Theory of countertrade; a Look into Advantages of different types of Countertrade

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Abstract:

Countertrade is a trading method in which the exchange of goods or services takes place between two or more than two parties as per their need, without involving any money or currency. It happens according to the rules and regulations of countertrade of the countries involved in the process. The developing countries have practiced countertrade since many years for strengthening their economic and political position.

This paper aims to explore different advantage and disadvantages of the different types of the countertrade. This paper is comprises of 7 sections. First section introduces the study, subsequent section defines the concept of countertrade followed by a section elaborating the history of the countertrade. Fourth section describes various kinds of the countertrade, fifth and sixth section discusses the advantage and disadvantages of the countertrade while the final section concludes this study.

Key Words: Countertrade, Barter, Buy-back, Offset, Advance-purchase, Switch transactions, Build-operate-Transfer

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1. Introduction.

The countertrade transaction is used in multiple forms which can be bilateral or multilateral, but it cannot be taken in unilateral transactions.[1] This is because it comprises of the involvement of two or more than two parties which can be both national and international. Countertrade is the type of trade which involves the exchange of goods or services between two or more than two parties as per their needs. Countries all over the world use it in such a situation when they have something in excess and the Govt. or a party can exchange their goods or services with another country or party in return of something they need and vice versa.[2] Such an exchange of commodities is done in order to fulfill the needs of the people. It does not involve money, and takes place according to the rules and regulations relating to countertrade of the countries involved in the process.

Countertrade is a latest term of the international trade that has gained immense popularity all over the world as it gives a solution to overcoming the financial and developmental issues that countries all over the world are facing as a result of the crisis of international debt.[3] Due to the rise in the need of expansion of industrial sector in developing countries, the demand of imported energy oil has contributed to a rise in its cost. This has created an increase in external debt that is a result of reduction in market power, new regulations for exchange, technological requirements and unstable political conditions caused by regional wars and internal conflicts.

1Kang Rae Cho, "Using Countertrade as a Competitive Management Tool," *Management International Review* 27, no. 1 (1987): pp. 50-57.

2Robert Howse, "BEYOND THE COUNTERTRADE TABOO: WHY THE WTO SHOULD TAKE ANOTHER LOOK AT BARTER AND COUNTERTRADE," *The University of Toronto Law Journal* 60, no. 2 (2010): pp. 289-314.

3Cedric Guyot, "Countertrade Contracts in International Business," *The International Lawyer* 20, no. 3 (1986): pp. 921-959.

A transaction based on the laws of countertrade comprises of the agreement of involved parties to sell goods or services in separate, yet interrelated transactions. But this takes place according to the rules and regulations of the involved countries, and they are obliged to fulfill these set of obligations if they wish to successfully carry out such a transaction.[4]

In recent times, countertrade has become such a global phenomenon that about twenty to thirty percent of international trade is done through it. One of the reasons for it becoming so widely accepted and followed is due to the debt crisis that the world is facing. This has directly affected multilateral trading and the international monetary system that was being applied all over the world since World War II.[5]

Along with that, the process of economic development in many of the countries, that have a developing or nonmarket economy, has been impeded by developing countries due to their incompatible economic system. This incompatibility is mainly due to the implementation of varying political and economic theories to trade along with the immense control of central government over aspects such as industrial and manufacturing development.[6]Nonmarket and developing countries are using countertrade as a tool in order to advance the economic development, along with overcoming the debt problem which has led to an increase in unemployment and minimum application of their industrial production capacity.

Countertrade generally takes place in situations when,

[4] Erwin Amann and Dalia Malin, "Risk Sharing in International Trade: An Analysis of Countertrade," *The Journal of Industrial Economics* 42, no. 1 (1994): pp. 63-77.
[5]Scott J. Lochner, "Guide to Countertrade and International Barter," *The International Lawyer* 19, no. 3 (1985): pp. 725-759.
[6]See supra note 3

1. One or both the parties interested in trade lack the funds to pay, or don't want to use their scarce currency reserves.[7]
2. It helps in maintaining a nation's established export prices while they face decline in demand.[8]
3. A nation's goods or services that they wish to export may have limited market value in foreign markets with which they wish to trade.[9]

Most countries are facing one or more of the given conditions, and hence they follow countertrade. It is also widely requested or followed by governmental formal (law or regulation) or informal (guidelines or recommendations) policy.[10] In times when the world is facing economic uncertainty and the global industry is undergoing reforms, countertrade has appeared as an ideal solution for both developed and developing countries in order to increase exports and national economy for promoting economic growth.[11]

