

PROFESSIONAL PROGRAMME EXAMINATION
JUNE 2011
STRATEGIC MANAGEMENT, ALLIANCES AND
INTERNATIONAL TRADE

Time allowed : 3 hours

Maximum marks : 100

PART A

(Answer ANY TWO Questions from this part.)

Question 1

(a) *Distinguish between the following :*

- (i) *'Market risk' and 'business risk'.*
- (ii) *'Delphi techniques' and 'cross impact analysis'.*
- (iii) *'Concentric diversification' and 'conglomerate diversification'.*
- (iv) *'Management information system' and 'decision support system'.*
- (v) *'Inter-firm comparisons' and 'intra-firm comparisons'.* (3 marks each)

(b) *As a Company Secretary, how would you perceive the 'risk elements' that a shareholder will have in a company from financial risk point of view ?*
(5 marks)

Answer 1(a)(i)

Difference between Market Risk and Business Risk

Market risk is the risk where the value of an investment will increase/decrease due to changes in market factors and is generally uncontrollable. Market risk cannot be avoided no matter how many different stocks might be present in the portfolio. This is the day-to-day fluctuations in a stock's price. It applies mainly to stocks and options.

Business risk on the other hand refers to the situation of uncertainty associated with operating cash flows of a business. Business risk can be internal and external. External business risk is the result of operating conditions which are imposed upon the organization by circumstances beyond its control. The major business risks which give rise to variation in cash flows and business value are price risk, credit risk and pure risk.

Answer 1(a)(ii)

Difference between Delphi Techniques and Cross Impact Analysis

Both of these techniques are forecasting techniques. However the differences between them are as under:

In Delphi Techniques, the divergent expert opinions are consolidated to arrive at a compromise estimate of future. This involves the use of expert opinion through anonymous, interactive, controlled feedback among a group of experts. Normally the panel is polled by questionnaires in a search for opinions on reasonably well-defined issues. Each panel

member responds with a forecast and reasons for it. These responses are then statistically compiled and fed back anonymously to all the members of the panel. This technique is employed fairly widely in public and private sector planning. The key to Delphi technique lies in the coordinator and experts.

Cross Impact Analysis Technique is designed to assess the interactions among future environmental (socio, economic, political, legal etc) conditions. The analyst begins these exercises by assuming that a set of future environmental circumstances will come true. Through the use of matrix analysis, the analyst then attempts to assess the impact of these circumstances on the possibility and timing of others such as price, competition etc. if nothing else, the analyst is able to expose forecasting inconsistencies and to clarify underlying assumptions in the forecasts themselves.

Answer 1(a)(iii)

Difference between Concentric diversification and Conglomerate diversification

Concentric diversification occurs when a firm adds related products or markets. The goal of such diversification is to achieve synergy or strategic fit. Strategic fit in operations could result in synergy by the combination of operating units to improve overall efficiency.

Conglomerate diversification on the other hand occurs when a firm diversifies into areas that are unrelated to its current line of business. One of the reasons for this type of diversification is the limited opportunities in a firm's current line of business. Finding an attractive investment opportunity requires the firm to consider alternatives in others of business. This approach is also adopted by firms as a means of increasing the growth rate. In India, Tata's ITC and Mahindra and Mahindra are examples of conglomerate diversified companies.

Answer 1(a)(iv)

Difference between MIS and DSS

<i>MIS (Management Information System)</i>	<i>DSS (Decision Support System)</i>
1 Information form of a MIS is periodic and based on demands.	Information form of DSS is interactive.
2 Information formats are pre-specified and fixed.	DSS information formats are adhoc, flexible and adaptable.
3 Information is provided by extraction and manipulation of operational data.	Information is produced by analytical modeling of operational and external data.
4. It provides information about the performance of the organization.	It provides information and decision support technique to confront problems

Answer 1(a)(v)

Difference between Inter-firm comparisons and Intra-firm comparisons

Inter-firm comparisons is a technique of comparing the performances, efficiencies,

costs and profits of various concerns in an industry for assessing its own performance and ascertaining the reasons for any difference in performances/efficiencies etc.

Intra-firm comparisons means comparison of two or more departments or divisions belonging to the same firm with the objective of making meaningful analysis for the purpose of increasing the effectiveness of the departments or divisions involved.

Thus, both inter-firm and intra-firm comparisons are different in the sense that while former compares the performance of the firm with other firms, the latter compares the performance of its own division or departments. The comparison may cover the financial position or operating results or both.

Answer 1(b)

Lapses in risk control often lead to substantial financial losses by a company. A break-down in risk control eventually costs the shareholder money, directly or indirectly, either by being forced to inject more capital or by seeing the equity lose value when losses resulting from risk control failures become public knowledge. This could even lead to closure of the company if a desperate take over does not happen.

