

## **UNIT – I**

The purpose of introducing this subject is to give an overview about the legal environment and the intricacies involved in international trade.

Law is defined as a set of rules established by a government to regulate the conduct of individuals and groups in a society. These rules are legal obligations imposed on citizens and enforced by the Sovereign. It is the duty of citizens to obey these rules and those who violate them are liable for punitive action. One of the major reasons for the development of law was to give protection to individuals, to society, and to property. Law is not limited to regulating relationships between individuals or between individuals and their society but also be used as a positive force to promote worthwhile social goals.

In fact, in our consumer-oriented society law touches every aspect of business life. Therefore, it is imperative to know what Business Law is. Business law is that part of the law which deals with mercantile transactions of mercantile people. One of the reasons for studying business law is to learn to predict what the law will be in the conduct of businesses both at the national and international level. Understanding business law will enhance the ability to take right decisions without violating rules framed by the government. The following brief introduction helps the students to get acquaintance with Business Law.

### **INTERNATIONAL LAWS FOR BUSINESS**

Business today is truly international. International trade has existed since times immemorial. There are findings to indicate that international trade existed as long back as 2000 B. C. With increasing complexities and volumes in international trade, an urgent need for a uniform code for regulating these transactions was keenly felt. The importance of international trade and a uniform code is more keenly felt in present day economy where domestic and foreign politics play their influencing role in conducting transnational business.

International Law for business aims at providing the regulations required for execution of international transactions involving more than one nation. Every country has its own set of laws for regulating business. Therefore, it is apparent that every international business transaction has to comply with provisions of both domestic as well as international law. In order to ensure performance of the transaction(s), parties enter into treaties/agreement. These treaties are framed according to general practice and customs. The most significant aspect of international law is jurisdiction.

Though it is not important for students to go for a detailed study of business law in each country, understanding the structure of the legal system in different countries helps in making a good comparative study.

### **Why do we need Law?**

One should keep in mind that the base for law is a dispute. The judgment of a decided case becomes a referral point - known as a precedent. The reason behind this reference is to facilitate uniformity in deciding similar cases. It may be noted that precedents may be overruled if the judgment pronounced earlier is found to be erroneous. To enable students to have a better view of the legal structure, a discussion on the legal system existing in five economically important countries like Canada, Germany, Saudi Arabia, Japan and China would be fruitful.

**Canada**, the second largest country in the world framed its own constitution in 1982 by the act of British Parliament. It has a bicameral parliament - House of Commons and a Senate. Canada follows the principle of legislative supremacy, giving importance to precedents. Cases, statutes, customs and royal prerogative are the sources of Canadian law. The judges for federal and provincial courts are selected by Governor-General of Canada. The legal system of Canada is primarily based on the common law tradition. By and large, the regulatory framework is uniformly applicable throughout Canada with the exception of the

province of Quebec. Quebec has been given special rights to preserve its culture, language and governing institutions.

**Germany**, the largest European country, follows the civil law tradition. Of all the civil codes, the German Civil Code has had the widest influence in the development of laws in other countries like China, Japan and many Eastern and Central European countries. With the unification of the erstwhile two German nations, the political authority is divided between the federal government and the states. Matters of utmost importance like defence, foreign affairs, currency, nationality and intellectual property are exclusively looked into by the federal government. The Chancellor, the most powerful political figure, makes public policy and appoints heads of state. There is marked difference in the manner cases are resolved and the judiciary system that exists in Germany as compared to other countries. Two important codes play a significant role. They are the German Civil Code and the German Commercial Code. The civil code has 2300 sections divided into five parts with the first two covering legal and contractual obligations. The commercial code sets rules for doing business in Germany.

**Saudi Arabia**, an Islamic country, has a legal system that follows the Sharia –commandments of Prophet Mohammad. Unlike other countries, Saudi Arabian government has only two wings - the executive and judicial, and the King is the supreme authority. The regulations approved by the King are published in the official gazette. There are agencies to assist in regulating the administration of the Kingdom. The most important among them are the Supreme Commission on Labor Disputes, the Commissioner for the Settlement of Commercial Disputes and Board of Grievances. A well regulated country, Saudi Arabia strongly abides by the Holy Quran. As such students will note that unlike common law systems, charging of interest is prohibited among many other things. Dispute resolution normally results in damages or recession.

Despite the difference in the regulatory structure, the importance of Saudi Arabia in present day economy is continually growing.

**Japan**, is perhaps the only example of 'real development' in almost all areas. Japan which was battered and ravaged during the World War II, is now among the most advanced countries of the world. A look at its legal system shows traces of the Tokugawa period influence of the German Civil Code and the American influence. Right from the early days, Japanese gave much importance to the Confucian system where the head of the family/village was the deciding authority. His word was rarely contested. The process of industrialization in the nineteenth century saw Japan draw up a Civil Code based on the German Civil Code. This however, underwent a drastic change after the Second World War when the American influence separated the church and state and introduced a parliamentary system with a duly elected Prime Minister and a bicameral legislature. Despite, the American influence Japanese have a different outlook in matters of international trade. All contracts have the regular clauses. Yet, the Japanese treat an international transaction as an opportunity to develop personal ties and business relationships. They look for flexibility, amicable settlement of disputes and performance of contract in good faith.

**China** has for many hundreds of years been known for the superior quality of goods it produces and its ancient medical practice. Thus, international trade has been an integral part of Chinese economy. Very much like the Japanese Confucian attitude, the Chinese have deep faith in behaving in an honorable and ethical manner. Until recently, the attitude of Chinese towards practitioners of law has been discerning. Primarily because it has gone through a lawless period during the Cultural Revolution known as 'Dark Ages' in 1966 and the second revolution which started in 1976 with the death of Mao Zedong's. Today, China has a large, complex system of agencies, the most important among them being Ministry-of Foreign Economic Relations and Trade which

renders guidance in matters related to foreign trade. The governing statute for foreign trade is Foreign Economic Contract Law (FECL). According to FECL all contracts should be in writing, must express the real intent of the parties who must have legal contractual capacity and the contract should not violate law or public policy. Before resorting to arbitration, Chinese prefer to settle disputes out of court through friendly consultations, which again reflects their reliance on traditional value of honorable and ethical behavior.

**European Community** - The aftermath of the Second World War set the world leaders to think of a united Europe to achieve economic alliance and compatible political and legal setup. Thus, started the European community. The first step towards this was, building a common market between France and Germany for coal and steel through the European Coal and Steel Community (ECSC). The success of this led to signing of a number of treaties like the EURATOM, European Economic Community (EEC) and the Maastricht Treaty, all directed towards political and economic unity. To simplify the administration of ECSC, EURATOM and EEC, a merger treaty was subsequently signed.

The European community has a well organized administrative set-up comprising of council of ministers, parliament, commission, courts of justice and auditors, and advisory committees. These community institutions have developed substantive laws- which prevail over individual country laws and create rights in individuals and businesses which are to be protected by national courts.

## **INTERNATIONAL TRADE - LEGAL FRAMEWORK**

We have looked briefly into the various laws prevalent in different countries. Let us now concentrate on what will be the scenario if two or more nations wish to have trade relationships and the various regulations that one has to follow.

**GATT:**

The General Agreement on Tariffs and Trade popularly known as **GATT** attempts to promote multilateral fair trade and reduce trade barriers. Members of GATT reduce trade barriers by granting 'Most Favored Nation' (**MFN**) status and charging the lowest applicable tariff rates for imports from MFN. GATT provides for promotion of fair trade by prohibiting 'dumping' and 'unfair subsidies, bounties and grants'.

Lack of adaptability of GATT, to regulate world trade has resulted in nations entering into a direct trade relationship like the North American Free Trade Agreement for example. In other cases some developed nations have come forward to help the less-developed countries by permitting duty free imports of certain items under the Generalized System of Preferences.

**Regulation of Imports and Exports**

Tariff or duty which is levied on imports is one of the important sources of income for a country. Tariff is levied based on the classification of products, its value which usually is the transaction value and its place of origin.

The rate of duty levied on imported goods has significant impact on the domestic market for that product. To safeguard domestic interests some countries may resort to imposition of non-tariff barriers like adherence to strict quality standards in order to ensure safety to health and environment. Quotas and embargoes are the other forms of non-tariff barriers.

On the other hand, countries wanting to promote exports may extend technical, market, and financial assistance and tax benefits to the exporters. To check undue assistance, GATT imposes countervailing duties on exports supported by unfair subsidies. The United States regulates its exports under the Export Administration Act of 1979. The primary objective being to protect its economy in case of short supply, to protect national security and to further its

foreign policy objectives. The US has a complex regulatory structure for both imports and exports which includes the anti-boycott regulations.

### **Global Business Enterprises**

Let us now look at another important aspect of international law relating to international or global business organizations. International business organizations often known as Multinational Enterprises (MNE) are organizations having business entities in two or more countries. These entities are so interlinked that one exercises significant influence over the other.

MNE can adopt different channels for doing business. It may choose to do business either through its own firm or through agents and distributors. In the case of an agent and principal relationship, depending upon the country in which the agent would be operating, the terms and conditions are decided. Some countries provide for protective measures to safeguard against unfair termination of the agency.

Distributors on the other hand buy goods for the purpose of selling them and offering after-sales and warranty services. Unlike in agency contracts, distributors cannot bind the manufacturer with their acts. Distributorship contracts are normally for a fairly lengthy period as they involve large investment on part of the distributor.

Licensing of technology is another form of doing global business. Licensing agreement may: (i) permit manufacture of patented, trademarked or copyrighted product, or (ii) be a franchise arrangement.

MNE may also choose to carry-on business in different countries by investing directly. This investment can be either by acquiring an existing company, opening a branch, establishing branches or starting a joint venture.

### **Regulation of Global Competition:**

Competition may make businesses to resort to unfair, restrictive and monopolistic trade practices. Many developed as well as developing countries

have adopted regulations to prevent such malpractices. For instance, the US has enacted antitrust laws – Sherman Act and Clayton Act. The European Community through Articles 85 and 86 of the Treaty of Rome also attempts at regulating unfair business competition. Japan too has antimonopoly law to prohibit unreasonable trade practices and abuse of dominant market power. Regulations have also been passed to check hostile acquisitions and strategic alliances.

### **Protecting Business Property Rights**

Inventions, creations, technological advancements when protected take the form of copyrights, patents, trademarks or trade secrets. These intellectual properties are assets of business enterprises, as they are essential for the success of businesses. Hence, the need to encourage their growth and also provide legal protection against misuse, theft, etc.

Copyright law gives authors and artists the right to control the reproduction and performance of their work(s). The period of protection varies in each country. By and large, protection is granted to authors for their life plus 50 years, and for photographic and works of applied art for 25 years.

Patents provide exclusive right to manufacture or use an invention for a specific period of time. Patent laws are primarily territorial. However, there are a couple of international agreements to provide patent protection like the European Patent Convention and the Patent Co-operation Treaty. Lack of a universally accepted patent law hinders introduction of a product on a global basis.

Trademark is any work, name, symbol, or device or any combination thereof adopted and used by manufacturer or merchant to identify his goods and distinguish them from those manufactured or sold by others.

Apart from protecting their intellectual property rights, business enterprises are faced with a more complex problem of dealing with piracy and



counterfeit goods. Pirates and counterfeiters cause great harm as they deprive the owner of the protected work his share of royalty, the authorized dealer his profit and the buyer of quality product. The US government through an amendment of the Trade Act of 1974, attempts to counteract such practices under Section 301 of the said act.

Another problem faced by business enterprises is the gray market, where legitimate goods are marketed through unauthorized channels. Protecting intellectual property rights do not prevent governments from expropriating such property for public use. The criteria for such expropriation should be that these properties are taken for public use and a 'just' compensation is paid for their acquisition.

### **The MNE as world citizen**

Merely by their size, MNE have an edge over other corporations. Their ability to access capital helps in developing countries. They also possess the powers to exploit natural and human resources, demolish local economies and corrupting and controlling political figures.

The United Nations Commission on Trade and Development (UNCTAD) has been making efforts for evolving a code of conduct for MNE to ensure their positive influence on the economy and avoid economic menace like the collapse of the Bank of Credit and Commerce International (BCCI) .the organization for Economic Co-operation and Development (OECD), has set guidelines to protect corporations in its member countries from MNE abruptly. Following the Bhopal disaster, various governments have through treaties and conventions sought to adopt policies to reduce various polluting activities and protecting environment.

Thus 'International Law for Business' covers a whole gamut of business aspects with an international perspective.

### **CONTRACTS**

After having discussed about the general legal framework prevailing in the international business scenario, let us now discuss the other aspects involved in international business laws, viz., Contract - legal provisions; payments terms; international sales agreements; rights and duties of agents and distributors.

### **Legal Provisions:**

Contracts are an integral part of business and assume significance in case of transactions for sale of goods between two or more countries. Different contract laws in each country necessitated formulation of a uniform international law - for contracts. Thus, in 1988, the United Nations Convention on Contracts for the International Sale of Goods (CISG) came into force with 10 nations endorsing it.

The CISG is organized in four parts. Part I (Articles I to 13) contains the Convention's general provisions, including rules on the scope of its applications and rules of interpretation. Part II (Articles 14 to 24) governs the formation of contracts. Part III (Articles 25 to 88) governs the rights and obligations of buyers and sellers. Part IV (Articles 89 to 101) contains provisions for the ratification and the entry into force of convention.

The essentials of a valid contract are that there should be an offer and acceptance and consideration. Utmost care is required to be taken while drafting the contract for incorporating the terms and conditions. This is important as a single contract can be incorporated in more than one way in case of any ambiguity. To ensure uniformity in international contracts, certain common terms relating to price, delivery, title, insurance like FOB, CIF, C&F, FAS, etc., have come into use. These are known as Incoterms. These are used in contracts involving sale of goods.

It is reiterated that the term 'contract' is not restricted only to sale of goods. There are contracts for setting up ventures, mergers and acquisitions and for transfer of intellectual property.

In order to ensure performance of contracts and provide for remedy in case of dispute, CISG also provides a resolution mechanism. Generally, the choice of forum and enforcement clauses is included in a contract, so as to define the area of jurisdiction in case of a dispute.

### **Letters of Credit**

Naturally, a contract for sale of goods involves purchase of goods for consideration .which is often money, and the mode of payment is an important clause in a contract. With today's dynamic market transactions across countries, Letters of Credit" (LOC) is considered to be one of the safest mode of payment. (LOC is an instrument issued by a bank or other person at the request of an account party that obliges the issuer to pay to a beneficiary a sum of money within a certain period of time upon the beneficiary's presentation of documents specified by the account Payee)

There is another use for LOC in America and Japan. It is the "standby Letters of Credit". In these two countries, banks are not permitted to engage in insurance activities. Standby LOC are more like insurance policies, performance bonds or repayment guarantees. Despite the inbuilt safety-net, frauds do take place in the transactions because the LOC requires payment to be made against presentation of documents and since banks are under no obligation to scrutinize the underlying transaction, the buyer may be defrauded. Two cases - United Bank Ltd. vs. Cambridge Sporting Goods Corporation and Itek Corporation vs. First National Bank of Boston make an interesting reading.

### **Transport and Insurance**

A contract is incomplete unless the parties have decided on the mode of transport to be utilized for transporting the goods and the extent of risk coverage. Sales contracts involving transportation customarily contain trade terms like FOB and CIF. Transportation may be either by air or ship. When shipped, the parties to a contract may adopt the provisions of the Carrier of

Goods by Sea Act (COGSA) to adjust their liability. One of the important shipping documents is the 'Ocean Bill of Lading' which is a contract between the carrier and the shipper. It serves as a receipt for the goods and also as a negotiable document of title. Where goods are transported by air, the documentation is called an 'Air Waybill'. An air waybill performs the same functions as a bill of lading, except that it is generally non-negotiable. A bill of lading or an air waybill is among the many documents to be submitted to the banks for obtaining Payment under a LOC.

Most contracts also have an insurance clause to minimize risk of loss or damage during transit.

#### **PAYMENT TERMS:**

##### **1) Letter of Credit**

A document issued by a bank (issuing bank) stating its commitment to pay someone a stated amount of money on behalf of a buyer so long as the seller meets very specific terms and conditions. Letters of credit are more formally called documentary letters of credit.

Before payment, the bank responsible for making payment on behalf of the buyer verifies that all documents are exactly as required by the letter of credit. If an United States exporter is unfamiliar with the credit risk of the foreign bank, or if there is concern about the political or economic risk associated with the country in which the bank is located, it is advised that a letter of credit issued by a foreign bank be "confirmed" by a U.S. bank. This means that the U.S. bank adds its pledge to pay to that of the foreign bank. Letters of credit that are not confirmed are called "advised" letters of credit. The local Department of Commerce district office or an international banker will help exporters determine whether a confirmed or advised letter of credit is appropriate for a particular transaction.

## **Types of Letter of Credit**

**Irrevocable (unconfirmed)** - A letter of credit that cannot be amended or cancelled without prior mutual consent of all parties to the credit. Such a letter of credit guarantees payment by the bank to the seller/exporter so long as all the terms and conditions of the credit have been met. This is the most popular form of letter of credit.

**Revocable (confirmed)** - A letter of credit that can be cancelled or altered by the drawee (buyer) after it has been issued by the drawee's bank. Revocable letter of credits are rarely used because of security concerns.

**Transferable**- A letter of credit that can be redirected at the seller's request. These are used when an export broker is involved. Once all conditions on the letter of credit are met, the broker's bank receives the payment, takes out his commission, and completes the transaction as negotiated.

**Sight** - A letter of credit that requires payment to be made upon presentation of documents.

**Time Draft**- A letter of credit that states payment is due within a certain time (usually 30, 60, 90, or 180 days).

Changes made to a letter of credit are called amendments. The fees charged by the banks involved in amending the letter of credit may be paid either by the buyer or the seller, but the letter of credit should specify which party is responsible. Since changes are costly and time-consuming, every effort should be made to get the letter of credit right the first time.

An exporter is usually not paid until the advising or confirming bank receives the funds from the issuing bank. To expedite the receipt of funds, wire transfers may be used. Bank practices vary, however, and the exporter may be able to receive funds by discounting the letter of credit at the bank, which involves paying a fee to the bank for this service. Exporters should consult with their international bankers about bank policy on these issues.

**Payment and Risks with Letter of Credits:**

	Time of Payment	Goods Available to Importer	Risk to Exporter	Risk to Importer
Irrevocable	At sight of presentation of documents to issuing bank; or specified number of days after acceptance by issuing bank	After Payment	Risk lies with United States confirming bank	None
Revocable	Same as Confirmed	After payment	Risk lies with foreign issuing bank and economic conditions of issuing bank	None
Sight	When shipment is made	After payment	Risk lies with local confirming bank	Assured shipment is made, but relies on exporter to ship goods described in the documents
Time Draft	At maturity of draft, may or may not be discounted	Usually before payment	Risk lies with local confirming bank	Assured shipment is made, but relies on exporter to ship goods described in

				the documents
Red Clause	A percentage of total amount before shipment. Balance is same as type of L/C	After payment	See irrevocable and revocable	The percentage of payment in advance is at total risk. Balance same as type of L/C
Revolving Letter of Credit	Variable	Variable	See irrevocable and revocable	None
Standby Letter of Credit	At time shipment is received	Usually before payment	Delay in payment. Also see irrevocable	None
Back-to-back	Same as irrevocable	After payment	None	None
Transferable	Same as irrevocable	After payment	Same as irrevocable	None
Assignment of Proceeds	Same as irrevocable	After payment	Same as irrevocable	None

## 2) Cash in Advance (CIA)

Usually used only for small purchases and when the goods are built to order.

## 3) Draft (or bill of exchange)

An unconditional order in writing from one person (the drawer) to another (the drawee), directing the drawee to pay a specified amount to a named drawer at a fixed or determinable future date. May be date, sight, or time draft.

#### **4) Credit cards**

Used mainly in transactions where the dollar value of the items sold is low and shipment is to be made directly to the end user.

#### **5) Open Account**

The exporter bills the customer, who is expected to pay under agreed terms at a future date. Some of the largest firms abroad make purchases only on an open account, which is a convenient method of payment if the buyer is well established and has demonstrated a long and favorable payment record.

#### **6) Consignment Sales**

Exporter delivers goods to an agent under agreement that the agent sell the merchandise for the account of the exporter. The agent sells the goods for commission and remits the net proceeds to the exporter.

#### **7) Counter trade/barter**

Sale of goods or services that are paid for in whole or in part by the transfer of goods or services from a foreign country.

#### **Payment Problems**

The best solution to a payment problem is to negotiate directly with the customer. If negotiations fail and the sum involved is large enough to warrant the effort, obtain the assistance of your bank, legal counsel, and other qualified experts. If both parties can agree to take their dispute to an arbitration agency, this step is faster and less costly than legal action. The International Chamber of Commerce handles the majority of international arbitrations and is usually acceptable to foreign companies because it is not affiliated with any single country.

For more information on these issues, contact the U.S. Council for International Business, American National Committee of the ICC, 212-354-4480; American Arbitration Association, 212-484-4000; Trade Remedy Assistance Office International Trade Commission, 202-205-2200.



### **Risk Factors Influencing Payment Terms:**

	<b>Letter of Credit</b>	<b>Cash on Documents</b>	<b>Open Account</b>
Customer Relationship	New	Established	Established
Type of Order	Custom	Production	Production
Political Situation	Unstable	Stable	Strong
Economic Situation	Unstable	Stable	Strong
Competition	No	Yes	Yes
Volatility of Price Changing Downwards for Buyer	Yes	No	No
Cash Flow Timing and Needs	Yes	Adjustable	Adjustable

### **Payment Terms**

A list of things to consider when determining the best price for your product overseas.

### **Terms of Sale**

Terms in international business transactions often sound similar to those used in domestic business, but they frequently have very different meanings. For this reason, the exporter must know the terms before preparing a quotation or a pro forma invoice.

## **Preparing Quotes for International Buyers**

While a sales contract that spells out the details of a transaction is warranted for larger, more complex deals, a quotation in the form of a Proforma Invoice may be sufficient for smaller transactions.

Learn how to prepare Pro forma invoices and the information they should contain and more about how to prepare quotes.

Proper pricing, complete and accurate quotations, choosing the terms of the sale, and selecting the payment method are four critical elements in selling a product or service overseas. Of the four, pricing can be the most problematic, even for an experienced exporter.

## **Pricing Considerations**

The price considerations listed below will help an exporter determine the best price for the product overseas.

- ❖ At what price should the firm sell its product in the foreign market?
- ❖ What type of market positioning (customer perception) does the company want to convey from its pricing structure?
- ❖ Does the export price reflect the product's quality?
- ❖ Is the price competitive?
- ❖ Should the firm pursue market penetration or market-skimming pricing objectives abroad?
- ❖ What type of discount (trade, cash, quantity) and allowances (advertising, trade-off) should the firm offer its foreign customers?
- ❖ Should prices differ by market segment?
- ❖ What should the firm do about product line pricing?
- ❖ What pricing options are available if the firm's costs increase or decrease? Is the demand in the foreign market elastic or inelastic?

- ❖ Are the prices going to be viewed by the foreign government as reasonable or exploitative?
- ❖ Do the foreign country's antidumping laws pose a problem?

As in the domestic market, the price at which a product or service is sold directly determines a firm's revenues. It is essential that a firm's market research include an evaluation of all of the variables that may affect the price range for the product or service. If a firm's price is too high, the product or service will not sell. If the price is too low, export activities may not be sufficiently profitable or may actually create a net loss.

The traditional components of determining proper pricing are costs, market demand, and competition. Each of these must be compared with the firm's objective in entering the foreign market. An analysis of each component from an export perspective may result in export prices that are different from domestic prices.

It is also very important that the exporter take into account additional costs that are typically borne by the importer. They include tariffs, customs fees, currency fluctuation transaction costs and value-added taxes (VATs). These additional costs can add substantially to the final price paid by the importer, sometimes resulting in a total of more than double the U.S. domestic price.

### **Foreign Market Objectives**

An important aspect of a company's pricing analysis is determining market objectives. For example, is the company attempting to penetrate a new market, looking for long-term market growth, or looking for an outlet for surplus production or outmoded products? Many firms view the foreign market as a secondary market and consequently have lower expectations regarding market share and sales volume. This naturally affects pricing decisions.

Marketing and pricing objectives may be general or tailored to particular foreign markets. For example, marketing objectives for sales to a developing nation

where per capita income may be one tenth of that in the United States are necessarily different from the objectives for Europe or Japan.

### **Costs**

The computation of the actual cost of producing a product and bringing it to market is the core element in determining if exporting is financially viable. Many new exporters calculate their export price by the cost-plus method. In the cost-plus method of calculation, the exporter starts with the domestic manufacturing cost and adds administration, research and development, overhead, freight forwarding, distributor margins, customs charges, and profit.

The effect of this pricing approach may be that the export price escalates into an uncompetitive range. It clearly shows that if an export product has the same ex-factory price as the domestic product; its final consumer price is considerably higher once exporting costs are included.

Marginal cost pricing is a more competitive method of pricing a product for market entry. This method considers the direct, out-of-pocket expenses of producing and selling products for export as a floor beneath which prices cannot be set without incurring a loss. For example, additional costs may occur due to product modification for the export market that accommodates different sizes, electrical systems, or labels. On the other hand, costs may decrease if the export products are stripped-down versions or made without increasing the fixed costs of domestic production.

Other costs should be assessed for domestic and export products according to how much benefit each product receives from such expenditures. Additional costs often associated with export sales include:

- Market research and credit checks;
- Business travel;

- International postage, cable, and telephone rates;
- Translation costs;
- Commissions, training charges, and other costs involving foreign representatives;
- Consultants and freight forwarders; and
- Product modification and special packaging.

After the actual cost of the export product has been calculated, the exporter should formulate an approximate consumer price for the foreign market.

Sample Cost-Plus Calculation of Product Cost		
	Domestic Sale	Export Sale
Factory price	\$7.50	\$7.50
Domestic freight	.70	.70
subtotal	8.20	8.20
Export documentation		.50
subtotal		8.70
Ocean freight and insurance		1.20
subtotal		9.90
Import duty (12 percent of landed cost)		1.19
subtotal		11.09
Wholesaler markup (15 percent)	1.23	
subtotal	9.43	
Importer/distributor markup		2.44
subtotal		13.53

Retail markup (50 percent)	4.72	6.77
Final consumer price	\$14.15	\$20.30

### **Market Demand**

For most consumer goods, per capita income is a good gauge of a market's ability to pay. Some products may create such a strong demand such as popular goods like Levis, that even low per capita income will not affect their selling price. Simplifying the product to reduce its selling price may be an answer for the exporter to most lower per capita income markets. The firm must also keep in mind that currency fluctuations may alter the affordability of its goods. Thus, pricing should try to accommodate wild changes in the U.S. and/or foreign currency. The firm should anticipate the type of potential customers. If the firm's primary customers in a developing country are expatriates or belong to the upper class, a higher price might be feasible even if the average per capita income is low.

### **Competition**

In the domestic market, few companies are free to set prices without carefully evaluating their competitors' pricing policies. This situation is true in exporting, and is further complicated by the need to evaluate the competition's prices in each potential export market.

If there are many competitors within the foreign market, the exporter may have little choice but to match the market price or even under price the product or service in order to establish a market share. On the other hand, if the product or service is new to a particular foreign market, it may actually be possible to set a higher price than in the domestic market.

## **Pricing Summary**

In summary, here are the key points to remember when determining your product's price:

- Determine the objective in the foreign market.
- Compute the actual cost of the export product.
- Compute the final consumer price.
- Evaluate market demand and competition.
- Consider modifying the product to reduce the export price.
- Include "nonmarket" costs, such as tariffs and customs fees.
- Exclude cost elements that provide no benefit to the export function, such as domestic advertising.

## **Quotations and Pro Forma Invoices**

Many export transactions, particularly initial export transactions, begin with the receipt of an inquiry from abroad that is followed by a request for a quotation. The preferred method for export is a pro forma invoice, which a quotation is prepared in invoice format.

A quotation describes the product, states a price for it, sets the time of shipment, and specifies the terms of the sale and terms of the payment. Since the foreign buyer may not be familiar with the product, the description of it in an overseas quotation usually must be more detailed than in a domestic quotation. The description should include the following 15 points:

1. Seller's and buyer's names and addresses.
2. Buyer's reference number and date of inquiry.
3. Listing of requested products and brief description.

4. Price of each item (it is advisable to indicate whether items are new or used and to quote in U.S. dollars to reduce foreign-exchange risk).
5. Appropriate gross and net shipping weight (in metric units where appropriate).
6. Appropriate total cubic volume and dimensions packed for export (in metric units where appropriate).
7. Trade discount (if applicable).
8. Delivery point.
9. Terms of sale.
10. Terms of payment.
11. Insurance and shipping costs.
12. Validity period for quotation.
13. Total charges to be paid by customer.
14. Estimated shipping date from U.S. port or airport.
15. Currency of sale.

Pro forma invoices are not used for payment purposes. In addition to the 15 items previously mentioned, a pro forma invoice should include two statements. One that certifies the pro forma invoice is true and correct and another that gives the country of origin of the goods. The invoice should also be clearly marked "pro forma invoice."

Pro forma invoices are models that the buyer uses when applying for an import license, opening a letter of credit or arranging for funds. In fact, it is a good practice to include a pro forma invoice with any international quotation, regardless of whether it has been requested or not. When final commercial invoices are being prepared prior to shipment, it is advisable to check with the U.S. Department of Commerce or another reliable source for any special invoicing requirements that may be required by the importing country.



If a specific price is agreed upon or guaranteed by the exporter, the precise period during which the offer remains valid should be specified. Additionally, it is very important that price quotations state explicitly that they are subject to change without notice.

### **International Sales Agreements:**

#### **Terms of Sale**

In any sales agreement, it is important that there is a common understanding of the delivery terms since confusion over their meaning can result in a lost sale or a loss on a sale. The terms in international business transactions often sound similar to those used in domestic business, but they frequently have very different meanings. For this reason, the exporter must know the terms before preparing a quotation or a pro forma invoice.

The following are a few of the more frequently used terms in international trade:

- **CIF (cost, insurance, freight)** to a named overseas port where the seller quotes a price for the goods (including insurance), all transportation, and miscellaneous charges to the point of debarkation from the vessel. (Used only for ocean shipments.)
- **CFR (cost and freight)** to a named overseas port where the seller quotes a price for the goods that includes the cost of transportation to the named point of debarkation. The the buyer covers the cost of insurance. (Used only for ocean shipments.)
- **CPT (carriage paid to)** and **CIP (carriage and insurance paid to)** a named place of destination. These terms are used in place of CFR and CIF, respectively, for all modes of transportation, including intermodal.
- **EXW (ex works)** at a named point of origin (e.g., ex factory, ex mill, ex warehouse) where the price quoted applies only at the point of origin. The seller agrees to place the goods at the buyer's disposal at the specified

place within the fixed time period. All other charges are put on the buyer's account.

- **FAS (free alongside ship)** at a named port of export where the seller quotes a price for the goods that includes the charge for delivery of the goods alongside a vessel at the port. The seller handles the cost of wharfage, while the buyer is accountable for the costs of loading, ocean transportation, and insurance.
- **FCA (free carrier)** at a named place. This term replaces the former "FOB named inland port" to designate the seller's responsibility for handing over the goods to a named carrier at the named shipping point. It may also be used for multimodal transport, container stations, or any mode of transport, including air.
- **FOB (free on board)** at a named port of export where the seller quotes the buyer a price that covers all costs up to and including the loading of goods aboard a vessel.
- **Charter Terms:**
  - **Free In** is a pricing term that indicates that the charterer of a vessel is responsible for the cost of loading goods onto the vessel.
  - **Free In and Out** is a pricing term that indicates that the charterer of the vessel is responsible for the cost of loading and unloading goods from the vessel.
  - **Free Out** is a pricing term that indicates that the quoted prices include the cost of unloading goods from the vessel.

It is important to understand and use sales terms correctly. A simple misunderstanding may prevent exporters from meeting contractual obligations or make them responsible for shipping costs they sought to avoid.

When quoting a price, the exporter should make it meaningful to the prospective buyer. For example, a price for industrial machinery quoted "EXW

Saginaw, Michigan, not export packed" is meaningless to most prospective foreign buyers. These buyers would find it difficult to determine the total cost and might hesitate to place an order.

The exporter should quote CIF or CIP whenever possible, as it shows the foreign buyer the cost of getting the product to or near the desired country.

If assistance is needed in figuring CIF or CIP prices, an international freight forwarder can help. The exporter should furnish the freight forwarder with a description of the product to be exported and its weight and cubic measurement when packed. The freight forwarder can compute the CIF price usually at no charge.

If at all possible, the exporter should quote the price in U.S. dollars. This will eliminate the risk of exchange rate fluctuations and problems with currency conversion.

#### **FORMAT OF INTERNATIONAL SALES AGREEMENT**

Business Name \_\_\_\_\_

Contact Person \_\_\_\_\_

Address \_\_\_\_\_ City \_\_\_\_\_

State/Province \_\_\_\_\_ Country \_\_\_\_\_

Postal Code \_\_\_\_\_

Telephone Number \_\_\_\_\_

E-mail Address \_\_\_\_\_

#### **TERMS AND CONDITIONS**

1 The manufacturer warrants each product sold by the manufacturer to be free from defects in material and workmanship for a period of one year from the date of purchase, normal wear and tear excluded. No other warranty or guarantee is implied or expressed and manufacturer's liability is limited to replacement of defective products during the warranty period.

2 The buyer shall not sell or distribute or promote the sale or distribution of the products back into the United States.

3 Buyer is solely responsible, at his/her own expense, for securing all import and other necessary permits, licenses and registrations and complying with all regulatory requirements applicable to the sale or use of the products in buyer's state, province, and/or country.

4 The relationship contemplated by this agreement is one in which manufacturer is the vendor and the buyer is the vendee. The buyer is not an agent, employee, or legal representative of the manufacturer for any purpose whatsoever, and shall have no power or authority to incur or create any obligations or liability of any kind for or on behalf of the manufacturer. The buyer shall conduct its business as an independent contractor and all persons employed in such business shall be employees of the buyer.

5 Buyer may not use the name The Story Teller, the motto "See, Touch, Listen and Learn," the little boy kneeling at the easel or the logo as their business name or any form thereof. The buyer recognizes the validity of the manufacturer's intellectual property rights and will take no steps to register them or otherwise interfere with the ownership rights of the manufacturer.

6 All orders must be prepaid in US dollars. Money orders, cashiers check, direct wire or credit cards (Visa, MasterCard, and Discover) are acceptable forms of payment.

7 Prices for the products sold to the vendee shall be the manufacturer wholesale price in effect at the time of shipment. The manufacturer may change the wholesale prices in whole or part, with ninety-(90) days notice to the vendee.

8 Product is shipped within five days after payment is received. If a longer time is required, manufacturer will notify buyer.

9 The manufacturer shall not be liable to the buyer or any of the buyer's customers for any loss, damage, detention or delay resulting from fires, strikes,

lockouts, insurrections or riots, civil or military authority, acts of God, lack of timely instructions from or information from the buyer, war, act of government, unusually severe weather, default of any other manufacturer or supplier or subcontractor, freight embargoes, quarantine, transportation contingencies, or any other cause beyond its reasonable control.

10 Freight carrier handling charges, procurement of documents, duties, customs and taxes of every nature, air or ocean freight charges and insurance are paid by buyer. Shipments are sent freight prepaid unless arrangements are made otherwise.

11 Product returns are accepted within 30 days of shipment and are subject to a 10% restocking fee (based on retail dollars). The buyer will be responsible for all return freight handling charges, procurement of documents, duties, customs and taxes of every nature, air or ocean freight charges and insurance are paid by buyer.

12 Pre-authorization must be received before any return shipment.

13 Pre-authorization can be received by, faxing (801) 423-2568, or e mailing (ryan@thetoryteller.com) list of items to be returned and reason for your request.

14 This agreement shall be read and construed and have effect according to the laws of the State of Utah, US. Should any questions or disputes arise as to the true intent and meaning of, or the performance or breach of any provision under this agreement, every such dispute shall be, if not settled amicably by mutual consultation, forthwith settled by arbitration. This arbitration shall be in accordance with the UNICITRAL Rules of Arbitration as at present in force. In the event the parties cannot agree on a mutually acceptable arbitrator within thirty (30) days of the delivery of notice of arbitration as provided under said rules, then the International Chamber of Commerce, Paris, France, shall be the appointing authority only for the purposes of selecting the arbitrator. The

number of arbitrators shall be one (1) and the place of arbitration shall be Salt Lake City, Utah, UT. The language used in the arbitration shall be English. Judgment may be entered upon the award of the arbitrator and will be enforceable in accordance with applicable law against the liable party.

15 Any award by the arbitrator or judgement of any court, as the case may be, shall include payment and/or reimbursement of the prevailing party's costs and expenses incurred in connection with any dispute, controversy, claim or breach, including reasonable attorney's fee and costs of enforcing the award of the arbitrator.

16 The authentic text of this agreement shall be English.

**This agreement shall become valid and binding when signed and received by The Story Teller, PO Box 921, Salem, UT 84653**

\_\_\_\_\_

Authorized Buyer Signature

Manufacturer Authorized Signature

Date

**Agent or Distributors:**

Agency and Distributor arrangements are both examples of different methods of overseas market entry. For both Agency and Distributor Agreements, the basic parties involved are usually:

**The Principal (Exporter)**

**The Overseas Intermediary (Agent or Distributor)**

**The Overseas Buyers/end-user**

However, the relationships between these parties will differ depending on whether the Intermediary is an Agent or Distributor. The term 'Agent' is often used as a 'generic' term to describe either an agent or a distributor. The

term 'agent' is often, confusingly used, to describe what a 'distributor' arrangement is in fact. However, the two arrangements are fundamentally different in their operation, both offering different advantages and disadvantages to the parties concerned.

### **What are the differences between an Agent and a Distributor?**

**An Agent** is a person employed by a Principal to make contracts on the principal's behalf with Third Parties. The Agent puts the Principal into contractual relations with the overseas buyer(s). There is no contract of sale between the Agent and the Buyer. The agent does not take the commercial risk. It is the Principal who takes the commercial risk.

**A Distributor** buys goods for their own account to resell into their overseas market. The contract of sale is between the Principal and the Distributor. There is no contractual relationship between the Principal and the Distributor's customers.

### **Advantages and Disadvantages between an Agent and a Distributor:**

#### **1. Contracts of Sale**

**AGENCY:** In an Agency arrangement, the Principal will be dealing with '**multiple accounts**' and therefore must undertake separate '**operations**' for each contract of sale, for example:

For **each account** the Principal must:

Take the commercial risk (credit insurance)

Separate invoicing, accounting and administration

Separate distribution and shipping arrangements

Handling smaller order quantities

The **disadvantage** here is that all these operations will incur additional costs, (distribution, invoicing, accounting, administration, debt collection) resulting in increased prices or reduced profits).

**DISTRIBUTOR:** In a Distributor arrangement, the Principal only deals with **one account** i.e. that of the Distributor. The Distributor takes the commercial risk of multiple accounts.

The **advantage** here compared to Agency, is that:

Commercial risk is only with one account

Larger order quantities and bulk distribution

(Reduced costs)

## **2. Market Penetration**

**AGENCY:** Because the Principal is contracting directly with the customers in the market, the Principal has a presence and reputation in the market.

The **Advantage** of this is:

**Future product launches** into the market are easier if the ‘company’ is known.

**Market trends, customer knowledge** and **end-user requirements** can be monitored and responded to if there is a direct relationship.

**DISTRIBUTOR:** The Principal has no control over which customers the Distributor sells to.

The **company name** of the Principal may not be marketed and Promoted in the overseas market.

**Market trends** can not easily be directly monitored and reacted to by the Principal.

## **3. Terms and Conditions**

### **AGENTS**

Terms and Conditions of **Agency Agreements** are governed by EU law (Commercial Agents Regulations 1993. These Regulations cover primarily the Rights and Duties of Principal and Agent and are automatically incorporated into any Agency contract.

For example:

Duties of Agent:



To perform duties in person (and not delegate)

Carry out work with ordinary skill and diligence

Not accept a bribe or secret profits

Must be no conflict of interest between Agent and Principal

To obtain the **best price** from customers that is **reasonably obtainable**.

Duties of Principal:

Payment of Commission

Indemnify the Agent for any expenses incurred.

Rights of Agent:

**Termination:**

There are mandatory **Notice Periods:**

1 month during 1st year

2 months during 2nd year

3 months during 3rd and subsequent years

Compensation:

On termination the Principal must pay:

Compensation (calculated on the loss suffered as a result of the loss of the Agency.

Indemnity (capped at 1 years commission)

**DISTRIBUTOR**

The terms and conditions of a **DISTRIBUTOR** Agreement are essentially **Contractual**.

The terms and conditions of the Agreement are essentially based on the formal agreement between the Principal and Agent. However, there are restrictions imposed by both UK and EU law:

**Price Fixing Agreements:**

Price fixing is almost always inexcusable. **Minimum selling prices** are regarded as **'price fixing'**. However, Maximum 'Recommended' Selling Prices

are not in breach are not in breach of EU law but they are unenforceable because they do not affect competition.

**Advantages:** Agency – more price control (must obtain reasonable price) the distributor could kill the market by overpricing the product

**Disadvantages:** Agency – more regulations imposed:

Commission payment termination

#### **4. Order Quantities**

**AGENCY:** The volume of orders which the agent obtains is dependent on his/her ability to sell to contacts in the market.

**DISTRIBUTOR:** The contract between the Principal and Distributor often stipulates a minimum order quantity which the Distributor must take within a specified time period. The Principal is guaranteed a volume of sales provided the Distributor complies with the contract but is otherwise in breach of contract and can be sued for damages.

#### **DISADVANTAGES TO BOTH AGENTS AND DISTRIBUTORS**

a) Both Agents and Distributors usually require some kind of **Exclusivity** before they commit to representing their Principal. This means that the Agent or Distributor is given exclusive rights over a particular territory for a particular product. The Principal agrees that no other Agent or Distributor will be appointed to sell those products in that territory.

The **Disadvantage** here is that the Principal is **limiting** his/her market entry potential. Penetration into the market is dependent upon the ability and the results of the Agent/Distributor. It could be that there are other opportunities in the market which the Agent /Distributor are not accessing.

#### **b) Competing Products**

It is not unheard of for a Representative to request exclusivity with a view to keeping the Principal out of the market, because they are successfully selling competitors products.

## **ADVANTAGES TO BOTH AGENTS AND DISTRIBUTORS**

a) Both Agents and Distributors offer the Principal a **Presence** in the overseas market. This gives the advantage to the Principal of:

Local presence abroad

Language and cultural knowledge

Quicker service delivery (trouble shooting and servicing)

### **b) Complementary Products**

Both Agents and Distributors often have more than one Principal. It is important for the Principal to know who else the Agents/Distributor is representing, particularly if exclusivity is granted. An Agent or Distributor who represents a few Principals, who offer complementary products, can offer:

A comprehensive product range which enables products to be sold on the back of others. The agent will have an established database of customers and contacts to whom the Principal's products can be sold.

### **Laws Applicable to International Business**

Domestic Laws

Foreign Laws of Host Country

International Law

Executive Agreements

Treaties

Customary International (Common) Law

“Private Law” law of the K (Contract)

## **ISSUES INVOLVED IN INTERNATIONAL BUSINESS LAW**

### **TRANSNATIONAL SALES**

Choice-of-Law

Each court uses its own conflicts rules.

Federal courts sitting in diversity apply state rules.

Most courts enforce choice-of-law clause, unless it violates a significant public policy.

**Transfer Pricing:** Prices which entities under common control charge each other for goods and services.

**Tax Treaties:**

Increases coordination of tax authorities, fight tax evasion

Try to eliminate overlapping taxation (integrate systems)

One country may forgo taxing a type of income or transaction and allow the other country to tax it.

**International Litigation**

All international contracts should have Choice-of-forum clause and Choice-of-law clause.

**ARBITRATION**

An International contract should contain some of the following clauses

Agreement to submit some or all questions to arbitration

Place of arbitration

Must be signatory state

Should have history of enforcing arbitration awards

Issues must be arbitral in the place

Method of appointing arbitrators

Language in which arbitration takes place

Choice of law

**PUBLIC INTERNATIONAL LAW**

International Court of Justice applies:

- International Conventions (treaties)
- International Custom (general practice accepted as law)
- General Principles of Law Civilized Nations Recognize
- Judicial Decisions/School Writing (precedent not binding)

Customary International Law

- International Custom (2 elements):
- General Practice (material number of states)
- Acceptance as Law (bound to apply, not just preferred)

## **WORLD ECONOMIC ENVIRONMENT**

### **General Agreement on Tariffs and Trade (GATT)**

**Objectives:** reduce trade barriers & discriminatory treatment

Rules of tariff negotiation/adoption of tariff schedules

Rules governing international trade

Provides forum for consultation among members

Does not create a private right of action in U.S.

### **Article I: Non-Discrimination**

Most-Favored Nation: all members enjoy same benefits

Country must adopt all GATT agreements to be MFN

*Exceptions* (no trade restrictions between members):

Free-Trade Zones (individual duties to non-members)-NAFTA

Customs Unions (unified duties to non-members)-EU

### **Article II: Limits on Tariffs**

Members use rates in tariff schedules for all members

*Exceptions* (Arts. VI, XIX,):

Anti-Dumping (selling materially < FMV)

Countervailing Duties (to counteract export subsidies)

Escape Provision (temporary relief for unforeseen developments + serious injury to domestic producers)

### **Article III: National Treatment**

Laws/regs must treat imports same as domestic goods

### **Article XI: No Import Restrictions Other Than Tariffs**

*Exception:* quotas to maintain hard currency reserves

Harmful products may generally be banned (but banning a certain process—e.g., way of fishing—is more suspect)

### **Article XX: Conservation Laws Not Prohibited:**

Necessary to protect human, animal, plant life or health

Relating to conservation of exhaustible natural resources

*Chapeau:* Not arbitrary/unjustifiable discrimination or disguised restriction on international trade. *Shrimp-Turtle Case*

### **World Trade Organization (WTO)**

**Dispute Settlement Body (DSB):** if conciliation and mediation fail, DSB may assemble panel to hear case

Decision stands unless WTO vetoes it within 60 days

Appellate Body: hears appeals of law/legal interpretation

### **Agreement on Trade-Related Investment Measures (TRIMS):**

Forbids rules on investment in a country that:

Prevent the enterprise from importing goods

Require it to buy local goods

Require it to export a certain amount of goods

### **General Agreement on Trade in Services (GATS)**

### **Agreement on Trade-Related Aspects of I.P. Rights (TRIPS)**

## **International Monetary Fund (IMF)**

Objectives:

Facilitate foreign exchange among members (almost all U.N. members are IMF members)

Floating rate is used for exchange

Keep countries from de-valuing their currency to gain economic advantage (leads to race to the bottom)

Restrict national exchange controls

Exchange Controls: government restricts its citizens from exchanging its currency for foreign currency (central bank rations foreign currency)

*Exception:* country may maintain and adapt existing controls to remedy balance-of-payment problems

Special Drawing Rights (SDR): IMF members may draw currency from other members in order to temporarily equalize balance-of-payments

If member violates rules on exchange controls, its SDRs may be eliminated.

## **AGENCY & DISTRIBUTORSHIP AGREEMENTS**

Agents:

More control exerted by manufacturer, especially on price

Agent never takes title to goods

Manufacturer retains risk of non-payment

Agent makes \$ as commission on sales

Agent often has authority to bind principal in K

Fewer antitrust problems for exclusivity

Many countries have protective legislation for agents

May create a PE for tax purposes

Distributors:

Manufacturer has less control, especially on price

Distributor takes title to the goods (and risk of loss)  
Distributor has risk of non-payment  
Distributor makes \$ on profit (upside + downside risk)  
Distributor may not bind the principal in contract  
Exclusivity may raise antitrust problems  
Usually no protective legislation for distributors  
Probably will not create a PE

Issues in Agency/Distributor Agreements:

“Exclusive” (may manufacturer enter the market itself?)