A close look into the different types of countertrade shows that they cannot be standardized; rather all of them are unique in their own way. Thus, the different types or categorizes of countertrade should not be taken as rigid or mutually exclusive. Rather, one can find hybrid categories evolving in order to fulfill the needs of a particular transaction.[12]

[7] See supra note 5
[8]Ibid.
[9]Ibid,
[10]See supra note 6
[11] John C. Griffin Jr. and William Rouse, "Counter-Trade as a Third World Strategy of Development," *Third World Quarterly* 8, no. 1 (1986): pp. 177-204.
[12]See supra note 5

2. Meaning and Definition of countertrade.

Countertrade is an important tool for maintaining trade balance, while overcoming the deterioration that it previously faced. It is described as the process of linking imports of goods to the exports of the supplying country in exchange of goods between two parties in lieu of the use of foreign exchange.[13]The term Countertrade infers to a variety of trade arrangements through which the seller is required to provide the buyer with the product they need and in return, the seller takes some or all of the payment in a form that is not money.

Generally, the process of countertrade is not bound by one single law.[14] It is rather a negotiation done to carry on trade even when the country making the demand doesn't have ample money to pay for it. Countertrade helps the buyer in purchasing goods from the seller by making sure that scarce or restricted flow of cash happens across the buyers national boundaries, while still managing to get hold of the good or service that was in need.

Thus, we can describe countertrade as a trading method in which a country does not necessarily need to spend money in order to obtain a good, service or arm weapon. Such a transaction could rather comprise of a parallel set of obligations in which the involved parties agree to sell goods, services or arm weapons to each other in separate, but related transactions.[15] This implies that for any transaction to happen according to countertrade, an essential set of rules are imposed by one nation on its trading partners belonging to other nations. These obligations are

[13]See supra note 2
[14] See supra note 5
[15]Ronald Matthews, "Butter for Guns: The Growth of Under-the-Counter Trade", The World Today, Vol. 48, No. 5 (May, 1992), pp. 87-92, Royal Institute of International Affairs, Available at, https://www.jstor.org/stable/40396400, (Accessed January 20, 2020).

viewed as a kind of license to carry on business by exchanging goods or services between two or more parties without paying foreign currency.[16]

3. Background/Historical Examples of Countertrade.

There are many methods existing in the field of international trade that involve financing through banks or financial trade houses. But in this section, I will briefly talk about countertrade and its background, along with its evolution. Barter trade is the oldest method of trade and the basis from where countertrade evolved with time. The term Barter means trading goods in exchange for goods rather than money. This system was carried out through mutual trust and benefit, and was a bilateral relationship based often on personal ties. Barter was one of the earliest trading systems that were present before the advent of currency. The oldest usage of barter trade can be traced back to the primitive tribes. It was also used widely in the south eastern coast of Arabian Peninsula in pre-Islamic time period where goods were exchanged from Egypt and Syria exchanged for those from India, China and Indonesia.[17]

After the advent of Islam, Muslim traders started using the barter trade system in the absence of any other trade model being present. These transactions were done keeping the guidelines of the Holy Quran and Sunnah strictly in view. The Holy Quran clearly gives guidelines in its verses stating:

> *"Give just measure and cause no loss (to others by fraud). And weigh with scales true and upright. And withhold not things justly due to men, nor do evil in the land working mischief."* [18]

[16] See supra note 5
[17] See supra note 17
[18] Ibid

The Holy Prophet (PBUH) also taught his followers to be honest and just in their transactions to the extent that any deficiency in the good or commodity was to be clearly told and shown to the buyer. In one of the hadiths, the Holy Prophet (PBUH) said:

> *"Sell gold for gold and silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, of the same kind for the same kind, of the same quantity for the same quantity, and the same quality from hand to hand, and if they differ from each other in quality, sell them as you like but Some hand to hand."*[19]

The Holy Prophet (PBUH) guided the Muslims about the proper way of conducting business. For this purpose, He not only appointed an inspector to make sure that no unlawful trading happened, but he also made personal visits to the marketplace in order to advise traders to follow moral principles for conducting trade.

Muslim traders brought different merchandises to Indonesia, Samarkand, China and Bukhara and exchanged and imported other goods such as spices and silk. In the same time span, several centuries before the construction of the Suez Canal, they reached Morocco and Spain to bring back ebony and ivory from Africa. Between fifteenth and eighteenth centuries, the term barter system was mostly utilized by Spanish inter-colonial traders who were unable to adjust easily towards the innovative changes in science, technology and socio-economic situations.[20]

As far as the eighteenth century started, the industrial technologies were revolutionized and monetary system was introduced in most countries of the world. As a result, the percentage of the barter system usage started reducing increasingly. The eighteenth and nineteenth centuries saw a

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[19]Ibid.
[20] Ibid.

great shift from the traditional barter system towards modern monetization in the industrial world.[21]

After World War I, countertrade emerged again in the industrial world when it saved the German economy from the post war collapse. But the practice acquired its place in industry after World War II, when the Soviet Union and its Eastern bloc Allies used countertrade to extinguish political and economic restrictions on East-West trade.[22] The friendly nations in West started using it in an informal manner among them because Western bank credit was very difficult to achieve.

