

Analyzing Economic Integration

David C. Ranney

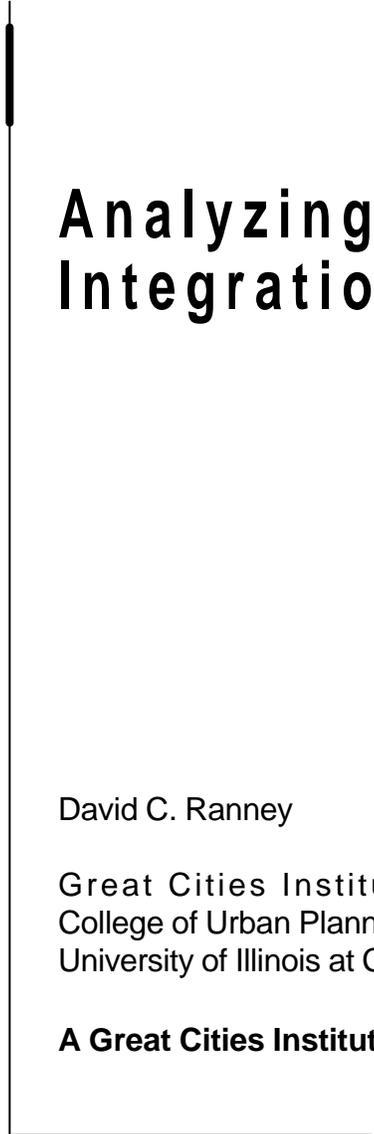
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Analyzing Economic Integration

Abstract

Analysis of economic integration should evaluate the dominant form of development which emphasizes growth through exports, high capital mobility, privatization, and governmental deregulation. This form of integration, termed neoliberalism, has its roots in the structural adjustment programs of the 1980's and has been generalized globally. Thus its impact should consider a period that includes at least the past decade. Because integration includes non-contiguous nations and supra-national corporations, units of analysis should be conceived as transnational spaces that include data from an appropriate configuration of nations and corporations.

There are many topics that should be included in a study of the impacts of neoliberalism. While the focus of this paper is on the study of trade, I argue that it is misleading to isolate trade analytically as many studies do. Trade should be considered in relation to capital flows, and impacts should include many variables that constitute the broad concept of social wage. It is also misleading to isolate the export side of the trade relation. The net impacts of exports and imports should be estimated. When imports are considered, some researchers have argued that negative impacts of imports are overstated unless one considers the extent to which they are product complements rather than substitutes. The paper cautions that models which are sensitive to elasticities of substitution should consider factors that could cause elasticities to vary over time. Furthermore, it is important to estimate opportunity costs of non-domestic product complements by considering potential benefits of import substitution. Finally the paper critically evaluates efforts in the U.S. to estimate export supported jobs and wages. I am specifically critical of some estimating methodologies and the tendency to view export growth rather than social wage as the policy goal.

Analyzing Economic Integration

Introduction

In studying economic integration it is important to be clear about exactly what it is we are studying. It is my view that what is often termed globalization or economic integration is best understood as a neoliberal approach to economic development which emphasizes growth through exports, high capital mobility, privatization, and governmental de-regulation including questions of labor and human rights and environmental standards. In addition, the impacts of this neoliberal approach to development are not limited to traditional economic categories such as growth rates or employment. These impacts include all aspects of the broader concept of social wage and include, in addition to growth and employment, wages and benefits; distribution of income and wealth; quality of housing and health care; food security; environmental quality; the basic rights of different segments of the population including labor, women, and various minority groups. Finally it is important to consider the extent to which institutionalization of neoliberal policies such as NAFTA and WTO lock nations into policies that have negative impacts on the above groups even when political regimes change. This conception of integration and its impacts have a number of analytical ramifications. I will explore in this paper those that relate to the time period to be analyzed, appropriate units for analysis, and how to study trade impacts.

