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SCOPE, ECONOMIC RATIONALE, AND INSTITUTIONAL FRAMEWORK OF COUNTERTRADE

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INTRODUCTION

Since late 1970's, in the world trade, there has been a noticable trend towards bilaterism in the form of different countertrade (CT) arrangements in response to the global recession due to first and second oil shocks, and historically high level of real interest rates and a growing protectionist trend in industrialized countries. Terms of trade of most of the non-oil-exporting developing countries also deteriorated sharply during the first part of 1980's. All of these unfavourable external economic developments have served to aggravate the chronic balance of payments difficulties in many developing countries and their debt service burden.

Balance of payment of most of the oil-producing developing and Muslim countries have been also adversely affected by the crude oil glut of 1982-87. Their oil revenues have fallen considerably owing to decline in their exports which led to the curtailment of their development targets and projects.

Currently, in consequence of the above mentioned unfavourable combined factors, nearly every developing country is facing very tight balance of payments. This situation caused initiation of a policy of CT instruments in many of the developing countries including the oil producing ones.

CT arrangements have taken a variety of forms, namely barter compensation, counterpurchase, buy-back, advance purchases, and offset deals. Basically, they are modified modern version of classical barter or quasi-barter arrangements between national and foreign

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traders under which the exporter is obliged to accept specified goods or services from the importer.

During the recent years, as a result of the accelerated increase in CT transactions in the world trade, there is a growing interest on the study of the theoretical and policy issues of countertrade. The purpose of this article is to overview some of the recent developments in the areas of techniques, financial and contractual issues of CT deals and examine the role of different forms of CT mechaisms in international trade during the 1980-86 period.

Currently, some CT case examples are available for all nations including the developed countries, but, at the country level, the true magnitude of CT deals is not known and cannot be estimated correctly because such deals are most often carried on by individual firms which often try to hide information on such arrangements to avoid government regulations. Whenever governments engage in such deals, trade data are not included in official statistics due to, firstly, the period of CT arrangements extends over many years so that estimation of the value of annual trade flows is very difficult, or, secondly, opposition of international organizations such a GATT and IMF to this type of mandated trade.

In spite of these limitations, this study intends to contribute to thoughts on this subject which has started developing very recently. However the reader should not expect to find a fully complete assessment of the role of CT on international trade and finance. The scarcity of data and availabilty of information are the main constratints for sound evaluation.

In addition to a brief review of the classification of CT transactions, historical developments and the global value of CT deals in mid 1980's, this paper will mainly emphasize the techniques, financial and legal issues of CT arrangements. The role of the public sector and international private trading houses in facilitating CT will also be examined. Finally, future prospect of CT arrangements will be assessed.

PART - I

CLASSIFICATION, FINANCIAL ARRANGEMENTS AND HISTORICAL BACKGROUND OF COUNTERTRADE TRANSACTIONS

1. Range of Special Transactions, Definition and Classification of Countertrade.

A. Range of Special Transactions

Recently, special transactions are classified by ASTRO in accordance with their importance for world trade. The following foreign trade methods are generally referred to as "special transactions": (1)

(1) ASTRO, **Complementary Manuel of Comprehensive Reference Service on Countertrade, Volume Manual** (Ljubljana-Yugoslavia, ASTRO, 1985), p. 16-17.

Countertrade

- Barter
- Compensation
- Counterpurchase
- Buy-back
- Offset deals

Advance purchases

Forfeiting

Switch

Leasing

This study will be devoted only to the analysis of different forms of CT transactions including advance purchases. Because, in a recent UNCTAD report which is relased in June 1986 advance purchases are also included as an another form of countertrade (2).

B. Definition and Classification of Countertrade

The term "countertrade" which has only recently entered the literature of international trade, originated in the East-West Trade (3). It is a modern version of barter trade. Mostly, it appears as a quasi-barter of imports and export transactions. By definition, the term countertrade (CT) includes "all foreign trade transactions in wihch an exporter commits himself to take products from the importer (or importer's country) in full or partial payment of his own supply" (4). Thus, CT is essentially a foreign trade transaction that contidioning or linking of exports to imports or imports to exports. The term CT may be applied to the entire linked trade obligations where the transfer of products, services and technology replaces or supplements a cash transaction. As a result, a countertrade operation is possible only if the seller of a good or service accepts in partial or full payment of goods or services from the purchasing country (5).

The most important characteristic of CT is that it is an **ad hoc,** transaction-by-transaction form of a barter or guasi-barter. Due to

(2) UNCTAD, "Report of the Asian Regional Workshop on Countertrade, Kuala Lumpur, March 24-28, 1986, p. 4; For informtaion on Forfeiting, Switch and leasing, see ASTRO Manual 1985, **Ibid.**, pp. 16-18.

(3) G. Banks, "The Economics and Politics of Countertrade", **The World Economy,** (London), Vol. 6, No. 2, June 1983, pp. 159, 172.

(4) ASTRO Manual, op. cit. p. 33.

(5) M. Trifunovic, "Yugoslav Experience in Countertrade Contribution to Analysis of Countertrade Development", paper presented at the International Workshop on CT, Belgrade, June 25-28, 1985, pp. 2, 8; L. Welt, **Countertrade** (London, Euromoney Puplication Limited, 1985) p.1; J. Griffin and W. Rouse, "Countertrade as a Third World Strategy of Development", **Third World Quarterly,** Vol. 8, No. 1, January 1986, pp. 1984-185.

this characteristics, CT is more similar to the barter of medieval times than bilateral clearing or trade arrangements which arose in the beginning of 1930s between much of the European governments. Without making this distinction one cannot eliminate the existing source of some confusion in the literature of CT (6).

According to Mr. H. Ferenz, an UNCTAD Consultant, CT has a variety of forms (7). There are four conventional types:

1. Classical Bater
2. Compensation
3. Counterpurchase Arrangement
4. Buy-back Arrangements

and two non-conventional forms:

1. Advance Purchase
2. Offset Deals

As can be seen from the following section in detail, any type of CT requires as conditional link between exports and imports, but this requirement is not always necessarily attained at approximately equal values (for the detailed analysis on the above see section 3).

2. Variants of Countertrade Techniques and their Financial Arrangements

As it is mentioned in section 1-B of Part - I, CT assumes a variety of forms. There are four conventional types (barter, compensation, counterpurchase and buy-back) and two non-conventional forms (advance purchases and offset deals) of countertrade. This section presents a brief overview of the theoretical aspects of various CT transactions as there is sufficient theoretical literature on the subject (8).

A. Conventional Types of Countertrade:

a) Classical Barter

Barter is the oldest form of countertrade. It involves a mutual and direct exchange of goods between partners without anly

(6) G. Banks, **op. cit.**, p. 160; for further theoretical discussion, see R. Mirus, and B. Yeung, "Countertrade and Foreign Exchange Shorrtages: A. Preliminary Assessment" **Weltrwirtschaftliches Archiv**, Vol. 123, no. 3, 1987, hh. 535-544.

(7) UNCTAD Report March 1986, **op. cit.**, p. 4.

