INCREASING EFFICIENCY AND ECONOMIC GROWTH THROUGH TRADE IN FINANCIAL SERVICES

HEARING

BEFORE THE

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OF THE

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INCREASING EFFICIENCY AND ECONOMIC GROWTH THROUGH TRADE IN FINANCIAL SERVICES

Tuesday, November 15, 2005

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY POLICY, TRADE, AND TECHNOLOGY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:04 p.m., in room 2128, Rayburn House Office Building, Hon. Deborah Pryce [chairwoman of the subcommittee] presiding.

Present: Representatives Pryce, Biggert, Manzullo, Kennedy, Neugebauer, Oxley, Waters, Crowley and Frank.

Chairwoman PRYCE. This hearing will come to order. I am very pleased to welcome all of you here today to this trade in financial services hearing. I would like to thank the witnesses for being here to discuss the importance of increasing efficiency and economic growth through trade.

This hearing will focus on the importance and benefits of expanding free trade in financial services, and I believe this hearing is quite timely in light of the upcoming trade talks in Hong Kong next month.

Just like manufactured goods and agricultural exports, the American financial services industry is fully dependent upon free and open international markets, and often faces unfair obstacles in its products and services. I look forward to hearing our witnesses assess the current state of financial trade and address ways to expand our exports and liberalize restrictive markets all across the globe.

Financial services chapters of free trade agreements seek to reduce or eliminate restrictions on the types of services financial services firms may provide, quantitative restrictions on the amount of products foreign firms may sell in the domestic market, and the restrictions on foreign direct investments. They also seek to enhance regulatory transparency and ensure that foreign firms are treated on an equal footing with domestic ones.

It is my hope that our witnesses from the Administration will address the status of the DOHA development round of negotiations in the World Trade Organization with respect to financial services, and especially the comments of Thursday, November 10, by Debbie Chio. Director General Lamy reported to WTO delegation heads that recent informal ministerial meetings were unsuccessful in reaching compromises on negotiations for trade barrier reductions. I would like to hear from our Administration witnesses, if they are able, that what, quote, trust deficit among negotiators exists, as Lamy noted.

U.S. financial services firms are among the most competitive in the world. As importantly, the entry of these firms into foreign markets will not only bolster economic activity and fuel job creation in those economies, but also help build new export markets. Because of the critical importance of financial services firms to the United States and to the globe, in both senses of economic growth, the subcommittee urges U.S. negotiators to ensure that the final DOHA services declaration does underscore the importance of eliminating barriers to the financial services sector.

I was pleased to read in Secretary Evans' testimony, and I see quoted in today's U.S. News bulletin, that he and I both agree: Increased liberalization in financial services trade also promotes economic development, capital formation, and regulatory transparency in developing countries. I commend the former Commerce Secretary for his role in promoting trade and support his claim that global development depends on financial freedom.

We welcome our witnesses here today, and I look forward to hearing your testimony.

I would now like to recognize my friend Barney Frank for an opening statement.

Mr. FRANK. Thank you, Madam Chairwoman. I apologize on behalf of the ranking member of this subcommittee, Representative Maloney of New York, who is ill. This is a subject in which she has a great deal of interest and is closely monitoring, and obviously regrets that she couldn't be here. And I should apologize because to some extent I am covering for her, but I have a schedule of other events as well, so I won't be able to stay throughout.

Two things I wanted to do. First of all, I am going to introduce one particular witness, if I can, Dr. Sydney Key, who will be testifying in the second panel. I should note that she is a former staff director of this subcommittee. When our side was in the Majority, I chaired this particular subcommittee, and I was very pleased that Dr. Key had agreed to come over and be the staff director for 2 years, and a lot of very important work got done with regard to the inspection panel at the World Bank and the increased transparency. So it is very good for us to welcome back an alumna of the subcommittee, and in that capacity she will be testifying.

I am also pleased to join in highlighting the importance of this issue. People elsewhere in the world ought to understand, obviously, that we have problems in the United States with not just the overall trade deficit, but the social consequences of that. There are problems that are caused in the United States by the terms of trade. There are areas where Americans used to work very hard where they don't work anymore because trade has shifted these jobs elsewhere. We can regret that, but there is not always a lot that we can do about it.

It is not in the interest of the world, it seems to me, for there to be more unhappiness in America about the terms of trade. We are talking today about an area where Americans can expect to do well, where we have significant advantage. People have said to us:

Well, you know, you can't expect to compete in these areas; you should compete in these other areas, these higher-end areas.

If Americans are denied the opportunity to pursue economic activity in these areas where we can do well, it will have negative consequences in terms of the attitude here. That is, the importance of the liberalization of trade in financial services is important not simply for itself, but for people who worry about attitudes in America towards globalization. It is a grave error, I think, for people to think that you can expect America to continue to support openness in those areas where we are probably in the short term going to lose economic activity and not give us the access where we can gain some. And, properly done, this is something that generates wealth for the United States and that generates jobs here. Financial services elsewhere represent economic opportunity here. So it is that particular context I want to add.

One other note. I was very glad in reading the testimony from the executive branch, from others, to note the absence of something, and that was any reference to the issue that we pursued elsewhere in our bilaterals of insisting that none of the countries we deal with have any controls whatsoever over the inflow of capital. I think the question of insisting on complete abolition of any restrictions on the inflow of capital, including efforts to try and discourage the inflow of short-term purely monetary investments, we have been pursuing that, I think it is a great mistake.

I am struck by the number of people who generally support free trade, Professor Bhagweti at Colombia, the International Monetary Fund and elsewhere, who think that it is unwise to couple support for free trade with an insistence on the complete absence under any circumstances of capital controls. And I am pleased to note that we are here talking about liberalization of trade in financial services without insisting on that. I think it is very important to note that distinction.

I would also add that, absence that, I think this becomes pretty noncontroversial in America. To the extent that our pushing for liberalization of trade in financial services gets linked to an insistence that no country be able to do anything about what they would consider an excessive volatility in the inflow of hot money, that would make something that can get broad support somewhat more controversial. So I am delighted that we have this in this form now, and in the form that this is, I think you will get a very united Congress pushing and strengthening the American position in these negotiations. And if we can ever resolve the foreign problem, we will get there.

I know that is not the subject, but I do have to note when I hear some of my colleagues who are the strongest proponents of free enterprise and no government subsidy and getting the government out of the economy and having people stand on their own two feet, when I then see their support for the American agricultural program, I am left to conclude that in all the great free market texts, Von Mises and Von Hayek, etc., there was a footnote that says none of this applies to agriculture, and it is apparently written in German, so I can't read it.

But I do wish you well in trying to bring some rationality to our awful agriculture policy. But on this, as it is presented, without the insistence on an abolition of total capital controls, I think we have a broad consensus.

Chairwoman PRYCE. I would like to recognize my colleague Ms. Biggert for an opening statement.

Mrs. BIGGERT. Thank you, Madam Chairwoman. And I would like to thank you for holding this hearing.

As we work to help jump-start U.S. exports, American businesses would do well to emulate the work of our financial services industry. Enjoying a $16 billion trade surplus, the U.S. financial services industry helps establish the economic infrastructure for other U.S. businesses to expand globally in developed and developing countries.

Opening the trade lanes is another way that we can facilitate global economic growth and reduce world poverty. Foreign borrowers will benefit from an increase in the number of domestic and foreign financial services providers, which will increase competition and provide capital to help entrepreneurs become self-sufficient and contribute to economic growth. More importantly, it is another way that can help shrink the U.S. trade deficit and help U.S. financial institutions expand, contribute to the U.S. economy, and create more U.S. jobs. No one stands to gain more from trade liberalization and financial services than do our U.S. firms. When markets are opened and barriers are down, America wins.

While many trade barriers have fallen during the past decade, there are more that need to fall. For the U.S. financial services sector to fully realize its potential at home and abroad, financial services laws, regulations, and standards need to be harmonized where underlying market conditions make this possible, although we need a better understanding of how prudent carve-outs can be implemented to supplement local market needs without undermining free trade in financial services opportunities.

In recent years we have held many hearings to examine efforts that are under way to harmonize financial services standards and regulations globally. This year I joined other members of this committee to meet our counterparts in the European Parliament to discuss these matters. While the financial services sector is making progress, these efforts too often are put on hold pending resolution of more controversial issues such as agriculture. During my first term in Congress, I attended the WTO ministerial meeting and witnessed firsthand the intensity of these negotiations once we got them out of lockdown in the hotel. So I know some discrepancies are more difficult than others to resolve.

That said, I am optimistic and anticipate that the DOHA round and other trade negotiations will reach a consensus on issues involving the nonfinancial services sector so that the financial services negotiations will have their day. And I expect that the U.S. position will prevail, and U.S. financial institutions will meet international standards that provide transparency and promise fluidity in business and market transactions, but that are cost-effective.

A global market that is a free market can only benefit all countries and people, but especially the United States. I look forward to hearing the testimony of today's witnesses on these matters and yield back.

Chairwoman PRYCE. Thank you.

I would like to recognize my colleague Mr. Crowley for an opening statement.

Mr. CROWLEY. Thank you. I want to thank Chairwoman Pryce for holding this hearing this afternoon on the important issues of breaking down global barriers in the realm of financial services. It is good to have the ranking member of the Full Committee, Mr. Frank, here as well, and my other colleagues.

Trade in financial services are an important issue for our country, and especially important for my home City of New York. The breaking down of global trade barriers in this sector will lead to massive economic growth and job creation both here in the United States and abroad. And this is an issue that I think Democrats and Republicans can and ought to agree upon.

Where we used to worry about New York losing jobs to New Jersey and North Carolina, now we have to worry about jobs and capital moving from New York to Brussels or Bangkok or Bangalore. Representing New York City makes me want to see the industry continue to flourish and keep my constituents working for many of the companies that do business in these fields. That is why I have tried to be active both on this committee and the International Relations Committee to open barriers to financial services firms in places like India, the world's largest democracy, and Vietnam, and other countries. And we have had some success, but more barriers need to be brought down. Additionally, I have championed bills and agreements that break down barriers and lead to more growth and jobs here in the United States and internationally.

Trade agreements, like the one with Australia, the fifth largest investor in the U.S. equity markets, means more jobs for my constituents and the companies of my city who trade securities or work for these firms. These trade agreements will keep our economy growing and will increase the investment and opportunities for our country.

I am interested to hear from our witnesses from the Trade Office, particularly, on the upcoming Hong Kong ministerial next month, and Ambassador Portman's recent trip to India, and I look forward to hearing our witnesses today. And, with that, I yield back the balance of my time.

Chairwoman PRYCE. I would like to welcome Representative Manzullo, and make note that, without objection, all Members' opening statements will be made a part of the record, anyone who comes in later.

I would like now to introduce our first panel. Clay Lowery serves as Assistant Secretary for International Affairs at the U.S. Department of the Treasury. Over the last year-and-a-half, Mr. Lowery served as the vice president of the Millennium Challenge Corporation and a member of its investment committee. Prior to serving on the MCC, he served as Deputy Assistant Secretary for Debt and Development Finance of the Treasury, and also worked as the National Security Council's Director of International Finance. Welcome.

And Christine Bliss is currently Acting Assistant U.S. Trade Representative for Services and Investment, responsible for overseeing all multilateral and bilateral services, negotiations, and policy issues. Ms. Bliss is the lead U.S. negotiator in the WTO services negotiations, and has negotiated the services and financial services chapter in the Morocco, CAFTA, and Bahrain free trade agreements. Welcome.

And we will begin with Mr. Lowery.

STATEMENT OF CLAY LOWERY, ASSISTANT SECRETARY OF INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. LOWERY. Chairwoman Pryce, Ranking Member Frank, and members of the subcommittee, thank you for inviting me to testify about trade in financial services.

As Secretary Snow has explained, the three goals of the Administration's international economic policy are to increase economic growth, promote global financial stability, and advance U.S. interests. In many respects, nothing embodies these goals more than our work to promote financial services liberalization in the WTO and in other fora.

The financial sector is the backbone of a modern economy, with virtually every sector of the economy depending on its services. Yet in developing countries, the financial sector is typically small and inefficient, and the barriers to financial services are still high. This means that entrepreneurs, small business owners, farmers, and other key drivers of employment and income creation either don't have access to capital, or, if they do, it is extremely expensive. As those barriers to financial services are lowered, competition should increase, and the benefits of a lower cost of capital and a better allocation of resources to more productive uses should accrue, particularly to those developing countries where the barriers are relatively high.

For instance, World Bank studies estimate that countries with open financial services sectors grow, on average, one percentage point faster than others, with the incremental growth rates being somewhat higher for developing countries.

The benefits of financial service liberalization extend beyond economic growth, however. Foreign participation in the financial sectors of developing countries brings in the strong new players that provide greater liquidity to the market, greater loss-absorption capabilities, and enhanced risk-management techniques.

The benefits of introducing global experience into the domestic market go far beyond their direct impact. There is a transfer of skills to local workers who go off to domestic firms where improvements in market practices are emulated, and a more competitive financial system also puts pressure on policymakers to make regulatory and supervisory structures more predictable and transparent, as well as to follow sound macroeconomic policies which are crucial to economic growth and financial stability.

In short, trade in financial services holds the promise of significant economic benefits for all countries, including the United States. As I am sure that some of the speakers in your next panel will highlight, the financial services sector plays an indispensable role in America's economy, providing individuals and businesses with depository services, credit, investment capital, and risk-transfer products, just to name a few areas.

Financial services represent over 8 percent of our economy, which is roughly 70 percent greater than it was 25 years ago, and it employs roughly 6 million individuals.

The WTO negotiations provide an opportunity to eliminate barriers in foreign markets to U.S. financial service firms, and improve the access of U.S. financial institutions to foreign markets. This helps our exporters continue to expand and develop new markets building upon U.S. competitive advantages in the provision of these services.

Given how important the opening of markets to financial services is to economic growth, financial stability, and our national interests, we have been disappointed in the progress that has been made in the WTO on financial services. At Treasury, we work very closely with our colleagues from USTR, Trade, and other agencies to heighten our engagement over the last year. In just the past few months, led by Secretary Snow and Deputy Secretary Kimmitt, Treasury has highlighted the development benefits of open financial sectors and encouraged WTO members to put forward high-quality offers in both multilateral fora, such as the G–20 and APEC, and through bilateral discussions in some of the most important developing countries, Brazil, China, India, and Korea, where Secretary Snow and Deputy Secretary Kimmitt have all traveled in the last few months. In fact, in each of the multilateral fora mentioned above, we have gained the endorsement for an ambitious DOHA round, but we will need to continue to push this issue and turn these words into concrete action.

We also need to recognize that we need to complement the WTO discussions by advancing the case and the cause of liberalization elsewhere. We do this through bilateral and regional free trade agreements, which my colleague from USTR can explain better, and through financial dialogues, which I will briefly point out.

For several years the Treasury Department and U.S. financial regulators have been conducting dialogues with our counterparts from a number of countries, Canada, Mexico, China, Japan, India, and the EU. These dialogues have three goals: one, promote a stronger global economy through sound regulation; two, encourage movement toward more competitive financial regimes; and, three, mitigate actual or potential cross-border friction in the financial services realm. In my written testimony I note some of the progress that we are making through these dialogues.

Finally, I would like to thank the Chairwoman and the committee for calling this timely hearing, and I would be happy to take any questions you may have.

[The prepared statement of Mr. Lowery can be found on page 144 of the appendix.]

Chairwoman PRYCE. Thank you very much.

Now we will hear from Ms. Bliss.

STATEMENT OF CHRISTINE BLISS, ACTING ASSISTANT U.S. TRADE REPRESENTATIVE FOR SERVICES AND INVESTMENT, OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

Ms. BLISS. Thank you. Chairwoman Pryce, Congressman Frank, Congressman Manzullo, and Congresswoman Biggert. The USTR appreciates the opportunity to appear before you today to describe our efforts to eliminate barriers to trade in financial services, particularly in the DOHA negotiations.

The services sector is the fastest-growing sector of the U.S. economy, accounting for 8 out of 10 U.S. jobs, and it also provides the brightest ray of hope for growth in developing economies, accounting for nearly 60 percent of GDP in such economies. An ever-expanding services sector is key to ensuring that this growth continues.

Now, you have heard from my colleague from Treasury about the important benefits of financial services liberalization both domestically and globally, and I would like to talk to you today about some of the ways in which we are going about and pursuing those benefits.

With respect to the WTO negotiations, while the United States remains committed to a high level of ambition in the DOHA round and to achieve a final package of substantial and meaningful results, we do not expect to achieve by the Hong Kong ministerial the complete framework that we had previously envisioned. Our aim nonetheless is to make as much progress as we can by the time of the ministerial so that we can achieve a final package in 2006.

We are seeking services market access commitments in key sectors providing meaningful new commercial opportunities for U.S. services suppliers, particularly in emerging markets such as Brazil, India, Malaysia, South Africa, Thailand, Indonesia, the Philippines, and Egypt, as well as several other countries. Financial services is at the top of the list of the key sectors that also includes telecommunications, energy services, express delivery, computer and related services, and distribution services. We are also seeking strengthened transparency disciplines for all services sectors.

Now, in return, developing countries have asked for expanded market access in areas such as tourism, medical services, and professional services. They have also asked for further liberalization regarding the temporary entry of service suppliers, expanded disciplines on domestic regulation, and some ASEAN countries have asked for rules establishing an emergency safeguard mechanism for services.

Some developing countries have also linked services liberalization to greater concessions in other areas of the DOHA negotiations, such as agriculture. And although we have been able to secure initial or revised offers from 69 out of the 148 WTO members, we still face a great challenge in terms of improving the quality of offers, particularly in financial services.

Now, since the WTO 1997 Financial Services Agreement, the United States has continued to secure meaningful financial services commitments through the WTO accession agreements, and I will highlight China and Saudi Arabia in that regard. And, in addition, we continue this effort through the ongoing accession negotiations with Russia, Ukraine, Vietnam, and other economies. We are seeking to build on these financial services commitments in the WTO services negotiations through the bilateral request/offer process by asking countries to provide commitments covering cross-border services for insurance, encompassing marine, aviation, transport reinsurance, brokerage, and auxiliary services; and for banking, securities, and all other financial services in areas such as financial information and advisory services.

With respect to commercial presence, we are including the right to establish new or to acquire existing companies in the form of wholly-owned subsidiaries, joint ventures, or branches. For both commercial presence and cross-border, we are seeking the removal of the discriminatory application of laws and regulations, and the removal of limitations such as monopolies, numerical quotas, and economic needs tests. And, finally, we are seeking transparency in the development and application of laws and regulations.

To amplify these bilateral efforts, we are working with a group of about 13 countries of varying levels of development, including the European Union, Canada, Japan, and Switzerland, who share our interest in financial services liberalization, and we have developed a set of general benchmarks for financial services liberalization through what is being termed in Geneva as a plurilateral approach. USTR and Treasury are working hand-in-hand along with other U.S. agencies to get financial service negotiators from key countries around the world more involved in the negotiations, through bilateral requests as well as possible plurilateral approaches. As my Treasury colleague has explained in his oral statement and also in his written statement, Treasury is also reaching out to finance ministers to highlight the DOHA services negotiations, including financial services.

Now, while we have secured some improvements in financial services in the offers submitted to date, there is considerable work ahead to bring the quality of those offers closer to our benchmarks. Why haven't we made more progress to date? There is no simple answer. Sometimes the problem is existing barriers; other times the country is liberalized, but has not yet bound that liberalization or offered to bind that liberalization. And even though we are proposing essentially the same market access benchmarks for each country, countries are at differing stages of liberalization, they have different views on the benefits of liberalization, and they often question the need to bind their liberalization.

Now, in addition, we hope that the United States' most recent WTO offer on agricultural liberalization will enhance our ability to press these countries to improve their offers not only in agriculture, but in the other DOHA core market access areas of nonagricultural market access and service.

Now, at the same time, the United States is also forging ahead to achieve a high level of financial services liberalization through regional and bilateral negotiations. The U.S. model FTA financial services chapter covers both investment and cross-border supply. It requires a negative listing for investment access, which means national treatment and other core obligations automatically apply unless the sector is carved out. It also includes strong disciplines on regulatory transparency, licensing, and other regulatory issues.

In addition to our existing FTA's that we previously negotiated, the Administration just announced the conclusion of the Oman FTA, which we expect to sign in mid-January. FTA negotiations are at an advanced stage with the Andeans currently, and that includes Colombia, Ecuador, and Peru. And we continue negotiations with the UAE, Panama, Thailand, as well as continuing our exploratory talks with the South African Customs Union countries of South Africa, Botswana, Lesotho, Namibia, and Swaziland.

Chairwoman PRYCE. Ms. Bliss, if I could interrupt. Your time has expired, and your whole statement will be included in the record, if your could summarize.

Ms. BLISS. Thank you very much. Just on that note, I would simply say that we wanted to highlight that our FTA negotiations have produced concrete benefits just as previously our multilateral negotiations have as well. So thank you for the opportunity to present this statement.

[The prepared statement of Ms. Bliss can be found on page 47 of the appendix.]

Chairwoman PRYCE. I would like to welcome Ms. Waters and Mr. Neugebauer, and our Full Committee Chairman, Mr. Oxley.

Mr. Chairman, would you like to make a statement?

The CHAIRMAN. Thank you very much, Madam Chairwoman. I am just going to ask unanimous consent that my statement be made part of the record, and welcome our friends from Treasury and USTR, as well as the private sector representatives who will be on the second panel.

I am looking forward to this hearing. Clearly, we thank you for your leadership on this important issue of financial services in the global economy and our trade relationships moving towards the DOHA round. And I yield back.

Chairwoman PRYCE. Thank you, Mr. Chairman.

Well, we will recognize all members for 5 minutes in which to ask questions and receive answers. And anybody who has further questions, we hope that we can submit those in writing to you.

I will just begin by asking, what is the Treasury doing outside of WTO to obtain staunch commitments from our trading partners? And what can this committee do to be of assistance, if anything?

Mr. LOWERY. Thank you, Madam Chairwoman.

Treasury actually over the last few months has very much picked up our pace. You and your colleagues had written a letter to the Secretary asking us to engage in a better way or a stronger way on financial services, and that is exactly what we have done. We have been able to work through the G–7, the G–20, the IMF, the World Bank, and the APEC Finance Minister's process to actually secure language to basically say that financial services are very important for DOHA, and we need an ambitious trade round in general and in financial services in particular.

The reason we have done this is because finance ministers sometimes only are paying partial attention to what is going on in trade rounds, and so we wanted to make sure the finance ministers are as engaged as their trade ministers are, and I think we have been able to do that.

In addition, Secretary Snow has just had recent trips to Brazil, India, and China, a couple of those trips right before Congressman Portman, Ambassador Portman, so as to basically talk to them about the importance of opening up their markets to our financial services firms.

In terms of what I think this committee can do, it is hard for me obviously to be too strong on this, but I think the main thing is three things. One is the language that comes out of this committee.

That is very important. Our trading partners do watch what you all say. Second is your votes. And third is, when you are traveling abroad, if there are things that we can do to help you, please let us know, because we think you are great ambassadors for the work we are trying to do. Thank you.

Chairwoman PRYCE. Ms. Bliss, do you have anything to add to that?

Ms. BLISS. Just very quickly. We—as I say, USTR works hand-in-hand with Treasury, and we think that the initiative that my colleague from Treasury just described is very important, because to be successful in the WTO, negotiations of services, we think it is critical that not only the trade ministries be involved, but the finance ministries as well. So we commend Treasury's efforts and think they are critical particularly to get financial services experts to actively participate in the negotiations. So thank you.

Chairwoman PRYCE. And can you elaborate on our main objectives in the DOHA/GATS negotiations? What precisely?

Ms. BLISS. Yes. Just quickly, our major objectives are twofold. And that is, really, our central objective relates to increased market access. And here we have focused broadly on service sectors, but we are highlighting key sectors, and those I have listed in my statement. Financial services is the first sector. But in addition, telecommunications, computer-related distribution, energy services, and express delivery. Because if you look at those core sectors, that is where U.S. services exporters and financial service exporters really have the greatest stake and potential in global markets. So we are focusing in those areas.

In addition, we are focusing on key emerging markets where we have a real stake in all of those sectors. And then, second, I would say we are also pursuing transparency disciplines which will enhance the market access commitments that we achieve in all of those sectors.

So, just quite quickly, those are our primary objectives in the services negotiations. And we think that the ability to expand our commitments beyond the Uruguay round will be of tremendous benefit both at home and also in the broader objective of promoting development in the DOHA round.

Chairwoman PRYCE. And by encouraging emerging and developing countries to liberalize their financial services sectors, do you have any feel for whether that would contribute to financial market instability? Either one of you?

Mr. LOWERY. Actually, we actually believe that the reverse will happen, which is that by bringing access of having experts and true strong financial firms, you will bring more liquidity, you will bring better risk management techniques, and will actually create less volatility in financial sectors around the world. There are actually some WTO and IMF and World Bank studies on this which actually show that most of the evidence suggests that opening up markets actually brings greater financial stability to countries.

Chairwoman PRYCE. Thank you both for being here, and I will now recognize Mr. Crowley.

Mr. CROWLEY. Thank you again. Thank you both for your testimony today.

Ms. Bliss, you mentioned Hong Kong ministerial on DOHA, and I know that Ambassador Portman is low on expectations in terms—in light of what you said, there has been a diminishment of expectations. But what—and less an expansive framework, I guess, is the expectation now. What does that entail? What does that actually mean for us?

Ms. BLISS. Thank you, Congressman. What I think Ambassador Portman has been trying to say is not that we have lowered our ambitions in any way or by the end of the day lowered our ambitions by the end of the round. It is just that what perhaps 6 months ago had been expected by Hong Kong in terms of an agreement on what are called the modalities or the frame—the negotiating frameworks for agriculture and NAMA, that more progress would be made by Hong Kong, so that then you could go immediately from Hong Kong into a very active, intensive, hands-on negotiating mode post-Hong Kong.

I think that is the level of—that is what has been ratcheted down a bit, realizing that probably won't happen by Hong Kong. But that doesn't mean that I think our expectation is that we aren't going to try and achieve that, but it may just happen earlier next year rather than by Hong Kong.

Mr. CROWLEY. Any idea when? I mean, these negotiations have been going on for some time now. Any idea when this might come to?

Ms. BLISS. Well, I don't think there has been any definitive decision made, but I would imagine there would be interest in having some kind of follow-up fairly quickly, early next year, to the Hong Kong meeting, with the hope that we could still finish by the end of 2006.

Mr. CROWLEY. I know Ambassador Portman was in India; I was reading about his trip, and USTR's general support for the expansion of mode 4 commitments. As you know, mode 4 relates to the temporary movement of business persons to another country in order to perform a service on site. This has been a critical and crucial issue for U.S. businesses in the developing world. What specific set of proposals has USTR made during the WTO services negotiations on that issue?

Ms. BLISS. We have been very clear that we have been mindful of the sensitivities in the Congress to this issue. So we have, certainly since I have been involved in the services negotiations, been very careful not to advance any forward-leaning proposals with respect to mode 4 in the services negotiations. So we as the United States are not making any offers with respect to temporary entry. We certainly listen to the requests that are made of us by other countries, but we have not advanced any proposals on temp entry and are not at this time in the negotiations.

Mr. CROWLEY. I will follow up in writing maybe a little bit more on that issue, because I know I have a short time.

Again, I know that Ambassador Portman has been to India, as I mentioned. I am a former co-chair of the India Caucus myself and have taken a great deal of interest in the potential and actual expansion of economic ties between the United States and India, understanding that a great deal has been done to break down some of the barriers as pertains to the financial services sector within

India that U.S. firms have been able to break through into the Indian commercial market. But I do know that there are still some barriers in terms of ownership of entities, U.S. corporations within India, a cap of 26 percent for most financial services, if not for all. Has there been any progress made towards expanding opportunity for ownership or percentage of ownership of American firms in India?

Ms. BLISS. The Indian—what I can tell you in terms of our bilateral discussions, and that is one of our—I would say our key issues that we are pressing India for in the negotiations; that India has expressed some willingness to raise that number. But, in our minds, it is still not sufficient, and they have not yet offered to bind a greater opening that would be far beyond the current level. It would be over 70 percent at least, I think, that we are seeking. But I cannot report to you as yet that the Indians have expressed a willingness to offer to bind at level. So it is something we are still pressing very hard on.

Mr. CROWLEY. It has been my experience that over 70 percent might be a pipe dream, at least for the short haul. And I don't know if necessarily that is a more realistic position to take. Quite frankly, the number I have been hearing is no more than 49; maybe you might get to 51.

But anyway, I appreciate it. My time is running out. I appreciate your both being here. With that, I yield back.

Chairwoman PRYCE. Thank you.

I would now recognize Chairman Oxley.

The CHAIRMAN. Thank you, Chairwoman Pryce.

First of all, let me ask Ms. Bliss, nontariff barriers, where are we in negotiation with other countries on nontariff barriers? Many times we hear complaints from the services sector, particularly the financial services sector, that in many ways nontariff barriers are much more pernicious than actual tariffs themselves. Where are we in those negotiations, and what progress are we making?

Ms. BLISS. Well, let me take that question in a couple of parts. In terms of what we are trying to pursue in the WTO, let me say with respect to financial services, we are very actively pursuing the removal of services barriers. And I think to translate the term nontariff barriers in a services context, that would be removal of, for example, commercial presence requirements to supply services cross-border. So that is one of our chief goals in terms of allowing cross border-supply, whether it be in insurance or in banking, securities.

And then with respect to mode 3, we are pursuing the freedom to establish with respect to legal forum whether it be in the form of a wholly-owned subsidiary or a branch, and to eliminate foreign equity restrictions. And so those are sort of general goals that we are seeking in the area of financial services.

Let me turn briefly to our FTA's, because we are pursuing liberalization on a negative list basis in the services context. We are very actively seeking the removal of barriers to services through the application of our national treatment requirement to eliminate discrimination, the market access obligation that goes directly to things like limiting the numbers of suppliers or any kind of quota that is put on, monopolies, economic needs tests. Then, in addition, we are also in the financial services context also able to secure disciplines with respect to the introduction of new products, which is a very useful element and can help circumvent the erection of regulatory barriers to the—for example, in the insurance sector.

So I think—and then also let me mention in our accession, our WTO accession negotiations, I think we have made some real progress, perhaps Saudi Arabia being the most recent example of that, of where we have been able to secure very meaningful bilateral and multilateral commitments to eliminate barriers to services and financial services. For example, in Saudi Arabia we got quite a meaningful branching commitment in the insurance area.

So I think in all of those areas we have made progress through our FTA's. We are making progress through our WTO accession negotiations, and we also have the promise of great progress in terms of the WTO services negotiations.

The CHAIRMAN. Is it easier in that sense to negotiate bilateral FTA's than it is in the overall scheme of trying to do it within the DOHA round?

Ms. BLISS. I suppose in terms of resources you could argue that, yes, it is. In terms of the overall trading system, while I think that bilateral agreements have great value, I think in the long term that it is also worthwhile to extend those disciplines that we have negotiated bilaterally to a multilateral context, and I think the whole system benefits as a result.

So I suppose you could say, yes, it is somewhat easier or more manageable to go country by country, but I think so far we have tried to sort of balance doing both simultaneously, and I think so far we have been able to have some synergy between the two processes that we are benefiting from.

The CHAIRMAN. One final question on services. What major countries have not made an offer on services yet? And what is your guess as to why those offers have not been forthcoming?

Ms. BLISS. Well, in terms of the markets where we would have the greatest interest, I think the primary offender in that would be South Africa. And I am not sure I have a good answer for you, except that what they have told us is: one, lack of resources; and two, lack of coordination in their capital. And I can't speak to the political aspects that may be involved there, but that has been a source of great frustration to us. And I would say South Africa in terms of market significance is probably the worst offender.

The Asian countries have been slow, but they have—the markets that we care about the most there, for example, Malaysia, Thailand, the Philippines, all have finally submitted offers. Now, they are not sufficient, but they have submitted offers. So that is encouraging. But I would say the outliers at the point, South Africa is the most concern.

The CHAIRMAN. Thank you. And pass on our best wishes to your new boss, and tell him that he has a lot of support up here on Capitol Hill, particularly from the Ohio delegation.

I yield back.

Chairwoman PRYCE. You have that right, Mr. Chairman.

Ms. Waters is recognized.

Ms. WATERS. Thank you very much, Madam Chairwoman.

I have always had some concerns about global trade and concerns about WTO, but on these financial services negotiations, I am concerned about our neighbors in the Caribbean, for example, the Bahamas and some of those areas. The financial services sector really is one of the biggest underpinnings of those societies. They have tourism, and they have banking. So what happens when they have to compete with the G–8's or the G–7's in this competition for financial services? What will happen to those smaller Caribbean countries?

Ms. BLISS. Let me just say something briefly, and then if my colleague from Treasury would want to say something as well. What I am—taking the Bahamas as an example. The way that the GATS works in the negotiations is that the countries are free to pick those subsectors and sectors in which they are able to make commitments and want to make commitments. And one of the things that we have made very clear, particularly when we are in discussions with the Caribbean nations or with the African nations that are perhaps not on the higher end of the developing countries scale, is that countries should look to those to make commitments in areas that are going to be of the greatest benefit of their economies and that will promote economic development.

So for the Bahamas in particular, in the banking sector, what we would say to them generally is look in the banking sector in areas where opening and encouraging investment, which is what making commitments can do, to draw more investment to a country, will it be of benefit to you. But they are certainly not required to make commitments in every subsector or sectors in which they are particularly sensitive.

And with respect to tourism, I think the idea there is that, again, opening up and making commitments in the area of tourism, to the contrary, rather than hurting an economy, should help it, because, again, it is drawing more investment, it is creating more jobs, it is creating more opportunities.

Ms. WATERS. What did you mean when you talked about eliminating foreign equity restrictions?

Ms. BLISS. Eliminating foreign equity restrictions in terms of countries that have capped the level of foreign investment, whether it is requiring investment only through joint ventures or saying that foreign equity can't exceed "X" percent when an investment is made through a subsidiary or an acquisition of an existing company. What we are trying to do is to get those kinds of limitations reduced or eliminated.

Ms. WATERS. Well, let me just say this: I have been involved over the years with what happened in the Eastern Caribbean on the banana trade, and little countries like Grenada literally just went belly up because they had to depend on the banana. That is really all they had. And the relationship that they had with the European Union helped them to be able to sell that banana on the European markets. But we, we took those countries to the WTO and challenged that relationship because of Chiquita bananas, and it just caused havoc in those little countries, and particularly, again, Grenada.

