The crisis-resilience of services trade

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Much attention has been focused on the impact of the current crisis on goods trade; hardly any on its impact on services trade. Using new trade data from the USA, and more aggregate data from other OECD countries, the authors show that services trade is weathering the current crisis much better than goods trade. On the basis of new evidence from Indian services exporters, it is suggested that services trade is more robust relative to goods trade for three reasons: less cyclical demand; lesser dependence on external finance; and few explicitly protectionist measures so far taken in services.

Keywords: services trade; services exporters; global cross-border trade; financial crisis

Introduction

The current gloom and doom about goods trade has obscured the quiet resilience of services trade. Services account for over one-fifth of global cross-border trade, and for some countries, such as India and the USA about a third of all exports. This paper uses latest data on cross-border trade in services from the USA released in June 2009 to show that while trade in goods has declined drastically, trade in some services has held up remarkably well (Figure 1).1 The more aggregate data available for other OECD countries also suggest that services trade has suffered less from the crisis than goods trade.2

Monthly US imports and exports of goods declined by about one-third in value terms from peaks of $194 billion and $117 billion, respectively, in July 2008, to $120 billion and $80 billion, respectively, in April 2009.3 The corresponding decline in services imports and exports was less than one-sixth, from $29 billion and $37 billion, respectively, in July 2008, to $25 billion and $32, respectively, in April 2009.4

Within services trade, interesting patterns emerge. US imports and exports of goods-related services, such as international transport, have shrunk in the first quarter of 2009 (year-on-year by about one-quarter) as has expenditure on tourism abroad (by about one-tenth), while imports of other private services have actually grown slightly. Within ‘other private services’, trade in financial services has also contracted in the last quarter (year-on-year exports by 13% and imports by an even higher 23%).

But trade in a range of other services is still growing. This pattern is evident in insurance (imports by 13%, exports by 16%) and, in particular, a range of business, professional and technical services (imports by 4% and exports by 2.5%). Telecommunication services are also holding up comparatively well, with both imports and exports declining slightly by 4% in the first quarter of 2009.

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Overall exports to the USA of developing countries which are relatively specialized in services, like India (31% pre-crisis share of services in total exports to the USA) have declined less than exports of countries and regions for which services are less important, such as Brazil (14% share) and Africa (4% share, excluding South Africa, the share of which is 13%). The contractions in their total exports (goods and services) to the USA in the first quarter 2009 were: India (17%), Brazil (26%), China (9%), and Africa (55%; South Africa: 46%). So far, China is an exception to this pattern as its services share to the USA is rather low (2.5%) yet its overall exports declined by only 11%.

For India, this relatively positive outlook is corroborated by Indian industry sources, which suggest that employment in the export-oriented information technology (IT) and business process outsourcing (BPO) services is expected to grow by about 5% (around 100,000 jobs) in 2009.

Based on new evidence from Indian services exporters, we find that services trade is buoyant for two reasons. First, on the supply side, services trade has been less affected by the crisis-induced scarcity of finance. Services trade, especially in electronically delivered business services, needs trade finance less than goods trade. When external funds are needed, e.g. for working capital, small and large firms tend to rely on advance payments from clients and their ability to raise finance against orders placed. Moreover, receivables in the BPO are fungible and easily factorized because they typically involve a short-term transaction, a buyer who is creditworthy, and disputes over the service rendered are rare. Generally, services-producing firms have even in normal times tended to be less dependent on external finance than goods production because they have limited tangible collateral. For example, two of India’s largest exporters of software and business-process services, Infosys and Tata Consultancy Services (TCS), have no external debt at all and rely completely on retained earnings for their operations.

Second, demand for a range of services seems to have contracted less than the demand for goods. One reason for the low-income elasticity of demand for services may be that they are not storable and so are less subject to the big declines in demand in downturns that affect durable goods like shoes and televisions. This is because many services

Figure 1. US monthly imports and exports of goods and services, January 2006–April 2009.
Source: BEA, US International Trade in Goods and Services, millions of dollars, months seasonally adjusted.
suffer neither from the ‘vintage effect’ – i.e. the willingness to wear an older pair of shoes or drive an older car – nor from the ‘inventory effect’ – i.e. the fact that cuts in final demand translate into bigger immediate cuts in demand for factory output because of inventory adjustment. Another reason is that a larger part of international demand for services – e.g. outsourced back-office services – is less discretionary than demand for goods such as computers. This is both because many outsourced services (e.g. book-keeping) are ‘necessities’ for producers; demand for some of these services is unrelated to the scale of production; and a larger part of services trade seems to involve long-term relationships (e.g. because of relationship-specific investments by buyers and sellers). There are also signs that the crisis is itself generating new tasks to be outsourced, such as legal process outsourcing or debt processing, as well as creating pressure generally to reduce costs through outsourcing.5

The relative buoyancy of services trade cannot be taken for granted. Over it too hangs the Damocles sword of protectionism. But protection is taking a subtle form, perhaps in deference to the invisibility of services and the fact that they are increasingly delivered electronically. First, explicit discrimination through preferential procurement seems at this stage less damaging than the implicit social and political disapproval of outsourcing. Developing country service exporters argue that it is the latter that has had a chilling effect on demand for their services. Similarly, the few visible explicit restrictions on employing or contracting foreign services providers in specific areas (e.g. financial services) are not as costly for both host and source as the increasing social and political aversion to immigration. In the longer term, subsidies to banks are probably less damaging than financial protectionism. The former are temporarily necessary to ensure the stability of the financial system. The latter seriously erode the case for openness. Inducing national banks to lend domesticaly in a crisis deprives developing countries in particular of capital when they most need it, and greatly strengthens the case for financial self-sufficiency.