(8) For further information on the subject see, R. Mirus and B. Yeung, **ibid**, pp. 535-544; L. Welt, **op. cit.**, pp. 9-16; ASTRO Manual 1985, **op. cit.**, 33-45; G. Banks, **op. cit.**, pp. 160-162; J. Griffin and W. Rouse **op. cit.**, pp. 185-189; UNCTAD Report March 1986, **op. cit.**, pp. 4-5; C.J. Gmur (Ed.) **Trade Financing** (London, Euromoney Publications, 1986), pp. 169-183; S.M. Rubin, **The Business Manager's Gide to Barter, Offset and Countertrade** (London, the Economist Intelligence Unit, 1986) pp. 5026.

financial payments and barter commision. In other words, it is the bilateral exchange of goods and services of equivalent monetary value. Under such transaction, a partner can not transfer his commitment to a third party.

Realization of a barter transaction depends of the double coincidence of wants of the two parties, and on their ability to agree that their mutual shipments are approximately equivalent value. Difficulties with this form of CT transaction usually begin with the valuation of goods and services to be exchanged and this coincidence of above mentioned pre-requisites. Due to these difficulties, barter trade is mostly applicable to the exchange of homogenous products such as oil, arms, food and raw materials, ad it is normally limited to government-to-government agreements, since qualities, prices, volumes and delivery times of certain homogenous agricultural and mineral products can be easily verified during the negotiations.

Figure 1. Barter Agreement (9)

Signatory Company X in Country A	— 100 % goods — — 100 % goods —	Signatory Company Y in Country B

Pure barter is mainly employed among the governments of the developing countries and their trade relations between East European countries. Genuine barter is rarely employed in industrialized countries. In order to finance vital import requirements without any monetary transfers barter agreements are made between the governments or govermental institutions on the one side, and STOs(*) or private companies on the other. It is widely used for the direct exchange of raw materials in return for foodstuff, cereals, oil, chemicals or industrial inputs. The barter agreement on the volumes, prices, quality, delivery times and transportation charges of goods and services to be exchanged is formulated roughly in a trade protocol. Since the prices of the goods to be exchanged are mostly agreed upon in advance for a few quarter or at least for a month, a great number of barter agreements never have materialized during the rapid fluctuations of commodity market prices.

In practice, the financial settlements in the partner countries of the barter arrangements are as follows: Signatories of barter agreements in respective countries are mostly STOs or private companies which are not permitted to maintain hard-currency holding. Exporter has to submit his shipping documents to the central bank and get credit in domestic currency of the equivalent of

(9) The figure 1 is derived from ASTRO Manual, and L. Welt, **ibid**, pp. 34 and 11 respectively.
(*) STOs = State Trading Organizations.

their foreign exchange proceeds. Importers have to deposit domestic currency equivalent to the foreign exchange allocation for which they apply at the central or foreign trade bank. Under barter agreements, the exporter of country A gets paid in domestic currency from one of the respective and responsible banks for his barter exports, unrelated to whether an importer of country A has placed an import order at the same time and deposited domestic currency to volume covering the responsible bank's credit to the exporter's account. On the import side, similar transactions need to be completed by the importers for a barter import. He deposits domestic currency with be central or foreign trade bank ad finalizes his barter import, unrelated to the activities of the exporter.

b) Compensation

Under a compensation arrangement, the seller of a product (exporter), service or technology takes full or partial payment in the form of a product. The purchase agreement is combined with the sale in a single contract. Full compensation deals are similar to classical barter arrangements with two important differences. Firsly, the partners invoice their deliveries but the invoice values are merely entered into a mutual compensation account with settlement of balance (in foreign exchange or kind) in contracted intervals. Secondly, in general, the exporter transfers the purchasing commitment to a third party, who may be end-user of the product or a trading agency.

In a partial compensation arrangements, the seller of a product (exporter) would, say, agree to accept from partner (importer) 60 percent in cash and 40 percent in kind. Again, exporter has the rihgt to transfer his purchasing commitment to a third party. Pure compensation agreements have a major disadvatage for the exporter. For, if no suitable products are available, the compensation obligation becomes an interest-free commercial credit until the existence of appropriate goods and services. Financing of a sale against compensation must be flexible since the delivery of the compensation products may be delayed.

Compensation arrangements are not concluded on a government-to-government basis. Governmental influence on compensation is indirect through foreign trade regimes. For example, compenstaion deals may be compulsory for low-priority imports for which no hard currency will be allocated buy the foreign exchange authorities.

c) Counterpurchase Arrangements

Counterpurchase arrangements (also called as parallel transactions, counterdelivery, reciprocal trade) links the value of exports to the value of imports ranging from 5 percent to over 100 percent of the original export order. The initial exporter must buy goods and services from the importer, but often they are unrelated to the original exporter's product line.

A major feature of counterpurchase is that two separate contracts should be signed and linked together with a protocol. The first one (primary contract) is typically a standard sales contract indistinguishable from those used in normal foreign trade tansactions. The second contract (CT contract) includes the details of the obligation of the seller to make counterpurchases from the buyer. For further information about the details of the primary and secondary contracts, see Section 1.B-d in Part II.

In general, the duration of a counterpurchase obligation is between six months to three years, the price formule is accepted as the recognized international price at the time of purchasing, and type of goods might include all products manufactured locally or only certain specific products . Unlike barter, each contract is separately financed and does not involve any payment in kind. Tis overcomes the valuation problems found in barter and enables the original exporter to be paid on delivery of his goods and services. At the same time, the exporter is given a needed amount of time to find a suitable products for his purchase obligation. In general, such obligation is transfeed by the exporter to a trading house which will dispose of (sell or transfer) the goods for a commission or discount. These discounts range from under 5 percent for disposal of easily-marketed standart goods such as oil, cement or grain and others, to as much as 25-40 percent for hard-to-market manufactured goods.

Because of mentioned advantages, counterpurchase is the most common form of countertrade, particularly in the state trading countries of Eastern Europe and with a number of developing countries, notably Algeria, Brazil, Indonesia, Iran, Iraq, Malaysia, Nigeria, Pakistan and Turkey. Counterpurchase deals are generally conducted between a state trading organization (the initiator in almost all case) and a private firm or a trading house. Linking of the two separate contracts in most instances, is a protocol arrangement which includes penalties for failure to carry out the counterpurchase contract.

d) Buy-back Agreements

Under a buy-back arrangement, the seller (exporter) of a plant, equipment and/or technology agrees to accept for his deliveries in exchange for payment in products extracted or manufactured with the equipment or turn-key plant he has supplied. The key rule for the turnkey sales contract is that the sale of plant and technology should always be concluded separately from the buy-back commitment. In addition to the derived nature of this trade from the production or extraction, buy-back arrangements generally differ from counterpurchase transactions in that the sums involved are much larger and the contract period longer, usually between five and twenty years. In addition, the value of the buy-lack commitment is usually more than 100 percent of the original export transaction in order to the cover financial charges and local costs, whereas in counterpurchase this ratio is almost always less than 100 percent or at most equal to one. In almost all buy-back cases, the supplier and equipment and the supplier of the knowhow and/or technology share the buy-back obligation proportionately to their share in the underlying turnkey contract.

Buy-back tansactions need to be distinguished from co-production or industrial co-operation arrangements. In many cases, such arrangements are the implemmentation of government-to-government trade protocols. Among their major goals have been the extrtacting of natural resources such as oil or coal, the mechanization of agriculture and light industries, and/or industrialisation of a given country.

Buy-back is the most rapidly growing form of CT due to growing demand for technology in Eastern European and developing countries. In the second half of the 1970's, buy-back deals were mainly limited to sales of plant and equipment to exploit raw materials or to produce bulk chemical goods. But during the first half of the 1980's, they have expanded to the manufacturing industries as well.

