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WORKING PAPERS

No. 178 December 1998

Assessing NAFTA - Part II

The Impact of NAFTA on Jobs, Wages, and Income Inequality

by

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ASSESSING NAFTA - Part II

THE IMPACT OF NAFTA ON JOBS, WAGES, AND INCOME INEQUALITY

by

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and

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PREFACE

This paper is one of three Lubin Working Papers on "ASSESSING NAFTA." These papers are part of a wider project to assess the impact of NAFTA, which was carried out in the fall and winter of 1997-98, for the Institute of International Trade and Investment in Japan.

Opinion about NAFTA in the U.S. is deeply divided. Critiques of NAFTA, particularly in the U.S., reflect a reaction to excessive claims made earlier by NAFTA proponents. More importantly, however, they reflect a growing anxiety about the economic and social impact of trade on Americans — on their jobs, income, employment, and labor standards, for example. Many Americans wonder if trade is responsible for stagnating wages, the decline of the share of U.S. workers employed in manufacturing, and rising levels of income inequality in American society. NAFTA has become a code-word for a host of fearful and contentious issues that have little to do with the agreement, including globalization, economic dislocation, job insecurity, ethnic paranoia, and even the future of the American middle class.

In this paper, we identify and assess recent research on the impact of NAFTA on trade, investment, jobs, income, and the environment. Our review led to these conclusions:

- NAFTA is an important agreement and, together with the Uruguay Round accord, will exert substantial influence over patterns of trade and investment in the future.

- However, to date, NAFTA has had only a modest direct impact on patterns of trade and investment in North America. The same holds true for employment and wages. The NAFTA side agreements have led to some change in environmental protection policy and in the protection and enhancement of labor rights. These results are also modest, and it is simply too early to evaluate the impact of the agreement on these areas.

- NAFTA, in our view, should be seen not as the beginning of the process of economic integration in North America, but as a response to powerful forces of change that began in the mid-1980s. These include changes in policy — particularly when the collapse of oil prices forced the Mexican and Canadian governments to abandon import-substitution economic development strategies and changes in markets — as rising levels of international competition forced firms to reduce excess capacity and to rationalize operations in North America.

- Changes in corporate structure and organization have been a more powerful force in driving the restructuring of the North American economy than NAFTA itself.

- NAFTA's greatest value has been its impact on government and business policies and decisions, factors that cannot be measured in economic terms. Most remarkable was Mexico's ability to maintain its commitment to trade liberalization during the peso crisis of December 1994 by reversing its traditional policy of closing markets by imposing import restrictions.

One finding is both clear and ominous. Whereas four years ago the United States took the leadership role in pressing for the implementation of a North American free trade agreement, today support for the agreement and for the expansion of NAFTA is stronger in Canada and Mexico (even after the peso crisis) than in the United States.

INTRODUCTION

The issue that aroused the most controversy in the debate over NAFTA was its likely impact on jobs and wages. As the author of a recent history of U.S. trade policy writes, "Although NAFTA raised questions about environmental protection, immigration, drug interdiction, and democracy, the bulk of the NAFTA debate focused on one issue—would NAFTA create or destroy jobs?"[1] A key reason for the controversy was the promise of job creation made by NAFTA supporters and the threat of job loss made by NAFTA opponents. All kinds of numbers were and, in fact, continue to be bruited about.[2] U.S. jobs and wage levels remained the central concern in the debate in the fall of 1998 over the impact of NAFTA and fast track authorization.

The situation was somewhat different in Canada and Mexico. Expectations here were more focused on the overall development of their economies. Mexican leaders assumed that a "win-win" situation would prevail, where the growth of Mexico's consumer market would enable all the NAFTA partners to expand their exports and gain new jobs; Canadians looked more at the competitiveness of their economy in this new free trade environment. Nonetheless, there were substantial fears in both countries that jobs would be lost. The restructuring of Canada's branch plant economy inevitably involved substantial downsizing of industrial and managerial work forces, and it helped produce levels of unemployment that were substantially higher than in the United States. Many Mexicans feared that free trade with the U.S. would lead to a terrible loss of jobs in their country's inefficient agricultural sector, and possibly in manufacturing as well.

Employment - The Problem of Counting

Despite the centrality of these issues, NAFTA's impact on jobs, wages, and income is difficult to assess. Why?

It is difficult to track job creation or destruction due to a single, specific development. Available numbers may not be effective measures of the impact on the labor markets. It is also hard to relate macroeconomic and microeconomic findings. While many people have lost jobs in the U.S. in recent years, and many have experienced economic adversity, overall, U.S. employment is at record high levels. How can there be a significant problem of job loss, say some economists, when unemployment is so low? Experts disagree sharply over patterns of change in wages, incomes, and income inequality in the U.S. over the past 20 years. Anxiety and fear are functions mainly of global change and of changing economic structures around the world, hardly of NAFTA alone. Nonetheless, NAFTA became, and remains, a symbol of these wider concerns. Ross Perot's line about the "giant sucking sound of jobs going south" is endlessly reiterated in these discussions.

Who is doing research on jobs and income? Little original research seems to have been carried out by NAFTA opponents. We identified three organizations that have carried out serious

[1] Susan Ariel Aaron, *Trade and the American Dream* (Lexington: The University Press of Kentucky, 1996) p. 140.
[2] See Keith Bradsher, "Trade Pact Job Gains Discounted," *New York Times* (22 February 1993), for an interesting discussion of the problems these estimates created for two of the most respected and influential trade analysts.

analyses of the impact of NAFTA on jobs: the Congressional Research Service (CRS)[3], the North American Integration and Development Center (NAID)[4], and the U.S. International Trade Commission (ITC)[5]. Their efforts were all undertaken at the same time, and they have drawn extensively from each other's findings. All three provided information and analysis for the President's three-year report on NAFTA.[6]

KEY ISSUES

The key battle between NAFTA supporters and opponents is over jobs and income inequality. Opponents claim that over 400,000 U.S. jobs were lost since 1993 because of NAFTA. Concern focuses primarily on job losses in the U.S. that are related to increased trade. The Economic Policy Institute (EPI) says that the increase in the trade deficit with its two NAFTA partners to $39 billion in 1996 (an increase of 332 percent from 1993) was responsible for the loss of 420,208 U.S. jobs. NAFTA's influence is seen as especially negative in the manufacturing sector. The EPI claims that NAFTA is responsible for 38 percent of the decline in manufacturing employment in America since 1989.