In the beginning of early 1950s, the agriculture department of US government initiated barter under certain circumstances.[23] Simple barter was used by the US government during 1950 to 73 to import strategic material from abroad to supply services asked by US government agencies. As a result, agricultural merchandises worth $6.65 billion were bartered under this program.

In 1970s, the world trading system was disrupted badly by a sharp rise in oil prices which were increased by the Organization of Petroleum Exporting Countries (OPEC).[24] This resulted in marking countertrade an important method of international trade. Since 1970s, arms have been exchanged with oil by OPEC and developing nations. Some of the OPEC nations such as Saudi Arabia, Venezuela and Indonesia required more refined and distinguished products to be manufactured and exported by developing countries. The production of some petro-chemicals, vegetable oils, urea, phosphate and steel require markets. The OPEC nations ask developed

[21] Dalia Marin and Monika Schnitzer, "A Theory of Countertrade with Evidence," *The American Economic Review* 85, no. 5 (December 1995): pp. 1047-1064.
[22] See supra note 5
[23] See supra note 11
[24] See supra note 5

countries to buy these products from them in terms of bilateral trade, production procedure, and investment.[25]

All the countries pursue barter in crude oil as an easy arrangement to obtain different sources of energy. Nowadays, most of the European countries are involved in barter of oil as "purchasers" and in this international trade oil is used as a "cash commodity". There are some recent examples to show this new trend: Saudi Arabia paid the quantity of oil equivalent to the price of airplanes to obtain ten Boeng 747's. Abu Dhabi exchanged oil with Mirage 2000 aircraft worth U.S $400 million from the French aerospace company "Dessault". [26]

4. Types of Countertrade.

There are main five types of transaction in countertrade e.g. barter, counter purchase, buy-back, offsets and advance purchase.[27] There is one common characteristic in all these transactions: a seller offers some products and services to a buyer, and in return the buyer promises to provide the services and goods required by the seller.

4.1. Barter.

The term "barter" is mostly used to illustrate all types of countertrade. In barter, there is a direct exchange of product-for-product (or service-for-product or service-for-service or product-for-service) without use of money.[28] The Article 607 of Law of Civil Transaction of UAE defines

[25] See supra note 11
[26]See supra note 3
[27] Jean-Francois Hennart, "Some Empirical Dimensions of Countertrade," *Journal of International Business Studies* 21, no. 2 (1990): pp. 243-270.
[28] See supra note 5

barter as the exchange of property, or a property right without the consideration of monetary terms.[29]

Although barter is considered as the oldest form of trade, yet a synchronized mutual satisfaction in performance does not exist anymore.[30]In contemporary times, barter agreements are contracts that are carried out over several years, generally for fungible goods like raw materials or agricultural products that allow the determination of quantities easily. According to a transaction based on barter, two persons or companies make a mutual agreement to exchange merchandises or services. A single contract comprises of the transaction; this defines no exchange of money between the parties. Sometimes special costs need to be covered with a small amount of money, or a down payment is required as a guarantee.[31] The contract should define two basic terms: two parties are engaged in a two-way exchange of goods, and the two deliveries in consideration to each other.

It is necessary that both the parties involved in barter trade should agree upon, and be satisfied by the quality of the products that are to be exchanged. As no funds get transferred in barter, the contract for it should comprise of parallel bank guarantees in the form of standby letters of credit. Other than that, in case of default, the non-defaulting party has the leverage of obtaining payment in the form of hard currency from the other party's bank.[32]A flow of goods between two parties on equal basis shows they are equal in value. Meanwhile, partial barter trade comprises of payment done with some percentage in the form of cash, and the rest in the form of goods. The amount and quantity for a negotiation are measured in terms of barrels, bales, tons, liters or other

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[29] See supra note 17
[30] Rolf Mirus and Bernard Yeung, "Economic Incentives for Countertrade," *Journal of International Business Studies* 17, no. 3 (1986): pp. 27-39.
[31]See supra note 3
[32]Ibid

physical measurements. The negotiators use the amounts to a shadow price in order to define the trading value of each product in consideration to the value of the other product.[33] In case one party causes a breach in fulfilling its portion of the obligation, the other or non-breaching party can ask for immediate payment following the pre agreed price and currency, instead of having to wait for the bartered product to be delivered.

