TRADE IN FINANCIAL SERVICES: CURRENT ISSUES AND FUTURE DEVELOPMENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON
INTERNATIONAL MONETARY POLICY AND TRADE

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

JUNE 26, 2001

Printed for the use of the Committee on Financial Services

Serial No. 107–30

U.S. GOVERNMENT PRINTING OFFICE

73–597 PS WASHINGTON : 2001

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

MICHAEL G. OXLEY, Ohio, *Chairman*

JAMES A. LEACH, Iowa
MARGE ROUKEMA, New Jersey, *Vice Chair*
DOUG BEREUTER, Nebraska
RICHARD H. BAKER, Louisiana
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
ROBERT W. NEY, Ohio
BOB BARR, Georgia
SUE W. KELLY, New York
RON PAUL, Texas
PAUL E. GILLMOR, Ohio
CHRISTOPHER COX, California
DAVE WELDON, Florida
JIM RYUN, Kansas
BOB RILEY, Alabama
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, North Carolina
DOUG OSE, California
JUDY BIGGERT, Illinois
MARK GREEN, Wisconsin
PATRICK J. TOOMEY, Pennsylvania
CHRISTOPHER SHAYS, Connecticut
JOHN B. SHADEGG, Arizona
VITO FOSSELLA, New York
GARY G. MILLER, California
ERIC CANTOR, Virginia
FELIX J. GRUCCI, JR., New York
MELISSA A. HART, Pennsylvania
SHELLEY MOORE CAPITO, West Virginia
MIKE FERGUSON, New Jersey
MIKE ROGERS, Michigan
PATRICK J. TIBERI, Ohio

JOHN J. LAFALCE, New York
BARNEY FRANK, Massachusetts
PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
KEN BENTSEN, Texas
JAMES H. MALONEY, Connecticut
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
BRAD SHERMAN, California
MAX SANDLIN, Texas
GREGORY W. MEEKS, New York
BARBARA LEE, California
FRANK MASCARA, Pennsylvania
JAY INSLEE, Washington
JANICE D. SCHAKOWSKY, Illinois
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
STEPHANIE TUBBS JONES, Ohio
MICHAEL E. CAPUANO, Massachusetts
HAROLD E. FORD JR., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
RONNIE SHOWS, Mississippi
JOSEPH CROWLEY, New York
WILLIAM LACY CLAY, Missouri
STEVE ISRAEL, New York
MIKE ROSS, Arizona

BERNARD SANDERS, Vermont

Terry Haines, Chief Counsel and Staff Director

SUBCOMMITTEE ON INTERNATIONAL MONETARY POLICY AND TRADE

DOUG BEREUTER, Nebraska, *Chairman*

DOUG OSE, California, *Vice Chairman*
MARGE ROUKEMA, New Jersey
RICHARD H. BAKER, Louisiana
MICHAEL N. CASTLE, Delaware
JIM RYUN, Kansas
DONALD A. MANZULLO, Illinois
JUDY BIGGERT, Illinois
MARK GREEN, Wisconsin
PATRICK J. TOOMEY, Pennsylvania
CHRISTOPHER SHAYS, Connecticut
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
MIKE FERGUSON, New Jersey

BERNARD SANDERS, Vermont
MAXINE WATERS, California
BARNEY FRANK, Massachusetts
MELVIN L. WATT, North Carolina
JULIA CARSON, Indiana
BARBARA LEE, California
PAUL E. KANJORSKI, Pennsylvania
BRAD SHERMAN, California
JANICE D. SCHAKOWSKY, Illinois
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
KEN BENTSEN, Texas

CONTENTS

TRADE IN FINANCIAL SERVICES: CURRENT ISSUES AND FUTURE DEVELOPMENTS

TUESDAY, JUNE 26, 2001

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL MONETARY
POLICY AND TRADE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, DC

The subcommittee met, pursuant to call, at 2:35 p.m., in room 2128, Rayburn House Office Building, Hon. Doug Bereuter, [chairman of the subcommittee], presiding.

Present: Chairman Bereuter; Representatives Roukema, Castle, Manzullo, Biggert, Capito, Sanders, Waters, Carson, and Sherman.

Chairman BEREUTER. The hearing will come to order. I regret we are getting such a late start. But the good news is that we expect—no assurances, but we expect that we'll be uninterrupted now for 2 hours. The Subcommittee on International Monetary Policy and Trade meets in open session today to examine financial services trade. The subcommittee will hear from private sector witnesses who will testify about financial services trade as it pertains to insurance banking and securities.

This hearing will be the beginning of this subcommittee's and the full committee's examination of this important subject. The word "trade" was actually added to this subcommittee's title. It had not been a part of the title before. And I am convinced that financial services exports have a substantial benefit for the American people and for American firms. And if this subcommittee and committee doesn't pursue it, then we are neglecting our responsibilities.

In fact, on July 11th, U.S. trade representative, Robert Zoellick, will brief the Members of the Financial Services Committee at the full committee level on pending issues and financial services trade, and he addressed some of those issues in a meeting this morning here on Capitol Hill. The Financial Services Committee has jurisdiction over trade as it pertains to financial services. This is quite important as U.S. cross-border trade and financial services have recently grown quite significantly.

U.S. cross-border transactions, of course, are between resident U.S. companies and foreign consumers. In the year 2000, U.S. cross-border exports of financial services equaled $20.5 billion, which is an increase of 26½ percent relative to 1999. Moreover, unlike the current overall U.S. trade deficit, U.S. financial services trade had a positive balance of $8.8 billion in the year 2000. It is important, I think, to note that these statistics do not even include the activities of the affiliates of U.S. companies, which are physically located in a different country.

I want to call my colleagues' attention to two memoranda addressed to this Member from the Congressional Research Service, at my request, and I think they provide good background for us as we prepare to explore this subject. And I want to particularly commend Patricia Workman and William H. Cooper for the work they have done on these memoranda and for their offer of further assistance.

[The information referred to can be found on page 33 in the appendix.]

Before introducing our distinguished panel of witnesses, I would like to briefly stress the following three issues that are quite important in today's hearings. First, U.S. policy toward foreign financial institutions, barriers to financial services trade and current efforts to open financial service markets. I am interested in the thoughts of our witness panel on these three particular subjects, as well, of course, as on other relevant subjects and issues. First, the U.S. uses a policy of national treatment for foreign financial institutions that have a presence in the U.S.

National treatment allows foreign-owned financial institutions and U.S. domestically owned financial institutions to be treated the same. In fact, under the Financial Reports Act of 1988, the Secretary of the Treasury must provide to Congress a quadrennial study of changes and laws that affect national treatment of foreign banks and security firms in the United States.

Second, U.S. financial service firms do confront many types of trade barriers. For example, Japan, until recently, restricted sales of foreign insurance companies of life and non-life insurance. Another example, the Brazilian government denies foreign marine cargo insurers the ability to compete for that business. I am interested in other specific examples which restrict foreign markets' access to U.S. financial institutions. But I think you could just give us an unlimited amount of such examples.

Third, even with these trade barriers, there are current efforts to open up financial service markets, which my colleagues are all aware of. Financial service trade is part of the larger framework of the World Trade Organization (WTO) negotiations on trade and services. The General Agreement on Trade in Services (GATT) within the WTO was concluded in 1997. As a result of a financial services agreement, it included member commitments to provide national treatment and market access to foreign providers of financial services.

Moreover, in the year 2000, a new round of service negotiations of course began in the World Trade Organization (WTO). Furthermore, the Free Trade Areas of the Americas, (FTAA), is another example of an effort to open up the financial services market. In June of 1998, nine negotiating committees, including one for financial services, were established under the 34 nations in the Western Hemisphere. Due to the prospective emerging markets, the U.S. financial services sector could benefit greatly from the FTAA.

Lastly, this Member believes that giving the President Trade Promotion Authority, (TPA), would provide new opportunities for financial services trade. While the U.S. continues to be the global leader in financial services, this position could be threatened by the lack of a TPA. Currently, the European union has free trade agreements with 27 countries, while the U.S. has only two such free trade agreements which are signed into law. The TPA would greatly enhance the credibility, I think, of the U.S. negotiating position in both the WTO and the FTAA.

On May 10th, President Bush provided Congress an outline of his 2001 legislative agenda, including the TPA. In addition, I, of course, would note, Representative Phil Crane introduced the TPA bill, HR 2149 which currently has 89 co-sponsors.

To assist the subcommittee examining these issues I am pleased we will have the opportunity to hear from our distinguished panel of private witnesses.

First Mr. Peter O'Connor, the Executive Vice President of Global Government Affairs and New Markets for ACE INA, will testify on behalf of the American Insurance Association (AIA). ACE INA, which has offices in 50 countries, is one of the world's largest providers of property and casualty insurance. Mr. O'Connor has 30 years of international management experience.

Second, the subcommittee will hear from Thomas L. Farmer, the General Counsel of the Banker's Association for Finance and Trade, (BAFT). This association, which represents internationally active financial institutions and companies, promotes the expansion of financial service markets worldwide. Mr. Farmer has had a distinguished career, which includes being a founding member of the Overseas Development Council and the former General Counsel of the Agency for International Development.

Third Mr. Steve Judge will testify on behalf of the Securities Industry Association, SIA. The SIA represents nearly 700 security firms, including investment bankers, broker dealers and mutual fund companies. SIA member firms are active in both U.S. and foreign markets. Mr. Judge has been the head of the Securities Industry Association since 1993. Prior to joining SIA, he was a congressional staff member for more than 13 years.

In addition, Dr. Mark Weisbrot, the Co-Director of the Center for Economic and Policy Research in Washington, DC will testify. Dr. Weisbrot has written different publications on trade and globalization. In addition, he is the author of a weekly column on economic and policy issues that is distributed to newspapers by the Knight Ridder Tribune media services.

We welcome the distinguished panel to our hearings, and without objection, your written statements will be included in their entirety in the record. But first, I turn to the distinguished Ranking Member of the International Monetary Policy and Trade Subcommittee, Representative Bernie Sanders from Vermont for any comments that he might have.

Mr. Sanders.

[The prepared statement of Hon. Doug Bereuter can be found on page 30 in the appendix.]

Mr. SANDERS. Thank you very much, Mr. Chairman, and welcome to our guests. And I thank you for holding this important hearing. I think the first point that I would make is that while it is very important to be talking about financial services and trade, we should understand, as Mr. Weisbrot will tell us, I suspect in a few moments, that our net exports of financial services currently total about $8.8 billion. Now that sounds like a lot of money. But even if this were to double in the next few years, the increase would only reduce our current account deficit by about two percent. So I think it is important to look at the issue of financial services within the context of our entire trade policy.

I happen to be one of the Members in the Congress who believes that our current trade policy overall is a disaster. And it is worthy of a lot more discussion than we presently hear. It is quite incomprehensible to me that in a time when we have this year, a trade deficit of over $400 billion, a record-breaking trade deficit, that we hear very, very little about that issue.

We have, as many of you know, presidents in recent years, whether it is currently President Bush or President Clinton or President Bush's father, the former President, they were all very strong free trade advocates. And what very often President Clinton and the others would tell us is that for every $1 billion in U.S. exports, we gain about 14,000 jobs. And that is true.

But unfortunately, they didn't do the other side of the equation. What happens when you have a $400 billion trade deficit? How many jobs do you lose? And the answer is obviously, that we lose many, many jobs. And, in fact, using the same accounting principles that President Clinton and others have used, we have lost over 1.4 million good-paying, manufacturing jobs since last year alone, and 6.3 million manufacturing jobs overall due to our failed trade policies.

So while today we will hear, in fact, that trade regarding financial services has been a positive for the United States, we cannot not put that in the overall context of our trade policies in general, which, to my mind, are a disaster. In terms of the North American Free Trade Agreement, (NAFTA), in terms of China, as all of you know, we have an $8.38 billion trade deficit with China. Let us talk about that as we discuss renewing most-favored-nation status for China, which I suspect will be coming before Congress in July.

In terms of NAFTA, we have now a $24.2 billion trade deficit with Mexico. Before NAFTA, as a matter of fact, that used to be a surplus. We have a $50 billion trade deficit with Canada, which has more than doubled since NAFTA. So I am not quite clear how people keep telling us that NAFTA, or most-favored-nation status and free trade with China has been this great success. And that is only in terms of job loss. But there are other aspects to the economy when you are looking at huge trade deficits, and that is the pressure on wages.

There was a recent poll, a study that came out, which indicated, lo and behold, guess what, the middle class has not been doing particularly well, despite the great economic boom. In fact, the average American today is working longer hours for lower wages than was the case 25 years ago before the great economic boom. And if you are looking at people who do not have college degrees, young entry-level workers without a college education saw their average real wage plummet by 28 percent between 1979 and 1997, because many of the jobs that traditionally had gone to high school graduates are now being done in China and in Mexico.

So Mr. Chairman, I will be brief. And with your permission, would like to enter my full comments into the record. But the bottom line is, we cannot just look at financial services and say "Hey, free trade is great." Now I understand that we don't have jurisdiction for these other issues within this subcommittee.

But my own view is we have got to be honest. Our current trade agreements are not working for the average American worker, for the vast majority of our people. Yes, they are working for multinational corporations who love the idea of being able to gain access to China and Mexico and every other country on earth where they can hire labor at very, very low wages, take American jobs, bring them abroad. But, I think, Mr. Chairman, I applaud you for holding this hearing, and I understand the limitations of our jurisdiction. But I am one who believes that our current trade policy has been a disaster for American workers. We need to rethink it. And with your permission, Mr. Chairman, I would submit my remarks for the record.

Chairman BEREUTER. Thank you, Mr. Sanders. Without objection, the gentleman's entire statement and other Members' opening statements which they may have will be a part of the record. Hearing no objection, that will be the order. Are there Members that wish to be heard in opening statement?

[The prepared statement of Hon. Bernard Sanders can be found on page 65 in the appendix.]

Mr. SHERMAN. Yes, Mr. Chairman.

Chairman BEREUTER. I see Mr. Sherman. Under the rule, Ms. Waters and Mr. Sherman are entitled to 3 minutes each.

Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman. I appreciate this hearing and I appreciate the fact that you organized this hearing on Trade and Financial Services and your willingness to allow the Members of the subcommittee to express our concerns regarding the direction of our Nation's trade policies. President Bush has placed the passage of Trade Promotion Authority, also known as Fast Track Authority, at the top of his legislative agenda on international trade. Fast Track Authority may be used for a new round of World Trade Organization negotiations, as well as negotiations for a Free Trade Area of the Americas and other regional and bilateral trade agreements. These trade negotiations could have far-reaching implications for people in the United States and around the world.

I am particularly concerned about the impact that trade agreements have on labor, the environment and public health. International trade cannot be expanded at any cost. We must insure that working people and their families actually benefit from international trade. This will not happen unless individual countries have laws and policies to improve wages, working conditions, protect the environment and address the needs of their people. Only then will increased trade result in rising incomes and the improvement of living standards in the United States and the countries in which we trade.

Let me begin by pointing out that I am not one to demand that all countries have the same minimum wage or that developing countries be forced to accept the same labor and environmental laws as the United States. However, labor unions, consumer advocates and environmental organizations must be at the table when the United States negotiates trade agreements and their legitimate concerns must be addressed. This will require the participation of people who represent labor unions and civil society organizations, and in the developing countries well as the United States.

I am especially concerned about the impact of WTO intellectual property rules on public health in developing countries. The Trade Related Aspects of Intellectual Property Rights, the TRIPs Agreement, is one of the international agreements enforced by the WTO. The TRIPs agreement allows pharmaceutical companies, for example, to demand monopoly prices for medicines for which they have patents, including medicines for the treatment of HIV and AIDS.

As a result of the TRIPs agreement and pressure from pharmaceutical companies, millions of people in developing countries have been denied life-saving medicines, because they cannot afford to pay the prices the pharmaceutical companies demand. A few countries have begun to respond to the HIV/AIDS pandemic by enacting laws to allow the distribution of generic HIV/AIDS medicines to their populations. Pharmaceutical companies have responded by using the WTO and TRIPs Agreement to challenge their laws.

I am not going to continue this statement. I will ask that it be submitted for the record. But let me just close by saying I am concerned about what is happening also in the Caribbean, our neighbors. And, because I have spent some time there, I have witnessed the way that we have treated them in terms of their banking laws. I think there is a lot of room for improvement.

We have a lot of American firms, for example, that are going down to the Bahamas, but they cannot get the tax credits for holding their conventions there. The conventions that they hold there are important trade for the Bahamas, for example, because their economy is built on tourism. And if, in fact, our companies are going there, the economy is built on tourism, they are our friends and our neighbors. When we talk about financial services, why don't we correct some of the problems that we have created before we even start to talk about some new ones?

Also, I want to just say this: If we are interested in "know your customer" rules and laws, we have got to practice what we preach. Let us not go someplace else demanding what we don't do here in the United States. With that, I will yield back the balance of my time.

[The prepared statement of Hon. Maxine Waters can be found on page 70 in the appendix.]

Chairman BEREUTER. Thank you, ma'am.

The gentleman and lady's entire statement under previous unanimous consent requests are included.

The gentleman from California, Mr. Sherman.

Mr. SHERMAN. I commend the Chairman for holding these hearings and commend the gentleman from Vermont, especially, for his focus on the most enormous trade deficit in the history of mammalian life and the effect that financial services can have on that. You don't have to be a member of the Progressive Caucus to see the importance of our trade deficit. At that table 2 years running, Chairman Greenspan has sat there and in response to my questions, has been amazed, as I am, that this trade deficit has gone on so long without exploding. And predicting that some day, some date that neither one of us would predict, that it has to come to an end, perhaps a crashing end.

The financial services area is one area where we have some competitive advantages and might be able to get some of that trade deficit reversed. But financial services are perhaps unique among the products in the world. If you have a competitive advantage in widgets, you export widgets and it helps your trade deficit.

In contrast, financial services, while it can produce tens of thousands of jobs here in the United States, could also be the vehicle for exporting hundreds of billions of dollars in capital. And I think it is important that we look at what we can do to keep capital in the United States. We had a $1.3 trillion tax cut in this country, adopted in large part to increase the amount of capital available for the expansion of American business, not to simply lead to the export of capital from the United States to other countries.

In addition, you have the enormous effect our financial services industry can have on some of the most horrific human rights problems around the world. Slavery, obviously, had an enormous impact on our economy. That was a century-and-a-half ago. Today, slavery is being practiced in Sudan and this House had the fortitude to close off Sudan and those companies that do business with Sudan from the U.S. capital markets, particularly the New York Stock Exchange.

And I think that this subcommittee ought to look for other opportunities where it does have an impact on our business, but is there anybody in this room that would want to gain an economic advantage by supporting or participating in slavery in Sudan? I don't think so.

So I commend the Chairman for holding these hearings and think that as we go through the process, we need to ask is our involvement in international financial markets going to help us with the trade deficit and is it going to reflect American values, particularly in dealing with some of most extreme human rights violations? I think, though, that I join with the gentleman from Vermont in saying we need a more comprehensive—outside the jurisdiction of this subcommittee—review of how a country that once ran the world's greatest trade surplus is now running the world's greatest trade deficit. I yield back.

Chairman BEREUTER. I thank the gentleman. And without any further ado, we will proceed with the witnesses. Because I think some of the major benefits will come from the questioning to the witnesses. I am going to ask the witnesses to summarize, in effect, to meet a 5-minute limitation. I regret doing that, but I think it is probably essential for the benefit of our deliberations.

First we would like to hear from Mr. Peter O'Connor, Executive Vice President of ACE INA testifying on behalf of the American Insurance Association.

Mr. O'Connor.

STATEMENT OF PETER O'CONNOR, EXECUTIVE VICE PRESIDENT, GLOBAL GOVERNMENT AFFAIRS AND NEW MARKETS FOR ACE INA, ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

Mr. O'CONNOR. Thank you, Mr. Chairman, and other distinguished Members of the International Monetary and Policy and Trade Subcommittee for holding this important hearing today. I am providing testimony today on behalf of the American Insurance Association, which represents 370 major U.S. property casualty insurers. Trade in financial services has grown rapidly over the last decade and is now a major component of the U.S. trade policy. And insurance has been a strong member of that increasingly robust trade sector. In fact, U.S. financial services exports last year stood at $17 billion, a 30 percent increase from 1999. Subsidiaries of U.S. insurers sold over $46 billion of products overseas in 1998.

Liberalization of trade and insurance, combined with the development of open and transparent regulatory regimes, is critical to the growth of U.S. insurers and to the health of the U.S. insurance industry overall. But more importantly, it is critical to the ability of emerging and transitional economies to grow and develop their economies and provide social safety net protections to their citizens. Insurance is important to any economy for a number of reasons, but I will cite only two. First, insurance is an essential and vital component of a country's financial infrastructure. Insurance companies can be major sources of national income. In collecting relatively small premiums from their many thousands of insureds, insurance companies are able to invest large sums locally.

This, in turn, deepens and broadens the domestic financial services marketplace, which generates higher savings rates and therefore greater economic development. Insurers are also the largest purchaser of Government bonds, which are used to finance infrastructure projects such as schools, hospitals, roads, and power plants.

Second, insurance supports beneficial increases in overall trade and investment and creates jobs, both in the U.S. and in the emerging market. American companies, including small- and medium-size enterprises, are more likely to export to and enter foreign markets if they have access to specialized products and services that they require and U.S. insurers provide. Increased sale of U.S. products overseas translates to more jobs being created back home to supply the overseas demand. Countries around the world, both developed and developing, are recognizing the important role of a healthy and competitive insurance marketplace in their economy.

As a result, U.S. insurance company investment and sales outside our country have increased substantially over the last decade. The insurance industry has been increasingly active in a number of public policy areas to promote expanded international trade. U.S. insurers strongly support the efforts of U.S. trade officials and many Members of Congress to expand trade in both the multilateral and bilateral arenas. But our focus in both realms is clear: greater market access for our business and greater regulatory transparency for our products.

On the multilateral front, the U.S. insurance industry strongly supports the Bush Administration's efforts to initiate a broad trade round within the World Trade Organization, beginning at its ministerial in Doha, Qatar in November. While the 1997 commitments are valuable, U.S. insurers are ready to build on those commitments and work with U.S. negotiators to gain further access to those markets and improve regulatory conditions.

Specifically, the U.S. insurance industry has rallied behind a proposed model schedule that urges countries to make improvements to their 1997 market access commitments, but also to address domestic regulatory issues that effectively act as barriers for U.S. insurers. On the bilateral front, the U.S. insurance industry has been strongly supportive of U.S. trade agreements to expand trade in all areas, including insurance with countries that welcome foreign investments and trade. We are particularly supportive of the U.S. bilateral trade agreement with Vietnam and have lobbied for its passage in Congress. The insurance industry supports ongoing trade negotiations with other countries, both developed and undeveloped, including the European Union, Japan and India.

Our recent focus has been on emerging markets that have long maintained less developed insurance systems, but now appear committed to creating modern and competitive insurance sectors, including China, India and Vietnam.

Based on the market opening commitments China made in its 1999 accession agreement with the U.S. and reaffirmed earlier this month, the industry was strongly supportive of permanent normal trade relations for China last year. We remain committed to normal trade relations for China this year, when Congress votes on that measure to maintain its current trade status until China becomes a full WTO member.

Finally, AIA and its member companies, as well as others in the insurance industry, strongly support the enactment of the Trade Promotion Authorities, known as TPA. We believe the stronger the mandate the President has to enter into trade agreements, the more likely it is the U.S. will be able to negotiate agreements that provide greater benefits to the U.S. economy and consumers.

All of these separate ongoing trade issues involving many countries around the world ultimately address different market barriers and economic circumstances that are unique in each country. But our goal with each issue is the same, to further open each market so that U.S. investors can fairly compete there.

In conclusion, Mr. Chairman, a healthy and productive global insurance infrastructure is vital to a prosperous, innovative and growing global economy. AIA, ACE INA and others in the insurance industry have been proud to play a role in expanding insurance sales abroad and in the process benefiting consumers, economies, and global living standards.

We look forward to working with you and all Members of the subcommittee on the major policy and trade challenges of this year. We appreciate having the opportunity to testify before you today and would be happy to answer any of your questions that you may have.

[The prepared statement of Peter O'Connor can be found on page 72 in the appendix.]

Chairman BEREUTER. Thank you Mr. O'Connor.

We will now hear from Mr. Thomas Farmer, General Counsel, Bankers' Association for Finance and Trade. Mr. Farmer, you may proceed.

STATEMENT OF THOMAS L. FARMER, GENERAL COUNSEL, BANKERS' ASSOCIATION FOR FINANCE AND TRADE

Mr. FARMER. Thank you, Mr. Chairman. You have our written statement. It is brief, and I am sure you have a chance to read it now or later, and I won't go into that statement in any detail. I will try to respond more directly to some of the issues that you and your colleagues have raised. Let me make one diversion here in anticipation of my colleague from the SIA.

Chairman BEREUTER. Bring the mike a little bit closer.

Mr. FARMER. Let me just say that I have just read his statement, and I wish to associate our association with what he has said. We have worked together on a lot of these issues, and we are quite close to them. Let me make a special reference to two issues that are in his statement that are not even alluded to in ours, which concern unilateral sanctions, and again, I think that is something that is worth discussing later. And then the brief reference to the adequacy finding by the European Union, (EU), on privacy issues. Again, that is an important issue and he has presented it very well.

Let me also say that we are very pleased that a number of Members of your subcommittee and the full committee have already expressed their views on that issue. And we hope to be able to work with you on resolving that before very long. Let me go ahead and address one of the issues that I have alluded to that the Chairman brought up, which is national treatment, which is an important principle and the Bankers' Association for Finance and Trade, (BAFT), has supported that for many years.