And I was also in St. Kitts, and, of course, they can't compete with sugar. Again, they depended a lot, and then they have all been trying to find other ways by which to support those economies. And I just worry that we have nothing in our negotiations with WTO to talk about what we do in these special cases, whether it is the banana or sugar or the financial services industry. We all know that—I mean, right or wrong, some of these places in the Bahamas have been tax shelters; that is how they made their money for years. But we have nothing in negotiations to talk about how we allow them to protect themselves. And to tell you the truth, I believe very strongly in joint ventures in equity. I believe that is how you grow your economies. That is how you hold onto some ownership. That is how you expand. And I would expect them to stand up for their right to have equity and to maintain ownership. So what do you say about that?

Well, my time is over, but that is my question.

Chairwoman PRYCE. And you can get back to Ms. Waters, if you would like to.

Ms. WATERS. Thank you.

Chairwoman PRYCE. Thank you very much.

Ms. Biggert.

Mrs. BIGGERT. Thank you.

Mr. Assistant Secretary, does the U.S. Treasury have the resources to pursue financial services liberalization?

Mr. LOWERY. Thank you. I guess it would be—resources are always tight, but we dedicate, we dedicate significant resources to these trade liberalization negotiations. We have offices that work on this. Obviously, something that has been very helpful to us, and we are working with some folks in Congress about this, are having attache positions. We have an attache currently in Japan which has been very helpful to us in our financial sector dialogue in Japan. We are opening up one in China, and we are trying to get somebody into the EU, and we would actually hope to even expand to maybe places like India, because this is something that we have seen as something that could be very helpful to us.

So it is kind of a mix. We feel like we have scarce resources that we can do our jobs, but with more resources obviously we can do it in a more effective way.

Mrs. BIGGERT. I guess that is kind of coming up in the appropriations soon. So you are not sure yet whether—

Mr. LOWERY. That is my understanding.

Mrs. BIGGERT. Okay. And, Ms. Bliss, about regulation. I guess we have some testimony today that highlighted the importance of increased regulatory transparency in the service sectors. The issues seem very basic and straightforward, and yet I understand that they are controversial. Is it true that a number of countries view these transparency proposals as an effort by the United States to export its standards, put those standards on other countries?

Ms. BLISS. Well, I think, you know, in presenting the U.S. horizontal transparency proposal in the GATS negotiations, a number of countries have raised the question, "Are you trying to insist that your Administrative Procedure Act be transferred to other countries' domestic legal systems?" And our response to that is no. I mean, we think that we do have a very superior model in the APA and how it works, but we recognize that there are different ways that countries can implement those essential elements of prior notice and comment and the other aspects of transparency.

So I think I can fairly say that we have and are continuing a dialogue to convince countries that, no, we are not just trying to rubber-stamp our practices on other countries. It is the core principles that we are trying to embed in a horizontal fashion.

Mrs. BIGGERT. How do you do this dialogue? Is this just in various meetings? Of course, maybe the rounds, but in other meetings, too, is this a discussion?

Ms. BLISS. Well, there are several venues. One is that the United States did table a formal transparency proposal in the main negotiating body, which is the Committee on Trade and Services special session, which is the overall body that coordinates the negotiations. So it would be in that formal body we have that discussion with all members present. Then in addition there is a Working Party on Domestic Regulation that is a subcommittee, and we also have continuing discussions in that working party with members. And then, in addition, in our bilateral negotiations we also pursue discussions on transparency, and I should add, in particular, on financial services.

Mrs. BIGGERT. Let me just come back to the Assistant Secretary—how do you get the word out, or how do you do negotiations? Is this just when you go to formal negotiations for trade, or is it in other contexts where you are out and about in foreign countries?

Mr. LOWERY. It is through a variety of mechanisms. And to build on what Ms. Bliss said, through some of the financial dialogues that we have with countries, Treasury, in many respects, is bringing together all the different regulators, OCC, the Fed, FDIC, to talk them through the regulatory transparency and supervisory standards with these countries around the world. Some of these are developing countries, some of them are developed countries, and so we are trying to carry the dialogue through a variety of mechanisms.

In addition, we actually have some technical assistance vehicles that we use to try to help countries to understand regulatory systems better because these are very important to their own financial systems as well as to something like the WTO round.

Mrs. BIGGERT. Thank you. I have one minute here.

I want to talk just a little bit about the travel visas, some of the countries, like India and Brazil, want to see that there are more of them so that their businesses can visit—their business members can visit the United States. When they do a transaction.

Do you see any change in the type of visas that will be available? Or do you push for that?

Ms. BLISS. What the Indians have indicated that they would like to see as a result of these negotiations are principally more uses for what they call contract service suppliers, which means that a service supplier comes to the United States, but it is being paid and has a contract with an employer outside of the United States. Also, for independent professionals that may come here to do work with or without a contract. They are particularly interested in seeing this in certain professional services, like engineering, just as an example. They are also interested in seeing a tie between that and what we do in domestic regulation on things like educational and professional qualifications. The Indians have not changed their position; they are very tough in insisting on that. And as I said, we have not made any sort of response or indicated any willingness to make an offer on that.

But to answer your question, that is what the Indians are seeking. And to date, we have not made any sort of response. Other countries have. A number of other developing countries have included some form of contractual service supplier in their offers.

Mrs. BIGGERT. Okay, thank you.

Chairwoman PRYCE. Mr. Manzullo.

Mr. MANZULLO. Thank you very much.

I read an article several years ago by a young man by the name of Bob Vasteen, a friend of the Cato Magazine—Bob is chucking back there—that talked about financial services as paving the way for merchandise with regard to exports. And this is more of a comment than a question, but I am very, very much disturbed over the fact that our government is placing severe restrictions on people coming to this country for the purposes of buying equipment. And it also involves tourism.

I was at the massive fabricators machine tool show and welding machine tool show in Chicago yesterday. I spend about 75 percent of my time in Congress working on manufacturing issues. And the host group, the Fabricators Manufacture Association, which is headquartered in Rockford, Illinois, was commenting on the fact that several Chinese who wanted to come to the United States and buy our equipment couldn't make it, they just couldn't get the visas. That also applied to a couple of booths that the Chinese wanted to set up with regard to their own equipment. And we had a particular situation in our area, Ingersol Milling Machines was on its death throes before it filed bankruptcy, and we desperately tried to bring over six Chinese engineers who wanted to buy an uncontrolled machine. And even though we have run into some really great people working in our government, and even though the Small Business Committee, which I chair, actually brokered a multi-visit yearly visa with China with regard to an MOU, I am just very much disturbed over the fact that we are losing conventions, and the United States is being looked upon as an unreliable supplier. And this has not been addressed adequately by the Administration.

Unfortunately, everybody thinks that if you are Chinese, you are a terrorist. And we continue to carp and complain about the trade deficit, and yet we have incredible opportunities to sell equipment to the Chinese and we can't get the people here. And I just don't know why this is not a priority. We have had several hearings on it, we have got another hearing going this week involving the Canadian passport issue, we are going to make it more difficult for Canadians to come into this country in order to buy our stuff.

And I think when we talk about tourism, which is obviously a service, we talk about opening our borders in negotiations. Why isn't this negotiated in terms of—at your level, or even made part of the conversation? Or perhaps it is. It is a question, if you want to bite at it.

Ms. BLISS. Well, let me just respond very briefly, and that is certainly the topic of the temporary entry of natural persons is what within the ambit of what is covered in GATS, but as I said previously, we have been very careful to be mindful of the sensitivities in Congress on the issue. So we have not made any proposals in the negotiations on it, but as I mentioned, there are other countries, developed countries in particular, that have included improvements in their GATS schedules in the area of visas and temp entry. But it is just that we, because of Congressional sensitivity, have not, have refrained.

Mr. MANZULLO. There is sensitivity on this part. We are losing our manufacturing base. In fact, the opening statement—I believe in your statement, Ms. Bliss, you said that the service sector is the fastest growing sector of the U.S. economy, accounting for 8 out of 10 U.S. jobs. I wouldn't be proud of that statement. I mean, these are people that used to work in manufacturing, we have lost 15,000 manufacturing jobs in Rockford, Illinois, and they have been replaced by many service jobs in the actual—and the average wage income of the American worker is going down. We are just not—we are missing something really big here, and that is, the United States has the biggest problem of all the countries in bringing people here to buy our stuff. And no one seems to be able to put their arms around this thing. And I appreciate, because of Congressional sensitivities, well, I am sensitive the other way, can you help me?

Chairwoman PRYCE. The gentleman's time is expired. Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Madam Chairwoman.

The first question I have for Mr. Lowery is what are the things that the Treasury is actually doing as far as trying to expand its services, I mean, what specific things are you involved in?

Mr. LOWERY. Treasury is involved in, through various means, to try to expand services, first, through what I guess would best be called rhetoric, which is to get commitments and endorsements from multilateral fora where we are meeting with our finance ministry colleagues.

Second is through our bilateral diplomacy—Secretary Snow has been travelling extensively—throughout Europe, Asia and South America to actually work with the countries on opening up their markets.

And thirdly is through the actual negotiations themselves, and that is the Free Trade Agreement negotiations as well as the WTO negotiations. And as Ms. Bliss pointed out earlier in her Q&A period, we have actually been able to make some very significant progress for our financial firms in the FTA's, and we are hoping we can make the same type of leaps forward in the WTO.

Mr. NEUGEBAUER. Thank you. Ms. Bliss, there is a lot of discussion these days about the deficit, in fact, we got some bad news last month. I think the deficit was at an all-time high. And then that conversation turns to China. A couple of questions there: One, do you think we focus too much on trade with China? And two, what are some of the bright spots in our trade negotiations that are going on that would lead us to believe that we are moving towards things that would help us reduce that deficit?

Ms. BLISS. Thank you. With respect to China, you know, I think we—certainly Ambassador Portman agrees that it is very important to keep the pressure on China, both in terms of implementing its existing WTO commitments and also pressing it in the GATS negotiations to improve those commitments.

For example, in terms of insurance and China's existing commitments, we certainly have been pressing China to reduce its capital requirements and to expand branching rights. And I think we have met with some success along those lines and made some progress.

In terms of the GATS negotiations, we are pushing China so that life insurers will have the right to establish wholly-owned subs or to branch into similarly-owned securities. We are also trying to pursue the right to establish wholly-owned subs and to remove the restrictions on the scope of activities that securities firms can engage in. So we see those as very important, and don't think there should be any emphasis taken off that effort.

In terms of where there are some bright spots? I think there are some bright spots. And I think that the FTA, just because the time frames are shorter and we are able to produce results, having concluded those negotiations, I think if you look at what we achieved, for example, in CAFTA, Morocco, some of the earlier negotiations, we were able to achieve, for example, in the insurance sector branching rights which didn't exist before. In the very concrete example of Costa Rica, Costa Rica agreed to a phase out of its insurance monopoly, which I think in the beginning of negotiations, we were very doubtful as to how much we can do, but I think that that was a significant achievement and the creation of new business opportunities.

Some of the smaller, but nonetheless important, negotiations, the FTA's in Oman and Bahrain, for example, we have been able to negotiate very clean commitments, particularly in the insurance sector and those areas, with very few carve outs either by the Omanis or Bahrainis. So that will bring opportunities for example in our insurance sector in that area of the world.

So those are just a few examples, but I think particularly in the FTA context, because we do have some history there, we have been able to make some achievement. So we are progressively moving ahead. And then as I said earlier, hopefully having that build toward a positive result in the WTO context as well.

Mr. NEUGEBAUER. So do I understand you are saying you feel like we, in the context of services, that we have been maybe more effective in the FTA's and the bilateral and multilateral area than we have in the WTO area?

Ms. BLISS. Only as I was saying, qualifying it because the time frames are shorter because of the FTA's that we have negotiated, particularly some of the more recent ones, we have done them in a time frame of, say, 2 years or 3 years, so we have been able, from start to finish, see the results; whereas the multilateral process, necessarily, because it involves so many countries and particularly services, so many sectors, it takes more time.

So I wouldn't suggest that one process is better than the other, I think it is just because the time frames are shorter, we are able to see results from a bilateral side.

Mr. NEUGEBAUER. Are the—

Chairwoman PRYCE. The gentleman's time has expired.

Mr. Kennedy.

Mr. KENNEDY. Well, thank you both for your testimony and your work on behalf of advancing markets for America abroad.

One question we oftentimes get, and you may have covered, and I am sorry if I missed it, but how does Sarbanes-Oxley affect our ability to get other folks to come here, list on our markets and those type of things as an export of financial services; and is there anything there as we look at Sarbanes-Oxley authorization that we need to consider?

Mr. LOWERY. Thank you for the question. We are in discussions in the EU through dialogue with, especially on Sarbanes-Oxley, so that they understand how does this affect their companies, and if they list in the United States.

My understanding—and I apologize, I don't have the details and we can probably get you better answers for the record in detail, but it is my understanding that it causes some issues, but we usually are able to find ways to smooth these things out. And many of the times it is mainly because of this regulatory dialogue that we have been able to establish over the last 2 or 3 years which was started off as a very informal dialogue that we have just been able to move forward, because it is kept at a very technical level, and it actually starts making countries more familiar with what we are trying to do through Sarbanes-Oxley. But let me get you a more detailed answer in writing.

Mr. KENNEDY. That would be great.

And as we look to expand opportunities for American financial services industries abroad, where would you assess the best opportunities to grow in terms of geography and in terms of categories of business? And what ifanything can we do here in Congress to help America be more competitive in those areas?

Mr. LOWERY. Well, the next panel is going to be able to answer that question a lot better than I am, but I think from what I have been hearing is the best market opening opportunities are in the big emerging markets, China, India, and Brazil. And I think that is why we have been pushing very hard with those countries and working with them very closely, because we think that these are good expert markups for our financial services firms.

I think that in terms of—as I said to an earlier question, I think that the way that Congress can help most is through its words, its actions, and when you are travelling abroad, there might be times when your diplomacy can help us as well.

Ms. BLISS. I would just add to that—and I totally agree—that in addition to those markets, I think that also the Asean markets are ones that we are looking to as important, as well as South Africa and some of the Latin markets. And it is really across the whole range of the universe of financial services, banking securities and insurance that we are pushing and see the opportunities.

Mr. KENNEDY. Because it struck me, as I visited some of those countries, that one of the big competitive advantages that we have in America is the way we allocate capital so efficiently, and we have expertise in this area. And are these countries, by leaving our people out, our securities firms and others, they are sort of depriving themselves of having that advantage for themselves. So I think it is a win-win situation for those other countries, for America. I appreciate your advocacy on it, I look forward to your being an advocate on your behalf.

Chairwoman PRYCE. Well, I thank this panel very much for the time you have given us and for your expertise in this area, and we look forward to working with you and advancing this cost. Thank you very much.

And as the next panel gets seated, I just want to announce that I have to leave for a meeting in the Capitol, and Ms. Biggert will be chairing this portion of the hearing. And I appreciate her help in that regard. And I will leave her to introduce you all.

Mrs. BIGGERT. [presiding] I would like to welcome the second panel today here for your testimony, and I would like to introduce the panel.

First we have Mr. Norman Sorensen as the senior vice-president, International Principal Financial Group and president of Principal International, Inc.

Mr. Sorensen serves as chairman of the board of the U.S. Coalition of Service Industries. CSI is the leading U.S. business association representing countries across a broad spectrum of service sectors, welcome.

Next we have Ms. Madeleine Champion. Ms. Champion is a managing director at JPMorgan Chase. She works with commercial bank clients doing business overseas. She is also the current president of the Banker's Association for Finance and Trade, on whose behalf she is appearing today. Welcome.

Also testifying today is Marc E. Lackritz, the president of the Securities Industry Association. He has served as president of SIA since 1992, representing approximately 600 security firms. Welcome.

We have Dr. Sydney J. Key, who has written extensively on international trade in financial services, and is testifying in a personal capacity as a former staff director of the subcommittee. Her publications include the Doha round and financial services negotiations, press 2003, and the financial services chapter in the World Trade Organization legal, economic and political analysis. Welcome.

And we will be joined by, in just a few moments, the 34th Commerce Secretary, now CEO of the Financial Services Forum, Don Evans. Secretary Evans was a core member of the President's economic team and served as one of the President's key advisors on international trade. And Secretary Evans has a busy schedule today and can only be with us for a short time, but will be leaving the president and COO of the Financial Services Forum, Robert Nichols, who is sitting at the table, and he will stay behind to answer questions that the committee might have. Mr. Nichols took over as president and COO of the Financial Services Forum in June 2005.

Prior to this role, he served as the Assistant Secretary for Public Affairs at the Treasury Department, serving as head of the communications team at Treasury in the Bush Administration.

So with that, we will begin with the testimony. And Mr. Sorensen, if you will begin, you are recognized for 5 minutes.

STATEMENT OF NORMAN R. SORENSEN, PRESIDENT AND CEO, PRINCIPAL INTERNATIONAL, INC., ON BEHALF OF THE COALITION OF SERVICE INDUSTRIES

Mr. SORENSEN. Thank you, Chairwoman Pryce, for the opportunity to testify today. Services account for 80 percent of U.S. gross domestic product, and 80 percent of U.S. jobs. Every new job in the services sector in the United States grows the industry further.

The United States is the most competitive exporter of services, that has been said before, with a $50 billion surplus last year, $16 billion accounted for by financial services in 2004 and the potential for expansion is vast.

With the Doha round of WTO, services negotiations are floundering, that has been said before; it is true. The bottom line is that while there is a sufficient quantity of offers, their quality is poor and they provide little or no commercial opportunity.

Liberalizing trade in financial services is essential to economic development. Easy access to low cost consumer credit, pensions, banking, insurance, and other services provide capital for businesses and improve people's lives. I think the prior panelist covered that rather well. Well-regulated and open financial systems boost economic growth, according to many studies, including the World Bank.

I have been asked to address issues relating to insurance, asset management, and pensions. I will be very brief.

We believe trade liberalization across these three sectors brings substantial benefits in each. Insurance provides important benefits, including financial security, creation of pools of capital for investment in basic infrastructure, and protection against loss on a shared basis. Asset management companies contribute economic growth by channeling individual savings to finance enterprise, providing long-term stable capital and mutual funds to give small investors access to professional management and diversification.

As many countries struggle to provide income support for aging populations—and that is a real hot subject these days, not only across the world, but also in the United States—they can benefit from state-of-the-art private pension products if they allow world class suppliers to offer those. For each of these sectors, industry has asked our trade negotiators to obtain the following: number one, the right to establish and own a majority share in those businesses—that has been said before; number two, the right to be treated the same as a domestic company; number three, the right to regulatory transparency and best practices; number four, the ability to trade across borders; and number five, protection of rights already acquired in a market.

The insurance industry has developed a model schedule that countries use to schedule these benefits, which I would be glad to submit for the record if I may, Madam Chairwoman.

Mrs. BIGGERT. Without objection, your whole testimony will be admitted, also. Thank you.

Mr. SORENSEN. The negotiations are going badly for three main reasons. The first is that many of the important developing countries from whom we seek offers do not have sufficient incentives to make them. Number one, an agriculture breakthrough is the linchpin of the entire Doha WTO round undertaking. If the European Union and the United States can reduce barriers to imports from developing countries and modify their support and subsidy payments, those countries would make services offers of a material nature.

Number two: a group of about 13 large developing countries will not liberalize their financial and other key markets because the United States is unable to discuss business travel facilitation. That has been discussed before. We need your committee's and broad Congressional support to improve business travel facilitation in order to run our own businesses better here and abroad, and to get the negotiating leverage we need in Geneva.

I met this morning with Secretary Gutierrez to basically make the same plea, which he hears from a number of other industry sectors as well.

Number three, another group, including Asean nations, has advocated an escape clause or safeguard for services. They seek reassurance that imports of services will not destabilize their economies. We should be able to find a practical way to address those issues without impairing our own core interests.

The Coalition of Service Industries does not believe that safeguards are in the interest of overall broad agreements, however, the practical necessities may require that both those countries' interests and ours can be addressed through a work-around situation.

Another factor in why the services talks are floundering is the difficulty of the so-called request and offer bargaining process which requires sector-by-sector, country-by-country negotiations; very complicated, very long, very deliberate, and some countries don't have the capabilities to actually work this process. To simplify the process, a formula approach has been offered that would require countries to make fixed levels of commitments. The European Union has made particularly controversial proposals which have received no support. It could, however, diffuse the impasse it has created, but instead, it has used the stand-off to help justify its refusal to make further concessions in agriculture. So we go back full circle to the agriculture issue.

Industry's experience in this and previous WTO negotiations on financial services demonstrates that finance ministries must lead the negotiations, or they will be less successful. Secretary Snow and his team have now taken an active role, thanks in part to this committee's demonstration of interest and evidenced by the letter that you, yourself, addressed to Secretary Snow which you endorsed.

Chairwoman Pryce, I believe we can achieve our goals for financial and other services but this would require progress in agriculture, business travel facilitation, and safeguards. It would be very difficult for the U.S. financial services sector to support a Doha round outcome that failed to include a strong financial services liberalization component. Thank you very much.

[The prepared statement of Mr. Sorensen can be found on page 149 of the appendix.]

Mrs. BIGGERT. Thank you.

Ms. Champion, you are recognized for 5 minutes.

STATEMENT OF MADELEINE CHAMPION, MANAGING DIRECTOR, JPMORGAN CHASE, ON BEHALF OF THE BANKER'S ASSOCIATION FOR FINANCE AND TRADE

Ms. CHAMPION. Thank you, Madam Chairwoman.

Although only a few of the largest U.S. banks operate on a truly global scale, international activities are an important part of the business of many U.S. banks, including all members of the Bankers Association for Finance and Trade.

In conducting those activities, U.S. banks encounter a wide range of trade barriers. India, one of the fastest growing economies in the world, provides a good example. Foreign banks doing business in India are subject to overall limits on their assets, and their ability to invest in local banks is very restricted. Foreign banks are also subject to higher taxes and more rigorous capital requirements than local banks.

China is another. Although China made a large number of commitments to open its markets to foreign participants when it gained accession to the WTO in 2001—and it has made impressive progress—banks from the United States and elsewhere continue to face significant obstacles. For instance, a single foreign investor in a Chinese bank may not own more than 20 percent of the equity, and total foreign investment in a single Chinese bank is limited to 25 percent.

The Chinese regulatory system is another impediment. A recent study of foreign banks in China found that new regulations are the most important issue they face and that the regulatory environment is regarded as the most difficult aspect of doing business there.

India and China are not alone in this regard. U.S. banks face difficult challenges in many other WTO member countries, including Indonesia, the Philippines, Thailand, and Korea. I mention those in particular, because they are some of the biggest and most interesting foreign markets. China and India are especially significant, and obtaining trading barrier reductions in their markets are high priorities for many American banks.

Of course, we also encounter barriers in countries that are not WTO members. Russia, which is seeking to join the WTO, is noteworthy. Russia prohibits foreign banks from operating through branches. Non-Russian banks are permitted to operate only through subsidiaries, and the Russian Central Bank has authority to impose an overall limit on foreign subsidiaries' share of total Russian bank capital.

We hope that the WTO's Doha round of trade negotiations will lead to a significant reduction in trade barriers generally, as well as reductions in barriers imposed specifically on foreign banks. But multilateral negotiations are not the only avenue for reducing trade barriers. We also support our country's bilateral negotiation of free trade agreements. Our banks will benefit from gaining greater access to foreign markets in whatever manner it is achieved. Local consumers and businesses in other countries also will benefit from the competition, management expertise, skills transferred, new operating methods, innovative products and services, and standards of conduct that U.S. and other foreign banks can bring to their markets.

Open and competitive markets are the ultimate objective, and they share certain fundamental characteristics; national treatment, unrestricted market access, and transparency. We believe that countries participating in the Doha round should have these characteristics as goals for their own financial markets, and BAFT will use them as benchmarks in evaluating the Doha round's progress with respect to banking services on a country-by-country basis. We also believe that countries like Russia, who wish to become WTO members, should make concessions that will bring their markets in line with these characteristics.

U.S. banks can realize significant benefits from a general reduction in global trade barriers, and thus have much to gain in the Doha round. We are concerned, however, about the slow progress so far. Many countries have not made initial offers or revised offers, and the overall quality of the offers that have been made generally is regarded to be unsatisfactory.

The success of the Doha round is important, and we urge all of the participating countries to redouble their efforts and make aggressive reductions in their trade barriers. The United States should take the lead in setting examples for others to follow. It has done so in the recent proposals to reduce agriculture subsidies and should do so across the board, including, in particular, with regard to business travel facilitation.

BAFT greatly appreciates the efforts of the U.S. Treasury Department and USTR in promoting financial services liberalization within the WTO negotiations, as well as in free trade agreements. Securing broad service liberalization, specifically significant financial services liberalization, is essential to achieving a WTO agreement we can support. Thank you.

[The prepared statement of Ms. Champion can be found on page 53 of the appendix.]

Mrs. BIGGERT. Thank you. Mr. Lackritz, if you don't mind, we will move over to Secretary Evans, since he is on a tight schedule, and then we will come back to you.

Mr. LACKRITZ. Not at all.

Mrs. BIGGERT. Thank you.

Welcome, Mr. Secretary. We did introduce you, so we will go ahead. And you know the drill, only this time you have a shorter period of time than when you are usually here—

Secretary EVANS. Unfortunately.

Mrs. BIGGERT. So you are recognized for 5 minutes.

STATEMENT OF HON. DON EVANS, CHIEF EXECUTIVE OFFICER, FINANCIAL SERVICES FORUM

Mr. EVANS. Thank you, Madam Chairwoman, very much. I am delighted to be here. It is an honor to present to both you and my good friend, Congressman Manzullo—

Mrs. BIGGERT. You notice we are both here from Illinois.

Mr. EVANS. Exactly, you have got Illinois covered. The manufacturing State, right? There you go.

Chairwoman Biggert, thank you for the opportunity to participate in this important hearing on increasing efficiency and economic growth through trade in financial services. And thank you for your leadership on the critical issue of the importance of trade to our Nation's economy and the broader global economy.

I am here as the chief executive officer of the Financial Services Forum, a financial and economic policy organization comprised of the chief executives of 20 of the largest financial institutions with operations in the United States.

The Forum's purpose is to promote policies that enhance savings and investment, and that ensure an open, competitive, and sound global financial services marketplace. I strongly believe that two of the greatest challenges confronting the United States and the world today are the need to address persistent poverty and the need to effectively deal with the challenges associated with globalization.

I am convinced that freer and more open trade is perhaps the most powerful tool at our disposal in both efforts, and that the multi-national framework known as the World Trade Organization is critical to maintaining an open global trading system governed by the rule of law.

Madam Chairwoman, as you know, my schedule today is such that I am only here to make a brief oral statement, but I am going to leave behind my colleague and friend, Rob Nichols, to answer any questions.

The World Trade Organization was established in 1994 during the Uruguay round of trade negotiations, the 8th round of multinational negotiations held under the General Agreement on Tariffs and Trade commonly known as GATS. The GATS was created in 1947 as part of the world's response to the devastation of World War II and the policy failures and Great Depression that led in part to that historic calamity.

The organizing principle was simple and inspired—to promote global stability and security by extending economic opportunity and raising living standards around the world. And the results have been nothing short of phenomenal. Between 1950 and 1998, global economic output rose by 530 percent, while the volume of merchandise exports rose 1840 percent. Over that 50-year period, the ratio of trade to global output tripled, from about 7 percent to more than 20 percent. In what has been the most dynamic era of economic development in human history, trade has become the basis for a prosperous world economy. Openness to trade has also become the distinguishing characteristic of the world's most productive economies.

Capitalizing on trading opportunities is a major reason why small but open economies such as Finland, Hong Kong, Singapore, and Taiwan are able to generate standards of living far higher than most of the largest and resource-rich countries, including China, India, Indonesia, and Brazil. Academic research has established that countries that have more open economies and that engage in international trade enjoy higher growth rates and faster reductions in poverty than more closed economies.

The World Bank has also determined that over the past 2 decades, those developing countries that engaged in trade enjoyed faster growth in real wages. Indeed, since World War II, no nation has prospered without exploiting opportunities to trade.

Of course, it hasn't just been the rest of the world that has reaped the rewards of trade. Lest we forget—and too many of us it seems do forget—the United States of America has benefited enormously from freer and more open trade. The United States represents about 18 percent of global trade, and it is the world's largest exporter. Since the creation of the WTO 10 years ago, U.S. exports of goods and services have increased 65 percent to more than $1 trillion, with manufacturing, agriculture, and high technology exports growing by 65, 38, and 67 percent, respectively.

Thanks in large part to the passage of the North American Free Trade Agreement, NAFTA, over that same period, U.S. exports to Mexico more than doubled, while exports to Canada and the EU grew by 66 and 56 percent, respectively. The growth in exports to China has been even faster, nearly quadrupling over the past 10 years.

The recent passage of the Central American Free Trade Agreement, commonly known as CAFTA, will add to this progress by providing American exporters with clear access to a market of 44 million customers, creating the second largest U.S. export market within Latin America—larger than Russia, India, and Indonesia combined.

The relative importance of trade to the U.S. economy has also increased. Twenty years ago, the total value of U.S. exports and imports amounted to 17 percent of America's GDP. Today, trade accounts for a quarter of our economic output and the jobs of more than 12 million American workers.

By offering prosperity in return for peaceful exchange and market-led cooperation, trade has become the foundation for progress around the world. The critical task before us now is to build on our achievements of the past 60 years by extending freer and more open trade to those countries and regions that have not, as yet, enjoyed the developmental power of international trade.

The Uruguay round of the early 1990's was significant in that it expanded coverage of GATS rules beyond manufacturing goods to include agricultural trade, services, trade-related investment measures, intellectual property rights and textiles. But its most significant achievement was the creation of the WTO, to administer GATS agreements and to settle disputes among WTO members. WTO membership now includes 148 nations. Additions of significance over the past decade include not only China, but also Jordan, Cambodia, and several former Soviet republics. And just last week, Saudi Arabia won approval to become the WTO's newest member next month. And membership negotiations for more than 20 other countries, including Russia, Vietnam, Ukraine, Afghanistan, and Iraq are ongoing. Such sustained interest in joining the WTO underscores the importance the world continues to associate with membership.

The creation of the WTO was, in many ways, the culmination of a decade-long bipartisan American commitment to lead the world away from economic isolationism and toward an open rules-based global trading system. And the United States continues to exercise its leadership in WTO. For example, the United States aggressively uses WTO machinery to enforce hard-won trade-related rights.

Since the creation of the WTO in 1994, the United States has brought more dispute settlement cases than any other member, casing involving products ranging from apples and dairy to biotechnology and telecommunication. The WTO also advances U.S. interests through more than 20 standing committees that meet regularly to administer agreements, allow members to exchange views, and to develop initiatives aimed at improving existing agreements and their operation.

Simply put, in a world where about 95 percent of consumers live beyond our borders, the WTO is an essential tool for advancing U.S. interests.

WTO countries are currently participating in the 9th round of negotiations called the Doha development round which was launched in Doha, Qatar, in November of 2001, in the immediate aftermath of the September 11th terror attacks. The main areas of focus in the negotiations are agriculture, industrial market access, services, trade facilities, WTO rules, and the promotion of economic development.

Madam Chairwoman, I know I have gone past my time, would you like me to conclude my remarks?

Mrs. BIGGERT. Yes. If you could bring your remarks to a close.

Mr. EVANS. I sure will, I would be happy to do that.

Mrs. BIGGERT. I know it is hard when you are used to longer time.

Mr. EVANS. The global trading system is not perfect and will always remain a work in progress. And given the complexities—technological, political, and cultural—that stem from the accelerating pace of globalization, further trade liberalization is hard work. But that hard work is even more important today than it was following a catastrophic world war.

To ensure that all nations reach the maximum benefit from trade, the global trading system must operate with predictability and transparency, without discrimination against the products of any nation, and providing the means to address unfair trade practices. This is a crucial responsibility of the World Trade Organization. We must keep in mind that while trade can cause transitional pain for some American workers, building walls around the United States would cause enormous permanent pain for all Americans. Imagine, for example, if U.S. computer companies were forced to make all their components at home; the cost of owning a computer would be much higher, so fewer businesses would have access to productivity-enhancing, wealth creating tools which help make them more profitable, grow fast, and better able to hire workers.

By capitalizing on what different countries do best, trade lowers costs, frees up capital and other resources to be used productively, raises living standards, and promotes growth and development, all of which promotes faster job creation. The participation and leadership of the United States in the global trading system, by way of the WTO, remains a critical element for ensuring America's continued prosperity and for meeting the challenges of ensuring a more stable and secure world.

Madam Chairwoman, thank you for allowing me to extend my remarks. And to all the members of the committee, it was a delight to drop by here and see you. I know I have more extended remarks, that may be hard to believe, but I have more extended remarks that will be submitted for the record. Thank you very much.

[The prepared statement of Mr. Evans can be found on page 64 of the appendix.]

Mrs. BIGGERT. Yes. Thank you very much, and thank you for being here. And your extended remarks will be included in the record. I appreciate you being here, thank you.

Mr. EVANS. Thank you. I appreciate it.

Mrs. BIGGERT. And thank you, Dr. Key and Mr. Lackritz, for your patience. I now would like to hear the testimony of Mr. Lackritz. I know that you have been here several times, welcome back, we are happy to have you here.

STATEMENT OF MARC E. LACKRITZ, PRESIDENT, SECURITIES INDUSTRY ASSOCIATION

Mr. LACKRITZ. Thank you, Chairwoman Biggert. It is a pleasure to be here, and thank you very much for the invitation to testify. Members of the subcommittee, and Chairwoman Biggert, I appreciate the chance to talk about the security industry's objectives and goals for the Doha development round of the WTO negotiations.

With a ministerial set to begin in less than a month, we really commend the subcommittee for holding this timely hearing. The subcommittee has a history of, a proud history, I think, of being a forceful, persuasive advocate for open, fair international markets, and we are confident that you will continue to work with U.S. negotiators in securing a commercially meaningful package of financial services commitments in the Doha round.

Open, fair, free international markets enhance globalization by fostering economic growth, providing new opportunities, and increasing competition. Indeed, the purpose of trade liberalization is not simply to increase the volume of global commerce, but also to improve the quality of people's lives.

The evidence is clear, open economies are more likely to lift people out of poverty than economies that are stagnant and closed, and an open trading system for financial services is a win-win situation, bringing economic benefits to newly-emerging economies while increasing jobs here at home and the services trade surplus.

The U.S. financial services sector is a key component in our economy in raising capital for new businesses, extending credit for corporate acquisitions, managing finances for retail customers, and providing risk management products and services to U.S. multinationals. Financial services firms affect every aspect of the economy.

