Testimony of

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before the

U.S. Trade Deficit Reduction Commission

March 13, 2000

Mr. Chairman and members of the Commission, thank you for the opportunity to present my views to you on the important issue of the U.S. trade deficit. This is a matter that I think is not well understood, so I commend you for your efforts to bring about better public recognition of both its causes and effects, as well as realistic and practical ways to address problems associated with the trade deficit.

If I may, I would first like to provide some general background on the economic sector in which my firm - American International Group - operates. As with the trade deficit, the role of the services sector in our economy is not well understood. But I believe it needs to be since it comprises nearly 80 per cent of our gross domestic product and is a positive contributor to our trade balance.

The Role of Services in the U.S. Economy

Mr. Chairman, over the last decade the role of services in the U.S. economy has grown dramatically. According to the most recent data from the Bureau of Economic Analysis at the U.S. Department of Commerce, services comprise 77.2 per cent of our national GDP. This compares to 19.3 percent for manufacturing and 3.5 percent for mining and agriculture. Contrary to popular misconception, the services sector does not consist principally of hamburger flippers. The service sector consists of distribution, education and financial services (including insurance), intellectual property-related services, telecommunications, travel services and a broad range of business, professional and technical services. Increasingly, the sector is home to extraordinarily dynamic information technology and other knowledge based industries. Clearly we are talking about the cream of America's commercial output and areas where we are most competitive around the world. Employment by these businesses provides jobs for over 98 million Americans.

The U.S. is the world leader in many of these industries, and they make a substantial positive contribution to America's trade balance. In 1999, exports of U.S. services were over $276 billion and enjoyed a net trade surplus of $76 billion. Much of this surplus was contributed by earnings from U.S. investments overseas. In contrast to our services surplus, our trade balance in goods was a deficit of over $248 billion. The surplus in services helps prevent our current account deficit from being much larger. Yet services is a relatively small part of our overall trade volume, only about 22 percent. It seems clear that we need to substantially increase the volume of services in our overall trade mix if we are going to reduce our trade deficit.

<u>International Rules for Trade in Services</u>

Freer trade in services will play a vital role in the shape of a globalized economy. The issues are many. I cannot address them all. Instead, allow me to spend a minute addressing the current international environment that governs trade in services. In 1995, when the World Trade Organization (WTO) was created, a component of the WTO called the General Agreement on Trade in Services (GATS) was also established. All members of the WTO are parties to the GATS, which consists of general commitments such as transparency and non-discrimination. In addition, countries may undertake more specific commitments to liberalize their markets related to individual service sectors such as financial services, telecommunications or accounting. In fact, separate negotiations on financial services, including insurance, were concluded in 1995 and again in 1997. We believe some useful commitments were achieved in these negotiations, but that frankly much more remains to be done.

In addition to this multilateral framework, the US. has negotiated various bilateral agreements in services, including several agreements on insurance with Japan. While much effort has been employed in negotiating and enforcing these agreements, the results in terms of improved market access for U.S. insurers is mixed.

Problems, Opportunities and Challenges

The framework governing trade in services is incomplete. In many regards, current rules do not meaningfully address the kinds of barriers that American financial companies - insurance companies, banks, securities firms and others - face in nearly every comer of the world. Let me identify some of the major problems we face in attempting to operate abroad:

- Equity limits: It is common for American financial services companies to be limited in the amount of ownership they can hold in a foreign market. At times, no foreign ownership is permitted. For example, until recently, India prohibited private insurance firms from operating at all. The government has now agreed to permit private firms, but will limit foreign ownership to 26 percent. We should be able to establish operations in foreign markets with the same freedom as local companies.

- Capitalization: U.S. firms are sometimes required *to* capitalize financial operations at levels in excess of that which is economically justified, or at levels higher than that of local companies.
- Limitations on product or geographic operation: In certain cases, U.S. firms are not permitted to conduct business in the same products or the same locations as local companies. We should be able to operate on the same non-discriminatory basis as local firms.
- Lack of transparency in regulatory decisions: Regulations are often applied in an uneven manner. Local firms may have products approved for sale faster then U.S. or foreign firms. Enforcement of solvency requirements may be more rigorously applied to foreign firms than to local ones.
- Protection for existing investments: In many countries, American firms have operated for years, but with no guarantee of protection. Any trade rules must begin by "grandfathering" these existing investments, and build a framework to encourage new investments.

