BARTER AND COUNTERTRADE: IMPLICATIONS FOR U.S. TRADE

by

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1983

Submitted to the Graduate Faculty of the
Department of Marketing
College of Business Administration
in partial fulfillment of
the requirements for the Degree of
MASTER OF BUSINESS ADMINISTRATION
July, 198~~4~~ 6

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Institution: Oklahoma State University

Location: Stillwater, Oklahoma

Title of Study: BARTER AND COUNTERTRADE: IMPLICATIONS FOR U.S. TRADE

Pages in Study: 77 Candidate for Degree of Master of Business Administration

Major Field: International Marketing

Scope and Method of Study: This study reveals the attitudes of Bank Export Trading Companies towards countertrade practices. The instrument used to explore the attitudes was a mail survey. The survey was designed, administered and analysed over a period of three months. Descriptive statistical analysis was used to arrive at the results.

Findings and Conclusion: Analysis indicated that countertrade has grown in popularity over the last ten years. It has shifted its focus from predominantly East-West trade to North-South trade. Although many countertrade arrangements are undertaken for purely commercial considerations, a substantial number are undertaken to fulfill government trade policy requirements. Governments in most countries intercede in international trade flows through trade regulations, administrative devices and other formal and informal activities. These intercessions result in countertrade arrangements which implement such objectives as assuring stable supplies of essential imports, minimizing balance of payment deficits or diversifying the domestic economy.

BARTER AND COUNTERTRADE:
IMPLICATIONS FOR U.S. TRADE

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ACKNOWLEDGEMENTS

I would like to express my sincere appreciation and regards to Professor Bob Curtis Hamm, for his invaluable assistance in the completion of this report.

I also express my appreciation to Dr Gerald M. Lage and the staff of the Centre for International Trade and Development for the guidance they provided.

My gratitude also extends to Mr Edward G. Holman at the library for his help in compiling the research for the report.

A note of special thanks to my friend Joby John for all the encouragement he provided.

Finally, my ultimate appreciation and gratitude to my parents, without whose financial help, love and encouragement, this study would not have been possible.

Table of Contents

CHAPTER		PAGE
I	Introduction	1
	Purpose	
II	Literature Review	4
	Forms of countertrade	5
	Evolving Forms of countertrade	17
	Choice of Products	22
	Financing countertrade	23
	Motivations to countertrade	28
	Risks associated with countertrade	30
	Philosophical Objections to contertrade	32
III	Methodology	35
IV	Analysis and Results	38
V	Conclusion	63
	Selected Reference	66
Appendix I:	Overview of Bank ETCs	70
Appendix II:	Letter to Respondents	72
Appendix III:	Questionnaire	73

Table of Figures

	Page
Figure I	7
Figure II	8
Figure III	10
Figure IV	12
Figure V	14
Figure VI	16
Figure VII	19
Figure VIII	21
Figure IX	24
Figure XI	27
Exhibit 1	36

CHAPTER ONE

In 1976, two hundred years after the great economist, Adam Smith criticized barter trade as a primitive, crude and unrefined system of international exchange in his book "The Wealth of Nations," barter has emerged as an important marketing tool on the international commercial scene. James Walsh, a senior economist for the U.S. Department of Commerce, estimates that "Countertrade (a form of barter) now accounts for one third of world trade" and predicts that it would account for half of world trade by the year 2000.[2]

The National Foreign Trade Council has reported an increase in barter trade by 50% in 1981, a 64% growth in 1982, and an additional 117% growth in the use of barter in 1983.[2] Part of this increase in non-monetary trade is attributed to a direct correlation between world economic conditions and the use of countertrade. It is believed that when the economic climate in industrialized countries worsens, there is an automatic ripple effect on the less developed nations, whereby their export markets and subsequently their foreign exchange earnings are depleted. When the monetary systems of the world have broken down under pressures of war, inflation and other conditions which have rendered trade in currency impractical and/or undesirable for a national economy, countertrade has emerged to restore commerce and trade between nations.

In the current era, the practice of countertrade first surfaced on the international scene after World War I. Germany used it during the Weimar Republic, when its currency had become too unstable to use as a medium of exchange. Similarly, after World War II, barter and clearing arrangements were used as a means to nurse a war-ravaged European economy back to health. On the other hand, countertrade has been used by the Communist countries from the outset due to problems of non-convertible currency. Today business' can expect barter or countertrade demands if any of the following conditions prevail:

1. 1. Priority attached to Western imports is low.
2. Total value of transaction is high.
3. A trading country requires reciprocal purchases either to generate hard currencies needed for Western purchases or to reduce the impact of such purchases on the balance of payments.

Economic factors within the international trade environment highlight the growing importance of the role of countertrade and barter. Many Third World countries now have serious foreign debt problems, which have caused hard currency shortages and exchange controls. Following the tradition set by the East European bloc (EEB), these developing countries have increased their reliance on the exchange of basic commodities for Western capital goods and technology. Organization of Petroleum Exporting Countries (OPEC), too finds exchanging oil for sophisticated military and industrial equipment an attractive prospect. Additional dependence on barter is stimulated by the refusal of Western governments to extend credit and foreign aid to Third World countries. All these factors indicate the growing importance of barter and countertrade in world trade today. The sizeable contribution to world trade and the numerous markets now active in the practice of countertrade require a working understanding of the various forms of non-monetized exchange.