The second section describes the trends revealed by the US services trade data, and compares it with developments in other OECD countries for which more limited data are available. The third section suggests reasons for the resilience of services trade, drawing upon evidence from India. The fourth section assesses the significance of protectionist measures affecting services trade. The fifth section concludes.

### Services trade during the crisis

#### US imports of services

In this section, we consider in turn the impact on US imports – in the aggregate and from specific trading partners, on US exports, on US affiliates trade, and on the trade of other OECD countries. Imports of services have proved much more resilient than imports of goods (as we saw in Figure 1). The upper panel of Figure 2 presents year-on-year growth rates of goods and services imports, respectively, on a monthly basis between January 2006 and April 2009. From mid-2008 onwards, the growth of imports of both goods and services started to decelerate, yet the downturn in merchandise trade was sharper. In April 2009, goods imports had contracted by 35% compared with April 2008 while services imports had declined by only 10%.

The contrast is even more striking when we look at the components of services imports (Figure 2, middle panel). It is no surprise to see imports of transportation services turn sharply negative (by 25%) given the contraction of international freight services. Interestingly, of the major components of commercial services, imports of ‘other private services’ are still growing slightly (1%).
Figure 2 (bottom panel) breaks down ‘other private services’ into its major components, namely financial, insurance, telecommunications, and business/professional/technical services. Again not surprisingly, given the financial origins of the current crisis, imports of financial services have shrunk drastically (by 23%). However, even in the first quarter of 2009, well into the crisis, growth rates of certain other services, such as insurance (13%) and business, professional and technical services (4%), are still positive. The high growth rates of insurance imports mainly reflect non-crisis related factors, namely rising premiums in the US market in the aftermath of the difficult 2005 hurricane season.
The impact on US trading partners

In general, the impact of the crisis on developing countries’ exports to the USA depends on the composition of their exports. Figure 3 shows the relationship between the change in countries’ exports in the first quarter of 2009 to the USA during the crisis and the share of services in a country’s total exports (annual growth rate in the upper graph, quarter-on-quarter change in growth rates in the bottom graph). The vertical axis in the upper panel depicts the change in the value of total exports (goods plus services). In terms of growth rates, exports of countries that are relatively specialized in services, like India (31% share of services in total exports to the USA), have declined less than exports of countries and regions for which services are less important, such as Brazil (14% share) and Africa (4% share). As the upper panel shows, the reductions in the value of total exports (goods and services) to the USA in the first quarter 2009 were: India (17 percentage points), Brazil (26 percentage points), and Africa (55 percentage points). Exports of countries that are comparable to India in terms of the extent of services specialization, for instance Australia and the Netherlands, have likewise been affected less severely.

As we have previously shown, it is in particular the category of other private services – which includes insurance, telecommunications and BPO services but excludes transport and travel – in which trade has continued to grow. In Appendix 2, Figure A3, we present the same analysis with a country’s share of ‘other private services’ in total exports on the horizontal axis. The relationship is similar, but the slope steeper and, at least for the change in growth rates, the correlation weaker than in Figure 3. The steeper slope reflects the fact that this more resilient class of services offers greater insulation against crisis-related reductions in exports. The weaker correlation reflects the fact that these more specific services represent a smaller share in overall exports.

US exports of services

The qualitative picture for US service exports (Figure 4) resembles that of US imports (Figure 2). Like imports, exports of services have proved much more resilient than exports of goods (as we saw in Figure 1). The upper panel of Figure 4 presents year-on-year growth rates of goods and services exports, respectively, on a monthly basis between January 2006 and April 2009. From mid-2008 onwards, the growth of exports of both goods and services started to decelerate, but the merchandise decline was precipitous. In April 2009, goods exports were 27% lower than in April 2008; the decline of services exports was 11%.

Within services (Figure 4, middle panel), exports of transport services declined (27%), as did expenditure by foreign tourists in the USA (17%), but exports of private services declined only slightly (3%). The most relevant sub-categories of other private services, as shown in the bottom panel, present a contrasting picture: in the first quarter of 2009, US exports of financial services have contracted significantly (13%), but exports are growing, of insurance (16%) and business, professional, and technical services (2%), respectively. Concerning the considerable growth of insurance services, it is believed that the subprime crisis itself has to some extent raised the demand for certain services, e.g. directors’ and officers’ liability insurance and errors and omissions insurance (see USITC, 2008, pp. 4–5).