Proponents, however, argue that NAFTA has created tens or even hundreds of thousands of new jobs. One supporter argues, for example, that because exports to Mexico and Canada grew by 10 percent in this period, it is reasonable to claim that 10 percent of the 4.84 million jobs created between 1993 and 1996 that were due to export growth can be accounted for by NAFTA-related exports.[7] U.S. Trade Representative Charlene Barshefsky claims that exports to Canada and Mexico support 2.3 million American jobs, up from 1.9 million before NAFTA came into effect.[8]

The most representative and wide-ranging critique of NAFTA after three years is found in a report titled, *The Failed Experiment: NAFTA at Three Years*, prepared by six think tanks concerned with trade, labor, and environmental issues.[9] The report of the "Group of Six" contends in their Executive Summary that "NAFTA and globalization generally have changed the

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[3] Mary Jane Bolle, *Nafta Labor Side Agreement: Lessons for the Worker Rights and Fast-Track Debate*, Congressional Research Service (CRS) Report for Congress 97-861-E (October 1997) and --- *NAFTA: Estimates of Job Effects and Industry Trade Trends After Three and One-Half Years*, Congressional Research Service (CRS) Report for Congress 96-176-E (Updated 9 September 1997).

[4] Raul Hinojosa Ojeda et al., *North American Integration Three Years After NAFTA: A Framework for Tracking, Modeling and Internet Accessing the National and Regional Labor Market Impacts*, North American Integration & Development Center (NAID), University of California, Los Angeles (December 1996).

[5] U.S. International Trade Commission (ITC), *The Impact of the North American Free Trade Agreement on the U.S. Economy and Industries: A Three-Year Review*; Investigation No. 332-381 (Washington, D.C: ITC, Publication 3945, June 1997).

[6] Office of the Executive, *Study on the Operation and Effects of the North American Free Trade Agreement* (Washington, D.C. July 1997), cited as "the President's report."

[7] Raymond Keating, "History's hard road," *Journal of Commerce* (30 September 1997) (by using the Commerce Department's estimate that every $1 billion increase in exports translates into 22,800 new jobs; see below, "The Debate Over Standard Employment Multipliers").

[8] Quoted in Peter Morton, "U.S. report sings NAFTA's praises" *The Financial Post* (12 July 1997).

[9] Economic Policy Institute, Institute for Policy Studies, International Labor Rights Fund, Sierra Club, Public Citizen's Global Trade Watch, U.S. Business and Industrial Council Educational Foundation, *The Failed Experiment: NAFTA at Three Years* (Washington DC: Economic Policy Institute, June 1997), cited as the Group of Six report.

composition of employment in America, stimulating the growth of lower paying services industries and accelerating the deindustrialization of our economy."[10] Trade policy alone is seen to be "responsible for 15 to 25 percent of the growth in the income gap that has occurred in the 1980s and 1990s."

Imports from low-wage countries are seen as the major cause of increasing wage inequality in the United States, and Mexico is said to account for 26.7 percent of the increase of U.S. imports from low-wage countries. The Report also underlines the impact of plant relocations from the U.S. to Mexico on direct investment in general, and, as the main point of discussion, on the possibility that firms will use a possible move as a threat, thereby preventing or blocking wage increases and union organization, all of which drive the decline in real wages of blue collar workers.

Professor Kate Bronfenbrenner of Cornell says that over half the firms used those threats to fight union organizing drives and, while in the bargaining process, 15 percent of firms actually closed down parts or all of the operations. In its 1996 report "Nafta - The Myths and the Realities," the Institute for Policy Studies (IPS) had already claimed that corporations were using these tactics "to bring Third World wages and working conditions back home."

The Debate Over Standard Employment Multipliers

Employment numbers based on "standard employment multipliers" have been widely used in this debate. However, most analysts agree that these numbers have served mainly to cloud the debate over NAFTA's impact on jobs. These statistical correlations were utilized originally by NAFTA proponents (and specifically the Commerce Department) to forecast likely job gains from NAFTA. It was claimed that for every $1 billion increase in exports, 13,000 (or more, for the number seems to have increased over time) jobs would be created.[11] Multiplying this figure by the growth in U.S. exports to Canada and Mexico in 1994-96 ($47.5 billion) suggests that about 618,000 new jobs were created in the U.S. economy in this period by new exports to our NAFTA partners. Therefore, this would represent approximately 7 percent of the 8.8 million jobs created in the U.S. economy over the same time.

Opponents of NAFTA contend that if increases in exports correlate with new jobs, then increases in imports should correlate with lost jobs. They argue that the substantial and increasing trade deficit the U.S. is now running with its NAFTA partners has resulted in substantial job losses — that is, so many jobs lost for each $1 billion of deficit.

Most analysts doubt the validity of this correlation. If it is, at best, indicative with regard to exports, it seems useless with regard to imports. Mary Jane Bolle, an economist with the Congressional Research Service (CRS), observes that "trade deficits cannot be used to measure net job *losses* because, as economists point out, there are no net job losses as long as output and employment continue to rise. New imports are just added to domestic output, and not substituted for it. Trade deficits, therefore, do not reflect aggregate jobs lost, but rather, arguably, at most,

[10] Executive Summary, Group of Six.

[11] Mary Jane Bolle, "NAFTA: Estimates of Job Effects and Industry Trade Trends After Three and One-Half Years" CRS Report for Congress, 96-176 E (Updated 9 September 1997, p. 2).

some job gains foregone (which have no identifiable victims) in sectors affected by trade.... This is not to say the job losses do not exist. They are very real, and perhaps more accurately counted directly and tallied up by industry."[12]

Others agree. The NAID, for example, observes that "despite the lack of ongoing research, there has nevertheless recently been much speculation in the press about the impact on U.S. employment due to NAFTA trade liberalization and the Mexican peso crisis. The recent round of speculations, however, have been based on estimations that have tended to reproduce many of the same errors which were typically found during the NAFTA debate on both sides of the issue."[13]

Opinion polls indicate that the public in NAFTA countries is still very confused about the employment impacts of NAFTA and about which country has benefited more from the agreement. The NAID again comments: "Most of the recent round of estimates … are still at best based on partial information from one or another source, extrapolated by very imprecise or faulty methodologies. Rarely have recent estimates clearly presented the data and methodologies which underlie their conclusions."[14] Raul Hinojosa Ojeda (who headed the NAID investigation) observes that the aim of their investigation was "to lower the rhetoric on both sides of the debate. NAFTA is neither a panacea nor is it a creator of a giant sucking sound."[15]

MEASURES AND ANALYSES

Are There Any Good Numbers Out There?

Several groups have attempted to measure the effects of increased trade on employment and wages. The findings of three of them — the NAFTA-Transitional Adjustment Assistance (TAA) Program, the North American Integration and Development (NAID) Center, and the International Trade Commission (ITC) — will be reviewed in the following section.