The U.S. financial services industry contributed $972 billion to U.S. GDP in 2004, about 8.3 percent of total GDP. More than 6.1 million employees support the products and services these firms offer. Importantly, financial services firms generated a trade surplus of $16 billion in 2004 on the strength of a record $27 billion of exports. And our contribution to the U.S. economy total output has been especially impressive, since it has been increased by nearly 4 times of the last 15 years, which is double the rate of increase of the overall economy.

We have consistently advocated trade liberalization that achieves three important objectives; first, commercial presence with national treatment; second, increased cross border assess; and third, transparent regulation.

To fully achieve those objectives, our industry recently drafted a model schedule of commitments which I would ask, Chairwoman Biggert, to be included in the record along with my written statement.

Mrs. BIGGERT. Without objection.

Mr. LACKRITZ. Thank you. This would allow securities firms to serve their global customers most efficiently while safeguarding critical regulatory goals. The model schedule would apply to debt and equity trading, securities underwriting and placement, asset management and advisory services.

A fundamental element of any WTO agreement is the absent ability to operate competitively through a wholly-owned commercial presence or other form of business ownership. Members should permit foreign suppliers of capital markets related services to establish a new commercial presence or acquire an existing commercial presence in the member's own countries. Firms should be allowed to choose their corporate forum and should receive the same treatment as domestic businesses.

In today's capital markets, services are increasingly being supplied electronically without the consumer or the supplier leaving its home territory. WTO members, however, have made virtually no commitments with respect to cross border supply in three of the four sectors of greatest interest to our industry, trading, underwriting and asset management. The model schedule calls for members to make basic commitments to permit cross border supply without quantitative limits or so-called economic needs tests, and to accord such suppliers nondiscriminatory treatment.

Regulatory transparency is as much a market access issue for securities firms as tariffs are for manufacturers. A nontransparent regulatory system can skew competition in favor of domestic suppliers even when the market is technically open to foreign suppliers. Financial regulation should be developed, adopted and enforced in a transparent, nondiscriminatory manner so that both providers and consumers know what the rules are and have confidence that they will be applied consistently and fairly.

Chairwoman Biggert, our industry is the world leader in international technology, finance and innovation. If we are to retain our pre-eminence, however, we must be able to meet the demands of both our U.S. and our foreign clients. SIA would like to express our appreciation to both the Treasury Department and the USTR for their continued efforts as forceful advocates for open and fair global financial markets. And Chairwoman Biggert, the Doha round negotiations offer Congress and the Administration another opportunity to secure open and fair access to foreign markets for U.S. firms and their clients. We are eager to continue working with your subcommittee and the Administration to ensure that these important trade talks achieve favorable results for issuers, investors, and financial services firms around the world. Thank you very much.

[The prepared statement of Mr. Lackritz can be found on page 78 of the appendix.]

Mrs. BIGGERT. Thank you very much, Mr. Lackritz.

Dr. Key, you are recognized for 5 minutes.

STATEMENT OF DR. SYDNEY J. KEY, FORMER STAFF DIRECTOR, SUBCOMMITTEE ON INTERNATIONAL DEVELOPMENT, FINANCE, TRADE, AND MONETARY POLICY, COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS, U.S. HOUSE OF REPRESENTATIVES

Dr. KEY. I want to thank the chairwoman and members of the subcommittee for the opportunity to testify.

This afternoon, I will try to put financial services liberalization in the General Agreement on Trade in Services in perspective by focusing on three issues: first, the relationship between market-opening efforts in the WTO, and the ongoing international work on strengthening domestic financial systems; second, the importance of undertaking binding commitments in the GATS; and third, the inclusion of regulatory transparency in the Doha round negotiations.

I would like to begin by emphasizing that the presence of foreign firms can create more competitive and efficient domestic markets for financial services, thereby supporting economic growth and development and contributing to a more resilient domestic financial system. At the same time, however, structural reforms to strengthen domestic financial systems, including ensuring adequate prudential regulation and supervision, are essential to obtain the maximum benefits of liberalization while minimizing the risks.

Work aimed at strengthening domestic financial systems is taking place in a variety of international fora. This work includes promoting cooperation and coordination among financial supervisors and setting voluntary, but widely accepted, international minimum standards and codes of good practices. As part of this effort, the financial sector assessment program of the IMF and the World Bank involves assessing the strengths and vulnerabilities of a country's financial sector, and monitoring and helping to build institutional capacity for the implementation of the international standards and codes.

Because measures to promote competitive markets and to strengthen domestic financial systems are complementary and mutually reinforcing, the relationship between financial sector regulation and liberalization has two distinct dimensions. On the one hand, liberalization requires reducing or removing anticompetitive regulations that pose unnecessary barriers to trade in services. On the other hand, liberalization also requires increasing the strength and quality of certain regulations and, in some areas, actually introducing new regulations. Thus, the process of liberalization involves reaching a consensus on where to draw the line between regulations that are simply anticompetitive barriers to trade and should, therefore, be eliminated and regulations that serve legitimate purposes.

For financial services, the GATS contains what is known as the prudential carve-out for domestic regulation. It is designed to ensure that the obligations and commitments a country has undertaken in the GATS will not interfere with the ability of the national authorities to exercise their responsibilities for prudential regulation and supervision. This provision was included in the GATS at the insistence of financial regulators. They made it absolutely clear that the inclusion of financial services in a multilateral trade agreement would be unacceptable without a specific carve-out from the obligations of the agreement for prudential measures.

The second point I want to emphasize is the importance of obtaining binding commitments in the GATS. A GATS commitment is permanent in the sense it cannot be withdrawn without compensation of trading partners. Failure to honor a GATS commitment could open a country to a dispute settlement proceeding and, ultimately, to WTO-sanctioned retaliatory measures by its trading partners. As a result, binding even the status quo,that is, existing levels of liberalization, is significant.

Undertaking binding commitments in the GATS can also be an integral part of a country's longer-term policy reform agenda. For example, China, as part of its WTO accession agreement, made phased commitments in the GATS to open its banking sector to foreign direct investment within 5 years, that is, by December 11, 2006. In agreeing to this deadline, the Chinese government was also, in effect, setting a domestic political deadline for major reform of China's banking system.

Third, I would like to turn to the issue of how far the Doha round financial services negotiations should extend into the realm of domestic structural reform to deal with nondiscriminatory structural barriers to trade in financial services.

One area that could usefully be negotiated in the WTO that goes beyond traditional market opening is regulatory transparency. Stronger GATS rules on regulatory transparency would help eliminate barriers to trade in services created by opaque regulatory regimes, and also help ensure that a country does not use its regulatory regime to undermine its specific commitments to open markets.

In conclusion, I want to emphasize that a continuing challenge in financial services negotiations in the WTO is to provide support for and to build upon political and market forces that are creating pressures within a country for market opening and domestic structural reform. In this regard, a country's readiness for reform is critical. As the GATS explicitly recognizes, liberalization of trade in services is an ongoing process. For financial services, this process is being driven largely by market forces and new technologies. It is also being driven by the growing recognition among policymakers that market opening can benefit host-country consumers of financial services and, at the same time, contribute to the resiliency of domestic financial systems. Thank you.

[The prepared statement of Dr. Key can be found on page 72 of the appendix.]

Mrs. BIGGERT. Thank you very much, Doctor.

We will now proceed to the questions, and as in the first panel, each member is recognized for 5 minutes to ask questions, so I will recognize myself for 5 minutes.

Mr. Lackritz, you talked about the model schedule for GATS commitments for capital market-related services. If the model schedule were to apply to the United States, how would it impact the ability of foreign exchanges to establish trading screens in the United States without registration within the SEC?

Mr. LACKRITZ. Well, I think, in essence, we provide currently national treatment to anyone coming into our country to do business.

So currently, if a foreign exchange wanted to come into this country—in fact, it has happened in Chicago where we had that issue in fact, it is probably the one you are most familiar with—

Mrs. BIGGERT. Yes.

Mr. LACKRITZ. So, in fact, it would provide the same kinds of opportunities for foreign exchanges to do business here under the same rules and regulations that U.S. exchanges would have. So we provide that national treatment.

What we are trying to do with the model schedule is really to extend that kind of national treatment principle to some of these other developing countries that currently don't provide national treatment, don't permit establishment, don't have broad cross-border commitments, and don't have regulatory transparency. So we are trying to export that model really to other countries.

Mrs. BIGGERT. I guess we have always had the most open markets, and that is what we are trying to instill in other countries, but sometimes it seems to be difficult.

Has the SEC reacted to this proposal?

Mr. LACKRITZ. We have had—yes. We have had ongoing discussions with the SEC about our proposal, and I think they have been very encouraging so far. And I think we have also worked with our Treasury Department and our USTR with respect to the proposal, and in addition, had consultations now with over 35 countries in the context of the WTO negotiations as well as the WTO secretaries. So we are making a very active and aggressive effort to try and move this effort along.

Mrs. BIGGERT. Would that be the European? How have the Europeans and the Asian regulators reacted to the proposal?

Mr. LACKRITZ. So far we have been very encouraged by the response. So far the response has been very positive, but obviously, the proof will be in the pudding. And as the round of ministerial takes place next month, and then the offers come forward hopefully after that.

Mrs. BIGGERT. Mr. Nichols, Secretary Evans talked a lot about persistent poverty and the need to deal with the challenges associated with globalization, and he said that part of the challenge is to deal with the poverty, but really, if we have the open markets in the developing countries, this will alleviate the poverty. Could you expand a little bit on that?

Mr. NICHOLS. Sure. Thank you very much for your question, Congressman, and I appreciate it.

You know, one point, when we are talking about trade, in my experiences, we are often talking about import and export ratios and tariffs and it gets very technical, but the point that the forum would like to add to your hearing today and to the dialogue here is the impact it has on people, on actual people. And the World Bank just came out with a study that I would like to raise to your attention last week on the 9th that essentially said, with the successful achievement of a Doha trade round, they estimate that they will lift 32 million people from the poverty rolls. And I think as we are talking about trade, those are 32 million fantastic reasons for us to achieve success.

Mrs. BIGGERT. Do you think that what we have done to eliminate the debt owed by many of the most impoverished countries will really help to introduce the concept of trade into those countries?

Mr. NICHOLS. Debt relief is certainly an important part of the overall equation, but there is nothing better we can do to help emerging and developing nations than to establish strong trading ties, in fact, on the earlier panel, you asked the government witnesses about what markets that the financial services industry is looking to, and they answered correctly India and China are two that our members view as important opportunities.

But I will tell you, in addition to what they would do for the financial services industry, speaking of China, there is somewhere in the area of 7- or 800-million people living in poverty in inland China. Over time, if that Nation embraces financial services, that will help lift those people from poverty into a middle class and that is important and good for the entire globe.

Mrs. BIGGERT. Thank you. Mr. Sorensen, I think we are going to have plenty of time for this hearing, but I will ask the question now, I know you are in on a time schedule. Your testimony indicated that a number of major emerging markets are holding back on offering major improvements in services, liberalization, without progress in the United States on business travel visas. Your testimony, you had a recommendation how to resolve that issue. What kind of support is CSI receiving from other trade associations about this proposal?

Mr. SORENSEN. The European Services Forum, the Hong Kong associations largely in the developed countries, the Australian associations, Japanese associations which mirror our desire to get this resolved in one way or another, are extremely supportive. We have seen tremendous support also from the Business Roundtable, who have endorsed our proposal and it is being discussed with a number of members of Congress in the Judiciary Committee.

I think it will be a little while longer before we all get used to the fact that this is a proposal that allows for temporary entry of business people, technical people, and trainees, to come to the United States for a very defined period of time, with an exit. This is not an extension of permanent status; this is not an overstay time situation. The way it is done is by locking in the sponsorship company or entity that sponsors these individuals to come to the United States who will be subject to nonrenewal of their rights to do so should there be any violations.

And so, this adds teeth, if you will, to avoid some of the leakage that has been going on among a number of these categories, and so there is tremendous support. The Europeans in particular, not only the European Services Forum, but also the European Commission, Mr. Mandelson, whom I met with a couple of months ago, was particularly anxious to see this move forward. Once the agricultural situation is resolved, this will be the next major issue to be dealt with.

The final thing I will say is that this is reciprocal, so 148 countries would have the same obligations such that the United States, one of my trainees here, or one of my IT people would have a fast-track entry into the Indian market or the Brazilian market, the

Chinese market, all of which today offer tremendous delays similar to the delays that we have for temporary entry of personnel.

Mrs. BIGGERT. Thank you. My time has expired. The gentleman from New York, Mr. Crowley, is recognized for 5 minutes.

Mr. CROWLEY. I thank the gentlelady. An industry-related question, Mr. Sorensen. I have been working with such companies as New York Life and other insurance firms to pry open as I mentioned before the first panel, opportunities in the global market for services firms based here in the United States. We have seen successes in places like India and Vietnam, but I believe more needs to be done. There are far too many barriers for entries for financial services firms. I was wondering if anyone can comment on some of the things the U.S. financial services firms, in particular, the insurance industry, have been doing to get themselves into foreign markets and what things can be done better, what things can our government be doing to help them in this goal, and how does this help Americans here at home?

Mr. Nichols, this may correspond to the Doha issues in terms of uplifting 32 million people in the world, but how does it affect people abroad as well?

Mr. SORENSEN. I would be very, very brief on this. The insurance industry has developed a model schedule, it was developed in 2001, which has been submitted for the record. That schedule has been discussed with a number of foreign governments at the trade level, and at the insurance regulator level. Essentially, the Big 5, the Indians, the Chinas, the Brazils, Malaysia, and Indonesia, the response has been not overwhelmingly positive. On a scale of 1 to 10, we are at a 6 today. I would say that, for example, the ownership issues remain very, very large. One cannot own more than 26 percent of an insurance company in India today and although talk about the 49 percent access remains, that is still quite a ways to go.

One cannot own any more than 20 percent of a bank in China or more than 49 percent of an asset management company in China. So there is this holdback process which is driven by a number of factors at the government level. One of them, when we allow too much free flow, there may be destabilization in some economies, which have closed capital markets, India and Malaysia, perfect examples. There is not a free trade or, correction, free flow of capital. So we need to break that holdback, we need to break that holdback in a number of ways. The insurance industry is only one example. I think we probably need several years. The Doha issue would be a tremendous accomplishment if we have success in 2006, which seems increasingly elusive, we are hoping that that will go a long ways to resolving our issues.

Mr. CROWLEY. Anyone else want to comment on that?

Mr. LACKRITZ. I would reemphasize the model scheduled in the securities areas, and what we have tried to do to get more establishment of commercial enterprises in developing countries markets to improve cross-border access and regulatory transparency. On top of that, we, this last year, held our first conference on capital markets in China, and we had more than 600 attendees—Chinese attendees—and a number of representatives of our firms who are capable of doing global business, talking about equity markets, debt markets, underwriting, trading, exchanges, regulation, and I think the momentum resulting from that actually helps to sort of spread the word about the benefits of this. I think the biggest challenge we have as an industry may be—

Mr. CROWLEY. The benefits being that of transparency.

Mr. LACKRITZ. And fully developed capital markets. That these really help the countries themselves. This is an effort to help the countries develop faster. As Secretary Evans mentioned in his testimony, as we have cited, better capital markets improve economic growth, they improve opportunities, they accelerate development. There are benefits all the way around.

So I think a big challenge for us is to help educate some emerging markets about the benefits that more open systems, and more open financial services sectors really provide to their own countries, and I think that is the challenge that we face in addition to these negotiations and the commitments from our model schedule.

Mr. CROWLEY. Maybe some of the benefits are self-evident, but what are some of the benefits our country could derive?

Mr. LACKRITZ. First of all, any country dependent on one sector, for example, in financial services, runs the risk of destabilization, whereas if you have a broader array of sectors actively involved, you have sort of shock absorbers where there are market imbalances, and you have more diverse products and services that are available to customers to buy. So you have a more efficient capable allocation system where capital is going to go to its highest uses. You have more advisory services to help capital—people that have capital in those countries invest their capital most wisely.

Most importantly, you have for the companies in those countries that are providing the jobs and the growth, you have greater access to global flows of capital, so they get more ready access at lower cost, much lower cost of capital for all those companies which helps to accelerate development as well.

Mr. CROWLEY. Thank you. I also have one additional question if I can put that in writing and ask for your response.

Mr. LACKRITZ. Great.

Mrs. BIGGERT. Thank you. The gentleman from Illinois, Mr. Manzullo.

Mr. MANZULLO. Thank you. Mr. Sorensen, you are extremely popular here today, and I don't mean to diminish the roles of the other members of this distinguished panel, but I turn to page 5 of your testimony, business travel facilitation, and I just—I don't think this town gets it. If you go down to the last paragraph where it says: The Congress. Do you see that? Says: The Congress, U.S. trade negotiators in the business community need to work together to shape a business travel facilitation initiative. You heard they won't touch it.

Mr. SORENSEN. This is true, Congressman. USTR won't touch it, because they have been told not to. This is obviously a Judiciary Committee purview, and we understand that.

Mr. MANZULLO. As part of the Small Business Committee, we don't worry about minor things like jurisdiction.

Mr. SORENSEN. It is fortunate, sir, that you are in that position, because I would say, sir, that there is some misunderstanding. I believe that temporary entry should be precisely that, and it should have teeth, in other words, it is not to overstay an H1B visa or something that allows a person from another country to enter this country and feel free to revise a status. So this would be a fast-track thing for business people, technical people, trainees, and joint venture partners.

Mr. MANZULLO. Any thought that we can do this by treaty?

Mr. SORENSEN. I think we can. Basically, the issue here is convincing regulators not only in the United States but abroad. By the way, all of the developing countries are dying to have this become a lot easier because they are missing opportunities as well, as we are in the U.S. service industries.

Mr. MANZULLO. We had a situation back in Rockford, Illinois, again with Ingersol, they sold machines, and they are not controlled, to the Indians. The State would not allow the Indians to come to the United States to train on their own machine that they bought here. Now you wonder why companies like that go out of business. We have one stamping machine tool company left in this country, out of Dayton. We have one cold forming machine company left, National Machinery. We are losing our machine tooled industry in dramatic strides. We are giving it away because someone comes around and says my gosh, you can use that for a military application. Well, I guess so, if you like purple hubcaps on your tanks. You can transfer any technology like that.

But the problem that I have seen in Washington is this town does not understand the meaning of manufacturing and I am going to lay it at Mr. Greenspan's feet, as much as I admire Dr. Greenspan, he has said consistently before this committee not to worry about the loss of manufacturing jobs, it will always be compensated for in high end—high end white collar service jobs. I say, give me an example of what you are talking about and then my 5 minutes runs out. I could never get an example.

I was in Milan, Italy, at the tool trade show that takes place every 2 years, and I missed going to Frankfurt. I have traveled all over the world studying manufacturing and I have seen what has happened to us. We are being killed.

He was right when he wrote that article merchandise exports follow financial exports because it paves the way for the exchange of currency, and also the trust of individuals necessary to raise the level of business expectations. We don't have that here. Is there any specific legislation that you have in mind?

Mr. SORENSEN. Yes, sir. Congressman, we have proposed, I don't have it here unfortunately but I beg the Chairman's indulgence to provide it later in writing, a 2-pager that I left with Secretary Gutierrez today, because we appealed to him this morning as well. It is a very simple document. It is not legislation yet. We hope that it will become a proposal for legislation to allow a fast-track process two ways, for not only—in fact, I have just received it, and so I submit this for the record.

Mrs. BIGGERT. Without objection.

Mr. MANZULLO. One of the things that I would suggest that you add to that list of what you call professionals, managers, consultants, highly-skilled experts and technicians, add to that manufacturing representatives or customers.

Mr. SORENSEN. It is broad enough, Congressman, to include that.

Mr. MANZULLO. I would like to work with you on that, and if you think that we could be of assistance. One thing we can do is raise hell about the problem. This is the type of stuff you like to shove in the face of people who are screaming about the trade imbalance. The very big things that we can sell ourselves, we can't because we disinvite those people that want to buy our good stuff.

Mr. SORENSEN. If I may, Chairwoman, with your indulgence, just 2 more seconds. We don't want what is happening and unfortunately, you quoted a number of instances in the manufacturing to happen to the services industry. I have three joint-venture partners. One in China—China Construction Bank, the third largest bank in China—is a joint-venture partner. I could not bring two or three joint-venture partners to the United States because of some potentially prudently laid out immigration policies that call for delays and screening and all this, and I offered bonds. I said I will pay a bond to make sure that this person returns 3 days later after he or she signs an agreement with us.

Malaysia, the same situation. I had a joint-venture partner held in the airport for 2 days, a vice-chairman of a bank in Malaysia, a partner of ours. So, unfortunately, the pendulum has swung a little bit too far, but we do need to make sure that this proposal does not mean that this is another sort of visa thing for an open door. This is temporary entry for people that will have a beginning and an end and the entity would be the person to whom you would go to avoid overstays or leakage of the system. So it has teeth, which is what we want, and hopefully, the Judiciary Committee will listen.

Mrs. BIGGERT. Thank you. I have just a couple more questions. Dr. Key, your testimony indicates that the process of liberalization involves among other things reaching a consensus on where to draw the line between regulations that are simply anticompetitive barriers to trade, and should, therefore, be eliminated, and regulations that serve legitimate purposes. That's a quote.

Do you think that the IMF and the World Bank's work on standards and codes can minimize or eliminate unnecessary and inefficient regulatory differences?

Dr. KEY. The international work in the IMF and World Bank and specialized bodies like the Basel Committee on Banking Supervision on minimum international standards and codes of good practices can provide a basis for a general consensus that certain kinds of rules are legitimate, prudential measures and are important to have. They don't go so far as to say whether a particular national measure is appropriate, but they do represent a generally accepted view about the measures that are important for ensuring financial stability.

Mrs. BIGGERT. Then how would you propose we assess differences among developed economies such as the U.S., the EU, and Japan?

Dr. KEY. In terms of the regulatory—

Mrs. BIGGERT. Yes.

Dr. KEY. Prudential regulations that do not discriminate between foreign and domestic firms can have an impact as barriers to trade simply because they are different among countries, and for financial firms that are operating on a global basis that certainly can be a problem. I think the international work has gone a long way towards reducing this, but obviously there are still differences that remain because each country does bear the ultimate responsibility for its own regulation and supervision.

The EU internally in its single market program has gone much further with its policy of mutual recognition based on harmonization of essential standards. However, that has been undertaken within a unique supernational structure and much more extensive harmonization than has occurred internationally.

Mrs. BIGGERT. In Japan?

Dr. KEY. Japan is part of the international work in a variety of fora on generally accepted international minimum standards and codes of good practices.

Mrs. BIGGERT. Do you think a necessity test should exist when evaluating regulatory policy differences?

Dr. KEY. No, not for prudential regulation. In the prudential carve-out in the GATS, finance officials who negotiated it made sure that it would not have a necessity test. They were concerned about having a WTO dispute settlement panel decide whether a particular prudential rule was necessary or least trade restrictive and wanted to avoid any possibility of subjecting prudential rules to that kind of test. There is, however, an antiabuse provision that says a country may not use the prudential carve-out to avoid its obligations or commitments under the GATS.

Mrs. BIGGERT. Ms. Champion, your testimony indicates that BAFT intends to publish score cards regarding how open the financial sectors are for WTO members.

Ms. CHAMPION. Yes, we plan to evaluate the offers being made by particular countries in the WTO negotiations, with respect to banking products and financial services.

Mrs. BIGGERT. Is this going to be published?

Ms. CHAMPION. Yes, we plan to publish our score card.

Mrs. BIGGERT. So you don't expect to provide a name and shame mechanism to pressure countries to enhance their liberalization. We did this with the computers January 1st of the year 2000, with publishing—actually, the Government Reform Committee gave a—

Ms. CHAMPION. Y2K.

Mrs. BIGGERT. —gave a score card to all the agencies in the United States. In how they were doing and whether they are going to be ready for Y2K and businesses and everything, so I just wonder if you were going to have that kind of thing. It did help, I might add.

Ms. CHAMPION. Just a final comment, we do plan to publish our conclusions.

Mrs. BIGGERT. How will BAFT treat the EU countries. Will you rate each one separately or rate them in a block?

Ms. CHAMPION. We will look at them separately.

Mrs. BIGGERT. Thank you. Well, I guess I am the last man standing or the last woman sitting so we will bring this to a close, and the Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing.

Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record without objection, and I want to thank all of you for being such excellent witnesses. We really appreciate you coming and this has been, I think—it is too bad this is a Tuesday and many of our members aren't back yet, since we go into session tonight, but I think this is an issue that needs a lot of attention. It is very important to—certainly to this country, and our economic global economy and how we are in the world.

So I really appreciate all of you having been here. And with that, this hearing is adjourned.

[Whereupon, at 4:23 p.m., the subcommittee was adjourned.]

A P P E N D I X

November 15, 2005

Prepared, not delivered

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on International Monetary Policy, Trade, and Technology

Increasing Efficiency and Economic Growth through Trade in Financial Services
November 15, 2005

I want to thank Chairman Pryce and Vice Chairman Biggert for holding this important and timely hearing on trade in financial services. We meet at a point in time when progress in the Doha Development Round talks is in question. I join President Bush, British Prime Minister Tony Blair, APEC leaders, WTO Director General Pascal Lamy and others in calling for serious progress at next month's WTO Ministerial Meeting in Hong Kong.

I came to Congress in 1981, during the Cold War. In those days, it seemed self-evident that increasing free trade would generate political and economic benefits for a wide number of people throughout the globe.

I remember the optimism that the fall of the Berlin Wall created for free trade advocates, with the prospect of creating a truly global trading system and the establishment of the World Trade Organization (WTO). In the rubble of the September 11 terrorist attacks in 2001, WTO leaders sought to increase the scope and benefits of free trade to a broader set of economic actors through the Doha Development Round. The goal then and now is to unleash greater economic development through trade, thus distributing the benefits of a free and open trading system to a larger number of people across the planet.

Sixteen years after the fall of the Berlin Wall, almost to the day, I see a troubling backlash against free trade. People are questioning whether increased trade in fact generates economic benefits. People are seeking to protect their way of life and their trade preferences, rather than seek to generate new opportunities for growth and innovation associated with doing business with more people around the world.

These are short-sighted arguments that I hope will not sabotage the WTO's ability to deliver meaningful reform and economic opportunity to a growing community of nations, including over the weekend, Saudi Arabia.

Agricultural issues generate the greatest amount of press regarding free trade. However, the services (including financial services) sector constitutes 80 percent of private U.S. employment. In this sector, the United States runs a large and growing trade surplus which was $55.9 billion in 2002 and $96.1 billion in 2003.

As the most innovative and competitive country in the world, the United States has a strategic interest in fostering greater opportunities for our financial firms, consultants, accountants, and other high-end service professionals to export their services and products worldwide.

This is not a zero-sum game either. The knowledge transfer associated with increased American export of financial and other related services will help people in other countries develop more efficient and economically valuable capabilities at home, fostering economic growth abroad as well as an increased customer base for American goods and services. The multiplier effect associated with increased access to capital for foreign firms is also significant. Increased economic growth abroad can contribute to economic stability. To the extent that capital formation abroad also encourages growth of stock and bond markets, free trade in financial services can provide good working experience for how decisions can be taken through participatory and transparent decision-making processes which are the hallmarks of democracy.

Deeper and more liquid capital markets can also increase financial market resilience. In our inter-connected world, financial shocks can be transmitted more quickly across markets globally. We have a strategic interest, therefore, in fostering greater resilience and depth in foreign capital markets and enabling U.S. firms to participate in those markets on an equal footing with their counterparts.

Without objection, Madame Chairman, I would like to introduce into the record today letters to the USTR expressing my interest in progress within the Doha Round. These letters are co-signed by various Members of the Financial Services Committee and other Members of Congress.

The stakes for progress are high. Failure now would set back our ability to foster greater economic growth and greater peaceful interaction among all countries on the planet. One stream of thinking among extremists in the Middle East rejects global integration and the economic model that delivers growth and opportunity to all individuals that are resourceful enough to create and build their own businesses. We should not let these and other skeptics in Europe and elsewhere endanger the progress that can come from trade opportunities in the financial services and other sectors.

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Congressman Joseph Crowley
Remarks – Fin Serv Hrg – Trade
November 15, 2005

- I want to thank Chairwoman Pryce for holding this hearing this afternoon on the important issue of breaking down global barriers in the realm of financial services.

- Trade and financial services are an important issue for our country and for my home city of New York.

- The breaking down of global trade barriers in this sector will lead to massive economic growth and job creation both here in the US and abroad – and this is an issue that I think Democrats and Republicans can agree on.

- Where we used to worry about New York losing jobs to New Jersey and North Carolina, now we have to worry about jobs and capital moving from New York to Brussels, Bangkok or Bangalore.

- Representing New York City makes me want to see the industry continue to flourish and keep my constituents working for many of the companies in this field.

- That is why I have tried to be active both on this Committee, on the International Relations Committee to open barriers to financial services firms in places like India, the world's largest democracy, Vietnam and other countries.

- And we have had some success – but more barriers need to be brought down.

- Additionally, I have championed bills and agreements that break down barriers and lead to more growth and jobs here in America and internationally.

- Trade agreement like Australia who is the fifth largest investor in US equity markets, means more jobs for my constituents and the companies of my city who trade securities or work for these firms.

- These trade agreements will keep our economy growing, and will increase investments and opportunities for our countries.

- I am interested to hear from our witness from the Trade office, particularly on the upcoming Honk Kong ministerial next month and Ambassador Portman's recent trip to India.

- I look forward to hearing our witnesses today and yield back my time.

TESTIMONY OF

CHRISTINE BLISS

ACTING ASSISTANT U.S. TRADE REPRESENTATIVE FOR SERVICES AND INVESTMENT

BEFORE THE

HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY POLICY, TRADE AND TECHNOLOGY

ON

"INCREASING EFFICIENCY AND ECONOMIC GROWTH THROUGH TRADE IN FINANCIAL SERVICES"

November 15, 2005

WTO FINANCIAL SERVICES NEGOTIATIONS

- Mr. Chairman, USTR appreciates the opportunity to appear before your Subcommittee today to describe our financial services liberalization objectives in on-going trade negotiations, particularly the WTO Doha negotiations.

- The Doha Development Agenda is at the heart of President Bush's strategy to open markets, reduce poverty, and expand freedom through increased trade among all countries in the global trading system.

- We need to move toward a global trading system that provides incentives for innovation and growth in the most competitive aspects of productive sectors both at home and abroad. The services sector is the fastest growing sector of the US economy accounting for 8 out of 10 U.S. jobs. It also provides the brightest ray of hope for growth in developing economies as services accounts for nearly 60 percent of GDP in such countries.

- Financial services leads much of this development (as my Treasury colleague will elaborate on in his testimony). Of course, financial services also is a key part of U.S. exports and economic growth. In 2003, for the financial sector, sales by U.S.-owned affiliates (not including commercial banks) in foreign markets reached $ 122.2 billion. Insurance companies accounted for $ 80.4 billion of those sales. Other financial services firms, including securities and asset management firms, recorded sales of $ 41.1 billion in foreign markets.

- Regarding cross-border supply, U.S. insurance providers recorded cross-border premiums (exports) of $ 18.0 billion in 2004. U.S. banking and securities firms recorded cross-border exports of $ 27.4 billion in 2004 (not including core-deposit taking and lending activities). The U.S. enjoyed a surplus of $ 16.2 billion in 2004 in cross-border trade for non-insurance financial services.

- One of the best ways to successfully promote new U.S. trading opportunities and global economic growth is to complete the WTO Doha negotiations.

- Regarding the Doha negotiations, last week in Geneva, the United States made some progress in narrowing the differences, not just in agriculture, but also in non-agricultural market access (NAMA) and also in services. We and other WTO members are continuing to urge the Europeans to do more on agricultural market access and we are joining the Europeans to ask the more advanced developing countries, like Brazil and India, to do more particularly on manufactured goods and services.

- The United States remains committed to a high level of ambition in the final package. However, WTO members do not expect to have the complete framework that was envisioned six months ago by next month's meeting. Our aim, nonetheless, is to still make as much progress as possible in the days leading up to the Hong Kong Ministerial so that we can achieve a final package in 2006.

- We will continue to work hard to promote a high level of ambition on services and to ensure that the Ministers provide us with necessary guidance to propel the services negotiations forward. Ministers are likely to address issues such as market access; rules; domestic regulation; and development.

- Regarding services market access, the United States is pursuing comprehensive liberalization with a wide range of WTO members to ensure that the overall level of global access increases significantly.

- Within these broad objectives, we are focusing on key sectors for which a critical mass of countries must provide high levels of meaningful liberalization and commitments. Financial services is at the top of this list which also includes telecommunications, energy services, express delivery, computer-and-related services, distribution services as well as other sectors, particularly from emerging markets such as Brazil, India, Malaysia, Thailand, and Egypt. We are seeking commitments that will create meaningful new commercial opportunities in these markets.

- The U.S. also seeks improvements in services disciplines on transparency in domestic regulation that would apply across all services sectors.

- Of course, our WTO partners also have a wish-list for the services negotiations. Developing countries have expressed interest in particular sectors such as tourism, medical services, and professional services and are particularly interested in further liberalization from developed and developing countries alike regarding the temporary entry of service suppliers referred to as Mode 4. India and a group of developing countries are also seeking disciplines on domestic regulations which would extend beyond transparency into areas such as qualification standards. Certain of the Asean countries are seeking flexibility in the rules area –for example, relating to services "safeguards."

- In addition, some countries see services liberalization as primarily a trade for concessions in other areas of the Doha negotiations such as agriculture.

- Although we have been able to increase the level of participation in the negotiations to the point where 69 countries have submitted initial offers and of those 30 have provided revised improved offers (WTO membership totaling 148 recognizing that we may have more modest expectations for least-developed countries), the quality of offers in emerging markets of greatest interest is still poor. So as we plan for negotiations following the Hong Kong Ministerial, we face a major challenge in ensuring that our level of ambition remains high and we secure higher quality commitments.

Financial services

- This challenge is particularly great in the area of financial services. The WTO's 1997 Financial Services Agreement was a first step toward liberalization, with 107 countries making some commitments on financial services. Since then, the U.S. has completed a number of WTO accessions including China and Saudi Arabia which have incorporated significant financial services commitments and continues to negotiate stiff membership terms on financial services and other services sectors with other key economies such as the Ukraine, Russia and Vietnam.

- As part of the Doha negotiations, the United States is focusing on the universe of financial services, including banking, securities, insurance, asset management, pension funds, financial advisory and information and other financial services. The United States has set high, uniform benchmarks for access to improve access for commercial presence (investment) and cross-border supply (for example, supply through electronic means) including as necessary removal of existing barriers. Our objectives are similar across the various financial services sub-sectors.

