The Free Trade Debate: A Left Keynesian Gaze

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I Introduction

Following the intense debate, and ultimate passage of the North American Free Agreement (NAFTA), it has now emerged that the question of globalized free trade has become one of the principle issues on the economic policy agenda. Rather than the closing shot in the trade debate, NAFTA therefore represents an opening shot which is likely to be followed by many further negotiations establishing an international trading structure for the twenty-first century. For this reason, debate over the consequences of free trade is more important than ever.

Yet even as the importance of such a debate becomes evident, the monolithic character of the trade establishment within orthodox economics has largely prevented such a debate from developing. In part, this can be attributed to the professionalization of economics which operates to exclude the voices of lay-persons, and also divides disciplines into fields in which only field experts are given voice. Since field experts tend to share common intellectual assumptions and perspectives, this inevitably serves to narrow the scope of debate. However, the narrowness of the free trade debate can also be interpreted as a reflection of the ideological character of orthodox trade theory, the basis of which is derived exclusively from laissez-faire microeconomic theory.

The monopolization of the free trade debate by orthodox trade theorists has had enormous ramifications for both public understanding of the economic consequences of global free trade, and for the construction of policy recommendations. This is because the models that underlie free trade prescriptions assume full employment, and characterize workers as being paid what they deserve (i.e workers are paid their marginal products). Such a construction contrasts with a left Keynesian view of the economy, in which unemployment is the rule, and in which wages depend on conditions of power as manifested in the wage bargain. Depending on which perspective is right, there are enormously different consequences to free trade. If the left Keynesian position is correct, reliance on orthodox analysis for guidance in the trade debate is likely to produce misguided and damaging policy. It is this concern that motivates the current paper.

II Characterizing the economy

We begin our analysis with a left Keynesian characterization of the economy which involves three axiomatic principles. These are:

(i) the level of employment and output (GNP) depends on the level of demand for goods and services. Shortages of demand will tend to lower output and employment: excesses of demand will tend to produce inflationary pressures on prices and wages.

(ii) the level of demand depends importantly on the distribution of income between wages and profits. High wages tend to stimulate demand because of their effect on the level of consumption. However, to the extent that higher wages reduce the profit rate, they can adversely affect investment spending, which then aggregate demand. If the former effect dominates, then higher wages are expansionary.

(iii) The distribution of income between wages and profits depends on bargaining bewtween workers and firms. Conflict is an essential part of this bargain, since at the firm level for given levels of productivity, increases in profits come largely at the expense of wages: the reverse holds for increases in wages. Moreover, the relative bargaining positions of workers and firms depends importantly on the state of the economy, with increases in the rate of unemployment serving to weaken worker power through "reserve army" effects. Worker power is also affected by the ease with which firms can replace existing workers, and by labor legislation providing benefits for workers and protection against employer sanctions and layoffs.

III A taxonomic framework for analysing free trade

An immediate difficulty in assessing the welfare effects of free trade reforms concerns the questions of (i) whose welfare, and (ii) trade reform with whom. Real world economies are constituted by heterogeneous agents, and economies also differ in their typologies. Together, these features compel a recognition of heterogeneity in any legitimate analysis of trade reform. The taxonomic structure suggested by a Post Keynesian gaze distinguishes

(a) wage income vs. profit income, and

(b) high wage\high employment economies (HH) vs. low wage\surplus labor economies (LL).

The significance of recognizing the distinction between wages and profits is that it deconstructs the myth of an automatic single national interest. Instead, the economy consists of a multitude of agents, the vast majority of whom rely exclusively on wages for their income. Contrastingly, profit income largely accrues to a small minority, who represent the wealthiest segment of society. Introducing this distinction, means that any welfare assessment of free trade must explicitly confront the issue of income distribution, and that any welfare conclusions are contingent on the interpretation placed on these distributional effects. For left Keynesians, given that wage income represents the only source of income for the vast majority of people, the welfare effects of free trade reforms can largely be analysed by reference to their impact on employment and wages.

