Chapter 1

Introduction

Exchange is a fundamental economic activity that brings about many of the debates in the discipline of economics. Central to these debates are the questions of freedom and control on the activity of exchange and their implications on welfare and distribution of wealth. Controversies over free trade across national boundaries vis-à-vis interventionist trade policy are extensions of this central theme of freedom and control of exchange. Mainstream economic theory has frequently emphasised the importance of comparative advantage (arising due to differences in technology, factor endowments, and preferences) or difference between nations in the extent of economies of scale for attainment of allocative efficiency at both national and global levels through international exchange of goods and services. The theoretical case for free trade rests on the assumptions of intensifying competition through allowing free market interaction of buyers and sellers across nations. Presence of market distortions in the form of positive production externalities, size of market large enough to influence the international market price, uncertain demand for exports etc. have been identified as factors contributing to the theoretical case against free trade.

On one hand, concerns over factors such as distributional equity, macro economic objectives of achieving greater domestic employment, capacity utilisation, balance of external payments, improvement of international terms of trade, national security etc. have historically triggered intervention in free trade. On the other hand, while the debate over freedom and control of exchange and over freedom and intervention in international trade flows continue, negotiations take place between nations at bilateral and multilateral levels towards freedom of international trade from national interventions. Like any other policy shift, liberalisation of market access to foreign suppliers also brings about opposition from affected parties within these nations. The liberalisation attempts implicitly assume that any such losses will be compensated by the gains arising from trade liberalisation (like any other policy change) through policy
intervention at a domestic level. While such losses can be compensated in principle, it is many a times not the case in practice.

World Trade Organisation (WTO), built upon the organisational structure of General Agreement on Tariffs and Trade (GATT) and established in 1995, is an organisation responsible for negotiating and administering multilateral trade agreements among its Members. The three particular agreements currently under negotiation under the WTO are the General Agreements on Tariffs and Trade (GATT), the General Agreements on Trade in Services (GATS) and the Agreement on Trade Related Intellectual property Rights (TRIPS) dealing with goods, services and intellectual property respectively. In its Preamble, the Agreement establishing WTO spells out its objectives, namely, raising the standards of living and income, ensuring full employment, expanding production and trade and optimal use of the world’s resources. This Preamble also recognises that there is a need for positive efforts designated to ensure that developing countries, especially the least developed among them, secure better share of growth in international trade. The fundamental principles that the World Trade Organisation propagates among its Member states in all its agreements are (1) liberalisation of market access for free trade (in goods, services and intellectual property), (2) non-discriminatory treatment by Member states in formulating and implementing policy and (3) intensifying competition at the international level.

We desire to take a closer look at the trade agreements under the WTO. Given the wide nature of subjects encompassed by the agreements and activities of the organisation, we choose to explore and analyse the process of trade liberalisation on one particular sector, namely, the services sector. The General Agreement on Trade in Services under the WTO, a multilateral trade agreement with a purpose of liberalising services trade, lends itself well to that end. Services open to trade negotiation are many and each service sector is distinguished from another in more ways than one. These distinctions between services are sometimes too large to treat services as one homogenous sector. For example, financial services are distinguished from telecommunication services both in terms of their apparent form as well as in terms of implications of liberalisation of international trade. Given the limited scope of this dissertation, in both time and space, we have chosen to look into one particular service sector, that is, education services and analyse the implications of liberalising market access to foreign suppliers in that particular services sector. This dissertation is divided in to two parts. Part A (comprising of Chapters 2, 3 and 4) looks into the relatively broader aspect of trade liberalisation in services while Part B (comprising of Chapters 5, 6 and 7) probes into the liberalisation of trade in education services only. In both parts A and B discussions will have special reference to the trade negotiation under the WTO. Chapter 8 summarises and concludes the dissertation.

Services are distinguished from goods in many ways. Traditionally, services needed the presence of both producer and consumer for its production and exchange. For this reason many
services (especially service products) were thought of as non-tradable across national boundaries in the way goods are. Some of the service products have been exceptions and have been traded in the form of tourism services, students travelling abroad for studies etc. where consumers travel to the producers' nation to access such services produced in a foreign land. Technical progress, in general and particularly in the telecommunication and software industry, has made it possible to separate production of some services from its consumption. Hence trade has also been made possible in such services. For example, invention of computer software has made it possible for the consumer of many services to enjoy the service without the presence of the producer. Examples of such services include some management consulting and accounting services, engineering services, R&D, software development, legal services, data processing, secretarial, marketing, advertisements, telecommunication services, financial and insurance services. Nevertheless, services have long been traded as 'factor services' of labour and capital. Thus trade is possible both in factor services and some of the service products. When a factor service (in the form of labour or capital) is traded, production takes place in the importing country, which gives the exporting country a 'right to establish' (in case of capital) or a 'work permit' (in case of labour). When a service product is traded, production takes place in the exporting country and the importing country gives the exporting country a 'right to do business'. As services are traded in forms distinct from goods, the international barriers to services trade are different too in their forms from those applied to goods trade. While most of the barriers to market access for goods are applied at the borders, barriers to services trade are measures mostly applied within national boundaries. Discrimination in access to distribution networks, licensing requirements, qualitative standard requirements are examples of internal measures that act as barriers to services trade. A separate agreement was rendered under the WTO for the purpose of trade liberalisation in services in view of these dissimilarities, between goods and services, in ways of production, consumption, modes of delivery as well as in the barriers to trade.