Cross-border trade between affiliated firms

A significant proportion of cross-border trade takes place between affiliated firms. Figure 5 provides an alternative breakdown of ‘other private services’ into payment flows...
Figure 3. Change in the value and growth rate of exports to the US and share of services in exports, 2009-Q1, selected countries and regions.
Source: BEA, US International Transactions Accounts Data, Table 12: US International Transactions by Area, millions of dollars, not seasonally adjusted. Annual growth rates and change thereof in first quarter 2009. The slope coefficients in both charts are significant at the 2% level.
associated with services imports from affiliates and non-affiliates, respectively. The growth of intra-corporate payment flows has generally been more volatile. This volatility may reflect in part the greater discretion firms normally have in reporting the value of flows between affiliates (in terms of both recording the flow and pricing it). During the crisis, growth rates of intra-corporate flows have declined to become slightly negative in the first quarter of 2009. The growth of arms-length payments has declined since the middle of 2007 but is still positive.

Figure 4. US exports of goods and services, shares in 2008 and year-on-year growth rates: (a) total goods and services (monthly), (b) sub-categories of services (monthly), (c) sub-categories of ‘other private services’ (quarterly).

Source: BEA, US International Trade in Goods and Services and US International Transactions Accounts Data, Table 3(a), millions of dollars, seasonally adjusted.
Trade of other OECD countries

Over the past 4 years, the USA has on average accounted for 17% of all OECD imports of services and 20% of all OECD exports of services. How far does its experience reflect that of the OECD countries more generally? Trade data for the first quarter of 2009 have been released by all but one other OECD country (Swiss data for this quarter are missing, while we also include Brazil as the only non-OECD country reporting first quarter figures). These data are only available at an aggregate level, i.e. for services trade as a whole and not for its subcomponents. Figure 6 shows for each country the annual growth rate of goods imports (on the vertical axis) and services imports (on the horizontal axis). Both rates are negative for all countries. Yet interestingly, imports of goods are contracting faster for all countries, thereby placing all countries below the 45° line. Until more detailed data become available, we can only conclude that evidence from other OECD countries does not contradict the picture of the relative resilience of services trade emerging from US data.\(^{13}\)

Understanding the resilience: the experience of Indian services exporters

This section provides a new perspective on the crisis from the point of view of services exporters. Specifically, we explore the impact of the crisis on Indian companies that export IT services or IT-enabled services (ITES) (also referred to as BPO).

At first glance, two aspects of the current crisis do not bode well for Indian services firms’ prospects. First, the epicentre of the crisis, the US accounts for 51% of India’s services exports to the OECD countries (as of 2006), and reportedly an even larger 60% share of its exports of IT and BPO services.\(^ {14}\) The UK, also affected by the crisis, accounts for a further 21% of India’s OECD exports. Second, from a sectoral point of view, financial services and insurance remain the biggest of all markets which Indian services exporters serve.

However, even though the financial turmoil is clearly hurting the industry, Indian exporters have weathered the crisis (much) better than companies engaged in merchandise
trade. Growth rates of sales and employment are expected to be cut in half, but this still leaves the sector with growth rates that would be considered buoyant in many manufacturing sectors. Instead of slashing jobs, the industry continues to remain a net hirer. In absolute terms, around 100–110,000 new jobs will be created in 2009, as compared with 223,000 in 2008. Since a counterfactual 160,000 jobs would conceivably have been added in the absence of the current crises, the employment dent left by the financial crisis amounts to about one-third of new job additions lost.

The muted impact at the industry level does hide considerable heterogeneity at the firm level, in terms of size as well as business field (IT versus BPO). Moreover, uncertainty about the consequences for outsourcing providers of growing demand for protectionism in the USA and elsewhere further cloud Indian exporters’ prospects.

**Impact on demand for services exports**

India’s IT and ITES sector is heavily geared towards foreign markets. In the fiscal year 2008, roughly three-quarters (or $40bn) of the sector’s output was destined for exports. The industry’s increasing diversification in terms of geographic base, industries served, and the portfolio of services offered, has to some extent cushioned against the negative demand shock that originated mainly from the US economy. Industry sources expect that domestic sales, which currently level at about $11bn and account for only a quarter of total sales, may compensate for the loss in export demand only to a limited extent.

Nevertheless, as far as the IT export market is concerned, the slump in demand clearly shows up in export figures: while sales grew by some 24% during the first half of the fiscal year 2008 (April–September), growth slowed down to 12% in the second half (October–March), so that overall growth is expected to be 16–17%. In the ITES sector,
growth in 2008 fiscal year is widely expected to be somewhat higher at 20–22%. No significant growth is expected in 2009, and average growth over the next 2 years is likely to fall to around 15% – which is one-half of last decade’s annual average growth rate of 30%.