This contrasts forcefully with orthodox trade analysis, which places little weight on the distinction between wage and profit income, and uses the device of a representative consumer to pretend that all persons are the same. Given this hypothetical representative consumer, the measure of trade reform becomes its effect on total national income. The argument is that if total national income is increased, then the representative consumer is better off, and consequently trade reform is beneficial. This difference in the criterion assessing trade reform is central to understanding the distinction between the left Keynesian gaze and the conventional gaze.

Just as there is heterogeneity within economies, so too there is heterogeneity across economies. This latter form of heterogeneity is also critical for assessing the impact of free trade reforms, because the effects of free trade depend importantly on the mix of economies being linked by the trade liberalization. From a left Keynesian gaze, it transpires that free trade is often best when conducted between countries that share common characteristics. This contrasts with orthodox analysis, where the greatest gains to trade arise when countries have the greatest dissimilarities. This difference in conclusion follows from differences in the criterion for assessing the welfare effects of trade reform, and from differences in interpretation regarding how the economy works and how it is impacted by free trade.

For left Keynesians, a minimalist taxonomy involves distinguishing between what may be termed "high wage\high employment (HH)" economies and "low wage\labor surplus economies (LL)". HH economies may be identified with economies belonging to the OECD, and are typified by the U.S economy: they are also sometimes referred to as the Northern economies in North-South discourse, or as the industrialized economies. LL economies may be identified with the less developed countries, which are identified as the Southern economies in North-South discourse. This taxonomy has features in common with the the distinction bewteen capital-abundant and capital-scarce economies which characterizes the orthodox trade literature. However, the capital-abundant\capital-scarce distinction is a narrowly constructed taxonomy: the HH\LL distinction is intended to be far more encompassing, capturing the notion that economies are social systems, and that multiple facets of these systems are relevant for understanding the imapct of trade liberalization.

Whereas othodox analysis focuses exclusively on relative endowments of capital and labor as the factor determining the pattern and impact of trade, the above suggested HH-LL taxonomy is intended to accomodate a range of socio-economic characteristics including firms' social security and health cost obligations, firms' rights to pollute and obligations to prevent pollution, employee protection laws, and worker safety laws. In general HH countries tend impose heavier obligations on firms, have stronger anti-pollution laws, and have stonger employee protection laws than do LL countries, reflecting the stronger position that workers in these countries have secured for themselves.

The critical economic import of these socio-economic characteristics is that they significantly alter the costs of production. Consequently, they change the international structure of private absolute and private comparative advantage. When there is free trade between HH and LL countries, these costs can determine the pattern of international production and trade. The welfare consequences of these effects, as seen from the left Keynesian gaze, are analysed below.

IV The impact of free trade

The previous section outlined the difficulties associated with making welfare assessments of free trade, and the necessity of analysing free trade reforms within a context recognizing structural difference across countries. This section uses the framework developed in sections II and III to analyse the potential impact of free trade reforms on the U.S. economy which is identified as an HH economy (the analysis is therefore also applicable to other countries which are also HH economies). All welfare assessments of free trade are therefore predicated on the vantage of an HH economy: the welfare effects of free trade on LL economies is another chapter. However, it is worth noting that LL countries may win or lose, and the change in their economic welfare depends on the specifics of their situation and the manner in which their welfare interest is defined.

From a U.S. perspective there are two types of reform. The first concerns trade liberalizations involving another HH country (designated HH-HH reforms): the second concerns trade liberalizations involving an LL economy (designated HH-LL reforms).

(1) HH-HH reforms:

This type of reform places countries with broadly similar socio-economic characteristics (i.e. employment conditions, social security laws, pollution rights, etc.) in a free trade relationship. The similarity of these characteristics is important, because it means that they are of reduced significance. This is because their impact on costs is broadly equal across countries, so that free trade confers no competitive advantage or disadvantage on either party.