Analysing and exploring the process of trade liberalisation in services requires, as a first step, a survey of the theoretical understandings on the subject. We begin with an outline of the 'theoretical' understandings on the welfare and distributional implications of trade liberalisation in general and trade liberalisation in services in particular in Chapter 2. Existing literature on international trade identifies certain situations where trade in goods enhances welfare. It can be noted that even in these situations where trade in goods is welfare enhancing, trade in services may not be. The difference occurs as transactions in the services market differ from goods in many respects. Attempt has been made to locate some circumstances / instances, pointed out in the existing theoretical literature, where a liberalised trade regime in services may not exhibit gain for every trading partner. The nature of the service in question, whether the service is traded as a final product or a factor service, form of trade in the particular service, structure and size of the
market of the service in question etc. play important roles in determining the pattern of trade, its welfare and distributional implications.

Having elucidated the essential theoretical understanding on the subject of trade in services we shall proceed to an exposition on the process of opening up of trade in services sector as per the General Agreement on Trade in Services. Chapter 3 will elaborate the principles and disciplines of GATS and exemplify some ambiguities present in GATS text.

According to the Preamble of the GATS, this agreement aims to establish a multilateral framework of principles for trade in services among its Member countries as a means of promoting economic growth of all trading partners and the development of developing countries. The preamble to GATS also asserts the desire to progressively liberalise trade in services, under conditions of transparency, through successive rounds of multilateral negotiations aimed at promoting the interests of all participants on a mutually advantageous basis and securing overall balance of rights and obligations while giving due respect to national policy objectives. A desire has also been expressed to facilitate the increasing participation of developing countries in trade in services and expansion of their service exports through strengthening of their domestic service capacity, its efficiency and competitiveness. According to its Preamble, the agreement recognises the Members' rights to introduce new regulations on the supply of service within their territories in order to meet national policy objectives. It acknowledges that given the asymmetries in degree of development of service regulations in different countries, developing countries have particular need to exercise this right. GATS defines trade in services as transactions in any of the following four forms - (1) cross border supply, (2) consumption abroad, (3) commercial presence and (4) temporary presence of natural persons. 'Cross-border-supply' is the supply of service directly to the consumer in one country from the producer in another country, without anyone having to move to foreign country. This is the group of service activities whose trade, as discussed above, has to a large extent been made possible due to technological progress especially in telecom industry. 'Consumption abroad' refers to trade in services, where the consumer moves to the country of the supplier (tourism, students travelling abroad for studies etc.). 'Commercial presence' and 'temporary presence of natural persons' refer to trade in factor services of capital and labour respectively. The principles of non-discrimination and progressive liberalisation are fundamental to the GATS. This agreement (as per the Most Favoured Nation clause) requires Members to be non-discriminating between other Member countries in respect of formulating and implementing measures affecting international trade. Also Members can commit to provide non-discriminatory treatment to foreign suppliers of services vis-à-vis the domestic suppliers (as per National Treatment clause).

Nevertheless, design and drafting are the preliminary steps towards the functioning of any treaty or agreement that has to be followed by the signing parties. Once any such agreement
is in operation, ambiguities about the time and manner of application of the rules and principles consisting it come to light. Chapter 3, as we have mentioned above, exemplifies some ambiguities present in GATS along with elaboration of the basic rules and principles of the agreement. In the course of operation of the agreement disputes are inevitable whenever at least two signing parties find themselves in situations where one or more of the rules consisting the agreement can be interpreted in several ways. Settlement of such disputes necessitates resolution of the so-called ambiguities and interpretations of the relevant clauses. Chapter 4 provides a review of the settled disputes involving general rules and principles of the GATS to illustrate how the related ambiguities have been resolved, in relation to the agreement. This 'legal' analysis of the rules, disciplines and case-laws under the GATS throws light on the way the objectives of establishment of the WTO and those of GATS have been attempted to be fulfilled by the organisation, particularly by its dispute settlement body. It is observed that the objective of progressive liberalisation of trade has been the most important and motivating force behind the legal process of dispute settlement, irrespective of whether the objective of trade liberalisation is consistent with the other objectives of growth, increasing income and employment and raising living standards of Members. It is also apparent that the conditions, given by the theoretical literature on trade in services, under which all involved parties may not benefit from trade liberalisation of services, have hardly been taken into account in formulating and interpreting the rules and principles of the agreement.

