



**ISLAMIC DEVELOPMENT BANK
ISLAMIC RESEARCH AND TRAINING INSTITUTE**

COUNTERTRADE: POLICIES AND PRACTICES IN OIC MEMBER COUNTRIES

**Seminar Proceedings Series
No. 24**

ISLAMIC RESEARCH AND TRAINING INSTITUTE

Establishment

The Islamic Research and Training Institute (IRTI) was established by the Board of Executive Directors of the Islamic Development Bank (IDB) in 1401H (1981.) The Executive Directors thus implemented Resolution No. BG/14-99, which the Board of Governors of IDB adopted at its Third Annual Meeting, held on 10 Rabi Thani 1399H (14 March 1979.) The Institute became operational in 1403H (1983.)

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The purpose of the Institute is to undertake research for enabling the economic, financial and banking activities in Muslim countries to conform to *Shari 'ah*, and to extend training facilities to personal engaged in economic development activities in the Bank's member countries.

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- (a) to organize and *coordinate* basic and applied research with a view to developing models and methods for the application of *Shari 'ah* in the fields of economics, finance and banking;
- (b) to provide for the training and development of professional personnel in Islamic Economics to meet the needs of research and *Shari 'ah* observing agencies;
- (c) to train personnel engaged in development activities in the Bank's member countries;
- (d) to establish an information center to collect, systematize and disseminate information in fields related to its activities; and
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The President of the IDB is also the President of the Institute. The IDB's Board and Executive Directors acts as its supreme policy-making body. The Institute is headed by a Director responsible for its overall management and is selected by the IDB President in consultation with the Board of Executive Directors.

The Institute consists of three technical divisions (Research, Training, Information) and one division of Administrative and Financial Services.

Location

The Institute is located in Jeddah, Saudi Arabia.

Address

ISLAMIC DEVELOPMENT BANK
ISLAMIC RESEARCH AND TRAINING INSTITUTE
Postal Address: P.O.Box 9201, Jeddah 21413
Kingdom of Saudi Arabia
Cable Address: BANKISLAMI- Jeddah Telephone: 6361400
Facsimile: 6378927 / 6366871
E. Mail Address : IDB @ ISDB.ORG.SA Home Page: HTTP ://WWW.IRTI.ORG



ISLAMIC DEVELOPMENT BANK
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**COUNTERTRADE :
POLICIES AND PRACTICES IN
OIC MEMBER COUNTRIES**

Papers and proceedings of a seminar on countertrade jointly organized by the Islamic Research and Training Institute of the Islamic Development Bank and the Middle East Export Trade Center (OTIM), Istanbul, Turkey, held in Istanbul, Turkey during 19-21 December 1989.

Edited by

M. FAHIM KHAN

Seminar Proceedings - No.24

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ISLAMIC RESEARCH AND TRAINING INSTITUTE

King Fahd National Library Cataloging-in-Publication Data

Khan, M. Fahim - Jeddah

Countertrade: Policies and Practices in OIC Member Countries

252 P, 17 x 24 cm- (Seminar Proceedings — No.24)

1.Countertrade — Islamic Countries I. Khan, M. Fahim
382.956 4754/22

ISBN: 9960-32-114-2

Legal Deposit No. 4754/22
ISBN: 9960-32-114-2

The views expressed in this book are not necessarily those of the Islamic Research and Training Institute or of the Islamic Development Bank.

References and citations are allowed but must be properly acknowledged.

First Edition 1416H (1995)
Second Edition 1422H (2002)

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

In the name. of Allah, The Beneficent, The Merciful

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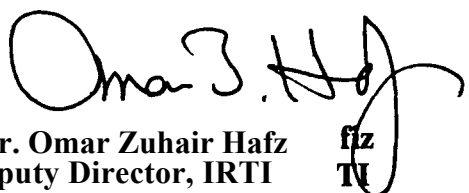
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FOREWORD

IRTI in its research activities pays special attention to areas relating to promoting trade and economic cooperation among member countries. Countertrade is viewed by IRTI as a potential means of enhancing trade among member countries and of promoting economic cooperation among them. Looking at countertrade as a very recent phenomenon, IRTI felt the need to create, among planners and policy makers, awareness about various facets of this new mode of trade and to exchange ideas on the possibility of exploiting this mode for their mutual benefit. It was against this background that a seminar on "Countertrade Policies and Practices in OIC Member Countries" was organized by IRTI in December, 1989 in collaboration with the Middle East Trade and Export Center, Istanbul.

This book contains the proceedings of this seminar which have been edited by Dr. Fahim Khan who, despite his involvement as Head, Research Division, found the time to undertake this task.

One must also express appreciation to Dr. Emin Carikci who was responsible for all the groundwork involved in making this seminar possible and to the late Dr. A.N.M. Azizur Rahman who was chairman of the Technical Advisory Committee that worked out all the technical details of the seminar and made the necessary arrangements to hold it in Istanbul.



Dr. Omar Zuhair Hafz
Deputy Director, IRTI

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MESSAGE OF THE PRESIDENT, IDB

Dear Brothers in Islam,

I profoundly thank the Government of the Republic of Turkey for providing the opportunity to host this important seminar in the historic city of Istanbul. The Turkish Government has always been very cooperative in the Islamic Development Bank's efforts to make contributions to the economic development of its member countries, and the Bank has always been appreciative of the Turkish Government's cooperation. I am also grateful to the Middle East Trading and Export Center of Turkey which has collaborated with IRTI in organizing this seminar which should prove to be very helpful in promoting trade and economic cooperation among OIC member countries.

Ever since its inception in 1975, the Islamic Development Bank has continuously been striving towards the expansion of trade cooperation among OIC member countries and has been regularly searching for additional ways and means to expand intramember country trade. Countertrade has recently emerged as a potential source of enhancing trade particularly among developing countries and, hence, of contributing to their economic development. Realizing this, the Islamic Research and Training Institute of the Islamic Development Bank decided to organize in collaboration with the Middle East Trading and Export Center of Turkey a seminar on the subject of countertrade to enable the officials in member countries to discuss in detail various aspects of this recently developed practice from the point of view of its implications for the economies of member countries and to explore the potential for utilizing this recently developed institution for enhancing trade and economic cooperation within the OIC. I am glad that with the concerted efforts of the two institutions, IRTI and OTIM, this seminar has been made possible.

I am grateful that the member countries have spared some of their senior officials to attend this useful seminar, and I am sure that their mutual deliberations will lead to some very useful policy recommendations for the IDB as well as for its member countries. I fully appreciate the efforts of those scholars who agreed to contribute papers and case studies for discussion in this seminar. These will, I am sure, turn out to be very useful documents and will help focus the discussion of the seminar.

- 1) It is worth noting that the seminar deliberations will not be confined to theoretical aspects of countertrade, pertinent to technical and legal matters and its present significance in international trade, but they will also cover the experience acquired, by some OIC member countries in this regard.
- 2) The seminar will tackle and scrutinize the present position of countertrade in OIC member countries, intertrade and its possible effect on promoting trade among Islamic countries and the role of the IDB in this domain.

It is relevant to mention that the IDB is also organizing a symposium on countertrade to be held in conjunction with its Annual Meeting of Governors scheduled to take place in Algiers on the 3rd of Sha'baan 1410H (28th February 1990). The purpose of this symposium is to obtain more clarity and a correct and concrete perspective on countertrade, before determining the role of the IDB in this trade activity.

- 4) The IDB is currently implementing three trade finance schemes. This fact expresses the stress it lays on trade as the engine of growth and the catalyst of production process. The assumed role of the IDB in countertrade could be regarded as complementary to the existing trade finance schemes. This may be feasible, for instance, if we suppose that these schemes can accord a sort of bridge financing, if required, to countertrade transactions in order to fill commodity commitment gaps.

- 5) Finally, I would like to emphasize that no successful countertrade activity can be performed by the IDB in the future, unless we have the right tools for this kind of trade exercise. Among these important tools, I include the continuous and regular flow of trade data and information and regular contacts with the concerned governments, agencies and institutions.
- 6) It is understood, however, that any effectiveness we can expect, *Insha-Allah*, from this exercise will greatly depend on the full cooperation and active participation of interested governments and all other parties involved.

I pray to *Allah Subhanahu Ta 'ala* to help you in your deliberations and I look forward to seeing very positive outcomes from this seminar.

Wa Assalam Alaikum Wa Rahmatullah Wa Barakatuhu.

INTRODUCTION

In its seventeen years of existence the Islamic Development Bank has proved to be a major catalyst in expanding trade cooperation among OIC member countries. Ever vigilant in this role, the Bank is continuously in search of additional ways and means of expanding intramember country trade. Countertrade is viewed at the Bank as a potential means of enhancing trade among member countries. Although countertrade is currently estimated to account for about one-fourth of world trade, it was realized that there was little general awareness in the member countries about the nature and scope of this mode of trade. The Islamic Research and Training Institute of the Islamic Development Bank decided to organize a seminar not only to create general awareness about the concept of countertrade, but also to explore the possibilities and potentialities of this mode of trade from the point of view of member countries and the IDB.

The specific objectives of this seminar were to study:

- i) the recently developed theory and practice of countertrade (CT) and to examine the role of different forms of CT mechanisms in international trade during the first part of the 1980s;
- ii) the experiences of those member countries most involved in CT operations and to examine the potential role of other selected OIC member countries with regard to CT; and
- iii) the potential areas for economic cooperation through countertrade among member countries.

The participants of the seminar were selected mainly from the trade, commerce, finance and planning organizations of member countries. The seminar was confined to participation from English-speaking member countries only.

Written papers were invited to form the basis for discussion in the seminar. This included one background paper surveying the concept and form of countertrade, five case studies, and one paper on applied aspects of countertrade from the point of view of its role in enhancing economic cooperation among member countries.

The background paper, "Countertrade Arrangements: Survey and Critical Review", provides a theoretical and analytical review of conventional (e.g., barter, compensation, counterpurchase and buy-back arrangements) and nonconventional (advance purchase, offset deals, etc.) countertrade transactions.

The five case studies on Policies, Practices and Potentials in the area of countertrade relate to :

- i) Indonesia
- ii) Malaysia
- iii) Turkey
- iv) Egypt
- v) Pakistan

These member countries were selected for case studies because of their relatively greater exposure to countertrade operations.

Each case study focuses on the country's experience in the application of countertrade practices, reviewing the policies, procedures, current usage and future potential of benefitting from countertrade as a means of enhancing export growth. The case studies also highlight legal aspects, negotiating framework, financing, fulfillment and pricing problems. In the case of Turkey, recent developments in the build-operate-transfer (BOT) scheme are also highlighted.

The paper on the applied aspects of CT discusses "the possible role of the IDB in organizing countertrade transactions among the OIC member countries". The paper evaluates different countertrade schemes from the point of view of their compatibility with current foreign trade (short- and long-term) financing operations; joint ventures; equity

investments and other existing modes of finance. The main stress is on identifying potential areas of growth and the major constraints in introducing countertrade transactions for the benefit of member countries.

The presentation and discussion of these papers provided a useful basis for the exchange of ideas culminating in a set of recommendations addressed to planners and policy makers of IDB member countries, the IDB itself and other concerned international agencies. Before summarizing the recommendations, it may be instructive to have an overview of the presentations made during the seminar. The overview is presented here with respect to three aspects: the theory of countertrade, the case studies and applications and the role of the IDB.

THEORY OF COUNTERTRADE

It is difficult to provide a precise definition of countertrade that can cover all its forms. However, a full description of countertrade can be given by describing the various forms of CT transactions. Dr. Abul Eyoun has done a good job in his paper, "Countertrade Arrangements: Survey and Critical Review", of describing the following forms of countertrade:

- 1) Barter Trade: This is a direct reciprocal trade based on double coincidence of wants without the exchange or involvement of money.
- 2) Counterpurchase: This involves a simultaneous agreement to import the other party's products not related to exported goods, while each party is paid in cash upon the delivery of its products to the other party.
- 3) Compensation Arrangement: The seller is compensated for his exports by a counter supply of goods by the importer.
- 4) Buy-Back Arrangements: This is similar to the compensation arrangement and involves the payment for an

import of machinery or equipment partially or fully in the form of goods produced by the machinery or plant.

- 5) **Switch Trading:** This is a form of bilateral clearing arrangement for settling financial claims arising from imports and exports from compensation and similar arrangements. If B has a credit in its account against A (arising through compensation or other payments arrangements), then B locates a country, C, which is interested in purchasing the products of A. B sells its credit (clearing currency units) at a discount to C to receive hard currency. C uses B's clearing currency to purchase goods from A.
- 6) **Offset:** Under Direct Offset arrangements, the components of sold item are to be produced within the buying country and the seller agrees to buy these components to use them in-house. Under Indirect Offset, the seller agrees to buy unrelated products from the buyers. This is similar to the case of counterpurchase.

Dr. Abul Eyoum discusses in detail not only the features of each form of countertrade, but also the advantages and disadvantages of each of them. In addition, he also describes the techniques that are used for financing countertrade arrangements. He discusses the techniques of "escrow accounts" and forfeiting arrangements. According to Dr. Abul Eyoum, there are several factors involved in the growth of countertrade. These include:

- a) The poor world economic performance limiting the world capacity to accommodate trade expansion for developing countries.
- b) Internal disequilibria in developing countries resulting in excess supplies of goods which are not in demand in the world markets.

- c) The growing protective policies of the developed world which prevent developing countries from expanding their trade.

This last point is shared by several other participants as well. Mumtaz Abdullah supports countertrade as a means of protecting developing countries against those practices of developed countries which Dr. Fahim Khan termed, "quasi-countertrade activities," and which are making it difficult for developing countries to survive in the international market and to reduce their balance of payments. Abdullah's paper claims that 200 types of restraint are operating on the exports of developing countries, two-thirds of which pertain to the EEC and the United States.

Analyzing the macro- and microeconomic implications of countertrade arrangements, Dr. Abul Eyoun also concludes that there is a need for CT arrangements both on the part of both developing and developed countries. Although Dr. Abul Eyoun believes that CT arrangements are inefficient, he advocates that countertrade should be judged on a case-by-case basis, considering the costs and benefits to the countries involved.

Dr. Ma'abid Ali Al-Jarhi, however, does not regard countertrade as an inefficient means of trade per se. According to him CT is a result of imperfections and, therefore, it cannot be a cause of inefficiency as long as it is conducted on the basis of profit maximization. It is resorted to only when it is less costly than available arrangements and hence, is efficient. Dr. Ma'abid Jarhi suggests that all CT transactions would become efficient if the following imperfections could be removed:

- a) Since we have no "international currency" issued by a universally accepted "central bank", several national currencies assume the role of an international currency whose use often turns out to be less than desirable for a variety of reasons.
- b) Since capital flows among countries as foreign exchange balances, the imperfections of the international payments system are sufficient to distort international capital markets.

- c) Countertrade is resorted to in order to avoid trade and exchange restrictions or to offset their impact.
- d) The role of public enterprises is becoming increasingly important in Socialist developing countries which pursue various non-economic objectives (rather than profit maximization), and countertrade may often serve these objectives better.
- e) Imperfections arising because of a lack of information or more specialized but restricted information may also lead to the development of countertrade arrangements.

Against this background, Dr. Ma'abid Jarhi naturally concludes that the inefficiencies in CT arrangements alluded to by Abul Eyouun may be removed by the following guidelines:

- i) Public enterprises should not be allowed to conduct CT unless they are strictly managed according to the profit motive.
- ii) Specialized companies should be developed at the regional level to help provide a shield against the monopolistic behavior of market specialists and, hence, help in arriving at efficient (profitable) CT deals.
- iii) Efforts should be made to reduce the sources of inefficiency.
- iv) Necessary financing should be generated to support countertrade operations so that the lack of foreign exchange does not become an excuse. This can be strengthened by participating with neighboring countries in regional trade finance, finance guarantee and multilateral settlement schemes.

A general discussion on the significance of countertrade for Muslim countries emphasizes that Muslim countries will not be able to reap the benefits of their countertrade transactions unless they promote these transactions within Muslim countries through bilateral arrangements

or by forming regional groups. Suggestions for an Islamic common market and an Islamic Free Trade Union are also discussed. The need for establishing a market information system to promote the exchange of market information among Muslim countries is also highlighted.

THE CASE STUDIES

The case studies include a description of the countertrade policies of Pakistan, Egypt, Turkey, Indonesia and Malaysia. The country representatives emphasize the importance of countertrade for their respective economies. Barter trade is mentioned as the main instrument utilized in Pakistan for countertrade. The Pakistani experience highlights two categories of barter trade: a) fast moving barter trade with countries like Bulgaria, Hungary and Czechoslovakia and b) slow moving barter trade with countries like the USSR and China. The countries within the category of fast moving trade permit exports and imports from third countries, whereas countries in slow moving trade categories do not permit this. The provision for third country imports under barter is reported as a cash substitution device as it helps the agencies involved in barter trade to buy from worldwide sources.

Pakistan also operates a scheme called Pay As You Earn (PAYE) which is reported to be a type of buy-back arrangement. Under this scheme, foreign manufacturers of machinery supply machinery on a credit basis to Pakistani importers/manufacturers. However, this credit is repayable by exporting the products of the machinery to the countries which supplied the machinery. Pakistan decided to encourage countertrade more vigorously in 1985 in view of its deteriorating terms of trade, the increasing protectionist policies in world markets and the lack of foreign exchange to enable Pakistan to enter international markets. Countertrade is seen as an effective instrument to promote the export of nontraditional items and to penetrate nontraditional markets.

The Trading Corporation of Pakistan is the public body responsible for arranging countertrade transactions. Specific policies and guidelines have been laid down for countertrade arrangements. These are aimed at

achieving price competitiveness, additionality in exports and monitoring the direction of countertrade operations.

The performance of countertrade operations; however, is reported to be slow in Pakistan mainly because of regulatory policies, liberalized imports, and pressure from the IMF to restrict bilateral arrangements.

Malaysia adopted a countertrade policy in 1982 as a trade promotion measure. Countertrade is carried out by the Unit Khas Countertrade (UKC) of the Ministry of Trade and Industry. The Ministry has issued guidelines and criteria governing countertrade operations in order to ensure that countertrade does not contradict Malaysia's overall foreign trade policy and does not prejudice the reputation of Malaysia as a quality supplier. The experience so far has been successful.

Countertrade in Indonesia was officially introduced in 1982 in an attempt to expand exports and as a response to protectionism in industrialized countries. Indonesia has specific guidelines for countertrade operations. The permanent countertrade partners of Indonesia are West Germany, Japan and the OECD countries.

Bangladesh operates most of its countertrade operations through a state trading organization, known as the Trading Corporation of Bangladesh. These arrangements include Special Trading Agreements (STAs) in which the value is fixed for both exports and imports of goods after mutual consultations. The validity for such agreements is one year though extendable through mutual consultations. Other countertrade agreements are operated through special nonconvertible US Dollar accounts opened in the banks nominated by foreign partners with a scheduled bank in Bangladesh. Imbalance at the end of the agreement is settled as per terms laid down in the agreement. Such agreements have helped Bangladesh to attain additionality in its exports and to overcome foreign exchange constraints.

The recent economic upsurge in Turkey is partly attributed to countertrade and to build-operate-transfer (BOT) which is a variant of the offset method of countertrade operations. By 1985, countertrade

accounted for nearly 40 percent of Turkey's total trade. The private sector also engages in countertrade and a company whose exports are over \$ 0.50 million can engage in countertrade. However, all countertrade operations are monitored by the Ministry of Foreign Trade and Treasury which operates under the Prime Minister's Secretariat.

Iran is reported to have recently entered into countertrade operations mainly to sell its oil in order to acquire essential commodities.

Mumtaz Abdullah presents countertrade as the only solution available to the member countries for promoting their exports and overcoming the rising trend of protectionism in industrialized countries. Great potential is reported for the growth of countertrade among OIC member countries. Mumtaz Abdullah gives two reasons for this.

Firstly, restrictions laid down by the IMF regarding the clearing of accounts within three months coupled with the barriers imposed by developed countries (particularly the EEC, and its emergence as a single market in 1992 and the emergence of other new regional groupings) can pose serious problems for developing countries which will force them to seek countertrade arrangements among themselves.

Secondly, the recent performance of OIC member countries in countertrade practices has been very satisfactory. Oil has been identified as a major import commodity for countertrade for non-oil producing member countries. Abdullah's description of the countertrade experiences of Asian countries of the OIC reveals that though the classical form of countertrade, i.e., barter trade, has long existed in such OIC countries as Pakistan and Bangladesh, the use of nonconventional forms of countertrade is not only very recent, but also very insignificant (with the exception of Turkey), and most of the trade is carried out by public sector enterprises. Abdullah's case studies also claim that OIC countries have succeeded in using countertrade for its own purpose rather than as a substitute for regular foreign trade. The objectives to be achieved by countertrade include:

- a) Diversification and creation of new markets for various economic and noneconomic reasons.
- b) Saving foreign exchange

Abdullah, however, points out the lack of a proper institutional setup to make countertrade operations effective and efficient. No serious efforts to plan and monitor countertrade through the private sector are reported.

Abdullah also points out several reasons why Asian OIC countries are not able to pursue countertrade policies successfully. These include:

- i) Inability to successfully link exports and imports in countertrade arrangements.
- ii) Pressures from international organizations, particularly the IMF.
- iii) Lack of institutional arrangements to settle claims/disputes arising out of countertrade agreements.

Although Dr. Fahim Khan does not agree with Abdullah's emphasis that countertrade is the only solution available to developing countries to solve their contemporary trade problems, he does underline the importance of exploiting the institution of countertrade particularly to achieve the following objectives:

- i) Create trade within the OIC.
- ii) Provide a substitute for trade with the developed world which often leads OIC countries to the problem of the scarcity of hard currency.
- iii) Make it possible for OIC countries to reinforce one another's development plans by coordinating trade policies.

Dr. Mamdouh El Masry gives a very detailed account of how countertrade is viewed and operated in Egypt. The central theme of his presentation is that despite many problems and complications arising out of countertrade deals, they are necessary in the face of the scarcity of foreign exchange. Dr. El Masry envisages that the role of trade will substantially increase in the future for the sake of the economic development of Egypt.

The Turkish experience has not been very different from that of the other countries described above. Armagan Asina reports that Turkey also favors countertrade arrangements with the view that their benefits for the economy outweigh their drawbacks. Turkey, like other countries, operates countertrade solely through the public sector. Armagan Asina feels that countertrade is not superior to free trade, but in view of its role in the Turkish economy, he calls countertrade a second best policy.

The papers presented by Zulkifli Serigar and Tri Mardjoko emphasize the need and significance of countertrade arrangements for the economy of Indonesia. Countertrade is seen as an important instrument not only for the increase of Indonesian exports, but also for the diversification of exports with respect to exportable items and the destination of exported items. Serigar and Mardjoko emphasize the need for coordinating all countertrade operations under one official agency, such as the Ministry of Trade. They make several specific suggestions within the Indonesian framework to improve the coordination in countertrade operations.

Aziz Kasim's presentation on Malaysia highlights objectives for the promotion of countertrade similar to those of Indonesia. They include:

- a) Consolidating and strengthening the existing export market.
- b) Diversifying export markets specifically by establishing long-term trade relations with nontraditional markets of countries with foreign exchange difficulties.

The Malaysian case study also emphasizes the point made earlier that countertrade in Malaysia has become important because of the increasing trend of protectionism in world trade particularly in developed economies. Under the present arrangement, the Malaysian Government, according to Aziz Kasim, does not sign countertrade agreements with any country on a government to government basis. Countertrade arrangements only involve private companies, government departments and agencies in specific cases. The Malaysian policy governing countertrade operations clearly specifies the countries and commodities to be involved in these operations. For example, countertrade is not permitted for primary commodities for which there is no overseas marketing problem and it is not permitted for countries which have the foreign exchange to purchase such goods. Footwear, textiles, rubber items, foodstuffs and electrical goods are the major manufactures allowed to be used in countertrade with countries where there is a problem in gaining market access. Some goods are specifically excluded from countertrade. These include logs, crude palm oil, tin, ore and all goods which are produced in the Malaysia Free Trade Zone and in licensed manufacturing warehouses. Imports under countertrade are restricted to those products which Malaysia needs in substantial quantities, such as, rice, sugar, iron ore, cotton, . coal, chemical products, fertilizer, machinery, defence equipment and vehicles.

Counterpurchase and compensation based on forms of countertrade are popular in the Malaysian countertrade experience. The paper of Aziz Kasim explains in detail the modus operandi of these two operations as practiced in Malaysia. The experience in these two operations has been, so far, mostly in offsetting the Malaysian Government's procurement from abroad. The private sector, however, is generally slow in using countertrade operations.

ROLE OF THE IDB

The presentation of the country papers leads to the session on the possible role of the IDB in organizing and financing countertrade operations. Makhlof, representing the IDB in the seminar, justifies the IDB's possible involvement in the countertrade operations of member

countries on the grounds that CT operations are only one of the possible tools to achieve one of the objectives of the IDB, which is to promote trade among member countries.

Makhlouf highlights the following possible role for the IDB in connection with the use of CT operations by its member countries :

- i) To serve as a focal point and a clearing house for CT information.
- ii) To play a catalytic role in creating CT opportunities.
- iii) To coordinate and monitor CT offers and deals.
- iv) To operate/finance a multilateral CT settlement scheme.
- v) To provide technical assistance to member countries in connection with CT operations.

The emphasis of Makhlouf 's presentation is placed on the following:

- 1) The IDB's function and objectives require it to undertake a CT role in the near future for the benefit of OIC member countries.
- 2) This involvement in CT operations, however, should progress gradually, though steadily.
- 3) The role of the IDB should not be based on exaggerated service fees or profit margins as is the practice in commercial banks and trade and finance houses. Some IDB services may even be rendered free of charge.
- 4) The IDB may find it more useful if it performs its CT activities through specialized companies in which it has a direct interest.

- 5) The IDB may also create a multilateral center of CT settlements using local currencies to effect local payments.

Dr. Fahim Khan, however, expressed some skepticism over the wide use of CT operations by the IDB. He recommends that the IDB consider involving itself only in the "buy-back cum switch" mode of trading between member countries with the objective of effecting a transfer of technology which is also one of the objectives of the IDB.

Dr. Fahim Khan, however, supports Makhoul's point with respect to the IDB playing the role of information center or information clearing house which would enhance cooperation among OIC member countries through trade as well as countertrade channels. A first step for the IDB towards planning an involvement in CT operations would be to conduct a survey and develop a data base by specifically collecting the following information:

- i) Country by commodity matrices indicating the potentials of trade and countertrade arrangements.
- ii) List of contacts and agencies involved in countertrade operations in member countries.

Dr. Fahim Khan, however, emphasizes the coordinating and advisory role of the IDB in the field of countertrade. He notes that although countertrade has several advantages, it can at times be damaging as well. In the context of OIC countries, there is a need for an institution that can advise countries when and when not to enter into a countertrade arrangement. There is a general bias against countertrade activities in the developed world. Therefore, any institution that includes in its membership countries of the developed world may not give the advice that is needed by or acceptable to Third World countries. The IDB is a Third World institution and is in a position to, provide such advice which is necessary for the economic development of OIC member countries.

RECOMMENDATIONS

Discussions on the concepts and applications of countertrade are followed by the recommendations of the seminar which can be summarized as follows:

- 1) Although there are costs involved in CT operations, the benefits in the context of contemporary situations in IDB member countries generally outweigh the costs.
- 2) There is a need for establishing a CT information exchange system in which country, commodity and agency profiles will be maintained. The IDB and the ICDT are the appropriate bodies to take charge of such a task.
- 3) The IDB is also urged to arrange technical advisory services as well as financial services in order to serve as a catalyst in promoting countertrade for the purpose of development and economic cooperation among Muslim economies.
- 4) The member countries are urged to set up performance criteria to ensure that CT deals are economically efficient.
- 5) The following recommendations are directed at the country level:
 - a) Developing an information network to help traders to exploit countertrade as well as trade potentials.
 - b) Proper drafting of countertrade contracts (including clauses for appropriate guarantees and penalties) to ensure proper completion of the transaction at the appointed time.
 - c) Encouraging the private sector to exploit countertrade potentials (without affecting trading opportunities)

COUNTERTRADE :
SURVEY AND CRITICAL REVIEW

COUNTERTRADE: ARRANGEMENTS, SURVEY AND CRITICAL REVIEW

DR. MAHMOUD ABUL EYOUN*

INTRODUCTION

The modern resurgence of countertrade (CT) came in two waves: the first was during the Great Depression of the 1930s and after the Second World War, and the second occurred in the late 1970s and early 1980s. The deterioration of the world's economic performance during those two periods is considered to be one of the major reasons for this resurgence.

The aim of this paper is to give a detailed overview of countertrade practices in the 1980s. The paper will cover the following topics:

1. Definition of countertrade.
2. Forms of countertrade.
3. Financial and legal aspects of countertrade.
4. Motives for the use of countertrade.
5. Directions and magnitude of countertrade.
6. The future of countertrade arrangements.
7. Conclusions.

I. DEFINITION OF COUNTERTRADE

(1) Is A Definition Possible?

Although the term countertrade has become a concept that is widely used between countries and despite the growing importance of

* Assistant Professor of Economics at The Faculty of Commerce, The University of Zagazig, Egypt, and Economic Advisor to H.E. The Minister of Economy and Foreign Trade in Egypt.

countertrade transactions in the world trading system, there is no universally accepted definition of countertrade. There is not even a general agreement about its spelling - one word, two words or a hyphen.¹ Indeed, countertrade terminology is not even standardized among countries.

This does not mean that defining countertrade is a dilemma. It is easy for everyone to remember or to imagine the practice of swapping products and services among individuals that took place either before the invention of money or after currencies had replaced the barter system. Countertrade is a form of trade that involves an element of reciprocity.

Broadly defined, countertrade² refers to the practice in which two parties link (in one way or another) a buying (importing) transaction with a selling (exporting) transaction in a reciprocal form. From this definition we can extract some of the characteristics of countertrade:

- a) CT is a practical form of bilateralism in international and domestic trade.
- b) Two parties are usually involved in any CT transaction.³ The parties may be private (or public) firms or sovereign nations.
- c) There are different linkage possibilities between the selling and the purchasing operations. These linkage possibilities refer to the different forms and categories of CT transactions.
- d) The selling and purchasing deals may involve a broad range of goods and/or services that can be traded between the parties involved in a CT transaction.

It is necessary to understand that countertrade is a generic term and that in order to make the concept clear to all of its users, we must rely on a broad definition that includes the main characteristics mentioned above.

(2) Common Misconceptions About Countertrade

There are two main misconceptions widely associated with countertrade. The first misconception is that countertrade is trade without money. Except in the barter form, money is used in all forms of countertrade. Money is used in the valuation of exchanged goods or services, and it is also transferred between the trading parties.

The second misconception associated with countertrade is that it refers to a single form of trade that is reciprocal. Reciprocity ranges between zero (nonreciprocal trade or conventional trade) and 100 (fully reciprocal trade). Accordingly, many forms of reciprocal trade are considered to be countertrade.⁴

II. FORMS OF COUNTERTRADE

In order to reduce the confusion caused by the different definitions of countertrade, we will try in this section to describe the main forms, types or modalities of countertrade. Although barter is the oldest form of countertrade, there are many forms that have been developed in response to the needs of trading partners.

(1) Barter Transactions

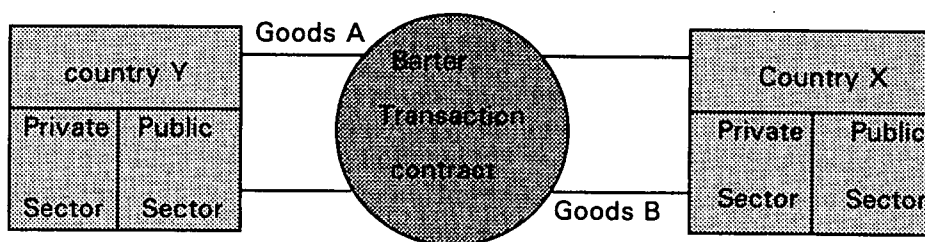
Barter is the oldest form of trade transaction, having been used long before the invention of money in any of its forms. Although most people think that barter deals disappeared completely after money transactions began to take place between trading partners, barter deals have been used continuously in underdeveloped societies⁵ and even between some developed countries.

The term "barter" is sometimes used as a generic term to indicate all forms of reciprocal trade. This is especially the case in the American literature on the subject. However, we see barter as the only form of countertrade and reciprocal trade in which money plays no part. Accordingly, the term should not be used to refer to other forms of countertrade in which money is used.

Barter in its "pure" or "classical"⁶ definition means the direct exchange of goods and/or services' between two parties who have double coincidence of wants without any exchange of money. As illustrated in Figure 1, the two parties involved in a barter transaction are usually two enterprises either public or private in two different countries with each party's goods different from the other's.

Fig.1.

Barter Diagram



The parties involved in barter deals are usually governmental, although the concept itself is frequently introduced by a private firm selling to a nation as a method of financing the nation's exports. The party who is in need of a barter transaction should have one or more of the following characteristics :

- a) As a buyer, he is not creditworthy or trustworthy in international financial markets.⁸ Usually a buyer seems to be unable to finance his imports because he has exhausted his foreign exchange reserves. He may also need to utilize a blocked currency of an old debt with another country by buying in kind.⁹

- b) As a seller, he should have a desire to dispose of a surplus of low-quality goods that otherwise cannot be sold.¹⁰ He may need to get rid of quantity and/or price restrictions imposed on the international trade of some commodities or raw materials."

The major difficulty with barter has always been that the double coincidence of wants requires a simultaneous need for a specific good by both parties. This difficulty in addition to the problems associated with fixing the values of exchanged goods and/or service¹² and the time period required for the completion of the deal means that the number of completed deals is still small.¹³ Barter transactions are not without risk. The risks in this business stem mainly from the nonfulfillment of the transaction by one party even though the other party has fulfilled its obligations. Another source of risk lies in the possible delay of delivery.

But despite all the difficulties and risks of barter deals, barter transactions are being increasingly used in international trade.¹⁴ It is growing in prominence in trade with Latin American and Southeast Asian nations due to the recent restrictions on international lending after the world debt crisis. Examples of government-government barter are the three deals, signed in February, 1982, with a cumulative value of US\$ 47 million, that involved the exchange of Jamaican bauxite for United States dairy products.¹⁵

(2) Counterpurchase

In a counterpurchase arrangement one party (an exporting private firm) exports goods to the second party (a sovereign nation) and simultaneously agrees to purchase or import other products not related to its exported goods from the second party equal in value to a stated percentage of the original sale within a specific period of time. Each party is paid in cash upon the delivery of its products to the other party.