At the level of individual goods markets, the abolition of tariffs and quotas lowers the price of imports: this is a source of increased well-being for all consumers, which includes wage-earners. The liberalization of domestic markets also serves to strengthen product market competition, which promotes lower prices and improved quality on domestically produced goods. This is another source of benefit, and to the extent that product mark-ups are driven down, it may increase the share of wages in output. This would then serve to increase demand, thereby stimulating employment and output. Finally, by creating a larger unified market, this allows for economies of scale and spreading of fixed costs: this generates lower prices, or can be used to support greater product variety (Krugman, 1979: 1980).

From a macroeconomic standpoint, the removal of foreign tariffs and protections increases the demand for exports. Since export demand is part of total demand, this stimulates employment and output, and strengthens the position of labor in the wage bargain. However, balancing this is the fact that the elimination of tariffs and quotas increases imports. Since imports represent a diminuition of demand for domestically produced output, this reduces employment and weakens the position of labor. The net effect on total demand therefore depends on the relative size of demand diversion into imports, compared to the creation of new export demand.

The extent of export demand creation depends importantly on the availability of international liquidity to finance expanded international trade. Without this liquidity, realizing the putative gains from free trade reform is problematic. However, HH countries tend to have access to international liquidity because of their good standing in international credit markets. As a result this does not appear to be a significant obstacle to an expansion of trade.

In sum, from a left Keynesian vantage, free trade liberalizations involving HH countries appear to carry significant benefits. Inevitably, there is some sectoral dislocation since enhanced product market competition leads to an elimination of inefficient domestic producers. This dislocation adversely impacts specific groups of workers, but for workers as a whole the liberalization appears beneficial. Prices and mark-ups are reduced so that the purchasing power of wages increases, while the easy availability of international liquidity means that financing an expansion of trade is unproblematic. The net result is likely to be an expansion of demand, employment, and output in the participating countries. It is this reasoning that leads one to conclude that had the acronym NAFTA stood for North Atlantic Free Trade Agreement, its passage would have been largely unopposed. Far from being protectionist, the left Keynesian gaze strongly advocates free trade between HH economies.

(2) HH-LL reforms:

Whereas HH-HH liberalizations are unproblematic, the left Keynesian perspective suggests the opposite for HH-LL liberalizations. Now the economies have radically different wage levels, capital:labor ratios, and socio-economic structures. This means that these factors no longer cancel out, and instead have significant effects on absolute and comparative costs. It is here that differences between the left Keynesian and orthodox visions become important and visible.

Once again, trade opens the possibility for both increased exports and increased imports, and the demand effects of this are potentially the same as in the case of the HH/HH trade liberalization. However, a significant difference from HH/HH trade liberalizations concerns differences in access to international liquidity. By and large HH economies have unlimited access to international liquidity, so that financing imports from LL countries is unproblematic. The same is not true of LL countries, whose low levels of wealth, high levels of debt, and generally lower standing within international financial markets, means that their ability to finance purchases from HH countries is highly problematic. Given this "finance" constraint, the positive demand effects of higher exports may be quite doubtful for the HH country. Instead, the export effect will likely be limited to the extent that the foreign exchange earnings of the LL country are recycled into foreign goods purchases.

The differences in capital:labor ratios will also set up incentives to re-allocate production. These effects are well recognized in the orthodox Hecksher-Ohlin model of international trade. This model predicts that there will be an incentive to transfer production of labor intensive goods to the LL country where wages are low, and to transfer production of capital intensive goods to HH countries where costs of capital are low. Of course, the model also assumes full employment so that there can be no unemployment as a result of the trade liberalization. However, even this orthodox model (Stolper-Samuelson, 1941), predicts that the share of output paid to labor will fall in the HH country, and the share of output paid to capital will rise. Consequently, from an income distributional standpoint, labor suffers in the HH country while capital gains.

