The Crisis Resilience of Services Trade

Ingo Borchert and Aaditya Mattoo, DECRG

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 United States close to a third of all exports. New data on cross-border trade from the United States reveals that since mid-2008, trade in goods declined drastically but trade in some services is holding up remarkably well. More aggregate data available for other OECD countries also suggests that services trade has suffered less from the crisis than goods trade.

Within services, trade in goods-related transport services and crisis-related financial services has shrunk, as has expenditure on tourism abroad. But trade in a range of business, professional, and technical services is still increasing. Hence, developing countries like India, which are relatively specialized in business process outsourcing and information technology services, have suffered much smaller declines in total exports to the United States than countries like China or regions like Africa, which are specialized in exports of goods, transport services, or tourism services.

Initial evidence suggests that services trade is buoyant relative to goods trade for two reasons: demand for a range of traded services is less cyclical, and services trade and production are less dependent on external finance. If further investigation confirms that trade in certain services is inherently less affected by crises, then these services could play a more prominent role in developing countries’ diversification strategies.

The apparent resilience of services trade may be jeopardized by protectionism. Even though few explicitly trade-restrictive measures have so far been taken in services, the changing political climate and the widening boundaries of the state in crisis countries could introduce a national bias in firms’ choices regarding procurement and the location of economic activity.

U.S. Services Imports and Exports

Monthly U.S. imports and exports of goods declined by about one-third in value terms from peaks of $195 billion and $121 billion, respectively, in July 2008, to $122 billion and $85 billion, respectively, in February 2009. The corresponding decline in services imports and exports was only by about one-tenth, from $29 billion and $38 billion, respectively, in July 2008, to $26 billion and $33 billion, respectively, in February 2009 (figure 1).

Within services trade, interesting patterns emerge (figures 2 and 3). Imports and exports of goods-related services such as international transport have shrunk in the last quarter (year-on-year by about one-fifth) as has expenditure on tourism abroad (by about one-tenth). However, imports of “other private services” have actually grown slightly by 2 percent.

There are contrasting trends within “other private services.” On the one hand, trade in financial services has contracted in the last quarter (year-on-year imports by 12.5 percent and exports by an even higher 17 percent). On the other hand, trade in a range of other...
Figure 1: U.S. Monthly Imports and Exports of Goods and Services, January 2006–February 2009


Figure 2: Year-on-Year Growth Rates of U.S. Monthly Imports of Goods and Services, January 2007–February 2009

Source: BEA, U.S. International Trade in Goods and Services, months seasonally adjusted.
services is growing, with U.S. exports growing even faster than imports. This pattern is evident in insurance (imports by 3 percent, exports by 9 percent); telecommunications (imports by 2.5 percent, exports by 25 percent); and, in particular, a range of business, professional, and technical services (imports by 7 percent and exports by 10 percent).

Trade of Other OECD Countries

The United States accounts for 17 percent of all OECD imports of services and 20 percent of all OECD exports of services. How far does its experience reflect that of the OECD countries more generally? Trade data for the fourth quarter of 2008 has been released by a number of other OECD countries as well as two non-OECD countries (Brazil and Indonesia). This data is only available at an aggregate level, that is, for services trade as a whole and not for its subcomponents. Figure 4 shows for each country the quarterly growth rate of goods imports (on the vertical axis) and services imports (on the horizontal axis). Both rates are negative for all countries, except for Japan, for which the services import growth is positive. But interestingly, imports of goods are contracting faster for all countries except Australia and Poland. Until more detailed data becomes 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 U.S. data.

The Impact on Developing Countries

Overall exports to the United States of developing countries that are relatively specialized in services, like India (38 percent share of services in total exports), have declined less than exports of countries and regions for which services are less important, such as Brazil (12 percent share), China (9 percent share) and Africa (15 percent share) (figure 5). The contractions in their total exports (goods and services) to the United States in the fourth quarter were India (2.5 percent), Brazil (13 percent), China (9 percent), and Africa (36 percent). This relatively positive outlook is
corroborated by Indian industry sources, which suggest that employment in the export-oriented IT and business process outsourcing services is expected to grow by about 5 percent (around 100,000 jobs) in 2009. Thus, even during the crisis the industry continues to be a net hirer. While growth rates of both sales and employment are expected to be cut in half, this still leaves the sector with growth rates that would be considered buoyant in many manufacturing sectors.

Understanding the Resilience of Services Trade

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 are able to raise finance against orders placed. Moreover, receivables in business process outsourcing are fungible and easily factorized because they typically involve a short-term transaction, a buyer who is creditworthy, and a low incidence of disputes over the service rendered. 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, 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 demand for goods. One reason is that services 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 suffer neither from the “vintage effect” (that is, the willingness to wear an older pair of shoes or drive an older car) nor from the “inventory effect” (that is, the fact that cuts in final demand translate into bigger immediate cuts in demand for factory output because of inventory adjustment). Another reason for less contraction is that a larger part of international demand for services—such as outsourced back-office services—is less discretionary than demand for goods such as computers. Many outsourced services such as bookkeeping 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 (for example, 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.

The Subtle Threat of Protectionism

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 (such as financial services) are not as costly for both host and source as the increasing social and political aversion to immigration.

Another worry is the widening boundary of the state as a result of increased government ownership of firms during the crisis. Even though there is as yet no concrete evidence, there is a fear that state ownership will induce a national bias in firms’ choices on procurement and location of economic activity. 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

A key area for future research is to understand the reasons for the resilience of services trade. One possibility is that this resilience reflects delayed adjustment, both domesti-
cally and internationally. While some services industries like construction are affected more quickly in a recession, other services industries tend to adjust more slowly. Alternatively, as we have conjectured, resilience could be a consequence of certain features of services or services trade itself: demand for a range of traded services is less cyclical, and services trade and production are less dependent on external finance. Clearly we need more thorough investigation of these hypotheses. If services trade is inherently less affected by crises, then there may be additional benefits to diversifying a country’s export structure towards services activities.

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 have seen rapid export growth, by far the largest exporters of these services are the United States and the countries of the European Union. The EU and United States account for 65 percent of world services exports; China and India for 6 percent. The United States and EU have both consistently run a huge annual surplus on services trade, currently nearly $160 billion for the United States and $220 billion for the EU countries. While U.S. services imports from India and China have indeed grown to around $22 billion in 2008, U.S. exports to these countries have expanded even faster, to over $26 billion. Even during the crisis U.S. exports of key services are growing faster than its imports.

The United States 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, distribution, 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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Endnotes
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.
3. Part of the decline in the value of goods imports could be due to the fall in commodity prices. But note that U.S. goods exports also declined over the last seven months by one-third.
4. In terms of year-on-year growth rates, the decline in the value of goods imports was 33 percent in February 2009 while the decline in the value of services imports was only 7 percent. U.S. exports present a similar picture of year-on-year declines: a decline in goods exports by 21 percent by February, and in services exports by 6.5 percent.
5. Combinations of these factors may also lead to dynamic effects. Say, for example, 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.