According to industry sources, two factors are contributing to the recent slow-down. First, the negative demand shock is being felt particularly in the case of discretionary IT projects. Second, there has been a general mood swing against outsourcing in crisis-hit countries, particularly in the USA, which is discussed in the fourth section. As far as demand contraction is concerned, there are significant differences between the IT and the ITES subsector. Indian exporters’ business is more severely affected in IT services, where about 60% of sales are of a discretionary nature, i.e. projects can be withdrawn, or not contracted at all, in times of economic hardship. ITES exports are apparently much less discretionary, with an estimated 70–80% of business characterized as non-discretionary. These latter types of services exports are likely to be more insulated from negative demand shocks because they involve activities that must be carried on even during the current crisis. For instance, in health care, a system upgrading project (IT) is discretionary whereas the processing of claims (ITES) has to continue. In banking, a project to realize end-to-end automation of payments (IT) is discretionary even though it might be cost saving, whereas transaction processing is non-discretionary. Figure 7 depicts the growing importance of ITES in the sector’s overall export performance.

Another reason for IT to be affected differently from ITES is because of differences between the two segments in the types of contractual relations. In IT, only about 25% of foreign trade takes place between captives (i.e. affiliates) and their parents, whereas in ITES, this share stands at some 40–45%. Most of the large financial firms, e.g. JP Morgan, have traditionally conducted their outsourcing business via captives. As demand contracts, Indian firms are apparently also being asked by buyers to reduce prices. The ensuing margin squeeze is likely to be greater in IT services where a larger portion of projects is conducted as arms-length trade.

In contrast to the negative effects of the recession, IT and BPO exporters may stand to gain from the current crisis as firms in industrialized countries are under increased pressure to cut costs. The financial dimensions of the crisis seems to have increased demand for certain types of outsourced tasks, such as legal process outsourcing or

Figure 7. Composition of India’s IT and ITES exports, 2000/01–2008/09.
Source: Reserve Bank of India, monthly bulletin March 2009, and National Association of Software and Service Companies (NASSCOM). Time periods are fiscal years which start in April.
activities related to debt processing. But in general, cost pressures have so far tended to manifest themselves in greater demand for outsourcing in core BPO areas rather than to entice companies to venture into new ‘context’ areas in which outsourcing has been less common. In traditional BPO areas, outsourcing options are being pursued more vigorously both with captive firms and at arms-length. There has also been a discernable acceleration in the speed with which outsourcing decisions are being taken. While decisions were being taken within 9–12 months before the crisis, the decision time has now shrunk to 6 months.

The impact of parental distress in sectors such as finance and automobiles is less clear. Industry officials indicate that an increased quantum of work is being done offshore in banking. But the impact is not uniform across firms. For example, in insurance, while AIG may have reduced the amount of outsourcing, AXA has not. In the automotive industry, outsourcing has been significantly reduced (by some 50%) as many operations, e.g. warranty claims or customer care, are discretionary. Thus, experiences of, and choices made by, one firm are not necessarily representative of the industry at large.

Impact on employment
The Indian IT and ITES sectors directly employ some 2.2 million people, of which 1.7 million are associated with services exports. The number of people indirectly employed – i.e. providing auxiliary services – is a factor of 3.5 to 4 greater than the directly employed, or an estimated 7–8 million. As in the case of revenues, the employment effects of the crisis largely take the form of reductions in growth rates, rather than layoffs, and a more intensive use of the existing workforce.

The latter effect leads to growth in employment being more muted than growth in sales. In 2009, while sales are still expected to grow by a rate in excess of 10%, employment is projected to expand by 5–6%. As noted above, cast in absolute numbers this means that around 100–110,000 new jobs will be created in 2009 (in comparison: 223,000 jobs were created in 2008). According to industry estimates, in the absence of the current crises, a counterfactual 160,000 jobs would conceivably have been added, thus the employment dent left by the financial crisis amounts to about one-third of new jobs not created. There has always been a high level of attrition in the industry and companies are using the crisis to more aggressively ‘cull’ non-performers.

This assessment provides us with some sense of direct employment effects. However, it is hard to assess the impact on indirect employment upstream business, e.g. in the upstream education sector that caters to the Indian services exports industry. These figures should, therefore, be viewed as a rather conservative lower bound.

At the same time, companies are seeking to maximize the utilization of their currently employed labour force through at least two channels. First, firms are pushing up utilization of their existing labour force, e.g. by eliminating reserves such as the 12–18% of labour-time that previously lay idle (workers were not engaged in billable activity but waiting to be employed). This reserve has now come down to 5–8%. Steps such as cutting breaks between login and logout have led to a further increase in productivity of about 6–8%. Second, there is a shift in the service line portfolio towards higher value added services, which likewise leads to increased labour productivity. In general, the Indian workforce is relatively young and skilled – the average age of an Infosys worker is 26 and most have engineering degrees. Workers are reported to exhibit a high degree of adaptability and flexibility in the crisis, reflected for example in the willingness to work on multiple tasks for longer hours.
**Limited dependence on external finance**

The previous section suggests that the unfolding financial crisis affects Indian services exporters through adverse demand shocks. In stark contrast to the manufacturing sector, tightening credit conditions are not constraining the production and export of services, for three reasons. First, the fact that many services are delivered electronically across borders, as digitized products, and occasionally through the movement of individuals to provide consulting onsite, obviates the need for traditional trade finance, the deteriorating availability of which has hurt goods trade.