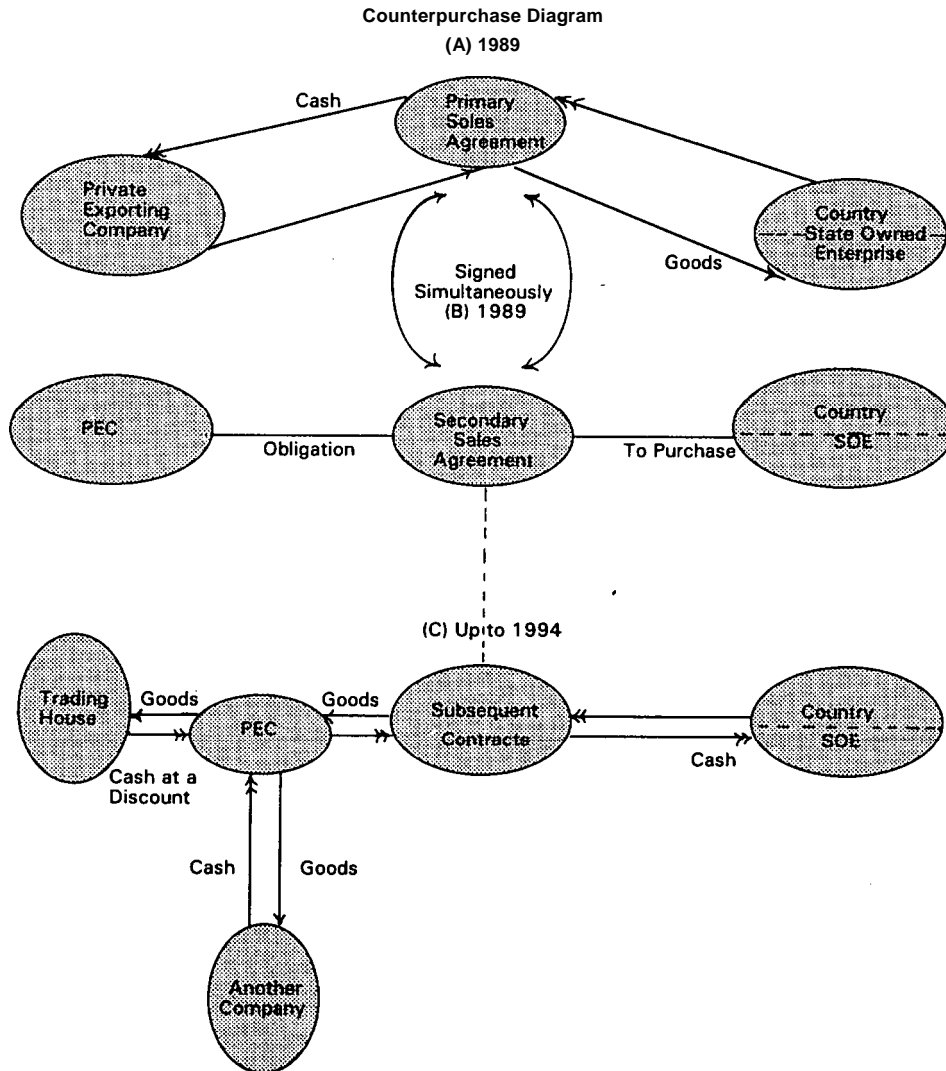
For the purpose of analysis we may note the following with respect to this form of countertrade :

- a) Counterpurchase transactions can be initiated by either the exporter or the importer. Usually exporting companies are asked by importing nations to purchase goods from the markets. 16
- b) It should be clear that each transaction is separately fulfilled and paid for in cash.
- c) It is common for the private exporting party to be allowed a period of time following the delivery of its goods to the buying nation to fulfill its purchase obligation. The time period may extend from three to five years specially in the transactions of the U.S.S.R. and Eastern European countries.17
- d) The parties agree upon a list of goods from which the private firm agrees to purchase the selected items either in advance or at a later date. The list usually contains products available in the market and not products resulting from the processing of the goods initially sold to the nation.¹⁸
- e) There is a possibility that the agreement between the two parties may give the exporting company the right to use a third party in selling the country's exported goods.¹⁹
- f) The sale of the country's goods to a third party is usually done at a discount.

The counterpurchase diagram in Figure 2 shows the process of the agreement between the parties and the sequence of events.

Although counterpurchase is most appropriate for creditworthy countries whose imports are paid for in cash, the obligation it imposes on the exporting company to purchase the country's goods is useful in balancing the incoming and outgoing flow of foreign exchange.

Fig.2.



Counterpurchase transactions include a degree of risk. In addition to the usual commercial risk there is the possibility of the nonfulfillment by the private exporting company of its obligation to buy local products, especially if the penalties are not high enough or if the ties between the secondary and the primary agreements are not tight enough. There is also the possibility that the country may provide the original exporting company with low-quality goods that cannot be marketed outside the country of origin resulting in a loss for the company. To avoid such losses, the original exporting company may exaggerate the value of the good or goods sold to the country at the beginning of counterpurchase negotiations.

Counterpurchase is frequently used in the Soviet Union, Eastern Europe, the Peoples' Republic of China and Indonesia.²⁰ In 1983, the National Foreign Trade Council (NFTC) conducted a survey of 110 United States firms to determine what forms of CT they are engaged in. The NFTC found that 55 per cent of the firms were engaged in counterpurchase.²¹

(3) Compensation

The word compensation is derived from the German word "Kompensations-geschaef", a term used to describe the clearing systems of the 1930s. At that time the private compensation scheme was one type of bilateral trade arrangement.²² Today, compensation agreements are barterlike arrangements in which a seller in Country A receives the price of the goods he exported to a buyer in Country B either in goods or in a combination of goods and foreign exchange. If the goods exported to Country B are paid for fully by a countersupply of goods, then the system is called "Total Compensation" as shown in Figure 3. If the goods exported to Country B are paid for partly by a countersupply of goods, then the system is called "Partial Compensation" as shown in Figure 4.

In their simplest form, total and partial compensation arrangements both assume that the buyer in the importing country is capable of selling the countertrade goods to the exporter of Country A. When the buyer in Country B is offering goods he does not produce, it is also possible for

him to find another local producer who can provide him with the countertrade goods required to pay for the original deal.

Fig.3.

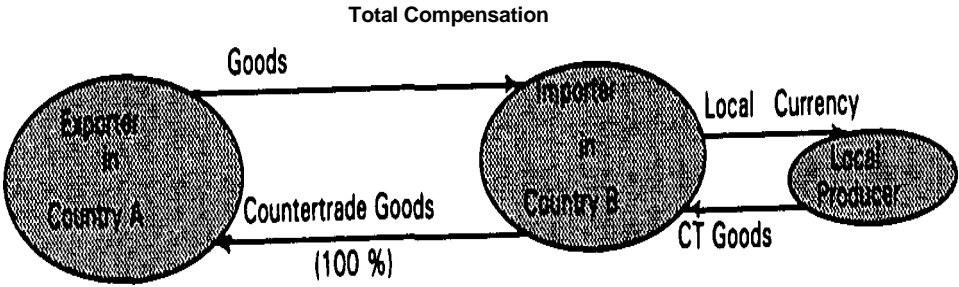
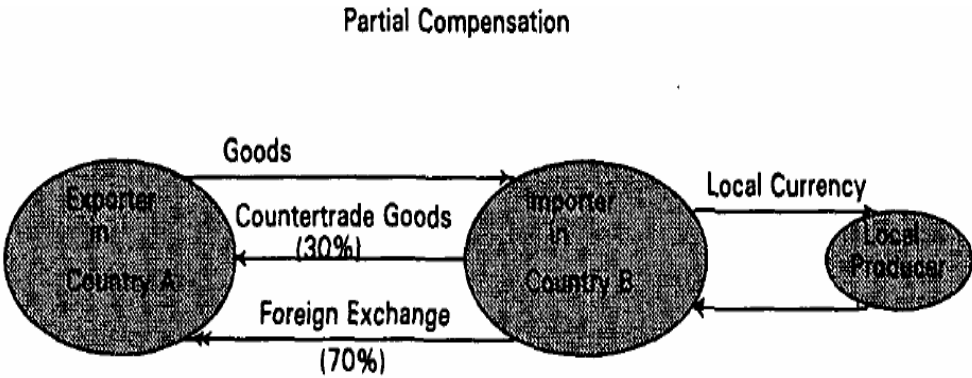


Fig.4.



In comparing compensation arrangements with barter, it should be noted that barter represents an exchange of goods of equal value without the valuation of the goods and with no alternative means of payment in cash. In both barter and compensation transactions, governments are parties to the transaction, but commercial entities may also engage in compensation transactions. The most important difference is that money can flow out of the importing country in compensation arrangements while money plays no role in barter transactions.²³

A comparison of compensation and counterpurchase reveals the following differences :

- a) Value: In compensation, the value of the countertrade goods should be at least equal to that of the original exports. In counterpurchase, goods are dealt with separately.
- b) Timing: Since the sale of CT goods is required for payment for the original exports, then shipment dates should be closely linked in the arrangement. In counterpurchase, the length of the time lag is not important.²⁴
- c) Third party: It is possible in the two forms of CT to assign the obligation to buy the countertrade goods to a third party.

The main source of risk associated with compensation transactions is that the obligation of the buyer to provide countertrade goods for the original exporter might not be fulfilled even after shipping the exports.

(4) Buy-back

In buy-back arrangements, a foreign supplier of machinery, equipment, technology or a complete turnkey project to another country agrees to be paid partially in the form of goods produced by the machinery or the plant.' It is very common to find the term buy-back used interchangeably with the term compensation because in both forms the payment for the exports can be in kind. In our opinion buy-back is a special type of compensation because of the following:

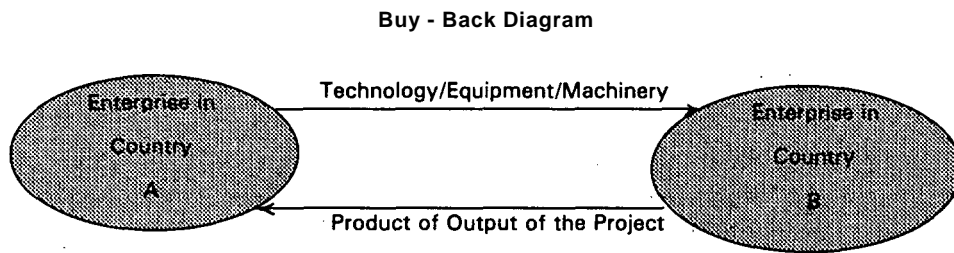
- a) Buy-back arrangements are normally used to help finance a project and/or to facilitate technology transfer from the owner of the technology to the user.
- b) The seller of the plant or the technology is obliged according to the buy-back contract to purchase the output of the plant he has delivered but not any countertrade goods.
- c) The value of buy-back goods frequently exceeds the value of the original machinery or equipment while in the case of compensation, it can never exceed the value of the original supplies.

The buy-back process, which is shown in Figure 5, is of growing interest to developing countries which seek new injections of foreign investment to enhance their development. It is also of great importance to Eastern European and Communist countries where the need for Western technology is of vital importance.

In 1968, the first buy-back agreement between the West and the East was concluded between the U.S.S.R. and Austria comprising the sale of pipes, equipment and materials from Austria for the development of gas fields in the U.S.S.R. Payment was partly in gas production. China is the country most active in seeking investments based on buy-back agreements. There are agreements between China and Japan, China and West Germany and China and the United States.²⁶

There are some problems with buy-back agreements. First, there is the problem of finance since the time lag needed for the plant to start up production may extend to a number of years. Secondly, the project may not be successful. The products of the new plant may compete in the world markets with the exports of the original supplier of the plant and machinery or technology.

Fig.5.



(5) Switch Trading

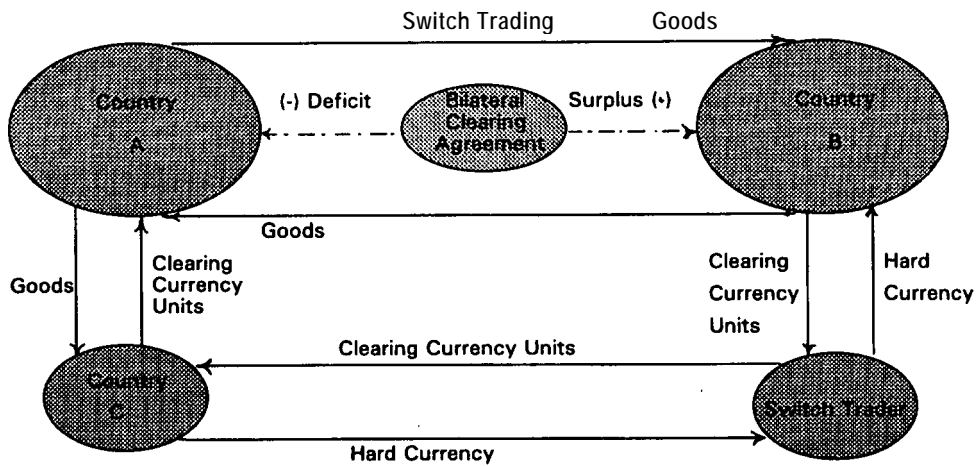
It is important to notice that switch trading has grown out of bilateral clearing agreements as a device or a method used to balance the books. In order to explain the meaning and the mechanism of switch trading as a form of CT, we will start by reviewing bilateral clearing agreements.

The bilateral clearing agreement is another form of the old bilateral trade arrangement along with the private compensation scheme and the payment agreement. It was designed for the settlement of financial claims arising from imports and exports between two countries in the 1930s.²⁷ Bilateral clearing agreements (BCA) seek to provide a mechanism for settling financial claims arising from all (or some) imports and exports between two countries²⁸ within an agreed period of time. Each country (partner) sets up a special account, called a "clearing account", in its central bank through which payment for imports and receipts from exports are cleared in its domestic currency, the "clearing currency unit", without the actual movement of foreign exchange across the borders of each country. If it is agreed that there should be a limit on the imbalance of the bilateral clearing accounts, this limit is called the "swing limit". At the end of the 'clearing period' or if the swing limit is reached, each country balances the accounts. If an imbalance exists and if there is no mechanism for settling the imbalance, then the central bank will credit the balance of the debtor country.

The imbalances in the clearing accounts made it possible to develop a device to balance the BCA. The outcome is "switch trading" which can be explained with the following example:²⁹

Suppose that there is a "trade protocol" between Country A and Country B according to which a BCA was reached and the two countries agree to purchase equal values of each other's products over a clearing period. If by the end of this period Country A has taken more products from Country B than what Country B has taken from A, B will have a "credit" in its clearing account (a surplus of the clearing currency units). If A has no products that B is interested in taking, switch trade can help balance the books if Country B locates another country, C, which is interested in purchasing A's products. Technically B has sold its "clearing currency units" to C which in turn has used them to buy goods from the debtor Country A. Country B should sell the clearing currency units at a discount against receiving hard currency from Country C. It is common that a switch trader or dealer (a trading intermediary) will help Country B find a third party against a portion of the discount it gives. Figure 6 shows the flow of goods and money in switch trading.

Fig .6.



The switch trader's fee represents the efforts necessary to structure a successful deal. His fees and the discount given to him by the creditor country are an additional cost to that country.³⁰

Switch trading is the most complicated form of countertrade, the future of which is correlated to the future of bilateral clearing agreements.

(6) Offset

The word "offset" is usually used to refer to countertrade concerned with a very high value of exports and/or a medium-to-high technology capital item, supplied by multinational corporations or a major manufacturer. It is divided into several categories such as coproduction, subcontractor production, technology transfer and overseas investment.³¹

Offset activity can be divided into two main categories - direct and indirect:

- a) Direct offset occurs when there is an agreement between the seller and the buyer that the components of the item sold are to be produced within the buying country and that the seller agrees to buy those components to use them in-house.
- b) Indirect offset occurs when the seller agrees to buy unrelated products from the buyer's country, similar to the case of counterpurchase.

Offset is used to limit the foreign exchange expenditure on high value imports, to avoid an increase in foreign debt, to increase local employment, to improve the state of the art in local industries, to reduce dependence on foreign suppliers, to promote exports especially in the case of indirect offset and to increase the level of foreign investment.³²

Defence, aerospace, telecommunications and other vital strategic equipment are the areas in which it is common to structure an offset deal. Figure 6 shows offset in a diagrammatic form.

(7) Advance Compensation

As stated earlier the main source of risk in compensation deals is the possibility that only one part of the deal will be concluded. The implication of such a risk is that countertrade goods cannot be sold, and, therefore, that no hard currency would be available to pay for exports. To overcome this problem, one might suggest that the countertrade goods should be shipped first. The objection to this is that the risk will then be transferred to the other country. Another solution is the simultaneous shipment of both the goods and the countertrade goods. This solution can also be valid in the case of total compensation deals but not in partial deals. The working technique which can overcome both parties' fears involves the use of escrow accounts and is called "advance compensation" .33

The escrow account is the vehicle for funds flow management where drawing funds by either party from the account is subject to certain conditions. If Country A is the exporting country and Country B is the supplier of CT goods and if it is agreed that B will make its goods available first and if the exporter in Country A is going to sell the countertrade goods to a third party in Country C and if the escrow agreement names the account-holding bank in Country A, then the steps of the transaction go as follows and as shown in Figure 7:

- a) The buyer of the countertrade goods in Country C establishes an LC in favor of the supplier of the CT goods in Country B. Funds from the LC are directed to an escrow account in a bank in Country A.
- b) The supplier of the CT goods ships his goods to the buyer in Country C, and then he presents the shipping documents to a local bank in Country B.
- c) The local bank in Country B provides local currency to the buyer who ships the CT goods to Country C.
- d) Shipping documents are sent to the escrow bank. In turn, the documents are presented under the letter of credit by the

escrow bank. Hard currency is drawn and credited to the escrow account, and the exporter in Country A is notified that there are funds available in the escrow account. If he ships his goods before an agreed date, he will be able to draw these funds.

- e) The exporter ships his goods to Country B, and the shipping documents are delivered to the escrow bank. After receiving the documents, the escrow bank checks them in order to pay the exporter.

The escrow bank forwards the documents to the local bank in Country B, and in turn the documents are presented to the importer in Country B.

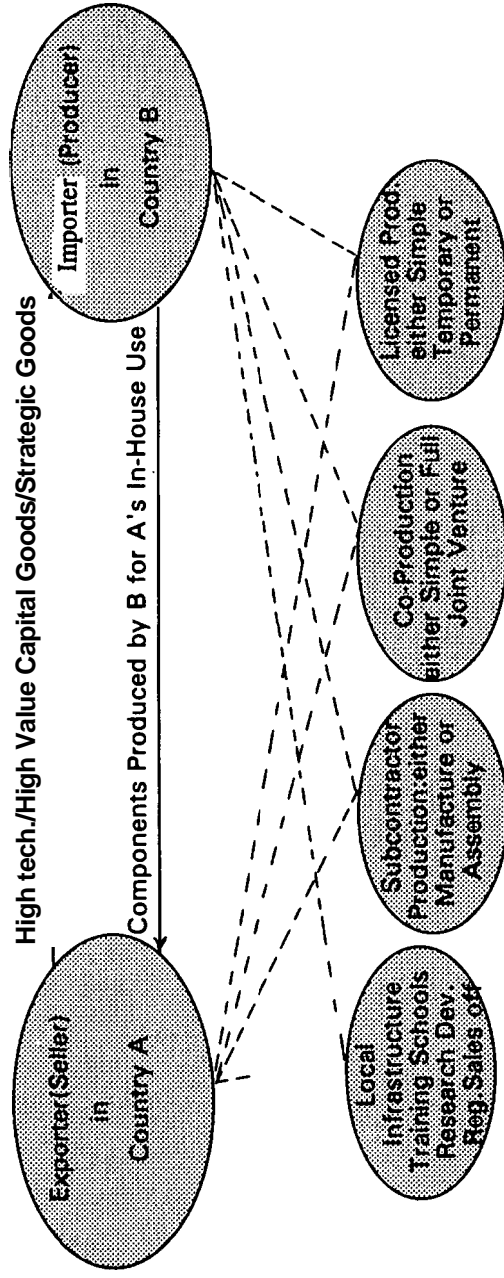
- t) The importer in Country B pays the local bank in his country in local currency upon receiving the documents, and, then, the funds are credited to the escrow account.

(8) Other Forms of CT³⁴

There are other forms of CT arrangements. The clearing agreement is one of the oldest forms of bilateral trade agreement, under which countertrade takes place among sovereign nations who agree to purchase equal values of one another's products over an agreed clearing period. Each country sets up a special account in its central bank through which payments for imports and receipts from exports are cleared in its domestic currency. There is no actual movement of foreign exchange across the national boundaries of each country, but there are always provisions to handle the resulting discrepancies between payments and receipts.³⁵

Fig. 6.

Direct Offset



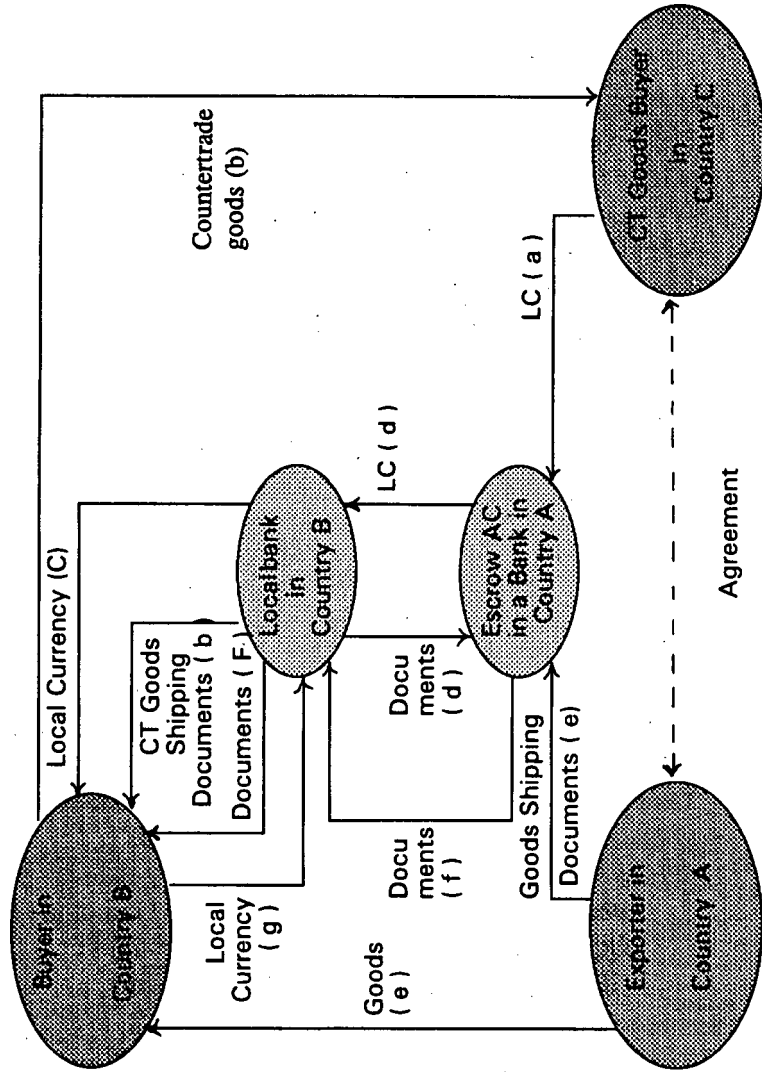


Fig. 8

When a firm purchases goods from a foreign country before selling its products to that country, the practice is called progressive or proactive countertrade. The firm does this for the purpose of developing the opportunity to sell its products in the future. The firm generates foreign exchange for the country prospectively. The firm may obtain the right to utilize its credits in serving as an agent for selling products of other firms to that country. If approved, the firm may also transfer these credits to other private firms for a fee.³⁶

Positive or reverse countertrade refers to the case in which private firms consider that what they are going to purchase from another country is so valuable that they prefer CT arrangements to conventional transactions. For example, a United States oil firm assisted in the development of a US\$ 300 million export refinery and another US\$ 300 million petrochemical complex in Saudi Arabia in exchange for the right to purchase 1.4 million barrels of crude oil over a 15-year period.³⁷

A specialized form of positive countertrade is called the develop-for-import transaction. The purpose of this CT form is to guarantee sufficient future supplies of a strategic scarce resource. The exporting country will provide the capital, equipment and technology to develop mining and energy projects in another country in which that resource is available. In exchange, the exporting country will be guaranteed a long-term supply of such projects' output. This form differs from buy-back in that the primary motive of the exporting country is to guarantee the future supplies of the resource or the commodity produced. For that reason, the main concentration of develop-for-import projects is on minerals, oil and gas.³⁸

III. FINANCIAL AND LEGAL ASPECTS OF COUNTERTRADE

In this section we will analyze the role of financial institutions, the methods of financing, the need for credit in countertrade transactions and the legal aspects of each form of countertrade.

(1) Countertrade Banking Service

As countertrade developed, countertrade related services including banking developed as well. Banks in the 1980s responded to the growing importance of CT by establishing a trading company or a trading department, by buying a majority/minority stake in a trading company or by establishing an advisory unit. The majority of banks established advisory units. One area of activity of such advisory units is dealing with the finance needed for the form of CT that includes a flow of funds.³⁹

(2) The Need for Financing

In the barter form of CT, financing is not required since only the flow of goods is involved. However, in the more complex forms of CT discussed in Section II of this paper, outside financing is generally required. The need for financing stems from the fact that the two parts of each deal are independent and do not take place simultaneously. There is a time lag that can extend up to many years, and both parties will require some form of payment guarantee.

(3) Methods of Financing

There are different financing methods used in countertrade to reduce the time between the export and the receipt of proceeds from the sale of the countertrade goods. Such methods include letters of credit, buyers' credit, suppliers' credit, forfeiting, evidence accounts and escrow accounts. Some of these methods are discussed below.

Letters of Credit: Many people think that because an exchange of goods is taking place in CT deals, the usual commercial precautions are abandoned.⁴⁰ This is not the case. The LC, for example, can provide both the exporter and the importer with a great deal of protection and security. There are many types of LCs which may be included in CT deals.⁴¹

- a) Standby letters of credit are used to guarantee the creditor that he is going to be paid on demand. To overcome some legal problems⁴² and the problem of delayed payment, as in the case of compensation, a standby letter of credit is needed to

guarantee the exporter. The validity of such letters of credit is subject to the possibility of obtaining a confirmed letter of credit. Confirmed letters of credit are difficult to obtain especially in the case of the uncreditworthiness of the debtor party.

- b) Transferable letters of credit should be issued by the buyer of the export goods in favor of the exporter if the latter is going to act as a trader. Issuing a transferable LC allows the trader on receipt to ask the advising bank to transfer all (or part) of the credit to the supplier of the export goods. Upon the shipment of the goods, the supplier presents the documents to the bank (or his correspondent) and receives the equivalent value. The bank (or correspondent) sends the documents to the trader who exchanges them for his own invoice including his profit and then draws the balance of the LC. Transferable letters of credit are needed in cases in which the exporter is obliged to act as a principal in purchasing the CT goods, if he is not permitted to transfer his rights and obligations to a third party under the CT contract. It is also needed when the trader himself lacks the resources to finance a trade deal between two parties.
- c) Back-to-back letters of credit are needed if a transferable LC cannot be arranged. In this case there are two letters of credit in a back-to-back arrangement. The importer (buyer) issues an LC (through a bank) in favor of the exporter (trader), who then issues (through his bank) another LC in favor of the supplier(s) of his export goods. It is very important to connect the value and expiry dates of the two LCs. In back-to-back CT, LCs are used in the same manner as is mentioned above. Because of the problems that may arise, CT specialists advise against the use of back-to-back letters of credit if an alternative can be established.^{a3}
- d) Assignment of debts and proceeds under a letter of credit can be used in CT deals especially in the compensation form of CT and when giving a discount. In the case of compensation,

the exporter may be the assignee of the credit established by the trader. If the trader needs some form of security to receive a discount from a transaction, a portion of the value of a letter of credit can be assigned to him.

Buyers' Credit: Most exporters of countertrade goods link their exports to buyers' credit to provide a mechanism for ensuring payment upon shipment. In the buy-back form of CT, the exporter of the machinery, equipment and/or plant may need to finance the cost and maintain liquidity. For this reason exporters may need to use buyers' credit, the cost of which is usually passed on to the purchaser in the sales contract. If the credit is going to be used by official export credit organizations, the interest rate cost will be low.⁴⁴

Escrow Accounts: As mentioned earlier, escrow accounts are the vehicle for funds flow management for the protection of all the parties involved in a countertrade deal.

Forfeiting:⁴⁵ This is a form of export finance developed in Vienna and Zurich to finance trade with Eastern European countries. Forfeiting is derived from the French, meaning "to surrender something". Although it has been used for over 30 years in certain parts of Europe, it has only recently been introduced on a wide scale, primarily because of the pressures caused by the world debt crisis. Today, the main market for the "forfeit" is located in London. When there is a need for long-term financing, the forfeiting bank purchases the exporters' receivables (in the form of bills of exchange and promissory notes), and discounts them (with an appropriate fixed discount rate), assuming that the exporter has fulfilled his obligations. The discounted amount of money is received by the exporter and the buyer receives credit for the agreed period of time.

(4) The Legal Aspects of Countertrade

Before dealing with the legal characteristics of the forms of countertrade and the drafting of countertrade contracts, one must make sure that the two parties are speaking the same countertrade language. As mentioned earlier, a reason for this is that there is disagreement over the use of countertrade terminology. Another reason is that countertrade

techniques have evolved from practice and, thus, countertrade is not a science with rules and laws. The Vienna based United Nations Commission on International Trade Law (UNCITRAL) is currently considering the possibility of establishing international guidelines.'

We will now turn to an examination of the legal characteristics of the barter, counterpurchase and buy-back forms of countertrade. Some practical drafting advice will also be given.⁴⁷

Barter Deals: Barter deals are simply a means for the exchange of two goods between two parties without the use of money. The barter contract is the same as any international sales contract amended to cover the exchange of one commodity for another. Barter transactions require the use of one contract. In addition to the barter contract, each party should prepare three other contracts: a transportation contract with a shipping line, an insurance contract with an insurance company and a bank guarantee or a standby letter of credit securing the delivery of each country's commodity. A barter contract should include the following:

- Clear identification of the parties.
- Identification of the contract as a barter agreement.
- Acknowledgement of the obligation of the parties to provide and accept goods.
- Description of each party's goods: specifications, the quantity, terms of delivery, packing, shipping and insurance, documents required and how they can be transferred.
- Bank guarantees.
- Quality guarantee and acceptance.
- Right of each party to inspect the goods before accepting them.
- Right of each party to consult a neutral surveyor.
- Establishment of a joint committee to monitor the agreement.
- Determination and settlement of claims.
- Marketing restrictions including third party participation.
- Penalties.
- Force Majeure.
- Arbitration.
- Choice of Law.

Counterpurchase Transactions: Counterpurchase transactions as defined earlier, involve separate but related sales of goods. Although separate contracts should be used to cover each party's sales, the linkage of the two (or three) contracts is very important. The first contract, namely a Primary Sales Agreement, is a normal international sales contract designed for the exchange of goods for cash (hard currency). The second, called the Secondary Sales Agreement, is a broad contract setting forth the other party's obligation to purchase goods from the second party. There may be a third contract, or a protocol, which links the other two contracts. In the case of the absence of this protocol, the Secondary Sales Agreement should include a provision linking it to the Primary Sales Agreement. It should be noted that the exporter will be keen not to refer to any counterpurchase in the primary agreement. In addition to the above mentioned contracts, each party should prepare the three other contracts with the shipping company, the insurance company and the bank.

The Primary Sales Agreement should include all the items mentioned in the barter contract checklist, in addition to the price, terms of payment, and methods of payment. The Secondary Sales Agreement should include, in addition to the items on the contract checklist of the Primary Sales Agreement, a list of the available counterpurchase goods, the quantity, the time period in which to fulfill the obligation, the linkage of the two agreements and the transferability of the counterpurchase agreement.

Buy-back Transactions: These are barterlike transactions, the complete implementation of which is subject to the start-up of the plant sold. It should be noted that the amount of output to be received in payment for the cost of the plant must be calculated carefully. There should also be three contracts. The first contract is the Primary Sales Agreement for the sale of machinery, equipment, technology or even a complete turnkey project. This contract must include clear, detailed provisions establishing the rights and obligations of the parties regarding the construction and the operation of the plant. The checklist for this contract should in addition to those items mentioned in the counterpurchase contract also include additional provisions related to the specific aspects of the agreement such as the performance of equipment,

the roles played by employees, consultants and technical advisors, and the quality standards of the final output of the plant. The second contract is the Secondary Sales Agreement in which the buy-back obligation is essential. This contract may exclude the list of available goods since the original exporter is obliged to buy the product of the plant. There should also be a pricing formula for the product to be produced in order to determine the value of the buy-back product. The third contract is the protocol in which the linkage of the two contracts is essential.

IV. MOTIVES FOR THE USE OF CT TRANSACTIONS

We turn now to an analysis of the motivations of different countries engaged in countertrade arrangements. The main question is why countertrade is used. In answering this question we will try to identify the political, economic and other motives for using countertrade. We will separate the motives for the use of CT in Eastern European countries from those of developing and developed economies.

EASTERN EUROPEAN COUNTRIES

Eastern European countries use countertrade as an important part of their foreign trade policy and as a way to overcome the uncertainty of domestic production plans and, simultaneously, to achieve the bilateral balancing of trade, which is a main objective of their foreign trade policy.⁴⁸

Recently, the desire of Eastern European countries to stimulate Western technology transfers coupled with the lack of convertible foreign exchange resources has forced these countries to enter into countertrade arrangements with the West.

DEVELOPING COUNTRIES

The motives for a developing country to use CT arrangements can be divided into four categories: first, economic and financial reasons; second, trade and marketing motives; third, development motives and fourth, political and strategic reasons.

(1) ECONOMIC AND 'FINANCIAL MOTIVES

Countertrade is used by developing countries for at least one of the following reasons:

a) CT as a counteraction to the negative effects of the world economic performance

A surge in CT activity occurred in the 1980s, and its association with the international economic difficulties facing developing countries is reminiscent of the rise of CT as a foreign trade policy in the 1930s and after the Second World War when liquidity problems, foreign exchange shortages, the uncreditworthiness of different countries and the need for enhancing development were some basic features of the international economy.

Over the past ten years, the world economy has not performed well. The continuous existence of large fiscal and external imbalances, the fluctuations of the output of industrialized countries and their reliance on protectionist measures, the sharp decline in the price of oil, the deterioration of the terms of trade of the producers of primary products, the lack of foreign financing associated with the needs of developing countries, the output recession in industrialized countries at the beginning of the 1980s and the worsening world debt crisis have all helped to cloud the international economic outlook. Table 1 summarizes the trends in world economic performance in the 1980s.

The surge in CT transactions can be attributed to the deterioration of the performance of the world economy in the 1980s as it was in the 1930s and 1940s.