Time Periods

Often the study of economic integration is hampered by an effort to isolate the impacts of particular agreements such as NAFTA. This is not only very difficult to do, it makes little analytical sense. Historically, the neoliberal approach to development has evolved out of global economic crisis that appeared as widespread stagflation in the 1970s and resulted in the collapse of the Bretton Woods Agreement.¹ This collapse created a void which neoliberalism quickly filled. An early effort to implement neoliberalism occurred in 1973 in the aftermath of the Chilean coup when General Pinochet invited University of Chicago economists into that country to reconstruct the economy on "free market" principles with the help of the General's army. Throughout the 1980s, global debt crisis enabled IMF and the World Bank to redirect their traditional mission to debt restructuring in return for the implementation of structural adjustment programs (SAPs) which facilitated global capital mobility, export-led growth strategies, privatization, and deregulation throughout the world. In this context, there was also the growth of export processing zones (EPZs) including the expansion of Mexico's maquiladora sector. The other end of these policies was massive deindustrialization in many developed countries throughout the 1980s. While often

characterized as a structural shift from manufacturing to service oriented economies, much of deindustrialization was associated with capital mobility made possible by the liberalization associated with SAPs and the growth of EPZs. In the City of Chicago, for example, there was a net loss of nearly 130,000 manufacturing jobs between 1979 and 1989. Over 60% of this loss involved firms whose corporate parents were expanding operations outside of the U.S.² As neoliberal policies became more widespread and politically acceptable through the SAPs, EPZs and the growing academic respectability of neoliberal theories, more coherent policy agreements were negotiated and implemented. In my own hemisphere this included the Free Trade Agreement between the U.S. and Canada (FTA) in 1988, the North American Free Trade Agreement (NAFTA) in 1993, the World Trade Organization (WTO) in 1994. Given this historical evolution, it is important to study the impacts of neoliberalism over a time span that includes at least the past decade.

Unit of Analysis

Another general analytical ramification of neoliberalism is the importance of identifying transnational spaces as units of analysis as opposed to limiting our work to a single nation or engaging in comparative national studies. I use the term "transnational space" instead of region because it may be desirable to utilize as a unit of analysis a group of nations which could not be easily defined as a region. For example, to understand the full impact of trade within the NAFTA area of Canada, U.S., and Mexico, it may be useful to include other nations with major trade relations with these nations (such as Japan) in the mix. Globalization is redefining meaningful units of analysis.

An analysis of a "transnational space," however, can be very difficult because of vast differences in data collection methods, conceptualizations and availability of comparable data across national borders. Also it is difficult because of different standards and programs that affect wages and benefits as well as other aspects of social wage.

How would it be possible, for example, to measure the impact of neoliberal policies over the past decade in a transnational space defined as Canada, the U.S. and Mexico? There are some areas where such a task is not difficult. If we are comparing *relative changes* in conditions over a ten year period, the fact that absolutes vary or are measured on differing bases would not create a problem. For example, we could measure changes in the distribution of wealth, income and poverty in each country over the ten year period. Then, we could try to do the same thing for all three countries together. We could also break that regional measure down on a national basis to measure inequality among nations. All of this would tell us three things that would shed light on impacts of neoliberalism: a) inequality within each nation; b) inequality among nations; c) inequality in the region as a whole.

Another way to study impacts in transnational spaces is to utilize case studies. I believe it would be useful to examine the activities of corporations that operate in all the nations in the space being analyzed. Case studies would look at these corporations over the past decade. The studies might examine the changing nature of the corporate activity including the products it makes, administrative structure, financial profiles, labor relations, wages paid in different places, employment. The cases would also attempt to assess the impact of corporate activity on living standards, political participation, and the environment. Another way to conduct such case studies would be to trace the impacts of a particular event such as a plant closing or plant location in one country throughout the transnational space. Such cases would allow us to see who is benefiting and who is bearing the costs of neoliberalism in practice. It would also enable us to trace class differences for the entire space as opposed to simply comparing national impacts.