Advanced buy-back negotiators of either side do not like buy-back commitments expressed as a fixed amount every year due to rapidly rising and falling prices overtime. In general, all payments in kind, are determined by current world competitive prices at the time of shipment. During each shipment, price of raw materials, bulk chemicals, and other commodities quoted on an international exchange can be easily figured out and they can be sold fairly easily. But, the manufactured non-standard products offered in buy-back does not have world market prices and is not always easily marketable.

As the buy-back deals usually take 5 to 10 years at least, professional trading houses do not play a big role in the settlement of buy-back transactions due to the rapid fluctuations of the market values of the products usually offered in buy-back (10). The US, Japanese and, to some extent, EEC-located companies, in general tend to request that buy-back products, particularly from Eastern European and developing countries, be marketed outside their home

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(10) For the detailed analysis of the buy-back contract, volume, fulfulment and pricing of buy-back products, see ASTRO Manual 1985, **op. cit.**, Chapter V on pp. 156-194; R. Mirus and B. Yeung, "Buy-back in Internvational Trade: A. Rationale". **Weltwirtschaftliches Archiv**, Vol. 122, No. 2, 1986, pp. 371-374; H. Oygur, "Karsilikli, Ticaret", **H. Ünv. İktisadi ve İdari Bilimler Dergisi**, Cilt 4, Sayı 1-2, 1986, pp. 119-125.

countries, knowing that cheaper by-product goods from these countries would compete with domestic products.

B. Non-conventional forms of Countertrade:

a) Advance Purchases

Advance purchases represent an inverted version of counterpurchase commitments. "The foreign supplier asks for advance payment in kind rather than supplying his equipment first and waiting for payment until the countertrade goods have been shipped and sold" (11). In fact, advance purchases are made by a supplier in good faith that the exporter of the advance-parchased goods will subsequently order (counterpurchase) a corresponding amount of equiment and services from him. In addition to collateral and bonafide advance purchases, another form of advance purchase is warehousing and pledging collaterals (12).

The sales proceeds of the advance-purchased products are either kept in-house by the supplied, or put into an "escrow or interim account" with a bank outside the advance-delivering company's home country, or used to establish "fancy letters of credit".

In warehousing and pledging collateral type of special transactions, a producer of mainly agricultural products and minerals would need funds before his goods can or should be sold. The producer might need funds before the collateral products were harvested or mined, or he has the collateral products readily available, but does not want to sell them at the time he needs funds due to low market prices for the product. In practice, this type of collateral business is typical for companies operating in the agricultural or mining sectors. For example, suppose that a firm X (FX) from an African country entered into negotiation on import of spare parts from the USA. Assume that no hard currency will be available for the deal, and FX has to make payment in mineral product. The problem for FX was that the world market prices for the minerals were depressed and it would suffer a loss from an immediate sale. An agreement might be reached that the mineras should be warehoused in the USA and the right of the title be transferreid to the US spare parts company. The US company would hold the goods but was not sell them without the FX's approval. Thus, the risk of speculating for a price increase at the mineral exchange was on FX's side. If the prices would fall further at the certain agreed percentage, the right of disposal should automatically be transferred to the US company. Thus, the full value of the US company's sale to FX could have been secured by a last minute emergency sale.

(11) H. Ferenz, in UNCTAD Report March 1986, **op. cit.**, p. 4.
(12) For detailed analysis see ASTRO Manual 1985, **op. cit.**, Chapter VIII on pp. 282-309.

b) Offset Deals

Offset deals are usually concluded upon governmental initiative for imports of military equipment and hardware, commercial aircraft and infrastructural development projects such as the construction and installation of airports, power station and communication systems. The offset-bound supplier commits himself to generate a certain amount of hard currency to help the offset-demanding government (importer) pay for his prime purchases and/or the supplier is supposed to invest in the importing country and agrees to purchase components for these goods and other related or unrelated products from this country.

Such deals are typical between multinational corporations in industrial countries on the offset-bound side, and STOs or government procurement offices on the offset-demanding side. Often, government bodies on either side will be involved from the very beginning or intervene in the negotiation. Offset deals has long been an established fom of CT in defence system and aircrafts, but in this decade, it is becoming more common in non-military sectors especially where the importing country is seeking to develop its own infrastructure and industrial capabilities. During the first part of 1980's, it has risen in frequency and also involves industrialized countries. Terms of delivery and consequently payment conditions of such projects are around five years, and they are usually financed by not only the offset-bound supplier but also jointly by state or public sector funds of both the supplier's government and the importing government (13).

Offset fulfilment may be the inverstment in new factories or the expansion of existing production facilities in the importing country, in many cases, with the subsequent buy-back of products from these plants. In a number of cases, counterpurchase of unrelated goods and services or commodities and the export marketing of unrelated products may be part of an offset package. Offset deals often lead to long-term cooperation, co-production and/or subcontractor production, licenced production, overseas investment (joint venture), technology transfer (14). All of these arrangemens are beyond the fulfillment of the original offset demand and they involve a significant backward-forward linkage effects (spillover effect) on the industrial development in the offset-demanding country.

(13) Irish Export Board, **Guides to Exporting: Countertrade**, (Dublin, Irish Export Board, August 1985) p. 56; and ASTRO Manual 1985 **op. cit.**, pp. 45 and 275-276.

(14) For the definition of these arrangements see, Government of Canada on Countertrade, **op. cit.**, pp. 1-2.

3. Historical Developmant and Magnitude of Countertrade Transactions

a) Historical Development of Countertrade

Countertrade is a modified modern version of the classical barter which dates back to ancient times when there was a direct exchange of goods and services between societies. Since the eighteenth century, as a result of the completion of the monetization of global society, barter trade increasingly diminished as a percentage of world trade, as gold, Britis pound and the US dollar provided a suitable intermadiary in international transactions.

Although the world inrcreasingly moved toward monetization and away from barter during the last three centuries, global liquidity crises in general, debt and foreign exchange problems in particular required the periodic use of non-monetary trade. In the 1930s, there was increasing recurrence of barter, bilateral and clearing arrangements as a result of the Great Depression. In the post-World War II era, barter and other forms of countertrade arrangement became the main instruments for intra-East Bloc trade as well as for trade between East and West. In the West, in addition to the post-war reconstruction of Europe and Japan, most of the military sales and the evolution of the military/industrial complexes of Western Europe and the United States have been linked since World War II by different forms of countertrade arrangements (15).

From 1950 to mid-1970s, the strong growth in world trade has been largely as a result of the elimination of trade barriars and increased opportunities for exchanging goods and services as a multilateral basis. But, since mid-1970s, there has been a noticeable increase in the various forms of countertrade deals, in response to the global recession, high interest rates and growing protectionist trend. All of these negative developments, including the ten-fold increase in oil prices between 1973 and 1980, resulted in huge external debt in most of the non-oil-exporting developing countries towards the end of 1970s (16).

Recently CT practices are spreading steadily. For example, in 1973 only 15 countries bartered regularly. Currently, as of June 1986, 22 countries had announced explicit legislation related to CT, while 72 other countries have various type of CT directives, and rest

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(15) J. Giffin and W. Rose, **op. cit.**, pp. 178-184; P. Agarwala, "Countertrade Policies and Practices of Selected Asian Countries and Their STOs", paper prensented at Workshop on Countertrade, Beijing, China, September 1985 (UNCTAD/UNDP Project RAS/81/068), pp. 4-5.

