

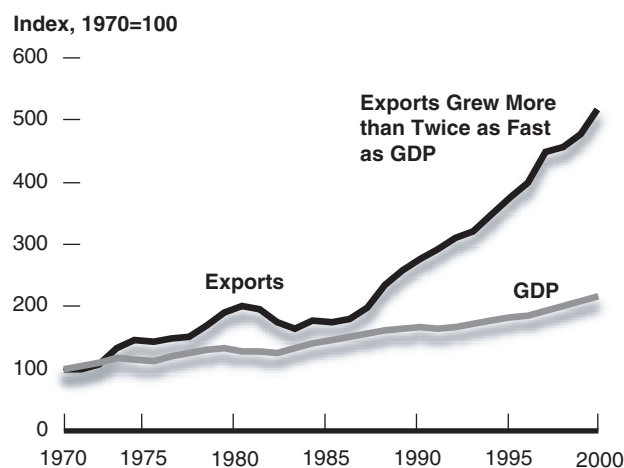


Strategic Objective:

Respond to the Impact of Global Market Forces on U.S. Economic and Security Interests

Issue: Globalization is increasing the interdependence of the world's economies and affecting national security and the economic well-being of the American people. U.S. exports have grown much faster than the economy (see fig. 2.3). Moreover, the United States has been the principal architect of an open world trading system and, as the world's largest exporter of goods and services, has benefited immensely from global trade. But segments of the U.S. and world populations have not shared equally in these benefits and may not do so in the future. Moreover, global market forces have made the United States more vulnerable to overseas economic crises. In addition, it has become more difficult for the United States to maintain control over critical technologies and the industrial base that U.S. economic and military security depends on. With the global reach of the Internet, electronic government and commerce applications move more easily across national boundaries. These applications thereby raise legitimate questions about legal responsibility, consumer protection, jurisdiction over offenses committed online, and many others. For policymakers, several aspects of these trends require particular attention:

Figure 2.3: Growth in U.S. Exports Compared to GDP since 1970



Source: Calculated from International Monetary Fund data.

- *Trade agreements* are increasing in number and importance to the U.S. economy. More than 300 international trade agreements affect hundreds of billions of dollars in trade and millions of U.S. jobs. The mutual dependence of international markets and the U.S. economy is expected to increase even further with China's recent admission to the World Trade Organization and the launching of new multilateral trade negotiations. Over 10 U.S. agencies have programs to promote U.S. exports. These programs include providing financial assistance through loans, loan guarantees, and grants as well as providing U.S. businesses with information on the export process.
- *The globalization of the defense industry*, driven by the drop in governments' military investments worldwide, is following patterns similar to those found in other commercial sectors. Defense companies are engaged in a wide variety of business arrangements across national borders. For example, U.S. companies enter into offset agreements, in many cases developing long-term supplier relationships, which will change the

nature of the market and the composition of the DOD supplier base. Although globalization has the potential to speed innovation and reduce costs, it also carries potential threats to the technological superiority of the U.S. military and may require even greater investments in weapons modernization.

- *Global financial health* and the maintenance of the global financial and trade systems are critical to long-term U.S. objectives and are cornerstones of U.S. foreign policy. Financial crises in Argentina, Mexico, Asia, Russia, and elsewhere have raised questions about what can be done to prevent, solve, or contain the spread of regional financial crises and what can be done to reduce the debt burden on poor countries. International financial institutions, such as the International Monetary Fund (IMF) and the World Bank, are at the center of efforts to address financial crises. The United States is the major contributor to the IMF and relies heavily on it and the World Bank to promote world economic health. The operations and transparency of these institutions have come under increased scrutiny.
- *Oversight of financial institutions and markets* has become increasingly challenging. Each day, millions of households collectively have trillions of dollars flowing through the nation's financial institutions and markets. The globalization of financial firms and markets along with constantly advancing technology have created opportunities for increased efficiencies but also have increased the speed and potential scope of undesirable

results that may occur, such as the flow of illegal finances or the spread of financial crises. The global scope of firms, along with difficulties in valuing knowledge-based assets, also raise questions about the accounting and disclosure models that underpin U.S. financial markets. Finally, the globalization of electronic commerce increases access but makes it harder to protect consumers and businesses from fraudulent and abusive marketing as well as adding to audit, security, backup, and disaster recovery concerns.

Performance Goals: To support efforts by the Congress and the federal government to address these issues, GAO will

- analyze how trade agreements and programs serve U.S. interests,
- improve understanding of the effects of defense industry globalization,
- assess how the United States can influence improvements in the world financial system,
- assess the ability of the financial services industry and its regulators to maintain a stable and efficient global financial system,
- evaluate how prepared financial regulators are to respond to change and innovation, and
- assess the effectiveness of regulatory programs and policies in ensuring access to financial services and deterring fraud and abuse in financial markets.