It is thus within every shareholder's right to question the company's Board and Senior Management on how the firm manages and controls risk, since good risk management must start from the very top. Constitution of Risk Management Committee and its reports have to be reviewed periodically and management's response to mitigate the risk has to be brought to the attention of the Audit Committee which in turn apprises the Board of the level of risk that the company is exposed.

There follows a list of questions which shareholders should ask their board and senior management. The answers contain risk management and control guidelines which shareholders could use as a template to evaluate whether their company has a firm grip on risk control.

To sum up, the onus is on the top Management to instill confidence on shareholders in eventually disclosing the risks that were brought to their attention during the year and actions initiated by them in mitigating the same. Like an Ombudsman for banking system, it will not be too late to see a Risk Ombudsman for every company who will vet the reports of risk management committee and steps taken to prevent the identified risks through a separate communication to the shareholders along with the Annual Report.

Question 2

It is passenger operation which helps people at large connect with Indian Railways (IR). And yet, passenger services have generally been viewed by IR management largely as social service obligation. Passenger business have inflicted an annual loss of over ₹ 20,000 crore. Earnings of ₹ 23,488 crore from passenger traffic in 2009-10 accounted for only 27% of IR's gross revenues; freight earnings of ₹ 58,502 crore contributed 65%.

Passenger business worldwide accounted for 57% and freight 43% of the \$313 billion global rail market (in 2005). Not that railway passenger business is inherently loss-making. On IR, it is the ordinary second-class segment that is the major culprit. While the second class mail/express fare was 23.1 paise per km. in 2000-01; it

remained stubbornly stuck at 23.2 paise per km. even in 2008-09. The ordinary second-class fare, largely responsible for loss-making, has remained untenably low at 14.9 paise per km. and suburban travel still lower, at 12.9 paise per km. The fare on State road transport services in 2008-09 averaged 48.37 paise per km.

About 10 million passengers in India travel by air in a month, IR transports twice as many in a day. Even so, IR accounts for a meager 12% of India's total passenger traffic, roads carrying over 87%. Cost-effective rail travel demand, far outstripping supply, will further grow substantially in view of the country's declining agriculture sector driving migration from rural areas for an integrated national labour market. The urban population is projected to rise from current 286 million to 575 million by 2030, keeping the population on the move. Also, the specter of climate change favours IR to reposition rail travel in preference to car and airlines.

There is projection of 7,189 million inter-city passengers by 2025-26 against 2,835 million passengers in 2007-08. If GDP grows 8% or more, annual demand for transport generally rises 10-12%, implying the number of originating non-suburban rail passengers exceeding 12,000 million by 2025.

On the basis of above case study, you are required to answer the following questions as the CEO of Indian Railways :

- (i) Describe the environmental factors responsible for performance of railways as a commercial entity. (5 marks)*
- (ii) Describe components of a strategic plan for railways to meet passenger demand highlighting consideration for each component. (10 marks)*
- (iii) Write a note on commercial revival of IR using Gap Analysis. (5 marks)*

Answer 2(i)

India has seen a significant shift in transport volumes away from railways to road and air transport in the recent times. As a result, once the backbone of domestic transport, railways have during the past 20 years seen their market share decline sharply. Indeed in the 1980s, this phenomenon generated some thinking as to whether the railways were still relevant. In the 1990s, however, concern for the environmental costs of transport in general and of road transport in particular, resulted in a growing acceptance that rail has an important role to play in the national and international movement of goods and people.

The environmental factors responsible for performance of railways consist of economic, technological, political, social, legal and global surroundings. The factors which are responsible are as follows:

1. Chronic financial deficits i.e. Constraints on charges imposed through Government regulation; Persistent excess capacity; Provision of guaranteed service levels at fixed prices or with 'excess' competition (in comparison with other modes of transport); Provision of services at below marginal cost; Failure to understand or identify costs; Ineffectiveness in collecting revenues; Low productivity; Unduly high operating costs; Overmanning.
2. Growing operating subsidies i.e., Lack of 'corporatization'; Inadequate distinction between roles of government and of the railway operator; Inadequate subsidy policies.

3. Archaic pricing systems where charges are not related to cost; Prices are not related to marginal costs; Costs not properly identified or measured; Inadequate financial and management accounting systems; Inadequate or non-existent pricing objectives or statements of pricing policy.
4. Lack of an equitable fare structure and excessive fares; Lack of user or community representation in service and price decision making.
5. Low operating efficiency; Low labour productivity and Poor management and technical efficiency.
6. Low service quality; Severely congested services i.e., Lack of competition; no peak-load pricing; Inadequate cost recovery in pricing policies; Inability to reinvest operating surpluses or raise funds for investment.
7. Deficiencies in the physical infrastructure, Poor asset maintenance i.e., Failure of pricing policies to recover capital costs; Structural inability to retain/reinvest surplus funds; Regulations preventing investment or borrowing.
8. Inadequate funds to invest in transport infrastructure and/or services.
9. Widespread state ownership and operation of transport infrastructure and services.
10. Low private sector participation in the transport sector.