(16) Government of Canada, **Countertrade Primar for Canadian Exporters** (Ottawa, External Affairs of Canada, October 1985) p. 2; L. Eisenbrand, "Why is Countertrade Thriving?", in UNIDO, **Industry and Development**, No. 15, (New York, UN, 1985), p. 39.

of the countries conduct CT without spelling out their policies and without admitting it offcially (17).

B. Global Value of Countertrade

The most recent estimates of the percentage of CT in international trade vary enormously - from 10 to 40 percent, depending upon the definition used (18). The following is a selection of the estiamtes:

Institutions	% of World Trade
IMF	Around 10
UNCTAD	25-30
U.S. Dept. of Commerce	35-40

Terminological and classfication difficulties as well as the lack of official national trade statistics on CT deals are the main reasons for the variation of these estiamtes. When the above mentioned both conventional and non-conventional types of CT mechanisms (which excludes bilateral trade) are included, it is estimated by Helmet Ferenz, the UNCTAD Consultant, that CT transactions accounted for 550 billion dolars or 27.6 percent of the world trade (2.000 billion dollars) in 1984.

Table - 1

Estimated Percentages of Countertrade in the Exports of Main Country Groupings, as provided by Mr. H. Ferenz (*)

Region	Share of World Exports	Of which: Countertrade portion	Countertrade as share of world trade
OECD	65	25	16.3
OPEC	10	15	1.5
CMEA (COMECON)	10		
of which			
intra-CMEA	(70)	80	5.6
Other countries	(30)	40	1.2
Non-OPEC			
Developing Countries	15	20	3.0
			27.6

With world trade in 1984 estimated at $ 2.000 billion, countertrade is estimated to be at least $ 550 billion, to which a margin of over $ 100 billian may be added.

(*) Source: UNCTAD, "Report on the Asian Regional Workshop on Countertrade" held at Kuala Lumpur, March 24-28, 1986, p. 32.

(17) UNCTAD Report March 1986, **op. cit.**, pp. 4- ; ASTRO-Manual, pp. Survey 1-8.

(18) Ibid (UNCTAD), p. 5; L. Eisenbrand, **op. cit.**, p. 37; S. Rubin, op. cit., p. 7; IMF, **Annual Report on Exchange Arrangement and Exchange Restrictions,** (Washington D.C., IMF, 1986), footnote 10 on p. 33.

Out of this 27.6 percent, as can be seen from the Table-1, 4.5 percent belongs to developing countries, 16.3 percent td OECD countries and 6.8 percent to East European and other countries. In 1984, estimated portion of countertrade in the exports of OECD countries was 25 percent; 15 percent for OPEC and 20 percent for non-OPEC developing countries.

According to the estimate of ASTRO, in 1985 countertpurchase deals accounted for 51 percent of all the CT transactions in the world. The usage of CT by major types is estimated to be as follows:

Barter 14 percent,
Compensation 6 percent,
Counterpurchase 51 percent,
Buy-back 12 percent,
Offset deals 15 percent, and
Advance purchase 2 percent.

Even if there is an agreement on the definition of CT, there will still be tremendous variations in global estimates which are caused by the lack of data on transactions and the secrecy that surrounds its practice. For example, offset deals can hardly be quantified since there is a lot of political secrecy involved. There are other factors which cause the lack of data on CT transactions. Firstly, they are not separately tabulated in standard national trade statistics. Secondly, most governments are reluctant to give information on their CT activities due to political reasons, especially as the US, IMF, World Bank and GATT have openly opposed mandated CT transactions. Thirdly, most estimates are based on rumours of proposed deals rather than actual CT transactions which be realized in many years (19).

In the absence of any official statistics from the national authorities, it would be difficult to figure out a definite figure correnctly reflecting the global value of CT transactions. All that one can say is that the practice of CT deals are on the upswing, not only among developing countries but also in industrialized countries.

United Nations Industrial Development Organization (UNIDO) estimated, in 1985, that CT deals increased 50 percent in 1981, 64 percent in 1982 and 117 percent in 1983 (20). According to a forthcoming Oxford publication, today, more than 2500 companies, over 500 banks and 250 brokers are doing CT world wide, and annual value of CT transactions in world trade reached to $ 250 billion in 1986. Thus, "countertrade has become a corporate strategy for successful business growth. With the challanges and potential of

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(19) ASTRO Manual 1985, **op. cit.**, pp. 16-17; and J. Griffin and W. Rouse, **op. cit.**, pp. 190-191; G. Banks, **op. cit.**, p. 162.
(20) L. Eisenbrand, **op. cit.**, p. 37.

countertrade increasing, it has long been felt that there is need for a countertrade" (21).

C. Features of selected Countertrade goods and services:

Goods and services entering into a CT transaction may be of different nature and no rule exists as to which goods and services would be better for CT than others. This section examines some of the major problems and pitfalls inherent in CT goods mostly offered by developing countries in world-wide CT deals (22).

Raw materials are generally not offered by CT demanding developing countries as CT goods since they can easily be sold for convertible currency. Whenever raw materialst are offered in CT deals, they usually form part of government-to-government agreement through STOs or implemet a large buy-back arrangement. In such an arrangement, the buy-back-accepting firm would generally rovide mining equipment and accept payment in ores or minerals which have been mined with these imported equipment. There is almost no quality problems in this type of deal but main issue might be delays in deliveries.

A number of developing countries are offering increasing amount of semi-manufactured or finished products which are mainly from the field of engineering, chemistry, metallurgy, light industry and agriculture. Semi-manufactured products include diverse materials such as preserved foodstuffs, various textile products, furniture, iron and steel bars, wire, aluminium profiles, flat glass and different type of synthetic materials for which export markets have yet to be established.

The main issue of the semi-manufactured and finished product in a CT deal is the quality problem of the CT goods. The quality of these products in developing countries varies widely from country to country and often within the same country from firm to firm. Semi-manufactured or manufactured products from joint ventures with industrialized countries' partner are rarely available as CT goods because they are mostly reserved for domestic consumption and seldom for hard-currency exports.

Any company accepting these low quality goods to fulfil its CT obligation should be prepared to spend much time and effort in reselling of such goods. Because of this reason, many CT-committed industrial companies usually rely on the services of a trading house

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(21) Oxford, **The Oxford International Countertrade Directory** (Oxford, De Bard (U.K.) Ltd., forthcoming in 1988), pp. Introduction and cover pages.

(22) For further information, see **ibid.**, pp. 104-118; T. Kopinski, **op. cit.**, pp. 16-19; Government of Canada, **op. cit.**, p. 3; J. Garson, "Compensated Trade: Experience of Some African Countries", paper prepared for UNCTAD Secretariat, UNCTAD/ECDC/Misc. 20, July 1985, pp. 2-25; G. Banks, op. cit., p. 167.

which has experience and proper knowledge of the market to resell these items with a minimum loss.

Some CT-demanding developing countries offer services as the object of countertrade. Such services include consultancy services, shipping and freight services, insurance, trourism, construction or even unemployed worker and manpower (23).

PART - II

ECONOMIC MOTIVATIONS AND COSTS, FINANCIAL AND LEGAL ISSUES AND ORGANIZATION OF COUNTERTRADE

1. Motivations and Costs of Countertrade Policies

A. Rationale for Countertrade:

Countertrade is, in general, motivated by the desire to economize on the use of hard currency, the desire to stimulate the transfer of advanced technology from abroad, to improve access to foreign markets and maintain market shares, and to take advantage of available credit facilities in the industrialized countries. The emergence and recent growth of CT demads may be atributed to several factors in different groups of countries (24).

