Executive Summary

A basic and necessary characteristic of an expanding world economy is the market-oriented, unfettered flow of capital, goods, and services across national boundaries. However, when sluggish economic conditions prevail in markets, when special national interests are served, or when competitive considerations afford the imposition of reciprocal obligations in cross-border trade, some countries find it expedient to impose compensatory conditions on their foreign trade. Prominent international currency and economic crisis such as the 1982 global banking crisis, 1987 stock market crash, 1994-95 Mexican crisis, 1997-98 Asian crisis and 1998 Russian crisis had raised many to question the inherent reliability and stability of the current financial and trading system. The world economy is in its worse scenario as even the economy of the apparently world's richest countries are slowing sharply. As globalization strives to flourished, governments are faced with fierce competition and, stagnant and declining demand. Even with strong demand, especially in emerging markets such as Central and Eastern Europe, the government may not have enough hard currency to pay its much needed imports. Hence, many economies are now resorting to countertrade as an alternative to money mediated transactions in the international business environment.

Managed or conditioned trade involving contractually-enforced reciprocity commitments such as countertrade has always existed in international commerce. Characteristics of such trade practices are: the type of unilateral action or reciprocity required of suppliers; the preferential treatment granted in return; and the nature of public intervention in the transaction. Use of the practice has been particularly common in countries where governments are the dominant player in the domestic economy. In fact, countertrade practices are practically always influenced by some form of government intervention or scrutiny.

Countertrade opportunity has arise in the emergence of new emerging markets such as central and eastern Europe, as well as many of the developing countries as a medium to fulfill their import needs. Countertrade has since become the world's new way to do business. The growth of countertrade is significant in the past decades when the world trade witnessed

a dramatic increased in countertrade transaction. According to some estimates, more than 30% of world trade was in the form of countertrade in 1998, up from only 2% in 1975. Its growth has created various type of countertrade arrangement that makes it more flexible in arranging an exchange. In its oldest form, pure barter was comparatively unusual, a more widely used forms were barter-like deals such as compensation, buyback, offset and switch trading. There are other more recent forms of countertrade that had been established in order to ensure the smooth flow of goods and services among countries.

The motivating factors for the growth of countertrade are various, from non-convertibility of currencies or liquidity shortages to the extension of governments' trade and industry policies and objectives. Countertrade was no longer being viewed as an instrument propagated only by developing countries; its importance has also motivated developed countries to adjust their international trading policies in order to gain momentum in trading with emerging markets.

The growth of countertrade has brought to questions on whether the existing money mediated trading system was not sufficient to support the world trade. The objective of this study is firstly, to find out the underlying causes for the dramatic growth of countertrade since the introduction of 'money'. As countertrade is a very controversial form of trade, due to its secretive and complex nature, its dramatic growth rate brought forward the awareness of the underlying problems of the current financing and trading system. The root-cause need to be identified in order to understand the reasons for its growing practices even though countertrade is related to many critics and problems. Secondly, this study is also aimed to find out the consequences of countertrade to the developing countries as well as to the world trade as a whole. This may give an overall view on whether countertrade is a viable solution to the various international trade problems. As such, it hopes that this study will contribute towards the development of a more efficient and effective trading system that helps a smoother flow of goods and services among countries in the world.