Counter trade

[Economics](), [Trade]()

Counter Trade Counter Trade: Unquestionably, currency is the preferred payment medium for any export or import transaction—it is easy, fast, and straightforward to transact. Sometimes, though, compa¬nies must adapt to the reality that buyers in many countries cannot do so, whether due to the fact that their home country's currency is nonconvertible, the country doesn't have enough cash, or it doesn't have sufficient lines of credit. Sometimes companies and coun¬tries find it practically impossible to generate enough foreign exchange to pay for imports.

In recourse, they devise creative ways to buy products. For example, Indonesia traded 40, 000 tons of palm oil, worth about US$15 million, with Russia in exchange for Russian Sukhoi fighter aircraft. This trade, like others that fall under the umbrella term countertrade, illustrates that buyers and sellers often find creative ways of settling pay¬ment for imports and exports. Countertrade refers to any one of several different arrangements that parties negoti¬ate so that they can trade goods and services with limited or no use of currency.

Technically, countertrade can be divided into two basic types: barter, based on clearing arrangements used to avoidmoney-based exchange; and buybacks, offsets, and counter purchase, which are used to impose reciprocal commitments. Countertrade is an inefficient way of doing business. By default, companies prefer the straightforward efficiency of cash or credit. In the case of countertrade, rather than sim¬ply consulting current foreign exchange rates, buyers and sellers must enter complex and time-consuming negotiations to reach a fair value on the exchange—how many gallons of palm oil for how many planes, for example.

In some situations, the goods that are sent as payment may be poor quality, packaged unattractively, or difficult to sell and service. Also, there is a lot of room for price and financial distortion in countertrade deals, given that nonmarket forces set the prices of these goods. Ultimately, countertrade and its vari¬ations threaten free market forces with protectionism and price fixing that can complicate trade relations with other countries. Still, the harsh reality of international trade means that countertrade is often unavoid¬able for companies that want to do business in markets that have limited or no access to cash or credit.

Complicating matters is the fact that as much as companies may dislike them, many emerging markets prefer forms of countertrade to preserve their limited monetary assets, generate foreign exchange, and improve the balance of trade. In addi-tion, these methods help emerging markets reduce their need to borrow working capital as well as let them access thetechnologyand marketing expertise of MNEs. More signif¬icantly, benefits beyond financing the immediate transaction do accrue to companies.

Accepting the option to countertrade shows managers' good faith and flexibility in the face of onerous conditions. These sensitivities can position the firm to gain preferential access to emerging markets. Philosophically, the idea of countertrade fits with many countries' basic notions of business. For example, the idea of " barter and trade" is part of some African traditions that are reluctant to conform to " Euro-centric" methods of cash payment. It is difficult to gauge the size of the countertrade market. Estimates in the past have ranged from 10 to 40 percent of total global exports.

This figure has proven tough to verify due to inconsistent reporting and disclosure. Countertrade generally increases in economies that are experiencing widespread economic problems. In Argentina, countertrade among common citizens has increased due to a severe shortage of cash. There are several types of countertrade. The three most common ares- (1) Barter Barter, the oldest form of countertrade, is a transaction in which goods or services are traded for goods or services of equal value without any exchange of cash or credit.

Each term of the exchange is negotiated in terms of the immediate trade of goods or services. For instance, Thailand and Indonesia signed a $40 million deal in which Indonesia would supply Thailand with an agricultural aircraft, train carriages, and fertilizer in exchange for Thai rice—no monies were or would be exchanged. There are barter firms that act as an intermediary between the exporter and importer, often taking title to the goods received by the exporter for a price or selling the goods for a fee and a percentage of the sales value. (2) Buybacks

Buybacks are products the exporter receives as payment that are related to or originate from the original export. Buyback arrangements are quite common in the sale of technology, licenses, and even complete " turnkey" factories. Payment is made in full or in part either by products manufactured in the new facility or by production from the new license or tech¬nology. Buyback countertrade is especially popular for turnkey infrastructure projects. For example, the customer pays for the project, say a steel mill, with government-backed long-term credit.

The exporting contractor first guarantees that the project will work when com¬pleted and then agree to buy back products or services from the completed facility or to serve as a distributor for products exported from the host country. The host-country buyer uses these hard currency payments to liquidate the original long-term credit. Throughout the relationship, no cash changes hands and no credit arrangements are necessary. The buy-back contract merely states that the output from the newly constructed facility is to be applied to the original price of the exports.

This sort of arrangement was worked out between PepsiCo and Russia. Pepsi provided syrup to state-owned bottling plants in Russia and received Stolichnaya vodka in return, which it then marketed in the West. (3) Offset Trade An increasingly important form of countertrade is offset trade, a transaction that takes place when an exporter sells products for cash and then helps the importer find opportuni¬ties to earn hard currency. Offsets are most often used for big-ticket items, such as military sales.

The Czech government made offset the deciding factor, as opposed to technical and performance criteria and price, in its jet fighter procurement. Offset arrangements are usually one of two types. 1. Direct offsets include any business that relates directly to the export. Generally, the exporter seeks contractors in the importer's country to joint-venture or coproduce certain parts if applicable. For example, an aircraft exporter could partner with a company in the importer's country to manufacture components that would be used in the manufacture of the aircraft. . Indirect offsets include all business unrelated to the export. Generally, the exporter is asked by the importer's government to buy a country's goods or invest in an unre¬lated business. Some of the most common direct offset practices in military sales include coproduction, licensed production, subcontractor production, overseas investment, and technology transfer. Examples of indirect offsets might include assisting in the export of unrelated products from the host country or generating tourist revenues for the host country.