In the Eastern European countries, CT is generally motivated by shortage of hard currency and the desire to stimulate the inflow of modern technology and know-how from Western countries, to reduce the uncertainties in forecasting foreign demand for their export products and to use it as a means of achieving bilateral balancing of foreign trade. Thus, these countries consider CT an essential tool of central economic planning with which to balance their international trade and reduce balance of payment deficits.

Many developing countries are now turning to CT in response to conditions that closely parallel those of Eastern Europe in the 1970's: growing debt service ratio, falling commodity price, generally the worsening terms of trade, declining export and import capacity, shortages of convertible foreign exchange and thereby deteriorating domestic economic performance.

Countertrade is not a common practice in trade between the industrialized countries which conduct over 75 percent of their trade between themselves. The major exceptions have arisen in defence,

(23) **Public Enterprise**, Vol. 6, May 1986, p. 264.

(24) For further information, see IMF, **Exchange Arrangements and Exchange Restrictions, Annual Report 1986** (Washington D.C., IMF, 1986), pp. 32-33; Irish Export Board, **op. cit.**, pp. 8-11; L. Welt, **op. cit.**, pp. 4-7; T. Kopinski, **op. cit.**, pp. 3-8; UNCTAD Report March 1986, **op. cit.**, pp. 8-15; and G. Grant, "Countertrade: Third World: Practical Option", **Pakistan and Gulf Economist**, December 21-27, 1985, pp. 57-59.

aviation and large high technology deals which often involve an element of offset deals or counterpurchase. As mentioned before, offset deals involve longest fulfillment period from five to twenty years, large amount of and wide range of economic activity, from investing in or purchasing from a selected industry or industries, to joint production, sub-contracting parts of large projects and the transfer of advanced techology.

In developing countries, the basic goal of each goverment is to provide the economy with nesessary imports in the circumstances of heavy external debt burden. By allowing CT deals, officially or unofficially, these countries normally try to pursue the following goal through CT transactions. These are promotion of non-traditional product exports, increase in foreign exchange reserves, improvement of balance of payment, penetration into new markets, opening of markets for goods that may not be internationally competitive, opening possibility for a discount on the multilaterally fixed official (say oil) prices through inflated price of the country's export goods.

a) Overcoming Foreign Exchange Shortages:

The most common favourable argument for CT practices is that is enabes to increase the import capacity of a country which has been facing hard-currency shortages by linking of imports to exports. The foreign exchange shortage arises when a country lives beyond its external means of payment. Many developing countries with overvalued currencies and tight exchange controls see CT transactions as a way to carry out foreign trade when the price system no longer allows them to solve their balance of payment problems through traditional trade arrangements.

When the allocations of foreign exchange are insufficient for certain companies in the nation through CT they are unable to conduct foreign trade. Thay are able to obtaion necessary foreign raw materials, equipment and technology which are needed to increase the export capacity of firm and the nation.

CT deals may also increase the availability of hard-currency credit fom the industrialized countries, and could raise a country's capacity to import which may result in increase volume of exports or an improved terms of trade.

b) Promotion of Exports and Additionality in Exports:

By linking of imports to exports developing countries and their enterprises might not only secure necessary intermediate goods, but also gain entrance to foreign markets where their products could not be sold for cash, thereby overcoming the various market barriers. Thus, additionality of exports was one of the main objectivies in conducting CT. It is possible to secure additionality by issuing a list of commodities and products that have not been exported to a target market, together with a list of countries to which the goods could not be exported because of their poor quality and/ or high per unit cost. Such products migh include primary commadities with some value added, but the emphasis would be on non-traditional products such as semi-manufactured and manufactured goods, depending on the merits of each case.

Regarding evaluation and monitoring of additionality in exports and the diversification of export markets involve many problems and these problems cannot bu underestimated. In order to attain these objectives, a complex system of controls need to be established, so that CT export goods will not be re-directed to the country's traditional markets. For that purpose, the control of shipping documents and customs clearance forms is necessary to prevent a situation of unwanted self-competition in traditional markets, even though the full effectiveness of such control are questioned.

In addition, during the negotiation phase, it is very important to define clearly the following explicit terms to avoid subsequent disputes.

These are,

- the full description of products and services available for countertrade;
- the delivery schedules of these goods and services;
- their technical specifications and standards;
- pricing mechanisms and their financial values;
- quantities available under countertrade operations;
- the possibility of transfer of commitments to third parties; and
- other commercial terms and conditions specific to CT. For example, if a full description of the goods and services could not be given, at least trade ad marketing prohibitions and penalty clauses for non-fulfillment of the CT obligations should be explicitily mentioned in advance (25).

c) Other Benefits of Countertrade:

One of the major justification given for its current widespread use by the governments of developing countries is that CT deals do not imply a direct budgetary outlay. Other justification is that CT transactions assist in disguising prices and offer a means to adopt differential pricing without openly contravening international produced agreemints, so long as the CT deal is on an **ad hoc** and limited in scope. For example, CT can act as a hidden discount on the official price for its exports by allowing a country to charge the list

(25) UNCTAD Report, **Ibid.**, p. 11.

price for its exports while paying above the market prices for counter-traded imports. Thus, the complexity of the deal makes it possible to hide the real price assigned to either purchase or sale. CT deals might also help in maximising the buyer's bargaining power if there is bulk exchange of products and services (26).

B. Constraints Against Contertrade:

a) Countertrade as an Instrument of Multiple Exchange Rate

When a domestic product is sold at less than the official price and/or an import is bought for more, the result is a selective devaluation, tailormade for each CT transaction. Then, CT is the equivalent of a hidden export subsidy, an import tax or a mixture of the two. Thus CT may be used as an instrument in bringing about a sort of selective devaluation or multiple exchange rate applicable to each CT transaction. This leads to price distortions in view of the spill-over effects in the rest of the economy, and regressive social transfer if costs were loaded on to imports widely used and consumed among the poorer part the population (27).

Thus, multiple exchange rate has detrimental effect on not only efficient allocation of resources, but income distribution as well. The exchange rate is the price of foreign exchange in terms of national currency. It is a key variable which affects the relation between domestic and foreign prices. Implementation of realistic exchange rate policy, rather than multiple exchange rate, might be the most effective instruments or simultaneously promotign exports and reducing imports in an efficient manner without any administrative burden, (28) since devaluation is usually considered as a combination of a float **ad valorem** import duty to all imports and an equivalent ad valorem subsidy on all exports (29). But, contrary to a devaluation that operates across the board for all trade deals, CT transactions produce selective, arbitrary and case-by-case devaluation which would lead to the following direct and indirect economic disadvantages for the economic development of a country.

b) Socio-economic Costs of Countertrade:

As mentioned before, governments, especially in developing countries, have been tempted to use CT since it does not require a

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(26) **Ibid.**, pp. 7-8; P. Agarwala, (1985), **op. cit.**, p. 26; J.'de Miramon, Countertrade: An Ippusory Solution, **The OECD Observer**, No. 134, May 1985, p. 25; J. Garson, **op. cit.**, pp. 22-23.

(27) Ibid.; T. Kopinski, op. cit., p. 6-7.