Table 1

WORLD ECONOMIC PERFORMANCE

		1981	1982	1983	1984	1985	1986	1987*	1988
	Growth of Real GDP (annual change in percent)								
	Developing Countries	3.4	2.1	2.1	5.1	4.8	4.2	3.1	3.7
	Industrial Countries	1.9	-0.5	2.2	4.6	2.8	2.5	3.1	2.8
2.	Current Account Balance (billions of U.S. dollars)								
	Developing Countries	-106.7	-103.0	-57.2	-32.1	-37.4	-35.5	4.4	-7.9
	Industrial Countries	2.4	1.4	2.9	-35.1	-24.7	21.6	49.4	-49.8
3.	Public and Private Lending to DC (billions of U.S. dollars)								
	Net flows	75.7	68.9	54.4	40.8	25.6	25.6	.	.
4.	Debt Indicators for DC (percent)								
	Ratio of debt to GNP	22.4	26.3	31.4	33.0	35.8	35.4
	Ratio of debt to exports	98.0	117.6	134.8	121.2	143.7	144.5	56.6	147.6
	Debt service ratio	17.5	20.6	19.4	19.5	21.4	22.3	19.1	19.3
5.	Volume of Trade (annual change in percent)								
	Developing countries exports	-5.9	-7.7	3.0	7.1	0.8	9.6	7.3	6.4
	Developing countries imports	8.0	-3.9	-2.3	2.8	-1.1	-4.6	2.8	7.2
	Industrial countries exports	3.9	-2.1	2.9	9.9	4.6	2.6	4.3	4.6
	Industrial countries imports	1.6	-0.6	4.6	12.6	4.6	9.0	6.1	6.0
6.	Terms of Trade (annual change in percent)								
	Developing countries								
	Fuel exporters	3.6	-0.8	-3.5	1.8	-2.4	-19.3	3.4	-1.6
	Primary product	11.0	0.3	-8.5	0.7	-2.8	-47.9	11.6	-12.7
	Exporters	-10.1	-6.0	1.5	3.8	-4.4	9.4	-2.4	1.6
	Industrial countries	-1.6	1.8	1.5	0.2	0.7		0.9	2.0

Source: World Bank, World Development Report, 1987

*IMF, World Economic Outlook, April, 1988

b) CT as a means of facing internal disequilibria

Many developing countries face internal disequilibria either in the relationship between output and expenditure, fiscally, or in the current account of the balance of payments. The reasons behind each phenomenon may be temporary or structural.

Countertrade can provide developing countries with consumption goods needed to meet the basic needs of the

population. If there is an excess supply of some products or raw materials, CT can make the needed goods available.

Countertrade is considered a means of circumventing the problems caused by foreign exchange shortages caused by the increase of imports or the decrease of exports. It is sometimes a means of avoiding the uncreditworthiness of the country in world financial markets.⁴⁹

Countertrade is also considered a means of escaping the problems caused by a fixed exchange rate at a level that does not correspond to its market value.⁵⁰ An overvalued fixed exchange rate is a usual practice in a number of developing countries. This overvaluation reduces the cost of imports but leaves the exports of these countries less competitive in world export markets. In a study made by the Research Department of the IMF, the number of countries which chose to peg their currencies to a single currency was 93 as of June 30, 1983. Most of these countries are developing countries.⁵¹

c) Countertrade as a means of avoiding international trade restrictions

Countertrade is sometimes used to avoid the restrictions and limitations imposed by developed countries, international law, and/or international cartels on the world trade of certain commodities.

Developed industrial economies are increasingly using nontariff barriers (NTB) to protect their markets.⁵² In 1986, almost 17 percent of the imports of industrial countries were subject to NTBs.⁵³ NTBs are brought more heavily to bear on the major exports of developing countries. CT may be used as a way to open new markets to compensate for closed ones. OPEC, for example, used to restrict the output of its member countries to prevent oil prices from declining. Countertrade in oil was used to finance some oil exporting economies in the 1980s.

(2) TRADE AND MARKETING MOTIVES

Countertrade is used as a means of creating new markets and of increasing the existing market share for the products exported by developing countries. In some cases CT is used to market new products, nontraditional products or a short-term surplus of a commodity." Whatever the purpose of the marketing policy through CT arrangements, it is clear that opening new outlets for the products of developing countries is of vital importance.

(3) DEVELOPMENTAL MOTIVES

Countertrade, in some of its forms, is also used to benefit development." Development processes in less-developed countries can be enhanced by one or more of the following activities :

- a) involving major exporters in development by providing developing countries with intermediate goods and the spare parts of the major manufactured goods produced locally for other goods and services,⁵⁶
- b) providing the country with technologies to be used in developing the country's industry,
- c) exporting of nontraditional and competitive products to foreign markets, and
- d) fulfilling a target posed for any sector of the economy.

Countertrade can also be used as a means of creating or protecting employment in developing countries."

(4) POLITICAL REASONS

Countertrade can also be used to reduce reliance on other countries for strategic reasons, to reduce trade deficits with a partner, to pay off a debt to a creditor country and/or to liquidate a blocked account in a country.

DEVELOPED ECONOMIES

Developed countries do not regard countertrade as an end in itself, but rather they use it to achieve the following diversified purposes :

- a) To circumvent governmental restrictions, obstacles or currency controls imposed by developing countries which lead to the exclusion of foreign products from the markets of those countries.⁵⁸
- b) To expand trade with developing countries in order to gain a new foreign market or to compensate for a recession in the markets of developed countries.
- c) To overcome blocked funds in developing countries caused by the unremitted profits from local subsidiaries⁵⁹ or by an unpaid debt.
- d) To assure the purchase from a developing country of raw materials needed by an enterprise in an industrial country for a longer period of time and at a reasonable price.

To cope with countertrade, it is important for the buying country as well as the exporting country to understand the motives of the other party. This mutual understanding is important in the negotiations of countertrade deals.

V. DIRECTIONS AND MAGNITUDE OF CT (1)

The World Economy and World Trade

The good performance of the world economy is usually reflected in an increase in the volume of world trade. Between the early 1950s and the early 1970s, the world economy achieved both high growth and low inflation with trade growing at a rate of 8 percent a year.⁶⁰ During the past ten years, there have been more fluctuations in the performance of the world economy. As shown in Table 1, fluctuations have affected both industrial and developing countries.

Developing countries found themselves in a difficult situation because of the deterioration of their terms of trade and the large imbalances in their balance of payments current accounts. At the same time industrial countries restricted their imports in order to rectify their balance of payment current accounts. They used nontariff barriers as a means of protecting local markets. It is not known whether the movement toward protectionism is a temporary reaction to the world economic crisis or the beginning of a new trend brought about by the lack of faith in the principles of free trade.

(2) The Share of CT in World Trade

It cannot be denied that countertrade has become an increasingly important form of trade. This development is probably best understood in the context of the overall performance of the world economy and the challenges faced by developing countries. The growth in CT over the last decade can be attributed to the new trend of trade-for-development used by Eastern European countries, China and other developing countries.

The current volume of countertrade transactions in all its directions and flows between the countries of the world is difficult to estimate. Press reports have suggested that the CT share of world trade is between 3 percent and 40 percent⁶¹.

International organizations have also estimated the volume and the share of CT in world trade. The OECD, for example, estimates that countertrade was 4.8 percent of world trade in 1983⁶². Lower figures provided by the IMF suggest that the CT share of world trade could have been as little as one percent. The GATT estimate was around 8 percent of world trade in 1984.⁶³

It is obvious that official estimates tend to be low and that the estimates of traders tend to be high. The difficulty of correctly estimating the volume of CT transactions is due to the following reasons:

- a) Detailed data are not likely to be published by partners if strategic goods are involved in CT or if the CT transaction is an under-the-table deal.

- b) It is difficult to estimate the annual volume of CT because most forms of CT transactions extend over several years.
- c) Estimates cannot rely on the figures announced by the parties of each deal at the time of the signing of the contracts because the success ratio is almost always below the originally planned values.
- d) Trade statistics are gathered mainly from customs documents using customs code numbers for the classification of products. These documents do not show whether the goods covered are part of CT transactions.⁶⁴

With the difficulty of estimating the volume of CT and its share in world trade, it is essential to note that CT transactions are growing both in value and in their share of world trade. Companies are using CT proactively and many countries with limited reserves of hard currency prefer CT arrangements to cash transactions.

(3) Most Commonly Used Forms of CT⁶⁵

In 1983, the U.S. National Foreign Trade Council (NFTC) conducted a survey of 110 firms in the United States to determine what forms of CT they were engaged in. The NFTC found that 55 percent of those firms were engaged in counterpurchase, 24 percent were engaged in offset arrangements, 9 percent practiced compensation, 8 percent used switch trading and 4 percent were involved in barter agreements.

In 1986, Carter and Gagne surveyed 60 companies and found that 73 percent of them engaged in offset arrangements. The next most common arrangement was counterpurchase (60 per cent), followed by compensation (22 per cent), barter (10 per cent) and switch trading (3 per cent). It is clear from the total percentage that companies are using more than one form of CT at a time.

(4) Why CT is Growing

CT in its many forms can be considered a response to the difficulties facing both industrial and developing countries. CT is vital for centrally planned Eastern European countries as a means of overcoming the uncertainty of domestic production plans and achieving the bilateral balancing of trade. It is also required by Eastern European countries as a means of stimulating Western technology transfers. Developing countries need countertrade in order to finance imports from each other instead of relying on the conventional imports-for-cash method. CT transactions are also required by developing countries as a means of enhancing their regional economic integration and their political solidarity. Industrial countries would prefer CT if the goods countertraded were more valuable to them than money. For all of these reasons, countertrade is growing and is expected to grow as long as the need for it exists by both parties.

(5) Flows of Countertrade Goods

CT transactions currently involve most of the countries of the world. However, to determine the directions or the flows of countertraded goods, it is important to start by determining the locations of the partner countries. Geographically, there are three groups of CT partner countries: North (which includes the 24 OECD member countries), East (which includes the Eastern European countries) and South (which includes all the developing countries). Using these geographic groups, we can distinguish the following flows of CT goods:

- a) The East/West direction, commonly called West/West, is the most important in trade relations between Western countries, including the United States and Canada, and Eastern European countries and other centrally planned economies. The OECD has estimated the value of Western exports to Eastern European countries through CT transactions at US\$ 35 billion during the period between 1969 and 1979. The most common forms of CT include the transfer of technology and know-how and the sale of machinery and equipment for natural resources. One of the most important examples of a CT

transaction was the Siberian Pipeline deal in which Western companies provided the U.S.S.R. with pipeline equipment while they counterpurchased gas for 15 years.⁶⁶

- b) The East/South direction⁶⁷ has very strong trade relationships with many developing countries. The form of trade most preferred by Eastern European countries is long-term bilateral trade and payment agreements. These relationships have been maintained for a long period of time with many countries in Latin America and the Indian subcontinent. With the existence of bilateral trade and payment agreements, it is difficult to distinguish countertrade transactions.
- c) The North/South direction dates back to the 18th century colonial period when American colonies traded European manufactured goods for African slaves.⁶⁸ North/South countertrade is now estimated to account for about 40 percent of the total trade of developing countries. It is also growing. Bussard⁶⁹, in a survey of United States firms, showed that the number of firms engaged in CT transactions was 13 in 1972, rose to 27 in 1979 and reached 88 in 1983.

CT between industrial and developing countries is occasionally organized on a government to government basis. In the North, it usually involves private, commercial organizations; while in the South, government agencies or state-owned enterprises are most often involved. The fields of interest include engineering, construction, military equipment, aerospace, primary commodities and semimanufactured goods. A few Western trading companies and banks have extensive experience in CT.

An analysis of 262 cases of ad-hoc countertrade involving developing countries in the period 1977-1983 covered by the EIU,⁶⁹ showed that 54 percent of the developing countries involved had countertrade relations with OECD countries. According to the same study, Indonesia is a leading example and oil a major commodity in North/South countertrade.

- d) There are also other countertrade transactions between each group. East/East countertrade is a well-known example of CT between Eastern European countries for the reasons mentioned above. North/North countertrade between two OECD member countries is very common especially in the form of offset. There has been considerable growth in South/South countertrade both within the continents and between them. It has been carried out frequently in Latin America and Southeast Asia. Some CT transactions are common between OIC member countries. For example, OIC member countries engaging in CT include Algeria, Bangladesh, Indonesia, Iran, Iraq, Libya, Jordan, Egypt, Qatar, Sudan, Tunisia, Morocco, Nigeria, Pakistan and Turkey.

VI. THE FUTURE OF COUNTERTRADE ARRANGEMENTS

(1) Views of International Organizations

Any discussion of the future of countertrade must take into account the views on CT practices taken by organizations concerned with international trade in that the future of CT transactions can be influenced by the position of these organizations. We will analyze the policies of GATT, the IMF, the UNCTAD and the OECD.

GATT

Although there is no official GATT published position on CV°, GATT will oppose CT deals if they are incompatible with the rules and actions of GATT. To determine to what degree countertrade is consistent with GATT principles, two things have to be examined. The first is the nature of the CT deal, and the second is the degree of governmental involvement in each deal.

It is impossible to examine each CT deal to determine its compatibility with GATT rules. Such an examination is not usually undertaken unless there is an official complaint that a deal contains an export subsidy or a dumping practice⁷¹ or any of the practices that contradict the rules and principles of GATT.

On the other hand, GATT oversees the activities of governments and does not deal with private commercial entities. Moreover, it does not deal with all governments because GATT only oversees the activities of state-controlled economies⁷². These limitations make it difficult for GATT to deal with all CT practices.

What GATT can and cannot do can be summarized as follows:

- a) It is the responsibility of GATT to challenge a country's CT policy if the country has a "buy national" policy, even though CT activities are executed by private parties.
- b) Since state trading enterprises, according to GATT principles, should behave on the basis of nondiscriminatory treatment and in accordance with commercial considerations, GATT should evaluate a CT deal if the state trading enterprises circumvent GATT rules.⁷³
- c) GATT cannot deal with the countertrade practices of state-controlled economies because GATT regulations do not address the problems of accommodating state-controlled economies.

For all of these reasons, there is no officially published or announced position of GATT on countertrade but many writers consider GATT to be against CT.⁷⁴

The IMF

The International Monetary Fund does not formally oppose CT. It considers CT to be a reaction to increasing protectionism caused by recession and frequent variations of exchange rates. However, since the Fund exists - to promote international monetary cooperation and to eliminate exchange restrictions, its members are encouraged to terminate bilateral payment agreements.

CT, as a bilateral relationship between trading countries, may undermine the objective of the multilateral trading system, which is the basic objective of the Fund. In its Annual Report on Exchange

Arrangements and Exchange Restrictions, 1983, the Fund takes the position that CT deals share many of the microeconomic disadvantages that are common in bilateral payment agreements⁷⁵. The Fund's local officers merely use moral suasion to try to show developing countries the disadvantages of countertrade.⁷⁶

It is expected that the IMF may officially oppose CT since its rules oppose bilateralism in international trade.

The OECD

The Organization for Economic Cooperation and Development, with its 24 member countries, aims partly to "contribute to the expansion of the world trade on a multilateral, nondiscriminating basis in accordance with international obligations"⁷⁷. A 1985 report on countertrade prepared by the secretariat of the OECD stated that since in OECD member countries countertrade transactions are generally carried out by private enterprise with no government intervention, it was not necessary for OECD member governments to contemplate any specific control or regulation of countertrade transactions since the usual trading rules can be applied.⁷⁸ The general conclusions of this report showed that in countertrade the advantages had been often overestimated and the disadvantages minimized.⁷⁹

The UNCTAD

Since developing countries have, to date, not expressed a collective view on CT, the question of its possible use in North-South trade negotiations has not yet been raised in the multilateral forum where North-South issues are discussed. Thus, the UNCTAD has not yet taken a position on countertrade.

(2) Government Reactions to Countertrade

As stated earlier, developing countries have not to date expressed a collective view on CT. Some developing countries are strong advocates of CT, e.g., Indonesia, Uruguay and Ecuador. Other developing countries are moderately interested in CT, such as, Malaysia and

Guyana.⁸⁰ The arguments of the advocates will be mentioned later in this section.

It is not expected that any of the industrial countries which are members of the IMF and the OECD will officially support CT arrangements. However, no Western governments have outlawed the practice, and they are not expected to do so. On the other hand, they nearly all actively pursue a CT policy in the form of offset requirements. A few governments, e.g., New Zealand, have actually published offset regulations.⁸¹ The arguments of those countries opposed to countertrade will be discussed later.

(3) Why Is There An Argument Over Countertrade?

This question can be answered on two different levels: the macroeconomic or international level, and the microeconomic or national level.

a) The macroeconomic or the international level

Economists and international trade specialists have found many problems related to countertrade on the macroeconomic level.

- 1) The increase of CT arrangements internationally causes distortions in the multilateral trade and payment system. These distortions are due to the fact that CT helps perpetuate economic inefficiencies in the market place either because of the lack of transparency (especially concerning costs and prices) or because of government intervention in the market mechanism.
- 2) CT is a return to the bilateral system of trade, and it is not subject to any international rules or multilateral supervision.
- 3) CT affects the international payment system in many ways. It reduces the foreign exchange available to repay foreign debt. It takes no account of the progress achieved in international settlement.⁸² It contradicts the policy of

increasing the creditworthiness of developing countries since there is no increase in exports earnings.

- 4) Government intervention in the trading system can cause discrimination which affects competitiveness in the world markets.

b) The microeconomic or the national level

The fact that the countertraded goods of developing countries have to be sold at a discount as an incentive given to the purchaser or the final user of these goods means that loss and gain calculations should be made by each party involved in any CT transaction. This discount can be viewed as a discriminatory policy practiced by the exporter or as an opportunity cost to developing countries.

If countertrade could take place without discounts, then the enforcement of international prices would lead to economic efficiency. The fact that selling without a discount is almost impossible in selling to a third party sets an obligation on the developing country to sell at a discount, supporting the argument that CT is costly.

There are other costs associated with CT. These are the commissions paid to trading companies and banks, the extra insurance costs associated with the uncertainties of CT, which may extend up to several years with management costs arising from lengthy negotiations, and the costs related to government intervention to enforce countertrade laws.

On both the macroeconomic and the microeconomic level there are arguments against CT. On the other hand, many CT advocates have answers to these arguments.

(4) Drawbacks: The Arguments against Countertrade

In addition to the views of international organizations and the problems caused by countertrade on the international and the national level, those opposed to countertrade emphasize the following drawbacks:⁸³

- a) CT is time-consuming.
- b) CT includes many areas of uncertainty, e.g., the availability of countertraded goods, the quality of the goods and the effect of political unrest.
- c) In addition to the types of costs mentioned above, uncertainty adds to the costs of the banks covering CT transactions.
- d) Some forms of CT require extra financing such as the case of counterpurchase and buy-back. So it is not true that CT is trade without money.
- e) People often forget that, as most elementary textbooks explain, barter is an inferior method of exchange because it relies on the "double coincidence of wants".
- f) Mandatory or compulsory CT is costly and usually increases bureaucratic problems.

(5) Advantages: The Arguments for Countertrade⁸⁴

Advocates of CT arrangements put forth the following practical advantages of CT:

- a) CT assures access to supplies and guarantees the availability of desired commodities for a longer period of time.
- b) CT can circumvent the nontariff barriers imposed by some countries.
- c) CT is a method for avoiding the declining terms of trade of developing countries.
- d) Some forms of countertrade can help enhance the development plans of developing countries.

- e) CT can promote the excess supply of some commodities resulting in a savings in the storage of such commodities.
- f) Voluntary CT can expand trade and benefit development if it can circumvent governmental restrictions, obstacles and currency controls.
- g) CT agreements can maintain strategic security for the countries involved and support political ties between them.

VII. CONCLUSIONS

In order to evaluate countertrade, it is important to take into consideration the arguments of those both for and against CT.

The arguments of those opposed to CT are based on theoretical considerations and on the principles of multilateral agreements. It is not to be expected that the recent growth of countertrade will put an end to those multilateral agreements. At the same time, we cannot expect that countertrade as a counteraction measure will completely disappear in the near future if the original reasons for it cease to exist.

It cannot be denied that there is a need for CT arrangements on the part of both developing and developed countries. Western countries will not stop countertrading; IMF or OECD member countries can circumvent GATT rules and regulations, which are not tight enough to prevent CT. Eastern European countries will continue CT as long as the need for centrally planned economies exists. Trade among developing countries using countertrade is expected to expand in the near future taking into consideration the situation in the European Community in 1992, along with the expected performance of the world economy, which will also affect developing countries.

Although countertrade may cause economic inefficiencies, approval or disapproval of CT must take into consideration the results of comparing the costs and the benefits. This may mean that when evaluating CT, which is a subject beyond the scope of this paper, one

should deal on a case-by-case basis. Accordingly, CT is profitable to a developing country if:

- 1) CT can be done without discounts,
- 2) the other party can fully absorb the costs of CT,
- 3) the costs of CT can be minimized while the benefits are maximized,
- 4) CT is used to sell nontraditional and value-added exports to an existing market, or to a new market,
- 5) CT is used to expand the share of the developing country in an existing market,
- 6) CT can reduce the country's need for foreign exchange and guarantee the availability of a required commodity during a specific period of time, and
- 7) CT can result in development assistance.

NOTES

- 1) Stephen F. Jones, "Barter and Reciprocal Trade With Developing Countries", Economist Intelligence Unit (EIU) Special Report No.174, The Economist Publication Ltd., London, 1984, p. 1.
- 2) McVey's definition is that CT is a practice in international trade in which two parties link an import transaction and an export transaction in a reciprocal fashion. Carter and Gagne's definition is that CT is a word used to refer to all international and domestic trade in which goods are exchanged for goods. See: T.B. McVey, "Overview of the Commercial Practice of Countertrade" in B.S. Fisher, K.M. Harte (eds.), Barter in The World Economy (N.Y., Praeger, 1985), p.9, and also see: J. R. Carter and J. Gagne, "The Do's and Don'ts of International Countertrade", Sloan Management Review, Spring, 1988, p.31.
- 3) It, is also possible that three parties can be involved in a CT arrangement.
- 4) Jones, op.cit., pp.9-12.
- 5) Dick Francis, The Countertrade Handbook (N.Y., Quorum Books, 1987), p.5.
- 6) Jones, op.cit., p.79.
- 7) Carter and Gagne, op.cit., p. 31.
- 8) Ibid., p.32.
- 9) McVey, op.cit., p. 17.
- 10) Ibid., p.16.
- 11) An example would be the case of avoiding price or quota restrictions imposed by OPEC on its member countries.
- 12) OECD, "Countertrade, Developing Country Practices", A Secretariat Report prepared for the Trade Committee and its Working Party, OECD, Paris, 1985, p.30.
- 13) Unofficial and unannounced barter deals make it difficult to know the exact number of international transactions that took place.

- 14) McVey, op.cit., p. 17.
- 15) Jones, op.cit., p.40.
- 16) Francis, op.cit., p.18.
- 17) McVey, op.cit., p. 15.
- 18) UNDP, The Ministry of Foreign Affairs (Brazil), "Juridical - Legal Aspects of CT Operations" A Seminar held on December 3-4, 1986, Main Report, English translation.
- 19) Jones, op.cit., p.13, and also see: McVey, p.16.
- 20) Ibid., p.15.
- 21) Carter and Gagne, op.cit., p.32.
- 22) I. Wexler, Fundamentals of International Economics, 2nd ed., (N.Y., Random House, 1972), pp.174-176. This is a good reference for the development of the concept.
- 23) Francis, op.cit., pp.15-16.
- 24) Ibid., p.16.
- 25) Carter and Gagne, op.cit., p.32, and also see: Jones, op.cit., p.18.
- 26) Ibid., p.18. Another example of buy-back is that Occidental Petroleum negotiated a U.S. \$ 20 million deal with the U.S.S.R. under which Occidental would build several plants in the U.S.S.R. and receive ammonia over a 20-year period as partial payment. Also see: Carter and Gagne, op.cit., p.32.
- 27) Wexler, op.cit., pp.172-176.
- 28) It is also sometimes the case between state-owned trading companies or private traders. See: Francis, op.cit., p. 141.
- 29) McVey, op.cit., pp.18-19.
- 30) Francis, op.cit., p.20.
- 31) Jones, op.cit., p.15, quoted from a U.S. Dept. of Treasury Report, 1983.

- 32) Francis, op.cit., pp.24-25.
- 33) Ibid., pp. 75-81.
- 34) McVey, op.cit., pp.18-21.
- 35) As an example of the clearing agreement, a French exporter buying DM 1,000 worth of steel from Germany would pay the equivalent amount in Francs to the Bank of France. The French exporters who sell products to Germany are paid in Francs out of the same account. The same thing will happen to the exporters and importers in Germany. See: Wexler, op.cit., pp.175-176.
- 36) Indonesia, for example, has announced that it will allow the crediting of Indonesian exports generated by one firm against the CT commitments of another firm selling to Indonesia. See: McVey, op.cit., p.19.
- 37) Also there is the well-known "gas-for-pipes" transaction that took place between a group of private firms and the Soviet Union. See: McVey, op.cit., p.20.
- 38) Ibid., pp. 20-21.
- 39) Francis, op.cit., pp.103-106.
- 40) Ibid., p. 45.
- 41) Ibid., pp.72-81.
- 42) The legal systems of the United States and England, do not recognize "penalties" in contracts. See: *ibid.*, p. 72.
- 43) In their use, two problems can arise. The first is that the documents presented and accepted under the first L/C could prove unacceptable under the second. The second is that a third party may attempt to seize the money due under the first L/C if he is a creditor of the beneficiary. See: *ibid.*, p.74.
- 44) Examples are SACE of Italy, HERMIS of Germany and COFACE of France.
- 45) See: Francis, op.cit., Appendix 6, pp. 253-261.
- 46) Michael Rowe, "Countertrade And the Law II: Drafting the Contract", Development Business, August 16, 1989, p. 3.

- 47) David N. Koschik, "Structuring Barter and Countertrade Transactions" in Fisher and Harte (eds.), op.cit., p. 38.
- 48) Kyung Mo Huh, "Countertrade: Trade Without Cash", Finance and Development, IMF, December, 1983, p. 14.
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- 70) The General Agreement on Tariffs and Trade is a contract among member countries under which the member countries agree to limit their freedom of action to regulate international trade. See: R. Michael Gadbow, "The Implications of Countertrade under the General Agreement on Tariffs and Trade" in Fisher and Harte (eds.), op.cit., pp. 254-266.
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COMMENT

DR. MABID ALI AL-JARHI*

I have read with great interest Mahmoud Abul Eyoum's comprehensive paper on countertrade (CT). The material presents several theoretical as well as practical issues some of which I will deal with in this comment.

I. THEORETICAL ISSUES: WHY CT OCCURS

We live in a world in which money is used for the exchange of goods and services. Any transaction conducted according to barter or semibarter rules must be due to market imperfections. The following are five CT imperfections.

(A) Imperfect International Payment System

The International Payment System is a monetary system characterized by multiple currencies. Multiple currency systems are inherently unstable at the domestic level and are even more so at the international level because of the lack of a central monetary authority.

Since we have no "international currency", i.e., a universally accepted medium of exchange issued by an international "central bank", several national currencies are used as substitutes. However, their use is less than desirable for several reasons.

The first reason is that sovereignty rights accrue automatically to the country of issue, to the extent that its legal tender is used in the international market. Anyone holding, e.g., dollar banknotes or demand deposits with an American bank, is paying the United States sovereignty rights equivalent to giving a loan in the value of his dollar holdings at a zero rate of interest. This also happens to those holding dollars when the

* Senior Economist, The Arab Monetary Fund, Abu Dhabi, United Arab Emirates.

United States economy inflates faster than other countries. The payment of sovereignty rights is done automatically, as it is not subject to negotiations.* If negotiations were possible, traders would be motivated to use no monetary transactions when their cost is less than that of sovereignty rights.

The second reason is related to Gresham's Law. Every rational trader would try to pay for international transactions in the least desirable currency, presumably the least stable. Although relative instabilities of exchange rates should eventually be reflected in international interest rate differentials, when the system receives a shock, it adjusts over a period of time, during which transactions have no clear indicator of relative instabilities. In addition, as is obvious from the experience of the 1980s, the foreign exchange markets experience continuous shocks. The ultimate result is that a transact or will resort to a combination of tactics, including strategic behavior, hedging and consulting professional market experts, each of which is costly. Hence, any non- or semi-monetary means of trading which is less costly would be used.

(B) Imperfect International Capital Markets

Since capital flows among countries as foreign exchange balances, the imperfections of the International Payments System would be sufficient to distort international capital markets.

However, capital flows must also include capital goods, and associated services, some of which are produced in less than perfectly competitive conditions. Therefore, producers of capital goods and services with monopolistic powers will try to maximize their returns by using pricing schemes that combine time-in-sales with an extension of buying privileges to the output of the factories using their capital goods. Buyers of capital goods, recognizing such powers, will accede.

* Except, perhaps when someone gives the United States a loan through a contract which provides indexation against inflation.

This explains why producers of capital goods and services sell them in combinations, sometimes encompassing all, as in turnkey arrangements. It also explains why those producers contract to purchase some of the prospective output of the machines they sell, for the discount they obtain in advance on prices is an additional way to capture "The Consumers' Surplus".

(C) Trade and Exchange Restrictions

Trade and exchange restrictions tend to either prohibit movement of goods and services and foreign exchange, or make them costlier. When trade and exchange restrictions are combined, they can hinder international trade, where movements of goods and services are usually offset by settlements in foreign exchange. In such a cases, countertrade would be resorted to for the purpose of avoiding a settlement in foreign exchange. It also can be used as a cover for obtaining foreign exchange at a premium through parallel markets.

(D) Public Enterprise Behavior

The existence of large public enterprises, especially in Socialist and developing countries, has given rise to a category of business behavior which differs from the customary wealth or profit maximization. Managers are often bureaucrats who attempt to fulfill production targets, with little or no link to profit criteria, especially when the government budget bears the final financial results.

Countertrading provides managers of public enterprises with a chance to swap some of their products for their import requirements, without having to state specific prices which would expose low levels of efficiency. In this case, the transparency of the financial side of marketing is avoided for a lack of motivation to maximize profit.

(E) Specialization in Markets and Commodities

There is no doubt that the international markets (of goods, services and capital) are a complex network of ever-changing multilateral

relationships. This makes it profitable to specialize in international trade in general or in some aspect of it.

Specialists of international trade can be viewed as selling information related to potentially profitable exchanges, together with the ability to assist in concluding them. It is quite possible that the available information about certain exchanges is not divisible or, if divided, that it would command a lower price. In such cases, trade specialists would find it profitable to sell their information in packages. This can be done by combining the information about the demand for some goods with that about the supply of some others on each side of the exchange. Several forms of countertrading can, therefore, be developed.

II. PRACTICAL ISSUES: SHOULD WE USE CT AND HOW?

Having reviewed the theoretical reasons behind the use of CT, two important practical questions remain: Should we use CT and, if so, how can we use it efficiently?

(A) Should we use CT?

Dr. Abul Eyouun refers to an opinion held by those who are against CT that since countertrade is some kind of barter or quasi-barter exchange, it is inefficient. It must be obvious from the above that CT is a result of several imperfections. It cannot be the cause of inefficiency as long as it is conducted on the basis of profit maximization. When CT is carried out in this way, it is resorted to because it is less costly, i.e., more efficient than pure money exchanges.

The problem of inefficiency arises when CT is practiced by parties which are not directly interested in the profit motive, as in the case of public enterprises not operating on commercial bases.

All CT transactions would become efficient if the five imperfections mentioned above were to be set right. In fact, we would be taken a long way towards eliminating profitable CT operations if we reformed the international payment system through the replacement of the

current multiple currency system with a single currency, such as, the SDR.

However, until such a remote possibility materializes, there will remain opportunities to conduct profitable CT.

(B) How to use CT

An added implication of the theoretical issues is the question of what kind of general guidelines to propose for conducting CT. The following are examples:

- 1) Public enterprises should not be allowed to conduct CT unless they are strictly managed according to the profit motive and full transparency is guaranteed.
- 2) Developing countries should establish companies, preferably at the regional level, that specialize in different aspects of foreign trade. These companies would be used as a shield against the monopolistic behavior of market specialists and assist in conducting profitable CT deals with foreign producers. In addition, they can serve in promoting intraregional trade.
- 3) An effort must be taken to reduce the sources of inefficiencies in countertrading. First, transparency must always be insisted upon. Second, financial instruments representing import or export rights, guaranteed by the, monetary authorities and being transferable, can be used to introduce an element of multilateralism into CT.

* Some countries might find it beneficial, but not always possible, to shield themselves against some of the inefficiencies of the world payment system through the establishment of a regional currency.

- 4) The lack of foreign exchange is sometimes mentioned as an excuse for CT. Using such an excuse could encourage inefficient CT.

Countries lacking funds to finance trade can do the following:

- Carry out adjustment programs to assist in removing imbalances in the domestic as well as foreign sectors.
- Participate with neighboring countries in regional trade-finance, finance-guarantee and multilateral settlement schemes.

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GENERAL DISCUSSION

The general discussion on the presentations of Abul Eyoun and Jarhi on the theory of countertrade was opened by the chairman of the session by underlining the need of combining financing with countertrade. He gave the following example to highlight this need:

Suppose we want to import into Turkey scrap or steel from Sudan. We can finance that through, for example, the DIB, but we do not give that financing to Sudan. We use it to pay Turkey in cash to buy, for example, buses from Sudan.

As another example, suppose Morocco wants oil from Saudi Arabia and has oranges to offer in return. We will take oranges from Morocco and then give oil to Morocco, simply by financing the Saudi export of oranges and will finance, by the same amount to pay in cash for petroleum to give it to Morocco.

With these remarks, the chairman invited general discussion from the floor.

The general discussion basically concentrated on the need for creating and promoting countertrade within the Islamic World. Several participants drew attention to the disadvantaged position of developing countries when engaged in countertrade with developed countries. It was pointed out that exports from developed countries move faster because of their ability to produce quickly, whereas imports from developing countries move slowly because of production, supply and quality bottlenecks. Thus, developed countries accumulate surpluses which puts developing countries in a poor position from which to negotiate further countertrade arrangements. One suggestion in this respect was that countries should concentrate on bilateral arrangements of countertrade rather than indulging in multilateralism. Such an arrangement, of course, would be met with criticism from organizations, such as, GATT and the IMF, which oppose bilateralism. Some participants then strongly recommended that Islamic countries should develop their own free trade regions or common markets to carry out effective countertrade

transactions. The RCD, the EEC and the Caribbean Group were referred to as examples of regional groups which promote countertrade without coming into conflict with the policies of international trade and financial organizations. A suggestion was made that while talking of establishing monetary unions, attention should be paid to the development of an Islamic Foreign Trade Union.

A reference was also made to the lack of market information and its exchange among member countries and emphasis was placed on developing an effective market information system to exchange information about supplies and demands among Muslim countries.

While replying to the comments and suggestions from the floor, Dr. Abul Eyoun agreed that slow export performance from developing countries because of supply and quality bottlenecks puts those countries at a disadvantage vis-a-vis developed countries. He, therefore, emphasized the need for paying special attention to developing export industries so as to match the speed of imports from developed countries, which would also be beneficial for trade and development.

**COUNTERTRADE:
PRACTICES IN OIC MEMBER COUNTRIES**

COUNTERTRADE: EXPERIENCE OF PAKISTAN AND OTHER OIC MEMBER COUNTRIES

MIAN MUMTAZ ABDULLAH*

INTRODUCTION

Countertrade arose in the aftermath of World War II when the war torn economies of Europe needed raw materials both for reconstruction and for the development of industries and trade. As the European economies developed, this mechanism was replaced by free and multilateral trade. Only the Eastern European economies which needed raw materials and an export market for their semi-finished goods adopted countertrade in the form of bilateral agreements with developing countries. In the 1980s, the oil crisis aggravated the debt repayment problem and led to a shrinking commodity market and growing protectionism. The uneven distribution and the increasingly impaired flow of financial, technical and natural resources forced a large number of developing countries to impose conditions on their foreign trade by linking imports with exports.

VARIETIES OF COUNTERTRADE

There are various kinds of trade linkage, and countertrade is an amalgam of many methods of conducting international transactions. Only some of the varieties of countertrade will be discussed in this paper.