Therefore barter is useful in situations when it,

- Bypasses price controls, whether public or private.
- Bypasses exchange controls.
- Bypasses creditor's monitoring of imports.[34]

An example of simple barter is the $200 million exchange of frozen lambs for crude oil between the countries of New Zealand and Iran.[35]

4.2. Counter-purchase.

Counter-purchase has been discussed in detail below:

4.2.1 The Concept of Counter-purchase.

Counter-purchase is the type of countertrade that involves the first party agreeing to sell goods to the second party, along with having a separate but related agreement with the second party for purchasing other unrelated products.[36] In this situation, the first party agrees to certain

[33]Ibid.
[34] See supra note. 30
[35] See supra note 11
[36] Thomas B. McVey, "Countertrade and Barter: Alternative Trade Financing by Third World Nations," *Maryland Journal of International Law*, no. 6 (1981): pp. 197-220.

conditions for providing a specified product that include quality, quantity, along with time and place of delivery.

The counter-purchase contract can be defined in terms of a transaction that involves the seller to provide the buyer with deliveries. This is done by agreeing through a contract for purchasing goods from the buyer equal to the agreed percentage of the original sale contract value.[37]

One of the examples of counter-purchase is the 1989 contract signed between PepsiCo and the former Soviet Union of $3 billion, in which PepsiCo agreed to purchase and market Russian Vodka and ten Soviet-built ocean vessels. In return for this, PepsiCo agreed to double its Soviet bottling network along with nationwide distribution of soft drinks to be done in aluminum and plastic bottles.[38]

4.2.2 Distinctive features of Counter-purchase.

Three separate yet inter related legal instruments make up the contractual triangle for conducting a counter-purchase transaction and when considered together, lead to establishing the terms and conditions of a deal. These are as follows:

i. The principal contract for any transaction follows the cash in exchange for goods rule.
ii. The contract for a counter-purchase transaction is based on the condition that the original seller is obliged to purchase goods from the buyer.

[37] See supra note 3
[38] Belay Seyoum, "Countertrade: Export-Import Theory, Practices and Procedures", Routledge, New York and London (2009), 2nd ed., pp. 271-291,

iii. The two contracts are joined together by a protocol that acts as an instrument for making both parties to agree to commit themselves for entering their respective contracts by purchasing the other party's goods.[39]

The first two points that talk about contractual obligations need to be seen as distinctive transactions that have separate contracts as well as currency payment. These agreements are done separately for allowing financial arrangements and risk guarantees along with insulating the obligations of the two transactions from each other.

1.4.2.2.1 Two Distinct Contracts.

A transaction according to the rules of counter-purchase is based on conducting two separate agreements for purchase that are "linked" under a single heading or protocol.[40] These two agreements for sale are negotiated and carried out at the same time. The first agreement would normally comprise of a standard contract for transnational sale of products in which the first party consents to be responsible for providing a specified product under certain conditions of quality, quantity, time and place of delivery. Such a transaction lasts for the duration of only one to five years.[41]

For a counter-purchase transaction, a price is specified and hard currency is required to be paid upon delivery. A second agreement in which the first party consents to purchasing goods from the second party is often more loosely structured and has a broader scope. On many occasions, the first party agrees at a firm price for carrying out the purchase of a set amount of specified goods at the time of completing the first transaction.

[39] See supra note 33
[40] See supra note 39
[41]See supra note 1

1.4.2.2.2 Two Distinct Payments.

A counter-purchase transaction includes doing two distinct payments in the same manner as two distinct contracts. A prearranged price is most likely to be accepted in hard currency. In this way, the price under principle contrast and for a contract based on counter-purchase has to be decided in the same currency in order to make sure the transaction does not get affected by the impact of fluctuations in exchange rate.[42] In case the first party can select what goods it wished to purchase over a certain time period, the price is generally expressed in the form of a formula. For performing a successful counter-purchase contract, a level of non-determination is sought for. Thus, the price formula in the framed contract permits a future estimation, while conducting the purchase to avoid any hassle in the event of world price changes. Any commitment of reciprocal purchase is given in the form of either currency or instead as percentage from the principal contract which may vary from up to ten to hundred percent.