Answer 2(ii)

Strategic Planning

Strategic planning refers to the process of deciding on objectives of the organization, on changes in these objectives, on the resources used to attain these objectives and on the policies that are to govern the acquisition, and disposition of these resources.

Therefore even IR will have to plan for change in order to reach its ultimate goal. Effective planning will help IR to adapt change by identifying opportunities and avoiding problems. This way it can set the direction for the other functions of management and for teamwork. Planning improves decision-making. All levels of management engage in planning.

Some of the important examples of strategic planning includes planned growth rate in sales, mergers and acquisitions, diversification by technologies, types of products, customers and geographical areas, planning activities in the areas of organizing, staffing, finance, etc.

Based on this the following are the components of strategic plan for railways with consideration:

- (i) Identification of demand-supply gap (as the urban population is projected to rise from 286 million to 575 million by 2030 and also that the agriculture sector is moving from rural areas) in different zones of Indian Railways so as to ascertain the most burdened areas;
- (ii) Development of strategic plans to cope up with the increased demand including projected increase of 7189 million inter-city passengers by 2025-26 as against

2835 million in 2007-08. The need is to emerge out of the groovy traditional style of thinking wherein the focus has been to increase the number of rail trips or addition of passenger bogies;

- (iii) Exploring the possibility of the following :
 - (a) Ensuring public private participation;
 - (b) Privatization of certain routes with revenue sharing;
- (iv) Constituency nurturing based on political consideration needs to be stopped. Professionals should be involved while developing strategic plans;
- (v) Introduction of fast trains at least on the crowded routes to serve the dual purpose of optimum utilization of rail capacity and recourse to segmented privatization;
- (vi) Increasing the rail fare in comparison to road and air transport and bringing it at par with other modes. The rail fare for second class mail/express increased to 23.2 paise per km in 2008-09 as against 23.1 paise per km in 2000-01 whereas the fare of road transport in 2008-09 averaged 48.37 paise per km.

Answer 2(iii)

Gap Analysis

GAP analysis is the process of identifying the gap between the optimized allocation and integration of the inputs and the current level of allocation. This helps company provide insight into areas that have room for improvement. The gap analysis process involves determining, documenting and approving the variance between business requirements and current capabilities. Gap analysis naturally flows from benchmarking and other assessments. Once the general expectation of performance in the industry is understood, it is possible to compare that expectation with the level of performance at which the company currently functions. This comparison becomes the gap analysis.

Under Gap Analysis attention is first focused on the gaps between the actual and anticipated values that certain variables take on and the values that are most desirable. Once the gaps are properly identified, attention shifts to devising ways to close them.

In the context of the Indian Railways, the strategy should be concerned with the position and role of the railways in relation to their environment and designing of optimal strategy in the present circumstances.

On an overall consideration of the situation, the Indian Railways needs to focus on improving the performance in terms of increase in revenue with regard to second class ordinary, mail and express fares which is still stuck at 23.2 paise per km in comparison to 23.1 paise per km in 2000-01. These need to be upgraded in order to enable the Indian Railways to recover the cost and to allow it to earn the reasonable profits. But surprisingly the road transport fare stands almost at double the fare structure of railways which was at around 48.37 paise per km in 2008-09. Environmentally also railways are preferable to air or road transport. It indicates the need to enhance the utilization of existing line capacities. In addition, Indian Railways needs to explore the extension of rail network to areas with earnings potential. It will help the railways to recover the losses, earn revenues and then pay attention to the hitherto neglected areas.

Question 3

- (a) *Suggest ways to overcome resistance to change. Which is the least effective style of managing change and why ?* (10 marks)
- (b) *What are the ten 'P' elements of risk in business ? Describe at least one element for each 'P'.* (10 marks)

Answer 3(a)

Change is a natural phenomenon. Research findings on individual and organizational behaviour revealed that organization and individuals resist change.