First, there is the barter arrangement where there is a direct exchange of goods of approximately equal value between two parties with no money involved. This type of countertrade is normally the result of bilateral agreement between two governments specifying the limits of trade and the commodities to be traded. A number of Socialist countries

* Additional Secretary, Ministry of Commerce, Pakistan.

have entered into barter arrangements with other developing countries. Pakistan is a member of eight such barter agreements.

Another form of countertrade is what is called the buy-back agreement. This is the result of long-term industrial cooperation agreements between developed industrial countries and developing countries whereby the latter agrees to buy machinery, equipment, technology and complete plants from industrial countries and to pay back in the form of a variety of resultant products. China is the leading example of a country which has successfully used such an arrangement. The buy-back mode is simple to operate, but due to the time lag for the installation of the plant and the production of its finished products, a number of difficulties arise particularly with regard to prices and finance.

Another form of countertrade is "switch trading" which operates within the ambit of the bilateral agreement. Due to imbalances, it also involves a third party who can use the goods and services under the bilateral protocol and in return pays the equivalent of the clearing value in reduced hard currency. Many consider this to be more a form of financing than trade. Brazil is a country which has used this mode of countertrade. Then there is the "off-set" which has a variety of meanings in countertrade circles but is generally used to refer to countertrade concerned with very high-value exports usually involving either civil/military aircraft or other military equipment. Offset agreements involve the major Western multinational corporations, particularly American and British Corporations, which are in the air, space and defence industries. Offset can also involve coproduction contracts, license production, subcontract production, overseas investment, technology transfer and other countertrade. A leading example of this type of offset is the Greek purchase of aircraft against offset. These aircraft included 40 F-16s from General Dynamics against 100 percent offset and 40 Mirage 2000s from France against 60 percent offset. The agreement for the French aircraft included 12 percent direct investment in the expansion of existing industries or new industries or infrastructure, 12 percent construction by Greek contractors in third countries, 12 percent tourism to be promoted by the manufacturers, 35 percent countertrade purchases

of Greek products emphasizing new clients and markets and 30 percent or more coproduction and maintenance of aircraft in Greek industries.

Finally, there is countertrade itself. There is no generally accepted definition of the term countertrade. It is used more in a generic sense to refer to a form of trade involving an element of reciprocity. The Economic Commission of Europe (ECE) has used the term countertrade as a "generic term" covering both barter and barterlike transactions, counterpurchase to designate short- and medium-term transactions involving an original sales contract and counterpurchase agreement and product buy-back to designate long-term industrial cooperation agreements where compensation is in whole or in part effected by the purchase of the resultant products. Countertrade is not trade without exchange of money except in the case of normal barter. It supplements normal trade. Countertrade transactions have, as a basic characteristic, some kind of linkage, legal or otherwise, between exports and imports of goods and services in addition to, or in place of, a financial settlement.

IMPORTANCE OF CT FOR DEVELOPING COUNTRIES

Developing countries face a number of problems, not the least of which being the dearth of foreign exchange and growing protectionism by developed states. The manufactured products of developing countries face tough competition not only from other countries but also from competition with the "treasuring of developed states" who subsidize their products in order to compete with imports. Not only do developed states provide financial support to their products, they also raise nontariff barriers to imports from developing countries. A recent GATT Secretariat Report on the Trading System (1988) listed about 200 export restraint arrangements presently in force. Unfortunately, two-thirds of these restraints pertained to the EEC and the United States who have used them for protection purposes. Thus developing countries are not only being forced to break these barriers to their exports, but they also have to look for new markets and reduce foreign exchange costs on imports so as to improve their trade balance positions. A partial answer to the problem is to have countertrade agreements as a part of the broader framework of trade policies. Countertrade agreements are designed to:

- a) Alleviate or overcome the shortage of foreign exchange;
- b) Support the continuation of industrialization programs;
- c) Promote the export of nontraditional goods for which there is a low demand in foreign markets; and
- d) Sustain export prices of goods in time of declining demand.

ESSENTIALS OF COUNTERTRADE ORGANIZATION

The essential elements for conducting countertrade are:

- a) A trade organization: Such an organization not only provides finance but also generates sufficient resources to meet the financial obligations involved. One of the earliest example of such an organization was the Japanese SAGO SHOSHA. Normally government trading organizations are used as the medium for such countertrade transactions.
- b) Agreements: A counterpurchase transaction often involves two separate agreements, i.e., the original sales contract and an agreement on the part of the primary exporters to counterpurchase an agreed amount of goods. Most of these agreements contain penalty clauses for failure to counterpurchase the goods as required.

EFFECTS OF COUNTERTRADE

There are both advantages and disadvantages to countertrade in terms of the effect that it has on the trade of a country.

(a) Advantages

- 1) It helps increase exports through the diversification of products and markets.

- 2) In times of severe foreign exchange constraints, it helps maintain the flow of imports.
- 3) It helps overcome the adverse effects of international cartels and other price support mechanisms for primary products.
- 4) It helps maximize the buyers' bargaining power if there is a bulk exchange of goods and services.

(b) Disadvantages

- 1) The cost of transactions is higher than normal. Imports become expensive.
- 2) There is lack of price transparency.
- 3) Price distortions effect the rest of the economy.
- 4) It leads to selective and arbitrary currency devaluation with respect to individual export items.

PAKISTAN'S EXPERIENCE

(a) Barter

Barter trade was started in Pakistan in the early 1960s. It has grown and acquired substantial size as well as considerable diversity in the items traded. Pakistan only has barter agreements with the U.S.S.R., Czechoslovakia, Hungary, Poland, China and Bulgaria, all of which are Socialist countries. Apart from these, there are commodity exchange arrangements with M/s. Kemira of Finland and M/s. Sukab of Sweden. The current barter ceilings are shown below:

- 1) U.S.S.R. US \$ 40 million (each way)
- 2) Czechoslovakia About US \$ 60 million (each way)

- | | |
|-------------|-----------------------------------|
| 3) Hungary | US \$ 40 million (each way) |
| 4) Poland | US \$ 25 million (each way) |
| 5) China | About US \$ 15 million (each way) |
| 6) Bulgaria | US \$ 80 million (each way) |
| 7) Kemira | US \$ 100 million (each way) |
| 8) Sukab | US \$ 104 million (each way) |

Barter trade normally accounts for about 6 to 8 percent of the global trade of Pakistan and about 3 to 4 percent of the total trade with bartering countries. All barter agreements with the Socialist countries and Commodity Exchange Arrangements with Sweden and Finland envisage a financial ceiling each way for the exchange of specified commodities. The transactions under these arrangements are conducted through interbanking agreements concluded between the National Bank of Pakistan and the designated bank of the bartering partners. The interbanking agreements provide procedures for the settlement of accounts. Socialist countries are important both for exports of goods and as a source of imports of industrial machinery and raw materials and, therefore, it was essential for Pakistan to enter into an agreement with them in order to obtain a sizable share of that market.

An import list specifically identifies barter commodities for import. Most of the barter items are allocated to public sector agencies while the remainder are allocated to the private sector. Similarly, an export list specifies barter items for export. Barter partners buy from Pakistan a mix of fast-moving and slow-moving items. An endeavor is made to maintain a ratio of 40 percent for fast-moving items, such as, raw cotton, cotton yarn, naphtha and leather, and 60 percent for slow-moving items, such as, engineering and other manufactured goods.

The barter partners of Pakistan can be divided into two groups: fast-moving and slow-moving. The fast-moving group includes Sukab and

Kemira, Bulgaria, Hungary and Czechoslovakia. They allow third country imports and exports which in turn helps Pakistan obtain some essential items, e.g., DA fertilizer, edible oil, wheat and machinery and equipment from Western countries. The countries of the fast-moving group deploy their barter by deploying their own foreign exchange and import Pakistani goods to destinations other than their own countries.

The second group includes barter arrangements with Poland, China and the U.S.S.R. which are slow-moving and do not provide for third country imports and exports. Third country imports under barter arrangements are allowed for the following reasons:

- i) The bartering partners deploy their own foreign exchange and supply sophisticated machinery against the export of Pakistani goods.
- ii) Third country imports help public sector agencies buy from worldwide sources and thus maintain a uniform inventory.
- iii) All third country imports under barter act as a cash substitution device.

In order to ensure price competitiveness, public sector agencies are allowed to accept a price premium up to a maximum of 7.5 percent in concluding purchase contracts under barter. This has been done to encourage the use of barter allocations by public sector departments and agencies in order to relieve pressure on foreign exchange reserves. On the other hand, fast-moving export items are also sold at a slight premium.

Trade under barter arrangements has been growing over the past few years, but the total size of trade under barter remains small. In the past, Pakistan has had a positive balance in barter trade, but, recently, due to large purchases of wheat and fertilizer, the trade balance has evened out.

(b) Pay As You Earn Scheme (PAYE)

This scheme, which has been in practice in Pakistan for a long time, is operative in the private sector, particularly in textiles. Under this scheme foreign manufacturers of machinery, supply machinery on a credit basis to Pakistani importers/manufacturers. However, this credit is repayable by the export of the products of the machinery to those countries which supplied the machinery. In other words, it is a Product Buy-Back Arrangement. It is mostly operative in the textile sector and has worked fairly well. However, its usage is not universal.

(c) Countertrade

In May, 1985, Pakistan decided to engage in countertrade for the following reasons:

- a) Global decreases in oil and commodity prices, the latter (e.g., rice, raw cotton, etc.) being Pakistan's major foreign exchange earners,
- b) Increasing protectionism in many markets, as a result of world recession,
- c) Foreign exchange shortages or restrictions imposed on developing countries as a result of debt rescheduling, and
- d) The fact that some of the nontraditional goods of Pakistan, such as, engineering, were either not finding markets or were not competitive, while at the same time there were countries which needed these engineering goods but did not have foreign exchange.

It was also felt that countertrade would not only enable Pakistan to remain competitive in an increasing number of export markets and to maintain its presence in these markets through the network of its countertrade partners, but that it would also provide a means for the

penetration of nontraditional markets through the network of countertrade partners.

In pursuance of this decision, it was decided that the party to conduct Pakistan's countertrade should be a state trading organization, i.e., the Trading Corporation of Pakistan. This decision was motivated by the fact that GATT and the IMF may object to the government's involvement in countertrade. Therefore, the TCP as a trading organization was asked to initiate the process of countertrade.

GUIDELINES FOR COUNTERTRADE

In order to successfully conduct countertrade, it was necessary to formulate certain guidelines for the selection of countertrade items, partners and a monitoring mechanism. The basic guidelines laid down for countertrade were:

(a) Price Competitiveness

Countertrade should be conducted in an atmosphere in which prices are internationally competitive both for Pakistani exports and imports. This was essential so as to ensure that Pakistan does not lose in countertrade transactions.

(b) Additionality in Exports

- i) It was recognized that countertrade would be a mechanism for ensuring additionality in exports particularly through the export of nontraditional items, slow-moving items and surplus items which otherwise due to financial and technical limitations could not have been exported in substantial quantities to exploit the full market potential.
- ii) Furthermore, it was to be ensured that certain items, which were normally traded in the international market and exported by Pakistan for cash, should only be included in limited quantities so as to act as an incentive for the export of

nontraditional items and should not become the main item of export, thereby depriving the country of precious cash resources.

- iii) It was to be ensured that the normal markets are not disturbed in any way by the inclusion of commodities which are normally sold for cash. Countertrade should aim at nontraditional markets and there should be no underselling in any of Pakistan's traditional markets.
- iv) The main emphasis should be on targeted areas for certain commodities.

(c) flexibility

Countertrade should not act as a straitjacket for the public sector . confining it into a rigid pattern. Flexibility should be the principle.

(d) Monitoring

There should be an organization responsible for monitoring the arrangements of all imports and exports and swing limits and for ensuring that goods are going to the right markets and that a proper ratio is maintained between traditional and nontraditional Pakistani export items. Similarly, this monitoring organization would also check imported items to determine their usefulness to the country. This would mean that all transactions would be properly monitored from the opening and execution of letters of credit and the establishment of prices and markets to the final settlement of claims.

(e) Review

A review should be carried out after every six months so that a strict watch can be kept on the system and its utility.

SELECTION OF PARTIES

In order to select countertrade partners, the TCP invited proposals from 53 multinational firms. The criteria for selection was based on the following principles:

(a) Company's Profile

The company's profile included information about the nature of the company's business and field of activities; size of the firm including its capital; assets; profits earned during the previous three years; network and trade transactions carried out during the previous three years and financial ability to conduct countertrade.

(b) Area of Operations

The areas of operations of the multinational firms were also carefully scrutinized. Detailed information was requested regarding countertrade experience and branches and subsidiaries in the form of outlets in Pakistan, Asia and Latin America.

(c) Confidential Reports

Confidential reports about the multinational firms were obtained from various sources abroad including Pakistani embassies.

Based on this information, an indexed comparative statement was prepared of the various firms which had offered to act as countertrade parties, and it was decided to enter into countertrade agreements with the following six multinational companies:

- 1) M/s. Mitsubishi Corporation of Tokyo, Japan.
- 2) M/s. Prudential Bache Trade Corporation, New York, USA.
- 3) M/s. M.G. Services Company, London, U.K.
- 4) M/s. Compagnie Commercial Sucres Et Denvees (Sucden), Paris, France.

- 5) M/s. A.B. Sukab, Sweden, and
- 6) M/s. Marcotrade, Switzerland.

In the end M/s. A.B. Sukab and M/s. Marcotrade did not sign the countertrade agreements while another party, M/s. Enka of Turkey, was added to the list. Accordingly, the TCP signed frame agreements with the five selected multinational firms:

FEATURES AND PARAMETERS OF COUNTERTRADE

(a) Itemwise Export Ceilings

The export emphasis was to be on nontraditional and new items would give additionality in exports. However, in order to generate interest, some traditional items were also included to cover the size of the countertrade agreements. The ratio between the two was 30 percent for traditional and 70 percent for nontraditional items.

(b) Import List

Import items were not specified. Goods of any origin could be imported provided they were in accordance with the Import Policy.

(c) Ceiling of Countertrade

The ceiling of the countertrade under each agreement was fixed at US \$ 50 million each way with a swing limit of US\$ 10 million. This implied:

- i) That the value of goods sold and bought would be settled through a trade account to be opened in US dollars Pakistani Banks designated for countertrade and the nominated banks of the countertrade partners. LCs would be opened by these banks only.
- ii) The difference between the value of purchase by the two sides would not exceed US\$ 10 million at any point in time.

iii) Any credit/debt balance in the account would be settled through delivery of goods through an extended period of 90 days, but if any balance was left thereafter, it could be settled by a cash payment not to exceed US\$ 5 million.

(d) The frame agreement and the bank agreement were to be valid for one year only and could be extended by mutual consent. If they were extended, no cash settlement would be made for the previous years.

(e) Exports from Pakistan would be on an FOB basis and imports would be on a C&F basis or an FOB basis (for public sector imports).

(f) Settlement of any claims of goods imported or exported would be settled outside the arrangement.

PERFORMANCE AND CRITICAL APPRECIATION

Countertrade agreements with the multinationals expired after one year on June 4, 1987.

These agreements were extendable for 90 days for the settlement facility only. The Government of Pakistan did not exercise the option of extending the countertrade agreements, since during the pendency of the countertrade agreements, the total trade transacted amounted to only US\$ 16.045 million as against the targeted value of US\$ 450 million (both ways). The trade transaction of US\$ 16.045 million consisted entirely of exports; no imports took place under the countertrade. The reasons for this low volume were analyzed, and it was found that:

a) The frame agreement did not generate an increase in the volume of business and, in fact, led to a slowdown in business. The absence of a built-in mechanism to encourage large turnover had a dampening effect. The concept of countertrade envisages a mandatory linkage between the purchase and sale of goods, but the agreement did not provide any such linkage and import and export transactions were

treated as independent entities. For this reason, the agreement did not result in the boosting of exports.

- b) The presence of a liberal import policy acted as a deterrent to imports under countertrade. A large number of imports for cash are available to the private sector, and the countertrade partners could not compete with these imports, particularly with the higher prices involved. Moreover, the import requirements of public sector agencies controlled by the government were not eligible for countertrade with the result that they did not use countertrade as a vehicle for the import of their requirements which could be linked with the export of their products.
- c) No incentives were given to the countertrade parties for the reduction in import licence fees, import duties, etc., which could have encouraged importers to import through multinationals.
- d) The Government of Pakistan under an agreement with the International Monetary Fund agreed to phase out existing bilateral agreements and refrain from entering into any new agreements which might increase exchange restrictions.

The above mentioned factors show that the basic defect in the countertrade agreements lay in the fact that imports were not linked with exports. The import of specific commodities should have been restricted to countertrade transactions and linked to the import of specific items. In fact Pakistan could easily have utilized countertrade for the import of palm oil, sugar, fertilizers, tea, etc., and could have asked the countertrade parties to export engineering goods, rice and other goods against them. However, under the free import policy, these items can be imported for cash by any registered importer and, therefore, any advantage which the countertrade parties could have had was nullified. Similarly, the public sector agencies which produce engineering goods imported their raw material requirements independently under cash licences. If these public sector agencies could have been brought under

the umbrella of countertrade through the mechanism of budgetary allocation, their import requirements from the importing countries could have been partly offset by their counterpurchases of Pakistani goods.

Thus, the failure of the countertrade can be attributed to the nonlinkage of imports with exports which was inherent in the frame agreement. While other countries have found countertrade to be a good vehicle for international trade, Pakistan failed to utilize it for the purpose for which it was set up.

STATE TRADING AGREEMENTS

Pakistan had been importing tea freely from worldwide sources. The major sources were Kenya, Sri Lanka, Bangladesh, Indonesia and China. In the case of Kenya alone, it was found that while Pakistan imported tea worth millions of dollars from Kenya, Kenya's imports from Pakistan were negligible. Pakistan, therefore, decided to link the import of tea with exports from Pakistan under agreements to be entered into with specified states. Pakistan decided in its Trade Policy of 1987-1988 that the import of tea would be on the following basis:-

- a) Up to 70 percent requirement of tea would be imported through Special Trading Agreements with the supplying countries. As an initial step, the countries to be included in the trade agreements would be Kenya, Sri Lanka, Bangladesh and Indonesia. A reasonable percentage of imports into Pakistan was to be linked with the export of engineering goods from Pakistan.
- b) The remaining 30 percent of the tea requirement would be imported freely in cash by the existing importers of tea but subject to the condition that no more than one-third of their imports would be from any single source.

In view of the fact that Pakistan was one of the world's largest importers of tea, the announcement of the new Import Policy had a salutary effect on tea prices. The Trading Corporation of Pakistan was

directed to enter into Special Trading Agreements with the designated countries for the import of tea against the export of engineering goods and other value-added items. Accordingly, it entered into Special Trading Agreements worth US\$ 20 million with Bangladesh, US\$ 30 million with Sri Lanka and US\$ 20 million with Indonesia for the import of tea in lieu of exportable goods. Kenya nominated a private party which failed to enter into an agreement and consequently imports from Kenya were restricted to cash imports. Against the import of tea under Special Trading Agreements, the main items of export were engineering goods, nontraditional goods and other manufactured goods, such as, sports goods, surgical goods and cotton yarn. Due to the weak market response to Pakistani export items in STA countries, the respective governments could not compel their private sectors to import these items from Pakistan. Therefore, while Pakistan was able to import tea of substantial value under the STAs, an equivalent export could not be made.

As a consequence, the STA countries demanded the inclusion of traditional export items, such as, rice, cotton and other primary commodities. In the case of Bangladesh, there were no serious problems, but different problems were faced with the other countries. In the case of Indonesia, two private companies were nominated by the government, but due to procedural problems, the companies failed to honor the contract and indulged in unethical practices. Against a commitment of US\$ 20 million worth of tea imports, only US\$ 1.3 million worth of tea could be imported in the first few months. On the other hand, exports resulted in an adverse balance of trade under the STA, necessitating cash settlement in hard currency along with payment of interest.

In the case of Sri Lanka, a large quantity of tea was imported, but exports moved slowly. Moreover, due to the pressure of the IMF, the Sri Lankan Government did not agree to the extension of the STA for a further period of time.

As exports were negligible, the adverse balance of trade was increasing and tea prices were rising, it was decided to abandon the experiment and allow the free import of tea for cash in January, 1989, and, thus, this experiment ended in failure.

EXPERIENCE OF OTHER OIC COUNTRIES

A number of members of the Organization of Islamic Conference are associated, in one form or another, with countertrade. Some of these members include Malaysia, Bangladesh, Egypt, Turkey, Sudan, Tunisia, Syria, Saudi Arabia and Iran. Countries having no or little countertrade include Kuwait, North Yemen, Oman, Qatar and Nigeria. As it is impossible to discuss all of these countries, I have selected only a few examples of countertrade/barter in which members of the OIC are involved.

MALAYSIA

Malaysia adopted a countertrade policy in 1982 as a means of promoting and increasing the export of Malaysian goods and commodities and of rectifying the country's balance of trade position as well as of saving foreign exchange. Countertrade is carried out by the Unit Khas Countertrade (UKC) of the Ministry of Trade and Industry. The guidelines are such that each deal is determined on its merit, although preference is given to tenders that include elements of countertrade for public sector contracts. Most Malaysian products may be considered for countertrade arrangements subject to the approval of the UKC. However, purchases must be made from Malaysian companies in Malaysia. Primary export commodities, such as, rubber, palm oil, tin and oil, are included in the list. Countertrade proposals are governed by the following criteria:

- a) Exports must be to the country of origin of the tenderer.
- b) Exports must be in line with Malaysia's export interests.
- c) Exports must be additional to and will not displace sales that Malaysian exporters are making or could reasonably be expected to make.
- d) Exports must be for new markets; and

- e) Exports must be in such a manner as not to prejudice the reputation of Malaysia as a quality supplier or disrupt Malaysia's commercial interests.

Whenever a government department issues tenders for purchase, a clause is added for payment through an offset with Malaysian goods. The experiment has proved to be quite successful.

INDONESIA

In 1982, countertrade was officially introduced by the Indonesian Government for government contracts in an attempt to expand exports and as an economic response to protectionism in industrialized countries. The regulations governing countertrade are contained in the Ministry of Trade Document entitled "Guidelines for Implementation of Linking Government Procurement with Indonesian Non-Petroleum Exports". These guidelines apply to governmental imports valued at over US\$ 500,000 which are linked with exports from Indonesia. They exclude procurement under soft loans and credits from international institutions like the World Bank, the Asian Development Bank and the Islamic Development Bank. The foreign supplier is required to sign a Letter of Understanding in which he agrees to purchase Indonesian products equal to the FOB value of the imported products. This is submitted to the Director General of External Trade for approval. The actual transactions are, however, carried out directly between the foreign importers and Indonesian exporters. An example of this type of agreement is the STA between Indonesian tea exporters and Pakistani importers through the Trading Corporation of Pakistan.

Four important features of Indonesian countertrade policy are :-

- 1) Countertrade exports must provide additionality to historical sales.
- 2) In case of noncompliance by the foreign party, a penalty of 50 percent of the value of export obligations is to be levied under the Letter of Understanding.

- 3) Indonesian export products must be exported in stages during the pendency of the contract and must be completed at least three months prior to the termination of the period of contract for government procurement.
- 4) Obligations can be assigned to a third party trading house.

Indonesian imports include fertilizer, buses, passenger ships and machinery, whereas exports mainly consist of hard and soft commodities, textiles and plywood. The permanent countertrading partners of Indonesia are West Germany, Japan and OECD countries.

BANGLADESH

Bangladesh has entered into both barter agreements and Special Trading Agreements. Most of the barter agreements are with Socialist countries for the exchange of goods of mutual interest. The responsible organization is the government-sponsored Trading Corporation of Bangladesh which signs agreements for the exchange of goods with private business houses of foreign countries. Such agreements include Special Trading Agreements, (e.g., the one with Pakistan in connection with the export of tea), countertrade agreements and trade promotion agreements. A value is fixed for both the export and import of goods after mutual consultations. The values of the STAs vary and range between US\$ 5 to 15 million each way. The agreement with M/s. Comtrade Limited, Switzerland, was for a maximum value of US\$ 18 million, and recently, Bangladesh entered into an agreement with M/s. Kemira of Sweden for a trade of US\$ 5 million each way.

The validity of the STA is one year extendable by mutual consultations. The validity periods of countertrade agreements range from three to six months. STA transactions are routed through special nonconvertible U.S. dollar accounts opened on the nominated banks by foreign partners with a scheduled bank in Bangladesh. Imbalance at the end of the agreement. is settled as per terms laid down in the agreement. Such agreements have helped Bangladesh to attain additionality in its exports and to overcome foreign exchange constraints.

TURKEY

The recent economic upsurge in Turkey is partly attributable to countertrade and "build-operate-transfer" (BOT) techniques. Foreign companies bidding for public sector imports worth a minimum of US\$ 0.1 million are given preferences if they can arrange offsets to cover part of the costs. One of the first attempts at countertrade was made between ENKA (a Turkish Government Trading Corporation) and the Trading Corporation of Pakistan for a trade of US\$ 0.5 million each way, but, unfortunately, this attempt was unsuccessful. However, by 1985 countertrade accounted for nearly 40 percent of ENKA's total trade.

Major Turkish export items under countertrade include textiles, foodstuff, machinery and equipment, paper and cardboard, construction and building materials, rubber and plastic products, furniture, chemical products and transportation vehicles. Import items include oil products, fertilizers and minerals. Major OIC partners of Turkey in countertrade are Iran, Iraq and Libya who account for nearly 35 percent of Turkey's total trade.

The framework of countertrade provides that a company whose total export is over US\$ 0.5 million can engage in countertrade. The monitoring of countertrade is a direct responsibility of the Ministry of Foreign Trade and Treasury which operates under the Prime Ministers' Secretariat. Public Sector agencies and enterprises enjoy the same position as a General Trading Company in respect of countertrade.

IRAN

In recent years, Iran has used countertrade effectively to meet import requirements and to export its excess commodities. In 1982, it sold oil to purchase Japanese construction machinery and New Zealand lamb. Since 1983, it has had an agreement with Pakistan to sell oil for agricultural produce and other consumer goods. In fact third parties were involved in this agreement to supply essential commodities to Iran after the war. Another important countertrade partner has been Turkey. In

addition, Iran has initiated bilateral barter agreements with several countries.

POTENTIAL OF COUNTERTRADE AMONG OIC COUNTRIES

It will be seen that countertrade is the only solution available to OIC member countries in order to promote their exports and to overcome the rising trend of protectionism in industrialized countries. There is a great potential for growth in countertrade among OIC member countries, and it may well be a potential area of expansion in the coming years through both government-to-government deals and ad-hoc transactions. The depression in commodity prices and high interest payments on debts are limiting the availability of foreign exchange for imports. This will further aggravate the situation and the- remedy will have to be sought in mutual trade.

Restrictions laid down by the IMF regarding the clearing of accounts within three months coupled with the barriers imposed by developed countries, particularly the EEC with its eventual emergence as a single market in 1992, can pose serious problems for developing Muslim countries. Moreover, the 1980s, have seen the emergence of regional groups, such as, the ASEAN Group, the Caribbean Group and the Latin American Group, which has further limited the scope of trade of newly developing Muslim countries. The remedies, therefore, will have to be sought in mutual trade between OIC member countries.

The countertrade experience of some OIC member countries has been very satisfactory and can assist in developing a new approach to the conduct of countertrade among members of the OIC. These countries among themselves can cater to one another's needs and prove beneficial to their fellow members. The oil requirements of most non-oil producing countries can be met by importing oil under countertrade while the products produced by these countries can be used to satisfy the requirements of oil producing countries for a variety of items produced in the Third World. The products which can be traded among OIC

member countries include textiles, engineering goods, leather goods, agricultural commodities, minerals, including oil, and even manpower.

Restrictions laid down by the IMF regarding the clearing of the accounts within three months can be fitted into the overall structure of the agreements so as to make them acceptable to international bodies. However, rigid policies will have to be avoided and flexibility given to the countertrade parties where the benefits of countertrade should outweigh other considerations. Countertrade among OIC member countries would facilitate the expansion of trade between members without disturbing existing trade with the developed world.

ROLE OF THE ISLAMIC DEVELOPMENT BANK

To facilitate countertrade arrangements among Muslim countries, a system is needed for exchanging goods which does not depend upon payment in convertible currencies and is operated by an institution in which Muslim countries have confidence and which operates in accordance with the rules which they have devised. Such an institution must be technically competent and independent of influence from any particular group of countries. The Islamic Development Bank is such an institution.

The IDB can play a vital role in bringing together OIC member countries under its umbrella for countertrade. It can act as the Central Clearing Bank for the transactions of the countertrade parties and at the same time provide guarantees which may be necessary for the least developed OIC member countries. As a first step it can establish and continually update a data bank containing comprehensive information on the countertrade policies and practices followed by its members. It can set up a countertrade business center/exchange in the Bank with all the necessary support systems to help member countries in the conduct of countertrade. Such a center would :

- 1) Identify potential countertrade partners among the various members and bring them together for a successful conclusion of business.

- 2) Provide all the information, support and consultancy services required for negotiations and the conclusions of countertrade transactions, including switching, leasing and buy-back.
- 3) Provide support for negotiating countertrade financing by contributing to the development of a financial network.
- 4) Develop guidelines for countertrade negotiations and for the drawing up of model contracts.
- 5) Innovate new contract packages to realize countertrade business.
- 6) Provide a forum in which Muslim countries can discuss and realize their long-term trade relationships at optimal levels of cost and risk.

Thus, the Islamic Development Bank by setting up a countertrade center/exchange would be able to provide a forum for discussing, negotiating, deliberating and realizing the countertrade activities of member countries. The countertrade center/exchange would also be able to solve the numerous financial problems of member countries by encouraging trade rather than aid, while at the same time member countries would benefit in terms of cost savings and increased revenue earnings.

COMMENT

DR. M. FAHIM KHAN*

Mian Mumtaz Abdullah has provided a good account of the countertrade experiences of some OIC member countries. The paper is very informative and educative, and aspects of it paper are very thought provoking.

Even though there are several purely economic arguments for countertrade arrangements (which I will highlight in my discussion on the paper of Makhoul), I agree with Abdullah that countertrade is required to protect developing countries against those practices of developed countries which we may call "quasi-countertrade" activities and which are making it difficult for developing countries to survive in the international market and to solve their balance of payment difficulties. It is very instructive to note in Abdullah's paper that there are 200 export restraint arrangements, two-thirds of which pertain to the EEC and the United States. Developing countries are thus compelled to depend on bilateral arrangements to look for markets for their products in order to reduce their balance of payments. Most of these bilateral arrangements turn out to be what the developed world now refers to as countertrade arrangements.

Despite the fact that countertrade is becoming indispensable, there is definitely a need for developing countries to use countertrade arrangements to the best of their advantage and not to let these arrangements erode the economic benefits that are available to them through regular trade channels.

I think Abdullah has made a very good point in suggesting that countertrade arrangements should be made by developing countries as a part of the broader framework of their trade policies.

* The author is in the Islamic Research & Training Institute of the Islamic Development Bank. The views in this paper are his personal views and do not reflect or imply an official position on any aspect in any way.

This is a lesson that we should learn from the "quasi-countertrade" policies of the developed world where these policies are an integral part of trade policies.

The value of Mumtaz Abdullah's paper lies in its description of the countertrade experiences of Asian OIC countries with emphasis on Pakistan. This paper along with the other case studies in this seminar should not only help us understand countertrade realities in OIC member countries but should also highlight important lessons which may help the **IDB** to exploit its potential for promoting economic development within and for promoting trade and economic cooperation among OIC member countries.

Let us look again at the main features of the existing countertrade practices in OIC member countries. From the paper of Mumtaz Abdullah, it is clear that although the classical form of countertrade, i.e., barter trade, has long existed in some OIC countries, such as, Pakistan and Bangladesh, the use of nonconventional forms of countertrade is not only very recent but also very insignificant (with the possible exception of Turkey).

A Manual of Comprehensive Reference Service on Countertrade prepared by the International Association of State Trading Organization (ASTRO) of developing countries clearly indicates that very few countries in the Third World, in general, and in OIC countries, in particular, formally and openly recognize countertrade arrangements or give them a distinct place in their trade policies. There are, however, several OIC countries that carry out countertrade operations through public sector organizations by issuing the necessary directives from time to time. Some OIC member countries are not officially involved in such arrangements although some private companies at their own level demand countertrade in their transactions with their partners abroad. A paper prepared in the

* "Complementary Manual of Comprehensive Reference Service on Countertrade", ASTRO, TTTOVA 104, P.O.B. 92 - YU 61109 Ljubljana, Yugoslavia, 1985.

Islamic Research & Training Institute' classified OIC countries by the level of official recognition of countertrade arrangements as shown in the following table:

Table 1

**LEVEL OF OFFICIAL RECOGNITION OF
COUNTERTRADE PRACTICES IN OIC COUNTRIES**

CT legislation enacted	Indonesia, Jordan, Malaysia, Saudi Arabia and Syria.
CT directives (CTD)	Algeria, Egypt, Guinea (Bissau), Guinea (Conakry), Indonesia, Iran, Iraq, Jordan, Libya, Malaysia, Morocco, Nigeria, Pakistan, Saudi Arabia, Syria, Tunisia and Turkey.
CT demand by companies	CTD countries and Bangladesh, Benin, Senegal, Sierra Leone, Somalia, Sudan, and United Arab Emirates.

Source: Derived from ASTRO Survey 1986, ASTRO-Volume Manual, complementary Manual of Comprehensive Reference Service on Countertrade, (Ljubljana, ASTRO, 1985) pp.1-8.

A second feature that emerges from the study of Mumtaz Abdullah is that it is clearly an objective of OIC countries that countertrade should serve its own purpose and should not in any way become a substitute for regular foreign trade. OIC countries have the following two objectives to be achieved through countertrade operations:

- a) Diversification in the creation of new markets for various economic and noneconomic reasons;
- b) Saving foreign exchange.

* Dr. Emin Carikci, "Countertrade Experience and Economic Cooperation Among Selected OIC Member Countries", Mimeograph, Islamic Research and Training Institute, Islamic Development Bank, Jeddah, 1988.

In the case of the first objective, countertrade is "conducted in an atmosphere where prices are internationally competitive both for exports and for imports". In the case of the latter objective, (which has been referred to by Mumtaz Abdullah as additionality of exports), countertrade aims at exporting nontraditional export items, slow-moving items or surplus items importing in return the goods which otherwise would be imported for cash. Competitive pricing is not the primary objective. This, in fact, is a useful guideline for all those developing countries which have not thus far entered into countertrade agreements while engaging in countertrade indiscriminately.

Pursuing an objective approach towards countertrade requires careful planning and monitoring. Mumtaz Abdullah points out that though there is awareness in OIC member countries of the need to carefully plan and monitor countertrade arrangements, no proper institution has been established by these countries to achieve this objective. Some attempts have been made to plan and monitor countertrade through state trading organizations, but there has been little effort made to plan, organize and monitor countertrade through the private sector within the overall framework of the economic and trade policies of OIC member countries. This is an area that requires particular attention from the planners and policymakers in OIC member countries.