Second, to the extent that external funds are needed, advance payments and factoring continue to help meet financing needs. The former is important in an industry that produces customized products with significant relationship-specific investments by the service supplier. The latter instrument is available to small and large firms alike, even though the discount margins for large firms may be smaller. Even before turning receivables into cash, many Indian IT firms are able to leverage contracts in order to pre-finance working capital at the time when the order is placed provided the contract involves a recognized party or government.

Importantly, receivables in the BPO industry are fungible and easily factorized because they typically involve a short-term transaction, a buyer who is highly creditworthy, and disputes over the service rendered are rare. The latter feature makes the receivables a negotiable, irrevocable instrument that is detached from the underlying transaction. Since factoring as a trade credit instrument is on the rise, at least as compared with conventional documentary credit, reliance on this particular form of credit puts BPO services a step ahead of other sectors, notably manufacturing.

The third reason for the sector’s tenacity is found in its relative independence from debt finance. Indeed, the financial structure of IT and ITES firms is in general characterized by low leverage with little, if any, debt. While access to external finance is of some importance, working capital is predominately financed by retained earnings or, for start-ups, through venture capital.

A brief glance at Infosys, one of the largest BPO services exporters and a leader in the industry, illustrates the point of minimal financial dependence. With over 100,000 employees, Infosys is debt-free. On the cost side, software development expenses are the single most important item, eating up 57% of gross revenues, the overwhelming part of which consists of salaries. In fact, services production involves few intermediate inputs so that 86% of revenue is value added. It may seem that under these circumstances, financing working capital poses quite a challenge as nothing tangible is produced that could be used as collateral. But in the case of Infosys, internal cash flows are sufficient to cover working capital, capital expenditure, investment in subsidiaries, dividends, and still leave a surplus. While the excellent financial condition of Infosys might not be fully representative, TCS, another large BPO supplier, likewise does not carry any debt on its balance sheet. At the same time, a fair amount of venture capital (some $500 million) seems to be available for nascent firms.

It seems likely that the low dependence on debt finance – which works to the benefit of services firms at a time when sources of external credit dry up – is the result of the fact that services producing firms have to stand on their own feet even in ‘normal’ times. Software development services, for instance, require potentially large upfront expenses which must be financed until payment can finally be collected, and in addition such products typically carry a high degree of uncertainty regarding future profits. With no tangible collateral on hand, financing of working capital is a generic problem of services suppliers that existed
well before the current credit crisis. Developing a financial strategy that relies largely on retained earnings (or initially on venture capital) is a consequence of services providers’ inherent difficulty in accessing commercial credit.

Overall, industry executives do not consider access to finance as a major concern for Indian services exporters. The way the crisis is affecting the financial position of services suppliers is by potentially squeezing their margins. To the extent that the length of the working capital cycle is elongated, the cost of funds is increasing which in turn reduces margins.

There is also evidence that the crisis has prompted some changes in payment patterns. As a means of financing, advance payments used to be a common feature in the industry. Apparently, prior to the crisis hardly any firm providing IT and ITES would have considered an outsourcing project without a down payment. The unfolding crisis and the associated slump in demand are eroding Indian exporters’ bargaining position so that some deferral of fees and invoices is increasingly observed.

The relatively comfortable situation of IT and ITES exporters does not necessarily represent the situation of all services firms, as matters are highly specific to individual sectors. Agents providing transportation services, for example, face more or less the same problems in the crisis as do manufacturing firms. Quite apart from the slump in demand, freight charges are usually paid in advance and are financed as part of the trade credit package. Therefore the collapse of trade credit is hitting transport agents as hard as it affects merchandise exporters.

**Protectionism**

Services industry sources in developing countries suggest that a bigger problem than any explicit restrictions is the general mood of protectionism emerging in crisis-hit countries. This mood has not produced visible restrictions but generated increasingly strong implicit political pressure to retain jobs domestically. While the negative demand shock can to some extent be quantified, evaluating the effect of the incipient protectionist sentiment is harder. Consider two examples of explicit restrictions drawn from the USA, the market on which this paper has focused and which, because of its size and openness to cross-border trade in services, is of greatest significance to services exporters like India.

In light of the Buy American provisions in recent US legislation, it is instructive to recall the history of past sub-federal initiatives that sought to promote onshore employment. For instance, in the years 2001–2002, New Jersey drafted legislation for preferential procurement, including stipulations that work was to be done by firms with US employees rather than firms that outsourced. However, the bill was progressively diluted as it passed through the legislative process. To begin with, the Act would only apply to government-funded projects, thereby excluding any private sector financed projects. Moreover, in case of a cost differential between potential providers exceeding a certain percentage (approximately 15–20%) a waiver would be automatically granted. These modifications rendered the Act ultimately ineffectual, and the New Jersey experience seems to represent the fate of several similar legislative projects in other US states. The apparent popularity of such measures notwithstanding, there appears to be a sizable US business constituency that would potentially be hurt by such measures, as reflected in the recent letter 150 US companies sent to President Obama in which they caution against the Buy American initiative.