Resistance to change is likely to be minimised if the management help employees to adjust to contemplated change with a supportive conduct and behaviour. The imperative need is to make the employees feel that their interest in the work situation is being adequately considered and fully protected by the management. It should be impressed upon the employees that in the long run they will gain from change and the management will, by all means, help them to achieve these gains. If the supportive climate exists, the employees are likely to be more receptive to change. However, that apart, the following considerations should further be kept in view:

Ways to Overcome Resistance to Change

The basic problem in managing change is to overcome people resistance successfully. Problems of overcoming resistance to change can be managed in the following ways:

- (i) *Education and Communication* : If misinformation and lack of information create barriers to managing change, education and communication might be appropriate.
- (ii) *Participation* : Participation helps to give people in organizational change a feeling of importance. It creates the feelings among the employees that the decision is their own. They realise that the change process is a must.
- (iii) *Obtaining commitment* : Commitment to take part in changed programme can be obtained in private from each individual. However, getting a person to commit himself in private to a changed programme may yield fewer results than if he voluntarily and publicly gives his commitment to an idea of change.
- (iv) *Leadership* : A transformational leader can use personal reasons for change without arousing resistance. An effective leader tries to change the psychological needs of his followers.
- (v) *Training and Psychological Counselling* : Management can change the basic values of the people by training and psychological counseling. People should be educated to become familiar with change, its process, and working.
- (vi) *Coercion or Edict* : Coercion or edict is the imposition of change or the issuing of directives about change. It is the explicit use of power.

The least effective way of managing change out of the above mentioned may be:

Coercion or Edict : Coercion is the least successful style of managing change except in a state of crisis or confusion. Coercion or edict is the imposition of change or the

issuing of directives about change. It means confronting and forcing resisting employees to change. It is the explicit use of power. Managers may force people to go along with a change by using explicit and implicit threats involving transfer, loss of promotion, negative recommendations, dismissal etc. It can be extremely risky if it leaves and makes people angry at the initiators.

Answer 3(b)

The ten 'P' elements of risk in business are :

<i>S.No.</i>	<i>'P' elements</i>	<i>Elements</i>
1	Premises	Location of the organization, type of premises available for use.
2	Product	Industry sector, features of product, life cycle of the product, fashion trends.
3	Purchasing	Access to supplies, storage and warehouse facilities, stock control, payment terms and cost.
4	People	Workers in the organization, skills, training needs, motivation and commitment.
5	Procedure	Production procedures, record keeping and reporting systems, use of standards and emergency procedures.
6	Protection	Personal protection of workers, property and vehicle security, insurance cover, information systems and data security.
7	Processes	Production processes, waste and scrap disposal, skills, technology new materials.
8	Performance	Target sets, monitoring, measurement tools, validity of data.
9	Planning	Access to relevant data, management skills, external factors and levels of control, short and long term planning and investment options.
10	Policy	Range of policies that support strategic plans of the firm.

PART B

(Answer ANY ONE question from this part.)

Question 4

- (a) *Hero Honda joint venture formed in 1984 is a classic case of strategic alliance involving the Indian company Hero Group and Japanese automobile major Honda Motorcycle. The alliance has been terminated with the entire 26% stake of Honda Motorcycle in the venture bought by the Hero Group. Selling out of the venture*

gives the Japanese company the freedom to go it alone in the world's second largest market for two-wheelers.

- (i) *List out the advantages of the strategic alliance for both the organisations, in two-wheeler market in India. (5 marks)*
 - (ii) *What are the key success factors for managing an alliance ? In the light of these key success factors, identify the reasons for the termination of this successful joint venture. (5 marks)*
- (b) *Assuming that High Speed Auto Ltd. intends to acquire technical know-how to produce a small car for the Indian market in collaboration with a German car manufacturer, specify the broad issues to be covered in the agreement for foreign technical services in India. (10 marks)*

Answer 4(a)(i)

Advantages of strategic alliance are as under:

- Rapidly move to decisively seize opportunities before they disappear.
- Respond more quickly to change.
- Adapt with greater flexibility.
- Increase a company's market share.
- Gain access to a new market or beat others to that market.
- Quickly shore up internal weaknesses.
- Gain a new skill or area of competence.
- Rapidly meet a company's need for key resources such as more customers, additional capital, new/better products, new distribution channels, additional facilities, increased production capacity, or competent personnel etc.

Answer 4(a)(ii)

The key success factors for managing alliance are under:

- *Mutual Trust* : Mutual trust at senior management level carry ventures through turbulent times.
- *Ability to compromise* : When there are two strong companies, the ability to compromise is not easy to achieve. If you expect to receive some valuable technology, production or marketing know how from a partner, you must be willing to give something.
- *Favourable business condition* : Launching an alliance when favourable business conditions exist makes a venture life considerably easier for its partners.
- *Alliance Autonomy* : The autonomy mandates a high degree of responsibility and good judgement by the ventures management.

Reasons for termination of successful joint venture are as under:

- Different cultures, may quickly find the variations in their behavioral norms are creating breeding ground for misunderstanding, poor follow-through, and eventual distrust.

- Joint ventures are also potential for conflicts. They may result in disputes between or among partners due to varied interests.
- Slow down in decision making by partners.
- Changes in the business environment in two countries and changes in partner strength.
- Life cycle of joint ventures.