Mr. Chairman, these are but a few examples. Rather than providing an exhaustive list in my testimony, I have attached a letter written to U.S. Trade Representative Charlene Barshefsky and Secretary of Commerce William Daley prior to the Seattle WTO Ministerial meeting. This letter provides a fairly comprehensive list of the objectives that U.S. service industries seek from the next WTO round in order to be maximally competitive in overseas markets, and to bring about the greatest benefits to the U.S. economy and our citizens. I would note, Mr. Chairman, that many of these objectives are shared by some of our leading trading partners. We have worked closely with our colleagues in Europe and elsewhere to build support for these goals. Frankly, unless we get other countries to understand these goals, and how they support the development objectives of many developing countries, we are not likely to be successful at gaining agreement on them.

Where Do We Go From Here?

Mr. Chairman, allow me to offer a couple of suggestions for the Commission's consideration. Regarding the improvement of rules, future negotiations - either bilaterally or multilaterally under the GATS - should seek the following:

- Grandfather all existing investments and commit to making current regulations no more restrictive than at present.
- Establish a framework for liberalization that provides maximum liberalization up front and phases out remaining restrictions over a short and fixed timeline.
- Ensure that regulations do not micro-manage the marketplace but are "pro-competitive" in order to promote innovation and price competition to benefit both businesses and consumers.
- Provide reciprocity. The United States is not free of market barriers. We must be prepared to relax these in return for improved conditions of entry into foreign markets.

Regarding regulation., I would add that the U.S. financial services sector understands perhaps better than most the importance of a sound regulatory environment. After all, if regulators do not ensure that solvency margins or other prudential measures are enforced, and local financial markets collapse, it is often the soundly-managed American firms that are made to pick up more than our fair share of the financial mess that results. Accordingly, we are committed to assisting countries as they build modem regulatory regimes by providing technical assistance and training. We believe it is important for the U.S. government and international financial institutions to continue their efforts in this regard as well. More basically, we believe that the participation by American financial firms in the economies of developing countries significantly contributes to the growth of those economies, which in turn raises their standard of living and enables them to purchase more from the U.S. The list of benefits to local economies is long, and includes management skills, product diversity, risk management, distribution and marketing innovations, technological capabilities, capital accumulation and job creation, to name but a few. It is a synergistic relationship - the local economy benefits, and so does the U.S. trade balance.

Before closing, permit me to make a point, which I draw from my experience with the emerging U.S. -- Indian economic relationship. Knowledge based trade -- information technology, biotechnology -- will grow in size and importance in the years ahead until it becomes the most important commodity in the marketplace. Its handmaiden, e-commerce, which ensures the distribution of knowledge based and normal trade items, is also a rising international force. It is essential that the United States consider the needs of these sectors, define liberal trade policies and work now for an open world trading regime in knowledge based products. With our technological edge, our privileged access to capital markets and our head start in many knowledge based industries and in e-commerce, the United States stands to profit greatly. Not taking adequate action now and allowing trade barriers to arise will make our task in the future years more complex and deprive us of the full benefits to our export economy.

Conclusion

I would sum up by saying that the U.S. financial industry faces numerous hurdles to operating abroad. The elimination of these barriers and the establishment of clear, enforceable rules are largely jobs for our government. However, if these hurdles are removed and good rules are negotiated, the competitive characteristics of our industry means we will contribute more to America's economic growth, and most important to your task -- reducing our trade deficit.

Allow me to conclude by referring to a statement by Dr. Catherine L. Mann, in a recent study for the Institute for International Economics. Dr. Mann indicated that "...as income in a foreign country grows, its imports of U.S. services tend to rise disproportionately. Successful broad-based negotiations on trade in services will likely increase U.S . exports of services even further, with a positive effect on the trade deficit. The long-term trajectory of the U.S. external balances could be altered significantly by the combination of successful service-sector negotiations and broad-based liberalization and deregulation at home and especially abroad. These together would unleash higher productivity and faster growth at home and abroad, which would narrow the U.S. current account deficit."