I have had the privilege of working on that very issue for at least 20 years. And I have to tell you, it is a very blunt instrument, because it is really not in the interest of the U.S. to close its markets to foreign institutions for the reasons that I have mentioned in our statement. The depth and liquidity of the U.S. financial markets is very much supported and strengthened by the ability of foreign banks to get full national treatment in this country.

And this subcommittee, over the years, has passed legislation which has consistently, and we are very pleased about that, treated foreign institutions on the same basis as American institutions, and that is one of the reasons why our markets, the U.S. financial markets, are as deep and as liquid and as well-functioning. And one of the contentions we have made is that to a large extent, the vitality of the U.S. economy results from the lower cost of capital, the breadth of instruments that are available, and the access of foreign investors and lenders to the U.S. capital markets.

Almost consistently, the U.S. has benefited from the ability of foreign capital to operate in this country, whether it comes here through our institutions through their foreign head offices or from foreign-owned institutions through their local offices. This has been very successful, and we have made a lot of progress, and the U.S. Treasury has played a key role in persuading other countries, including Japan, to which you made references, and Canada, to which I made reference, to open up their markets to American financial institutions. The persuasive element in those negotiations, and I have seen them up close, has not been so much the threat that we will exclude them from our markets, but the fact that our markets are working better than their markets, and that it is in their interest to permit foreign-owned institutions into their markets.

Canada is maybe one of the prime examples of that. The U.S. Government has had this debate with the Canadians for a long time. Even in NAFTA, the Canadians did not want cross-border branching, and therefore it isn't part of NAFTA. But then in 1995, the Canadian government began to worry about the shrinkage of the Canadian capital market, the impact on the Canadian economy and their conclusion was, to a large extent, this was due to the fact that the Canadian government had made Canadian markets unattractive to foreign banks and so they reversed course.

And in 1997, in the General Agreement on Trade in Services, (GATS), they made a commitment to open up their markets to cross-border branching and then they did that. In this example, the function of the U.S. market has worked in a number of cases. I think Mr. Judge will agree with me also on the Japanese bilateral negotiations. Again the Japanese concluded that really it was in their interest to open up their markets. And I think that is the way to proceed in those negotiations, to have the principle of national treatment, but to realize its limitations, and importantly, to keep the openness of our markets as a glowing example of what really helps the economy, and the economy of the U.S.

So I would emphasize that I am not qualified—I am not an economist—to discuss trade imbalances generally, and certainly my charter doesn't run to that. But I would like to suggest that the attractiveness of U.S. markets, U.S. financial markets, has resulted in, partly through the structure of these markets, has resulted in a large inflow of foreign capital over the years.

I don't have any figures that compare the outflow or the inflow, but my guess is that on balance, there is more of an inflow. In any case, I think it has helped us deal with what is admittedly a very difficult situation, which is the trade imbalance. So I'd like to address those points.

[The prepared statement of Thomas L. Farmer can be found on page 79 in the appendix.]

Chairman BEREUTER. Thank you, Mr. Farmer.

We'd like now to hear from Mr. Steve Judge, Senior Vice President for Government Affairs, Securities Industry Association.

STATEMENT OF STEVE JUDGE, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, SECURITIES INDUSTRY ASSOCIATION

Mr. JUDGE. Chairman Bereuter, Mr. Sanders, Members of the subcommittee, thank you for the opportunity to present the securities industry's views on trade issues that affect the financial services industry. The U.S. capital markets are the deepest, most transparent and most innovative in the world. The securities industry's unique function, matching those who have capital with those who will use it productively and advising clients and investors on how to manage their investments, are vital to world's economic growth.

The U.S. financial services sector's continued strength depends upon access to foreign markets. It is critical that we continue to pursue access to all markets worldwide. Increased competition improves efficiency and provides consumers with the broadest range of products and services at the lowest cost. Countries that erect barriers to entry, not only harm our ability to provide the products and services our customers demand, but also inhibit growth and innovation in their own economy.

The products and services that U.S. financial services firms offer are eagerly sought by foreign individuals, institutions and governments. In fact, financial services exports topped $20.5 billion with a record trade surplus of $8.8 billion. Over the last decade, the U.S. capital markets have seen their share of the global pie shrink. Approximately 80 percent of the world's Gross Domestic Product, (GDP) and half of the world's equity and debt markets are located outside the U.S.

So obviously, many of the best future growth opportunities lie in non-U.S. markets. It is a long-established U.S. policy to promote economic growth through open markets. The Securities Industry Association, (SIA), supports efforts to eliminate the protectionist barriers through WTO financial services negotiations and through bilateral and regional pacts.

SIA strongly believes that substantial liberalization of financial services markets can only be realized if countries improve regulatory transparency. Lack of transparency and implementation and application of regulations frustrates markets' access in the same way as does tariffs.

Over the last 2 years, SIA has undertaken a major effort to increase regulatory transparency. We published a paper identifying the principles on which transparent regulatory systems are built. This effort has received the support of U.S. financial services regulators and we have worked with APEC, the OECD, IMF, WTO regulators in North America, Europe, Asia and Latin America. Indeed, just earlier today, SIA spoke to members of the International Organization of Securities Commissions on the importance of transparent regulation. And we will give a major presentation of this paper to their annual meeting on Friday in Copenhagen.

We are urging our trade negotiators to incorporate these transparency principles in future agreements. These principles would eliminate preferential access to regulatory proposals, require public availability of proposed regulations, provide an adequate public comment period on new regulations, and mandate the enforcement of regulations on a non-discriminatory basis.

SIA strongly supports the inclusion of financial services in the year 2000 round. We believe this is a tremendous opportunity to build upon the 1997 WTO accord. Though that agreement did not achieve the elimination of all the barriers that the securities industry sought, it did create a strong basis for further liberalization. SIA's objectives for the upcoming round are to expand on the 1997 commitments, transform voluntary liberalizations undertaken since 1997 into binding commitments, and to reject offers that do not fully grandfather existing investments and operations.

We are extremely supportive of the Administration's efforts to forge trade accords with Chile and Singapore, and the free trade area of the Americas. These targeted negotiations provide an opportunity for groundbreaking financial service agreements, and they must set a high standard against which future agreements will be measured.

SIA supports Trade Promotion Authority for the President as an essential tool in negotiating favorable trade agreements. We have been actively seeking a declaration from the European Union, (EU), that Title V of Gramm/Leach/Bliley, in combination with the Fair Credit Reporting Act and other U.S. laws and rules, constitutes adequate protection for personal data handled by the U.S. finance services sector for purposes of the EU data protection directive. Such a determination is critical for the U.S. financial services sector by guaranteeing that the uninterrupted flow of data will insure continued investor and market confidence.

The privacy debate in the United States will continue to evolve. A U.S./EU agreement on adequacy does not preclude further developments and privacy law in either the U.S. or in Europe. An EU adequacy determination would, however, allow U.S. financial services firms to comply with the extensive legal regimes already in place on both sides of the Atlantic without the threat of costly and disruptive data stoppages.

SIA is increasingly concerned about proposals to seek to use the U.S. capital markets to achieve foreign policy goals. U.S. capital markets attract investors and companies from all over the world, and regularly serve as a safe haven in times of crisis. Denying access to U.S. capital markets is not an effective tool for addressing complex foreign policy issues. Doing so could seriously disrupt investor confidence, both domestic and foreign in U.S. markets and jeopardize our continued vibrancy. If issuers are denied access to our markets through unilaterally imposed sanctions they may simply find capital in other markets where U.S. firms are less likely to be competitive.

As the world leader in providing innovative services and products, U.S. financial service firms are essential to job creation and economic growth in the United States and worldwide. Access to foreign markets is more necessary than ever to help firms meet their customer's demands. Your leadership will be a critical factor in deciding the framework for ongoing negotiations within the WTO and other upcoming market-opening trade accords.

Once again, I thank you for your efforts in the past and for the opportunity to testify today. SIA stands ready to work with you as an active participant in these important discussions.

[The prepared statement of Steve Judge can be found on page 84 in the appendix.]

Chairman BEREUTER.Thank you very much, Mr. Judge.

Now we will hear from Dr. Mark Weisbrot, the Co-Director of the Center for Economic and Policy Research. Mr. Weisbrot, you may proceed as you wish.

STATEMENT OF MARK WEISBROT, CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH

Mr. WEISBROT. Thank you. I would like to thank Chairman Bereuter and the subcommittee for this opportunity to testify on this issue. The Center for Economic and Policy Research is a non-profit, non-partisan policy institute and we seek to expand public debate on issues such as this. I will focus my remarks on the public interest in these agreements, such as the Free Trade Agreement of the Americas, (FTAA), the General Agreement on Trade in Services, and NAFTA, and also such legislation as Trade Promotion Authority.

While it is clear there are some gains to be made by U.S. financial firms and banks by the liberalization of trade in financial services, we must weigh these gains against the cost of entering into and expanding the international agreements by which such liberalization is achieved. You cannot liberalize trade in financial services without accepting the rest of the agreements, such as the FTAA. We must also consider the costs and risks associated with liberalization and deregulation, some of which only become apparent after the fact, as in our own savings and loan deregulation experience in the 1980s.

On the benefit side, it is argued that the expansion of trade in financial services can help reduce our trade deficit. As Congressman Sanders already pointed out, there is not going to make very much difference even if we were to double the $9 billion surplus that we currently have. It is about 2 percent of our current account deficit, which is now running at 4.5 percent of GDP, $450 billion a year. And as Congressman Sherman pointed out, this is a very serious problem and I am always amazed as an economist by how little attention it gets in the press. It will have to get some attention soon, because we cannot go on doing this indefinitely. Our foreign debt is now nearly 20 percent of the Gross Domestic Product. If we keep going at the rate we are going now, it will reach 50 percent in less than 7 years, which is a level that no industrialized country has ever had. And again, from an economic point of view, this is at least as serious a problem as a budget deficit of the same order. In fact, it is more serious, because the money is owed to people and institutions outside the country. And yet, Congress does take very seriously, and the press does take very seriously, the possibility of a Federal budget deficit 10 and 20 years into the future, while at the same time this much more important trade and current account deficit is basically ignored.

However, we should be wary of promises that expanding our trade through agreements such as NAFTA, the proposed FTAA or the WTO, will reduce our trade deficit, as the proponents of NAFTA promised back in 1993. Of course prominent economists argued that it was going to expand our trade, which it did, and expand our trade surplus and create a net gain of hundreds of thousands of jobs here, and instead—and I am using figures, they are only slightly different, because they are in constant 1992 dollars, from what Congressman Sanders said—but you can see our NAFTA deficit went from $16.6 billion in 1993, quadrupling to almost $62.8 billion in 2000, and of course our overall current account deficit has ballooned.

The subcommittee asked whether it would be advisable as part of the process of expanding trade in financial services to ease the restrictions on foreign companies that wish to sell securities in U.S. markets. I just want to mention that we have enough problems here policing our own securities markets, as was shown in the recent collapse of the bubble in tech stocks, and you have any number of examples.

One I gave here is Priceline, for example, which is now trading at 18 percent of its peak value. Well, they measured their revenue in terms of their ticket sales, airline ticket sales and hotel room sales, the total amount of them. This is one of the many accounting manipulations that was not stopped by the Securities and Exchange Commission, and partly as result of that, we had a huge bubble and it burst and millions of Americans are already having to change or postpone their retirement plans. So I would suggest that we need to get our own house in better order before we expand our own markets to more difficult-to-police foreign securities.

Finally, a couple more points if I can. The deregulation of financial services has other risks. We saw this in the Asian financial crisis, which most economists now agree was brought on by an opening up of capital markets in the region, which led to a sudden influx of hot money that flowed right out within the following year in 1997-1998. And you had a reversal of capital flows, about 11 percent of GDP for South Korea, Indonesia, Philippines, Malaysia and Thailand. This is what really brought on the crisis and the collapse of the currencies and the economic collapse in the region, which did have an effect also in the United States, particularly on certain industries. Steel workers, farmers were particularly hard hit.

So we have to be careful with international deregulation of financial services even on its own terms and apart from the other conditions that are included in these agreements.

I guess I am out of time, but if we do have time I would like to come back to some of the other conditions that are in these agreements that we should be particularly wary of.

[The prepared statement of Mark Weisbrot can be found on page 94 in the appendix.]

Chairman BEREUTER. Thank you very much. Gentlemen, thank you very much for your testimony. We very much appreciate it. We will now move to the 5-minute question rule, and I will begin the questioning by a question that I want to address to all of you. I will give you a minute or two to think about it and I would like to then have brief answers from each of you. I will move to a second question in the meantime. These are the two related questions.

What type of barriers do you believe are the most damaging to international trade in financial services? And then, second, I want to ask you which countries are the most restrictive, have the most restrictive rules for gaining market access? You can give me one, two or three nominees.

And in the meantime, Mr. Judge, I would like to go to a comment you had at page 6 related to what you describe as a NAFTA model for transitions; that is, transition periods, for entry into developing country markets. And the points that you are making that NAFTA could be in, that it is sector specific. Is that the primary reason you cite this or is it something about the transition period model itself?

Mr. JUDGE. No, it was the transition model itself. In some negotiations it makes sense to have a transition period to get to a goal of total market access and that cannot be accomplished immediately.

Chairman BEREUTER. How do you think, for example, the China WTO access treated your country on transition periods and other elements that limit or begin to open up your access to securities, exports, sales?

Mr. JUDGE. Our support for the China agreement was based on the general benefit to the economy. The securities industry itself did not receive as favorable a treatment under that as other industries did.

Chairman BEREUTER. It was one of their disappointments in short, wasn't it?

Mr. JUDGE. Yes, we were very disappointed in the agreement reached on securities with China.

Chairman BEREUTER. Now if I could come back and ask each of you, just doing down the line, Mr. O'Connor, do you want to give me what are the most damaging barriers to international trade in financial services?

Mr. O'CONNOR. Well, based on my experience, I think some of the barriers that are significant are ownership. In some countries there is a limitation on ownership for foreign companies. India has a limitation of 26 percent, which is very bothersome. Another one is the product approval process. That has been very problematic in Japan where foreign companies, until recently anyway, have been subject to another approval process for their products that was different than it was for Japanese companies. And then another example, I think certain countries, China comes to mind here, they have closed out certain sectors, certain product sectors for foreign companies. Automobile insurance is a closed sector. There were other sectors, but automobile is one.

Chairman BEREUTER. Let's deal with the barriers first. Mr. Farmer, which are your nominees?

Mr. FARMER. Well, we will talk about the barriers first.

Chairman BEREUTER. Yes.

Mr. FARMER. The commercial banking industry I don't think feels it has significant barriers to entry in any market that is of real interest to the industry in terms of an economy which would be worth trying to operate in.

Chairman BEREUTER. Is that because of national treatment giving us more leverage?

Mr. FARMER. That is basically due to the fact that the 1997 GATS agreement made a great deal of progress, and always I mention Canada and Japan being prime examples there. There are barriers in the sense of hurdles to operating successfully in some of these markets I have mentioned in my statement, where the regulatory structure is such that the risks for operating in those markets make them unattractive. Lack of transparency in the regulatory system, actually the SIA statement on that is quite comprehensive. Lack of ability to have input on regulatory structures, and the other thing I would say is weakness of the local banking sector. It really isn't possible to operate successfully in a country if the local banking sector, as it is, for example, in Russia, simply doesn't operate properly.

Chairman BEREUTER. That is interesting. We will have to come back to that one. I want the other barriers nominated by Mr. Judge if I may. Excuse me, Mr. Farmer. Mr. Judge.

Mr. JUDGE. Where they exist, ownership and market establishment barriers are still very important, but we found that, as Tom said, Mr. Farmer said, the 1997 WTO accords removed many of those. But more important are the lack of transparent regulatory systems in these countries. That is something that is really a country-by-country, barrier-by-barrier, regulation-by-regulation fight that we have to make.

Chairman BEREUTER. Thank you very much. I am out of time, but I want to go to Dr. Weisbrot to see if he wants to suggest the most egregious or difficult barriers.

Mr. WEISBROT. I can't speak for the industry, obviously—I think this is one of the problems with the way this is looked at—some of the things that are barriers to entry to financial services markets are actually regulatory measures that are necessary to maintain stability in local capital markets. And the example I gave in my testimony, for example, as to what brought on the Asian financial crisis was a removal of restrictions on foreign borrowing that allowed banks and corporations there to borrow almost unlimited amounts from abroad of short-term capital. Of course, this is what created the instability that led to the currency crashes that brought with it the whole collapse of the economies in the region, because you had this enormous influx of short-term capital, which was pushed very strongly by the U.S. Treasury Department. Prior to this deregulation it would not have been possible.

Chairman BEREUTER. Thank you very much. That subject about what caused the financial crisis in Asia is the subject of another discussion, but my judgment is that is only one of the reasons. The other was crony capitalism and mishandling of it by the IMF in its initial stages, but that is for another day.

Mr. Sanders.

Mr. SANDERS. Thank you, Mr. Chairman. I understand we have representatives from the insurance banking and securities industry here and you are testifying about financial services, and that is fair enough. That is your interest. But I would like you to do me a favor and put another hat on as well. Just pretend that you are not representing a financial services industry, but you are a Member of the United States Congress that has to look at financial services and a dozen other things. And if a constituent came up to you and said, sir, we now know that financial services are running a surplus, Mr. Congressman, but we have an $83 billion trade deficit with China—I know some of you have mentioned NAFTA. We have now a $24 billion trade deficit with Mexico, whereas before NAFTA, we had a surplus. We have a $50 billion trade deficit with Canada, which has more than doubled since NAFTA.

So now you are a United States Congressman and not just a representative of a financial service industry. Tell me what you would tell a constituent when a constituent said, hey, these are not working for me, because I lost my job or my wages are going down or my wife lost her job. So how do you feel about the China agreement, the NAFTA agreement overall? Overall, not just from your financial services. Give us some advice as to how we should vote on these issues.

Mr. O'Connor, if you could briefly respond, Mr. Farmer, Mr. Judge, Mr. Weisbrot.

Mr. O'CONNOR. Congressman, the insurance industry is a particular industry. It is not a manufacturing industry, it is a service industry. So I don't think anybody has lost their job in the insurance industry, because of opening of new markets. I would use the specific example of China. Right now, the Chinese can sell their goods in the United States. Basically they have a pretty good free access to the U.S. marketplace where U.S. companies don't have access to selling goods to the same extent in China. I would say the WTO accession and implementation of a bilateral trade agreement would reduce the trade deficit with a significant trading partner of the United States where we have a deficit, and that is China.

Mr. SANDERS. I appreciate that and, as you know, we don't pick and choose in general. When we are dealing with NAFTA, you are not just dealing with insurance, you are dealing with automobiles and steel and everything else.

So you did not quite answer my question. I am appreciative of the fact that the financial services industry is running a surplus, but we can't pick—well, we can pick and choose, but the approach we have taken is broad trade policy.

Mr. Farmer, how would you answer that question?

Mr. FARMER. Let me say I am neither a Member of Congress or an economist.

Mr. SANDERS. For a few minutes you will be a Member of Congress.

Mr. FARMER. I am way over my head. I think a lot depends on who your constituents are. I would think Mr. Bereuter's constituents, to the extent they are farmers, are quite happy with NAFTA and some of the other agreements. In other words, I think there are balances. Certainly I think if I were an economist, and I am not, I think you need to look at trade balances on a worldwide basis, not on a bilateral basis. I know we are running a worldwide deficit at this point also, but we are running also a capital account and this is one area where the financial services industry comes in well. A lot of this is balanced off by the need for, and the willingness of, our creditors to keep holding onto those little green pieces of paper that we give them, the dollar bills. That is partly due to the fact that they can invest these papers extremely well in the United States, thereby helping our capital markets, lowering our capital costs, and the part of the economy that is driven by them doing well.

Mr. SANDERS. I have to interrupt you, because we don't have much time and I want others to comment. I would say when we talk about trade or economic policy in general sometimes we miss the bottom line, and what the bottom line is to me, to be frank, is how the average citizen is doing. Does this trade policy benefit the average person? You are right, in some cases a farmer in Mr. Bereuter's district or my district benefits, but on average when you are running up a $400 billion plus trade deficit I think the evidence is overwhelming that the average American is not benefiting.

Mr. Judge, your view?

Mr. JUDGE. First of all, I might tell other industries to follow the example of the financial services industry. The financial services industry seems to have a pretty good example of how this can be done. I encourage other industries to follow the notion of expanding markets overseas. I would want to make sure there is a cause and effect relationship between the enactment of the trade agreement and the trade deficit that you point out. I am not sure in the absence of these trade agreements that the trade deficit would be all that much better. In fact, it could be worse. I would make sure I understood there is a cause and effect relationship there, and I am not sure there is one there yet.

Mr. SANDERS. Subject for another discussion.

Mr. Weisbrot.

Mr. WEISBROT. I don't think actually any economist would dispute the relationship between the trade agreements and the deficit. They might dispute the actual effect of that trade deficit on things like wages for employment over the long run. But I think what you would have to say is, first of all, the agreements—NAFTA and the FTAA, they are deliberately designed to make it easier for U.S. corporations to move their investments elsewhere, direct foreign investment elsewhere. So there is no doubt that they have that effect. The other effect they have is to push wages down. Here, if you look at them, is the one probably most important statistic that you can look at concerning the U.S. economy from the point of view of the people, and that is the median wage. That is, the real median wage adjusted for inflation is today the same as it was 27 years ago. Now this is unprecedented in American economic history. This means that the majority of the labor force in the United States has literally not shared in the gains from economic growth over the last 27 years. If you compare that to the previous 27 years, the typical wage increased by 80 percent. The difference between 80 percent and zero is huge, and a good part of that again, economists would argue how much, but a sizable part of that is due to our international commercial agreements and exchanges.

Mr. SANDERS. Thank you all.

Chairman BEREUTER. The time of the gentleman has expired. There were three Members here at the beginning of session. Mrs. Roukema was here at the beginning of the first session. First, we will hear from Mrs. Roukema, Mr. Castle, Mrs. Biggert, and then order of appearance under the committee rules.

Mrs. Roukema.

Mrs. ROUKEMA. I don't quite know where to begin here, but I have listened very carefully to what you have to say. And coincidentally I might tell you that I and Mr. Bereuter were at a policy hearing this morning where Trade Ambassador, I'm sorry, Bob Zoellick, our Trade Negotiator for the Bush Administration, was speaking, and we had noted the Trade Promotion Authority which a couple of you referenced. That has been evidently pointed out as something that Congress has to do. I don't know how high a priority you rank that. But I would like to know if you want to comment on the Trade Promotion Authority. I would be happy to hear that, but I would like to know what do you think our Trade Rep, Mr. Zoellick, should be doing now for your industry, and I heard you say you need more transparency country to country. And you did talk about some of the damaging barriers to financial services. What should the Trade Rep be doing with the Administration and through the Administration with your industry?

Mr. O'CONNOR. I think the Trade Representative should be addressing these barriers that we mentioned earlier.

Mrs. ROUKEMA. I'm sorry? Should be?

Mr. O'CONNOR. Addressing.

Mrs. ROUKEMA. Has there been any movement in that direction in the correspondence? There has been correspondence and dialogue.

Mr. O'CONNOR. Yes. There is an open communication link between our industry anyway and the U.S. Trade Representative, and we constantly advise. This is a moving target. As we go forward, we constantly advise what are the remaining barriers and what the problems are. Transparency continues to be a problem and we make our proposals to USTR and have frequent meetings with them, and they are very serious about us helping the financial services industry, particularly insurance, address these issues with the offending countries.

Mrs. ROUKEMA. Either you or anyone else, please amplify on that, but at the same time tell me, has there been any action taken besides communication and discussions?

Mr. FARMER. Could I? Let me say the way the U.S. Government is structured in financial services outside of insurance, the principal responsibility, negotiating responsibility is not with Mr. Zoellick, but with the Secretary of the Treasury. We have worked very closely with the Treasury over the years through various administrations and they have been very actively negotiating on these very issues with foreign governments.

My reference to Canada and Japan reflect mostly the efforts of the U.S. Treasury to get the regulatory structures improved in these countries, and that has continued to go on. And I would say the Treasury also is working with the IMF, which is beginning to give technical assistance to countries that don't understand regulation. And so through the Treasury/IMF channel there has been a lot going on.

As you know, the current Treasury is just getting into place for various reasons, and we are looking forward to even more activity by them when they get their top people in place.

Mrs. ROUKEMA. Thank you.

Yes, Mr. Judge.

Mr. JUDGE. First of all, we strongly support TPA, and we think it should be a high priority. Second, I think the U.S. Government should be encouraging that the WTO Financial Services Round to remove further barriers. I think Mr. Farmer pointed out the good relationship between USTR and the Treasury, and Treasury's responsibility for banking and securities and USTR's responsibility for insurance and other financial services.

The last Administration, and the previous Administration, have done a very good job working with the industry in trying to identify our major concerns and addressing them. I think so far the rhetoric out of the Administration has been very positive on these issues, and so we look forward to working with them in the next year or two and developing those negotiating positions.

Mrs. ROUKEMA. Excuse me. You said the rhetoric has been good, but has there been action as well?

Mr. JUDGE. I don't mean that pejoratively. The public statements have been very positive is a better way of saying that. My rhetoric was flawed there.

Mr. FARMER. The senior political officials of the Treasury are not yet in place and it is not fair to judge the Treasury performance on the last few months.

Mrs. ROUKEMA. Mr. Weisbrot.

Mr. WEISBROT. We are against the Trade Promotion Authority, and we think, first of all, the Constitution confers upon the legislative branch the authority to regulate commerce with foreign nations. It is a relatively recent development that it has been shifted more and more to the executive branch, and I think one of the problems of it is you have these commercial agreements that are negotiated that do neglect the public interest, as Congresswoman Waters was pointing out, in terms of environmental health, public health and of course the effect on workers.