4.3 Buy-back.

4.3.1 The Concept of Buy-back.

Buy-back can simply be considered as a mutual track of wants. In a buy-back contract, a seller can make a long term agreement for the sale of a plant, technology or equipment to a buyer in exchange of some other products resulting from that product construction. The products can be in the form of raw material, semi-finished or finished goods. [43]In the buy-back trade, capital goods are imported to give back the future results of the products invested in this respect. This investment is mostly done in the local economy to cause the national economy to exceed. While the process of construction of goods is in development phase, the output makes the local economy experience

[42]See supra note 3
[43] See supra note 17

an adverse change in the current account. In the buy-back transaction, several parties can take part. It normally comprises of the capital products, loans, infrastructure support, management and technology that result in the establishment of turn-key plant in the buyer country by the seller. Industrial cooperation is considered the key point of buy-back transaction.[44]

The buy-back contracts relating to cooperation agreements are defined by the United Nations Commission for Europe as:

> *"a particular type of long-term industrial cooperation agreement between two or more partners from different countries which provides that one of the partners will deliver, usually on credit, some equipment, licenses and know-how for the construction of industrial installations and the other partner will deliver, over several years, products manufactured in these installations in payment for the imported equipment and technical know-how".*[45]

Example,

The American company named Occidental Petroleum is the best example of buy-back. They made an agreement of exporting $20 million ammonia to Soviet Union resulting in construction of ammonia plants. They made a contract of purchasing quantities of ammonia from these plants for a period of 20 years.[46]

[44] Johannes Jacobus van Dyk (2014).
[45]See supra note 3
[46] See supra note 17

4.3.2 Distinctive Features of Buy-back.

The Buy-back deal comprises of two different agreements that is similar to counter purchase.[47] There is only one difference that the merchandises delivered and the counter-products resulting from the plants are closely related. In buy-back transaction, the second party pays in the form of output of the plant to the first party. A United Nations expert's group recommends the price formulae on international contracts;

1. Product needs to be put forward at the market price along with appropriate commission;
2. Every shipment should have a separate contract on pricing through negotiation;
3. Price should be determined periodically after every three, six or twelve months.[48]

Product quality is very important to get assured because different countries have different standards of the quality of things. Specifications of the product should be mentioned clearly in the agreements because it can lead to avoid further argument on quality.

A schedule for annual production should be designed to coordinate the product purchases with output. The first party cannot afford any storage costs, surpluses or delay in supply. It should also be paid for the technology and supplied equipment. A special committee should be developed to look for the problems occurring during the performance of the contract, and day-to-day execution is left totally on the second party. There is a guarantee of sale under the buy-back transaction. The maintenance of machinery, under good working condition, is the responsibility of the second party so the output would be produced in time.[49]

[47] See supra note 33
[48]See supra note 3
[49]See supra note 3

The obligation in buy-back can range from 10 to 100 percent. It involves only the percentage of the production when the second party requires production for local needs. The ratio is considered and managed according to the price, equipment and technology used in the plant. The time period to give back the output can range from five to twenty years.[50]

4.4 Offsets.

Offset is the type of Countertrade that consists of undergoing a commercial transaction or a series of transactions in which other than the procurement order, the exporter is also supposed to supply products, services, investment technology and skill set.[51] Along with that, it is also required of the exporter to not only hire subcontractors from the country they are importing to, but also use raw material or components originating from that country.

Arrangements like these are mainly used for the purpose of carrying on defense-related sales, selling commercial aircrafts or other high-technology products. Offset purchases are done in order to act as a compensation for the huge hard-currency payments as a result of the purchase. It also helps in creating investment and employment opportunities, and thus, is widely used by developed countries.[52] Other than that, offset countertrade is important as it contributes in helping infant industries to grow in buyer countries, and also in protecting local market while creating jobs and employment opportunities. Offset also helps justify economic benefits of spending, helps in reducing the negative effect on balance of payment, and helps in creating a competitive environment for industries from the view point of the seller.

Example,

[50] See supra note 33
[51] See supra note 17
[52]See supra note 41

One of the examples of an offset transaction is when Netherlands purchased patriot fire units for $305 million from Raytheon Corporation of United States. Raytheon had agreed to pay $115 million in direct offsets and $120 million in indirect offsets. In case of US purchasing goods and services from Netherlands, the latter obligation was to be discharged.[53]

4.4.1 Types of Offset.

Offset transactions are divided into two types; Direct Offset and Indirect Offset.

4.4.1.1 Direct Offset.

A transaction based on direct offset comprises of the seller being obligated to include locally produced content in the product it intends to sell to the buying country or company.[54] Direct Offset is used in the case when produced equipment's are sold and the country manages to achieve its industrial developmental goals. Coproduction or production through a subcontractor, investments, and technology transfers are included in direct offsets.

1.4.4.1.2 Indirect Offset.

An indirect offset is an arrangement carried out through a contract which includes goods and services acquired or produced in the purchasing country that are unrelated to the exports.[55] These goods or services can either be in the form of other products, raw materials, or they can be industrial equipment, technology or any other form of service.