One also gets the impression from Mumtaz Abdullah's paper that apart from a few exceptions, countertrade arrangements have not generally been very successful in OIC countries. Mumtaz Abdullah suggests several factors for this lack of success. Firstly, the absence of linkage between exports and imports in some countertrade agreements caused these agreements to be unsuccessful. Secondly, some countries had a liberal import policy which included the same goods being acquired through countertrade arrangements. This discouraged the countertrade arrangement particularly from the point of view of imports. Thirdly, pressure from the IMF, etc., proved to be a major problem. In some cases, countries had to discontinue their countertrade agreements as a result of such pressures. Fourthly, the lack of a proper mechanism for the settlement of claims/disputes arising out of countertrade agreements was also a discouraging factor.

Several problems in the promotion and effective utilization of countertrade arrangements are probably unable to be handled at the level of individual countries. The promotion and effective utilization of countertrade requires a joint cooperative effort by Third World countries. OIC countries have a lot of potential for such cooperation at both the global and regional levels, and Mumtaz Abdullah has provided good insight in his paper in this respect.

We must give serious thought to the recent developments, outlined by Mumtaz Abdullah, that necessitate Muslim countries to cooperate in their trade activities. The various restrictions laid down by the IMF, the trade barriers imposed by developed countries, particularly the EEC, the emergence of various regional groups, etc., have seriously limited the scope of Muslim countries for the expansion of trade. This is very clearly reflected by the declining share of OIC countries in world trade. I agree with Mumtaz Abdullah that effective cooperation among Muslim countries can overcome several of the difficulties including those imposed by organizations like the IMF. Due to the limitations of time, it was perhaps not possible for Mumtaz Abdullah to discuss various aspects of and strategies for using countertrade to enhance trade and economic cooperation among OIC countries. This is, in fact, a subject for further research. Some OIC institutions must take up this study in depth for the benefit of all OIC member countries.

CONCLUSION

Although I cannot agree with Mumtaz Abdullah that countertrade is the only solution available to developing countries for promoting their exports, I definitely do agree with him that countertrade must be exploited to the best advantage of OIC countries and as far as possible preferably with only Third World countries as their countertrade partners. One cannot fight the rising trend of protectionism in industrialized countries by engaging in countertrade with them, as this will simply strengthen what I have earlier referred to as the "quasi-countertrade" arrangements of the developed world.

After witnessing the successful operation of the concept of customs unions, common markets, etc., I believe that it is time for developing countries to think not only of their own unions and common markets for regular trade, etc., but also, and more importantly, of their own "countertrade unions".

A countertrade union of all or of regional groups of OIC member countries can help them coordinate their countertrade policies in their best interests. They can use it to make countertrade policies in order to :

- i) create trade among OIC member countries;
- ii) substitute trade with the developed world which often leads to the problem of the scarcity of hard currency; and
- iii) reinforce one another's development plans by coordinated trade policies.

Countertrade for developing countries is not a new phenomenon. In the past they have resorted to countertrade arrangements because of their lack of access to international markets for various reasons. The phenomenon has, however, gained recognition and become a topic of world discussion only after developed countries began entering into substantial countertrade contracts with oil rich countries, particularly in the Middle East. Most of the literature on the subject generally reflects the situation from the point of view of developed countries. It is essential that this phenomenon be studied in depth purely from the standpoint of the Third World. The discussion of this seminar will prove to be an important contribution to the literature on this aspect of countertrade. I suggest that some international Third World institution establish a unit to monitor the developments in this area and conduct in-depth studies of the issues involved. I think that it can be suggested that the IDB take up this task at least from the point of view of OIC member countries. The suggestion of Mumtaz Abdullah to establish a countertrade center at the IDB deserves consideration.

The development of two institutions is essential in OIC countries intending to use countertrade arrangements substantially. Firstly, there is a need to establish a coordinating agency that can coordinate countertrade arrangements between the public and private sector and which also can integrate them with the overall economic and trade policies of the country. This agency should also be a source of information and guidelines for the official utilization of countertrade arrangements both by the public and the private sector. Secondly, there is a need to develop a financial setup to provide the necessary financial support for countertrade arrangements. Specialized financial institutions need to be created for this purpose as is being done in the Western World. Mumtaz Abdullah has given the example of SAGO SHOSHA in Japan. This and other examples from the West can provide a basis for the development of industrial, regional or global institutions for OIC countries to cater to the growing needs of countertrade operations.

A CASE STUDY ON THE EXPERIENCE OF THE ARAB REPUBLIC OF EGYPT IN THE FIELD OF COUNTERTRADE (POLICIES, PRACTICES AND POTENTIALS)

MAMDOUH EL MASRY*

HISTORICAL BACKGROUND

Egyptian foreign trade policy has passed through several phases since World War II. One feature of the early 1950s was the large amount of free currency earned by foreign trade. However, control was imposed on foreign exchange with the increase in import requirements resulting from consumption and development conditions, which also necessitated setting import priorities, which were controlled by licence-giving, regulations and quantitative and administrative restrictions.

Importation from all over the world had to be conducted within the limits of the available free foreign currency, by means of direct contract and payment in free currency. These resources went short of demand in the late 1950s and deficits began to be recorded in the balance of trade and the balance of payments. These gaps had to be filled through credit facilities.

With the advent of the 1960s, the comprehensive planning principle started to prevail. The role of the public sector increased in different economic domains. Egypt's economic relationship with the Socialist block was strengthened, and Western economic pressure on Egypt increased. Under such circumstances, Egypt's foreign trade began to depend on bilateral clearing agreements in trade and payment with Socialist and several developing countries.

* The author is the Chairman of the Board of Directors, Misr Foreign Trade Co., Cairo, Egypt.

However, payments of commercial exchange with free market countries, whether advanced or developing, still had to be cleared in hard currencies.

In the early 1970s, several local and world changes took place, reflecting on Egyptian socioeconomic philosophy and trade policy. International trade financing organizations began putting pressure on Egypt to end clearing agreements, as they were seen to be contradictory to the fundamental principles of free international trade and a discriminatory tool in trade among countries, as well as being harmful to the normal flow and development of world trade. This occurred at a time when Egypt was entering upon a new era of economic openness. The private sector was assuming a position side by side with the public sector in the arena of production and foreign trade. This coincided with the beginning of the rise in petroleum prices. Petroleum headed the list of Egyptian exports yielding profits almost double those of other commodity returns. This provided a tangible improvement to the balance of payments.

Meanwhile, imports double and Egypt underwent an overall review of most of its economic laws and policies. Foreign trade and economic relations were also reexamined.

In the early 1980s, these developments led to the application of the countertrade system in foreign trade relations, in order to achieve numerous targets, such as: a) adapting to the necessity of change in commercial dealings with countries with hard currencies by promoting nontraditional exports thus affecting the commodity composition of exports, b) achieving equilibrium in commodities and the structure of foreign trade and c) facing the escalating requirements of importation, particularly of vital goods.

The relative success of countertrade with Socialist countries, led to extending it to several advanced and developing countries.

The contents of this paper clearly indicate that countertrade now occupies a prominent position in Egypt's commercial dealings with other countries and in its present trade policy.

PERMANENT FEATURES OF COUNTERTRADE IN EGYPT

This section reviews the motives for adopting countertrade as a part of the Egyptian foreign trade policy. It covers the patterns of countertrade including a description of the geographical and commodity composition of Egyptian countertrade transactions.

(a) Motives for the use of Countertrade

Egypt resorted to the use of countertrade for the purpose of:

- 1) Fulfilling the country's requirements of basic and strategic commodities without draining the country's resources of free currencies.
- 2) Marketing the local production of industrial and agricultural nontraditional commodities, diversifying exports and opening new markets.
- 3) Enabling public sector foreign trade companies to achieve designated import targets.
- 4) Improving the private sector's chance of participating in export operations and the marketing of its products at reasonable profitable prices.
- 5) Achieving the benefit of dealing in hard currencies, in addition to obtaining the value of exports in these currencies, in case the foreign party fails to provide commodities in return for exports.
- 6) Lessening dependence on borrowing from abroad to finance imports and limiting the increase of debt burdens.

(b) Patterns of Countertrade Applied in Egypt

Egypt practices several patterns of countertrade in its economic and foreign trade relations, including the exchange of commodities and services, industrial cooperation and extraction processes.

.1. Patterns and Formulas of Countertrade/Counterpurchase

The two parties to the deal pay the value in cash of what one receives from the other of commodities and services. Usually the implementation of such deals, takes place over a relatively short period of time (e.g., one to five years).

Buy-back: In the case of buy-back, which is also called Direct Compensation, agreement is concluded on buying machines or tools necessary to set a production industry, along with technical assistance, expertise and installation, in return for exporting part or all of the production of this industry. Completing this deal usually takes a relatively long period of time (e.g., five to ten years).

Clearing Agreements: In the case of clearing agreements, agreement is reached on the exchange of limited quantities of commodities, with equal total value to be calculated in settlement currencies, for a limited period of time (one year, for example). By virtue of such bilateral agreement, the exporter in both countries receives his dues from selling in local currency provided by the Central Bank in his own country.

2. Parties to and Nature of Countertrade Deals

Deals with Socialist Countries: These deals include long-term payment (clearing) agreements with these countries covering the bulk of the commercial exchange with them.

Deals with Free Market Countries: These include a limited group of commodities, whose total value or detailed prices are

defined. These deals are to be carried out in a short period of time.

Partial Compensatory Deals: These include exporting a certain commodity in free currency in return for setting aside a ratio of exports receipts with which to import a particular commodity.

Deals Conditional on One Type of Commodity: These deals require importing a certain commodity in return for exporting a certain commodity at full value.

Deals Complementary to Clearing Protocols: These deals are concluded at conditions and currency prices much different from regular protocols.

Deals with Industrial Countries Extending for Several Years: These deals pertain to imported investment commodities in return for various Egyptian commodities.

3. Geographic Distribution Trends of Countertrade Deals

In the period 1981 to 1988, Egypt concluded 92 deals with a total value of US\$ 4,801.7 million with various African, Asian, Arab, Eastern European and Western countries. The geographic distribution and the relative importance of the different groups of countries as regards the value of deals in 1987-1988 are as follows:

- Eastern European countries	45.5%
- Advanced Western countries	20.8%
- Arab countries	30.8%
- African and Asian countries	2.9%

The countries within each group are as follows:

which is an impediment to marketing in advanced countries. Countertrade is also an alternative to direct investment and capital : ' transfer through agreements which stipulate the industrial and technological cooperation to supply and install plants; while paying for them in counter commodities or products of the plants.

- b) The Egyptian Government's policy is for expansion in countertrade deals, with an emphasis on nontraditional exports. These deals also alleviate pressure on the balance of payments, and they support the requirements of development plans, particularly production and construction tools and foodstuff.
- c) The following serve - as - an indication of the increasing importance attributed to countertrade deals in Egypt's policies, economic plans and foreign trade:
 - The number of countertrade deals/agreements increased from one in 1981 to 27 in 1987. The value of these deals grew from US\$ 30 million in 1981 to US\$ 1,164 million in 1987.'
 - The geographic distribution of countertrade deals changed from, in the beginning, dealing only with Socialist countries to dealing with countries all over the world with different socio-economic systems and stages of development.
 - Egyptian exports through countertrade deals represent 60 percent of total commodity exports (excluding petroleum) with an average US\$ 600 million per year.
 - Egyptian imports through countertrade deals represent 30 percent of total imports worth an average 'US\$ 1,000 million per year.

(2) Nature of Countertrade Deal Operations Compared to Clearing/Bilateral Payment and Trade Agreements

Countertrade deals are concluded on the basis of international prices and are settled in free currencies with proofs of credit opened in

commercial banks according to commercial agreement and parallel banking arrangements.

The bilateral clearing agreement is concluded in local currency according to an agreed upon accounting exchange rate in relation to one of the free currencies. Implementation is effected via the Central Banks of both countries and a unified ceiling for indebtedness is decided upon. Within the context of this ceiling, credit facilities are exchanged and commodity exchange stops when the ceiling is reached. Moreover, the deal has to follow the proper constitutional and legislative channels in order to be endorsed.

The two systems agree to establish equal value lists for exchanged commodities, to set a maximum time limit during which the agreement is to be carried out, and to settle differences between the volume of each party's implementation in cash in a free currency.

Therefore, the clearing agreement represents an exchanged governmental commitment to export and import specified commodities within a definite period of time, not exceeding two years.

(3) Criteria and Rules Governing Decision Making in Concluding a Countertrade Deal

The following criteria are used in decision making in a countertrade deal:

- a) The biggest possible share of equilibrium and commodity offset to be achieved between exports and dollar imports (usually concluded in free currencies).

- b) The approval on deal items to be obtained from the appropriate Egyptian authorities in order to benefit from imports and exports.
- c) The export of cotton to be linked to the import of important strategic (dollar) commodities for the industrial and productive sectors in Egypt, such as reinforcement iron bars, wood, paper, construction equipment and tobacco.
- d) The value of cotton exported in the deal not exceed 20 percent of the total deal value provided that Egyptian cotton . be exported (related to the dollar commodities in importation lists) along with a penal clause on reexportation.
- e) The value of nontraditional commodities in the deal not to be less than 20 percent of the total value, particularly as regards commodities exported for the first time.
- f) All importation rules to be abided by, and importation to take place prior to exportation, in order to enjoy advance financing (in view of the monetary resources deficit).
- g) Raw cotton not to be listed in deals concluded with Japan and Western European countries with which deals can be made in hard currencies in order to guarantee maintaining traditional markets and to halt speculation on cotton prices in world markets.
- h) All such deals to be carried out or concluded by public sector companies only. Private and investment sectors are only allowed to export and import through one of these companies.

(4) Organizational Structure to Design, Endorse and Follow up Countertrade Deals in Egypt .

The following steps are taken in designing, endorsing and following up Egyptian countertrade deals:

- a) Ministerial Decree No.297 of 1986 passed by the Minister of Economy and Foreign Trade established a General Committee on Countertrade Transactions which issues approval on countertrade deals and agreements concluded between Egyptian and foreign entities. After receiving the approval of the Committee, the deals and agreements are presented to the Minister of Economy and Foreign Trade for final endorsement and implementation.
- b) The deal, preliminarily agreed upon and signed, is effective only after the approval of the Committee. The Committee is composed of delegates of the beneficiary sectors and representatives of the Public Sector Authority for Foreign Trade, the General Monetary Management and the Central Bank. The Committee discusses the draft deal, introduces amendments and ratifies the deal on a preliminary basis.
- c) The deal is not applicable except after being ratified by the Minister of Economy and Foreign Trade after being referred to him in a Committee report.
- d) After the Minister endorses the report, the Committee rapporteur writes to the concerned Egyptian authorities to brief them on the decision of the Committee.
- e) The Public Sector Authority for Foreign Trade, being responsible for the activities of foreign trade companies, conducts periodic follow-ups of the implementation of deals. The implementation follow-up takes place monthly and a report is sent every month to the Minister of Economy and Foreign Trade.

PREPARATORY STAGES IN COUNTERTRADE DEALS

This section covers an important stage in executing countertrade agreements. It explains the two parallel trade and monetary arrangements that countertrade operations regulate.

(1) Agreement of the Deal

The steps in making this agreement include the following:

- a) International contacts are made between foreign parties and competent Egyptian parties.
- b) A preliminary agreement is reached on the commodity lists that can be exchanged through the deal.
- c) The approval of the Egyptian beneficiary of the import and export items in the deal is obtained.
- d) A draft deal agreement, together with related monetary and banking arrangements, is negotiated with the foreign party.
- e) The draft agreement and annexes are submitted to the General Committee on Countertrade Transactions (Countertrade Deals) for preliminary approval or amendment.
- f) The draft agreement is signed if the General Committee gives preliminary approval with the condition that it is endorsed by the proper authorities.
- g) The final agreement is presented to the Committee on Countertrade Transactions for decision making and ratification.
- h) The Committee refers the final agreement to the Minister of Foreign Trade and Economy for ratification.
- i) A Minister's ratification is considered the final approval for a start-up taking the necessary executive measures.
- j) Upon the Minister's approval, the Committee rapporteur writes to the concerned Egyptian authorities to brief them on the decision of the Committee.

(2) Monetary and Banking Arrangements

The following steps are involved :

- a) Credits are opened in transferable free currencies, and, by the end of the deal term, accounts assets are to be settled in free currencies (should that be in Egypt's interest) or in goods (should that be in the foreign party's interest), all depending on the banking arrangements within whose context the deal is implemented.
- b) An account is opened at the local bank in return for a correspondence in the other country party to the deal. The value of exports is to be paid deducted from that account.
- c) Importation precedes exportation. The value of imports is deposited in the referred account and when a certain form for exportation within the range of the deal is ratified, it is stipulated that payment be made by means of deduction from that account. Moreover, the competent bank should certify that the value is within the range of the deposits of that account.
- d) In case the foreign party insists on exportation by the Egyptian party before importation, no goods would be allowed to be shipped from Egypt unless positive proof exists that credits have been opened in return for the goods to be shipped to Egypt within the framework of that deal.
- e) Implementing the deal should not incur the transfer abroad of any currencies.
- f) For those countertrade deals which include the exportation of commodities whose revenues enter the Foreign Currency Pool of the Central Bank (e.g., cotton and rice), the Central Bank's approval has to be obtained before including such commodities in the deal. Consideration is given to the fact that according to the monetary arrangement of countertrade deals, the

Foreign Currency Pool of the Central Bank shall not be supplied with the returns of these exports, in accordance with the arrangements stipulating the nontransference of any currencies abroad.

- g) The equation of the value of imports which would be added to the special account is to be calculated on the basis of the declared exchange rate at the Foreign Currency Pool. Payment for the value of cotton and rice is to be made to exporting companies on the basis of the declared exchange rate at the Egyptian Central Bank Pool along with adding the difference between the two rates to the account of profits resulting from foreign exchange transactions.
- h) Deduction for the imports within the range of these deals is effected from the monetary budgets and the monetary shares in free currencies appropriated to the sector benefiting from the importation operations within the range of the monetary budget.

GENERAL REVIEW AND ASSESSMENT OF COUNTERTRADE PERFORMANCE (1985-1989)

1) During the period 1985-1989, 59 countertrade deals were executed with a total value of US\$ 2,718.9 million. The geographical distribution of these deals was as follows:

Countries	No. of deals	Value of deals	Relative Importance %	Executor	Relative Importance %
East Europe	22	1117.2	41.1	409.2	51.3
West Europe	20	465.0	17.1	74.4	9.3
Arab Countries	8	1044.0	38.4	306.0	38.3
Africa	5	40.4	1.5	8.8	1.1
Asia	3	42.3	1.6	-	-
The U.S.A.	1	10.0	0.3	-	-
Total	59	2718.9	100.0	798.4	100.0

2) There were 37 deals with a total value of US\$ 2,271.2 million which were started but not yet completed by June 30, 1989. Contracts worth US\$ 1,230.8 million were signed. Proof credits worth US\$ 1,150.4 million were opened, and the value of executed deals. was US\$ 798.4 million.

3) Twenty-two deals were signed during the period 1986-1989, but so far they have not been enacted. These include ten deals signed in 1986-1987 worth US\$170 million in exports and imports. In 1988-1989, there were twelve such deals whose total value was US\$277.7 million in imports and exports.

Nonimplementation was due to the following:

- Recent ratification of deals.
- The existence of obstacles in the preparation of banking arrangements.
- The inadequacy of proposed import and export prices on both sides as a result of exchange rate problems before the application of the free banking market rate on countertrade deals.
- The length of time consumed by banking arrangements (three to six months).

POSITIVE RESULTS AND BENEFITS

The following were the objectives of countertrade deals in terms of boosting the Egyptian economy and foreign trade:

- 1) Promoting exports particularly of nontraditional commodities.
- 2) Marketing raw cotton in years of ample production and cotton yarn in years of ample store.

- 3) Importing strategic commodities needed by Egypt, in view of the scarcity of foreign currency, in a manner to prevent the occurrence of commodity bottlenecks and the resulting negative effects on producer and consumer demand.
- 4) Increasing and balancing the volume of commercial trade between Egypt and the outside world so as to alleviate balance of trade and payments problems and maintain the value of the Egyptian pound.
- 5) Developing all Egyptian exports through recourse to diversification.
- 6) Regaining foreign markets for Egyptian exports, particularly those that once dealt with bilateral clearing agreements systems for trade and payment, but then converted to the hard currency system of dealing.
- 7) Saving hard currency for other vital purposes.
- 8) Diversifying Egypt's trade partners around the world.
- 9) Benefiting from international experiences and the continuing growth in the field of counter deals.
- 10) Being freed from bilateral clearing agreements for trade and payment.
- 11) Avoiding an increase in foreign debt burdens resulting from the use of expensive credit facilities to finance imports, and also avoiding concluding some loans.
- 12) Opening new markets in developing countries all of which find it difficult to market their products and have the same interest in using countertrade.

- 13) Importing production requirements, tool and vital spare parts in order to continue production, industrial development, renewal and renovation.

PROBLEMS AND IMPEDIMENTS IN THE APPLICATION OF COUNTERTRADE

The main obstacles facing countertrade activity in Egypt are as follows:

- 1) The foreign party insists on making traditional commodities the largest part of Egypt's countertrade exports. These commodities are sold on the open market at profitable prices and are an important source of foreign currency.
- 2) The quantities of cotton exports are reduced in countertrade deals, as a result of the reduction of the quantity of cotton produced.
- 3) Some production sectors, particularly the industrial, refuse to implement the items listed for exportation (e.g., coke coal, aluminum, shoes, molasses, wool and glycerine), despite the ratification of these items by the general committee. They prefer to keep the foreign currency returns or to sell them in international outbiddings.
- 4) High prices are demanded by some production sectors (e.g., spinning and weaving) for countertrade export commodities. This leads to a rejection of the commodity by the foreign party at such prices, thus confusing the implementation of the rest of the deal.
- 5) Minimum prices (premises prices) exceed the international prices of some agricultural commodities for exportation.

- 6) The housing sector rejects the importation of reinforcement iron bars in countertrade deals with some Eastern European countries.
- 7) Some countries request to deal only in hard currencies instead of counter deals.
- 8) Egyptian countertrade export deals continue to depend on traditional commodities, thus increasing the cost of imports and negatively affecting the country's resources of hard currency, limiting the potentials of speedily developing nontraditional exports.
- 9) Delivery is delayed for reasons pertaining to production and shipping.

POTENTIALS AND NEW HORIZONS

The following recommendations are intended to make countertrade more effective and flexible and more responsive to the very nature of trade.

Reducing the cash dollar traditional commodities in countertrade deals to the minimum possible, guaranteeing that counter imports are vital strategic commodities usually imported in hard currency and consequently deducted from the foreign exchange budget. In other words, to effect an accurate balance between traditional export commodities and basic import commodities.

- 2) Linking imports in countertrade deals with development priorities.
- 3) Guiding countertrade deals more towards hard currency countries.

Taking care to direct more deals towards developing countries in Asia and Africa.

- 5) Achieving better coordination and cooperation among all parties related to production and foreign trade in the planning, implementing and future visualization of counter deals in order to attain the best agreements.
- 6) Encouraging the productive and commercial private sector to conclude and carry out counter deals, directly or indirectly, in order to benefit from their potential and efficiency.
- 7) Urging industrial companies to improve production and to study market requirements to be able to expand and diversify nontraditional exports.
- 8) Restricting countertrade deals to a limited number of commodities which can realistically be dealt with and abided by.
- 9) Opening assets in commercial banks, particularly (an Egyptian bank for the promotion of exports), to finance part of Egyptian exports in each countertrade deal, particularly nontraditional exports, so that without waiting to open proof credits, exports can be delivered on time in return for foreign commodities imports.
- 10) Having the Egyptian bank pay Egyptian exporters in Egyptian pounds, as soon as shipment procedures are over, provided that afterwards the Bank conducts the necessary banking arrangements with the bank assigned to carry out the deal on behalf of the Egyptian government.
- 11) Making the import orientation and export promotion policy the basic framework for the Egyptian negotiator in countertrade deals.

- 12) Using the counter deals system in the field of tourism in return for strategic import commodities, particularly with companies with a workers' incentive policy and with countries which can provide tourists in exchange for Egyptian exports.
- 13) Extending counter deals to the Egyptian military production, whose export potential is increasing and which enjoys a good reputation for quality, particularly with Arab and developing countries.

CONCLUSIONS

This section presents the main points currently discussed in Egypt for and against countertrade and highlights some positive aspects of the future of countertrade.

(1) Views for Countertrade

Views in favor of countertrade include the following:

- a) Countertrade is a method for increasing and promoting Egyptian exports in foreign markets, particularly the export of nontraditional commodities which figure marketing effort. In addition, countertrade helps to fulfill the country's requirements for basic commodities.
- b) We live in an age of economic groupings, which leads to protective measures for exports thus weakening the export chances of Egyptian products. Countertrade deals in their varied forms are able to bypass these protective measures.
- c) Countertrade helps offset the scarcity of foreign currency resulting from Egypt's increased volume of foreign indebtedness in addition to the permanent deficit in the Egyptian balance of trade in favor of its trading partners, due to the amount of Egyptian falling short of the quantity of imports.

d) Countertrade activates the production sector, particularly in the case of exports, thus increasing employment.

(2) Views against Countertrade

Views opposed to countertrade include the following:

- a) Countertrade deals have a negative effect on Egyptian national industry. They are in the best interest of traders, not industry, thus harming national industry.
- b) These deals aim to get rid of certain products, disregarding the seriousness of considerations in order to continue dealing.

(3) The Future of Countertrade

Despite the opposing views, countertrade is an attempt to break the fetters imposed on development as a result of a shortage of hard currency.

Hence, we believe that in the future countertrade will continue to be used, especially as it is now being used by more than one hundred countries.

Moreover, Egypt has managed to conclude and implement countertrade with great success, which has contributed to the promotion of exports and provided Egypt's basic requirements of some major commodities, particularly with Socialist countries.

(4) Role of Countertrade in Developing Egypt's Economic and Commercial Relations with Arab and Islamic Countries

Without doubt, the conscious flexible foreign policy observed by Egypt, which has been crowned by the restoration of normal ties with Arabs states and its good relations with Islamic countries, opens horizons for developing future commercial relations, particularly with Arab countries. Most of these countries face similar economic conditions

regarding the shortage of foreign currency necessary for economic development.

(5) Importance of Countertrade in Attracting Foreign Financing for Development and Investment

Egypt can benefit from countertrade by attracting the necessary foreign investment and financing to set up several service and production projects. Through countertrade foreign capital and financing can be attracted to several necessary projects in return for paying the case investment value expenditure for these projects or marketing products or services of these projects to creditor parties. This will increase social development without incurring without additional economic burdens.

(6) Proposal Pertaining to Foreign and Egyptian Banks

A specialized countertrade department should be established to facilitate banking procedures and provide counsel and guidance to commercial companies in the field.

(7) Proposal for Attracting International Institutions

International institutions such as the Islamic Development Bank and the Arab Monetary Fund should be briefed on the importance of countertrade in world markets and should play a role in the field. Moreover, future activity should be formulated into an annual plan in coordination with the plan for foreign trade.

(8) Proposals for Attracting Joint Private Sector Organizations

Joint private sector organizations of businessmen, such as, the Chamber of Commerce, the Producers Union and the Businessmen's Council should be represented in countertrade deals since they are conversant with the Egyptian market requirements for commodities and services.

**A CASE STUDY ON THE EXPERIENCE OF
TURKEY IN THE FIELD OF COUNTERTRADE
(POLICIES, PRACTICES AND POTENTIALS)**

ARMAGAN ASINA*

In the early 1930s, some European countries, e.g., Germany, stopped the free purchasing of goods and adopted a countertrade policy. Since those countries were the major trading partners of Turkey, Turkey had to organize itself according to the countertrade policy.

After the Second World War, Turkey liberalized its foreign trade policy together with other European countries. According to statistics, the share of countertrade (clearing) in overall foreign trade was over 50 percent before 1945, but decreased to 10 percent after that date.

Turkey signed "the Treaty of Money and Payment between European Countries" under the Marshall Plan in 1949 which gave Turkey the opportunity to finance imports with national currency under an agreed account, while clearing the residual of the account with foreign exchange.

In 1958, Turkey's new foreign trade policy restricted all kinds of barter or countertrade.

In 1963, when Turkey started the planned economy era, all kinds of clearing agreements were programmed to be eliminated. Accordingly, by 1974, only the Soviet Union and Albania were left as countries having clearing agreements with Turkey.

However, the economic crisis starting in 1974, affected Turkey and caused a shortage of hard currency. Hence, Turkey had to sign bank agreements, mostly with Eastern European countries, which were similar

* Advisor to the Undersecretary for Treasury and Foreign Trade, Turkey.

to clearing agreements. These countries were Czechoslovakia, Romania, Hungary, Poland and Yugoslavia.

The year 1980 was a turning point in the Turkish economy in that Turkey abandoned its import substitution policy and adopted an outward and market oriented policy of growth.

The main components of this policy were:

- . A flexible foreign exchange rate.
- The liberalization of foreign trade and payments regulations.
- A tight monetary policy.
- An interest rate policy designed to encourage domestic savings.
- The deregulation of prices especially in state economic enterprises.
- The encouragement of a foreign investment policy.
- A number of incentives to accelerate exports.
- A new tax system including value added tax.
- The establishment of free trade zones in various regions.

As a result of these policies:

- A strong pace of GNP growth was achieved.
- The value of merchandise exports jumped by 400 percent from US\$ 2.9 billion in 1980 to US\$ 11.7 billion in 1988.

- During the same period, imports increased reaching US\$ 14.3 billion in 1988.
- The export/import ratio increased to 82 percent in 1988 from 37 percent in 1980.
- As a percentage of the GNP, exports rose steadily from 5 percent in 1980 to around 20 percent in 1988.
- The chronic current account deficit was reversed for the first time in 16 years and resulted in a surplus of about US\$ 1.5 billion in 1988.
- The composition of exports drastically changed from agricultural to manufactured goods. The share of industrial products in total exports increased from 36 percent in 1980 to 77 percent in 1988.
- There was an increased diversification of exports in terms of commodities and countries. While Turkey exported 956 items to 83 countries in 1980, the number of exported items increased to nearly 4,000 and the number of countries to 123 by 1989.
- Turkey restored its creditworthiness to attract international lending, gained access to international capital markets and used external finance to implement her adjustment policy.
- Permits for foreign capital inflow increased from US\$ 97 million in 1980 to US\$ 825 million in 1988.
- In 1988, Turkey achieved without any difficulty a debt servicing amounting to US\$ 7.2 billion of which US\$ 2.8 billion was for interest payments.
- Some infrastructure projects, such as, power plants, motorways, bridges and extension of airports, were

undertaken by the private sector within the framework of the build, operate and transfer model.

More than 23 international banks opened branches or formed joint ventures in Turkey.

Under these favorable conditions, Turkey had bilateral trade agreements and banking arrangements with many countries up to 1988. As broadly defined by the IMF and the OECD, those agreements are countertrade or barterlike transactions since they contain a special account for payments and special limits or a product list.

In the case of banking arrangements, there was a special account opened at the central banks of each country. Some of them had credit limits (like the agreements with Romania and Hungary) so that if any party exceeded the limits, it would pay in cash. Interest could also be charged on a LIBOR basis. In bilateral trade agreements, there is no cash flow (as in the agreement with Iran). The account had a large credit limit and goods were used against goods in order to balance the account.

At present, the agreements between Turkey and the U.S.S.R., Poland and Czechoslovakia involve payments of some project credits by commodities. These agreements can also be considered to be countertrade arrangements.

In most of these bilateral agreements (except with Iran, Iraq and Libya), payments for services are excluded and subject to cash payment.

Once the general conditions have been determined by the agreement, other conditions such as price, shipment and delivery are determined freely by the companies involved. Then payments are made in local currency by the Central Bank of Turkey. Hence, there is no transfer of money, because everything takes place on account.

The Undersecretariat of Treasury and Foreign Trade is the responsible authority for signing bilateral agreements on behalf of the

Turkish Government, and the Central Bank is responsible for the notification of these agreements.

Among other forms of countertrade, the following are the most commonly used in Turkey:

- 1) Counterpurchase
- 2) Barter trade
- 3) Offset

As regards counterpurchase and barter trade, there is an article in the Turkish export policy which states: "Only State economic enterprises and foreign trade corporate companies are allowed to do counterpurchase and barter trade with permission from the Undersecretariat of Treasury and Foreign Trade".

At this point a brief word needs to be said about "Foreign Trade Corporate Companies" (F.T.C.C.). Any trading company registered as a corporation with a minimum capital of 1 billion TL and realizing an annual export volume of US\$ 100 million is granted the title of "F.T.C.C." In fact, such companies are nothing more than general trading companies of the Japanese or Korean style. They are granted special credit facilities, interest rate reductions and tax rebates. Also, imports from those countries with centrally planned economies can be realized by these companies. Today, there are around 30 F.T.C.C.s in Turkey, and they account for 52 percent of total Turkish exports.

The most popular form of countertrade in Turkey is the offset agreement which is mostly used in the defense industry.

There are two types of offset agreement. One is the direct offset arrangement in which the product, subject to the agreement, will be produced in Turkey as a coproduction and then will be exported. The other one is the indirect offset arrangement according to which the foreign company either invests in Turkey in fields not related to the product under agreement or agrees to provide assistance in the exporting of Turkish products to nontraditional markets.

There are five types of business that can be established in Turkey for the purpose of offset agreements. The first is government to government in which license arrangements allow the transfer of technical data in order to manufacture all or part of the product sold to Turkey.

The second is licensed production in which technical data is transferred to a Turkish private or public entity to manufacture a product of foreign origin.

The third is subcontractor production, usually between Turkish and foreign private parties. This does not necessarily involve license or technical data transfer but allows the production of a part or component of a foreign origin product by a Turkish manufacturer.

The fourth is overseas investment which often includes capital investment in Turkey to establish or expand a subsidiary of a parent company resulting from a particular commitment in the offset arrangement.

The fifth is technology transfer in which technical assistance is provided to a subsidiary or a joint venture in Turkey. Other activities such as research and development are conducted in Turkey as a result of an offset arrangement.

The recent purchase by the Turkish Ministry of Defense (MOD) of F-16 Jet Fighters from General Dynamics Inc. for over US\$ 4 billion is the largest countertrade arrangement in the history of Turkey. The project includes: various types of countertrade; a foreign military sales ("FMS") financing program; a joint venture between United States and Turkish partners and potential subcontracting opportunities.

The various forms of countertrade involved in this project are direct and indirect offsets. The direct offset phase consists of the Turkish MOD as the purchaser; General Dynamics as the seller of the aircraft and Tusas as the joint venture in Turkey with Turkish and United State partners. In this project, General Dynamics, General Electric and Westinghouse provide United States capital and technology. Also,

General Dynamics has agreed to help pay for a plant in Turkey for the coproduction of the F-16 Jet Fighter's components.

The indirect offset phase includes the obligations for General Dynamics, General Electric and Westinghouse to buy goods and services not related to the F-16 project for ten consecutive years (five periods of two-year programs).

The United States FMS financing was another booster to this project. This program was established to assist foreign governments in their military purchases in the United States while promoting the sales of American defense articles and services. FMS financing program is provided to foreign governments to purchase military goods and services from the United States Department of Defense, whereby the United States government has contractual responsibilities and covers all selling expenses. The FMS program has two types of assistance: direct loans and guaranteed loans. Direct loans are financed by the United States Department of Defense for the procurement of defense articles out of funds specially appropriated in the federal budget. Guaranteed loans are provided by the Department of Treasury's Federal Financing Bank for the procurement of defense articles. Guaranteed loans are guaranteed by the Guaranty Reserve Fund and do not require full appropriation, as they are primarily off budget.