Mr. Chairman and members of **the** Commission, I **thank** you for this opportunity to testify and would be **pleased** to respond to any questions you **might** have.

INDUSTRY SECTOR ADVISORY COMMITTEE
ON SERVICES FOR TRADE POLICY MATTERS
ISAC 13

November 19, 1999

The Honorable William M. Daley
Secretary of Commerce
14th Street & Constitution Avenue
Washington, D.C. 20230

Ambassador Charlene Barshefsky
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, DC. 20508

Dear Mr. Secretary and Madame Ambassador:

The members of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13) met on November 10, 1999 to formulate its recommendations for the Seattle Ministerial and the Services 2000 negotiations. These recommendations relate to cross-cutting issues, as well as to sectoral issues.

The Committee believes that the Seattle Ministerial Declaration must give an unqualified, strong impetus to the start of services negotiations in January 2000.. It believes that the inclusion of benchmarks, or a timetable for these negotiations in the Declaration itself is useful, and urges the U.S. Trade Representative to insist on their inclusion.

The Committee believes that negotiations on services in the WTO present governments with the opportunity to Liberalize trade in services by committing themselves to reducing barreirs to market entry in all modes of supply and to reform domestic regulations that hinder fair and open markets. The WTO negotiations on services should be used to achieve an open, competitive market in every services sector in every WTO member country.

Services trade liberalization is in the interest of all WTO members. The liberalization of services markets enhances economic growth, and helps provide developing countries with essential infrastructure to speed their modernization. It provides increased choice and opportunities for consumers of the broadest range of products and services at the lowest cost

It is particularly important for the United States. We are the world's most competitive supplier of traded services. Successful multilateral trade negotiations in services can materially improve our export performance and progressively offset our persistent trade deficit in goods.

For the United States to achieve its goals in services, however, its negotiators must be able to offer concessions. As U.S. services markets are essentially open to foreign competition, there are, with the exception of mobility of business personnel, few concessions in services that we are able to offer. Thus we urge you not to rule out the negotiation of issues that foreign governments express interest in negotiating.

To achieve these objectives, we urge US negotiators to:

- implement and enforce all GATS commitments and in particular the services agreements already negotiated. All WTO members should undertake and implement commitments to open markets for the supply of telecommunication services and adopt the regulatory principles of the reference paper. All signatories of the Financial Services Agreement should ratify and implement their commitments under that agreement.

- Secure binding commitments in as many sectors as possible for market access and national treatment.

- Seek to use innovative, time-saving negotiation techniques to obtain market opening commitments including horizontal commitments, agreement on models for sectoral liberalization, as well as the traditional "request/offer" technique.

- In reviewing MFN exemptions, countries should exclude only the most sensitive issues from liberalization.

- The Declaration should provide that the negotiation should conclude in three years.

With regard to regulatory issues, we urge that:

- Horizontal disciplines for domestic regulation that result in transparent and predictable regulatory institutions and outcomes, and the imposition of the least burdensome or least trade restrictive rules based on objective criteria, be developed under Article VI of the GATS.

- On a sector by sector basis where appropriate, regulatory principles that promote competition and open and efficient markets be developed..

- USTR & the Department of Commerce should work with state and local regulatory agencies to educate them of the benefits of allowing access to the U.S. market by foreign service providers, particularly professional service providers.

With regard to electronic commerce issues, we believe that:

- Unrestricted commitments on cross-border supply of services (mode 1) and consumption of services abroad (mode 2) should be obtained in order to expand electronic commerce.

- Unnecessary restrictions on the ability of U.S. firms established in a market to supply services electronically in that country under both existing and future commitments on commercial presence, should be removed.

- Delivery of services via the Internet is covered by existing GATS commitments, unless specified otberwise.

- The moratorium on customs duties on electronic transmissions should be extended indefinitely with a view to making it permanent.

- WTO trade negotiations should not be used to attempt to establish carveouts for the regulation of internet service providers or of internet services including access and fee structures.