Within the orthodox trade model wages are competitively established by reference to the technologically given marginal productivity of labor, and this process acts as a protection against exploitation of workers. However, for Post Keynesians wage determination represents the complex outcome of bargaining between workers and firms. In unionized industries the bargaining is explicit and visible: in non-unionized industries it is less visible owing to lack of formal processes. This bargain is framed by reference to firms' abilities to hire replacement workers at lower wages, balanced by the costs of firing existing workers, hiring and training new workers, and living with the consequences for worker morale and effort of being perceived as a harsh employer. It is in this dimension that the effects of HH/LL trade liberalizations may have their greatest impact, and it is this dimension that is completely absent in orthodox readings of trade reform.

The bargaining effects of HH/LL trade liberalizations work by raising the threat of employment termination. This is because costs of production are lower in LL countries owing to lower wages, and lower social overhead costs associated with environmental protection, worker safety, and social security. It is also true that LL workers tend to be less productive owing to differences in human capital, and differences in the extent of public "infrastructure" capital. However, these productivity differences are often more than offset by the extent of the wage and social overhead cost advantages, so that the net result is that the replacement threat of firms in HH economies is credibly enhanced by trade liberalizations with LL economies.

This worsening of labor's relative bargainning position in turn places downward pressure on wages. In a static economy this would ultimately show up in the form of lower wages: in a dynamic economy with real growth, this effect reveals itself through transition to a growth path with a reduced labor share. In a full employment world, this transition has distributional consequences, but no employment consequences: in a left Keynesian world it has both. On one hand the move to a lower wage path is bad for demand, and is "stagnationist": balancing this, the increase in the profit share is good for investment, and is "exhilarationist". If the former dominates, then the effect of the trade liberalization will be a relative reduction in demand which will be contractionary.

How real is this bargainning threat? There is certainly evidence that regional cost disparities have operated on worker-firm relations within the U.S.. Thus, within the U.S., one of the principal consequence of the 1970's oil shocks was to set up labor competition between the "sun" belt and the "rust" belt. This competition served to weaken the position of labor, and it is no accident that the lion's share of subsequent productivity growth has accrued to capital. Another recent (1993) example of such bargainning effects was in Connecticut, where United Technologies used the threat of moving production to Maine or Georgia as a means of getting both tax and union concessions. If such effects can operate within national economies, there is no reason to believe they won't operate between economies since international trade is just trade with the added feature of goods being transported across national boundaries.

From a welfare standpoint, not only do HH/LL liberalizations potentially disadvantage labor, they may also have adverse consequences for the socio-economic structure. This may be termed the "lowest common denominator" effect of free trade. Thus, to the extent that high costs of environmental pollution, worker safety standards, health care, or social security are seen as the cause of lost jobs or reduced wages, this will unleash political pressure to lower these politically determined costs. In this fashion, free trade can become a force for remodelling the socio-economic structure constructed over the course of the last seventy-five years.

(3) NAFTA

NAFTA represents a special example of an HH/LL liberalization. The above analysis therefore clearly applies to NAFTA. Thus, the import-export effects, the issue of a finance constraint on

Mexico, the threat of job replacement and a deterioration in labor's bargaining position, and the problem of differential social overhead costs are all present. However, there are some additional issues raised by Mexico's geographic contiguity to the U.S.. This is likely to strengthen the threat of job replacement since transportation costs from Mexican plants to the U.S. market will be smaller. Such costs represent an important source of protection to labor in HH countries, and the fact that these costs have been declining in recent years may partially help explain the deterioration in labor's position.

The contiguity of Mexico raises issues related to the nature of Mexico's demand for U.S. exports. The fact that Mexican incomes are so low means that it is unlikely that there will significant exports of consumption goods. Instead, for the forseeable future exports are likely to be made up of semi-finished goods shipped for finishing and re-export to the U.S., and capital goods. Semi-finished goods first show up as a U.S. export, and then show up as a U.S. import, so that they increase the volume of both U.S. exports and imports. However, to the extent that value is added in Mexico, they must ultimately give rise to a worsening of the trade balance since the value of the final import exceeds that of the initial export. More importantly, such semi-finished exports represent stripping out a stage of production (the finishing stage) from the U.S. economy, and a transfer of that stage to Mexico.