Survival of Confidentiality/Non-Compete Clause

Termination of Agreement

U.S. Law: generally does not protect agents/distributors.

“Good Faith” may be required in terminating agreement.

Notice of Termination (mandatory rule):

Term contract converts to Indefinite Period contract if continued

Indefinite Period contract (tacks prior term if continued):

1 mo. for 1st year

2 mo. if 2d year commenced

3 mo. if 3d or subsequent year commenced

May require 4mo/4yr, 5mo/5yr, 6mo/6yr notice

Principal’s notice period may not be less than agent’s

Damages or Indemnity (mandatory rule):

Up to 1 year’s (5-yr ave) compensation

*Exceptions:*

Agent terminates (unless due to illness, age, death)

Breach of K (agent does not meet sales quota)

Term expires (decision not to renew ≠ damages)

Non-Compete: limited to 2 years after termination.



Choice-of-Forum or Law: cannot avoid Directive *Ingmar* or “mandatory terms”

Rome Convention by choice-of-law or -forum clause

Mandatory terms may be “non-arbitral” for NY Conv

Exclusivity

3 Types of Restraints:

Territorial Exclusivity: exclusive right to sell in territory

Territorial Restrictions: may not sell outside territory

Non-Compete: may not sell competing goods

## QUESTIONS

1. Explain the necessity of International Business law and trace its history.
2. What is the Letter of Credit and explain and its different types.
3. What are the payment and risks involved in L/C's.? What factors influence payment terms.
4. Explain the contents of an International Sales Agreement.
5. What are the rights and duties of agents and distributors under international business?
6. What is the difference between agent and an distributor under International Business Laws.
7. Write short notes on
  1. GATT
  2. MNE
  3. Letter of Credit
8. What is the relevance of WTO in International Business?

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## **Unit- II**

### **GATT/WTO AND GLOBAL LIBERALIZATIONS**

#### **Regulatory framework of WTO**

The world trade Organization (WTO) the successor to the General Agreement on Tariffs and Trade GATT – established in 1984) came into being on 1 January 1995, is the only international organization dealing with the rules of trade between nations. And its heart is the WTO agreements, negotiated and signed by the bulk of the worlds trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters and importers conduct their business.

The global business environment is very significantly influenced by the WTO principles and agreements. They also affect the domestic environment. For example, India has had to substantially liberalise imports, including almost complete removal of quantitative imports restrictions. The Liberlisation of imports implies that domestic firms' have to face an increasing competition from foreign goods. Liberlisation of foreign investment can result in growing competition from MNCs. These liberalizations on the other hand, also provides new opportunities for Indian firms as the foreign markers become more open for exports and investments. The liberalization also enables Indian firms to seek foreign equity participation and foreign technology. This could help them to expand their business or improve competitiveness. Further the Liberlisation facilitates global sourcing by Indian firm's sop that they can improve their competitiveness. Indian suppliers can benefit from global sourcing by foreign firms.

Firms will have to be efficient and dynamic to survive the global competition. Inefficient firms may go out of business.

## **GATT**

The general Agreement on Tariffs and Trade (GATT), the predecessor of WTO was born in 1984 as results of the international desire to liberalise trade.

The establishment of an international Trade Organisation (ITO) had also been recommended by the Bretton Woods conference of 1944 which had recommended the IMF and World Bank. Although the IMF and World were established in 1946, because of objective that its enforcement provisions would interfere with the autonomy of domestic policy making, the ITO charter was never ratified. Instead the GATT, which had been drawn up only as an interim agreement to fill the gap u until the ITO charter was ratified, became the framework for international trading system since 1948. The international trading system since 1948was, at least in principle, guided by the rules and procedures agreed by the signatories to the GATT which as an agreement signed by the contracting nations which were admitted on the basis of their willingness to accept the GATT disciplines.

The GATT was transformed into a world Trade Organisation (WTO) with effect from January, 1995. Thus after about five decades, the original proposal of an international Trade Organisation has taken shape as the WTO. The WTO which is a more powerful body than the GATT has an enlarged role than the GATT. India is one of the founder members of the IMF, World Bank, GATT and the WTO.

## **Objectives and Principles**

The primary objective of GATT was to expand international trade by liberlising trade so as to bring about all round economic prosperity. The Preamble to the GATT mentioned the following as its important objectives.

- ❖ Raising standard of living

- ❖ Ensuring full employment and a large and steadily growing volume of real income and effective demand.
- ❖ Developing full use of the resources of the world.
- ❖ Expand of production and international trade.

GATT embodied certain conventions and general principles governing international trade among countries that adhere to the agreement. The rules or conventions of GATT required that:

1. Any proposed change in the tariff, or other type of commercial policy of a member country should not be undertaken without consultation of other parties to the agreement.
2. The countries that adhere to GATT should work towards the reduction of tariffs and other barriers to international trade, which should be negotiated within the framework of GATT.

For the realization of its objective, **GATT adopted the following principles:**

1. **Non – discrimination:** The principle of non discrimination requires that no member country shall discriminate between the members of GATT in the conduct of international trade. To ensure non discrimination the members of GATT agree to apply the principle of most favoured nation (MFN) to all import and export duties. This means that “each nation shall be treated as the most favoured nation.” As far as quantitative restrictions are permitted, they too, are to be administered without favor.

However, certain exceptions to this principle are allowed. For instance, GATT does not prohibit economic integration such as free trade areas or customs union, provided the purpose of such

integration is “to facilitate trade between the constituent territories and not to raise barriers to the trade of other parties,” The GATT also permits the members to adopt measures to counter dumping and export subsidies. However the application of such measures shall be limited to the offending countries.

2. **Prohibition of quantitative restrictions.** GATT rules seek to prohibit quantitative restrictions as far as possible and limit restrictions on trade to the less rigid tariffs. However, certain exceptions to this prohibition are granted to countries confronted with balance of payments difficulties and to developing countries. Further, import restrictions were allowed to apply to agricultural and fishery products if domestic production of these articles was subject to equally restrictive production or marketing controls.
3. **Consultation.** By providing a forum for continuing consultation, it sought to resolve disagreements through consultation. So far eight Rounds took several years. The Uruguay round, the latest one, took more than seven years to conclude, as against the originally contemplated more than four years. This shows the complexity of the issues involved in the trade negotiations.

### **An Evaluation of GATT**

The growing acceptance of GATT/WTO, despite their shortcomings, is evinced by the increase in the number of the signatories. When the GATT was signed in 1947, only 23 nations were party to it. It increased to 99 by the time of the Seventh Round and 117 countries participated in the next. i.e. the Uruguay Round. In July 1995, there were 128 signatories. In August 2003, 146 countries were members of WTO, and about two dozen more nations were negotiating membership. It is interesting to note that the Peoples Republic of China, which

was one of the original signatories of the GATT, quit it in the late 1940s following the assumption of power by the communist party, but got admitted to the WTO, after a prolonged negotiation, with effect from 1 January 2002. The WTO members now account for over 97 per cent of the international trade indicating the potential of the WTO in bringing about an orderly development of the international trade.

The 50 years preceding the dawn of the present century have seen as exceptional growth in world trade. Merchandise exports grew on an average of 6 per cent annually. Total trade in 2000 was 22 times the level of 1950. GATT and the WTO have helped to create a more liberal trading system contributing to unprecedented growth. The system was developed through a series of trade negotiations, or rounds, held under GATT. The first round dealt mainly with tariff reductions but later negotiations included other areas such as anti-dumping and non tariff measures. The last round the 1986 -1994 Uruguay Round – led to the creating of WTO and provided for global economic and business liberalization of very wide scope and ramifications.

One of the principal achievements of GATT was the establishment of a forum for continuing consultations. “Disputes that might otherwise have caused continuing hard feeling, reprisals, and even diplomatic rupture have been brought to the conference table and compromised”. GATT could achieve considerable trade liberalization. There were, of course several exceptions.

Agricultural trade was clearly an exception to the liberalization. Far from becoming freer, trade in agriculture became progressively more distorted by the support given to farmers (which took the form of severe barriers to imports and subsidies to exports) in the industrial nations.

Similarly, another exception was textiles. Trade in textiles was restricted by the Multifibre Arrangement (MFA). Under the MFA imports of textile items to a number of developed countries were restricted by quotas.

Besides agriculture and textiles, two exceptions to the general trend of trade liberalization have been trade of developing countries and economic integration. Developing countries with balance of payments problems have been generally exempted from the liberalization. Even the Uruguay Round has granted such exemptions to developing countries.

Although the picture of trade liberalization has to be qualified with such exceptions, the GATT achieved very commendable trade liberalization. The average level of tariffs on manufactured products in industrial countries was brought down from about 40 percent in 1947 to nearly three per cent after the Uruguay Round.

Indeed the period of 1950 – 1973 is conspicuous by the splendid results of progressive trade liberalization. In 275 years since 1720, this period witnessed the highest average annual growth rates in output and international trade. These rates were substantially higher than for any other period. Indeed, the 1950s and 1960s are described as the golden decades of capitalism. The output levels of companies' using newer and newer technologies in many cases were much larger than the domestic markets could absorb. Expansions of markets to other countries enable even companies in other industries to increase their output. There was also a surge in international investments.

The progressive liberalization of trade, however, suffered a setback since 1974, although the elimination of Tariff Barriers continued, even the developed countries have substantially increased Non Tariff Barriers since then.

The collapse of the Bretton Woods systems in the early 1970s and the oil crisis made matters very difficult for many countries, both developing and developed, and as a result of these demands for protection increased dramatically. The exports of developing countries have been hit very hard by the NTBs, as pointed out earlier in this chapter.



Further, the exports of developing countries gained significantly less from the GATT Rounds than did exports of the industrial nations. The trade liberalization has been confined mostly to goods of interest to the developed liberalization, but also there was an increase in protection. Manufactured products of interest to developing countries like textiles and clothing, footwear etc. have been subject to increasing non tariff barriers. While the developed countries enjoy a more liberalized trading environment, the growing NTBs have been severely affecting the exports of developing countries. Ironically, the developed countries are increasing the protectionism when the developing countries are liberalising. This is indeed a sad commentary on the GATT and other multilateral organizations.

### **THE URUGUAY ROUND**

Uruguay Round (UR) is the name by which the eighth and the latest Round of the multilateral trade negotiations (MTNs) held under the auspices of the GATT is popularly known because it was launched in Punta del Este in Uruguay, a developing country, in September 1986.

Because of the complexities of the issues involved and the conflict of interests among the participating countries, the Uruguay Round could not be concluded in December 1990 as was originally scheduled. When the negotiations dragged on, Arther Dunkel, the then Director General of GATT, presented a Draft Act embodying what he thought was the result of the Uruguay Round. This came to be popularly known as the Dunkel Draft. This was replaced by an enlarged and modified final text which was approved by the delegations from the member countries of the GATT on 15<sup>th</sup> December 1993. This Final Act was signed by ministers of 125 governments on 15<sup>th</sup> April 1994. The results of the Uruguay Round are to be implemented within ten years since 1995. Different time periods are given for effecting the different agreements.

The first six Rounds of MTNs concentrated almost exclusively on reducing tariffs; while the Seventh Round (Tokyo Round – 1973 – 1979) moved on to tackle non tariff barriers (NTBs). The UR sought to broaden the scope of MTNs far wider by including new areas such as:

- ❖ Trade in services
- ❖ Trade related aspects of intellectual property (TRIPs)
- ❖ Trade related investment measures (TRIMs)

Because of the inclusion of these new aspects in the GATT negotiations, the developing countries had serious apprehensions, about outcome of the Uruguay Round.

The Uruguay Round took up three basic subjects for discussion:

1. Reducing specific trade barriers and improving market access.
2. Strengthening GATT disciplines.
3. Problems of liberalization of trade in services, trade related aspects of intellectual property rights (TRIPs) and trade related investment measures (TRIMs)

The most outstanding feature of the UR was the inclusion of the subjects in the 3<sup>rd</sup> item referred to above in the MTNs of GATT. The traditional concerns of the GATT were limited to international trade in goods. The UR went much beyond goods to services, technology, investment and information.

Some of the important features of the Uruguay Round Agreement are given below.

## **WORLD TRADE ORGANISATION**

Following the UR Agreement, GATT was converted from a provisional agreement into a formal international organization called World Trade Organisation (WTO) with effect from 1 January, 1995. WTO now serves as a single institutional framework encompassing GATT and all the results of the Uruguay Round. It is directed by a Ministerial conference that will meet at least

once every two years and its regular business is overseen by a General council. The WTO Secretariat is based in Geneva, Switzerland.

The membership of the WTO increased from 128 in July, 1995 to 144 countries as of 1 January, 2002 and about two dozen more nations were negotiating for the membership. It is interesting to note that the People Republic of China, which was one of the original signatories of the GATT quit it in the late 1940s following the assumption of power by the communist party, but got admitted to the WTO, after a prolonged negotiations, with effect from 1 January, 2002. The WTO members now potential of the WTO in bringing about an orderly development of the international trade.

### **GATT AND WTO**

The old GATT system allowed, under what was known as the 'grandfather clause', existing domestic legislation to continue even if it violated a GATT agreement that a member country had accepted by being a signatory to GATT. The WTO, specially rules this out.

This situation, after the coming into effect of WTO, may be described as the GATT is dead, long live the WTO.

Under the old system, there were two GATT's:

- (i) GATT the Agreement—i.e., the agreement between contracting parties (governments) setting out the rules for conducting international trade
- (ii) GATT the Organisation – an international organization created to facilitate discussions and administration related to the Agreement

(ad hoc, through, continued to exist until the establishment of the WTO).

GATT the Organisation, ceased to exist with the establishment of WTO, GATT the agreement, which always dealt with (and still does) trade in goods, continues to exist, in amended form, as part of the WTO alongside two new agreements, viz., General Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs). The old text is now called "GATT 1947" and the updated version is called 'GATT 1994'.

Difference between GATT and WTO

GATT	WTO
<ul style="list-style-type: none"> <li>GATT was Ad hoc and provisional agreement are permanent</li> </ul>	<ul style="list-style-type: none"> <li>WTO and its</li> </ul>
<ul style="list-style-type: none"> <li>GATT had contracting parties</li> </ul>	<ul style="list-style-type: none"> <li>WTO has members</li> </ul>
<ul style="list-style-type: none"> <li>GATT system allowed existing domestic this Legislation to continue even if it violated a GATT agreement</li> </ul>	<ul style="list-style-type: none"> <li>WTO does not permit</li> </ul>
<ul style="list-style-type: none"> <li>GATT was less powerful, dispute settlement than</li> </ul>	<ul style="list-style-type: none"> <li>WTO is more powerful than</li> </ul>

System was slow and less efficient, its ruling dispute settlement mechanism is  
Could be easily blocked. Faster and more efficient, very difficult to block  
the rulings.

In Short, the WTO is GATT plus a lot more. GATT (the institution) was small and provisional, and not even recognized in law as international

Organisation. GATT (the agreement) has been amended and incorporated into the new WTO Agreement. GATT deals only with trade in goods. The WTO Agreements now cover services and intellectual property as well.

The WTO is a more powerful body with enlarged functions than the GATT and is envisaged to play a major role in the world economic affairs. To become a member of the WTO, a country must completely accept the results of the Uruguay Round.

### **Functions**

The WTO's overriding objective is to help trade flow smoothly, freely, fairly and predictably.

It does this by:

1. Administering the WTO trade agreements
2. Providing the forum for negotiations among its members concerning their multilateral trade relations in matters dealt with under the Agreement.
3. Administering the mechanism for settling trade disputes between the member countries.
4. Monitoring national trade policies.
5. Providing technical assistance and training for developing countries
6. Co operating with other international organizations like the IMF and IBRD and its affiliated agencies with a view to achieving greater coherence in global economic policy making.

### **WTO Principles**

The WTO agreements have three main objectives:

- ❖ To help trade flow as freely as possible.
- ❖ To achieve further liberalization gradually through negotiation.
- ❖ To set up an impartial means of settling disputes.

A number of simple, fundamental principles run throughout all the WTO agreements. They are the foundation of the multilateral trading system. They include:

- ❖ Non – discrimination (“most favoured-nation” treatment and “national” treatment)
- ❖ Freer trade, predictable policies, encouraging competition.
- ❖ Extra provisions for less developed countries.

These are described under the objectives of GATT above.

### **Organizational Structure**

Decisions in the WTO are made by the entire membership-this is typically by consensus. A majority vote is also possible but it has never been used in the WTO, and was extremely rare under the WTO’s predecessor, GATT. The WTO’s agreements have been ratified in all members’ parliaments.

The WTO’s top level decision making body is the Ministerial conference which meets at least once every two years.

Below this is the General Council (normally ambassadors and heads of delegation in Geneva, but sometimes officials sent from members’ capitals) which meets several times a year in the Geneva headquarters. The General Council also meets as the Trade Policy Review Body and the Dispute Settlement Body.

At the next level, the Goods Council, Services Council and Intellectual Property (TRIPS) Council report to the General Council.

Numerous specialized committees, working groups and working parties deal with the individual agreements and other areas such as the environment, development, membership applications and regional trade agreements.

All WTO members may participate in all councils, committees, etc., except Appellate Body, Dispute Settlement panels, Textiles Monitoring Body, and plurilateral committees.

### **The WTO Agreements – A Bird’s Eye View**

The WTO endeavors to ensure that trade is as fair as possible and as free as practicable by negotiating rules and abiding by them. The WTO’s rules – the agreements are the result of negotiations between the members. The current sets were the outcome of the 1986 -1994 Uruguay Round negotiations which included a major revision of the original General Agreement on Tariffs and Trade (GATT).

GATT is now the WTO’s principle rule-book for trade in goods. The Uruguay Rounds also created new rules for dealing with trade in services, relevant aspect of intellectual property, dispute settlement and trade policy reviews. The complete set runs to some 30,000 pages consisting of about 30 agreements and separate commitments (called schedules) made by individual members in specific areas such as lower customs duty rates and services market opening.

Through these agreements, WTO members operate a non-discriminatory trading system that spells to their rights and their obligations. Each country receives guarantees that its exports will be treated fairly and consistently in markets of other countries. Each promises to do the same for imports into its own market. The System also gives developing countries some flexibility in implementing their commitments.

**Goods:** Trade in goods was the concentration of GATT until the Uruguay Round negotiations. From 1947 to 1994, GATT was the forum for negotiating lower customs duty rates and other trade barriers; the text of the General Agreement spelt out important rules, particularly non discrimination.

Since 1995, the updated GATT has become the WTO’s umbrella agreement for trade in goods. It has annexes dealing with specific sectors such as agriculture

and textiles and with specific issues such as state trading, product standards, subsidies and actions taken against dumping.

**Services:** Banks, insurance firms, telecommunications companies, tour operations, hotel chains and transport companies looking to do business abroad can now enjoy the same principles of freer and fairer trade that originally only applied to trade in goods.

These principles appear in the new General Agreement on Trade in Services (GATS). WTO members have also made individual commitments under GATS stating which of their services sectors they are willing to open to foreign competition, and how open these markets are

**Intellectual property:** The WTO's intellectual property agreement amounts to rules for trade and investment in ideas and creativity. The rules state how copyrights, patents, trade markers, geographical names used to identify products, industrial designs, integrated circuit layout designs and undisclosed information such as trade secrets – “intellectual property” – should be protected when trade is involved.

**Dispute settlement:** The WTO's procedure for resolving trade quarrels under the Dispute Settlement Understanding is vital for enforcing the rules and therefore for ensuring that trade flows smoothly. Countries bring disputes to the WTO if they think their rights under the agreements are being infringed. Judgments by specially appointed independent experts are based on interpretations of the agreements and individual countries commitments.

The System encourages countries to settle their difference through consultation. Failing that, they can follow a carefully mapped out, stage by stage procedure that includes the possibility of a ruling by a panel of experts, and the chance to appeal the ruling on legal grounds. Confidence in the system is borne out by the number of cases brought to the WTO – almost 250 cases in seven years



compared to some 300 disputes dealt with during the entire life of GATT (1947 – 1994).

**Policy review:** A the trade Policy Review Mechanism's purpose is to improve transparency, to create a greater understanding of the policies that countries are adopting, and to assess their impact. Many members also see the reviews as constructive feedback on their policies.

All WTO members must undergo periodic scrutiny, each review containing reports by the country concerned and the WTO Secretariat.

### **Development and Trade**

Over three quarters of WTO members are developing or least developed countries. All WTO agreements contain special provision for them, including longer time periods to implement agreements and commitments, measures to increase their trading opportunities and support to help them build the infrastructure for WTO work, handle disputes, and implement technical standards.

The 2001 Ministerial conference in Doha set out tasks, including negotiations, for a wide range of issues concerning developing countries. Some people call the new negotiations the Doha Development Round.

Before that, in 1997, a high level meeting on trade initiatives and technical assistance for least developed countries resulted in an "integrated framework" involving six intergovernmental agencies, to help least developed countries increase their ability to trade, and some additional preferential market access agreements.

A WTO committee on trade and development, assisted by a sub committee on least developed countries, looks at the special needs of the developing countries. Its responsibility includes implementation of the agreements, technical cooperation, and the increased participation of developing countries in the global trading system.

### **Technical Assistance and Training**

The WTO organizes around 100 technical cooperation missions to developing countries annually. It holds on average three trade policy courses each year in Geneva for government officials. Regional seminars are held regularly in all regions of the world with a special emphasis on African countries. Training courses are also organized in Geneva for officials from countries in transition from central planning to market economies.

The WTO set up reference centers in over 100 trade ministries and regional organizations in capitals of developing and least developed countries, providing computers and internet access to enable ministry officials to keep abreast of events in the WTO in Geneva through online access to the WTO's immense database of official documents and other materials. Efforts are also being made to help countries that do not have permanent representatives in Geneva.

### **Salient Features of UR Agreement**

#### ***Liberalization of Trade in Manufactures***

Liberalisation of trade in manufactures is sought to be achieved mostly by reduction of tariffs and phasing out of non tariff barriers.

#### **Tariff Barriers**

The major Liberalisation in respect of trade in manufacturing goods, regarding tariffs are

1. Expansion of tariff bindings
2. Reduction in the tariff rates
3. Expansion of duty free access

The UR agreement envisages substantial tariff reductions in both industrial and developing countries.

The main liberalization by industrial countries include the expansions of tariff bindings (i.e., commitment not to exceed a particular level of tariff) to cover 99

per cent of imports, the expansion of duty free access from 20 to 43 per cent of imports, and the reduction of trade weighted average tariff by 40 per cent, from 6.2 to 3.7 per cent.

However, the gain to developing countries from the tariff cuts by industrial countries is less impressive. The reduction in the average tariffs on their exports to industrial markets is 30 per cent and the labour intensive manufactures (textiles, clothing, leather goods) and certain processed primary products (fish products) which are regarded as sensitive have been below average tariff cuts.

In industrial countries, tariffs will be eliminated in several sectors like steel, pharmaceuticals and wood and wood products.

Developing countries agreed to bind their tariffs on 61 percent of their imports of industrial products, compared with 13 per cent before the UR Round. They also offered to reduce their trade weighted average bound tariff on imports from industrial countries by 28 percent, from 15 to 11 per cent. The offers of tariff reduction on manufactures by developing countries are estimated to amount to over a third of the work total. The expansion of tariff binding by the developing countries, which rules out future increases in tariffs, is regarded as a significant achievement.

India has bound tariffs at 40 per cent (where they were above 40 per cent in 1993 – 1994) on industrial raw materials, components and capital goods and at 25 per cent in other cases. After the UR Agreement comes into force, about 68 per cent of India's tariff lines will be bound (Compared to five per cent earlier). In comparison, many developing countries in Asia and Latin America have bound between 90 and 100 per cent of their tariff lines at levels comparable to, or lower than, India's bindings.

### **Non – tariff Barriers**

In the area of NTBs, the Agreements to abolish voluntary export restraints (VERs) and to phase out the Multifibre Arrangements (MFA) are regarded as landmark achievements for developing countries.

The phasing out of the existing VERs within four years and the MFA within ten years would scale back the coverage of NTBs on the trade of developing countries from 18 per cent of their 1992 exports'. As trade in derestricted product lines would tend to grow faster than other trade, this coverage could fall to 4.2 per cent by 2005.

The UR Agreement seeks to phase out the MFA by 2005. According to some estimates the phasing out of MFA would contribute about 20 per cent of the total welfare gains from the UR. The largest gains will go to the MFA importers who will be able to import basic clothing and textiles from the more efficient suppliers in ASEAN, China, South Asian and other regions. By 2005, the total benefits to the European Community, the US and Canada are estimated at \$56 billion per year at 1992 prices. Income gains of over \$13 billion are projected for highly competitive exporters such as China, Indonesia, Thailand and South Asian exporters, despite the loss of quota rents provided under the MFA. Some less competitive exporters will suffer from the loss of their preferential access to industrial country markets unless they are able to increase their efficiency, and some currently unrestricted importers will lose as the exports currently diverted toward them by restrictions elsewhere can flow freely to the other markets.

### **Liberlisation of Agriculture Trade**

As mentioned earlier, one of the salient features of the UR was the inclusion, for the first time, of agriculture in the MTN. The exclusion of agriculture from the previous Rounds and its effective exemption from the GATT discipline made agriculture a highly protected sector in the developed

countries. The depressing impact of this on world prices prevented efficiently procures from realizing the benefits of their comparative advantage. Exports from developing countries suffered a lot.

The important aspects of the UR Agreement on agriculture include

1. Tariffication
2. Tariff binding
3. Tariff cuts
4. Reduction in subsidies and domestic support.

### **Tariffication and Tariff Cuts**

Tariffication means the replacement of existing non tariff restrictions on trade such as import quotas by such tariffs as would provide substantially the same level of protection.

From the first year of the Agreements implementation, nearly all order protection is to be bound by tariffs, which (in principle) are to be no higher than the tariff equivalent of the protection levels prevailing in the base periods.

Industrial countries are then to reduce their tariff bindings by an average of 36 per cent within six years (from 1995) while all developing countries but the poorest are required to reduce tariffs by an average of 24 per cent over a period for reduction of tariffs on agricultural products.

On agricultural tariffs, developing countries have the flexibility of indicating maximum ceiling binding. India has indicated ceiling bindings of 100 per cent on primary products and 300 per cent on edible oils.

### **Subsidies and Domestic Support Policies**

The UR Agreement deals with three categories of subsidies.

1. Prohibited subsidies – those contingents upon export performance or the use of domestic instead of imported goods.

2. Actionable subsidies – those that have demonstrably adverse effects on other member countries.
3. Non actionable subsidies – including those provided (with stipulated limitations) to industrial research and pro competitive development activity to disadvantaged regions, or to existing facilities to adapt themselves to new environmental requirements.

The Agreement also puts restrictions on the use of countervailing measures against competitors' subsidies. To prevent undue hardship, developing countries and countries in transition from centrally planned to market economies are allowed extra time to bring the subsidies into conformity with the new rules.

While industrial economies are required to reduce, over six years, the volume of subsidies agricultural exports by at least 21 per cent and the value of subsidies at least by 36 per cent, the respective figures for developing countries are 14 per cent and 24 per cent. All countries are bound not to introduce new subsidies.

The UR agreement has brought the domestic support policies also under the multilateral trade discipline. However, domestic support measures that have almost a minimal impact on trade (“green box” policies) such as general government services in the areas of research, disease control, infrastructure and food security as also certain direct payments such as certain income support policies, structural adjustment assistance, payment under environmental programmes and regional assistance programmes are exempted. The non exempted types of subsidies included in the aggregate measure of support (AMS) required to be reduced include assistance in the form of production limiting subsidies and assistance given for growth of agriculture and rural development like procurement at support prices and subsidies on inputs and credit. However, even these subsidies are required to be reduced only if their total amounts as a proportion of the value of agricultural production exceed five

percent in case of developed countries and 10 per cent in case of developing countries. If the non exempted subsidies are above these limits, they are required to be reduced by 20 per cent in case of developed countries and by 13.3 per cent in developing countries by 1999.

According to government of India, India's total AMS is negative (without taking into account exemptions available of input Subsidies to low income and resource poor Farmers) and there are no reduction commitments. Nor does India have any minimum market access commitments in agriculture (the UR Agreement provides for the establishment of minimum access tariff quotas, at reduced tariff rates, where the access is less than 3 per cent of the domestic consumption). The minimum access tariff quotas are to be expanded to five per cent over the implementation period).

Assistance for "food security" such as the food subsidy under the public distribution system (PDS) will be exempted to the extent they confine to the poor.

### **Non agricultural Export Subsidies**

Countries whose per capita income is less than \$ 1000 us not bound to phase out export subsidies. (India's per capita Income in 1994 was only \$ 310). However, even such countries will have to phase put export subsidies on products where the share in the world exports is 3.25 per cent or more in two consecutive years. This is applicable to India in respect of exports of diamonds.

### **GATS**

The General Agreement on Trade in Services (GATS) which extends multilateral rules and disciplines to services is regarded as a landmark achievement of the UR, although it achieved only little in terms of immediate liberalization.

Because of the special characteristics and the socio-economic and political implications of certain services, they have been generally subject to

various types of national restrictions. Protective measures include visa requirements, investment regulations, restrictions on repatriation, marketing regulations, restrictions on employment of foreigners, compulsions to use local facilities, etc. Heavily protected services in different countries include banking and insurance; transportation; television, radio, film and other forms of communication; and so on.

The GATS defines services as the supply of a service from the territory of one member (country) into the territory of any other member; in the territory of one member to the service consumer of any other member; by a service supplier of one member, through commercial presence in the territory of any other member; or by a service suppliers of one member in the territory of any other member.

In short, the GATS cover four modes of international delivery of services.

1. Cross border supply (transborder data flows, transportation services)
2. Commercial presence (provision of services abroad through FDI or representative offices)
3. Consumption abroad (tourism)
4. Movement of personnel ( entry and temporary stay of foreign consultant)

While industrial countries have offered market access commitment of some kind on over half (about 54 per cent) of their service activities, developing countries. Tourism and travel related services are the only activities in which substantial number of developing countries made commitments.

The framework of GATS includes basic obligation of all member countries on international trade in services, including financial services, telecommunications, transport, audio visual, tourism, and professional services, as well as movement of workers.



Among the obligations is a most favoured nation (MFN) obligation that essentially prevents countries from discriminating against foreign suppliers of services.

Another obligation is the transparency requirements according to which each member country shall promptly publish all its relevant laws and regulations pertaining to services including international agreements on trade in services to which the member is a signatory. Further, each member shall also respond promptly to all requests for specific information, by any other member, pertaining to any aspect of the service covered by the GATS. Each member shall also establish one or more enquiry points to provide specific information to other members. However no member needs to provide any confidential information, the disclosure of which would impede law enforcement, or otherwise be contrary to public interest, or which would prejudice legitimate commercial interests of particular enterprise, public or private.

The GATS lays down that increasing participation of developing countries in world trade shall be facilitated through negotiated commitments on access to technology, improvements in access to distribution channels and information networks and the liberalization of market access in sectors and modes of supply of export interest to them.

With reference to domestic regulation, the Agreement lays down that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner. There would be a requirement that parties establish ways and means for prompt reviews of administrative decisions relating to the supply of services.

It is recognized that particular pressures on the balance of payments of a Member in the process of economic development or economic transition may necessitate the use of restrictions to ensure, inter alia, the maintenance of a level

of financial reserves adequate for the implementation of its programme of economic development or economic transition.

A member country may, therefore, apply restrictions on international transfers and payments for current transactions under certain circumstances envisaged under the GATS. In the event of serious balance of payments and external financial difficulties or threat thereof, a member may adopt or maintain restrictions on trade in services on which it has undertaken specific commitments including on payments or transfers for transactions related to such commitments.

The commitments of member countries under the GATS also include national treatment (that is, to treat foreign suppliers of service like domestic suppliers) and provision of market access.

The Agreement on Trade in Services also establishes the basis for progressive liberalization of trade in services through successive rounds of negotiations, which also applies to other agreements under the Final Act.

As stated earlier, the fear of the developing countries is that the liberalization of trade in services will lead to the domination of the services sector of the developing countries by the multinationals of the industrialized countries. As a matter of fact, the trade in services is already dominated by the developed countries. The developing countries are net importers of services and their deficit has been growing. The apprehension is that a liberalization of trade in services will accentuate the problem.

Although many services are labour intensive and, therefore, the developing countries should be expected to have an advantage here, there have been several constraints in benefiting from this advantage. These include, technical, organizational, financial and legal. Moreover, immigration laws of developed countries restrict the manpower flow from the developing to developed countries. This severely limits the scope of developing countries in

benefiting from their comparative advantage. It may be noted that the industrial countries did not like to bring this issue in the Uruguay Round.

### **TRIMs**

Trade Related Investment Measures (TRIMs) refers to certain conditions or restrictions imposed by a government in respect of foreign investment in the country. TRIMs were widely employed by developing countries.

The Agreement on TRIMs provides that no contracting party shall apply any TRIM which is inconsistent with the WTO Articles. An illustrative annex identifies the following TRIMs as inconsistent.

1. Local content requirement (i.e., a certain amount of local inputs be used in Products).
2. Trade balancing required (i.e., imports shall not exceed a certain proportion of exports)
3. Trade and foreign exchange balancing requirements
4. Domestic sales requirement (i.e., a company shall sell a certain proportion of its output locally)

The Agreement requires the notification of all WTO inconsistent TRIMs and their phasing out within two, five and seven years by industrial, developing and least developed countries respectively. Transition period can be extended for developing and least developed countries if they face difficulties in eliminating TRIMs.

A number of TRIMs were employed in India prior to the liberalization ushered in 1991 and many of them have been phased out since then.

### **TRIPS**

One of the most controversial outcomes of the UR is the Agreement of Trade Related Aspects of Intellectual Property Rights including trade in counterfeit Goods (TRIPS). TRIPS along with TRIMs and services were called the “new issues” negotiated in the Uruguay Round.

Protection of intellectual property rights has become an issue of wide and serious discussion with the formation of the General Agreement on Trade Related Aspects of Intellectual property Rights (TRIPs) under the Uruguay Round (UR) Agreement of the GATT (now the WTO)

Intellectual property rights may be defined as “information with commercial value”. IPRs have been characterized as a composite of “ideas, inventions and creative expression” plus the “public willingness to bestow the status of property” on them and give their owners the right to exclude others from access to or use of protected subject matter.”

According to the WTO, intellectual property rights are the rights given to persons over the creations of their minds. They usually give the creator an exclusive right over the use of his/her creation for a certain period of time.

Intellectual property rights are customarily divided into two main areas:

### **Copyright and Rights Related to Copyright**

The right of authors of literary and artistic works (such as book and other writings, musical compositions, paintings, sculpture, computers programs and films) are protected by copyright, for a minimum period of 50 years after the death of the author.

Also protected through copyright and related (sometimes referred to as neighboring”) rights are the rights of performers (e.g. actors, singers and musicians), producers of phonograms (sound recordings) and broadcasting organization. The main social purpose of protection of copyright and related rights is to encourage and reward creative work.

### **Industrial Property**

Industrial property can usefully be divided into two main areas:

One area can be characterized as the protection of distinctive signs, in particular trademarks (Which distinguish the goods or services of one undertaking from those of their undertakings) and geographical indications

(which identify a good as originating in a place where a given characteristic of the good is essentially attributable to its geographical origin).

The protection of such distinctive signs aims to stimulate and ensure fair competition and to protect consumers, any enabling them to make informed choices between various goods and services. The protection may last indefinitely, provided the sign in question continues to be distinctive.

Other types of industrial property are protected primarily to stimulate innovation, design and the creation of technology. In this category fall inventions (protected by patents), industrial designs and trade secrets.

The social purpose is to provide protection for the results of investment in the development of new technology, thus giving the incentive and means to finance research and development activities.

A functioning intellectual property regime should also facilitate the transfer of technology in the form of foreign direct investment, joint ventures and licensing.

The protection is usually given for a finite term (typically 20 years in the case of patents).

While the basic social objectives of intellectual property protection are as outlines above, it should also be noted that the exclusive rights given are generally subject to a number of limitations and exceptions, aimed at fine-tuning the balance that has to be found between the legitimate interests of right holders and of users.

IPRs may be legally protected by patents, copyrights, industrial designs, geographical indications, and trade marks. Special (Sui generic) forms of protection have also emerged to address specific needs of knowledge producers as in the case of plant breeder's rights and the protection of layout designs of integrated circuits. A number of countries also have trade secret laws to protect undisclosed information that gives a competitive advantage to its owner.

The UR Agreement on TRIPs, described under the two broad categories mentioned above, covers seven intellectual properties, viz.,

1. Copyright and related rights (i.e. the rights of performers, producers of sound recordings and broadcasting organization)
2. Trademarks including service marks
3. Geographical indication including appellations of origin
4. Industrial designs
5. Patents including the protection of new varieties of plants
6. The layout designs of integrated circuits
7. Undisclosed information, including trade secrets and test data.

On copyrights and related rights, the Agreement requires compliance with the provisions of Bern Convention to which India is a signatory and the new Copyright Act of India already meets the requirements of the TRIPs Agreement. Trade and Merchandise marks Act of 1958 was replaced by a new Act, namely. The Trade Marks Act, 1999, so as to provide for the protection of service marks also.

### **Objectives of Protection of Intellectual property**

**Encourage and regard creative work.** The main social purpose of protection of copyright and relating rights is to encourage and reward creative work. This is also relevant to protection in other areas (e.g. industrial designs and patents).

**Technological innovation.** Intellectual property rights are designed to provide protection for the results of investment in the development of new technology, thus giving the incentive and means to finance research and development activities.

**Fair competition.** The protection of distinctive signs and other IPRs aims to stimulate and ensure fair competition among producers.

**Consumer protection.** The protection of distinctive signs should also protect consumers, by enabling them to make informed choices between various goods and services.

Transfer of technology. A functioning intellectual property regime should also facilitate the transfer of technology in the form of foreign direct investment, joint ventures and licensing.

Balance of right and obligations. While the basic social objectives of intellectual property protection are as outlined above, it should also be noted that the exclusive rights given are generally subject to a number of limitations and exceptions, aimed at fine tuning the balance that has to be found between the legitimate interests of right holders and of users.

### **Patents**

A patent is a legal protection granted for an invention that is new, non – obvious and useful. The patent grants the patent holder the exclusive right to make use or sell the patented products or process. The main purpose of the patent system is to benefit the society. Patents, by providing an opportunity to recoup the cost of invention (Which is quite substantial in many cases) and to make profit out of the invention, encourage research and development and thereby contribute to the well being of the society.

An invention, to be patentable, must satisfy the following three conditions.

1. It is new.
2. It is useful to the society
3. It is non obvious to a person possessed of average skill in the art.

Exclusion of an invention from patentability for commercial exploitation

Is permitted if it is necessary to protect public order or morality, including to protect human, animal or plant life or health or to avoid serious prejudice to the

environment. A nation may also exclude from patentability (a) diagnostic therapeutic and surgical methods for the treatment of humans or animals:

(b) Plants and animals other than micro organisms and essentially biological process for the production of plants or animals other than non biological and micro biological process. However, members shall provide for the protection of plant varieties either by patents or by an effective sui generis system or by any combination thereof.

According to the Indian Patents Act, 1970, invention means any new and useful (i) art, process, method or manner of manufacture

(ii) machine, apparatus or other article

(iii) substance produced by manufacture, and includes any new and useful improvement of any of them, and an alleged invention.

While the patent grants the exclusive right to the inventor to exploit his invention for commercial gain for a specific period of time, it also imposes on him the duty of fully disclosing the invention.

### **Indian Patent Law and the TR Agreement**

The TR agreement on patents is in substantial variance with the Indian patent Act of 1970 and, therefore, has given rise to a lot of controversy in India. Being a member of the WTO, India is bound to align its patent law with the TR Agreement.

The TR Agreement in respect of patents lays down more stringent conditions and stronger protection than the Indian law.

Under the Indian Patents Act of 1970, only process patent (and no product patent is applicable in respect of inventions relating to substances intended for use as food, drug or medicines, or substances produced by chemical processes is limited to the methods or processes of manufacture only. This means that one can make and market a product similar to the patented product through a different process or method than the patented one. This practice has



been very prevalent in the Indian pharmaceutical industry. The UR Agreement requires both product and process patents.

Under the 1970 Act, patents expiry period is 5 to 7 years for some products and 14 years for other products, whereas the UR Agreement stipulates 20 years for all products.

A major criticism of the Ur agreement is that the acceptance of product patents will strangle the growth of the Indian pharmaceutical industry and the monopolization of the vital areas of this industry by multinationals will result in sharp increase in drug prices. This fear however seems to be exaggerated. One study shows that the patented drugs constitute less than 16 per cent of the Indian pharmaceutical market, and within the patented drugs segment, more than half of the drugs have other therapeutic equivalents. Even in respect of these drugs, it would not be very easy to jack up prices controls and other means. The Drug Prices Control Order (DPCO) has been in India to control prices. It is also argued that today, the lack of patent protection has made foreign firms shy away from producing most of them in India. Indian companies have shown no interest in sub licensing their manufacture. As a result, Indians forced to buy life saving drugs, like those for cancer, have to pay ruinous prices. Once patent protection is available, many of the drugs now being imported will start being made here, and their prices will fall. One view is that when a new patent system becomes effective, countries like India would become a production base for multinationals and it would also increase the pharmaceutical exports from India.

A major area of concern for India is the protection of the biodiversity. India does not have a sui generis system for its protection. The absence of a legal mechanism to protect our heritage of common knowledge and even what are there in the ancient books and scripts may lead to biopiracy by firms/individuals in developed countries as happened in the case of granting

patent for the 'invention' in the USA that turmeric can promote the healing of wounds or the medicinal and other properties of neem.

## **DISPUTE SETTLEMENT**

A proper mechanism for settling disputes is essential for effective and smooth functioning of a rule based system. The WTO's procedure underscores the rule of law, and it makes the trading system more secure and predictable. The system is based on clearly defined rules, with timetables for competing a case.

WTO members have agreed that if they believe fellow members are violating trade rules, they will use the multilateral system of settling disputes instead of taking action unilaterally. That means abiding by the agreed procedures, and respecting judgments.

Typically, a dispute arises when one country adopts a trade policy measure or takes some action that one or more fellow WTO members considers to be breaking the WTO agreements, or to be a failure to live up to obligations. A third group of countries can declare that they have an interest in the case and enjoy some rights.

A procedure for settling disputes existed under the old GATT, but it had no fixed timetables, rulings were easier to block, and many cases dragged on for a long time inconclusively. The Uruguay Round agreement introduced a more structured process with more clearly defined stages in the procedure. It introduced greater discipline for the length of time a case should take to be settled, with flexible deadlines set in various stages of the procedure. The agreement emphasizes that prompt settlement is essential if the WTO is to function effectively. It sets out in considerable detail the procedures and the timetable to be followed in resolving disputes. If a case runs its full course to a first ruling, it should not normally take more than about one year – 15 months if the case is appealed. The agreed time limits are flexible, and if the case is considered

urgent (e.g. if perishable goods are involved), then the case should take three months less.

The Uruguay Round agreement also made it impossible for the country losing a case to block the adoption of the ruling. Under the previous GATT procedure, ruling could only be adopted by consensus, meaning that a single objection could block the ruling. Now, ruling are automatically adopted unless there is a consensus to reject a ruling any country wanting to block a ruling has to persuade all other WTO members (including its adversary in the case) to share its view.

Although much of the procedure does resemble a country or tribunal, the preferred solution is for the countries concerned to discuss their problem and settle the dispute by themselves. The first stage is therefore consultations between the governments concerned, and even when the case has progressed to other stages, consultation and mediation are still always possible.

### **ANTI DUMPING MEASURES**

The UR Agreement provides greater clarity and more detailed rules concerning the method of determining dumping and injury, the procedure to be followed in anti – dumping investigations, and the duration of antidumping measures. It also clarifies the role of dispute settlement panels in conflicts relating to anti dumping actions taken by national authorities.

A product regarded as dumped when its export price is less than the normal price in the exporting country or its cost of production plus a reasonable amount for administrative, selling and any other costs and for profits.

Anti dumping measures can be employed only if dumped imports are shown to cause serious damage to the domestic industry in the importing country. Further, antidumping measures are not allowed if the margin of dumping (i.e., the price differences) is de minimis (defined as 2 per cent of the

export price of the product) or the volume of dumped imports is negligible (less than 3 per cent of imports of the product in question)

Dumping occurs when the price at which the goods are exported to India is lower than their normal value. The difference between this export price and the normal value is known as the margin of dumping. It is generally expressed as a percentage of the export price. In the ordinary course of trade, the normal value is the comparable price at which goods under complaint are sold in the domestic market of the exporting country or territory. If the normal value cannot be determined this way, the following two alternative methods are provided for

1. Comparable representative export price to an appropriate third country
2. Cost of production in the country of origin with reasonable addition for administrative, selling and general costs and for profits.

In India, anti – dumping actions are taken by the Directorate of Anti Dumping and Allied Duties, Ministry of commerce, as per the Customs Tariff Act, 1975, as amended in 1995, based on Article VI of GATT 1994. For the government to initiate anti dumping action, the Indian industry must be able to show that dumped imports are causing or threatening to cause material injury to the Indian domestic industry. Obviously, the ability of India to do so depends on proper environmental monitoring, database and procedural familiarity.

Material retardation to the establishment of an industry is also regarded as injury. For anti dumping actions, a causal link between the material injury being suffered by the Indian industry and the dumped imports must be established.

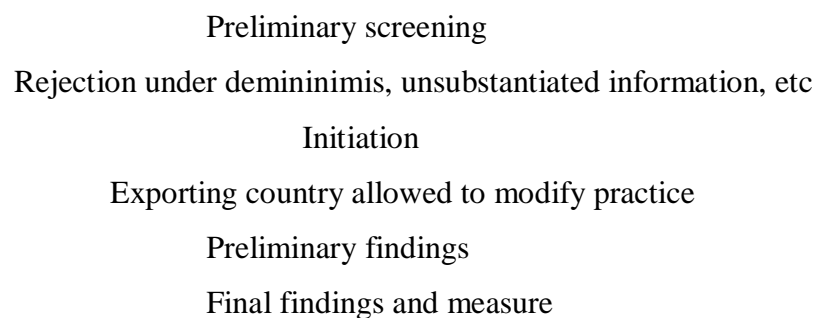
The economic and financial impact of the dumped imports on the concerned Indian industry can be demonstrated, inter alia, by decline in output, loss of sales, loss of market share, reduced profits, decline in productivity, decline in capacity utilization, reduced return on investments,

price effects, and adverse effects on cash flow, inventories, employment, wages, growth, invested, ability to raise capital etc. Anti dumping action is not applicable if the margin of dumping is insignificantly small (less than two per cent of the export price) or the volume of imports is negligible (i.e., the volume from one country is less than three per cent of the total imports of that product), provided the aggregate imports from such countries do not account for more than seven per cent of total imports.

Anti dumping duty shall not exceed the margin of dumping. It is suggested that it would be desirable of the appropriate authorities impose a lesser duty which is adequate to remove the injury caused to the domestic industry. The Government of India has accepted this principle.

Anti dumping actions may be suspended or terminated if the exporter concerned furnishes an undertaking to revise the price to remove the dumping or the injurious effect of dumping. The rules also provide for retrospective measures in certain cases.

The anti dumping investigation process is diagrammatically presented in figure 1.1.



### **1.1 Anti dumping investigation process**

## **Safeguard Actions**

Members may take safeguard actions, i.e., import restrictions to protect a domestic industry from the negative effects of an unforeseen import surge, if a domestic industry is threatened with serious injury. The UR Agreement however, prohibits the use of such actions where they constitute grey area measures, including voluntary export restraints, orderly marketing arrangements or other similar measures applied on either exports or imports. The existing grey area measures are to be phased out by 1999. Further, the Agreement provides for discipline on the use of all safeguard measures, including time limits, requirements for safeguard investigation, and non discrimination (generally) among sources of supply.

Safeguard measures would not be applicable to developing countries where their share in the member country's imports of the product concerned is relatively small.