The Study of Trade

My conception of neoliberalism and its impacts have implications for how we study trade. First of all, the analysis of trade should be subject to the analytical points raised above. A time period that captures institutional changes in trade relations needs to be determined. Secondly, an appropriate transnational space should be selected. On this second point, it is limiting to look solely at bi-lateral or even tri-lateral trade relations defined by an agreement such as NAFTA because that will miss the impact of imports and exports from nations outside of the formal trade agreement.

A further point is that many analysts try to isolate trade from other aspects of economic integration. This can be particularly distorting when the isolation of trade is accompanied by its consideration only in a bi-lateral relationship. That can tend to trivialize the importance of a policy such as NAFTA by arguing that impacts are minimal.³ Other studies that isolate the trade relationship do just the opposite; they point to the growth of trade or export supported jobs as evidence that a policy like NAFTA is working -- ignoring the actual impacts of trade in terms of employment, wages and benefits, income and wealth distribution, labor rights and environmental standards.⁴ In Mexico, for example, much of the demand for imports is unrelated to domestic demand; rather it is driven by the need for inputs for Mexico's exports.⁵ When considering trade in isolation from other considerations, one could conclude (as the above cited study does) that trade is stimulating exports, and end the story there. But such a conclusion leaves out the fact that imports of intermediate products are displacing domestic manufacture in Mexico. Counting only jobs stimulated by exports and looking at imports only as a means to more export activity distorts the total effect of trade.

The Importance of Imports

A number of analysts of NAFTA in the U.S. have not only isolated trade in the manner described above, they have also considered only the export side of the relationship. This practice ignores the extent to which benefits from exports are offset by losses from importing goods. Between 1991 and 1996 there has been a growing U.S. *trade deficit* (more imports than exports) with the rest of the world. The deficit has increased during this period from \$-67 billion to \$-188 billion. After the passage of NAFTA and the collapse of the Mexican economy, the U.S. has run a major trade deficit with Mexico. The U.S. merchandise trade deficit with Mexico between January and October, 1996 stood at \$ -14 billion. The U.S. is also running a deficit with Canada of nearly \$-23 billion.

Proponents of neoliberalism often ignore imports in their analysis. One reason for this lies in the assumptions behind their studies. Most of the studies either assume full employment or they assume that competitive labor markets will make the costs of displacement relatively small or transitory. Thus workers displaced by cheaper imports will only suffer temporary, "frictional" unemployment. Workers who suffer actual unemployment will, in theory, find another job in short order. Those who suffer a loss of wages when the new job pays less or who suffer wage loss due to employer threat to close down are considered to have been "overpaid." A recent report from First Chicago/NBD Bank asserts that global competition and deregulation have meant greater efficiencies through corporate layoffs and outsourcing.⁶ The report viewed layoffs and outsourcing as positive, assuming that workers would eventually find jobs at a more appropriate, "efficient" rate of pay. But if we are attempting to uncover the impacts of neoliberalism on working people rather than just firms, this one sided approach to the analysis of the trade relationship is not useful. In addition, rising productivity and stagnant wages in the U.S. suggests that wages are more a function of the relative power of capital and labor than greater "efficiency."

There is a similar problem with studies that have examined wage impacts of trade. A much cited U.S. government study by Lester Davis argues that over the long term, the primary benefit to U.S. workers of increasing exports is the growth in demand for higher skilled workers in jobs that pay higher wages.⁷ The theoretical rationale for this position is that the U.S. will export those goods in which the nation has a comparative advantage. To gain such an advantage, these goods will be produced competitively with high productivity and hence high wages. The Davis study and its updates claim that such benefits are already showing up. It is argued that 1994 hourly earnings of non-farm production workers in jobs supported by U.S. goods exports averaged 13-20% higher than the national average paid to all non-farm workers. Yet, a forthcoming study by the Economic Policy Institute (EPI) offers a critique of the use of industry wage averages to estimate export-related wages.⁸ EPI finds that while jobs and industries with a high share of exports do pay wages above the national average, so do jobs in import competing industries. Furthermore, an analysis of industries where import and export shares are growing rapidly yields a different result. Industries where the **import share** is expanding by more than 2% per year paid \$11.79 per hour compared to industries where the **export share** was growing by more than 2%, which paid only \$10.95 per hour. The growth of import and export shares may be more relevant to decisions about future trade policy than the levels of imports and exports, which may reflect the past effects of expanded trade.