Answer 4(b)

The broad issues to be covered in the agreement for foreign technical services in India are as under:

- Technical Services to the Indian company.
- Deputation of technical personnel.
- Training of personnel of the Indian Company.
- Secrecy condition such as strict confidence and secrecy and shall not be disclosed by the Indian Company.
- Consideration Technical Services fee to the Foreign Company.
- Prior Government approval.
- Duration of the agreement.
- Termination of the agreement.
- Force Majeure conditions, such as acts of God, Government laws and regulations, strikes, Lockouts, war or any other causes beyond its control.
- Arbitration clause, in case of any dispute or difference arising between the parties.
- Miscellaneous conditions.
- Law applicable to the agreement.

Question 5

Describe in brief the following in connection with direct investment outside India by an Indian company in an overseas joint venture (JV)/wholly owned subsidiary (WOS) under automatic route of FEMA :

- (i) Different methods of funding of investment.*
 - (ii) The conditions to be fulfilled for investment by an Indian entity engaged in financial sector.*
 - (iii) The conditions for capitalisation of exports and other dues.*
 - (iv) Compliances of reporting of initial investment, subsequent investment and filing of annual returns.*
 - (v) Conditions for allowing investments in JV/WOS through the medium of a special purpose vehicle (SPV).*
- (4 marks each)*

Answer 5(i)

Methods of Funding of investments are as under :

- Drawl of foreign exchange from an Authorised Dealer Bank in India;
- Capitalization of exports;
- Swap of shares;
- Utilization of proceeds of External Commercial Borrowings (ECBs)/Foreign Currency Convertible Bonds (FCCBs);
- In exchange of ADRs/GDRs issued 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;
- Balances held in EEFC account of the Indian party; and
- Utilisation of proceeds of foreign currency funds raised through ADR/GDR issues.

Answer 5(ii)

Conditions for Investments in Financial Services Sector

An Indian party seeking to make investment in an entity engaged in the financial sector should fulfill the following additional conditions:

Provided that Indian party:

- is registered with the appropriate regulatory authority in India for conducting the financial sector activities;
- has earned net profit during the preceding three financial years from the financial services activities;
- has obtained approval for investment in financial sector activities abroad from regulatory authorities concerned in India and abroad; and
- has fulfilled the prudential norms relating to capital adequacy as prescribed by the regulatory authority concerned in India.

Answer 5(iii)

Conditions for capitalisation of exports and other dues are:

- Indian parties are permitted to capitalize the payments due from the foreign entity towards exports, fees, royalties or any other dues from the foreign entity for supply of technical know how, consultancy, managerial and other services within the ceilings applicable. Capitalisation of export proceeds remaining unrealized beyond the prescribed period of realization will require prior approval of the Reserve Bank.
- Indian software exporters are permitted to receive 25 per cent of the value of their exports to an overseas software start-up company in the form of shares without entering into Joint Venture Agreements, with prior approval of the Reserve Bank.

Answer 5(iv)

The Indian Party is required to report of investment, in form ODI to the Authorised Dealer Bank for submitting to the Reserve Bank within a period of 30 days from the date of the transaction.

ODI, comprising of four parts:

Part I - includes the following:

Section A – Details of the Indian Party

Section B – Details of Investment in New Project

Section C - Details of Investment in Existing Project

Section D – Funding for JV / WOS

Section E – Declaration by the Indian Party (to be retained by AD Category – I bank)

Section F - Certificate by the Statutory Auditors of the Indian Party (to be retained by AD Category – I bank)

Part II - Reporting of Remittances

Part III - Annual Performance Report (APR)

Part IV – Report on Closure/Disinvestment/Voluntary Liquidation/Winding up of JV / WOS

In cases where the investment is being made jointly by more than one Indian party, form ODI is required to be signed jointly by all the investing entities and submitted to the designated branch of the AD Category – I bank.

The same procedure should be followed where the investment is made out of the proceeds of ADR / GDR issues of an Indian party.

Answer 5(v)

Conditions for investments in JV/WOS abroad by Indian parties through the medium of a Special Purpose Vehicle (SPV) are:

- Investment permitted under the Automatic Route.
- Indian party is not included in the Reserve Bank's Caution list or is under investigation by the Enforcement Directorate or included in the list of defaulters to the banking system circulated by the Reserve Bank/any other Credit Information company as approved by the Reserve Bank.
- Indian parties whose names appear in the Defaulters' list require prior approval of the Reserve Bank for the investment.

PART C

(Answer ANY TWO questions from this part.)