Having provided an elucidation of theoretical understanding on the implications of trade liberalisation in services and an account of the rules, disciplines and case-laws of General Agreement on Trade in Services in Part A we shall proceed in Part B to probe into the liberalisation of trade in a particular service sector, namely education services. Currently under negotiation under the General Agreement on Trade in Services, education service is an unusual service in several ways. It has characteristics distinct from many other goods and services. The most atypical of its characteristics is that the quality of the service provided by any particular institute bears upon the quality of its consumers (students) along with other usual parameters such as computational and library facilities, or quality of teaching etc. Also, in many of the Member countries, especially in developing Member countries, education has so far been largely provided by the public sector or by non-profit institutions. Education had been considered largely as a public good and the State had been conceived as the primary provider of education. Such provisioning of education had particular implications for the financing of education, its quality and access, as well as cultural and social values of the society. Given this set up of provision of education, liberalisation of market access to foreign providers essentially entails provision of education by profit earning suppliers. This shift in the provision of education is subject to diverse and conflicting opinions. Trade liberalisation in education essentially
undermines the identification of education as a publicly provided service and this change should have some implications on the funding and quality of and access to education. Part B of the thesis addresses this issue.

We introduce the process of trade liberalisation and the current state of negotiation in education services under the General Agreement in Trade in Services in Chapter 5. Following the classification of international delivery modes of services adopted by GATS, liberalisation of market access in education services by Member states involves allowing one or more of the following - (1) foreign providers to supply educational software etc. through telecommunication or mail, under the Cross Border mode, particularly for distance learning programs; (2) exchange of foreign students and students travelling abroad to study under the Consumption Abroad mode; (3) establishment of affiliated universities, satellite or branch campuses of foreign educational institutions by the Commercial Presence mode; (4) professors, teachers and researchers and other professionals to immigrate and work on a temporary basis through the Presence of Natural Persons mode. Under GATS the process of trade liberalisation in services (including education services) involves optional commitments for allowing Market Access and providing National Treatment to foreign-service providers. Members can also make 'Proposals' reflecting their concerns on the process and direction of liberalisation, under the WTO. Chapter 5 provides an account of the current state of commitments and presents the 5 proposals tabled by WTO Members concerning liberalisation of education services. This review of the commitments and proposals reveals the areas of concern and apprehension of Members regarding liberalisation of market access for education to foreign suppliers. This chapter also presents the relevant debate and policy issues in connection with trade in educational services. The debate concentrates primarily on three connected issues, namely access to and quality of education that 'traded education' providers and those providing domestically are expected to provide under a liberalised trade regime and the impact of trade liberalisation on distribution of income.

As pointed out above, liberalisation of market access to foreign providers essentially entails provision of education by profit earning suppliers and hence instituting free market in provision of education. So the debate on traded education resemble the debate on publicly provided education, or those provided under a non-profit basis, vis-à-vis privately provided education for profit earning. Chapter 6 attempts to trace the arguments, as obtained from theoretical literature on economics of education, with respect to provision of education on a profit-earning basis.

In Chapter 7 we choose to address this issue of trade liberalisation in education services through a theoretical model. Our focus in this chapter is liberalisation of market access in education sector, through a particular mode of supply, namely Commercial Presence (establishment of an affiliate university in case of education services) and the related concerns
over quality of and access to education. We focus on the concerns associated to import of education, particularly to a developing country with an established public education system, like that of India. The specific issues that we attempt to explore are (1) quality of education an affiliate university is likely to offer to its prospective students; and (2) alterations in the access to education as result of trade in education through Commercial Presence.

The question of quality of education expected from an affiliate university appears to be a significant source of concern for importing countries. On one hand, there are expectations that affiliates of reputed foreign universities will provide a superior quality of education than that available in most developing countries. On the other hand, there are also apprehensions that cost minimising 'exporters' might offer a poor quality of education. There are more than one dimension to quality of education. The literature on 'economics of education' on the issue of quality of education identifies 'teaching quality' and 'students' quality' as indicators of the quality of education. Literature on 'education' also identifies 'resources used by an institute on students' as another indicator of the quality of education; yet this particular indicator of educational quality had not been incorporated in theoretical analyses in economics. We attempt to incorporate this aspect of the measure of quality of education into the analysis. The existing literature suggests that the institution of free market improves teaching quality as long as the teachers' earnings are directly related to the number of students in the class and the students are informed about the quality of service they are purchasing, even before the transaction is made. The literature also suggests that an improved students' quality can be expected from an institute driven by profit motive, vis-a-vis that in a non-profit institute as long as non-profit institutes provide education to all students irrespective of their merit and the for-profit institute does not involve any extra cost in selecting better quality students. Our finding of the theoretical model in Chapter 7 that incorporates 'resources used by an institute on the students' as another indicator of the quality of education along with 'students' quality' is as follows. It shows that the affiliate university offers a quality of education (measured by the amount of educational resources incurred per student) that is relatively superior than the domestic university of the importing country if and only if (1) it can charge a price beyond some threshold value for a superior educational quality and (2) the domestic university maintains a cut-off student quality that is neither too high or too low. In all other situations the affiliate university does not improve upon the domestic university in terms of quality measured by the amount of educational resources incurred per student. As a result of this trade, education may become accessible to some students with superior economic background making distribution in the access to education biased towards them. Gain from trade is unambiguous for the exporting country.

1 Adam Smith, John Stuart Mill as mentioned in 1\textcopyright 6, (\textcopyright 6)