The export of capital goods also raises a number of issues. First, there is the question of Mexico's finance constraint, and whether Mexico will be able to secure the liquidity needed to finance such purchases. Second, there is the issue of investment diversion. Such diversion arises if exports of capital goods to Mexico are the result of substitution of investment in Mexico for investment in the U.S.. Thus, U.S. and foreign corporations may decide to build plants in Mexico to take advantage of the lower production costs, and correspondingly reduce investment in the U.S..

To the extent that this occurs, the gain in U.S. exports is offset by a decline in investment in the US.. Moreover, the U.S. loses the lasting benefits of job creation and permanently enhanced production capabilities that would have occurred in the absence of such diversion. This problem likely characterizes all HH/LL liberalizations, but the contiguity of Mexico will make it stronger in the case of NAFTA.

IV Conclusion: A left Keynesian trade policy for the U.S.

The above analysis of trade liberalizations indicates how their welfare effects depends on whether they are between HH countries, or whether they are between HH and LL countries. This contrasts with orthodox trade theory which makes makes no distinctions between liberalizations, and treats all liberalizations as unambiguously beneficial. Indeed, orthodox theory deems the greatest benefits come from liberalizations between HH and LL countries, where the difference in capital:labor ratios is greatest.

Given this left Keynesian analytic framework for evaluating the effects of free trade, what policy conclusions can be drawn for U.S. trade policy? The analysis would suggest the following:

(1) Free trade between HH countries which have similar wage levels and socio-economic structures is desirable.

(2) Free trade between HH and LL countries which have fundamentally different wage levels and socio-economic structures is problematic. Such trade requires case by case evaluation, according to the principles enumerated in (3) - (5) below.

(3) Where there are differences in technical ability to produce goods, trade should be free on the grounds of "technical efficiency". Thus, it makes no sense for the U.S. to produce coffee when climatic differences confer natural a technical advantage in the production of coffee on Latin

America. This is the traditional Ricardian theory of comparative advantage, which emphasizes differences in technology as the basis for trade.

(4) Where there are conditions of domestic monopoly, there should be free trade as a means of enforcing competitive behavior. In this case free trade serves to prevent domestic monopolists from earning monopoly profits at the expense of domestic consumers. The application of this principle is readily understood in terms of the history of the "Big Three" U.S. auto producers. Here, the introduction of free trade in autos has conferred billions of dollars of benefits for consumers by producing lower prices and improved quality.

(5) Where the only reason for trade is the low wage structure and absence of social overhead costs, then trade should be managed through imposition of a "social tariff" . The purpose of this tariff is to compensate for low wages and lack of committment to social goals regarding the environment, worker health and safety, and social security. Where countries meet these minimum standards, there should be no tariff: where they don't, the social tariff should be imposed. The revenues from this social tariff could be paid to the U.S. treasury, or alternatively they could be paid into a fund for distribution back to the developing countries. There are many ways in which this fund could work: revenues could be paid to the World Bank or some like organization; alternatively, revenues could be used to provide free export credits, thereby actually stimulating U.S. exports while furthering the development project in LL countries. Most importantly, the social tariff system provides a self-interest incentive for LL countries to improve wages and socio-economic structures by offering the prospect of unrestricted market access if they do. Efficiently correcting the foul inequalities of development has long been one of the most intransigent policy problems: the social tariff is a policy tool that offers a plausible and efficient means of doing so.

Underlying these principles of trade, is the fundamental notion that it is unacceptable for trade to be based exclusively on wage competition, and competition over social welfare standards. Thus, trade should not seve as a means of undermining the bargaining position of American labor in its wage bargain with capital, and nor should trade serve as a force for rolling back the laws and regulations regarding the environment, worker safety, and social security. The goal of international trade should be to export American prosperity, rather than import developing country poverty. This is the core moral principle guiding a left Keynesian gaze. It contrasts with the orthodox position, in which competition that sets foreign workers against domestic workers as a means of lowering domestic wages is deemed a good. This is because orthodox anlaysis assumes full employment, and assumes that workers get paid back by sharing in the higher profits. When the economy is equally owned by all, it doesn't matter whether one is paid in wages or though profits: however, when ownership is as radically skewed as it is, shifting income from wages to profits has enormous implications. Likewise, when there is full employment, shifting jobs overseas doesn't matter, for workers just find new and better jobs: however, when there is unemployment, this is not the case.