Mrs. ROUKEMA. Excuse me, I wasn't quite sure. What did you say about Trade Promotion Authority? Whose responsibility did you say it is?

Mr. WEISBROT. Congress should have the responsibility, the main responsibility, for trade and commercial agreements.

Mrs. ROUKEMA. You are saying we should be pushing that immediately?

Mr. WEISBROT. No, I think what Trade Promotion Authority does is it shifts that authority to the executive branch by allowing Congress to have only an up or down vote on that. So it really takes most of the power away from Congress on that.

Mrs. ROUKEMA. But you are the minority on that?

Mr. WEISBROT. I don't know if I am the minority in the country.

Mrs. ROUKEMA. I mean on the panel.

Thank you very much.

Chairman BEREUTER. The gentlelady from Illinois, Mrs. Biggert, is recognized.

Mrs. BIGGERT. Thank you very much, Mr. Chairman. I have a question. What areas do you want to see addressed in the next round of negotiations? I will start with Mr. O'Connor.

Mr. O'CONNOR. I will pick up on that and also respond to Congresswoman Roukema's question further. AIA, the industry association that I represent, has identified 150 barriers, trade barriers, entry barriers, market barriers, and that list is being prepared and it will be transmitted to USTR. And that will be also on the agenda for the Doha Ministerial, which will take place this fall.

Mrs. BIGGERT. Are you optimistic that there will be progress made on these fronts?

Mr. O'CONNOR. In some areas. That is a long list. But there are some priority areas. I think I mentioned a couple of them earlier, and we are hopeful that there will be progress.

Mrs. BIGGERT. OK. About 10 years ago, the U.S. financial services industry was quite concerned with the development of the EU and how that would affect the ability of U.S. firms to compete. So what has been the experience of the financial sector with the EU?

Mr. FARMER. Let me say on banking it has been excellent. There have been lengthy negotiations with the EU, again very strongly assisted by the U.S. Treasury, and the end result has been that U.S. financial institutions are treated the same way as European institutions just as we treat them over here. I would say on the whole within the G–7 countries now there is a reciprocity of the national treatment and equal access to each others' institutions that is exemplary.

The EU privacy directive is another matter. It is a misunderstanding we think on the part of the Europeans as to what our privacy regime consists of, and that is understandable. It is very new. It is very complex, and I think we are just beginning to understand ourselves how it is working and how effective it is.

Mrs. BIGGERT. Then just another general question is what are the benefits to the U.S. financial services firms when new markets are opened to their services and how does this help our economy?

Mr. JUDGE. How does it help our economy? It helps in several ways. First, when new markets are opened up, U.S. firms are able to provide services to that economy that they were unable to provide before. That provides revenue for U.S. firms.

Second, it means the economies in those countries are more competitive, they are more advanced. It provides us the ability to export other goods into that country that they may not have been able to purchase before. They may not have had the income or they may not have had the need for those goods and services produced by United States manufacturers.

Third, we provide export financing for those exports into that country. There are several ways in which greater access by U.S. firms to those countries increase U.S. economic interests.

Mrs. BIGGERT. Thank you. Thank you, Mr. Chairman.

Chairman BEREUTER. Thank you very much, Mrs. Biggert.

The gentleman from Illinois, Mr. Manzullo, is recognized.

Mr. MANZULLO. Thank you very much. Unfortunately, the people that were criticizing you for only having an $8 billion trade surplus do not realize that the trade surplus for all services is $80 billion. And that is engineering, architectural, legal, I think about 17 different areas that all become part of what we know as trades and services. For years I have belonged to a group called the Transatlantic Business Dialogue that entered into a memorandum of understanding on policy standards which would open up the way in EU, for more American service sectors. I wonder if you could comment? There are continued negotiations for transparency in each of those 17 areas.

Mr. Farmer, you already stated that things couldn't be any better in banking in Europe. But is there any improvement in our relations in the EU for banking? And then Mr. Judge for securities and Mr. O'Connor on insurance.

Mr. FARMER. Well, I would just say that basically leaving aside our current debate on the privacy issue, the important thing is not to disrupt the good relationship that is now working. And these are capital markets which we think are doing well, and the Europeans are beginning to get to a Europe-wide financial market, which doesn't yet exist, and when it does, I think it is going to be very beneficial for our firms as well. I don't think we have any real disputes or differences of views between ourselves.

Mr. MANZULLO. We will leave that alone, then. Good.

Steve.

Mr. JUDGE. Well, I think Tom is right that this is an evolving relationship between the United States and Europe. As they have greater common markets, there are fewer country-by-country differences, and so that is an advantage. We do have different regulatory systems, and we have to learn how each of the different systems work. They need to learn about ours and we need to learn about theirs.

On balance, I think the relationship between the United States and the EU is as good as any relationship in the world, but clearly there are areas we can work on, and we are working on them. They have begun efforts in several areas, privacy, capital adequacies. We have an ongoing dialogue with the EU at present on some of their new initiatives and that we expect to continue. So those are areas we have to work on. On balance, it is a pretty good relationship. We have some issues at present.

Mr. O'CONNOR. The U.S. insurance industry and the trade associations, working together with the Europeans, have come up with a model schedule which deals with an ideal form of regulation, transparent regulation, that we would like to have adopted as much as possible around the world, so that we have to start to have a global scale, a global model of regulation that we can all follow. A lot of progress has been made on that and we have good support from the Europeans as well.

Mr. MANZULLO. Would that apply to China also?

Mr. O'CONNOR. Yes.

Mr. MANZULLO. I know we have Met Life in our district and they have been trying to get into China for a considerable period of time.

The other question I have is more of a comment. Bob Vastine, who is with the Coalition of Service Industries—I think you are all part of that—wrote an article in the *Keough Journal* several months ago where he states that when we pierce markets initially with the service industry that the merchandise sector will follow behind that. And I would like your comments on that.

Mr. JUDGE. I think that is a very good point, that it is many times the easiest way in which to enter a market, the first entrant being the financial services industry. But doing so, you bring in the tools with which other parts of the economy and other parts of the U.S. economy can export into that country. You have the financing for the export, you have the financial infrastructure in place to make those exports possible. So I think in many ways we in the financial services sector are the door opener for many trade relationships.

Mr. MANZULLO. Could Ex-Im Bank have any role in providing more financial services for exports?

Mr. FARMER. I would not say that, but I think obviously to the extent that our customers, our exporters are able to export better with Ex-Im financing, thereby the economy benefits. I don't think that it directly benefits the financial services sector other than its ability to effectively serve and provide export financing, especially for small business, which is more dependent because of its risk profile for Ex-Im support than maybe some of the others.

Mr. O'CONNOR. On the insurance side, certainly the availability of insurance products from foreign insurance companies in a new opening market helps ease the entry for manufacturing companies who are entering into a market and want to have insurance coverage that provides the similar type coverage that they will be getting in the U.S. So that does help encourage investment overseas.

Mr. MANZULLO. Thank you very much.

Chairman BEREUTER. I thank you.

I do have a couple more questions, and we will take questions from other Members if they wish. First of all, you all have excellent testimony.

Mr. O'Connor, I particularly was struck by the five reasons you cite why insurance is important to any economy. I think that is very succinct and it seems to me out of enlightened self-interest insurance sectors ought to either be developed in those countries or they should permit American and other developed country insurance companies to come there if they want their economy to thrive. I think that is a very interesting citation of five simple reasons why it is important that insurance must exist for an economy to thrive.

I am struck, as I listen to you—particularly the three representatives of the financial services sector, how Mr. Farmer has fewer concerns and complaints. It seems to me it must relate to the fact that there is a banking system in every country, crude or as inadequate as it may be; whereas insurance is not really available in any substantial area of some developing countries, or it does not cover the areas of insurance that we would cover in this country. The same is true with securities. And so we can make national treatment work as leverage to assure that American banks doing business abroad in a different country, or within the EU market areas, are treated equally; national treatment in turn if we give them national treatment in this country.

So we lack that leverage. I don't know if you, Mr. Judge, or you, Mr. O'Connor, have anything to suggest to us as to how we can have more leverage for insurance and securities. If you do, I would like to hear it now or later. What can we do to better arm the USTR to make sure we get a good deal for your sectors?

Mr. JUDGE. One of the key things that we have found in discussing trade opportunities with other countries is that it is important that they understand that it is in their own best interest to allow freer access by U.S. financial services firms, banking, insurance and securities into their markets, that that increases their economic efficiencies, that that increases the opportunities for growth. One thing I think that is important is their own self-interest, and we have to educate them about that.

In terms of leverage, we have a very open market and we do not support negotiations of restricting our market in order to provide leverage over other countries and financial services. We think that probably has some short-term and long-term problems in it. But what is important is that banking tends to be the first industry that is out there. And in order to have a good securities market you have to have an accumulation of assets to have an efficient securities market. I think the same is probably true for insurance. You need to have a basis first of a good commercial banking market.

Mr. O'CONNOR. I think the greatest leverage that we have in our industry is the fact that we generate—let me put it another way. We mobilize savings within a country so we can generate a tremendous pool of funds that haven't been generated before that would be invested in state bonds, government bonds, which I said earlier in my testimony would then be invested in infrastructure projects such as schools, hospitals, highways, railways, airports. I think that is significant leverage. And as countries see that the U.S. has had a lot of experience in mobilizing capital and putting that capital to work to build infrastructure, when the new markets see that message and understand that message, I think that is terrific leverage, because they are all very concerned about building a modern infrastructure as quickly as possible.

Chairman BEREUTER. Japan has historically been one of the most difficult countries for the insurance sector, for foreign insurance companies to leap to clear. Do you think that has contributed in any fashion to their financial problems? For example, the Japanese people right now are putting their money into the post offices there as their major savings outlet. And as you know, the interest rates that are paid there are basically just storing their money. Do you have any suggestions as to whether or not this is a major impediment or cause of their financial problems? Or would that be an exaggeration?

I am searching for a good rationale why we can convince the Japanese they have to bring their barriers down.

Mr. O'CONNOR. The reason for the problems in the Japanese economy, particularly in the insurance sector, which is really troubled, there is a flight to quality to the State postal savings system. I think the significant part of that problem was created by a lack of transparency in regulation, and I would say that regulation is a problem there.

Chairman BEREUTER. Am I imagining things or have you in your sector made a breakthrough in Korea lately? Did I read you finally had success for opening up markets in South Korea, in the Republic of Korea?

Mr. O'CONNOR. It is not on our priority list. At least in our industry, on the P and C side, we have been active for many years. It is a difficult market to do business in, but we don't see a significant barrier at this time.

Chairman BEREUTER. I would like to supply all four of you with copies of two memoranda that are prepared for the Members here by the Congressional Research Service, particularly the last one dated April 27, which looks at the potential impact on the financial services sector of agreements in Jordan and Singapore and Vietnam, and I know one of you specifically mentioned your interest in Vietnam. Is that you, Mr. Judge?

Mr. JUDGE. I mentioned Singapore.

Chairman BEREUTER. Singapore, and they also look at Chile.

Dr. Weisbrot, I can't help engaging you a little bit here in light of what you said with respect to your lack of support for Trade Promotional Authority, and I think it is beyond my capacity to turn you around on that today, but I would make this comment and invite you to respond to it if you wish.

The reason we granted President Ford Fast Track Authority, which is now named Trade Promotional Authority, as you probably know, was related to the fact that you are absolutely right that under the Constitution Congress has the authority to regulate foreign commerce, but the problem we ran into is that countries or groups of countries were unwilling to proceed with trade negotiations, because they realized they could sit there all day, and finally after months, perhaps work out agreements with the United States Trade Representative and then Congress could come along and second-guess them. So that was not the end of the line when they finally shook hands across the table as to what the agreement could be. And so we delegated to the President, every President until the President's party failed him in the House, to give President Clinton Trade Promotion Authority for then-called Fast Track Authority. We always gave the President that ability. And the assurance we gave to the countries across the table from us in those trade negotiations is that Congress couldn't change it. They could vote up or down, but they couldn't amend it and it would be handled expeditiously in 90 days. So we reached Fast Track Authority only because we reached an impasse with trade negotiations. They were unwilling to let that negotiation be second-guessed by Congress when it finally came to us, since both Houses have to approve that kind of agreement, that kind of a treaty.

So what alternative do we really have, given the unwillingness of other countries to engage us in trade negotiations under the old arrangement?

Mr. WEISBROT. Well, I have two or three answers to that.

Chairman BEREUTER. OK.

Mr. WEISBROT. First of all, I do hear the story a lot, but I do also see examples of a story when the U.S. negotiators are taken seriously without the Fast Track Authority. You did see the Multilateral Agreement on Investment was negotiated from 1994 to 1997, and it was about 90 percent complete, according to people who were involved in the negotiations, and it did eventually collapse, but it had nothing to do with the United States not being taken seriously, and I don't remember any country or anybody in any other country in negotiations raising the issue that the United States did not have Fast Track Authority to negotiate with the 28 other members of the Organization for Economic Cooperation and Development in which the treaty was being negotiated. And that was a major treaty. That was every bit as powerful as NAFTA or the proposed FTAA in terms of things that were being negotiated.

So I think it clearly is possible to negotiate without the Fast Track Authority.

Chairman BEREUTER. You can negotiate, but you can't conclude.

Mr. WEISBROT. Like I said, it was never an issue, and they could have concluded. If it was not for the opposition from over 600 nongovernmental organizations all around the world who mounted an enormous campaign against that agreement, I think it would have been concluded. I don't think it would have fallen apart as a result of the authority of the United States not being respected there to negotiate that agreement.

The other thing is if you look at the agreements you are talking about where back in the seventies you are talking about the GATT, for example, General Agreement on Tariffs and Trade, where the issue being negotiated was really just tariffs and some non-tariff barriers to trade, mainly just tariffs. And now these trade agreements are enormously much more powerful. That is why I don't call them trade agreements. I always call them commercial agreements, because it is a misnomer to call NAFTA or the FTAA a trade agreement, because the provisions of those agreements that have the most impact on society and the economy of the member countries are, in fact, the non-trade parts of those agreements.

So the agreement, for example, that Congresswoman Waters mentioned on intellectual property rights, which is included in NAFTA and the WTO and will be included in the FTAA, and of course the investor-to-State dispute resolution mechanism of NAFTA, which gives corporations for the first time ever the right to directly sue governments for regulations, environmental or any other kind of regulations that infringe on their profits, that is an enormous change that affects every aspect of our regulation. There has already been environmental regulation, both in Canada and it is now threatening environmental regulation in California of the gasoline additive MTBE, which California tried to ban and it is now being challenged by a Canadian company. There are a number of examples of these cases, and of course there are all the cases in front of the WTO. Basically these agreements have reached into a broad area that affects public health and safety enormously, much more than the General Agreement on Tariffs and Trade did, and to tell Congress they have only an up or down vote on these issues to me is just a terrible abdication of responsibility.

Chairman BEREUTER. Well, if I had an alternative that was workable, and you haven't given us one.

Mr. WEISBROT. I think Congress——

Chairman BEREUTER. And it is not just agreements. I admit to you, in fact, that recent agreements like NAFTA are very broad in their implications. They are trade related, they are commerce related. They are international commerce related. But they are broad, I will give you that. They have an effect on our society as well as the other partners of society. But it is not just the trade agreements of the seventies. We didn't have to go. We weren't forced by our negotiating partners to go to some new arrangement until 1974. And then from 1974, from 1994 to 1996, I think it was 1994, we had all these Presidents successively given this grant of power by Congress, saying you do your best to conclude the deal and you can be assured that your trade partner knows that proposed agreement that we finally have inked is not going to be changed. It may go down entirely, but it is not going to be changed. It is not that they do not respect us. They know that the man who is sitting at the table does not have the final authority. We uniquely have given our parliamentary body, in this case the Congress, the final say because of our Constitution. So tell me an alternative.

Mr. WEISBROT. Can I suggest one? One would be for Congress to set the guidelines, to set out a series of goals and say this is what we want the executive to negotiate in these agreements.

Chairman BEREUTER. Yes, that can certainly be done.

Mr. WEISBROT. And then they know beforehand this is what they are supposed to negotiate, and then they resolve the problem you are referring to, where other countries might worry that the Congress is not going to approve that agreement. Then you will have a real congressional input from a body that is much more accountable to the public than the USTR.

Chairman BEREUTER. That is certainly a reasonable suggestion on your part. Just how far do you take it? Do you take it to the point of micromanagement, where in effect it is impossible for negotiation to proceed? But it doesn't have to be taken to that point. So I accept your suggestion that we can be more detailed in the guidelines that we give to our trade negotiators and you can even differentiate between what they will do on bilateral versus multilateral.

Mrs. Capito, you have the last word if you would like.

Mrs. CAPITO. No, I don't have any questions.

Chairman BEREUTER. I would like to thank you very much.

I believe we have just barely scratched the surface. I am very interested in this subject. I believe we can make progress and we can assist you and therefore reduce the trade deficit that we have by enhancing the level of services, especially the financial services, that we are able to export abroad. And I know Chairman Oxley is particularly interested that the subcommittee and committee make progress in this area.

So for the first time in anybody's memory this House of Representatives is going to focus on trying to make sure that financial service exports are more successful. Thank you, gentlemen, for your testimony.

[Whereupon, at 4:09 p.m., the hearing was adjourned.]

APPENDIX

June 26, 2001

Opening Statement

Subcommittee on International Monetary Policy and Trade

Financial Services Trade

Chairman Doug Bereuter

June 26, 2001

The Subcommittee on International Monetary Policy and Trade meets in open session today to examine financial services trade. The Subcommittee will hear from private sector witnesses who will testify about financial services trade as it pertains to insurance, banking and securities. This hearing will be the beginning of this Subcommittee's and the full Committee's examination of this important subject. In fact, on July 11th, United States Trade Representative Robert Zoellick will brief the members of the Financial Services Committee on pending issues in financial services trade.

The Financial Services Subcommittee on International Monetary Policy and Trade has jurisdiction over trade as it pertains to financial services. This is quite important as U.S. cross-border trade in financial services has recently grown quite significantly. U.S. cross-border transactions are between resident U.S. companies and foreign consumers. In year 2000, U.S. cross- border exports of financial services (banking, securities, and insurance) equaled $20.5 billion, which is an increase of 26.5 percent relative to 1999. Moreover, unlike the current overall U.S. trade deficit, U.S. financial services trade had a positive balance of $8.8 billion in 2000. It is important to note that these statistics do not even include the activity of the affiliates of U.S. companies who are physically located in a different country.

Before introducing our distinguished panel of witnesses, I would like to briefly stress the following three issues that are quite important to today's hearing: U.S. policy towards foreign financial institutions, barriers to financial services trade, and current efforts to open financial service markets. I am interested in the thoughts of our witness panel on these three particular subjects, as well as other relevant subjects and issues.

First, the U.S. uses a policy of "national treatment" for foreign financial institutions that have a presence in the U.S. National treatment allows foreign owned financial institutions and U.S. domestically owned financial institutions to be treated the same. In fact, under the Financial Reports Act of 1988, the Secretary of the Treasury must provide to Congress a quadrennial study of changes in laws that effect national treatment of foreign banks and securities firms in the U.S.

Second, U.S. financial service firms do confront many types of trade barriers. For example, Japan, until recently, restricted sales of foreign insurance companies of life and non-life insurance. Furthermore, the Brazilian government denies foreign marine cargo insurers the ability to compete for business. I am interested in other specific examples which restrict the foreign market access of U.S financial institutions.

Third, even with these trade barriers, there are current efforts to open up financial service markets. Financial services trade is part of the larger framework of World Trade Organization (WTO) negotiations on trade in services. The General Agreement on Trade in Services (GATS) within the WTO was concluded in 1997. As a result, a Financial Services Agreement (FSA) included member commitments to provide national treatment and market access to foreign providers of financial services. Moreover, in year 2000, a new round of service negotiations began in the WTO.

Furthermore, the Free Trade Area of the Americas (FTAA) is another example of an effort to open up financial service markets. In June of 1998, nine negotiating committees, including one for financial services, were established among the 34 nations in the Western Hempishere. Due to the prospective emerging markets, the U.S. financial service sector could benefit greatly from the FTAA.

Lastly, this Member believes that giving the President Trade Promotion Authority (TPA) would provide new opportunities for financial services trade. While the U.S. continues to be the global leader in financial services, this position could be threatened by the lack of TPA. Currently, the European Union has free trade agreements with 27 countries, while the U.S. has only two such free trade agreements which are signed into law. The TPA would greatly enhance the credibility of the U.S. negotiating position in both the WTO and the FTAA.

On May 10th, President Bush provided Congress with an outline of his 2001 legislative agenda including TPA. In addition, Representative Phil Crane introduced a TPA bill, H.R. 2149, which currently has 89 cosponsors, including this Member.

To assist the Subcommittee in examining these issues, I am pleased that we will have the opportunity to hear from our distinguished panel of private witnesses. First, Mr. Peter O'Connor, the Executive Vice President, of Global Government Affairs and New Markets for Ace INA, will testify on behalf of the American Insurance Association. Ace INA, which has offices in 50 countries, is one of the world's largest providers of property and casualty insurance. Mr. O'Connor has 30 years of international management experience in Europe, the Middle East, Africa, South America, and Asia Pacific.

Second, the Subcommittee will hear from Thomas L. Farmer, the General Counsel of the Bankers' Association for Finance and Trade (BAFT). This association, which represents internationally active financial institutions and companies, promotes the expansion of financial service markets worldwide. Mr. Farmer has had a distinguished career which includes being a founding member of the Overseas Development Council and a former General Counsel of the Agency for International Development.

Third, Mr. Steve Judge will testify on behalf of the Securities Industry Association (SIA). The SIA represents nearly 700 securities firms (including investment banks, broker-dealers, and mutual fund companies). SIA member-firms are active in both U.S. and foreign markets. Mr. Judge has been the head of the Securities Industry Association's Washington Office since 1993. Prior to joining SIA, he was a congressional staff member for more than 13 years.

In addition, Dr. Mark Weisbrot, the Co-Director of the Center for Economic and Policy Research in Washington DC, will testify. Dr. Weisbrot has written different publications on trade and globalization. In addition, he is the author of a weekly column on economic and policy issues that is distributed to newspapers by the Knight-Ridder/Tribune Media Services.

We welcome the distinguished panel to our hearing. And, without objection, your written statements will be included in their entirety in the Record. I turn to the distinguished Ranking Member of the International Monetary Policy and Trade Subcommittee, Representative Bernie Sanders, for any comments that he may have.

Congressional Research Service

Memorandum March 26, 2001

TO: Hon. Doug Bereuter
Attention: Kyle Gilster

FROM: Patricia Wertman (x7-7748)
Specialist in International Trade and Finance
and
William H. Cooper (x7-7749)
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

SUBJECT: Foreign Trade in Financial Services: Background Information

This memorandum is a partial response to your request for information on U.S. foreign trade in financial services. For the purpose of this memorandum, financial services include banking, securities, and insurance. It should be kept in mind that in collecting data (discussed below), the Department of Commerce separates insurance from banking and securities services.

This memorandum delineates the main issues concerning foreign trade in financial services. These include (1) basic definitions of financial services, (2) data depicting the significance of financial services trade to the U.S. economy, (3) an explanation of U.S. policy on trade in financial services and how that policy has been implemented, and (4) an examination of the types of barriers that U.S. firms confront in trying to market their products abroad.

Your request for research on the treatment of financial services in current and pending bilateral, regional and multilateral agreements and in U.S. economic relations with the European Union and China will be addressed in a additional memoranda to follow. We trust you will find this information useful. Please call either one of us if you have additional questions.

Background

Services play an important role in the U.S. economy. The United States, like most major economies, is a "service economy." Gross Domestic Product (GDP) at the end of the fourth quarter 2000 amounted to $10,112.8 billion. Of that amount, $5,365.0 billion or 53.1

percent was attributable to the production of services.[1] The production of goods, by comparison, amounted to $3,819.0 billion or 37.8 percent of GDP. Some 106.7 million individuals or 75.3 percent of the total civilian labor were employed in the production of services, as of February 2001.[2]

The services category of GDP is varied. It includes, for example, transportation, utilities, finance, insurance, travel services, entertainment, health care, legal services, and social services. Most of these services never enter international trade, that is, they are not cross-border transactions. Rather they involve transactions such as visiting one's local beautician/barber for a haircut or eating a meal at a local restaurant.

International trade in services is, nevertheless, becoming increasingly important. According to the World Trade Organization (WTO), world exports of commercial services amounted to $1.35 trillion in 1999.[3] In the same year, the United States had service exports of $271.9 billion and a positive balance in its international trade in services of $80.6 billion.[4]

Data Collection and Coverage

In the United States, data on international trade in private services is collected under the International Investment and Trade in Services Act (P.L. 94-471, 90 Stat. 2059, 22 USC 3101-3108, as amended). Under this authority the Bureau of Economic Analysis (BEA) of the U.S. Department of Commerce (DOC) conducts eleven surveys on services trade. Three of these surveys specifically collect data on transactions in banking and securities (jointly surveyed and designated as "financial services") and insurance services (separately surveyed). The three surveys specifically applicable to financial service providers and to insurance companies are:

- the Benchmark Survey of Financial Services Transactions Between U.S. Service Providers and Unaffiliated Foreigners (BE-80, benchmarks surveys for 1994 and 1999);
- the Annual Survey of Financial Services Transactions Between U.S. Service Providers and Unaffiliated Foreigners (BE-82, conducted annually for non-benchmark years since 1995); and
- the Annual Survey of Reinsurance and Other Insurance Transactions by Insurance Companies With Foreign Persons (BE-48, annually since 1996).