Question 6

- (a) *State the similarities and differences between 'anti-dumping duty' and 'countervailing duty'.* (5 marks)

- (b) *Highlight the differences between GATT and WTO.* (5 marks)
- (c) *Elucidate the concept of 'most favoured nation' (MFN).* (5 marks)
- (d) *Describe the significance of 'rules of origin' under WTO system for ensuring fair international trade.* (5 marks)

Answer 6(a)

Dumping and subsidies — together with anti-dumping (AD) measures and countervailing duties (CVD) — are often linked. Experts speak of “AD-CVD” in one breath. Many countries handle the two issues under a single law, apply similar process to deal with them and give a single authority responsibility for investigations. Occasionally, the two WTO committees responsible for these issues meet jointly.

There are a number of similarities. The reaction to dumping and subsidies is often a special offsetting import tax (countervailing duty in the case of a subsidy). Like anti-dumping duty, countervailing duty is charged on products from specific countries and therefore it breaks the GATT principles of binding a tariff and treating trading partners equally (MFN). The agreements provide an escape clause, but they both also say that before imposing a duty, the importing country must conduct a detailed investigation that shows properly that domestic industry is hurt.

But there are also fundamental differences, and these are reflected in the agreements.

Dumping is an action by a company. With subsidies, it is the government or a government agency that acts, either by paying out subsidies directly or by requiring companies to subsidize certain customers.

But the WTO is an organization of countries and their governments. The WTO does not deal with companies and cannot regulate companies' actions such as dumping. Therefore the Anti-Dumping Agreement only concerns the actions governments may take against dumping. With subsidies, governments act on both sides: they subsidize and they act against each others' subsidies. Therefore the subsidies agreement disciplines both the subsidies and the reactions.

Answer 6(b)

The differences between GATT and WTO are:

- GATT was ad hoc and provisional. The General Agreement was never ratified in members' parliaments, and it contained no provisions for the creation of an organization. The WTO and its agreements are permanent. As an international organization, the WTO has a sound legal basis because members have ratified the WTO agreements, and the agreements themselves describe how the WTO is to function.
- GATT had “contracting parties”. The WTO has “members”.
- GATT dealt with trade in goods. WTO covers goods, services and intellectual property as well.
- The WTO dispute settlement system is faster, more automatic than the old GATT system. Its rulings cannot be blocked.

Answer 6(c)

Most-favoured-nation (MFN) suggests some kind of special treatment for one particular country, but in the WTO it actually means non-discrimination — treating virtually everyone equally. Under the WTO, each member treats all the other members equally as “most-favoured” trading partners. If a country improves the benefits that it gives to one trading partner, it has to give the same “best” treatment to all the other WTO members so that they all remain “most-favoured”. Most-favoured nation (MFN) status did not always mean equal treatment. In the 19th Century, when a number of early bilateral MFN treaties were signed, being included among a country’s “most-favoured” trading partners was like being in an exclusive club because only a few countries enjoyed the privilege. Now, when most countries are in the WTO, the MFN club is no longer exclusive. The MFN principle ensures that each country treats its fellow-members equally.

Answer 6(d)

“Rules of origin” are the criteria used to define where a product was made. They are an essential part of trade rules because a number of policies discriminate between exporting countries: quotas, preferential tariffs, anti-dumping actions, countervailing duty (charged to counter export subsidies), and more.

Rules of origin are also used to compile trade statistics, and for “made in” labels that are attached to products.

This first-ever agreement on the subject requires WTO members to ensure that their rules of origin are transparent; that they do not have restricting, distorting or disruptive effects on international trade; that they are administered in a consistent, uniform, impartial and reasonable manner; and that they are based on a positive standard. In other words, they should state what does confer origin rather than what does not.

Question 7

(a) *Under the Madrid and Hague Systems dealing with the international registration of marks and industrial designs, match the following :*

- | | |
|---------------------------------|---|
| (i) <i>Strasbourg Agreement</i> | (a) <i>Concerns with establishing an international classification for industrial designs.</i> |
| (ii) <i>Nice Agreement</i> | (b) <i>Establishing an international classification of the figurative elements of marks.</i> |
| (iii) <i>Vienna Agreement</i> | (c) <i>Concerning the international classification of goods and services for the purposes of the registration of marks.</i> |
| (iv) <i>Locarno Agreement</i> | (d) <i>Concerning the international patent classification.</i> |

(1 mark each)

(b) *State, with reasons in brief, whether the following statements are true or false :*

- (i) *Anti-dumping cases initiated by WTO have increased significantly since mid 1990s.*
- (ii) *Trade creation describes the situation where the removal of tariff barriers*

between members of the trading bloc now enable various products to be purchased at lower prices, thereby stimulating intra-regional trade.