Another type of countertrade agreement was signed between Turkey and the U.S.S.R. in 1984. According to this agreement, Turkey buys natural gas from the U.S.S.R. and the payment is made by the export of certain Turkish products.

Finally, the "ECO Agreement" between Iran, Pakistan and Turkey can be seen as an example of countertrade under which these countries buy and sell goods to each other.

Apart from these developments in countertrade relations, a new form of countertrade has been introduced under the name of "build-operate and transfer" (BOT). This system, motivated by the decrease in government investments and foreign investment incentives, is used in

some infrastructure investments, such as, hydropower plants, airports, subways, ports and railways. The BOT account has now reached around US\$ 500 million, and it is expected to reach US\$ 1.5 billion.

I would like to conclude by stating the merits and drawbacks of countertrade arrangements from Turkey's point of view.

First of all, countertrade may be an alternative technique for expanding international trade. If it is used in the most suitable projects and structured properly, it can facilitate financial arrangements and help to create new markets. Projects that are suitable for countertrade arrangements require fixed capital and/or advanced technology intensive investments that are of great importance for the economic development of the importing country.

The types of projects that can make a positive contribution to the Turkish economy include: projects targeting the needs of the Turkish market, projects directed for exports that upgrade local production and enhance efficiency, cost effectiveness and competitiveness in the world market, and projects focusing on the development of local natural resources.

In past instances, countertrade obligations imposed on exporters have been used mainly as a means to market goods which were in low demand, in surplus, or which were uncompetitively priced (e.g., manufactures from Eastern Europe). Today, countertrade requirements are most often intended to cope with credit constraints which affect the ability of a growing number of Third World countries to finance trade. For many of these countries, countertrade now seems a potential alternative for the financing of imports for which foreign exchange credit is no longer forthcoming.

Although economic adjustments are well underway in certain countries, including Turkey, the fact remains that the ability to import is impeding their efforts.

Therefore, the following arguments can be mentioned in favor of countertrade:

- 1) The importance of countertrade gains momentum when the world debt crisis, coupled with lending restrictions imposed by Western commercial banks, decreases the availability of funds, which in turn increases the cost of lending.
- 2) Countertrade can be used to provide an alternative to prevent the negative effects of an adverse foreign exchange rate and the oppressive hard currency repatriation policies which may be imposed by developing countries.
- 3) The presence of export promotions provided by some countries to their exporters, who are faced with countertrade demands, has also encouraged the practice of countertrade.

Despite all these favorable arguments for countertrade, there are some drawbacks.

- 1) Countertrade is not an economically defensive way of continuing trade. This is because the buyer cannot choose the most competitive supplier, and costs increase because of the restricted number of suppliers. Also, the transaction costs (the time and effort spent on matching the requirements of buyer, seller and user) are more than the costs incurred in normal trade relations.
- 2) As with other forms of bilateralism, countertrade limits trade to the level of the partner having the lower export capacity.
- 3) Countertrade will not enable a user country to permanently increase its exports. In the short term, countertrade may give the illusion of increasing exports because it disposes of merchandise which is difficult to sell.

- 4) It is not certain that countertrade allows developing countries to conserve their foreign exchange earnings. The ideal situation would be one in which countertrade supplements traditional exports paid for in foreign currency.
- 5) The organization of countertrade requires a high degree of commercial and financial competence and good business skills if products are to be disposed of rapidly and at the highest possible price. But developing countries do not have the management capability or information and distribution channels necessary to promote their exports. Hence, these countries are likely to be at a disadvantage in countertrade because of a lack of negotiating power.

In short, the arguments against countertrade can be summarized as follows:

- a) Restriction of free importation rights.
- b) Dependency on prices.
- c) Diversion from the free market.

Turkey may benefit from certain features of countertrade. Countertrade provides the minimum use of the foreign exchange reserves of the Turkish Government. It provides the maximum utilization of business facilities in Turkey by increased local employment, improved training and the growth of economic productivity. Countertrade may encourage foreign capital and/or technology transfers through joint ventures established in Turkey. Such a flow of foreign capital and technology will satisfy the demands of the international market. Finally, countertrade may help to maintain Turkey's export prices at stable levels in the event of decreasing international demand.

The countertrade partners of Turkey can maximize the return of their past research and development (R & D) investments and can share future R & D expenses with their Turkish partners by conducting joint research activities. They may take advantage of unused Turkish capacities, natural resources, raw materials and an inexpensive labor

force. They will also have less transportation, marketing and production expenses in their efforts to enter other markets in the region.

Countertrade arrangements will increase local employment and commerce in Turkey. Countertrade, particularly in the defense area, can make Turkey more capable of carrying out its efforts towards peace in the region.

However, if Turkey countertrades the goods that it already exports to the country of its countertrade partner, then Turkey will be losing foreign exchange revenues.

Another drawback is that if the price of one of the commodities subject to countertrade changes dramatically, the countertrade volume may increase. For example, during the recent sharp decrease of oil prices, Turkey, as an oil importer, suffered dramatic decreases in its export volume subject to the countertrade arrangements with its oil suppliers.

Countertrade arrangements often involve the sale of products at a discounted price and this may affect world prices of such commodities and may result in a decrease of foreign exchange for the seller of the discounted products. Countertrade transactions may often lead parties to incur additional costs in order to comply with their countertrade requirements.

Under countertrade facilities, marketing costs and expertise are often borne by the countertrade partners of Turkey. After the termination of countertrade, this foreign market may be lost and overcapacity of production may result.

Countertrade arrangements are complex and may be less favorable because of the limited selection of lower quality goods and services. Products subject to countertrade may displace suppliers of similar products in other countries, and depending on the extent of the displacement those nations may take retaliatory actions.

The philosophy behind certain types of countertrade conflicts with free trade principles and is inconsistent with bilateral and multinational trade agreements. Government-mandated countertrade goes against the principles that GATT has laid down for eliminating or minimizing governmental interference in international trade flows.

However, it is a fact that countertrade transactions increase year by year and have gained importance in world trade. We now live in a world of modern countertrading ranging from relatively simple deals to complicated compensated agreements which may involve many nations and goods. In other words, the poor reputation of barter which goes back to the 18th century when a Dutchman exchanged US\$ 24 worth of trinkets for Manhattan is no longer valid.

I want to conclude by saying: Countertrade is a second-best policy.

A CASE STUDY ON THE EXPERIENCE OF INDONESIA IN THE FIELD OF COUNTERTRADE

(POLICIES, PRACTICES AND POTENTIALS)

ZULKIFLI SERIGAR AND TRI MARDJOKO*

INTRODUCTION

Barter trade has been used since ancient times and is still applied today in several different forms. For the past six years, Indonesia has been engaged in countertrade in the form of counterpurchase related to the government procurement of imported goods. Countertrade is not popular in Indonesia even though it has the potential to increase exports, especially in saturated market conditions. The government attempts to increase exports by means of the normal system of trade. Surprisingly, most government officers do not realize the benefit of countertrade, and the same is true of the private sector.

HISTORICAL BACKGROUND

Counterpurchase was first introduced in Indonesia in 1982 by government regulation. At that time the economy was in a difficult position. Seventy percent of Indonesian export revenue was dependent upon oil and gas. Non-oil and gas commodities were given relatively little attention. Exports were limited to traditional products, such as, coffee, rubber, tin, spices and other primary products that had been exported since the colonial era. The revenue received from the oil boom in the 1970s financed government projects and the importing of consumer goods. Industry aimed at import substitution and, hence, enjoyed government protection. In the early 1980s when oil and gas prices reached their lowest level, export revenue collapsed creating problems for

* Paper was presented by Tri Mardjoko, Head of Countertrade Division, Ministry of Trade, Indonesia.

debt servicing, and industrial foreign debt haunted the industry and the industry did not grow. The steps taken by the government to sustain economic development included the implementation of countertrade arrangements in the form of counterpurchase. This was introduced only as an emergency policy.

FEATURES OF COUNTERTRADE IN INDONESIA

Indonesia resorted to countertrade in order to increase its exports and imports and to widen its domestic market for capital and consumer goods. Countertrade is one means for enhancing the volume of international trade.

No country is hurt by countertrade, and, indeed, countertrade may benefit all countries whether developed or developing. The government encourages the business community to take advantage of the existence of countertrade as one of the ways to increase business.

The types of countertrade applied by Indonesia are offset, compensation, buy-back and **counterpurchase**. Offset is implemented by IPTN, the Indonesian Aircraft Producer. Indonesia has ordered a squadron of F-16s for the Air Force. The contract includes exporting airplane components for F-16s and Boeings. The quality and reliability of the those components were tested and accepted.

Compensation is used, by the Indonesian Nickel Corporation (INCO), buy-back by Indonesian Aluminum (INALUM) with Japan and countertrade/counterpurchase with Iran and Iraq. Indonesia buys crude oil from both Iran and Iraq under counterpurchase arrangements worth US\$ 300 million annually. As mentioned in the Memorandum of Understanding, Iran and Iraq should use this money to buy Indonesian commodities, namely, rubber, textile, coffee, wood products, paper and paper products. Counterpurchase as mentioned before, is limited to government procurement.

The Countertrade Division of the Department of Trade is responsible for the implementation of countertrade. Countertrade Iran and Iraq is carried out through a special Memorandum of Understanding

managed as a pilot project by the Research and Development Bureau of the Ministry of Trade. Other forms of barter trade are carried out by other institutions.

Counterpurchase is limited to government procurement. Any procurement arranged by government bodies has to be done through international tenders. The successful tenderer is obliged to buy Indonesian export commodities based on a one-to-one ratio to the FOB value of imported goods. The government body in this case may be a ministry, other government institution, state-owned company, or a provincial government-owned company. The countertrade project locations in Indonesia are spread all over the country. Indonesia has 27 provinces, and each of them arranges government procurement. Public enterprises in these 27 local governments also arrange government procurement. Supplier countries in Indonesian counterpurchase transactions consist of North American, European, East Asian, ASEAN, South American, Oceanian and Eastern European countries. The destinations of Indonesian exports include African countries. It can be said that Indonesian counterpurchase arrangements cover almost the entire world.

Counterpurchase through government procurement began in 1982. However, very few commodities are involved in counterpurchase arrangements. From 1982 to 1988, the number of commodities per year involved in countertrade arrangements ranged from 19 to 40. The highest (40) was in 1983 and the lowest (19) was in 1982. The annual average was about 25 commodities. Even these few commodities consisted mainly of traditional products. The products can be classified into three groups: a) industrial products consisting of ethanol, ammonia, fertilizer, textile, iron, nickel, cement, calcium citrate and DDT; b) mining products consisting of aluminum and coal and c) agricultural products consisting of vegetable oil, beverages, foodstuff, marine products, cereal, forest products and spices. Actually, these are traditional commodities that already have established markets. Counterpurchase is meant to achieve product and market diversification, but that has not yet been accomplished.

POLICIES AND RULES GOVERNING COUNTERTRADE IN INDONESIA

The policies and rules of counterpurchase in Indonesia are similar to those of other countries implementing countertrade. Countertrade plays a significant role in increasing the value of international trade especially for those LDCs that suffer from a lack of foreign exchange. They have an opportunity to increase their exports and imports for their development:

For Indonesia, countertrade plays a complementary role with normal trade.

The Ministry of Trade (MOT) as the government authority for the administration of countertrade deals with counterpurchase activities. Government procurement is done through international tender for project with a value of more than 500 million Indonesian rupiahs. The tenderers must provide a letter of undertaking (LU) before they apply to participate in international tenders. In the letter of undertaking, they must state their intentions to buy Indonesian commodities, if they are appointed as the successful tenderer. The Ministry of Trade approves the letter of undertaking for the beneficiaries. Successful tenderers make an agreement with the Ministry of Trade about the commodities and the exporters they intend to deal with in the form of Annex A, and then every step of the transaction is approved by the Ministry of Trade, until the project period is over and the obligations are satisfied.

The Ministry of Trade wishes to implement countertrade to the benefit of Indonesian exports in terms of product and market diversification as well as in terms of the development of existing markets. However, the procedure is only to encourage the successful tenderer or its assignee. The execution of countertrade is free in terms of which commodities they want to buy and which country they want to ship their goods. There is no obligation to specify certain commodities and markets.

The public sector, especially the tender issuer, generally excuses the obligation of counterpurchase bound to their procurements. However,

a few state-owned companies have not fulfilled the obligation because due to administrative shortcomings, countertrade regulations have not yet been widely circulated.

Exporters in the private sector are very enthusiastic about countertrade because it provides them with another option for selling their products abroad.

The Ministry of Trade facilitates countertrade transactions but does not interfere in countertrade activities. It approves the letter of undertaking, Annex A, the assignment agreement, and the confirmation of fulfillment of the obligation of countertrade transaction. All approval includes the use of a checklist list system in the general area of documentation. There is no special treatment in conducting countertrade transactions.

STAGES IN AGREEMENT PREPARATION AND DECISION-MAKING IN COUNTERTRADE OPERATIONS

(1) Preliminary Assessment

In the international tender conducted by government institutions as the tender issuer, a tenderer needs to provide a letter of undertaking. In this letter, the tenderer generally states that he will buy Indonesian products if he gets the project. The Ministry of Trade checks the letter as the preliminary assessment for the tenderer, and the approval is sent to the issuer of the tender. Only the approved tenderer can participate in the international tender.

(2) Negotiation for Countertrade Agreement

The Ministry of Trade arranges with the successful tenderer or its affiliate company or third party (assignee) for executing the counterpurchase, including the value, commodities and delivery time. The rest of the transaction is a normal commercial transaction.

(3) Third Party

The Indonesian Government allows a third party to participate in the countertrade transaction as an assignee for the successful tenderer to buy Indonesian commodities. Both of them arrange an assignment agreement that is approved by the Ministry of Trade.

(4) Penalties

No strict sanctions exist for the execution of countertrade. There are some penalty regulations, but they have never been executed. The payment for government procurement is usually broken down into several steps in accordance with the progress of the project. A penalty is to be imposed if the party conducting the countertrade fails to fulfill its countertrade obligations when the payment for government procurement is due. The penalty is 50 percent of the remaining payment due at the end of the period.

MECHANISM FOR EXECUTING COUNTERTRADE OPERATIONS

1. The issuance of executive approval, permits and licenses from official competent authorities is done in limited areas. Government involvement in the execution of countertrade is only in the approval of tender and export documents and in providing information needed for the transaction. Officially, the approval is issued by the Director General of Foreign Trade, Ministry of Trade. The remainder of the process consists of normal commercial transactions.

2. The delivery time of export commodities bound to the countertrade obligation is in accordance with the period of government procurement. Failure to meet the time schedule may lead to the penalty mentioned above.

3. The Ministry of Trade provides exporter and commodity lists for countertrade transactions in cooperation with commodity associations. The party conducting the countertrade and the exporters are free to arrange their transactions in a normal commercial manner.

COUNTERPURCHASE MECHANISM

(A) General Issues

- Government procurement is done through international tender. The tender issuers are: government departments, government institutions, state-owned companies and provincial government-owned companies.
- Obligation of counterpurchase:
 - The value of the project exceeds 500 million Indonesian rupiahs.
 - Financial source is the government annual budget and export credit.

Exceptions: - Soft loan finance, IDB, ADB, World Bank.

- Local components, services and taxes.
- Foreign expertise services.
- Joint venture company procurements.

Commodities bound to countertrade purchase: industrial, agricultural and mining products.

Exceptions include commodities under export control, and under special trading agreement.

The value of counterpurchase obligations equals the FOB value of imported goods.

Counterpurchase documents: Letter of Undertaking, Assignment Agreement (if applicable), Annex A, Annex B, Award, PEB, L/C, Invoice.

- Parties engaging in counterpurchase are free to choose commodities and exporters to fulfill the obligation.
- Terms of payment are on a commercial basis and should be in hard currency(ies).
- Counterpurchase contracts are not traded in the futures markets.

(B) Authorized executives who can issue an official letter for the successful tenderer

(1) Department and non-Department Institutions of the Government of Indonesia

Chief of the Project or similar position for a value under 500 million Indonesian rupiahs:

- Director General or similar position for a value from 500 million to one billion rupiahs.
- Minister or similar position for a value from one to three billion rupiahs.
- Minister or similar position after approval by the Coordinating Minister EKUIN for a value exceeding three billion rupiahs.

(2) State-Owned and Provincial-Owned Company (BUMN, BUMD)

President of BUMN/BUMD or similar position for a value under three billion rupiahs.

President of BUMN/BUMD or similar position after approval by Coordinating Ministers EKUIN for a value exceeding three billion rupiahs.

(C) Counterpurchase Administration Procedures

The procedures include:

- Participating tenderers provide Letter of Undertaking (LU) included in the tender documents.
- LU approval from the Ministry of Trade.
- Tender execution.
- Successful tenderer (supplier) decision by tender issuer.
- Approval of tender issuer decision by Ministry of Trade.
- Counterpurchase Agreement between Ministry of Trade and Counterpurchase - Annex A.
- Approval of Ministry of Trade for issuing Award done by tender issuer.
- Counterpurchase execution in accordance with the period of government procurement.
- Supplier reports to Ministry of Trade about counterpurchase realization proved by export documents (invoice, B/L, PEB).
- Official letter issued by the Ministry of Trade confirming the fulfillment of counterpurchase obligations.

GENERAL REVIEW AND 'EVALUATION OF THE ROLE OF COUNTERPURCHASE IN INDONESIA

Counterpurchase progress has not been satisfactory since its implementation in 1982. The following figures reveal the poor performance of counterpurchase:

(1) Performance of Achievements

	1982	1983	1984	1985	1986	1987	1988
Projects bound to Counterpurchase ¹	26	58	57	67	29	29	30
Participating Countries	10	14	16	22	24	25	25
Successful Tenderers	23	45	47	42	24	14	19
Commodities	19	40	28	22	27	31	30
Export Destined Countries ²	29	42	37	42	32	32	34
Oil & Gas Export	18.1	16.1	16.0	12.7	8.3	8.6	7.7
Non-Oil & Gas Exports	3.9	5.0	5.9	5.9	6.5	8.6	11.5
Value of Counterpurchase Obligation	0.22	0.51	0.33	0.32	0.16	0.16	0.16
Counterpurchase Realization	0.14	0.43	0.29	0.33	0.20	0.18	0.22
Counterpurchase Cumulative Realization ¹	0.14	0.57	0.86	1.19	1.39	1.57	1.79
Realization/Non Oil & Gas	3.33	8.60	4.91	5.59	3.07	2.09	1.21
Realization/Counterpurchase Obligation	63	84	82	103	80	112	157
Government Budget for Project Developments	7.5	9.5	6.6	6.5	7.7	7.0	6.5
Foreign Assistance Project Developments		-	124	262	355	441	-

(2) Problems and Obstacles

Counterpurchase has been conducted in Indonesia for the past six years. There have been no major problems or obstacles so far in term of the misinterpretation of the Agreement, contract execution, reconsideration of the contract, pricing, time delivery and shipping arrangement, because the countertrade operation is generally conducted along the lines of normal commercial procedures.

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1. In Unit.
 2. CP: Counterpurchase.
 3. In billion US\$.

Problems usually arise only in the following areas:

- Countertrade is not a popular way to trade.
- Government institutions lack information about the benefits of countertrade.
- Foreign suppliers treat countertrade as a burden.
- Countertrade administered by the Ministry of Trade only consists of counterpurchase.
- There is no law enforcement.

CONCLUSIONS

(1) Pros and Cons of Countertrade in Indonesia

There is little awareness in the Ministry of Trade about countertrade. Attention is focused on how normal trade can lead to export growth. Countertrade is ignored due to the apprehension that countertrade may create a trade distortion or that it may bring about retaliation from trading partners. The international business community regards countertrade as a barrier to normal and free trade practices. Countertrade is considered a costly option that disturbs the supply and demand equilibrium.

On the other hand, it is argued that counterpurchase is a potential option for the participating parties. Only a few businessmen use this option so that there is relatively little competition. Countertrade will benefit a country most if it is implemented in appropriate areas and treated as a complement to normal trade. Countertrade is useful in those areas in which normal trade is facing obstacles.

To accommodate both point of views, the areas of normal trade and countertrade should be defined clearly through an effective implementation of the necessary regulations. Countertrade issues require

a solid management team and the implementation of countertrade requires the extension of services to the business community.

(2) The Significance of Countertrade in Establishing a Closer Economic and Commercial Relationship among OIC Members

Trading among OIC members needs to be increased for the sake of our collective prosperity. For the time being, every trading country is focusing only on the markets of developed countries which are very crowded and competitive. However, the majority of OIC member countries find it difficult to enter this kind of market especially with their industrial products. Countertrade is the only way to expand exports through the exchange of commodities among OIC member countries. Market enlargement in one member country will expand the economy and increase the demand for commodities from other member countries. This will result in continuous economic development in all OIC member countries.

I would like to take this opportunity to appeal to the governments of OIC member countries to enhance Islamic solidarity by promoting trading among OIC member countries.

PROPOSAL TO DEVELOP COUNTERPURCHASE POLICIES AND MECHANISMS IN INDONESIA

Counterpurchase will be of the most benefit to the Indonesian economy if it is arranged so as to meet the following criteria:

- Counterpurchase in Indonesia should be coordinated by the Ministry of Trade.
- Counterpurchase regulations should be supported and executed by other government institutions. All government procurement should be carried out by means of counterpurchase.

- Foreign trading houses which deal with Indonesian Government procurements should conduct themselves in accordance with the regulations of the country.
- Cooperation and trading practices among Islamic countries should be intensified and increased especially in the area of countertrade. Islamic international institutions should play an important role in this respect.
- The business community in Indonesia should be encouraged to participate intensively in countertrade especially with the private sectors of Islamic countries.

**A CASE STUDY ON THE EXPERIENCE OF MALAYSIA
IN THE FIELD OF COUNTERTRADE
(POLICIES, PRACTICES AND POTENTIALS)**

A. AZIZ KASIM

It is pertinent that I should briefly touch on the present world situation in countertrade before Malaysia's countertrade policy and its implementation are discussed. To this end, I have divided this paper into three parts. The first covers, in brief, the situation of countertrade in the world today; the second describes the scope and objectives of Malaysia's countertrade policy and the third explains its implementation.

**PART A: THE PRESENT WORLD SITUATION IN
COUNTERTRADE**

Countertrade, as it is known today, has traditionally been regarded as an Eastern European phenomenon, but now it is being practiced by nearly all countries in the world and involves not just governments, but also trading houses, multinationals, banks and nongovernmental organizations. In the United States, for example, there is a well-established internal barter business whereby companies exchange products (airlines, for example, 'pay' for various services in plane seats).

A number of countries in Southeast Asia have in recent years introduced countertrade regulations. In Indonesia, countertrade is mandatory for all government foreign procurements of US\$500,000 and above, in which respect all participants have to undertake to buy goods from Indonesia equivalent to 100 percent of the import content of the contract with a 50 percent penalty for nonperformance.

The position in the Philippines is different. The Philippines have yet to formulate a countertrade policy, but barter arrangements have already been used as a method for financing some imports and moves are under way to set up a more systematic procedure for carrying out

countertrade. The situation in Thailand is similar to that of the Philippines in that countertrade arrangements have been undertaken on an ad hoc basis.

In other parts of the world, a substantial number of Third World nations have also implemented or are about to introduce barter or countertrade programs. Mexico, for example, published a decree which sanctions barter transactions in lieu of conventional transactions which normally would involve foreign exchange. Similarly, Guatemala has announced that it would be enacting a countertrade program. Under the terms of barter agreements between Jamaica and the United States, Jamaican alumina and bauxite are traded for American agricultural surplus. In Brazil, an 'unofficial' policy exists under which favorable treatment of import license applications is granted to parties which create a corresponding amount of exports. India has a countertrade policy covering almost all imports, and so do Pakistan and Bangladesh.

Australia, Switzerland, the Netherlands, Canada, Belgium, and the United Kingdom, to name but a few, have an offsets policy for their defence and civil requirements, and have also undertaken some other forms of countertrade arrangements on an ad hoc basis. The United States Government, on the other hand, has a barter program under the Department of Agriculture which disposes of surplus agricultural commodities, acquires strategic materials, and fills some government needs overseas. New Zealand has a countertrade policy, similar to Malaysia, whereby foreign tenderers and suppliers for government procurements are invited to propose countertrade.

There is no reliable data on the actual number of countertrade deals that have been transacted worldwide. This lack of data is due to the fact that countertrade transactions are not separately identifiable in official trade statistics. This is exacerbated by the secrecy that surrounds most countertrade deals and is partly due to the traditional reluctance of many trade organizations to divulge trade information and partly due to other factors relating to countertrade. The most reluctant are the authorities in some developing countries who do not want international institutions such as the IMF to know of certain agreements. Nevertheless, some countertrade observers are of the opinion that if the subject is worldwide

countertrade, then the amount of countertrade deals that have been transacted would be in the region of about 15 percent to 20 percent of the world trade.

PART B: MALAYSIAN GOVERNMENT'S POLICY ON COUNTERTRADE AND ITS IMPLEMENTATION

I. INTRODUCTION

Malaysia has since July, 1983 used countertrade as an instrument to promote and increase trade both in Malaysia's traditional and nontraditional markets. It should be noted, however, that Malaysia's countertrade policy is nonmandatory and is only used as an additional trading arrangement to complement the existing trading practice as well as in certain government procurements from abroad. As such, countertrade is only encouraged in cases which are considered suitable and beneficial to the country.

The decision of Malaysia to use countertrade was based on the consideration that Malaysia needs to consolidate and strengthen existing markets, to diversify export markets, especially nontraditional markets, and to establish trade relations on a long-term basis. Countertrade has become more relevant and important due to the trend of increasing protectionism in world trade, in particular in the developed economies, and also due to Malaysia's endeavor to expand trade with the nontraditional market countries whose economic systems differ from Malaysia's and which are experiencing foreign exchange difficulties. Countertrade is also used in connection with major government purchases from abroad and, thereby, helps to conserve the use of foreign exchange. Hence, countertrade in Malaysia is encouraged both in the public and private sectors.

Under its present countertrade policy, Malaysia will not sign countertrade agreements with any country on a government to government basis. Countertrade arrangements can only involve private companies and government departments and agencies, and agreements to be signed are for specific cases.

In short, the objectives in Malaysia's decision to conduct countertrade can be summarized as follows:

- to increase and promote the export of primary commodities, semimanufactured and manufactured products;
- to diversify and create additional exports;
- to find new market outlets; to find markets in countries lacking foreign exchange;
- to improve Malaysia's balance of trade position with specific countries;
- to strengthen and consolidate Malaysia's export markets which are faced with international competition;
- to save foreign exchange; and lastly
- to develop a wider range of sources for imports.

It should be mentioned that countertrade in Malaysia's context includes barter, offsets, compensation, buy-back and counterpurchase. However, it is compensation and counterpurchase that have played a prominent role in Malaysia's countertrade arrangements.

II. CONDUCTING COUNTERTRADE IN LINE WITH THE GOVERNMENT'S POLICY

The countries and the products for exchange in line with the government's policy on countertrade have been categorized as follows:

(A) Countries

Countries with which Malaysia may conduct countertrade have in general been grouped into five categories, which are:

- countries which will be awarded major government contracts, such as, contracts for construction projects, supplies, works and services. For these countries, countertrade is used to promote the sales of certain primary commodities, semimanufactured and manufactured products;
- countries with which Malaysia is experiencing persistent trade deficits;
- developing countries which are important and growing markets for Malaysian commodities and certain semimanufactured and manufactured products;
- developing oil producing/exporting countries.

(B) Product Coverage

As for products to be traded in countertrade arrangements, the following criteria is to be used:

- Countertrade should not be used for primary commodities which are not facing any problems in overseas markets. It should not be used with countries which have the foreign exchange to purchase such goods;
- Countertrade that involves Malaysian primary commodities should be conducted preferably with countries that are facing foreign exchange shortages;
- Malaysian primary commodities may be used to make up the volume in countertrade arrangements on a case-by-case basis; and

- Malaysian semimanufactured and manufactured products are to be used in countertrade with countries where there is a problem of gaining market access. Examples of these items are footwear, textiles, items of rubber, foodstuff, electrical components and electrical goods.

However, the following goods and commodities will not be considered for countertrade arrangements under any circumstances:

- logs and sawlogs;
- crude palm oil; and
- tin ore and tin-in-concentrates

Apart from the above, goods produced in the Malaysian Free Trade Zone and in Licensed Manufacturing Warehouses will also be excluded from the list of products for any countertrade transactions.

III. GOODS AND COMMODITIES TO BE IMPORTED BY MALAYSIA

Items to be imported by Malaysia under countertrade arrangements include products which Malaysia needs in substantial quantities, such as, rice, sugar, iron ore, cotton, coal, animal feed, chemical products, fertilizers, machinery and equipment, defence equipment and vehicles.

IV. SPECIAL UNIT ON COUNTERTRADE OR UNIT KHAS COUNTERTRADE (UKC)

As countertrade will be a permanent feature of Malaysia's external trade arrangements, especially in the government's procurement from overseas, the government has established a special unit or Unit Khas Countertrade (UKC) within the Ministry of Trade and Industry to formulate and implement government policies and guidelines on countertrade, as well as to oversee the country's countertrade activities. In short, the functions of the UKC can be summarized as follows:

- to formulate policies and guidelines on countertrade and to implement them on the advice of the Countertrade Coordinating Committees;
- to act as an information collection and dissemination center on countertrade. Such information pertains to products to be exchanged, and the list of potential buyers and sellers both local and overseas of countertrade products;
- to act as a reference point for receiving countertrade proposals from foreign governments and overseas and local sellers/buyers and distributing those proposals to prospective local and overseas sellers/buyers;
- to provide advisory services to government departments and agencies involved in overseas purchasing and in the issuing of certain tenders on the policies and guidelines regarding the incorporation of countertrade elements in their tenders, tender agreements and contracts;
- to advise government departments and agencies and companies in the private sector in drawing up countertrade agreements;
- to negotiate countertrade agreements on behalf of government departments and agencies;
- to advise government departments and agencies and private companies involved in exports on the policies and guidelines on countertrade with the objective of persuading them to participate in countertrade transactions; and
- to monitor the progress of the implementation of countertrade.

However, the UKC will not be involved in the actual countertrade transaction which simply means that it will neither act as an intermediary to buy or to sell goods and services nor will it take up a trade position that would involve undertaking business and nonbusiness risks.

V. GOVERNMENT PROCUREMENT SYSTEM

In pursuing the countertrade policy, the government has directed all government departments, agencies and companies, at the Federal and state levels, to insert countertrade conditions in tender documents for certain purchases, works and services procurement where the foreign content is valued at one million ringgit (US\$ 500,000) and above. To this end, adjustment was made to the procurement system to incorporate the elements of countertrade. This adjustment is done in the following two ways:

1. by inserting a countertrade condition in the tender document whereby tenderers are invited to propose countertrade. The countertrade proposals are a very important element in the tender evaluation process and will be one of the decisive factors in awarding contracts when pricing, technical and other considerations are comparatively similar, and
2. for specific supplies in which the normal tendering system is dispensed with, the government department or agency concerned will be asked to submit a detailed list of supplies required, and the government will secure the required supplies through countertrade arrangements, and channel these supplies directly to the concerned agency.

A "Letter of Undertaking for Countertrade Obligation" is attached to the tender document for the would-be bidders to complete and to submit as part of the bid document.

It should be noted that the countertrade arrangement covers all procurement which does not involve financing by international lending agencies such as the World Bank or the Asian Development Bank. Procurement financed by these organizations is exempted from the countertrade condition because such procurement needs to be undertaken in line with the stipulations of the lending agencies.

VI. MALAYSIA'S COUNTERTRADE ACTIVITIES

From the introduction of the countertrade policy up to August, 1989, Malaysia signed countertrade deals tied to government procurement worth US\$ 900 million. For 1989 up to August alone, the country signed deals worth US\$ 350 million.

All these deals were signed between Malaysian government departments, agencies and companies and local/foreign contractors and suppliers. The fulfillment of the contract/agreement is undertaken by the contractors and suppliers themselves or by their third parties which are mainly Malaysian general trading companies and countertraders. At the moment, there are a number of general trading and countertrade companies in Malaysia that are capable of undertaking countertrade obligations on behalf of the contractors and suppliers.

PART C: MALAYSIA'S EXPERIENCE IN IMPLEMENTING COUNTERPURCHASE AND COMPENSATION ARRANGEMENTS

I. INTRODUCTION

Counterpurchase and compensation are the two types of countertrade, especially the former, that have played a prominent role in Malaysia's countertrade arrangements, although the Countertrade Policy allows the country to engage in other forms of countertrade. This part of the paper will highlight Malaysia's experience in both counterpurchase and compensation and the procedures and modus operandi in conducting successful countertrade arrangements.

Counterpurchase and compensation as they have been practiced by Malaysia can be briefly described as follows:

(1) Counterpurchase

A counterpurchase deal, which is also called a parallel arrangement, is conducted under two separate contracts: one for the sale of the supplier's goods with the stipulation of full payment in the agreed

currency, and the other for the supplier to utilize in full or in a certain percentage of the payment, to purchase products in the buyer's country. The goods exchanged are technically independent of one another. Each delivery is paid for separately with the supplier receiving payment for his delivery, and in turn he pays for his purchases of goods from the buyer's country. The supplier's commitment contract under the counterpurchase arrangement may be transferred to a third party in the event that the supplier is not a trading company.

(2) Compensation

In a compensation arrangement, the foreign supplier agrees to take full or partial payment in kind for the goods sold. A trust account in the local currency is opened at a local bank where payment for the goods purchased from the foreign supplier is kept to be used to purchase the goods as agreed upon from the buyer's country. The goods exchanged are technically independent of one another. In this form of arrangement, the supplier may use or may transfer the purchasing commitment to a third party who may be an end user of the products or a trading house.

To date, Malaysia's experience in both forms of countertrade has been mostly in offsetting the Malaysian government's procurement from abroad. The Malaysian private sector has struck very few countertrade deals. This is due to the fact that Malaysia is a free economy country, and the country's countertrade policy is nonmandatory. Thus, the private sector is slow in the process of turning to this method of trading even in cases where countertrade is better than having no trade at all. Hence, Malaysia's experience in countertrade is mainly in offsetting government procurement from abroad.

II. PROCEDURES AND MODUS OPERANDI IN COUNTERPURCHASE AND COMPENSATION ARRANGEMENTS

The following are the procedures and the modus operandi in counterpurchase or compensation agreement negotiation, and the monitoring process to be undertaken to ensure that the countertrade commitment, i. e. the counterpurchase or the compensation arrangement,

is fulfilled either by the contractor/supplier or by their third party in accordance with the agreement signed.

To make it easier to understand, the topics have been divided into two sections, viz:

- negotiating the counterpurchase or the compensation agreement;
and
- monitoring the performance of the contractor/supplier or their third party in fulfilling the countertrade obligations as agreed upon under the agreement.

Before elaborating further, I would like to emphasize that the UKC is the organization charged with the responsibility for undertaking both functions.