In addition, BEA conducts Benchmark (BE-20) and Annual Surveys (BE-22) of selected service transactions exceeding $500,000 by all U.S. persons with unaffiliated foreigners.

---

[1] Calculated from Table 1.3, Gross Domestic Product by Major Type of Product. U.S. Department of Commerce. *Survey of Current Business*, March 2001, on-line version. The balance was attributable to the building of "structures."

[2] U.S. Department of Labor. Bureau of Labor Statistics. News. *The Employment Situation: February 2001*. Table A. Online version.

[3] WTO. *International Trade Statistics 2000*, Chapter 4, Table IV.2. Online version. The WTO notes that trade in transportation services is significantly under-reported.

[4] U.S. Department of Commerce. Bureau of Economic Affairs. Table 1. U.S. International Transactions, as of March 15, 2001. On-line version.

These two surveys mainly cover business, professional, and technical services. Financial services and primary insurance transactions by non-service providers are, however, among the covered transactions.

Banking and securities services ("financial services") covered in the benchmark (BE-80) and annual survey (BE-82) include three basic types of transactions:

- credit-related fees, such as: fees for establishing, maintaining, or arranging credits, letters of credit, bankers acceptances, mortgages, factoring services, financial lease contracts, and loan guarantees that are commonly provided by banking establishments;
- fees on securities transactions, such as: commissions and other fees for securities transactions (including derivatives transactions) or futures trading, brokerage, underwriting, and private placements; and
- other financial services, such as: fees for asset/liability management, debt renegotiation, credit card services, financial advisory and custody services, foreign exchange brokerage services, other financial services.

Interest payments are specifically excluded because interest is a payment for use of loan proceeds and is not a fee for the establishment, maintenance, and arrangement of credit. Real estate management services and commodity or merchandise brokerage services are also excluded because they are not considered financial services.

Insurance transactions covered in the annual insurance surveys (BE-48) include:

- premiums earned and losses incurred on reinsurance assumed from foreign insurance companies,
- premiums incurred and losses recovered on reinsurance ceded from foreign insurance companies, and
- premiums earned and losses incurred on primary insurance sold to foreign persons.

Trade in services may occur through two channels: 1) as a cross-border transaction, that is, as an export or as an import, or 2) through a purchase or sale by or to an affiliate operating abroad. The channel of delivery is often determined by the nature of the service itself.

Delivery Channel One: Cross-Border Trade

Cross-border transactions are transactions between residents and foreigners. Cross-border trade includes both transactions between unaffiliated parties and transactions within multinational companies (intra-firm trade). Cross-border transactions, both exports and imports, unaffiliated and affiliated (intra-firm), are summarized quarterly in the DOC statistical presentation of U.S. International Transactions, that is, the "balance of payments." The latest data were released on March 15, 2001. Annual data for the year 2000 are preliminary.

As illustrated by **figure 1**, on the left below, the United States had a substantial current account deficit from 1992-2000. The current account represents net exports of goods and services to foreigners at a particular point in time, such as a calendar year. **Figure 2**, on the right above, shows the balances on merchandise trade and on services trade. The driving factor in the U.S. current account deficit has been a substantial merchandise trade deficit. The U.S. balance on international trade in services, however, has been positive throughout the period, with service exports exceeding service imports. Service exports have, thus, made a positive contribution to the balance on current account. The balance on services peaked, however, in 1997 at $90,733 million. Preliminary data for the year 2000 show a balance on services trade of $80,988 million, a decline of 10.7 percent from the 1997 peak, but a slight increase from 1999.

FIGURE 1. U.S. Current Account Deficit, 1992-2000

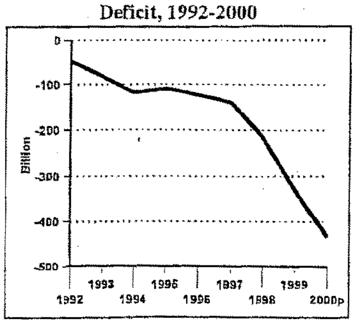


FIGURE 2. U.S. Merchandise and Services Trade Balances, 1992-2000

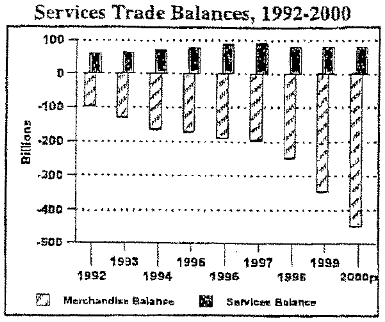


FIGURE 3. U.S. Trade in Financial Services and Insurance (net) with Unaffiliated Foreigners, 1992-2000p

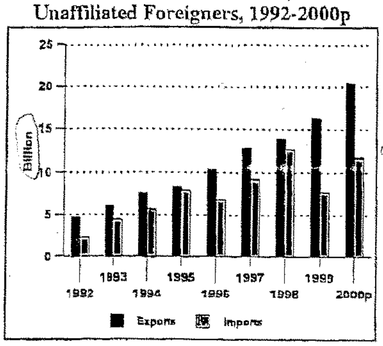
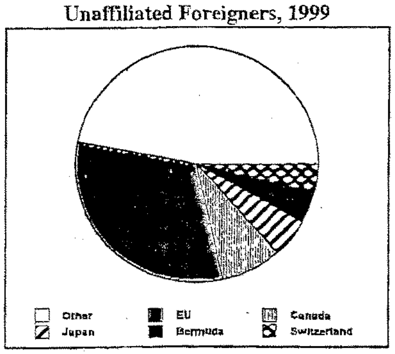


Figure 3 shows both exports and imports of financial services (banking and securities) and insurance (net) combined. Focusing on exports, preliminary data for 2000 indicate that cross-border exports of U.S. financial services and insurance (premiums net of losses) with unaffiliated foreigners together accounted for $20,511 million, or 6.9 percent of total service exports of $296,227 million. The category included $17,851 million in banking and securities services exports and $2,660 million in net insurance service exports. Financial service and insurance exports increased from $16,220 million in 1999, an increase of 26.5%. The bulk of this increase was attributable to a substantial increase in banking and in securities-related services.

In both 1999 and 2000, the combined categories of financial services and net insurance had a substantial positive balance, $8,568 billion ~~million~~ in 1999 and $8,831 billion ~~million~~ in 2000, the latter figure representing a slight (3.1 percent) increase from the previous year. Similarly, the financial services and insurance categories combined accounted for 10.6 percent and 10.9 percent of the total services surplus in 1999 and 2000, respectively.

FIGURE 4. U.S. Exports in Financial Services and Insurance (net) with Unaffiliated Foreigners, 1999



As **figure 4** suggests, the large markets for U.S. exports of financial services and insurance tend to be in developed countries and/or in countries that have active financial sectors, such as Switzerland and Bermuda. Nevertheless, the category designated "other" accounts for nearly half (45.8 percent) of combined U.S. financial services and insurance exports. Moreover, it includes some significant markets, such as Mexico, Argentina, and Brazil, which are not known particularly for being offshore financial centers.

Delivery Channel Two: Foreign Affiliates of Multinational Corporations

Services are also delivered through affiliates of U.S. corporations operating abroad and foreign corporations operating in the United States. Affiliates of multinational companies are regarded as residents of the countries in which they are located. Sales by foreign affiliates of U.S. companies are, therefore, considered, transactions with foreign persons. Similarly, sales by the U.S. affiliates of foreign companies to U.S. persons are transactions between U.S. residents. Since sales and purchases by affiliates largely occur within the same country, neither type of sale is an international transaction. Their value is not, therefore, captured by the international transactions data that are reported quarterly by the DOC. Instead, estimates for the services transactions of affiliates are developed separately as part of larger DOC studies of direct investment.

Details on services trade of affiliates are presented annually in articles published in the DOC's *Survey of Current Business*.[5] In 1998, the latest year for which data on the services transactions of affiliates are available, sales of services to foreigners by the foreign affiliates of U.S. firms amounted to $309.0 billion, while purchases by U.S. persons from the U.S.

---

[5] The latest detailed analysis of affiliate activity and related data are presented in U.S. Department of Commerce. U.S. International Services: Cross-Border Trade in 1999 and Sales Through Affiliates in 1998. *Survey of Current Business*. October 2000, p.119-161. Also available on-line. It should be noted that the quarterly international transactions data do include data on the cross-border trade of affiliates, both the foreign affiliates of U.S. firms and the U.S. affiliates of foreign firms.

affiliates of foreign firms amounted to $255.1 billion.[6] Services delivered by U.S. affiliates operating abroad have exceeded cross-border service exports since 1996; services delivered by the affiliates of foreign companies operating in the United States have exceeded cross-border service imports since 1989.[7] Thus, the largest channel of delivery for services entering international trade is through direct investment. The DOC notes, however, that

> [f]or specific types of services . . . the relative importance of the two channels is difficult to gauge because the available data on U.S. cross-border trade are generally classified by type of service, whereas the data on sales of services through affiliates are classified by primary industry of the affiliate.[8] [Underlining added.]

Moreover, the industry classification of affiliates has been shifted from the 1987 SIC-based ("Standard Industrial Classification") system to the 1997 NAICS-based ("North American Industry Classification System") system. This has made for some discontinuity in the data series. Notably, under the SIC-based classification system, "services" did not include finance and insurance.

U.S. Policy

The United States employs a policy of national treatment for foreign financial institutions that operate in the United States. That is, the United States endeavors to provide "equality of competitive opportunity" to foreign-owned banks and securities firms operating in the United States to that afforded domestically-owned firms.[9] At the same time, the United States promotes the role of U.S. financial services firms abroad by encouraging other countries to apply national treatment to foreign firms in their markets.

The national treatment of foreign financial services firms is ensconced in U.S. law. For example, the International Banking Act of 1978 provides for national treatment of foreign banks in the United States. Subsequent changes to U.S. banking laws and regulations have taken into account national treatment of foreign banks.

In addition, under the Financial Reports Act of 1988, the Secretary of Treasury must provide to Congress a quadrennial study of changes in laws that affect national treatment of foreign banks and securities firms in the United States. The study also provides information on the treatment of U.S. banks and securities firms in other countries indicating whether or not they are accorded national treatment. In addition to the reporting requirements, the statute states that the President, or his designee, "when advantageous" should conduct discussions with governments of major financial centers to ensure that they provide national treatment to U.S. financial services firms and that they allow U.S. firms to offer as wide a range of products as possible comparable to what they offer in the United States.

The statute provides no authority to impose sanctions or other means to enforce national treatment of banks and securities firms in other countries. Proposals to strengthen this

---

[6] Ibid., p. 119.

[7] Ibid., p. 120.

[8] Ibid.

[9] Department of the Treasury. *National Treatment Study–1998*, Washington. 1998. p. 28.

provision have been offered in the Congress but have not been enacted. During the 103rd Congress, for example, the "Fair Trade in International Services act of 1994" (S.1527, H.R. 3248) was incorporated into a broader bill but dropped during conference. Among other things, the bill would have required the Secretary of Treasury to identify and report to Congress every two years on countries which do not provide national treatment to U.S. banks and securities firms and to apply sanctions if negotiations fail to get the countries to apply national treatment.

The United States has been pressing other countries to open their markets to U.S. financial services firms in bilateral agreements, regional arrangements (such as NAFTA) and in multilateral fora, including OECD and the WTO/GATS. (The treatment of financial services in these and other fora will be discussed in the follow-up memoranda.) In addition, the U.S. Department of Commerce promotes exports of insurance by providing firms with information on opportunities and on foreign government regulations regarding insurance. The Treasury Department assists banks and securities firms.

Barriers to Financial Services Trade

Financial services firms confront several types of barriers. For example, some countries impose restrictions on the types of products service providers may sell. Until recently, for example, Japan heavily restricted sales by foreign insurance companies of life and non-life insurance and limited them to sales of specialty or "third-sector" insurance, a market in which Japanese companies were not very competitive. Other countries impose ceilings on the amount of products that foreign firms may sell.[10] The Government of Brazil denies foreign marine cargo insurers the opportunity to compete for business and requires state companies doing business with insurance brokerage firms to use 100 percent Brazilian-owned brokerages.[11] Most Indian banks are government-owned, and entry of foreign banks remains highly regulated. Foreign bank branches and representative offices are permitted based upon reciprocity and India's estimated or perceived need for financial services. As a result, access for foreign banks has traditionally been limited.[12]

As mentioned above, because they are intangible, most services trade is not conducted across borders but within borders. It is important, therefore, for many U.S. financial services firms to establish a physical presence in the foreign market in order to sell its services. The presence could be in the form of a wholly-owned subsidiary, a branch of a U.S.-based firm or a joint-venture with a local firm. One category of barriers faced by U.S. financial services is foreign government restrictions on foreign direct investment. Some foreign governments, for example, limit or completely restrict foreign ownership of banks and securities firms or require the employment of home-based personnel. It should be kept in mind that, these restrictions aside, the overall trend is one of worldwide liberalization of financial services markets. Many countries in Asia and Latin America, for example, have reduced capital controls, foreign investment restrictions, and other limits. Some observers have suggested that the rapidity of liberalization in East Asia in the early and mid-1990s might have contributed to the Asian financial crisis in 1997-1998.

---

[10] Feketekuty, Geza. *International Trade in Services: An Overview and Blueprint for Negotiations.* American Enterprise Institute. 1988. p. 131-132.

[11] Office of the United States Trade Representative. *National Trade Estimate Report.* 2000, p. 20.

[12] Ibid. p. 164.

Congressional Research Service

Memorandum April 27, 2001

TO: Hon. Doug Bereuter
Attention: Kyle Gilster

FROM: William H. Cooper(x7-7749)
Specialist in International Trade and Finance
and
Patricia A. Wertman (x7-7748)
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

SUBJECT: Foreign Trade in Financial Services: Bilateral and Regional Agreements and Relations

This memorandum is a further response to your request for information on U.S. trade in financial services. It examines how U.S. financial services are treated in completed bilateral trade agreements with Jordan and Vietnam, in the negotiations on prospective trade bilateral agreements with Chile and Singapore, and in negotiations on the Free Trade Area of the Americas (FTAA). In addition, it reviews financial services trade in the context of China's accession to the World Trade Organization (WTO), their treatment in the North American Free Trade Agreement (NAFTA), and issues pertaining to financial services in U.S. bilateral relationships with Japan and the European Union. Finally, the memo concludes by examining the role played by trade in financial services within the group of countries participating in the Asian-Pacific Economic Cooperation (APEC) Forum and that organization's movement toward freer trade.

A third forthcoming memorandum will examine how financial services are addressed in the World Trade Organization (WTO) and the Organization for Economic Cooperation and Development (OECD). Please call if you have additional questions.

U.S.-Jordan Free Trade Agreement (FTA)

The United States and Jordan signed a free-trade agreement (FTA) on October 24, 2000. Jordan is the fourth country to complete an FTA with the United States, following Israel, Canada, and Mexico. Jordan is a key ally in a strategically important region. The FTA, thus, has symbolic significance as a part of the on-going Middle East peace process. The Jordanian FTA is also potentially significant because it is the first FTA to incorporate environmental and labor standards (Articles 5 and 6, respectively) directly within the main body of the text of an FTA.

The proposed U.S.-Jordan FTA would eliminate virtually all tariff and non-tariff barriers between the United States and Jordan within ten years. This includes all barriers to services trade. The FTA grants most-favored-nation (MFN) treatment in services.[1] Specific commitments regarding services trade are set out in the Services Schedule to Annex 3.1 of the agreement. The Jordanian FTA is also the first bilateral treaty in which the United States has incorporated provisions on e-commerce.

The FTA would not have a major impact on the U.S. economy or on U.S. exports and imports because the bilateral commercial relationship is relatively small. The Jordanian economy had a gross domestic product (GDP) of $8 billion[2] in 1999, compared to a U.S. GDP of $9,299 billion in the same year, that is to say, the measured size of the Jordanian economy equaled less than 1/10th of 1% of the U.S. economy. U.S. exports to Jordan amounted to $312 million in 2000, our 75th largest export market; imports (customs basis) amounted to $73 million, our 123rd largest source of imports. The resulting bilateral U.S. trade surplus of $239 million was negligible in terms of the U.S. external merchandise trade deficit of $434.3 billion in 2000.

Trade with the United States is also not a major factor in Jordan's external trade picture, accounting, in 1999, for 8.4% of Jordan's imports, but only 1.7% of its exports. The FTA might, nevertheless, prove to be valuable to Jordan as it attempts to modernize and energize its domestic economy by opening Jordan up to the influences of the global economy. Indeed, the FTA is part of broad effort to connect Jordan to the global economy, an effort that, for example, led Jordan to join the World Trade Organization (WTO) in April 2000.

Data on U.S. services trade with Jordan are not disaggregated from the data on U.S. services trade with other Middle Eastern countries. Given the size of the trading relationship, however, it is safe to say that Jordan is not currently a significant market for U.S. service industries, including financial and insurance services. Nevertheless, some individual U.S. companies might well benefit from a reduction in Jordan's trade barriers, a shift that might contribute to an altered perception of market potential.

The Jordanian banking system has 13 commercial banks, five investment banks, two Islamic banks, one industrial development bank and a number of specialized credit institutions.[3] Five of the commercial banks are branches of foreign banks. In practice, there are no significant differences between the operations of the commercial banks and those of the investment banks. Many of the banks are small and family-owned. Unofficial estimates place non-performing loans at about 30% of outstanding loans.[4] The opening up of Jordan's banking sector to competition from abroad, along with a proposal to raise minimum capital requirements to JD 50 million, is likely to trigger further consolidation within the banking

---

[1] Most-favored-nations clauses in commercial treaties bind the signatories to extend trading benefits equal to those accorded any third state, whether or not they are signatories of the treaty. They, thus, assure equality of trading opportunity.

[2] Jordan's GDP of JD5,723.5 million in 1999 converted at the rate of $1.4104 per Dinar. IMF. *International Financial Statistics.*

[3] U.S. Department of Commerce. *Jordan Country Commercial Guide FY 2001*. Available at http://www. usatrade.gov.

[4] Ibid.

sector. **Table 1** presents selected data on the capital and assets of Jordan's five leading banks.

Table 1. Top Five Jordanian Banks, Selected Data, December 1999 ($ Million)				
Bank	Tier One Capital	Total Assets	Capital/Assets %	Profit/Capital %
Arab Bank	1,558	19,653	7.93	18.62
The Housing Bank for Trade & Finance	317	2,185	14.49	11.73
Jordan National Bank	80	1,285	6.26	-27.78
Cairo Amman Bank	55	1,219	4.48	18.96
Jordan Kuwait Bank	51	535	9.47	15.77

Source: *The Banker*, October 2000, p. 12.

The Arab Bank Group is the only Jordanian bank with a worldwide presence. About one-fifth of Arab Bank Group's assets and about one-quarter of its deposits are in Jordan.[5] The Housing Bank focuses on the local market.

The Jordanian government would like to broaden and deepen the local capital market. The corporate bond market is relatively undeveloped, due to rigid interest rates and the absence of a secondary market.

U.S.-Vietnam Trade Agreement

Trade between the United States and Vietnam is small. In 2000, for example, U.S. merchandise exports to Vietnam totaled $368 million and U.S. imports totaled $822 million. U.S. official data on services trade do not disaggregate services trade with Vietnam. However, one can assume that these trade flows are small as well. The small volume of trade is the result of the size of the Vietnamese economy, the legacy of the war between the two countries, the central-planned structure of the Vietnamese economy, and the relative mix of trade barriers that each country imposes on the other.

The purpose of the U.S.-Vietnam agreement, which was finalized on July 13, 2000, is to establish conditional normal trade relations between the United States and Vietnam in accord with Title IV of the Trade Act of 1974, the so-called the Jackson-Vanik amendment.[6] The agreement cannot go into effect until the Congress passes a joint resolution of approval. The agreement establishes conditions under which the two countries are to conduct trade. One major condition is that the two countries extend mutual "most-favored-nation" treatment

[5] Jon Marks. Bankers awaken. *The Banker*, October 1999, p. 110.

[6] For more details on the agreement, see CRS Report RL30416, *The Vietnam-U.S. Bilateral Agreement*, by Mark E. Manyin.

(MFN, sometimes called "normal trade relations" [NTR] status), which, in practice, means applying the lowest non-preferential tariffs on each others imports. A second condition is the application of "national treatment" to the products of the other country, that is, those products are treated no less favorably than domestic products.

The Vietnamese government has undertaken some reforms to introduce private sector participation in the economy. But these reforms have been in fits and starts, and more than half the economy remains under state control.

Under the bilateral agreement, Vietnam has pledged to take specific measures to open its markets, including services, to U.S. trade and investment. Vietnam's commitments toward services are sector specific and delineated in an annex to the agreement. For those sectors covered by the agreement, the agreement lays out governing principles, although even for these sectors, the application of the principles may be restricted. Vietnam agrees to apply MFN and national treatment to U.S.-supplied services. In addition, the Vietnam government is to implement regulations in a reasonable, objective, and impartial manner. Furthermore, those Vietnamese enterprises that operate as monopolies and that also provide services outside of their monopolized sector must do so in accordance with conditions of the agreement.

Vietnam has made specific commitments in opening trade and investment in financial services to U.S.-based providers. Regarding insurance, the agreement distinguishes between insurance required by law, such as motor-vehicle insurance or construction-related insurance, and insurance not mandated, such as life insurance. After the agreement has been in effect three years, Vietnam will permit U.S. firms providing non-mandatory insurance to invest in joint ventures with Vietnamese-owned firms up to a level up to 50% ownership. After the agreement has been in effect five years, U.S. insurance firms can establish 100%, wholly-owned firms in Vietnam. Regarding mandatory insurance, U.S. firms may invest in joint ventures (to unspecified level of equity) three years after the agreement enters into force and can establish 100% wholly-owned firms in Vietnam six years after the agreement comes to force.

During the first three years after the agreement has gone into effect, Vietnam will permit U.S. non-bank financial firms to establish joint ventures with Vietnamese firms (to unspecified levels of equity ownership) and to establish 100%-owned firms after three years in effect. Securities brokerage firms are limited to establishing representative offices in Vietnam.

In the area of banking services, the agreement allows U.S. banks to establish branches in Vietnam in the form of joint ventures with Vietnamese banks with 30%-49% ownership during the first nine years of the agreement's effective period and 100%-owned branches after nine years. U.S. banks may also invest in privatized Vietnamese banks to the same level as Vietnamese investors. After the agreement enters into force, U.S. banks may accept deposits in Vietnamese currency (dong) on a graduated basis until full national treatment is reached. Furthermore, after the agreement has been in effect three years, the central bank of Vietnam will provide U.S. banks with access to discounting, swap, and forward facilities on a full national treatment basis.

Proposed U.S.-Chile FTA

Negotiations on the proposed FTA between Chile and the United States were launched on December 6-7, 2000 in Washington. Two subsequent rounds of talks have been held, in Santiago on January 8-11 and in Miami on March 26-30. The next round of talks will be in Santiago in May 2001.

Economically, a free-trade agreement with Chile could boost the trade of specific companies and sectors, but would be unlikely to affect the U.S. economy significantly. The Chilean economy had a projected GDP of about $71.7 billion in 2000, compared to a U.S. GDP of $9,963.1 billion, that is to say that the measured size of the Chilean economy equals less than 1% of the U.S. economy. U.S. exports to Chile amounted to $3,455.1 million in 2000, our 32nd largest export market; imports (customs basis) amounted to $3,227.9 million, our 40th largest source of imports. The result of this bilateral trade was a modest U.S. trade surplus with Chile of $227.2 million in 2000. Politically, however, many experts believe that the successful conclusion an FTA with Chile might have significance well beyond the size of the economic relationship, possibly providing a workable model for dealing with trade-related labor and environment issues and adding impetus to the Free Trade Area of the Americas (FTAA) negotiations.

Chile is the fifth largest market for U.S. exports of financial services (banking and securities) and net insurance services in the Latin America and Caribbean area.[7] In 1999, U.S. cross-border exports to Chile in financial services amounted to $96 million; net insurance services exports amounted to $6 million. Cross-border imports from Chile amounted to $11 million in financial services and $1 million in net insurance services. Thus, the United States had a trade surplus with Chile in financial services of $85 million and in net insurance services of $5 million. Taken together, these equaled 3.9% of the $2,306 million regional U.S. trade surplus in financial and net insurance services, but a mere 1.1% of the worldwide U.S. surplus of $8,568 million in financial and net insurances services.

In general, Chile has a largely open international trading regime. The 2001 Foreign Trade Barriers Report notes, however, that

> Chile's relatively open services trade and investment regime stands in contrast to its relatively limited GATS [General Agreement on Trade in Services] commitments. In particular, Chile maintains a "horizontal" limitation, applying to all sectors in Chile's GATS schedule, under which authorization for foreign investment in service industries may be contingent on a number of factors, including employment generation, use of local inputs and competition. This restriction undermines the commercial value and predictability of Chile's GATS commitments.[8]

During the 1997 WTO negotiations on financial services, Chile reserved the right to apply economic needs and national interest tests when licensing foreign financial services suppliers. In practice, however, foreign banks operating in Chile are allowed to establish

---

[7] Statistically, the grouping is designated as "Latin American and Other Western Hemisphere." It includes Bermuda, but excludes Canada.

[8] USTR. *Foreign Trade Barriers*. Annual Report, 2001. On-line version, p. 40. GATS, the General Agreement of Trade in Services, was negotiated in the Uruguay Round.

branches and subsidiaries. They are guaranteed nondiscriminatory treatment under a 1960 law and under Chile's foreign investment law (Decree Law 600). Foreign banks are permitted to engage in the same range of services and may establish subsidiaries for securities and insurance brokerage, leasing, and factoring. Lending limits applicable to foreign banks are based on the banks' local capitalization rather the parent's capital.