The NAFTA-TAA Program

The International Trade Commission's report states that "the linkage between trade policy and labor market effects is less direct than the link between the trade agreement and a single bilateral trade flow."[16] Changes in trade policy affect the quantities and prices of traded goods, which then affect the labor force that produces those goods. As a result, labor market findings are less conclusive than the findings reported with respect to trade flows. The major difficulty besides that of figuring out a relation between trade flows and employment numbers is seen to be that of isolating the data on NAFTA's impact from other factors, such as the peso crisis. Bolle claims that

[12] Mary Jane Bolle, op cit.
[13] Also quoted from NAID (footnote 4, p. 7): Bob Herbert [1994], for example, used an estimate of "one million jobs lost due to NAFTA" without any critical examination of its source. *The Los Angeles Times* has reported without critical examination the California Trade and Commerce Agency's regular claim that "Nafta is clearly benefitting California's economy..." which is based solely on export figures without ever mentioning imports. (LAT 6-27-96.html).
[14] Raul Hinojosa Ojeda et al, pp. 7-8.
[15] "Tracking NAFTA," *Mexico Business* (March 1997), pp. 26-28.
[16] U.S. International Trade Commission, pp. 4-14.

because it is virtually impossible to discern job effects *from* NAFTA, the documentation is really about job effects *since* NAFTA.

One source of information, however, is specifically linked to NAFTA—data collected by the Department of Labor on how many workers have been certified under the NAFTA Transitional Adjustment Assistance (NAFTA-TAA) Program.[17] The certification identifies those who are eligible for training or income replacement benefits because imports from our NAFTA partners "contributed importantly" to their job loss, or because their plant relocated to Mexico or Canada."[18] The TAA represents the closest approach to a *direct* measurement of job losses due to NAFTA. After three and a half years (Jan 1994-June 1997) the Department of Labor certified 133,052 job losers from 1,108 plants under the NAFTA-TAA Program. In the TAA registration period between 1993 and 1995, this represented approximately 2.4 percent of the total number of U.S. workers dislocated.[19]

What about NAFTA's impact on absolute levels of employment? The more detailed analyses of NAFTA's impact on jobs have focused on the manufacturing sector, which accounts for 20 percent of the non-farming labor force and for nearly 90 percent of all the certified NAFTA-TAA workers.[20] However, manufactured goods account only for a dwindling percentage of the United States' consumption.[21] CRS results show that the extent to which NAFTA is exacerbating the decline in absolute employment in affected industries is low. An absolute decline in employment occurred in only seven of 18 manufacturing industries that showed job losses due to NAFTA. In only one of those seven industries, the paper industry, did NAFTA account for a considerable share of lost jobs (33 percent). Other job losses were presumably due to productivity gains or non-NAFTA related declines in output.[22] Overall, between 1993 and 1996, manufacturing employment grew by 382,000 jobs, or about 2 percent, and has more than made up for NAFTA job losses.

The NAID, in its very detailed analysis and sorting (by sectors, regions, effects etc.) of the NAFTA-TAA numbers, also found that the job losses did not significantly affect the majority of the 20 SIC (Standard Industrial Classification) categories reviewed. Twelve of them were actually found to be growing ("though admittedly out of recession, but nevertheless, growing").[23] NAFTA-TAA registered job losses appeared to be a significant contributor to nationwide net job losses only in the apparel (22.8 percent) and textile industries (21.7 percent), and the leather industry (11.2 percent), which, however, is rather small and long-declining.

Even in these more rigorous analyses, the data are criticized. However closely related these counted losses are to NAFTA effects, all sides agree that the numbers probably do not account for all of the layoffs, since not everybody files for the offered help. NAFTA supporters say that this is

[17] Hinojosa Ojeda et al, p. 53 (the "only official recording system of NAFTA impacts").
[18] Mary Jane Bolle, CRS Report for Congress 96-176-E (Updated 9 September 1997), p. 4.
[19] ITC, pp. 3-8.
[20] Hinojosa Ojeda et al., p. 53.
[21] Gary Burtless et al., *Globaphobia: Confronting Fears About Open Trade* (Washington, D.C.: The Brookings Institution, The Progressive Policy Institute, The Twentieth Century Fund: 1998), p. 52.
[22] See also Gary Burtless et al., p. 53.
[23] Raul Hinojosa Ojeda et al., p. 54.

because most workers found another job and, therefore, did not bother applying. Opponents disagree and maintain that the program is not well known, and that many workers who have lost their jobs have been discouraged by the paperwork and bureaucracy. As a result, they do not claim benefits and often settle for lower paying jobs.

The TAA numbers may just as well overstate the actual number of NAFTA-impacted workers, since the program is not tied to *NAFTA provisions* per se, but rather to increases in imports from, or shifts in production to, *NAFTA partners*. The NAID criticizes the potential misuse of these numbers as well and points out the relevant inadequacies in great detail. However, it sees the NAFTA-TAA register as a relevant source of information if used appropriately and, therefore, we have integrated it in its own analysis.

The NAID Analysis

The NAID's critique of the sole use of NAFTA-TAA numbers as an indicator for NAFTA's impact on employment is a more detailed one. By separating the aggregate numbers and cases into different schemata, it points out that a great majority of the cases certified through the NAFTA-TAA come from plant relocations (or production shifts—about 58 percent of all certifications):

> The NAFTA-TAA certification method has the virtue of being based on empirically reported incidences of employment dislocations, but is limited by the fact that this data is based on self-reporting by workers and firms. This method is judged to be more accurate for large firms involved in the highly visible process of plant movements to other NAFTA countries. This method is seen as much less reliable as a measure of import penetration, particularly in smaller firms…[24]

The NAID checked possible relations between NAFTA-TAA numbers and trends and the trade changes since the implementation of NAFTA. However, it did not find any correlation. "This illustrates that NAFTA-TAA may not be picking up some impacts." Therefore, to be able to estimate the impact of imports — or generally the changes in trade patterns — on employment, the NAID developed a new model, the "NAID-Armington Direct Employment Impact Estimation Method."

Because imports do not always replace domestic production, the NAID uses Armington elasticities in a partial equilibrium model that accounts for the degree of complementarity of imports and domestic goods. In addition, the model tries to integrate the relevance of the complementarity of U.S. and Mexican production by looking not only at the level of imports and exports, but more specifically by distinguishing between intermediate and final products, and therefore accounting for the high level of re-imports of formerly exported intermediary products.

This model certainly represents a more accurate approach to assess dimensions of trade flows, but as the NAID itself points out, it can only account for direct impacts on a sectoral level.

[24] Raul Hinojosa Ojeda et al., p. 52.

The indirect effects would have to be investigated at an aggregate level.[25] Also, the partial equilibrium analysis is not to be seen as a complete gauge of the impact of plant relocations, which makes the NAID-Armington method and the NAFTA-TAA methodology complementary measures of the trade and investment impacts of North American Integration.