- The WTO work program on electronic commerce should be re-established.

With regard to labor mobility (mode 4), we recommend:

- That the temporary movement of key business personnel should be a priority agenda item for the 2000 round.

- A precise definition of "key business personnel," including those with technical and managerial skills, should be agreed by the WTO.

- Governments should make their regulatory regimes governing movement of key business personnel transparent; each signatory should publish a simple explanation of its visa and work permit requirements and should publish annually statistics showing the numbers of temporary working visas granted and available to be granted.

- There is an urgent need for the establishment of expedited procedures for short-term transfers of personnel.

Finally, we believe that:

- Governments, international organizations, and industry organizations should extend technical assistance to developing countries to enable their participation in services negotiations.

- The Ministerial Declaration should include an agreement that transparent procedures should apply to public procurement.

- The classification of services should be reformulated where necessary to describe accurately the structure of service industries.

- And the transparency and openness of the WTO should be improved, including access to WTO proceedings, documents and decisions on a timely basis.

SECTORAL ISSUES

The 2000 round of services negotiations is the first opportunity to include virtually all service sectors in liberalization negotiations, and to apply the lessons learned since the Uruguary Round on how to negotiate in the complex services field. Because it is a comprehensive negotiation, it gives us the opportunity to negotiate in new areas such as energy services, express delivery services, health and legal services, and aspects of financial services, such as pensions and financial security products.

Summarized below are some key objectives for liberalization in a number of sectors:

Insurance

Governments should pursue full market access and national treatment commitments from all WTO members, according to the GATS Understanding on Financial Services, as well as additional commitments that result in a pro-competitive market environment for foreign insurers in those markets. Insurance underwriters, intermediaries, reinsurance providers and others believe it is critical for the WTO to address issues that relate to the restrictive nature of insurance regulation in many markets. Insurers do not dispute the necessary role of regulation. They focus on developing regulation that promotes competition. Key elements of such regulatory reform include:

Full market access and freedom of form of establishment an operations;

National treatment for foreign insurance providers and intermediaries;

Transparent legal, administrative and regulatory environments;

Focus on solvency and prudential standards, not micro-management of price and form;

- Freedom to introduce new products and services;

- Stan&till on new restrictions and grandfathering of existing investments;

- Cross-border trade and free access to international reinsurance markets.

Financial Services

Although a good first step, the 1997 financial services annex to the GATS did not eliminate all barriers to international trade in financial services. The next services negotiations should **attempt** to achieve important new liberalization commitments including all financial services products and many more countries, with special regard to the opportunities offered by electronic commerce. WTO members should seize the opportunity offered by the new round to unleash the positive force of electronic delivery of financial services.

- More countries should make commitments in financial services and financial information, and existing commitments should be expanded to cover more services and more modes of supply. Existing exemptions should be reduced or eliminated.

- More countries should commit to unrestricted flows of financial information.

- The relationship between telecommunications liberalization and electronic trade in financial services must be recognized.

- In telecommunications, existing commitments need to be implemented, more countries need to make commitements, and discriminatory tariffs should be eliminated. Additional commitments co greater unbundling by communication providers should be made. There should be more specificity on reasonable rates for leased lines, and affirmation that existing commitments apply to iutemet access.

- Internet providers should not be regulated as common carriers.

- WTO members should reaffirm that existing commitments are technology-neutral and that financial service providers may use any protocol, including *the* Internet to supply a service.

- A common legal infrastructure of certification, disclosure, payment and privacy standards is also important; until such infrastructure is developed, national regulators should forebear in the imposition of *new* regulatory barriers to cross-border financial services.

- WTO members should recognize that national-based regulation of items such as safety and soundness and consumer protection measures can become barriers to cross-border provision of financial servioces. Review of best practices, harmonization of regulatory standards, mutual recognition of regulatory regimes, and recognition of the greater sophistication of wholesale customers as compared to retail customers would help reduce these barriers.

- WTO members should therefore evaluate how well their regulation of financial services providers advances the goals of competition, fairness, and transparency.