## **An Evaluation of the Uruguay Round**

The Uruguay Round was by far the most complete and controversial one. The fact that it took more than seven years to complete the negotiations as against the originally contemplated more than four years indicates the complexities involved. It is the inclusion of new areas like TRIPs, TRIMs, services and the attempts to liberalise agricultural trade and the elimination of NTBs like MFA that increased the complexity of the negotiations.

The success of the UR Agreement will depend upon the spirit with which it will be translated into practice. The tariffication of trade barriers was claimed to be a significant success of the UR. However, because of the way the NTBs were converted into tariffs, the so called dirty tariffication, many of the tariff bindings exceeded the protection rate applying during the base period (which itself was one of generally high level of protection), some by as much as 200 per cent.

Several estimates of the gains from the UR Agreement are available. They vary widely. According to some estimates the real world income (in constant 1992 US Dollar) will increase by between \$ 212 billion and \$ 274 billion in 2005. Further, such annual increases will follow. This amounts to around one percent of world GDP. According to a GATT study the gain will be as high as \$510 billion.

Most of the gains will accrue to the developed countries. Some developing countries in the category of leased developed countries and net food importers are expected to lose because of the Uruguay Round packages.

According to some estimates the increase in real income will be roughly 1.6 per cent of GDP for the European Union, 0.2 per cent for the US and 0.9 for Japan. As a single country, the largest gain in absolute terms will accrue to the US (between \$28 and \$ 67 billion). It will be between \$ 27 and \$ 42 billion for Japan, between \$61 and \$98 billion for the EU and between \$ 36 and \$78 billion for the developing countries. The gain would amount to about 2.5 per cent of the GDP for china, 0.5 per cent for India, 0.6 per cent for South Africa and 0.3 per cent for Brazil.

According to GATT estimates, World trade would increase by 12 per cent (on top of the normal growth rate), if the UR package is completely implemented. In constant 1992 US dollar, this represents an increase of \$745 billion. The value of world exports (including services will increase by around 10 percent. Exports of North America will increase by 8 per cent and European Union by 10.3 per cent. Some of the largest projected increases in world trade are in areas that are of interest to developing countries. For instance, world trade in textiles is projected to grow by 34 percent, that in clothing by 60 per cent and that in agricultural, forestry and fishery products by 20 per cent.

According to the estimates made by the World Bank, OECD and the GATT Secretariat the income effects of the implementation of UR package will

add between \$213 to \$274 billion annually to world income. The GATT Secretariat's estimate of the overall trade impact is that the level of merchandise trade in goods will be higher by \$745 billion in the year 2005, than it would otherwise have been. The largest increase will be in the areas of clothing (60 per cent), agricultural, forestry and fishery products (20 per cent) and processed food and beverages (19 per cent). Since India's existing potential export competitiveness lies to a significant extent in these product groups, India could be expected to obtain gains in these sectors.

According to one estimate, cuts in protection on total merchandise trade will increase real incomes in developing countries by \$55 to \$90 billion (or 1.2 to 2 per cent of their GDP in 1992) while the gains to the world as a whole will be in the order of \$200 billion.

#### **UR AGREEMENT AND DEVELOPING COUNTRIES**

The developing countries, in general, are dissatisfied with the outcome of the Uruguay Round. The wall Street Journal has reports that while the US and EC are getting the best pieces of the world trade pie, the developing countries are getting the crumbs.

Some of the areas like TRIPs, TRIMs and services have been very sensitive as far as the developing countries are concerned as the Uruguay Round Agreement in them mean that the developing countries will have to lower the protection against competition from the unequal developed economies. However, as in the previous Rounds, the UR also gives special considerations to developing countries, particularly to the least developed countries and to those with balance of payments problems. The Agreement, however, lays down that member countries imposing trade restrictions for balance of payment purposes should do so in a way that causes minimum disruption to international trade and quantitative restrictions should be avoided as far as possible.



In deed, it would be the developed countries who would suffer most by liberalization of the agricultural sector. But to argue that the developed countries should completely liberalise agriculture without any reciprocity on part of the developing countries is clearly illogical. As a matter of fact, the UR proposals in respect of agriculture, as in several other cases, give special consideration to the developing countries. Developed countries will, however, be hit hard. For example, agricultural subsidies in the European countries have been of the order of 30 to 50 per cent.

While the liberalization of agricultural trade and the increase in agricultural prices due to cut in producer subsidies in the developed countries would benefit agricultural exporters, the increase in food prices due to cut in subsidies may adversely affect the food importers. More than 100 of the developing nations are reported to be net food importers. However, the increase in food prices should be expected to make food production in these countries more competitive leading to an increase in production. It may be noted here that it has been alleged that the subsidization of production and export of farm production in the developed countries would have the effect of discouraging their production in the developing countries where farmers have not been able to compete with the imported stuff bearing artificially low price because of the subsidies. It is estimated that since subsidies agricultural exports cannot be dumped on the world market, international agricultural prices could go up by as much as 10 per cent.

One of the major areas of disappointment for many developing countries is trade in textile. A textile is one of their most important export items but developed countries have been following a very restrictive import policy. The developing countries wanted a fast phasing out of the Multifibre arrangement (MFA) under which the textile imports have been restricted. However, the MFA will be phases out, in stages, over a 10 year period and a major part of the

liberalization will take place only towards the end of the transitional period. A little consolation for the developing countries is that the US demand for extending the phase out period to 15 years was not accepted.

International trade in textiles is estimated to be worth \$ 240 billion a year. Estimates are that after the phasing out of MFA, world exports of textiles may go up by \$25 billion a year. With a 2.2 per cent share in the world textile trade. India's share in the additional exports could be \$0.55 billion. But the real gain will depend on the country's ability to compete with countries like china, Hong Kong, Taiwan, South Korea, etc., which are considered leaders in the textile trade.

Developing countries were very apprehensive about the proposal to liberalise trade in services. However, fortunately for them, the differences of opinion between the US and EC on this issue left the service sector largely unaffected. The effect of the UR is not the same on all countries. For example, a measure which favorable agents one developed country may unfavorably affect another developed country. Further, the extent of the favorable or unfavorable impact may also vary. It is therefore, quite natural that conflict of interests have occurred both among developed and developing countries. Latin American countries were perhaps not very interested in liberlising the trade in textiles because they calculated that if they could gain a direct entry to the NAFTA through some regional arrangement, it would provide them an edge over competitors like India and Pakistan.

Some studies also show that sub Saharan Africa, Indonesia and some Caribbean islands will be poorer as a result of the UR Agreement. However, if liberalization leads to higher productivity, they would also gain.

No country is, therefore, entirely pleased with the UR proposals. "The surest proof of the success of the Uruguay Round is that no country is entirely happy at the outcome." Although India is quite dissatisfied that the textile trade

is not adequately liberalised, some people in the US are angry over the liberalization move, alleging that two million jobs in the US would now hang in balance.

As the foreign minister of Uruguay remarked, all nations which signed the Uruguay Round Trade Agreement have “a sense of shared dissatisfaction.” As the GATT Director General Peter Southerland stated, the signing of the Uruguay Round trade pact does not mean the end of disputes. There will be disputes between developed and developing countries, between developing countries and between developed countries. “There are more than 5 billion people competing for their share of the pie, and that makes conflicts all the more inevitable.”

One of the achievements of the UR is the making of the rules and regulations more transparent, thus making trade harassment and unilateral actions more difficult. The results of the UR will be implemented by the newly set up World Trading Organisation (WTO) making dispute settlement and arbitration easier.

The tragedy, however, is that not only that the developed countries are not earnestly implementing the provisions of the UR Agreement which will benefit the developing countries, but also they tend to become more protectionists in several respects.

### **UNEQUAL PARTICIPATION**

Although it was expected that significant benefits would accrue to the developing countries from the UR Agreement, they have been encountering many road blocks.

The developing countries are disadvantaged in the WTO system because of their inability to effectively participate in the negotiation process. They suffer from lack of intellectual and financial capability to meaningfully participate in the

discussions and negotiations. They are not able to understand the implications and possible impacts of different proposals and agreement because of their analytical deficiencies. According to Dubey, “most of the agreements and understandings reached during the Uruguay Round trade negotiations are unequal and unbalanced from the point of view of developing countries. This was mainly because of the weak bargaining position of these countries, their general state of unpreparedness of the negotiations, their dearth of skilled manpower and financial resources to participate effectively, and the lack of transparency in the negotiating process.

Besides, lack of earnestness on the part of the governments is also responsible for the suffering of the developing countries. For example, they delay in taking protective measures in respect of geographical indications by Government of India are responsible for the basmati rice issue and the like.

#### **IMPLEMENTATION ISSUES**

The developing countries are virtually deceived in several cases as the UR Agreement has been implemented in letter and spirit by the developed countries. They have resorted to covert measures to deny the developing countries the legitimate benefits of the proposed trade Liberalisation.

Dubey points out that, subsidies normally maintained by developed countries have been made non actionable, while several of those given by developing countries in pursuit of an export led development strategy have either been prohibited or put in the actionable category. Subsidies to farmers maintained by major developed countries have, instead of coming down, gone up primarily because these countries were able to switch over to subsidies permissible under the Agreement on Agriculture, before the commencement of its implementation. Liberalisation of textiles trade has hailed as a boom for the developing countries. However here also the developing countries have been deceived because developed importing countries have sought to comply with the

liberalisation set out in the Agreement on Textiles and Clothing (ATC) by taking credit for the items already outside restriction.

Developing countries have identified various instances of inequalities and imbalances in the Uruguay Round Agreements and submitted a large number of formal proposals for rectifying them. These proposals have been known as the implementation issues. It is argued that the implementation issues should be urgently resolved and any new round of MTN shall be taken up only after that. However, the developed countries want the new round of MTN soon.

“The implementation issues are not a spanner thrown by a group of developing countries to ape a new round of trade negotiations. Their attempt to resolve them is designed to safeguard their most vital trading interests and to restore a modicum of balance in WTO agreements after and unfortunately belated realization that developing countries were short changed in the Uruguay Round negotiations. What is at stake is the very credibility of the international trading system in the eyes of the developing countries. Resolution of the implementation issues is the only way to restore credibility.

#### **THE DOHA DECLARATION**

The fourth ministerial meeting of the WTO was held in Doha in November 2001 in which Ministers from the 142 member countries participated. They attracted a lot of attention because of the conflict of interests of the developed and developing countries.

The developed countries wanted a new round of multilateral trade negotiation to be launched soon, covering what are known as the Singapore Issues (a list of seven items which were proposed at the meeting in Singapore in 1996 for future negotiations. These included: investment, competition policy, trade facilitation, transparency in government procurement, environment, agriculture and trade related aspects of intellectual property rights (TRIPs)

Developing countries like India on the other hand held that the implementation Issues should be resolved before a new Round. Indian has almost single handedly fight against the developed countries. The Doha meet concluded by drawing up the 'Doha development Agenda' for new trade liberalization talks; with India approving the ministerial declaration only after it was satisfied that the conference Chairman's statements had addressed the country's concerns in the four Singapore issues of foreign investment, competition policies, transparency in government procurement and trade facilitation.

Although the developed nations, as expected, won the upper hand, India's bold stand has had a commendable impact. Because of India's refusal to approve the agenda unless it was modified, the Chairman of the meeting announced that an explicit consensus would be required at the fifth ministerial conference in 2003, before negotiations could begin on the highly controversial Singapore issues. It is an indication that when the strong position taken by a single developing country can have such positive effects; collective action by the developing countries can have profound impact.

The Doha Ministerial adopted three major declarations: (i) on the negotiating agenda for the new WTO round (ii) on some 40 implementation concerns of the developing countries and (iii) on the political statement dealing with patents and public health.

One remarkable achievement of the Doha Ministerial for developing countries is that in the case of TRIPs and public health, it allowed waiver of the patent law to face a national emergency. Now it will be possible for developing countries to set aside the patent laws if they have to face epidemics such as malaria, tuberculosis and AIDS. Each country has been given the freedom to define a national emergency.

In agricultural, it is conceded by all countries that subsidies need to be reduced and should be ultimately phased out. However, in the case of food security concerns, exception is permitted. All forms of export subsidies will be phased out. This is a big problem for the developed countries which have been providing mounting subsidies.

The success or failure of developing countries will depend on to what extent India can muster the support of other developing countries to fight for their common cause as well as how well it will do its own home work to be effective at the negotiation

### **UR AGREEMENT AND INDIA**

The Uruguay Round Agreement has come in for scathing criticisms in India. Many politicians and others have argued that India should withdraw from the GATT. Most of the criticisms are either baseless or due to lack of knowledge of the international trading environment, and misinformation, or are just meant to oppose the government by the opposition parties.

It is true that the Round mostly benefits the developed countries. That does not mean that developing countries like India are losing only that their gain is limited as compared to that of the developed countries.

Accepting the demand of some of the critics that India should withdraw from the WTO will be a great blunder that the nation can commit. By being a part of WTO India enjoys the most favoured nation (MFN) status with all the other members of the WTO. Opting out of the system would mean an infinitely laborious task of entering into bilateral negotiations with each and every one of the trading partners which would amount to 'having one's arms twisted bilaterally by the US, the EC and Japan, turn by turn, on everything from intellectual property rights to NPT, human and environmentally clean

technologies for packaging.” It may be noted at this juncture that China got readmitted to the system after a long wait and lobbying.

One major controversy of GATT is the agricultural subsidies. Much hue and cry has been raised in India about this factor. However, it needs to be mentioned that the GATT decision would not adversely affect India’s Agricultural subsidies and its agriculture exports. Other developing countries would also largely benefit because of the lowering of the agricultural protection by the developed countries, in spite of the fact that the wish of the developing countries that the major Western nations would totally drop subsidies for their producers. Substantially lower tariffs and open markets did not materialize.

According to Government of India, the Market Access Agreements signed by India with the USA and EU will result in additional export earnings of around Rs1100 crore in the initial years and the additional access achieved will get magnified in the second and third phases of integration of the textiles trade with the multinational trade system and will provide larger earnings during these periods.

Assuming that India’s market share in world exports improves to one per cent, and that she is able to take advantage of the opportunities that are created, the trade gains may consequently be placed at \$ 2.7 billion exports per year. More generous estimates range from \$ 3.5 to 7 billion worth of extra exports.

However India’s gain will be much less than those of several other developing countries like China and the newly industrialized economies because:

India’s share in the world trade is very low and (2) the foreign trade – GNP ratio of India is low. The gain will also depend on the rate of growth of India’s exports.

India has taken several measures to comply with the TRIPs Agreement. On copyrights and related rights, the Agreement requires compliance with the



provisions of Bern Convention to which India is a signatory and the new Copyright Act of India already meets the requirements of the TRIPs Agreement. Trade and Merchandise Marks Act of 1958 were replaced by a new Act, namely, The Trade Marks Act, 1999, so as to provide for the protection of service marks also.

Our recently amended patent law contains provisions for mandatory disclosure of source and geographical origin of the biological material used in the invention while applying for patents in India. Provisions have also been incorporated to include non-disclosure or wrongful disclosure of the same as grounds for opposition and for revocation of the patents, if granted. To protect traditional knowledge from being patented, provisions have also been incorporated in the law to include anticipation of invention by available local knowledge, including oral knowledge, as one of the grounds for opposition as also for revocation of patent. In order to further strengthen these provisions, a new provision has been added to exclude innovations, which are basically traditional knowledge or aggregation or duplication of known properties of traditionally known component or components from being patented.

India is a party to the Convention of Biological Diversity (CBD), which came into force in December 1993. The CBD offers opportunities to India to realize the benefit of these resources. The Protection of Plant Varieties and Farmers Rights Act were passed with the objective of giving a significant thrust to agricultural growth by providing an effective system for the protection of plant varieties and farmers rights. This is expected to stimulate investment in R&D for the development of new plant varieties.

The Geographical Indication of Goods (Registration and Protection) Act, 1999 passed by parliament is another step taken by India. The Act primarily intends to protect the valuable geographical indications of our country. The protection under the Act is available only to the geographical indication

registered under the Act and to the authorized users. The Act permits any association of persons or producers or any organization or authority established by law representing the interest of the producers of goods to register a geographical indication. It may be possible to argue that the holders of the traditional knowledge in goods produced and sold using geographical indication can register and protect their traditional knowledge under this law.

Various suggestions have been advanced in India to extend protection to knowledge, innovations and practices. These include; (i) documentation of TK, (ii) registration and innovation patent system, and (iii) development of an associated TK could help in checking bio – piracy. Documentation could be a double-edged sword. It is assumed that if the material/knowledge is documented, it can be made available to patent examiners the world over so that prior art in the case of inventions based on such materials/knowledge are/ is readily available to them.

The Indian legislation for the Protection of Plant Varieties and Farmers' Rights Act 2001 also acknowledges that the conservation, exploration, collection, characterization, evaluation of plant genetic resources for food and agriculture are essential to meet the goals of national food and nutritional security as also for sustainable development of agriculture for the present and future generations. It also acknowledges that the plant genetic resources for food and agriculture are the raw material indispensable for crop genetic improvement. The concept of effective benefit sharing arrangement between the provider and the recipient of the plant genetic resources forms an integral part of our Act.

## **Unit III**

### **Regulation & Treaties in International Business**

**The learning objectives from this lesson are as follows:**

- 1. To understand the basic concept of Licensing & Franchising**
- 2. To understand the basic concept of Joint Ventures**
- 3. To understand the basic concept of GATT**
- 4. To understand the working of World Trade Organisation (WTO)**
- 5. To understand Trade Related Investment Measures(TRIMS)**
- 6. To understand Trade Related Intellectual Property Right(TRIPS)**
- 7. To understand Dumping & Counter trade**
- 8. To understand the E-Commerce Transactions and its effect on Taxation**

#### **1. LICENSING**

Licensing can be defined as a contractual arrangement whereby one company (the licensor) makes an asset available to another company (the licensee) in exchange for royalties; license fees, or some other form of compensation. The licensed asset may be a patent, trade secret, or company name. Licensing is a form of global market entry and an expansion strategy with considerable appeal. A company with advanced technology, know-how, or a strong brand image can use licensing agreements to supplement its bottom-line profitability with little initial investment. Licensing can offer an attractive return on investment for the life of the agreement, providing the necessary performance clauses are in the contract. The only cost is the cost of signing the agreement and of policing its implementation.

Of course, anything so easily attained has its disadvantages and risks. The principal disadvantage of licensing is that it can be a very limited form of participation. When licensing technology or know-how, what a company does not know can put it at risk. Potential returns from marketing and manufacturing may be lost, and the agreement may have a short life if the licensee develops its own know-how and capability to stay abreast of technology in the licensed product area. Even more distressing, licensees have a troublesome way of turning themselves into competitors to industry leaders. This is especially true because licensing enables a company to borrow-leverage and exploit-another company's resources. In Japan, for example, Meiji Milk produced and marketed Lady Borden premium ice cream under a licensing agreement with Borden, Inc. Meiji learned important skills in dairy product processing, and, as the expiration dates of the licensing contracts drew near, rolled out its own premium ice cream brands.

Perhaps the most famous U.S. licensing fiasco dates back to the mid-1950s, when Sony cofounder Masaru Ibuka obtained a licensing agreement for the transistor from AT&T's Bell Laboratories. Ibuka dreamed of using transistors to make small, battery-powered radios. Bell engineers informed Ibuka that it was impossible to manufacture transistors that could handle the high frequencies required for a radio; they advised him to try making hearing aids. Undeterred, Ibuka presented the challenge to his Japanese engineers, who spent many months improving high-frequency output. Sony was not the first company to unveil a transistor radio; an American-built product, the Regency, featured transistors from Texas Instruments and a colorful plastic case. However, it was Sony's high quality, distinctive approach to styling, and marketing savvy that ultimately translated into worldwide success.

Conversely, the failure to seize an opportunity to license can also lead to dire consequences. In the mid-1980s, Apple Computer chairman John Sculley

decided against licensing Apple's famed operating system. Such a move would have allowed other computer manufacturers to produce Macintosh-compatible units. Meanwhile, Microsoft's growing world dominance in computer operating systems and applications got a boost from Windows, which featured a Mac-like graphical interface. Apple belatedly reversed direction and licensed its operating system, first to Power Computing Corporation in December 1994 and then to IBM and Motorola. The Mac clones have been very popular; Power Computing shipped 170,000 Macintosh clones in 1996, and in 1997 the Mac clones had captured over 25 percent of the Mac market. Despite these actions, the global market share for Macintosh and Mac clones has slipped below 5 percent. Apple's failure to license its technology in the pre-Windows era ultimately cost the company over \$125 billion dollars (the market capitalization of Microsoft, the company that won the operating system war).

As the Borden and transistor stories make clear, companies may find that the upfront, easy money obtained from licensing turns out to be a very expensive source of revenue. To prevent a licensor/competitor from gaining unilateral benefit, licensing agreements should provide for a cross-technology exchange between all parties. At the absolute minimum, any company that plans to remain in business must ensure that its license agreements provide for full cross-licensing-that is, the licensee shares its developments with the licensor. Overall, the licensing strategy must ensure ongoing competitive advantage. For example, license arrangements can create export market opportunities and open the door to low-risk manufacturing relationships. They can also speed diffusion of new products or technologies. .

When companies do decide to license, they should sign agreements that anticipate more extensive market participation in the future. Insofar as is

possible, a company should keep options and paths open for other forms of market participation. One path is a joint venture with the licensee.

Trademarks can be an important part of the creation and protection of opportunities for lucrative licenses. Image-oriented companies such as Coca-Cola and Disney, as well as designers such as Pierre Cardin, license their trademarked names and logos to overseas producers of clothing, toys, and watches. Business is booming: The top-tier names are expanding their fee income by 15 percent a year and more. When licensing a trademark, the challenge is to 'maintain and enhance the brand equity of the marque. This means that licensees must be carefully 'selected and supervised. A bad licensee can seriously depreciate the value of a marque by turning out merchandise or services that do not meet up to the standard of the marque.

**Franchising is a form of licensing. It is the practice whereby a company permits its name, logo, cultural design, and operations to be used in establishing a new firm or store.**

## **2. JOINT VENTURES**

A joint venture with a local partner represents a more extensive form of participation in foreign markets than either exporting or licensing. The advantages of this strategy include the sharing of risk and the ability to combine different value chain strengths-for, example, international marketing capability and manufacturing. One company might have in-depth knowledge of a local market, an extensive distribution system, or access to low-cost labor or raw materials. Such a company might link up with a foreign partner possessing considerable know-how in the area of technology, manufacturing, and process applications. Companies that lack sufficient capital resources might seek 'partners to jointly finance a project. Finally, a joint venture may be the only way

to enter a country or region if government bid award practices routinely favor local companies or if laws prohibit foreign control but permit joint ventures. Because of these clear advantages, especially in emerging markets, the conventional wisdom is that a joint venture is the only way to go. Not all agree With this "wisdom." In China, according to Wilfried Vanhonacker, the situation is changing rapidly, and today companies should think beyond the equity joint venture (EJV) with a well-connected local partner and consider the alternative of a wholly foreign-owned enterprise (WFOE). In China, EJVs and WFOEs are substantially the same in terms of taxation and corporate liability. They operate under similar rules and regulations. There are some technical differences, but the bottom line is that the WFOEs take less time to establish than EJVs and do not require a board of directors.

Today, there is a shift on the part of foreign investors in China from the EJV to the WFOE. The reasons are fundamental: Investors achieve greater flexibility and control with a WFOE, and the government is becoming more concerned about what a company brings to the country in terms of jobs, technology, and know-how than it is about how its deals are structured.

In China, as everywhere, each case must be decided on its merits. Two questions must be answered in every case: What does each partner bring to the deal, and what are the interests and capabilities of the partners going forward? The fact is that joint ventures are hard to sustain even in stable environments because the partners to a joint venture have different capabilities, resources, visions, and interests. In fast-growing and fast-changing environments, it is much more difficult to sustain joint ventures. In China, for example, access to markets has been hindered by what foreign investors thought was the essential success factor in China: *guanxi* (relationships). In fact, what many investors have discovered is that China is a big country and the scope of their partner's *guanxi* is limited. Many investors have discovered to their disappointment that

their partner lacked the *guanxi* needed to move forward. A WFOE can retain agents and advisors to assist it in acquiring the land; materials, approvals, and services that it needs to do business in China.

It is possible to use a joint venture as a source of supply for third-country markets. This must be carefully thought out in advance. One of the main reasons for joint venture "divorce" is disagreement about third-country markets in which partners face each other as actual or potential competitors. To avoid this, it is essential to work out a plan for approaching third-country markets as part of the venture agreement.

The disadvantages of joint venturing can be significant. Joint venture partners must share rewards as well as risks. The main disadvantage of this global expansion strategy is that a company incurs very significant costs associated with control and coordination issues that arise when working with a partner. Also, as noted earlier with licensing, a dynamic joint venture partner can evolve into a stronger competitor. In some instances, country-specific restrictions limit the share of capital help by foreign companies. Cross-cultural differences in managerial attitudes and behavior can present formidable challenges as well. James River's European joint venture, Jamont, brought together 13 companies from 10 countries. Major problems included computer systems and measures of production efficiency; Jamont uses committees to solve these and other problems as they arise. For example, agreement had to be reached on a standardized table napkin size; for some country markets, 30 by 30 centimeters was the norm; for others, 35 by 35 centimeters' was preferred.

Difficulties such as those outlined previously are so serious that, according to one study of 170 multinational firms, more than one third of 1,100 joint ventures were unstable, ending in "divorce" or a significant increase in the U.S. firm's



power over its partner.<sup>15</sup> Another researcher found that 65 joint ventures with Japanese companies were either liquidated or, transferred to the Japanese interest in 1976. This was up from 6 in 1972, a 600 percent increase. The most fundamental problem was the different benefits that each side expected to receive.

In an alliance the real payoff is from learning skills from the partner rather than just getting products to sell while avoiding investment. Yet, compared to American and European firms, Japanese and Korean firms see to excel in their ability to leverage new knowledge that comes out of a joint venture. For example, Toyota learned many new things from its partnership with GM about U.S. supply and transportation and managing American workers—that have been subsequently applied at its Camry plant in Kentucky. However, some American managers involved in the venture complained that the manufacturing expertise they gained was not applied broadly throughout GM. To the extent that this complaint has validity, GM has missed opportunities to leverage new learning. Still, many companies have achieved great successes pursuing joint ventures. Gillette, for example, has used this strategy to introduce its shaving products in the Middle East and Africa.

### **MARKETING STRATEGY ALTERNATIVES**

Regardless of the entry form selected, companies must decide on their marketing strategy for each market. Broadly, the alternatives are to use independent-agents and distributors or to establish a company-owned marketing subsidiary.

The advantage of the agent/distributor option is the fact that it requires little investment. It is a pay-as-you-go option. The disadvantage of this option is that it does not create a company presence in the market and it does not give a

company control over its marketing effort. In addition, agents and distributors are not necessarily a no investment option. If the manufacturer has deep pockets, any -termination of an agency or distributorship agreement may lead to a claim by the agent or distributor for lost profits and damages. A written contract with a no-cause termination clause is 110 guarantee of protection from an agent/distributor lawsuit because agents and distributors may press claims on the grounds of a breach of good faith.

In many countries, companies combine the company-owned marketing subsidiary with agents and distributors. This option gives the company local presence- and control of the marketing effort and, where cost-effective, takes advantage of distributor and agent capabilities. The local presence of the company can provide a much better communications link with the regional and world headquarters and, if it is well executed, ensure that the company's effort reflects the fullest potential of the company's ability to execute a global strategy with local responsiveness.

With a local subsidiary presence, a company can focus on formulating and executing marketing strategies and plans that work. In China, Procter & Gamble (P&G) operates with a combination of joint venture-s and its own company presence, with P&G marketing executives directing the company's China strategy. This approach has enabled P&G to increase its share of the urban shampoo market to 60 percent as compared to 9 percent for Unilever. P&G has invested heavily in market research, advertising, and distribution, and in creating its own command presence in the market. As a result of these initiatives, Head & Shoulders, P&G's brand, is China's fastest growing hair care brand.

## **GATT –General Agreement on Trade and Tariff**

The General Agreement on Tariffs and Trade (GATT) was a multilateral treaty that laid down agreed rules for conducting international trade. It came into force in January 1948. Its basic aim was to liberalise trade and for 47 years it had been concerned with negotiating the reduction of trade barriers and with international trade relations. Overseeing the application of its rules was an important and continuing part of its activities. GATT also provided a forum in which countries could discuss and overcome their trade problems and negotiate to enlarge international trading opportunities. The rapid and uninterrupted growth in the volume of international trade till 1994 provided a good testimony for the success of the GATT.

### **Trade Negotiation Under GATT:**

Eight major trade negotiations took place under the GATT auspices are enlisted below:

1. Geneva - 1947
2. Annecy – 1949
3. Torquay – 1951
4. Geneva – 1956
5. Geneva, Dillon Round – 1960-61
6. Geneva ,Kennedy Round – 1964-67
7. Geneva,Tokyo Round – 1973-79
8. Punta del,Uruguay Round – 1986-94

The first round in 1947 (Geneva) saw creation of the GATT. The second round in 1949 (Annecy, France) involved negotiation with nations that desired GATT membership. The principal emphasis was on tariff reduction. The third

round in 1951 (Torquay, England) continued accession and tariff reduction negotiations. The fourth round in 1956 (Geneva) proceeded along the same track as earlier rounds. The fifth round in 1960-61 (Geneva, Dillon Round) involved further revision of the GATT and the addition of more countries. The sixth round in 1964-67 (Geneva, Kennedy Round) was hybrid of earlier product-by-product approach with across the board tariff reductions. The seventh round in 1973-79 (Geneva, Tokyo Round) centered on the negotiation of additional tariff cuts and developed a series of agreements governing the use of non-tariff measures. The eighth round (Uruguay Round) started in 1986 and was concluded in April 1994.

### Uruguay Round

Uruguay Round of Multilateral Trade Negotiations was launched at Punta del Este in September 1986. These talks were the most ambitious and complex so far. Negotiations covered not only traditional GATT subjects such as tariff and non-tariff measures and the improvement of GATT rules and disciplines on subsidies, safeguards, etc. but also extended to new areas not dealt with by GATT earlier, such as Trade Related Intellectual Property Rights (TRIPs), Trade Related Investment Measures (TRIMs) and Trade in Services and Agriculture. The Uruguay Round was formally concluded at the Ministerial Conference held in Marrakech, Morocco, from 12-15 April 1994. India, along with 110 other countries authenticated the results of the Uruguay Round by signing the Final Act. In addition, 104 countries also signed the Agreement establishing the World Trade Organisation (WTO). The WTO Agreement has come into force from January 1, 1995 and India has become a founder member of the world Trade Organisation, by ratifying the WTO Agreement on 30th December 1994.

Estimates have been made by the World Bank, OECD and the GATT Secretariat, which show that the income effects of the implementation of the Uruguay Round package will add between 213 and 274 billion U.S. dollars annually to the world income. The GATT Secretariat's estimate of the overall trade impact is that the level of merchandise trade in goods will be higher by 745 billion U.S. dollars in the year 2005, than it would otherwise have been. The GATT Secretariat further projects that the largest increases will be in the areas of clothing (60 per cent), agriculture, forestry and fishery products (20 per cent) and processed food and beverages (19 per cent). Since India's existing and potential export competitiveness lies in these product groups, it is logical to believe that India will obtain large gains in these sectors. Assuming that the India's market share in world exports improves from 0.5 per cent to 1 per cent, and that we are able to take advantage of the opportunities that are created, the trade gains may conservatively be placed at 2.7 billion U.S. dollars of extra exports per year. A more generous estimate will range from 3.5 to 7 billion U.S. dollars worth of extra exports.

There are several areas in the Uruguay Round package that relate to market access. The more important ones are tariffs, textiles and garments and agriculture.

- (i) In most developed countries, industrial tariffs have been reduced and are now bound at very low levels (an average of 5 per cent). They are not a significant barrier to trade. Developing countries have also been reducing their tariffs. The overall tariff reduction in the Uruguay Round is an average of one-third. On industrial raw materials, components and capital goods, India has bound tariffs at 40 per cent (where they were above 40 per cent (1993-94) and at 25 per cent in other cases). Tariff reductions where necessary are to be carried out

in six equated annual installments from March 1,1995. As the reference date for reducing tariffs January 1,1990, when Indian tariffs were high and substantial autonomous tariff reductions have been undertaken, since then, in the initial years there is no obligation to undertake significant tariff reductions. At present 50 per cent of our tariff lines are bound and after the Uruguay Round Agreement come into force, about 68 per cent of tariff lines will be bound. In comparison, many developing countries in Asia and Latin America have bound between 90 percent and 100 percent of their tariff line at levels comparable to, or lower than, India's bidding.

(ii) The textile and clothing agreement also forms part of the market access. A major achievement has been the commitment to integrate this sector into multilateral frame work. The 10 year transition period in the textile agreement will enable India to devise policies and allow strategic reaction on the part of industry so as to reap the greatest benefit from integration of textile in GATT. In addition India has linked tariff reduction in and bindings in textile and garments to the implementation of textile agreement.

(iii) India has assured that all major programme for the development of agriculture will be exempted from the discipline from agricultural agreement. On agricultural tariff developing countries have the flexibility of indicating maximum ceiling bindings.

#### Agreements on Textiles

India has signed two separate agreements with the USA and the EU on December 31,1994 on the subject of Market Access in Textiles. These agreements have been entered into with a view to facilitate trade in textile

products between India and the USA and EU countries. At present, approximately two-thirds of India's total textile exports are to these countries.

It has been estimated that if India is able to utilise fully the additional access gained as a result of the two agreements, it will result in additional earnings of around Rs. 1,100 crore per annum in the initial years. Because of the growth rates in the quotas built into the Agreement on Textiles and Clothing of the Uruguay Round, the additional access achieved will get magnified in the second and third phases of integration and will provide larger earnings during these periods.

In order to accommodate some of the concerns of the USA and the EU, India was agreed to grant a phased tariff liberalisation schedule for certain items with the WTO, at varying rates, for periods commencing from three to seven years. In addition, India has also agreed to open up its market for textile products, in a phased manner. Broadly speaking, in the first phase India has agreed to allow fibres, yarns and industrial fabrics, which are basic raw materials and in some of which domestic requirements are not adequately met, to be placed on the OGL. In the next phase, fabrics and in the subsequent phase, made-up items and garments are to be allowed to be imported under OGL. This has been done in keeping with the policy of making available raw materials at internationally competitive prices.

### **Dilution of Special and Differential Treatment**

Developing countries lost a considerable part of their differential treatment, although differential treatment of least developed countries was largely protected. They had to agree to a binding of tariff levels as a price for accession to GATT/WTO. However, bound tariffs have been set at substantially higher levels. They also lost flexibility in using trade policy measures for balance of

payments difficulties; they have committed themselves to giving preference to tariffs over quantitative measures.

And the momentum of trade liberalization helped ensure that trade growth consistently outpaced production growth throughout the GATT era. The rush of new members during the Uruguay Round demonstrated that the multilateral trading system, as then represented by GATT, was recognized as an anchor for development and an instrument of economic and trade reform.

A whole corpus of jurisprudence on trade matters evolved under the aegis of GATT. The WTO is, in a large measure, built upon the strong foundation provided by the GATT.

### **World Trade Organisation**

The WTO was established on January 1, 1995. The WTO is the embodiment of the Uruguay Round results and the successor to GATT. 76 Governments became members of the WTO on its first day. As of December 2000, there are 142 members of the WTO and 34 countries have an observer status. There is a waiting list of 28 members. They account for more than 90 per cent of the world trade. The WTO is based in Geneva, Switzerland. Its essential functions are: Administering and implementing the multilateral and plurilateral trade agreements which together make up the WTO;

1. Acting as a forum for multilateral trade negotiations;
2. Seeking to resolve trade disputes;
3. Overseeing national trade policies; and
- 4. Cooperating with other international institutions involved in global policy-making.**



The World Trade Organization is not a simple extension of GATT. On the contrary, it completely replaces its predecessor and has a very different character, which is mentioned below.

1. The GATT was a set of rules, a multilateral agreement, with no institutional foundation, only a small associated secretariat. The WTO is a permanent institution with its own secretariat.
2. The GATT was applied on a 'provisional basis" even if, after more than forty years, governments chose to treat it as a permanent commitment. The WTO commitments are full and permanent.
3. The GATT rules applied to trade in merchandise goods. In addition to goods, the WTO covers trade in services and trade-related aspects of intellectual property.
4. While GATT was a multilateral instrument, by the 1980s many new agreements had been added of a plurilateral, and therefore selective nature. The agreements which constitute the WTO are almost all multilateral and, thus, involve commitments for the entire membership.
5. The WTO dispute settlement system is faster, more automatic, and thus much less susceptible to blockages, than the old GATT system.

WTO is a watchdog of international trade, regularly examining the trade regimes of individual members. In its various bodies, members flag proposed or draft measures by others that can cause trade conflicts. Members are also requiring notifying various trade measures and statistics, which are maintained by the WTO in a large data base.

The WTO is also a management consultant for world trade. Its economist keeps a close watch on the pulse of the global economy, and provides studies on the main trade issues of the day.

## **Ministerial Working Groups Set up by the WTO**

The WTO set up five Ministerial Working Groups to deliberate on the key areas of negotiations. These were:

1. Agriculture
2. Implementation and Rules
3. Market Access
4. Singapore Agenda and other issues
5. Systemic issues

These Groups did considerable work to focus on the different perception! of the member governments and attempted listing of basic issues which needed to be addressed. Even though no final conclusion could be arrived at, the following gives a synoptic view of what transpired in those Working Group meetings:

### **1. Agriculture**

The main issues on which debate took place were:

- (i) Integrating agriculture into the mainstream of WTO rules (whether agriculture should ultimately be treated in the same way as industrial products).
- (ii) The final objective for reducing export subsidies (whether to eliminate or not)
- (iii) Market Access
- (iv) Domestic Support
- (v) Non-trade concerns and multi-functionality
- (vi) Developing Country Issues

The discussions proceeded on two broad lines. One group favoured the ultimate goal of complete integration of agricultural trade with the WTO rules, total

elimination of export subsidies, substantial increase in market access and support to non-trade objectives through policies not distorting trade. The other group emphasized the distinct character of agriculture totally and the consequential non-desirability of subjecting agriculture to the disciplines governing other products. The principle of elimination of export subsidies was also not acceptable to this group which also stressed the need to take cognizance of multi-functionality of agriculture. According to press reports, there was some movement towards convergence of views on export subsidies.

## **2. Implementation and Rules**

The major areas of concern requiring action, as highlighted by the developing participating Governments, were:

- (i) difficulties faced in implementing certain WTO Agreements and the need for extending deadlines in TRIPs, TRIMs and Customs Valuation.
- (ii) changing certain provisions of Anti-dumping, Subsidies and Textiles Agreements.

The European Community supported negotiations on anti-dumping, subsidies, Technical Barriers to Trade, State Trading, TRIMs, Regional Trade Agreements and environment related issues. It expressed a certain degree of flexibility regarding implementation issues. The USA indicated its flexible attitude regarding TRIMs, customs valuation, agriculture, SPS, rules of origin and making S&D' provisions more operational for the developing countries.

There was a strong divergence of standpoints on anti-dumping, subsidies and textiles. Japan stressed the need to consider anti-dumping measures as a disguised form of protectionism, nullifying the benefits of tariff reduction.

### **3. Market Access**

(i) The points for deliberations included, inter alia, the following:

Coverage of the scope of negotiations—whether they should cover all agricultural products or there should be some exemptions.

(ii) Overall objective of the negotiations, i.e., the level of tariff cuts.

(iii) Non-tariff measures affecting market access.

(iv) How to address this specific concern of the least developed countries? There was a proposal for extending bound zero tariffs for exports from the least developed countries to the developed country markets.

There was also a discussion on the methodology of tariff cutting exercise. Unlike the Uruguay Round which followed the request-offer approach, there was a proposal for the harmonized approach to facilitate comparisons of tariff reduction proposals. There was also a proposal for combining the request-offer and harmonization approaches in future negotiations.

### **4. Singapore Agenda and Other Issues**

The major issue was whether members could agree to start negotiations on investment and competition as parts of the new Round. There was divergence of opinion on this. While a number of delegations were in favour of negotiations to be launched in the Third Ministerial Conference, others were of the view that study and analysis of these topics should continue to be in the Working Groups on investment and competition set up in the Singapore Ministerial Conference. There was also no progress towards convergence of view on TRIPs, Government procurement and trade facilitation.

### **5. Systemic Issues**

The Group deliberated on the following:

- De-restriction of documents,
  - WTO organisational structure to improve transparency and decision making,
  - Improving information flows, and
  - Enhancing public understanding of participation in the working of WTO.
- The Group also deliberated on the role of the NGOs in inter-governmental organisations such as WTO.

### **Trade Related Investment Measures(TRIMS)**

In the late 1980's, there was a significant increase in foreign direct investment throughout the world. However, some of the countries receiving foreign investment imposed numerous restrictions on that investment designed to protect and foster domestic industries, and to prevent the outflow of foreign exchange reserves. Examples of these restrictions include local content requirements (which require that locally-produced goods be purchased or used), manufacturing requirements (which require the domestic manufacturing of certain components), trade balancing requirements, domestic sales requirements, technology transfer requirements, export performance requirements (which require the export of a specified percentage of production volume), local equity restrictions, foreign exchange restrictions, remittance restrictions, licensing requirements, and employment restrictions. These measures can also be used in connection with fiscal incentives as opposed to requirement. Some of these investment measures distort trade in violation of GATT Article III and XI, and are therefore prohibited.

Until the completion of the Uruguay Round negotiations, which produced a well-rounded Agreement on Trade-Related Investment Measures (hereinafter the "TRIMs Agreement"), the few international agreements providing

disciplines for measures restricting foreign investment provided only limited guidance in terms of content and country coverage. The OECD Code on Liberalization of Capital Movements, for example, requires members to liberalize restrictions on direct investment in a broad range of areas. The OECD Code's efficacy, however, is limited by the numerous reservations made by each of the members. In addition, there are other international treaties, bilateral and multilateral, under which signatories extend most-favoured-nation treatment to direct investment. Only a few such treaties, however, provide national treatment for direct investment. Moreover, although the APEC Investment Principles adopted in November 1994 provide rules for investment as a whole, including non-discrimination and national treatment, they have no binding force.

### **Legal Frame Works**

GATT 1947 prohibited investment measures that violated the principles of national treatment and the general elimination of quantitative restrictions, but the extent of the prohibitions was never clear. The TRIMs Agreement, however, contains statements prohibiting any TRIMs that are inconsistent with the provisions of Articles III or XI of GATT 1994. In addition, it provides an illustrative list that explicitly prohibits local content requirements, trade balancing requirements, foreign exchange restrictions and export restrictions (domestic sales requirements) that would violate Article III:4 or XI:1 of GATT 1994. TRIMs prohibited by the Agreement include those which are mandatory or enforceable under domestic law or administrative rulings, or those with which compliance is necessary to obtain an advantage (such as subsidies or tax breaks). Figure 8-1 contains a list of measures specifically prohibited by the TRIMs Agreement. Note that this figure is not exhaustive, but simply illustrates TRIMs that are prohibited by the TRIMs Agreement. The figure, therefore, calls particular attention to several common types of TRIMs. We would add that this figure identifies measures that were also inconsistent with Article III:4 and XI:1

of GATT 1947. Indeed, the TRIMs Agreement is not intended to impose new obligations, but to clarify the pre-existing GATT 1947 obligations. Under the WTO TRIMs Agreement, countries are required to rectify any measures inconsistent with the Agreement, within a set period of time, with a few exceptions.

### **Future Challenges**

The TRIMs Agreement is only a first step toward eliminating trade distortions. Although some policies, such as certain export requirements, are not expressly prohibited by the TRIMs Agreement, it is important that governments understand the capacity of such measures to distort trade. Disciplines on these policies will need to be given further consideration in the new investment working group that the WTO Ministerial Conference decided to establish in December 1996. The TRIMs Agreement is scheduled to come up for review within five years of the entry into force of the WTO Agreement and efforts should be made to incorporate appropriate new rules to address such additional policies at that time.

### **Efforts to establish multilateral agreement on Investment at the OECD**

Members of the OECD have been negotiating a comprehensive and legally-binding "Multilateral Agreement on Investment" (MAI) that would provide for both the liberalization and the protection of foreign investments. The Agreement would provide 1) a high degree of discipline on investment protection; 2) broad obligations to liberalize investment; and 3) an effective dispute-settlement mechanism that would include a scheme for litigating disputes between investors and states as well as between states. It was expected that the Agreement would be open to all countries, not just OECD members.

Negotiations, which began in May 1995 with a goal of presenting a draft to the OECD Ministerial Council in April 1998, were extended because of an inability to reach a compromise on liberalization commitments, general exceptions and

considerations to the environment and labour. However, immediately before the resumption of the negotiations in October 1998, France withdrew from the negotiations due to the reason that the above-mentioned high degree of discipline would violate its sovereignty. Thus, it became difficult to continue the negotiations and at present the negotiations are not conducted.

The following four points about MAI remain to be solved: whether to allow exceptions to the "standstill" clause for certain specific areas; whether exceptions to most-favoured-nation treatment should be allowed for regional economic integration organizations; whether to allow a general exception for cultural reasons; and whether to include provisions covering environment and labour issues. In addition, there is no concrete results regarding country-specific exceptions.

There are strong needs for some Multilateral Framework on Investment (MFI). The OECD Committee on International Investment and Multinational Enterprise (CIME) is scheduled to discuss, towards the OECD Ministerial Council in May 1999, how to develop the future work programme including the continuation of the analytical work.

### **How to establish a legal frame work for Investment at the WTO**

WTO investment disciplines are found in the TRIMs Agreement and the GATS, but both of these deal with particular areas or particular aspects of investment. There is currently no comprehensive multilateral legal framework that provides investment disciplines. As we have noted, the OECD was negotiating a comprehensive, legally-binding Multilateral Agreement on Investment (MAI) that would liberalize investment and provide protection for foreign investments. However, it is said that the level of commitments to be included in the agreement was too high for developing countries and there were doubts about



how many developing countries would actually join. The WTO Singapore Ministerial Conference of December 1996 therefore decided to establish a Working Group on the Relationship between Trade and Investment so that countries could examine the need for comprehensive investment rules in which the developing countries participate as well as the developed countries. In the past two years the Working Group did analyze and review the following three issues: "implications of the relationship between trade and investment for development and economic growth," "the economic relationship between trade and investment," and "stock-taking and analysis of existing international instruments". The Group reported the results of the review to the General Council. The WTO General Council decided to extend the Working Group's work programme to further analyze and discuss on investment. Whether to negotiate comprehensive rules on investment will be further discussed, with a view towards the Third WTO Ministerial Conference at the end of 1999, within the framework of the General Council's preparatory process for the next trade negotiations starting in 2000. Along with this process, the Working Group continues his work in order to contribute to the General Council's discussion.

### **Trade Related Intellectual Property Right(TRIPS)**

Desiring to reduce distortions and impediments to international trade, and taking into account the need to promote effective and adequate protection of intellectual property rights, and to ensure that measures and procedures to enforce intellectual property rights do not themselves become barriers to legitimate trade;

Recognizing, to this end, the need for new rules and disciplines concerning:

(a) the applicability of the basic principles of GATT 1994 and of relevant international intellectual property agreements or conventions;

(b) the provision of adequate standards and principles concerning the availability, scope and use of trade-related intellectual property rights;

(c) the provision of effective and appropriate means for the enforcement of trade-related intellectual property rights, taking into account differences in national legal systems;

(d) the provision of effective and expeditious procedures for the multilateral prevention and settlement of disputes between governments; and

(e) transitional arrangements aiming at the fullest participation in the results of the negotiations;

**Recognizing** the need for a multilateral framework of principles, rules and disciplines dealing with international trade in counterfeit goods;

**Recognizing** that intellectual property rights are private rights;

**Recognizing** the underlying public policy objectives of national systems for the protection of intellectual property, including developmental and technological objectives;

**Recognizing** also the special needs of the least-developed country Members in respect of maximum flexibility in the domestic implementation of laws and regulations in order to enable them to create a sound and viable technological base;

**Emphasizing** the importance of reducing tensions by reaching strengthened commitments to resolve disputes on trade-related intellectual property issues through multilateral procedures;

**Desiring** to establish a mutually supportive relationship between the WTO and the World Intellectual Property Organization (referred to in this Agreement as “WIPO”) as well as other relevant international organization.