These findings support the view that imports may depress wages in certain industries and occupations. Study of trade's wage impacts needs to consider the net effect of imports and exports as well as the threat of imports replacing jobs. Unions have complained that firms under competition from imports or who could easily produce in other countries with lower wages use that fact to bid down wages. A recent study of such "whipsaw bargaining" in the U.S. concluded that threats to close or move production were used in half of all campaigns by U.S. unions to organize. In manufacturing industries that face more import competition, "whipsaw" tactics were used in 64% of all cases.⁹

For all of these reasons, efforts to estimate the impact of trade on wages must consider the net impact -- wage gains in exporting industries minus wage losses in industries where imports dominate. It is also useful to analyze such net impacts in terms of export and import shares rather than levels. Finally the incidence and impact of "whipsaw bargaining" should be considered part of trade's impact on wages.

The Issue of Import Substitutability

Some research that does consider the impacts of imports makes a distinction between imports that are product complements and those that are product substitutes.¹⁰ The basic argument is that job displacement due to imports can be overestimated if one does not account for the extent to which imports are complementary to domestic production. For example, imports that are not close substitutes for domestic goods would be consumed by distinct market niches that complement the demand for domestic products. Other imports may be inputs into domestic production or their demand may simply reflect rising domestic demand without displacing domestic production.

Models that attempt to account for these possibilities estimate employment effects of trade by utilizing elasticities of substitution. The resulting estimates are highly sensitive to the elasticities. But the estimation of the elasticities themselves is very difficult and has a wide margin for error. One source of possible error concerns the possibility that elasticities of substitution may change -- particularly in the aftermath of trade policy changes. The estimates of NAFTA trade effects by Hinojosa et. al. assume that the elasticities are constant over time.¹¹ In fact they use elasticities estimated in 1988 to estimate employment impacts of NAFTA, thus ignoring the distinct possibility that NAFTA itself may stimulate a change in the elasticities.

Furthermore, the whole concept of substitutability ignores the likelihood that imports may have opportunity costs. If an import is an intermediary product for domestic production, for example, there is a possibility that the demand for intermediate products could better be satisfied domestically. In fact, it could be argued that importing intermediary products seriously impairs multiplier benefits of domestic production by limiting the stimulation of employment and wages from domestic supplier firms. Prior to the imposition of structural adjustment in Mexico in 1983, the domestic content of non-maquiladora production was more than 91%. At the time of NAFTA's passage it had declined to 50%. It is currently at about 40%. In the maquila sector it is only 22%; excluding labor the figure is only 1.45%.¹² The point is that estimating product substitutability and estimating employment impacts of imports based on elasticities of substitution ignores the potential benefits of import substitution.

When elasticities of substitutability are based on the notion that imports are simply satisfying rising domestic demand, there is a further problem. In addition to the opportunity cost of not satisfying domestic demand with domestic products, rising domestic demand

may reflect increasing income maldistribution resulting from neoliberal development. In this case, even if the elasticities are accurate, using them to estimate employment impacts of trade fails to consider the distribution of that impact. My research in the Chicago area illustrates the problem. It reveals that during the 1980's nearly 130,000 manufacturing jobs were lost in the City of Chicago and that 61% of this loss involved plant closings and major layoffs by corporations who were expanding operations in other countries. Other jobs went down due to import competition. And that job loss was replaced with jobs paying lower wages and with lower benefits.¹³ During the same period, however, wealthy people increased their already high incomes, causing incomes in the area to be redistributed upward. Increasing demand in domestic markets under these circumstances is in part a result of neoliberal policies that led to greater inequality. To say that imports which satisfied the rising domestic demand didn't cause the loss of jobs is true. But that ignores a significant part of the impact of neoliberal development policies in general.