- We are looking for any and all means to generate momentum for the negotiations. The bilateral request/offer process remains the core of the negotiations and the fundamental means to pursue our export interests. However, we have spent much of the past year working with other countries such as the EU, Canada, Japan, Switzerland that export financial services or have an interest in the benefits of financial services for economic growth through what is being termed in Geneva a "plurilateral" approach to put additional prominence on the sector and to emphasize the need for meaningful financial services offers.

- One recent result of our work at the WTO is a "Statement on the Importance of Financial Services Liberalization," co-sponsored by about a dozen members representing different levels of economic development, and including a call for high market access benchmarks. The benchmarks are generally reflective of the requests for access that we have heard from our financial services industry.

- These objectives have been presented to the WTO Membership and have been incorporated in an informal Annex of sector specific proposals that has been prepared by the WTO Secretariat at the request of the Chair of the Services negotiations. The hope if that the sector benchmarks listed in the Chair's Annex can be used to guide countries in the negotiations and in preparing their revised offers.

- The United States, like other Members, has also submitted specific bilateral requests to all WTO Members, excluding the least developed countries detailing the types of improvements we are seeking across services sectors. For Financial Services we are requesting that countries provide:

  --Commercial presence: Right to establish new and acquire existing companies, in the form of wholly-owned subsidiaries, joint-ventures or branches;

  --Cross-border: For insurance, cross-border supply and consumption rights are particularly important for marine, aviation, transport insurance, reinsurance, brokerage, and auxiliary services. Cross-border supply and consumption is important for financial information and advisory services and cross-border consumption is important for banking, securities and all other financial services;

  --For both commercial presence and cross-border, removal of discrimination between domestic and foreign suppliers regarding application of laws and regulations ("national treatment"). Removal of non-discriminatory limitations such as monopolies, numerical quotas and economic needs tests; and

  --Transparency in development and application of laws and regulations, speedy licensing procedures and commitments on other regulatory issues as needed (as mentioned, we are pursuing this on a horizontal –cross-sectoral—basis).

<u>Financial services offers</u>

- Some of the offers submitted to date have provided small improvements on financial services – mostly related to investment -- but the United States continues to seek meaningful offers from a majority of WTO members to meet the benchmarks outlined above. We need greater participation, particularly among emerging markets, such as Brazil, India, China, Malaysia, Thailand, Indonesia, South Africa and the Philippines.

- Why haven't we made more progress to date, especially in these key markets?

- Sometimes the problem is existing barriers. Other times the country has liberalized but has not yet brought the liberalization into its offer. We are proposing the same benchmarks for access for each country but the amount of pain may differ depending on how far the country has advanced with its own liberalization plans or the recognition of the importance of financial services for economic development.

- We are working at all levels to improve the quality of the financial services commitments. As my Treasury colleague will explain in more detail, Treasury is reaching out to Finance Ministers to put more prominence on the Doha services, including financial services, negotiations. Both USTR and Treasury are working to get the financial services negotiators from key countries more involved in the negotiations through bilateral requests as well as the possibility of plurilateral approaches. We hope they come to see us in Geneva. But if not, we'll find a way to reach out to them in their capitals.

- In the last month, the United States made a major offer of new agricultural liberalization and in doing so we expected to see similar offers from other WTO Members not only in agriculture but also in services and other areas of the negotiations. So we hope that this will provide some new momentum and that as other parts of the Doha agenda begin to move forward, we can successfully press countries to improve their services offers, particularly in financial services.

FINANCIAL SERVICES INITIATIVES BEYOND THE WTO

- The United States also is forging ahead to achieve regional and bilateral liberalization in financial services. Our Free Trade Agreement (FTA) objectives are fully supportive of our WTO objectives by maintaining high benchmarks for liberalization which provide immediate access for U.S. suppliers and may also result in more active participation by the FTA partners in the WTO Doha negotiations.

- The U.S. model FTA financial services chapter is comprehensive and covers both investment and cross-border supply. We require our trading partners to use a negative listing for investment access – whereby national treatment and other core obligations automatically apply unless the sector is carved out. We also include strong disciplines on regulatory transparency, licensing and other regulatory issues.

- The Bush Administration has concluded FTAs with Jordan, Singapore, Chile, Australia, Morocco, the Central American nations of Nicaragua, Guatemala, El Salvador, Honduras, Costa Rica, and the Dominican Republic (the Central America-Dominican Republic FTA or CAFTA-DR), and Bahrain. We recently announced our conclusion of the Oman FTA which we expect to sign in mid-January and would then reflect on the most appropriate timeframe for introducing it for Congressional consideration.

- We have ongoing FTA negotiations with several countries. We are meeting this week at an advanced stage of the negotiations with the Andeans (Colombia, Ecuador, Peru). We continue negotiations with the UAE and Panama. With Thailand, we are seeking to build on the existing Treaty of Amity to provide enhanced access for a full range of financial services suppliers. We are continuing exploratory talks with the South African Customs Union countries –South Africa, Botswana, Lesotho, Namibia and Swaziland.

- New and pending FTA partners, taken together, would constitute America's third largest export market and the sixth largest economy in the world.

- The FTAs have resulted in significant liberalization, often well beyond what has been achieved in the GATS. Just a few examples: Singapore agreed to groundbreaking liberalization of its banking regime over time, including for wholesale and retail banking. Costa Rica will open up its insurance monopoly over time. And Chile, Singapore, the CAFTA nations, and Morocco agreed to concrete changes to their regimes to ensure that insurance can be provided on a cross-border basis.

- We also participate actively in regional fora such as APEC to promote some of the same objectives –market access and transparency –that we explore in a more binding fashion as part of the Doha services negotiations.

CONCLUSION

- USTR appreciates the opportunity to testify before you today regarding the U.S. Government's trade objectives in the ongoing WTO Doha negotiations and our various bilateral and regional initiatives.

Increasing Efficiency and Economic Growth Through Trade in Financial Services

Statement of
Madeleine L. Champion, Managing Director
JPMorgan Chase & Co.
on behalf of the
Bankers' Association for Finance and Trade

before the U.S. House of Representatives
Committee on Financial Services
Subcommittee on Domestic and International Monetary Policy,
Trade and Technology

November 15, 2005

Introduction

I am pleased to be with you today to discuss the banking industry's views on increasing efficiency and economic growth through trade in financial services. I am testifying today as the president of BAFT—the Bankers' Association for Finance and Trade—an organization founded in 1921. Today BAFT is an affiliate of the American Bankers Association and its membership includes most of the major American banks that are active in international banking and also many of the major international banks chartered outside of this country.

My employer, JPMorgan Chase & Co., is one of the largest U.S. financial services institutions. Many of our clients engage in business activities around the world and we provide them with a wide range of retail and commercial banking, securities, asset management, and other investment banking products and services on a global basis. Our commitment to lowering international trade barriers reflects our clients' interests as well as our own.

Importance of International Business Activities

Although only a few of the largest U.S. banks operate on a truly global scale, international business activities are an important part of the business of many U.S. banks, both large and small. As one of the global banks, JPMorgan Chase in 2004 earned more than 30% of its total revenues in international activities—transactions that involve customers located outside of the United States. We have operations in more than 50 countries. The importance of our international business is reflected in our international council, an advisory board with 26 members from the U.S. and 16 other nations.

Similar statistics can be cited for other global U.S. banking organizations. Citigroup is on the ground in more than 100 countries and territories, ranging from Argentina to Zambia. In 2004 Citigroup earned 53% of its income outside of North America. Bank of America has offices in 35 countries, supporting clients in 150 countries. In 2004, 5.7% of Bank of America's assets were attributable to non-U.S. business, as was 5.6% of its total revenue. Another major U.S. bank, Wachovia, has 40 international offices.

Other U.S. banks participate in international business through trade finance and correspondent banking. For example, Wells Fargo is a partner in a joint venture called Wells Fargo HSBC Trade Bank, a U.S. national bank dedicated exclusively to international trade, and Comerica has more than 1,400 correspondent banks worldwide.

Whatever their international business activities might comprise, BAFT members support the reduction of international trade barriers. To the extent those barriers impede the flow of goods and services across national borders, they limit the commercial activity and economic growth that U.S. banks finance. To the extent they impede U.S. banks' ability to conduct business across borders and within foreign markets, those barriers directly limit the banks' growth and profitability. Reduction of international trade barriers will benefit American banks *and* their customers of all sizes and kinds. Today many more American businesses, including small and medium-sized companies, are establishing operations overseas and require local banking services. In many cases, it is advantageous for them to be able to do business with the local office of an American bank. Reduction of trade barriers also will help to address our country's worrisome trade deficit, which is at an all-time high (currently running at an annual rate of $706 billion). The U.S. generally is an open market and we will be the beneficiaries of a reduction in international trade barriers as markets in other countries become more open to us. This is particularly true with respect to banking and other financial services where the U.S. enjoys competitive advantages; it is a trade sector that has shown the capacity for substantial growth and it will grow even faster when trade impediments are removed.

Restrictions Faced by U.S. Banks in Foreign Markets

U.S. banks maintain representative offices, branches, and subsidiaries, and conduct diverse business activities, in many foreign markets around the world. In fact, until the adoption of the Gramm-Leach-Bliley Act in 1999, U.S. banking organizations were permitted to engage in a much broader range of financial activities outside of the U.S. than they were permitted to conduct at home. One of my firm's predecessor banks, JPMorgan, first developed its securities underwriting and dealing capability (and related operational services such as custody and cash management) in Europe and the U.K. because at the time it was not permitted to conduct those activities within the U.S. Notwithstanding the scope of their international business, however, U.S. banks continue to encounter a wide range of restrictions on their presence and business activity in foreign markets.

China provides a good example. This is a country that has experienced tremendous growth since 1978 when Chinese political leaders began the transition to a market-oriented system. The gross domestic product of China has quadrupled since 1978 and by 2004 China was the second-largest economy in the world. This clearly is a desirable market with huge potential for financial services firms from the U.S. and elsewhere.

In connection with its accession to the WTO in December 2001, China made a large number of commitments to open its markets to foreign participants, including banks, and it has made impressive progress. Foreign banks were allowed immediately to engage in foreign (*i.e.*, non-Chinese) currency operations throughout China. Last December, China began to phase-in Chinese-currency operations for foreign banks (based on location) and the country has committed to eliminate geographical restrictions and customer limitations on foreign banks by the end of 2006. Despite these important steps, however, U.S. and other non-Chinese banks continue to face obstacles in Chinese markets.

These include China's restrictive limits on foreign investment in Chinese banks. A single non-Chinese investor may not own more than 20% of the equity in a Chinese bank, and total foreign investment in a single Chinese bank is limited to 25%. Although foreign banks are permitted to operate through branches, they are subject to capital requirements that are applied on a branch-by-branch basis and exceed the capital requirements imposed on local banks. The branch licensing process also is slow and, among other things, requires a foreign bank to have a representative office in the same province for at least two years before obtaining a branch license. Representative offices are limited to representing only the head office of the bank, but not the business activities of its branches, subsidiaries, or affiliates.

The regulatory system in China is another impediment for U.S. and other non-Chinese banks. A study of foreign banks in China, published by PricewaterhouseCoopers in September 2005, found that new regulations are the most important issue they face and that the regulatory environment is regarded as the most difficult aspect of doing business there. Criticisms expressed by the foreign banks included: interpretation of regulations varies from place to place, regulations are not well thought-out and applied in an arbitrary and ad hoc manner, and the overall nature of the legal framework is rudimentary.

We don't wish to single out China as being a uniquely difficult place for U.S. banks to do business, particularly in light of the significant progress they have made and which we believe they fully intend to continue to make in the future (though we should continue to closely monitor their progress in meeting their commitments). U.S. banks face difficult challenges in many WTO-member countries. For example, a review of various countries' limits on foreign banks undertaken by the Coalition of Service Industries in February 2003 noted that in India foreign banks' share of total system-wide banking assets was limited to 15%; foreign banks were subject to higher taxes than domestic banks; and foreign banks were subject to more restrictive capital requirements than domestic banks. Foreign banks are permitted to operate in India through branches and wholly owned subsidiaries, but their investments in non-distressed private-sector Indian banks generally are limited to less than a controlling interest (foreign banks that acquire troubled institutions may be able to acquire control). Foreign investment in India's public-sector banks, which dominate the banking market, is even more limited. Although India plans to allow greater foreign investment in private banks, that will not occur until 2009.

In Indonesia, a 1988 deregulation package partially opened banking to foreign investment. In 1998 Indonesia exceeded its WTO commitments by allowing foreign banks to own up to 99% of the equity in local banks. But in 2003, CSI noted that Indonesia was not granting licenses for new branches or subsidiaries of foreign banks. In the Philippines, foreign banks may control no more than 30% of the country's total banking assets; there is a moratorium on licenses for new banks and there are discriminatory limits on foreign banks opening new branches. The United States Trade Representative's 2005 Report on Foreign Trade Barriers noted that rural banking in the Philippines is totally closed to foreigners.

In Thailand, foreign banks are permitted to open only one branch and an off-site ATM is classified as a branch. Foreign investment in Thai banks is capped at 25% of total equity. (We hope these issues will be addressed in the free trade agreement the U.S. and Thailand are negotiating and hope to conclude in early 2006.) Korea permits foreign banks to operate through subsidiaries or branches, but imposes branch lending limits on the basis of branch capital. USTR's 2005 Report concluded that, "All banks in Korea continue to suffer from a non-transparent regulatory system and must seek approval before introducing new products and services—an area where foreign banks are most competitive."

Similar restrictions and limitations can be found in many other countries. I've chosen the ones I've mentioned because they are found in some of the biggest and most interesting foreign markets for U.S. and other banks. China and India, as the world's fastest growing economies, are particularly significant and obtaining trade barrier reductions in their markets are high priorities for many American banks.

I also want to mention several limitations imposed on foreign banks in Russia, which is not yet a WTO member. (The Russian Federation is in the process of negotiating with current WTO members regarding the market-opening concessions it is willing to make in order to gain accession to the WTO.) Russia prohibits foreign banks from operating through branches. Non-Russian banks are permitted to operate only through subsidiaries—my bank has a Russian subsidiary, as does Citi—and the Russian Central Bank has the authority to impose a limit on foreign bank subsidiaries' share of the total charter capital of Russian banks.

U.S. banks hope that the WTO's Doha Round of trade negotiations will lead to a significant reduction in trade barriers generally, as well as in the restrictions imposed specifically on foreign banks by many WTO-member countries. But multilateral negotiations are not the only avenue for reducing trade barriers. We also support our country's bilateral negotiation of free trade agreements and we hope these efforts will continue. Our banks will benefit from gaining greater access to foreign markets in whatever manner it is achieved. Local consumers and businesses in other countries also will benefit from the competition, management expertise, skills transfer, new operating methods, innovative products and services, and standards of conduct that U.S. and other foreign banks can bring to their markets. In addition, particularly in developing countries, the presence of highly rated international banks generates greater confidence in the banking system and encourages local citizens to open accounts and become integrated into the economy. Increasing deposits in the banking system adds liquidity and stability to the local economy and makes funds more available for local business. The benefits of opening local markets to foreign competition extend to all levels of the economy.

Characteristics of Open and Competitive Markets

Open and competitive markets share certain fundamental characteristics: national treatment; unrestricted market access, including freedom to choose a suitable business structure; and transparency. We believe that countries participating in the Doha Round should have these characteristics as a goal for their own financial services markets and that their offers and revised offers to reduce trade barriers should strive to achieve that goal. BAFT plans to evaluate the Doha Round's progress with respect to banking services on a country-by-country basis using these characteristics as a benchmark. We also believe that countries like Russia that wish to become WTO members should make concessions that are consistent with these fundamental characteristics.

National treatment is achieved when domestic and foreign firms have the same opportunities to compete and are subject to the same rules governing their activities in the local market, without regard to the location of their charter or home office or that of a parent or affiliate. Of course, different rules can and should apply to firms that are situated differently, but only with respect to relevant factors such as business activities and type of organization; the differentiating factor should *not* be nationality.

Unrestricted market access means that domestic and foreign firms should have the same ability to offer their products and services in all segments of a particular market. This includes government procurement. Government entities should not prefer local firms solely because of their nationality. It also means that domestic and foreign firms should have the ability to serve their customers in whatever manner they determine to be best suited to their business needs: by establishing a business entity locally (and having the choice whether to operate through a subsidiary or a branch), by using a local business entity with support services coming from outside the country, by providing products and services across borders without a local establishment, and by providing products and services to customers who cross borders to obtain them. The choice should be governed by the requirements of the business and the needs of its customers, and not by dictates based on nationality or borders. Unrestricted market access requires that employees have the ability to travel across borders freely for business purposes, and that businesses have the ability to move employees into and out of local markets based on business need (referred to as business travel facilitation). Unrestricted market access also means that countries should not impose economic needs tests as a barrier to market entry—the market itself is a much better and impartial judge of economic need.

Transparency is a particularly high priority for banks and other financial firms because their businesses are highly regulated. Banks spend an enormous amount of time and money determining how they can conduct business in the various jurisdictions in which they operate and keeping abreast of changes in the regulatory rules in each of those jurisdictions. Transparency means that the laws, regulations, and other rules governing banking activities in a particular country should be written, compiled in an intelligible manner, and accessible to the banks that must comply with them. Both domestic and foreign banks should be given advance notice of proposed new rules and regulations or changes in existing ones, with reasonable opportunity to comment. They should have advance notice before new rules and regulations go into effect and should be given sufficient time to study, understand, and comply. Transparency means that laws, regulations, and rules should be applied in a consistent and uniform manner among institutions, whether domestic or foreign, and from place to place within a particular country.

Transparency also is needed with respect to licenses and the licensing process. The requirements for granting a license should be specific and objective, and they should be written and accessible to the banks and individual bank employees that need licenses for particular activities. Decisions on license applications should be made promptly and reasons should be given if license applications are denied. Full transparency also requires that an appeal process be available for disappointed license applicants.

Conclusion

We believe that U.S. banks can realize significant benefits from a general reduction in global trade barriers and, thus, they have much to gain in the WTO's Doha Round of trade negotiations. We are concerned, however, about the slow progress being made in the Doha Round. Of the 148 WTO members, only 93 (including each of the EU countries as a separate entity) had made initial offers covering financial services as of mid-October 2005 (initial offers were due on March 31, 2003) and only 52 had submitted revised offers (which were due May 31, 2005). Although BAFT has not yet evaluated individual countries' offers, the overall quality of the initial and revised offers generally is regarded to be unsatisfactory, as reported by the WTO's Trade Negotiations Committee (TNC) Chairman (and WTO Director-General) Supachai Panitchpakdi in July. In fact, some countries' offers do not even go so far as to commit to trade barrier reductions that equal what the countries permit in actual practice today. The TNC Chairman's July report included comments from various participants that described countries' financial services offers similarly.

The success of the Doha Round is important and we urge all of the participating countries to redouble their efforts and make aggressive reductions in their trade barriers. It is in their own best interest to do so. The U.S., as the world's largest and strongest economy, should take the lead and set an example for others to follow. We have done so in our proposal to reduce agricultural subsidies and should do so across the board, including in particular with regard to business travel facilitation.

BAFT greatly appreciates the efforts of the U.S. Treasury Department and USTR in promoting financial services liberalization within the WTO negotiations. I would like to emphasize that securing broad services liberalization—and specifically significant financial services liberalization—is essential to an agreement being one we can support.

Statement of the Honorable Donald L. Evans
Chief Executive Officer, Financial Services Forum

Testimony Before the
Subcommittee on Domestic and International Monetary Policy, Trade and Technology
of the
House Financial Services Committee

November 15, 2005

** Embargo Until 2:00 p.m. November 15, 2005 **

Madame Chairwoman Pryce, Vice Chairwoman Biggert, Ranking Member Maloney, thank you for the opportunity to participate in this important hearing on increasing efficiency and economic growth through trade in financial services. And thank you for your leadership on the critical issue of the importance of trade to our nation's economy and the broader global economy.

I am here as the chief executive officer of the Financial Services Forum, a financial and economic policy organization comprised of the chief executives of 20 of the largest financial institutions with operations in the United States. The Forum's purpose is to promote policies that enhance savings and investment and that ensure an open, competitive, and sound global financial services marketplace.

I strongly believe that two of the greatest challenges confronting the United States and the world today are the need to address persistent poverty, and the need to effectively deal with the challenges associated with globalization. I am convinced that freer and more open trade is perhaps the most powerful tool at our disposal in both efforts, and that the multinational framework known as the World Trade Organization is critical to maintaining an open global trading system governed by the rule of law.

Madame Chairwoman, as you know, my schedule today is such that I am only able to make an oral statement. I apologize for the brevity of my appearance, and very much appreciate the chance to discuss a topic so critical to the well-being of our economy, our nation, and, indeed, our world. My colleague, Rob Nichols, President of the Financial Services Forum, will be delighted to answer any questions that Committee members might have. My brief remarks today will be accompanied by written testimony, which will be submitted for the record.

Chairman Oxley, before I begin, on the occasion of your recent announcement to retire at the end of your current term, let me congratulate you on a remarkable career of public service. For ten years you have faithfully represented the interests and concerns of your constituents in Ohio's 4th District, and for nearly six years you have lead this distinguished Committee. Over that period, you have been a tireless advocate of the individual investor and depositor, and have worked hard to ensure that the U.S. financial system remains the envy of the world. I thank you for your service to our nation, and wish you well as you move on to new endeavors.

Trade as a Path To Peace and Prosperity

Madame Chairwoman, as you know, the World Trade Organization (WTO) was established in 1994 during the Uruguay Round of trade negotiations – the eighth round of multinational negotiations held under the General Agreement on Tariffs and Trade (GATT). The GATT was created in 1947 as part of the world's response to the devastation of World War II and the policy failures and Great Depression that led in part to that historic calamity. The organizing principal was simple and inspired – to promote global stability and security by expanding economic opportunity and raising living standards around the world.

The connection between trade and economic development had been made 170 years earlier by Adam Smith in his classic work "The Wealth of Nations." Trade, Smith explained, increases the size of markets, thereby promoting competition and all the associated benefits, such as greater efficiency, lower prices, and innovation. Trade also provides access to the resources, goods, and services that nations lack or can only make with great difficulty. Trade, therefore, promotes peace by substituting internal development for territorial enlargement through conquest. To these seminal observations, British economist David Ricardo added his notion of comparative advantage, whereby countries with very different capacities and levels of productivity can still trade to mutual benefit.

The great significance of the GATT was that it marked the first time the world had enshrined these principals in a multinational framework aimed at promoting global economic growth and development by reducing barriers to trade.

And the results, have been nothing short of phenomenal. Between 1950 and 1998, global economic output rose by 530 percent, while the volume of merchandise exports rose 1,840 percent. Over that 50-year period, the ratio of trade to global output tripled, from about 7 percent to more than 20 percent. In what has been the most dynamic era of economic development in human history, trade has become the basis for a prosperous world economy.

Openness to trade has also become the distinguishing characteristic of the world's most productive economies. Capitalizing on trading opportunities is a major reason why small but open economies such as Finland, Hong Kong, Singapore, and Taiwan are able to generate standards of living far higher than most of the world's largest and resource rich countries, including China, India, Indonesia, and Brazil.

Academic research has established that countries that have more open economies and that engage in international trade enjoy higher growth rates and faster reductions in poverty than more closed economies.[1] The World Bank has also determined that over the past two decades, those developing countries that engaged in trade enjoyed the fastest growth in wages.[2] Indeed, since World War II, no nation has prospered without exploiting opportunities to trade.

It should also be emphasized that the gains associated with free trade have not been purely economic in nature, but also political. China's remarkable assent over the last twenty years followed Deng Xiaoping's decision to emulate what he saw happening in Taiwan and to set a course of greater openness. And China's progress helped inspire India to embark on its own ambitious program of trade and foreign investment liberalization. The resulting accelerations in economic growth – to an average annual rate of 6 percent in India and more than 9 percent in China – have lifted hundreds of millions of people out of poverty, perhaps the greatest achievement in the war on poverty in history.

Of course, it hasn't just been the rest of the world that has reaped the rewards of trade. Lest we forget – and too many of us, it seems, do forget – the United States of America has benefited enormously from freer and more open trade. The U.S. represents about 18 percent of global trade and is the world's largest exporter. Since the creation of the WTO ten years ago, U.S. exports of good and services have increased 65 percent to more that $1 trillion, with manufacturing, agricultural, and high technology exports growing by 65, 38, and 67 percent, respectively.

Thanks in large part to the passage of the North American Free Trade Agreement (NAFTA), over that same period, U.S. exports to Mexico more than doubled, while exports to Canada and the EU grew by 66 and 56 percent, respectively. The growth in exports to China has been even faster, nearly quadrupling over the past 10 years. China's entry into the WTO in December of 2001 greatly improved market access, with China committing to reduce its tariffs on industrial products, which had averaged 25 percent, to an average of about 9 percent.

The recent passage of the Central American Free Trade Agreement (CAFTA) will add to this progress by providing American exporters with clear access to a market of 44 million consumers, creating the second largest U.S. export market within Latin America – larger than Russia, India, and Indonesia combined.

Many people think of trade as benefiting mainly large corporations, and so it's important to note that small businesses are increasingly important players in the global economy, with a critical stake in advancing U.S. interests in the WTO agenda. Between 1992 and 2002, U.S. exports from small and medium-sized enterprises rose 54 percent to $158.5 billion.

The relative importance of trade to the U.S. economy has also increased. Twenty years ago, the total value of U.S. exports and imports amounted to 17 percent of America's GDP. Today, trade accounts for a quarter of our economic output – and the jobs of more than 12 million American workers. Add to that the nearly 7 million American workers currently employed by foreign firms who outsource jobs to the United States. Honda employs 24,000 Americans, and is the largest single employer in central Ohio; Nestle employs 43,000; BMW employs 5,000 in South Carolina alone; Toyota will soon open a new plant in San Antonio, Texas, adding 2,000 new jobs to the 33,000 Americans the company already employs.

By offering prosperity in return for peaceful exchange and market-led cooperation, trade has become the foundation for progress around the world. The critical task before us now is to build on our achievements of the past sixty years by extending freer and more open trade to those countries and regions that have not as yet enjoyed the developmental power of international trade.

The Critical Importance of the WTO

The Uruguay Round of the early 1990s was significant in that it expanded coverage of GATT rules beyond manufactured goods to include agricultural trade, services, trade-related investment measures, intellectual property rights, and textiles. But the Round's most significant achievement was the creation of the WTO to administer GATT agreements and to settle disputes among WTO members.

WTO membership now includes 148 nations. Additions of significance over the past decade include not only China, but also Jordan, Cambodia, and several former Soviet Republics. And membership negotiations for more than 20 other countries, including Russia, Vietnam, Ukraine, Saudi Arabia, Afghanistan, and Iraq are ongoing. Such sustained interest in joining the WTO – particularly given that fact that membership criteria today are far more demanding than under the GATT regime – underscores the importance the world attaches to membership in the WTO, as well as the significant benefits associated with a member-driven, rules-based approach to the global trading system.

The creation of the WTO was in many ways the culmination of a decades-long, bipartisan American commitment to lead the world away from economic isolationism and toward an open, rules-based global trading system. And the United States continues to exercise its leadership in the WTO. For example, the U.S. aggressively uses WTO machinery to enforce our hard-won trade-related rights. Since the creation of the WTO in 1994, the U.S. has brought more dispute settlement cases than any other member, cases involving products ranging from apples and dairy, to biotechnology and telecommunications.

The WTO also advances U.S. interests on a day-to-day basis through the more than 20 standing WTO Committees that meet regularly to administer agreements, allow members to exchange views, and to develop initiatives aimed at improving existing agreements and their operation.

Responding to U.S. leadership, the WTO's agenda has provided the path for significant market-opening progress over the past decade, such as concluding the Information Technology Agreement (ITA) to eliminate tariffs worldwide on IT products, and bringing the Basic Telecommunications Agreement into effect, which opened up 95 percent of the world's telecommunications markets. Both achievements enable citizens around the globe to take advantage of the Information Age.

Study after study shows that the WTO's rules-based system promotes openness and predictability, leading to increased trade and improved prospects for economic growth in member countries. In addition, by promoting the rule of law, the WTO fosters a better business climate in developing countries, which helps them attract more foreign direct investment, thereby increasing economic growth around the globe.

Simply put, in a world where over 95 percent of consumers live beyond our borders, the WTO is an essential tool for advancing U.S. interests.

WTO countries are currently participating in the ninth round of negotiations, called the Doha Development Round, which was launched in Doha, Qatar, in November of 2001, in the immediate aftermath of the September 11th terror talks. The main areas of focus in the negotiations are agriculture, industrial market access, services, trade facilitation, WTO rules and the promotion of economic development.

As has been the case before, the Doha negotiations have an effective deadline – the expiration of President Bush's "fast-track" authority in July of 2007. To meet this deadline, the President would likely have to present the text of any agreement to Congress by sometime early that Spring – meaning the Doha negotiations must successfully conclude by the end of 2006.

A successful conclusion to the Doha Round matters for at least four important reasons – reasons that everyone in this room should care about:

- First, it would be illogical and self-defeating to abandon the WTO framework, given the phenomenal impact of expanded trade on global economic growth, together with the increasing extent to which American jobs depend on trade. The world has accomplished much in sixty years, but there is much more work to be done, particularly as the process of globalization broadens and accelerates. The United States and the world need the WTO more now than ever before.

- Second, success at Doha promises substantial economic gains. Indeed, a World Bank study released just last week estimates the global gains from further trade liberalization at nearly $300 billion a year – even without factoring in productivity gains generated by additional competition.[3]

- Third, the same World Bank study states that the developing world stands to gain the most from a successfully completed Doha Round. According to the study, developing countries would obtain 45 percent of the gains reaped from freer trade, well above their one-fifth share of global output. This outsized potential gain stems from the fact that developing countries retain the highest barriers to trade, and because the developing world's comparative advantage is in products, such as agriculture, that remain highly protected in world markets.

- Fourth, failure of the Doha Round would be the first since the creation of the GATT nearly sixty years ago. Failure would undermine the credibility of the WTO, which would be tragic, as it represents the world's most significant and productive achievement in multilateral rule-making.

Given such high stakes, the United States and our trading partners in Europe and around the world must put the broader good ahead of special or parochial interests and recommit to doing what is necessary to bring the Doha Round to a successful and productive conclusion.

Trade in Financial Services

The focus of this hearing is the promotion of economic growth through trade in financial services. This focus is appropriate, because the financial sector is unlike other sectors of the economy. Indeed, in many ways, it is the essential sector upon which the vitality and growth of all other sectors depend.

As we all know, starting a business, expanding an existing business, buying a home, sending a kid to college, really any productive or entrepreneurial activity, requires money – investment capital. Money and credit are the lifeblood of any economy. As the financial sector becomes more developed and sophisticated, capital formation becomes more effective and efficient, increasing the availability of investment capital and lowering costs. A more developed and sophisticated financial sector also increases the means and expertise for mitigating risk – by this I mean everything from derivatives for businesses to avoid price and interest rate risks, to insurance products to mitigate the risk of natural disasters.

The depth and flexibility of the financial sector is also critical to the broader economy's resilience – its ability to weather, absorb, and move beyond the inevitable booms and busts of a dynamic economy. For these reasons, the financial sector is really a "force multiplier" for progress and development, amplifying and extending the underlying strengths of an economy.

I decided to join the Financial Services Forum because I've been a regular customer of the industry for more than four decades. Like virtually every kid, my first experience with the financial sector was starting a small savings account – at the Spring Branch bank in Houston, Texas. When I started a business, I got a loan. And when I needed to make payroll, my banker helped me do it. Later in my career, when our company needed equity to grow and build value and create more jobs, we went to the capital markets. I knew this industry took good care of its customers, because they took good care of me, our employees, and our shareholders.

And all around the world – in western China; or Mumbai, India; or the Ache province of Indonesia – there are other kids with dreams of their own – to enjoy a life better than their parents knew, to go to college, launch a career, start a family, open a business, and make their community better. Every step of the way, those kids are going to need a financial partner – to get the loans they'll need, to help them save and invest, and to insure their cars, businesses, and homes.

The biggest impediment to development in the world's poorest countries is not a lack of generosity on our part or a lack of ideas or motivation on their part – it is a lack of financial freedom. In the poorest nations on earth, people can't gain title to their home so they can borrow money; can't start businesses without paying enormous bribes to authorities; can't turn their hard work and inventions into marketable products. These people can never prosper, even with all the charity in the world.

The surest way to deliver people from poverty is to get them jobs and allow them trade. And a great way to create more jobs is to help communities become part of the global financial community. Trade permits the sharing of world class know-how, best practices, and global standards. It raises the bar for everyone. And when that happens, the results are inspiring and prove something we all hold dear: every life has promise, and we all should have a chance to succeed.

As each nation joins the global economic community, they will take different approaches, and each nation will make a unique contribution to our shared prosperity. But regional or national differences must not be allowed to justify protectionism or corruption. Nor should our differences get in the way of working toward the common goal of eliminating poverty.

When someone saves a dollar in a bank, or a peso or yuan or rupee, they should be able to do so with confidence. And when they want to invest, either at home or abroad, nothing should stand in their way. This is what is known as the free flow of capital – and it is the essence of what the financial services community stands for. Where opportunity exists, capital must be allowed to go.

Just as a free press allows ideas to thrive, and the free practice of religions allows faith to flourish, the free flow of capital is the single most important force driving the global economy. It was essential to America's rise as an economic giant – and it is essential to today's developing markets.

It's tempting for some to try to impede the free flow of capital. Some say that investment by foreigners in America, or investment by Americans in foreign markets, is a threat, and represents a loss of sovereignty. But when someone puts their money in your nation, it is not an invasion. It is a sign of faith and trust in your future. It is a sign of confidence that as you grow, your success will create success for others.

Economic growth is not a zero sum game – when it happens in one place in the world, it also will happen somewhere else. And our world will be better off for it.

America makes countless opportunities available to our young men and women so they can get an education, buy a home, start a business, and create opportunities for someone else to get a job. This happens because Americans believe in our young people, and because the United States has built a financial services industry that believes in taking chances on the future. I am proud to have joined an industry that sees opportunity everywhere, and stands ready to help bring prosperity to every corner of the globe.

Conclusion

Madame Chairwoman, the global trading system is not perfect and will always remain a work in progress. And given the complexities – technological, political, and cultural – that stem from the accelerating pace of globalization, further trade liberalization is hard work. But that hard work is even more important today than it was following a catastrophic World War. To ensure that all nations reap the maximum benefit from trade, the global trading system must operate with predictability and transparency, without discrimination against the products of any nation, and providing the means to address unfair trade practices. This is the crucial responsibility of the World Trade Organization.