Using both methods, the NAID's overall findings are:[26]

- The overall positive or negative employment impacts of U.S.-Mexico trade have not been significantly affected by the liberalization of tariffs due to NAFTA.

- The net employment impacts due to NAFTA tariff liberalization have been slightly positive, representing a very small share of new jobs being supported by exports to (or put at risk of displacement through imports from) Mexico.

- The overall net U.S. employment impacts since the NAFTA implementation (1994-96) have also been slightly positive, even taking into account the large impact of the peso crisis of 1995.

- Negative employment impacts related to imports have actually declined when comparing pre- and post-NAFTA periods, due primarily to steep annual declines in labor intensity of U.S. manufacturing.

- The most important negative impact on employment has been the decline in U.S. exports due to the Mexican peso crisis, not the liberalization of tariffs due to NAFTA.

These findings are basically congruent with those of the other assessments by organizations that favor NAFTA. But a rather new perspective to the assessment of the issue is brought up by this analysis:

- Though unfortunately not central to the NAFTA debates, the real issue with respect to U.S. employment levels concerns the development of policies that can achieve sustainable growth in Mexico. While the "Mexican Rescue Package" appears to have been crucial in averting another deep collapse, it is by no means certain that sustainable growth has been assured.[27]

The NAID stresses that other developments that affect U.S. exports to Mexico are much more important for the American labor market than the increase in competitive imports. "As in the early 1980s, the principal danger to jobs was not the pattern of trade, but the inability to sustain a stable macroeconomic environment between the United States and Mexico."

The NAID's very modest bottom line is that 2,990 net jobs were created by NAFTA.

The ITC Analysis

[25] Furthermore, the effects stemming from trade diversion are not fully captured by the new model, which is one of the reasons the NAID itself claims that this model still has a tendency to overstate the impacts.
[26] Raul Hinojosa Ojeda et al., p. 12.
[27] Raul Hinojosa Ojeda et al., p. 13.

The ITC analysis confirms the NAID findings in both its quantitative and qualitative analyses. The ITC's detailed industry level and sector-by-sector analyses represent a major contribution to more reliable and transparent information especially with respect to the trade flows. (See CFAR Working Paper No. 177, the first in this Series.) At this point, as we examine the impact of NAFTA on employment and wages, we will not elaborate on the techniques or methodologies used, but, in an attempt to embrace the findings of the major substantial research available, will restrict ourselves to a brief outline of the major results of the quantitative as well as the qualitative analysis.

Quantitative analysis. These industry level effects are based on an analysis of 120 selected 4-digit SIC categories. Because labor effects can occur through changes in employment or earnings, these variables were examined separately. Furthermore, specific attempts were made to separate the effects of NAFTA from changes due to typical business cycle shifts.[28] The principal finding reported is that relatively few U.S. industries (representing less than 4 percent of the non-farm labor force, or less than 17 percent of the manufacturing labor force) show evidence of having been affected, either positively or negatively, by NAFTA in its first three years. The ITC findings, therefore, support the argument that NAFTA has had no statistically significant effect on the U.S. manufacturing labor force as a whole.

Among those industries with "significant NAFTA effects," hours worked were most often found to be positively related to NAFTA, while earnings were more often found to be negatively related.

Qualitative analysis. In its qualitative (sector-by-sector) analysis, the ITC found that NAFTA had a negligible effect on 59 of the 68 sectors examined. With regard to employment, negligible impacts were found in 66 of the 68 sectors.[29] In only one sector—apparel—did NAFTA show significant impact on U.S. wage levels. There, imports attributable to NAFTA shifted the composition of employment to higher-wage fabric cutting jobs, and, overall, wages increased by 12 percent in the U.S. apparel sector from 1993-96.[30]

The lack of data prevented the ITC from investigating the impact of NAFTA on productivity in its quantitative analysis. In its qualitative analysis, the ITC was able to detect productivity gains (between 3 and 10 percent from 1993 to 1995) in all of the sectors where NAFTA had significantly affected exports or imports.[31]

Conclusions On Jobs

[28] ITC, pp. 4-14.
[29] ITC, Executive Summary, pp. xxiii, xxiv. The imports from Mexico in these two sectors (footwear and apparel) appear to have largely displaced imports from other countries. And those imports from Mexico on average have higher U.S. content than imports of these products from Asian and other countries! (ITC findings mentioned in President's report, p. 41).
[30] As cited in President's report, p. 42.
[31] Ibid.

The conclusion drawn from all these analyses is that NAFTA has had no significant aggregate impact on jobs. All agree that the U.S. labor force has been at virtually full employment for almost the entire duration of NAFTA. In April 1997, the U.S. unemployment rate stood at 4.9 percent, the lowest level in 24 years. This is why, for example, economists such as B. L. Weinstein at the Center for Economic Development and Research at the University of Texas in Denton even see a benefit in imports (especially in intra-firm trade). This is because imports may provide a relief valve against bottlenecks that give rise to inflationary pressures.[32] This suggests why the impact of NAFTA on job dislocation and employment creation should be analyzed at the sectoral level.

Sydney Weintraub,[33] from the Center for Strategic and International Studies argues that the labor market effects of NAFTA is an issue of minor significance in an overall evaluation of the Agreement, given the current low level of unemployment in the United States and the rapid rate of job creation. The implication is that the Agreement has had no real discernible effect on aggregate jobs in the economy, certainly not in a negative direction.[34] He does not offer his own empirical work, but cites others' findings—for example, the NAID report and the reports of the Congressional Research Service.

A new book entitled *Globaphobia, Confronting Fears About Open Trade*, released by the Brookings Institution, the Progressive Policy Institute, and the Twentieth Century Fund, underlines that "trade is not about generating more or fewer jobs, but generating better jobs and a higher national standard of living."[35]

Similarly, Raul Hinojosa argues that jobs gain/loss accounting methodologies should not be used in most cases to evaluate the relative benefits of trade, although these methodologies should be central to our understanding of the adjustment costs of the impacts of trade:

> In evaluating the relative benefits of trade, it is much more important to focus on understanding the long-term dynamic impacts on productivity growth and overall welfare gains, not merely on the short-term employment effects. Accurately identifying employment displacement risks, however, is very important to assist workers and communities take adequate steps to prepare for a positive adjustment. Failure to identify and address adjustment risk will inevitably generate exaggerated political opposition to trade liberalization, in some cases based on ignorance and fear, and in some cases based on the legitimate defense of uncompensated individual costs which are incurred on behalf of the overall societal welfare.[36]

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[32] Quoted in *U.S: News and World Report* (7 July 1997), p. 59.
[33] Sidney Weintraub, *NAFTA at Three* (Washington, D.C.: Center for Strategic and International Studies, 1997).
[34] "Job creation and loss are overwhelmingly a function of conditions in the U.S. economy. Foreign trade with a single country is marginal in this respect. Macroeconomic policy - monetary policy of the Federal Reserve Board, the management of fiscal policy, and shifts in the value of dollar in relation to other currencies - is much more significant than trade outcomes, particularly with a single country like Mexico, in determining domestic employment." Sidney Weintraub, *Nafta at Three*, p. 12.
[35] Gary Burtless et al., p. 45.
[36] Raul Hinojosa Ojeda et al., p. 15.