Analyze How Trade Agreements and Programs Serve U.S. Interests

Key Efforts

- ❑ Assess preparations for, and progress in, trade negotiations
- ❑ Assess the concerns of civil society on trade globalization
- ❑ Evaluate the implementation of and compliance with trade agreements, including China's adherence to its WTO commitments
- ❑ Evaluate the structure, processes, and resources that are used to develop and implement U.S. trade policy and programs
- ❑ Evaluate the relationship between trade and other U.S. policy goals and emerging international challenges

Significance

The United States, increasingly aware that global trade is a key component of economic and foreign policy, seeks to increase exports and ensure that U.S. firms are able to compete in global markets. Moreover, the United States uses its trade promotion programs as tools to support other foreign policy objectives. U.S. trade and investment assist developing countries around the globe in instituting market-based economies, democratically elected governments, and stability in areas of conflict. The United States is also a leader in exporting services, developing new technologies, and investing in other countries. At the same time, the future direction of U.S. trade policy is debated in the Congress and throughout the nation, while international negotiations are targeted for mass demonstrations. Trade proponents maintain that establishing new trade rules, expanding coverage of trade agreements to new countries, and enforcing existing trade agreements are critical to U.S. commercial interests. For these reasons, the United States seeks a new round of trade negotiations within the World Trade Organization (WTO), works to ensure that China and other countries will make meaningful reforms upon becoming WTO members, and remains engaged in efforts to establish a Free Trade Area of the Americas. In addition, the U.S. government budgeted about \$2.6 billion in fiscal year 2000 to promote exports. Some critics of U.S. trade policy and programs doubt that regional and global trade regimes can effectively achieve their desired outcomes and may compromise U.S. sovereignty. Others express concern that the United States has not been sufficiently aggressive in monitoring and enforcing over 400 existing trade-related agreements. Further concerns exist about the effectiveness of the 19 U.S. government agencies that have a role in promoting and financing exports. Finally, some groups contend that liberalized trade adversely affects workers and the environment and that trade agreements should not contradict efforts to address other U.S. policy goals. In such an environment, GAO can provide the Congress with independent, in-depth analyses of the status of trade negotiations, the extent to which trade agreements are being implemented, and the effectiveness of the U.S. government apparatus to develop and implement trade policy and programs.

Potential Outcomes that Could Result when GAO's Work Is Used

Increased congressional understanding of the progress on trade negotiations, key emerging issues, economic implications, and the relationship of these issues to U.S. objectives

Analyze How Trade Agreements and Programs Serve U.S. Interests (cont.)

Improved implementation of and compliance with trade agreements to ensure the United States obtains anticipated benefits and mitigates costs

Improved development and execution of U.S. trade policy

Improved targeting and coordination of U.S. trade promotion and financing programs to achieve intended purposes and reduce costs

Greater congressional understanding of the linkages and potential trade-offs between trade and other U.S. policy goals

Improve Understanding of the Effects of Defense Industry Globalization

Key Efforts

- ❑ Evaluate the commodity classification and jurisdiction procedures for establishing export licensing responsibility
- ❑ Evaluate controls over foreign participation in critical U.S.-funded research, development, and production efforts
- ❑ Evaluate the effectiveness of the Department of Defense's controls over industrial security
- ❑ Evaluate reforms of the foreign military sales programs
- ❑ Determine the degree to which U.S. military superiority is protected in the technology transfer process

Significance

Domestic firms that develop defense products, produce parts and components for weapons systems, and perform system integration on those weapons are rapidly forming business relationships with overseas firms. This globalization of industry has the potential to speed innovation and reduce costs, but it also carries potential threats to the technological superiority of the U.S. military. Little is known about the effect of increased globalization on national security. Continuing to protect critical technologies will present new challenges. In some industry sectors, such as satellite launches and communications, the line between defense and commercial products has disappeared. In other sectors, companies have made sales to foreign governments through a wide variety of agreements with conditions known as "off-sets," which often involve long-term supplier relationships and technology transfers. These company-based activities may constrain government procurement options. Planned exports of U.S. frontline systems still in development may have the unintended consequence of improving capabilities of potential adversaries. As a result of globalization, the United States may be required to make even greater investments in weapons modernization.

Potential Outcomes that Could Result when GAO's Work Is Used

Improved effectiveness of the export licensing process

More informed decisions on the expanded use of licensing exemptions

Enhanced security over military critical processes, products, and technologies

Improved processes for the government-to-government exchange of military goods and services

Assess How the United States Can Influence Improvements in the World Financial System

Key Efforts

- ❑ Examine the roles, missions, and operations of international financial institutions in the world's financial system
- ❑ Assess the effectiveness of activities and strategies to maintain the stability of the international financial system and address financial crises
- ❑ Analyze proposals to change a portion of multilateral lending to grants to mitigate national debt burdens for very poor countries

Significance

Maintaining the health of the global financial system is critical to long-term U.S. objectives and is a cornerstone of U.S. foreign policy. International efforts to maintain this system are primarily undertaken through multilateral organizations, most notably the World Bank and the International Monetary Fund (IMF), which use various means to help countries deal with financial problems and development needs. Recently, in light of continuing financial crises and persistent poverty in many developing countries, the Congress and others have questioned the effectiveness of the IMF, the World Bank, and related multilateral organizations in achieving their goals. These criticisms have centered on issues such as the organizations' ability to detect and prevent financial crises, the possible negative effect of the organizations' programs on recipient countries—especially the poor—and the increasing debt burdens of middle- and low-income countries. The United States is the major contributor to the IMF and the World Bank and is therefore the largest shareholder in both institutions. Continued U.S. financial support may hinge on these institutions undertaking reforms to increase their transparency and effectiveness.