We must keep in mind that, while trade can cause transitional pain for some American workers, building walls around the United States would cause enormous permanent pain for all Americans. Imagine, for example, if U.S. computer companies were forced to make all their components at home: the cost of owning a computer would be much higher, so fewer businesses would have access to productivity-enhancing, wealth-creating tools, which help make them more profitable, grow faster, and better able to hire more workers.

By capitalizing on what different countries do best, trade lowers costs, frees up capital and other resources to be used more productively, raises living standards, promotes growth and development – all of which promotes faster job creation.

It's worth remembering that twenty years ago, many argued that the United States needed "common sense" protections and a government-initiated "national strategy" to prevent millions of manufacturing jobs from being "exported" to Japan and other Pacific rim "Asian Tigers." Fortunately, calls for protectionism and increased government direction of the economy were rejected. Instead, U.S. companies cut costs, increased research and development, and invested in productivity-enhancing technologies. As a result, the longest economic expansion in the nation's history was unleashed, creating 35 million new jobs and launching the information technology sector, whose jobs paid, on average, 75 percent more than the jobs sent overseas.

The United States is an economic phenomenon, with annual output exceeding $11 trillion – greater than the total output of the next five most productive economies combined. This unprecedented economic success is not due to the size of the U.S. population or its natural resources – other countries have more – but to the free-market principles and policies around which the economy is organized. Free trade is a critical ingredient in that proven recipe for prosperity.

And the participation and leadership of the United States in the global trading system by way of the WTO remains a critical element for ensuring America's continued prosperity, and for meeting the challenges of ensuring a more stable and secure world.

Madame Chairwoman and members of the Committee, it is an honor to be with you today. Thank you for the opportunity to contribute to your deliberations.

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[1] "Trade, Growth, and Poverty," World Bank, 2001; Jeffery Frankel and David Romer, "Does Trade Cause Growth?" World Bank 1999; and Francisco Alcala and Antonio Ciccone, "Trade and Productivity," World Bank 2001.

[2] "World Development Report," World Bank, 1995, p. 55.

[3] Kym Anderson and Will Martin, "Introduction and Summary to Agricultural Trade Reform and the Doha Development Agenda," World Bank, November 2005.

Testimony of Dr. Sydney J. Key
Former Staff Director of the Subcommittee[1]

Before the
Subcommittee on Domestic and International Monetary Policy,
Trade and Technology
Committee on Financial Services
U.S. House of Representatives

"Increasing Efficiency and Economic Growth
Through Trade in Financial Services"

November 15, 2005

Financial services liberalization under the General Agreement on Trade in Services (GATS) is one part of the larger process of achieving markets that are competitive and efficient on a global basis and strengthening domestic financial systems. Trade in financial services—together with enhanced prudential regulation and supervision and other basic structural reforms—can play an important role in helping countries build financial systems that are more competitive and efficient, and therefore more stable. The Doha round negotiations offer an opportunity to contribute further to this effort by supporting and building upon political and market forces for liberalization and by obtaining binding commitments subject to the WTO dispute settlement mechanism.

This afternoon, I will try to put financial services liberalization in the GATS in perspective by focusing on three issues:

1. the relationship between efforts in the WTO to open markets and the work on strengthening domestic financial systems that is taking place in other international fora;

2. the importance of undertaking binding commitments in the GATS;

3. using the Doha round negotiations to go beyond traditional market opening to include regulatory transparency.

1. <u>Complementary and mutually reinforcing relationship between trade liberalization and strengthening domestic financial systems, including prudential regulation and supervision</u>

[1] Dr. Key is testifying in a personal capacity as a former Staff Director of the Subcommittee. This statement is adapted from her book THE DOHA ROUND AND FINANCIAL SERVICES NEGOTIATIONS (AEI Press, 2003) and her chapter on financial services in THE WORLD TRADE ORGANIZATION: LEGAL, ECONOMIC AND POLITICAL ANALYSIS, Arthur Appleton, Patrick Macrory, and Michael Plummer, eds. (Springer, 2005).

The financial sector is a critical component of a nation's economy: it not only contributes directly to output and employment but also provides an essential infrastructure for the functioning of the entire economy. Opening markets to foreign financial firms can benefit both consumers of financial services and the domestic economy as a whole. The presence of foreign firms can create more competitive and efficient markets for financial services, thereby supporting economic growth and development and contributing to a more resilient domestic financial system. At the same time, however, ensuring adequate prudential regulation and supervision of financial firms and markets, together with other fundamental domestic structural reforms to strengthen domestic financial systems, is essential to obtain the maximum benefits of liberalization while minimizing the risks. Basic structural reforms include increasing transparency and accountability in both the private and public sectors; introducing effective risk management techniques; and developing the institutional infrastructure, such as insolvency laws and appropriate judicial procedures.

Work aimed at strengthening domestic financial systems is taking place in a variety of international fora, ranging from the International Monetary Fund (IMF) to specialized bodies such as the Basel Committee on Banking Supervision. This work includes promoting cooperation and coordination among financial supervisors and setting voluntary—but widely accepted—international minimum standards and codes of good practices. The Financial Sector Assessment Program of the IMF and World Bank, which involves assessing the strengths and vulnerabilities of a country's financial sector, includes monitoring and helping to build institutional capacity for implementation of the international standards and codes.

Because measures to promote competitive markets and to strengthen domestic financial systems are complementary and mutually reinforcing, the relationship between financial sector liberalization and regulation has two distinct dimensions. On the one hand, liberalization requires reducing or removing anticompetitive regulations that pose unnecessary barriers to trade in services. On the other hand, liberalization requires increasing the strength and quality of certain regulations and, in some areas, introducing new regulations. Thus the process of liberalization involves, among other things, reaching a consensus on where to draw the line between regulations that are simply anticompetitive barriers to trade—and should therefore be eliminated—and regulations that serve legitimate purposes.

For financial services, the GATS contains a "prudential carve-out" for domestic regulation that is designed to ensure that the obligations or commitments a country has undertaken in the GATS will not interfere with the ability of the national authorities to exercise their responsibilities for prudential regulation and supervision. This provision was included in the GATS at the insistence of financial regulators, who made it clear that the inclusion of financial services in a multilateral trade agreement such as the GATS would be unacceptable without a specific carve-out from the obligations of the agreement for prudential measures.

The prudential carve-out allows a country to take prudential measures "for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed" or "to ensure the integrity and stability of the financial system" regardless of any other provisions of the GATS. Thus prudential measures could, in principle, be inconsistent with a country's national treatment or market access commitments or its MFN obligation. To guard against abuse of the prudential carve-out, the GATS provides that prudential measures may not be used to avoid a country's obligations or commitments under the agreement.

The prudential carve-out differs from other exceptions for domestic policy contained in the GATS in one very significant respect.[2] In contrast to health and safety, for example, where only "necessary" measures are excepted, *all* prudential measures are excepted. As a result, a prudential measure may not be challenged on the ground that it is not "necessary" or "least trade restrictive." Moreover, the prudential carve-out overrides the GATS requirements for domestic regulations.

The absence of a necessity test does not, however, resolve the issue of whether a measure is prudential or is being used to avoid the obligations of the agreement. An allegedly prudential measure that violates a country's obligations or commitments under the GATS might be challenged on the grounds that its purpose is really trade restrictive rather than prudential and therefore it does not fall within the scope of the prudential carve-out. This question is subject to WTO dispute settlement procedures and potentially to a determination by a dispute settlement panel.

Financial regulators do not seem particularly concerned about this possibility. Several factors appear to account for this lack of concern. First, prudential issues are dealt with intensively in other international fora, so there is some basis for assuming that certain types of rules will be considered prudential. Moreover, a WTO member that was concerned about whether a particular measure would be generally accepted as prudential had the option of listing that measure as a limitation when making initial commitments for national treatment and market access, thereby avoiding the need to rely on the prudential carve-out. Second, and extremely important, only governments, not private parties, may bring claims to dispute settlement in the WTO. Absent a truly egregious action, governments may prefer to respect each other's ability to determine which rules may be prudential. Third, if a prudential or other financial services issue did reach a WTO dispute settlement panel, the GATS contains a provision, included at the insistence of financial regulators, that any dispute settlement panel dealing with financial services must have the appropriate expertise regarding the specific financial service at issue.

To date, there has been no dispute settlement proceeding and no requests for consultation on a financial services issues. So the scope of the prudential carve-out and its antiabuse provision remain untested in WTO jurisprudence.

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[2] In addition to the domestic policy exceptions in the GATS, a separate exception for national security allows a WTO member to take any action that the member considers necessary for the protection of its essential security interests.

2. <u>Importance of undertaking binding commitments in the GATS</u>

A fundamental element of the GATS that is important for financial services, and, of course, for other services as well, is that it provides a mechanism for parties to undertake legally binding commitments subject to enforcement under the WTO dispute settlement mechanism. A GATS commitment is permanent in the sense that it cannot be withdrawn without compensation of trading partners. The GATS does, however, provide a balance-of-payments safeguard that allows commitments to be suspended temporarily in the event of "serious balance-of-payments and external financial difficulties or threat thereof," subject to certain conditions.

Failure to honor a GATS commitment could open a country to a dispute settlement proceeding and, ultimately, to WTO-sanctioned retaliatory measures by its trading partners, which could be extremely costly. Thus binding even existing liberalization is extremely important. Indeed, a major reason for the existence of "binding gaps"—which are created by a country's failure to bind in the GATS liberalizing measures that are already in effect or scheduled to go into effect—is a reluctance to make commitments that are subject to enforcement through the WTO dispute settlement mechanism and may not be withdrawn without compensation of trading partners.

Since the conclusion of the previous GATS negotiations on financial services commitments in December 1997, further market opening for financial services has taken place in a number of emerging market economies, either through unilateral action or as part of the conditionality in IMF stabilization programs. Without concomitant changes in GATS commitments, new binding gaps are created. Unlike the financial services chapters in the North American Free Trade Agreement (NAFTA) and most U.S. bilateral free trade agreements, the GATS does not contain a "ratchet" that would automatically lock in or bind new liberalizing measures that reduce or eliminate barriers to national treatment or market access. Thus it is important to use the Doha round negotiations to close binding gaps.

Undertaking binding commitments in the GATS can also be an integral part of a country's longer-term policy reform agenda. For example, China, as part of its WTO accession agreement, made phased commitments in the GATS to open its banking sector to foreign direct investment within five years, that is, by December 11, 2006. In agreeing to this deadline in the WTO, the Chinese government was also in effect setting a domestic political deadline for major reform of China's banking and financial system.

China's commitments in the GATS for foreign direct investment in the banking sector include licensing based solely on prudential criteria and removal of customer and geographic restrictions on local currency business. Licensing based solely on prudential criteria means, among other things, no economic needs tests or numerical quotas on licenses, no restrictions on juridical form, and no ceilings on foreign ownership. State ownership interests in domestic banks remain unaffected by China's GATS commitments--that is, elimination of the ceilings on foreign ownership interests does not mean that the state is committing to give up any ownership interest.

3. Beyond traditional market opening: Regulatory transparency

In the Doha round financial services negotiations, expanding and strengthening market-opening commitments ("market access" and "national treatment") is, of course, the highest priority. A more difficult issue is how far the Doha round financial services negotiations should extend into the realm of domestic structural reform—that is, reducing or eliminating nonquantitative and nondiscriminatory structural barriers to trade in financial services. In considering whether, or to what extent, it is realistic or appropriate to negotiate and bind in the GATS financial services liberalization that goes beyond national treatment and market access, it seems reasonable to proceed selectively.

An important area that goes beyond traditional market-opening that could usefully be negotiated in the WTO is regulatory transparency. The GATS already contains a general transparency obligation that requires countries to publish all laws, regulations, administrative decisions relating to trade in services. In the Doha round negotiations, the United States is advocating inclusion of stronger GATS rules on regulatory transparency applicable to all services sectors in which specific commitments have been made. In addition, in bilateral "requests" for liberalization made to individual countries, the United States is seeking commitments for transparency in financial sector regulation similar to the transparency commitments in the financial services chapters in recent bilateral free trade agreements, such as those with Chile and Singapore. GATS commitments on regulatory transparency could complement and build upon the work on transparency that is part of the ongoing international efforts to strengthen domestic financial systems.

Regulatory transparency is qualitatively different from other domestic structural reforms because it involves rules about developing and applying rules, that is, procedural as opposed to substantive barriers. Procedural reform can, however, engender substantive change. Increased transparency in developing and applying regulations can lead to higher quality regulations. Such regulations are likely to be clearer; more effective and less burdensome in achieving their goals; and applied more reasonably, objectively, and predictably. Regulatory transparency helps to achieve these goals because it promotes accountability—that is, it creates an environment in which regulatory authorities must explain and accept responsibility for their actions with regard to development and application of rules.

A fundamental element of transparency in developing regulations involves establishing a meaningful procedure for interested parties to comment on a proposed regulation prior to its adoption in final form. Specific approaches would, of course, vary among countries—and over time within countries—depending on the legal system, the institutional arrangements for financial regulation and supervision, and the size and stage of development of financial markets. Transparency in applying regulations includes, for example, requiring regulators to publish requirements for authorization to provide a service and to respond to a request for information about the status of an application.

Although increased transparency per se should contribute to both substantive and procedural fairness in financial services regulation, principles specifically designed to enhance procedural fairness in applying regulations are usually linked with proposals for greater regulatory transparency. The GATS already addresses some basic elements of procedural fairness in applying regulations. Several of these, however, cover only those services for which specific commitments to national treatment or market access have been made; for example, requirements that regulations must be applied in a "reasonable, objective and impartial manner" and that regulatory authorities must act on applications in a timely fashion. A provision of the GATS that applies more generally requires a country to maintain a mechanism for appeal of an adverse regulatory ruling affecting trade in services.

Conclusion

A continuing challenge in financial services negotiations in the WTO is to provide support for and to build upon political and market forces that are creating pressures within a country for market opening and domestic structural reform. A country's "readiness" for reform is critical. As the GATS explicitly recognizes, liberalization of trade in services is an ongoing process. For financial services, this process is being driven largely by market forces and new technologies. It is also being driven by the growing recognition among policymakers that market opening can benefit host-country consumers of financial services and, at the same time, contribute to the resiliency of domestic financial systems. The development of international minimum standards and codes of good practices for sound financial systems and their implementation by individual countries provides a strong foundation for moving ahead with further liberalization of trade in financial services in the Doha round negotiations.

TESTIMONY OF

MARC E. LACKRITZ
PRESIDENT
SECURITIES INDUSTRY ASSOCIATION

BEFORE THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON
DOMESTIC AND INTERNATIONAL MONETARY POLICY,
TRADE AND TECHNOLOGY
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON INCREASING EFFICIENCY AND ECONOMIC GROWTH THROUGH TRADE IN FINANCIAL SERVICES

NOVEMBER 15, 2005

Madam Chairwoman and Members of the Subcommittee:

My name is Marc Lackritz, President of the Securities Industry Association (SIA).[1] I appreciate the opportunity to testify about the securities industry's goals and objectives for the Doha Development Round of the World Trade Organization (WTO) negotiations. With the Hong Kong Ministerial set to begin in less than a month, we commend the subcommittee for holding this timely hearing. Indeed, this subcommittee has been a forceful, persuasive advocate for open and fair international markets, and we are

[1] The Securities Industry Association brings together the shared interests of approximately 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated $236.7 billion in domestic revenue and an estimated $340 billion in global revenues. (More information about SIA is available at: www.sia.com.)

confident that you will continue to work with U.S. negotiators in securing a commercially meaningful package of financial services commitments in the Doha Round.

The Doha Round provides U.S. negotiators with an opportunity to remove obstacles in foreign markets that impede the competitiveness of U.S. firms and hamper U.S. economic growth and job creation. Importantly, trade liberalization will result in real benefits in developing countries, by enhancing and strengthening capital market efficiency, increasing financial sector stability, bolstering economic growth, and raising the standard of living. By liberalizing trade in financial services, WTO members will help suppliers of goods and services capitalize fully on the new market-opening opportunities created by a Doha Round agreement.

My testimony will address the following key points: 1) the importance of financial services – and open global markets – to the U.S. economy; 2) the benefits of liberalizing financial markets for developing countries; and 3) the securities industry's objectives for the Doha Round.

The Financial Services Sector: A Catalyst for U.S. Economic Growth

The U.S. financial services sector is a key component of the U.S. economy. Financial services firms touch all aspects of the economy, from raising capital for new businesses, to extending credit for corporate acquisitions, to managing finances for retail customers, to providing risk-management products and services to U.S. multinationals. In playing this unique and critical role in the U.S. economy, the financial services sector has contributed tremendously to the country's strong rates of economic growth and job creation over the last decade. A strong, vibrant, financial services industry is essential to continued job growth and expansion in the U.S. economy.

The U.S. securities industry has fueled the nation's – and the world's – economic engines. The securities industry is on track to raise a record $3.8 trillion in new capital for our growing economy in 2005 – for new plants, new technologies, new schools, and new jobs. That is the fifth consecutive year the industry has raised more than $3 trillion in a $12 trillion economy. In the last six years securities firms raised nearly $16 trillion for U.S. businesses, an amount that already surpasses the $12.4 trillion total raised in the previous 30 years. Impressively, the U.S. securities industry's contribution to total output of the U.S. economy increased by nearly four times from 1989-2004–double the rate of increase of the overall economy.[2]

More broadly, the U.S. financial services industry[3] contributed $972 billion to U.S. Gross Domestic Product (GDP) in 2004, about 8.3 percent of total GDP.[4] More than 6.1 million employees support the products and services these firms offer.[5]

Financial services firms are also exporters. In 2004, exports totaled a record $27.4 billion, and generated a trade surplus of about $16.2 billion. Foreign individuals, institutions and governments eagerly seek the multitude of innovative, unrivaled

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[2] U.S. Department of Commerce.
[3] Includes securities firms and related activities, banks, and insurance companies.
[4] http://www.bea.doc.gov/bea/pn/GDPbyInd_VA_NAICS.xls
[5] http://www.bls.gov/news.release/pdf/empsit.pdf

services and products U.S. financial services firms offer. The continued vitality of the financial services sector is directly linked to its ability to sell its products in foreign markets.

U.S. financial services firms have increased their presence in foreign markets because both the U.S. economy and securities markets – while still the largest in absolute terms – have seen their share of the global pie shrink. A number of market share indicators illustrate this trend. According to the International Monetary Fund, approximately 70 percent of the world's GDP, for example, and more than half of the world's equity and debt markets are located outside the United States. Similarly, more than half of the $15.3 trillion in global pension assets are outside of the United States.[6]

In addition, many of the best growth opportunities are in non-U.S. markets. By some projections, markets such as China, Brazil, and India will be among the largest in the world by 2050. U.S. investors and corporations have already tapped these new markets, and U.S. securities firms will need to have open and fair access as well to serve the international focus of their clients.

Benefits of Liberalizing Financial Markets

Liberalization of trade in financial services in general – and in capital markets-related services in particular – is central to achieving the Development Round's goals of

[6] International Financial Services, London, Fund Management – City Business Series (p.5) http://www.ifsl.org.uk/uploads/CBS_Fund_Management_2005.pdf

economic growth. The development and expansion of the financial sector indisputably advances economic growth in both developed and developing countries. In turn, the more open a financial sector is to competition – whether from inside or outside the country – the greater the benefits are to that economy. For example, in 2001, the World Bank estimated that by 2015 the developing world would gain more than $300 billion in annual output, or an additional two percent of GDP, from financial sector liberalization.

As capital markets "deepen" – that is, as additional, and more varied, securities are issued and more participants trade – they further strengthen the financial systems of developing countries. The World Bank has found that more liquid local bond markets enhance the effectiveness of domestic monetary policy, reduce economies' exposure to foreign currency-denominated debt, and contribute to the overall soundness of domestic financial systems.

In addition, leading regulatory authorities in both the developed and developing worlds concur that an important lesson from recent financial crises is that a wider range of nonbank financial institutions, including viable debt and equity markets, can minimize the danger of overburdening the banking system. Overall, liberalization yields benefits at all levels of an economy: existing financial institutions are able to diversify their investment portfolios, thereby enhancing their stability; and local businesses gain greater access to capital and to new and more flexible means of financing from both domestic and non-domestic investors. More investment, in turn, leads to the formation of new local businesses and to the expansion of existing ones – i.e., economic growth, which benefits all citizens by creating jobs, and generating more and better products and services at more competitive prices.

Securities Industry Goals and Objectives for the Doha Round

The GATS and the commitments made in the 1997 financial services negotiation represented an important first step in establishing international rules in financial services. However, this first step will prove to be of fleeting value unless Members move decisively to expand their commitments. Unlike other WTO agreements, the most important market access rules in GATS apply to a Member *only* in those service sectors and "modes" of supply in which the Member agrees to be bound (the so-called "positive list" approach to trade liberalization). In other words, the value of GATS as a market access tool is only as good as the specific commitments that individual Members agree to undertake.

Although the 1997 financial services negotiation increased Members' specific commitments beyond where they were in 1995, it left many sectors and modes of supply with no coverage or only limited coverage under GATS rules. As a result, securities firms continue to face a number of discriminatory barriers that impede their ability to meet the demands of their clients.

To overcome these difficulties, the global securities industry has drafted a "Model Schedule" of GATS commitments for capital markets-related services. The Model Schedule reflects the industry's view of the types of commitments that would enable securities firms to serve the global customers most efficiently while safeguarding important regulatory objectives. The Model Schedule is indeed a global initiative, as it is now co-sponsored by the leading securities associations in Europe, Canada, and Australia, and we are actively consulting with our counterparts in other jurisdictions, including Japan.[7]

In the Doha Round, the industry seeks commitments that reflect the global nature of the modern financial services markets and the way U.S. firms actually provide the capital markets services that their global customers demand. Those services include: 1) *trading* of debt and equity securities and other financial instruments; 2) *underwriting* and placement of securities; 3) *asset management*, including investment advice and financial planning, and 4) *advisory* services on all types and on all aspects of financial transactions, including mergers and acquisitions, corporate restructurings, and privatizations.

In each of these subsectors, the industry seeks commitments in all four "modes of supply," meaning: 1) cross-border supply, for example, when customers and suppliers conduct business by telephone or e-mail without either leaving their home territory (mode 1); 2) customers traveling abroad to consume services (mode 2); 3) suppliers establishing a subsidiary in the home territory of the consumer (mode 3); and 4) suppliers sending their professionals abroad to provide services in the home territory of the consumer (mode 4).

[7] The organizations include, for example, the International Capital Markets Association, the Investment Dealers Association of Canada, and the International Banks and Securities Association of Australia.

We seek these broad commitments because a single capital markets transaction today often necessitates more than one securities activity that involves all four modes of GATS "supply". For example, a debt underwriting may require in-person meetings with an issuer's management, as well as electronic and telephonic exchanges of information. In addition, the issuer may enter into a derivatives contract with the underwriter to hedge its interest rate risk. Commitments in all capital-markets related activities and in all four modes of supply are essential to securing the benefits of capital-markets liberalization and to sensibly integrating consumers into the global financial markets.

Trade Liberalization Is Consistent With Sound Regulation

A Member's commitments to liberalize trade in capital markets-related services must be undertaken in the context of a fair, effective, and transparent regulatory regime. Sound regulation is essential to healthy, competitive markets because individuals and companies must be confident that markets in which they are seeking to invest or raise funds are well regulated.

Financial services regulations typically include standards that a supplier must meet in order to be authorized or licensed to do business in a market. Such standards – collectively referred to as "authorization requirements" – include the supplier's knowledge, resources, skills, and risk management procedures. Similarly, regulations known as "conduct of business rules" apply to suppliers doing business in a market and address disclosure of information (including risk warnings) to customers, disclosure of information about the supplier, order execution, and the protection of customer assets. Finally, “market conduct rules” relate to fraud, insider dealing, and market manipulation.

When drafting the Model Schedule, our objective was increase market access while not undermining financial regulation. The Model Schedule, therefore, preserves fully intact two important regulatory exceptions provided for in the GATS: 1) the prudential measures clause, which allows Members to protect investors and ensure the integrity and stability of their financial systems; and 2) the balance of payments clause, which allows Members to impose restrictions on capital transfers to address balance of payments or external financial difficulties.

The following three core objectives underpin the securities industry’s Model Schedule:

1) **Commercial Presence** – securities companies should be permitted to establish or expand a commercial presence and should be accorded national treatment (i.e., the same treatment as domestic suppliers):
   - by acquiring an existing company or establishing a new company, and
   - by choosing its corporate form (e.g., wholly owned subsidiary, branch, or joint venture with local partner);

2) **Cross-Border** – securities companies should be permitted to provide services cross-border to sophisticated investors without the obligation to establish a local presence and without local authorization:
    - which reflects the practice of a number of key financial regulators, and
    - does not exempt securities companies from conduct-of-business rules, such as measures to protect against and punish fraud and market manipulation; and,

3) **Transparency** – financial regulations should be developed, adopted, and enforced in a transparent, non-discriminatory manner.

1. Freely Established Commercial Presence

Establishing and developing relationships are critical elements in providing financial services. Often, it is essential to have a business presence in the host country to effectively deliver services. Despite the progress made during the last Round, many developing nations still deny foreign investors the right to structure their businesses efficiently, or they prevent them from establishing a commercial entity at all. In many cases, establishment is limited to minority joint venture, or is hindered by an "economic-needs test."

A fundamental element of any WTO agreement is the ability to operate competitively through a wholly owned commercial presence or other form of business ownership.

Members should permit foreign suppliers of capital-markets related services to establish a new commercial presence or acquire an existing commercial presence in the Members' territories. Such suppliers should be able to choose their corporate form (e.g., a 100 percent-owned subsidiary, a branch, or a joint venture) and be treated no less favorably than domestic suppliers (i.e., national treatment).

2. Increased Cross-Border Access

In today's capital markets, services are increasingly being supplied electronically, without the consumer or the supplier leaving its home territory. WTO Members, however, have made virtually no commitments with respect to cross-border supply in three of the four sectors of greatest interest to our industry – trading, underwriting, and asset management. The absence of such commitments leaves securities firms unable to supply services cross-border in those markets where it is not permitted by domestic law. Likewise, securities firms cannot supply their services in markets where cross-border supply is currently permitted by domestic law, but not guaranteed by an international commitment.

The Model Schedule calls for Members to make basic commitments to permit cross-border supply without quantitative limits, or so-called "economic needs tests," and to accord such suppliers non-discriminatory treatment. The industry also recommends that Members embody in their GATS commitments one of several types of domestic regulatory regimes that have been developed to promote well-regulated cross-border trade. As described in a report of the International Organization of Securities

Commissions, these regimes exempt foreign suppliers under certain circumstances from local authorization requirements, taking into account one or more of the following factors:

- Whether the investor is sophisticated (as defined in local law), thereby recognizing that the securities laws need not protect sophisticated investors in certain circumstances;

- Whether the foreign supplier is well regulated in its home jurisdiction (i.e., unilateral or mutual recognition of other regulators);

- Whether the foreign supplier solicits customers, or actively markets its services, in the local jurisdiction; and

- Whether the securities transaction is "intermediated by" (i.e., conducted through) a locally authorized supplier.

Even when a domestic regime exempts such suppliers from authorization requirements, the provision of the services typically would remain subject to the conduct of business and market conduct rules.

The securities industry hopes that the United States will work to increase cross-border access commitments. U.S. negotiators should encourage other Members to increase their cross-border commitments so that their consumers can reap the benefit of innovative financial services to which they might otherwise be denied. Similarly, the

United States should itself make commitments that, at the least, bind the United States to current (and not inconsiderable) levels of cross-border access into this country.

3. Transparency

Regulatory transparency is as much a market access issue for securities firms as tariffs are for manufacturers. A non-transparent regulatory system can skew competition in favor of domestic suppliers even where a market is technically open to foreign suppliers.

That is why regulation must be transparent: both suppliers and consumers of capital markets-related services must know what the rules are and have confidence that the rules will be applied consistently and fairly. Although there are different ways to achieve this objective, in general, regulators should: i) propose regulations in draft form and provide interested parties the opportunity to comment on such draft regulations, where practicable; ii) make publicly available the requirements that suppliers must meet in order to supply a service; and iii) enforce laws and regulations according to fair and transparent criteria.

Binding Commitments to Open Markets

Many Members currently provide market access that is consistent with some or all of the previously described recommendations. In most cases, however, this level of access is not reflected in Members' GATS commitments. At a minimum, therefore, both developed and developing Members should upgrade their commitments to reflect the level of market access afforded under their domestic laws. This will provide the legal certainty and predictability that stimulate economic activity.

Conclusion

Madam Chairwoman, the Doha Round negotiations offer Congress and the Administration another opportunity to secure open and fair access to foreign markets for U.S. firms and their clients. The U.S. securities industry is the world leader in international technology, finance, and innovation. If we are to retain our preeminence, however, we must be able to meet the demands of both our U.S. and foreign clients.

SIA would like to take this opportunity to express its appreciation to both the Treasury Department and USTR for their continued efforts as forceful advocates for open and fair global financial markets. Congressional leadership will be a critical factor in making sure that Hong Kong produces a negotiating framework for the Doha Round negotiations that create substantial new market opportunities. SIA is eager to work with your subcommittee and the Administration to ensure that these important trade talks achieve favorable results for the financial services industry.

SIA ICMA Investment Dealers Association of Canada Association canadienne des courtiers en valeurs mobilières AFMA

January 31, 2006

Secretary John Snow
Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, D.C. 20220

Re: Liberalization Goals for Capital Markets-Related Services

Dear Secretary Snow,

We write to share with you our thoughts on how to liberalize trade in capital markets-related services. As you know, the Hong Kong Ministerial Declaration provides a roadmap for achieving significant progress in services liberalization. We set forth in the attached paper the commitments that the industry believes should be sought from selected WTO Members. We respectfully ask that the United States incorporate these commitments both in its bilateral requests and in collective requests related to financial services.

These commitments build on the negotiating framework that the United States and other Members have established for financial services. They incorporate the liberalization targets of the June 8, 2005 "Friends of Financial Services" paper, including robust commitments in Mode 3, adherence to the definitions in the GATS Annex on Financial Services, and the importance of regulatory transparency. They advance the negotiating objectives set forth in the Hong Kong Ministerial Declaration, particularly Annex C, which calls for Mode 1 and 2 commitments "at existing levels of market access." They also reflect Members' interest, as reported by the Chairman of the Council for Trade in Services, in obtaining Mode 1 commitments in financial services supplied to sophisticated customers. Thus, these commitments continue the progress that has been made and lay the groundwork for expanding access to capital markets-related services, thereby generating substantial economic benefits for WTO Members.

We appreciate your consideration. We look forward to working with you to achieve an ambitious result in the Doha Round that will have securities industry support.

Sincerely,

Mark E. Lackritz, President
Securities Industry Association (US)

Richard O'Toole, Chairman, Working
Group on Trade, International Capital
Market Association (Europe)

Duncan Fairweather

Duncan Fairweather, Executive Director
Australian Financial Markets Association

Ian Russell

Ian Russell, Senior Vice President
Investment Dealers Association of Canada

Identical letters and documents are being sent to:

US Trade Representative Rob Portman

Australia
Minister for Trade Mark Vaile
Treasurer Peter Costello

Canada
Minister of International Trade
Minister of Finance

European Commission
Commissioner for Trade Peter Mandelson
Commissioner for Internal Market and Services Charlie McCreevy

Japan
Minister of Economy Trade & Industry Toshihiro Nikai
Minister for Foreign Affairs Taro Aso
Minister of State for Economic and Fiscal Policy and Financial Services Kaoru Yosano

Switzerland
Head of the Federal Department of Economic Affairs, Federal Councillor Joseph Deiss
Federal Department of Finance, Federal Councillor Hans-Rudolf Merz
Chairman of Swiss Federal Banking Commission Eugen Haltiner

WTO Commitments in Capital Markets-Related Services

January 31, 2006

As associations representing globally active securities firms,[1] we request that you pursue, through both bilateral and collective requests, new and improved GATS commitments in capital markets-related services. In particular, we ask that you seek robust commitments, which we describe below, in the trading, underwriting, asset management, and advisory subsectors. We believe that the requests that we recommend will lay the groundwork for a productive negotiation leading to ambitious results. We stand ready to work with you to ensure that the final results of the negotiation will serve the industry's objectives and provide the economic benefits associated with liberalization of capital markets-related services.[2]

These commitments build on the negotiating framework that WTO Members have established for financial services. They incorporate the liberalization targets of the June 8, 2005 "Friends of Financial Services" paper, including robust commitments in Mode 3, adherence to the definitions in the GATS Annex on Financial Services, and the importance of regulatory transparency. They advance the negotiating objectives set forth in the Hong Kong Ministerial Declaration, particularly Annex C, which calls for Mode 1 and 2 commitments "at existing levels of market access." They also reflect Members' interest, as reported by the Chairman of the Council for Trade in Services, in obtaining Mode 1 commitments in financial services supplied to sophisticated customers. Thus, these commitments continue the progress that has been made and provide a basis for expanding access to capital markets-related services.

I. ELEMENTS OF THE REQUEST

A. Cross Border Access (Mode 1)

We ask that you seek full Market Access and National Treatment commitments in Mode 1 so that suppliers and consumers of capital markets-related services may transact business on a cross-border basis, free from quantitative restrictions, economic needs tests, or discrimination based on nationality. Subject to the Additional Commitments described in the next paragraph, (i)

[1] The sponsors of this request currently include the Securities Industry Association (United States), the International Capital Markets Association (Europe), the Australian Financial Markets Association, and the Investment Dealers Association of Canada.

[2] For a discussion of the economic benefits of expanding trade in capital market-related services, see the attached paper, "Capital Markets Liberalization: A Powerful Catalyst for Growth in Developing Economies."

such commitments would not prevent a Member from imposing authorization requirements[3] on cross-border suppliers consistent with those imposed on domestic suppliers and (ii) we would not object if your requests allowed Members to impose a commercial presence requirement in the trading, underwriting, and asset management subsectors.

We ask that you seek Additional Commitments in Mode 1 under which Members would exempt foreign suppliers under certain circumstances (particularly when dealing with sophisticated investors) from authorization and commercial presence requirements. Members may continue to apply conduct of business rules and market conduct rules to these suppliers.[4] Such commitments would promote effective cross-border access to capital markets-related services. As briefly described in the attached annex, many Members currently exempt foreign suppliers providing services on a cross border basis from authorization requirements, taking into account one or more factors, including investor sophistication.