Since the 1980s' financial crisis, Chilean authorities have not allowed new banks – domestic or foreign – to enter the banking sector except via the purchase of existing institutions.[9] This constraint has not, however, proven to be a barrier to foreign banks. According to the 1998 *National Treatment* study, at the end of 1997, 29 banks and three consumer finance companies were operating in Chile. Of this total, 17 were foreign banks. Six U.S. banks, with a total of 35 branches, accounted for 4.3% of deposits and 16.1% of assets at the end of 1997.[10] By 1999, the International Monetary Fund (IMF) estimates that foreign banks controlled more than half (53.6%) of Chilean bank assets.[11] According to the IMF, analysts expect that the integration of banking with insurance and pension fund activities will increase foreign participation.[12]

On a historical cost basis, direct investment in Chile by U.S. banks (depository institutions) amounted to $606 million at the end of 1997; by the end of 1999, this figure had risen to $656 million, equal to 6.6% of total U.S. direct investment in Chile of $9,886 million.[13] The increase in U.S. direct investment in Chile's banking sector between 1997 and 1999 amounted 8.3%.

The 1998 *National Treatment Study* states that "[t]here are no legal discrimination or restrictions against foreign securities firms wishing to operate in Chile's securities markets."[14] The principle of nondiscriminatory treatment is guaranteed both by Decree Law 600 and by Article 19 of Chile's constitution. Foreign brokerage firms must be established as subsidiaries. As of the end of 1997, the study notes, four U.S.-owned securities firms had nearly 38% of all stock broker assets in the Chilean market, with several other U.S. firms having partial ownership stakes or affiliations in or with other brokers.[15] U.S. firms also own a number of pension fund management companies, "Adminstradores de Fondos de Pension" (AFPs), which were created when Chile privatized its government-run pension system in

---

[9] U.S. Department of Commerce. *Chile Country Commercial Guide FY 2001*. Available at http://www.usatrade.gov.

[10] The six U.S. banks continue to operate in Chile. They are Citibank, Bank of Boston, Republic National Bank, Chase Manhattan Bank, American Express, and Bank of America. U.S. Department of the Treasury. *National Treatment Study*, 1998. On-line version, p. 166 and p. 170.

[11] IMF. International Capital Markets: Developments, Prospects, and Key Policy Issues, by a Staff Team lead by Donald J. Matheson and Garry J. Schinus. September 2000, Table 6.1, p. 153. On-line version. This is defined as the ratio of banks where foreigners own more than 50% of total equity to total bank assets. When the threshold is set at 40%, foreigners still controlled 53.6% of total bank assets in 1999.

[12] Ibid, p. 209.

[13] U.S. Department of Commerce. BEA. *Survey of Current Business*. September 2000, Table 10.1, p. 68 and p. 70. On-line version.

[14] U.S. Department of the Treasury. *National Treatment Study*, 1998. On-line version, p. 171.

[15] Ibid., p. 174.

1981), mutual funds, insurance companies, and foreign investment fund management companies.

Proposed U.S.-Singapore FTA

In November 2000, the United States and Singapore agreed to begin negotiations on establishing a free trade area.[16] The negotiations began immediately and are still in progress. A draft of a possible agreement has not been released and, therefore, it cannot be directly determined how an agreement would address financial services. However, by examining how U.S. financial services are currently treated in Singapore provides some indication of what a bilateral FTA might include.[17] In 1999, U.S. exports (or payments for sales of financial services) to Singapore equaled $238 million. U.S. imports (or payments for the purchase) of financial services from Singapore equaled only about $85 million.[18]

Singapore's treatment of foreign financial service providers is quite liberal and is commensurate with Singapore's objective of being a major financial center in East Asia. In general, the Singapore government does not require notification of foreign direct investment other than to determine whether the investment might be eligible for an incentive program.

In the last two years, the Singapore government has taken measures to improve access to foreign services providers to what was already a relatively open market. In March 2000, for example, the government lifted a 49% share restriction on foreign ownership of local direct insurers to permit 100% ownership. It also has made available licenses to foreign firms to sell re-insurance in Singapore.

Singapore overtly welcomes foreign banks with few restrictions. Consequently, 141 of the 153 commercial banks in Singapore are foreign-owned, and the government is liberalizing the banking sector even further.[19] In May 1999, the government removed a 40% share ceiling on foreign ownership of local banks. The Singapore government restricts the establishment of foreign bank-owned and operated ATMs that are not located at the bank site and excludes foreign banks from participation in a cash card network system, the Network for Electronic Transactions, Singapore (NETS).

Foreign securities brokers have the same rights of establishment in Singapore as domestic brokers. By January 2002, foreign securities firms will have full access rights to the Singapore Exchange (SGX).

---

[16] For more details on the agreement, see CRS Report RS20755, *Singapore-U.S. Tree Trade Agreement,* by Dick K. Nanto.

[17] This description of treatment of foreign financial service providers in Singapore is taken from Office of United States Trade Representative. *2001 National Trade Estimates Report on Foreign Trade Barriers.* April 2001. p. 391-395.

[18] U.S. Department of Commerce. *Survey of Current Business.* October 2000. p. 148-149. These data undoubtedly underestimate the value of financial services as they do not include services bought and sold between U.S. parent companies and their Singapore affiliates and likewise between Singaporean parent companies and their U.S. affiliates.

[19] United States Trade Representative. *2001 National Trade Estimates Report on Foreign Trade Barriers.* Washington. p. 417.

Proposed Free Trade Area of the Americas (FTAA)

A Free Trade Area of the Americas (FTAA) was first proposed by then President William J. Clinton at the first Summit of the Americas in Miami in December 1994. Thirty-four nations, every country in the Western Hemisphere except Cuba, participated. At the second Summit of the Americas, held in Santiago, Chile in April 1998, the 34 countries agreed to launch negotiations to establish the proposed free trade area. In June 1998, nine negotiating committees, including one for financial services, were established. Negotiations have been held in Miami since September 1998. In November 1999, FTAA trade ministers agreed to complete an initial consolidated draft, with bracketed text, of the proposed FTAA for submission to next ministerial meeting on April 6-7, 2001. This draft text has been completed. Although the announced intention is to make the draft public, as of this writing, this does not appear to have happened. In January, however, USTR noted in a press release that the "draft text is available for review by cleared advisors, **including all Members of Congress.**" [Bolding added.][20]

Hemispheric leaders, meeting at the third Summit of the Americas, held in Quebec, Canada on April 20-22, 2001, agreed that the FTAA negotiations would be completed not later than January 2005 and that the agreement would enter into force not later than December 2005. Only Venezuela "reserved" its position on the deadline.

USTR has outlined its goals in the services portion of the FTAA negotiations.[21] Negotiations are to take a top-down ("negative list") approach, that is, everything is to be liberalized except those sectors or measures for which a country negotiates a reservation. This is essentially the approach that was taken during the NAFTA negotiations. The services chapter should cover measures taken by central, regional or local governments and authorities. The FTAA negotiators need to negotiate special provisions for financial services so that they are effectively covered in a combined fashion in both the services and the investment chapters of the FTAA agreement. More broadly, US negotiators are seeking:

- "Most-Favored-Nation Treatment (MFN), that is, treatment that is no less favorable than service suppliers of another country, whether or not that country is a Party to the FTAA;
- National Treatment, that is, that all service suppliers would be treated no less favorably than an FTAA country treats its own service suppliers;
- Market access, to include
  1) the removal of non-discriminatory quantitative restrictions,
  2) guaranteed access to and use to publicly-provided telecommunications networks, and
  3) prohibition of "no local presence" requirements, a goal which might require specialized provisions in the case of financial services;

---

[20] Office of the United States Special Trade Representative. FTAA Negotiating Groups Meet Ministerial Challenge: USTR Releases Public Summaries of U.S. Positions. Press Release, January 6, 2001, p. 2. Available on-line.

[21] This paragraph draws from the USTR statement, *FTAA Negotiating Group on Services: Public Summary of U.S. Position*. Available on-line.

- Transparency in the domestic regulation of services; and, finally,

- Denial of benefits to
  1) "shell" companies, and
  2) companies that are directly or indirectly owned by non-FTAA countries with which the United States does not maintain diplomatic relations.

The United States could make significant trade gains in the financial/insurance sector were the FTAA to enter into effect. This is particularly the case since most of the countries in the area are emerging markets where increased growth might be expected to lead to a greater demand for increasingly sophisticated financial services and products. A significant exception to that statement is Bermuda, which is an offshore financial center and a significant net exporter of (net) insurance services to the United States. Indeed, the United States had a trade deficit of -$2,083 million in the combined financial services/net insurance sector with Bermuda in 1999.[22]

Latin America is already a significant market for the financial and insurance service exports of U.S. firms. As shown in **table 2** below, U.S. exports in this sector to countries in the Western Hemisphere amounted to $7, 296 million, thus accounting for nearly half (45.0%) of all such exports worldwide. Excluding NAFTA (i.e. Canada and Mexico) and Bermuda, they still amounted to $4,876 million or a healthy 30.1% of U.S. financial and insurance services exports worldwide.

Table 2. U.S. Financial Service and Insurance (net) Exports to the Western Hemisphere 1999 ($ Million)

Region	Financial Service (Banking & Securities)	Net Insurance	Total
Worldwide	13,925	2,295	16,220
Western Hemisphere *Of which:*	5,463	1,833	7,296
NAFTA (Canada & Mexico)	1,455	282	1,737
Other Western Hemisphere (Excluding NAFTA) *Of which:*	4,008	1,551	5,559
Argentina	268	114	382
Brazil	332	6	338
Chile	96	6	102
Venezuela	84	-6	78
Bermuda	667	16	683

Source: CRS, from U.S. DOC. BEA. *Survey of Current Business*, October 2000. Table 5.4.

[22] Calculated from U.S. DOC, BEA data as shown in tables 1 and 2.

The bulk of U.S. financial and net insurance exports to Western Hemisphere countries are attributable to the export of banking and securities services. These amounted to $5,463 million (39.2% of the worldwide total of banking- and securities-related service export, which totaled $13,925 million). They also equaled about twice the level of U.S. net insurance exports to the region of $1,833 million. The two NAFTA partners accounted for roughly one-quarter of the regional exports in this sector.

Sectoral imports, which are shown in **table 3** below, reflect a somewhat different picture. Whereas banking and securities services dominated U.S. hemispheric (and worldwide) exports, imports from the Western Hemisphere are dominated by net insurance imports. The United States imported $4,128 million in financial and net insurance services from the Western Hemisphere in 1999. Of this amount, $3,497 million was attributable to net insurance imports, about 4 ½ times the level of financial service (banking and securities service) imports. The latter amounted to only $631 million or 15.3% of the hemispheric total.

Table 3. U.S. Financial Service and Insurance (net) Imports to the Western Hemisphere 1999 ($ Million)

Region	Financial Service (Banking & Securities)	Net Insurance	Total
Worldwide	3,574	4,078	7,652
Western Hemisphere *Of which*:	631	3,497	4,128
NAFTA (Canada & Mexico)	266	235	501
Other Western Hemisphere (Excluding NAFTA) *Of which:*	365	3,262	3,627
Argentina	28	-9	19
Brazil	61	8	69
Chile	11	1	12
Venezuela	10	*	10
Bermuda	61	2,705	2,766

* = Less than $500,000.
Source: CRS, from U.S. DOC. BEA. *Survey of Current Business*, October 2000. Table 5.4.

Bermuda accounted for the dominance of insurance in the sectoral import picture. It accounted for $2,766 million or just over two-thirds (67.0%) of the sectoral imports coming from the Western Hemisphere and over one-third (36.1%) of sectoral imports worldwide. Only $501 million or 12.1% of U.S. imports from the region were due to the two NAFTA countries.

The United States maintained a healthy hemispheric trade surplus of $3.2 billion, accounting for more than one-third (37%) of the worldwide sectoral surplus of $8.6 billion. The two NAFTA partners account for $1.2 billion of the hemispheric surplus. As noted earlier, Bermuda was the only major market in which the U.S. sustained a sectoral trade deficit.

The United States has a substantial direct investment position in the Western Hemisphere. Including the NAFTA partners, U.S. direct investment in the Western Hemisphere countries amounted to $334.9 billion, about 30% of total U.S. foreign direct investment in 1999. Of this, $4.3 billion was in depository institutions (banks) and $149.2 billion was in the financial sector other than depository institutions. Canada accounted for about one-third of U.S. foreign direct investment in the hemisphere.[23]

Direct investment in the United States by the FTAA countries amounted to $124,307 million, of which Canada accounted for a little less than two-thirds (64.1%). Investment in depository institutions by the FTAA countries amounted to $5,655 million in 1999; in financial services other than banks, to $13,050 million.[24]

Financial Services and China's Accession to the World Trade Organization (WTO)

In November 1999, the United States and China completed a bilateral agreement establishing conditions for China's accession to the World Trade Organization (WTO). China completed similar agreements with other major trading partners as part of the accession process. The agreement covers a range of sectors, including banking, securities, and insurance.

Financial services are a very small portion of total U.S.-China trade. In 1999, the United States sold $13.1 billion in goods to China and imported $81.8 billion (customs basis.) In the same year, the United States sold about $78 million in financial services (banking and securities) and $2 million in (net) insurance premiums to unaffiliated buyers in China and purchased virtually no financial services from Chinese providers.[25]

China has made significant inroads in building private sector participation in its economy. Nevertheless, the government remains a dominant force in the economy as an owner and operator of major assets, including those in the financial sector. A major purpose of the U.S.-China agreement on WTO accession is to mesh the mixed structure of the Chinese economy with the disciplines imposed by the WTO and to ensure U.S. interests are taken into account.

Under the accession agreement China is committed to broadening foreign banks' access to its banking sector. Currently, foreign bank participation is severely restricted to only certain activities and within designated regions. According to the agreement, foreign banks will be able to conduct unrestricted foreign currency transactions immediately after accession. Foreign banks will be able to conduct transactions in local currency with Chinese enterprises within two years of WTO accession and with Chinese individuals within five

---

[23] Data from U.S. DOC. BEA. *Survey of Current Business*, July 2000, p. 66.

[24] Ibid., p. 68.

[25] U.S. Department of Commerce. Bureau of Economic Analysis. *Survey of Current Business*. October 2000. p. 148-149.

years of accession. The number of permitted locations of local currency activity will be increased in stages and will be geographically unrestricted after five years. Furthermore, foreign banks will be able to operate in any form five years after accession.

Foreign investment in securities operations is currently prohibited. Under the accession agreement, China has committed to permit 33% ownership participation in fund management enterprises immediately upon accession to the WTO and to raise the allowable share to 49% three years after accession. Foreign firms will be able to invest in underwriting joint ventures up to 33% of equity. These joint ventures will be allowed to underwrite domestic and foreign-currency denominated securities and will be accorded national treatment in fund management activities.

China's government permits foreign insurance firms to sell insurance but on a restricted basis. They are confined to Guangzhou and Shanghai, and the government has used its licensing authority to limit the foreign participation to 16 firms. The government has also restricted the range of products that foreign companies may provide. Under the bilateral accession agreement, foreign firms will be able to insure for "large-scale risk" throughout the country immediately upon accession and will eliminate all geographical restrictions on all types of permissible coverage three years after China's accession to the WTO. The agreement does not define "large-scale risk." In subsequent discussions, Chinese negotiators wanted to set a threshold of $80,000; that is, coverage below that amount would be restricted. U.S. negotiators sought $10,000. Reportedly, the two sides settled on a threshold of $25,000.[26]

The government will also broaden the range of permissible coverages over a five-year period after accession to include 85% of total premiums. (Insurance required by law will be excluded from foreign participation.)

In addition, upon accession, the government will permit life insurance companies up to 50% ownership of life insurance joint ventures with Chinese partners of their choice. Furthermore, foreign non-life insurers will be able to establish branch offices in China and to form joint ventures with up to 51% foreign ownership immediately after accession. Two years after accession, foreign non-life insurance companies will be able to establish wholly-owned subsidiaries. Finally, the bilateral accession agreement provides that foreign re-insurance companies will be able to sell re-insurance without restrictions.

Financial Services Trade under the North American Free Trade Agreement (NAFTA)

The United States currently has free-trade agreements with three countries – Israel, and Canada and Mexico under the North American Free Trade Agreement (NAFTA). NAFTA superseded the bilateral U.S.-Canada FTA that had been in force since January 1, 1989. The combined economies of Mexico, Canada, and the United States had an estimated GDP in

---

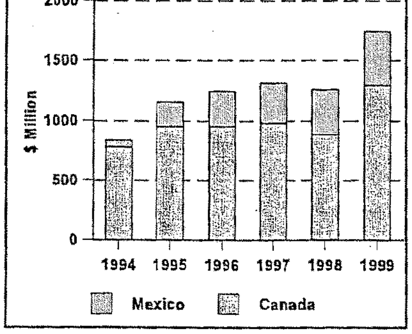
[26] *Inside U.S. Trade.* March 30, 2001.

2000 of about $11,195.5 billion, about one-quarter more than the GDP of the European Union.[27] Thus, at the end of 2000, NAFTA was the world's largest trading bloc.

U.S. trade with its NAFTA partners is enormous. Canada is our leading trading partner worldwide, our leading export market ($178,785.6 million in 2000), and our leading source of imports ($229,209.1 million, customs basis). The U.S. trade deficit with Canada, at $50,423.5 million, is the third largest. Mexico is the second largest market for U.S. exports ($111,720.9 million) and the third largest source of U.S. imports ($136,910.5 million, customs basis). The U.S. bilateral trade deficit with Mexico is the fifth largest, at $24,189.7 million.

NAFTA entered into force on January 1, 1994. **Figure 1** shows U.S. financial service (banking and securities) and net insurance exports to Mexico and Canada. The six-year period for which data are available shows a substantial increase in financial sector exports. During the period total financial services/net insurance exports to our two NAFTA partners more than doubled, rising 109% from $831 million to $1,737 million. As a share of financial services and net insurance exports worldwide, however, exports to the two countries dropped slightly, declining from 11.2% of the worldwide total of $7,439 million in 1994 to 10.7% of the worldwide total of $16,220 million in 1999. Another way of stating this is that U.S. worldwide exports in this sector rose at a slightly faster pace worldwide than did exports to our two NAFTA partners. Nevertheless, during the six-year period, U.S. exports of financial and net insurance services to both countries grew substantially faster than both the increase in their real GDP[28] and the increase in U.S. merchandise exports to the two countries.[29]

Figure 1. U.S. Financial Service and Insurance (net) Exports to Mexico and Canada, 1994-1999



Canada is a developed market economy that, in 1999, had a GDP that was about one-third larger than Mexico's still developing economy.[30] U.S. financial service and net

[27] U.S. GDP ($9,963.1 billion) data from BEA. GDP data for Canada ($675.42 billion), Mexico ($557.0 billion), and the European Union ($8,917.9) from Department of State Background Notes and Country Reports on Economic Policy and Trade Practices (EU only). On-line versions.

[28] Real GDP growth over the period 1994-1999 was 14.8% for Mexico and 17.6% for Canada. By comparison, in the United States it was 20.8%. Calculated from IMF. *International Financial Statistics*. March 2001.

[29] U.S. merchandise exports to Canada rose by 45.0%; to Mexico, 70.7%. Calculated from U.S. Department of Commerce. BEA. *Survey of Current Business*, April 1996 and on-line data March 2001.

[30] Using International Monetary Fund data, in 1999, the GDP of Mexico was $479.45 (P4,583.76

(continued...)

insurance exports to both countries grew substantially from 1994-1999. U.S. financial services/net insurance exports to Canada rose from $780 million in 1994 to $1,297 million in 1999, an increase of 66.3%. Financial service/insurance exports to Mexico also increased dramatically, rising from a relatively low base of $51 million in 1994 to $440 million in 1999, an increase of 762.7%. Exports to Mexico rose in every year – including the years immediately following the late 1994 financial crisis – except 1998. Exports to Canada also declined slightly in just one year, 1996.

Exports to Canada grew at a pace that was both less rapid than worldwide financial services/insurance exports and, as noted above, less rapid than the sector's exports to Mexico. As a result, exports to Mexico increased as a share of the total financial services and insurance exports to the two NAFTA partners. In 1994, Mexico's share constituted 6.1% of the two-country total; in 1999, 25.3%.

As shown in **figure 2**, U.S. imports of financial services and net insurance services have fluctuated significantly during the six-year period in which NAFTA has been in effect. In the peak year of 1998, financial service and net insurance imports amounted to $984 million. The very next year, however, marked a period-low for these imports, amounting to $501

Figure 2. U.S. Financial Service and Insurance (net) Imports from Mexico and Canada, 1994-1999

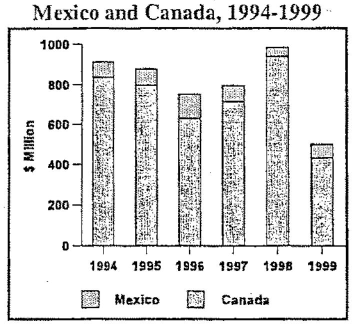
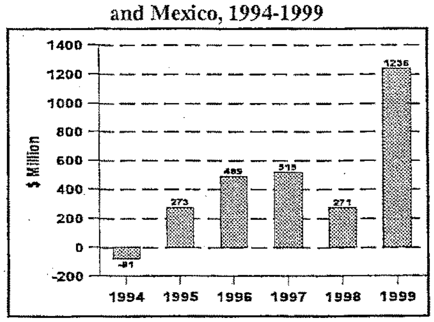


Figure 3. Balance of U.S. Trade in Financial Services and Insurance (net) with Canada and Mexico, 1994-1999



million, down 49.1% from the 1998 peak, but also down 45.1% from the 1994 level of $912 million. As figure 2 also makes clear, the bulk of imports from the two NAFTA partners came from Canada, whose share of the two countries' total fluctuated between 83.8% (1996) and 95.4% (1998). Finally, the share of U.S. worldwide imports of financial services and net insurance services accounted for by the two NAFTA partners dropped steadily from 16.0% in 1994 to 6.5% in 1999.

Figure 3 illustrates a significant shift in the balance of trade in financial services and net insurance services between the United States and its NAFTA partners during the years 1994-1999. During the period a significant surplus emerged, amounting to $1,236 million

---

[30] (...continued)
converted at the rate of P9.5604 per U.S. dollar). Canadian GDP was $644.75 (C$957.91 converted at the rate of C$1.4857 per U.S. dollar). IMF. *International Financial Statistics.* March 2001.

in 1999. This equaled 14.4% of the worldwide U.S. trade surplus in financial and net insurances service of $8,568 million. This shift is attributable more to an increase in U.S. exports (+109.0%) than a decrease in U.S. imports (-45.1%).

The U. S.-Canada FTA was the first agreement to include services trade. The bilateral phase-out of tariffs between Canada and the United States was completed on January 1, 1998. NAFTA extended the free trade agreement to Mexico. It also expanded its application to important sectors. NAFTA was the first trade agreement to deal comprehensively with trade in financial services. These are covered by Chapter 14 of the NAFTA agreement. NAFTA guaranteed the right of establishment and of national treatment. NAFTA also established the Financial Services Committee, which supervises the implementation of Chapter 14 and deals with issues that arise between the signatories. Issues that cannot be resolved by the Committee may be taken to the NAFTA dispute settlement mechanism.

In Canada, the banking industry falls under federal regulation; securities regulation is under provincial control. The Bank Act that governs the banking sector in Canada receives a mandatory review every five years. It was amended in 1992, 1997, and 1999. Insurance companies may incorporate under either federal or provincial law. Insurance companies must have a commercial presence in order to offer insurance and re-insurance services in Canada. They may branch from abroad if they maintain trustee assets equal to their liabilities. They are subject to investment review thresholds, and, in some provinces, authorization.

Prior to 1980 Canada did not allow foreign banks to operate in Canada. Subsequently, they were permitted to open separately capitalized subsidiaries, but the subsidiaries were subject to growth-limiting controls on authorized capital and market share. After the entry into force of the U.S.-Canada FTA, U.S. banks were exempted from these controls, as well as from a variety of other controls on foreign banks. In December 1996, the government established a Task Force on the Future of the Canadian Financial Services Sector chaired by Harold MacKay. In early 1997, the government announced that it would permit direct foreign-bank branching, a policy that was endorsed by the MacKay Task Force report in September 1998. To fulfill Canada's WTO commitments, the legislation permitting foreign-bank branching was enacted in June 1999.

Under current Canadian law two types of branches are permitted: full-service and lending. Full-service branches are permitted to take non-retail deposits that are larger than C$150,000 (currently somewhat less than US$100,000). Lending branches are not allowed to take any deposits and can borrow only from other financial institutions. Foreign banks may opt-out of Canadian Depository Insurance.

Canadian banks are divided into two types: Schedule I (widely-held, publicly traded) and Schedule II (closely held). As of March 31, 2000, there were eleven domestic banks, forty foreign subsidiaries, and two foreign branches. The eleven domestic banks had assets of C$1,385.7 billion (about $953.4 billion); the foreign banks, assets of C$89.8 billion (about $61.8 billion). Data were not available for the two foreign branches.[31] In reality, the Canadian banking sector is dominated by six Schedule I banks. Foreign banks are not active in the retail banking market because the market is already saturated. Instead, they tend to

[31] Canada. Office of the Superintendent of Financial Institutions. *Annual Report*, 1999-2000. On-line version.

participate in other areas, such as investment banking. **Table 4** below presents data on the top six Canadian banks.

Table 4. Top Six Canadian Banks, Selected Data July 31, 2000 U.S.$ Million			
Bank	Tier One Capital	Total Assets	Pre-Tax Profit
Royal Bank of Canada	8,830	186,305	1,886
Scotiabank	8,773	163,478	1,506
Canadian Imperial Bank	8,119	178,712	1,592
Bank of Montreal	7,534	158,449	1,462
Toronto Dominion Bank	6,188	183,393	748
National Bank of Canada	2,594	49,497	411

Source: *The Banker*, November 2000, p. 69. Currency Conversion by CRS at the rate of C$1.4872 per U.S. dollar.