**Intellectual Property Rights** may be defined as “information with a commercial value”. IPR have been characterized as a composite of “ideas, inventions and creative expression “ along with Public Willingness to bestow the status of property “ on them and give their owners the right to exclude others from access to , or use of, protected subject matter”.

**The Uruguay Agreement on TRIPs covers seven intellectual properties, viz,**

1. Copyright and related right
2. Trade marks
3. Geographical indications
4. Industrial design
5. Patents
6. Layout design of integrated circuits
7. Undisclosed information

Copyright and related rights, the agreement require compliance with the provision of Berne Convention. Some of a few IPR are given below.

## **Trade Mark**

### **Protectable Subject Matter**

1. Any sign, or any combination of signs, capable of distinguishing the goods or services of one undertaking from those of other undertakings, shall be capable of constituting a trademark. Such signs, in particular words including personal names, letters, numerals, figurative elements and combinations of colours as well as any combination of such signs, shall be eligible for registration as trademarks. Where signs are not inherently capable of distinguishing the relevant goods or services, Members may make registrability depend on distinctiveness acquired through use. Members may require, as a condition of registration, that signs be visually perceptible.

2. Paragraph 1 shall not be understood to prevent a Member from denying registration of a trademark on other grounds, provided that they do not derogate from the provisions of the Paris Convention (1967).

3. Members may make registrability depend on use. However, actual use of a trademark shall not be a condition for filing an application for registration. An application shall not be refused solely on the ground that intended use has not taken place before the expiry of a period of three years from the date of application.

4. The nature of the goods or services to which a trademark is to be applied shall in no case form an obstacle to registration of the trademark.

5. Members shall publish each trademark either before it is registered or promptly after it is registered and shall afford a reasonable opportunity for petitions to cancel the registration. In addition, Members may afford an opportunity for the registration of a trademark to be opposed.

### **Right Conferred**

1. The owner of a registered trademark shall have the exclusive right to prevent all third parties not having the owner's consent from using in the course of trade identical or similar signs for goods or services which are identical or similar to those in respect of which the trademark is registered where such use would result in a likelihood of confusion. In case of the use of an identical sign for identical goods or services, a likelihood of confusion shall be presumed. The rights described above shall not prejudice any existing prior rights, nor shall they affect the possibility of Members making rights available on the basis of use.

2. Article 6bis of the Paris Convention (1967) shall apply, *mutatis mutandis*, to services. In determining whether a trademark is well-known, Members shall take account of the knowledge of the trademark in the relevant sector of the public, including knowledge in the Member concerned which has been obtained as a result of the promotion of the trademark.

3. Article 6bis of the Paris Convention (1967) shall apply, *mutatis mutandis*, to goods or services which are not similar to those in respect of which a trademark is registered, provided that use of that trademark in relation to those goods or services would indicate a connection between those goods or services and the owner of the registered trademark and provided that the interests of the owner of the registered trademark are likely to be damaged by such use.

### **Exceptions**

Members may provide limited exceptions to the rights conferred by a trademark, such as fair use of descriptive terms, provided that such exceptions take account of the legitimate interests of the owner of the trademark and of third parties.

### **Term of Protection**

1. Initial registration, and each renewal of registration, of a trademark shall be for a term of no less than seven years. The registration of a trademark shall be renewable indefinitely.

### **Requirement of Use**

1. If use is required to maintain a registration, the registration may be cancelled only after an uninterrupted period of at least three years of non-use, unless valid reasons based on the existence of obstacles to such use are shown by the trademark owner. Circumstances arising independently of the will of the owner of the trademark which constitute an obstacle to the use of the trademark, such as import restrictions or other government requirements for goods or services protected by the trademark, shall be recognized as valid reasons for non-use.

2. When subject to the control of its owner, use of a trademark by another person shall be recognized as use of the trademark for the purpose of maintaining the registration.

### **Other Requirement**

The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as use with another trademark, use in a special form or use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings. This will not preclude a requirement prescribing the use of the trademark identifying the undertaking producing the goods or services along with, but without linking it to, the trademark distinguishing the specific goods or services in question of that undertaking.

### **Licensing and Assignment**

Members may determine conditions on the licensing and assignment of trademarks, it being understood that the compulsory licensing of trademarks shall not be permitted and that the owner of a registered trademark shall have the right to assign the trademark with or without the transfer of the business to which the trademark belongs.

### **Geographical Indications**

#### **Protection of Geographical Indications**

1. Geographical indications are, for the purposes of this Agreement, indications which identify a good as originating in the territory of a Member, or a region or locality in that territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin.
2. In respect of geographical indications, Members shall provide the legal means for interested parties to prevent:
  - (a) the use of any means in the designation or presentation of a good that indicates or suggests that the good in question originates in a geographical area other than the true place of origin in a manner which misleads the public as to the geographical origin of the good;
  - (b) any use which constitutes an act of unfair competition within the meaning of Article 10bis of the Paris Convention (1967).
3. A Member shall, ex officio if its legislation so permits or at the request of an interested party, refuse or invalidate the registration of a trademark which contains or consists of a geographical indication with respect to goods not originating in the territory indicated, if use of the indication in the trademark for such goods in that Member is of such a nature as to mislead the public as to the true place of origin.

4. The protection under paragraphs 1, 2 and 3 shall be applicable against a geographical indication which, although literally true as to the territory, region or locality in which the goods originate falsely represents to the public that the goods originate in another territory.

#### **Additional Protection for Geographical Indications for Wines and Spirits**

1. Each Member shall provide the legal means for interested parties to prevent use of a geographical indication identifying wines for wines not originating in the place indicated by the geographical indication in question or identifying spirits for spirits not originating in the place indicated by the geographical indication in question, even where the true origin of the goods is indicated or the geographical indication is used in translation or accompanied by expressions such as “kind”, “type”, “style”, “imitation”.

2. The registration of a trademark for wines which contains or consists of a geographical indication identifying wines or for spirits which contains or consists of a geographical indication identifying spirits shall be refused or invalidated, ex officio if a Member's legislation so permits or at the request of an interested party, with respect to such wines or spirits not having this origin.

3. In the case of homonymous geographical indications for wines, protection shall be accorded to each indication, subject to the provisions of paragraph 4 of Article 22. Each Member shall determine the practical conditions under which the homonymous indications in question will be differentiated from each other, taking into account the need to ensure equitable treatment of the producers concerned and that consumers are not misled.

4. In order to facilitate the protection of geographical indications for wines, negotiations shall be undertaken in the Council for TRIPS concerning the establishment of a multilateral system of notification and registration of



geographical indications for wines eligible for protection in those Members participating in the system.

**International Negotiations; Exceptions**

1. Members agree to enter into negotiations aimed at increasing the protection of individual geographical indications under Article 23. The provisions of paragraphs 4 through 8 below shall not be used by a Member to refuse to conduct negotiations or to conclude bilateral or multilateral agreements. In the context of such negotiations, Members shall be willing to consider the continued applicability of these provisions to individual geographical indications whose use was the subject of such negotiations.

2. The Council for TRIPS shall keep under review the application of the provisions of this Section; the first such review shall take place within two years of the entry into force of the WTO Agreement. Any matter affecting the compliance with the obligations under these provisions may be drawn to the attention of the Council, which, at the request of a Member, shall consult with any Member or Members in respect of such matter in respect of which it has not been possible to find a satisfactory solution through bilateral or plurilateral consultations between the Members concerned. The Council shall take such action as may be agreed to facilitate the operation and further the objectives of this Section.

3. In implementing this Section, a Member shall not diminish the protection of geographical indications that existed in that Member immediately prior to the date of entry into force of the WTO Agreement.

4. Nothing in this Section shall require a Member to prevent continued and similar use of a particular geographical indication of another Member identifying wines or spirits in connection with goods or services by any of its nationals or domiciliaries who have used that geographical indication in a

continuous manner with regard to the same or related goods or services in the territory of that Member either (a) for at least 10 years preceding 15 April 1994 or (b) in good faith preceding that date.

5. Where a trademark has been applied for or registered in good faith, or where rights to a trademark have been acquired through use in good faith either:

(a) before the date of application of these provisions in that Member as defined in Part VI; or

(b) before the geographical indication is protected in its country of origin;

Measures adopted to implement this Section shall not prejudice eligibility for or the validity of the registration of a trademark, or the right to use a trademark, on the basis that such a trademark is identical with, or similar to, a geographical indication.

6. Nothing in this Section shall require a Member to apply its provisions in respect of a geographical indication of any other Member with respect to goods or services for which the relevant indication is identical with the term customary in common language as the common name for such goods or services in the territory of that Member. Nothing in this Section shall require a Member to apply its provisions in respect of a geographical indication of any other Member with respect to products of the vine for which the relevant indication is identical with the customary name of a grape variety existing in the territory of that Member as of the date of entry into force of the WTO Agreement.

7. A Member may provide that any request made under this Section in connection with the use or registration of a trademark must be presented within five years after the adverse use of the protected indication has become generally known in that Member or after the date of registration of the trademark in that Member provided that the trademark has been published by that date, if such date is earlier than the date on which the adverse use became generally known in

that Member, provided that the geographical indication is not used or registered in bad faith.

8. The provisions of this Section shall in no way prejudice the right of any person to use, in the course of trade, that person's name or the name of that person's predecessor in business, except where such name is used in such a manner as to mislead the public.

9. There shall be no obligation under this Agreement to protect geographical indications which are not or cease to be protected in their country of origin, or which have fallen into disuse in that country.

### **Intellectual Property – Industrial Design and Patent**

#### **INDUSTRIAL DESIGNS**

##### **Requirements for Protection**

1. Members shall provide for the protection of independently created industrial designs that are new or original. Members may provide that designs are not new or original if they do not significantly differ from known designs or combinations of known design features. Members may provide that such protection shall not extend to designs dictated essentially by technical or functional considerations.

2. Each Member shall ensure that requirements for securing protection for textile designs, in particular in regard to any cost, examination or publication, do not unreasonably impair the opportunity to seek and obtain such protection. Members shall be free to meet this obligation through industrial design law or through copyright law.

## **Protection**

1. The owner of a protected industrial design shall have the right to prevent third parties not having the owner's consent from making, selling or importing articles bearing or embodying a design which is a copy, or substantially a copy, of the protected design, when such acts are undertaken for commercial purposes.
2. Members may provide limited exceptions to the protection of industrial designs, provided that such exceptions do not unreasonably conflict with the normal exploitation of protected industrial designs and do not unreasonably prejudice the legitimate interests of the owner of the protected design, taking account of the legitimate interests of third parties.
3. The duration of protection available shall amount to at least 10 years.

## **Patents**

### **Patentable Subject Matter**

1. Subject to the provisions of paragraphs 2 and 3, patents shall be available for any inventions, whether products or processes, in all fields of technology, provided that they are new, involve an inventive step and are capable of industrial application. **(5)** Subject to paragraph 4 of Article 65, paragraph 8 of Article 70 and paragraph 3 of this Article, patents shall be available and patent rights enjoyable without discrimination as to the place of invention, the field of technology and whether products are imported or locally produced.
2. Members may exclude from patentability inventions, the prevention within their territory of the commercial exploitation of which is necessary to protect ordre public or morality, including to protect human, animal or plant life or health or to avoid serious prejudice to the environment, provided that such exclusion is not made merely because the exploitation is prohibited by their law.

### **3. Members may also exclude from patentability:**

(a) diagnostic, therapeutic and surgical methods for the treatment of humans or animals;

(b) plants and animals other than micro-organisms, and essentially biological processes for the production of plants or animals other than non-biological and microbiological processes. However, Members shall provide for the protection of plant varieties either by patents or by an effective sui generis system or by any combination thereof. The provisions of this subparagraph shall be reviewed four years after the date of entry into force of the WTO Agreement.

#### **Rights Conferred**

1. A patent shall confer on its owner the following exclusive rights:

(a) where the subject matter of a patent is a product, to prevent third parties not having the owner's consent from the acts of: making, using, offering for sale, selling, or importing for these purposes that product;

(b) where the subject matter of a patent is a process, to prevent third parties not having the owner's consent from the act of using the process, and from the acts of: using, offering for sale, selling, or importing for these purposes at least the product obtained directly by that process.

2. Patent owners shall also have the right to assign, or transfer by succession, the patent and to conclude licensing contracts.

#### **Conditions on Patent Applicants**

1. Members shall require that an applicant for a patent shall disclose the invention in a manner sufficiently clear and complete for the invention to be carried out by a person skilled in the art and may require the applicant to indicate the best mode for carrying out the invention known to the inventor at

the filing date or, where priority is claimed, at the priority date of the application.

2. Members may require an applicant for a patent to provide information concerning the applicant's corresponding foreign applications and grants.

### **Exceptions to Rights Conferred**

Members may provide limited exceptions to the exclusive rights conferred by a patent, provided that such exceptions do not unreasonably conflict with a normal exploitation of the patent and do not unreasonably prejudice the legitimate interests of the patent owner, taking account of the legitimate interests of third parties.

### **Other Use Without Authorization of the Right Holder**

Where the law of a Member allows for other use of the subject matter of a patent without the authorization of the right holder, including use by the government or third parties authorized by the government, the following provisions shall be respected:

(a) authorization of such use shall be considered on its individual merits;

(b) such use may only be permitted if, prior to such use, the proposed user has made efforts to obtain authorization from the right holder on reasonable commercial terms and conditions and that such efforts have not been successful within a reasonable period of time. This requirement may be waived by a Member in the case of a national emergency or other circumstances of extreme urgency or in cases of public non-commercial use. In situations of national emergency or other circumstances of extreme urgency, the right holder shall, nevertheless, be notified as soon as reasonably practicable. In the case of public non-commercial use, where the government or contractor, without making a patent search, knows or has demonstrable grounds to know that a valid patent is

or will be used by or for the government, the right holder shall be informed promptly;

(c) the scope and duration of such use shall be limited to the purpose for which it was authorized, and in the case of semi-conductor technology shall only be for public non-commercial use or to remedy a practice determined after judicial or administrative process to be anti-competitive;

(d) such use shall be non-exclusive;

(e) such use shall be non-assignable, except with that part of the enterprise or goodwill which enjoys such use;

(f) any such use shall be authorized predominantly for the supply of the domestic market of the Member authorizing such use;

(g) authorization for such use shall be liable, subject to adequate protection of the legitimate interests of the persons so authorized, to be terminated if and when the circumstances which led to it cease to exist and are unlikely to recur. The competent authority shall have the authority to review, upon motivated request, the continued existence of these circumstances;

(h) the right holder shall be paid adequate remuneration in the circumstances of each case, taking into account the economic value of the authorization;

(i) the legal validity of any decision relating to the authorization of such use shall be subject to judicial review or other independent review by a distinct higher authority in that Member;

(j) any decision relating to the remuneration provided in respect of such use shall be subject to judicial review or other independent review by a distinct higher authority in that Member;

(k) Members are not obliged to apply the conditions set forth in subparagraphs (b) and (f) where such use is permitted to remedy a practice determined after judicial or administrative process to be anti-competitive. The need to correct anti-competitive practices may be taken into account in determining the amount of remuneration in such cases. Competent authorities shall have the authority to refuse termination of authorization if and when the conditions which led to such authorization are likely to recur;

(l) where such use is authorized to permit the exploitation of a patent (“the second patent”) which cannot be exploited without infringing another patent (“the first patent”), the following additional conditions shall apply:

(i) the invention claimed in the second patent shall involve an important technical advance of considerable economic significance in relation to the invention claimed in the first patent;



(ii) the owner of the first patent shall be entitled to a cross-licence on reasonable terms to use the invention claimed in the second patent; and

(iii) the use authorized in respect of the first patent shall be non-assignable except with the assignment

### **Revocation/Forfeiture**

An opportunity for judicial review of any decision to revoke or forfeit a patent shall be available.

### **Term of Protection**

The term of protection available shall not end before the expiration of a period of twenty years counted from the filing date .

### **Process Patents: Burden of Proof**

1. For the purposes of civil proceedings in respect of the infringement of the rights of the owner referred to in paragraph 1(b) of Article 28, if the subject matter of a patent is a process for obtaining a product, the judicial authorities shall have the authority to order the defendant to prove that the process to obtain an identical product is different from the patented process. Therefore, Members shall provide, in at least one of the following circumstances, that any identical product when produced without the consent of the patent owner shall, in the absence of proof to the contrary, be deemed to have been obtained by the patented process:

(a) if the product obtained by the patented process is new;

(b) if there is a substantial likelihood that the identical product was made by the process and the owner of the patent has been unable through reasonable efforts to determine the process actually used.

2. Any Member shall be free to provide that the burden of proof indicated in paragraph 1 shall be on the alleged infringer only if the condition referred to in

subparagraph (a) is fulfilled or only if the condition referred to in subparagraph (b) is fulfilled.

3. In the adduction of proof to the contrary, the legitimate interests of defendants in protecting their manufacturing and business secrets shall be taken into account

### **Dumping & Counter trade**

#### **DUMPING**

Dumping is an important global pricing strategy issue. GATT's 1979 Antidumping Code defined dumping as the sale of an imported product at a price lower than that nominally charged in a domestic market or country of origin in addition, many countries have their own policies and procedures for protecting national companies from dumping. The U.S. Antidumping Act of 1921, which is enforced by the U.S. Treasury, did not define dumping specifically but instead referred to unfair competition. However, Congress has defined dumping as an unfair trade practice that results in "injury, destruction, or prevention of the establishment of American industry." Under this definition, dumping occurs when imports sold in the U.S. market are priced either at levels that represent less than the cost of production plus an 8 percent profit margin or at levels below those prevailing in the producing country.

Dumping was a major issue in the Uruguay Round of GATT negotiations. Many countries disapproved of the U.S. system of antidumping laws, in part because the Commerce Department historically almost always ruled in favor of a U.S. company filing a complaint. Another issue was the fact that U.S. exporters were often targeted in antidumping investigations in countries with few formal rules for due process. The US negotiators hoped to improve the ability of US. Companies to defend their interests and understand the bases for rulings.

The result of the GATT negotiations was an Agreement on Interpretation of Article VI. From the US point of view, one of the most significant changes between the agreement and the 1979 code is the addition of a standard of review that makes it harder to dispute US. There were also a number of procedural and methodological changes. In some instances, these have the effect of bringing regulations more in line with U.S. law. For example, in calculating fair price for a given product, any sales of the product at below cost prices in the exporting country are not included in the calculations; inclusion of such sales would have the effect of exerting downward pressure on the fair price. The agreement also brought GATT standards into line with US. Standards by prohibiting governments from penalizing differences between home-market and export-market prices of less than 2 percent

As the nature of these issues and regulations suggests, some countries use dumping legislation as a legitimate device to protect local enterprise from predatory pricing practices by foreign companies. In other nations, they represent protectionism, a device for limiting foreign competition in a market. The rationale for dumping legislation is that dumping is harmful to the orderly development of enterprise within an economy. Few economists would object to long run or continuous dumping. If this were done, it would be an opportunity for a country to take advantage of a low-cost source of a particular good and to specialize in other areas. However, continuous dumping rarely occurs; the sale of agricultural products at international prices, with farmers receiving subsidized higher prices, is an example of continuous dumping. The type of dumping practiced by most companies is sporadic and unpredictable and does not provide a reliable basis for national economic planning. Instead, it may hurt domestic enterprise.

Recently, there has been a shift in the countries bringing charges of dumping. In 1998, the United States, EU, Australia, and Canada brought approximately one

third or 225 of the cases opened. This is down significantly from the late 1980s when these same countries accounted for four fifths of all cases.<sup>12</sup> The leading countries bringing suit were South Africa, the United States, India, the European Union and Brazil.

Nearly 20 percent of the cases were brought against the EU or member countries followed by China and Korea.

One U.S. company, Smith Corona Corporation of New Canaan, Connecticut, filed an antidumping complaint against Brother Industries of Japan in 1974 and was involved in dumping-related litigation until the day it declared bankruptcy. One of the lessons from this saga is that it can take years to get relief from the International Trade Commission (ITC). Smith Corona had to refile its original complaint; the ITC finally found in its favor in 1980, ordering a 48,7 percent duty on imports of portable typewriters.

However, the duties only applied to typewriters; Brother responded by designing new products with chip-based memory functions. Because this new product was no longer classified as a typewriter-rather, it was a word processor-Brother effectively sidestepped the duties. Brother also began assembling typewriters and word processors from imported parts in a plant in Tennessee. This example shows to what lengths a company will go to get around dumping regulations; Brother used both product innovation and a new sourcing strategy. Finally, in an ironic twist, Brother turned the tables on Smith Corona by accusing the latter of dumping. The rationale: Many of Smith Corona's typewriters are imported from a plant in Singapore; Brother pointed to its own U.S. plant as evidence that it was the true U.S. producer.

For a positive proof of dumping to occur in the United States, both price discrimination and injury must be demonstrated. The existence of either one without the other is an insufficient condition to constitute dumping. Companies

concerned with running afoul of antidumping legislation have developed a number of approaches for avoiding the dumping laws. One approach is to differentiate the product sold from that sold in the home market. An example of this is. An auto accessory that one company packaged with a wrench and an instruction book, thereby changing the accessory to a tool. The tariff rate in the export market happened to be lower on tools, and the company also acquired immunity from antidumping laws because the package was not comparable to competing goods in the target market. Another approach is to make non-price-competitive adjustments in arrangements with affiliates and distributors. For example, credit can be extended and essentially have the same effect as a price reduction.

### *Types of Dumping*

There are several types of dumping: sporadic, predatory, persistent, and reverse. Sporadic dumping occurs when a manufacturer with unsold inventories wants to get rid of distressed and excess merchandise. To preserve its competitive position at home, the manufacturer must avoid starting a price war that could harm its home market. One way to find a solution involves destroying excess supplies, as in the example of Asian farmers dumping small chickens in the sea or burning them. Another way to solve the problem is to cut losses by selling for any price that can be realized. The excess supply is dumped abroad in a market where the product is normally not sold.

**Predatory dumping** is more permanent than sporadic dumping. This strategy involves selling at a loss to gain access to a market and perhaps to drive out competition. Once the competition is gone or the market established, the company uses its monopoly position to increase price. Some critics question the allegation that predatory dumping is harmful by pointing out that if price is

subsequently raised by the firm that does the dumping, former competitors can rejoin the market when it becomes more profitable again.

Hitachi was accused of employing predatory pricing for its EPROM (electrically programmable read-only memory) chips. A memo prepared by the company urged U.S. distributors to "quote 10 percent below competition (until) the bidding stops, when Hitachi wins." The Justice Department, after a year long investigation, dropped the probe because it found that there was insufficient evidence to prosecute.

Zenith has long accused Japanese television manufacturers of using predatory dumping. It charged in its antitrust suit that major Japanese manufacturers, through false billing and secret rebates, conspired to set low, predatory prices on TV sets in the U.S. market with the purpose of driving U.S. firms out of business in order to gain a monopoly. Both the Japanese and U.S. governments defended the Japanese firms' cooperation on the grounds of "sovereign compulsion." In other words, the defendants' cooperation was the result of a compliance with the Japanese government's export policy. After sixteen years of legal maneuvering, the Supreme Court dismissed the conspiracy theory but ordered a trial concerning the dumping charge.

**Persistent dumping** is the most permanent type of dumping, requiring a consistent selling at lower prices in one market than in others. This practice may be the result of a firm's recognition that markets are different in terms of overhead costs and demand characteristics. For example, a firm may assume that demand abroad is more elastic than it is at home. Based on this perception, the firm may decide to use incremental or marginal-cost pricing abroad while using full-cost pricing to cover fixed costs at home. This practice benefits foreign consumers, but it works to the disadvantage of local consumers. Japan, for

example, is able to keep prices-high at home, especially for consumer electronics, because it has no foreign competition there. But it is more than willing to lower prices in the U.S market .in order to gain or maintain market share. Japanese consumers, as a result, must "Sacrifice by paying higher prices for Japanese products that are priced much lower in other markets.

The three kinds of dumping just discussed have one characteristic in common: each involves charging lower prices abroad than at home. It is possible, however, to have the opposite tactic-**reverse dumping**. In order to have such a case, the overseas demand must be less elastic, and the market will tolerate a higher price. Any dumping will thus be done in the manufacturer's home market by selling locally at a lower price.

### Legal Aspect of Dumping

Whether dumping is illegal or not depends on whether the practice is tolerated in a particular country. Switzerland has no specific antidumping laws. Most countries, however, have dumping laws that set a minimum price or a floor on prices that can be charged in the market.

Illegal dumping occurs when the price charged drops below a specified level. What are the unfair or illegal price level, and what kind of evidence is needed to substantiate a charge of dumping? The case of Melex golf carts from Poland illustrates the difficulty in determining a fair price. The success of Melex in the United States led to an accusation of dumping.

The Treasury Department was unable to ascertain whether Melex's U.S. price was lower than prices at home in Poland because Poland has no golf courses and no demand for such a product. The cost of production was unsuitable for determining its fair price. Poland, as a socialist economy, does not let market forces fully dictate the costs of factors of production. For this reason, the 1974 Trade Act does not allow production costs in a communist/socialist country to be used for comparison purpose.

To determine fair costs, the Treasury began to use a small Canadian manufacturer's costs as reference prices, only to see the Canadian firm stop making golf carts. Also, Poland protested that the Canadian firm's production costs were too high and unsuitable for comparison. The Treasury's next step was to rely on reference prices of a comparable product from free-market countries. Mexico and Spain were chosen because they were considered to be similar to Poland in terms of their level of economic development. Even though Mexico and Spain do not produce golf carts, they were used anyway to determine what



their production costs would be if they produced such a product. After much review and discussion, the ruling was that the "constructed" value did not differ appreciably from Melex's actual price.

The 1980 ruling did not end the matter. The American producers still wanted Melex to pay the dumping charges for the years 1979 to 1980, and the Commerce Department's 1992 review imposed a duty of \$599,053.51 plus interest. Melex has continued to fight the case, which has outlasted five U.S. administrations, Poland's martial law, and the Soviet Union empire.

One item of evidence of dumping occurs when a product is sold at less than fair value. The Commerce Department, for example, made a final determination that imports of certain small-business telephone systems and subassemblies from Japan and Taiwan were being sold in America at less than fair value. Subsequently, the U.S. International Trade Commission made final determinations and found injury to industries in the United States from such imports. The Commission's injury finding led to antidumping duties being placed on imported products to offset their price advantage.

Another example of dumping evidence is a product sold at a price below its borne-market price or production cost. The United States relies on the official U.S. trigger price, which is designed to curb dumping by giving an early signal of an unacceptable import price. In the case of steel, the trigger price sets a minimum price on imported steel that is pegged to the cost of producing steel in Japan. According to the General Accounting Office, some 40 percent of all imports at one time were priced below the trigger price.

To provide relief, the Antidumping Act requires the Department of Commerce to impose duties equal to the dumping margin. The antidumping duty is based

on the amount by which the foreign market value or constructed value exceeds the purchase price or an exporter's sale price.

### **How to Dump (Legally and Illegally)**

Dumping is a widespread practice. Exporters and their importers insist on its use, when necessary, and will find ways to conceal the practice. One can learn from the Mitsui case. Mitsui was responsible for generating the largest dumping case and pleaded guilty to all twenty-one counts involving kickbacks and the falsifying of documents to customs officials in order to sell steel below trigger prices. Mitsui attempted to conceal its dumping activities through several means. It hid the origin of the Japanese steel products by disguising them as U.S. made (e.g., wire rope imported to Houston). It submitted false documents to conceal the true merchandise value and backdated invoices to avoid trigger prices. Furthermore, it gave its U.S. customers a rebate equal to, the difference between the nominal exchange rate and the actual exchange rate, and the calculations were made after product entry. These illegal rebates totaled, \$1.3 million between 1978 and 1981. Another deceptive method involved the use of damage claims. Mitsui honored false claims that goods were damaged during shipment and granted credits of \$22,676 for damaged Korean wire nails without investigating or reporting these losses to its insurance company. In spite of these ingenious methods, Mitsui was exposed and paid heavy fines for dumping and fraud.

Sears was similarly indicted for conspiring with Sanyo and Toshiba to file false customs invoices involving the importation of Japanese TV sets between 1968 and 1975. To avoid customs penalties on low-priced Japanese sets whose prices were below Japanese market prices, Sears certified the purchase prices to be higher than what was actually paid. For two of those seven years, Sears overstated Toshiba's price by \$1.66 million and Sanyo's prices by \$7 million.

To prevent Japanese firms from dumping their EPROM chips in the U.S. market, the United States and Japan have established "fair market values" or minimum prices for these chips. But American chip makers asserted that the Japanese violated the trade agreement by dumping chips in Hong Kong, Taiwan, and Singapore and by selling chips to Korean users at fair market value but with rebate. The problem was that these chips could find their way to the U.S. market or that U.S. semiconductor customers might move their manufacturing operations to these other markets to take advantage of lower chip prices.

Without doubt, dumping is a risky practice that can cause a great deal of embarrassment, in addition to the payment of large financial penalties. Thus, a preferable strategy is to use other means to legally overcome dumping laws. One method that can help avoid charges of dumping is to differentiate the exported item from the item being sold in the home market. By deliberately making the home product and its overseas version not comparable, there is no home-market price that can be used as a basis for price comparison. This may be one reason why Japanese automakers market their automobiles under new or different names in the United States. Another method used to circumvent dumping laws is to provide financing terms that can have the same effect as a price reduction.

The dumping problem can also be overcome if the production of a product, rather than its importation is carried out in the host country. This option has become necessary for Japanese manufacturers, who have no desire to lower prices in Japan because they do not have to contend with foreign competitors. The high prices at home, however, work to the disadvantage of Japanese manufacturers because it is easy to prove that they are engaged in dumping in the U.S. market.

## **COUNTERTRADE**

Counter trade constitutes an estimated 5 to 30 percent of total world trade. Counter trade greatly proliferated in the 1980s. Perhaps, the single most important contributing factor is LDCs' decreasing ability to finance their import needs through bank loans. I Regarding Russia, its officials have estimated that 90 percent or more of the transactions having to do with "critical imports" involve reciprocal trade exchanges. Counter trade in Russia may proliferate because, with the Russian banking system in disarray, it is difficult to arrange traditional export financing (e.g., letter of credit).

Counter trade, one of the oldest forms of trade, is a government mandate to pay for goods and services with something other than cash. It is a practice, which requires a seller as a condition of sale, to commit contractually to reciprocate and undertake certain business initiatives that compensate and benefit the buyer. In short, a goods-for-goods deal is counter trade.

Unlike monetary trade, suppliers are required to take customers' products for their use or for resale. In most cases, there are multiple deals that are separate yet related, and a contract links these separable transactions. Counter trade may involve several products, and such products may move at different points in time while involving several countries. Monetary payments' may or may not be part of the deal.

There are three primary reasons for counter trade: (1) counter trade provides a trade financing alternative to those countries that have international debt and liquidity problems, (2) counter trade relationships may provide LDCs and MNCs with access to new markets, and (3) counter trade fits well conceptually with the resurgence of bilateral trade agreements' between governments. The advantages of counter trade cluster around three subjects: market access, foreign

exchange, and pricing. Counter trade offers several advantages. It moves inventory for both a buyer and a seller. The seller gains other benefits, too. Other than the tax advantage, the seller is able to sell the product at full price and can convert the inventory to an account receivable. The cash-tight buyer that lacks hard currency is able to use any cash received for other operating purposes.

### Types of Counter trade

There are several types of counter trade, including barter, counter purchase, compensation trade, switch trading, offsets and clearing agreements.

**1. Barter-** Barter, possibly the simplest of the many types of counter trade, is a onetime direct and simultaneous exchange of products of equal value (i.e., one product for another). By removing money as a medium of exchange barter makes it possible for cash-tight countries to buy and sell. Although price must be considered in any counter trade, price is only implicit at best in the case of barter. For example, Chinese coal was exchanged for the construction of a seaport by the Dutch, and Polish coal was exchanged for concerts given by a Swedish band in Poland. In these cases, the agreement dealt with how many tons of coal was to be given by China and Poland rather than the actual monetary value of the construction project or concerts. It is estimated that about half of the U.S. corporations engage in some form of barter primarily within the local markets of the United States.

**2. Counter purchase (Parallel Barter)-** Counter purchase occurs when there are two contracts or a set of parallel cash sales agreements, each paid in cash. Unlike barter which is a single transaction with an exchange price only implied, a counter purchase involves two separate transactions-each with its own cash value. A supplier sells a facility or product at a set price and orders unrelated or

non-resultant products to offset the cost to the initial buyer. Thus, the buyer pays with hard currency, whereas the supplier agrees to buy certain products within a specified period. Therefore money does not need to change hands. In effect, the practice allows the original buyer to earn back the currency. GE won a contract worth \$300 million to build aircraft engines for Sweden's JAS fighters for cash only after agreeing to buy Swedish industrial products over a period of time in the same amount through a counter purchase deal. Iraq persuaded the New Zealand Meat Board to sell \$200 million worth of frozen lamb for a purchase of the same value of crude oil. Brazil exports vehicles, steel, and farm products to oil-producing countries from which it buys oil in return.

**3. Compensation Trade (Buyback)**-A compensation trade requires a company' to provide machinery, factories, or technology and to buy products made from this machinery over an agreed-on period. Unlike counter purchase, which involves two unrelated products, the two contracts in a compensation trade are highly related. Under a separate agreement to the sale of plant or equipment, a supplier agrees to buy part of the plant's output for a number of years. For example, a Japanese company sold sewing machines to China and received payment in the form of 300,000 pairs 'of pajamas. Russia welcomes buyback.

**4. Switch Trading**-Switch trading involves a triangular rather than bilateral trade agreement. When goods, all or part, from the buying country are not easily usable or salable; it may be necessary to bring in a third party to dispose of the merchandise. The third party pays hard currency for the unwanted merchandise at a considerable discount. A hypothetical example could involve Italy having a credit of \$4 million for Austria's hams, which Italy cannot use, A third-party company may decide to sell Italy some desired merchandise worth \$3 million for a claim on the Austrian hams. The price differential or margin is accepted as being necessary to cover the costs of doing business this way. The company can

'then sell the acquired hams to Switzerland for Swiss francs, which are freely convertible to dollars.

**5. Offset-** In an offset, a foreign supplier is required to manufacture/assemble the product locally and/or purchase local components as an exchange for the right to sell its products locally. In effect, the supplier has to manufacture at a location that may not be optimal from an economic standpoint. Offsets are often found in purchases of aircraft and military equipment. One study found that more than half of the companies counter trading with the Middle East were in the defense industry and that the most common type of counter trade was offset.<sup>4</sup> These companies felt that counter trade was a required element in order to enter these markets.

**6. Clearing Agreement-** A clearing agreement is clearing account barter with no currency transaction required. With a line of credit being established in the central banks of the two countries, the trade in this case is continuous, and the exchange of products between two governments is designed to achieve an agreed-on value or volume of trade tabulated or calculated in nonconvertible "clearing account units." For example, the former Soviet Union's rationing of hard currency limited imports and payment of copiers. Rank Xerox decided to circumvent the problem by making copiers in India for sale to the Soviets under the country's "clearing" agreement with India. The contract set forth goods, ratio of exchange, and time length for completion. Any imbalances after the end of the year were settled by credit into the next year, acceptance of unwanted goods, payment of penalty, or hard currency payment. Although nonconvertible in theory, clearing units in practice can be sold at a discount to trading specialists who use them to buy salable products.

### Problems and Opportunities

Although counter trade is a common and growing practice, it has been criticized on several fronts. First, counter trade is considered by some as a form of protectionism that poses a new threat to world trade. Such countries as Sweden, Australia, Spain, Brazil, Indonesia, and much of Eastern Europe demand reciprocity in order to impose a discipline on their balance of payments. In other words, imports must be offset by exports. Indonesia links government import requirements in contracts worth more than Rp. 500 million to the export of Indonesian products, other than oil and natural gas, in an equivalent amount to the foreign-exchange value of the contract. Mexico took a hard line in 1981 against foreign automakers by ordering them to earn back hard currency if they wanted to stay in business with Mexico. As a result, VW de Mexico had to purchase and export Mexican coffee. Nissan Mexicana agreed to accept coffee, horsemeat, chickpeas, and honey. Brazil enacted a similar requirement and was able to extract agreements from foreign-owned automobile and truck makers to export nearly \$21 billion worth of vehicles and other products in return for the right to import duty-free parts for their Brazilian plants. Despite this charge, there is evidence that counter trade does not necessarily restrict the overall trade volume.

Second, counter trade is alleged to be nothing but "covert dumping." To compensate any supplying partners for the nuisance of taking another-product as payment, a counter trading country frequently trades its products away at a discount. If the counter trading country discounts directly by selling its goods itself in another market instead of through a foreign firm, dumping would clearly occur. But according to an International Trade Commission study, the practice does not seem to be harmful to the United States. Counter trade activity actually results in U.S. exports always greatly exceeding the value of imports.



Thus, it would appear that many products that U.S. firms agree to take from their customers for overseas marketing are not dumped back in the U.S. market.

Third, counter trade is alleged to increase overhead costs and ultimately the price of a product. Counter trade involves time, personnel, and expenses in selling a customer's product-often at a discount. If another middleman is used to dispose of the product a commission must also be paid. Because of these expenses, a selling company has to raise- the price of the original order to compensate for such expenses as well as for the risk of taking another product in return as payment. The fact that the goods are saleable--either for other goods or, in the end, for cash somewhere else means that additional and probably unnecessary costs must be incurred. As explained by Fitzgerald, "Counter trade requirements, like any trade restrictions, increase the cost of doing business. These cost cannot be passed into the international market but must be borne within the country imposing the requirements." It is believed that barter transactions are responsible for reducing Russia's revenues by 500 billion rubles.

Related to this charge of increasing costs is the problem of marketing unwanted merchandise that may remain unsold? A company may have to take on the added job of marketing its customer's goods if it does not want to lose business to rivals who are willing to do so. GE lost a major sale of CAT scanners to Austrian hospitals after Siemens agreed to preserve 4,000 jobs by stepping up production of unrelated electronic goods within its Austrian plants. McDonnell Douglas was able to secure a contract to sell 250 planes to former Yugoslavia only after agreeing to market such Yugoslav goods as hams and other foods, textiles, leather goods, wine, beer, mineral water, and tours. The company had a difficult time selling the \$5 million worth of hams and finally did so to its own employees and suppliers. With Regard to the Yugoslavian tours, the best the company could do was to offer the trips as incentives to employees.

Financing, essential in virtually all types of conventional transactions, becomes more complicated in the case of counter trade this is especially true when the sale of one product is contingent on the purchase of an unrelated product in return. Understandably, banks may hesitate to provide credit for such a deal because of their concern that the exporter may not be able to profitably dispose of the product given to the exporter as payment.

When a company is unable or does not want to be concerned with disposing of the product taken from its customer, it can turn to companies that act as intermediaries. The intermediaries may agree to dispose of the merchandise for a commission or they may agree to buy the goods outright. The Mediators is one such middleman organization that operates a \$500 million a year business globally.

An examination of counter trade literature found that an overwhelming number of the published articles were theoretical rather than empirical. There are a few empirical studies, however, that have shed some light on the practice of counter trade. According to one model, developing countries, which impose counter trade, have these characteristics: declining foreign exchange reserves, commodity terms of trade, and balance of trade and increasing debt-service ratios. There is some evidence that these variables can help exporters identify those countries, which are likely to be counter traders.

The results of one study dispel some widely held views about counter trade. First the relationship between a country's credit rating and its propensity to counter trade is not as strong as commonly believed. Second, buyback and counter purchase are substitutes to foreign direct investment. Third, there is a surprisingly large volume of counter trade between developing countries themselves. Fourth, each counter trade type seems to have its own separate motivation. Barter -allows exchange without the use of money and explicit

prices. Barter is therefore useful in order to bypass: (1) exchange controls, (2) public or private price controls, and (3) a creditors' monitoring of imports.

Those firms that tend to benefit from counter trade are the following: (1) large firms that have extensive trade operations from large, complex products; (2) vertically integrated firms that can accommodate counter trade take backs; and (3) firms that trade with countries that have inappropriate exchange rates, rationed foreign exchange, import restrictions, and importers inexperienced in assessing technology or in export marketing. In contrast firms whose characteristics are the opposite of those just enumerated are likely to encounter significant barriers to counter trade operations and to receive few benefits.

In general, the U.S. government is opposed to government-mandated counter trade. However, recognizing that counter trade is a fact of life, the U.S. government has maintained a hands-off policy toward counter trade arrangements that do not have government intervention or those American exporters choose to pursue. It does not oppose participation by American firms in counter trade transactions when they do not have a negative impact on national security. But the U.S. policy prohibits federal agencies from promoting counter trade in their business and official contacts.

Interestingly, the U.S. government itself has published a guide on counter trade practices so that U.S. firms can take advantage of marketing opportunities in the former Soviet Union. The irony is that the Russian government, seeking hard currency earnings, now appears to prefer cash transactions and has begun to discourage counter trade transactions of marketable commodities. Still, those Russian products that do not have a ready market probably will still require some form of counter trade.

There is no question that counter trade is a cumbersome process. Yet a firm is unwise not to consider it. Much like other trade practices, counter trade presents

both problems and opportunities. More often than not, problems of counter trade are more psychological rather than real obstacles. Problems can be overcome. One need only remember that in the final analysis all goods can be converted into cash.

### E-commerce transactions

What is E-commerce?

E-commerce or electronic commerce, in its widest sense, means consumer and business transactions conducted over a network, using computers and telecommunications. In other words, e-commerce refers to the exchange of goods or services for value on the internet. It includes, inter alia, on-line shopping, on-line trading of goods and services, electronic fund transfers, electronic data exchanges and on-line trading of financial instruments.

The OECD documents on e-commerce in a somewhat more restricted manner as commercial transactions between individuals and organisations, based on the processing or transmissions of digitised data units, sound, and visual images, which are carried out over open networks (like internet) or over a closed network (like intranet) with a gateway to open networks. This more specific definition would therefore exclude electronic data interchange (EDI), carried out over closed networks, if such EDIs are being used by themselves, without access to an open network (e.g. credit cards used over a closed network, connecting specified merchants with a card organisation).

Whatever be the definition, this method of carrying on a business is widely different from the traditional practice of business. Where traditional business have rested squarely on the physical presence and delivery of goods, doing business via the internet, as is the case in e-commerce transactions, physical presence of goods is not required at all. Consequently, geographical boundaries between nations hold no significance. Secondly, in such type of transactions,

physical delivery of goods is not necessary. Where the goods and services are available in digital form, e.g. computer software, music, magazines, drawings etc. physical transactions are replaced by transfer of bytes. Thirdly, e-commerce transactions can be completed almost instantaneously across the world and irrespective of the time of the day.

### **Issues and problems in taxing e-commerce transactions :**

Due to absence of national boundaries, physical presence of goods and non-requirement of physical delivery, taxation of e-commerce transactions raises several issues. There have to be understood in the light of international taxation. International taxation arises from cross border transactions for the reason that the author of the transactions arises in one country (called the Home State) and the sites of the transactions is in the other country (Host State).

Income arises out of such transaction is eligible to tax in both countries by virtue of 'personal attachment' to the transfer (in the Home State) and again by virtue of 'economic attachment' to the income itself (in the lost State). Thus, this gives rise to double taxation of the same income. This problem is generally solved by a Double Taxation Avoidance Agreement (DTAA) between the two countries concerned. The problematic issues arising in respect of e-commerce transactions are as follows:

### **How to determine 'economic attachment':**

In order to determine economic attachment. the situs of the transactions should be clearly determined. In a traditional commerce transaction, the situs of the transaction is clearly known, because of the physical presence and the physical delivery. Therefore the Source Rule as laid down in section 9 of the Income-tax Act, 1961 can be clearly applied to effect Host State taxation. Section 9 provides that income is deemed to accrue or arise in Indian taxable territory if there is a business connection. In E-commerce situations, with transactions being

completed in cyberspace, it is often not clear as to the place where the transaction is effected, giving rise thereby to difficulties in implementing Source Rule taxation.

How to determine existence of a permanent establishment: Under most bilateral double tax treaties, a country will seek to tax corporate business profits if they can be applied to a 'permanent establishment' in that country. The basic requirement is, therefore, that there must be a place of business and it must have some permanence.

The major taxation problem of e-commerce is that no establishment is necessary across the border to carry on business. With regard to tangible property, the source can be traced, as the delivery has to cross the other territory through the customs or postal barrier. The destination also will be known from the shipping address. Where the seller may be located in a tax-heaven country and there is no treaty for avoidance of taxation, it will be difficult to enforce tax laws on the non-resident business. In such cases, the natural option should be to tax the resident as the agent, especially where the non-resident cannot be reached. The difficulty is not so much in taxing those who are assessed and who maintain accounts but in taxing others who do business and there is no record of their transactions, like the persons liable to pay the 'use tax' in US. With the development of WAP (Wireless Application Protocol) which integrates mobile telephony with the Internet, e-commerce will be taken over by M-commerce (Mobile Commerce). This makes the place of origin of business invisible thus adding complication to the existing scenario and is a real challenge to domestic jurisprudence.

Further, how such income is to be attributed to the permanent establishment is also a significant matter. This is relevant to determine whether income from sales can be made on host country soil. For instance, if a particular income is

classified as royalties or fees for technical services, or dividends or interests, then irrespective of the existence of a permanent establishment, the income will be liable to host country taxation under section 115A of the Income-tax Act. On the other hand, if the income is classified as income from sales, then unless there is a permanent establishment, there can be no taxation in the host country. And if there is a permanent establishment, how much income is to be taxable will be determined by how much of the income is to be attributed to the permanent establishment.

**Legal difficulty:**

Till now all cross-border commercial transactions have to cross the customs barrier or the postal barrier. All trade and commerce are operated in a physical world and in terms of tangible goods. Hence, there is a check on these transactions, though smuggling remains outside the scope of any control. Even in the present situation, the tax authorities are unable to fully grapple with the problem of myriad ways of tax evasion. In e-commerce transactions, the contracting parties are in two different states and, therefore, the question would arise as to which state law would be applied.

**Nature of contract:**

A contracted need not necessarily be in writing unless, the statute requires it to be so. It can be oral. This will create problems relating to the law that will be applicable in case of disputes. In a contract, generally the parties are free to choose the law applicable to the contract and the same can be expressed or implied in the terms of the contract. In some cases, the principal place of business is relevant in deciding the law applicable. In some other case, the place where the buyer normally resides decides the law to be applied. Where there is a clause for retention of title until the buyer performs some act, then the matter of which *lex situs* will govern the validity clause is open to question. In

answering this, the Rome Convention says that if the contract accords with the rules of anyone of the States, its validity cannot be questioned. This would be the most satisfactory solution and can be followed. All these problems arise mostly regarding transactions relating to movables and those relating to immovable properties are less difficult. There are many areas where the present domestic laws including international laws would be inadequate to deal with the emerging new field of e-commerce.

**Taxable jurisdiction:**

The taxable jurisdiction of any country covers its national boundary. Besides this the territorial jurisdiction includes territorial sea and airspace above as per the territorial waters, continental shelf, exclusive economic zone and other Maritime Zones Act, 1976. Each one extends to specified nautical miles from the base line. The following are the limits indicated therein:

- (i) Territorial Water -12 nautical miles from the nearest point of appropriate base line.
- (ii) Contiguous Zone - 24 nautical miles beyond and adjacent to the territorial waters from the base line.
- (iii) Continental Shelf-200 nautical miles from the base line.
- (iv) Exclusive Economic Zone is an area beyond and adjacent to the territorial waters extending to 200 nautical miles from the base line.