(i) Negotiating the Counterpurchase or Compensation Agreement

Once the government department, agency or company has identified the contractor/supplier that will be awarded the contract, they inform the UKC to meet with the would-be contractor/supplier for preliminary discussions. At the meeting(s) held, the contractors/suppliers are informed of the countertrade options that can be considered, and they are asked to name a third party to undertake the countertrade commitment if they are in no position to do so themselves. Once these have been agreed upon, all relevant parties, i.e., the agency or government department concerned, the contractor/supplier and their third party, if any, are invited to the negotiating table.

If the form of countertrade to be used is counterpurchase, then the following agenda items are discussed and agreed upon:

a) Counterpurchase

- the value of the contract/supply;
- the value of the counterpurchase commitment;
- the list of Malaysian goods to be exported;

- the variation clause, if any;
- the destination of the goods;
- the time frame to complete the counterpurchase obligation; the security deposit to be provided;
- documentary evidence to be provided to verify the purchases;
- liquidated damages;
- force majeure;
- assignment, if any;
- validity and termination of the counterpurchase contract/agreement; and
- arbitration.

(b) Compensation

The same agenda items are discussed if the form of countertrade is compensation except that there is no requirement for a security deposit. Instead a clause is inserted in the contract/agreement that payment for the goods under the Supply Contract is to be utilized for the purchase of goods from the buyer's country.

Once negotiation is complete and agreement has been achieved, the agreement is prepared for signature by all parties concerned with the exception of the UKC. The signatories are the government department/agency/company concerned and the contractor/supplier as well as the third party, if any. The UKC is not a party to the agreement.

(ii) Monitoring the Fulfillment of the Obligation Under the Agreement

Once the agreement has been signed, a copy is sent to the UKC so that it can monitor the implementation of the agreement.

The contractor/supplier or their third party has to submit all documentary evidence, i.e., the export and payment documents, to the UKC for verification that the purchases and exports have been undertaken in accordance with the terms and conditions of the agreement signed. Of

course, under the compensation arrangement there are not any payment documents to be submitted.

The process is as follows:

- The contractor/supplier or their third party submits copies of the following export and payment documents:
- Bill of lading.
- Packing list.
- Commercial invoices.
- Customs export declaration in Malaysia stamped by the Malaysian Customs (an original carbon copy is required).
- Letter of credit and/or other documents giving proof to the satisfaction of the Special Unit on Countertrade that payment has been made (this documentary evidence is not required for a compensation arrangement).

The UKC, after verifying all the documents, then confirms by letter to the contractor/supplier or their third party within two weeks after receipt of the documents that the purchases and exports are in accordance with the agreement signed. If the exports are not in accordance with the agreement, the party concerned will be informed otherwise. Under the compensation agreement, the UKC informs the department or agency concerned that the purchases were in order and that the money held in the trust account is to be released and paid directly to the local supplier. The amount to be paid should be exactly the amount shown in the export documents. The monitoring process continues for each and every export until the countertrade obligation has been fulfilled. Should, in the process of verification, it be found that there are goods purchased that do not come within the terms of the agreement, i.e., in the types of goods as identified or that exports were to other than the approved destinations, then the confirmation by the UKC shall be reduced accordingly.

GENERAL DISCUSSION ON THE COUNTRY CASE STUDIES

DR. ABUL EYOUN

I think the only issue we have to raise is whether or not countertrade is efficient from the economic point of view. This may raise a question about being in favor of or opposed to countertrade. I think that this is actually a matter of semantics. In the 1930s, when the world faced economic difficulties, countertrade, barter and clearing agreements were used extensively. But after the establishment of the IMF in 1948, agreements were made to emphasize the multilateral trading system, and nobody any longer talked about countertrade. Then in the 1980s when industrialized nations were faced with the contraction of their economic growth and when debt problems increased for developing countries and nontariff barriers were imposed on their economies, developing countries were forced to resort to countertrade. Nobody objected to this at that time. In the future, if the process of development and the rate of growth in industrialized countries dramatically increase, then these countries may start opposing countertrade.

DR. M. AL-JARHI

The possibility of countertrade leading to an export surplus is very remote. I would like to mention an example. After the decline and contraction in trade relationships between Egypt and Eastern European countries in the 1970s, Egypt had an increase in inventories. The reason was that some public enterprises and factories were producing low-quality goods for export to Eastern Europe. These goods were exported at large discounts, and they were suitable for that kind of market. However, suddenly it was realized that they were not suitable for the Egyptian market and, naturally, not suitable for the Western market. So we had inventories which represented disallocated resources.

The way to ensure that countertrade will not lead to this state of affairs is what I referred to as operating on a commercial basis for profit maximization. The market price system gives you accurate signals about the allocation of resources. If you do not have these signals, you will go astray. This point cannot be overemphasized.

What has been mentioned about the need to promote intraregional trade is also very important. The existence of intraregional tariffs may be an impediment to this kind of goal. But I would like to add that what is more important is not tariff restrictions but nontariff restrictions. Nontariff restrictions are much more devastating than tariff restrictions. I have been present at many meetings where tariff negotiations were conducted by representatives of Arab governments, and I have found that it was very easy to get concessions on tariffs but not on nontariff restrictions. Unless concessions are made on nontariff restrictions, tariff concessions are completely worthless.

The IMF is worried about the health of the international monetary system. Of course, countertrade opens the door to the weakening of that system. But, on the other hand, the use of countertrade is a result of the weakness of that system. Before the IMF asks developing countries not to engage in countertrade, it should ask Western countries to agree on an international currency. The present weak international monetary system is the source of such practices as countertrade. The European monetary unit is being used more often, and it is being strengthened.. The SDR is being weakened. It is declining badly. We had hoped that the SDR would become the international currency, but it has not. So, as developing countries, we have a lot of grievances as far as the international monetary system is concerned, and when the IMF asks us about this, we must turn the question back to them.

As far as the interesting question of the expansion of the activities of the program of intratrade finance is concerned, it is really a very good idea.

DR. ABUL EYOUN

In 1992, the unification of the European Community will be complete. How are we as Islamic countries going to face the unification of the markets of European countries ? Are we prepared to counter this action ? I think we should at least have an agreement to facilitate the transfer of goods and services between our countries whether the means be countertrade or conventional trade. We have to open our markets to each other somehow.

DR. M. AL-JARHI

The first issue is that we should be careful not to use countertrade as a trade restriction, and we should think of suitable institutional arrangements to carry out the export and import of all commodities efficiently. Secondly, Abdullah made a good and highly justified comment when he said that Muslim countries, members of the OIC, import low-quality goods from the Western world, but they do not import from each other goods which may be of a better quality. To what extent have we been marketing our goods in each other's countries ? If you go to open-trade countries, such as, the Gulf countries you will see Pakistani rice competing with Indian rice. I think the Pakistanis should make sure that this competition is at least made on equal, if not better, terms for the Pakistanis. Perhaps they are not very interested in marketing rice, because rice is a cash commodity, but then let us try to find items other than rice. I think a lot of effort is required to market our own goods in the Islamic countries in general. We should not sit back and complain about Islamic countries importing from the Western world before we have first made an effort to market our own goods. Some Islamic countries find this problem less difficult, especially those countries which have public corporations working in foreign trade to export their products in bulk to the Western world. Then, the Western countries pack those same products under their own names and distribute them to Islamic countries. For example, a lot of French and Italian olive oil sold in the markets is basically Moroccan, Tunisian and Algerian olive oil which has been packed in French and Italian packages. Why shouldn't the countries which produce the olive oil do their own packing ? We cannot export effectively without proper marketing, and countertrading will not solve the problem. It would not be a good substitute for marketing.

Thirdly, I refer to the issue relating to the institutional framework. Dr. Fahim Khan mentioned a few ideas. I have to admit that I am somewhat alarmed by them. First of all, we are calling for a countertrade union. This idea is a bit out of focus. Asking the IDB to monitor countertrade deals is also unrealistic. How can they do it ? Arab monetary funds have no way of following up the deals of countertrading in Arab countries. It is almost impossible, even if it is done through government agencies. One cannot know, day by day, or even month by month, what is happening because the information networks are not there, and it would be very costly and time-consuming to establish them. If, for example, we want to encourage countertrade on a healthy basis in Islamic countries, what can the IDB do ?

Let us dream a little bit. Suppose each Muslim country establishes a trading company which is specialized in marketing in international trade. This company would be a private sector company established by merchants, banks, and other institutions. Suppose further that we decide to have a joint trading company for all Western countries. All Muslim countries will participate in terms of capital and expertise in this company, and this company would specialize in making deals, including, but not restricted to, countertrade. We would look for profitable deals and for goods to export and import through Islamic countries. These companies might benefit from IDB financing schemes. If they need finance, they will go to the IDB to get the finance, and of course, there will be creditworthiness in it, because they will be very large companies.

Now, something like this could work, but I do not think that it is a good idea to ask the IDB itself to go into countertrading. IT is not suitable for the IDB as an institution to carry out commercial business. It is an international organization; it has bureaucracy; it has red tape; it cannot get into trade; it will not encourage trade; it will restrict it; it will become a burden on trade. So, let us not do that; let us reserve trade for' those who can deal with it, who are specialized in it. So, I think this is what we ask for. We ask for marketing, we ask for institutions which would be private, privately owned, privately managed, and which would work at the Islamic World level, and which would work in all kinds of international trade, including countertrade. I hope that at some time in

the future we will not need countertrade at all. Perhaps we will reach the point where we will have good monitoring relations between Islamic countries, or our currency and our payment relations improve so that we will not need countertrade at all. That would be a healthy 'development, and we would not be resistant to it.

DR. ABUL EYOUN

I have only a few comments to discuss with my friends and brothers here. One of them has already been raised by one of our brothers. I will simply concentrate on one issue that has been raised in Mumtaz Abdullah's paper. It has been mentioned that, in Pakistan, for the selection of the parties for countertrade transactions, they require company profiles from the parties concerned. Why do they need a company profile ? Private firms need to export their products, and they need to import some other products. Why do they need a balance sheet and a statement of financial ability to conduct countertrade. If the private sector is going to see countertrade from the point of view of the government, it will not be countertrade. Small private enterprises need to countertrade as well as large ones. If you are going to put a limit on the size of the company, who is going to do countertrade ? By excluding some parties, you are creating a kind of monopoly in the market of countertrade. Actually, countertrade, like any trade, is simple trade between two parties who want to exchange goods, or exchange goods for money. But if restrictions are going to be made, this will not -work.

We should have a policy for marketing the products of OIC member countries between ourselves. We have to market our products between ourselves as members of countries of the same family. We also have to use countertrade as a method of trade promotion, not as a method of trade restriction. Sometimes I feel that the people in the market do not know what countertrade means. We may have some large public enterprises/companies working in countertrade, and they may have large amounts of information about countertrade, and they may have good communications with other parties, but the problem is what the local producer knows about countertrade. How can he get access to potential buyers in order to promote his products outside his country ? As OIC

member countries, we need an information system to create a flow of information among countertrade parties in OIC member countries. This information system is essential before we start talking about countertrade. Additionally, we should have a trading house, a broker or a middleman who can connect the buyer to the seller.

DR. ABDUL AZIZ JALLO

The reason we should resort to countertrade is because other more traditional and classical mechanisms have not really succeeded, if you look at the trade among OIC countries. To expand trade among OIC countries we must realize there are many factors that will determine the success or the failure of countertrade arrangements. Some of these are internal to the countertrade mechanisms themselves. But I think we should also realize that a whole series of other support facilities and factors need to be built into this, because they are also the obstacles to the promotion of nontraditional trade. I have in mind very simple things, let us say, for example, the credit, the availability and supply of credit, the questions of guarantees, of insurance, of control over market channels, in other words, who is really in charge of importing and exporting. The requirements for engaging in countertrade seem to be a lot of technical expertise, a lot of qualified manpower, in a very well developed institution. But when we talk about underdeveloped countries, these are precisely the factors that hamper trade. Take my own country, Sierra Leone, for example. How can a country such as Sierra Leone engage in countertrade to any extent, and be able to cope with all of these very intricate, very delicate, and very technically complex negotiations and also have the organization and institution base to sustain this to any extent? I think these are areas that are relevant for the IDB, not actually engaging in countertrade, but perhaps providing training. The IDB does already have some trade promotion mechanisms. It has in fact already developed schemes in association with the private sector, Islamic banks, the Longer Term Trade Financing Scheme and the IDB Unit Investment Scheme, which are apparently doing very well.

MAKHLOUF

The point raised by our brother from Turkey concerning second-best approach is, of course, true, because in the same way customs unions and protectionism are second-best approaches, since the best approach is unobtainable. Of course, countertrade is not the only way or the best way to solve problems of foreign trade within Islamic developing countries. However, as a second-best approach, it is now being used within international trade and becoming more and more significant as both secret and open trade.

The second point concerns information and is of the utmost importance. Information in countertrade is like raw material for industry. To industrialize certain products for countertrade, information is imperative. The facts that Brother Abdullah presented about six countries point to the lack of information about the countertrade needs of OIC member countries and indicate that we cannot engage in countertrade activity without accumulating information and establishing an efficient countertrade network. I propose that before we embark on making any suggestions on the part of the IDB for creating an Islamic trading house, a survey should be conducted on the countertrade traffic between OIC countries in terms of places, sectors, rules, commodity components, values, achievements, and difficulties encountered in countertrade. Before such data are available, no effective or successful action can be undertaken. Thirdly, the idea of a middleman or a trading house for Islamic countries is vital. An Islamic trading company is in the process of being established and countertrade will be among its activities. The subscribed capital of the trading company is US\$ 50 million to be shared only by Islamic banks.

We come now to countertrade among OIC members. I think the IDB can act as an information center bringing countries together. Suppose Sudan needs an expert in financing, and it is willing to sell its sesame. The Bank can put an importer of sesame in touch with the appropriate parties and in turn provide them with an expert from England or the United States. It is not only the trade element that we should concentrate on. We should also think about the expansion of services.

My recommendations for the expansion of countertrade would be as follows:

Forget setting up an Islamic trading corporation. We do not want to get involved in such things. What we want is an exchange center. Give us information about each other. Help us to come into contact with each other. Help us to solve our financial problems. Put us in touch with one another by means of a financial network in the Islamic World. Bring Islamic countries into contact with one another so that people can exchange their goods.

DR. ABUL EYOUN

I would first like to discuss the possibility of the local economy to producing the goods needed by the majority of countertrade dealers. I sometimes feel that local companies do not have the ability to produce profitable goods. The commission that usually holds negotiations with the foreign party may lack this type of information. The inside knowledge about the local market available to the negotiators in countertrade transactions is very important. If we establish an information system among OIC members, negotiators will have a good idea of the production possibilities of each country and will better be able to conduct negotiations.

From my readings, I have found that the success ratio of barter trade or countertrade is very low, not exceeding 30 percent. Why ? The answer is that there is a slow motion picture inside our countries, and from other foreign countries or companies there are very fast motion pictures. The flow of their goods is very fast and the flow of our goods is very slow. This is because the information systems in our countries are not complete. I believe that we have to establish a link between producers and negotiators. If the negotiators are going to be civil servants, they have to know everything about the market. If they are from the private sector, then they themselves know what they have.

The second point I would like to discuss refers to what my colleague, El Masry, has said about the involvement of tourism in countertrade in the Egyptian experience. I have some information about this point which may be of use to OIC members. The first time services were involved with countertrade was in 1986 or 1987. A public company in Egypt producing televisions entered into an assembly agreement with the Japanese Company NEC. According to that agreement, NEC provided the Egyptian company with the components needed for the assembly of the television sets. NEC sent a group of its employees to Egypt to enjoy a holiday and at the same time to deliver the components of NEC television sets. This is a wonderful example, and I think negotiations now are underway concerning General Motors and KLM. It is very important to include services as well as goods in countertrade.

Also brother Makhlof mentioned that an Islamic trading company is in the process of being established and that countertrade is one of the activities of this company. The IDB will not engage in countertrade. The IDB will only assist in facilitating transactions for trading companies. As regards the creation of an information clearing house or center, I think it is a very good idea. To have an escrow account for trade agreements is also a very good idea as long as the IDB has the financial capacity to assist. We could combine financing with countertrade to make it easier to operate.

MUMTAZ ABDULLAH

I would like first of all to agree with certain remarks which have been made. I do agree that countertrade should not be used as a substitute for general trade, and in fact in my paper, I said: "import-export of nontraditional goods which are in low demand in foreign markets which is a substitution". I also said: "if countertrade provides additionality, in exports, it is not a substitute for exports". Countertrade is only an addition to exports. So let me make it very clear that I do not consider countertrade to be the only method for improving trade. It provide additionality to nontraditional exports. I again agree that count' not a substitute for marketing. You have to have a good' system. However, we must remember that developing countries are not

advanced in marketing and that they have to use some other means until they develop the facility for marketing. I also agree that there is a lack of information about .trade, not to mention countertrade. We know everything about America, Japan, Germany and the EEC. But what do we ' know about each other?.

We know that this country exports oil. But do we know what else they export? This is precisely the problem which I have posed. I have never advocated that the IDB set up a trade union or a trading corporation.

I said that the IDB should set up a countertrade business center or an exchange through which information flows. I do not want the IDB to become involved in countertrade. I want to provide information and open a center for the exchange of information.

I said that the IDB should identify countertrade partners among its members, the countries which are engaging in trade or countertrade and bring them together, providing all the information and supporting consultancy services that might be needed by OIC member countries. I also said that the IDB should negotiate countertrade financing, in order to help countries get financing, not to provide them with financing, but to help them to contribute to the development of a financing network which is the job of the Islamic Development Bank.

I also emphasized the need to establish guidelines for countertrade negotiations. Again this is the job of the exchange center which will help define markets and provide potential information about countertrade so that each country can benefit from the examples of other.

I think that the IDB should provide a trade-exchange center or an information-exchange center where all types of information would be available. I am against an Islamic trading corporation. Let every country function independently, but provide information to the exchange center, and disseminate this information from there.

The question was raised as to why we ask for company profiles? If you are a banker, before you do business with a man, what do you do? You look at the record of the man who comes to borrow from you. You try to determine whether or not he is reliable. You want to know whether or not he will be able to pay you back. You would also like to know if companies have the ability to market nontraditional goods. It is very easy to market oil, but it is very difficult, in this present time, to sell nontraditional goods, like the sesame sold by Sudan. Can you find a market for it? Can this company go and find a market for it or for other nontraditional items. These are the reasons we ask for company profiles.

**A POSSIBLE ROLE OF
THE ISLAMIC DEVELOPMENT BANK**

A POSSIBLE ROLE OF THE ISLAMIC DEVELOPMENT BANK

FAROUK H. MAKHLOUF

The Islamic Development Bank has devoted particular attention, since the early stage of its operation, to developing and boosting trade among Islamic countries. This policy is based on Article 2 (Paragraph VII) which stipulates that one of the functions of the IDB is to assist in the promotion of foreign trade among member countries.

Among the trade promotion measures currently being considered by the IDB is countertrade. The importance it accords to this type of trade activity is a response to the justifiable motives that OIC countries have for engaging in countertrade.

Any involvement of the IDB in countertrade operations would also be in harmony with the considerable momentum gained by CT during the last two decades in international trade, and likewise in the foreign trade of OIC member countries. This proposed intervention would also serve some of the vital trade and development interests of these countries and some of the purposes of the IDB.

Such an assumed new function would be additional and complementary to the present activities of the IDB in the field of promoting trade among Islamic countries. These activities presently include three Trade Finance Schemes, namely; ITFO (Imports), LTTFS (Exports) and IBP (Imports & Exports).

However, the crucial point in the IDB's utilization of countertrade may be to accord valuable assistance to member countries, by providing assurance and confidence to countertrade parties and to reduce or eliminate many of the problems inherent in present CT practices. Examples of these problems are: failure to fulfill commitment, delays in shipments, commodity-supply gaps which need to be financed in cash,

misinterpretation of agreement clauses, deviation from agreed specifications or packing, etc. These drawbacks of CT reduce its benefits. The IDB could help countries avoid many traditional CT problems and, thus, increase its benefits.

In assuming its expected new role in the field of CT, the IDB's objectives and policy therein would never be similar to those of commercial banks and trading houses. The IDB is not a profit-seeking institution; it has developmental responsibilities and is a multipurpose body, which is evident in the IDB's present financing terms and conditions. Beneficiaries of Trade Finance Schemes implemented by the IDB can enjoy safe financing and easy terms, as is manifested by the following:

- Profit margins (markups obtained by the IDB are fixed at relatively concessional cost.
- Special rebate of 15 percent of the markup is given if due amounts are paid to the IDB as per schedule.
- Repayment periods are longer than those required by commercial banks.
- The entire relationship between the IDB and the importer puts the exporter in a position of nonrecourse. Once he ships the goods, he is paid by the IDB. There is no financial risk.
- There is no favor whatsoever of a financial nature from exporter to importer. The latter can select the former freely, i.e., according to the best offer.
- There is no reward to the IDB except the profit margin (markup).
- The legal documentation required by the IDB is comparatively straightforward.

In spite of these factors, the IDB can perform within its future CT activities some of the CT functions of commercial banks and trading houses.

Examples of these are: bridge financing and cofinancing, banking arrangements of transactions, organization and management of deals, advisory and technical services, etc.

The purpose of this paper is to survey the IDB's preparatory work with respect to countertrade and to highlight its objectives therein. Some efforts will also be made to explore and speculate as to the IDB's possible CT functions. This effort is necessarily based on assumptions, which are, however, reasonable in light of the IDB's nature and overall objectives.

The IDB does not possess, as yet, any final policy guidelines or blueprint of operational principles or working plan.

The role of the IDB in countertrade would be widely diversified. It could include many functions ranging from simple services to sophisticated activities. This role has to evolve with time.

However, the IDB's activities could entail the following examples:

- Focal point and clearing house of CT information.
- Creator of CT opportunities.
- Coordinator of CT offers.
- Monitor of CT deals.
- Technical assistant and adviser.
- Countertrader.
- CT bridge financier.
- Joint CT/IDB finance schemes manager.
- Operator/Financier of a multilateral CT settlements scheme.

Thus, any elaboration in this study on CT forms to be adopted or CT techniques to be implemented are merely hypothetical. However, these working hypotheses are founded on the IDB's distinct nature and its multilateral responsibilities.

The purpose of this paper is to shed light on the evolution of the IDB's actions in assuming a countertrade role, the objectives of such a role, and the possible nature of the IDB's activities. The paper introduces an explanatory model of some assumed IDB countertrade functions, and it discusses some institutional matters.

The exploratory steps taken on this matter, the deliberations of the Istanbul Seminar on Countertrade and the Algeria Symposium on the same subject will certainly help the IDB to better identify the dimensions of its prospective role in countertrade, and, subsequently, to draw up a full-fledged policy and operational plan in this new field of trade activity in line with its responsibility to promote trade among OIC member countries.

The growing interest of the IDB in developing a CT capacity is timely and appropriate. Many IDB members are widely utilizing CT as one of their foreign trade policies and instruments. Nevertheless, they need some sort of international codification of countertrade and the benefit of the services which can be rendered by the IDB in this regard.

The role which can be played by the IDB is diverse. It could range from the simple organization of the exchange of CT data, to the coordination, management and monitoring of deals, to full involvement in transactions as a principal and direct participant. Such a new role for the IDB should evolve gradually and could have linkages with existing IDB financing activities, particularly those of trade financing.

I. OBJECTIVES AND MOTIVES FOR IDB INVOLVEMENT IN CT

The broad justifications and objectives of an IDB role in CT are based on the IDB's multipurpose nature and widely diversified functions. Such objectives would necessarily differ from one stage to another in the process of performing CT activities. The level of fulfilling these objectives would also depend on many other factors which at the moment are difficult to assess.

Furthermore, such new activity by the IDB would be in line with the growing importance of countertrade during the last two decades in the arena of international trade and likewise in the foreign trade of member countries. This proposed function would, in the meantime, serve some of the vital trade and development interests of OIC member countries and some of the purposes of the IDB.

The following are some of the key policy objectives which motivate and justify the possible involvement of the IDB in countertrade activity:

- Furthering the implementation of IDB Articles of Agreement in the domain of trade,
- Fostering economic cooperation and mutual dependence among OIC member countries through the promotion of the exchange of goods and services,
- Creating a sort of linkage and integration between the present IDB trade finance schemes and countertrade as an additional trade promotion facility through the IDB,
- Responding positively to the increasing significance of countertrade in international trade and in the trade of Islamic countries which can, therefore, benefit more from countertrade, Assisting OIC member countries in obtaining some of their import needs for development and consumption purposes, in spite of the limitation of hard currency,
- Promoting the exports of OIC member countries, especially nontraditional goods, and facilitating their access to other members and foreign markets,
- Alleviating, relatively, some of the pressures on the balance of payments of member countries,

- Reducing the negative effects of the scarcity of foreign exchange suffered by most OIC member countries in their economic and commercial performance,
- Facilitating and encouraging multilateral trade operations among OIC member countries and settlements of trade balances among them through switch countertrade deals and cross payment compensation techniques,

Assisting OIC member countries in their efforts to use foreign trade to improve their external debt situation,

- Generating some profits for the IDB as a result of *Murabaha* operations or intermediary services performed through the utilization of countertrade,
- Helping OIC member countries to face some of the consequences of the strong competition and protectionist policies of developed countries, and
- Connecting the investment and technological needs of OIC member countries with trade, by means of countertrade deals with each other or with foreign countries.

II. IDB ACTIVITIES TO PROMOTE TRADE AMONG MEMBER COUNTRIES

Since its inception the IDB has developed and implemented three schemes (modes) of trade financing. There are other modes and supporting mechanisms currently being considered by the Bank, as a part of its package of trade promotion measures, such as, the establishment of an export credit guarantee scheme, a multilateral Islamic clearing union, an Islamic trading company and the promotion of countertrade.

The following is a brief description of the three existing trade financing schemes:

(1) Import Trade Financing Operations (ITFO)

This scheme started operations in Safar, 1397H (February, 1977G) with the purpose of promoting trade among member countries in general, and of helping member countries by enabling them to import some items necessary for development. This program also made it possible for the IDB to utilize a tangible portion of its surplus funds not urgently needed for financing the IDB's ordinary medium- and long-term operations. By Jumad Awwal, 1410H (December, 1989G), the number of ITFO operations approved by the IDB was 488 with a total value of 5.33 billion Islamic Dinars (ID) or US \$ 6.24 billion.

(2) The Longer Term Trade Financing Scheme (LTTFS)

This scheme began at the end of 1407H (1987G) in the form of a special fund managed by the IDB, but enjoying financial autonomy. The LTTFS has its own budget, and its resources are, therefore, independent from the funds and resources of the bank.

The LTTFS aims at promoting the exports of nontraditional commodities among OIC member countries, through providing financing to the exports of its member countries. Currently, 20 countries are members of the scheme and their total contribution is ID 131.5 million or about US\$ 175 million. The IDB contribution to the resources of the LTTFS is ID 150 million or about US\$ 195 million. Thus, the global contributions to the scheme amount to US\$ 370 million.

The LTTFS provides partial financing for eligible exports ranging between 30-40 percent of the total FOB value of the commodity. The Governing Body of the LTTFS may increase this ratio of financing up to 80 percent for operations less than ID 3 million.

By Jumad Awwal, 1410H (December, 1989G), the number of LTTFS operations approved by the IDB was 49 for a total value of ID 75.15 million or US\$ 97.51 million.

(3) The Islamic Banks Portfolio (IBP)

The IBP was established at the end of 1407H (1987G). It provides financing for both the export and import of capital and noncapital commodities as well as for leasing operations.

The total number of Islamic Banks participating in the IBP is currently 21, including the IDB which is the Manager of the IBP as (*Mudarib*). The initial capital of the IBP is US\$ 65 million fully paid. The regulations of the IBP allow for future capital increases up to ten times the initial capital, making the total resources which could be available for financing operations about US\$ 715 million. IBP activities are mainly oriented towards the promotion of the trade activities of exports and imports of the private sector.

By Jumad Awwal, 1410H (December, 1989G), 25 IBP operations had been approved for a total value of US\$ 72.3 million.

III. PREPARATORY WORK UNDERTAKEN BY THE IDB TO IDENTIFY A POSSIBLE ROLE IN COUNTERTRADE

The IDB's interest in countertrade activities among OIC member countries began recently. Some IDB missions held meetings and conducted exploratory discussions with the representatives of the specialized governmental trading agencies of some member countries and leading international trading houses.

In 1989, the IDB began establishing contacts with some experienced commercial banks with countertrade experience and with leading trading houses.

The IDB received favorable reactions from member countries which welcomed its utilization of countertrade for the benefit of OIC members. It has become evident that countertrade, which is already widely practiced by and among many OIC countries, could be an effective tool for enhancing intertrade and stimulating economic cooperation among OIC member countries in general.

The IDB is now well aware of the benefits for member countries which may be realized from countertrade transactions. It also realizes that these countries expect the IDB to adopt a policy and take some action on their behalf. The IDB has completed preliminary studies and contacts on this matter, and it is now engaged in some practical consultations with a number of specialized trading houses and international banks. It is also exchanging views with commercial representatives of OIC member countries in Jeddah, through regular unofficial meetings. This preparatory stage also includes the holding of seminars and symposia, among which is the Istanbul seminar and a symposium to be held in Algeria in conjunction with the forthcoming IDB Annual Meeting of Governors.

At a later stage, the IDB would begin drafting and developing policy guidelines and an operational plan in light of the above mentioned explorations. It would then engage in building an information network, a data base and the channels needed for undertaking CT activities.

The next step would be the institutionalization of the IDB's countertrade functions. This includes:

- Approval of Policy Guidelines and an Operational Plan.
- Working out the legal framework.
- Allocation of certain standby financial resources within the present Trade Finance Scheme.
- Preparation of basic documentation.
- Administrative requirements and technical facilities.

As soon as preparatory work is done, the IDB would embark on the effecting of a limited number of countertrade deals among member countries and probably with the involvement of nonmembers, if this is required and useful to the concerned OIC parties. This exercise would expand gradually, along with the experience gained during the next few years.

The early stage of the IDB's utilization of countertrade represents a learning period. In this stage, the IDB would gain more experience, build up a wide range of contacts and assess the real size and significance

of its intervention in the future. The more the IDB draws lessons from its countertrade experience and establishes a wide range of **data** and contacts, the more it will be able to expedite its countertrade activities **and** render its role therein more effective.

IV. HYPOTHETICAL FORMULAS OF IDB FUNCTIONS IN PERFORMING COUNTERTRADE ACTIVITIES

It is imperative that any plan for a countertrade role for the IDB is not primarily profit-seeking. The IDB has certain responsibilities and preoccupations in promoting trade among member countries. Thus, if it performs activities in this regard, it cannot act simply as a trading house or a commercial bank. It can only assume its developmental duties and operate its activities on the basis of sound commercial techniques.

It would also cooperate, in one way or another, with other countertrade parties, including companies and banks, whether or not they belong to member countries, as long as this serves the best interests of member countries.

We can now put forward some working assumptions for the role of the IDB in countertrade as follows:

(1) Catalytic Role

This role consists of a set of technical advisory and intermediary functions. Some of these services could be provided free of charge and others could be provided for a fee.

Such activities would include the following functions:

- a) **A focal point and a clearing house for CT information.** This requires continuous and regular compilation and dissemination of CT data on goods and services traded (e.g., quantities, quality, specifications, prices, packing, dates of availability, etc.). Diversified relevant information would also include firms (e.g., production capacities), market capacities,

regulations, opportunities, tenders, government purchases, tariff and nontariff barriers, etc. Parties to this activity would be the authorities of member countries, agencies and trading companies. It would also comprise some third parties, such as, joint chambers of commerce.

- b) **Linking and matching CT opportunities.** This will be done on the basis of available data followed by dissemination to interested countries.
- c) **Coordinating and projecting specific CT operations.** This will be done upon the IDB's own initiative or upon the request of interested member countries or other parties, based on advance information. This exercise would be followed by contacts and possible coordination with respective countries.
- d) **Organizing, supervising, and monitoring the execution of CT transactions upon the request of member countries.** This would entail processing the arrangement facilities of the deals, reviewing the risks involved, conducting negotiations, etc., until the deals are finalized.
- e) **Providing technical assistance on CT to member countries.** This will include advisory services, training, techniques, seminars and symposia.
- f) **Organizing business conferences and roundtable meetings among countertraders in member countries and abroad.** This will help to establish close working relations among countertraders and to explore CT opportunities.

(2) Trading Role

This role requires the IDB to exercise the functions of a trader in return for a profit margin or a service fee. It may comprise the following activities:

- a) To buy and sell vis-a-vis the two original parties, or a third party in switch deals. In so doing, the IDB would be using the mechanisms of trading houses. It could channel some operations through a company, and it would be backed within the guarantees exchanged among the original parties. The purpose of this activity is to facilitate deals and to provide assurances and confidence to CT partners.
- b) To be a partner in joint deals with other firms and banks, in accordance with a certain formula of profit-sharing. IDB finance would come through existing trade financing schemes.
- c) To arrange for the inclusion of foreign parties in certain CT operations, to the benefit of member countries in order to secure vital import supplies or to assist member countries in embarking on new markets.
- d) To encourage the establishment of trading corporations specialized in CT. The new Islamic Trading Company (currently being established) is an example.

(3) Financing/Investment Role

This role requires the IDB to perform the functions of banks and financing houses. Such services would be rendered against profit margins or interest free loan services. The role might comprise the following activities:

(A) Providing Bridge Financing in Two Forms

Foreign bridge financing in favor of a foreign CT creditor to fill gaps between commodity commitments, whether such gaps are agreed upon in advance (contractual) or emerge in later stages of transactions in accordance with appropriate arrangements.

Local bridge financing in favor of local producers and suppliers to avoid delays in the deliveries of counterimports, which could take the form of the IDB acting as *a Murabaha* or operations manager. Finance could be channeled through the existing three trade finance schemes by making use of their financial resources and mechanisms. Alternatively, the IDB could in the future allocate special resources for this purpose.

This role could be played by the IDB solely or jointly with other interested banks or companies.

(B) Connecting IDB Modes of Finance and CT Transactions

The purpose of this technique is to raise the performance efficiency of IDB operations to help members fulfill their commitment vis-a-vis the IDB and use debt-management in creating effective trade/finance relationships for the benefit of all concerned parties. The crucial element of this CT pattern is exchanging goods for debit and investment shares to secure final payment to the creditors. CT experience has developed various techniques to fit such a case.

The assumptions in this area include the following:

- To recover IDB dues and overdues pertaining to all types of operations.
- To inject the intermediation of existing trade finance schemes as a means of organizing and settling payments related to CT deals, through their mechanisms and financial resources. Some parts of such operations would be purely commodity exchanges.

- To disinvest contributions to equities. This could also be useful in certain aspects of the operations of the Unit Investment Fund.
- To get back overdues of member countries on capital shares.

(4) Establishing, Operating and Financing a "Multilateral Scheme of Countertrade Settlement" Among Contributing Member Countries

The main elements of this scheme can be summarized as follows:

- A multilateral agreement establishing the scheme is concluded.
- Revolving funds with uniform and mutual credit ceilings are established. Their assets are denominated in hard currency (e.g., US\$), but payments are made - by importers and to exporters - in local currencies.
- Funds are used by commercial banks under the supervision of central banks.
- Operation of the funds is confined to local currency payments to exporters or receipts from importers.
- Prices of goods exchanged must be related to world prices and denominated in hard currency.
- Payments should be valued in hard currency according to a unified date for all parties in contributing member countries (e.g., shipment dates).
- Each member country can specify the export goods (of national origin) which are included or excluded for the purpose of the scheme.