Weintraub and others, when trying to identify and measure the effect of NAFTA on income and jobs, focus on how NAFTA creates institutional frames—such as the side agreements on labor and on environmental cooperation (NAALC & NAAEC), institutions that seek to reduce the impact of change on a global scale of which NAFTA is only part. In this view, Transitional Adjustment Assistance is one prominent example of how sectoral effects can be relieved.

Wages and Income Distribution

The NAID study has been questioned because it was sponsored by the U.S. government. The NAID report also failed to deal with the more delicate question as to how wages and income distribution are being affected by the changes in trade patterns. One economist at the AFL-CIO, for example, says that most benefits from NAFTA go to corporate elites.[37]

Raul Hinojosa did, however, discuss these issues in an interview published in *Mexico Business*.[38] "We did a little exercise that we didn't include," he said. The average wage in sectors (in the U.S.) in which imports from Mexico have increased is actually higher than the average wage in sectors where the U.S. exports to Mexico have risen. This differs from wider experience, where average wages in export-oriented jobs is higher than average wages in import-oriented jobs. Hinojosa believes this is because the imports from Mexico are in the lower-paid segments of the production process of a relatively higher paying sector. He sees this as an indicator of a very tight and complex industrial interdependence between Mexico and the U.S., which has been a trend of the last 15 years, not one that originated with NAFTA.

> This could be good or it could be bad, depending on the evolution of Mexican wages and productivity. If Mexico remains a simple low-wage manufacturer with chronic crises that prevent an increase in real wages, then this will be bad for the U.S. It will prevent Mexico from expanding its potential as a market for U.S. products. And it will prevent Mexican wages and productivity from rising in a way that would better complement the ability of North America to become more competitive. *If you've got a low-wage option sitting there locked into an industrial structure, you're not necessarily going to move toward higher technology investments.*

[37] "Nafta critics blast UCLA study reporting job impact as modest," *Journal of Commerce* (20 December 1996).
[38] "Tracking NAFTA," *Mexico Business* (March 1997), pp. 26-28.

Hinojosa counters Ross Perot's giant sucking sound prediction caused by better paying jobs being lost to Mexico leaving lower wage jobs behind, saying that a detailed analysis permits one to see that the "types of jobs that go, are the more labor-intensive, lower-skilled, lower-paid."

The ITC's comment on the quality of the newly created jobs and growing inequality in income distribution is based on the Council of Economic Advisors' (CEA) assessment that most of the new jobs created in the 1990s are "good" jobs.[39] The CEA analysis adds that the number of lower-paying jobs also increased and that employment in the middle of the earnings distribution fell. The CEA further noted that "a disproportionate share" of employment growth in the current expansion is in the service sector. The CEA reported that during the February 1994-February 1996 period, managerial and professional jobs were the main contributor to net increases in services employment. Meanwhile, gains in real household income during the 1993-95 period were greater, in percentage terms, for the lowest-income households.

THE IMPACT OF FOREIGN COMPETITION AND INTERNATIONAL TRADE

NAFTA discussions are a subset of much wider arguments now underway on the impact of foreign competition and international trade on American jobs, wages, and our standard of living. Globalization and technological advances in communications and transportation are restructuring not only how but also where economic activities are carried on. The impact of foreign competition and international trade (especially with developing countries) on American standards of living, jobs, and wages is another widely felt source of anxiety today.

One concern has to do with the impact of foreign competition on U.S. jobs. As Paul Krugman and Robert Lawrence have observed, "the conventional wisdom holds that foreign competition has eroded the U.S. manufacturing base, washing out the high-paying jobs that a strong manufacturing sector provides. More broadly, the argument goes, Americans' real income has lagged as a result of the inability of many U.S. firms to sell in world markets. And because imports increasingly come from Third World countries with their huge reserves of unskilled labor, the heaviest burden of this foreign competition has ostensibly fallen on less educated American workers."[40]

Income inequality between richer and poorer nations increased over most of the past century. It has been estimated that average income per capita in the richer countries soared from 11 times that of the poorest in 1870 to 52 times by 1985, and it is likely to be greater still today.

Concern is growing, however, that this trend is now being reversed. The developing nations contain a huge army of unskilled workers. Indeed, some 40 percent of the world's labor supply consist of peasants whose average income is less than $1600 a year. Unskilled workers in the richer countries (who make up 8 percent of the world's labor supply) earn an average of $17,000 a year. There is strong temptation, it is assumed, for employers to substitute the lower for the higher-paid unskilled workers by moving production to poorer countries.

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[39] CEA, *Economic Report of the President* (February 1997), pp. 141-42, and p. 164.
[40] Paul Krugman and Robert Z. Lawrence, "Trade, Jobs and Wages," *Scientific American* (April 1994).

Some statistics seem to support this view. Imports from developing countries now comprise one-third of all U.S. imports, as compared to 14 percent in 1970, and manufactured goods now make up about half of all imports from developing countries, compared to 5 percent in 1955.[41]

Increasing imports from developing and newly industrializing countries are often blamed for rising levels of unemployment in Western Europe and stagnating wages in the U.S. Some contend that unless developed nations are protected against "social dumping," workers in these countries will have to settle for third-world working conditions and levels of pay or high levels of unemployment. Some observers, Professor Adrian Wood for example, claim that trade has reduced the demand for unskilled labor in rich countries by about one-quarter, which is more than enough to explain the increased wage inequality in the U.S. and the rise of unemployment in Europe.[42]

Is the decline in the share of U.S. workers employed in manufacturing and the share of U.S. output accounted for by value added in manufacturing the result of rising imports?

From 1970 to 1990, imports rose from 11.4 percent to 38.2 percent of the manufacturing contribution to U.S. GDP. However, manufacturing exports also rose dramatically in the same period, from 12.6 percent to 31 percent of value added. Many manufacturing firms may have laid off workers in the face of competition from abroad, but others have added workers to produce for expanding export markets.

Krugman and Lawrence conclude: “If trade in manufactured goods had been balanced from 1970 to 1990, the downward trend in the size of the manufacturing sector would not have been as steep as it actually was, but most of the deindustrialization would still have taken place. Between 1970 and 1990 manufacturing declined from 25.0 to 18.4 percent of GDP; with balanced trade, the decline would have been from 24.9 to 19.2 percent, about 86 percent as large.”