But electronic commerce takes place through satellite and the server can be in any part of the globe. It can in all probability be in a tax-haven country. Another condition for taxing the income arising or accruing beyond the taxable territories in the physical residence of the taxpayer for 182 days or more. This becomes meaningless with the Internet access. The information highway provides numerous visits to another jurisdiction outside the control of border mechanism.



How business is transacted through e-commerce.

E-commerce is but a method of conducting business transactions and not a business transaction by itself. Therefore, the contents of a business transaction done through ecommerce are no different from that of a business transaction carried out through traditional means.

Divergence however arises in two dimensions - the business methods and the business concepts. The first area, which is very different, viz. the means of doing business. is analysed. In e-commerce there are three distinct means of doing business: electronic advertising, electronic sales and electronic delivery. The presence of anyone or more of these is sufficient to characterise the business as e-commerce.

These are separately discussed below:

**Electronic advertising:**

Advertising is done on the open networks, through websites. Potential customers access the websites and obtain the information they need which enables them thereafter to proceed with the transaction in suitable cases. If the e-commerce business is restricted to putting up a website alone, then the rest of the transaction is completed through traditional means; i.e. the placing of orders by telephone or mail, the making of payment by cheque and credit card and the delivery of goods through a carrier, the telephone etc. being referred to as intermediaries.

**Electronic sales:**

This is done through 'smart' resources which enable the potential customer to place an order on the internet. The payment is effected through a closed network by means of credit cards.

**Electronic delivery:**

This is of course possible only for goods and services that can be fully digitised, but this range is quite wide and ever expanding. Texts, visual materials, audio materials and computer software are digitised. Therefore products like journals, books, music, plans, designs, drawings and games to mention a few, would be goods available in digitised form. Besides goods, services like diagnostic services, could also be available in digitised form. Therefore a whole host of goods and services could be delivered electronically.

The Committee of Fiscal Affairs of the OECD has been actively working on taxation issues relating to e-commerce. The committee has developed the taxation framework conditions setting forth the governing principles in relation to e-commerce. The key conclusion was that the taxation principles that guide Governments in relation to conventional commerce, should also guide them in relation to e-commerce. It was postulated that this would be possible only by adapting and adopting the existing principles to a-commerce situations.

For adapting and adopting the existing principles, the following key areas in the context of international tax were identified:

- (1) the extent to which a website or a server can constitute a permanent establishment and how income may be attributed to it; and
- (2) the manner in which payments for digitised products are to be characterised.

Permanent establishment in e-commerce situations

We now discuss different situations which arise in an e-commerce environment and consider whether these situations would constitute a permanent establishment.

### **Situation A –**

Existence of a website on host country while : A website may be defined as a set of web documents belonging to a particular organisation, It consists of data and programmes in digitised form which is stored on a server of the internet service provider. On the other hand, a permanent establishment, as the name itself suggests, is a fixed place of some permanence from where a business is carried on. Therefore, the existence of a website, by itself, would not constitute a permanent establishment.

### **Situation B –**

Server on host country soil: A server is a system which carries out activities initiated by an end-user's computer. The question whether a server can be considered whether a server can be considered as a permanent establishment is more complicated. It is possible that the enterprise that operates the server may be different from the enterprise that carries on business through the website. The use of a particular internet service provider (ISP) does not give website owner the right of control over the server's operation. The server's location is not at that enterprise's disposal. The server could easily be removed to other locations.

In such a situation, the server's location cannot be considered to be the place of business.

On the other hand, if the enterprise itself owns or leases and operates the server, and the computer equipment is fixed, and business is carried on through the server, it could be construed to be a permanent establishment. Therefore what is essential to be considered in this issue, is not merely whether a server exists or host country soil. but also what the value as well as extent of its operations are. As the permanent establishment concept deals not only with permanence and a geographical link with the host soil, but also with the actual carrying on of the

business, the values and extent of the operations carried out by the server becomes important. We now consider separately the above points.

*Nature of operation –*

The nature of operations could have a very wide range. The range could profess from being a mere provider of information, to being a forwarding address to acting as a warehouse for digitised goods, to contributing directly to productivity and value creation, thereby realising profits. In a situation where the server acts as a mere provider of information it cannot be considered to be a permanent establishment. At the other end, where it contributes to productivity, the server will become a permanent establishment for distinctions which falls in between there two entrances, it would be necessary to go to the next step of examining the extent of operations.

**Extent of operations**

In the extent of operations, as well, there could be a wide range of activities. server would be simply located on host country soil with skeletal support services, or it could be a server with multiple services, ,or it could be a server which carries on the complete set of operations. In the last situation, there would clearly be a permanent establishment.

Situation C –

Server functioning as an agent: It is Possible that a server on host country soil could be construed to be a dependent agent of the foreign enterprise. Such a situation will apply in the case of 'Smart' servers. 'Smart' servers are programmed to not only provide information but also to take and process orders from persons who make a 'hit' 'n the website. Such a server has the Power to contract on behalf of the foreign enterprise and habitually exercises this power, It is possible to argue that since such a server is a dependent agent of the foreign enterprise. it may be considered to be a permanent establishment.

However, a contrary a logical view would be that the website together with the server that hosts it can only constitute the medium through which orders are placed. The time acceptance of the order is not done by the machine itself but by the person or corporation which inserted. into the machine a programme capable of performing these tasks. Therefore, the website and the server would not constitute a permanent establishment.

According to the principles of international taxation, business income cannot be taxed on Host State soil, unless there is a permanent establishment in the Host State. If there is such a permanent establishment, then the only income which the Host State is entitled to tax is the income attributable to the permanent establishment. Such attributable income is determined by imagining the permanent establishment to be an entity independent of the foreign enterprise, and dealing With the foreign enterprise at arm's length price. The issue therefore translates to one for determining the transfer price between the foreign enterprise and permanent establishment, and rewriting the transaction between the two, at arm's length.

#### **Determination of the nature of income :**

The manner of taxation in income arising from e-commerce transactions, as it also the case in conventional commercial transactions, depends on the characterisation of the income. The characterisation of income is relevant because different types of income are taxed differently. Once this is identified, the existing rules may be adopted and adapted to the e-commerce transactions.

In conventional commerce, when all rights in a property are transferred it would amount to a sale giving rise therefore to business income. On the other hand, when only limited rights in a property are transferred, the transferor retaining substantial rights therein, the income therefrom would be classified either as a royalty in the case of intellectual properties, or a lease rent in the case of

tangible properties. Thirdly, if the ultimate results of the transaction is the rendering of services, the income would have to be characterised either as fees for professional services.

Similarly, in an e-commerce situation, if licensing of a know-how is done, the payment for this would clearly be characterised as a royalty income in terms of most double taxation avoidance agreements and this would be so irrespective of whether this is done by physical transfer of information or by transfer of digitised information. If on the other hand, practically all rights in a design are transferred, whether physically or through electronic transfer of digitised information, with no rights being retained by the transferor, under most double taxation avoidance agreements, the transaction would be considered to be one which is more in the nature of outright sale of the design rather than a licence thereof. The payment for this would then be characterised as a sale consideration rather than as a royalty.

The principles of adopting and adapting postulated by the OECD and the US treasury unable a proper determination of the character of income in most cases. However, the problem arises in the case of transactions involving software. This is discussed below:

#### **Transactions involving software:**

The process of adopting and adapting existing rules to e-commerce transactions becomes complicated in the case of transactions involving software. For instance, where a packaged product like Windows 98 is sold, we normally refer to it as buying a product. Moreover, this sale in reality, not a sale but an agreement or a licence to use the software. The product comes in a transparent shrink wrap packaging through which the licence agreement can be read.

When the buyer tears open the packaging, this act is tantamount to his signing the agreement or licence. By doing so, the buyer (licensee) accepts the terms of

the licence, then he agrees to use the software only at that one work station, to not make copies except for archival purposes, to not alter the contents, etc. other than a licence. When it comes to taxation of such transactions the characterisation of the income would become extremely relevant. If for instance the transactions were to be treated as a sale transaction, and the title is transferred outside the buyer's country, the transaction would not be subject to host country taxation in the buyer's State; this is because there would be no permanent establishment of the 'seller' of the software in the buyer's State, and therefore no subjection to Host

### **Taxation of E-Commerce Transactions :**

State taxation. If on the other than the transactions were to be treated as one of licensing, irrespective of the fact that there might be no permanent establishment in the buyer's State, the amount paid by the buyer would, (according to most double taxation avoidance agreements and most domestic tax laws), be considered not as a sale consideration, but after a licence fee constituting a royalty and this would therefore be subject to Host State taxation on the basis of the Source Rule, the payer of the consideration being a resident of the Host State.

### **Let us now examine this issue in the context of Indian law.**

Section 14 of the Copyright Act, 1957, as amended by the Copyright (Amendment) Act, 1999, defines "copyright" to mean the exclusive right to do or authorise the doing of any of the following acts, in respect of a work or any substantial part thereof

a) in the case of a literary, dramatic or musical work, not being a computer programme,

i) to reproduce the work in any material form including the storing of it in any medium by electronic means:

ii) to issue copies of the work to the public not being copies already in circulation:

iii) to perform the work in public; or communicate it to the public;

iv) to make any cinematograph film or sound recording in respect of the work;

v) to make any translation of the work;

vi) to make any adaptation of the work;

vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-clause

b) in the case of a computer programme,

i) to do any of the acts specified in clause

ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme:

Provided that such commercial rental does not apply in respect of computer programme where the programme itself is not the essential object of the rental.

It is therefore abundantly clear that computer programmes, including software would clearly be considered to be covered by copyright. Therefore if software is licensed or its use is permitted in any manner, in accordance with Explanation 2 to section 9(1)(vi) of the Income-tax Act, the income would be royalty in nature. The income would therefore be deemed to arise in India in accordance with section 9(1)(vi)(b) when the payer of the same is an Indian resident, unless it could be established that the software is used in a business outside India. When therefore purchase consideration in respect of any software to be used in India is paid to a non resident, who has exported software, the payment will be



construed as income deemed to arise or accrue within India, in terms of section 9(1)(vi); it would become income of the non resident subject to Indian tax in terms of section 5(2); and consequently tax would require to be deducted by the buyer of the software in terms of section 195. In terms of most double taxation agreements entered into by India with other countries, again the amount would be considered royalty income accruing or arising within India, and therefore subject to Indian withholding tax. Therefore, what is most important in this context is the underlying concept of copyright.

**US Revenue Regulations Approach:** The US Revenue Regulations clearly use a two stage approach. In the first stage, the distinguishing done is whether the transfer is of a copyright article or of a copyright right. Thereafter, at the second stage, two different parameters are used for copyright articles and for copyright rights, but these parameters are rational and not arbitrary.

In the case of a copyrighted article, the source code is generally not given, which means that it is only use of the copyrighted article, that is possible. Nothing beyond the use of the copyrighted article would be possible, if the only transfer effected is on the copyrighted article. On the other hand, if there is a transfer of the copyright right (as contrasted to transfer of right merely in the copyright article) all the underlying rights in the intellectual property are also transferred. The source code is most available, with the result that it would be possible to delete, add, modify, adopt and use in all possible manners, the software in which the rights are transferred.

If the transfer in a copyright article is that of significant benefits and burdens of ownership, then the income imbedded in the transaction is considered to be sales income.

If on the other hand, only insignificant benefits and burdens of ownership have been transferred, and then this is treated as a rental income.

## Unit IV

### **REGULATORY FRAMEWORK & TAXATION**

The learning objectives from this lesson are as follows:

1. To understand the basic concept of Cross Border Transactions
2. How to get payment of the product exported
3. How to make payment of the product imported
4. To understand the legal safeguards available for payment defaults
5. To understand the international legal environment
6. To understand the Multilateral and Bi-lateral Treaties
7. To understand the significance of India's Policy towards Multilateral and Bi-lateral Treaties

### **CROSS BORDER TRANSACTIONS**

Export financing is often a key factor in a successful sale. Contract negotiation and closure are important, but at the end of the day, the company must get paid.

The following factors are important to consider in making decisions about financing:

- **The need for financing to make the sale.** In some cases, favorable payment terms make a product more competitive. If the competition offers better terms and has a similar product, a sale can be lost. In other cases, the buyer may have preference for buying from a particular exporter, but might buy the product because of shorter or more secure credit terms.

- **The length of time the product is being financed.** This determines how long the exporter will have to wait before payment is received and influences the choice of how the transaction is financed.

- **The cost of different methods of financing.** Interest rates and fees vary. Where an exporter can expect to assume some or all of the financing costs, their effect on price and profit should be well understood before a pro forma invoice is submitted to the buyer.

- **The risks associated with financing the transaction.** The riskier the transaction, the harder and more costly it will be to finance. The political and economic stability of the buyer's country can also be an issue. To provide financing for either accounts receivable or the production or purchase of the product for sale, the lender may require the most secure methods of payment, a letter of credit (possibly confirmed), or export credit insurance or guarantee.

- **The need for pre-shipment finance and for post-shipment working capital.** Production for an unusually large order, or for a surge of orders, may present unexpected and severe strains on the exporter's working capital. Even during normal periods, inadequate working capital may curb an exporter's growth. However, assistance is available through public and private sector resources discussed in this chapter.

For help in determining which financing options may be available or the most beneficial to the exporting endeavors, the following sources may be consulted:

- The banker;
- The local Department of Commerce Export Assistance Center (EAC);
- The local Small Business Administration office;
- The Export-Import Bank of India

- The state exports promotion or export finance office.

### **Extending Credit to Foreign Buyers**

Foreign buyers often press exporters for longer payment periods. While it is true that liberal financing is a means of enhancing export competitiveness, exporters need to weigh carefully the credit or financing they extend to foreign customers. Moreover, the extension of credit by the seller to the buyer is more common outside the United States. Indian sellers who are reluctant to extend credit may face the possibility of the loss of the sale to their competitors.

A useful guide for determining the appropriate credit period is the normal commercial terms in the exporter's industry for internationally traded products. Buyers generally expect to receive the benefits of such terms. For off-the-shelf items like consumer goods, chemicals, and other raw materials, agricultural commodities, and spare parts and components, normal commercial terms range with few exceptions from 30 to 180 days. (An allowance may have to be made for longer shipment times than are found in domestic trade, because foreign buyers are often unwilling to have the credit period start before receiving the goods.) Custom-made or high-value capital equipment, on the other hand, may warrant longer repayment periods. Once credit terms are extended to a buyer, they tend to be precedent for future sales, so the exporter should review with special care any credit terms extended to first-time buyers.

Exporters should follow the same careful credit principals they follow for domestic customers. An important reason for controlling the credit period is the cost incurred through use of working capital or through interest and fees. If the buyer is not responsible for paying these costs, then the exporter should factor them into the selling price. The exporter also should recognize that longer credit periods may increase any risk of default.

Customers are frequently charged interest on credit periods of a year or longer but less frequently on short-term credit (up to 180 days). Most exporters absorb interest charges for short-term credit unless the customer pays after the due date.

Obtaining cash immediately is usually a high priority with exporters. Converting export receivables to cash at a discount with a bank is one way to do so. Another way is to expand working capital resources. A third approach, suitable when the purchase involves capital goods and the repayment period extends a year or longer, is to arrange for third-party financing. An example of this is a bank making a loan directly to the buyer for the product, with the exporter being paid immediately from the loan proceeds while the bank waits for payment and earns interest. A fourth possibility, when financing is difficult to obtain, is to engage in counter trade to afford the customer an opportunity to generate earnings with which to pay for the purchase

These options may involve the payment of interest, fees, or other costs by the exporter. Some options are more feasible when the amounts are in larger denominations. Exporters should also determine whether they incur financial liability should the buyer default.

### **Commercial Banks**

The same commercial bank facilities used to finance domestic activities, including revolving lines of credit for working capital, are often sought to finance export sales until payment is received. Banks do not regularly extend financing solely on the basis of an individual order as they prefer to establish an ongoing business relationship.

A logical first step for an exporter seeking to finance short-term export sales is to approach the local commercial bank with which it already does business. If the bank previously has extended credit to the exporter, the bank will be familiar with the exporter's financial standing, credit need, repayment record, and ability

to perform. The bank may be willing to raise the overall limit on an existing working capital line of credit, expand its scope to cover export transactions, or approve a separate line specifically adapted to export-related transactions such as discounting.

Alternatively, the exporter may wish to approach a commercial bank with an international department. Such a bank will be familiar with export business and also be in a position to provide international banking services related to documentary collections and letters of credit, including the discounting of drafts. An intermediate approach is to retain a relationship with the exporter's bank, but seek a referral to a correspondent bank that has an international department.

The exporter should visit the bank's international department, to discuss export plans, available banking facilities, and applicable charges. The exporter may wish to inquire about such matters as: fees for amending or confirming a letter of credit; processing drafts; and about the bank's experience in working with Overseas Government agencies that offer export financing assistance. Generally, the bank's representative handling the exporter's account will not be lodged in the international department. It is in the exporter's best interest to create and foster a close working relationship with the international department.

The responsibility for repaying a working capital loan ordinarily rests with the exporter, even if the foreign buyer fails to pay. The bank takes this contingency into account in deciding on an export working capital line of credit. It is to the benefit of the bank and the exporter to improve the quality of the export receivables by using letters of credit by making use of credit insurance, or by using Export-Import Bank or Export Credit Guarantee Corporation of India Limited (ECGC).

An exporter shipping capital goods may want the commercial bank to make medium-term loans directly to the foreign buyer to finance the sale. Such loans

are available for well established foreign buyers in more stable markets, but where there is an element of risk, the bank may require a standby letter of credit, recourse on the exporter in case of default, or similar repayment reinforcement.

### **Discounting and Banker's Acceptances**

A time draft under an irrevocable letter of credit confirmed by a Domestic bank presents relatively little risk of default, so an exporter may be willing to hold such a draft until it matures. Unless the exporter has ample funds needed for other purposes, holding drafts will use up working capital.

As another course of action, the exporter's bank may be willing to buy, or lend against, time drafts from an exporter that a creditworthy foreign buyer has accepted or agreed to pay at a specified future date. This in effect converts the time draft into immediate cash. The amount received by the exporter is less than the face value of the draft. The difference, called a "discount," represents interest and fees that the bank charges for holding the draft until maturity. The bank may also require the exporter to reimburse the bank in case the draft is unpaid at the due date.

In a third instance, a commercial bank may undertake to accept the obligation of paying a draft for a fee; this is called a banker's acceptance. Banker's acceptances are usually in large denominations. Only a few well-known banks are accepted in the market as "prime-name" banks for purposes of creating banker's acceptances.

### **Other Private Sources**

#### **Factoring, Forfeiting, and Confirming**

**Factoring** is the discounting of a foreign account receivable that does not involve a draft. The exporter transfers title to its foreign accounts receivable to a factoring houses (an organization that specializes in the financing of accounts

receivable) for cash at a discount from the face value. Although factoring is sometimes done without recourse to the exporter, the exporter should verify the specific arrangements. Factoring of foreign accounts receivable is less common than factoring of domestic receivables.

**Forfeiting** is the selling, at a discount, of longer term accounts receivable or promissory notes of the foreign buyer. These instruments may also carry the guarantee of the foreign government. Because forfeiting may be done either with or without recourse to the exporter, the exporter should verify the specific arrangements.

**Confirming** is a financial service in which an independent company confirms an export order in the seller's country and makes payment for the goods in the currency of that country. Among the items eligible for confirmation (and thereby eligible for credit terms) are the goods themselves; inland, air, and ocean transportation costs; forwarding fees; custom brokerage fees; and duties. For the exporter, confirming means that the entire export transaction from plant to end user can be fully coordinated and paid for over time. Although confirming is common in Europe & United States, it is still in its infancy in India.

These three financing options are less frequently encountered and less widely available than commercial bank financing. Nevertheless, where offered locally, they help fill a financing gap for exporters.

### **Export Intermediaries**

In addition to acting as export representatives, many export intermediaries, such as export trading companies (ETCs) and export management companies (EMCs), can help finance export sales. Some of these companies may provide short-term financing or may simply purchase the goods to be exported directly from the manufacturer, thus eliminating any risks associated with the export



transaction as well as the need for financing. Some of the larger companies may make counter trade arrangements that substitute for financing in some cases.

### **Buyers and Suppliers as Sources of Financing**

Foreign buyers of capital goods may make down payments that reduce the need for financing from other sources. In addition, buyers may make progress payments as the goods are completed, which also reduce other financing requirements. Letters of credit that allow for progress payments upon inspection by the buyer's agent or receipt of a statement by the exporter that a certain percentage of the product has been completed are not uncommon.

In addition, suppliers may be willing to offer terms to the exporter if they are comfortable that they will receive payment. Suppliers may be willing to accept assignment of a part of the proceeds of a letter of credit or a partial transfer of a transferable letter of credit. However, some banks allow only a single transfer or assignment of a letter of credit. Therefore, the exporter should investigate the policy of the bank that will be advising or confirming the letter of credit.

### **Government Assistance Programs**

Several government agencies, as well as a number of state and local ones, offer programs to assist exporters with their financing needs. Some are guarantee programs that require the participation of an approved lender; others provide loans or grants to the exporter.

Government programs generally aim to improve exporters' access to credit rather than to subsidize the cost at below-market levels. With few exceptions, banks are allowed to charge market interest rates and fees including fees paid to the government agencies to cover the agencies' administrative costs and default risks.

Government guarantee and insurance programs are used by commercial banks to reduce the risk associated with loans to exporters. Lenders concerned with an exporter's ability to perform under the terms of sale, and with an exporter's ability to be paid, often use government programs to reduce the risks that would otherwise prevent them from providing financing. In other cases, lenders to a foreign buyer of goods and services are reluctant to provide the financing without support from a Government agency.

In overview, the Export-Import Bank of India is the government's largest and most comprehensive trade finance agency, offering numerous programs to address a broad range of needs and small and medium-sized, as well as large, exporters. Credit insurance protects against default on exports sold under short-term credit. Other guarantee and loan programs extend medium- and long-term credit for durable goods.

### **Pre-export Financing**

The Working Capital Guarantee Program enables lenders to provide financing an exporter needs to purchase or produce a product for export, as well as finance short-term accounts receivable. If the exporter defaults on a loan guaranteed under this program, Ex-Im Bank reimburses the lender for the guaranteed portion - generally, 90 percent of the loan - thereby reducing the lender's overall risk. The Working Capital Guarantee Program can be used either to support ongoing export sales or to meet a temporary cash flow demand arising from a single export transaction.

The loan principal can be up to 100 percent of the value of the collateral put up by the exporter, a relatively generous percentage. Eligible collateral includes foreign receivables, exportable inventory purchased with the proceeds of the loan, and goods in production. The term of the guaranteed line of credit is generally one year, but a longer period of renewals may be arranged.

### **Post-export Financing**

ECGC (Export Credit Guarantee Corporation of India) offers commercial and political risk insurance. Under the majority of policies, the insurance protects short-term credit extended for the sale of consumer goods, raw materials, commodities, spare parts, and other items normally sold on terms of up to 180 days. If the buyer fails to pay, ECGC reimburses the exporter in accordance with the terms of the policy. Coverage is also available for some bulk commodities sold on 360-day terms and for capital and quasi-capital goods sold on terms of up to five years. ECGC insurance is the largest Government Programme supporting short-term export credit.

ECGC policies for exporters include the Small Business Policy, Single-Buyer Policy, and Multi-Buyer Policy. Another policy, the Umbrella Policy enables an administrator to handle most administrative duties for a group of exporters. With prior written approval, an exporter can assign the rights to any proceeds to a lender as collateral for financing.

ECGC's policies generally cover up to 100 percent of defaults due to specified political risks, such as war and expropriation, and up to 95 percent due to defaults arising from other commercial risks, such as buyer default and insolvency. Exporters generally must meet content requirements and, under some policies, must insure all eligible foreign sales.

### **Multilateral Development Banks**

The Multilateral Development Banks (MDBs) are international financial institutions owned by member governments. Their individual and collective objective is to promote economic and social progress in their developing member countries. The MDBs (African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, Inter-American

Development Bank, and the World Bank Group) achieve this objective by providing loans, technical cooperation, grants, capital investment, and other types of assistance to governments, government agencies, and other entities in their developing member countries. The practical expression of MDB support usually takes the form of a project or study.

Increasingly, the MDBs are providing funding to private sector entities for private projects in developing countries. A growing number of companies and project developers around the world are taking advantage of this funding, which is secured based on the financial, economic, and social viability of the projects in question.

The MDBs have been traditionally heavily involved in infrastructure and poverty-alleviation projects. All of the banks support projects in the following sectors: agriculture, energy, environment, finance, industry, transportation, telecommunications, health, education, urban development, tourism, microenterprise, and public sector, as well as other types of economic reform. All of the banks provide some funding for private ventures.

The design and execution of MDB-financed public sector projects affords lucrative business opportunities for suppliers, consultants, and contractors from MDB member countries. Many of the goods and services required for these projects are procured or purchased through International Competitive Bidding (ICP) or open tendering. These methods require notification to the international community that a contract is being let; the notification is to provide potential bidders with timely and adequate notification of a purchaser's requirements and an equal opportunity to bid.

The MDBs also provide debt, equity, and guarantee financing to eligible private ventures in developing countries. These funds, offered on commercial terms, can

be accessed directly by private project sponsors and do not require a government guarantee.

### **State and Local Export Finance Programs**

Several cities and states have funded and operate export financing programs, including preshipment and postshipment working capital loans and guarantees, accounts receivable financing, and export insurance. To be eligible for these programs, an export sale must generally be made under a letter of credit or with credit insurance coverage. A certain percentage of state or local content may also be required. However, some programs may require only that certain facilities, such as a state or local port, be used; therefore, exporters may have several options.

### **FOREIGN EXCHANGE MARKET**

The subject of foreign exchange is, in the words of H.E. Evitt, "that section of economic science which deals with the means and methods by which rights to wealth in one country's currency are converted into rights to wealth in terms of another country's currency.<sup>4</sup> As he further observes, it "involves the investigation of the method by which the currency of one country is exchanged for that of another, the causes which render such exchange necessary, the forms which such exchange may take, and the ratios or equivalent values at which such exchanges are effected."

There are different interpretations of the term foreign exchange, of which the following two are most important and common:

1. Foreign exchange is the system or process of converting one national currency into another, and of transferring money from one country to another (Dr. Paul Einzig).

**2. Secondly**, the term foreign exchange is used to refer to foreign currencies. For example, the Foreign Exchange Regulation Act, 1973 (FERA) defines foreign exchange as foreign currency and includes all deposits, credits and balance payable in any foreign currency and any drafts, traveller's cheque, letters of credits and bills of exchange, expressed or drawn in Indian currency, but payable in any foreign currency.

#### Functions of Foreign Exchange Market

The foreign exchange market is a market in which foreign exchange transactions take place. In other words, it is a market in which national currencies are bought and sold against one another.

A foreign exchange market performs three important functions:

**Transfer of Purchasing Power:** The primary function of a foreign exchange market is the transfer of purchasing power from one country to another and from one currency to another. The international clearing function performed by foreign exchange markets plays a very important role in facilitating international trade and capital movements.

**Provision of Credit:** The credit function performed by foreign exchange markets also plays a very important role in the growth of foreign trade, for international trade depends to a great extent on credit facilities. Exporters may get pre-shipment and post-shipment credit. Credit facilities are available also for importers. The Euro-dollar market has emerged as a major international credit market.

**Provision of Hedging Facilities:** The other important function of the foreign exchange market is to provide hedging facilities. Hedging refers to covering of export risks, and it provides a mechanism to exporters and importers to guard themselves against losses arising from fluctuations in exchange rates.

## **Methods of Affecting International Payments**

There are five important methods to effect international payments.

**Telegraphic Transfer:** By this method, a sum can be transferred from a bank in one country to a bank in another part of the world by cable or telex. It is, thus, the quickest method of transmitting funds from one centre to another.

**Mail Transfer:** just as it is possible to transfer funds from a bank account in one centre to an account in another centre within the country by mail, Mail Transfer can accomplish international transfers of funds. These are usually made by air mail.

**Cheques and Bank Drafts:** International payments may be made by means of cheque and bank drafts. The latter is widely used. A bank draft is a cheque drawn on a bank instead of a customer's personal account. It is an acceptable means of payment when the person tendering is not known, since its value is dependent on the standing of a bank which is widely known, and not on the credit-worthiness of a firm or individual known only to a limited number of people.

**Foreign Bill of Exchange:** A bill of exchange is an unconditional order in writing, addressed by one person to another, requiring the person to whom it is addressed to pay a certain sum on demand or on a specified future date.

There are two important differences between inland and foreign bills. The date on which an inland bill is due for payment is calculated from the date on which it was drawn, but the period of a foreign bill runs from the date on which the bill was accepted. The reason for this is that the interval between a foreign bill being drawn and its acceptance may be considerable, since it may depend on the time taken for the bill to pass from the drawer's country to that of the acceptor. The

second important difference between the two types of bill is that the foreign bill is generally drawn in sets of three, although only one of them bears a stamp, and of course, one of them is paid.

Nowadays, it is mostly the documentary bill that is employed in international trade. This is nothing more than a bill of exchange with the various shipping documents - the bill of lading, the insurance certificate and the consular invoice - attached to it. By using this, the exporter can make the release of the documents conditional upon either (a) payment of the bill, if it has been drawn at sight, or (b) its acceptance by the importer if it has been drawn for a period.

**Documentary (or Reimbursement) Credit:** Under this method, a bill of exchange is necessarily employed, but the distinctive feature of the documentary credit is the opening by the importer of a credit in favour of the exporter, at a bank in the exporter's country.

To illustrate the use of the documentary credit, let us assume that Menon of Cochin intends to purchase goods from Ronald of New York and that the terms of the deal have been agreed upon by them. Then the transaction would be carried through the following stages:

**(a) Menon**, the importer, instructs his bank, say the State Bank of India (SBI), to open a credit in favour of Ronald, the exporter, at the New York branch of the SBI (if the SBI has no branch in New York, it will appoint some other bank to act as its agent there). The SBI will then inform Mr Ronald by a letter of credit that it will pay him a specified sum in exchange for the bill of exchange and the shipping documents.

**(b) Ronald** may now dispatch the goods to Menon at Cochin, draw a bill of exchange on the SBI and then present the documentary bill to the New York branch of the SBI. If all the documents are in order, the bank will pay Ronald.



The bank will charge for its services, and will also charge interest if the bill is not payable at sight.

(c) **The New York branch of the SBI** then sends the documentary bill to its Cochin office for payment or acceptance, as the case may be, by Menon. When the bill is paid, Menon's account will be debited by that amount. Every thing being in order, the banker will release the bill of lading from the bill to enable Menon to claim the goods on their arrival at the Cochin port.

### **Dealings on the Foreign Exchange Market**

A very brief account of certain important types of transactions conducted in the foreign exchange market is given below.

#### **Spot and Forward Exchanges**

The term spot exchange refers to the class of foreign exchange transaction which requires the immediate delivery, or exchange of currencies on the spot. In practice, the settlement takes place within two days in most markets. The rate of exchange effective for the spot transaction is known as the spot rate and the market for such transactions is known as the spot market.

The forward transaction is an agreement between two parties, requiring the delivery at some specified future date of a specified amount of foreign currency by one of the parties, against payment in domestic currency by the other party, at the price agreed upon in the contract. The rate of exchange applicable to the forward contract is called the forward exchange rate and the market for forward transactions is known as the forward market.

The foreign exchange regulations of various countries, generally, regulate the forward exchange transactions with a view to curbing speculation in the foreign exchanges market. In India, for example, commercial banks are permitted to offer forward cover only with respect to genuine export and import transactions.

Forward exchange facilities, obviously, are of immense help to exporters and importers they can cover the risks arising out of exchange rate fluctuations by entering into an appropriate forward exchange contract.

### **Forward Exchange Rate**

With reference to its relationship with the spot rate, the forward rate may be at par, discount or premium.

**At Par:** If the forward exchange rate quoted is exactly equivalent to the spot rate at the time of making the contract, the forward exchange rate is said to be at par.

**At Premium:** The forward rate for a currency, say the dollar, is said to be at a premium with respect to the spot rate when one dollar buys more units of another currency, say rupee, in the forward than in the spot market. The premium is usually expressed as a percentage deviation from the spot rate on a per annum basis.

**At Discount:** The forward rate for a currency, say the dollar, is said to be at discount with respect to the spot rate when one dollar buys fewer rupees in the forward than in the spot market. The discount is also usually expressed as a percentage deviation from the spot rate on a per annum basis.

The forward exchange rate is determined mostly by the demand for and supply of forward exchange. Naturally, when the demand for forward exchange exceeds its supply, the forward rate will be quoted at a premium and, conversely, when the supply of forward exchange exceeds the demand for it, the rate will be quoted at discount. When the supply is equivalent to the demand for forward exchange, the forward rate will tend to be at par.

## **Futures**

While a futures contract is similar to a forward contract, there are several differences between them. While a forward contract is tailor-made for the client by his international bank, a futures contract has standardized features -1 the contract size and maturity dates are standardized. Futures can be traded only on 3m organised exchange and they are traded competitively. Margins are not required in respect of a forward contract but margins are required of all participants in the futures market- an initial margin must be deposited into a collateral account to establish a futures position.

## **Options**

While the forward or futures contract protects the purchaser of the contract from the adverse exchange rate movements, it eliminates the possibility of gaining a windfall profit from favourable exchange rate movements. For example, if an Indian exporter has forward contract to sell his future dollar receipts at \$1 = Rs. 48/ he is protected against the risk of a depreciation of the dollar by the time he receives the payment (for example, \$1 = Rs. 46). However, the forward contract prevents him from gaining the profit of possible appreciation of the dollar (say, \$1 = Rs. 50). Currency options are designed to overcome this problem.

An option is a contract or financial instrument that gives holder the right but not the obligation, to sell or buy a given quantity of an asset at a specified price at a specified future date. An option to buy the underlying asset is known as a call option, and an option to sell the underlying asset is known as a put option. Buying or selling the underlying asset via the option is known as exercising the option. The stated price paid (or received) is known as the exercise or striking price. The buyer of an option is known as the long and the seller of an option is known as the writer of the option, or the short. The price for the option is known as premium. With reference to their exercise characteristics, there are two types

of options, American and European. An European option can be exercised only at the maturity or expiration date of the contract, whereas an American option can be exercised at any time during the contract.

### **Swap Operation**

Commercial banks who conduct forward exchange business may resort to a swap operation to adjust their fund position. The term swap means simultaneous sale of spot currency for the forward purchase of the same currency or the purchase of spot for the forward sale of the same currency. The spot is swapped against forward. Operations consisting of a simultaneous sale or purchase of spot currency accompanied by a purchase or sale, respectively, of the same currency for forward delivery, are technically known as swaps or double deals, as the spot currency is swapped against forward.

### **Arbitrage**

Arbitrage is the simultaneous buying and selling of foreign currencies with the intention of making profits from the differences between the exchange rate prevailing at the same time in different markets.

For illustration, assume that the rate of exchange in London is £ 1 = \$2 while in New York £ 1 = \$2.10. This presents a situation wherein one can purchase one pound sterling in London for two dollars and earn a profit of \$0.10 by selling the pound sterling in New York for \$2.10. This situation would, hence, lead to an increase in demand for sterling in London and consequently, an increase in the supply of sterling in New York. Such operations, i.e., arbitrage, could result in equalizing the exchange rates in different markets (in our example London and New York).

Arbitrage in foreign currencies is possible because of the ease and speed of modern means of communication between commercial centres throughout the world. Thus, an operator in New York might buy dollars in Amsterdam and sell them a few minutes later in London.

The effect of arbitrage, as has already been mentioned, is to iron out differences in the rates of exchange of currencies in different centres, thereby creating, theoretically speaking, a single world market in foreign exchange.

### **INTERNATIONAL BANKING**

Leading international banks include Bank of America, Citigroup, HSBC Holdings, Credit Agricole Group, Chase Manhattan, Industrial and Commercial Bank of China (ICBC), UBS, Deutsche Bank etc. Most of the world's 50 largest banks are from Japan, U.S., France, U.K., and Germany. **London, New York, and Tokyo**, however, is by far the most important international finance centers because of the relatively liberal banking regulations of their respective countries. These three financial centers are frequently referred to as full service centers because the major banks that operate in them usually provide a full range of services.

International banks are banks, which accept foreign currency deposits, finance international business and provide associated and ancillary services like hedging and advisory services and operate internationally.

Areas in which international banks typically have expertise to provide consulting services and advice to their clients are foreign exchange hedging strategies, interest rate and currency swap financing, and international cash management services. Banks that provide a majority of these services are commonly known as universal banks or full service banks.

## **Types of international Banking Offices**

There are different types of international banking offices ranging from correspondent bank relationships, through which minimal service can be provided to a bank's customers, to branch offices and subsidiaries providing a fuller array of services.

**Correspondent Bank:** A correspondent bank is bank located elsewhere that provides a service on behalf of another bank, besides its normal business. The correspondent banking system enables a bank's foreign client to conduct business worldwide through his local bank or its contacts. The most important correspondent banking service often is related to the foreign exchange transactions of the client. However, correspondent bank services also include assistance with trade financing, such as honoring letters of credit and accepting drafts drawn on the correspondent bank.

The correspondent bank mode is ideal because of its low cost when the volume of business is small. The possible disadvantage is that the clients may not receive- the required level of service.

**Representative Offices:** A Representative Office is a small service facility staffed by the parent bank personnel that is designed to assist the foreign clients of the parent bank in dealings with the bank's correspondents and to provide the clients with a level of service>greater than that provided through merely a correspondent relationship.

**Foreign Branches:** Foreign branches, which may provide full services, may be established when the volume of business is sufficiently large and when the law of the land permits it. Foreign branches facilitate better service to the clients and help the growth of business.

**Subsidiaries and Affiliates:** A subsidiary bank is a locally incorporated bank that is either wholly or majority owned by a foreign parent and an affiliate bank is one that is only partially owned but not controlled by its foreign parent. Subsidiaries and affiliates are normally meant to handle substantial volume of business. Their autonomy, compared to branches, more operational and strategic management leverage.

**Offshore Financial Centres:**

A major contributor to the growth of international banking is the offshore banking centres. "An offshore banking center is a country whose banking system is organised to permit external accounts beyond the normal economic activity of the country. The principal features that make a country attractive for establishing an offshore banking operation are virtually total freedom from host-country governmental banking regulations - for example, low reserve requirements and no deposit insurance, low taxes, a favourable time zone that facilitates international banking transactions, and to a minor extent, strict banking secrecy laws."

The offshore financial centers "are either operational centers, with extensive banking activities involving short-term financial transactions, or booking centers, where little actual banking activity takes place but where transactions are recorded to take advantage of secrecy and low (or no) tax rates. In the latter case, individuals may deposit money offshore to hide it from their home-, country tax authorities, either because the money was earned illegally- such as in drug trade or because the individual or company does not want to pay tax. London is an example of an operational center; the Cayman Islands is an example of a booking center."

International banks regard offshore financial centers as very good source for raising deposits, taking advantage of lower borrowing costs and tax rates. The offshore financial centers are centers for the Eurocurrency market. Offshore banks operate as branches or subsidiaries of the parent bank.

Offshore financial centers have one or more of the following characteristics:

- Large foreign-currency (Eurocurrency) market for deposits and loans (that in London, for example).
- Market that is a large net supplier of funds to the world financial markets (that in Switzerland, for example).
- Market that is an intermediary or pass-through for international loan funds (those in the Bahamas and the Cayman Islands, for example).
- Economic and political stability.
- Efficient and experienced financial community.
- Good communications and supportive services
- Official regulatory climate favorable to the financial industry, in the sense that it protects investors without unduly restricting financial institutions.

The International Monetary Fund recognizes the Bahamas, Bahrain, the Cayman Islands, Hong Kong, the Netherlands, Antilles, Panama, and Singapore as major offshore banking centers.

### **Non-Banking Financial Companies**

Non-banking financial companies (NBFCs) are financial intermediaries engaged primarily in the business of accepting deposits and making loans and advances, investments, leasing, hire purchase, etc. NBFCs are a heterogeneous lot. They include investment companies, finance corporations, mutual benefit funds, hire-purchase finance companies, loan companies and leasing companies.



The global liberalization has enabled large NBFCs to expand their business globally. The growth of FII investment in India is one of the manifestations of their expansion of business in developing countries. Foreign NBFCs are active in India in mutual fund business, hire-purchase financing, insurance etc.

### **FOREIGN EXCHANGE MANAGEMENT ACT**

The Foreign Exchange Regulations Act (FERA), 1973, regulated foreign exchange transactions in India. This Act also sought to regulate certain aspects of the conduct of business outside the country by Indian companies and in India by foreign companies.

The FERA was widely described as a draconian and obnoxious law. Following the economic liberalization ushered in 1991, some amendments to the FERA were effected in 1993.

The main objective of FERA, framed against the background of severe foreign exchange problem and the controlled economic regime, was conservation and proper utilization of the foreign exchange resources of the country.

There was a lot demand for a substantial modification of FERA in the light of the ongoing economic liberalization and improving foreign exchange reserves position. Accordingly, a new Act, the Foreign Exchange Management Act (FEMA), 1999, replaced the FERA.

The FEMA, which came in to effect from January 1, 2000, extends to the whole of India and also applies to all branches, offices, and agencies outside India, owned or controlled by a person resident in

#### **Objectives**

The objectives of FEMA are:

- o To facilitate external trade and payments

o To promote the orderly development and maintenance of foreign exchange market.

o Dealing In Foreign Exchange etc.

**Section 3 of FEMA** imposes restrictions on dealings in foreign exchange and foreign security and payments to and receipts from any person outside India. Accordingly, except as provided in terms of the Act, or with the general or special permission of the Reserve Bank, no person shall

(a) Deal in any foreign exchange or foreign security with any person other than an authorized person;

(b) Make any payment to or for the credit of any person resident outside India in any manner;

(c) Receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner;

(d) Enter in to any financial transaction in India as a consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

Further, save as otherwise provided in this Act, no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India, holding of foreign exchange etc.

Save as otherwise provided in this Act, no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.

### **Current Account Transactions**

FEMA permits dealings in foreign exchange through authorized persons for current account transactions. However, the Central Government can impose reasonable restrictions in public interest.

### **Capital Account Transactions**

Any person may sell or draw foreign exchange to or from an authorized person for a capital account transaction permitted by the Reserve Bank in consultation with the Central Government.

The Reserve Bank may, however, without prejudice to the generality of this, prohibit, restrict or regulate the following:

- (a) Transfer or issue of any foreign security by a person resident in India;
- (b) Transfer or issue of any security by a person resident outside India;
- (c) Transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
- (d) Any borrowing or lending in foreign exchange in whatever form or by whatever name called;
- (e) Any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;
- (f) Deposits between persons resident in India and persons resident outside India;
- (g) Export, import or holding of currency or currency notes;
- (h) Transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;

(i) Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;

(J) Giving of a guarantee or surety in respect of any debt, obligation or other liability incurred

1. By a person resident in India and owed to a person resident outside India; or

2. By a person resident outside India.

A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

The Reserve Bank may prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.

The Reserve Bank shall not impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business.

### **Export of Goods and Services**

1. Every exporter of goods shall

(a) furnish to the Reserve Bank or to such other authority a declaration as specified, containing true and correct material particulars, including the amount representing the full export value or, if the full export value of the goods is not ascertained at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India;

(b) furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realization of the export proceeds by such exporter.

For the purpose of ensuring that export value of the goods is received without any delay, the Reserve Bank may direct any exporter to comply with such requirements as it deems fit.

Every exporter of services shall furnish to the Reserve Bank or to such other authorities a declaration as specified, containing the true and correct material particulars in relation to payment for such services.

### **Realization and Repatriation of Foreign Exchange**

Where any amount of foreign exchange is due or has accrued to any person, he shall take all reasonable steps to realize and repatriate it to India within the time and in the manner prescribed by the RBI. Several exemptions are, however, granted to this clause.

### **Contravention and Penalties**

Under this chapter, penalty for Any kind of contravention under this Act is liable to a penalty up to thrice the amount involved where it is quantifiable or up to Rs. 2 lakhs where it is not quantifiable and where such contravention is continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues. This provision is in

total contrast to the respective provision in the erstwhile FERA which provided for imprisonment and no limit on fine. Under FEMA, a person will be liable to civil imprisonment only if he does not pay the fine within 90 days from the date of notice and that too after formalities of show cause notice and personal hearing. If he does not respond to the notice, there can be a warrant of arrest.

### **Administration of the Act**

The FEMA has assigned an important role to the Reserve Bank of India in the administration of this Act. The rules, regulations and norms pertaining to several sections of the Act are to be laid down by the RBI, in consultation with the Central Government.

The Act requires the Central Government to appoint as many officers of the Central Government as Adjudicating Authorities for holding inquiries pertaining to contravention of the Act. There is also a provision for appointing one or more Special Directors (Appeals) to hear appeals against the order of the Adjudicating Authorities. The Central Government shall also establish an Appellate Tribunal For Foreign Exchange to hear appeals against the orders of the Adjudicating Authorities and the Special Director (Appeals).

The FEMA provides for the establishment, by the Central Government, of a Director of Enforcement with a Director and such other officers or class of officers as it thinks fit for taking up for investigation the contraventions under this Act.

### **FERA and FEMA - A Comparison**

Important differences between FERA and FEMA have been summed up as follows:

1. In FEMA, only the specified acts relating to foreign exchange are regulated, while in FERA, anything and everything that has to do with foreign exchange

was controlled. Also, the aim of FEMA is facilitating trade as against that of FERA, which was to prevent misuse. In other words, the theme of FERA was: 'everything that is specified is under control' While the theme of FEMA is : 'everything other than what is expressly covered is not controlled.' Thus there is a lot of deregulation.

2. FEMA is a much smaller enactment - only 49 sections as against 81 of FERA.

3. In the process of simplification, many of the "laid downs" of the erstwhile FERA have been withdrawn.

4. Many provisions of FERA like the ones relating to blocked accounts, Indians taking up employment abroad, employment of foreign technicians in India, contracts in evasion of the act, vexatious search, culpable mental state etc. have no appearance in FEMA.

International Monetary System: Historically, the foreign exchange system has undergone many changes and there have been many methods of determining the exchange rate.

### **Trade Barriers**

The main objectives of imposing trade barriers are to protect domestic industries from foreign competition, to guard against dumping, to promote indigenous research and development, to conserve the foreign exchange resources of the country, to make the balance of payments position more favourable, and to discriminate against certain countries.

Trade barriers may be broadly classified into tariff and non-tariff barriers.

### **TARIFFS**

Tariffs in international trade refer to the duties or taxes imposed on internationally traded commodities when they cross the national borders.

## **Classification of Tariffs**

There are different ways of classifying the tariffs.

(i) On the basis of the origin and destination of the goods crossing the national boundary, tariffs may be classified into the following three categories:

### **Export duties**

An export duty is a tax imposed on a commodity originating from the duty-levying country destined for some other country.

### **Import duties**

An import duty is a tax imposed on a commodity originating abroad and destined for the duty-levying country.

### **Transit Duties**

A transit duty is a tax imposed on a commodity crossing the national frontier originating from, and destined for, other countries.

(ii) With reference to the basis for quantification of the tariff, we may have the following threefold classification:

### **Specific Duties**

A specific duty is a flat sum per physical unit of the commodity imported or exported, thus a specific import duty is a fixed amount of duty levied upon each unit of the commodity imported.

### **Ad-Valorem Duties**

Ad-valorem duties are levied as a fixed percentage of the value of commodity imported/exported. Thus, while the specific duty is based on the quantum of commodity imported/exported, the ad-valorem duty is based on the value of the commodity imported/exported.



### **Compound Duties**

When a commodity is subject to both specific and ad-valorem duties, the tariff is generally referred to as compound duty.

(iii) With respect to its application between different countries, the tariff system may be classified into following three types:

#### **Single Column Tariff**

The single-column, also known as the uni-linear, tariff system provides a uniform rate of duty for all like commodities without making any discrimination between countries.

#### **Double Column Tariff**

Under the double-column tariff system, there are two rates of duty on some or on all commodities. Thus, the double-column tariff discriminates between countries.

The double-column tariff system may be broadly divided into:

- (a) General and conventional tariff;
- (b) Maximum and minimum tariff.