[53]Ibid
[54] See supra note 47
[55]See supra note 41

4.5 Advance-purchase.

4.5.1 General remarks on Advance-purchase.

Advance-purchase is the type of transaction which includes the exporter purchasing certain products from the importer in advance, with the hopes of a future export too. This is also known as anticipatory purchase as it is carried out with the expectation of a future purchase, or as reverse counter-purchase.[56] Advance purchase is different from counter-purchase and barter, but it still includes exchange of goods in return for goods under separated contracts.

Parties involved in this type of trade present commercial certificates which decrease risks entailed in advance purchases. In the process of advance purchase, a certificate guaranteed by the central bank or foreign trade bank of the country is required from the importer.[57]

The certificates are needed to be prepared transferable to third parties. The use of commercial certificates could increase the ratios of higher countertrade, as it lessens the resistance to higher demands due to certificates transferability. Further, the countertrade has been made more flexible after the introduction of two additional innovations presented by the parties. The first one is that the goods are exchanged on the basis of a letter of intent. The so-called general agreements are considered to be the second innovation. The parties who have long-term business relationships are usually involved in utilizing these innovations. The duration of the contract is usually fixed within four to five years.

[56]Amanda Perry-Kessaris, “Legal Implications of Countertrade in an Economic Context,” *SSRN Electronic Journal*, 1996, https://doi.org/10.2139/ssrn.1438177.
[57] “Part II- Countertrade,” *Soviet and Eastern European Foreign Trade*, 1989, pp. 41-95-97-132.

4.5.2 Why Advance-Purchase?

A transaction based on advance-purchase attempts to generate hard currency for either meeting the demands of a countertrade transaction or in order to maintain trade relations. This involves doing an advance purchase and concludes allotting the revenue for succeeding exports.[58] It results in a secured payment for the exporter in his later exports. The pressure on parties is eliminated in selecting counter delivery goods quickly. It also extinguishes the fact of penalties due to the long time period of counter delivery of goods.

4.6 Other Types of Countertrade.

There are two more types of countertrade i.e. Switch Transaction and Build-Operate-Transfer but that are not much used as compared to the other types.

4.6.1 Switch Transaction.

A "switch" transaction denotes a three-way transaction in which three parties (nations) are involved.[59] First and second party make an agreement to exchange goods mutually, but later the second party discovers that it does not have enough hard currency to fulfill the requirements under the contract. When the first party does not show any interest in purchasing second party's products, the second party sells its commodities to a third party. The third party either pays in the form of currency to the first party, or delivers goods required and liked by the first party to satisfy the mutual obligation of the agreement made by the second party. There is switching of destinations and documentations on the high sea involving many buyers, brokers and markets in this transaction so that it becomes extremely risky. It becomes beneficial for the original seller because the third

[58] Abdol hossein Shiravi Khozani (1997)

[59] See supra note 39

party pays in the form of currency for goods to him.[60] The third party can demand a big amount of discount from second party on the commodities delivered.

Example:

An U.S. company makes an agreement to provide fertilizer to Pakistan but the U.S. seller does not have any interest in the goods made and to be delivered by Pakistan. A switch trader (a Romanian company) buys Pakistani goods and pays cash to the U.S. exporter preserving its commission.[61]

4.6.2 Build-operate-Transfer (BOT).

Build-operate-Transfer (BOT) refers to transactions involving significant projects of infrastructure in power, toll-roads, transport sector, industries and dams. There is involvement of foreign association of investors and suppliers with local partnership. The projects are completed for profit over fixed number of years. After completion, they are transferred to a pre-agreed entity (private or government).[62] The revenues that are generated and gathered from the projects are usually used to pay for the equipment and services, the suppliers of the machinery, any debt and the cost over running the operation. Contracts are made to fix the terms and condition, and the time period for completion.

Example,

There is a good example of the construction of motorways in Pakistan. Korean company made the contract to construct motorways in Pakistan. They completed the project and generated

[60]Agia Hanna Meleka, "The Management of Barter in International Affairs: Opportunities and Limits," *World Affairs* 149, no. 1 (1986): pp. 49-53.
[61]See supra note 41
[62] See supra note 47

money from tolls for many years. After that they handed it over to Pakistan government and went back.

5. Advantages of Countertrade.

There are many benefits of countertrade. It is considered to be significant in acting as a tool for solving several international trading issues. Countertrade can be utilized in securing reliable sources of raw material. It can also ensure intermediate products over the long term transactions. It can also be beneficial in utilizing outdated products in exchange.[63] Many countries rely on countertrade to comply for their basic necessities.