The purpose of the study was to go beyond making estimates of the size of countertrade activities being conducted, to analyze it's status, growth prospects, peculiarities, and nature by studying the attitudes of Bank Export Trading Companies (ETCs) in the United States. An attempt has been made to evaluate the specific requirements in transacting countertrade arrangements.

This study has been organized in four rubrics: chapter II will discuss the rationale for the existence of countertrade; the various forms of countertrade and the philosophical objections of multinational institutions. Chapter III describes the design of the study. Chapter IV presents the results of the study. Chapter V comments on the durability of various countertrade approaches in the 1980s by Bank ETCs.

CHAPTER TWO

A review of the literature reveals a considerable amount of confusion regarding the concept of countertrade. The terms used to describe this practice vary from country to country and even from one study to another. Perhaps the best definition of countertrade is provided by the Organization for Economic Cooperation and Development (O.E.C.D.): "Countertrade is an international commercial operation in the framework of which, the seller has to accept in partial or total settlement of his deliveries, the supply of products (or more rarely services) coming from the purchasing country."

Estimates of the share of world trade accounted for by countertrade varies significantly -- ranging from a low of 1% reported by IMF's 1983 study on "Exchange Arrangements and Exchange Restrictions," to a high of 40% according to some press reports. Official government statistics on the dollar value of products exchanged, markets involved in barter and countertrade or on the extent of countertrade arrangements are not available for several reasons. Firstly, transactions between U.S.corporations, Less Developed Countries (LDCs) and centrally planned economies are considered 'proprietary information ' and are not released.[16] Secondly, valuation of goods received at fair market prices, does not accurately represent replacement cost or current market value especially when technology transfer or long-term contractual investments are involved.[16] Thirdly, goods obtained through countertrade are often shipped directly by United States corporations to third country markets. This means that transaction costs are not included in computing the value of a countertrade agreement. Fourthly, if the marketing responsibilities for goods received in countertrade are turned over to trading specialists, it results in a transfer of ownership to an intermediary or third party. Lastly, no attempt has been made to develop a framework for analysis by countries and firms engaged in countertrade. A result of this has been a series of aggregate 'guesstimates' of the share of countertrade in total international trade.

What has nevertheless become apparent is the growing concern which countertrade has generated. Some of the resultant effects include: increased pressure on exporters to engage in countertrade, higher ratios of countertrade required of exporters, and the increasing numbers of countries (90 in all) now requiring countertrade arrangements.

Forms of Countertrade:

Terminology about the various forms of countertrade lack standardization. Consequently, the same words often convey different things to various practitioners of countertrade. Perhaps the greatest cause of this lack of standardization is attributed to the fact that countertrade is a relatively new subject or practice. Although countertrade is the most ancient form of international trade, the particular types of countertrade currently used, have emerged only in the past decade. As a result, the practice lacks data needed to formulate precise terms and definitions. The problem of classifying countertrade is further exacerbated by the fact that, countertrade forms are defined according to the contingencies of commercial conditions surrounding each individual deal, and these defy any attempt towards categorization. For instance, a barter transaction may have elements of counterpurchase or compensation in it. Another reason for differences in terminology is that different countries choose to refer to the same practice by different names.

Variables in countertrade practices:

Before discussing the various forms of countertrade, a discussion of some of the characteristics by which countertrade is categorized will be useful.[39]

1. **Relative Duration:** Countertrade transactions can be completed within a time period of 10-15 days or may span over two decades.

2. **Form of Settlement:** Settlement may involve partial or total payment in goods, services or hard currency combinations.

3. **Relation of Products Traded:** Products traded can be totally unrelated or in a form resulting from the original sale (e.g. buy-backs).

4. **Value Relations of Deliveries:** Counterdeliveries as a proportion of the original sale vary from a small percentage to well over 100%.

5. **Legal Arrangements:** Countertrade can be transacted under a single contract or may necessitate two or more legal instruments.

6. Size of the Deal: The dollar value of a countertrade agreement may range from a few thousand to several billions of dollars.

7. **Technology Transfer Motives:** Many underdeveloped or East European countries may employ countertrade arrangements to acquire sophisticated Western technology.

In the following explanations, the terms used are ones that are most commonly cited by current authoritative sources. Many individual transactions may fail to fall into one category or another, without embodying all of its characteristics. Another deal on the other hand may incorporate more than one of the forms in a single commercial arrangement. By applying these classifications, an attempt has been made to identify the general varieties of countertrade.