Contrast this experience with the following example of how firms’ choices are being influenced by the change in political mood. On 6 April 2009, Sallie Mae, a company which
manages $180 billion in education loans and has 10 million student and parent customers, announced plans to move 2000 overseas jobs back to the USA from India and the Philippines, reversing a cost-savings measure the company took a year ago. The company said it plans to fill jobs, including positions in call centres, IT and operations, in the USA over the next 18 months. The projected cost is about $35 million annually because of higher labour expenses. Sallie Mae chief executive Albert L. Lord was quoted as saying: ‘It’s the right thing to do. The value of a company’s franchise is essentially measured in financial terms, but there are a lot of values in a company that relate to the long-term value of a franchise. It’s a wise investment in the company’s future . . . It was a tough decision to move these jobs overseas. It was a lot easier to make the decision to bring them back’.

Rep. Paul E. Kanjorski (Democrat from Pennsylvania), whose Wilkes-Barre district will receive 600 new Sallie Mae jobs, was quoted as saying: ‘It’s a patriotic act. It sends a great message to corporate America to think as deeply as you can’.

In addition to the changing political climate, a related concern is the widening boundary of the state as a result of increased government ownership of firms during the crisis. The US Government has already spent $245 billion under the Capital Purchase Program to hold preferred stocks in more than 200 financial companies. Particularly large investments have been made in giant financial corporations, such as Citigroup and Bank of America, under the Targeted Investment Program and Asset Guarantee Program, and on AIG under the Systemically Significant Failing Institutions Program. General Motors and Chrysler have received $30 billion under the Automotive Industry Financing Program and the Automotive Supplier Support Program. The worry, for which there is as yet no concrete basis, is that state ownership will induce a national bias in firms’ choices on procurement and location of economic activity.

Another example of explicit restrictions is the provision in the recent US stimulus bill making it difficult for financial institutions that have received taxpayers’ funds to hire specialty occupation (H-1B) visa holders if they have recently made US workers redundant. Given the binding aggregate quota on H-1B visas, a restriction on employment in a particular sector probably has limited impact, other than on foreign workers with skills that are specific to the restricted sectors. Thus the restrictions on employing or contracting foreign services providers in specific areas (e.g. financial services) are not as costly for both host and source as the increasing social and political aversion to immigration of service providers and the possibility of retaliatory restrictions. As Lloyd Blankfein, the chief executive of Goldman Sachs warned, the company had 200 people in the USA on H-1B visas but also 2000 employees who worked overseas but paid US taxes; the latter could be the target of retaliatory measures by other governments

Finally, in the longer term, subsidies to banks are probably less damaging than financial protectionism. The former are temporarily necessary to ensure the stability of the financial system. The latter seriously erode the case for openness. Inducing national banks to lend domestically in a crisis deprives developing countries, in particular, of capital when they most need it and greatly strengthens the case for financial self-sufficiency.

Conclusion

Using new trade data from the USA, we show that services trade is weathering the current crisis much better than goods trade. The latest available evidence from other OECD countries corroborates this picture, as services imports have invariably shrunk less than goods trade flows. Particularly striking is the continued growth of trade in a range of
business, professional, and technical services. We find that countries like India, which are relatively specialized in BPO and IT services, have suffered much smaller declines in total exports to the USA than countries like Brazil or regions like Africa which are specialized in exports of goods, transport services or tourism services.

Future research needs, first of all, to confirm the more general validity of our findings, since the resilience hypothesis advanced in this paper is based almost entirely on recent bilateral US import data. One alternative possibility, for instance, is that this resilience reflects delayed adjustment, both domestically and internationally. While some services industries like construction are affected more quickly in a recession, other services industries tend to adjust more slowly.19

If the resilience finding is indeed robust, then a priority for research must be to identify more rigorously the underlying reasons. We have conjectured that resilience is a consequence of certain features of services or services trade itself, highlighting two broad classes of reasons: demand for a range of traded services is less cyclical, and services trade and production are less dependent on external finance. Within each explanation, however, there is a need for a more nuanced understanding of the forces at work. Concerning the demand side, we highlighted the vintage and inventory effects due to services’ non-storability as well as the less discretionary nature of demand for business services, such as book-keeping or the preparation of tax returns. Likewise, the broad notion of reduced financial dependence could reflect step-motherly treatment of services even in good states of the world, the ability of service exporters to free-ride on the reputation of clients, or the absence of delivery lags, the relative significance of each of which need to be determined.