(28) P. Agarwala, "Price Distortions and Growth: A study of the Association in Developing Countries", **Finance and Development**, March 1984, p. 35; Emin Çarıkçzı, "Trade Strategies and Prospect for Economic Cooperation among selected OIC Member Countries Egypt, Saudi Arabia and Turkey", Unpublished research paper prepared for IRTI/IDB in 1985, pp. 92-93.

(29) N. Kaldor, "Devaluation and Adjustment in Developing Countries", **Finance and Development**, June 1983, p. 36.

direct budgetary subsidy and that this is one of the reasons for its current widespread use. Even if this policy does not require budgetary outlay, the economic costs associated with it have to be borne by the society as a whole. When the promotion of exports of certain manufactured products is linked to a higher cost of foodstuffs or oil imports, then one of the by-products of this CT may be a virtual tax on the relatively large number of users of the imported product, a tax whose proceeds accrue to the smaller group of producers of the goods exported.

Apart from the basic issues of inefficiency of resource allocation and social costs, some of more common serious direct economic disadvantages of CT deals generally encountered are: (30)

- a limited choice of products or services that are available for trading at internationally competitive prices;

- poor quality of goods;

- the difficulty of marketing products that are not directly consumed by the buyer, especially when the exporter places geographical or commercial restrictions on the marketing of products;

- a higher product cost resulting from payments of commissions or fees to the middlemen (trading house, broker, consultant/agent or banker) handling sales of products and from bridge financing that may be needed, due to long delivery dates;

- a higher financial cost resulting from additional risk which is not usually present on normal bank-financed foreign trade that must be covered, and

- possible distortions in the internal sector and delay in the adoption of necessary adjustment measures.

c) Complexity of Countertrade Financing

Countertrade is a complex, expensive and risky method of trading. Because, traders have to involve purchase and re-sell goods outside their area of product specialisation and with no readymade cash markets in the industrialized countries. They have to buy from unknown suppliers, pay prices that are generally inflated for inferior quality of goods, worry about shipping documentation, warehosing, insuring and financing export of products. A countertrade transaction could involve finding buyers and sellers, conducting prolonged negotiations, managing currency transactions, exposing oneself to risks and still remaining competitive, as can be seen from the following example.

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(30) IMF, Exchange Arrangement (1986), **op. cit.**, p. 33, I. Hodara, **op. cit.**, p. 10.

> "A convoy of trucks loaded with fresh strawberries crosses the border from Hungary into Austria. Several weeks later, a container load of strawberry jam, packed in Austria, arrives in Cairo for sale on the local market. A broker in Hong Kong, actign on instructions from the Austrian trading company at the center of the web, prepares a mixed shipment of video recorders and tape cassettes for delivery to Budapest. Soon, Hungarians are happily watching "Rambo" videos, the Egyptians are eating jam and the Austrian trading company is looking for a customer for several tons of Egyption rugs and traditional dolls. No money has changed hands, but the economies of four countries have benefited from the intricate commercial minuet-another successful exercise in modern barter-trade" (31).

Administrative procedures involved in finalizing CT deals can be also more lengthy and complex, especially when participating countries do not have written offcial rules and regulations on the subject. Becaues of this and other reasons, a great number of CT transactions are not completed successfully. However, many non-oil exporting developing countries, due to shortage of foreign exchange, may face a dilemma between CT or no additional trade at all. This might be the reason why an increasing number of developing countries are considering the implementation of official rules and regulations on countertrade.

d) Complexity of Negotiating and Drafting Countertrade Contracts

It is recently estimated that 51 per cent of all CT deals are in the form of counterpurchases. Buy-back is becoming one of the most rapidly growing forms of CT transaction forming a share of 12 per cent in all CT deals (32). Since these two types of CT deals account for around two-third of all the CT transactions, a brief information on their contractual issues would be of an immense help. In fact, contract formalities of counterpurchase and buy-backs are very similar and involve two separate contracts namely the "primary sales contract" and the "secondary sales contract or CT contract". These two contracts should there be linked together with a "protocol".

Except in the case of pure barter deals, where products are generally exchanged under a single contract, most CT deals should consist of two separate purchase agreements, namely **primary contract** and **CT contract** and a third agreement as a **protocol,** linking the two together. Thus, even though the following analysis primarily applies to the counterpurchase and/or buy-back contacts,

(31) **Newsweek,** January 20, 1986, p. 34.
(32) ASTRO Manual 1985, **op. cit.,** pp. 16-17.

every bit of their details will equally apply to the other forms of CT transactions, excluding barter (33).

As a result, a CT agreement constitutes the protocol, the primary contract (the primary sales agreement) and the secondary contract (the secondary sales agreement or the CT contract), and they should include the following clauses or provisions:

Protocol: It is essentially an agreement setting out the reciprocal nature of obligations, with the parties entering into the two independent saes contacts.

Primary Contract (the primary sales)

- **Recitals:** The parties entering into the agreement.

- The **time of execution** of the contract.

- The **obligation of the purchaser.**

- The **description of the goods** and their detailed specifications.

- The **quantity of the goods** covered by the contract and any allowable percentage variations in the quantity.

- The **price of the goods** shipped and the terms of their payments.

- The **method of payment**, including the currency and the allocation of risks and burden of exchange rate losses.

- The **time and terms of delivery** of the goods.

- **Packaging and shipping** such as the term of shipment, the type of vessel.

- **Insurance:** The responsibilities of the respective parties as to the provision of a policiy or marine cargo insurance.

- A clause stating the **governing law as to risk and title.**

- **Documents** that specify the responsibilities of parties for delay and the processing of the documents.

- The **invoice.**

- **Quality** guarantees **of goods.**

- **Buyer's rights to incpect the goods** or provide for inspection by a neutral party at the port of destination or place of delivery.

- **Remedies** agreed upon by the parties **for defaults** arising out of late delivery and/or for breach in the contract concerning delivery.

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(33) T.B. McVey, "Countertrade and Barter: Alternative Trade Financing by Third World Nations", **The International Trade Law Journal**, Spring/Summer 1981; J.C. Grobow, "Negotiating and Draifting Contracts in International Barter and Countertrade Transactions", **North Carolina Journal of International Law and Commercial Regulation**, Spring 1984, pp. 255-271; L. Welt, **op. cit.**, pp. 35-37.

- Consequences of **Force majure** such as of strikes, lockouts, trade disputes, war, riots, fires or epidemics etc.

- The **consequences** suffered by either of the two parties to the contract in the event of **a bankruptcy.**

- **Arbitration and appeal.**

- The **choice of the law** for hearing disputes. It states the parties agree that the court of a named country will hear the dispute.

- The **languages** of the contract.

<u>Secondary Contract</u> (the CT contract)

- **Recitals:** the parties entering into the agreement.

- **The time** of contract execution.

- The **obligation of the seller** to make **counterpurchases** from the buyer.

- Listing the **available goods** and the availability of period of time.

- The **obligation of the counterpurchaser** to take the goods subject to contract.

- The **description** and detailed specifications **of the CT goods.**

- The **quatity** of the goods covered by the ontract and allowable percentage variations in the quantity.

- The **price** of the goods and the **terms of their payments.**

- The **time period** to complete the counterpurchases by the seller.

- **Marketing restrictions,** if any, imposed upon the seller with respect to the use or resale of the CT goods.

- The **method of payment,** including the currency and allocation of risks and burden of exchange rate losses.

- The appropriate **time and terms of delivery** variations.

- **Packing and shipping** indication the terms of shipment, the type of vessel etc.