The deception in orthodox trade theory is that it begins with the persuasive Ricardian theory of trade based on differences in technical efficiency attributable to differences in climatic and natural resource endowments, but then ends up justifying trade on the basis of relative wage costs. Free trade between the developed and under-developed worlds therefore implicitly becomes a means of indirectly pitting workers in developing countries who have no protections or bargaining power against workers in developed countries, who have had the historical good fortune to establish a relatively strong bargaining position.

Economics is a contested social science, and there are few areas of widespread agreement. However, one such area is "the law of one price", which states that where commodities and services are traded in an open market there will be a tendency for similar commodities and sevices to trade at a single uniform price. Applied to free trade between the developed and under-developed world, it is labor that is implicitly being traded through its embodiment in imports, and the pressure for price equalization will be felt on wages, conditions of employment, and attitudes toward pollution in production.

Making the left Keynesian case for a sensible trade policy requires care. This is because left Keynesians recognize that not all free trade is the same, and there is a need to distinguish trade between developed (HH/HH trade) economies, and trade between developed and under-developed countries (HH/LL trade). This introduces an element of complexity, which places left Keynesians at a rhetorical disadvantage vis-a-vis orthodox free trade theory, which just asserts that all trade is the same and trade benefits all. Moreover, implementing a left Keynesian trade regime calls for intervention and judgement in the setting of industry (competitive vs. uncompetitive) and country (HH vs. LL) standards. This clearly opens possibilities for rent-seeking and the type of government failure identified by Krueger (1974). However, it would be a tragedy if such arguments were used to prevent the development of intelligent economic policy: rather, they should serve to make policy analysts aware of the sources of policy failure so that they can be guarded against.

How important is trade policy? For European economies with their larger involvement in trade (measured as a percentage of GNP) it is likely to be extremely important. What about the U.S.? Here trade is a much smaller share of GNP, and trade with LL countries a small part of that. Despite this, trade policy should still be considered an issue of enormous import. First, though trade may be small compared to the economy, leverage exerted at the margin can still have significant effects on distributional outcomes: it is the credible threat of movement rather than actual movement by companies that matters. Second, the deleterious economic effects of unbriddled international wage competition represent part of the general economic malaise that has afflicted U.S. economic performance. This malaise also partakes of domestic market forces that are difficult to counter, and every opportunity to reverse them should therefore be exploited. For this reason alone trade policy is important.

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| .It is noteworthy that the political debate over NAFTA was much more contested than the debate amongst economists. The latter was characterized by almost uniform support for the agreement. If the economist's principle of rational self-interest is to be believed, the extent of opposition to NAFTA should itself be sufficient to cast doubt on the benefit to the public weal of the agreement.

| .Gordon (1994) points out that there is often considerable slippage between economic theorizing and the formation of economic policy. Incorporating increasing returns to size within orthodox trade theory means that there is no longer a theoretical presumption in favor of free trade. A similar observation is made by Eatwell (1994). This objection to free trade is different from that associated with a left Keynesian gaze. However, what is interesting is that orthodox economists continue to unquestioningly promote free trade policy despite doubts about its benefits even within their own theoretical paradigm.

| .These conflicting tendencies of higher real wages are examined in Bhaduri and Marglin (1990).

| .If confronted by the fact that there are distinctions between wage and profit income, the response of orthodox economics is that in "theory" lump-sum redistributions can make everyone at least as well-off as they were before the reform: the fact that such redistributions are not possible in the "real world" is deemed of no consequence.

| .Broadly speaking, from a left Keynesian perspective, Americans stand to gain the most from trade with countries and groups such as the E.E.C.: for orthodox neo-classical trade theorists, Americans stand to gain the most from trade with such countries as India, Mexico, and the Phillipines.