The more powerful reason for the decline in the share of manufacturing in U.S. GDP is that the composition of domestic spending has shifted away from manufactured goods. In 1970, U.S. residents spent 46 percent of their outlays on goods (manufactured, grown, or mined) and 54 percent on services and construction. By 1991, the shares were 40.7 percent and 59.3 percent respectively, as people began spending comparatively more on, for example, health care, travel, entertainment, legal services, and fast food. The reason is that goods have become relatively cheaper, primarily because productivity in manufacturing has grown much faster than in services, which is passed on in lower consumer prices.

Ironically, the conventional wisdom here has things almost exactly backward. Policymakers often ascribe the declining share of industrial employment to a lack of manufacturing competitiveness brought on by inadequate productivity growth. In fact, the shrinkage is largely the result of high productivity growth, at least as compared with the service sector. The concern that

[41] See Stephanie Flanders and Martin Wolf, “Haunted by the Trade Spectre,” *Financial Times* (24 July 1995).
[42] See Adrian Wood, *North-South Trade, Employment and Inequality* (Oxford: Oxford University Press, 1994).

industrial workers would lose their jobs because of automation is closer to the truth than the preoccupation with a presumed loss of manufacturing because of foreign competition.

If foreign competition is neither the main villain in the decline of manufacturing nor the root cause of stagnating wages, has it not at least worsened the lot of unskilled labor? Has the increasing integration of the global economy pushed down the real wages of less-educated and less-skilled American workers? Percy Barnevik, CEO of ABB Asea Brown Boveri, observed a couple of years ago that "it is a fallacy to think that industry will increase employment overall in the Western world..." He foresees "a massive move from the Western world." Jobs, Barnevik says, will shift to Asia and Eastern Europe: "Western European and American employment will just shrink...like farming at the turn of the century."[43]

This is where the "factor price equalization" theory is supposed to kick in. This theory states that as a richer country trades with a poorer country, the richer one imports labor intensive products and exports products that demand more highly skilled workers. As the demand for unskilled workers falls, the price they can command falls as well, and, as this occurs, employers will seek to substitute lower-skilled, lower-paid workers for more highly skilled labor.

This kind of analysis typically leaves out productivity differentials. Labor costs are much less frequently the key factor in locational decision. Final output cost is the determining factor. Labor costs in Mexico might be lower than in the U.S., but lower productivity, inadequate infrastructure, and poor work habits, for example, can lift final output costs higher than in countries where workers receive much better pay. Relocation of jobs will take place not just when labor prices are lower, but when final output costs are lower.

In most manufacturing industries, the labor share of the final cost is falling, which makes labor costs increasingly less relevant to location issues. Indeed, some fear that work that has been carried on in low-skill, low-wage nations may now be migrating back to more developed countries as capital intensive production.

Moreover, the U.S. continues to purchase much more from other advanced countries, whose workers have similar skills and wages, than from poorer countries. Increasing low-wage competition from trade with developing countries is offset by the rise in wages and skill levels among our traditional trading partners. Data show that U.S. firms continue to invest more and create more jobs in higher-wage countries, such as Canada and the nations of Western Europe, than in low-wage countries.

Has global integration created a link between the rising inequality in rich countries and the rising levels of trade with poorer countries?

This link doesn't fit well into the factor-price equalization theory, which says that the wages of the unskilled in rich countries will fall only if the relative prices of the goods that use the unskilled labor also fall. In addition, according to the theory, such a decline in the price of unskilled labor should encourage companies to substitute unskilled workers for more expensive

[43] Quoted in Brian O'Rilly, "Your New Global World Force," *Fortune* (12 December 1992).

higher-skilled employees. Neither of these has taken place. What this all provides is even stronger grounds for believing that technological change is the main reason for the decline in the demand for unskilled workers in high-income countries.[44]

Another investigation of the relationship between world trade and worsening income inequality arrives at the same conclusion. Gary Burtless, from the Brookings Institution, asks if trade harms unskilled U.S. workers.[45] He finds that inequality is growing in both the most and the least trade-affected industries at about the same rate.

> Over the past quarter century, the nation has seen a dramatic shift in the pattern of demand for workers with different levels of skill. Job opportunities for the less-skilled have shrunk, and relative wages for unskilled and semiskilled workers have plunged. But these trends are not confined to the traded-goods sector. They are also apparent in industries, such as construction and retail trade, where international trade is a minor concern. International trade, it seems, has not been the decisive factor in the trend toward greater earnings inequality.

Like Burtless, Krugman and Lawrence conclude that "the sources of U.S. difficulties are overwhelmingly domestic, and the nation's plight would be much the same even if world markets had not become more integrated."

> The share of manufacturing in GDP is declining because people are buying relatively fewer goods; manufacturing employment is falling because companies are replacing workers with machines and making more efficient use of those they retain. Wages have stagnated because the rate of productivity growth in the economy as a whole has slowed, and less skilled workers in particular are suffering because a high-technology economy has less and less demand for their services. Our trade with the rest of the world plays at best a small role in each case.

This is not to say that we have no reason to be concerned at all over the impact of globalization.

New problems may be brewing in some high-skilled sectors of the economy. Highly skilled software programmers in India, for example, who are equipped with the latest computers and telecommunications equipment, but who work for much less than software programmers in New York, might possess a competitive advantage. Given appropriate communications capacity, it doesn't matter very much if programmers are down the hall, in another state or, for that matter, in India.

Here, too, the problem may look worse than it is. In software programming in particular, the shortfall in supply domestically may well have encouraged employers to look abroad. Moreover, Indian programmers' compensation will tend to rise as demand for their services and the quality of their work increases. Furthermore, some high-tech operations will prefer to have

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[44] Stephanie Flanders and Martin Wolf, "Haunted by the Trade Spectre," *Financial Times* (24 July 1995).

[45] Gary Burtless, "Worsening Income Inequality--Is World Trade to Blame," The Conference Board, *Economic Times*, Vol. 7, No. 5 (May 1966).

their programmers clustered closely around them, to encourage the formation of a critical mass of intellect and innovation. Finally, it is difficult to think of too many industries in which this kind of situation applies.

What the example of Indian software programmers illustrates is not really so much the relationship between industrial and developing countries, but the rapidly increasing flexibility of business organizations. Companies no longer need even to think about shifting some of their operations abroad. Instead, they can outsource a far broader array of their business activities. They can worry much less about bricks and mortar, full-time employees, or relationships that constrain managerial autonomy.

THE NORTH AMERICAN AGREEMENT ON LABOR COOPERATION

Side agreements on labor and the environment were absolutely critical to the ratification of NAFTA. The U.S. Congress, supported by many organizations in all three countries, agreed to pass the NAFTA Agreement only after two "side deals" were worked out to help correct perceived abuses to labor and the environment in Mexico.