- The tyhe of **insurances.**

- **Documents** related to the responsibilities of the parties for delay and processing of the documents.

- The **invoice.**

- **Guarantees of quality.**

- **Seller's rights to inspect the goods** or provide for inspection by a neutral party.

- A clause as to **default.**

- **Penalties** to be paid in the event of contract breaches by the seller.

- Consequence of **Force majure** such as strikes, lockouts, trade disputes, war, riots, fires or epidemic etc.

- The consequences of a **bankruptcy.**

- The **choice of the law** to be applied to the resolution of a dispute.

- The **languages** of the contract.

Buy-back contracts are also similar to above mentioned contracts. However, primary contract of buy-back contains additional clauses on the following matters as performance of equipment/technology, consultants ad technical advisors, and overall separation of equipment and technology.

Making two separate contracts in most CT transactions has its merits. Firstly, separate contracts allow the two parties the obligation to be insulated from each other. Secondly, two separate contracts make it easier to obtain subsidized credits and/or export guarantees from a bank or national Eximbanks for the primary sales contract, since it is separated from the obligations of the CT side of the transaction. In addition, each party is aware of the obnligations it needs to perform independently. If one party encounters any setback, the other party (the nonbreaching party) is stratetgically in a better position to have a claim to make an independent contract.

Although two contracts are independent, it is important to note that both of them are negotiated simultaneously. Since more than one legal system are involved in CT deals, it is vitally important the wording of the contracts leave no ambiguity in their interpretation.

2. Organization of Countertrade, and the Role of International Trading Houses and Banks in its Financing

Section 1 in Part-II clearly shows that CT is a complicated and risky business. In East-West trade, Eastern European countries are the initiators of countertrade. In market-oriented developed and developing countries STOs are in most cases the initiators of CT deals. In some developed countries CT offers sometimes are initiated by private companies.

A. Role of the Public Sector and STOs:

Unlike the Eastern European countries, overwhelming majority of developing countries have no institutionalized systems of countertrade. In market-oriented countries, CT is in its infancy and the whole thing is in a process of evolution. But, the existing available experiences and skills on the subject currently are mainly in the developed countries. Developing countries are aware of the importance of CT deals and their STOs are gradually adopting the new system to their needs. But, still the major problem for most STOs is that CT deals are unfamiliar territory. Because these transactions are, in general, large and cover long time span, the risk of making mistakes can be very costly. Thus, STOs of developing countries have to get an insight into the complexity and difficulty of CT transactions (34).

a) Goverment Level

When any goverment introduces a CT in its foreign trade policy, in general, it aims at realization of following two basic goals. These are either that CT has to be limited to incremental trade, and/or that CT must be applied to secure financial cover for the country's import targets. Whenever a country's foreign trade policy reaches more sophisticated and diversified stage, the government most probably will then consider the CT only as an instrument of incremental trade expansion to the target markets. In this case, CT would not be permitted to reduce or redirect of established trade channels. Through the CT deals, the government would try to export the country's exportable surplus products to the target markets and thereby to alleviate the country's marketing weakness.

In reality, marketing weakness is not only reason for increase in CT demands. Economies, greatly depending on export of raw metarials such as crude oil, bauxite and phosphates or agricultural product namely, jute, rice and tea would in general find sufficient buyers for their output. The real issue is that these buyers cannot supply the products needed in return by the export countries. In order to face this problem, for developing countries, the establishment of some sort of CT coordinating bodies is advisable. However, there is no standard organizational system which would be the best for these countries, but the following conceptions could be more applicable to the needs of the developing countries (35).

In a developing country where there is a strong state economic influence in many sectors, **CT advisory committee** may be subordinate to the ministry of foreign trade and/or the central bank of the country. The committee members should be recruited from the ministries and/or industrial sectors and can be exchanged on an **ad hoc** basis for the peculiarities of each CT deal.

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(34) For further information, see ASTRO, "Report of International Workshop on Countertrade" No. CTW - 5, Belgrade, June 25-28, 1985, pp. 2 and 9; L. Eisenbrand, **op. cit.**, p. 47; ASTRO Manual 1985, **op. cit.**, pp. 373-383.

(35) For further information, see P. Agarwala (September 1985), **op. cit.**, pp. 19-23; Irish Export Board, **op. cit.**, pp. 12-13; Astro Manual, **ibid.**

If strong public presence exists in a few industrial sectors with low state influence on the private sector, the **CT advisory committe** might be composed of representatives from the respective state-controlled industrial sectors and repsentative of the related private sectors. Representation of private sectors by the respective heads of commercial, industrial and/or agricultural chambers are more suitable. Inter-sectorial and **ad hoc** committee are giving better results than standing assignments. Any **ad hoc** committeee could either be dissolved or assigned a new mission after completion of any advisory duty.

If a developing country has a strong private sector and low-influence public sector, the establishment of a **CT coordinating body** is advisable. This body could be an independent **legal e**ntity, similar to a national trading house in deveyoped countries, that would deal for its own account without any linkage to any specific ministry or state institution.

b) STO or Corporate Level

If an STO or a company decided to engage in CT deals in its foreign trade transactions, the formulation of CT policies and their implementation should be in the authority of the same executive or same executive committee. Because, CT-demanding side, in general, expects to negotiate with a single authority in order not to face any confusion during the implementation of CT arrangements. Again, there is no easy rule of thumb as to what organizational structure would be the best for an STO or a company, but, at least, the following conceptions which need to be approved or decided by the respective authorities are: (36)

- Shall we mainly be CT-demanding or CT-accepting in our foreign trade deals?

- If mainly CT-demanding: should we include goods and services from a third party in our offer of CT goods?

- If mainly CT-accepting: should CT products be for internal use or resale to a third party?

- If resale to a third party; should it be handled through our own trading division or an outside trading house?

In developing countries, the role of the private sector in CT is largely subordinated to that of the STOs. Only a few multinational private companies which have joint venture abroad are effectively able to engage in countertrade transactions.

B. Role of the Trading Houses, Agents and Banks:

One of the options available to an exporter in dealing with countertrade situation is to seek the assistance of a third party such

(36) ASTRO Manual, ibid., pp. 382-383.

as a trading house, broker, consultant/agent or specialized bank. They usually supply market intelligence for certain CT goods for a fixed fee or for a commission. On the basis of one of these changes or both, they might also accept the responsibility of the counterpuchase commitment.

A trading house or broker will agree to take given CT goods and open a letter of credit for its purchases only when it has found a difinite buyer for these goods. The deals between 100 thousand and 500 thousand U.S. dollars are the ideal size of a compensation or counterpuchase commitment for the majority of trading houses. Because, in this range, it is easier to find one single end user to buy the full consignment. At the same time, if the deals are more than $ 0.5 billion, the exporter of the CT goods may not be in a position to deliver the full quantity in one shipment. On the other hand, transactions of less than $ 100.000 may require almost the same effort in finding a buyer of CT goods as larger deals. As a result, the fees charged as a percentage of the obligation for a deal are expected to be higher for smaller transactions, lower for longer deals (37).

Recently, in the Western world, an ever increasing number of trading houses (companies) and banks are organizing themselves for CT transactions and actively engaging in this type of trade. They are operating acoording to functional, product and geographic specialization. They usually have a wide knowledge of dealing in a variety of products with respect to their product and geographic specialization. They have already established their sales network for countertrade goods. Due to complexity of CT deals, the developing countries concerned are, therefore, becoming increasingly dependent on these intermediaries for the marketing of their exports of CT goods (38).