Potential Outcomes that Could Result when GAO's Work Is Used

Clarification of roles and responsibilities of these institutions, thereby providing more effective leveraging of resources

Enhanced focus on alternative strategies for strengthening the financial infrastructure and institution building efforts

Improved understanding of alternative strategies employed by countries to maintain financial stability

Improvements in preventing or mitigating the impact of unsound financial practices or unanticipated events (such as an energy crisis or natural disasters) on national or world financial stability

Reductions in the debt burden on poor countries

Assess the Ability of the Financial Services Industry and Its Regulators to Maintain a Stable and Efficient Global Financial System

Key Efforts

- ❑ Assess regulatory agencies' efforts to ensure global financial system integrity, especially regarding challenges posed by financial interdependence across institutions, markets, and countries
- ❑ Assess regulatory efforts to ensure effective functioning of the nation's financial markets in the light of cross-border competition
- ❑ Assess regulators' response to the impact of financial conglomerates on safety, soundness, and competition in the financial services industry

Significance

The financial services industry is experiencing unprecedented growth and development, both in the size of financial institutions and in the range and impact of services being provided to customers. Millions of U.S. households have invested in the financial markets or deposited money at financial institutions. Each day, trillions of dollars flow through domestic and global financial institutions and markets. Ensuring that the financial system is stable, but also efficient and flexible enough to meet the changing demands of the system's customers, is an important part of the government's role in ensuring the proper functioning of the nation's economy. Over the years, the Congress has been called on to respond to many threats to the financial system and its primary customers—U.S. citizens. Although sets of tools have been established to deal with traditional financial instability, it is not clear whether these same tools will be sufficient in the face of new threats.

Potential Outcomes that Could Result when GAO's Work Is Used

Improved efficiency, effectiveness, and consistency of the federal regulatory framework

Increased efficiency and competitiveness of the nation's financial markets

Enhanced congressional and regulatory understanding of the effects of conglomerates on financial market stability and efficiency

Evaluate How Prepared Financial Regulators Are to Respond to Change and Innovation

Key Efforts

- ❑ Assess how regulatory oversight adapts to financial firms whose businesses cross the traditional lines of functional regulation
- ❑ Evaluate how well regulatory agencies are responding to innovations in financial products
- ❑ Assess how well regulators use technology to increase flexibility and reduce regulatory burdens

Significance

Globalization of financial firms and markets, along with constant advances in technology, have created opportunities for increased efficiencies but have also increased the speed and potential scope of less desirable results. Rapid and efficient financial transfers facilitate the functioning of both legal and illegal economic activity. Financial crises can also spread faster and farther than ever before. In addition, the consolidation of financial institutions from different segments of the industry has resulted in large conglomerates that offer a range of products that are not subject to federal regulation or oversight. This change and innovation challenge financial regulators to remain prepared to respond in ways that protect customers and markets but also avoid stifling market efficiencies and the introduction of beneficial new products and services.

Potential Outcomes that Could Result when GAO's Work Is Used

Improved methods to more effectively identify and address regulatory gaps and overlaps

Improved readiness of regulators to oversee new markets and products

Innovative use of technology by regulators to better target oversight

Less burdensome regulatory compliance efforts by financial institutions

Assess the Effectiveness of Regulatory Programs and Policies in Ensuring Access to Financial Services and Deterring Fraud and Abuse in Financial Markets

Key Efforts

- ❑ Determine whether consumers and businesses, particularly low- and moderate-income consumers and small businesses, have appropriate access to financial services and how effective regulatory programs are in ensuring fair and open access to financial markets
- ❑ Assess the effectiveness of regulatory programs and policies, including accounting, disclosure, and auditing requirements, in deterring fraud and abuse in the financial marketplace

Significance

Consumers and businesses—such as borrowers, investors, and purchasers of insurance—depend on fair and open access to financial services for their financial health and development. As a result of consolidation, technological advances, and globalization, consumers and businesses are vulnerable to fraudulent and abusive practices in the marketing and providing of financial services. Over the years, various regulatory programs and policies have been adopted with elaborate compliance and enforcement systems to help ensure open and fair access to markets and to protect customers from fraud and abuse, especially in securities and insurance markets. However, removal of historical legislative barriers and changes in the structure of the industry has raised questions about the regulatory effectiveness of these programs and policies. Some of these questions have centered on the adequacy of existing sales practices, fair lending, and financial privacy policies and programs in addressing current developments in a global financial services industry. More recently, concerns have emerged about the validity of the accounting and disclosure models, and their ability to provide timely and useful information to investors.

Potential Outcomes that Could Result when GAO's Work Is Used

Increased fair and open access to financial markets

Improved regulatory actions to deter fraud and abuse within the financial services industry