The general and conventional tariff system consists of two schedules of tariff- the general and the conventional. The general schedule is fixed by the legislature at the very start and the conventional schedule results from the conclusion of commercial treaties with other countries. The maximum and minimum system consists of two autonomously determined schedules of tariff – the maximum and the minimum. The minimum schedule applies to

those countries which have obtained a concession as a result of a treaty or through M.F.N. (most favoured nation) pledge. The maximum schedule applies to all the other countries.

### **Triple-Column Tariff**

The triple-column tariff system consists of three autonomously determined tariff schedules – the general, the intermediate and the preferential. The general and intermediate rates are similar to the maximum and minimum rates mentioned above under the double-column tariff systems. The preferential rate is generally applied in trade between the mother country and the colonies.

(iv) With reference to the purpose they serve, tariffs may be classified into the following categories.

### **Revenue Tariff**

Sometimes the main intention of the government in imposing a tariff may be to obtain revenue. When raising revenue is the primary motive, the rates of duty are generally low, lest imports should be highly discouraged, defeating the objective of mobilizing revenue for the government. Revenue tariffs tend to fall on articles of mass consumption.

### **Protective Tariff**

Protective tariff is intended primarily, to accord protection to domestic industries from foreign competition. Naturally, the rates of duty tend to be very high in this case because generally, only high rates of duty curtail imports to a significant extent.

### **Countervailing and Anti-Dumping Duties**

Countervailing duties may be imposed on certain imports when they have been subsidized by foreign governments. Anti-dumping duties are applied to imports which are dumped on the domestic market at prices either below their cost of production or substantially lower than their domestic prices. Countervailing and

anti-dumping duties are, generally, penalty duties and an addition to the regular rates.

### **Impact of Tariff**

Tariffs affect on economy in different ways. An import duty generally has the following effect:

#### **(i) Protective Effect**

An import duty is likely to increase the price of imported goods. This increase in the price of imports is likely to reduce imports and increase the demand for domestic goods. Import duties may also enable domestic industries to absorb higher production costs. Thus, as a result of the production accorded by tariffs, domestic industries are able to expand their output.

#### **(ii) Consumption Effect**

The increase in prices resulting from the levy of import duty usually reduces the consumption capacity of the people.

#### **(iii) Redistribution Effect**

If the import duty causes an increase in the price of domestically produced goods, it amounts to redistribution of income between the consumers and producers in favour of the producers. Further, a part of the consumer income is transferred to the exchequer by means of the tariff.

#### **(iv) Revenue Effect**

As mentioned above, a tariff means increased revenue for the government (unless, of course, the rate of tariff is so prohibitive that it completely stops the import of the commodity subject to the tariff).

#### **(v) Income and Employment Effect**

The tariff may cause a switchover from spending on foreign goods to spending on domestic goods. This higher spending within the country may cause an expansion in domestic income and employment.

#### **(vi) Competitive Effect**

The competitive effect on the tariff is, in fact, an anti-competitive effect in the sense that the protection of domestic industries against foreign competition may enable the domestic industries to obtain monopoly power with all its associated evils.

#### **(vii) Term of Trade Effect**

In a bid to maintain the previous level of imports to the tariff-imposing country, if the exporter reduces his prices, the tariff-imposing country is able to get imports at a lower price. This will, ceteris paribus, improve the terms of trade of the country imposing the tariff.

#### **(vii) Balance of Payments Effect**

Tariffs, by reducing the volume of imports, may help the country to improve its balance of payments position.

#### **Nominal Tariff and Effective Tariff**

Nominal tariff refers to the actual duty on an imported item. For example, if a commodity X is subject to an import duty of 25 percent ad valorem, the nominal tariff is 25 per cent.

#### **Optimum Tariff**

If a country raises its tariff (import duty) unilaterally, its terms of trade may improve and its volume of trade may decline. The improvement in the terms of trade initially tends to more than offset the accompanying reduction in the

volume of trade, Hence a higher trade indifference curve is reached and community welfare is enhanced. Beyond some point, however, it is likely that the detrimental effect of successive reductions in the trade volume begins to outweigh the positive effect of further improvements in their terms of trade; as a result, community welfare begins to fall. Somewhere in between there must be a tariff which optimizes a country's welfare level under these conditions.

Thus, the optimum tariff is the rate of tariff beyond which any further gain from an improvement in the terms of trade will be more than offset by the related decline in volume. By raising the rate of tariff beyond the optimum rate, it may still be possible to improve the country's terms of trade; but the gain from this improvement in the terms of trade is more than offset by the related decline in the volume of trade.

#### **Non-Tariff Barriers :**

Non-tariff barriers (NTBs), many of which are described as new protectionism measures (as against tariffs which are regarded as traditional barriers), have grown considerably. According to a World Bank study, NTBs in major industrial countries affect more than one-third of imports from developing countries, compared to more than one-fourth from all countries.

NTBs are of two categories, Firstly, there are those which are generally used by developing countries to prevent foreign exchange outflows or result from their chosen strategy of economic development. These include import licensing, foreign exchange regulations, canalization of imports etc. The second category of NTBs is those which are used by developed economies to protect domestic industries which have lost international competitiveness and/or which are politically sensitive for government of these countries.

The NTBs are less transparent, difficult to Identify and their impacts on exporting countries are almost impossible to quantify.

As a matter of fact several advanced countries like the U.S.A., who are high priests of free trade, resort to several NTBs, particularly against developing countries. They are even accused of involving in arms-twisting tactics to mend the economic policies of the developing countries. The Super 301, of the Omnibus Trade and Competitiveness Act, 1988, of the U.S.A. is a case in point.

Jagdish Bhagwati observes that since the late 1970s, in the US and the EC, protectionism has increasingly taken the covert shape. In those countries which advocated free trade, the U.S. and the West European countries, there has been a growing demand for more protective measures in the wake of the challenge of their trade supremacy, particularly by the Pacific Rim nations. The growing demand in the EC and US for local content regulation and the controversial Super 301 of the US Act are manifestations of these. The Super 301 may allegedly be used for covert protectionism, like harassment of successful foreign rivals. First the rivals may be accused of indulging in unfair trade' and then they may be taken through time consuming and expensive procedures.

The following are some of the important non-tariff barriers.

### **Voluntary Export Restraints**

Voluntary Export Restraints (VERs) are bilateral arrangements instituted to restrain the rapid growth of exports of specific manufactured goods. The United States and the European Community have thus regulated the imports of several products. The recent advances in VERs and other new protectionism measures dates from the establishment of the Multi-Fiber Arrangement (MFA) in the mid 1970s. Other bilateral arrangements have involved mainly restraining the growth of specific exports from Japan and the newly industrializing countries (NICs).

## **Administered Protection**

Administered protection encompasses a wide range of bureaucratic government actions, which have grown in absolute as well as relative importance over the last decade or more. Most recent VERs are in fact regarded as the outgrowth of administered protection actions.

Important administrative protection measures include the following:

**(i) Health and Product Standards :-** Several health and product standards imposed by the developed countries hinder the exports of developing countries because of the added costs or technical requirements. The need for maintaining health and product standards is unquestionable. The objection should be to their use with the deliberate intention trade restriction or discrimination.

The Agreement on Technical Barriers to Trade (also known as the Standards Code) evolved by the Tokyo Round of the GATT lays down that when governments or other bodies adopt technical regulation or standard for reasons of safety, health consumer or environmental protection, or for other purposes, these should not create unnecessary obstacles to trade. Exporters from developing countries complain, however, that this code is not respected by developed countries in several cases.

**(ii) Customs Procedures:** Certain customs procedures of many countries become trade barriers. For example, studies point out that frequent changes of Japan's customs regulations are themselves a significant barrier to exporters, especially those not affiliated with Japanese overseas joint ventures.

The Tokyo Round formulated a Customs Valuation Code intended to provide a uniform and neutral system for the valuation of goods for customs purposes which will conform to the commercial realities and to prevent the use of arbitrary or fictitious value.

**(iii) Consular Formalities :** A number of countries insist on certain consular formalities like certification of export documents by the respective consulate, of the importing country, in the exporting country. This becomes a trade barrier when the fees charged for this is very high or the procedure is very cumbersome.

**(iv) Licensing:** Many countries regulate foreign trade, particularly imports, by licensing. In most cases, the purpose of import licensing is to restrict imports.

**(v) Government Procurement :** Government procurements often tend to hinder free trade. The Tokyo Round has, therefore, formulated an agreement on government procurement with a view to securing greater international competition in government procurements.

**(vi) State Trading :** State trading also hinders free trade many a time because of the counter trade practices, canalization, etc. State trading was an important feature of the foreign trade of the centrally planned economics and many developing countries. With the economic liberalizations in most of these countries, the role of state trading has declined.

**(vii) Monetary Controls:** In addition to foreign exchange regulations, other monetary controls are sometimes employed to regulate trade, particularly imports. For instance, to tide over the foreign exchange crisis in 1990-91 and 1991-92, the Reserve Bank of India took several measures which included as 25 per cent interest rate surcharge on bank credit for imports subject to a commercial rate of interest of a minimum 17 per cent, the requirement of substantially high cash margin requirement on most imports other than capital goods, and restrictions on the opening of letters of credit for imports.

**(viii) Environmental Protection Laws:** The growing concern for environmental protection has led to the extension of environmental protection regulation to the imports. For example, the U.S. congress was considering a



legislation to prohibit the import of shrimp harvested with commercial fishing technology which might adversely affect the endangered or threatened sea turtles unless the President certified that the supplying country has a turtle conservation programme comparable to that of the U.S.

**(ix) Foreign Exchange Regulations :** Foreign exchange regulations are an important way of regulating imports in a number of countries. This is done by the State monopolizing the foreign exchange resources and not realizing foreign exchange for import of items which the government do not approve of for various reasons. Restrictions on currency convertibility can also affect imports.

### **NTBs and India's Exports**

The problem of NTBs for Indian exports has been growing. The ADB study of the effects NTBs on India's exports to developed countries has come to the following conclusion.

Conventional NTBs generally do not exist in developing country markets at least for Indian exports. Their impact on exports of marine products and leather and leather manufactures to developed economies is somewhat marginal. Their potential adverse effects on India's emerging exports of temperate zone agro-products can be critical. Exports of metal manufactures and ready made garments from India have suffered on account of the NTBs in developed economies. Extension and intensification of NTBs is bound to severely restrict India's export expansion in these two relatively important export sectors of the economy. Apart from the actual imposition of these NTBs, the "noise" created is often adequate to drive out exporters and induce a fall in exports. NTBs and their administration bring about undesirable of rewards between rent, profit and wage incomes. The uncertainty they create clearly has an adverse effect on capacity creation and investment in the industry. As a factor responsible for an investment shortage, NTBs prevent the industry from making full use of

technological potential and economies of scale. These facts were unambiguously brought out in the findings of our survey of garment firms in India.

The above mentioned study has also pointed out that in the case of NTBs Indian exporters have not taken full advantage of the scope which exists. Thus, improvements in domestic capability will surely yield export expansion at least in the short run.

The problem of NTBs for Indian exports has increased recently. The threat under the Super 301 and Special 301 is an indication of this. The indications are that India may have to face more problems in future. NTBs are often employed when a country's exports to a country increases considerably, causing problems to the industries in importing countries when the exporting country does not toe the economic or political lines.

## **QUANTITATIVE RESTRICTIONS - QUOTAS**

Quantitative restrictions or quotas are an important means of restricting imports and exports. A quota represents a ceiling on the physical volume of the import/export of a commodity.

In this section, we shall confine ourselves to quantitative restrictions on imports, i.e., import quotas.

### **Types of Import Quota**

There are four important types of import quotas, including import licensing. These are:

#### **(i) Tariff Quota**

A tariff quota combines the features of the tariff as well as of the quota. Under a tariff Quota the imports of a commodity up to a specified volume are allowed duty free or at a special low rate; but any imports in excess of this limit are subject to duty-a higher rate of duty.

### **(ii) Unilateral Quota**

In a unilateral quota, a country unilaterally fixes a ceiling on the quantity of the import of particular commodity.

### **(iii) Bilateral Quota**

A bilateral quota results from negotiations between the importing country and a particular supplier country, or between the importing country and export groups within the supplier country.

### **(iv) Mixing Quota**

Under the mixing quota, the producers are obliged to utilize domestic raw materials up to a certain proportion in the production of a finished product.

### **Import Licensing**

Quota regulations are generally administered by means of import licensing. In India, for instance, the import of almost all the items is prohibited except under, and in accordance with, a licence or a customs clearance permit issued under the Imports (Control) Order, 1955, or an Open General Licence issued by the Government or under any other provision under the above order.

Under the import licensing system, the prospective importers are obliged to obtain a licence from the licensing authorities: the possession of an import licence is necessary to obtain the foreign exchange to pay for the imports. In a large number of countries, import licensing has become a very powerful device for controlling the quantity of imports-either of particular commodities or aggregate imports.

## **Impact of Quotas**

Like fiscal controls, the quantitative restrictions on imports have a number of effects on the economy. The following are, in general, the important economic effects of quotas:

### **(i) Balance of Payments Effect**

As quotas enable a country to restrict the aggregate imports within specified limits, quotas are helpful in improving its balance of payments position.

### **(ii) Price Effect**

As quotas limit the total supply, they may cause an increase in domestic prices.

### **(iii) Consumption Effect**

If quotas lead to an increase in prices, people may be constrained to reduce their consumption of the commodity subject to quotas or some other commodities.

### **(iv) Protective Effect**

By guarding domestic industries against foreign competition to some extent, quotas encourage the expansion of domestic industries.

### **(v) Redistributive Effect**

Quotas also have a redistributive effect if the fall in supply due to important restrictions enables the domestic producers to raise prices. The rise in prices will result in the redistribution of income between the producers and consumers in favour of the producers.

### **(vi) Revenue Effect**

Quotas may have revenue effect. The government may obtain some revenue by charging a license fee.

## **GATT –General Agreement on Trade and Tariff**

The General Agreement on Tariffs and Trade (GATT) was a multilateral treaty that laid down agreed rules for conducting international trade. It came into force in January 1948. Its basic aim was to liberalise trade and for 47 years it had been concerned with negotiating the reduction of trade barriers and with international trade relations. Overseeing the application of its rules was an important and continuing part of its activities. GATT also provided a forum in which countries could discuss and overcome their trade problems and negotiate to enlarge international trading opportunities. The rapid and uninterrupted growth in the volume of international trade till 1994 provided a good testimony for the success of the GATT.

### **Trade Negotiation Under GATT:**

Eight major trade negotiations took place under the GATT auspices are enlisted below:

1. Geneva - 1947
2. Annecy – 1949
3. Torquay – 1951
4. Geneva – 1956
5. Geneva, Dillon Round – 1960-61
6. Geneva ,Kennedy Round – 1964-67
7. Geneva,Tokyo Round – 1973-79
8. Punta del,Uruguay Round – 1986-94

The first round in 1947 (Geneva) saw creation of the GATT. The second round in 1949 (Annecy, France) involved negotiation with nations that desired GATT membership. The principal emphasis was on tariff reduction. The third round in

1951 (Torquay, England) continued accession and tariff reduction negotiations. The fourth round in 1956 (Geneva) proceeded along the same track as earlier rounds. The fifth round in 1960-61 (Geneva, Dillon Round) involved further revision of the GATT and the addition of more countries. The sixth round in 1964-67 (Geneva, Kennedy Round) was hybrid of earlier product-by-product approach with across the board tariff reductions. The seventh round in 1973-79 (Geneva, Tokyo Round) centered on the negotiation of additional tariff cuts and developed a series of agreements governing the use of non-tariff measures. The eighth round (Uruguay Round) started in 1986 and was concluded in April 1994.

### **Uruguay Round**

Uruguay Round of Multilateral Trade Negotiations was launched at Punta del Este in September 1986. These talks were the most ambitious and complex so far. Negotiations covered not only traditional GATT subjects such as tariff and non-tariff measures and the improvement of GATT rules and disciplines on subsidies, safeguards, etc. but also extended to new areas not dealt with by GATT earlier, such as Trade Related Intellectual Property Rights (TRIPs), Trade Related Investment Measures (TRIMs) and Trade in Services and Agriculture.

The Uruguay Round was formally concluded at the Ministerial Conference held in Marrakech, Morocco, from 12-15 April 1994. India, along with 110 other countries authenticated the results of the Uruguay Round by signing the Final Act. In addition, 104 countries also signed the Agreement establishing the World Trade Organisation (WTO). The WTO Agreement has come into force from January 1, 1995 and India has become a founder member of the world Trade Organisation, by ratifying the WTO Agreement on 30th December 1994.

### **Dilution of Special and Differential Treatment**

Developing countries lost a considerable part of their differential treatment, although differential treatment of least developed countries was largely

protected. They had to agree to a binding of tariff levels as a price for accession to GATT/WTO. However, bound tariffs have been set at substantially higher levels. They also lost flexibility in using trade policy measures for balance of payments difficulties; they have committed themselves to giving preference to tariffs over quantitative measures.

And the momentum of trade liberalization helped ensure that trade growth consistently outpaced production growth throughout the GATT era. The rush of new members during the Uruguay Round demonstrated that the multilateral trading system, as then represented by GATT, was recognized as an anchor for development and an instrument of economic and trade reform.

A whole corpus of jurisprudence on trade matters evolved under the aegis of GATT. The WTO is, in a large measure, built upon the strong foundation provided by the GATT.

### **World Trade Organisation**

The WTO was established on January 1, 1995. The WTO is the embodiment of the Uruguay Round results and the successor to GATT. 76 Governments became members of the WTO on its first day. As of December 2000, there are 142 members of the WTO and 34 countries have an observer status. There is a waiting list of 28 members. They account for more than 90 per cent of the world trade. The WTO is based in Geneva, Switzerland.

Its essential functions are:

Administering and implementing the multilateral and plurilateral trade agreements which together make up the WTO;

1. Acting as a forum for multilateral trade negotiations;
2. Seeking to resolve trade disputes;
3. Overseeing national trade policies; and

4. Cooperating with other international institutions involved in global policy-making.

The World Trade Organization is not a simple extension of GATT. On the contrary, it completely replaces its predecessor and has a very different character, which is mentioned below.

1. The GATT was a set of rules, a multilateral agreement, with no institutional foundation, only a small associated secretariat. The WTO is a permanent institution with its own secretariat.

2. The GATT was applied on a 'provisional basis' even if, after more than forty years, governments chose to treat it as a permanent commitment. The WTO commitments are full and permanent.

3. The GATT rules applied to trade in merchandise goods. In addition to goods, the WTO covers trade in services and trade-related aspects of intellectual property.

4. While GATT was a multilateral instrument, by the 1980s many new agreements had been added of a plurilateral, and therefore selective nature. The agreements which constitute the WTO are almost all multilateral and, thus, involve commitments for the entire membership.

5. The WTO dispute settlement system is faster, more automatic, and thus much less susceptible to blockages, than the old GATT system.

WTO is a watchdog of international trade, regularly examining the trade regimes of individual members. In its various bodies, members flag proposed or draft measures by others that can cause trade conflicts. Members are also required to notify various trade measures and statistics, which are maintained by the WTO in a large data base.



The WTO is also a management consultant for world trade. Its economist keeps a close watch on the pulse of the global economy, and provides studies on the main trade issues of the day.

### **Ministerial Working Groups Set up by the WTO**

The WTO set up five Ministerial Working Groups to deliberate on the key areas of negotiations. These were:

1. Agriculture
2. Implementation and Rules
3. Market Access
4. Singapore Agenda and other issues
5. Systemic issues

These Groups did considerable work to focus on the different perception! of the member governments and attempted listing of basic issues which needed to be addressed. Even though no final conclusion could be arrived at, the following gives a synoptic view of what transpired in those Working Group meetings:

#### **1 Agriculture**

The main issues on which debate took place were:

- (i) Integrating agriculture into the mainstream of WTO rules (whether agriculture should ultimately be treated in the same way as industrial products).
- (ii) The final objective for reducing export subsidies (whether to eliminate or not)
- (iii) Market Access
- (iv) Domestic Support
- (v) Non-trade concerns and multi-functionality

(vi) Developing Country Issues

The discussions proceeded on two broad lines. One group favoured the ultimate goal of complete integration of agricultural trade with the WTO rules, total elimination of export subsidies, substantial increase in market access and support to non-trade objectives through policies not distorting trade. The other group emphasized the distinct character of agriculture totally and the consequential non-desirability of subjecting agriculture to the disciplines governing other products. The principle of elimination of export subsidies was also not acceptable to this group which also stressed the need to take cognizance of multi-functionality of agriculture. According to press reports, there was some movement towards convergence of views on export subsidies.

**2. Implementation and Rules**

The major areas of concern requiring action, as highlighted by the developing participating Governments, were:

- (i) difficulties faced in implementing certain WTO Agreements and the need for extending deadlines in TRIPs, TRIMs and Customs Valuation.
- (ii) changing certain provisions of Anti-dumping, Subsidies and Textiles Agreements.

The European Community supported negotiations on anti-dumping, subsidies, Technical Barriers to Trade, State Trading, TRIMs, Regional Trade Agreements and environment related issues. It expressed a certain degree of flexibility regarding implementation issues. The USA indicated its flexible attitude regarding

TRIMs, customs valuation, agriculture, SPS, rules of origin and making S&D' provisions more operational for the developing countries.

There was a strong divergence of standpoints on anti-dumping, subsidies and textiles. Japan stressed the need to consider anti-dumping measures as a disguised form of protectionism, nullifying the benefits of tariff reduction.

### **3. Market Access**

(i) The points for deliberations included, inter alia, the following:

Coverage of the scope of negotiations—whether they should cover all agricultural products or there should be some exemptions.

(ii) Overall objective of the negotiations, i.e., the level of tariff cuts.

(iii) Non-tariff measures affecting market access.

(iv) How to address this specific concern of the least developed countries? There was a proposal for extending bound zero tariffs for exports from the least developed countries to the developed country markets.

There was also a discussion on the methodology of tariff cutting exercise. Unlike the Uruguay Round which followed the request-offer approach, there was a proposal for the harmonized approach to facilitate comparisons of tariff reduction proposals. There was also a proposal for combining the request-offer and harmonization approaches in future negotiations.

### **4. Singapore Agenda and Other Issues**

The major issue was whether members could agree to start negotiations on investment and competition as parts of the new Round. There was divergence of opinion on this. While a number of delegations were in favour of negotiations to be launched in the Third Ministerial Conference, others were of the view that study and analysis of these topics should continue to be in the Working Groups on investment and competition set up in the Singapore Ministerial Conference. There was also no progress towards convergence of view on TRIPs, Government procurement and trade facilitation.

## **5. Systemic Issues**

The Group deliberated on the following:

- (i) De-restriction of documents,
- (ii) WTO organisational structure to improve transparency and decision making,
- (iii) Improving information flows, and
- (iv) Enhancing public understanding of participation in the working of WTO.

The Group also deliberated on the role of the NGOs in inter-governmental organisations such as agriculture, including the abolition of subsidies. However, despite failure in the Seattle Conference, further negotiations in trade liberalisation took place in Doha in 2001 in mandated areas which include agriculture, services, TRIPs and TRIMs.

### **Export Import Policy (2002-07)**

#### **Exim Policy 2002-07 highlights**

##### **Service Sector:**

Duty free import facility for service sector having a minimum foreign exchange earning of Rs.10 lakhs.

The duty free entitlement shall be 10% of the average foreign exchange earned in the preceding three licensing years. However, for hotels, the same shall be 5% of the average foreign exchange earned in the preceding three licensing years. This entitlement can be used for import of office equipments, professional equipments, spares and consumables. However, imports of agriculture and dairy products shall not be allowed for imports against the entitlement. The entitlement and the goods imported against such entitlement shall be non-transferable.

**Agro Export:**

1. Corporate sector with proven credential will be encouraged to sponsor Agri Export Zone for boosting agro exports. The corporates to provide services such as provision of pre/post harvest treatment and operations, plant protection, processing, packaging, storage and related R&D.
2. DEPB rate for selected agro products to factor in the cost of pre-production inputs such as fertiliser, pesticides and seeds

**Status Holders**

1. Duty-free import entitlement for status holders having incremental growth of more than 25% in FOB value of exports (in free foreign exchange).
2. This facility shall however be available to status holders having a minimum export turnover of Rs.25 crore (in free foreign exchange). The duty free entitlement shall be 10% of the incremental growth in exports and can be used for import of capital goods, office equipment and inputs for their own factory or the factory of the associate/supporting manufacturer/job worker. The entitlement/ goods shall not be transferable. This facility shall be available on the exports made from 1.4.2003.
3. Annual Advance Licence facility for status holders to be introduced to enable them to plan for their imports of raw material and components on an annual basis and take advantage of bulk purchases.
4. The Input-Output norms for status holders to be fixed on priority basis within a period of 60 days.
5. Status holders in STPI shall be permitted free movement of professional equipments like laptop/computer.

### **Hardware/Software**

- To give a boost to electronic hardware industry, supplies of all 217 ITA-1 items from EHTP units to DTA shall qualify for fulfillment of export obligation.
- To promote growth of exports in embedded software, hardware shall be admissible for duty free import for testing and development purposes. Hardware upto a value of US\$ 10,000 shall be allowed to be disposed off subject to STPI certification.
- 100% depreciation to be available over a period of 3 years to computer and computer peripherals for units in EOU/EHTP/STP/SEZ .

### **Jems and Jewellery**

1. Diamond & Jewellery Dollar Account for exporters dealing in purchase/sale of diamonds and diamond studded jewellery.
2. Nominated agencies to accept payment in dollars for cost of import of precious metals from EEFC account of exporter.
3. Gem & Jewellery units in SEZ and EOUs can receive precious metal i.e Gold/silver/platinum prior to exports or post exports equivalent to value of jewellery exported. This means that they can bring export proceeds in kind against the present provision of bringing in cash only.

### **Export Cluster**

1. Upgradation of infrastructure in existing clusters/industrial locations under the Department of Industrial Policy & Promotion (DIPP) scheme to increase overall competitiveness of the export clusters.
2. Supplemental efforts to be made under the ASIDE scheme and similar schemes of other Ministries to bridge technology and productivity gaps in

identified clusters. 10 such clusters with high growth potential to be reinvigorated based on a participatory approach.

### **Rehabilitation of the sick units**

For revival of sick units, extension of export obligation period to be allowed to such units based on BIFR rehabilitation schemes. This facility shall also be available to units outside the purview of BIFR but operating under the State rehabilitation programme.

### **Removal of Quantitative Restrictions**

1. Import of 69 items covering animal products, vegetables and spices, antibiotics and films removed from restricted list.
2. Export of 5 items namely paddy except basmati, cotton linters, rare earth, silk cocoons, family planning devices except condoms removed from restricted list.

### **Special Economic Zone (SEZ)**

1. Sales from Domestic Tariff Area (DTA) to SEZs to be treated as export. This would now entitle domestic suppliers to Drawback/ DEPB benefits, CST exemption and Service Tax exemption.
2. Agriculture/Horticulture processing SEZ units will now be allowed to provide inputs and equipments to contract farmers in DTA to promote production of goods as per the requirement of importing countries. This is expected to integrate the production and processing and help in promoting SEZs specialising in agro exports.
3. Foreign bound passengers will now be allowed to take goods from SEZs to promote trade, tourism and exports.
4. Domestic sales by SEZ units will now be exempt from SAD.

5. Restriction of one year period for remittance of export proceeds removed for SEZ units.
6. Netting of export permitted for SEZ unit provided it is between same exporter and importer over a period of 12 months.
7. SEZ units permitted to take jobwork abroad and exports goods from there only.
8. SEZ units can capitalise import payables.
9. Wastage for subcontracting/exchange by gem and jewellery units in transactions between SEZ and DTA will now be allowed.
10. Export/import of all products through post parcel/courier by SEZ units will now be allowed.
11. The value of capital goods imported by SEZ units will now be amortised uniformly over 10 years.
12. SEZ units will now be allowed to sell all products including gems and jewellery through exhibitions and duty free shops or shops set up abroad.
13. Goods required for operation and maintenance of SEZ units will now be allowed duty free.

#### **Export Oriented Unit(EOU)**

1. Agriculture/Horticulture processing EOUs will now be allowed to provide inputs and equipments to contract farmers in DTA to promote production of goods as per the requirement of importing countries. This is expected to integrate the production and processing and help in promoting agro exports.
2. EOUs are now required to be only net positive foreign exchange earner and there will now be no export performance requirement.



3. Foreign bound passengers will now be allowed to take goods from EOUs to promote trade, tourism and exports.
4. The value of capital goods imported by EOUs will now be amortized uniformly over 10 years.
5. Period of utilisation of raw materials prescribed for EOUs increased from 1 year to 3 years.
6. Gems and jewellery EOUs are now being permitted sub-contracting in DTA.
7. Wastage for subcontracting/exchange by gem and jewellery units in transactions between EOUs and DTA will now be allowed as per norms.

8. Export/import of all products through post parcel/courier by EOUs will now be allowed.
9. EOUs will now be allowed to sell all products including gems and jewellery through exhibitions and duty free shops or shops set up abroad.
10. Gems and jewellery EOUs will now be entitled to advance domestic sales.

### **EPCG Scheme**

1. The scheme shall now allow import of capital goods for pre-production and post-production facilities also.
2. The Export Obligation under the scheme shall now be linked to the duty saved and shall be 8 times the duty saved.
3. To facilitate upgradation of existing plant and machinery, import of spares shall also be allowed under the scheme.
4. To promote higher value addition in exports, the existing condition of imposing an additional Export Obligation of 50% for products in the higher product chain to be done away with.
5. Greater flexibility for fulfillment of export obligation under the scheme by allowing export of any other product manufactured by the exporter. This shall take care of the dynamics of international market.
6. Capital goods upto 10 years old shall also be allowed under the scheme.
7. To facilitate diversification into the software sector, existing manufacturer exporters will be allowed to fulfill export obligation arising out of import of capital goods under the scheme for setting up of software units through export of manufactured goods of the same company.

8. Royalty payments received from abroad and testing charges received in free foreign exchange to be counted for discharge of export obligation under EPCG scheme.

### **DEPB Scheme**

1. Facility for provisional DEPB rate introduced to encourage diversification and promote export of new products.
2. DEPB rates rationalised in line with general reduction in Customs duty.

### **Advance Licence**

1. Standard Input Output Norms for 403 new products notified.
2. Anti-dumping and safeguard duty exemption to advance license for deemed exports for supplies to EOU/SEZ/EHTP/STP.

### **DFRC Scheme**

1. Duty Free Replenishment Certificate scheme extended to deemed exports to provide a boost to domestic manufacturer.
2. Value addition under DFRC scheme reduced from 33% to 25%.

### **Reduction in Transaction Cost**

1. High priority being accorded to the EDI implementation programme covering all major community partners in order to minimise transaction cost, time and discretion. We are now gearing ourselves to provide on line approvals to exporters where exports have been affected from 23 EDI ports.
2. Online issuance of Importer-Exporter Code (IEC) number by linking the DGFT EDI network with the Income Tax PAN database is under progress.
3. Applications filed electronically (through our website [www.nic.in/eximpol](http://www.nic.in/eximpol)) shall have a 50% lower processing fee as compared to manual.

**Miscellaneous**

1. Actual user condition for import of second hand capital goods upto 10 years old dispensed with.
2. Reduction in penal interest rate from 24% to 15% for all old cases of default under Exim Policy.
3. Restriction on export of warranty spares removed.
4. IEC holder to furnish online return of imports/exports made on yearly basis.
5. Export of free of cost goods for export promotion @ 2% of average annual exports in preceding three years subject to ceiling of Rs.5 lakh permitted.

## **Unit - V**

In exercise of the powers conferred by clause (b) of Section 9 and clause (e) of subsection (2) of Section 47 of the Foreign Exchange Management Act, 1999 (42 of 1999), the Reserve Bank of India makes the following regulations for opening, holding and maintaining of Foreign Currency Accounts and the limits up to which amounts can be held in such accounts by a person resident in India, namely:

### **1. Short title and commencement :-**

- I. These Regulations may be called the Foreign Exchange Management (Export of Goods and Services) Regulations, 2000.
- II. They shall come into force on 1st day of June 2000.

### **2. Definitions:-**

In these Regulations, unless the context requires otherwise, -

- (i) 'Act' means the Foreign Exchange Management Act, 1999 (42 of 1999) ;
- (ii) 'authorised dealer' means a person authorised as an authorised dealer under sub-section (1) of section 10 of the Act, and includes a person carrying on business as a factor and authorised as such under the saidsection 10 ;
- (iii) 'Exim Bank' means the Export-Import Bank of India established under the Export-Import Bank of India Act, 1981 (28 of 1981);
- (iv) 'export' includes the taking or sending out of goods by land, sea or air, on consignment or by way of sale, lease, hire-purchase, or under

any other arrangement by whatever name called, and in the case of software, also includes transmission through any electronic media ;

- (v) 'export value' in relation to export by way of lease or hire-purchase or under any other similar arrangement, includes the charges, by whatever name called, payable in respect of such lease or hire-purchase or any other similar arrangement;
- (vi) 'form' means form annexed to these Regulations;
- (vii) 'schedule' means schedule appended to these Regulations;
- (viii) 'software' means any computer programme, database, drawing, design, audio/video signals, any information by whatever name called in or on any medium other than in or on any physical medium ;
- (ix) 'specified authority' means the person or the authority to whom the declaration as specified in Regulation 3 is to be furnished;
- (x) 'Working Group' means the Group constituted by the Reserve Bank for the purpose of considering proposals of export of goods and services on deferred payment terms or in execution of a turnkey project or a civil construction contract;
- (xi) the words and expressions used but not defined in these Regulations shall have the same meanings respectively assigned to them in the Act.

### **3. Declaration as regards export of goods and services :-**

- (1) Every exporter of goods or software in physical form or through any other form, either directly or indirectly, to any place outside India, other than Nepal and Bhutan, shall furnish to the specified authority, a declaration in one of the forms set out in the Schedule and supported by

such evidence as may be specified, containing true and correct material particulars including the amount representing

- (i) the full export value of the goods or software; or
- (ii) if the full export value is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions expects to receive on the sale of the goods or the software in overseas market, and affirms in the said declaration that the full export value of goods (whether ascertainable at the time of export or not) or the software has been or will within the specified period be, paid in the specified manner.

(2) Declarations shall be executed in sets of such number as specified.

(3) For the removal of doubt, it is clarified that, in respect of export of services to which none of the Forms specified in these Regulations apply, the exporter may export such services without furnishing any declaration, but shall be liable to realise the amount of foreign exchange which becomes due or accrues on account of such export, and to repatriate the same to India in accordance with the provisions of the Act, and these Regulations, as also other rules and regulations made under the Act.

#### **4. Exemptions :-**

Notwithstanding anything contained in Regulation 3, export of goods or services may be made without furnishing the declaration in the following cases, namely:

- a) trade samples of goods and publicity material supplied free of payment;
- b) personal effects of travelers, whether accompanied or unaccompanied;

- c) ship's stores, trans-shipment cargo and goods supplied under the orders of Central Government or of such officers as may be appointed by the Central Government in this behalf or of the military, naval or air force authorities in India for military, naval or air force requirements;
- d) goods or software accompanied by a declaration by the exporter that they are not more than twenty five thousand rupees in value;
- e) by way of gift of goods accompanied by a declaration by the exporter that they are not more than one lakh rupees in value;
- f) aircrafts or aircraft engines and spare parts for overhauling and/or repairs abroad subject to their reimport into India after overhauling /repairs, within a period of six months from the date of their export;
- g) goods imported free of cost on re-export basis;
- h) goods not exceeding U.S.\$ 1000 or its equivalent in value per transaction exported to Myanmar under the Barter Trade Agreement between the Central Government and the Government of Myanmar;
- i) the following goods which are permitted by the Development Commissioner of the Export Processing Zones or Free Trade Zones to be re-exported, namely:
  - 1) imported goods found defective, for the purpose of their replacement by the foreign suppliers/collaborators;
  - 2) goods imported from foreign suppliers/collaborators on loan basis;
  - 3) goods imported from foreign suppliers/collaborators free of cost, found surplus after production operations.



- j) replacement goods exported free of charge in accordance with the provisions of Exim Policy in force, for the time being.

**5. Indication of importer-exporter code number :-**

The importer-exporter code number allotted by the Director General of Foreign

Trade under Section 7 of the Foreign Trade (Development & Regulation) Act, 1992 (22 of 1992) shall be indicated on all copies of the declaration forms submitted by the exporter to the specified authority and in all correspondence of the exporter with the authorized dealer or the Reserve Bank, as the case may be.

**6. Authority to whom declaration is to be furnished and the manner of dealing with**

**the declaration :-**

**A. Declaration in Form GR/SDF**

- (i) The declaration in form GR/SDF shall be submitted in duplicate to the Commissioner of Customs.
- (ii) After duly verifying and authenticating the declaration form, the Commissioner of Customs shall forward the original declaration form/data to the nearest office of the Reserve Bank and hand over the duplicate form to the exporter for being submitted to the authorized dealer.

**B. Declaration in Form PP**

- (i) The declaration in form PP shall be submitted in duplicate to the authorized dealer named in the form.

- (ii) The authorised dealer shall, after countersigning the declaration form, hand over the original form to the exporter who shall submit it to the postal authorities through which the goods are being despatched. The postal authorities after despatch of the goods shall forward the declaration form to the nearest office of the Reserve Bank.

### **C. Declaration in Form SOFTEX**

- (i) The declaration in form SOFTEX in respect of export of computer software and audio/video/television software shall be submitted in triplicate to the designated official of Department of Electronics of Government of India at the Software Technology Parks of India (STPIs) or at the Free Trade Zones (FTZs) or Export Processing Zones (EPZs) in India.
- (ii) After certifying all three copies of the SOFTEX form, the said designated official shall forward the original directly to the nearest office of the Reserve Bank and return the duplicate to the exporter. The triplicate shall be retained by the designated official for record.

### **D. Submission of duplicate declaration forms to the Reserve Bank**

On realisation of the export proceeds, the authorised dealer shall, after due certification, submit the duplicate of the GR/SDF, PP or as the case may be, SOFTEX form to the nearest office of the Reserve Bank.

### **7. Evidence in support of declaration:-**

The Commissioner of Customs or the postal authority or the official of Department of Electronics, to whom the declaration form is submitted, may, in order to satisfy themselves of due compliance with Section 7 of the Act and

these regulations, require such evidence in support of the declaration as may establish that

- a) the exporter is a person resident in India and has a place of business in India;
- b) the destination stated on the declaration is the final place of the destination of the goods exported;
- c) the value stated in the declaration represents –
  - 1) the full export value of the goods or software; or
  - 2) where the full export value of the goods or software is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions expects to receive on the sale of the goods in the overseas market.

**Explanation:**

For the purpose of this regulation, ‘final place of destination’ means a place in a country in which the goods are ultimately imported and cleared through Customs of that country.

**.8. Manner of payment of export value of goods:-**

Unless otherwise authorized by the Reserve Bank, the amount representing the full export value of the goods exported shall be paid through an authorized dealer in the manner specified in the Foreign Exchange Management (Manner and Receipt and Payment) Regulations, 2000.

**Explanation:**

For the purpose of this regulation, re-import into India, within the period specified for realisation of the export value, of the exported goods in respect of which a declaration was made under Regulation 3, shall be deemed to be realization of full export value of such goods.

**9. Period within which export value of goods/software to be realized:-**

The amount representing the full export value of goods or software exported shall be realized and repatriated to India within six months from the date of export: Provided that where the goods are exported to a warehouse established outside India with the permission of the Reserve Bank, the amount representing the full export value of goods exported shall be paid to the authorized dealer as soon as it is realized and in any case within fifteen months from the date of shipment of goods. Provided further that the Reserve Bank, or subject to the directions issued by that Bank in this behalf, the authorized dealer may, for a sufficient and reasonable cause shown, extend the said period of six months or fifteen months, as the case may be.

**Explanation:**

For the purpose of this regulation, the “date of export” in relation to the export of software in other than physical form, shall be deemed to be the date of invoice covering such export.

**10. Export on Elongated Credit Terms:-**

No person shall enter into any contract to export goods on the terms which provide for a period longer than six months for payment of the value of the goods to be exported: Provided that the Reserve Bank may, for reasonable and sufficient cause shown, grant approval to enter into a contract on such terms.

#### **11. Submission of export documents:-**

The documents pertaining to export shall, within 21 days from the date of export as, as the case may be, from the date of certification of SOFTEX form, be submitted to the authorised dealer mentioned in the relevant declaration form: Provided that, subject to the directions issued by the Reserve Bank from time to time, the authorised dealer may accept the documents pertaining to export submitted after the expiry of the specified period of 21 days, for reasons beyond the control of the exporter.

#### **12. Transfer of documents:-**

Without prejudice to Regulation 3, an authorised dealer may accept, for negotiation or collection, shipping documents including invoice and bill of exchange covering exports, from his constituent (not being a person who has signed the declaration in terms of Regulation 3): Provided that before accepting such documents for negotiation or collection, the authorised dealer shall –

- a) where the value declared in the declaration does not differ from the value shown in the documents being negotiated or sent for collection, or
- b) where the value declared in the declaration is less than the value shown in the documents being negotiated or sent for collection, require the constituent concerned also to sign such declaration and thereupon such constituent shall be bound to comply with such requisition and such constituent signing the declaration shall be considered to be the exporter for the purposes of these Regulations to the extent of the full value shown in the documents being

negotiated or sent for collection and shall be governed by these Regulations accordingly.

### **13. Payment for the Export:-**

In respect of export of any goods or software for which a declaration is required to be furnished under Regulation 3, no person shall except with the permission of the Reserve Bank or, subject to the directions of the Reserve Bank, permission of an authorised dealer, do or refrain from doing anything or take or refrain from taking any action which has the effect of securing –

- (i) that the payment for the goods or software is made otherwise than in the specified manner; or
- (ii) that the payment is delayed beyond the period specified under these Regulations; or
- (iii) that the proceeds of sale of the goods or software exported do not represent the full export value of the goods or software subject to such deductions, if any, as may be allowed by the Reserve Bank or, subject to the directions of the Reserve Bank, by an authorised dealer; Provided that no proceedings in respect of contravention of these provisions shall be instituted unless the specified period has expired and payment for the goods or software representing the full export value, or the value after deductions allowed under clause (iii), has not been made in the specified manner within the specified period.

### **14. Certain Exports requiring prior approval:-**

#### **A. Export of goods on lease, hire, etc**

No person shall, except with the prior permission of the Reserve Bank, take or send out by land, sea or air any goods from India to any place

outside India on lease or hire or under any arrangement or in any other manner other than sale or disposal of such goods.

**B. Exports under trade agreement/rupee credit etc.**

- (i) Export of goods under special arrangement between the Central Government and Government of a foreign state, or under rupee credits extended by the Central Government to Govt. of a foreign state shall be governed by the terms and conditions set out in the relative public notices issued by the Trade Control Authority in India and the instructions issued from time to time by the Reserve Bank.
- (ii) An export under the line of credit extended to a bank or a financial institution operating in a foreign state by the Exim Bank for financing exports from India, shall be governed by the terms and conditions advised by the Reserve Bank to the authorised dealers from time to time.

**C. Counter Trade:-**

Any arrangement involving adjustment of value of goods imported into India against value of goods exported from India shall require prior approval of the Reserve Bank.

**15. Delay in Receipt of Payment:-**

Where in relation to goods or software export of which is required to be declared on the specified form, the specified period has expired and the payment therefore has not been made as aforesaid, the Reserve Bank may give to any person who has sold the goods or software or who is entitled to sell the goods or software or procure the sale thereof, such directions as appear to it to be expedient, for the purpose of securing, (a) the payment therefore if the goods or software has been sold and (b) the sale of goods and

payment thereof, if goods or software has not been sold or re-import thereof into India as the circumstances permit, within such period as the Reserve Bank may specify in this behalf; Provided that omission of the Reserve Bank to give directions shall not have the effect of absolving the person committing the contravention from the consequences thereof

**16. Advance payment against exports:-**

1. Where an exporter receives advance payment (with or without interest), from a buyer outside India, the exporter shall be under an obligation to ensure that –

- i) the shipment of goods is made within one year from the date of receipt of advance payment;
- ii) the rate of interest, if any, payable on the advance payment does not exceed London Inter-Bank Offered Rate (LIBOR) + 100 basis points, and
- iii) the documents covering the shipment are routed through the authorized dealer through whom the advance payment is received; Provided that in the event of the exporter's inability to make the shipment, partly or fully, within one year from the date of receipt of advance payment, no remittance towards refund of unutilised portion of advance payment or towards payment of interest, shall be made after the expiry of the said period of one year, without the prior approval of the Reserve Bank.

(2) Notwithstanding anything contained in clause (i) of sub-regulation (1), where the export agreement provides for shipment of goods extending beyond the period of one year from the date of receipt of advance payment, the exporter shall require the prior approval of the Reserve Bank.



### **17. Issue of directions by Reserve Bank in certain cases:-**

(1) Without prejudice to the provisions of Regulation 3 in relation to the export of goods or software which is required to be declared, the Reserve Bank may, for the purpose of ensuring that the full export value of the goods or, as the case may be, the value which the exporter having regard to the prevailing market conditions expects to receive on the sale of goods or software in the overseas market, is received in proper time and without delay, by general or special order, direct from time to time that in respect of export of goods or software to any destination or any class of export transactions or any class of goods or software or class of exporters, the exporter shall, prior to the export, comply with the conditions as may be specified in the order, namely ;

- a) that the payment of the goods or software is covered by an irrevocable letter of credit or by such other arrangement or document as may be indicated in the order
- b) that any declaration to be furnished to the specified authority shall be submitted to the Reserve Bank for its prior approval, which may, having regard to the circumstances, be given or withheld or may be given subject to such conditions as the Reserve Bank may deem fit to impose ;
- c) that a copy of the declaration to be furnished to the specified authority shall be submitted to such authority or organisation as may be indicated in the order for certifying that the value of goods or software specified in the declaration represents the proper value thereof.

(2) No direction under sub-regulation (1) shall be given, and no approval under clause (b) of that sub-regulation shall be withheld by the Reserve Bank, unless the exporter has been given a reasonable opportunity to make a representation in the matter.

### **18. Project exports**

Where an export of goods or services is proposed to be made on deferred payment terms or in execution of a turnkey project or a civil construction contract, the exporter shall, before entering into any such export arrangement, submit the proposal for prior approval of the approving authority, which shall consider the proposal in accordance with the guidelines issued by the Reserve Bank from time to time.

#### **Explanation:**

For the purpose of this Regulation, ‘approving authority’ means the Working Group or the Exim Bank or the authorized dealer.

#### **Schedule**

##### **(Refer to Regulation 3)**

Form **GR**: To be completed in duplicate for export otherwise than by Post including export of software in physical form i.e. magnetic tapes/discs and paper media.

Form **SDF**: To be completed in duplicate and appended to the shipping bill, for exports declared to Customs Offices notified by the Central Government which have introduced Electronic Data Interchange (EDI) system for processing shipping bills notified by the Central Government.

Form **PP**: To be completed in duplicate for export by Post.

Form **SOFTEX**: To be completed in triplicate for declaration of export of software otherwise than in physical form, i.e. magnetic tapes/discs, and paper media.

**Schedule I**

**(See Rule 3)**

1. Remittance out of lottery winnings.
2. Remittance of income from racing/riding etc. or any other hobby.
3. Remittance for purchase of lottery tickets, banned/proscribed magazines, football pools, sweepstakes, etc.
4. Payment of commission on exports made towards equity investment in Joint Ventures/ Wholly Owned Subsidiaries abroad of Indian companies.
5. Remittance of dividend by any company to which the requirement of dividend balancing is applicable.
6. Payment of commission on exports under Rupee State Credit Route.
7. Payment related to "Call Back Services" of telephones.
8. Remittance of interest income on funds held in Non-Resident Special Rupee(Account) Scheme.

