CENTER FOR ECONOMIC AND POLICY RESEARCH

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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

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[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)

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 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.

[4] See Scott Sinclair, "GATS: How the WTO's New Services Negotiations Threaten Democracy" 2000: Canadian Centre for Policy Alternatives

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 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

[5] Article II, section 8.
[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.

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).

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