(1 mark each)

(c) Attempt the following :

(i) Which two of the following are the most likely effects of the imposition of a tariff on an imported good —

- (a) The domestic price of the imported good will fall*
- (b) Overseas production of the good may be stimulated*
- (c) Overseas unemployment will come down*
- (d) The domestic price of the imported good will rise*
- (e) Gain of tax revenue by the Government.*

(ii) Which two of the following arguments are used by critics of free trade —

- (a) Free trade does not take into consideration the productivity differences between countries*
- (b) Free trade may lead to unemployment*
- (c) Free trade often ignores the effects of monopoly elements on consumer welfare*
- (d) Free trade can only work within trading blocs*
- (e) Free trade reduces international specialisation.*

(iii) Which two of the following are the most integrated forms of regional trading arrangement —

- (a) Customs Union*
- (b) Economic Union*
- (c) Free trade area*
- (d) Multilateral trading area*
- (e) Common markets.*

(1 mark each)

(d) Explain the concept of 'boxes' under WTO terminology for agriculture agreement and briefly describe each of them.

(6 marks)

(e) What are the principles of multilateral trading system under WTO ?

(5 marks)

Answer 7(a)(i)

Strasbourg Agreement - **(d)** Concerning the International Patent Classification

Answer 7(a)(ii)

Nice Agreement - **(c)** Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks

Answer 7(a)(iii)

Vienna Agreement - **(b)** Establishing an International Classification of the Figurative Elements of Marks

Answer 7(a)(iv)

Locarno Agreement - **(a)** Establishing an International Classification for Industrial Designs

Answer 7(b)(i)

True

WTO Annual Reports show, the use of anti-dumping measures has increased dramatically in recent years, considerably greater than the numbers of such measures in force in the 1990's and Anti dumping cases initiated by WTO have increased significantly since mid 1990s

Answer 7(b)(ii)

True

The static effect of Regional economic integration is that it may result in either trade creation or trade diversion . Trade creation describes the situation where the removal tariff barriers between members of the trading block now enable various products to be purchased at lower price, there by stimulating intra regional trade

Answer 7(c)(i)

- (d) The domestic price of the imported goods will rise
- (e) Gain of tax revenue by the Government

Answer 7(c)(ii)

- (b) Free trade may lead to unemployment
- (c) Free trade often ignores the effect of monopoly elements on consumer welfare

Answer 7(c)(iii)

- (b) Economic Union
- (e) Common Market

Answer 7(d)

In WTO terminology, “boxes” which are given the colours of traffic lights in general identify subsidies: green (permitted), amber (slow down — i.e. be reduced), red (forbidden).

The ‘amber box’

For agriculture, all subsidies and other domestic support measures considered to distort production and trade (with some exceptions) fall into the amber box. The total value of these measures must be reduced.

The ‘green box’

In order to qualify for the “green box”, a subsidy must not distort trade, or at most cause minimal distortion. They have to be government-funded (not by charging consumers higher prices) and must not involve price support. They tend to be programmes that are

not directed at particular products, and include direct income supports for farmers that are not related to (are "decoupled" from) production. "Green box" subsidies are therefore allowed without limits, provided they comply with relevant criteria.

The 'blue box'

The blue box is an exemption from the general rule that all subsidies linked to production must be reduced or kept within defined minimal ("de minimis") levels. It covers payments directly linked to acreage or animal numbers, but under schemes, which also limit production, by imposing production quotas or requiring farmers to set aside part of their land. Countries using these subsidies say they distort trade less than alternative amber box subsidies.

Answer 7(e)

The principles of multilateral trading system are as under:

- *Without discrimination* : a country should not discriminate between its trading partners (they are all, equally, granted "most-favoured-nation" or MFN status); and it should not discriminate between its own and foreign products, services or nationals (they are given "national treatment");
- *Freer* : with barriers coming down through negotiation;
- *Predictable* : foreign companies, investors and governments should be confident that trade barriers (including tariffs, non-tariff barriers and other measures) should not be raised arbitrarily; more and more tariff rates and market- opening commitments are "bound" in the WTO;
- *More competitive* : by discouraging "unfair" practices such as export subsidies and dumping products at below cost to gain market share;
- *More beneficial for less developed countries* : by giving them more time to adjust, greater flexibility, and special privileges.