B. CONSUMERS WHO TRAVEL ABROAD (MODE 2)

We ask that you seek full Market Access and National Treatment commitments from Members, thereby allowing their consumers to travel outside their territories to obtain capital markets-related services.

C. COMMERCIAL PRESENCE (MODE 3)

We ask that you seek full Market Access and National Treatment commitments in Mode 3, thereby allowing foreign service suppliers to establish and operate enterprises in the Member's territory, free from quantitative restrictions, economic needs tests, restrictions on corporate form, limits on foreign ownership, and measures that discriminate based on nationality. Such commitments would not prevent a Member from imposing authorization requirements.

D. TRANSPARENT REGULATION

We ask that you seek from Members commitments to ensure that all measures relating to financial services are adopted, maintained, and applied in a non-discriminatory, transparent, and efficient manner. In particular, we seek commitments that would require Members to: (i) propose regulations in draft form and provide interested parties the opportunity to comment on such draft regulations, where practicable; (ii) make publicly available the requirements that suppliers must meet in order to supply a service; and (iii) enforce laws and regulations according to fair and transparent criteria.

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[3] "Authorization requirements" refer to standards that a supplier must meet in order to be authorized or licensed to do business in a market, such as standards that address the supplier's knowledge, resources, skills, and risk management procedures.

[4] "Conduct of business rules" include rules relating to disclosure of information (including risk warnings) to customers, disclosure of information about the supplier, execution of orders, and the protection of customer assets. "Market conduct rules" relate to fraud, insider dealing, and market manipulation.

We attach the latest draft of the Model Schedule of WTO Commitments for Capital Markets-Related Services, which represents the industry's overall view of the commitments that would best promote the growth of capital markets. The Model Schedule may also be used to provide guidance as to how each of the commitments described above could be drafted and inscribed in a Member's schedule of specific commitments.

II. MEMBERS OF INTEREST

We ask that you incorporate the commitments described above into collective requests on financial services and that you seek them bilaterally from the following Members, which are of primary interest to our member-companies:

Argentina	Korea
Brazil	Malaysia
Chile	Mexico
China	Philippines
Egypt	South Africa
India	Taiwan
Indonesia	Thailand

We understand that one or more of these Members might participate in making collective requests for financial services. We would support their inclusion as requestors, provided that the collective request is deemed to be a request of them as well as those Members to whom the request is directed. In the coming days, we will send you a chart for each Member that compares the commitments that we recommend to the commitments provided for in that Member's current schedule for the four principal subsectors. The charts will also note any Additional Commitments that the Members have made that relate to one or more of these subsectors.

Annex

As described in a recent report of the International Organization of Securities Commissions,* many Members already provide exemptions from authorization requirements under domestic law for cross-border suppliers, taking into account one or more of the following factors:

- whether the investor is sophisticated (as defined in local law), thereby recognizing that the securities laws need not protect sophisticated investors in certain circumstances or to the same extent as other investors;
- whether the foreign supplier is well regulated in its home jurisdiction (*i.e.*, unilateral or mutual recognition of other regulators);
- whether the foreign supplier solicits customers, or actively markets its services, in the local jurisdiction; and
- whether the securities transaction is "intermediated by" (*i.e.*, conducted through) a locally authorized supplier.

* Technical Committee of the International Organization of Securities Commissions, "Regulation of Remote Cross-Border Financial Intermediaries," February 2004, *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD162.pdf.

GLOBAL SECURITIES INDUSTRY

WTO INITIATIVE TO LIBERALIZE TRADE IN CAPITAL MARKETS-RELATED SERVICES

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TAB 1

RECOMMENDATIONS FOR LIBERALIZATION OF TRADE IN CAPITAL MARKETS-RELATED SERVICES

October 10, 2005

SIA INVESTMENT DEALERS ASSOCIATION OF CANADA ICMA IBSA INTERNATIONAL BANKS AND SECURITIES ASSOCIATION OF AUSTRALIA

RECOMMENDATIONS FOR LIBERALIZATION OF TRADE IN CAPITAL MARKETS-RELATED SERVICES

I. OPEN CAPITAL MARKETS CONTRIBUTE TO ECONOMIC GROWTH, DEVELOPMENT AND STABILITY

1. Capital markets facilitate economic growth and development by substantially broadening the range of vehicles for savings and investment and lowering the cost of capital for businesses and entrepreneurs. The banking sector is strengthened by the capital markets, which provide liquidity by making available both tradable investments and the opportunity to transform previously illiquid loans into tradable securities. The capital markets also offer participants an efficient way to hedge various forms of economic risks.

2. By diversifying both the avenues for investing savings and the sources of funding for entrepreneurial activity beyond the banking sector, capital markets enhance financial stability. Such diversification ameliorates the negative effects of economic downturns. Banks experiencing unusually large demands by depositors are able to draw on a deeper pool of liquid assets. Moreover, when banks experience financial difficulties, the capital markets offer an alternative mechanism for sustaining broad economic activity. As Malaysian financial authorities have observed:

> So far, banks have played an important role in financing the needs of the country's rapidly growing economy. But the experience of the recent crisis points to a real danger of over-burdening the banking system with the task of financing production in the economy. A more diversified financial system – one in which the capital market plays a much bigger role than it does currently – can minimise this danger and would result in a more efficient and robust mechanism for mobilising and allocating financial resources in the economy.[1]

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[1] Securities Commission (Malaysia), "Capital Market Masterplan Malaysia," at chpt. 2, p. 30, *available at* http://www.sc.com.my/eng/html/cmp/CHAPTER2.PDF. Alan Greenspan, Chairman of the U.S. Federal Reserve Board, also noted during the Asian crisis: "Recent adverse banking experiences have emphasized the problems that can arise if banks are almost the sole source of intermediation. Their breakdown induces a sharp weakening in economic growth. A wider range of nonbank institutions, including viable debt and equity markets, are important safeguards of economic activity when banking fails." Testimony of Chairman Alan Greenspan Before the Committee on Banking and Financial Services, U.S. House of Representatives, January 30, 1998, *available at* http://www.federalreserve.gov/boarddocs/testimony/1998/19980130.htm.

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3. The development of capital markets is assisted by the presence of foreign suppliers of capital markets-related services, whether through commercial presence or the delivery of services cross-border. Experience demonstrates that foreign suppliers enhance competition and bring to a market additional capital, innovative financial products, technology, and expertise. Each of these factors can reduce the cost of financial services, and thereby improve the competitiveness of domestic companies that use these services.

4. Capital markets-related services include all "banking and other financial services (excluding insurance)" listed in paragraph 5(a)(v)-(xvi) of the GATS Annex on Financial Services except consumer banking-related services (*e.g.*, deposit-taking, consumer credit, and payment cards). The subsectors of primary importance to the capital markets are trading, underwriting, asset management, and financial advisory services.

II. SOUND REGULATION OF THE CAPITAL MARKETS

5. Sound regulation designed to protect investors, promote fair, efficient, and transparent markets and reduce systemic risk is essential to healthy and competitive markets. Individuals and companies seeking to invest or raise funds will not rely on the capital markets unless they have confidence that those markets are well regulated.

6. Financial services regulations typically include standards that a supplier must meet in order to be authorized or licensed to do business in a market, such as standards that address the supplier's knowledge, resources, skills, and risk management procedures ("*authorization requirements*"). Financial services regulations also address the conduct of a supplier doing business in a market, including rules relating to disclosure of information (including risk warnings) to customers, disclosure of information about the supplier, execution of orders, and the protection of customer assets ("*conduct of business rules*"), as well as rules relating to fraud, insider dealing, and market manipulation ("*market conduct rules*").

7. An effective regulatory regime (and its associated GATS commitments) will maximize access for suppliers and consumers without undermining key regulatory objectives. As the International Organization of Securities Commissions ("IOSCO") has noted, a regulator often conducts a:

> [cost-benefit] analysis to facilitate an understanding of the financial and other costs of the proposed regulation to the intermediary as compared to the benefits the regulation is expected to produce for investors and other market participants.[2]

8. Under GATS, Members can make commitments that are consistent with their regulatory capacity. In addition, all commitments are subject to two important exceptions: the prudential measures clause, which allows Members to take measures to protect investors and ensure the integrity and stability of their financial systems; and the balance of payments clause, which allows Members to impose restrictions on capital transfers to address balance of payment or external financial difficulties.

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[2] Technical Committee of the International Organization of Securities Commissions, "Regulation of Remote Cross-Border Financial Intermediaries," February 2004, at 4, *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD162.pdf ("IOSCO Report").

III. CAPITAL MARKETS LIBERALIZATION

9. A single capital markets transaction today often involves more than one subsector and implicates all four modes of supply. For example, an underwriting (subsector xi) of debt securities may require in-person meetings (including due diligence) with management of the issuer, as well as electronic and telephonic exchanges of information (Mode 1, 2, 3, and 4). In addition, the issuer may enter into a derivatives contract with the underwriter to hedge its interest rate risk (subsector x). As a result, in order to most sensibly integrate their consumers with the global financial markets and to secure the benefits of capital-markets liberalization, Members should make commitments in all capital markets-related subsectors and in all four modes of supply.

A. CROSS BORDER ACCESS (MODE 1)

10. Members should permit suppliers and consumers of capital markets-related services to transact business on a cross-border basis, and such suppliers and their services should be entitled to national treatment.

11. Members should facilitate cross-border access by exempting foreign suppliers under certain circumstances from *authorization requirements* (as described in paragraph 6). As described in the IOSCO Report, many Members currently do so, taking into account one or more of the following factors:

- whether the investor is sophisticated (as defined in local law), thereby recognizing that the securities laws need not protect sophisticated investors in certain circumstances;
- whether the foreign supplier is well regulated in its home jurisdiction (*i.e.*, unilateral or mutual recognition of other regulators);
- whether the foreign supplier solicits customers in, or actively markets its services in, the local jurisdiction; and
- whether the securities transaction is "intermediated by" (*i.e.*, conducted through) a locally authorized supplier.

As recognized in the IOSCO Report, the regulation of cross-border suppliers is based on "considerations relating to the goals of investor protection, efficient capital markets, and the appropriate balance between these two."[3] Even when such suppliers are exempted from authorization requirements, the provision of the services typically would remain subject to *conduct of business* and *market conduct rules* (as described in paragraph 6).

B. CONSUMERS WHO TRAVEL ABROAD (MODE 2)

12. Members should allow their consumers to travel outside their territories to obtain any capital markets-related service. Many Members already permit their consumers to do so, based on a balancing of the goals of investor protection and efficient capital markets as referred to in the IOSCO Report.

[3] IOSCO Report at 1.

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C. Commercial Presence (Mode 3)

13. Members should permit foreign suppliers of capital markets-related services to establish a new commercial presence or acquire an existing commercial presence in the Members' territories. Such suppliers should be able to choose their corporate form (*e.g.*, a 100%-owned subsidiary, a branch or a joint venture) and be treated no less favorably than domestic suppliers (*i.e.*, national treatment).

D. The Movement of Persons (Mode 4)

14. Members should permit temporary entry into their territories for persons who supply capital markets-related services to work with clients or to staff a commercial presence.[4]

E. Reflect Existing Favorable Market Access Conditions in Commitments

15. Many Members currently provide market access that is consistent with some or all of the recommendations described above. In most cases, however, this level of access is not reflected in their GATS commitments.[5] Members – both developed and developing – should at a minimum ensure that their commitments reflect the level of market access afforded under their domestic laws. This will afford the legal certainty and predictability that stimulate economic activity.

F. Transparent Regulation

16. Regulation must be transparent: both suppliers and consumers of capital markets-related services must know what the rules are and have confidence that the rules will be applied consistently and fairly. Although there are different ways to achieve this, in general, regulators should: (i) propose regulations in draft form and provide interested parties the opportunity to comment on such draft regulations, where practicable; (ii) make publicly available the requirements that suppliers must meet in order to supply a service; and (iii) enforce laws and regulations according to fair and transparent criteria.

IV. MODEL SCHEDULE FOR CAPITAL MARKETS-RELATED SERVICES; TECHNICAL ASSISTANCE AND CAPACITY-BUILDING

17. The global securities industry has drafted a "Model Schedule" of GATS commitments for capital markets-related services.[6] The Model Schedule reflects the industry's view of the commitments that would best secure the benefits described in this paper.[7]

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[4] A GATS commitment of this type would not apply to persons seeking permanent employment and would not prevent a Member from regulating entry to address national security concerns or the orderly movement of persons.

[5] *See* Report of the Meeting Held on 28 June and 2 July 2004, *Note by the Secretariat*, TN/S/M/11, 8 September 2004, at para. 68; *see also* Report of the Meeting Held on 1 June 2005, *Note by the Secretariat*, TN/S/M/14/Suppl.2, 17 June 2005, at para. 12.

[6] A number of Members have noted that model schedules of commitments, in conjunction with the request-offer approach, could assist in achieving effective commitments in the current round of negotiations. *See* Report of the Meeting Held on 28 June and 2 July 2004, *Note by the Secretariat*, TN/S/M/11, 8 September 2004, at para. 68; *see also* Report of the Meeting Held on 1 June 2005, *Note by the Secretariat*, TN/S/M/14/Suppl.2, 17 June 2005, at para. 12.

18. Recognizing that the regulation of financial services is extraordinarily complex, it is appropriate, and indeed necessary, that developed countries provide technical assistance to developing countries as the latter expand their capacity to regulate their capital markets. Such assistance should be made on both a bilateral and multilateral basis. Moreover, suppliers of capital markets-related services are committed to using their own substantial experience in financial market regulation to work with both developed and developing country regulators in order to help implement the recommendations set forth in this paper.

V. CONCLUSION

19. Members that liberalize their capital markets will promote economic growth, development, and financial stability. We urge all Members to liberalize their capital markets in a manner consistent with the recommendations in this paper.

[7] The Model Schedule does not represent the regulatory regime of any particular Member, but rather reflects aspects of the regimes of various Members.

TAB 2

MODEL SCHEDULE OF WTO COMMITMENTS FOR CAPITAL MARKETS-RELATED SERVICES

MODEL SCHEDULE OF WTO COMMITMENTS FOR CAPITAL MARKETS-RELATED SERVICES[1]

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS

GENERAL NOTES ON SCHEDULING[2]

Each Member should adhere to the following principles when scheduling commitments under the General Agreement on Trade in Services ("GATS," or "Agreement"):

1) A Member should strive to make commitments in accordance with the Model Schedule. Where a Member fails to do so, its commitments at least should reflect the level of access to the market provided under domestic law. Where a Member's commitments are below the level of access to the market provided under domestic law, the Member should, at a minimum, commit itself not to limit or restrict the present degree of market opportunities or the benefits already enjoyed by financial service suppliers of any other Members that are supplying services in the territory of the Member or to persons of the Member, whether or not those suppliers have established a commercial presence.

   Note: The second sentence closes gaps that might exist between the regulatory treatment required under international treaty obligations and the (better) regulatory treatment that the government actually accords. The third sentence protects acquired or pre-existing rights.

2) Where a Member's domestic law provides greater market access to financial service suppliers of other Members than the commitments in the Model Schedule, the Member's GATS commitments should reflect the level of access under domestic law.

   Note: The Model Schedule should not be a ceiling on Members' GATS commitments.

3) A Member should schedule its specific commitments in accordance with the subsectors listed in the Annex on Financial Services. A Member should list and undertake commitments in each of the subsectors included in the Model Schedule and in each of the four modes of supply.

   Note: This note increases transparency and consistency and identifies areas where further liberalization needs to occur.

[1] Capital markets-related services include the following activities from paragraph 5(a) of the Annex on Financial Services: (vi) lending (*e.g.*, syndicated and margin lending), (ix) guarantees and commitments, (x) trading, (xi) underwriting, (xiii) asset management, (xiv) settlement and clearing services, (xv) provision and transfer of financial information, and (xvi) advisory, intermediation, and other auxiliary financial services related to subsectors (v) - (xv).

[2] The General Notes on Scheduling are intended to serve as guidance for the scheduling of commitments. Unlike the headnotes, specific commitments, and annexes below, the General Notes on Scheduling would not appear in a Member's schedule of specific commitments.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
4) A Member should express any conditions or limitations on, or qualifications to, the commitments in the Model Schedule with specific reference to existing measures maintained by the Member. *Note: Where a Member has made a commitment but subjected that commitment to condition, limitation, or qualification, the Member should specify and list the nonconforming measure of domestic law which corresponds to that condition, limitation, or qualification. This increases transparency and legal certainty.*			
5) A Member should consider the reduction and ultimate elimination where practicable of all its Article II MFN Exemptions relating to the subsectors set forth in footnote 1.			
6) The commitments set forth in this schedule build upon, and cannot detract from, the commitments a Member has made in its previous schedule of specific commitments annexed to GATS. Commitments can be withdrawn only in accordance with Article XXI of GATS.			
7) The commitments in the Model Schedule are subject to all of the exceptions set forth in the Agreement, including the exception for prudential measures described in paragraph 2(a) of the Annex on Financial Services and the exception for balance-of-payments and external financial difficulties set forth in Article XII.			
HEADNOTES (Applicable to All Subsectors in this Schedule)			
1) Commitments of [Member] in this schedule shall not affect any other international legal obligation of [Member] that accords a financial service or financial service supplier of any other Member treatment more favorable than that accorded by this schedule.			
2) Any commitment that [Member] undertakes not to impose authorization[3] requirements shall not limit the ability of [Member] to adopt or maintain any measure: a) requiring a financial service supplier to notify [Member] that it has begun to provide a financial service in [Member]; b) requiring a financial service supplier to consent to the jurisdiction of [Member]; c) relating to market conduct, including any measure relating to fraud and market manipulation; or d) in the case of services described in subsector (xiii) or advisory services related thereto as described in subsector (xvi), requiring notice registration.[4]			

[3] The term "authorization" in respect of a financial service supplier means any measure that requires the financial service supplier to obtain a license from or otherwise receive the approval of [Member] or any self-regulatory body in [Member] in order to engage in the relevant activity. The term "authorized" has a corresponding meaning.

[4] The term "notice registration" refers to any measure that requires a financial service supplier to notify [Member] of: (1) basic, objective information concerning supplier's business (*e.g.*, its name, address, telephone number, or description of its business practices); or (2) any prior violation of law or self-regulatory organization rule related to fraud or that constitutes criminal conduct. [Member] may require the financial service supplier to receive confirmation that [Member]

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS

3) [*The following commitment applies only to Members that have previously agreed to schedule their commitments according to the Understanding.*] [Member] hereby incorporates by reference the Understanding on Commitments in Financial Services ("Understanding"). In the event of any inconsistency between the commitments in the Understanding and commitments in this schedule, the commitments in this schedule shall control to the extent that such commitments are more favorable with respect to the treatment of a financial service or a financial service supplier of any other Member.

Note: The Model Schedule contains commitments that address many of the subjects that are addressed in the Understanding. In those circumstances, the commitments in the Model Schedule supersede the commitments in the Understanding if the commitments in the Model Schedule are more favorable. For subjects not addressed by the Model Schedule, the commitments in the Understanding are binding on the Member.[5]

4) Any conditions or limitations on, or qualifications to, the commitments in this schedule shall be limited to existing non-conforming measures.

Note: This obligation is similar to the "standstill" provision of the Understanding on Commitments in Financial Services ("Understanding") (¶ A).

5) When membership or participation in, or access to, any self-regulatory body, securities or futures exchange or market, clearing agency, or any other organization or association, is required by [Member] in order for financial service suppliers of any other Member to supply financial services on an equal basis with financial service suppliers of [Member], or when [Member] provides directly or indirectly through such entities privileges or advantages in supplying financial services, [Member] shall ensure that such entities accord national treatment to financial service suppliers of any other Member that have established a commercial presence in the territory of [Member].

Note: This commitment tracks the language of the commitment in the Understanding but clarifies an apparent drafting error (¶ C.2).

6) [Member] shall grant financial service suppliers of any other Member the right to establish or expand within its territory, including through the acquisition of existing enterprises, a commercial presence. [Member] may impose terms, conditions, and procedures for authorization of the establishment and expansion of a commercial presence in so far as they do not circumvent [Member's] obligations under this paragraph and this schedule, and they are consistent with other obligations of the Agreement. This obligation is in addition to the specific commitments set forth in this schedule.

Note: This commitment tracks the language of the commitment in the Understanding (¶¶ B.5-B.6).

has received supplier's completed notification, and may decline to provide such confirmation based on the information provided pursuant to clause (2).

[5] This and other explanatory notes in the Model Schedule, which appear in italicized type, are included solely for the purpose of assisting in the understanding of the commitments contained in the Model Schedule. They would not appear in a Member's schedule of specific commitments.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS

7) Subject to the application on a non-discriminatory basis of any requirements related to juridical form, [Member] shall permit a financial service supplier of any other Member established in its territory to offer in its territory any new financial service.[6]

Note: This commitment is based on the Understanding (¶ B.7), but, unlike the Understanding, permits restrictions on juridical form.

8) For greater clarity, the obligations of Article XI of the Agreement not to impose restrictions on current or capital transactions include restrictions on the exchange of currency.

Note: This commitment clarifies the obligation in GATS Article XI by adding the specific reference to exchange restrictions. The Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (S/L/92), adopted by the Council for Trade in Services on 23 March 2001, include a similar clarification (¶ 6).

9) Where [Member] applies any measure to the supply of both banking and securities services, [Member] shall endeavor to remove or to limit any significant adverse effects of that measure on any financial service supplier of any other Member that occur because such supplier concentrates its activities in the supply of securities services.

Note: This commitment is based on the language of the Understanding (¶ B.10(c)).

10) [Member] adopts the attached reference paper on transparency (Annex A), which forms an integral and legally binding part of this schedule.

11) To the extent that [Member] imposes capital requirements, it shall impose such requirements only on a financial service supplier authorized or required to be authorized in [Member]. Any capital requirement imposed by [Member] shall be for the purpose of addressing legitimate credit, market, operational, legal, and systemic risks.

12) Where a financial service supplier of another Member seeks authorization from [Member] to supply a service, and the supplier is authorized to supply the relevant service in that Member, [Member] should take into account the qualification requirements and procedures, technical standards, and licensing requirements applied by the other Member when deciding whether to authorize the supplier. This does not limit the authority of [Member] to

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[6] A "new financial service" in respect of [Member] refers to a service of a financial nature, including services related to existing and new products or the manner in which a product is delivered, that is not supplied by any financial service supplier in the territory of [Member] but which is supplied in the territory of another Member.

Note: This definition tracks the definition in the Understanding (¶ D.3).

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS

apply its own non-discriminatory qualification requirements and procedures, technical standards, and licensing requirements in a manner consistent with its obligations in this schedule.

Note: This commitment requires Members to consider the requirements of authorization regimes of other Members.

13) [Member] shall not require a financial service supplier of any other Member that has established a commercial presence in [Member] to appoint natural persons of any particular nationality as members of the board of directors or as senior managerial or other essential personnel. [Member] may require that a majority of the board of directors be resident in the territory of [Member], provided that the requirement does not materially impair the ability of the financial service supplier to exercise control over its entity established in the territory of [Member].

14) A financial service supplier of any other Member that supplies a financial service in [Member] may contract with an affiliate for the performance of any aspect of that service, subject to customer consent where applicable, provided that:

(a) where the supplier is authorized in [Member], [Member] may:

(i) restrict the supplier from contracting with an affiliate for the performance of the supplier's supervisory or compliance responsibilities; and

(ii) require the supplier to: (A) retain responsibility for the proper supervision and performance of those functions; and (B) ensure that the contract does not materially impair the effective operation of the supplier's systems and controls, or the ability of [Member] to supervise supplier's compliance with relevant obligations; and

(b) whether or not the supplier is authorized in [Member], [Member] shall not require that the affiliate be authorized in [Member] or in any other Member to the extent that, in performing its contractual obligations, the affiliate performs functions that are clerical, ministerial, or technological in nature, including data processing and technology support (but not including solicitation of customers or custody of customer funds or securities). For all other functions, [Member] may require that the affiliate be authorized in [Member] if [Member] would otherwise be permitted to do so under this schedule.

15) [Member] shall not adopt or maintain any measure that would restrict the supply of any of the financial services in subsectors (vi), (ix) – (xi), or (xiii) - (xvi) to financial service suppliers that are authorized to supply any of the financial services in subsectors (i) - (v), (vii), (viii), or (xii) or that would restrict the supply of any of the financial services in subsectors (x), (xi), or (xiii) - (xvi) to financial service suppliers authorized to supply any of the financial services in subsectors (vi) or (ix).

Note: In general, this commitment prevents a Member from restricting a securities company from supplying securities-related services merely because the company is not authorized to supply banking or insurance services.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
16) [Member] shall not adopt or maintain any measure that would restrict a financial service supplier from supplying any of the financial services in subsectors (vi), (ix) – (xi), or (xiii) – (xvi) merely because the supplier is also authorized in [Member] to supply a financial service in any of those subsectors. *Note: In general, this commitment prevents a Member from restricting a securities company from supplying a securities-related service merely because the company is also authorized to supply any other securities-related service.*			
17) [Member] shall not adopt or maintain any measure relating to the investment of assets by collective investment schemes or by financial service suppliers that accords treatment less favorable to financial instruments issued by any other Member or issued by or entered into with persons of any other Member, or to units of collective investment schemes of any other Member, than it accords to like instruments issued by [Member] or issued by or entered into with persons of [Member] or to collective investment schemes of [Member].[7] *Note: This commitment prevents discrimination against foreign collective investment schemes or financial instruments issued by or entered into with foreign entities.*			
18) [Member] shall permit a financial service supplier of any other Member to supply any of the financial services in subsectors (vi), (ix) – (xi), or (xiii) – (xvi) to a juridical person in [Member] for such juridical person's benefit, without establishing a commercial presence and without being authorized in [Member], if that juridical person is, directly or indirectly, controlling, controlled by, or under common control with the financial service supplier. *Note: This commitment precludes a Member from imposing authorization or commercial presence requirements on companies when they engage in transactions with related parties (e.g., a parent, subsidiary, or other affiliate).*			
19) Recognizing that the movement of natural persons across borders is an essential means by which financial services are delivered, [Member's] horizontal commitments in mode 4 reflect the objectives set forth in Annex B.			

[7] For purposes of this schedule, a "collective investment scheme of another Member" shall be considered a "juridical person of another Member," as defined in Article XXVIII (m) of the Agreement.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
SPECIFIC COMMITMENTS[8]			
(vi) Lending of all types, including consumer credit, mortgage credit, factoring, and financing of commercial transactions;	(1) Except as provided in its Additional Commitments, [Member] may require a financial service supplier of another Member to establish a commercial presence where [Member] requires the supplier to obtain authorization to supply the services in this subsector. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	(1) None.[9] (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	- [Member] shall permit a non-resident supplier of financial services[10] to supply any of the financial services in subsector (vi) to any juridical person for any business purpose without establishing a commercial presence and without being authorized in [Member]. - [Member] shall permit a non-resident supplier of financial services to supply any of the financial services in subsector (vi) to persons in [Member] for the purpose of financing transactions in any of the instruments listed in subsector (x) (A) – (F), and to lend securities to such persons, without

[8] Article XVIII specifically provides for the undertaking of Additional Commitments not subject to scheduling under Article XVI or XVII and contemplates that such commitments would relate to, among other things, "qualifications, standards or licensing matters."

[9] [Member] acknowledges that national treatment obligations apply to Mode 1 commitments pursuant to Article XVII, *i.e.*, treatment shall be considered less favorable if it modifies the conditions of competition in favor of services or service suppliers of [Member] compared to like services or service suppliers of any another Member.

[10] A "non-resident supplier of financial services" is a financial service supplier of a Member that supplies a financial service into the territory of [Member] from an entity established in the territory of another Member, regardless of whether such a financial service supplier has or has not established a commercial presence in the territory of the [Member].

Note: This definition tracks the language of the Understanding (¶ D.1).

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
			establishing a commercial presence and without being authorized in [Member], if: a) such persons are qualified investors;[11] or b) a financial service supplier authorized in [Member] acts as intermediary in relation to the service and supervises any offer of the service to persons in [Member] by the non-resident supplier.
(ix) Guarantees and commitments;	(1) Except as provided in its Additional Commitments, [Member] may require a financial service supplier of another Member to establish a commercial presence where [Member] requires the supplier to obtain authorization to supply the services in this subsector. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	(1) None. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	- [Member] shall permit a non-resident supplier of financial services to supply any of the financial services in subsector (ix) to any juridical person for any business purpose without establishing a commercial presence and without being authorized in [Member].

[11] The term "qualified investor" is defined in Annex C to this schedule.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
(x) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following: (A) money-market instruments (including cheques, bills, certificates of deposits); (B) foreign exchange; (C) derivative products including, but not limited to, futures and options; (D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements; (E) transferable securities;	(1) Except as provided in its Additional Commitments, [Member] may require a financial service supplier of another Member to establish a commercial presence where [Member] requires the supplier to obtain authorization to supply the services in this subsector. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	(1) None. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	- [Member] shall permit a financial service supplier of any other Member to trade all instruments listed in subsector (x) (A) - (F). - [Member] shall permit a non-resident supplier of financial services to supply any of the financial services in subsector (x) to persons in [Member], (i) without the non-resident supplier (a) establishing a commercial presence, (b) being authorized in [Member], and (c) providing (1) any notice or filing in respect of an offer, sale, or contract in [Member], or (2) any prospectus or other offering document relating thereto; and (ii) without the instrument listed in subsector (x)(A) – (F) being registered[12] if: a) the non-resident supplier does not offer the service to persons in [Member] (other than to qualified investors); b) such persons are qualified investors; or c) a financial service supplier authorized in [Member] acts as intermediary in relation to the service and supervises any offer of the service to persons in [Member] by the non-resident supplier.

[12] The term "registered" in respect of a security or other financial instrument listed in subsector (x)(A) – (F) includes any measure that requires a security or other instrument to be enrolled with or approved by [Member] or any self-regulatory body in [Member] in order for the security or other instrument to be offered and sold to or entered into with persons in [Member].

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
(F) other negotiable instruments and financial assets, including bullion.[13]			- [Member] shall not require a person of another Member who trades for or enters into for its own account any instrument referred to in subsector (x) to be authorized to engage in such activity, or to establish a commercial presence in the territory of [Member], unless such person is supplying a financial service to customers in [Member]. *Note: This commitment protects entities from having to be authorized and/or commercially present when engaging in proprietary trading without providing a service, for example, entities dealing as a corporate customer.*
(xi) Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues;	(1) Except as provided in its Additional Commitments, [Member] may require a financial service supplier of another Member to establish a commercial presence to offer and sell securities to persons in [Member] where [Member] requires the supplier to obtain authorization to offer and sell such securities.[14]	(1) None. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	- A financial service supplier of any other Member is permitted to participate in the issuance of all kinds of securities. - [Member] shall permit a non-resident supplier of financial services to supply any of the financial services in subsector (xi), without establishing a commercial presence and without being authorized in [Member], provided that when the supplier offers and

[13] Nothing in this schedule affects [Member's] authority to regulate, on a non-discriminatory basis, securities and other similar exchanges.

[14] For services in this subsector other than the offering and selling of securities, [Member] shall not require a financial service supplier of another Member to establish a commercial presence in [Member] to supply such services cross-border.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
	(2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.		sells securities to persons in [Member]: a) persons to whom such securities are offered and sold are qualified investors; or b) a financial service supplier authorized in [Member] acts as intermediary in relation to the sale and supervises any offer to persons in [Member] by the non-resident supplier. - [Member] shall permit a non-resident supplier of financial services to offer and sell the securities of any issuer (i) without the non-resident supplier providing (a) any notice or filing in respect of such offer or sale in [Member], or (b) any prospectus or other offering document relating thereto and (ii) without the security being registered, if the offer and sale is to qualified investors.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
(xiii) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository, and trust services;	(1) Except as provided in its Additional Commitments, [Member] may require a financial service supplier of another Member to establish a commercial presence where [Member] requires the supplier to obtain authorization to supply the services in this subsector. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	(1) None. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	- [Member] shall permit a non-resident supplier of financial services to supply any of the financial services in subsector (xiii) to a *de minimis*[15] number of persons in [Member] without establishing a commercial presence in [Member], without being authorized in [Member], and without being subject to notice registration[16] in [Member]. - [Member] shall permit a non-resident supplier of financial services to supply any of the financial services in subsector (xiii) to persons in [Member] without establishing a commercial presence and without being authorized in [Member], if: a) such persons are qualified investors; or b) a financial service supplier authorized in [Member] acts as intermediary in relation to the service and supervises any offer of the service to persons in [Member] by the non-resident supplier.

[15] [Member] may define "*de minimis*" for the purposes of this commitment and the second Additional Commitment in subsector (xvi).

[16] The term "notice registration" is defined in footnote 4.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
			- [Member] shall permit the offer and sale of interests in collective investment schemes of any other Member to persons in [Member], without the scheme (i) being registered,[17] (ii) establishing a commercial presence, or (iii) providing any notice or filing in respect of such offer or sale or of any prospectus or other offering document relating thereto, if the offer and sale is to qualified investors. - [Member] shall not adopt or maintain measures relating to taxation that subject collective investment schemes of any other Member or investors in those schemes to levels of taxation, reporting requirements, or other conditions which are less favorable than applied to collective investment schemes of [Member] or investors in those schemes.
(xiv) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;	(1) Except as provided in its Additional Commitments, [Member] may require a financial service supplier of another Member to establish a commercial presence where [Member] requires the	(1) None. (2) None. (3) None.	- [Member] shall ensure that a non-resident supplier of financial services established in its territory has non-discriminatory access to centralized payment utilities, clearing, settlement, and depository systems for securities and derivatives, regardless of

[17] The term "registered" in respect of collective investment schemes includes any measure that requires such a scheme to be enrolled with or approved by [Member] or any self-regulatory body in [Member] in order for interests in the scheme to be offered and sold to persons in [Member].

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
	supplier to obtain authorization to supply the services in this subsector. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	(4) Unbound, except as indicated in the horizontal section. See also Annex B.	whether such systems are operated by public or private entities of [Member]. *Note: This commitment is based on one of the commitments found in ¶ C.1 of the Understanding, but is broader in that it includes access to both public and private entities.*
(xv) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services;	(1) None.[18] (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	(1) None. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	- [Member] shall not adopt or maintain measures that prevent or restrict transfers of information or the processing of financial information, including transfers of data by electronic means, or that prevent transfers of equipment, where such transfers of information, processing of financial information, or transfers of equipment are necessary for the conduct of the ordinary business of a financial service supplier. Nothing in this paragraph restricts the right of [Member] to protect personal data, personal privacy, and the confidentiality of individual records and accounts so long as such right is

[18] [Member] acknowledges that where it has taken an unlimited Market Access commitment in mode one (*i.e.*, cross-border supply), which is signified by the word "none," [Member] shall not require a financial service supplier of another Member to establish a commercial presence in [Member] to supply services cross-border.

