Question No.5 What is counter trade? Discuss the various forms of counter trade. What are the pros & cons of counter trade from firm's point of view.

Solution: Countries facing balance of payment difficulties encourage countertrade as a means of financing imports. Under countertrade, imports are paid for, not in the form of convertible money, but in the form of goods. Countertrade is an umbrella term, encompassing various different types of trade transactions, in which payment is made either wholly or partly in the form of goods. Countertrade refers to the reciprocal and compensatory trade agreements involving the purchase of goods or services by the seller from the buyer of his product, or arraignments whereby the seller assists the buyer in reducing the amount of net cost of the purchase through some form of compensatory financing.

As both the volume of world trade and the number of participants have grown, countertrading techniques have become numerous and advanced. As stated by the UN commission on international trade law: "countertrade is now common between developing countries, between developed and developing countries and between developed countries. Moreover it is taking place irrespective of whether there exists an institutional framework, i.e. government agreements, for it or not."

Countertrade activities fall into three main categories

1) A means of financing – often where the buyer is short of foreign exchange- with no, or only a partial, exchange of money between the original buyer and the seller;

2) A trading technique aimed, perhaps, at developing a new export market or boosting existing volumes of export business;

3) A means of balancing trade for either economic or political reasons – this was most frequently the case with the east European countries.

The bilateral trade India had with the erstwhile Soviet Union and some East European Countries, for example, was a form of countertrade. Our imports from these countries were being paid in foreign non-convertible rupees which the exporting countries had to use for purchases of goods and services from India. Countertrade takes several forms other than the bilateral trade referred to above.

1. Counterpurchase: The exporter has to undertake to purchase specified goods from the importing country of a value which is an agreed proportion of his exports. Obviously, the specified goods will be such as do not have a ready international market.

2. Offset: Compensatory, reciprocal trade agreements for industrial goods and services as a condition of military-related export sales and services. It is also used in the purchase

of civilian aircraft and has become the norm in the aerospace/defence sector. Offset is divided into two categories: indirect offset and direct offset. indirect offset involves goods and services unrelated to the aerospace/defence material being sold. Direct offset involves compensation in related goods and usually involves some form of co-production, license or joint venture.

3. Buyback: The exporter of capital goods is obliged to buy a specified proportion of the production for which the importer is using the capital goods. A petrochemical plant may be imported and the seller of the plant has to buy a proportion of the output in payment of the cost of the plant. Another example, textile machinery against textile manufactured with it or gas pipelines in exchange for natural as transported through them.

4. Barter: The exchange of goods or services of equivalent value without the use of currency.

5. Technology Transfer: The transfer of technology mandated as part of a countertrade or of7set agreement, other than coproduction or license production. It may be in the form of research and development, technical assistance and training, or patent agreements between manufacturers. This is central to many Third World enterprises, public and private, and is the focus of a large number of countertrade and offset deals.

The “reciprocity” which is a feature of virtually all forms of countertrade falls into several different categories, most of which are of greater benefit to the buyer or importer than to the seller or exporter. While countertrade provides a way of boosting trade between countries with non-convertible currencies and markets are opened up on both sides which otherwise would not have existed, it has its own disadvantages. The practice of countertrade impedes time functioning of a free market and has the potential to create severe economic distortions, for example, to prices. Countertrade involves lengthy and protracted negotiations; documentation is complicated, weighty and expensive, also driving the true “cost” of the transaction even higher. Countertrade is ultimately inflationary.