| .Workers in industries with domestic monopoly power may suffer from such liberalizations, to the extent that they have been able to capture some of the monopoly rents earned by firms. However, since these high wages are derived from product market monopoly, they effectively come at the expense of all workers in the rest of the economy. This situation is illustrated by the U.S. auto and steel industries, where unions were able to extract high wages in the period to 1970 when international competition in these in industries was weak.

| .The normative criterion used to assess the welfare effects of trade reforms has been that of the well-being of workers. In some countries it is harder to talk about a representative worker. This is particularly true of countries with large agricultural sectors (such as France), in which case there may be a divide between the well-being of rural and urban workers. However, in the U.S., agricultural employment now represents a small fraction of total employment, so that this problem is not really salient.

| .Per orthodox trade theory these differences can also matter. Thus, production of goods that are pollution or safety intensive will be shifted to LL countries where the cost of pollution or safety is lower. Since there is also full employment, HH countries benefit additionally to the extent that the "bads" associated with pollution and personal injury are shifted to the LL country.

| .It is the tension between "exhilirationism" and "stagnationism" that prevents increases in wages from always being a sure means of expanding economic activity. At some point the adverse effect of wage increases on investment may come to dominate the positive effect on consumption spending.

| .Free trade is a natural complement to the huge U.S. national debt built up over the last decade. The debt has succeeded in hamstringing social policy, by leaving no revenues for expansion of social programs. However, it has not succeeded in creating a political directive to dismantle the existing socio-economic structure of employment: job loss and reduced wage shares caused by cost

disadvantage may. This socio-political dimension of free trade is evident in the NAFTA (see Grinspun, 1993).

| .The economic impacts of NAFTA are extensively explored in the Deccember 1993 issue of the Review of Radical Political Economics which was exclusively devoted to this subject. Koechlin (1993a) provides an overview of the debate. Stanford (1993) provides a simulation analysis of the wage and employment effects of NAFTA on the U.S., Canadian, and Mexican economies under a range of alternative assumptions regarding its impact on labor's bargaining power, and the level of trade creation. This simulation model incorporates the concerns with demand craetion, demand diversion, and income distribution that characterize the Post Keynesian approach to trade reform.

| .The welfare effects of HH/LL liberalizations for LL countries are not the clear-cut symmetric opposite of those for HH countries. In the case of NAFTA and Mexico, there is a division between urban and rural workers, so that the device of a representaive worker will not suffice for analysing NAFTA's welfare effects on Mexico. Urban workers potentially gain from NAFTA, while rural workers lose owing to the liberalization of trade in agricultural products. Moreover, even if there is an increases in urban sector jobs, this does not mean that urban sector wages will increase. Mexico is a labor surplus country with a rapidly growing workforce, and the loss of jobs in the agricultural sector will compound the problem of urban unemployment. The one clear group that wins is the oligarchy which owns Mexican industry. This illustrates the need to analyse trade liberalizations on a country by country basis.

| .This issue is emphasized by Koechlin (1993b).

| .Finally, one should add that the U.S. already enjoyed open access to the Mexican market as a result of the trade reforms already undertaken by the Mexican government. These reforms were not an act of charity or fair play, but rather reflected Mexican self-interest that can be understood in terms of the theory of effective protection. Mexican imports of U.S. goods tend to be semi-finished goods for re-export and capital goods. These goods represent inputs into the Mexican production system. By imposing tariffs, previous Mexican governments had raised Mexican costs of production, and harmed Mexico's international competitiveness. The elimination of tariffs on such inputs (but not consumption goods) therefore represented a move of enlightened self-interest by Mexico. However, it also means that NAFTA has conferred no additional competitive advantage on U.S. manufacturers. This suggests that any induced increase in U.S. capital goods exports to Mexico may well have a significant element of U.S. investment diversion.

| .Obviously, this raises questions of what these minimum standards should be. A suggestion for the wage standard might be 40% of the U.S. minimum wage, but this is obviously open to negotiation.