The main advantages of counter trade have been discussed below.

5.1 Countertrade as a Development Tool.

In many countries, countertrade is deemed more profitable for their development in comparison to conventional trade that involves currency. These mostly include third world and developing countries. These countries are utilizing countertrade in order to develop sectors like industry that include defense, technology and energy plants.[64] This is why third world countries are more and more taking up countertrade as an important element of their international economic interaction. In times such as now, when there is economic uncertainty, illiquidity and realignment of industry globally, countertrade has appeared as a solution. This is because countertrade helps third world and developing countries in economic growth, by helping in increasing exports and creating economic diversification. As international trade is one of the foremost pillars in the economic development of third world or developing countries, therefore they prefer to use countertrade instead of conventional trade due to weak financial conditions. Thus, it can be said

[63]See supra note 1
[64] See supra note 11

that countertrade helps such countries to try to achieve targets that they have laid down in national plans, along with allowing them to gain control over the other problems.[65]

5.2 To Access new Markets.

Countertrade opens up new opportunities in the market for trade. This happens as countertrade leads the developing countries to acquire foreign goods needed in their country, while developed countries get an opportunity to sell goods that they might be having a difficulty in selling for exchange of cash in the market.[66] In this way, we can say that countertrade contributes in paving the way for economic interchange between countries that have a market for their goods, and the countries that fail to sell their goods in the market. This leads to creating opportunities for sale and currency generation that was not possible in the case of conventional trade, along with paving way for trade into difficult markets. Often countries are unable to sell goods or products in the international market due to a tough competition with others.[67] But countertrade can help overcome this problem as it provides the seller with new opportunities to set up market for their goods, build a reputation and have agreements for selling with other parties that can benefit both parties in the long term. In this way, countertrade is taken as a method to pave way for developing countries to sell their goods to western developed market.

5.3 To Avoid Currency and Debt Crises.

A party or country can overcome their financial issues such as debt created through trade or blocked funds by using countertrade. In situations in which a company does not receive timely payment for its exports and has a restriction imposed on it returning its secondary earnings from

[65] See supra note 17
[66] See supra note 5
[67] Raj Aggarwal, "International Business Through Barter and Countertrade," *Long Range Planning* 22, no. 3 (1989): pp. 75-81.

foreign markets, countertrade can be a very useful method to lessen their financial problems. They can also acquire goods without having to face debt crisis due to trade.[68] Through countertrade, a country can easily import goods or services that are their essential need, without having any effect on their foreign currency reserves which might be scarce. Countertrade is also being used as a means of earning hard currency along with creating export opportunity for their domestic output.

It is being opted as the primary trade method largely by the poor countries of the world that do not own hard currency for trade. Through countertrade, they not only acquire the goods and services they need, but they also save themselves from financial debt and payment imbalance.[69]

5.4 Access to Technology.

Another advantage of countertrade is that third world or developing countries can use it in order to bring new technology to their country. This happens when they use countertrade as their transaction mode as they do not have enough funds to carry out conventional trade and therefore, they can avoid taking debts in this way. A developed country may provide funds, equipment and technology to a developing country in exchange for raw materials or other scarce resources. This technology and equipment can later be used by the developing country in order to properly utilize these raw materials.

An example is when Western firms supported Saudi Arabia in developing its oil refinery and petroleum industry in which Saudi Arabia had to provide them the right to purchase a certain amount of oil in exchange over a decided time period.[70]

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[68]See supra note 41
[69] See supra note 63
[70]See supra note 41

Providing services in return for goods is also a feature of countertrade which can lead to the training of professionals of a developing country in using the latest technology. These trained people can contribute to the development of their country by bringing about technological reforms over the course of time.

6 Disadvantages of Countertrade.

In regards to countertrade, many countries and trade organizations have some reservations which are discussed below.

6.1 Double Coincidence of Wants.

One of the main arguments presented against countertrade is the probability of having double coincidence of wants. This is one of the biggest issues that might cause a hindrance in successfully carrying out a countertrade transaction. This issue takes place when out of the two countries that want to do a transaction based on countertrade, one country is able to provide the required goods, but the other party doesn't own the goods that are needed in exchange. Thus, both parties involved in such a deal need to own goods that the other party needs.[71]Countertrade can only take place systemically when both parties carrying out it can provide for the diverse needs of the other party. Only be overcoming the double coincidence of wants can a successful countertrade deal be carried out by trading parties.