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons

SUBSECTORS	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT	ADDITIONAL COMMITMENTS
			not used to circumvent the provisions of the Agreement. *Note: This commitment tracks the language from the Understanding (¶ B.8).*
(xvi) Advisory, intermediation, and other auxiliary financial services on all the activities listed in paragraphs (v) through (xv), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.	(1) None. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	(1) None. (2) None. (3) None. (4) Unbound, except as indicated in the horizontal section. See also Annex B.	- A financial service supplier of any other Member is permitted to provide financial advisory services for subsectors (v) - (xv). - [Member] shall permit a non-resident supplier of financial services to supply advisory services on those activities listed in subsector (xiii) to a *de minimis* number of persons in [Member] without establishing a commercial presence in [Member], without being authorized in [Member], and without being subject to notice registration in [Member]. - [Member] shall permit a non-resident supplier of financial services to supply any of the financial services in subsector (xvi) to persons in [Member], without being authorized in [Member], if: a) such persons are qualified investors; or b) a financial service supplier authorized in [Member] acts as intermediary in relation to the service and supervises any offer of the service to persons in [Member] by the non-resident supplier.

October 10, 2005 DRAFT

Annex A

TRANSPARENCY AND OTHER PRINCIPLES FOR REGULATION OF FINANCIAL SERVICES

Members recognize that transparent measures and policies and reasonable, objective, and impartial administration governing the activities of financial service suppliers are important in facilitating access of financial service suppliers to, and their operations in, their respective markets.

I. TRANSPARENCY IN REGULATION – GENERALLY

A. Members shall ensure that measures are adopted, maintained, and applied only for the purpose of achieving legitimate public policy objectives that are expressly identified, such as protecting investors, maintaining fair, efficient, and transparent markets, and reducing systemic risk.

B. Members shall develop, communicate, apply and enforce measures in a fair and non-discriminatory manner.

II. TRANSPARENCY IN DEVELOPMENT OF REGULATIONS

A. Each Member shall, to the extent practicable: (i) publish in advance, in readily accessible form, any new regulations or amendments to existing regulations that it proposes to adopt; and (ii) provide interested persons a reasonable opportunity to comment on such proposed regulations.

B. At the time it adopts final regulations, each Member should, to the extent practicable, address in writing substantive comments received from interested persons with respect to the proposed regulations.

C. Each Member shall treat information supplied by applicants for authorization confidentially.

D. To the extent practicable, each Member should allow reasonable time between publication of final regulations and their effective date.

E. Each Member shall maintain or establish appropriate mechanisms that will respond to inquiries from interested persons regarding measures of general application.

F. Each Member shall make names, official addresses, and official contact information of competent authorities publicly available.

III. TRANSPARENCY IN APPLICATION OF REGULATIONS

A. Each Member shall establish in writing, and make available to the public, the activities for which an authorization or license or notice to a regulator to supply a financial service is required, and the criteria therefor.

B. On the request of an applicant, each Member's relevant regulator shall inform the applicant of the status of its application. If such regulator requires additional information from the applicant, it shall notify the applicant without undue delay.

C. Each Member's regulators shall make administrative decisions on a completed application within 120 days, and promptly notify the applicant of the decision.. Where it is not practicable for a decision to be made within 120 days, the relevant regulator shall notify the applicant without undue delay and shall endeavor to make the decision within a reasonable time thereafter.

D. Each Member shall base decisions on whether to authorize or license any entity and its employees on the applicant's qualifications, competence and ability to supply the service.

E. On request, and as appropriate, each Member should provide the applicant with the reasons for denial of an authorization or license.

F. Each Member shall ensure that any costs charged in connection with fulfilling its obligations pursuant to GATS Article III are reasonable. Furthermore, each Member shall ensure that any fees charged in connection with applications for an authorization or license are reasonable.

G. Where testing is required for authorization or licensing, each Member should schedule such testing at reasonably frequent intervals and open such examinations to all eligible applicants, including foreign and foreign-qualified applicants.

H. Each Member shall make publicly available the judicial, arbitral, or administrative procedures referred to in GATS Article VI:2(a) for review or appeal of administrative decisions.

I. Each Member shall, where appropriate, permit an affected service supplier to submit its views and supporting documents in any procedure referred to in GATS Article VI:2(a).

Annex B

MOVEMENT OF NATURAL PERSONS

[Member] recognizes that the efficient delivery of financial services requires that financial service suppliers be able to send their representatives abroad on a temporary basis to interact with their customers and potential customers. [Member], therefore, reflects in its mode 4 commitments the following principles:

- Representatives of financial service suppliers (*e.g.*, "business visitors") should be able to engage in a broad range of activities. Such activities should include, for example, participation in business meetings or conferences, negotiation of contracts, consultation with business associates, or preparation for the establishment of a commercial presence. The duration of the representative's stay preferably should be six months, and, in any event, should not be less than three months.

- Where a financial service supplier has established a commercial presence in [Member], such supplier should be able to employ certain types of qualified persons from abroad, whether or not these persons were previously employed by that supplier. The types of qualified persons should include executives and senior personnel who are knowledgeable of the financial services sector and/or the supplier's business operations, as well as financial professionals-in-training who possess appropriate academic qualifications.

Annex C

DEFINITION OF "QUALIFIED INVESTOR"

"Qualified investor" means, for the purpose of this schedule, domestic or foreign, any of the following:

a) national, regional, and local governments, public bodies that manage public debt, central banks, and international and supranational monetary or financial organizations;

b) juridical persons that own and invest on a discretionary basis net investments in excess of [US $25 million] or its equivalent in the currency of [Member] at the time the determination is required or juridical persons acting for the account of one or more "qualified investors," as that term is defined in this annex; or

c) natural persons as determined by [Member] within 12 months of the date on which this schedule takes effect based on criteria not more restrictive than those for juridical persons, or, failing such determination by [Member], natural persons that own and invest on a discretionary basis net investments in excess of US $5 million, or its equivalent in the currency of [Member], at the time the determination is required.

TAB 3

CAPITAL MARKETS LIBERALIZATION: A POWERFUL CATALYST FOR GROWTH OF DEVELOPING ECONOMIES

October 10, 2005

CAPITAL MARKETS LIBERALIZATION: A POWERFUL CATALYST FOR GROWTH OF DEVELOPING ECONOMIES

Executive Summary

In November 2001, the members of the World Trade Organization launched a new, ambitious round of international trade negotiations. Named the "Doha Round" after the city in Qatar in which its initial ministerial conference was held, the trade Round has also come to be known as the "Development Round" because one of its main objectives is to encourage growth among developing countries by reducing barriers to commerce in developing and developed countries alike.

This paper documents how and why the liberalization of trade in financial services – and in capital markets-related services in particular – is central to advancing the goals of economic growth that are central to the Development Round. In addition, there are a number of misperceptions about possible adverse effects of capital markets liberalization which this paper seeks to address and put to rest. In summary:

- Economists have established empirically that the development and expansion of the financial sector plays a key role in advancing economic growth in both developed and developing countries. In turn, the more open a financial sector is to competition – whether from inside or outside the country – the greater are the benefits to that economy. For example, in 2001, the World Bank estimated that by 2015 the developing world would gain over $300 billion in annual output, or an additional 2 percent of GDP, from financial sector liberalization [World Bank, *Global Economic Prospects and the Developing Countries* (2001)].

- The financial sector typically begins with commercial banking and a system of payments and then, over time, expands to include capital markets, generally starting with short-term government debt markets and basic equity markets. The capital markets provide diversified vehicles for saving and investment, additional sources of capital, and increasingly sophisticated instruments (such as derivatives) for managing risk.

- In particular, as capital markets "deepen" – *i.e.*, as more, and more varied, securities are issued and more participants trade – they bring important benefits to developing countries:

  - Deeper capital markets lead to faster economic growth by increasing the supply and reducing the cost of capital, thereby increasing its availability for investment in the creation and expansion of businesses, and by improving the allocation of capital to its most productive uses through rigorous monitoring by larger numbers of investors.

  - Deeper capital markets promote financial stability, both at the "micro" level of individual financial institutions, and at the "macro" level of entire financial systems and economies.

    - Deeper capital markets strengthen local financial institutions by offering them a wider menu of readily traded assets (*i.e.*, securities) in which to invest and thereby both enhancing the liquidity of their assets and improving portfolio diversification.

- Deeper markets also strengthen the financial system itself. For example, the World Bank has found that more liquid local bond markets enhance the effectiveness of domestic monetary policy, reduce economies' exposure to foreign currency-denominated debt, and contribute to the overall soundness of domestic financial systems. In addition, leading regulatory authorities in both the developed and developing worlds concur that recent financial crises demonstrate that a wider range of nonbank financial institutions, including viable debt and equity markets, can minimize the danger of overburdening the banking system.

♦ Empirical evidence suggests that liberalization of trade in capital markets-related services can sharply accelerate the financial deepening process:

- Liberalization increases access for local businesses to funds in the global marketplace.

- The entry of global securities firms, whether through a commercial presence or operating cross-border, provides consumers of capital markets-related services with a broader choice of suppliers and types of services.

- Global securities firms can also enhance innovation in developing country capital markets, by introducing critical market tools, such as repurchase agreements, interest rate swaps, bond futures, mortgage and remittance securitization products, and other new financing techniques that can both mitigate, and more accurately price and allocate, risk.

- By thus enhancing the variety, quality, and efficiency of capital markets-related services, liberalization in turn enhances the competitiveness of the domestic businesses that use these services.

Finally, there are a number of misperceptions about possible adverse effects of capital markets liberalization that may be unnecessarily hindering valuable liberalization efforts. This paper explains why they lack a factual basis. In summary:

- Empirical studies indicate that liberalization should narrow – not enlarge – income disparities within and possibly even across countries.

- Liberalization does not mean the absence of regulation; on the contrary, liberalization requires sound regulation that promotes stability and safety but does not impede the innovation that lies at the heart of any well-functioning market economy. In addition, any liberalization of trade in capital markets-related services will leave in place the so-called "prudential carve-out" already enshrined in the General Agreement on Trade in Services ("GATS"), which allows Members to take appropriate measures to protect investors or to ensure the integrity and stability of their financial systems.

- Fears that liberalization would displace existing businesses generally have not been realized.

In sum, liberalization of capital markets-related services can generate benefits for all participants in economies, and enhance macroeconomic growth and stability, while preserving the authority of local regulators to safeguard investors and the financial system. The Development Round offers a unique opportunity for countries to make commitments that will help them achieve the benefits of capital markets liberalization.

I. Background: The Respective Roles of Banks and Capital Markets

Banks are the most familiar type of financial intermediary, taking deposits from savers and lending them to borrowers in the private and public sectors. Well-regulated banks provide (i) a generally safe venue for individuals and businesses to store (and earn a return on) their wealth (especially where the deposits are government-insured); (ii) a mechanism for payment for transactions (this is the principal function of "demand" or checking accounts); and (iii) a source for borrowed funds.[1]

Capital markets also "intermediate" between savers and the users of capital, typically by bringing together buyers and sellers of tradable claims, or "securities," which generally fall into two broad categories: debt and equity. The capital markets also make available other tradable instruments, including derivatives, such as options, forwards, futures, and swaps on securities, currencies, and commodities.

Liberalizing trade in the financial services that underlie capital markets promotes the development of those markets. These services include:

- *trading*, that is, buying and selling debt and equity securities, currencies, and commodities, and entering into derivative transactions;
- *underwriting* stocks, bonds, and other securities, raising capital for issuers, and placing financial instruments with investors;
- *asset management*, including investment advice and financial planning for institutional and individual investors; and
- *advising* on all types and on all aspects of financial transactions, including mergers and acquisitions, corporate restructurings, and privatizations.

A. Capital Markets Follow Banking as Financial Sectors Develop

Banking originated to provide safe havens for savers and to provide customized loans with relatively short maturities to borrowers, funded by short-term deposits (many payable on demand). Banks are traditionally reluctant to make loans with significantly longer maturities

[1] Two other types of financial intermediaries are insurance companies, which accept premiums and promise to pay claims covering losses identified by contract, and pension funds, which accept contributions from individuals and return them, all at once, or, more typically, over an extended period in the form of an annuity beginning when the individuals retire.

than their deposit liabilities, especially if the interest rates on the loans and deposits are fixed, which increases the bank's exposure to substantial losses if interest rates unexpectedly and markedly change.

As economies grow in size, and businesses grow in scale and complexity, a need for longer-term or even permanent sources of capital develops that traditional bank lending cannot adequately address. In addition, as investors amass greater wealth, they begin to seek investment opportunities that provide higher returns (even at higher risk) than those available from traditional consumer banking products. The capital markets can provide higher yielding investments in the form of debt and equity instruments in almost infinite variety. Thus, capital markets afford more choice to both savers and users of capital.

B. Banks and Capital Markets Are Complementary and Synergistic

Though banks historically have preceded capital markets, the two types of institutions and systems of finance are complementary and intertwined, even though they also compete. Indeed, the existence and robust development of the capital markets is essential not only for the sound operation of banks, but for the sound operation of other types of financial institutions as well.

For example, as capital markets develop, banks seek to diversify their asset portfolios by investing in securities to complement the less liquid loans that constitute their natural portfolio. Being tradable, securities can be much more easily sold if banks experience a large demand by depositors seeking earlier-than-expected return of their deposits. Other financial institutions – such as insurers and pension funds – also could not effectively operate without the ability to purchase securities, which enables them to match their assets to their funding obligations to their customers and plan participants.

As another illustration of the benefits of capital markets to banks, consider the financial innovations in recent decades that have transformed many previously illiquid loans into tradable securities, a process that has come to be known as "securitization." This innovative and increasingly important technique encourages banks to originate more loans at lower rates, with a resulting increase in the overall supply of lower-cost capital. As discussed below, securitization holds great promise for developing countries.

Even more conventional forms of securities – such as equity shares – can help promote the growth of local banking sectors. The need for longer-term and permanent capital generates investment that leads to commercial activity which, in turn, generally requires shorter-term borrowing. Thus, larger stock markets in emerging markets tend to be associated with larger banking sectors.[2]

[2] According to one study, based on a sample of 17 major emerging markets, there is a positive relationship between the ratio of bank deposits to GDP and the ratio of stock market capitalization to GDP [Singh, *et al.*, 2001].

In addition, it is often important for issuers of securities to have bank loans or lines of credit, which assures investors that the issuers have the cash necessary to pay the interest on debt securities, even if the issuer's business suffers a decline in its cash flow. For example, investors and often regulators demand that many issuers of commercial paper – short-term issues of unsecured debt by private corporations – have backup bank credit facilities.

In short, capital markets and depository institutions are mutually reinforcing, so that a strengthened banking sector and a robust capital market tend to support each other. Consequently, it should not be surprising to find that businesses grow faster as *both* capital markets and banks develop [Demirguc-Kunt and Maksimovic, 1998],[3] or that stock market development actually tends to increase the use of bank finance in developing countries [Demirguc-Kunt and Maksimovic, 1996].

II. Financial Sector Deepening Stimulates Growth, Enhances Stability, and Strengthens Important Finance-Related Infrastructures

Empirical evidence strongly suggests that it is the liquidity and thus the depth of markets rather than their size that is the key to economic growth [Levine and Zervos, 1998]. This conclusion is evident from the scholarly studies that examine both the microeconomic and macroeconomic benefits of financial deepening.

A. Financial Sector Deepening and Faster Growth

Economic theorists have long pointed to a connection between financial development and economic ("real sector") growth. For example, Schumpeter [1911] emphasized the importance of banks in funding entrepreneurs and established businesses, spurring technological innovation and hence economic growth. British economist J.R. Hicks later noted that the liquidity of capital markets in 18th century England helped ignite the innovation that was associated with the industrial revolution, by allowing inherently "illiquid" long-term investments, such as machinery, which was far too expensive to be paid for by internally generated funds, to be financed from outside sources [Hicks, 1969, pp. 143-145].

During the past two decades, data have become available for both developed and developing countries that have allowed scholars to test these and other propositions relating to the causes of economic growth. Studies focused specifically on the financial sector have confirmed what Schumpeter, Hicks, and other theorists before had claimed: that financial development helps spur growth for businesses, industries, and entire economies by increasing the supply and reducing the cost of capital for investment in growth-generating plant, equipment, personnel, and other factors of production.

For example, two studies have found that *individual businesses* in countries with greater financial development are better able to obtain more outside financing and thus grow faster than businesses in countries where finance is less mature. In the first study, Demirguc-Kunt and

[3] This finding is based on a 26-country cross-sectional analysis using data for manufacturing firms over the 1980-91 period.

Maksimovic [1998] analyzed a sample of 30 developing and developed countries covering the period 1980-91, and found that active stock markets, along with an effective legal system, facilitate business growth. In the second study, Love [2003] considered a sample of over 5000 businesses in 36 countries during 1988-98 and found that financial development (measured by a combination of equity market valuations and credit available relative to total output) eases businesses' "financing constraints" and makes them more willing to invest. Moreover, she estimated that the beneficial impact of financial development is twice as large for businesses in countries with low levels of financial development than in countries where financial development is "average." This is especially important for small businesses that face even greater financing constraints in less financially developed economies.

Similarly, a recent report by the McKinsey Global Institute [2005, pp. 47-48] notes that deeper financial sectors (measured by total assets in financial institutions and securities issued, relative to total output) are associated with a wider variety of financial institutions and instruments, thus providing users of capital "with more choice and access." Thus, for example, the growth of pension funds in Chile has provided a powerful source of demand for securities, which in turn gives Chilean companies easier access to the equities market for funding.

Financial deepening promotes growth of individual businesses in other ways as well. For example, financial deepening provides incentives for businesses to manage their operations in an efficient and growth-enhancing fashion. Properly managed banks are expert in judging the credit-worthiness of borrowers and monitoring their performance thereafter. Capital markets perform the same function, with the most liquid markets providing ongoing monitoring of businesses' performance and requiring, by virtue of their public nature, enhanced disclosure of performance by the businesses issuing debt or equity securities. Markets can be powerful forces for enforcing discipline, by assessing risk and punishing or rewarding performance, as the case may be.

Capital markets also enable entrepreneurs to take greater risks. With greater access to debt and equity as a means of exit from their investments or as a source of continuing finance, entrepreneurs can be more willing to take the risks inherent in founding new and, innovative ventures, expanding operations, entering new markets and developing new product and service offerings.

Other research has confirmed that there is a link between financial sector development and *industry performance*. Rajan and Zingales [1998] conducted a statistical analysis of multiple manufacturing industries in 41 countries during the 1980s and found that industries requiring more outside financing – whether from depository institutions or capital markets – grew more rapidly in countries with more developed financial sectors.

Empirical research also supports the proposition that if financial sector deepening promotes not only the growth of businesses and industries, but also the growth of *entire economies* as well. King and Levine [1993] studied 77 countries over the period 1960-89, and, after controlling for various factors, found a strong positive relationship between measures of the depth of the banking sector in different countries (bank deposits relative to total output) and different measures of their productivity growth. The authors suggest that this relationship is causal in nature, since the level of financial development is a good predictor of subsequent capital formation and growth. Levine and Zervous [1998] found similar, strong relationships between measures of stock market development and economic growth in a 42-country sample for the period 1976-83. Like King and Levine, this study also suggests a causal relationship, since measures of both bank credit and stock market liquidity help predict future rates of growth of capital, productivity, and total output.[4]

Financial development not only enhances the overall levels of investment in an economy, it also helps economies grow by *allocating those investments more efficiently* than otherwise would be the case. One study using industry-level data for 65 countries over the period 1963-95 found that countries with higher levels of financial development both increase investment more in growing industries and decrease it more in declining industries than in countries with lesser degrees of financial development. [Wurlger, 2000].

B. Financial Deepening that Includes the Capital Markets Leads to Greater Financial Stability

Financial deepening that includes the capital markets promotes and strengthens financial stability. This benefit, which is sometimes overlooked, was dramatically illustrated by the financial crises suffered by economies in Asia and Russia in the late 1990s, and subsequently by Argentina. In these countries, banks – rather than the capital markets – played the central role in financing the needs of the economy, and they also were both a main source and transmission mechanism of the financial and economic breakdowns that occurred. As Malaysian financial regulatory authorities have observed:

> So far, banks have played an important role in financing the needs of the country's rapidly growing economy. But the experience of the recent crisis points to a real danger of over-burdening the banking system with the task of financing production in the economy. A more diversified financial system – one in which the capital market plays a much bigger role than it does currently – can minimise this danger and would result in a more efficient and robust mechanism for mobilising and allocating financial resources in the economy [Capital Market Masterplan, Chapter 2, Trends and Challenges, p. 30].

Similarly, Alan Greenspan, the Chairman of the U.S. Federal Reserve Board, said during the Asian crisis:

> Recent adverse banking experiences have emphasized the problems that can arise if banks are almost the sole source of intermediation. Their breakdown induces a sharp weakening in economic growth. A wider range of nonbank institutions, *including viable debt and equity markets,* are important safeguards of economic activity when banking fails. [Greenspan, 1998, emphasis added].

[4] Several earlier studies also find that stock market liquidity – a measure of capital markets development – facilitates long-run growth [Levine, 1991; Holmstrom and Tirole, 1993; and Bencivenga *et al.*, 1995].

Thus, it is important for financial systems to be *diversified,* rather than to rely too heavily on only one form of intermediation. If banks get into financial trouble, capital markets offer an alternative vehicle for raising funds and saving wealth. The reverse is true if securities prices fall sharply.

Consistent with these views, the World Bank [World Bank, 2005, p. 77] recently concluded that development of local bond markets can enhance the effectiveness of domestic monetary policy, reduce economies' exposure to foreign currency-denominated debt, and contribute to the overall soundness of domestic financial systems.

C. Financial Deepening that Includes the Capital Markets Strengthens Infrastructures Critical to Sound Economic Development

In commenting on the growth of domestic bond markets in developing countries as a sign of financial maturity,[5] the World Bank pointed to resulting improvements in instrumentalities and processes critical to sound financial and economic performance [World Bank, 2005, pp. 76-78, citations omitted]:

- Bond markets foster the development of critical and highly productive finance-related infrastructures, such as clearing and settlement systems, rating agencies to assist investors in evaluating issuers, and regulatory and legal frameworks.

- Local bond markets offer governments an effective tool for conducting and managing domestic monetary policy, because issuing bonds can reduce the government's need to finance deficits by printing money or raising taxes.

- A liquid bond market also can be used as a tool to reduce inflation, manage shocks, and help guide consumption and investment cycles.

III. Capital Markets Trade Liberalization Will Accelerate and Magnify the Beneficial Effects of Financial Deepening

Liberalized trade in capital markets-related services, whether provided through a commercial presence or provided cross-border, will offer consumers of capital markets-related services with a broader choice of suppliers, and in particular will enhance their access to global capital markets, sophisticated advice and new financial products. [6] Liberalized regimes will

[5] The Bank noted that the amount of outstanding local bonds as a share of total output had almost doubled from 1993 to 2002 (from 20 percent to 37 percent).

[6] Firms that are not already in a market will find that offering their services cross-border, without initially establishing a physical presence, is a way to test the market and to develop a sufficiently broad client base to justify later establishing such a presence. Even once foreign firms establish offices in other markets, it is far more efficient for many of the services and products they offer to be imported from their offices in other countries, including their home offices, than to duplicate the development of these offerings and the associated back-office support in each location where the firms seek to do business.

attract more non-domestic investors to local markets and can help provide discipline to local businesses by facilitating better corporate governance practices [Stulz, 1999]. All these changes will enhance the competitiveness of domestic businesses.

A. Empirical Research Confirms the Beneficial Impact of Capital Markets Liberalization on Economic Growth and Stability

The substantial increases that liberalization of trade in capital markets-related services will bring in available capital and in the available range of financial instruments should further lower the cost of capital for businesses. This result was confirmed in one study of 27 countries, which found the cost of capital to be lower in the countries that had liberalized than in those that had not [Kalirajan, *et al.*, 2000]. This finding accords with the experiences of four countries that opened their markets to financial services companies from other countries as a condition of joining the European Union – Greece, Ireland, Portugal, and Spain. The result was a lower cost of capital in each of the acceding countries [Claessens and Jansen, 2001].

As the costs of capital further decline, investment by individual businesses should continue to rise. That is exactly what one study of financial services liberalization in eleven emerging market countries found. Investment was roughly 80 percent higher by the end of the third year after liberalization [Henry, 2000].

Standard economic models suggest that as investment goes up, so does output. World Bank researchers estimate that GDP growth is up to one percentage point higher in countries that have liberalized their financial sectors than in other countries [Mattoo, *et al.*, 2001].[7] Similarly, recent empirical evidence suggests that allowing non-domestic investors to purchase equities of domestic companies stimulates annual GDP growth – on average, by as much as one full percentage point [Bekaert, *et al.*, 2004a].

Available evidence also confirms that liberalization enhances stability as well as growth.[8] For example, economists have demonstrated that openness to non-domestic capital for portfolio investment purposes has led to greater stability and less volatility in equities markets: non-domestic investors provide added liquidity and thus depth to these markets, which makes them less susceptible to wide swings in valuations than if they were closed to such investors. This is a central finding of a study of 28 emerging market economies [Kaminsky and Schmukler, 2002], and is consistent with statistical evidence indicating that equity markets liberalization is

[7] Other researchers have also found a positive relationship between financial liberalization and economic growth, independent of any positive effect on growth exerted by the removal of capital controls [Bonfiglioli and Mendicino, 2004].

[8] A lesson to be drawn from the Asian financial crisis is not that liberalization is bad but that countries should be wary of pegging their exchange rates to foreign currencies, which can encourage excessive short-term borrowing in foreign currencies (by lulling borrowers into believing that they face no currency risk when taking funds from foreign lenders). The countries that were most affected by that crisis generally have since abandoned their pegs, cut their foreign currency borrowing, and instead built up large foreign currency reserves. Singapore and, to a lesser extent, Korea have liberalized entry by foreign securities firms into their capital markets. The key point, however, is that the Asian financial crisis does not provide a rationale for developing countries to deny themselves the benefits that capital markets liberalization can bring.

associated with reduced volatility in national consumption growth [Bekaert, *et al.*, 2004b].[9] Furthermore, the presence of non-domestic financial institutions in a market reduces the volatility in capital flows [Kono and Schuknecht, 2001], and thus reduces the risk of banking crises in particular [Barth, *et al.*, 2004].

B. Entry by Global Securities Firms Promises Services of Particular Significance for Developing Economies

Liberalization will make available a number of financial techniques and resources that should have special positive potential in developing economies. For example, global securities firms can bring their expertise in "securitizing" assets to the developing world, where securitization either has not yet occurred or is in its infancy. Peruvian economist Hernando De Soto has estimated that as much as $9 *trillion* of real estate assets are held "informally" – without registered titles, an essential precondition both for ownership and for mortgage credit – throughout the developing world [De Soto, 2000]. As ways are found to transform informally held property into formally titled property, mortgage credit should grow, and, as it does, so should the opportunity for securitization. And as more mortgages (and other types of loans) are securitized, the cost of credit should decline. This outcome would be of great importance to parts of the world, such as Latin America, where local banks have been reluctant to extend credit to private borrowers.[10]

In addition to securitization of mortgages, the World Bank has suggested that debt instruments backed by remittances from expatriates living abroad and receipts from tourism and exports could provide an important source of finance for many developing countries. Since the first remittance-backed securities (or as they are now known, "diversified payment rights" or DPRs) were issued in Mexico in 1994, a number of other countries – Brazil, El Salvador, Kazakhstan, Peru, and Turkey, for example – also have issued them. From 2000 to 2004, a total of $10 billion in DPRs were floated, $4 billion by Brazil alone (which saved 700 basis points in interest costs relative to the cost of issuing government debt). Using their experience in securitization generally, global securities firms are ideally positioned to help this market further expand. Although a number of legal and institutional hurdles remain, the World Bank projects that eventually $9 billion annually could be raised by developing countries issuing DPRs. These assets not only can afford local residents alternative, high-yielding investment opportunities, but DPRs also could help attract non-domestic capital that would help finance local investment.[11]

Second, global securities firms can expose their own non-domestic clients to investment opportunities in developing countries and thereby enhance the flow of capital into such countries. The same World Bank report that celebrated the recent growth of capital markets in developing countries also notes that, so far, there has been relatively little non-domestic investment interest

[9] Though the authors acknowledged that their results are weaker for emerging markets countries, they do not observe an increase in consumption growth volatility when countries liberalize.

[10] During the 1990s, the average level of bank credit to GDP in Latin America was just 28 percent, significantly lower than in developing countries in other parts of the world [IADB, 2004].

[11] The source for the data in this paragraph is the World Bank, 2005, pp. 108-109.

in many emerging bond markets – due in significant part to ignorance or misperceptions of the risk associated with these instruments and markets. Global securities firms can give their clients information to overcome these barriers. In the process, global securities firms add to the benefits of domestic bond markets the Bank has outlined, while enabling their clients to better diversify their portfolios.

Third, developing countries can benefit from the knowledge and experience that global securities firms have in assisting government privatization efforts. Though a number of governments throughout the world already have privatized many formerly state-owned enterprises – often by offering their shares to the public through initial public offerings (IPOs) – government ownership (of banks in particular) is still prevalent in many countries. As governments continue privatizing state-owned enterprises and assets, they will want to take advantage of the skills and services offered by global securities firms.

Fourth, global securities firms could help facilitate the expansion of pension systems in the developing world. As recent reports from the United Nations and the International Monetary Fund have documented, the *entire world* is aging, not just the populations of developed countries [International Monetary Fund, 2004; United Nations, 2004].[12] Further development of capital markets will enhance economic growth, and the pension funds that are created in the process – public and private – will be a growing source of demand for the securities that are issued and traded in capital markets. The asset management experience of global securities firms can help maximize returns earned by developing country pension funds and the employees whom they benefit.

IV. WTO Commitments Will Greatly Enhance Entry into Developing Economies by Global Securities Firms

If liberalization of trade in capital markets-related services can generate all of these benefits, why shouldn't countries liberalize unilaterally? A few have, and they quickly have become homes to much financial activity. For example, Singapore now hosts over 100 non-domestic commercial and investment banks. With its vibrant stock exchange, Singapore has become a "financial hub" for activity throughout Southeast Asia. Indeed, the most active investors in the securities firms of that region after the 1997 crisis have been from Singapore. Among the transition economies of Eastern Europe, Hungary has been in the forefront of integrating its financial sector with global capital markets. Ireland, only two decades ago the poor cousin of Europe, now is the financial gateway for financial firms seeking to do business in Europe, and has one of the highest per capita incomes in Europe [OECD, 2005, p. 85].[13]

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[12] Indeed, according to the sources cited above, developing countries will be home to an increasing share of the world's elderly, from roughly 60 percent now to 80 percent by 2050. Developing countries will need to do everything they can to grow in the meantime to generate the savings that will be necessary to provide even minimal levels of financial support for people when they are too old to work.

[13] As of 2004, Ireland was the home to approximately 450 international financial institutions, including roughly half of the top 50 financial institutions in the world, and more than half of the world's top 20 insurers. Collectively, these institutions employ over 20,000 Irish citizens [Deloitte, 2004]. Ireland also hosts almost 2,000 foreign mutual fund companies, which perform their custody and administration services in the country.

The Development Round offers a unique opportunity for countries to make commitments that will help them achieve the benefits of capital markets liberalization. The chief advantage of multilateral agreements is that, unlike unilateral or even bilateral liberalization, they can immediately generate faster growth for the entire global economy, which in turns benefits all countries that choose to be integrated globally (through cross-border trade and capital flows). In addition, by formally adopting liberalization, multilateral agreements signal to global investors that they can have confidence in the economies of the countries that make commitments under them. *Indeed, the World Bank has estimated that by 2015, the developing world would gain over $300 billion in annual output, or an additional 2 percent of GDP, from general financial sector liberalization* [World Bank, 2001].[14]

V. Correcting Misperceptions About Liberalization of Trade in Capital Markets-Related Services

A number of concerns are often expressed about possible adverse impacts of liberalization of trade in capital markets-related services. This paper closes by explaining why some of those most frequently repeated concerns are misplaced.

A. The Gains From Liberalization and Financial Deepening Will Be Widely Shared

Contrary to what may be conventional wisdom, financial deepening can contribute to poverty reduction. The most recent and thorough study of this issue covers 52 countries over the period 1960-99 and not only confirms this poverty reducing effect, but also provides some interesting and important estimates [Beck, *et al.*, 2004]. In particular, this study estimates that if Brazil had had the same credit-to-GDP ratio (a measure of financial intermediary development) as Korea throughout this 40-year period, the average income of the poor in Brazil would have grown at 1.5 percent annually, instead of at zero. Or contrast data from the same study for Chile and Peru, respectively. In Chile, which has a relatively high ratio of credit-to-GDP, the percentage of the population living on less than $1/day declined at a remarkable 14 percent annual rate between 1987 and 2000. But in Peru, which by comparison has a poorly developed financial intermediary sector, the number of people living in such extreme poverty increased at an annual rate of 19 percent over this period.[15]

The findings by Love [2003] (mentioned above) suggest additional ways in which capital markets liberalization can positively affect distribution of income and access to investment capital. As noted, Love found that financial development enhanced local businesses' ability to raise outside financing twice as much in countries where financial development started from a

[14] World Bank, 2001, p.172. This document suggests that developing countries could gain nearly $900 billion in annual GDP from liberalizing trade in services generally, 4.5 times the gains from further liberalization of goods markets.

[15] The study noted that if Peru had had the same level of financial development as Chile, the number of such extremely poor people would have increased at only 5 percent per year, so in 2000 the share of Peruvians living on less than $1 would have been about 2 percent rather than the actual 15 percent.

low level than in countries where financial development was average. She also found that the underdevelopment of the financial sector disadvantages small firms more than large firms. These results imply, first, that the deepening of financial sectors in relatively undeveloped economies should narrow funding disadvantages smaller firms have relative to larger firms. Furthermore, from Love's finding that financial development disproportionately benefits comparatively less developed economies, one can infer that liberalization could also narrow income disparities across countries.

B. Sound Regulation Must Accompany Liberalization

Another unfounded concern is that liberalization will result in the weakening of domestic financial regulation. The very opposite is the case.