Analytical Problems in Estimating Export Supported Jobs and Wages

Efforts to estimate trade related jobs and wages face yet another analytical problem related to using trade data aggregated into industry averages. Estimates of the number of jobs supported by exports in the Davis study include a calculation of the value of goods and services required to produce intermediate inputs for the exported product as well as capital goods and the goods and services required to get the final product to the point of transport (trade margins).¹⁴ In addition, the value added in the process of combining inputs into the final product is calculated. From these values, Davis subtracted the value of imported products to arrive at a *domestic content* estimate. Then, average employment-output ratios (the number of workers per \$ 1 billion of output) were calculated *for each industry* (ie. steel, chemicals, etc.). These ratios were then multiplied by the domestic content figures for each industry to arrive at the number of jobs supported by exports. The employment numbers were expressed in terms of full time equivalent (FTE) employment. This means that part time work was combined by using average hours into a fewer number of full time jobs.¹⁵

A common inference made from estimates using this methodology is that \$1 billion in exports account for approximately 15,000 jobs. Yet, the author of the government report is emphatic about the fact that *this is an improper use of his study*. To quote Lester Davis, "...the average number of jobs supported by exports, as presented in the main body of this report, should not be used to estimate marginal employment impacts from changes in exports."¹⁶ The reason is that the estimate of a ratio of jobs to exports is an average over a number of industries for a given year. Davis shows that the ratios vary considerably from one industry to the next and over time. Changes in inflation, productivity, the use of imports to produce the final product, and the composition of exports greatly effect the ratio. For this reason, numbers that use an average for a single period and across different industries can't be used for other periods, other industry compositions, or to predict changes in employment generated by a different set of exports.

I would also argue, however, that the methodology used in the Davis study makes *any* inference drawn from specific numbers suspect, and the problem gets worse when estimates are made of sub-national areas.¹⁷ The methodology uses output-to-employment ratios that are averaged by industry without accounting for the possibility of considerable variation of output employment ratios **among firms** within industries. An industry, as used in this study, includes a group of business establishments that produce related, yet very different products or services. Electronic and related equipment, for example, is an industry. It includes establishments that make electric transmission equipment, motors and generators, household appliances, electric lighting equipment, radios, TVs, stereos, telephones, electronic components and many other things.¹⁸ With establishments in a

particular industry producing so many different products, averages of the characteristics of establishments within an industry can obscure some important differences among them. In this case what may be obscured are differences in output-to-employment ratios.

To illustrate the problem, let us assume that in a particular region there are 100 establishments that make up a particular industry. Suppose that the industry produces \$ 2 billion in output (including the domestic content of intermediate inputs, capital and trade margins) using 30,000 full time equivalent (FTE) workers. Further, suppose that half of the output goes to exports. The methodology of the Davis study would conclude that the exports in this industry from the region support 15,000 FTE jobs. But what if the industry included 10 highly capital-intensive establishments that employ 100 workers each? These 10 establishments produce virtually all of the goods for export. Meanwhile, the other 90 establishments in the industry produce solely for the domestic market and employ the remaining 29,000 workers. In this example, the actual number of jobs supported by exports would be only 1,000. While the example is admittedly extreme, the point is that the methods used in the Davis study cannot account for variations in capital intensity within an industry. Nor can the methodology pinpoint any characteristics of establishments within exporting industries that don't export and distinguish them from those that do.

