the CCP by assisting the workers affected and lagging regions. While a greater focus on adjustment at the EU level is needed, this is primarily a matter for the member states, given that the EU has neither the mandate nor the instruments best suited to assist those who are negatively affected by international competition.

The legitimacy concerns expressed by civic interest groups with respect to trade agreements signal a mistrust in the institutions created to negotiate and implement EU trade policy. Improvements in the governance of EU trade policy have been made, but greater transparency is vital for accountability. Information on the effects of agreements and the operation of the CCP more broadly is a necessary condition for analysis and learning. Too little is known about whether and how EU trade agreements are

¹⁶ European Commission, WTO modernization. Introduction to future EU proposals; Government of Canada, Strengthening and Modernizing the WTO: Discussion Paper; Bertelsmann Stiftung (ed.), Revitalizing Multilateral Governance at the WTO: Report of the High-Level Board of Experts on the Future of Global Trade Governance.

¹⁷ Proposal for a regulation of the European Parliament and of the Council on the European Globalisation Adjustment Fund (EGF), COM/2018/380 final.

¹⁸ Commission Communication, Strengthening Innovation in Europe's Regions: Towards resilient, inclusive and sustainable growth at territorial level, COM(2017) 376 final.

implemented and the distributional effects of trade policy. An example concerns the activities of the specialised committees created to oversee the operation of agreements. The Commission is creating a website with information from the various meetings of domestic advisory groups created under the trade and sustainable development chapters. A similar effort should focus on improving access to information on regulatory cooperation fora and regulatory dialogue frameworks instituted with trade partners. This could include information on the agenda and, where appropriate, on the ongoing implementation of regulatory cooperation together with other dimensions of trade agreements. It would be desirable to enhance the monitoring capacity of the European Parliament in this respect to ensure greater democratic control and legitimacy.¹⁹ Monitoring groups could act as contact groups between the European Parliament and the bodies charged with implementing EU trade agreements.

Sustaining an open single market does not preclude action against anti-competitive practices by foreign firms and addressing the adverse effects of foreign government policies. EU trade and competition policy regimes can and should be used to ensure a level playing field. Joining the trend towards greater use of trade protection or weakening EU competition policy to support the creation of dominant EU ‘champions’ will not solve the domestic distributional issues that are sources of anti-trade political pressures or address the systemic problems associated with China’s economic policies. These call for dialogue and negotiation of effective arrangements, ideally in the WTO. The recent provisional agreement between the European Commission, the Council and the European Parliament on a future framework for foreign investment-screening to address security risks posed by foreign investments²⁰ illustrates that the EU has tools to condition access to its market, but it is important for them not to be used, if adopted, for protectionist purposes. The proposed framework leaves the final say to the member states and may give rise to both greater complexity and uncertainty for investors.²¹ Care needs to be taken to ensure that reviews do not raise the costs of investing in Europe. Similarly, proposals to apply a price penalty to tenders for public contracts from firms based in countries that discriminate against EU suppliers in their public procurement markets if consultations with these countries fail to resolve matters risk increasing public procurement costs.²²

Conclusion

The EU benefits from an open trade policy stance and an effective rules-based multilateral trading system. The rise in protectionism in major trading nations (notably the US and several large emerging economies) can only be detrimental to the EU economy. Internal and external factors are challenging the EU’s ability to use the CCP and at the same time increasing the salience of trade policy as an instrument of external policy.

The EU is responding to protectionist pressures by continuing to pursue trade agreements and supporting an ambitious WTO reform agenda. It has a key role to play, given the depth of distrust between China and the US, the Union’s extensive relationships with many developing countries, the many dialogues and linkages that have been established with China and the EU’s leadership in

¹⁹ The European Parliament has created monitoring groups to scrutinise EU trade negotiations and in some cases also their implementation but the activities of such groups largely depend on the standing of the rapporteur. See L. Puccio and R. Harte, *The European Parliament’s role in monitoring implementation of trade policy*, in O. Costa, *The European Parliament in times of EU crisis: Dynamics and Transformation*, Palgrave, 2019.

²⁰ Provisional agreement resulting from interinstitutional negotiations - Proposal for a regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union (COM(2017)0487 – C8-0309/2017 – 2017/0224(COD)), 6 December 2018.

²¹ Dr. T. Heinrich, Dr. T. Kuhn, M. Powell, Genevra Forwood, O. Berg, S. Kueper, *New EU Foreign Direct Investment Regulation—Initial Steps towards Harmonized European Investment Controls*, White and Case, 7 January 2019.

²² Amended proposal for a Regulation of the European Parliament and of the Council on the access of third-country goods and services to the Union’s internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries, COM(2016) 34 final.

negotiating trade and investment agreements that encompass non-trade concerns and values. The EU has both a unique opportunity and arguably the responsibility to play a bridging role between developing countries' global trade concerns and those of the OECD member countries regarding WTO reforms and an associated updating of multilateral rules on issues that are driving current trade conflicts – notably subsidies and related 'make it here' policies. Reaching an agreement on WTO reform will be challenging. Realism suggests the Union should in parallel prepare a 'plan B' that minimizes trade policy uncertainty for EU firms operating internationally to the greatest possible extent. Such a plan B should centre on the Asia-Pacific area and Africa, and encompass:

- bilateral engagement with China, Europe's second largest export destination, to improve trade conditions confronting EU companies, address concerns that China has with access to the EU and explore potential cooperation in areas of common interest, such as the Belt and Road Initiative;
- considering the scope to deepen economic relations with CPTPP countries, including possible accession; and
- renewed efforts to conclude deeper trade agreements with African partners to complement economic development assistance and investment flows.

Greater transparency and more effective monitoring of the implementation of EU trade agreements and their impacts on EU stakeholders is critical to bolster support for EU trade policy. In this respect, the role of the European Parliament in monitoring the implementation of EU trade agreements should be enhanced. Such monitoring and associated analysis should extend to the distributional effects of trade and the reach and effectiveness of domestic policies to address the economic adjustment costs of an open EU trade policy and ensure that gains from trade are shared more equally throughout the economy. While this is primarily a matter for national governments, the EU can play a bigger role in providing adjustment funding to firms, workers and regions that are negatively affected by globalization.