1.0 Introduction and Organization of the Report

The great economic crisis at the end of the 1920's recorded a significant upsurge in international barter due to the breakdown of the international trade and payments system as well as global economic depression. Further intensity of barter was fostered by the continuous international economic recession and liquidity problems particularly in the 1970's. The number of countries that required countertrade in their international deals soared from only 15 countries in 1972 to 100 countries in 1988 (Klang, 1997). The obvious increase was marked by the oil crisis in 1974 where countertrade was employed as a method of controlling currency exchanges in East-West trade. Since then, countertrade has been an integral part of economic practices between the Eastern countries (Eastern Europe) and their Western counterparts (OECD countries). For Asia, Indonesia became the first country to mandate countertrade in 1982.

The use of countertrade practices is a fact of life in today's international trading environment. Countertrade is commonly regarded as an inefficient nuisance, resorted to only when normal trading medium are inaccessible (Cohen and Zysman, 1986). Countertrade takes place mostly in emerging markets like less developed markets, developing markets as well as centrally planned economies. The economic indicators in these countries are weak as characterized as average or low income per capita, widespread exchange or capital controls, immature financial markets, inadequate communication and often have greater swings in currency values. These may further create high inflation rates and currency depreciation that cause balance of payment problems. Massive currency devaluations and other foreign currency risks have led to a resurgence of trading without cash as a real alternative in keeping business alive in these markets. Besides, currency controls that include currency-convertibility restrictions will cause the shortage of hard currency that will also lead to balance of payment problems.

With their nonconvertible currencies and various economic weaknesses, Eastern Europe and the Soviet Union as well as other emerging or developing countries use countertrade as an alternative to hard currency. Assets exchanged in countertrade practices may range from physical goods to intangibles such as technical transfers, commercial rights, and services.

Since 1997, the Asian and Latin American currencies have again been in a state of profound destabilization, something that is grist to the mill of the barter expert. A recent example of this is Argentina, where the peso has collapsed against the dollar, leaving the country unable to pay for its import needs in the usual way. Now it is using its commodities, many of them tied to the dollar, to pay its bills.

Countertrade denotes various types of 'barter-like' agreements that require a seller, as a condition of sale, to commit contractually to reciprocate and undertake certain business initiatives that compensate and benefit the buyer (Onkvisit and Shaw, 1997). It is a prevalent and feasible trading mechanism which complements conventional modes of payment with full or partial payment in goods. It also represent and alternative to no trade especially when conventional finance credit is difficult, costly or unavailable to support a particular transaction.

The demand for countertrade arrangement is charting an upward trend in international business scene. According to the president of the Australian Countertrade Association, Malcolm Taylor, there are inquiries for barter deals with Indonesia, Thailand, Malaysia and the Philippines (Brown, 1998). Approximately 60% of all the countries in the world require certain form of countertrade in their procurement and around 20% to 30% of world trade is countertrade. The annual global market size for countertrade is estimated to be in the range of US$200 to US$500 billion (APCA, 2002). Hence, individual countries that do not wish to be left out in the world trade would not afford to miss the opportunities created from countertrade arrangements.

The issues related to countertrade activities are much debated. It ranges from the role of countertrade as facilitator of trade between rich and poor nations to a fierce critique of its rationale, inefficiencies and the damaging impact it has on the economies it is claimed to help (Egan & Shipley, 1996). While countertrade continues to grow as a key driver of world trade, it is at the same time criticized by international trading organizations such as OECD, GATT (now WTO) and IMF. They criticized countertrade because it disrupt the multilateralized trading system as countertrade is considered as exclusively bilateral in nature and may lends itself to intervention by government through disguised price.

They also argued that countertrade is substituting market competition and forces with reciprocity, protection and price setting, hence refraining free trade. Nevertheless, the countries that make up these organizations continue to countertrade and develop methods of simplifying and enabling companies to increase their export revenues (Klang, 1997). Attempts were made to create a legal base so that practice of countertrade could be accepted internationally and minimize confusion. In 1993, the United Nations Commission on International Trade Law (UNCITRAL) has published its Legal Guide on International Countertrade Transactions. Ever since then, countertrade has re-emerged as a vital trading tool for all kinds of business transactions, from disposing of unwanted or excess production or as a mode to enter new market, to the purchase of crucial raw materials as well as the purchase of military and strategic supplies. Today, beside occurring in trade with developing countries, reciprocal trade arrangements or countertrade, represent a reality of doing business with government purchasing agencies in both developed and developing countries when significant dollar value military or civilian procurements are involved.

This paper attempts to study the growth of countertrade, its causes and consequences. It will begin with the literature review on countertrade studies. Section 1 demonstrates literature review covering countertrade definitions and the illustrations of the different forms of countertrade practices. A brief highlight on the use of the various forms of countertrade will be made. Section 2 of this report will explore the growth of countertrade in general. Some empirical evidence will be provided. This is followed by the discussion on the causes and motivation of countertrade in Section 3. Section 4 will describe the consequences of countertrade. Focus will be on the benefits and drawbacks generated from countertrade practices. A brief analysis on the growth of countertrade as an evidence of the underlying weakness of the current trading/financial system will be made towards the end of this report. Finally a brief review on the future of countertrade, both in short term and long term will be made will conclude the report.