In late 1998, Canadian Finance Minister Paul Martin vetoed Royal Bank's takeover of Bank of Montreal and a merger between Canadian Imperial Bank of Commerce and Toronto-Dominion Bank. Nevertheless, further consolidation in the Canadian banking industry would appear likely.

As previously noted, the third partner in NAFTA is Mexico. The smallest economy of the three, Mexico has been struggling to modernize its economy, including its financial system, at least since the 1980s. All but two of Mexico's banks – the local branch of Citibank and Banco Obrero, owned by the Mexican Labor Federation – were nationalized in the wake of the August 1982 peso collapse. The banks were again privatized in 1991-1992, in some cases to investors that were ill-prepared to run them. The newly privatized, but untested and undercapitalized banks, rapidly expanded assets in a bid for market share. Faced with an external financial crisis beginning in late 1994, followed by the worst domestic recession since the 1930s, non-performing loans climbed rapidly. Domestic credit collapsed and has still not recovered to pre-crisis levels.[32] Government costs associated with restructuring and consolidating the troubled Mexican banking sector have been estimated at 18-19% of GDP.[33]

Both NAFTA and the peso crisis have fundamentally altered the Mexican banking sector. It is not only open, but, by January 2001, 50% of bank assets were controlled by banks that are foreign-owned.[34] Under NAFTA, Mexico extended the principle of national treatment to U.S. and Canadian banks, thereby permitting their wholly-owned Mexican

[32] According to *The Banker*, the ratio of credit to GDP in Mexico is about 15% now, compared to 40% before the peso crisis. Robinson, Karina. Tequila Hangover Subsides. *The Banker*, March 2001, p. 79.

[33] See Taylor, Robert. Approaching the Promised Land. *The Banker*, February 2000, p. 53, and Robinson, Karina. No More Tequila Crises. *The Banker*, July 2000, p. 60.

[34] Robinson, Karin. Tequila Hangover Subsides. *The Banker*, March 2001, p. 78.

subsidiaries to undertake, with some minor restrictions, the full range of banking activities allowed to Mexican banks. Under NAFTA rules of origin, moreover, the U.S. and Canadian subsidiaries of other countries could establish subsidiaries in Mexico. Like Canada, Mexico initially did not permit foreign banks to establish branches. Transitional limits based on market share and net capital were also set. A 1995 financial reform package eased limits on the acquisition of Mexican banks by NAFTA-based banks, in the process potentially opening Mexico's three largest domestic banks to acquisition by NAFTA-based banks. In January 1997, a modified version of U.S. accounting standards was implemented. In 1998, Mexico eliminated restrictions on foreign investment in Mexico's top tier banks. In 2000, new laws regarding bankruptcy and secured transactions were passed. Finally, stricter capital requirements are being phased in over a three-year period that ends in 2003.

The Mexican banking sector is, like Canada's, highly concentrated. In 2000, two Spanish banks, BBVA (Banco Bilbao Vizcaya Argentaria) and BSCH (Banco Santander Central Hispano) took over, respectively, Bancomer and Banca Serfin. It was estimated that, after the merger with BBVA, Bancomer would have a credit portfolio equal to about one-third of Mexico's entire banking sector, and a market share of bank deposits about one-third larger than its nearest competitor.[35] The BSCH acquisition of Banca Serfin made Serfin the third largest Mexican bank. **Table 5** provides selected data on the banking business of Mexico's six largest banks.

Table 5. Top Six Mexican Banks, Selected Data (Banking Business Only)
December 31, 2000
$ Million

Bank	Total Assets	Tier One Capital	Capital/ Assets %	Non-Performing Loans/ Total Loans
BBVA Bancomer	40,790	1,709*	4.19	7.8
Banamex	34,902	24,303*	7.07	3.7
Banca Serfin	13,077	695	5.31	2.9
Banco Bitalb	12,694	659	5.19	8.0
Grupo Financiero Banorte	10,539	558*	5.29	5.2
Banco Santander Mexicano	10,339	NA	NA	0.9

Source: *The Banker*, March 2001, p. 77. Currency Conversion by CRS at the rate of P9.5722 per U.S. dollar. * To 2003 rules.

Direct investment is also a major channel for the trade in services, although the resulting transactions are not cross-border transactions, that is, exports or imports. The United States and Canada have large cross-border investments. The stock of U.S. direct investment (historic cost basis) in Canada amounted to $111,707 million in 1999. Of this, the Canadian banking industry accounted for $1,977 million; the finance/insurance/real estate industries

[35] Taylor, Robert. Merger Creates Dominant Force. *The Banker*, July 2000, p. 56.

combined, $25,084 million.[36] Sales of private commercial services (all sectors) by U.S. majority-owned affiliates in Canada were $26.7 million in 1998.[37] Private commercial sales of Canadian majority-owned firms operating in the United States amounted to $43.4 million.[38]

Cross-border investment between the United States and Mexico is significantly less than that between the United States and Canada. The stock of United States direct investment (historic cost basis) in Mexico was $34,265 million, of which $1,182 million was in depository institutions and $25,084 was in the combined finance/insurance/real estate sectors.[39] Mexican investment in the United States amounted to $3,612 million, of which $199 million was in depository institutions.[40] Sales of services in Mexico by U.S. majority-owned affiliates (all sectors) amounted to Mexico in 1998 amounted to $3.1 billion, while sales of services by Mexican firms operating in the United States were $531 million.

U.S.-Japan Economic Ties

U.S.-Japan trade in financial services has been modest in terms of total U.S.-Japan trade, although it is likely to increase as technology improves the efficiency of transactions and Japan proceeds to liberalize its financial markets. In 1999, U.S. exports (or receipts from sales) of financial services (banking and securities), plus (net) insurance premiums were $814 million. U.S. imports (or payments for purchases) from Japan of financial services from Japan were $210 million. In comparison, U.S. exports of financial services to Canada in 1999 were $1,297 million and imports from Canada were $35 million. The volume of U.S.-Japan trade in financial services has not changed appreciably during the last few years. In 1996, for example, exports totaled $794 million while imports totaled $296 million.[41]

Savings deposits and other personnel assets in Japan are valued around $10 trillion, a huge potential market for U.S. banks and securities firms.[42] However, financial services are heavily regulated, limiting participation by U.S. and other foreign companies and restricting entry by new domestic firms. The need for reform in the financial services sector became particularly evident when the "asset bubble" of the 1980s burst in the early 1990s exposing the fragility of the banking system. Many banks held loans that were collateralized by overvalued stocks, real estate, and other assets. Weaknesses in the Japanese financial sector were further exposed as a result of the East Asian financial crisis in 1997-98.

---

[36] BEA data quoted in U.S. Department of State. *Canada: 2000 Country Report on Economic Policy and Trade Practices*. March 2001. On-line version.

[37] U.S. Trade Representative. *2001 National Trade Estimate Report on Foreign Trade Barriers*, p. 30. On-line version.

[38] Ibid.

[39] U.S. Department of Commerce. BEA. *Survey of Current Business*, July 2000, p. 66. On-line version.

[40] Ibid, p. 68. The value of Mexican investment in the finance/insurance/real estate sectors was suppressed to avoid disclosing data of individual companies.

[41] See footnote 4.

[42] CRS Report RS20335, *Japan's Landmark Financial Deregulation: What it Means for the United States*, by Dick K. Nanto. p. 1.

In order to encourage reform in Japan's financial sector and to promote participation of U.S. financial firms in Japan, the United States engaged in negotiations with Japan to revise laws and government regulations and to change corporate management practices that have impeded U.S. presence in the sector. In February 1995, the countries concluded the "Measures by the Government of Japan and the Government of the United States Regarding Financial Services." Under the agreement, Japan made commitments regarding the use of "administrative guidance" in advising Japanese financial firms, including making it more transparent, and opening up the private sector-government advisory process to foreign firms. The government also relaxed barriers to financial firms participating in funds management, such as pension funds and investment trusts. Furthermore, it reduced restrictions on the introduction of new and innovative investment products and loosened barriers to financial securities cross-broader transactions. According to the Office of the United States Trade Representative (USTR), Japan had fulfilled its commitments, in some cases ahead of schedule. [43]

In 1996, Prime Minister Hashimoto's government announced a "Big Bang" program of financial deregulation. The program has included removing walls that had prevented some parts of the financial sector from investing in other parts, such as allowing banks and securities companies to sell insurance. [44]

The United States and Japan have continued discussions on financial services under the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy, a framework that the two countries launched in 1997. The United States has used the discussions to continue pressing Japan to undertake reforms. Among other things, Japan has agreed to ease the introduction of new products and to strengthen accounting standards. Japan's banking crisis, the "Big Bang" reforms, and bilateral agreements have increased the presence of U.S. financial firms in the Japanese market. A number of U.S.-based companies now provide funds management securities brokerage services.[45]

Along with banking and securities services, barriers in Japan's insurance market have been an issue in U.S.-Japan trade. Specifically, American firms have complained that little public information is available on insurance regulations and on how those regulations are developed, thereby, making it difficult to know how to get approval for doing business in Japan. They also assert that regulations favor insurance companies that are tied to business conglomerates — the keiretsu — making it difficult for foreign companies to enter the market.

Japan is the second largest insurance market in the world, slightly behind the United States, with around $450 billion in direct insurance premiums in 2000. However, foreign insurers account for only a small portion of the Japanese insurance market. After years of negotiations, the United States got Japan to agree in October 1994 to take measures to open its market for life insurance and non-life insurance (fire and auto insurance). At the same time, Japan agreed to delay deregulation of the so-called third-sector insurance market, which encompasses specialty insurance coverage — such as cancer, hospitalization, nursing

---

[43] Office of the United States Trade Representative. *2001 national Trade Estimate Report on Foreign Trade Barriers.* p. 218-219.

[44] For more information on financial sector deregulation in Japan see CRS Report RS20335, *Japan's Landmark Financial Deregulation: What it Means for the United States,* by Dick K. Nanto

[45] Ibid. p. 6.

care, and personal accident — so as not to reduce the competitive advantages foreign firms, particularly U.S. firms, had built in this market.

At the end of 1995 and early 1996, U.S. officials and the American insurance industry were becoming concerned that Japan was reducing regulations on the third sector as well as the others contrary to the agreement. After many months, U.S. and Japanese negotiators reached a second agreement on December 15, 1996. Under this agreement, Japan would open life and non-life insurance market to foreign competition and limit domestic company entry into the third sector until thirty months after it has made "substantial" progress in deregulating the life and non-life sectors But the United States has protested that Japan has already allowed domestic companies to enter the third sector. Japan has argued that it has already made the "substantial progress" stipulated in the agreement. The two sides have failed to agree to even meet to work out their differences. On February 24 2000, the Japanese government Financial Supervisory Agency announced that it would allow Japanese life and non-life insurance companies to do business in the third sector beginning January 1, 2001.

Financial Services Trade and the European Union (EU)[46]

In 1999, the European Union (EU) was the single largest market for cross-border trade with the United States in financial services (banking and securities) and net insurance services. U.S. cross-border exports amounted to $4,752 million and $238 million, respectively. Cross-border imports from the EU amounted to $2,007 million in financial services and $498 million in net insurance services. Thus, the United States had a surplus in financial service trade to the EU of $2,745 million and a deficit in net insurance trade of -$260 million. Taken together U.S. trade in financial services and net insurance produced a surplus equal to 3.1% of the worldwide U.S. services surplus of $80,588 million in 1999.

The financial markets of the EU are among the world's largest and most sophisticated. The EU-move toward ever greater economic integration has brought two tectonic shifts of importance to financial markets:

- the implementation of a common currency, the "euro," on January 1, 1999, by 11 of the member states;[47] and
- the creation of an increasingly integrated, single market for financial services supported by a common legal framework.

The effect of these developments has largely been to ease the ability of U.S. financial firms to operate within the European Union.

EU rules now permit banks operating in one EU country to have branches in another country and to operate across member state borders without impediment. Banks are

---

[46] The 15 member states of the European Union include Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

[47] As of January 1, 2001, Greece joined the "euro," bringing the number of participating countries to twelve.

regulated by home-country regulators; products permitted in the home country may be marketed elsewhere in the EU. EU banking directives set community-wide minimum standards. Additionally, EU law grants foreign bank subsidiaries national treatment. This is superseded and reinforced by EU commitments to provide "most-favored-nation" treatment to both subsidiaries and branches under the General Agreement on Trade in Services (GATS) of the WTO. Thus, U.S. banks operating in Europe are more likely to have common concerns shared with their domestic European competitors than to have unique concerns by virtue of being foreign banks.

The attempt to create an integrated market also applies to the securities markets (stocks and bonds), but has apparently been less successful than the consolidation of an EU-wide banking market. A recent *Economist* notes that the EU securities market remains fragmented, governed by "a colourful patchwork of regulation," with some forty different regulatory authorities.[48] This fragmentation "diminishes the depth and liquidity of the markets and makes the cost of capital in Europe persistently higher than it is in America. It also makes it more difficult for entrepreneurs to find start-up funds."[49]

The EU endorsed a Financial Services Action Plan (FSAP) at its Lisbon Summit in March 2000. The plan would accelerate the lagging efforts toward securities market integration. In addition, the EU also set up a committee (the Lamfalussey Committee) to study securities market regulation. The committee issued its final report in February 2001. A dispute between EU finance ministers and the EU Commission over the Lamfalussey report was settled at the March 23-24, 2001 EU summit held in Stockholm. This should allow the EU to move ahead toward full integration of the securities market by 2005 – if the agreement is not scuttled by the European Parliament.

While securities-market regulatory structure lags, the market itself continues moving toward greater integration. A recent study by the Bank for International Settlements (BIS) suggests that, as macroeconomic conditions are becoming more synchronized in Europe due to the introduction of the euro, the pricing of equity risk is focusing increasingly on industrial sectors viewed from a pan-European perspective rather than on country-specific factors.[50]

These trends may present challenges (and opportunities) for U.S. securities firms operating in Europe. They are not distinct, however, from those faced by European securities firms. As with the EU's commercial banking market, the 1998 *National Treatment Study* by the U.S. Department of Treasury notes that, as a result of the EU GATS commitments, there are very few strictly 'national treatment' issues for U.S. financial services firms operating in the EU.

U.S. officials are working with state insurance regulators to determine whether it might be possible to increase regulatory cooperation or develop mutual-recognition mechanisms with the EU. The insurance sectors under consideration include commercial lines, reinsurance, and agency/brokers. Pension fund management, which is federally regulated, is also under consideration.

---

[48] EU Financial Regulation: A Ragbag of Reform. *The Economist*, March 3, 2001, p. 63.

[49] Ibid.

[50] BIS. *Quarterly Review*, March 2001, p. 13-14.

The EU's Data Privacy Directive constitutes a significant exception to an environment that is generally conducive to the operations of U.S. financial firms. The Directive, which went into effect on October 24, 1998, prohibits the transfer of all personal data and information originating in the EU to organizations outside the EU unless their data privacy protections are deemed "adequate" by the EU. The Directive has the potential to interrupt the flow of information that normally lubricates business conducted between organizations in the EU and the United States. To prevent such an interruption, U.S. officials negotiated a "Safe Harbor" agreement that went into effect on November 1, 2000.[51] U.S. firms adhering to "Safe Harbor" are automatically deemed as having fulfilled the EU privacy requirements.

The financial services sector was excluded from the Safe Harbor provisions, along with the telecommunications sector, and, initially, the transportation sector. The negotiations excluded the financial sector because the negotiations coincided with congressional consideration of comprehensive reforms to the U.S. financial system, including new rules regarding the privacy of personal financial data. The proposed reforms became the Gramm-Leach-Bliley (GLB) Act (P.L. 106-102), signed into law on November 12, 1999. The EU and the United States have not, however, reached agreement on the treatment of financial institutions. GLB permits the sharing of personally identifiable information between affiliates, which is not deemed as complying with the EU privacy requirements. Additionally, U.S. enforcement of Safe Harbor commitments is by the Federal Trade Commission (FTC) and, for air carriers, by the Department of Transportation (DOT). The former does not have jurisdiction over banks, savings and loans, or credit unions.

The EU has made a political commitment not to enforce the Privacy Directive against U.S. firms until July 1, 2001. The Bush Administration has objected strongly to a recent European Commission proposal to adopt standard clauses for contracts between U.S. and European firms that would obligate U.S. firms to operate under the stricter EU privacy rules.[52]

The Asian-Pacific Economic (APEC) Forum

The Asian-Pacific Economic Cooperation (APEC) forum is an association of 21 economies of the region.[53] APEC was originally organized to coordinate and cooperate on international trade and investment matters of mutual concern. Among other things, the goal of APEC is to encourage the free flow of all goods, capital, and *services,* including financial services, and to promote the removal of barriers to trade and investment. In 1994 in Bogor, Indonesia, APEC member-country leaders declared their intention to establish free trade and investment among the members by 2010, for fully industrialized member economies, and by

---

[51] For more information on the European Data Privacy Directive and "Safe Harbor," see U.S. Library of Congress. Congressional Research Service. *The EU-US "Safe Harbor" Agreement on Personal Data Privacy,* by Patricia A. Wertman. February 21, 2001. 6 p. RS20823.

[52] See Simpson, Glenn R. *U.S. Officials Criticize Rules On EU Privacy.* Wall Street Journal, March 17, 2001, B7.

[53] Member economies of APEC are the United States, Canada, Mexico, Chile, Peru, Japan, South Korea, China, Taiwan, Hong Kong, Indonesia, Brunei, Malaysia, Singapore, Thailand, the Philippines, Vietnam, Australia, New Zealand, Papua New Guinea, and Russia. For additional information on the history and operation of APEC see CRS Report RL30688, *Asia Pacific Economic Cooperation (APEC) and the 2000 Summit in Brunei,* by Dick K. Nanto.

2020 for all member countries. The following year, in Osaka, Japan, the leaders agreed to an agenda to implement the Bogor initiative. Unlike other trading arrangements that the United States participates in, including NAFTA and the WTO, APEC members are not working toward the free trade and investment goals through give-and-take negotiations. Instead, APEC uses the force of peer pressure to obtain voluntary trade liberalization actions by individual member-countries who set their commitments down in individual action plans (IAPs). The IAPs are the primary building blocks for implementing the free trade and investment objectives of APEC. The IAPs loosely conform to goals established in common action plans (CAPs) that APEC member-countries have developed. The CAPs and IAPs are not legally binding commitments, but "concerted unilateral actions" that are voluntary. However, the action plans are expected to conform to basic principles, and it is also expected that member-countries will realize the benefits from trade liberalization and will be motivated to fulfill the action plans.[54]

Financial services are not a major focus of the APEC agenda, primarily because of the broad range of other services that have been deemed of greater importance. In the agenda developed in Osaka in 1995, the leaders highlighted trade in telecommunications, transportation, energy, and tourism services as targets for action by its members but indicated that members should also work toward trade liberalization in other service sectors. However, some countries, for example China and Vietnam, have included actions in financial services as part of their IAPs.

[54] Ibid. p. 4.

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on International Monetary Policy and Trade
June 26 2001

"Trade in Financial Services - Current Issues and Future Developments"

I want to thank Chairman Bereuter for holding this important hearing on trade in financial services. This is the first of several trade-related proceedings the Committee plans to pursue as Congress undertakes consideration of several important issues involving U.S. trade policy. I would also like to thank today's witnesses and I look forward to hearing about their trade experiences as well as the policies they recommend for the further expansion of trade in financial services.

The U.S. financial services industry is the most open, competitive and transparent in the world. By providing credit and capital formation it establishes the foundation for economic growth. The financial services sector is one of the few sectors in which the U.S. enjoys a trade surplus. This Committee has jurisdiction over the Export-Import Bank, the International Monetary Fund, and the several international financial institutions such as the African and the Asian Development Banks. These organizations play a leading role in furthering the export of U.S. financial services and expansion of free market economies. The U.S. financial services industry provides the valuable infrastructure and technical expertise needed for U.S. exporters to have greater access to world markets.

It is therefore of great importance that we take the full measure of all aspects of the international trade agenda with respect to financial services and the key role the Financial Services Committee can play.

There are a number of important concerns that must be addressed to ensure that U.S. service providers are treated fairly in the international arena. Foreign markets need to be open on a non-discriminatory basis to American firms. Barriers to entry and expansion need to be reduced. Foreign legal systems need to be transparent. Lengthy and difficult approval processes for new products need to be removed. And limitations on the right to buy and sell financial products across borders need to be corrected.

Our financial services firms have demonstrated an adept ability to compete in global markets for all types of financial products when the playing field is leveled. Open financial markets fuel economic growth, create better paying jobs and provide domestic and foreign consumers with more choices and opportunities.

As part of this discussion on trade policy, I would also like to take this opportunity to voice my strong support for granting Trade Promotion Authority (TPA) to the President. TPA will enable the Congress to work closely with the President to negotiate trade agreements that will strengthen the American economy. These agreements can then come into force in an expedited fashion. Without such authority, other countries are reluctant to enter into agreements with the U.S.

TPA will be especially beneficial to our financial services industry. Since we entered into NAFTA, exports in financial services to our NAFTA partners have more than doubled. Financial Services exports have enjoyed an overall net increase of 273 percent over the last 10 years. In 2000, the financial services trade surplus reached $8.8 billion dollars.

As we continue to hear predictions about the uncertainty of the U.S. economy in the future, it is important to note that our country experienced its greatest period of economic growth after the successful negotiation of NAFTA and the Uruguay Round on GATT. Now is the right time to institute a trade policy that will encourage economic growth again. With the combination of Trade Promotion Authority, an active and vital Export-Import Bank, well managed and well-capitalized U.S. international financial institutions, and free trade, both the U.S. economy and the world economy will benefit.

Thank you, Mr. Chairman. I yield back the balance of my time.

Statement by Rep. Bernard Sanders on Trade Issues for International Monetary Policy and Trade Subcommittee Hearing on Tuesday, June 26th at 2pm in 2128 Rayburn

---

I thank the Chairman for holding this important hearing on "Trade in Financial Services."

While the U.S. ran an $8.8 billion financial services trade surplus in 2000, I believe it would be counterproductive to concentrate on this one relatively minor aspect of our trade policy without looking at U.S. trade policy in general which contributed to a $449.5 billion trade deficit in goods in 2000. In my view, United States trade policy in terms of Permanent Normal Trade Relations with China, the World Trade Organization and the North American Free Trade Agreement have been a complete disaster for the average worker, human rights and the environment.

Former President Clinton, and free trade advocates have argued for these policies because of their assertion that every $1 billion in U.S. exports translates into approximately 14,000 jobs. If this theory is true, then it should also be true that every $1 billion in our U.S. trade deficit equals the loss of 14,000 jobs. Well, the U.S. trade deficit in goods reached a record $449.5 billion in 2000, $104 billion higher than last year. Using this theory, we have lost 1,456,000 good paying manufacturing jobs since last year and 6.3 million manufacturing jobs overall due to our failed trade policies.

We now have an $83.8 billion trade deficit with China, a $24.2 billion trade deficit with Mexico and a $50.4 billion trade deficit with Canada which has more than doubled since NAFTA. This is a recipe for disaster.

Despite the so-called "economic boom" that we hear so much about, tens of millions of American workers today are working longer hours for lower wages than was the case 25 years ago. In fact, young, entry level workers without a college education saw their average real wages plummet by 28% between 1979 and 1997 because they are forced to work in the low wage service industry as opposed to manufacturing - where wages are much higher.

The United States today has the most uneven distribution of wealth and income of any industrialized nation, and many people in the middle class are working incredibly long hours to keep their heads above water. It used to be that in the United States one worker could work 40 hours a week and bring in enough income to support the entire family. Today, despite the so-called "economic boom," real wages have not kept pace with inflation for many workers and most families need two breadwinners in order to pay the bills.

The International Labor Organization (ILO), recently reported that the United States now has the dubious distinction of having its workers work longer hours than any other industrialized country in the world. One of the reasons for this is that our failed trade policy is exporting decent paying manufacturing jobs, rather than goods.

You might think that these trade policies are bad for American workers, but they must be good for other workers throughout the world? Surely, these workers must have seen an increase in their living standards as a result of U.S. and international trade policy, right? Wrong.

NAFTA for example has been a complete disaster for Mexican workers. Over one million more Mexicans work for less than the minimum wage of $3.40 per day today in their country than before NAFTA, and during the NAFTA period, eight million Mexicans have fallen from the middle class into poverty.

In China, multinational companies are lowering standards as they shift production from the older publicly owned factories in the North of China- where wages are 50 cents an hour- to booming privately owned sweatshops in the South of China. In the South they slash wages, eliminate benefits, impose enormously long overtime hours and fire any worker who is even seen discussing factory conditions. In China, anyone attempting to organize an independent union will be immediately fired and incarcerated- without trial- in a psychiatric hospital or in a hard labor camp.

In other words, U.S. and international trade policy has been a complete failure for workers throughout the world as multinational companies push wages and living standards lower and lower.

How has trade policy been for the environment? Here are the facts.

** Since NAFTA, the increase of industry along the U.S. and Mexican border has created worsening environmental and public health threats in the area. Along the border, the occurrence of some diseases, including hepatitis, is two or three times the national average, due to lack of sewage treatment and safe drinking water.

** We all know that multinational corporations have invested tens of billions of dollars in China. One of the "attractions" of China for foreign investors is that they do not have to comply with any meaningful environmental regulations. Today, five of the world's ten most polluted cities are in China and an estimated two million people die each year there from air and water pollution. Water pollutants are so toxic that 80 percent of China's rivers have no fish remaining in them.