Question 8

(a) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*

- (i) *The _____ of goods imported into India is the price paid or payable for the goods by the first independent buyer.*
- (ii) *_____ is the first ever set of multilateral, legally enforceable rules covering international trade in services.*
- (iii) *The Third WTO Ministerial Conference, 1999 was held in _____ between 30th November, 1999 and 3rd December, 1999.*
- (iv) *_____ increases the price of imported goods.*
- (v) *The _____ introduced the term 'European Union' in November, 1993.*

(1 mark each)

- (b) *“The subsidies and countervailing measures (SCM) agreement creates three narrowly defined categories of non-actionable subsidies.” Explain.* (5 marks)
- (c) *Briefly describe the role of appellate body in review of the panel report when a party to trade dispute files appeal against the panel report.* (5 marks)
- (d) *Doha Ministerial Conference, 2001 has failed to fulfill its commitment to correct and prevent restriction and distortion in world agricultural market. Do you agree ? Discuss.* (5 marks)

Answer 8(a)

- (i) The **Export Price** of goods imported into India is the price paid or payable for the goods by the first independent buyer.
- (ii) **General Agreement on Trade in Services (GATS)** is the first ever set of multilateral, legally enforceable rules covering international trade in services.
- (iii) The Third WTO Ministerial Conference, 1999 was held in **Seattle, Washington USA** between 30th November, 1999 and 3rd December, 1999.
- (iv) **Tariff** increases the price of imported goods.
- (v) The **Maastricht Treaty** introduced the term ‘European Union’ in November, 1993.

Answer 8(b)

The SCM Agreement creates three narrowly defined categories of subsidies, which are non-actionable, i.e., which cannot be challenged multilaterally, or is subject to countervailing action. These subsidies presumably are protected either because they are considered extremely unlikely to cause adverse effects or because they are considered to be of particular value and not to be discouraged. The three categories are:

- Basic research and pre-competitive development subsidies. These subsidies cannot exceed a designated proportion of project costs and can only be used for certain expenditures in order to be non-actionable. Research and development subsidies in the civil aircraft sector do not benefit from non-actionable status.
- Assistance to disadvantaged regions. Regional aids are non-actionable provided that they are not limited to specific enterprises or industries within the region, that they are given pursuant to a general scheme of regional development, and that the region is disadvantaged by comparison with the Member as a whole in terms of objective criteria such as GNP per capita and unemployment.
- Assistance to adapt existing facilities to new environmental requirements. Such assistance must be on a one-time basis, be limited to 20 per cent of adaptation costs, and be available to all firms, which can adopt the new equipment and processes.

Subsidy programmes, which are notified to the Committee before they are implemented, are protected unless and until the Committee or arbitration body determines that they do not qualify for non-actionable status. Subsidy programmes which have not been notified before implementation may be investigated by a panel or an investigating authority but if found to meet the criteria for non-actionability, shall be treated as non-actionable.

Answer 8(c)

Either side can appeal a panel's ruling. Sometimes both sides do so. Appeals have to be based on points of law such as legal interpretation - they cannot reexamine existing evidence or examine new evidence.

Three members of a permanent seven-member Appellate Body set up by the Dispute Settlement Body and broadly representing the range of WTO memberships hear each appeal. The appeal can uphold, modify or reverse the panel's legal findings and conclusions. Normally appeals should not last more than 60 days, with an absolute maximum of 90 days.

The Dispute Settlement Body has to accept or reject the appeals report within 30 days and rejection is only possible by consensus.

Appeals are limited to issues of law covered in the panel report and legal interpretations developed by the panel. The Appellate Body must address, but also limit its review to, each of the issues of law covered by the panel report and the legal interpretations developed by the panel which were appealed during the appellate proceeding. The Appellate Body may uphold, modify or reverse the legal findings and conclusions of the panel.

Answer 8(d)

Recognizing the work undertaken in the negotiations initiated in early 2000 under Article 20 of the Agreement on Agriculture, including the large number of negotiating proposals submitted on behalf of a total of 121 members, Ministers recalled the long-term objective referred to in the Agreement to establish a fair and market-oriented trading system through a programme of fundamental reform encompassing strengthened rules and specific commitments on support and protection in order to correct and prevent restrictions and distortions in world agricultural markets.

Ministers committed themselves to comprehensive negotiations aimed at: substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support.

Ministers agreed that special and differential treatment for developing countries shall be an integral part of all elements of the negotiations and shall be embodied in the schedules of concessions and commitments and as appropriate in the rules and disciplines to be negotiated, so as to be operationally effective and to enable developing countries to effectively take account of their development needs, including food security and rural development.

Taking note of the non-trade concerns reflected in the negotiating proposals submitted by Members, Ministers confirmed that non-trade concerns will be taken into account in the negotiations as provided for in the Agreement on Agriculture.

There is a considerable dispersion amongst Governments in their approach to agricultural policy. At one extreme are Governments which limit their attention to the pursuit of economic efficiency within their agricultural sectors, at the other are Governments which regard their agricultural sectors as fulfilling a higher level social objective without regard to efficiency. Given these quite different positions, it is proving difficult to find any middle ground in the current negotiation in the WTO which are initiated under Article 20 of the Agreement in Agriculture and there is also inconsistency and divergent interests across the members of the WTO.