6.2 The Initial Exporter does not Need Available Products.

Another disadvantage of countertrade can be the situation when the initial exporter does not need the products that were previously agreed upon by both parties during contract. This happens because the agreement of countertrade does not clearly define aspects of the goods such

[71] See supra note 70

as the quality of the good and its market value. In order to overcome this issue, the exporter needs to be given the right to have the products they aim to buy inspected by a third party before they are delivered.[72] Other than that, a warranty of goods on behalf of the seller can be included in the contract, assuring the buyer that the product they will get will be substantial in reference of quality in price compared to other similar products available in market. This helps in saving the seller from getting pressurized by the buyer to give them discount or the buyer from cancelling the deal at the last moment.

6.3 Quality of Goods is Poor.

Another disadvantage of countertrade is that the quality of products is often compromised by being not substantial enough. This happens to be a big factor considered by the parties planning to carry out a countertrade based transaction, as the goods offered in such a transaction might be low in quality and high in price. A further complication in this situation is that it is not easy to determine and agree on the quality of the good at the time of the contract as it has no specification about quality in the contract. Therefore, it gets difficult for the buyer to confirm that the products they will acquire as a result of countertrade will be of substantial quality.[73] It gets very problematic for the exporter, as an uncertainty exists about the quality of the product and its availability during the process of carrying out the transaction. This is caused by an absence of a detailed description of the product in the contract. Adding more clauses in the contract about the quality of the product can lead to overcoming this problem.

[72] See supra note 5

[73]See supra note 59

6.4 Lack of Standardization.

At the time of generating a contract, the commodities which are going to be countertraded are classified as members of a list of possible goods. They are bought at a future date, therefore making it impossible to set a price at the time of designing a contract. The law of a contract can be applicable and defined in two ways. Either a court can regulate it or it can be organized by the parties involved in countertrade. Both these methods can defy problems in countertrade deals. Two major problems can be defined in the application of law during the procedure of the countertrade contracts.[74]

Firstly, there are the cases in which requirements of both the parties are contained in the same contract. The problem occurs in regards to where to decide the main obligation as the foremost characteristic of the contract. Second is the situation in which requirements of both the parties are contained in separate contracts. Each obligation may be defined with a different law. As a result, organizations prefer cash trade over countertrade to avoid complications. Many countries lack organizational capabilities, information and distribution channels needed to endorse their exports. Countertrade is considered more complex and lack standardization rather than conventional trade.[75]

7 Conclusion.

Countertrade is an innovative method of trade that has gained immense popularity all over the world. This type of trade involves an exchange of goods between two or more parties without necessarily involving payment in the form of hard currency. Rather, it consists of payment in the form of goods and services. The concept of countertrade has not birthed in the recent times, but

[74] Ibid
[75]See supra note 1

has existed in history since the beginning when man started exchanging goods at the time when currency did not exist. This was called barter and that is known as the earliest forms of countertrade. Later, with changing times and evolving global economy, different types of countertrade were formulated out of which the main five types have been discussed in the above chapter. But these different types of countertrade do not exist in isolation, rather they are inter related and being used together in order to fulfill the requirements of the countries that wish to participate in countertrade.

Countertrade has helped countries in overcoming their economic and developmental issues. It came into prominence due to the debt crisis that was dominating all over the world and was contributing in damaging the world's economy. In this situation, countertrade has risen up as a solution for developing third world countries by avoiding financial debt in order to obtain goods that are much needed in their country. This has helped boost the economy of such countries, and is an important step in the way of providing them economic stability in the long run. About twenty to thirty percent of trade happening all over the world is being conducted by following countertrade. It is deemed more beneficial in comparison to conventional trade as a countertrade transaction does not have any effect on a country's currency reserves, which might be scarce. In this way, countertrade allows them to achieve their national targets while also increasing the exports of their country.

Countertrade has also opened new avenues of trade as many countries have found market for their products through it. This is helpful as any country owning a certain product in excess can exchange it with another country for a product they need. Hence, the developing countries manage to get the foreign goods needed in their country, while developed countries get the opportunity to sell goods for which they lacked a market. Other than goods, a country can also receive services and technology in exchange for goods that can help in having more professionals of different fields in their country.

Certain rules and regulations are involved in countertrade which is decided by the parties that wish to take part in such kind of trade at the time of designing a contract. A few loopholes in these contracts can cause hindrance in the way of carrying out a successful transaction based on countertrade. This might happen when a country involved in countertrade fails to provide the required products to the party interested in buying. Other than that, the provided product might not be of substantial quality according to the needs of the buyer, or can be overpriced. This issue rises as the trading contract might lack any specification in regards to the quality and price of goods. Thus, we can say that in order to carry out countertrade without facing such issues, more attention needs to be paid to technical issues while designing the contracts. And also it needs to be based on not just the demands of one party, but rather according to the wants and needs of both parties involved in the contract.