In other words, trade policy has been a disaster for the environment.

Well, what about human rights? Let's look at China. Has China's human rights record improved or deteriorated since the passage of Permanent Normal Trade Relations? I think that without question it has worsened.

The citizens of China cannot join free unions, cannot practice their religion, and cannot speak out against their government without the fear of going to jail.

Ngawang Choephel, a former Middlebury College student, is one of many people in China facing long prison sentences for trumped up charges. His "crime" was to use a video camera to record dance in his native Tibet. How can we have a "free" trade agreement with a country that is not "free?"

If our trade policies are a disaster for workers, the environment, and human rights, who does it help? The multinational corporations. These corporations contributed hundreds of millions of dollars to pass these trade policies because it allows them to continue moving their factories to China and other poor countries where they pay desperate workers 15, 20 or 30 cents an hour. For these corporations, hiring workers at starvation wages who cannot form unions, who cannot speak out for their rights and who cannot criticize their government without going to jail is far preferable to investing in the United States and paying a living wage to workers here.

This year we will be debating the so-called Free Trade Area of the Americas, Fast Track, and whether to continue granting Most Favored Nation status to China.

As we debate these issues, I will be in agreement with those people who believe that trade should represent the best interests of American workers and not just the multinational corporations, who believe that trade policy must protect the fragile environment of this planet, and who believe that the United States must stand for democracy, human rights and religious freedom - and not just corporate greed. These ideas must form the basis of any future trade agreements. I thank the Chairman.

Trade in Financial Services Hearing
Statement by Rep. Maxine Waters
June 26, 2001

I would like to thank Chairman Doug Bereuter for organizing this hearing on Trade in Financial Services. I appreciate his willingness to allow the members of this subcommittee to express our concerns regarding the direction of our nation's trade policies.

President Bush has placed the passage of trade promotion authority -- also known as "Fast Track" authority -- at the top of his legislative agenda on international trade. Fast Track authority may be used for a new round of World Trade Organization (WTO) negotiations, as well as negotiations for a Free Trade Area of the Americas (FTAA) and other regional and bilateral trade agreements. These trade negotiations could have far reaching implications for people in the United States and around the world.

I am particularly concerned about the impact that trade agreements have on labor, the environment and public health. International trade cannot be expanded at any cost. We must ensure that working people and their families actually benefit from international trade. This will not happen unless individual countries have laws and policies to improve wages and working conditions, protect the environment and address the needs of their people. Only then will increased trade result in rising incomes and the improvement of living standards in the United States and the countries with which we trade.

Let me begin by pointing out that I am not one to demand that all countries have the same minimum wage or that developing countries be forced to accept the same labor and environmental laws as the United States. However, labor unions, consumer advocates and environmental organizations must be at the table when the United States negotiates trade agreements, and their legitimate concerns must be addressed. This will require the participation of people who represent labor unions and civil society organizations in developing countries as well as the United States.

I am especially concerned about the impact of WTO intellectual property rules on public health in developing countries. The Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement is one of the international agreements enforced by the WTO. The TRIPS agreement allows pharmaceutical companies to demand monopoly prices for medicines for which they have patents, including medicines for the treatment of HIV/AIDS. As a result of the TRIPS agreement and pressure from pharmaceutical companies, millions of people in developing countries have been denied life-saving medicines because they cannot afford to pay the prices the pharmaceutical companies demand.

A few countries have begun to respond to the HIV/AIDS pandemic by enacting laws to allow the distribution of generic HIV/AIDS medicines to their populations. Pharmaceutical companies have responded by using the WTO and the TRIPS agreement to challenge their laws.

Brazil has developed a model program for the treatment and prevention of HIV/AIDS in developing countries. Brazil's program is based on the local manufacture and free distribution of generic HIV/AIDS medicines. This program has cut the number of AIDS-related deaths in half and has been cited by the World Bank and the United Nations as one of the best in the world.

The United States, on behalf of international pharmaceutical companies, filed a formal WTO complaint against Brazil's patent law. Yesterday, the United States Trade Representative (USTR) announced that this complaint was being withdrawn from formal WTO litigation. I commend USTR for withdrawing this complaint and allowing Brazil to treat patients with HIV/AIDS without worrying about international pressure or economic sanctions authorized by the WTO.

WTO patent rules need to be reformed to address public health concerns. This will allow other developing countries such as the countries of sub-Saharan Africa to follow Brazil's example and make affordable HIV/AIDS drugs available to people who need them.

We do not need a new round of WTO negotiations that will give even more power to wealthy corporations like the pharmaceutical companies that have challenged the rights of developing countries to treat patients with HIV/AIDS. What we need is a reevaluation of the existing WTO rules to accommodate labor, environmental and public health concerns.

It is time for our nation's trade negotiators to begin to listen to the concerns of labor union leaders, environmentalists, health care advocates and human rights activists from the United States and throughout the world. I am looking forward to hearing the witnesses at this hearing, and I hope they will address the impact of current and proposed trade agreements on working people, the environment and public health both in the United States and in the countries with which we trade.

Thank you.

STATEMENT OF THE AMERICAN INSURANCE ASSOCIATION

TESTIMONY
OF
PETER O'CONNOR
EXECUTIVE VICE PRESIDENT OF ACE INA
ON BEHALF OF
THE AMERICAN INSURANCE ASSOCIATION
ON TRADE IN FINANCIAL SERVICES-
CURRENT ISSUES AND FUTURE DEVELOPMENTS
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL MONETARY POLICY AND
TRADE OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

JUNE 26, 2001

American Insurance Association

The American Insurance Association is a national trade organization of property and casualty insurers.

American Insurance Association

Thank you, Mr. Chairman, and other distinguished members of the International Monetary Policy and Trade Subcommittee, for holding this important hearing today.

My name is Peter O'Connor, and I am Executive Vice President of ACE INA. ACE INA is one of the world's largest providers of property and casualty insurance to a broad range of local and multinational clients. Our history dates back to 1792 with the establishment of the Insurance Company of North America (INA), which ACE acquired from Cigna Corporation in July 1999. INA was the first stock insurance company in North America, the first company to write insurance in China in 1897, and one of the first to establish an international department for business on all continents in 1946. Today's INA has offices in 50 countries, spanning six continents. ACE INA employs 1,400 people in Pennsylvania, 4,500 people in the U.S., and over 7,000 people around the world. ACE INA is one of the world's few truly global insurers.

I am providing testimony today on behalf of the American Insurance Association, which represents over 370 major U.S. property-casualty insurers. AIA has an active International Committee that lobbies for and promotes public policy positions both here in the U.S. and abroad, advocating trade competition, open markets and effective insurance regulation around the world. I am currently the vice chairman of this committee.

When most people think of international trade, they seldom think of financial services, such as insurance. They focus more on manufacturing products, agriculture, and goods that have a greater historical trade context. Indeed, many of our country's great trade successes and challenges relate to these products.

The reality, however, is that trade in financial services has grown rapidly over the last decade and is now a major component of U.S. trade policy. And, insurance has been a strong member of that increasingly-robust trade sector. In fact, U.S. financial services exports last year stood at $17.8 billion, a 30 percent increase from 1999. Subsidiaries of U.S. insurers sold over $46 billion of products overseas in 1998.

THE IMPORTANCE OF INSURANCE IN THE GLOBAL ECONOMY

Insurance is an integral part of any economy. Insurance takes on different appearances and is provided in many ways throughout the world, but its functions and critical importance to any economy and to the overall financial infrastructure of the world cannot be overstated.

1130 Connecticut Avenue, N.W., Suite 1000 ▾ Washington, DC 20036 ▾ Phone: 202/828-7100 ▾ Fax: 202/293-1219 ▾ www.aiadc.org

Liberalization of trade in insurance, combined with the development of open and transparent regulatory regimes, is critical to the growth of U.S. insurers and to the health of the overall U.S. insurance industry. But more importantly, it is critical to the ability of emerging and transitional economies to grow and develop their economies and provide social safety-net protections to their citizens.

Insurance is important to any economy for a number of reasons, but I will cite only five:

- **First, insurance is an essential and vital component of a country's financial infrastructure.**

Insurance companies can be major sources of national income. In collecting relatively small premiums from their many thousands of insured, insurance companies are able to invest large sums locally. And unlike banks, whose financing is often short-term oriented, many insurers provide long-term financing which is important to sustained economic development. This, in turn, deepens and broadens the domestic financial services marketplace, which generates higher savings rates and therefore greater economic development.

- **Second, insurance supports beneficial increases in overall trade and investment and creates jobs, both in the U.S. and in the emerging market.**

American companies, including small- and medium-sized enterprises, are more likely to export to, and enter, foreign markets if they have access to the specialized products and services that they require and U.S. insurers provide. Increased sale of U.S. products overseas translates to more jobs being created back home to supply the overseas demand. High-tech, energy, and infrastructure sectors especially need the products and services of U.S. insurers. These types of sophisticated coverage and related services are essential for effective and efficient risk management in emerging and transitional markets.

- **Third, insurance strengthens social and economic policies that address risks threatening businesses, workers and their families, and the environment.**

Open, competitive insurance markets give emerging and transitional countries the means to develop social and economic policies that mitigate risks threatening businesses (concerns for security of property, possible liability, and worker safety), workers and their families (health care needs, disability and retirement plans), and the environment. Insurance promotes financial stability by allowing large and small businesses to operate with less volatility and risk of failure. Unlike most other industries, insurance causes almost no adverse environmental impact. Together, these factors provide greater overall financial, and therefore, social stability -- critical public policy areas that, in the future, will become more prominent issues in developing countries as incomes rise and political freedoms expand. Insurers can materially aid this process.

- **Fourth, insurance can substitute for government security programs and support privatization processes.**

Many countries face large fiscal constraints and deficits, partly because large, state-owned enterprise systems are a drag on the economy and increasingly unfeasible to run in today's economic conditions. This applies both to state-owned enterprises that support government social safety net programs and the privatization of state companies where the new public corporations must learn to compete in an era of global competition.

- **Fifth, foreign insurers transfer technological and managerial expertise.**

Sustained economic development requires application of state-of-the-art technical, managerial, and marketing techniques, including development of adequate insurance supervisory systems. U.S. insurers bring all these skills into foreign markets. As more insurers enter foreign markets, the greater the knowledge transfers. Demand for actuaries, underwriters, and other insurance personnel is increasing, resulting in increased wages, and therefore increased standard of living. U.S. insurers operating in developing markets offer high-quality and higher-paying jobs than can be found in the domestic industry. Since many of these markets are seeing a competitive insurance sector for the first time, they need input on effective rules and regulation governing insurance, which U.S. insurers can provide.

U.S. INSURANCE ACTIVITY IN GLOBAL MARKETS

As the world community, particularly its emerging markets, has acknowledged the important role that a healthy and competitive insurance market plays in its development, I am happy to report that U.S. insurance company investment and sales outside our country has increased substantially over the last decade. In fact, according to the U.S. Department of Commerce, over a nine-year period from 1990 to 1998, U.S. majority-owned company insurance sales overseas grew by 114 percent. Additionally, U.S. cross-border export of insurance products, which is limited only to a small number of products (primarily reinsurance and marine insurance), has increased on average by nearly 7 percent since 1994.

Fortunately, this increase in U.S. insurance investment throughout the world is expected to continue to significantly grow for a number of reasons, but primarily for three reasons. First, as many countries reform their economies and encourage foreign investment, the need for more and diverse insurance products will grow and require foreign insurance investment and expertise. This is particularly true in countries where state-run enterprises are being replaced by private enterprises, and private insurance companies are being formed to compete with former state-owned monopolies, such as in China and India. Second, as U.S. companies in general participate in the further expansion of world trade, U.S. insurers will often follow these customers and underwrite their clients' risks abroad. Third, U.S. and western European insurance markets are largely saturated, necessitating companies to increasingly look to emerging markets to grow and expand their business to remain competitive in a global marketplace. For example, according to Swiss Re, the level of insurance penetration (insurance premiums as a percentage of GDP) in 1999 was significantly higher among G-7 and OECD countries (9.01 percent and 8.61 percent, respectively) than developing countries, such as Brazil (2.01 percent), China (1.63 percent), India (1.93 percent), Egypt (0.65 percent), and Vietnam (0.58 percent).

KEY TRADE POLICY PRIORITIES FOR U.S. INSURERS

The insurance industry has been increasingly active in a number of public policy areas to promote expanded international trade. U.S. insurers strongly support the efforts of U.S. trade officials and many Members of Congress to expand trade in both the multilateral and bilateral arenas, but our focus in both realms is clear: greater market access for our products, expertise and capital, and greater regulatory transparency for our businesses.

On the multilateral front, the U.S. insurance industry strongly supports the Bush Administration's efforts to initiate a broad trade round within the World Trade Organization beginning at its ministerial in Doha, Qatar in November. While negotiations in services, including insurance, have already commenced as part of the WTO's embedded program, we know that the success of those negotiations are largely dependent on the success of a more comprehensive round. The 1997 General Agreement on Trades in Services (GATS) provided a major boost to services exports and foreign insurance investment and created a framework for expanding liberalization in the future. While the 1997 commitments are valuable, U.S. insurers are ready to build on those commitments and work with U.S. negotiators to gain further access to those markets and improve regulatory conditions there through a new round.

Specifically, the U.S. insurance industry, including companies and trade associations representing its property and casualty, life, reinsurance, and brokerage sectors, have rallied behind a proposed "model schedule" that urges countries to make significant commitments as part of the current WTO services negotiations in the areas of transparency in insurance rule-making and in regulation itself. While many countries made historic market access commitments in the 1997 GATS, many regulatory or regulatory system hurdles remain in different countries that effectively act as barriers to competition for U.S.

insurance companies. The industry's transparency objectives seek commitments in the areas of adequate public comment periods, reasonable timetables for the consideration of license applications, sufficient and public explanations for rulemaking actions, and other basic transparency requirements that we too often take for granted in the U.S. but are surprisingly sparse in overseas markets. In the area of direct regulation overseas, U.S. insurers are seeking the abolition of government insurance monopolies, a guaranteed majority form of ownership, full national treatment for foreign insurers to ensure that they have equal treatment under the law relative to domestic insurers, and other equitable regulatory requirements that will permit them to compete on new product development and pricing.

On the bilateral front, the U.S. insurance industry has been strongly supportive of U.S. trade agreements to expand trade in all areas, including insurance, with countries that welcome foreign investment and trade. We are particularly supportive of the U.S. bilateral trade agreement with Vietnam and have lobbied for its passage in the Congress. Furthermore, we are encouraged by ongoing free trade negotiations with Chile and Singapore that we believe will result in new market-opening commitments from those governments for U.S. insurance products.

The insurance industry supports ongoing trade negotiations with other countries, both developed and undeveloped, as well, including the European Union, Japan and India. Each of these countries and regions has its own barriers to competition that we are trying to remedy through ongoing negotiations, and we work closely with our USTR negotiators in this regard. Certain barriers are severe enough to drastically limit foreign investment, such as India's restriction on foreigners owning more than 26 percent equity in joint ventures and Brazil's failure to privatize its state-run reinsurance monopoly and open its reinsurance market to competition. Others have tremendous historical and political ramifications, such as the Postal Service of Japan's significant market share in the domestic life insurance industry through its underwriting and distribution of over 20 separate insurance products. This heavy government involvement in the sale and distribution of private insurance products discourages private industry participation in the market, both foreign and domestic, and greatly limits its competitiveness.

Our recent market focus has been on developing countries that have long maintained less developed insurance systems but now appear to be committed to creating modern and competitive insurance sectors, including China, India and Vietnam. Based on the market-opening commitments China made in its 1999 accession agreement with the U.S. (and reaffirmed earlier this month), the industry was strongly supportive of Permanent Normal Trade Relations (PNTR) for China last year. We remain committed to Normal Trade Relations (NTR) for China this year when Congress votes on that measure to maintain its current trade status until China becomes a full WTO member. China's accession to the

WTO will not fully open China's insurance market to U.S. insurers, but it will open it significantly and allow many U.S. companies the opportunity to offer insurance products there for the first time.

Finally, AIA and its member companies, as well as others in the insurance industry, strongly support the enactment of Trade Promotion Authority (TPA). We believe the stronger the mandate the President has to enter into trade agreements, the more likely it is the U.S. will be able to negotiate agreements that provide greater benefits to the U.S. economy and consumers than would otherwise be the case.

All of these separate, ongoing trade issues involving many countries around the world ultimately address different market barriers and economic circumstances that are unique in each country, but our goal with each issue is the same: to further open each market so that U.S. insurers can fairly compete there.

CONCLUSION

Before I conclude, Mr. Chairman, I wanted to acknowledge the outstanding work of the U.S. Trade Representative's office and the Department of Commerce in promoting U.S. insurance exports and helping U.S. insurers gain greater market access throughout the world. Both agencies have been effective partners in our efforts to expand overseas and develop effective laws and regulations in these markets. The DOC's Office of Finance, which organizes important U.S. insurance technical assistance missions to key markets, including Vietnam, India and China, have helped us tremendously in establishing excellent dialogues with government officials there and opportunities to provide constructive input on improving the regulatory systems of many countries. Our USTR negotiators have worked diligently with us to understand and effectively advocate our key trade priorities that have resulted in meaningful market opportunities for our companies and consumers worldwide. We truly value our excellent relationships with both agencies.

Mr. Chairman, a healthy and productive global insurance infrastructure is vital to a prosperous, innovative and growing global economy. AIA, ACE INA and others in the insurance industry have been proud to play a role in expanding insurance sales abroad and, in the process, benefiting consumers, economies, and global living standards. We are excited about the new opportunities that we believe will further open markets to U.S. insurance products and look forward to working with you and all Members of the Subcommittee on the major policy and trade challenges of this year. Again, we appreciate having the opportunity to testify before you today to provide a brief glimpse of the U.S. insurance industry's trade-related activities and would be happy to answer any questions you may have.

Statement of

Thomas L. Farmer

General Counsel

Bankers' Association for Finance and Trade

Before the

Subcommittee on International Monetary Policy and Trade

Committee on Financial Services

United States House of Representatives

Washington, D.C.

June 26, 2001

Hearing on Trade in Financial Services – Current Issues and Future Developments

Mr. Chairman and Members of the Committee:

I am pleased to accept your invitation to present the views of the U.S. banking industry on the subject of "Trade in Financial Services."

I speak in my capacity as General Counsel of the Bankers' Association for Finance and Trade – known as BAFT – whose voting membership includes virtually all U.S. banks that are active in international finance. BAFT has been in continuous operation for the past 80 years and has, throughout that period, acted as the principal spokesman for the international operations of the U.S. banking industry.

When we speak of trade in financial services we refer to the ability for U.S. and non-U.S. financial institutions to deliver their services across national boundaries. That means access of foreign financial firms to the U.S. market as well as access of U.S. firms to foreign financial markets. Unfettered financial flows into and out of the U.S. are not only beneficial to the U.S. economy but also essential to its continued vitality.

In this connection let me stress that U.S. financial institutions occupy a preeminent place in global finance and are thus a unique national asset. There are many reasons for this preeminence, but let me mention a few:

1. First of all, the home market for U.S. financial firms is the largest and richest economy in the world.

2. For the past 50 years the dollar has been the strongest and the only truly global currency. In providing global clearing and payments services, U.S. banks have, as a result, advantages over foreign banks.
3. The U.S. capital markets are the deepest, most liquid, transparent and open capital markets in the world and provide a large interconnected structure for all types of financial institutions and financial instruments.
4. To a considerable extent, delivery of financial services means delivery of information. As a result, the most efficient financial service providers rely heavily on the IT industry. U.S. preeminence in information technology also benefits the competitive position of U.S. financial firms.

All of these factors contribute to the low cost and broad availability of capital to U.S. enterprises and thus constitute an essential element of the strength of the U.S. economy.

Furthermore, the ability of U.S. financial firms to market their services abroad helps to stimulate foreign economies and makes them better prospects for U.S. exports. Additionally, the strength and efficiency of U.S. financial firms has over a period of many years has assisted the U.S. balance of payments by providing a very substantial surplus on current trade account.

You asked that we address "The most important policy issues facing the financial services industry in relation to international trade." Undoubtedly number one in that category is to ensure that the U.S. government – whether it be the legislative or executive branches or the regulatory agencies-- is careful to avoid any measures that would curtail the openness or vitality of the U.S. capital markets thereby lessening the attractiveness of the U.S. for foreign lenders or investors.

The success of the U.S. capital markets has been the principal tool for U.S. official negotiators – the Treasury, USTR, the Department of State and the Board of Governors of the Federal Reserve System – in their efforts to persuade numerous countries to grant better access for U.S. financial services providers. What has loosely been called the Anglo-American model for financial services has in recent years gained adherents in other countries which constitute important markets for U.S. financial services. As a result, U.S. negotiators have met with considerable success in gaining access in recent years for U.S. banks in continental Europe, Japan, Mexico, Canada, Chile and Korea.

These successful market-openings have resulted from a blend of bilateral and multilateral negotiations. Since the U.S. had elected long ago to make its financial markets fully accessible to foreign financial services providers, promises of additional access to U.S. markets were not a tool for U.S. negotiators for obtaining additional opportunities in foreign markets for U.S. firms. Rather, it was the economic success of the open U.S. financial markets that provided the leverage for the U.S. negotiators. An outstanding example of this was Canada which, until recently, had firmly resisted repeated U.S. efforts to induce Canada to permit cross-border bank branching into Canada – even after the conclusion of the NAFTA agreement. Then, in 1995, the Canadian authorities concluded on their own that the Canadian capital markets were shrinking in large part due to Canadian restrictions on foreign bank activities. As a result, Canada in the 1997 GATS agreement undertook to authorize foreign banks to operate branches of their home office in Canada. This change was subsequently authorized by legislation passed by the Canadian Parliament.

Looking ahead one must conclude that the most significant remaining barriers to expanded U.S. bank operations abroad are not foreign governmental barriers on entry but weak local banking systems, poor regulatory regimes generally characterized by insufficient transparency, inadequate laws regarding bankruptcy and corporate governance and other weaknesses of the local legal system and, very importantly, underdeveloped accounting practices.

While these concerns relate mostly to countries outside of the G-7 groups they do affect some markets that are rapidly assuming major economic significance such as China, Russia, Eastern and Central European countries, India, Korea and other Asian and Latin American countries. Even if U.S. banks are authorized to operate in countries that are characterized by such deficiencies in their banking and regulatory structures, the risk for U.S. banks in such countries is disproportionately high and therefore makes such operations unattractive for U.S. and other foreign banks.

Therefore, our suggestion is that U.S. negotiators concentrate their efforts on persuading the relevant countries to improve their banking and regulatory and legal regimes and that the Congress encourage such efforts.

STATEMENT
BY

STEVE JUDGE
SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS
SECURITIES INDUSTRY ASSOCIATION

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

HEARING ON TRADE IN FINANCIAL SERVICES — CURRENT ISSUES AND FUTURE DEVELOPMENTS

June 26, 2001

Mr. Chairman and Members of the Subcommittee, my name is Steve Judge and I am senior vice president, government affairs, of the Securities Industry Association ("SIA")[1]. Thank you for giving me this opportunity to present the securities industry's views on trade issues that impact the financial services industry, particularly the securities industry.

The US capital markets are the deepest, most transparent and innovative in the world. The securities industry's unique functions — matching those who have capital with those who will use it productively, and advising clients and investors on how to manage their investments — are vital to world economic growth. It is critical that we continue to pursue access to all markets worldwide. Open and competitive financial services markets reduce financial transaction costs, increase the efficient allocation of resources, and enhance the competitiveness of U.S. firms. Barriers to entry and discriminatory treatment stifle the innovation and creativity of the securities industry, in turn harming the ability to provide the products and services our customers demand.

---

[1] The Securities Industry Association brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member-firms (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. The U.S. securities industry manages the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates approximately $270 billion in revenues yearly in the U.S. economy and employs more than 380,000 individuals.

The Financial Services Sector is a Catalyst for U.S. Economic Growth

The U.S. securities industry — with its unrivaled and innovative products and services — plays an integral part in powering the global economy. U.S. based securities firms are world leaders in raising capital, helping investors develop and manage their investments, and counseling companies in buying, selling, and forming strategic alliances with other businesses.

The U.S. financial services sector's continued strength depends on unfettered access to foreign markets. Whether firms are raising capital for a new business, extending credit for a corporate acquisition, managing savings for a retail customer, or supplying risk management tools to U.S. multinationals, this sector touches all aspects of the U.S. economy. In light of the financial service sector's unique role in the U.S. economy, its health is essential if the U.S. economy is to continue to show the rates of economic growth and job creation that it has over the last 10 years.

The U.S. financial services industry's strength is impressive. Financial services firms contributed more than $750 billion to U.S. Gross Domestic Product (GDP) in 1999, nearly eight percent of total GDP. More than six-million employees support the products and services these firms offer. The securities industry alone raised $17 trillion for U.S. businesses from 1990 to 2000 — an amount that far surpassed the total raised during the first two centuries of U.S. history. Perhaps most striking is how the securities industry has increased its relative importance to the U.S. economy. From 1980-1997, U.S. securities firms' contribution to total output of the U.S. economy increased by 8.4 times – three times the increase of the overall economy.[2]

It is important to underscore that financial services firms are also exporters. In 1999, financial services exports topped $20.5 billion, with a record trade surplus of $8.8 billion. Clearly the cutting edge services and products U.S. financial services firms offer are eagerly sought by foreign individuals, institutions and governments. The continued well being of this sector is directly linked to its ability to sell its products in foreign markets.