- The scheme is to be administered by a central office within the IDB.
- The scheme would be modified in the financing mechanism, if the IDB is prepared to open credits of unified amounts to supply the funds of members. These amounts would be used to finance the operations, with a ceiling to each operation. The IDB would obtain a profit margin on operations on the basis of *Murabaha*.
- The scheme should finance only small CT deals not exceeding US\$ 2 million each in order to spread its utility to a wide range of goods.
- Central multilateral settlements should be effected annually. Debtor members are responsible vis-a-vis the central office to settle the debit balance by goods to creditor members through direct negotiations among the respective members.
- Trade exchanges and credit/debit balances of members are not to be settled bilaterally, rather, they are to be pooled.

If the debtor member fails to settle its debt by exports within a fixed period, the debt has to be settled in cash in hard currency and has to be paid within a fixed period.

If the debtor country is unable to settle its trade debt in cash, it can get financing from the IDB.

- An appropriate mechanism conforming to Islamic Shari'ah could be designed to organize the IDB involvement, whether through service fees or profit margin or both.

Other mechanisms and channels of settlement could be secured by the IDB central unit of settlements and by cooperating trading companies. Debtor members can offer marketable exports to intermediate companies which

undertake to use their receipts in payment to creditor countries.

V. CONCLUSION

- 1) The IDB is expected to undertake a CT role in the near future for the benefit of OIC member countries.
- 2) The IDB's CT intervention will progress gradually but steadily.
- 3) IDB intervention will not be passive; it will take some active initiatives.
- 4) IDB operations will not be confined to OIC member countries. They might include nonmembers wherever this is considered beneficial to members.
- 5) CT operations would involve foreign trading companies and groups and some leading banks experienced in this field and having interests in common with member countries and the IDB.
- 6) The IDB's role in CT would require the full cooperation of member countries, their active response, and efficient communications with all the respective parties.
- 7) The IDB's role would not be based on exaggerated service fees or profit margins as the primary objective or criteria for the IDB's activities, although it would operate on a sound commercial basis. Some of the IDB's services should be rendered free, others would be against reduced fees or a reasonable profit margin.
- 8) The IDB's activities in CT would be widely diversified in order to include composite deals comprising elements and swaps of trade/finance/investment/debt management.

- 9) The IDB would find it desirable and useful to perform or channel some of its CT activities through specialized trading companies, in which it has direct interests, such as, capital sharing or contractual relations. An example of these could be the Islamic Trading Company (currently being established).
- 10) A multilateral scheme of CT settlements would be created using local currencies to effect local payments. This scheme would introduce continuity and equilibrium between imports and exports among contributing countries.

APPENDIXES

APPENDIX I

EXPLANATORY EXAMPLES *IDB/TPD ASSUMED CT FUNCTIONS

Example No. 1

- I. Within the exchange of data and information on CT possibilities among member countries through the IDB/TPD as a focal point, the TPD matches a CT opportunity between Country A and Country B.
- II. The TPD informs the two countries of the prospective deal and offers its assistance to bring them both together and to provide its services to the extent they would deem appropriate.
- III. Upon the request of the two parties, the TPD projects a deal in light of specific detailed information on goods, prices, global value, regulations, etc. The TPD reviews the risks involved and contacts the banks of the two parties. The TPD then arranges a meeting to negotiate the draft of the CT trading arrangement and the parallel banking arrangement, including guarantees.
- IV. The agreement is signed. The IDB is entrusted with the follow-up of the transaction execution until all commitments therein are fulfilled. This includes: (1) keeping the guarantees, (2) suggesting and supervising swing limits and shipments, (3) monitoring the deal to record dues and specify balances, (4) requesting the debtor party to fulfill its obligations and (5) using guarantees, if necessary.
- V. The IDB may receive a reasonable service fee from the two parties.

* IDB = Islamic Development Bank.
TPD = Trade Promotion Department (IDB).

APPENDIX II

EXPLANATORY EXAMPLES IDB/TPD ASSUMED CT FUNCTIONS

Example No. 2 Countertrade Role

- I. The IDB initiates or is requested by one or two member countries (governments, agencies, private companies, etc.) to arrange and/or participate in a CT deal on the basis of a profit margin. The purpose is to facilitate the deal, to provide assurance and confidence and to incorporate other parties in the deal on the basis of *cofinance/Murabaha*.
- II. The TPD contracts other parties and foreign parties, if necessary, to facilitate the arrangement and finalizes the agreement among the original parties. The arrangement includes bank (or other) guarantees. In case of the failure of any party to fulfill its commodity obligation, the IDB is ready • to finance the gap. The parties of the deal finalize contracts. Other parallel contracts are signed by them on behalf of the IDB as the seller and buyer vis-a-vis both parties on the basis of *Murabaha*. This includes a reasonable profit margin (markup).
- III. The IDB supervises the deal and finalizes it. It receives its profit margin from both parties for performing the role of intermediary (quasi trading house) and prospective or effective financier.

APPENDIX III

EXPLANATORY EXAMPLES IDB/TPD ASSUMED CT FUNCTIONS

Example No. 3 Financing Role

- I. The IDB is requested by concerned member countries, which are parties to a countertrade operation (either bilateral or triangular), to utilize the intermediation of the existing trade-finance scheme to facilitate their CT deal.
- II. The intervention of the IDB may take one of the following forms, commensurate with the circumstances or the formation of the deal:
 - (i) To provide bridge financing of a gap which is known in advance on the basis of an independent (*Murabaha*) agreement for a portion of the goods equal to the gap.
 - (ii) To provide financing on the basis of the IDB's countertrade role as (*markup/Murabaha*), if a gap is unknown in advance but probable.
 - (iii) To provide full financing to some parties in a triangular deal using trade financing schemes as an intermediary to secure commodity exchange, by using the three elements together in one mechanism: (cash payment, finance facility and commodity exchange). This can be accomplished by using the payment dues of Party A, as exporter to Party B, to finance its counterimports from Party C. In this case, Party B enjoys the use of the trade finance facility, and Party C is paid in cash:

COMMENT

DR. M. FAHIM KHAN¹

Farouq Makhoul has presented a very useful paper on the possible role of the IDB in organizing and financing countertrade transactions for the benefit of OIC member countries. The paper is so comprehensive that I can hardly add anything to it. Indeed, as a discussant, I can, at best, only further elaborate on some of the points raised in the paper.

There can be no ambiguity about the need for an international development financial institution like the IDB to explore a role in the countertrade operations of member countries. I think the fundamental justification for the existence of a development financial institution and for the existence of countertrade is the same. That justification is to foster economic development. Hence, the same argument that justifies the financing of trade by a development financial institution also justifies the financing of countertrade by the same financial institution.

Makhoul has described thirteen different objectives and motives for the involvement of the IDB in countertrade. As this is quite an exhaustive list, I can scarcely think of adding (or deleting) any objective or motive. I would, however, like to elaborate upon one particular motive listed by Makhoul which is:

"The promoting of the exports of OIC member countries especially nontraditional goods and facilitating their access to other members and foreign markets".

The objective of expanding the exports of nontraditional goods has also been emphasized in the paper of Mumtaz Abdullah.

* The author is in the IRTI of the IDB. The views in this paper are his own and do not in any way reflect or imply an official position on the part of either the IRTI or the IDB.

This aspect of countertrade in fact provides it with an economic argument. Countertrade is usually regarded as a nonmarket institution and, hence, is not considered an efficient economic activity. However, let us consider a developing country trying to export nontraditional goods in order to earn foreign exchange and to foster economic development. The problem for this country is how to find a market for these nontraditional products with which the country currently has no comparative advantage. The low-income economy does not provide enough domestic demand for tariff protection to help the country develop. Moreover, it is not possible for the country to enter the international market because of its lack of competitiveness and because of international restrictions on subsidizing exports.

There is a lot of complementarity of production and consumption within Third World countries, in general, and within OIC countries, in particular. These countries through cooperating in trade can provide an extended market for each other's products. But how can they accommodate each other's products? Each one of them suffers from a scarcity of foreign exchange and would like to save as much of it as possible. Hence, none of them would like to buy another country's less competitive products, when the same or better products are available at more competitive prices in the international market. Countertrade is a simple answer. Through countertrade, the importing country . can accommodate another country's less competitive products and satisfy its own demands as well while losing no foreign exchange (in fact, saving foreign exchange). This accommodation expands the market for the producing country and gives it a chance to become competitive through "learning by doing". "Learning by doing" for an "infant industry" is not a new argument. If it is a valid argument for justifying "protection", then it is equally an argument for countertrade. But, then, the question is where does the role of the IDB come in. The role of the IDB can only be that of financing. Of course, a country trying to expand the output of an "infant industry" for exports needs financing and the IDB may be able to provide it. But how can the IDB receive the repayment of its financing if the countertrade exports do not earn foreign exchange. In the context of the IDB, this may not be a serious issue.

Makhlouf's paper has made the following suggestions in this respect:

- 1) To recover IDB dues and overdues pertaining to all types of operations.
- 2) To disinvest contributions to equities.
- 3) To get back overdues of member countries on capital shares.

These methods can provide a good way of financing countertrade activities in member countries. However, to confine the IDB to only these forms may imply giving the IDB a passive role in countertrade activities. In my view, the IDB can play a more active role provided it is possible to make some changes in its capital/ financial structure.

The Islamic Development Bank is required, by its Charter, to use only Islamic modes of financing to finance operations in member countries. Equity participation is one of the Islamic modes of financing. "IDB accords equity participation a prominent place in its financing operations". (Annual Report 1987-88, p. 116). However, the share of equity participation in the total financing of the IDB has, so far, been quite low as the Bank has faced difficulties in the past in expanding the role of this mode of financing. Some of the difficulties relate to the scarcity of foreign exchange, the fluctuations of exchange rates and the redeemability of the Bank's capital. Financing countertrade can be a fruitful method of overcoming these difficulties by providing an opportunity to disinvest (or accept redemption of its equity shares) in the form of a countertrade mode by accepting goods or equipment and utilizing these goods for making equity investments in another country which may be in need of these goods. Although from the Shari'ah point of view there may be problems in offering goods/equipment for equity participation, these problems can be overcome by devising a mechanism for the market evaluation of the goods in question and by making this market value a basis for equity participation. In the light of the suggestion made in Makhlouf's paper regarding "a multilateral scheme of

countertrade settlements" which requires the valuation of countertraded goods at world market prices, this problem may not arise at all.

At this stage, I would suggest that initially the Bank should not plan to become involved in all forms of countertrading. It should initially confine itself to objectively selecting one or two forms of countertrade. In my view, the buy-back arrangement should be given priority because of its positive implications for the transfer of technology and industrial development. As already explained in the seminar, buy-back is a source of long-term industrial cooperation agreements between two countries where one country agrees to buy a plant from another country and pays back in the form of the output of that plant. However, the IDB's use of this form of countertrade for the purpose of the transfer of technology may require the Bank to deal with nonmember (developed) countries, which may be acceptable if it is in the greater interest of . member countries. Another form of countertrade that requires the immediate attention of the Bank is switch trading which requires a third party that can use the goods and services.

As Mian Mumtaz Abdullah mentioned, the buy-back form of countertrade is generally considered to be a form of financing rather than of trade and, hence, the involvement of financial institutions would be more suitable. Furthermore, the IDB as the financial institution of the Islamic World and through its involvement in trade financing in different countries is in a better position to determine the partners best suited for a switch trade deal. Through the IDB, member countries will find better partners for such deals than through bilateral negotiations.. It may even be more beneficial if the IDB uses a combination of buy-back and switch trade deals for the purpose of the development of member countries. Under a `buy-back cum switch trade' mode, the IDB may do the following:

- 1) Provide the financing to help a member country, Country X, obtain technology or a certain plant from a developed country.

- 2) Help another member, Country Y, purchase the products of that plant from Country X and pay the developed country for the equipment directly or through the IDB.

In his paper, Makhoul describes in some detail the preparatory work undertaken by the IDB to identify its possible role in CT activities. The description is quite impressive. It shows that the IDB wants to carefully plan and organize its involvement in CT activities. Countertrade, being a nonmarket institution, definitely requires careful planning and organization in order to avoid the inefficiencies that nonmarket institutions are likely to become involved in without careful planning. Competitive markets have a built-in mechanism (or an 'invisible hand') to take care of all aspects of efficiency. Nonmarket institutions do not have such a built-in mechanism. Careful and objective planning is a substitute for that invisible hand. I would, however, like to re-emphasize the point touched upon by Makhoul that access to all necessary information is the key to successful and objective planning. A first step for the IDB towards planning its involvement in CT operations would be to conduct a survey and develop a data base by specifically collecting the following information:

- 1) Country/commodity matrix indicating the major potential commodities that different member countries are willing to offer for export under countertrade arrangements.
- 2) Country/commodity matrix matching the import needs of member countries and the potential of member countries to produce the same through countertrade arrangements.
- 3) List of official contacts or official agencies entitled to or involved in countertrade operations in member countries.
- 4) Survey of the different modes or forms of countertrade most preferred or considered most suitable or generally used by different member countries.

Such a data base will be extremely helpful when the IDB starts drafting and developing policy guidelines and an operational plan for countertrade financing, and it will also help the IDB to advise member countries of the potentialities of beneficial countertrade partners, commodities and modes of operations. Makhlouf does mention the need for such a data base.

In the context of the potential role of the IDB in countertrade activities, I think that the suggestion by Makhlouf regarding the establishment of a settlement scheme for multilateral countertrade claims deserves consideration. With this scheme, the IDB can play a significant role in promoting trade and economic cooperation among OIC member countries. Several problems that countries now face in bilateral countertrade transactions can be solved if the IDB acts as the countertrade clearing agent. This suggestion, however, may face practical difficulties in view of objections from international financial organizations like the IMF and the World Bank. There is, however, no doubt that such a step may be helpful in promoting cooperation among OIC member countries which is one of the explicit objectives of the IDB. This suggestion in fact points to another useful role that the IDB can play in the context of the countertrade operations of member countries. Countertrade can benefit a country's balance of payments and economic development in several ways, but it can 'also damage the balance of payments and economic development in several ways. An indiscriminate use of countertrade activities may lead to negative consequences either for exporting countries or for importing countries or for both. In the context of OIC countries, there is a need for an institution that can not only closely monitor all the countertrade activities of member countries, but can also help them to coordinate these activities in a way that is conducive to the economic development of all member countries. The IDB may play a role in this regard.

What is important is to promote countertrade activities as a complement to international trade and not as a substitute for it. In other words, to operate countertrade when international trade is not feasible. But who can best advise a country when or when not to become involved in a countertrade arrangement? There is a general bias against

countertrade activities in the developed world, and any institution that is involved with the developed world may not give the advice that is needed by or acceptable to Third World countries. A Third World institution is in a position to give more acceptable advice to Third World countries. The IDB is a Third World institution and is in a position to take up the task for its member countries. Although it is a large task, it is very important and badly needed for the economic development of OIC member countries.

GENERAL DISCUSSION

M. AL-JARHI

We would like some more information about the Islamic Trading Company which the IDB is going to establish. This is an interesting idea, and this information would help us put this company in the right perspective as far as countertrade is concerned.

DR. ABUL EYOUN

Do we, or do we not, as OIC member countries, need the IDB to play a role in countertrade? Do we need the IDB to be involved in financing, mediating, trading, etc.? This is a simple question and I want the answer to it.

MAKHLOUF

Dr. Jarhi inquired about the Islamic Trading Company (ITC). The establishment of this company was adopted in principle at the 13th Annual Meeting of the IDB in Rabat last year. A preparatory committee was established under the auspices of the IDB. The statutes of this company have already been adopted. Its subscribed capital has been set at US\$ 50 million to be contributed by Islamic banks.

As for the points raised regarding the role of the IDB in countertrade, I do not think it is intended to increase the burden of the IDB, but rather to alleviate some of its burdens. Since most member countries are among the least developed countries, the role of the IDB will be to assist them in their development. Countertrade is a recent development and we are all aware of its benefits.

As regards the assumptions behind the IDB's role in CT, in the short run, we would envisage establishing an exchange data base, contacting companies and banks, matching opportunities like the role of a clearing house in information, satisfying the needs of member countries

and providing information about markets, goods prices, institutions and other parties interested in such activities.

The linkage in the trade relations of OIC countries is very much needed. The various trade schemes of the IDB have taken a number of years since their inception to become constructive and real. The new activities would not compete with these schemes, but rather where, possible would be channelled through the existing mechanisms of the IDB and in the interests of member countries. This linkage is very important in countertrade, diversified activities, investment, financing and commodity trade. This mixture or linkage is very useful but it requires know-how, something which the IDB should acquire in the meantime; and the more experience it acquires, the more effective role it will be able to perform.

The most important point which brother Fahim Khan mentioned is how the interests of the Bank and those of member countries will in the long term be similar. This is the most constructive way of doing things. It is desirable to bring the interests of the Bank and of its member countries together and to offset a passive position by a positive one.

RECOMMENDATIONS OF THE SEMINAR

RECOMMENDATIONS OF THE SEMINAR

The seminar organized jointly by IRTI/IDB (Jeddah) and OTIM (Turkey) focused its discussion on the following:

- 1) Presenting the recently developed methodologies and practices of CT and examining its different forms and techniques during the 1980s.
- 2) Discussing the experience of the OIC member countries most involved in CT transactions.
- 3) Attempting to examine the potential areas for economic cooperation among member countries through CT, and looking into alternative routes that the IDB may take in furthering CT transactions.

During six working sessions, from December 19 to December 21, 1989, two theoretical papers and four case studies were discussed in detail. General discussions raised many important points either concerning the practical experience of the OIC member countries engaged in CT deals or concerning the role of the IDB in the future of CT among OIC member countries.

After the discussions, two working groups were able to conclude their recommendations. The first group (list of members in Annex A) was assigned the task of examining the following topics:

- 1) Costs and benefits of CT with particular reference to its role in the promotion of economic and trade cooperation among member countries.
- 2) Institutional arrangements at the OIC level.
- 3) The expected role of the IDB.

After a detailed scrutiny of the topics, the group reached the following recommendations:

1. BENEFITS AND COSTS OF COUNTERTRADE

Benefits

1. CT helps overcome balance of payments difficulties through the following:
 - a) It helps maintain the flow of imports in time of severe foreign exchange shortages.
 - b) It facilitates direct capital inflow to practicing countries.
2. It assists in evading restrictions imposed on international trade through the following:
 - a) It provides additionality in exports through the diversification of products and market.
 - b) It helps in overcoming adverse effects and imperfections caused by international cartels and other support mechanisms for primary products.
 - c) It assists in maximizing the buyers' bargaining power in the bulk exchange of goods and services.
3. It has several developmental benefits:
 - a) It helps in the acquisition of technology and know-how.
 - b) It increases the quality of exportable goods and services.
 - c) It helps to create more jobs in practicing countries.

Costs

- 1) The cost of transaction is higher than normal. This makes imports expensive.
- 2) There is a lack of price transparency.
- 3) Price distortions are created by countertrade in the market which affects the rest of the economy.
- 4) Countertrade may lead to selective and arbitrary currency devaluation with respect to individual export items.
- 5) It is complex in operation and needs expertise which is generally lacking in developing countries.
- 6) It leads to a lack of continuity and may lead to noncompliance of the terms of the agreements/commitments.

Comparing the above costs and benefits, in the context of the current situation in IDB member countries, it was concluded that in order to encourage OIC member countries to expand their trade and to overcome balance of payment difficulties, CT would be advisable despite its drawbacks as an additional form of trade depending on the circumstances prevailing in each case.

2. INSTITUTIONAL ARRANGEMENT AT THE OIC LEVEL

There is a need for establishing a CT Information Exchange System where country and commodity profiles will be maintained in collaboration with the ICDT and the IRTI.

1. Advisory and technical support services are also needed. They can perform the following:

- a) Upon the request of parties, to identify countertrade partners and to bring them together for the successful conclusion of business.
 - b) Suggest possible areas and products for CT member countries.
 - c) Provide all information, support and consultancy services, if required, for negotiations and conclusions of such trade.
 - d) Develop guidelines for countertrade negotiations and develop model contracts.
 - e) Innovate new model contract packages to realize CT business.
2. Financial services are also needed for the following:
- a) To provide support to negotiate countertrade financing through the IDB's financing schemes.
 - b) To provide bridge financing.
3. Trade services are needed for the following:
- a) To encourage trade among member countries through the establishment of Islamic trading houses.
 - b) To explore the possibilities of establishing mechanisms for the resolution of trade disputes among OIC countries in collaboration with the Islamic Chamber of Commerce.
 - c) To continue efforts to organize a multilateral trading system among OIC members.

3. POSSIBLE ROLE OF IDB

It was recognized that the IDB has a number of functions delegated to it and while discharging, among others, its function of encouraging

trade, it should look into the possibility of the use of countertrade by member countries. In the discharge of this function, it should examine and encourage both multilateral trade and countertrade as a catalyst, financier or technical advisor.

The second group (list of members is in Annex A) was responsible for examining the practical side of CT in order to highlight the problems facing the CT operations of OIC member countries and to suggest a way of solving them.

The group reviewed the experiences of some OIC member countries in CT and found that successful deals in this field would be carried out more easily and efficiently if the following requirements were met:

(A) Setting Performance Criteria

Performance criteria should be set to ensure that CT deals are economically efficient. In this regard the following issues must be considered:

- 1) Goods exchanged should be valued according to their international prices wherever applicable.
- 2) The unit of account used should be a convertible stable currency, i.e., the U.S. dollar.
- 3) The ultimate result of each deal should be net accrual of profit to the party concerned.

(B) Assistance with Information Design and Evaluation

The existing institutional structure in each OIC member country should form, within itself, a network to provide the parties interested in carrying out CT deals with the following:

- 1) Information regarding possible commodities to be traded, potential CT partners and possible trading conditions.
- 2) Careful design and evaluation of potential CT agreements.
- 3) Technical assistance during CT negotiations.

(C) Qualitative Balance Between the Export and Import Sides

In order that a CT deal be beneficial to an OIC member country, the contents of the export and import sides must be designed to achieve the following:

- 1) Include the highest possible proportion of nontraditional export goods.
- 2) Maintain a reasonable amount of domestic value added in the goods to be traded.
- 3) Ensure a proper balance between exports and imports.

(D) Proper Contract Drafting

Contracts must be carefully drawn up in order to provide the following:

- 1) A strong link clause that clearly sets an obligation on each party to import the other party's products.
- 2) Simple and specific provisions.
- 3) A short and clearly specified list of goods to be traded.
- 4) A proper timetable for completion of transaction by both parties.
- 5) Appropriate guarantees and penalty clauses.

(E) Private Sector Involvement

The private sector should be encouraged to participate in profitable CT transactions through the following :

- 1) Removing the obstacles that might prevent its participation.
- 2) Making relevant information available to the private sector.

(F) Strengthening Production Base

Generally, it is necessary to have a strong production base for active trade. Therefore, OIC member countries are urged to diversify their products and improve their quality to an international standard in order to increase their competitiveness in the international market.

(G) Improving the Trade Service Industry

The promotion of trade, in general, and CT, in particular, requires improving the trade support industry, especially in the fields of marketing, banking, insurance, shipping, packing, storage and inspection.

The improvement of these services can be realized through the building up of the necessary infrastructure.

(H) Facilitating Multiparty Participation in CT.

In order to facilitate multilateral participation in CT, third party participation should be allowed by all OIC member countries.

CONCLUSION

The seminar participants believe that the IDB should work on the above mentioned recommendations in order to make CT a possible and alternate option to expand intramember country trade.

It is also recommended that periodic conferences be held to review the progress of CT among member countries. A conference gathering all Trade Promotion Centers in OIC countries would help enhance trade among Muslim countries. A Standing Committee in the IRTI/IDB should also be constituted to work out the details and to collect information on current export and import items under CT and the organizations and institutions currently involved in CT transactions.

DISCUSSION ON RECOMMENDATIONS

MAKHLOUF

The role of the IDB is still vague and the impression is that it will be confined to technical assistance. This is contradictory to the purpose of this seminar and to the purposes and objectives which we have to realize. We need to make things clearer. The OIC has no mechanisms or organs to undertake this assistance. It is only the IDB, the ICDT, the Ankara Center and other bodies that can come forward to help in this respect. At the beginning of the recommendations in the first paragraph concerning the OIC, we may say between brackets, "the IDB or other competent organs" and we can merge the paragraph concerning the IDB in the main recommendation or leave it as it is without concentrating on technical assistance, because the IDB is not particularly competent in these services. Its main objective is financing and other related services. So, I propose that we find a way to scrutinize the role of the IDB in a new, purposeful way. The OIC has no tools to perform this function. So, the paragraph needs simple rephrasing, not a substantial change.

DR. ABUL EYOUN

I would first like to comment on some observations made concerning the second group regarding the prevailing market prices. Sometimes market prices do not reflect market forces. The distortions are caused by the intervention of governments in market forces. That is why Brother El-Jarhi insisted on using international prices as a guide in order to evaluate the benefits and the cost of CT. But the prevailing prices are not the same.

Secondly, private sectors should be encouraged to trade among themselves and be given a chance. Controls may cause some distortion in international and internal markets. That is why I and my brother, El-Jarhi, insisted on saying that we should use international prices as a guideline in order to evaluate transactions. However, the market price

that may prevail in Southeast Asia may not be the same as that in the Middle East. So we must use international prices in order to evaluate transactions.

M. ABDULLAH

We think that multilateral trade and countertrade should go side by side. We recognize that the IDB has a number of functions. In discharging them, the IDB promotes trade, and eventually it will be involved in countertrade as well. It has a number of areas in which to act, and countertrade is one of them.

There is a need for establishing a countertrade transactions exchange and an advisory and technical expert services center. We recognize that the IDB has a number of functions entrusted to it including that of trade promotion. As such, it should look into the possibility of countertrade among member countries. In discharging this function, it should examine and encourage multilateral trade and countertrade.

ANNEXES

ANNEX A
COMPOSITION OF THE WORKING GROUPS AND
DRAFTING COMMITTEE

A. COMPOSITION OF WORKING GROUPS I AND II

GROUP I

Mumtaz Abdullah	-	Chairman
Mohd Jamal Mahussin		
El Idrisai Lalami Lahbib		
Tri Mardjoko		
Hasan Parilti		
Jassar Al-Jassar		
Recai Basaran		
Ouattara Maimouna		
Bakri S. Shata		
Farouk H. Makhoulouf		
Dr. Abdul Aziz Jalloh		
Dr. M. Fahim Khan		

GROUP II

Mahmoud Abul Eyoun	-	Chairman
Nayef A. Alfadl		
Abdullah M. Hussan		
A. Aziz Kasim O.		
Obella		
Comlan Laurent Brice		
Khwajah Abdur Rahman		
Kassem El-Said		
Mamdouh El-Masry		
Armagan Asina		
Mabid Al-Jarhi		

**B. COMMITTEE FOR DRAFTING RECOMMENDATIONS
OF THE SEMINAR**

Dr. Mahmoud Abul Eyoun - Chairman
M. Mumtaz Abdullah
Rajaei Recai Basaran
Tri Mardjoko

ANNEX B

PROGRAM OF THE SEMINAR

December 19, 1989

08:30 - 09:00 Registration
Inaugural Session

Working Session I

09:30 - 10:15 Paper 1: Countertrade Arrangements:
Survey and Critical Review
Dr. Mahmoud Abul Eyoum

10:15 - 10:35 General Discussion
Discussant: Dr. Mabid Al-Jarhi

Zuhr prayers and lunch break

Working Session II

13:30 - 14:15 Paper: Countertrade : Experience of Pakistan
and other OIC Member Countries Mian
Mumtaz Abdullah

General Discussion

Asr prayers and coffee break

15:00 - 15:20 Discussion

Discussant: Dr. M. Fahim Khan

December 20, 1989

Working Session III

- 09:00 - 09:30 Case Study of Egypt by Dr. Mamdouh El-Masry
09:30 - 10:00 Case Study of Turkey by Dr. Armagan Asina
10:00 - 11:00 General Discussion

Coffee Break

- 11:30 - 12:00 Case Study of Indonesia by Zulkifli Serigar and
Tri Mardjoko
12:00 - 12:30 Case Study of Malaysia by Aziz Kasim
12:30 - 13:30 General Discussion
Zuhr and Mr prayers and lunch break
15:00 - 17:00 Meeting of Working Groups
Meeting of the Drafting Committee

Working Session IV

- 09:00 - 09:30 Paper: Possible Role of the IDB by Farouk Makhlof
09:30 - 09:45 Discussant: Dr. M. Fahim Khan
09:45 - 11:00 General Discussion

Coffee Break

- 11:30 - 12:15 Presentation of Reports of Working Groups by Group Leaders
12:15 - 13:15 General Discussion
Zuhr and Asr prayers and lunch break
15:00 - 16:00 Presentation of Recommendations by the Drafting Committee
Conclusion

ANNEX C

PARTICIPANTS OF THE SEMINAR

A. PARTICIPATING COUNTRIES AND INSTITUTIONS

Countries

Pakistan
Kuwait
Egypt
Turkey
Iraq
Benin
Sudan
PDR of Yemen
Malaysia
Morocco
Indonesia
Uganda
Bangladesh
Saudi Arabia

Institutions

Islamic Development Bank, Jeddah, Saudi Arabia Saudi

International Bank, London, U.K.

Development Bank of Turkey, Ankara, Turkey Arab

Monetary Fund, Abu Dhabi, U.A.E.

B. LIST OF PARTICIPANTS

	Name	Country
1.	Ghazi Al Nakkah	Iraq
2.	Oode Obella	Uganda
3.	A. Aziz Kasim	Malaysia
4.	Mohd Jamal Mahussin	Malaysia
5.	Hassan Jaber Abu Zaid	Saudi Arabia
6.	Mian Mumtaz Abdullah	Pakistan
7.	Sodqi Abdul Hadi Saleh	Jordan
8.	M. El Idrissi L. Lahbib	Morocco
9.	Maimouna Ouattarra	Burkina Faso
10.	Alpha Diallo	Guinea
11.	Tri Mardjoko	Indonesia
12.	Comlan Laurent Brice	Benin
13.	Mahmoud I. Abu! Eyoun	Egypt
14.	Mamdouh El Masri	Egypt
15.	El Said Fouad Kasem	Egypt
16.	Hassan Mohd Saleh	Sudan
17.	Malile Mohamed	Algeria
18.	Khwajah Abdur Rahman	Bangladesh
19.	Armagan Asena	Turkey
20.	Beratiye Oncu	Turkey
21.	Fikret Kurtay	Turkey
22.	Asomani Massimia	Comoros
23.	Jassar Al-Jassar	Kuwait
24.	Abdullah Mohd Hassan	S. Yemen
25.	Abdul Aziz Jalloh	Sierra Leone
26.	Baki Shata	IDB
27.	Naif Ahmad Al Fadl	IDB
28.	Farouk H. Maklouf	IDB
29.	Ma'abd El Jarhi	Arab Monetary Fund
30.	Dr. Mohd Fahim Khan	IRTI/IDB

شركة المدينة للطباعة والنشر / جدة
طريق المدينة المنورة - شرق الكوبرى المربع
تليفون: ٦٣٩٦٠٦٠ - فاكس: ٦٣٩١٠٠٣

THE ISLAMIC DEVELOPMENT BANK (IDB)

Establishment of the Bank

The Islamic Development Bank is an international financial institution established in pursuance of the Declaration of Intent issued by the Conference of Finance Ministers of Muslim countries held in Jeddah in Dhul Qa'da 1393H (December 1973). The Inaugural Meeting of the Board of Governors took place in Rajab 1395H (July 1975) and the Bank formally opened on 15 Shawwal 1395H (20 October 1975).

Purpose

The purpose of the Bank is to foster the economic development and social progress of member countries and Muslim communities individually as well as jointly in accordance with the principles of *Shari 'ah*.

Functions

The functions of the Bank are to participate in equity capital and grant loans for productive projects and enterprises besides providing financial assistance to member countries in other forms of economic and social development. The Bank is also required to establish and operate special funds for specific purposes including a fund for assistance to Muslim communities in non-member countries, in addition to setting up trust funds.

The Bank is authorized to accept deposits and to raise funds in any other manner. It is also charged with the responsibility of assisting in the promotion of foreign trade, especially in capital goods among member countries, providing technical assistance to member countries, extending training facilities for personnel engaged in development activities and undertaking research for enabling economic, financial and banking activities in Muslim countries to conform to the *Shari 'ah*.

Membership

The present membership of the Bank consists of 53 countries. The basic condition for membership is that the prospective member country should be a member of the Organization of the Islamic Conference (OIC) and be willing to accept such terms and conditions as may be decided upon by the Board of Governors.

Capital

The authorized capital of the Bank is six billion Islamic Dinars. The value of the Islamic Dinars, which is a unit of account in the Bank, is equivalent to one Special Drawing Right (SDR) of the International Monetary Fund. The subscribed capital of the Bank is now 3654.78 million Islamic Dinars payable in freely convertible currency acceptable to the Bank.

Head Office

The Bank's Headquarters is located in Jeddah, the Kingdom of Saudi Arabia and the Bank is authorized to establish agencies or branch offices elsewhere.

Financial Year

The Bank's financial year is the Islamic lunar Hijra year.

Language

The official language of the Bank is Arabic, but English and French are additionally used as working languages.



ABOUT THE AUTHOR

M. Fahim Khan holds B.A. and M.A. (Statistics) from Punjab University, Pakistan, M.A. and Ph.D. in Economics from Boston University, USA. He is associated with the Islamic Research and Training Institute (IRTI) since 1988 serving at various positions such as Head Research Division, Acting Director IRTI, Head Training Division and he is currently Chief, Islamic Economics, Cooperation and Development Division. Before joining IRTI, he has worked in various teaching, research and managerial positions in the Ministry of Planning, Government of Pakistan as Deputy Chief, International Institute of Islamic Economics, International Islamic University, Islamabad as Professor and Director, School of Economics, King Abdulaziz University Jeddah as Visiting Professor and Quaid-e-Azam University Islamabad as Visiting Professor. He is currently on deputation to the State Bank of Pakistan as Advisor on Transformation of the Financial System.

M. Fahim Khan has published/edited 10 books on Islamic economics, banking and finance. These include *Money and Banking in Islam and Fiscal Policy and Resource Allocation in Islam* jointly edited with Ziauddin Ahmed and Munawar Iqbal and *Essays in Islamic Economics* published by the Islamic Foundation, Leicester, UK. In addition to that he has over 15 publications in refereed journals. He has extensively contributed to the development of teaching and research institutions, programs and activities as well as to preparing various reports and working papers. He has presented over 20 papers to various International Conferences and Seminars. The main areas of his current interest are Islamic economics, banking and finance particularly, the development of financial instruments for public sector resource mobilization. The author's e-mail address is mfahimkhan@hotmail.com.

ISLAMIC DEVELOPMENT BANK
ISLAMIC RESEARCH AND TRAINING INSTITUTE
Postal Address: P.O.Box 9201, Jeddah - 21413
Kingdom of Saudi Arabia
Cable Address: BANKISLAMI-Jeddah Telephone: 6361400
Facsimile: 6378927 / 6366871
E-mail: Address: IDB@ISDB.ORG.SA Home page: [HTTP://WWW.IRTI.ORG](http://WWW.IRTI.ORG)

Legal Deposit No.4754/22
ISBN : 9960-32-114-2