Financial Services: Pensions

The global problem of aging populations will be a major challenge to most WTO members goverments in the next century. The WTO can help member nations cope with this problem by incorporating pension products and services and management of pension assets.

- WTO classifications should be improved to cover the provision of pension products and services as well as efficient management of pension assets.

- WTO members should schedule phase-in plans and market access improvements consistent with the pension reform recommendations of the World Bank and Organization for Economic Cooperation and Development.

Energy Services

The WTO Ministerial should increase substantially global market access opportunities for energy services providers through all appropriate modalities in the new round of negotiations.

- Clarification of the application of existing GATS commitments to certain energy services, the extension of existing **GATS commitments to other energy services,** and the development of new disciplines as necessary to ensure meaningful market access commitments, including an open regulatory environment that covers such areas as interconnection guarantees and transparent, non-discriminatory licensing procedures, should be the goal of negotiations in this sector.

Air Cargo and Express Delivery Services

Air cargo and express delivery operators are key players in ensuring the development of global commerce, especially electronic commerce. The globalization of the manufacturing process and the growth of e-commerce have created a need for a globally integrated air cargo network. Further multilateral liberalization in the air cargo sector, and particularly with respect to the services provided by integrated cargo carriers, is urgently needed and should be a priority of governments.

- Air transport services should continue to be treated separately under the GATS Aviation Annex. The required review of the annex should focus on the best way to liberalize that sector.

- Cargo service providers and shippers worldwide would benefit from an open international air cargo market, and also an open regime for express delivery services.

- Express delivery services should be a negotiating priority for the next round of WTO negotiations.

- Express delivery services should be adequately classified.

- Express services, with the exception of air transport services, should be treated as a separate new sector under GATS.

Telecommunications

Countries that have committed to full liberalization in the WTO should implement those commitments in **their entirely, including the** terms of the Reference Paper.

- **Countries** that have committed to partial **liberalization** should expand their commitments to include full liberal&ion and adoption of the pro-competitive principles **contained in the** Reference Paper, and accelerate the implementation **if prior** commitments are scheduled to implemented in the future.

- Countries **that** are WTO members but **have not made commitments** under the Basic Telecommunications Agreement should schedule **full commitments by a date certain in the near future.**

Information Technology Services

Information technology is an enabling service that improves the overall efficiency and competitiveness of economies. Although it was not particularly controversial during the Uruguay Round, a number of countries made no or few commitments in this sector.

- Negotiators should aggressively pursue commitments **from** all countries in all modes of supply **in** computer and related services,

- Classification **of** services should be both refined and expanded for computer and related services.

Accountancy

Accountancy **needs** to be a genuinely global profession in order to serve the world's capital markets and **to** support economic development.

- **WTO** members should increase the number of bilateral mutual recognition agreements between WTO Members following the **Guidelines** for Mutual Recognition agreements or Arrangements in the **Accountancy Sector,**

- **WTO** members should improve commitments for **accountancy services and further** develop the Disciplines on Domestic Regulation **in the** Accountancy Sector in accordance with the requirements of GATS article **VI:4.**

Legal Services

Trade in legal services is growing in response to demand, but is impeded by a panoply of restrictions in the form of national laws, regulations and professional rules.

- WTO members should establish **a framework** within which the national regulation of the legal profession continues, without unnecessarily **restricting** the ability of non-national legal service providers to offer their services.

- This **framework** should allow consumers to obtain the services they need on a non-discriminatory basis.

Entertainment

Entertainment and media services are an important trade strength for the United States. The U.S. must continue to press hard for liberalization commitments in this sector.

- The services classification list must be revised to better describe the range of service industries that are relevant to bade in audiovisual services.

- Negotiators should seek to open global markets to trade in audiovisual services while at the same time taking care to promote and preserve cultural diversity.

- WTO members should fully implement TRIPS to ensure that audiovisual works of all nations are protected from piracy. Negotiators should avoid wakening, reopening or delaying implementation of TRIPS.

Conclusion

The 2000 round of services negotiations offers a fresh new opportunity to secure trade liberalization commitments in a wide range of services, not limited to those discussed above. We hope that these views provide useful guidance to our trade negotiators.

Sincerely,

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