The North American Agreement on Labor Cooperation (NAALC), was designed to cushion anticipated negative effects from the agreement on employment, without giving up the overall welfare effects expected from an increase in trade. The NAACL focuses on regulating transitional adjustment assistance and provides a legal framework to assure a certain standard of labor conditions and the enforcement of labor rights.

What is the NAALC?

Mary Jane Bolle of the Congressional Research Service observes that "the North American Free Trade Agreement (NAFTA), between the United States, Mexico, and Canada, is the first trade agreement ever linked to worker rights provisions in a major way." [46] The "side agreement" on labor cooperation—the North American Agreement on Labor Cooperation (NAALC)—went into effect with NAFTA on January 1, 1994. The NAALC is "broad" in that the NAFTA signatories agree to enforce their own labor laws and standards while promoting 11 worker rights principles. Figure I/1 displays these principles and the extent of their enforceability.

[46] Mary Jane Bolle, CRS Report for Congress 97-861-E (October 1997).

Figure I/1 NAALC's Labor Principles

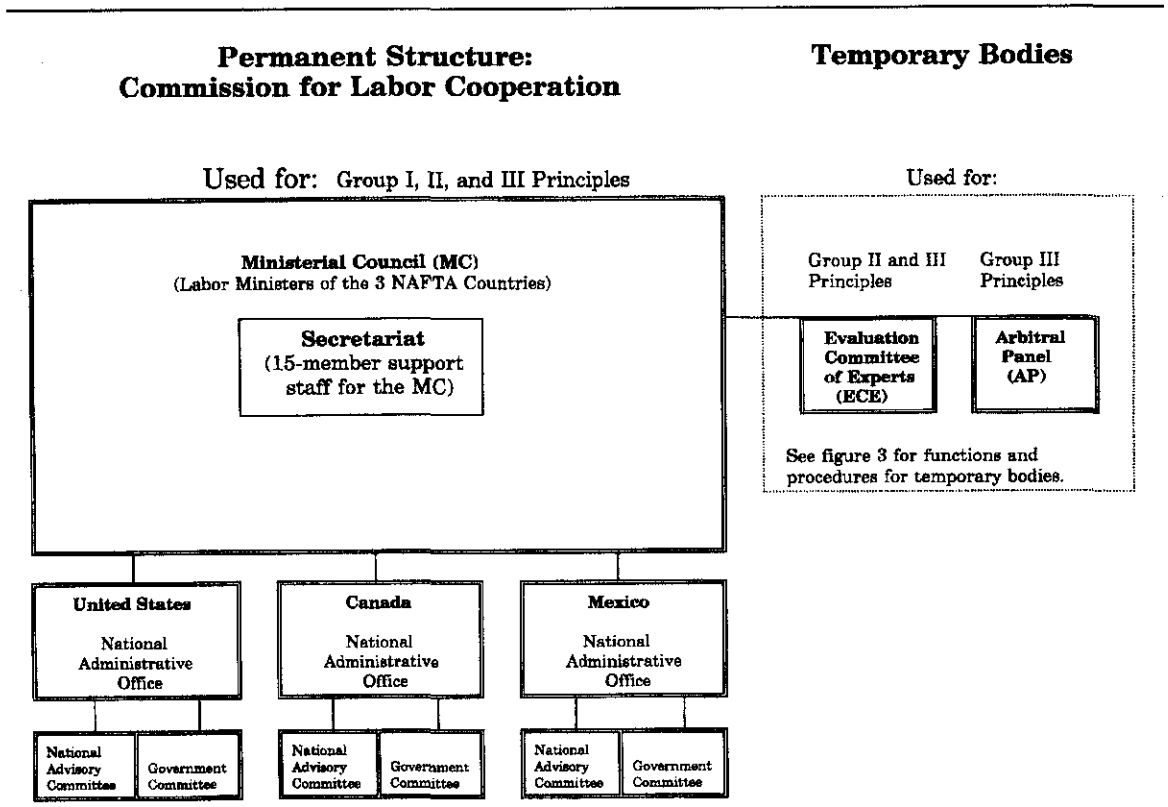
Group and Principles	Extent of Enforceability
Group I	
1. Freedom of association and protection of the right to organize	Enforceable by discussion of the National Administrative Offices, Secretariat, and Ministerial Council
2. The right to bargain collectively	
3. The right to strike	
Group II	
1. Prohibition of forced labor	Enforceable by discussion as indicated for Group I plus evaluation by an Evaluation Committee of Experts
2. Minimum employment standards pertaining to overtime pay	
3. Elimination of employment discrimination	
4. Equal pay for men and women	
5. Compensation in cases of occupational injuries and illnesses	
6. Protection of migrant workers	
Group III	
1. Labor protection for children and young Persons	Enforceable by discussion as for Group I, evaluation as for Group II, and sanctions determined by an Arbitral Panel
2. Minimum employment standards pertaining to minimum wages	
3. Prevention of occupational injuries and illnesses	

The key "weakness" of the NAALC lies in the enforceability of these principles. "The side accord on labor is careful to list guiding principles that the Parties are committed to promote, albeit subject to each Party's domestic law, but these are guiding principles only, not intended to establish common minimum standards for a Party's domestic law."[47] Sanctions as an enforcement tool against countries that do not self-enforce are applicable to only three of the 11 labor principles — minimum wages, child labor, and occupational safety and health. Those principles in Group I are subject only to discussions among NAALC partners and those in Group II may be addressed, in addition, by recommendations from an outside committee of experts. The road to sanctions against a country that does not enforce its own laws is a long one and may take more than two years when all procedures specified by the NAALC are followed. Sanctions in any case are not applicable to three basic rights — the right to organize, bargain collectively, and strike.

[47] "The NAFTA Side Accords on Labour and the Environment," Fasken Martineau (International Practice Group), *NAFTA Special Bulletin* (December 1993).

The NAALC provides for the creation of a Commission on Labor Cooperation (CLC) with a three-part structure (Figure I/2).

Figure I/2 Administrative Structure Set Up by NAALC



This structure includes a Ministerial Council consisting of the labor ministers of Mexico, Canada, and the United States; a 15-person Secretariat to provide technical advice to the council and report on labor-law issues and the status of pending matters; and a National Administrative Office (NAO) for each country to serve as the point of contact between the commission and each government.[48]

The very existence of a labor side agreement is groundbreaking in the history of trade agreements. It can, as Mary Jane Bolles observes, be viewed from four perspectives:

- It is an accomplishment to some in that it promotes international engagement in labor rights and standards on an unprecedented scale. It is a first acknowledgment that workers making goods for export are intimately connected with the products that are traded;

[48] This structure is very similar to that of the institutions established by the side agreement on the environment (NAAEC) (see Part III). There is here the same general idea of a cooperative effort of mainly investigation with less focus on forced implementation but with greater benefit from publicity for certain issues.