## Schedule II

(See Rule 4)

<b>Purpose of Remittance</b>	<b>Ministry / Department of Govt. of India whose approval is required</b>
1. Cultural Tours	Human Resources Development, (Department of Education and Culture)
2. Advertisement in foreign print media , for the purposes other than promotion of tourism, foreign investments and international bidding (exceeding US\$ 10,000) by a State Government and its Public Sector Undertakings	Ministry of Finance, (Department of Economic Affairs)
3. Remittance of freight of vessel chartered by a PSU	Ministry of Surface Transport, (Chartering Wing)
4. Payment of import by a Govt. Department or a PSU on c.i.f. basis (i.e. other than f.o.b. and f.a.s. basis)	Ministry of Surface Transport, (Chartering Wing)
5. Multi-modal transport operators making remittance to their agents abroad	Registration Certificate from the Director General of Shipping
6*. Omitted.	Omitted.
7. Remittance of container detention charges exceeding the rate prescribed by Director General of Shipping	Ministry of Surface Transport (Director General of shipping)
8. Remittances under technical collaboration agreements where payment of royalty exceeds 5% on local sales and 8% on exports and lump-sum payment exceeds US\$ 2 million	Ministry of Industry and Commerce
9. Remittance of prize money/sponsorship of sports activity abroad by a person other than International/National/State Level sports bodies. If the amount involved exceeds US\$ 100,000 Ministry of Human Resources Development (Department of Youth Affairs and Sports)	Ministry of Finance, (Insurance Division)
10. Payment for securing Insurance for health from a company abroad	Ministry of Finance, (Insurance Division)

11. Remittance for membership of P & I Club	Ministry of Finance, (Insurance Division)
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**\*Item No.6 - omitted - In terms of Government Notification - G.S.R. 442 dated 22<sup>nd</sup> October 2002**

**Schedule III**

**(See Rule 5)**

1. Remittance by artiste e.g. wrestler, dancer, entertainer etc. (This restriction is not applicable to artistes engaged by tourism related organisations in India like ITDC, State Tourism Development Corporations etc. during special festivals or those artistes engaged by hotels in five star categories, provided the expenditure is met out of EEFC account).
2. Release of exchange exceeding US\$ 5,000@ or its equivalent in one calendar year, for one or more private visits to any country (except Nepal and Bhutan).
3. Gift remittance exceeding US\$ 5,000 per remitter/donor per annum.
4. Donation exceeding US\$ 5000 per remitter/donor per annum.
5. Exchange facilities exceeding US \$ 5,000 for persons going abroad for employment.
6. Exchange facilities for emigration exceeding US \$ 5,000 or amount prescribed by country of emigration.
7. Remittance for maintenance of close relatives abroad,

(i) exceeding net salary (after deduction of taxes, contribution to provident fund and other deductions) of a person who is resident but not permanently resident in India and is a citizen of a foreign state other than Pakistan.

(ii) Exceeding US \$ 5000 per year, per recipient, in all other cases. Explanation: For the purpose of this item, a person resident in India on account of his employment of a specified duration (irrespective of length thereof) or for a specific job or assignment; the duration of which does not exceed three years, is a resident but not permanently resident.

8. Release of foreign exchange, exceeding US\$ 25,000 to a person, irrespective of period of stay, for business travel, or attending a conference or specialised training or for maintenance expenses of a patient going abroad for medical treatment or check-up abroad, or for accompanying as attendant to a patient going abroad for medical treatment/check-up.

9. Release of exchange for meeting expenses for medical treatment abroad exceeding the estimate from the doctor in India or hospital/doctor abroad.

10. Release of exchange for studies abroad exceeding the estimate from the institution abroad or US\$ 30,000, per academic year, whichever is higher.

11. Commission to agents abroad for sale of residential flats/commercial plots in India, exceeding 5% of the inward remittance.

12. Short term credit to overseas offices of Indian companies.

13. Remittance for advertisement on foreign television by a person whose export earnings are less than Rs.10 lakhs during each of the preceding two years.

14. Remittance of royalty and payment of lump-sum fee under the technical collaboration agreement which has not been registered with Reserve Bank.
15. Remittance exceeding US\$ 100,000/ per project, for any consultancy service procured from outside India
16. Remittances for use and/or purchase of trade mark/franchise in India.
17. Remittance exceeding US\$100,000/-, by an entity in India by way of reimbursement of pre-incorporation expenses.
- \*18. Remittance of hiring charges of transponders.

### **PART III**

#### **Export of Goods and services**

##### **Section `A` : General**

##### **A.1 Trade and Exchange Control**

(i) In exercise of the powers conferred by clause (a) of sub-section (1), sub-section (3) of section 7 and sub-section (2) of section 47 of the Foreign Exchange Management Act, 1999 (42 of 1999), the Reserve Bank has made the Foreign Exchange Management (Export of Goods and Services) Regulations, 2000 relating to export of goods and services from India, hereinafter referred to as the 'Export Regulations'. These Regulations have been notified *vide* Notification No. FEMA 23/2000-RB, dated 3rd May, 2000, as amended from time to time.

(ii) Any reference to Reserve Bank should be made to the office of Exchange Control Department within whose jurisdiction the applicant person, firm or

company resides or functions unless otherwise indicated. If for any particular reason, a firm or company desires to deal with a different office of the Exchange Control Department, it may approach the office within whose jurisdiction it functions for necessary approval.

## **A.2 Exemptions from Declarations**

(i) The requirement of declaration of export of goods and software in the prescribed form will not apply to the cases indicated in Regulation No. 4, *ibid*. The requirement of declaration also shall not apply to goods sent for testing abroad, subject to re-import.

(ii) Gift of goods exceeding rupees one lakh in value require approval of the Reserve Bank.

(iii) Authorised Dealers may consider requests for grant of GR waiver from exporters for export of goods free of cost, for export promotion upto 2 percent of average annual exports of the applicant during the preceding three years subject to a ceiling of Rs.5 lakhs.

(iv) Export of goods not involving any foreign exchange transaction directly or indirectly, requires the waiver of GR/PP procedure from Reserve Bank.

## **A.3 Numbering of forms**

GR, PP and SOFTEX forms will bear specific identification numbers. In all applications/correspondence with the Reserve Bank, this identification number should invariably be cited. In the case of declarations made on SDF form, the port code number and shipping bill number should be cited.



#### **A. 4 Manner of Payment**

(i) The amount representing the full export value of the goods exported shall be received through an authorised dealer in the manner specified in the Foreign Exchange Management (Manner of Receipt & Payment) Regulations, 2000 notified *vide* Notification No. FEMA 14/2000-RB, dated 3rd May, 2000.

(ii) Payment for export may also be received by the exporter in the following manner :

- a. In the form of bank draft, pay order, banker's or personal cheques.
- b. Foreign currency notes/foreign currency travellers' cheques from the buyer during his visit to India.
- c. Payment out of funds held in the FCNR/NRE account maintained by the Buyer
- d. Through International Credit Cards. When payment, in respect of goods sold to overseas buyers during their visits is received in this manner the GR/SDF (duplicate) should be released by the authorised dealers only on receipt of funds in their Nostro account or on production of a certificate by the exporter from the Credit Card servicing bank in India to the effect that it has received the equivalent amount in foreign exchange, if the authorised dealer concerned is not the Credit Card servicing bank. ADs may also receive payment for exports made out of India by debit to the credit card of an importer where the reimbursement from the card issuing bank/organisation will be received in foreign exchange.

- e. All transactions between a person resident in India and a person resident in Nepal may be settled in Rupees. However, in case of export of goods to Nepal, where an importer resident in Nepal has been permitted by the Nepal Rashtra Bank to make payment in free foreign exchange, such payments shall be routed through the ACU mechanism.
- f. Payment of export may also be received by the Gem & Jewellery units in SEZs and EOUs in the form of precious metals i.e. Gold / Silver / Platinum equivalent to value of jewellery exported on the condition that the sale contract provides for the same and the approximate value of the precious metals is indicated in the relevant GR / SDF / PP Forms.

#### **A. 5 Guarantees against Exports**

Prior approval of Reserve Bank should be obtained by authorised dealers for issue of guarantees in respect of caution-listed exporters.

#### **A.6 (i) Foreign Currency Accounts –**

Reserve Bank may consider applications in Form EFC from exporters having good track record for opening foreign currency accounts with banks subject to certain terms and conditions. Applications for opening such an account with a branch of an authorised dealer in India may be submitted through the branch at which the foreign currency account is to be maintained. If the foreign currency account is to be maintained abroad the application should be made by the exporter giving details of the bank with which the account will be maintained. An Indian entity has also been permitted to open, hold and maintain in the name of its office/branch set up outside India, a foreign currency account with a bank

outside by making remittance for the purpose of normal business operations of the said office/branch or representative subject to certain conditions.

Indian corporates who have set up overseas offices abroad have been permitted to acquire immovable property outside India for their business as also staff residential purposes with prior permission of RBI, until further notice.

A unit located in a Special Economic Zone (SEZ) may be allowed to open , hold and maintain a Foreign Currency Account with an authorised dealer in India subject to certain specified conditions.

**(ii) Diamond Dollar Account –**

Under the scheme of Government of India, firms and companies dealing in purchase/sale of rough or cut and polished diamonds / diamond studded jewellery, with track record of at least three years in import or export of diamonds and having an average annual turnover of Rs. 5 crores or above during preceding three licensing years (licensing year is from April to March) are permitted to transact their business through Diamond Dollar Accounts and may be allowed to open not more than five Diamond Dollar Accounts with their banks. Accordingly, eligible firms and companies may apply for permission to the Chief General Manager, Exchange Control Department, Exports Division, Reserve Bank of India, Central Office, Mumbai 400 001, through their authorised dealer.

**(iii) Exchange Earners' Foreign Currency (EEFC) Account**

A person resident in India may open, hold and maintain with an authorised dealer in India, a foreign currency account to be known as Exchange Earners' Foreign Currency (EEFC) Account. This account will be maintained only in the

form of non-interest bearing current account and no credit facilities either fund-based or non-fund based, should be permitted against the security of balances held in EEFC accounts, by the authorised dealers. The limits of eligible credits to the EEFC accounts are 70% for Export Oriented Units or units in (a) Export Processing Zone or (b) Software Technology Park or (c) Electronic Hardware Technology Park and to 50% for other persons resident in India in respect of inward remittance received through normal banking channel, other than the remittance received pursuant to any undertaking given to the Reserve Bank or which represents foreign currency loan raised or investment received from outside India *or those received for meeting specific obligations by the account holder.*

Exporters who have been certified as "Status Holder" in terms of the EXIM Policy are permitted to credit amount upto 100% of their eligible receipts of foreign exchange to their EEFC Account

Payments received in foreign exchange by a unit in Domestic Tariff Area (DTA) for supply of goods to a unit in Special Economic Zones out of its foreign currency a/c. are to be treated as eligible foreign exchange earnings for the purpose of credit to the EEFC A/c. Authorised Dealers may credit such payments received in foreign exchange by a unit in DTA to its EEFC A/c.

Authorised Dealers may till further notice, permit their exporter constituents to extend trade related loans / advances to overseas importers out of their EEFC balances without any ceiling.

Authorised Dealers may permit exporters to repay packing credit advances whether availed in Rupee or in foreign currency from balances in their EEFC A/c. and / or rupee resources to the extent exports have actually taken place.

**(iv) Supply of goods from units in Special Economic Zones (SEZs) to units in Domestic Tariff Area (DTA)**

Authorised Dealers may permit units in DTAs to purchase foreign exchange for making payment for goods supplied to them by units in SEZs.

**A.7 Counter-trade Arrangement**

(i) Counter trade proposals involving adjustment of value of goods imported into India against value of goods exported from India in terms of an arrangement voluntarily entered into between the Indian party and the overseas party through an Escrow Account opened in India in U.S. dollar will be considered by the Reserve Bank. All imports and exports under the arrangement should be at international prices in conformity with the Exim Policy and Foreign Exchange Management Act, 1999 and the Rules and Regulations made thereunder. No interest will be payable on balances standing to the credit of the Escrow Account but the funds temporarily rendered surplus may be held in a short-term deposit up to a total period of three months in a year (*i.e.*, in a block of 12 months) and the banks may pay interest at the applicable rate. No fund based/or non-fund based facilities would be permitted against the balances in the Escrow Account.

(ii) Application for permission for opening an Escrow Account may be made by the overseas exporter/organisation through the authorised dealer with whom the account is proposed to be opened, to the office of Reserve Bank under whose jurisdiction the authorised dealer is functioning.

**A.8 Export of goods on lease, hire, etc.**

Export of machinery, equipment, etc., on lease, hire, etc., basis under agreement with the overseas lessee against collection of lease rentals/hire charges and

ultimate re-import require prior approval of the Reserve Bank. Exporters should apply for necessary permission, through an authorised dealer, to the concerned Regional Office of the Reserve Bank, giving full particulars of the goods to be exported.

#### **A.9 Participation in Trade Fairs abroad**

(i) Participants in international exhibition/trade fair have been granted general permission *vide* Regulation 7(7) of the Foreign Exchange Management (Foreign Currency Account by a Person Resident in India) Regulations, 2000 notified under Notification No. FEMA 10/2000-RB, dated 3rd May, 2000 for opening temporary foreign currency account abroad. Exporters may deposit the foreign exchange obtained, by sale of goods, at the international exhibition/trade fair and operate the account during their stay outside India provided that the balance in the account is repatriated to India within a period of one month from the date of closure of the exhibition/trade fair and full details are submitted to the concerned authorised dealer.

(ii) Firms/Companies and other organisations participating in Trade Fair/Exhibition abroad are now permitted to take/export goods for exhibition and sale outside India without the prior approval of the Reserve Bank of India. Unsold exhibit items may be sold outside the exhibition/trade fair in the same country or in another third country. Such sales at discounted value are also permissible. It would also be permissible to 'gift' unsold goods upto the value of US \$ 5000 per exporter, per exhibition/trade fair.

Authorised Dealers may approve GR Form of export items for display or display-cum-sale in trade fairs/exhibitions outside India subject to the following;

- i. The exporter shall produce relative Bill of Entry within one month of re-import into India of the unsold items.
- ii. The sale proceeds of the items sold are repatriated to India in accordance with Foreign Exchange Management (Realisation, Repatriation, and Surrender of Foreign Exchange) Regulations, 2000.
- iii. The exporter shall report to the Authorised Dealer the method of disposal of all items exported, as well as the repatriation of proceeds to India.

Such transactions approved by the Authorised Dealers will be subject to 100% audit by the internal inspectors/auditors of the Authorised Dealer concerned.

#### **A. 10 Project Exports and Service Exports**

(i) Export of engineering goods on deferred payment terms and execution of turnkey projects and civil construction contracts abroad are collectively referred to as 'Project Exports'. Indian exporters offering deferred payment terms to overseas buyers and those participating in global tenders for undertaking turnkey/civil construction contracts abroad are required to obtain approval of Authorised Dealer/Exim Bank/Working Group at post-award stage before undertaking execution of such contracts. Regulations relating to 'Project Exports' and 'Service Exports' are laid down in the Memorandum on Project Exports (PEM).

(ii) Pure supply contracts (contracts for export of goods) where at least 90 per cent of the export value is realised within the prescribed period, *i.e.*, six months from the date of export and the balance amount within a maximum period of two years from the date of export are not treated as deferred payment exports, provided the exporter does not require/avail of any funded or non-funded facility/ies for such exports from authorised dealers.

(iii) Exporters desiring to submit bids for execution of projects abroad including service contract have been allowed to issue Corporate Guarantee in lieu of Bid Bond Guarantee, provided the amount of such guarantee shall not exceed 5% of the contract value.

#### **A. 11 Export on Elongated Credit Terms**

Exporters intending to export goods on elongated credit terms may submit their proposals giving full particulars through their banks to the concerned Regional Office of Reserve Bank for consideration.

#### **A. 12 Export of goods by Special Economic Zone - Job work abroad**

Units in SEZs are permitted to undertake job work abroad and export goods from that country itself subject to the conditions that -

- (i) Processing / manufacturing charges are suitably loaded in the export price and are borne by the ultimate buyer.
- (ii) The exporter has made satisfactory arrangements for realisation of full export proceeds subject to the usual GR procedure.

#### **A. 13 Forfaiting**

Export-Import Bank of India (Exim Bank) and authorised dealers have been permitted to undertake forfaiting, for financing of export receivables. It would be in order for authorised dealers to allow remittance of commitment fee/service charges, etc., payable by the exporter as approved by the Exim Bank/the concerned authorised dealer. Such remittance may be permitted in advance in one lump sum or at monthly intervals as approved by the concerned agency.



## **Section B – GR / PP / SOFTEX PROCEDURE**

### **B 1 Disposal of Copies of Export Declaration Forms**

(i) Copies of export declaration forms should be disposed of as under :

(a) GR forms should be completed by the exporter in duplicate and both the copies submitted to the Customs at the port of shipment along with the shipping bill. Customs will give their running serial number on both the copies after admitting the corresponding shipping bill. The Customs serial number will have ten numerals denoting the code number of the port of shipment, the calendar year and a six digit running serial number. Customs will certify the value declared by the exporter on both the copies of the GR form at the space earmarked and will also record the assessed value. They will then return the duplicate copy of the form to the exporter and retain the original for transmission to Reserve Bank. Exporters should submit the duplicate copy of the GR form again to Customs along with the cargo to be shipped. After examination of the goods and certifying the quantity passed for shipment on the duplicate copy, Customs will return it to the exporter for submission to the authorised dealer for negotiation or collection of export bills.

(b) Within twenty-one days from the date of export, exporter should lodge the duplicate copy together with relative shipping documents and an extra copy of the invoice with the authorised dealer named in the GR form. After the documents have been negotiated/sent for collection, the authorised dealer should report the transaction to Reserve Bank in statement ENC under cover of appropriate R-Supplementary Return. However, the duplicate copy of the form together with a copy of invoice etc. will henceforth be retained by the authorised dealer and may not be submitted to Reserve Bank.

**Note:** (i) In the case of exports made under deferred credit arrangement or to joint ventures abroad against equity participation or under rupee credit agreement, the number and date of Reserve Bank approval and/or number and date of the relative RBI circular should be recorded at the appropriate place on the GR form.

(ii) Where Duplicate copy of GR form is misplaced or lost, authorised dealer may accept another copy of duplicate GR form duly certified by Customs.

(c) On account of introduction of Electronic Data Interchange (EDI) System at certain Customs offices where shipping bills are processed electronically, the existing declaration in GR form is replaced by a declaration in form SDF (Statutory Declaration Form) . The SDF form should be submitted in duplicate (to be annexed to the relative shipping bill) to the concerned Commissioner of Customs. After verifying and authenticating the declaration in form SDF, the Commissioner of Customs will hand over to the exporter, one copy of the shipping bill marked 'Exchange Control Copy' in which form SDF has been appended for being submitted to the authorised dealer within 21 days from the date of export. The authorised dealer should accept the Exchange Control (EC) copy of the shipping bill and form SDF appended thereto, submitted by the exporter for collection/negotiation of shipping documents. The manner of disposal of EC copy of shipping Bill (and form SDF appended thereto) is same as that for GR forms.

(d) In cases where ECGC initially settles the claims of exporters in respect of exports insured with them and subsequently receives the export proceeds from the buyer/buyer's country through the efforts made by them, the share of exporters in the amount so received is disbursed through the bank which had handled the shipping documents. In such cases, ECGC will issue a certificate to

the bank which had handled the relevant shipping documents after full proceeds have been received. The certificate will indicate the number of declaration form, name of the exporter, name of the authorised dealer, date of negotiation, bill number, invoice value and the amount actually received by ECGC.

*(e) The authorised dealer should ensure by random check of the relevant duplicate forms by their internal / concurrent auditors to confirm that non-realisation or short realization allowed, if any, is within the powers delegated to them or has been duly approved by Reserve Bank, wherever necessary.*

(f) Where a part of export proceeds are credited to EEFC account, the export declaration (duplicate) form may be certified as under :

"Proceeds amounting to.....  
representing.....% of the export realisation  
credited to EEFC account maintained by the exporter with....."

(ii) The manner of disposal of PP forms is same as that for GR forms. Postal authorities will allow export of goods by post only if the original copy of the form has been countersigned by an authorised dealer. Therefore, PP forms should be first presented by the exporter to an authorised dealer for countersignature. Authorised dealer will countersign the forms in accordance with directions in paragraph B.2 and return the original copy to the exporter, who should submit the form to the post office with the parcel. The duplicate copy of the PP form will be retained by the authorised dealer to whom the exporter should submit relevant documents together with an extra copy of invoice for negotiation/collection, within the prescribed period of twenty-one days.

## **B. 2 Counter signature on PP Forms**

PP forms will be presented by the exporter to an authorised dealer for counter signature. Authorised dealers should countersign the PP forms after ensuring that the parcel is being addressed to their branch or correspondent bank in the country of import. The concerned overseas branch or correspondent should be instructed to deliver the parcel to consignee against payment or acceptance of relative bill. Authorised dealers may, however, countersign PP forms covering parcels addressed direct to the consignees, provided :—

- a. an irrevocable letter of credit for the full value of the export has been opened in favour of exporter and has been advised through authorised dealer concerned;

or

the full value of the shipment has been received in advance by the exporter through an authorised dealer;

or

- b. the authorised dealer is satisfied, on the basis of the standing and track record of the exporter and the arrangements made for realisation of the export proceeds, that he could do so.

In such cases, particulars of advance payment/letter of credit/authorised dealer's certification of standing, etc., of the exporter should be furnished on the form under proper authentication. Any alteration in the name and address of consignee on the PP form should also be authenticated by the authorised dealer under his stamp and signature.

### **B.3.A. Terms of payment - Invoicing - (Software)**

(i) In respect of long duration contracts involving series of transmissions, the exporters should bill their overseas clients periodically, *i.e.*, at least once a month or on reaching the 'milestone' as provided in the contract entered into with the overseas client and the last invoice/bill should be raised not later than 15 days from the date of completion of the contract. It would be in order for the exporters to submit a combined SOFTEX form for all the invoices raised on a particular overseas client, including advance remittances received in a month.

(ii) In respect of contracts involving only 'one shot operation', the invoice/bill should be raised within 15 days from the date of transmission.

(iii) The exporter should submit declaration in Form SOFTEX in triplicate in respect of export of computer software and audio / video / television software to the concerned designated official of Government of India at STPI / EPZ /FTZ /SEZ for valuation / certification not later than 30 days from the date of invoice / the date of last invoice raised in a month, as indicated above. The designated officials may also certify the SOFTEX Forms in respect of EOUs which are registered with them.

(iv) The invoices raised on overseas clients as at (i) to (iii) above will be subject to valuation of export declared on SOFTEX form by the concerned designated official of Government of India and consequent amendment made in the invoice value, if necessary.

### **B.3.B. Disposal of SOFTEX forms**

As for disposal of SOFTEX forms the procedure indicated in Regulation 6 of Export Regulations is to be observed. However, the duplicate copy of the form

together with a copy of invoice etc. will henceforth be retained by the authorised dealer and may not be submitted to Reserve Bank.

#### **B.4 Shut out shipments and Short Shipments**

(i) When part of a shipment covered by a GR form already filed with Customs is short-shipped, exporter must give notice of short-shipment to Customs in form and manner prescribed. In case of delay in obtaining certified short-shipment notice from Customs, exporter should give an undertaking to the authorised dealer to the effect that he has filed the short-shipment notice with the Customs and that he will furnish it as soon as it is obtained.

(ii) Where a shipment has been entirely shut out and there is delay in making arrangements to re-ship, exporter will give notice in duplicate to Customs in the manner and in form prescribed for the purpose, attaching thereto the unused duplicate copy of GR form and the shipping bill. Customs will verify that the shipment was actually shut out, certify copy of the notice as correct and forward it to Reserve Bank together with unused duplicate copy of the GR form. In this case, the original GR form received earlier from Customs will be cancelled. If the shipment is made subsequently, a fresh set of GR form should be completed.

#### **B. 5 Consolidation of Air Cargo**

Where air cargo is shipped under consolidation, the airline company's Master Airway Bill will be issued to the Consolidating Cargo Agent who will in turn issue his own House Airway Bills (HAWBs) to individual shippers. Authorised dealers may negotiate HAWBs only if the relative letter of credit specifically provides for negotiation of these documents in lieu of Airway Bills issued by the airline company. Authorised dealers may also accept Forwarder's Cargo Receipts (FCR) issued by steamship companies or their agents (instead of

'TATA' approved agents), in lieu of bills of lading, for negotiation / collection of shipping documents, in respect of export transactions backed by letters of credit, only if the relative letter of credit specifically provides for negotiation of this document, in lieu of bill of lading. Further, relative sale contract with the overseas buyer should also provide that FCR may be accepted in lieu of bill of lading as a shipping document.

### **B.6 Exports by Barges/Country Craft/Road Transport**

Following procedure should be adopted by exporters for filing original copies of GR/SDF forms where exports are made to neighbouring countries by road, rail or river transport :

- a. In case of exports by barges/country craft/road transport, the form should be presented by exporter or his agent at the Customs station at the border through which the vessel or vehicle has to pass before crossing over to the foreign territory. For this purpose, exporter may arrange either to give the form to the person in charge of the vessel or vehicle or forward it to his agent at the border for submission to Customs.
- b. As regards exports by rail, Customs staff have been posted at certain designated railway stations for attending to Customs formalities. They will collect the GR/SDF forms in respect of goods loaded at these stations so that the goods may move straight on to the foreign country without further formalities at the border. The list of designated railway stations is obtainable from the Railways. In respect of goods loaded at stations other than the designated stations, exporters must arrange to present GR/SDF forms to the Customs Officer at the Border Land Customs Station where Customs formalities are completed.

- c. In terms of an agreement on Border Trade between India and Myanmar, exchange of certain specified locally produced commodities, by people living along the India-Myanmar border on both sides under barter trade arrangement as also trade in freely convertible currency, has been permitted. Authorised dealers should follow strictly the revised guidelines issued in terms of A.P.(DIR Series) Circular No.17 dated 16.10.2000.

### **Section C – Authorised Dealer’s Obligation**

#### **C. 1 Delay in submission of shipping documents by exporters**

In cases where exporters present documents pertaining to exports after the prescribed period of twenty-one days from date of export, authorised dealers may handle them without prior approval of Reserve Bank, provided they are satisfied with the reasons for the delay.

#### **C. 2 Check-list for Scrutiny of Forms**

Authorised dealer/exporter should verify the following :

- i. Authorised dealer should ensure that the number on the duplicate copy of a GR form presented to them is the same as that of the original which is usually recorded on the Bill of Lading/Shipping Bill and the duplicate has been duly verified and authenticated by appropriate Customs authorities. In the case of SDF form, the Shipping Bill No. should be the same as that appearing on the Bill of Lading.
- ii. Bill of Lading/Airway Bill issued on ‘freight prepaid’ basis may be accepted where the sale contract is on f.o.b., f.a.s. etc. basis provided the amount of freight has been included in the invoice and the bill.



Conversely, in the case of c.i.f., c.& f. etc. contracts whose freight is sought to be paid at destination, it should be ensured that the deduction made is only to the extent of freight declared on GR/SDF form or the actual amount of freight indicated on the Bill of Lading/Airway Bill, whichever is less. Likewise, where the marine insurance is taken by the exporters on buyer's account, authorised dealer should verify that the actual amount paid is received from the buyer through invoice and the bill.

- iii. The documents submitted do not reveal any material *inter se* discrepancies in regard to description of goods exported, export value or country of destination.

**Note :**

- A. The export realisable value may be more than what was originally declared to/accepted by Customs on the GR/SDF form in certain circumstances such as where in c.i.f. or c. & f. contracts, part or whole of any freight increase taking place after the contract was concluded is agreed to be borne by buyers or where as a result of subsequent devaluation of the currency of the contract, buyers have agreed to an increase in price.
- B. In cases where the documents are being negotiated by a person other than the exporter who has signed GR/PP/SDF/SOFTEX Form in respect of the concerned consignment of export, authorised dealers may negotiate the documents after ensuring compliance with Regulation 12 of "Export Regulations".
- C. In certain lines of export trade, final settlement of price may be dependent on the results of quality analysis of samples drawn at the time

of shipment; but the results of such analysis will become available only after the shipment has been made. Sometimes, contracts may provide for payment of penalty for late shipment of goods in conformity with trade practice concerning the commodity. In these cases, while exporters declare to Customs the full export value based on the contract price, invoices submitted along with shipping documents for negotiation/collection may reflect a different value arrived at after taking into account the results of analysis of samples or late shipment penalty, as the case may be.

As such variations stem from the terms of contract, authorised dealers may accept them on production of documentary evidence after verifying the arithmetical accuracy of the calculations and on conforming the terms of underlying contracts.

### **C. 3 Trade Discount**

Bills in respect of exports by sea or air which fall short of the value declared on GR/SDF forms on account of trade discount may be accepted for negotiation or collection only if the discount has been declared by exporter on relative GR/SDF form at the time of shipment and accepted by Customs.

### **C. 4 Advance Payments against Exports**

Exporters may receive advance payments (with or without interest) from their overseas buyers. It should, however, be ensured that the shipments made against the advance payments are monitored by the authorised dealer through whom the advance payment is received. The appropriations made against every shipment must be endorsed on the original copy of the inward remittance certificate issued for advance remittance.

**Note :** Purchase of foreign exchange from the market for refunding advance payment credited to EEFC account may be allowed only after utilising the entire balances held in the exporter's EEFC accounts maintained at different branches/banks.

### **C. 5 Part Drawings**

In certain lines of export trade, it is the practice to leave a small part of the invoice value undrawn for payment after adjustment due to differences in weight, quality, etc. to be ascertained after arrival and inspection, weighment or analysis of the goods. In such cases, authorised dealers may negotiate bills, provided

- a. the amount of undrawn balance is considered normal in the particular line of export trade, subject to a maximum of 10 per cent of the full export value; and
- b. an undertaking is obtained from exporter on the duplicate of GR/SDF/PP forms that he will surrender/account for the balance proceeds of the shipment within the period prescribed for realisation.

**Note :** In cases where exporter has not been able to arrange for repatriation of the undrawn balance in spite of best efforts, authorised dealers on being satisfied with the *bona fides* of the case, should ensure that the exporter has realised at least the value for which the bill was initially drawn (excluding undrawn balances) or 90% of the value declared on GR/PP/SDF form, whichever is more and a period of one year has elapsed from the date of shipment.

## **C. 6 Consignment Exports**

(i) When goods have been exported on consignment basis, authorised dealer, while forwarding shipping documents to his overseas branch/correspondent, should instruct the latter to deliver them only against trust receipt/undertaking to deliver sale proceeds by a specified date within the period prescribed for realisation of proceeds of the export. This procedure should be followed even if, according to the practice in certain trades, a bill for part of the estimated value is drawn in advance against the exports.

(ii) The agents/consignees may deduct from sale proceeds of the goods expenses normally incurred towards receipt, storage and sale of the goods, such as landing charges, warehouse rent, handling charges, etc. and remit the net proceeds to the exporter

(iii) The account sales received from the Agent/Consignee should be verified by the authorised dealer. Deductions in Account Sales should be supported by bills/receipts in original except in case of petty items like postage/cable charges, stamp duty etc.

### **Notes :**

A. In case of goods exported on consignment basis, freight and marine insurance must be arranged in India.

B. Reserve Bank will permit, on application, exporters with satisfactory track record a longer period up to twelve months for realisation of export proceeds for exports on consignment basis made to CIS countries and East European countries financed in any permitted currency.

C. Authorised Dealers may consider the applications received from exporters and grant permission for opening / hiring warehouses abroad subject to the following conditions :

- (a) Applicant's export outstanding does not exceed 5 per cent of exports made during the previous year.
- (b) Applicant has a minimum export turnover of USD 1,00,000/- during the last year.
- (c) Period of realisation should be as applicable i.e., 180 days for non-status holder exporters and 365 days for status holder exporters.
- (d) All transactions should be routed through the designated branch of the authorized dealer.

The above permissions may be granted to the exporters initially for a period of one year and the renewal thereof may be considered subject to the applicant satisfying the requirement at (a) above. Authorised Dealers granting such permission / approvals should maintain a proper record of the approvals granted.

#### **C-7 Despatch of Shipping Documents**

(i) While Authorised dealers should normally despatch shipping documents to their overseas branches/correspondents expeditiously, they may despatch shipping documents direct to the consignees or their agents resident in the country of final destination of goods in cases where advance payment or an irrevocable letter of credit has been received for the full value of the export shipment and the underlying sale contract/letter of credit provides for despatch of documents direct to the consignee or his agent resident in the country of final destination of goods.

(ii) In cases not covered by (i) above also, authorised dealers may accede to the request of the exporter, for despatch of documents for whatever reason, direct to the consignee/agent provided the exporter is a regular customer and the authorised dealer is satisfied, on the basis of standing and track record of the exporter and the arrangements made for realisation of export proceeds, that the request can be acceded to.

(iii) Documents in respect of goods or software which are accompanied with a declaration by the exporter that they are not more than rupees twenty five thousand in value and not declared on GR/SDF/PP/SOFTEX form, in terms of paragraph A.2 may be directly sent by the exporter to the consignee.

(iv) Documents in respect of goods exported against 100% advance remittance, in terms of paragraph C.4 may be directly sent by the exporter to the consignee.

(v) Authorised Dealers may permit 'Status Holder Exporters' (as defined in the EXIM Policy), and units in Special Economic Zones (SEZ) to despatch the export documents to the consignees outside India subject to the terms and conditions that

a. the export proceeds are repatriated through the authorised dealer named in the GR Form

and

b. the duplicate copy of the GR form is submitted to the Authorised Dealer for monitoring purposes, by the exporters within 21 days from the date of export.

### **C.8 Handing Over Negotiable Copy of Bill of Lading to Master of Vessel/Trade Representative**

Authorised dealers may deliver one negotiable copy of the Bill of Lading to the Master of the carrying vessel or trade representative, in respect of exports to certain landlocked countries if the shipment is covered by an irrevocable letter of credit and the documents conform strictly to the terms of the Letter of Credit which, *inter alia*, provides for such delivery.

### **C. 9 Export Bills Register**

- i. Authorised dealers should maintain Export Bills Register, in physical or electronic form. Details of GR/SDF/PP form number, due date of payment, the fortnightly period of R Supplementary Return with which ENC statement covering the transaction was sent to Reserve Bank and the period of R Supplementary Return with which the duplicate copy of GR/SDF/PP form is submitted to Reserve Bank should be available.
- ii. Authorised dealers should ensure that all types of export transactions are entered in the Export Bills Register and are given bill numbers on calendar year basis (*i.e.* January to December). The bill numbers should be recorded in ENC statement and other relevant returns submitted to Reserve Bank.

### **C.10 Follow-up of Overdue Bills**

(i) Authorised dealers should closely watch realisation of bills and in cases where bills remain outstanding, beyond the due date for payment or six months from the date of export, the matter should be promptly taken up with the concerned exporter. If the exporter fails to arrange for delivery of the proceeds, within six months or seek extension of time beyond six months the matter should be reported to Reserve Bank stating, where possible, the reason for the delay in realising the proceeds. The duplicate copies of GR / SDF / PP Forms

should, however, continue to be held by authorised dealer until full proceeds are realised except in case of undrawn balances covered by Note under paragraph C 5. Authorised dealers should follow up export outstandings with exporters systematically and vigorously so that action against defaulting exporters does not get delayed. Any laxity in the follow up of realisation of export proceeds by authorised dealers will be viewed seriously by Reserve Bank leading to the invocation of the penal provision under FEMA 1999.

(ii) Exporters who have been certified as 'Status Holder' in terms of EXIM Policy are permitted to realise and repatriate the full value of export proceeds within a period of 12 months from the date of shipment.

(iii) The stipulation of twelve months or extended period thereof for realisation of export proceeds is no longer applicable for units located in Special Economic Zones (SEZs). The units in SEZs will however continue to follow the GR/ PP / Softex export procedure outlined in Section B - Part III of this circular.

(iv) Authorised dealers should furnish to Reserve Bank, on half-yearly basis, a consolidated statement in Form XOS giving details of all export bills outstanding beyond six months from the date of export as at the end of June and December every year. The statement should be submitted in triplicate within fifteen days from the close of the relative half-year.

#### **C. 11 Reduction in invoice value on account of prepayment of usance bills**

Occasionally, exporters may approach authorised dealers for reduction in invoice value on account of cash discount to overseas buyers for prepayment of the usance bills. In such cases authorised dealers may allow cash discount to the extent of amount of proportionate interest on the unexpired period of usance, calculated at the rate of interest stipulated in the export contract or at the prime



rate/LIBOR of the currency of invoice where rate of interest is not stipulated in the contract.

### **C. 12 Reduction in Value**

If, after a bill has been negotiated or sent for collection, the amount thereof is desired to be reduced for any reason, authorised dealer may approve such reduction, if satisfied about genuineness of the request, provided :

- a. the reduction does not exceed 10% of invoice value,
- b. it does not relate to export of commodities subject to floor price stipulations,
- c. the exporter is not on the exporters' caution list of Reserve Bank, and
- d. the exporter is advised to surrender proportionate export incentives availed of, if any.

In the case of exporters who have been in the export business for more than three years, reduction in invoice value may be allowed, without any percentage ceiling, subject to the above conditions as also subject to their track record being satisfactory, *i.e.*, the export outstandings do not exceed 5% of the average annual export realisation during preceding three calendar years. For the purpose of reckoning the percentage of outstanding export bills to average export realisations during the preceding three calendar years, outstandings in respect of exports made to countries facing externalisation problems may be ignored provided the payments have been made by the buyers in the local currency.

### **C. 13 Export Claims**

Authorised dealers may remit export claims on application, provided the relative export proceeds have already been realised and repatriated to India and the exporter is not on the caution list of Reserve Bank. In all such cases of remittances, the exporter should be advised to surrender proportionate export incentive, if any, received by him.

### **C.14 Change of buyer/consignee**

Prior approval of Reserve Bank is not required if, after goods have been shipped, they are to be transferred to a buyer other than the original buyer in the event of default by the latter, provided the reduction in value, if any, involved does not exceed 10% and the realisation of export proceeds is not delayed beyond the period of six months from the date of export. Where the reduction in value exceeds 10%, all other relevant conditions stipulated in paragraph C.12 should also be satisfied.

### **C.15 Extension of time limit**

1. (i) In cases where an exporter has not been able to realise proceeds of a shipment made within the period prescribed (*i.e.*, within six months from the date of export), for reasons beyond his control, but expects to be able to realise proceeds if extension of the period is allowed to him, necessary application (in duplicate) should be made to the concerned Regional Office of Reserve Bank in form ETX through his authorised dealer with appropriate documentary evidence other than cases referred to in item (ii) below.

(ii) Reserve Bank of India have permitted authorised dealers to extend the period of realization of export proceeds beyond 6 months from the date of export where

the invoice value does not exceed US \$ 1,00,000 subject to following conditions;

- a. The Authorised Dealer is satisfied that the exporter has not been able to realise export proceeds for reasons beyond his control
- b. The exporter submits a declaration that he will realise the export proceeds during the extended period.
- c. The extension may be granted upto a period of 3 months at a time and while considering the extension beyond one year from the date of export the total export outstandings of the exporter should not be more than 10% of the average of export realisations during the preceding 3 financial years.

2. The ceiling of US \$ 1,00,000 would not apply where the exporter has filed suits against the importer abroad. In such cases extension may be granted upto six months at a time, irrespective of the amount involved.

3. Cases which are not covered by the above instructions and cases indicated below would require prior approval from the Regional Office of the Reserve Bank.

- I. Where the export invoices are under investigation by Enforcement Directorate / Central Bureau of Investigation or other investigating agencies.
- II. where invoice value exceeds US \$ 1,00,000 (except in cases covered under paragraph 2 above).

All the export bills outstanding beyond six months from the date of export may be reported in XOS statement as usual. However, where extension of time has

been granted by authorized dealer, the date upto which extension has been granted may be indicated in the 'Remarks' column.

4. As a temporary measure for a period of one year w.e.f. September 1, 2001, exporters were allowed a period of 360 days from the date of shipment, for realisation and repatriation of full value of goods/software for exports to certain specified countries. This relaxation has been further extended upto August 31, 2003.

5. Manufacturers/exporters of certain specified products and having export contracts of Rs.100 crores and above in value term in one year have been allowed w.e.f. 1<sup>st</sup> October 2001, for a period of 365 days from the date of shipment for realisation and repatriation of full value of ` the exports of the products specified. This relaxation has been further extended upto September 30, 2003.

### **C. 16 Shipments Lost in Transit**

When shipments from India for which payment has not already been received either by negotiation of bills under letters of credit or otherwise are lost in transit, authorised dealer must ensure that insurance claim is made as soon as the loss is known. The duplicate copy of GR/SDF/PP form should be forwarded to Reserve Bank with following particulars :

- a. Amount for which shipment was insured.
- b. Name and address of insurance company.
- c. Place where claim is payable.

In cases where claim is payable abroad, authorised dealer must arrange to collect the full amount of claim due on the lost shipment, through the medium of his

overseas branch/correspondent and forward the duplicate copy of GR/SDF/PP form to Reserve Bank only after the amount has been collected. A certificate for the amount of claim received should be furnished on the reverse of the duplicate copy.

**Note :** Sometimes claims on shipments lost in transit are also partially settled directly by shipping companies/airlines under carrier's liability. Authorised dealers should ensure that amounts of such claims if settled abroad are also repatriated to India by exporters.

### **C. 17 Payment of Claims by ECGC**

Where export has been covered by a policy issued by ECGC, settlement of a claim by the Corporation does not absolve the exporter of the statutory obligation undertaken on the GR/SDF/PP form to realise proceeds of the export within prescribed period. In such cases, exporter should, in consultation with ECGC, take all necessary steps for realising the proceeds. Authorised dealers should also continue to hold the duplicate copies of GR/SDF/PP forms in their custody and initiate follow-up measures in the normal manner.

### **C. 18.A "Write off" of Unrealised Export Bills**

(i) An exporter who has not been able to realise the outstanding export dues despite best efforts, may approach the authorised dealer, who had handled the relevant shipping documents, with appropriate supporting documentary evidence with a request for write off of the unrealised portion. Authorised dealers may accede to such requests subject to the undernoted conditions :

- a. The relevant amount has remained outstanding for one year or more;

- b. The aggregate amount of write off allowed by the authorised dealer during a calendar year does not exceed 10% of the total export proceeds realised by the concerned exporter through the concerned authorised dealer during the previous calendar year;
- c. Satisfactory documentary evidence is furnished in support of the exporter having made all efforts to realise the dues;
- d. The case falls under any of the undernoted categories :
  - i. The overseas buyer has been declared insolvent and a certificate from the official liquidator indicating that there is no possibility of recovery of export proceeds produced;
  - ii. The overseas buyer is not traceable over a reasonably long period of time;
  - iii. The goods exported have been auctioned or destroyed by the Port/Customs/Health authorities in the importing country;
  - iv. The unrealised amount represents the balance due in a case settled through the intervention of the Indian Embassy, Foreign Chamber of Commerce or similar Organisation;
  - v. The unrealised amount represents the undrawn balance of an export bill (not exceeding 10% of the invoice value) remained outstanding and turned out to be unrealisable despite all efforts made by the exporter;
  - vi. The cost of resorting to legal action would be disproportionate to the unrealised amount of the export bill or where the exporter even after winning the Court

case against the overseas buyer could not execute the Court decree due to reasons beyond his control;

- vii. Bills were drawn for the difference between the letter of credit value and actual export value or between the provisional and the actual freight charges but the amount has remained unrealised consequent on dishonour of the bills by the overseas buyer and there are no prospects of realisation.
  
- e. The case is not the subject matter of any pending civil or criminal suit;
  
- f. The exporter has not come to the adverse notice of the Enforcement Directorate or the Central Bureau of Investigation or any such other law enforcement agency;
  
- g. The exporter has surrendered proportionate export incentives, if any, availed of in respect of the relative shipments. The authorised dealer should obtain documents evidencing surrender of export incentives availed of before permitting the relevant bills to be written off. Authorised dealers are to put in place a system under which their internal inspectors or auditors carry out random sample check/percentage check of outstanding export bills written off.

(ii) Where there is no further amount to be realised against the GR/SDF/PP form covered by the write off, authorised dealer should certify the duplicate form as under :

"Write off of.....

(Amount in words and figures)

permitted in terms of paragraph C.18 of Directions to Authorised Dealers."

Date .....

Stamp & Signature of  
Authorised Dealer

(iii) Status holders exporters (viz. Export Houses, Trading Houses, Star Trading Houses, Superstar Trading Houses) and manufacturer exporters exporting more than 50% of their production, and recognised as such by DGFT, may be permitted to "write off" outstanding export bills upto an annual limit of 5% of their average annual realisations (not turnover) during the preceding three calendar years. The limit of 5% will be cummulatively available in a year and subject to the following conditions.

1. The exporter should submit to the concerned authorised dealer a Chartered Accountant's certificate indicating –

- a. the export realisation in the preceding three calendar years and also the amount of "write off" already availed of during the year, if any.
- b. the relevant GR/SDF Nos. to be written off, Bill No., invoice value, commodity exported, country of export,
- c. the export benefits, if any, availed of by the exporter have been surrendered.

2. It is clarified that the following do not qualify for the "write off" facility :-



- a. Exports made to countries with externalisation problem i.e. where the overseas buyer has deposited the value of export in local currency but the amount has not been allowed to be repatriated by the central banking authorities of the country.
- b. GR/SDF forms which are under investigation by agencies like, Enforcement Directorate, Directorate of Revenue Intelligence, Central Bureau of Investigation, etc. as also the outstanding bills which are subject matter of civil / criminal suit.

3. After the "write off" has been permitted authorised dealer may certify the duplicate form as under :-

"write off of .....

(Amount in words and figures)

permitted in terms of AP(DIR Series) Circular No.30 dated April 4, 2001."

Date

Stamp & Signature of  
**Authorised Dealer"**

4. Authorised dealers may note to take into account the amount written off under this facility while arriving at the eligible amount under paragraph C.18 of AP (DIR Series) Circular No.12 of September 9, 2000.

5. Authorised dealers may forward a statement in form EBW to the Regional Office of Reserve Bank under whose jurisdiction they are functioning, indicating details of write offs etc.

**C. 18.B 'Netting off' of export receivables against import payments - Units in Special Economic Zones (SEZs)**

Authorised dealers may allow requests received from exporters for 'netting off' of export receivables against import payments for units located in Special Economic Zones subject to the following :

- (i) The 'netting off' of export receivables against import payments is in respect of the same Indian entity and the overseas buyer / supplier (bilateral netting). The netting may be done as on date of balance sheet of the unit in SEZ.
- (ii) The details of export of goods is documented in GR(O) forms / DTR as the case may be while details of import of goods / services is recorded through A1 / A2 form as the case may be. The relative GR / SDF forms will be treated as complete by the designated authorized dealer only after the entire proceeds are adjusted / received.
- (iii) Both the transactions of sale and purchase in 'R' Returns under FET-ERS are reported separately.
- (iv) The export / import transactions with ACU countries are kept outside the arrangement.
- (v) All the relevant documents are submitted to the concerned authorised dealer who should comply with all the regulatory requirements relating to the transactions.

### **C. 19 Return of Documents to Exporters**

The duplicate copies of GR/SDF/PP forms and shipping documents, once submitted to authorised dealers for negotiation, collection, etc., should not ordinarily be returned to exporters, except for rectification of errors and resubmission.

### **C.20 Exporters' Caution List**

Authorised dealers will also be advised whenever exporters are cautioned in terms of provisions contained in Regulation 17 of "Export Regulations". Authorised dealers should not accept for negotiation/collection shipping documents covering exports declared on GR/SDF/PP forms completed by such exporters nor countersign PP forms completed by them unless the GR/SDF/PP forms bear approval of Reserve Bank.