The reason for the U.S. financial services sector's increasing commitment to foreign markets is clear. Over the last decade, the U.S. economy and securities markets – while still the largest in absolute terms – have seen their share of the global pie shrink. Approximately 80 percent of the world's GDP and half of the world's equity and debt markets are located outside the U.S. Moreover, over 96 percent of the world's population resides outside the U.S., with India and China alone accounting for 2.3 billion people. Many of the best future growth opportunities lie in "non-U.S." markets. U.S. investors and corporations have already begun to tap these new markets. U.S. investors hold approximately

[2] U.S. Department of Commerce.

$2.5 trillion of foreign stocks and bonds, and U.S. corporations invested nearly $800 billion in the 1990s alone to acquire foreign corporations and to supplement their foreign operations. U.S. securities firms continue to expand their already substantial foreign operations in order to serve the existing and growing international focus of their U.S. and foreign clients.

Expanding Business Opportunities for U.S. Financial Services Firms

It is a long-established U.S. policy to promote economic growth through open financial services markets. Increased competition improves efficiency and provides consumers with the broadest range of products and services at the lowest cost. Many of our trading partners, though, continue to have barriers that keep foreign firms out of their markets, or prevent U.S. financial services firms from competing fairly upon gaining entry. Yet foreign firms have virtually unlimited access to the U.S. market.

SIA supports efforts to eliminate protectionist barriers, whether through the World Trade Organization (WTO) financial services negotiations or through bilateral and regional pacts. To continue to meet the credit and investment needs of issuers and investors in global markets, U.S. financial services firms must be allowed open and fair access to foreign markets. SIA's objective is to achieve substantial liberalization of financial services markets in developing and developed countries.

U.S. broker-dealers often find it difficult to enter or work effectively in foreign markets because of discriminatory, punitive, and costly barriers. Even when they successfully gain entrance into some foreign markets, they often experience unfair treatment in the form of high startup costs, nontransparent laws and regulations, and impediments to introducing innovative products. In other cases, the barriers may either limit the ability of U.S. investors to acquire local shares or restrict U.S. firms from underwriting and distributing securities.

Multilateral and bilateral trade agreements are effective tools for gaining access to closed markets. Such agreements aim for binding commitments from participants to remove specific barriers in their financial services markets so that U.S. firms gain tangible commercial benefits. The U.S., in turn, offers national treatment and full, immediate market access, guaranteeing foreign firms the ability to benefit from new opportunities arising from changes in U.S. law. The multilateral financial services agreement reached in 1997's WTO negotiations, for example, was a good first step toward reducing or eliminating many of the most egregious barriers that firms and their clients face in the 102 participating countries. It also guaranteed the current levels of access for foreign financial services firms in developed countries. We believe this provides an excellent platform upon which the current WTO financial services negotiations should build.

The economies of all the participating countries will reap the benefits of the WTO pact: increased competition, more choice, greater efficiency, a broader range of products and services, and lower costs. More work must be done during the current round of negotiations to achieve regulatory transparency and to expand cross-border activities, as described below.

WTO Financial Services Negotiations: What Needs To Be Done

SIA strongly supports the inclusion of financial services in the Year 2000 Round. We believe this offers a tremendous opportunity to build upon the 1997 WTO accord, which was laudable for being the first multilateral accord on financial services. Though that agreement did not achieve the elimination of a number of barriers which the securities industry sought, it did create a strong basis for further liberalization. Since 1997, many countries have recognized the value of open markets to their own economies and have voluntarily reduced barriers to entry and made great progress on national treatment in financial services. SIA's objectives for the upcoming round include convincing countries to turn those voluntary liberalizations into binding commitments and to build on those voluntary efforts to make additional binding commitments. As a result, as the negotiations progress, we will recommend that our U.S. negotiators reject deficient offers, such as those that codify only the legal status quo or that do not fully grandfather existing investments and operations.

In addition, SIA strongly believes that substantial liberalization of financial services markets in developing and developed countries can only be achieved if countries make strong commitments to improved regulatory transparency.

SIA has consulted closely with the Administration on its WTO financial services proposal, and we believe that it is strong and includes important language on regulatory transparency commitments. We look forward to working with the Congress and the Administration on making these proposals a reality. We believe the Administration's proposal will move us towards the securities industry's goals and objectives for the negotiations, which are based on the following core considerations:

1. Binding Commitments to Open Markets

In the 1997 Agreement, many of the commitments made were to "lock-in" current practice or then — current law. While some progress was made on efforts to reduce and eliminate existing barriers, much work remains to be done. For example, in the case of Malaysia, foreign ownership of local securities firms is limited to minority ownership. To meet the GATS goal of "Progressive Liberalization" (Appendix A) the Year 2000 Round negotiations must result in substantial binding commitments by countries to remove specific financial services barriers.

Unless specific barriers are lifted, the agreement will provide little tangible benefits to the U.S. Importantly, any agreement reached during the Year 2000 Round must grandfather existing investments and not create new restrictions. This is particularly important given that during the last two years, many countries have opened their markets beyond the commitments they made at the conclusion of the last Round. Current access must be made part of any final agreement.

2. *Freely Established Commercial Presence*

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

The ability to operate competitively through a wholly-owned commercial presence or other form of business ownership must be a fundamental element of an agreement. Non-residential financial services companies must be given every opportunity to establish a viable business presence outside their home country. Once established, companies in foreign markets should receive the same (i.e., national) treatment as domestic companies.

3. *Elimination of Investment and Equity Limitations*

U.S. institutional and retail investors hold nearly $1.2 trillion of foreign stocks. Increasingly, U.S. investors are acquiring securities from developing markets to diversify their holdings. U.S. investors, however, are often constrained by ceilings and limitations on the purchase of these securities, which artificially raise their costs. Additionally, these limitations also have costs to the local markets, reducing liquidity and increasing volatility. These restrictions should be reduced and, eventually, eliminated.

4. *Transparent Laws and Regulations*

In negotiating greater access for goods, reductions in tariffs provide a easily measurable way to reduce barriers to trade; i.e., tariffs on widgets can be reduced from 50 percent to 10 percent over a five-year period. Financial services firms, however, are confronted with non-tariff barriers. These barriers come in two forms – regulatory shortcomings and lack of transparency in the implementation and application of regulations – and prevent access in the same way as tariffs do. Unlike tariffs, however, no quantitative mechanism exists to reduce regulatory barriers.

During the last two years, SIA has undertaken a major effort to improve global regulatory transparency. We have met with and made presentations to representatives from APEC, the OECD, IMF, the WTO, and regulators in North America, Europe, Asia, and Latin America. Indeed, just earlier today, SIA spoke to members of the International Organization of Securities Commissions on the importance of transparency, and will give a major presentation to this international organization on Friday on the same issue. The securities industry has been a leading advocate on this issue, and we hope that the Congress will support this critically important effort.

In this regard, we would urge negotiators to work on provisions that would, *inter alia*, eliminate preferential access to regulatory proposals; require public availability of proposed regulations; provide an adequate public comment period on new regulations; and mandate the enforcement of regulations in a non-discriminatory manner.

From a business standpoint, ensuring a high level of transparency is as essential to a successful financial services agreement as tariff cuts are to an agreement on trade in goods. Lack of transparency in the implementation of laws and regulations – including limited public comment periods on proposed regulations, non-transparent approval mechanisms for firms and financial products, or other practices which are not dealt with pursuant to written regulations – can seriously impede the ability of securities firms to compete fairly.

Regulatory prohibitions also limit the ability of U.S. firms to compete in foreign markets. In some cases, the sale of specific products requires regulatory approval. In other instances, the ability to establish a commercial presence is impaired because of redundant restrictions on new licenses. Elimination of these barriers is complicated, especially when countries claim that the barriers are "prudential" in nature; that is, they exist to protect the safety of consumers and soundness of the marketplace. We believe, however, that many of these restrictions go beyond any legitimate prudential objective.

5. Reasonable Transition Periods

The securities industry understands that local financial services firms in developing markets will need time to adapt to new competitive pressures. In this regard, reasonable transition periods should be considered, with remaining restrictions progressively eliminated throughout the transition. The transition time frames, however, must be accompanied by an initial down payment that results in immediate liberalization. Permanent restrictions on market share, activities or geographical location are unacceptable. NAFTA's sector specific transition periods is a useful model to study.

6. Increased Cross-Border Access

The cross-border provision of financial services should be an important element of a WTO financial services agreement. Cross-border provisions should, for example, include the right to buy and sell financial products cross-border and the right to participate in and structure transactions. We believe this can be accomplished while addressing appropriate prudential concerns.

Bilateral and Regional Pacts

SIA is extremely supportive of Administration efforts to forge bilateral trade accords with Chile and Singapore and, on a regional scale, the Free Trade Area of the Americas. We believe that these trade agreements will be viewed as models for other upcoming negotiations, and therefore should result in quality, high-level, and forward-looking trade pacts.

These more targeted negotiations (as compared to those at the WTO) provide an opportunity to negotiate groundbreaking financial services agreements. Specifically, we believe that such bilateral and regional agreements should be negotiated using a "top-down" model. That is, the agreements should proceed from the premise that market access and national treatment should be guaranteed, except for narrowly-defined explicit exceptions that would be reduced and eventually eliminated at fixed future dates.

Trade Promotion Authority (TPA)

SIA supports Trade Promotion Authority for the President as an essential tool to negotiate good trade agreements. TPA gives the U.S. the ability to take a leadership role in trade liberalization. As Ambassador Zoellick noted in his recent testimony to the Senate Committee on Finance, "By leading, the United States adds to its ability to shape the future trading system. By leading, the United States is guiding the merger of regional integration within an open global system. By leading, the United States helps create models of liberalization that we can apply elsewhere. As a result, the United States can add to its leverage on behalf of America's farmers and ranchers, industries and service providers, workers and families."

European Privacy Directive

SIA has been actively seeking a declaration from the European Union (E.U.) that Title V of the Gramm/Leach/Bliley Act (GLBA), in combination with the Fair Credit Reporting Act (FCRA) and other US laws and rules, together with the robust enforcement regime that prevails in the United States, constitutes "adequate" protection for personal data handled by U.S. financial services sector for purposes of the E.U. Data Protection Directive. Moreover, especially because it is of particular concern to the EU, we note that the SEC, the securities self regulatory organizations (SROs) and the Federal Reserve have extensive authority to receive customer complaints about, and take action against, firms that fail to comply with the comprehensive federal regulatory scheme, or fail to fulfill their representations under the privacy policies which Title V mandates that they develop and regularly notify to their customers. Such a determination is critical for the financial services sector and, by guaranteeing the uninterrupted flow of data, will ensure continued investor and market confidence. We are well aware that the privacy debate in the United States continues to evolve, and that a U.S./E.U. agreement on adequacy will not preclude further developments in privacy law in either the US or Europe. An EU adequacy determination would, however, allow the US financial services industry to move forward in implementing compliance with the extensive legal regimes in place on both sides of the Atlantic, without the threat of costly and disruptive data stoppages.

Capital Markets Sanctions

SIA is increasingly concerned by the proposed use of the U.S. capital markets to achieve foreign policy goals. The U.S. capital markets are the preeminent in the world, attracting investors and companies from all over the world, and regularly serving as a safe haven in times of crisis. Denying access to U.S. capital markets is not an appropriate tool for addressing complex foreign policy issues. Doing so could seriously disrupt investor confidence – both domestic and foreign – in the U.S. markets, thereby jeopardizing their continued vibrancy. Moreover, in today's marketplace, issuers have access to capital on a global basis. If issuers are denied access to the U.S. markets through unilaterally imposed sanctions, they will simply find capital in other markets where U.S. firms are less likely to be competitive.

Capital markets sanctions will have the unintended effect of redirecting business out of the U.S. In this highly competitive, global environment there are few products and services for which the U.S. is the sole supplier. Closing the U.S. capital markets to influence the behavior of foreign countries sets a poor policy precedent which might easily provoke other countries to pursue their own foreign policy objectives through a similar mechanism. In sum, we believe it is a mistake to unilaterally try to resolve complex foreign policy issues through an untested formula that would greatly impair the U.S. capital markets.

America's capital markets played an enormous role in fueling the record U.S. economic expansion, and are unrivaled in their depth and liquidity. These attributes, however, should not be taken for granted. The continued health of these markets is dependent on economic and political certainty and predictability. The historic U.S. commitment to open and fair markets has been fundamental to these developments. Moreover, the economic and political certainty provided by the U.S. capital markets has been a key component of the U.S. financial service sector's ability to nurture and establish a substantial foreign client base. Supported by foreign business opportunities, the U.S. financial services sector accounts for nearly 8 percent of U.S. GDP and employs nearly six million Americans.

Legislation limiting, or eliminating access, could easily erode the certainty and predictability that has been the hallmark of the U.S. capital markets.

Conclusion

As world leaders in providing innovative products and services, U.S. financial services firms are essential to the international competitiveness of the U.S. economy. Access to foreign markets is more important than ever as our customer base continues to invest and establish operations in foreign markets. U.S. employment and economic output depend on open markets and the free flow of capital worldwide.

Congressional leadership will be a critical factor in deciding the framework for ongoing negotiations within the WTO and other upcoming market opening trade accords. SIA stands ready to work with policymakers as an active participant in these important trade issues.

Sam Johnson
★ U.S. CONGRESS ★

July 12, 2001

Mr. Steve Judge
Securities Industry Association PAC
1401 Eye St., NW
Suite 1000
Washington, DC 20005-2225

Dear Steve,

I want to thank you for your generous contribution. I appreciate your support and your confidence in me to represent you in Washington.

While we still have a tremendous amount of work to accomplish, I know we will be successful in promoting our conservative agenda. With a majority in the Congress and George W. Bush as President, our hopes of passing our agenda looks good. However, we must continue to work to reclaim the Senate in 2002.

Thank you again for your contribution. I hope you will call my office if there is anything I can do in the future.

Sincerely,

Sam

Sam Johnson
Member of Congress

Mail To:
P.O. Box 860096
Plano, Texas 75086-0096

972-424-9573
FAX: 972-422-4797
Paid for by Friends of Sam Johnson

1912 Ave K
Suite 104
Plano, Texas 75074

CENTER FOR ECONOMIC AND POLICY RESEARCH

"Trade in Financial Services—Current Issues and Future Developments"

Testimony of Mark Weisbrot
Co-Director of the Center for Economic and Policy Research

before the

Subcommittee on International Monetary Policy and Trade
of the
House Committee on Financial Services

June 26, 2001

1015 18th Street, N.W., Suite 200 ❖ Washington, D.C. 20036 ❖ Phone (202) 293-5380
Fax (202) 822-1199 ❖ cepr@cepr.net ❖ http://www.cepr.net

Testimony of Mark Weisbrot
Co-Director, Center for Economic and Policy Research
June 26, 2001

I would like to thank Chairman Bereuter and the Committee for this opportunity to testify today on the subject of expanding our trade in financial services. The Center for Economic and Policy Research is a non-profit, non-partisan policy institute that seeks to expand public debate on issues -- mostly economic issues -- that are too often seen as the province of experts, from which the majority of people are therefore excluded. I will focus my remarks on the public interest in the agreements by which the liberalization of trade in financial services is being pursued: the Free Trade Agreement of the Americas, the General Agreement on Trade in Services (GATS), NAFTA -- and legislation, such as Trade Promotion Authority.

While it is clear that there are some gains to be made by US financial firms and banks from the liberalization of trade in financial services, we must weigh these gains against the costs of entering into and expanding the international agreements by which such liberalization is achieved. We must also consider the costs and risks associated with liberalization and deregulation, some of which only become apparent after the fact -- as in our own Savings and Loan deregulation in the 1980s. When these costs and risks are weighed against the potential benefits of liberalizing trade in financial services, it seems that the best course of action would be to avoid further expansion until our foreign commercial policy is fundamentally transformed.

On the benefit side, it is argued that the expansion of trade in financial services can help to reduce our trade deficit. This is certainly a worthy goal. The United States is presently running a current account deficit of $450 billion annually, or approximately 4.5 percent of GDP. From an economic standpoint, this is at least as serious a problem as running a Federal budget deficit of the same magnitude -- probably worse, since the debt accumulated as a result of these current account deficits is owed to people and institutions outside the country. This foreign debt, near the highest in the industrialized world at almost 20 percent of GDP, is a burden on future generations of Americans. It is growing at a rate that is clearly unsustainable by any economic measure. At current growth rates, our foreign debt will reach 50 percent of GDP in less than seven years.

Nonetheless, we should be wary of promises that expanding our trade through agreements such as NAFTA, the proposed FTAA, or the WTO will reduce our trade deficit. The proponents of NAFTA, including a number of reputable economists, made this argument back in 1993, promising that a continued expansion of our trade would create a net gain of hundreds of thousands of jobs here. In fact the opposite happened -- our trade deficit with the NAFTA countries went $16.6 billion in 1993, to $62.8 billion in 2000 (in constant 1992 dollars), and our overall current account deficit has ballooned to its present record of $450 billion.

The expansion of trade in financial services should therefore not be considered outside of the agreements in which it is embedded. But even if we were to consider financial services in isolation, the potential benefits are limited. The argument for expansion is based on the fact that the United States is running a trade surplus in this area, and -- in contrast to most other areas of trade -- exports have expanded more rapidly than imports, as trade in financial services has grown. While this is true, our net exports of financial services currently total about $8.8 billion. Even if this were to double in the next few years, the increase would only reduce our current account deficit by about 2 percent.

The Committee has asked whether it would be advisable, as part of the process of expanding trade in financial services, to ease the restrictions on foreign companies that wish to sell securities in US markets. It would seem that we currently have considerable problems regulating our own securities markets as they now stand, in the wake of the recent collapse in technology stocks. Companies used a variety of accounting tricks to inflate their revenues at the peak of the bubble. According to Fortune magazine, for example, Priceline.com would report as revenue the full value of airplane tickets and hotel rooms it had booked, although travel agencies do not normally do this, since they keep only a small fraction of these funds.[1] Priceline is now trading at 18 percent of its peak value, and the collapse of tech stocks since March 2000 has forced millions of Americans to change or postpone their retirement plans. In many cases the large financial firms encouraged small investors to put their retirement savings in stocks, telling them (wrongly) that they could not lose if they were holding stocks "for the long haul." Before we further open our securities markets to foreign firms, we might want to get our own house in better order, so that we can have the proper regulation to protect the millions of small investors who have placed much of their retirement savings in the stock market.

The de-regulation of financial services entails other risks, as we saw just a few years ago in the Asian financial crisis. As a number of prominent economists have argued -- including such high profile advocates of expanding trade as Jeffrey Sachs[2] of Harvard, Columbia University's Jagdish Bhagwati,[3] and also former World Bank Chief Economist Joseph Stiglitz -- this crisis was largely brought on by the opening up of financial markets of countries such as South Korea and Indonesia. This resulted in a huge influx of short-term foreign lending, which subsequently rushed out even faster-- a reversal of capital flows within a year of about 11 percent of the GDP of South Korea, Indonesia, Thailand, the Philippines, and Malaysia. The result was a collapse of currencies, credit, and ultimately the economies of the region. This also had a "blowback" effect on our own economy, as thousands of steel workers lost their jobs, and agricultural producers in the United States were also hard hit by Asian crisis.

The agreements for international deregulation of financial services, such as the General Agreement on Trade in Services, cover a broad range of services, and could seriously erode the ability of governments to regulate much of commerce in the public interest. For example, Article VI:4 of the GATS "calls for the development of any "necessary disciplines" to ensure that 'measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade.'[4] This is a general problem with all of these agreements: the attempt to subordinate the larger national and public interest to commercial interests, and to the interests of particular corporations.

For these reasons it is especially important that the Committee consider the expansion of trade in financial services in conjunction with the larger agreements -- NAFTA, the proposed FTAA and the WTO -- of which this expansion is a part. When one looks carefully at the impact of these agreements, it is clear that they are misnamed: their most important impacts have little to

[1] See Jeremy Kahn, "Presto Chango! Sales are Huge!" Fortune, March 20, 2000.
[2] See, e.g., Radelet, Steven and Jeffrey Sachs. "The Onset of the East Asian Financial Crisis. " Harvard Institute for International Development, March 30, 1998; and Radelet, Steven and Jeffrey Sachs. "The East Asian Financial Crisis: Diagnosis, Remedies, Prospects. " Harvard Institute for International Development, April 20, 1998
[3] Jagdish Bhagwati, "The Capital Myth: The Difference Between Trade in Widgets and Dollars," Foreign Affairs 77:3 (May/June 1998)
[4] See Scott Sinclair, "GATS: How the WTO's New Services Negotiations Threaten Democracy" 2000: Canadian Centre for Policy Alternatives

do with trade. One of the most damaging parts of NAFTA was its creation of the "investor-to-state dispute resolution" mechanism, whereby foreign investors were given the right to sue governments for regulatory actions that infringe upon their ability to make a profit. This has turned out to be an enormous threat to environmental regulation, and one that could never have passed Congress if it were known to the public.

Consider the complaint brought under NAFTA's Chapter 11 by the Ethyl corporation. In 1997, the Canadian government banned the import of MMT, a gasoline additive made from manganese that is not used in the United States. There is no doubt that this action was taken for the purpose of environmental health and safety, mainly from fears of MMT as a potential neurotoxin, especially for children.

Under the threat of losing a $250 million lawsuit, the Canadian government repealed the legislation banning MMT and paid the corporation $13 million in damages. There are a now a number of similar cases pending, including a $970 million claim by Canada's Methanex corporation against the state of California over another banned gasoline additive, Methyl Tertiary-Butyl Ether (MTBE). Because it is highly water soluble, a known animal carcinogen and possible human carcinogen, and very costly and difficult to clean up, it is seen as a major threat to groundwater. In California, more than 10,000 groundwater sites have already been contaminated by MTBE.

Our government now wants to extend this power to foreign investors from 33 countries in the Free Trade Area of the Americas. As is usual with these agreements, they are negotiated in secret: although a committee made up primarily of corporate CEO's and other business people with particular interests in the agreement is allowed to see the drafts, they are not available to the press or to the public.

The authority of Congress to approve these agreements has also been usurped by the "fast-track" procedure, now renamed as "Trade Promotion Authority." It is often argued that the United States cannot negotiate these agreements without granting this authority to the executive branch, but this does not appear to be true. From 1994-97 the US negotiated a wide-sweeping agreement within the 29-nation OECD called the Multilateral Agreement on Investment (MAI). The agreement ultimately collapsed in the face of a campaign against it by over 600 NGOs, for many of the reasons discussed here. But there was no evidence that the United States negotiators ran into any trouble for their lack of "fast-track" authority.

It is for good reason that the US Constitution confers upon the legislative branch the authority "to regulate Commerce with foreign nations."[5] It is only in the last couple of decades that this power has been transferred to the executive, and during this time the scope of our international agreements has also expanded exponentially to subordinate the environment, public health, and a host of other regulatory issues to the expansion of trade. The loss to the public has been great.

Last but not least, it is worth briefly looking at what the expansion of commerce, through agreements and arrangements that do not take into account the public interest, has brought to the average citizen both at home and abroad. In the United States, the median real wage today is currently the same, in terms of its purchasing power, as it was 27 years ago. This one statistic tells a very big story. *Median*: that means the 50th percentile, i.e., half of the entire labor force is

[5] Article II, section 8.

at or below that wage. This includes office workers, supervisors, everyone working for a wage or salary—not just textile workers or people in industries that are hard hit by import competition or runaway shops. *Real*: that means adjusted for inflation, and quality changes. It is not acceptable to argue, as is often done, that the typical household now has a microwave and a VCR. That has already been taken into account in calculating the real wage.

This means that over the last 27 years, the typical wage or salary earner has not shared in the gains from economic growth. Now compare this result to the previous 27 years (1946-1973), in which foreign trade and investment formed a much smaller part of the US economy, and was more restricted. During this time, the typical wage increased by about 80 percent.

It must be emphasized that these statistics are not in dispute among economists. Their validity is also verified by the experience of most people who are old enough to have lived through the first half of the post-World-War II era. In the sixties and seventies, it was not uncommon for an average wage earner to buy a home and support a family with one income, and even put their children through college. This is no longer true.

There are differences among economists as to how much of the typical employee's misfortune has been due to globalization. But few would deny that it is a significant factor. William Cline, a staunchly pro-globalization expert in this area, has estimated that 39 percent of the increase in wage inequality from 1973-93 has resulted from increased trade.[6] (This does not include the effect of increasing international investment, which has also put downward pressure on wages.) Other estimates have been smaller, but they still are enormous when we compare them, for example, to the measured gains from increasing trade.

Increased opening to international trade and capital flows, in the manner that has been pursued over the last two decades, has not seemed to help most people in the poorer countries of the world. During the last 20 years, the economies of Latin America have grown by only 7 percent per person, for the whole period (1980-2000). By contrast, in the previous 20 years (1960-1980), per capita growth was 75 percent.[7] There has been a slowdown in growth during the era globalization throughout most of the low to middle income countries of the world, with the poorest nations suffering the worst declines. In addition, and partly as a result of this growth slowdown, there has also been reduced progress in life expectancy, infant and child mortality, education, and other social indicators over the last two decades.[8]

For all of these reasons, until we can ensure that the majority of people can share in the benefits from increasing international trade and commerce, and ensure that we do not compromise the ability of our governments to regulate these activities, as well as their ability to protect the environment and public health, we should not seek to expand these agreements through the proposed FTAA, Trade Promotion Authority, or continued negotiations to expand the General Agreement on Trade in Services (GATS).

---

[6] Cline, William R. 1997. *Trade and Income Distribution*. Washington, DC: Institute for International Economics, November.

[7] See Weisbrot, et al, "The Emperor Has No Growth: Declining Economic Growth Rates in the Era of Globalization," Center for Economic and Policy Research, May 2001.

[8] See Weisbrot et al, "The Scorecard on Globalization: 20 Years of Diminished Progress," CEPR, June 2001