- It falls short of the original plan to others in that many feel that it does not go far enough to protect workers, particularly in enforcement;

- It is a signal of alarm to a third group in that the NAALC impinges on the freedom of multinational corporations to bring goods to the consumer at the lowest cost and it deprives developing countries of possible competitive advantage; and

- It is considered unnecessary by a fourth group in that the International Labour Organization is mandated to deal with these issues.

The real key to uncertainty lies in the fact that the NAALC "can be viewed as a vehicle that at the same time both promotes worker rights and preserves sovereignty. Herein lies another area of controversy."[49]

The impact of the NAALC in so short a period can only be modest. To date, only six cases have been reviewed by national panels, five in Mexico and one in the U.S. All have restricted themselves to fact-finding.

Despite this slow start, two results seem to be evident. First, at least in one case, NAALC has encouraged Mexico to begin enforcing its own labor law permitting workers the right to organize and bargain collectively. Under the NAALC eight submissions were made — six alleged Mexico's failure to enforce its own law relating to the right of workers to organize into unions. The sixth of these led to union registration by an independent organization. Some observers think that the repetitive pattern of submissions on this subject is why Mexico eventually granted union status to workers from one company.[50]

The second result has been "the creation of a labor communications superhighway" (in the words of Mary Jane Bolle) that connects the three NAFTA partners. "In its first three years, NAALC has fostered studies comparing the labor laws of the three countries, nurtured the development of a standardized system of labor market indicators, and been responsible for studies comparing productivity levels and wage rates."

Another positive but indirect impact of NAFTA and the NAALC is increased pressure on Mexico's trade unions. Most unions in Mexico are established by the state within the CTM, the Confederation of Mexican workers, and workers are employed only if they join these unions. Other independent unions have been forbidden. Recently, labor has begun to forge its own cross-border alliances, with support from unions and labor federations in Canada and the U.S. In the past, Mexicans resisted help from the North, and the North wasn't really interested either. Now, however, "the trade agreement had made clear not only to labor bureaucrats but to grass-roots unionists all across the continent how working together to improve wages and conditions in Mexico also would benefit workers north of the border by reducing the incentive for corporations to move factories south."[51]

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[49] Mary Jane Bolle, CRS Report for Congress 96-176-E (Updated 9 September 1997), pp. 8-9.
[50] Mary Jane Bolle, CRS Report for Congress 97-861-E (October 1997) Summary.
[51] Sam Dillon, "After 4 Years of Nafta, Labor Is Forging Cross-Border Ties," *New York Times* (20 December 1997).

There are, of course, many criticisms of the NAALC. A Canadian group argues that at best, the NAALC did little more than create an apparatus for holding public meetings, which are often ignored by employers since the law itself provides no means to punish abuses. The recommendation of "Ministerial consultations," a closed-door conference among government officials, is the strongest remedy offered workers under the NAALC, with no guarantee that any issue must be resolved.[52] Moreover, say other critics, when cases were "won" by Mexican workers, that meant holding a piece of paper in their hand that says you were right, but with no resulting reinstatement of workers — "not a single employer was sanctioned, no union ever recognized."[53]

Senator Richard Gephardt and many others say that NAFTA's environmental and labor provisions should be linked to provisions on investment and trade and be part of the core agreement rather than side agreements. Gephardt notes that Mexico already has a lot of the required laws within its constitution and, therefore, sees the problem more in Mexico's enforcement.[54] Moreover, countries have to enforce only their own laws. The NAALC cannot stop any government from changing its own labor law and driving down standards. In federal systems — like those of all three partners — the national government could sign the agreement and try to enforce it, but they could find that the final responsibility rests in the hands of states or provinces. "The extent of Canada's obligations are limited by its division of powers. While the federal government is the signatory, from a constitutional perspective, it cannot interfere in matters properly provincial. In the result, Canada is only a qualified signatory to the side accord applicable to as many of its provinces as possible and Canada is to set out in a separate declaration to the other Parties a list of any provinces for which Canada is to be bound."[55] (This is not likely, the authors remind us, at least in the U.S. and Canada, where the NAALC principles have long been part of "the fabric of federal and provincial labor and employment laws in Canada" and the U.S.).

More could be done, some lawyers suggest.[56] The Commission on Labor Cooperation could play a constructive role by encouraging cooperative activity among the three NAFTA partners on many policy issues. The U.S. NAO has sponsored Occupational Safety and Health Act training seminars in specific industries, set up training programs, and sponsored workshops. Even more usefully, it has pushed to harmonize statistics in NAFTA. "But more is possible, especially in the legal area, for it is abundantly clear that none of the three countries really understand the others' legal cultures. It would be unfortunate if these cooperative efforts were derailed because of

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[52] Common Frontiers, *Challenging 'Free Trade' in Canada: The Real Story* (Montreal, 1996)**;** as well as The Institute for Policy Studies, *NAFTA's first Two Years – The Myths and the Realities* (Washington, 1996).

[53] Terry Collingsworth, Counsel for the International Labor Rights Fund, which litigated the five Mexican cases before the Mexican NAO, quoted in Joel Millman, "Nafta's Do-Gooder Side Deals Disappoint," *Wall Street Journal* (15 October 1997).

[54] Richard Gephardt, "The Case Against Extending NAFTA Throughout Latin America," *The American Canada Watch* (August/September 1997).

[55] Fasken Martineau, *NAFTA Special Bulletin*, December 1993.

[56] Marshall J. Breger, "Hitting Mexican Industry with NAFTA Rules - U.S. labor unions are trying to turn the procedures established under NAFTA side agreement into a mechanism for halting job flight south of the border," *Legal Times* (14 November 1994).

a concerted effort to replay the NAFTA wars through the Commission on Labor Cooperation. The NAO report process was never meant to be a labor-rights court."

In the debate over fast track, the labor issue, which was never meant to be the center point of NAFTA, became explosive. On one side, emotions aroused by the possible impact of NAFTA on jobs and employment led to a focus on these issues as the major point of dispute and, therefore, as one major cause of the failure of NAFTA. Indeed, leading legislators urged President Clinton to abandon his quest for fast-track negotiating authority and instead launch a new campaign for international labor standards.[57]

On the other side, resistance to linking trade liberalization, labor, and environmental regulation has increased substantially. Many powerful interests in the United States and across the NAFTA partnership feel that this linkage is a recipe for disaster. The Republicans in Congress said that they would support fast track and the extension of NAFTA to Chile and through the Western Hemisphere only if the labor and environment side agreements were dropped.

[57] "Clinton told to back labor standards," *Journal of Commerce* (28 January 1998).

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