## **Section D – REMITTANCES CONNECTED WITH EXPORT**

### **D.1 Agency Commission on Exports**

(i) Authorised dealers may allow payment of commission, either by remittance or by deduction from invoice value, on application submitted by the exporter. The remittance on agency commission may be allowed subject to the following conditions:

- a. Amount of commission has been declared on GR/SDF/PP/SOFTEX form and accepted by Customs authorities or Ministry of Information Technology, Government of India / EPZ authorities as the case may be. In cases where the commission has not been declared on GR/SDF/PP/SOFTEX form, remittance thereof may be allowed after satisfying about the reasons adduced by the exporter for not declaring

commission on Export Declaration Form, provided a valid agreement/written understanding between the exporter and/or beneficiary for payment of commission subsists.

b. The relative shipment has already been made.

(ii) Authorised dealers may allow payment of commission by Indian exporters, in respect of their exports covered under counter trade arrangement through Escrow Accounts designated in U.S.dollar, subject to the following conditions :

- a. The payment of commission satisfies the conditions as at (a) and (b) stipulated in paragraph above.
- b. The commission is not payable to Escrow Account holders themselves.
- c. The commission should not be allowed by deduction from the invoice value.

NOTE : Payment of commission is prohibited on exports made by Indian Partners towards equity participation in an overseas joint venture / wholly owned subsidiary as also exports under Rupee Credit Route.

## **D.2 Refund of Export Proceeds**

Refund of export proceeds may be allowed by authorised dealers through whom the proceeds were originally received, provided such goods are re-imported into India on account of poor quality etc. and evidence of re-import has been submitted. In all such cases, exporters should be advised to surrender the proportionate incentives availed of, if any, against the relevant export.

**Reserve Bank of India**  
**(Exchange Control Department)**  
**Central Office**  
**Mumbai 400 001**  
**Notification No.FEMA 23 /2000-RB dated 3rd May 2000**  
**( As amended upto 30th June 2003\* )**

In exercise of the powers conferred by clause (a) of sub-section (1) and subsection (3) of section 7, sub-section (2) of section 47 of the Foreign Exchange Management Act, 1999 (42 of 1999), the Reserve Bank of India makes the following regulations relating to export of goods and services from India, namely:

**1. Short title and commencement :-**

- (i) These Regulations may be called the Foreign Exchange Management (Export of Goods and Services) Regulations, 2000.
- (ii) They shall come into force on 1<sup>st</sup> day of June, 2000.

**2. Definitions :-**

In these Regulations, unless the context requires otherwise, -

- (i) 'Act' means the Foreign Exchange Management Act, 1999 (42 of 1999) ;
- (ii) 'authorised dealer' means a person authorised as an authorised dealer under sub-section (1) of section 10 of the Act, and includes a person carrying on business as a factor and authorised as such under the said section 10 ;
- (iii) 'Exim Bank' means the Export-Import Bank of India established under the Export-Import Bank of India Act, 1981 (28 of 1981);
- (iv) 'export' includes the taking or sending out of goods by land, sea or air, on consignment or by way of sale, lease, hire-purchase, or under any other arrangement by whatever name called, and in the case of software, also includes transmission

through any electronic media ;

- (v) 'export value' in relation to export by way of lease or hire-purchase or under any other similar arrangement, includes the charges, by whatever name called, payable in respect of such lease or hire-purchase or any other similar arrangement;
- (vi) 'form' means form annexed to these Regulations;
- (vii) 'schedule' means schedule appended to these Regulations;
- (viii) 'software' means any computer programme, database, drawing, design, audio/video signals, any information by whatever name called in or on any medium other than in or on any physical medium ;

**\* Note: Amendment to Regulation 6D & Regulation 9(2)(a) is being notified shortly**

- (ix) 'specified authority' means the person or the authority to whom the declaration as specified in Regulation 3 is to be furnished;
- (x) 'Working Group' means the Group constituted by the Reserve Bank for the purpose of considering proposals of export of goods and services on deferred payment terms or in execution of a turnkey project or a civil construction contract;
- (xi) the words and expressions used but not defined in these Regulations shall have the same meanings respectively assigned to them in the Act.

### **3. Declaration as regards export of goods and services :-**

- (1) Every exporter of goods or software in physical form or through any other form, either directly or indirectly, to any place outside India, other than Nepal and Bhutan, shall furnish to the specified authority, a declaration in one of the forms set out in the Schedule and supported by such evidence as may be specified, containing true and correct material particulars including the amount representing -

- (i) the full export value of the goods or software; or
  - (ii) if the full export value is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions expects to receive on the sale of the goods or the software in overseas market, and affirms in the said declaration that the full export value of goods (whether ascertainable at the time of export or not) or the software has been or will within the specified period be, paid in the specified manner.
- (2) Declarations shall be executed in sets of such number as specified.
- (3) For the removal of doubt, it is clarified that, in respect of export of services to which none of the Forms specified in these Regulations apply, the exporter may export such services without furnishing any declaration, but shall be liable to realise the amount of foreign exchange which becomes due or accrues on account of such export, and to repatriate the same to India in accordance with the provisions of the Act, and these Regulations, as also other rules and regulations made under the Act.

#### **4. Exemptions :-**

Notwithstanding anything contained in Regulation 3, export of goods or services may be made without furnishing the declaration in the following cases, namely:

- a) trade samples of goods and publicity material supplied free of payment;
- b) personal effects of travellers, whether accompanied or unaccompanied;
- c) ship's stores, trans-shipment cargo and goods supplied under the orders of Central Government or of such officers as may be appointed by the Central Government in this behalf or of the military, naval or air force authorities in India for military, naval or air force requirements;
- d) goods or software accompanied by a declaration by the exporter that they are not more than twenty five thousand rupees in value;

- e) by way of gift of goods accompanied by a declaration by the exporter that they are not more than one lakh rupees in value;
- f) aircrafts or aircraft engines and spare parts for overhauling and/or repairs abroad subject to their reimport into India after overhauling /repairs, within a period of six months from the date of their export;
- g) goods imported free of cost on re-export basis;
- h) goods not exceeding U.S.\$ 1000 or its equivalent in value per transaction exported to Myanmar under the Barter Trade Agreement between the Central Government and the Government of Myanmar;
- i) The following goods which are permitted by the Development Commissioner of the Export Processing Zones, *Electronic Hardware Technology Parks*, *Electronic Software Technology Parks* or Free Trade Zones to be re-exported, namely:
  - 1) imported goods found defective, for the purpose of their replacement by the foreign suppliers/collaborators;
  - 2) goods imported from foreign suppliers/collaborators on loan basis;
  - 3) goods imported from foreign suppliers/collaborators free of cost, found surplus after production operations.
- (ia) *goods listed at items (1), (2) and (3) of clause (I) to be re-exported by units in Special Economic Zones, under intimation to the Development Commissioner of Special Economic Zones/concerned Assistant Commissioner or Deputy Commissioner of Customs;*
- j) replacement goods exported free of charge in accordance with the provisions of Exim Policy in force, for the time being.
- k) *goods sent outside India for testing subject to re-import into India;*
- l) *defective goods sent outside India for repair and re-import provided the goods are accompanied by a certificate from an authorised dealer in India that the export is for*



*repair and re-import and that the export does not involve any transaction in foreign exchange;*

- m) exports permitted by the Reserve Bank, on application made to it, subject to the terms and conditions, if any, as stipulated in the permission.

**5. Indication of importer-exporter code number :-**

The importer-exporter code number allotted by the Director General of Foreign Trade under Section 7 of the Foreign Trade (Development & Regulation) Act, 1992 (22 of 1992) shall be indicated on all copies of the declaration forms submitted by the exporter to the specified authority and in all correspondence of the exporter with the authorised dealer or the Reserve Bank, as the case may be.

**6. Authority to whom declaration is to be furnished and the manner of dealing with the declaration :-**

**A. Declaration in Form GR/SDF**

- (1) (i) The declaration in form GR/SDF shall be submitted in duplicate to the Commissioner of Customs.
- (ii) After duly verifying and authenticating the declaration form, the Commissioner of Customs shall forward the original declaration form/data to the nearest office of the Reserve Bank and hand over the duplicate form to the exporter for being submitted to the authorised dealer.

**B. Declaration in Form PP**

- (2) (i) The declaration in form PP shall be submitted in duplicate to the authorised dealer named in the form.
- (ii) The authorised dealer shall, after countersigning the declaration form, hand over the original form to the exporter who shall submit it to the postal authorities through which the goods are being despatched. The postal authorities after despatch of the goods shall forward the declaration form to the nearest office of the Reserve Bank.

**C. Declaration in Form SOFTEX**

- (3) (i) The declaration in form SOFTEX in respect of export of computer software and audio/video/television software shall be submitted in triplicate to the designated official of Ministry of Information Technology, Government of India at the Software Technology Parks of India (STPIs) or at the Free Trade Zones (FTZs) or Export Processing Zones (EPZs) or Special Economic Zones (SEZs) in India.
- (ii) After certifying all three copies of the SOFTEX form, the said designated official shall forward the original directly to the nearest office of the Reserve Bank and return the duplicate to the exporter. The triplicate shall be retained by the designated official for record.

**D. Submission of duplicate declaration forms to the Reserve Bank**

On realisation of the export proceeds, the authorised dealer shall, after due certification, submit the duplicate of the GR/SDF, PP or as the case may be, SOFTEX form to the nearest office of the Reserve Bank.

**7. Evidence in support of declaration :-**

The Commissioner of Customs or the postal authority or the official of Ministry of Information Technology to whom the declaration form is submitted, may, in order to satisfy themselves of due compliance with Section 7 of the Act and these regulations, require such evidence in support of the declaration as may establish that -

- a) the exporter is a person resident in India and has a place of business in India;
- b) the destination stated on the declaration is the final place of the destination of the goods exported;
- c) the value stated in the declaration represents -

- 1) the full export value of the goods or software; or
- 2) where the full export value of the goods or software is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions expects to receive on the sale of the goods in the overseas market.

**Explanation :**

For the purpose of this regulation, 'final place of destination' means a place in a country in which the goods are ultimately imported and cleared through Customs of that country.

**8. Manner of payment of export value of goods :-**

Unless otherwise authorised by the Reserve Bank, the amount representing the full export value of the goods exported shall be paid through an authorised dealer in the manner specified in the Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2000.

**Explanation :**

For the purpose of this regulation, re-import into India, within the period specified for realisation of the export value, of the exported goods in respect of which a declaration was made under Regulation 3, shall be deemed to be realisation of full export value of such goods.

**9. Period within which export value of goods/software to be realised :-**

The amount representing the full export value of goods or software exported shall be realised and repatriated to India within six months from the date of export :

Provided that where the goods are exported to a warehouse established outside India with the permission of the Reserve Bank, the amount representing the full export value of goods exported shall be paid to the authorised dealer as soon as it is realised and in any case within fifteen months from the date of shipment of goods;

Provided further that the Reserve Bank, or subject to the directions issued by that Bank in this behalf, the authorised dealer may, for a sufficient and reasonable cause shown, extend the said period of six months or fifteen months, as the case may be.

**Explanation :**

For the purpose of this regulation, the "date of export" in relation to the export of software in other than physical form, shall be deemed to be the date of invoice covering such export.

- (2) (a) *Where the export of goods or software has been made by a unit situated in a Special Economic Zone or by a Status Holder Exporter, as defined in the Exim Policy in force, then notwithstanding anything contained in sub-regulation (1), the amount representing the full export value of goods or software shall be realised and repatriated to India within twelve months from the date of export;*

*Provided that the Reserve Bank may for a sufficient and reasonable cause shown, extend the said period of twelve months*

- (b) *The Reserve Bank may for reasonable and sufficient cause direct that the unit shall cease to be governed by sub-regulation (2):*

*Provided that no such direction shall be given unless the unit has been given a reasonable opportunity to make a representation in the matter;*

- (c) *On such direction, the unit shall be governed by the provisions of sub-regulation (1), until directed otherwise by the Reserve Bank.*

**10. Export on Elongated Credit Terms :-**

No person shall enter into any contract to export goods on the terms which provide for a period longer than six months for payment of the value of the goods to be exported :

Provided that the Reserve Bank may, for reasonable and sufficient cause shown, grant approval to enter into a contract on such terms.

**11. Submission of export documents :-**

The documents pertaining to export shall, within 21 days from the date of export as, as the case may be, from the date of certification of SOFTEX form, be submitted to the authorised dealer mentioned in the relevant declaration form:

Provided that, subject to the directions issued by the Reserve Bank from time to time, the authorised dealer may accept the documents pertaining to export submitted after the expiry of the specified period of 21 days, for reasons beyond the control of the exporter.

**12. Transfer of documents :-**

Without prejudice to Regulation 3, an authorised dealer may accept, for negotiation or collection, shipping documents including invoice and bill of exchange covering exports, from his constituent (not being a person who has signed the declaration in terms of Regulation 3) :

Provided that before accepting such documents for negotiation or collection, the authorised dealer shall -

- a) Where the value declared in the declaration does not differ from the value shown in the documents being negotiated or sent for collection, or
- b) Where the value declared in the declaration is less than the value shown in the documents being negotiated or sent for collection,

require the constituent concerned also to sign such declaration and thereupon such constituent shall be bound to comply with such requisition and such constituent signing the declaration shall be considered to be the exporter for the purposes of these Regulations to the extent of the full value shown in the documents being negotiated or sent for collection and

shall be governed by these Regulations accordingly.

**13. Payment for the Export :-**

In respect of export of any goods or software for which a declaration is required to be furnished under Regulation 3, no person shall except with the permission of the Reserve Bank or, subject to the directions of the Reserve Bank, permission of an authorised dealer, do or refrain from doing anything or take or refrain from taking any action which has the effect of securing -

- (i) That the payment for the goods or software is made otherwise than in the specified manner; or
- (ii) That the payment is delayed beyond the period specified under these Regulations; or
- (iii) That the proceeds of sale of the goods or software exported do not represent the full export value of the goods or software subject to such deductions, if any, as may be allowed by the Reserve Bank or, subject to the directions of the Reserve Bank, by an authorised dealer;

Provided that no proceedings in respect of contravention of these provisions shall be instituted unless the specified period has expired and payment for the goods or software representing the full export value, or the value after deductions allowed under clause (iii), has not been made in the specified manner within the specified period.

**14. Certain Exports requiring prior approval :-**

**A. Export of goods on lease, hire, etc.**

No person shall, except with the prior permission of the Reserve Bank, take or send out by land, sea or air any goods from India to any place outside India on lease or hire or under any arrangement or in any other manner other than sale or disposal of such goods.

**B. Exports under trade agreement/rupee credit etc.**

- (i) Export of goods under special arrangement between the Central Government and Government of a foreign state, or under rupee credits extended by the Central Government to Govt. of a foreign state shall be governed by the terms and conditions set out in the relative public notices issued by the Trade Control Authority in India and the instructions issued from time to time by the Reserve Bank.
- (ii) An export under the line of credit extended to a bank or a financial institution operating in a foreign state by the Exim Bank for financing exports from India, shall be governed by the terms and conditions advised by the Reserve Bank to the authorised dealers from time to time.

**C. Counter Trade**

Any arrangement involving adjustment of value of goods imported into India against value of goods exported from India, shall require prior approval of the Reserve Bank.

**Delay in Receipt of Payment :-**

**15.**

Where in relation to goods or software export of which is required to be declared on the specified form, the specified period has expired and the payment therefor has not been made as aforesaid, the Reserve Bank may give to any person who has sold the goods or software or who is entitled to sell the goods or software or procure the sale thereof, such directions as appear to it to be expedient, for the purpose of securing, (a) the payment therefor if the goods or software has been sold and (b) the sale of goods and payment thereof, if goods or software has not been sold or re-import thereof into India as the circumstances permit, within such period as the Reserve Bank may specify in this behalf ;

Provided that omission of the Reserve Bank to give directions shall not have the effect of absolving the person committing the contravention from the consequences thereof.

**16. Advance payment against exports :-**

- (1) Where an exporter receives advance payment (with or without interest), from a buyer outside India, the exporter shall be under an obligation to ensure that -
  - i) The shipment of goods is made within one year from the date of receipt of advance payment;
  - ii) The rate of interest, if any, payable on the advance payment does not exceed London Inter-Bank Offered Rate (LIBOR) + 100 basis points, and
  - iii) The documents covering the shipment are routed through the authorised dealer through whom the advance payment is received;

Provided that in the event of the exporter's inability to make the shipment, partly or fully, within one year from the date of receipt of advance payment, no remittance towards refund of unutilised portion of advance payment or towards payment of interest, shall be made after the expiry of the said period of one year, without the prior approval of the Reserve Bank.

- (2) Notwithstanding anything contained in clause (i) of sub-regulation (1), where the export agreement provides for shipment of goods extending beyond the period of one year from the date of receipt of advance payment, the exporter shall require the prior approval of the Reserve Bank.

#### **17. Issue of directions by Reserve Bank in certain cases :-**

- (1) Without prejudice to the provisions of Regulation 3 in relation to the export of goods or software which is required to be declared, the Reserve Bank may, for the purpose of ensuring that the full export value of the goods or, as the case may be, the value which the exporter having regard to the prevailing market conditions expects to receive on the sale of goods or software in the overseas market, is received in proper time and without delay, by general or special order, direct from time to time that in respect of export of goods or software to any destination or any class of export transactions or any class of goods or software or class of exporters, the exporter shall, prior to the export, comply with the conditions as may be specified in the order, namely ;



- a) that the payment of the goods or software is covered by an irrevocable letter of credit or by such other arrangement or document as may be indicated in the order ;
  - b) that any declaration to be furnished to the specified authority shall be submitted to the Reserve Bank for its prior approval, which may, having regard to the circumstances, be given or withheld or may be given subject to such conditions as the Reserve Bank may deem fit to impose ;
  - c) that a copy of the declaration to be furnished to the specified authority shall be submitted to such authority or organisation as may be indicated in the order for certifying that the value of goods or software specified in the declaration represents the proper value thereof.
- (2) No direction under sub-regulation (1) shall be given, and no approval under clause (b) of that sub-regulation shall be withheld by the Reserve Bank, unless the exporter has been given a reasonable opportunity to make a representation in the matter.

## **18. Project exports**

Where an export of goods or services is proposed to be made on deferred payment terms or in execution of a turnkey project or a civil construction contract, the exporter shall, before entering into any such export arrangement, submit the proposal for prior approval of the approving authority, which shall consider the proposal in accordance with the guidelines issued by the Reserve Bank from time to time.

### **Explanation:**

For the purpose of this Regulation, 'approving authority' means the Working Group or the Exim Bank or the authorised dealer

**Schedule**  
**( Refer to Regulation 3)**

- Form **GR:** To be completed in duplicate for export otherwise than by Post including export of software in physical form i.e. magnetic tapes/discs and paper media.
- Form **SDF:** To be completed in duplicate and appended to the shipping bill, for exports declared to Customs Offices notified by the Central Government which have introduced Electronic Data Interchange (EDI) system for processing shipping bills notified by the Central Government.
- Form **PP:** To be completed in duplicate for export by Post.
- Form **SOFTEX:** To be completed in triplicate for declaration of export of software otherwise than in physical form, i.e. magnetic tapes/discs, and paper media.

**Master Circular- Import of Goods and Services**

Import of Goods and Services into India is being allowed in terms of Section 5 of the Foreign Exchange Management Act 1999 (42 of 1999), read with Notification No. GSR 381(E) dated May 3, 2000 as amended from time to time.

2. This Master Circular consolidates the existing instructions on the subject of **“Import of Goods and Services”** at one place. The list of underlying circulars is set out at Annex -1.

3. As recommended by the Committee on Procedures and Performance Audit on Public Services (CPPAPS) (Chairman : Shri S. S. Tarapore) set up by the Reserve Bank, this Master Circular is being issued with a sunset clause of one year. This circular will stand withdrawn on July 1, 2005 and be replaced by an updated Master Circular on the subject.

List of circulars which have been consolidated in this Master Circular

**Import of Goods and Services**

<b>Sl. No.</b>	<b>Circular No.</b>	<b>Date</b>
1.	AP (DIR Series) circular no 106	June 19, 2003
2.	AP (DIR Series) circular no 4	July 19, 2003
3.	AP (DIR Series) circular no 9	August 18,2003
4.	AP (DIR Series) circular no 15	September 17,2003
5.	AP (DIR Series) circular no 49	December 15,2003
6.	AP (DIR Series) circular no 66	February 06,2004
7.	AP (DIR Series) circular no 72	February 20,2004

## **PART I**

### **Introduction**

Import trade is regulated by the Directorate General of Foreign Trade(DGFT) under Ministry of Commerce & Industry, Department of Commerce, Government of India. Authorised dealers, while undertaking import transactions, should ensure that the imports into India are in conformity with the Export Import Policy in force and Foreign Exchange Management (Current Account Transactions) Rules, 2000 framed by Government of India vide Notification No. G.S.R.381 (E) dated May 3, 2000 and the directions issued by Reserve Bank under Foreign Exchange Management Act from time to time.

Authorised dealers should follow normal banking procedures and adhere to the provisions of Uniform Customs and Practices for Documentary Credits (UCPDC), etc. while opening letters of credit for import into India on behalf of their constituents. In respect of import of drawings and designs, compliance with the provisions of Research & Development Cess Act, 1986 may be ensured. Authorised dealers may also advise importers to ensure compliance with the provisions of Income Tax Act, wherever applicable

## **PART II**

### **IMPORT OF GOODS**

#### **A.1 General**

Rules and Regulations from the Exchange Control angle to be followed by the authorised dealers while undertaking import payment transactions on behalf of their clients are set out in the following paragraphs. Where specific regulations do not exist, authorised dealers may be governed by normal trade practices. Authorised dealers may particularly note to adhere to "Know Your Customer"

(KYC) guidelines issued by Reserve Bank (Department of Banking Operations & Development) in all their dealings.

### **A.2 Form A 1**

Applications by persons, firms and companies for making payments, exceeding USD 500 or its equivalent, towards imports into India must be made on appropriate form A 1.

### **A.3 Import Licences**

Authorised dealers may freely open

letters of credit and allow remittances for import of goods unless they are included in the negative list requiring licence under the EXIM Policy in force. In such cases, licences marked 'For Exchange Control purposes' should be called for and special conditions, if any, attached to such licences adhered to. Exchange Control copy of the import licence submitted by importer for opening of Letter of Credit or making remittance, when fully utilised, should be retained by authorised dealers and may be preserved till its scrutiny by the internal auditors or inspectors is completed.

### **A.4 Obligation of Purchaser of Foreign Exchange**

- i. In terms of Section 10(6) of the Foreign Exchange Management Act, 1999 (FEMA), any person acquiring foreign exchange is permitted to use it either for the purpose mentioned in the declaration made by him to an authorised dealer under Section 10(5) of the Act or to use it for any other purpose for which acquisition of exchange is permissible under the said Act, or Rules or Regulations framed thereunder.
- ii. Where foreign exchange acquired has been utilised for import of goods into India the authorised dealer should ensure that importer furnishes an evidence of import to his satisfaction, as laid down in paragraph A.10.

- iii. In addition to the permitted methods of payment for imports laid down in Notification No.FEMA14/2000-RB dated 3<sup>rd</sup> May 2000, payment for import can also be made by way of credit to non-resident account of the overseas exporter maintained with a bank in India. In such cases also authorised dealer should ensure compliance with the instructions contained in sub-paragraphs (i) and (ii) above.

#### **A.5 Time Limit for Settlement of Import Payments**

(i). In terms of the extant regulations, remittances against imports should be completed not later than six months from the date of shipment except in cases where amounts are withheld towards guarantee of performance etc. Deferred payment arrangements including suppliers and buyers credit providing for payments beyond a period of six months from date of shipment upto a period of less than three years are treated as trade credits for which the procedural guidelines laid down in the Master Circular for trade credits may be followed.

(ii.) Authorised dealers may permit settlement of import dues delayed due to disputes, financial difficulties etc. Interest in respect of such delayed payments may be permitted in terms of the directions in para A.7 below.

NOTE: Remittances against import of books may be allowed without restriction as to time limit, provided, interest payment, if any, is as per the instructions in para A.7

#### **A.6 Advance Remittance**

Authorised dealers may allow advance remittance for import of goods without any ceiling subject to the following conditions :

- a. I).If the amount of advance remittance exceeds USD 100,000 or its equivalent, an unconditional, irrevocable standby Letter of Credit or a guarantee from an international bank of repute situated outside India or a

guarantee of an authorised dealer in India, if such a guarantee is issued against the counter-guarantee of an international bank of repute situated outside India, is obtained.

ii). In cases where the importer (other than a Public Sector Company or a Department/Undertaking of the Government of India/State Governments) is unable to obtain bank guarantee from overseas suppliers and the Authorised Dealer is satisfied about the track record and bonafides of the importer, the requirement of the bank guarantee/ standby Letter of Credit may not be insisted upon for advance remittances upto USD 1,000,000 (US dollar one million). Authorised Dealers may frame their own internal guidelines to deal with such cases **as per a suitable policy framed by the bank's Board of Directors.**

iii) A Public Sector Company or a Department/Undertaking of the Central/State Government/s which is not in a position to obtain a guarantee from an international bank of repute against an advance payment, is required to obtain a specific waiver for the bank guarantee from the Ministry of Finance, Government of India before making advance remittance exceeding USD 100, 000.

- b. Physical import of goods into India is made within six months (three years in case of capital goods) from the date of remittance and the importer gives an undertaking to furnish documentary evidence of import within fifteen days from the close of the relevant period.
- c. In the event of non-import of goods, authorised dealer should ensure that the amount of advance remittance is repatriated to India or is utilised for any other purposes for which release of exchange is permissible under the Act, Rules or Regulations made thereunder.

### **A.7 Interest on Import Bills**

Authorised dealers may allow payment of interest on usance bills or overdue interest **for a period of less than three years** from the date of shipment at the rates prescribed in the Master Circular on trade credits.

### **A.8 Remittances against Replacement Imports**

Where goods are short-supplied, damaged, short-landed or lost in transit and the Exchange Control copy of the import licence has already been utilised to cover the opening of a letter of credit against the original goods which have been lost, the original endorsement to the extent of the value of the lost goods may be cancelled by authorised dealers and fresh remittance for replacement imports permitted without reference to Reserve Bank, provided the insurance claim relating to the lost goods has been settled in favour of the importer. It may be ensured that the consignment being replaced is shipped within the validity period of the licence.

### **A.9 Guarantee for Replacement Import**

In case replacement goods for defective import are being sent by the overseas supplier before the defective goods imported earlier are reshipped out of India, authorised dealers may issue guarantees at the request of importer client for despatch/return of the defective goods, according to their commercial judgement.

#### **A.10.1 Evidence of Import**

- i. In case of all imports, where value of foreign exchange remitted/paid for import into India exceeds USD 100,000 or its equivalent, it is obligatory on the part of the authorised dealers through whom the relative remittance was made, to ensure that the importer submits :-



- a. the Exchange Control copy of the Bill of Entry for home consumption, or
  - b. in case of 100% Export Oriented Units the Exchange Control copy of the Bill of Entry for warehousing, or
  - c. Customs Assessment Certificate or Postal Appraisal Form, as declared by the importer to the Customs Authorities, where import has been made by post, as an evidence that the goods for which the payment was made have actually been imported into India.
- ii. Where imports are made in non-physical form, i.e., software or data through internet/datacom channels and drawings and designs through e-mail/fax, a certificate from a Chartered Accountant that the software/data/ drawing/ design has been received by the importer, may be obtained.

Note: Authorised dealers should advise importers to keep Customs Authorities informed of the imports made by them under this clause.

- iii. In respect of imports on D/A basis, authorised dealers should insist on production of evidence of import at the time of effecting remittance of import bill. However, if importers fail to produce documentary evidence due to genuine reasons such as non-arrival of consignment, delay in delivery/customs clearance of consignment, etc., authorized dealers may, if satisfied with the genuineness of request, allow reasonable time, not exceeding three months from the date of remittance, to the importer to submit the evidence of import.
- iv. Authorised dealers should acknowledge receipt of evidence of import e.g. Exchange Control copy of the Bill of Entry, Postal Appraisal Form or Customs Assessment Certificate, etc., from importers by issuing

acknowledgement slips containing all relevant particulars relating to the import transactions.

- v. Internal inspectors or auditors (including external auditors appointed by authorised dealers) should carry out verification of the documents evidencing import, e.g. Exchange Control copies of Bills of Entry or Postal Appraisal Forms or Customs Assessment Certificates, etc.,
- vi. Documents evidencing import into India should be preserved by authorised dealers for a period of one year from the date of its verification. However, in respect of cases which are under investigation by investigating agencies, the documents may be destroyed **only** after obtaining clearance from the investigating agency concerned.

#### **A.10.2**

Authorised dealers may accept either Exchange Control copy of Bill of Entry for home consumption or a certificate from the Chief Executive Officer (CEO) or auditor of the company that the goods for which remittance was made have actually been imported into India provided :-

- i. the amount of foreign exchange remitted is less than USD 1,000,000 (USD one million) or its equivalent,
- ii. the importer is a company listed on a stock exchange in India and whose net worth is not less than Rs.100 crores as on the date of its last audited balance sheet,

or

the importer is a public sector company or an undertaking of the Government of India or its departments.

The above facility may also be extended to autonomous bodies, including scientific bodies/academic institutions, such as Indian Institute of Science /

Indian Institute of Technology etc. whose accounts are audited by the Comptroller and Auditor General of India(CAG). Authorised dealers may insist on a declaration from the auditor/CEO of such institutions that their accounts are audited by CAG.

#### **A.11 Follow up for Import Evidence**

- i. In case an importer does not furnish any documentary evidence of import, as required under paragraphs A.10.1 & 2 above, within 3 months from the date of remittance involving foreign exchange exceeding USD100,000, the authorised dealer should rigorously follow-up for the next 3 months, including issue of registered letters to the importer.
- ii. Authorised dealers should forward to Reserve Bank a statement on half-yearly basis as at the end of June & December of every year, in form BEF(format enclosed) furnishing details of import transactions, exceeding USD 100,000 in respect of which importers have defaulted in submission of appropriate document evidencing import within 6 months from the date of remittance. The said half-yearly statement should be submitted to the Regional Office of Reserve Bank under whose jurisdiction the authorised dealer is functioning, within 15 days from the close of the half-year to which the statement relates.

#### **A.12 Receipt of import Bills/Documents**

- i. Import bills and documents should be received from the banker of the supplier by the banker of the importer in India. Authorised dealers should not, therefore, make remittances where import bills have been received directly by the importers from the overseas supplier, except in the following cases:
  - a. Where the value of import bill does not exceed USD 100,000.

- b. Import bills received by wholly-owned Indian subsidiaries of foreign companies from their principals.
  - c. Import bills received by Super Star Trading Houses, Star Trading Houses, Trading Houses, Export Houses, 100% Export Oriented Units/ Units in Free Trade Zones, Public Sector Undertakings and Limited Companies.
  - d. Import bills received by all limited companies viz. public limited, deemed public limited and private limited companies.
- ii. At the request of importer clients, authorised dealers may receive bills direct from the overseas supplier as above, provided the authorised dealer is fully satisfied about the financial standing/status and track record of the importer customer. Before extending the facility, authorised dealer should obtain report on each individual overseas supplier from the overseas banker or reputed credit agency.

#### **A.13 Import of Gold/Platinum/Silver by Nominated Banks/Agencies**

- i. Import of gold on consignment basis

Gold may be imported by the nominated agencies/banks on consignment basis where the ownership will remain with the supplier and the importer (consignee) will be acting as an agent of the supplier (consignor). Remittances towards the cost of import shall be made as and when sales take place and in terms of the provisions of agreement entered into between the overseas supplier and nominated agency/bank.

- ii. Import of gold on unfixed price basis

The nominated agency/bank may import gold on outright purchase basis subject to the condition that although ownership of the gold shall be

passed on to the importer at the time of import itself, the price of gold shall be fixed later, as and when the importer sells the gold to the users.

**NOTE :** Instructions contained in this paragraph would also apply to import of platinum and silver.

#### **A.14 Import factoring**

Authorised dealers may enter into arrangements with international factoring companies of repute, preferably members of Factors Chain International, without approval of Reserve Bank. However, authorised dealers will have to ensure compliance with the extant exchange control directions relating to imports, EXIM policy in force and any other guidelines/directives issued by Reserve Bank in this regard.

#### **Section-B**

##### **Merchanting Trade**

Authorised dealers may take necessary precautions in handling merchanting trade transactions or intermediary trade transactions to ensure that (a) goods involved in the transactions are permitted to be imported into India, (b) such transactions do not involve foreign exchange outlay for a period exceeding three months, and (c) all rules, regulations and directions applicable to export out of India (except Export Declaration Form) are complied with in respect of the export leg and all rules, regulations and directions applicable to import (except Bill of Entry) are complied with in respect of the import leg of merchanting trade transactions. Authorised dealers are also required to ensure timely receipt of payment for the export leg of such transactions.

Authorized Dealers may note that short-term credit either by way of suppliers' credit or buyers' credit is not available for merchanting trade or intermediary trade transactions. While undertaking bonafide merchanting trade transactions

on behalf of their trader clients, authorized dealers should ensure that the terms of payment for the import leg and the export leg of the transactions are such that

- i. the liability for the import leg of the transaction is extinguished by the payment received for the export leg of the transaction, without any delay and
- ii. the entire merchant trade transaction is completed within a period of 6 months.

### **Section – C**

#### **Import of Currency**

Import of currency, including cheques, is governed by clause (g) of sub-section (3) of Section 6 of the Foreign Exchange Management Act, 1999, and the Foreign Exchange Management (Export and Import of Currency) Regulations 2000, made by Reserve Bank vide Notification No.FEMA 6/RB- 2000 dated May 3, 2000 and No.FEMA 38/RB-2001 dated February 27, 2001.

#### **BEF**

(See paragraph A.11)

Statement showing the details of remittances effected towards import in respect of which documentary evidence has not been received despite reminders

Name and address of AD branch.....

Name of Controlling Office of AD branch .....

Statement for the half-year ended .....

#### **NOTES:**

- i. The statement should be submitted in duplicate, to the Regional Office of Reserve Bank under whose jurisdiction the A.D. branch is functioning.

- ii. Details of transactions where the amount of remittance exceeds USD 100,000 or its equivalent should only be included in the statement.
- iii. In cases where, at the time of advance remittance, purpose of remittance was as import and subsequently the exchange has been used for other purpose for which sale of exchange is permissible, and a document to the satisfaction of authorised dealer has been produced, such cases should not be treated as default and hence be excluded from the BEF statement.
- iv. Authorised dealers may accept 'Into Bond Bill of Entry' as a provisional evidence of import into India. However, they may ensure submission of Exchange Control copy of the Bill of Entry for Home consumption within a reasonable period of time. Where EDI system has been implemented by customs and the importer receives only one copy of the "ex-Bond Bill of Entry" from the customs, Authorised Dealers may advise importer to submit a photocopy of the "ex-Bond Bill of Entry" for home consumption after clearance of the goods from the warehouse / bond, which may be duly verified by the Authorised Dealer and accepted as final evidence of import. Cases where 'Into Bond Bill of Entry' has been submitted need not be reported in BEF statement.
- v. The statement should include details of all remittances, exceeding USD 100,000 from India or payments from abroad in connection with imports, including advance payments, delayed payments, etc. irrespective of the source of funding (i.e. EEFC accounts/foreign currency accounts maintained in India and abroad, payments out of external commercial borrowings, foreign investments in the shares of importers etc.)
- vi. The cases reported in Part I of statement for the previous half-year should not be reported again in Part I of the statement for the current half-year.





4								
5								
Etc								

**Part II**

Information regarding subsequent receipt of documentary evidence of Import from importers whose names were reported in Part I of earlier BEF statement/s

Sr.No.	Name and address of the importer	Period of the BEF statement and serial No. of the transaction reported earlier in Part I of BEF statement	Date of receipt	Amount of remittance		Remarks
				Currency & Amount	Rupee equivalent	
1	2	3	4	5		6
<b>A. Import by parties other than Public Sector Undertakings/Government Departments</b>						
1						
2						
3						
Etc						
<b>B. Import by Public Sector Undertakings/Government Departments</b>						

Note : The transactions reported in Part II of BEF statement of earlier half-year should not be repeated in Part II of the current half-year.

## C E R T I F I C A T E

- i. We certify that the particulars furnished above are true and correct as per our records.
- ii. We further certify that the statement includes all cases which are required to be reported under the prescribed procedure.
- iii. We undertake to continue to pursue the cases with the importers reported in Part I of the statement.

Stamp

(Signature of the Authorised Official)

Place:

Date:

Name

:

Designation :

**Annex- 2**

### **Foreign Exchange Management (Current Account Transactions) Rules**

#### **G.S.R.381(E), May 3, 2000**

(as amended by Notification S.O.301(E) dated March 30,2001, GSR 831(E) dated December 17,2002,GSR.397(E) dated May 1,2003 and GSR.731 (E) dated September 5,2003)

G.S.R.381(E)-In exercise of the powers conferred by Section 5 and sub-section (1) and clause (a) of sub-section (2) of Section 46 of the Foreign Exchange Management Act, 1999, and in consultation with the Reserve Bank, the Central Government having considered it necessary in the public interest, makes the following rules, namely :--

1. Short title and commencement.---(1) These rules may be called the Foreign Exchange Management (Current Account Transactions) Rules, 2000;

(2) They shall come into effect on the 1<sup>st</sup> day of June 2000.

**2. Definitions.---In these rules, unless the context otherwise requires :**

(a) “Act” means the Foreign Exchange Management Act, 1999 (42 of 1999);

(b) “Drawal” means drawal of foreign exchange from an authorised person and includes opening of Letter of Credit or use of International Credit Card or International Debit Card or ATM Card or any other thing by whatever name called which has the effect of creating foreign exchange liability;

(c) “Schedule” means a schedule appended to these rules;

(d) The words and expressions not defined in these rules but defined in the Act shall have the same meanings respectively assigned to them in the Act.

**3. Prohibition on drawal of Foreign Exchange.---**Drawal of foreign exchange by any person for the following purpose is prohibited, namely:

- a. a transaction specified in the Schedule I; or
- b. a travel to Nepal and/or Bhutan; or
- c. a transaction with a person resident in Nepal or Bhutan.

Provided that the prohibition in clause (c) may be exempted by RBI subject to such terms and conditions as it may consider necessary to stipulate by special or general order.

**4. Prior approval of Govt. of India.---**No person shall draw foreign exchange for a transaction included in the Schedule II without prior approval of the Government of India,

Provided that this Rule shall not apply where the payment is made out of funds held in Resident Foreign Currency (RFC) and Resident Foreign Currency (Domestic) Account of the remitter.

#### **5. Prior approval of Reserve Bank.**

No person shall draw foreign exchange for a transaction included in the Schedule III without prior approval of the Reserve Bank;

Provided that this Rule shall not apply where the payment is made out of funds held in Resident Foreign Currency (RFC) and Resident Foreign Currency (Domestic) Account of the remitter.

**6** (1) Nothing contained in Rule 4 or Rule 5 shall apply to drawal made out of funds held in Exchange Earners' Foreign Currency (EEFC) account of the remitter.

(2) Notwithstanding anything contained in sub-rule (1), restrictions imposed under rule 4 or rule 5 shall continue to apply where the drawal of foreign exchange from the Exchange Earners Foreign Currency (EEFC) Account is for the purpose specified in items 10 and 11 of Schedule II, or item 3, 4, 11, 16 & 17 of Schedule III as the case may be.

#### **7. Use of International Credit Card while outside India-**

Nothing contained in Rule 5 shall apply to the use of International Credit Card for making payment by a person towards meeting expenses while such person is on a visit outside India.

However, the restrictions on the use of the card for prohibited items will continue.

### **Schedule I**

**(See Rule 3)**

1. Remittance out of lottery winnings.
2. Remittance of income from racing/riding etc. or any other hobby
3. Remittance for purchase of lottery tickets, banned/proscribed magazines, football pools, sweepstakes, etc.
4. Payment of commission on exports made towards equity investment in Joint Ventures/ Wholly Owned Subsidiaries abroad of Indian companies.
5. Remittance of dividend by any company to which the requirement of dividend balancing is applicable.
6. Payment of commission on exports under Rupee State Credit Route, except commission upto 10% of invoice value of exports of tea and tobacco.
7. Payment related to "Call Back Services" of telephones.
8. Remittance of interest income on funds held in Non-Resident Special Rupee (Account) Scheme.

### **Schedule II**

**(See Rule 4)**

<b>Purpose of Remittance</b>	<b>Ministry/Department of Govt. of India whose approval is required</b>
1. Cultural Tours	Ministry of Human Resources Development, (Department of Education and Culture)

2. Advertisement in foreign print media for the purposes other than promotion of tourism, foreign investments and international bidding (exceeding USD 10,000) by a State Government and its Public Sector Undertakings	Ministry of Finance, (Department of Economic Affairs)
3. Remittance of freight of vessel chartered by a PSU	Ministry of Surface Transport, (Chartering Wing)
4. Payment of import by a Govt. Department or a PSU on c.i.f. basis (i.e. other than f.o.b. and f.a.s. basis)	Ministry of Surface Transport, (Chartering Wing)
5. Multi-modal transport operators making remittance to their agents abroad	Registration Certificate from the Director General of Shipping
6. Hiring of transponders by TV Channels and Internet Service providers #	Ministry of Information and Broadcasting
7. Remittance of container detention charges exceeding the rate prescribed by Director General of Shipping	Ministry of Surface Transport (Director General of Shipping)
8. Remittances under technical collaboration agreements where payment of royalty exceeds 5% on local sales and 8% on exports and lump-sum payment exceeds USD 2 million	Ministry of Industry and Commerce
9. Remittance of prize money/sponsorship of sports activity abroad by a person other than International / National / State Level sports bodies, if the amount involved exceeds USD 100,000.	Ministry of Human Resources Development (Department of Youth Affairs and Sports)
10. Deleted #	
11. Remittance for membership of P& I Club	Ministry of Finance, (Insurance Division)

# Please refer to A.P.(DIR Series) Circular No.76 dated February 24,2004.The related Notification will be issued separately.

### **Schedule III**

#### **(See Rule 5)**

1. Deleted ##
2. Release of exchange exceeding USD 10,000 or its equivalent in one calendar year, for one or more private visits to any country (except Nepal and Bhutan).
3. Gift remittance exceeding USD 5,000 per remitter/donor per annum.
4. Donation exceeding USD 5000 per remitter/donor per annum.
5. Exchange facilities exceeding USD 100,000 for persons going abroad for employment.
6. Exchange facilities for emigration exceeding USD 100,000 or amount prescribed by country of emigration.
7. Remittance for maintenance of close relatives abroad,
  - i. exceeding net salary (after deduction of taxes, contribution to provident fund and other deductions) of a person who is resident but not permanently resident in India and –
    - (a) is a citizen of a foreign State other than Pakistan; or
    - (b) is a citizen of India, who is on deputation to the office or branch or subsidiary or joint venture in India of such foreign company.
  - ii. exceeding USD 100,000 per year, per recipient, in all other cases.

***Explanation:*** For the purpose of this item, a person resident in India on account of his employment or deputation of a specified duration (irrespective of length thereof) or for a specific job or assignment; the

*duration of which does not exceed three years, is a resident but not permanently resident.*

8. Release of foreign exchange, exceeding USD 25,000 to a person, irrespective of period of stay, for business travel, or attending a conference or specialised training or for maintenance expenses of a patient going abroad for medical treatment or check-up abroad, or for accompanying as attendant to a patient going abroad for medical treatment/check-up.

9. Release of exchange for meeting expenses for medical treatment abroad exceeding the estimate from the doctor in India or hospital/doctor abroad.

10. Release of exchange for studies abroad exceeding the estimate from the institution abroad or USD 100,000, per academic year, whichever is higher.

11. Commission to agents abroad for sale of residential flats/ commercial plots in India, exceeding USD 25,000 or 5% of the inward remittance per transaction, whichever is higher. ##

12. Deleted ##

13. Deleted ##

14. Deleted ##

15. Remittance exceeding USD 1,000,000 per project, for any consultancy service procured from outside India.

16. Remittances for purchase of trade mark/franchise in India. ##

17. Remittance exceeding USD 100,000 by an entity in India by way of reimbursement of pre-incorporation expenses.



18. Deleted ##

## Please refer to A.P.(DIR Series) Circular No.76 dated Feb.24,2004. The related Notification will be issued separately.

### **DIRECT INVESTMENT OUTSIDE INDIA**

The investment is subject to investment not exceeding 200% of the net worth of the company for a Joint Venture or Wholly Owned Subsidiary. It is necessary for the Joint Venture or Wholly Owned Subsidiary conducting a bonafide business.

If the firm by its early acts found in the caution list / list of defaulters prepared by RBI, permission shall be declined. Nevertheless RBI can also decline permission when any investigation is on for any FEMA violation again Establishment that has submitted up to date returns in form APR in respect of all its overseas investments.

It is the responsibility of the firm to route all its investments overseas through one branch of an authorized dealer to be designated by it.

1. Investment under this Regulation may be funded out of one or more of the following sources, namely:
  - i. Out of balance held in the Exchange Earners' Foreign Currency account of the Indian party maintained with an authorized dealer in accordance with regulation 4 of Foreign Exchange Management (Foreign Currency Accounts by a person resident in India) Regulations, 2000
  - ii. Drawal of foreign exchange from an authorized dealer in India not exceeding 100% of the net worth of the Indian party as on the date of last audited balance sheet

**Explanation:**

For the purpose of the limit of 100% of the net worth the following shall be reckoned, namely:

- (a) cash remittance by market purchase
- (b) capitalization of export proceeds and other dues and entitlements as mentioned in regulation 11 and 12
- (c) fifty percent of the value of guarantees issued by the Indian Party to or on behalf of the joint venture company or wholly owned subsidiary
- (d) Utilization of the amount raised by issue of ADRs/GDRs by the Indian party
- (e) External Commercial Borrowing in conformity with other parameters of the ECB guidelines

**Explanation:**

For the purpose of reckoning net worth of an Indian party, the net worth of its holding company (which holds at least 51% stake in the Indian Party) or its subsidiary company (in which the Indian Party holds at least 51% stake) may be taken into account to the extent not availed of by the holding company or the subsidiary independently and has furnished a letter of disclaimer in favor of the Indian Party.

Provided further that the ceiling mentioned in sub-clause (2)(i) shall not apply where the investment is made out of balances held in its EEFC account, maintained in accordance with the Foreign Exchange Management (Foreign Current Accounts by a Person Resident in India) Regulations, 2000, as amended from time to time.

2. An Indian Party may extend a loan or a guarantee to or behalf of the joint venture / wholly owned subsidiary abroad, within the permissible financial commitment, provided that the Indian Party has made investment by way of contribution to the equity capital of the joint venture.
3. An Indian party makes direct investment without any limit in any foreign security out of the proceeds of its international offering of shares through the mechanism of ADR and/or GDR.

Provided that

- (a) the ADR/GDR issue has been made in accordance with the scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme 1993 and the guidelines issued there under from time to time by the Central Government
  - (b) the Indian Party files with the designated authorized dealer in form ODA full details of the investment proposed
4. For the purpose of investment under this Regulation by way remittance from India in an existing company outside India, the valuation of shares of the company outside shall be made
    - a. where the investment is more than USD 5 million, by a Category I Merchant Banker Registered with Securities and Exchange Board of India (SEBI), or an Investment Banker / Merchant Banker outside India registered with the appropriate regulatory authority in the host country

- b. in all other cases, by a Chartered Accountant or a Certified Public Accountant

**LIST OF ITEMS WHICH ARE PROHIBITED**

<b>HS code/Exim Code</b>	<b>Item Description</b>	<b>Policy</b>	<b>Condition Relating to the policy</b>
0106000120	Wild animals as specified under Wild Life Protection Act, 1972	Prohibited	Not permitted to be imported.
0106000220	Wild animals as specified under Wild Life Protection Act, 1972	Prohibited	Not permitted to be imported.
0106000320	Bees and other insects as specified under Wild Life Protection Act, 1972	Prohibited	Not permitted to be imported.
0106000920	Wild animals as specified under Wild Life Protection Act, 1972	Prohibited	Not permitted to be imported.
0208900010	Meat and edible meat offal, fresh, chilled or frozen of wild animals	Prohibited	Not permitted to be imported.

