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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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