Capital markets and consumers of capital market-related services require the transparency, predictability, and other characteristics associated with orderly markets that only sound regulation can provide. Indeed, it is in the interest of global securities firms intent on expanding access to their services to ensure that consumers have confidence in the markets in which those firms seek to do business. It is also appropriate, and indeed necessary, that developed countries provide technical assistance to developing countries in regulating their capital markets. Such assistance should be made not only on a bilateral basis but also through such entities as the International Organization of Securities Commissions (IOSCO).

Making commitments to liberalize will not compromise the safety and soundness of local financial systems or the protection of their investors nor deprive financial market regulators of their authority. Indeed, the GATS, the WTO agreement under which trade in financial services commitments are made, expressly reserves to countries making commitments in this sector the right to take prudential measures "for the protection of investors, depositors, policy holders or person to whom a fiduciary duty is owed," or to "ensure the integrity and stability of [their] financial system[s]." In addition, the GATS protects a Member's right, in accordance with GATS Article XII, to impose restrictions on capital transfers.

C. Liberalization Will Not Lead to Significant Displacement of Local Firms

It is frequently assumed that liberalization of capital markets-related trade will lead to significant displacement of local financial firms. But this assumption is contradicted by the reported experiences of the few developing countries that have already liberalized their capital markets. In 2001 scholars Ranjit Ajit Singh, Attila Emam, and Kar Mei Tang surveyed securities regulators from developing countries who are members of the Emerging Markets Committee of IOSCO. They found that "Fears of displacement of domestic firms have not, in general, been realized." [Singh, *et al.*, 2001, p. 181] One reason is that even where local securities firms already are doing business, liberalization may signal the strength of the domestic securities industry to the international investment community. [*Ibid.*] In addition, countries with relatively undeveloped financial sectors typically have few domestic securities firms.

Conclusion

Capital markets liberalization offers participants in the Development Round the opportunity to enhance their own economic growth and stability without imposing significant adjustment costs on domestic businesses. Liberalization yields benefits at all levels of an economy: existing financial institutions are able to diversify their investment portfolios, thereby enhancing their stability; and local businesses gain greater access to capital and to new and more flexible means of financing from both domestic and non-domestic investors. More investment, in turn, leads to the formation of more new local businesses and to the expansion of existing ones – *i.e.*, economic growth, which benefits all citizens by creating jobs, and generating more and better products and services at more competitive prices. Developing country governments will benefit, as capital markets facilitate the issuance and trading of government debt, which both lowers governmental financing costs and reduces the need to finance deficits by monetary means. In short, the array of benefits, and the spectrum of beneficiaries, is compelling. And as individual sectors reach higher levels of investment, growth, and stability, growth and stability for the economy as a whole improves. The time is ripe, therefore, for developing countries to realize these benefits by making commitments to liberalize trade in capital markets-related services.

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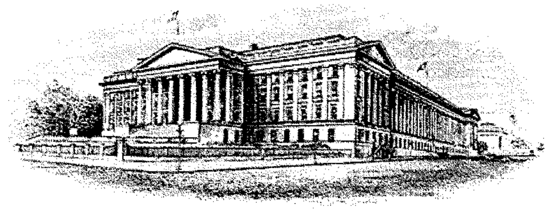

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Testimony before the
Subcommittee on Domestic and International Monetary Policy, Trade and Technology
Committee on Financial Services
U.S. House of Representatives**

Chairwoman Pryce, Ranking Member Maloney, and distinguished members of the subcommittee, thank you for inviting me to testify about trade in financial services. This hearing is timely as we stand just a few weeks away from the WTO Ministerial meeting in Hong Kong, which we hope will provide impetus to what we see as a key element of the Doha Development Agenda, the negotiations on services, especially financial services.

As Secretary Snow has explained, the three goals of the Administration's international economic policy are to increase economic growth, increase global financial stability, and advance U.S. interests. In many respects, nothing embodies these goals more than our work to promote financial services liberalization in the WTO and in other fora. This is what I would like to highlight in my testimony as well as explain how Treasury is promoting an ambitious financial services agenda as part of the Doha Development Round and as part of our everyday work.

Increasing Economic Growth and Promoting Financial Stability

The case for countries to liberalize trade in financial services is strong in both theoretical and empirical literature. The financial sector is the backbone of a modern economy with virtually every sector of the economy depending on its services. Yet, in developing countries, the financial sector is typically small and inefficient, possibly even controlled by a few large institutions with little incentive to compete. This means that entrepreneurs, small business owners, farmers, and other key drivers of employment and income creation either do not have access to capital or if they do – it is extremely expensive and is not conducive to businesses expansion.

While services account for over half of the world economy, and its share will grow as countries develop, the barriers to services are still high because they were outside the disciplines of the world trading system until the last set of global negotiations, the Uruguay Round. As those barriers are lowered, competition should increase and the benefits of a lower cost of capital and a better allocation of resources to more productive uses should accrue, particularly to those developing countries where the barriers are relatively high. For instance, World Bank studies estimate that:

- by 2015 the benefits of services liberalization in developing countries could provide income gains four and a half times greater than the gains from goods liberalization alone;
- countries with open financial services sectors grow, on average, one percentage point faster than others, with the incremental growth rates being somewhat higher for developing countries; and
- by 2015, the developing world would gain over $300 billion in annual output, or an additional 2 percent of GDP, from financial sector liberalization.

The benefits of financial services liberalization extend beyond economic growth, however. The requests to WTO members by the United States for enhanced foreign participation, national treatment, and greater regulatory transparency – as will be explained in more detail by my colleague from USTR – also promotes financial stability. Foreign participation in the financial sectors of developing countries brings in strong new players that provide greater liquidity to the market, greater loss-absorption capabilities, and enhanced risk management techniques. The benefits of introducing global experience into the domestic market go far beyond their direct impact. There is a transfer of skills to local workers who go off to domestic firms where improvements in market practices are emulated. This kind of qualitative benefit is harder to measure, but research has borne it out.

A WTO study of 27 emerging market countries found that allowing foreign financial institutions to establish locally and engage in a broad spectrum of financial activities contributed to greater financial sector stability. For banks in particular, a study of financial crises in emerging markets in Latin America showed that during periods of crisis, foreign banks established in those countries actually increased their local lending relative to domestically-owned institutions. This is aided by such institutions having an international capital base and not having concentrated pre-crisis lending to the country involved, unlike domestic institutions in the affected countries.

A more competitive financial system also puts pressure on policy makers to make regulatory and supervisory structures more predictable and transparent as well as to follow sound macroeconomic policies, which are beneficial to economic growth and financial stability.

Promoting National Interests

Trade in financial services holds the promise of significant economic benefit for all countries, including the United States. As I'm sure that some of the speakers in your next panel will highlight, the financial services sector plays an indispensable role in America, providing individuals, businesses, and the government with credit and liquidity, short and long-term investments, risk-transfer products, various payment systems, and depository services. The financial services sector is not only a vital part of our economy -- accounting for over 8% of U.S. GDP – but it is a sector growing in importance -- roughly 70% greater than it was in 1980. In 2004, finance, insurance, real estate, rental, and leasing contributed more than any other industry group to real GDP growth – about 25 percent. Finance and insurance alone (excluding real estate, rental and leasing) are also key engines of job creation: 6 million jobs (about 4.5 percent of all employment) and growing.

Financial services—from banking to asset management to insurance—represent one of the most dynamic sectors of our economy. Consumers enjoy the convenience of ATMs, online banking, and a host of other innovations that make financial transactions cheaper and less time-consuming. Businesses today rely on a sophisticated range of financial products to hedge risk and make their services more competitive. The WTO negotiations provide an opportunity to eliminate barriers in foreign markets to U.S. financial services firms. Improving the access of U.S. financial institutions to foreign markets helps our exporters continue to expand and develop new markets, building upon U.S. competitive advantage in the provision of these services. U.S. firms have led the way in our economy and can bring those innovations to developing countries.

Engagement

We have been disappointed in the progress that has been made in the WTO on financial services. At Treasury, we have worked with our colleagues at USTR, State, and other agencies to heighten our engagement over the last year. In just the past few months, led by Secretary Snow and Deputy Secretary Kimmitt, Treasury has highlighted the development benefits of open financial sectors and encouraged WTO members to put forward high-quality offers in multilateral fora -- the G-7, G-20, IMF, World Bank, and APEC – and through bilateral discussions in some of the most important developing markets -- Brazil, China, India, and Korea.

Multilaterally, we have made good progress, winning endorsement in each of these key organizations for an ambitious Doha Round. Bilaterally, we have made some progress, but much works remains to be done. The Hong Kong Ministerial is an important milestone, but not the end of the road. We will continue to press for further liberalization in services, especially financial services, through these various fora. We will also continue to push this issue in our bilateral meetings with economic leaders across a broad spectrum of countries.

Beyond the WTO

Given the importance of further liberalization in services, especially financial services, to the global economy, we have recognized the need to complement the WTO discussions by advancing the cause of liberalization elsewhere. We do this through bilateral and regional Free Trade Agreements (FTAs) and through financial dialogues.

Bilaterally and regionally, the United States is conducting ongoing negotiations of FTAs, which include state of the art financial services provisions. These are making an important contribution to trade liberalization. Bilateral and regional FTAs can lead to increased confidence in the benefits of liberalization both from countries having made some of the hard choices that go with negotiating an FTA and from directly experiencing the benefits. We have completed high standard financial services chapters with Bahrain, Chile, Singapore, Morocco, and Australia to name a few. We are negotiating with Thailand, the Andeans, Panama, the Southern African Customs Union (SACU) and UAE. These agreements have provided our industry with substantial new opportunities in many cases and in others locked in the open regimes of our trading partners. For instance, beginning in July of this year, U.S. banks will be able to obtain licenses in Singapore for full services banks that were restricted prior to the FTA. In the first year of the Singapore and Chile FTAs, U.S. exports to those countries together increased by $4 billion. More broadly, the Administration has achieved more than $64 billion in tariff reduction commitments in its FTAs.

For several years, the Treasury Department and U.S. financial regulators have been conducting dialogues with our counterparts from a number of countries with three important objectives in mind. One is to promote a stronger global economy, because dynamic financial markets that are soundly regulated have been proven both in our historical experience and throughout the world to stimulate competition, discipline economic agents, enhance opportunities afforded savers and investors, and to drive growth. Two is to encourage movement toward more competitive, better regulated financial regimes abroad, which enhance global financial stability. Three is to find ways to mitigate actual or potential cross border frictions in the financial services realm. In support of these dialogues and our ongoing work on financial services liberalization, we routinely reach out to U.S. private sector financial officials and trade associations for their input and expertise. Let me make brief remarks about a few of these dialogues.

U.S.-Canada-Mexico: Treasury and U.S. regulators have been discussing financial sector issues with our NAFTA partners for the past eleven years since the trade agreement was signed. Much has been achieved, such as the opening up of foreign branch banking in Canada or Mexico's receptivity to foreign investment in its banking sector, which has been key in restoring it to good health--although more needs to be done.

U.S.-Japan Dialogue: The United States has an active financial dialogue with Japan, the world's second largest economy. Our efforts in this dialogue and in financial services broadly have been aided by the presence of a Treasury attaché in Tokyo. In recent years, our discussions have focused on banking sector stability as Japan's Financial Services Agency tightened financial supervision, focused on resolving non-performing loans, improved the quality of bank capital, and inspected banks more thoroughly. The financial dialogue also has taken up the reform of Japan Post as part of the U.S. Administration's broad engagement with Japan on this issue. It is important that these reforms promote financial system stability and establish a level playing field so that private firms are not competitively disadvantaged.

U.S.-China Dialogue: In October, Secretary Snow led the 17th U.S.-China Joint Economic Committee meeting, which this year included Chairmen Greenspan, Cox, and Jeffery from the Federal Reserve, SEC, and CFTC, respectively, and their Chinese financial sector regulatory counterparts. In addition, Treasury convened the first Financial Sector Working Group bringing together working level officials from U.S. banking, securities, and insurance regulators with their Chinese counterparts for a day of informal discussion. This builds upon ongoing U.S. Administration outreach to China on financial services regulatory issues. We argued for better market access for foreign firms so they can contribute to improving the capital levels and risk management systems of Chinese financial sector. We also discussed numerous regulatory issues of concern to both the Chinese and our financial firms, such as cleaning up the Chinese banking sector, addressing problems in equity and bond markets, and improving insurance regulation. These efforts will be carried forward in the new year both with continued efforts from Washington and by our newly appointed attaché in Beijing.

U.S.-EU Dialogue: The U.S.-EU Financial Markets Regulatory Dialogue has focused on measures designed to further integrate EU financial markets, which, according to studies, could lift EU real economic growth by as much as one percentage point. Through its low-key and informal approach, this dialogue has been useful in managing issues that arise when legislation enacted in one jurisdiction has "spillover effects," in the other's jurisdiction, potentially creating uncertainty for enterprises. Moreover, the U.S.-EU Dialogue provides a forum for the Administration to advance the interests of U.S. financial firms that would thrive in the more competitive environment offered by a unified EU financial market. Going forward, Treasury intends to place an attaché in Brussels whose focus will include the dialogue and financial market integration more broadly.

U.S.-India: Secretary Snow returned last week from a trip to India, where he met with the Indian Finance Minister, Central Bank Governor, and other senior government and business leaders on a dialogue on financial, investment, and trade issues. This complements broader U.S. Administration outreach to India on trade and investment issues. They discussed additional liberalization of the Indian banking, insurance, pension, and fund management sectors, the need to strengthen and protect the financial sector against abuse, and the benefits to India from improving the investment climate. These and other challenges are the essential pillars to support sustainable growth, reduce poverty, and increase incomes. Going forward, we look to continuing this important and useful dialogue with India.

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CSI Coalition of Service Industries

Statement of Norman R. Sorensen
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and
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United States House of Representatives
Committee on Financial Services
Subcommittee on Domestic and International Monetary, Trade and Technology

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Introduction

Thank you, Chairman Pryce, for the opportunity to testify today on the crisis in the Doha Round Financial Services Negotiations. The Coalition of Service Industries (CSI) is the leading business organization dedicated to the reduction of barriers to US services exports. CSI was formed in 1982 to ensure that US trade in services, once considered outside the scope of U.S. trade negotiations, would become a central goal of future trade liberalization initiatives.

Today's hearing is timely, as only 28 days remain until the Sixth WTO Ministerial Conference in Hong Kong. This conference will determine whether the four-year-old Doha Development Agenda (DDA) negotiations can conclude successfully in 2006 and fulfill our ambitious agenda for services including financial services.

As you are undoubtedly aware services are critical to our economy, our foreign trade and to American jobs. Services account for nearly four-fifths of US economic output and represent 80% of the private sector workforce. We are the largest services exporter, with cross border exports of services having grown to $340 billion last year. We enjoy a $50 billion trade in services surplus, of which $16 billion is accounted for by financial services. Sales of services by US affiliates in foreign markets are even larger, rising from $190 billion in 1995 to over $477 billion in 2003. The operations of these affiliates are vital to US companies' global competitiveness, and thus to American jobs.

Along with agriculture and goods, services are one of the three main "pillars" of negotiation in the Doha Round. But the attention accorded to services in trade negotiations, at least until recently, has not been equal to that of the other two pillars. WTO members' participation in the services negotiations has been uneven and generally weak, and the talks are far behind schedule as a result. Failure would be a tremendous loss for the United States. It would be impossible for our sector to support a Round that did not achieve substantial liberalization in services.

The Road to Hong Kong

All World Trade Organization (WTO) Members signed the "rulebook" for services, the General Agreement on Trade in Services (GATS) at the conclusion of the Uruguay Round. But Members' actual commitments to free trade in services were in general poor. Lack of time and the sheer novelty and complexity of negotiating services precluded negotiating better commitments.

Recognizing that much work remained to be done in services, the Uruguay Round provided that negotiations continue immediately after the Round in four sectors: financial services, telecommunications, maritime and professional services.

The negotiations on telecommunication and financial services concluded successfully in February and December 1997 respectively.[1] A previous effort to negotiate a financial services agreement was terminated in 1995, when the United States decided that the agreement did not contain sufficient new liberalization to allow it to agree to the deal.

The 1997 financial services negotiations took place over 8 months, ending on December 13 that year. Members of the financial services business community visited Geneva during six of the monthly negotiating sessions to meet with the 20 Member delegations the Financial Leaders Working Group (FLWG) had targeted as those of most interest. Industry representatives from as many as 60 companies and associations from Europe and North America regularly met jointly with the chief financial services negotiators of both the EU and the US, and with representatives of the EU member states. This remarkable industry cooperation resulted in a well sustained common position.

The Current State of Play in Services and Financial Services Negotiations

Against this background, what is the state of play in the Doha Round services sector negotiations?

The bottom line is that while there is a sufficient quantity of offers to hold a negotiation, their quality is poor. The offers provide for little new liberalization, and in many cases do not even reflect current levels of openness. At this time, 69 initial offers have been put forward, meaning that more than 20 WTO Members that should do so still have not yet tabled an initial offer. Revised offers were to have been submitted by May 31 of this year. To date, only 28 members have tabled revised offers.

In his July 2005 report to the WTO Trade Negotiations Committee, Alejandro Jara, the former Chairman of the WTO Council for Trade in Services in Special Session, noted that "...a majority of these offers do not propose any improvement. If the current offers were to enter into force, the average number of sub-sectors committed by Members would increase only from 51 to 57... the overall quality of initial and revised offers is unsatisfactory. Few, if any, new commercial opportunities would ensue for service suppliers. Most Members feel that the negotiations are not progressing as they should. It is clear that much more work will be necessary in order to bring the quality of the package to a level that would allow for a deal."

The Critical Role of Financial Services for Economic Development

Financial services, broadly comprising banking, insurance, insurance intermediation, asset management, pension and retirement services, payments systems including credit cards, brokerage and securities, are essential prerequisites for dynamic modern economies. Liberalizing trade in financial services improves capital market efficiency, bolsters financial sector stability, and supports economic growth and job creation for both developed and developing countries. A World Bank study found that "a sound financial system boosts economic growth and particularly

[1] Maritime negotiations ended unsuccessfully, and professional services negotiations concluded with agreements on mutual recognition and related issues.

benefits people at the bottom end of the income league."[2] Enhanced competition stimulates modernization and provides consumers with the broadest range of products and services at the lowest cost. It is unfortunate that in "two poor states in India where the financial system is largely controlled by the government, borrowers paid bribes to officials amounting to between 8% and 42% of the value of their loans."[3] A level playing field for foreign financial services providers is critical. It can help reduce corruption and ensure that both agriculture and manufacturing become more competitive.

Sectors of Particular Concern

While the membership of CSI includes a broad array of financial services providers, for the purposes of this hearing I have been asked to address issues relating to insurance, asset management and pensions.

Insurance: Insurance can provide unique and important benefits to a society, including financial security to support economic growth, private compensation of loss in place of government compensation or no compensation, investment in basic infrastructure and a financial and political focus on loss prevention and mitigation. Insurance companies and intermediaries can only provide these societal benefits if the market is liberalized and insurers and intermediaries can enter, operate, and earn a profit. The FLWG Insurance Model Schedule and Best Practices outline the essential elements of market liberalization which must be addressed in the requests and offers, to realize these benefits.

Asset Management: Asset management companies also provide important benefits to countries whose markets are open. By offering mutual funds to investors, both small and large investors are afforded the opportunity to obtain professional management and diversification while saving for their future. In doing so, asset management companies contribute to economic growth by channeling individual savings into the world's capital markets. This can be particularly important for emerging markets, where mutual funds' portfolio investments provide a much needed source of stable long-term capital.

Pensions: As countries undertake reforms to ensure the stability and sustainability of their retirement systems by developing private pension systems, countries should provide effective market access for firms in managing private retirement assets worldwide. Pension plans should be permitted to invest in a wide range of investments to maximize returns to pension participants; and sponsors of defined contribution plans should be able to provide a wide range of permissible investment options.

Objectives for Financial Services Industry

Through negotiations on financial services since the Uruguay Round industry has sought to achieve the following priorities: the right to establish and own the majority share of a business, the right to be treated the same as a domestic company, the right to transparency, the ability to trade across borders, and protection of rights acquired in a market prior to the conclusion of a trade agreement.

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[2] Demirgüç-Kunt, A., L. Laeven and R. Levine "Finance, Firm Size, and Growth" World Bank, December, 2004.
[3] "The hidden wealth of the poor" The Economist November 3, 2005

Mode of Establishment and Ownership: Developing countries should permit the right to establish through a wholly owned entity or other form of business ownership such as a branch, and the right to operate competitively through established vehicles available to national companies, since companies have different strategic objectives and ways in which to structure themselves to achieve their objectives. Developing countries often cite concerns with regard to permitting branching; however, this form of establishment provides access to the home office capital as well as any local capital, and therefore has more financial protection than a subsidiary. Full ownership of the entity is important, particularly for financial services companies.

National Treatment: Our companies are often not offered a level playing field; national treatment should be afforded to ensure that we are not excluded from certain areas of a market, or regulated differently from domestic companies. Equal treatment benefits consumers since it encourages competition, greater product choice and lower prices and foreign and domestic financial services providers through an increase in demand, resulting in additional income.

Regulatory Transparency: This is of particular importance for global companies, particularly the financial services industry due to its complexity and heavily regulated nature. Similar to the U.S. Administrative Procedures Act, we seek notice and comment on rulemaking, prompt licensing decisions, clearly laid out requirements for licenses, explanations when licenses are denied, and the right to appeal to an objective tribunal. Regular interaction between regulators and the private sector in the form of notice and comment allows regulators to consider comments received prior to promulgating their final regulation. It has been shown that in instances where this dialogue exists, the quality of regulations has increased. CSI recently developed 'The Open Government Project' a website on regulatory transparency. It includes a set of best practices drawn from an analysis of current practice in fourteen countries (www.ogproject.org). Industry supported a U.S. proposal that amplifies GATS disciplines for transparency in domestic regulation at the WTO earlier this year.

Cross Border Services: Countries should remove unnecessary restrictions on cross-border trade in financial services. This is of particular concern to the asset management and insurance industry. All professional insurance intermediaries should be permitted to place business in the most suitable market for each risk and to render related services without being required to establish in the country where such services are delivered. This applies particularly to marine, aviation, and transport placements, and to clients facing international risks, large undertakings, or the need for reinsurance support.

Acquired Rights: Trade agreements should not impair the existing operations of those companies already established and should permit them to continue to expand their business on the basis of their existing license and corporate structure.

Reasons for Lack of Progress in Financial Services Negotiations

Chairman Pryce, earlier I indicated that the negotiations are going badly, that there are a number of offers, but that they have little commercial value. I believe there are two reasons for this.

The first is that many of the important developing countries from whom we most seek offers have not had a sufficient incentive to provide them. We believe that these countries can be divided into three groups, each of which will respond to offers from the United States and other developed countries.

Agriculture: Trade officials and observers in Geneva and in capitals are virtually unanimous in their agreement that an agriculture breakthrough is the lynchpin to the entire Doha Round undertaking. Agriculture has been the central issue in this Round from the outset. Many developing countries have explicitly linked their willingness to liberalize financial services and other services trade with progress in the agriculture negotiations.

We strongly supported Ambassador Portman's bold proposal in Zurich last month, in which he outlined US proposals for the reduction of subsidies and other forms of support that distort agricultural trade. Reciprocation by the EU would generate positive momentum for the Round. Those countries that have made services conditional on progress in agriculture would then have no further excuse not to negotiate services in earnest. But the EU response has fallen far short. Until agriculture is resolved, the services negotiations will not make progress. This is the single most important issue determining the outcome of the Hong Kong Ministerial Conference, particularly for Brazil and a number of other Latins.

Many developing countries export agricultural products. They are right in their demands that global markets, especially in developed countries, be opened to them. This is essential if they are to earn their way out of poverty.

Business Travel Facilitation: US business needs a new business travel facilitation program for two main reasons. First, existing programs do not meet our own companies' needs. Second, a group of about 13 important trading partners including India[4], have made it clear that their willingness to liberalize financial and other priority sectors is dependent on the willingness of the United States to discuss business travel facilitation.

We are unable to engage in such discussions in the Doha Round because there is no agreement in the United States Government on how to proceed. This impasse is adversely affecting the efforts of US services companies to expand their market share in key foreign countries.

A good example of problems we face relates to the entry of foreign professionals for training in the U.S. Current regulations do not, for example, permit on-the-job training. As a result, very few in-house corporate training programs are ultimately approved. The solution for one U.S. company was to establish a training facility in Ireland.

We are also regularly losing initial public offerings to London, Frankfurt & Hong Kong because senior executives cannot obtain their visas in a timely manner in order to hold "road shows" with major US investors across the country. A 2004 study by the Santangelo Group estimated that US business suffered $30.7 billion in lost revenues and added costs over the last two years as a result of visa problems.[5]

The Congress, US trade negotiators and the business community need to work together to shape a business travel facilitation initiative. The business community has fashioned a proposal to facilitate the temporary entry of key business personnel, by which we mean professionals, managers, consultants, and highly skilled experts and technicians. Congressional support, for this proposal will give us a much-needed way to move forward to solve our business travel problems, and also obtain valuable negotiating leverage in the Round.

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[4] Argentina, Bolivia, Brazil, China, Chile, Colombia, India, Mexico, Pakistan, Peru, Philippines, Thailand and Uruguay

[5] "Do Visa Delays Hurt U.S. Business?" The Santangelo Group

Emergency Safeguard Mechanism. Another group of developing countries, led by some of the ASEAN nations, have advocated an Emergency Safeguard Mechanism (ESM) for services, similar to anti-dumping remedies for goods. The U.S. and a large number of other WTO members have taken the position that an ESM for services is neither feasible nor desirable. The nature of services trade is such that it would be extremely difficult, if not impossible, to demonstrate damage from increased service imports. It would be even more difficult to determine remedies. For goods, the remedies are quantitative, in the form of tariffs and quotas, options which are not possible in services. Moreover, the record of the use and abuse of the escape clause for goods should make anyone interested in free trade hesitant in trying to apply it to services.

Despite the inherent problems with ESMs, some countries are unlikely to abandon their demands. An effort will therefore have to be made to find some acceptable compromise without sacrificing core US interests.

Efforts to Break the Deadlock

I stated earlier that there are two reasons why the services talks are floundering. The first reason is the lack of incentives to negotiate, caused by a lack of offers in agriculture, business travel facilitation and safeguards. The second reason is the capacity and time-intensive nature of services negotiations.

Services are based on a "request-offer" process, requiring multiple intensive negotiating sessions in which initial offers are followed by further negotiations, leading to improved offers, followed by further negotiation. These negotiations are undertaken trading partner by trading partner, sector by sector, across the range of service sectors in which concessions are being sought. It is easy to see how effective services negotiations can take, at a minimum, many months. Unfortunately, this process has not gained traction in the Doha Round.

The breakdown of the request-offer bargaining process is of concern to many governments. Some have therefore suggested "complementary approaches" to simplify the complex and time-consuming request-offer process. The European Commission (EC) has put forward an approach whereby developed countries would commit to liberalize in 80% of the 156 service sub-sectors identified in the GATS and developing countries in 60% of the sub-sectors. Developing countries generally have made commitments in a small portion of the sub-sectors identified in the GATS (about 15-20%), while the portion is higher for developed countries (about 60%).

Developing countries strenuously object that the EC proposal undermines their flexibility. A further flaw is that countries could meet the numerical requirement simply by making commitments in sectors in which we have no interest, while making no new commitments in priority sectors for the U.S., like financial services. The U.S. has been working on compromise proposals to bridge the gap between the EC and developing countries. But the EC insists that its formulaic approach be adopted or it cannot justify the cuts it has offered in the agriculture negotiations. Consequently we run the risk of de-railing the entire talks if the EC and other WTO Members are not prepared to show flexibility in their negotiating stance.

Success in Financial Services

Industry's experience in the 1997 WTO negotiations on financial services demonstrated conclusively that Finance Ministries must lead the financial services negotiations or they will not succeed. In those negotiations the highest officers of the U.S. Treasury were committed to their success and worked aggressively with fellow finance ministers to secure commitments.

It is good to report that Treasury Secretary John Snow and the new Undersecretary of the Treasury for International Affairs, Timothy Adams, have taken a fresh interest in the negotiations, in part responding to the concern of the U.S. financial services industry that Treasury leadership is urgently necessary, and to strong expressions of interest by the Members of this Committee and other Members of Congress, for which we thank you.

But as they have taken up in a more determined way the call for financial services liberalization, the new Treasury leaders report they have found a surprising lack of interest among their counterparts in other governments. Demonstrating the gulf that exists in many governments between Trade Ministries and Finance Ministries, US Treasury officials have found many of their opposite numbers unaware of or simply disinterested in the Doha Round negotiations and the opportunities the Round presents.

Therefore an important message that we all must continually emphasize is that financial services liberalization is first and foremost in the interest of the liberalizing country. Financial services form the infrastructure essential to economic development and are crucial to other areas of an economy. Countries where world class financial and other services are available are more attractive to foreign investment. Costs of investment, and associated risks for US providers, are higher in markets where there are not bound commitments.

Conclusion

Chairman Pryce, to achieve our goals for financial and other services, will require concessions by the United States in agriculture, business travel facilitation and safeguards. Demonstration of US willingness to engage these issues is the best way to elicit the offers we need in financial services.

We also need the support of the Congress to achieve these goals. Clear signals from Congress that services liberalization is a critical US interest and that no agreement is acceptable without such liberalization, would be very helpful for our cause.

Failure to negotiate commercially meaningful commitments for financial and other services would mean that the trade rules for services would fall far behind the reality of markets. This would mean lost opportunities for both US services producers and for countries that failed to modernize their services trade. The US services sector could not support a Doha round outcome that failed in this respect. We would enthusiastically support a conclusion of the Round that moved significantly forward in liberalizing services.

I thank you for your time, and would be glad to answer any questions you might have.

Business Roundtable

Coalition of Service Industries

WTO SERVICES NEGOTIATIONS--BUSINESS TRAVEL FACILITATION NEEDED TO HELP U.S. COMPANIES BE COMPETITIVE

U.S. service and manufacturing companies need a new business facilitation program for two reasons. First, existing programs don't work in today's fast-paced international business environment. And second, our trading partners have made it clear that progress in the WTO GATS negotiations in all service sectors is dependent on the willingness of the United States to discuss business travel facilitation at the same time.

U.S. manufacturing and services companies need a new and more efficient system to facilitate business travel to the United States and reciprocal systems in foreign countries.

- Employees need ongoing training to maintain their performance and to qualify for promotions and increased compensation.
- Customers need training on how to use products and services.
- Businesses need to bring global management teams together on a regular basis.
- Sales representatives need to meet with potential customers.
- Investors need to evaluate opportunities.
- Consultants need to be on site to adequately and effectively perform the services contracted for.

The current system for these short term business visits is too cumbersome and slow for today's fast-paced business operations.

- Measures that regulate the entry of foreign professionals for training in the U.S. are too restrictive. They do not, for example, permit on-the-job training. As a result, very few in-house corporate training programs are ultimately approved. *The solution for one U.S. company was to establish a training facility in Ireland.*
- Measures that regulate the entry of intracompany transferees are limited to employees who within the preceding three years have been employed abroad for at least one continuous year. In one case, a U.S. company could not bring in a new senior executive from an overseas affiliate for a short period to work on an international project. *The solution for this U.S. company was to have the U.S. based team travel to Canada to finish the project.*

Progress on services liberalization in the Doha Round and progress on business travel facilitation are linked. U.S. trade negotiators have not been able to open new markets for U.S. services companies in the Doha Round because key developing countries are unwilling to negotiate if the United States is unable to discuss how it will commit to a more modern and efficient business travel facilitation system at the same time.

- Key developing countries have signaled their willingness to discuss opening their markets in areas where the U.S. companies are the most competitive--such as telecommunications, express delivery, financial services and energy services--if we reciprocate in areas where they are becoming more competitive, such as consulting and technical assistance, which often require business travel.

The inability of the United States to engage in the business facilitation discussions in the Doha Round because there is no consensus in the United States on how to proceed is adversely affecting efforts of U.S. services companies to expand their market share in key foreign countries.

- The U.S. services sector is the fastest growing part of the U.S. economy and represents the most competitive services industries in the world.
- In 2004, U.S. services exports totaled $340 billion, up nearly 100 percent since the GATS adopted in 1994. U.S. services account for about 30 percent of the value of America's exports, and the U.S. services trade surplus in 2004 was more than $48 billion.
- U.S. services companies would be even more competitive and grow even faster if remaining foreign barriers are removed.

Business travel facilitation is not an immigration issue.

- In structuring negotiations on business travel, the GATS explicitly stated that negotiations under Mode 4 (Presence of Natural Persons) are not intended to include immigration issues. The GATS *Annex on Movement of Natural Persons Supplying Services under the Agreement* specifically states that "shall not apply to measure affecting natural persons seeking access to the employment market of a member, nor shall it apply to measures regarding citizenship, residence or employment on a permanent basis."

A new business travel facilitation system should have five basic elements.

- Available only for a specific project or event.
- Valid only for a short period of time.
- Application only by the sponsoring entity.
- Available on an expedited basis.
- Structured to prevent it from becoming a channel for employment on a longer or permanent basis or for immigration.

The Congress, U.S. trade negotiators and the business community need to work together to shape a business travel facilitation initiative so the promise of the Doha Round is not lost for U.S. companies.

October 21, 2005

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Responses to Questions from Congressman McHenry following November 15, 2005 House Financial Services Subcommittee hearing on "Increasing Efficiency and Economic Growth through Trade in Financial Services"

1. Q: Is it true that a number of countries view these transparency proposals as an effort by the United States to export its standards?
   A: To the degree that our trading partners have raised concerns about US proposals to promote regulatory transparency they generally relate to resource constraints rather than objections in principle to promoting greater transparency in the development of domestic regulations. While this is a legitimate concern, our transparency proposals do not mandate that countries implement transparency principles in a uniform manner and retain the flexibility to implement them in accordance with existing resources and legal frameworks.

   Q: How do you counter arguments that this kind of transparency is some form of cultural imperialism?
   A: Transparency is a building block of good governance in all democratic societies, regardless of a nation's particular form of government, culture, or level of development. We have found that our developed and developing country trading partners generally share this view. Many financial services regulators already recognize the need for regulatory transparency since the IMF, World Bank and the international regulatory bodies continue to highlight that transparency is an important element to ensure stable and well-functioning financial services regimes.

2. Q: Are some countries resistant to free trade because they are afraid greater economic growth will undermine their government's ability to control people and enforce strict rules?
   A: It is difficult to know exactly why some countries are more resistant to trade liberalization than others. However, there does seem to be a strong correlation between the trade liberalization and economic reform and more open and democratic societies.