By employment of an international trading company's services, developing countries can counter their lack of marketing experience in CT deals and the growing tide of protectionism by penetrating those Western markets that have otherwise become inaccessible to cheap foreign exports. Securing of a trading house's services might also reduces the unit cost for producers by providing economies of scale in both marketing, distributing and financing of different trade projects (39).

A trading house or agent can be helpful in the estimation of CT costs such as fees and subsidies. In practice, most CT experts use the term "subsidy" instead of "premium" or "discount", even though all of these expressions have the same meaning in CT activities. The subsidy represents the difference between the purchase price and the

(37) **Ibid.**, pp. 273 and 280,
(38) Agarwala (1985), **op. cit.**, pp. 25-27.
(39) R.B. Dennis, "The Countertrade Factor in China's Modernization Plan", **Columbia Journal of World Business**, Vol. XVII, No. 1, Spring 1982, p. 67.

price at which the CT goods can be sold to a third party in target markets. In order to find a buyer for them in a target market, as an incentive in the form of subsidy, CT goods usually must be sold 5 to 20 percent less than purchase price, depending on type of commodities and products. The best salable CT goods are farm products and raw materials and thereby they are subject to a very low subsidy. Chemical products, consumer goods and semi-finished goods require a higher subsidy because of their limited marketability. Machinery and other industrial goods have to be subsidized at higher rates. For, differences in quality of products, the availability of spare parts and after-sale service and other factors result in varying degree of subsidies for the same type of industrial goods which purchased from different countries (40).

Selecting the proper intermediary in CT activities is not a simple process. An exporter has to make comparison shop, since the range of services and costs may vary greatly between trading houses and agents. It is also advisable that the only time fees are paid to an intermediary is when counterpurchase obligation has been fulfilled. The exporter can they pay the service costs which generally consist of a commission plus a subsidy. The commission covers the financing charges, cost of penalty guarantee, general operating experditures and profit.

There are numerous banks and consultants which can provide assistance to an exporter for his CT transaction. In addition to offering CT services in the form o information on the various forms of CT, Banks also provide pre-export finaning, assist in negotiating CT arrangements, and locate buyers on appropriate trading houses or companies (41).

C. International Institutions and Countertrade:

International institutions such as GATT, IMF and the World Bank have been founded, after the Second World War, on the principle that multilateral and free of international trade would lead to a better international economic order and development. The main criticism directed by these institutions against CT is that it inhibits the free flow of international trade by encouraging bilateralism (42).

In reality, legally these international institutions cannot intervene any country's CT activities, because IMF and GATT had no provisions that specifically prohibited the practice of CT. But, it is assumed that this practice implicitly violates the spirit if not the article of the GATT and IMF. In spite of this, some of the recent IMF

(40) For further information, see ASTRO Manual, **op. cit.**, pp. 277-281; Irish Export Board, **op. cit.**, pp. 12-13; L. Eisenbrand, **op. cit.**, pp. 48-53.

(41) **Ibid.**

(42) J. Garson, op. cit., p. 31; IMF (1986), Exchange Arrangements, **op. cit.**, p. 33.

stabilization programs which imposed ceilings on imports had paradoxically induced some non-oil exporting developing countries to expand their CT activities in order to evade suc ceilings (43).

PART - III

SUMMARY, CONCLUSIONS AND FUTURE PROSPECTS OF COUNTERTRADE

a) Summary and Conclusions

The term "Countertrade" which has only recently entered the literature of international trade, originated in the East-West trade. It is a modern version of barter trade. Mostly, it appears as a quasi-barter and most of the CT settlements involve cash payments. Countertrade has a variety of forms. There are four conventional types (classical barter, compensation, counterpurchase arrangements and buy-back arrangements) and two non-conventional forms (advance purchases and offset deals) of countertrade. Any type of CT requires a conditional link between exports and imports, but this requirement is not always necessarily attained at approximately equal values.

This research clearly shows that CT as a comercial practice has gained wider acceptance during the 1980s. The lack of foreign exchange, the debt crisis and inadequate marketing capabilities are the main reasons motivating most of the developing countries to impose CT arrangments.

The main problems encountered in any discussion on CT is the absence of any internationally binding or accepted classification and terminology for the various types of CT arrangements. It is important to note that CT is not trade without money. With the exception of classifical barter, which is now extremely rare, CT consists of both financial and trading transactions. The goods are valued in monetary terms and each contract results in a commitment to pay irrespective of the performance of the other contract. Even though the two contracts (primary and CT contract) are linked through a protocol, individually each transaction is a straightforward export sale which enables the exporter to utilize the most effective form of financing available such as subsidized export credit and finance.

In fact, mandatory CT arrangements probably drain foreign exchange rather than saving by increasing transaction costs and reducing competition, so that a country pays more for its imports and receives less for its exports. Because, the CT deals involve complicated multiparty transactions in unfamiliar products and markets and thereby tend to increase the costs of trade, as additional

(43) UNCTAD Report (March 1986), **op. cit.**, p. 7.

risks which are not usually present in normal bank-financed foreign trade (conventional financing) must be covered.

By accepting higher prices for imported goods and raw materials for the same amount of exported commodities CT becomes an alternative to an explicit subsidy, devaluation and discounting without violating the existing IMF and GATT rules. Because, this kind of discounting is not within the coverage of the present guidelines of these institutions.

Developing countries with hard currency problems often used buying power of their state trading organizations (STOs) for trade promotion especially of their non-traditional exports through CT deals. However, their capabilities and experiences in this complex, expensive and risky method of trading field are rather limited. Unfortunately, the overwhelming majority of developing countries have not yet fully mastered the mechanics of CT. For most of these countries, CT is still in its infancy and the experiences and skills currently are mainly in the hands of developed countries. Because, countertrading in many commodities is a very specialized activity that requires a good knowledge of issues involved and a substantial experience in actual trading. Most of the developing countries simply do not have the necessary qualified personnel to run CT with maximum efficiency.

b) The Future Prospects of CT in the World Trade

During the mid-1980s, even though inflation has diminished and a worldwide recession has been avoided, the world economy still faces growing uncertainty due to persistent current imbalances and a slowdown in the growth of production and trade in many developed and developing countries. In addition most of the developing countries are highly indebted and middle-income countries have suffered significant falls in per capita income.

In developed countries major problems such as high real interest rates, declining investment rates, volatile exchange rates, growing current account imbalances, rising protectionism and high unemployment in Europe are still in existence as a result of a direct consequence of the continuous lasting divergence in the macroeconomic policies of the leading industrial countries.

For developing countries, the economic outlook remains bleak, especially for those with heavy debt burdens. Moreoever, inspite of considerable stablization and adjustment efforts, the unexpected deterioration in the external economic environment, such as slower growth in world trade, falling commmodity prices, reduced access to foreign markets, and the worsening in the availability and cost of external finance, has reduced the economic policy successes of many of them.

According to recent forecasts of the World Bank Publications, the unfavorable external environment facing developing countries is expected to persist at roughly its present level at least until mid-1990s. Thus, the constraints in the international market would remain and the willingness of both exporters and importers to search for further CT deals would continue in the near future.

In fact, expect for barter, most of the CT deals involve some sort of foreign inverstment and/or foreign trade financing. It is then reasonable to assume that the desire to use CT arrangements by developing countries in general are expected to continue whether or not world economy will be adjusted in the future..

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