We have also argued that even though few protectionist measures have so far been taken in services, the growing political and social aversion to outsourcing is a threat to trade. This aversion is obscuring the economic stake that all countries have in open global services markets. While developing countries like India, Brazil or China have seen rapid export growth, by far the largest exporters of these services are the USA and the countries of the European Union. The EU and USA account for 65% of world services exports; China and India for 6%.20 The USA and EU have both consistently run a huge annual surplus on services trade, currently nearly $160 billion for the USA and $220 billion for the EU countries. While US services imports from India and China have indeed grown to around $22 billion in 2008, US exports to these countries have expanded even faster, to over $26 billion. Even during the crisis, US exports of key services are growing faster than its imports.

The USA and EU have been powerful advocates of open services markets all over the world. Many developing countries have begun to reform their markets for communications, transport, financial, and other business services. A retreat from openness in services in industrial countries could undermine reform efforts in developing countries, and even trigger a costly spiral of retaliatory protection.

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Notes

1. This data also includes consumption of services abroad (in the category ‘travel’), but does not encompass sales through foreign affiliates or through the presence of foreign natural persons, two modes of services delivery which account for a large and growing share of international transactions in services. Unfortunately, recent data are not available for sales through affiliates, and sales by natural persons are not properly measured (see European Commission et al. (2002) and Maurer, Marcus, Magdeleine, and D’Andrea-Adrian (2008)).

2. The US accounts for about one-fifth of imports and exports of all OECD countries.

3. Part of the decline in the value of goods imports could be due to the fall in commodity prices. But note that US goods exports also declined over the last seven months by one-third.

4. In April 2009, the year-on-year decline in the value of goods imports was 35%; the decline in the value of services imports was a little over 10%. US exports present a similar picture of year-on-year declines: a decline in goods exports by 27% by February; in services exports by 11%. For the purposes of this analysis, we deduct from the total services flows as reported by the BEA the item Royalties and License Fees as well as the value of Government and Military service flows.

5. Combinations of these factors may also lead to dynamic effects. Say, the pressure to reduce costs during the crisis induces outsourcing. Once a firm incurs sunk costs in establishing the new arrangement and relationship, it does not make sense to reverse the arrangement even after the crisis has passed. The temporary shock might thus permanently ratchet up outsourcing activity. The recent tendency of outsourcing providers to engage clients in multi-year framework agreements, under which individual transactions are being carried out, may also lead to a greater durability of business relationships.

6. All data released by the Bureau of Economic Analysis for the first quarter of 2009 are labelled ‘preliminary’.

7. The majority of cross-border US insurance imports consist of reinsurance services, and most of the world’s largest reinsurance providers are located outside the USA. In 2005, Hurricanes Katrina, Rita, and Wilma caused premiums to rise in subsequent years (see USITC, 2009, pp. 3–6).

8. For a more detailed view of country and region-level data, see Appendix 2, Figure A2 and Table A1.

9. All countries’ shares of services in their exports and changes in exports are listed in appendix Table A1.

10. Even though it is primarily a commodity exporter, Argentina seems to have survived the fourth-quarter contraction comparatively well, but that is only because it had already suffered a significant contraction in the third quarter – because of the decline in commodity prices. Brazil had a similar experience.

11. The limited geographical breakdown of BEA import data prevents the inclusion of more countries in Figure 3, particularly other developing countries.

12. Figure 5 does not present the time series for payments and receipts involving non-US parent companies.

13. For another assessment of OECD trade during the crisis, see Araujo and Gonnard (2009).

14. Even though India’s share in US services imports has more than doubled since 1999, it still accounts for less than 2% of US services imports.

15. Estimates in this section are based on interviews with the Indian industry and industry association sources and are not comparable with the estimates presented in Section 2 based on US import data. There are significant differences between Indian and US estimates of India’s...
exports, particularly of the key category, business, professional and technical services (see e.g. United States Government Accountability Office, 2005). Among the reasons is that for this category of services, the Indian data, unlike the US data, include earnings of temporary Indian workers resident in the USA, exports between affiliated firms, as well as sales made to US-owned affiliates located outside the USA. These differences in methodology can lead to huge differences in measured trade: for example, in 2003 the US reported $420 million of business, professional and technical services imports from unaffiliated India entities, whereas India reported exports of such services from affiliated and unaffiliated entities amounting to roughly $8.7 billion.

16. ‘SLM to transfer overseas jobs to USA: Reston Student Lender to Move 2000 Workers Out of Asia’, by Thomas Heath in the Washington Post, 7 April 2009.
17. See also Guerrera (2009).
18. See, for example, Anthony Faiola and Mary Jordan (2009), ‘British Bank To the World Takes Its Cash Back Home: Battered RBS Caught In Protectionist Storm’, Washington Post, 28 March 2009.
19. See, for example, Jiang, Koller, and Williams (2009). It is also possible that payment for services occurs with a lag so that slackening demand is only gradually reflected in measured payments.
20. Data in this paragraph are from the World Trade Organization.

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Appendix 1. Longer term trends in global services trade

Cross-border exports of commercial services account for around 20% of overall global exports in both goods and services. Figure A1 shows that over the last decade, the share of services in worldwide exports has been fairly constant for most countries. This development masks interesting differences across countries and regions. Most notably, the share of services has been steadily increasing in India, particularly since 2003, but has been decreasing for Africa and China.