A further analytical problem has to do with the definition used for employment. The Davis study combines part time jobs into full time equivalents (FTE). The use of FTE means that two half time jobs is the equivalent of one full time job. Furthermore, no distinction is made in the Davis methodology between permanent and temporary jobs. In the U.S., part time workers presently constitute 16% of the workforce (23 million people). In some sectors (retail and service) they are over 30%.¹⁹ For the past 12 years, the temporary help industry has been growing on average, at five times the rate of growth of employment as a whole.²⁰ It now constitutes about 15% of the U.S. workforce and can account for 50% of job growth. These figures suggest that part time and temporary employment make up a significant proportion of the FTE export-supported jobs figures estimated by Davis and related studies. Research into the nature of part time and temporary work, moreover, suggests that from a qualitative perspective part time and/or temporary jobs are not the equivalent of full time permanent jobs. They pay lower wages and few provide benefits.²¹ The fact that export-supported job estimates contain part time and temporary work, limits the policy conclusions that can be drawn from the estimates of export supported employment. Furthermore, all of the arguments made above that questioned the validity of the export-supported jobs estimates apply equally to wages. The government estimates do not examine wages of workers producing goods for exports versus those who serve a domestic market. Rather they look at average wages in **industries** that are major exporters. The methodology cannot distinguish wages paid for exports from those paid to make goods for national consumption. Furthermore, higher wages found in industries that export could be due to higher rates of unionization, labor shortages in specific occupations, or higher productivity. The Davis study assumes that higher wages in particular industries are due to exports because exports are supposed to lead to higher wages. The study does not test this assumption by holding other potential wage factors constant.²² Thus the premise (exports lead to higher wages) is used as its own proof; a classic tautology.

Furthermore, the Davis study ignores an important trend that would support a contrary conclusion. As noted earlier, the theoretical justification for a link between exports and higher wages is that exporting firms must be competitive by achieving higher rates of productivity. This enables them to pay their workers higher wages. Yet, since 1989, the link between productivity and wages in the U.S. has not held. During that period, productivity increased by 21.8% while inflation adjusted wages increased by only 1.1%. This reflects a shift in the distribution of income between wages and

corporate profits which began shifting in favor of profits in 1984.²³

Conclusions

This brief overview of analytical issues in measuring the impacts of economic integration can be summarized as follows.

- Economic integration over the past decade has occurred within the context of a particular approach to economic development which I have termed neoliberalism. That approach emphasizes growth through exports, high capital mobility, privatization and governmental de-regulation. Research analyzing the impacts of a particular neoliberal policy such as NAFTA, therefore, should not confine itself to the period of NAFTA's existence. Rather the research should examine the evolution of the broader set of development policies of which NAFTA is a part and select a time period that captures that evolution.
- The nature of economic integration is such that confining an analysis to the borders of a nation or comparing national impacts is limiting and can be misleading. I have argued here to conceive of an appropriate transnational space as a unit of analysis that includes a group of nations that are integral to the economic integration being studied.
- Thirdly, I have argued that it is similarly limiting to attempt to isolate the impact of trade if the desire is to assess the impact of a development model of which trade is one part.
- When examining trade, moreover, it is misleading to isolate the impact of exports without considering the net of impact of both exports and imports. I demonstrate that imports do cause job loss and also depress wages in certain industries and occupations.
- Some research that attempts to account for the negative effects of imports distinguishes between imports that are product complements and those that are product substitutes. Such research contends that if you don't take product complements out of an analysis of the losses due to imports, the problem is over-stated. I have argued here that efforts to estimate this distinction have often failed to take account of the volatility of elasticities of substitution. Since models based on such elasticities are highly sensitive to their magnitude, the resulting impact estimates contain a serious source of error. Furthermore, the whole concept of substitutability ignores the likelihood that imports may have opportunity costs related to not producing the product or service locally. Furthermore, if an import is considered positive because it satisfies rising domestic demand, the analyst often ignores the possibility that such rising demand reflects increasing maldistribution of income brought about through the broader development policies associated with economic integration.
- This paper also points to a number of analytical problems that have arisen in efforts to estimate export supported jobs and wages.

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