Figure A1. Services exports as a share of total exports, by country or region, 1998–2008. Source: World Trade Organization, total merchandise trade and trade in commercial services statistics. Services trade data for 2008 are not available for China and India.
Appendix 2. Composition of goods and services imports of the USA

The panels in Figure A2 and Table A1 show the development over time of goods and services imports by the USA from selected source countries or regions. Besides goods, services flows are broken out by travel, transportation services and other private services. The pie charts on the left show shares, and the time series charts on the right show annual growth rates per quarter. It can be seen that imports of goods and transportation services decline sharply in the first quarter of 2009, whereas other private services fare better.

Figure A2. Goods and services imports by the USA from selected source countries and regions, composition and development over time.
Figure A2. Continued.
Figure A3. Change in the value (upper panel) and growth rates (lower panel) of exports to the USA and share of other private services in exports, 2009-Q1, selected countries and regions.
Source: BEA, US International Transactions Accounts Data, Table 12: US International Transactions by Area, millions of dollars, not seasonally adjusted. Annual growth rates and change thereof in first quarter 2009. The slope coefficient in the upper graph is significant at the 3% level, the coefficient in the bottom graph is borderline significant at the 10% level.
Table A1. Shares of services and private services in total trade with the USA (third quarter 2008) and growth rates of goods and services categories (first quarter 2009).

| Source country | Share of all services in total exports | Share of other private services in total exports | Growth rate goods | Growth rate services |
|----------------|----------------------------------------|-----------------------------------------------|------------------|---------------------|
| Hong Kong      | 51.7                                   | 19.4                                          | -47.9            | -15.9  -7.1         0 |
| UK             | 42.1                                   | 23.9                                          | -24.4            | -17.7  -7.2         -0.9 |
| Australia      | 31.0                                   | 16.5                                          | -9.3             | -14.8  -7.2         -24.6 |
| India          | 30.3                                   | 24.0                                          | -21.8            | -15.5  -7.1         -4.8 |
| Netherlands    | 30.2                                   | 13.7                                          | -17.4            | -23.1  -7.1         0.7 |
| Europe         | 25.6                                   | 12.5                                          | -27.2            | -19.5  -7.2         2.6 |
| France         | 23.8                                   | 8.6                                           | -22.1            | -15.0  -7.1         0.8 |
| Singapore      | 22.0                                   | 11.8                                          | -25.4            | -22.9  -7.1         -6.1 |
| Argentina      | 20.4                                   | 8.1                                           | -25.3            | -24.2  -7.1         11.6 |
| Germany        | 20.4                                   | 9.2                                           | -30.7            | -20.8  -7.2         0.3 |
| Italy          | 19.1                                   | 4.5                                           | -27.4            | -19.2  -7.2         6.0 |
| Belgium        | 16.9                                   | 10.8                                          | -36.6            | -13.9  -8.3         15.1 |
| Taiwan, China  | 16.3                                   | 1.7                                           | -26.0            | -22.6  -7.3         -21.6 |
| Brazil         | 13.8                                   | 8.5                                           | -29.1            | -18.8  -7.2         1.1 |
| Korea          | 13.5                                   | 1.9                                           | -17.6            | -20.4  -7.2         -16.7 |
| South Africa   | 13.0                                   | 6.1                                           | -50.7            | -13.9  -6.8         -14.0 |
| Japan          | 12.3                                   | 3.8                                           | -41.5            | -23.0  -7.2         -8.3 |
| Asia-Pacific   | 9.8                                    | 3.7                                           | -21.6            | -20.8  -7.2         -1.0 |
| South/Central  | 8.5                                    | 2.3                                           | -29.5            | -17.2  -8.1         5.5 |
| America        |                                        |                                               |                  |                     |
| Canada         | 7.2                                    | 2.9                                           | -38.2            | -20.0  -12.6        -9.9 |
| Mexico         | 6.1                                    | 1.4                                           | -20.1            | -20.5  -8.9         2.3 |
| Middle East    | 5.3                                    | 1.8                                           | -52.0            | -15.8  -7.1         -1.5 |
| Other Africa   | 3.9                                    | 1.6                                           | -37.3            | -9.6   -7.0          3.7 |
| China          | 2.5                                    | 0.8                                           | -10.9            | -25.7  -7.2         -0.5 |
| Venezuela      | 1.2                                    | 0.3                                           | -49.6            | -10.4  -7.1         9.4 |
| Mean           | 17.9                                   | 8.0                                           | -30.7            | -18.5  -7.5         -2 |

Source: BEA, US International Transactions Accounts Data, Table 12: US International Transactions by Area, millions of dollars, not seasonally adjusted.

Notes: Country entries are sorted by decreasing share of all services in their total exports; figures for regions are italicized. The second and third column contain the shares of total and other private services, respectively, in a country’s total exports (goods and services) to the USA in the third quarter of 2008. Growth rates in columns 4–7 are annual percentage changes in the first quarter 2009.