Barter:

In recent years barter has become rare, but not extinct; 1981 estimates

Figure I—Model of a Barter Transaction[32]

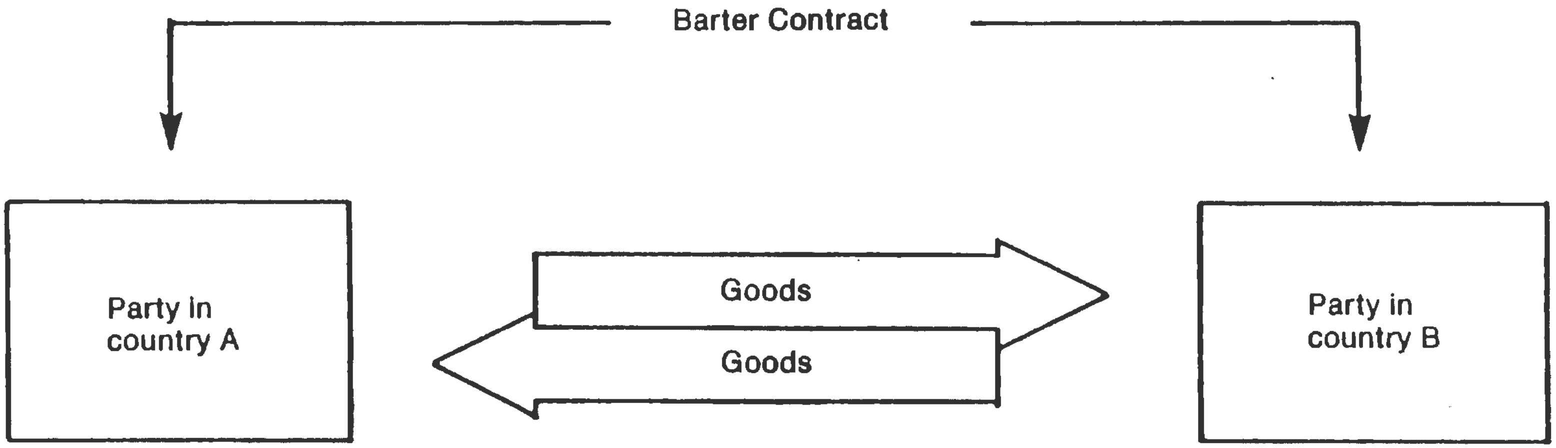
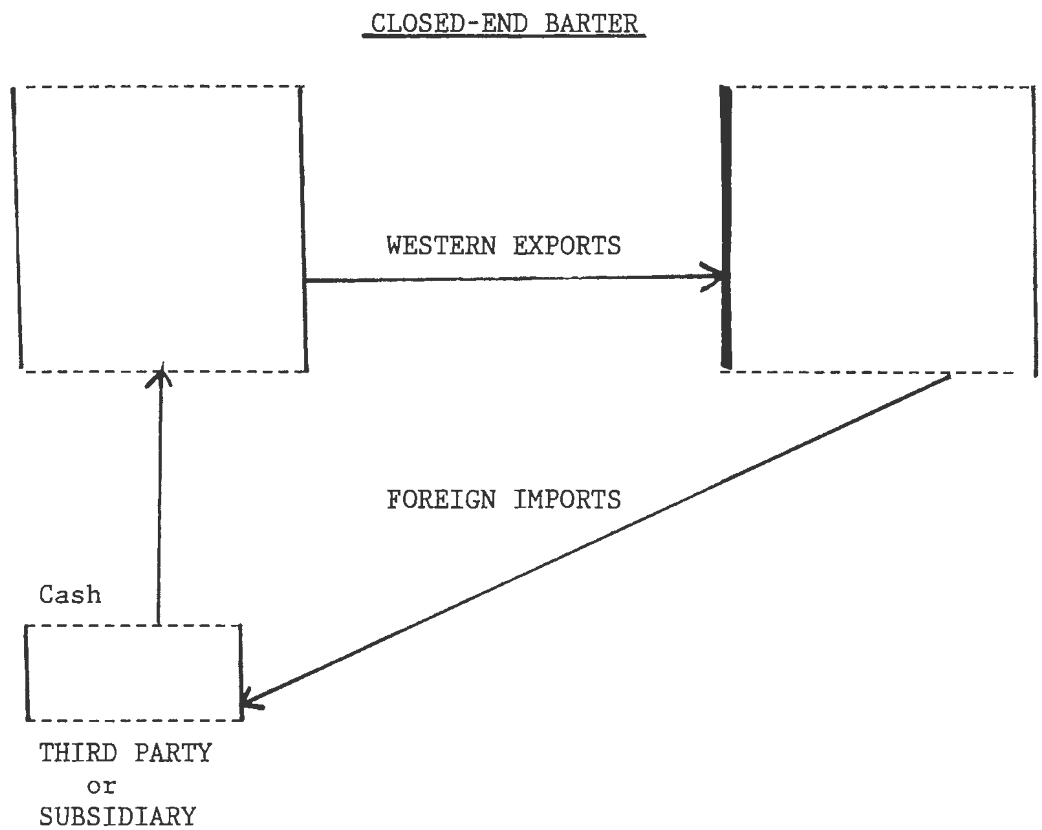


FIGURE II[17]


CLOSED-END BARTER
WESTERN EXPORTS
FOREIGN IMPORTS
Cash
THIRD PARTY
or
SUBSIDIARY

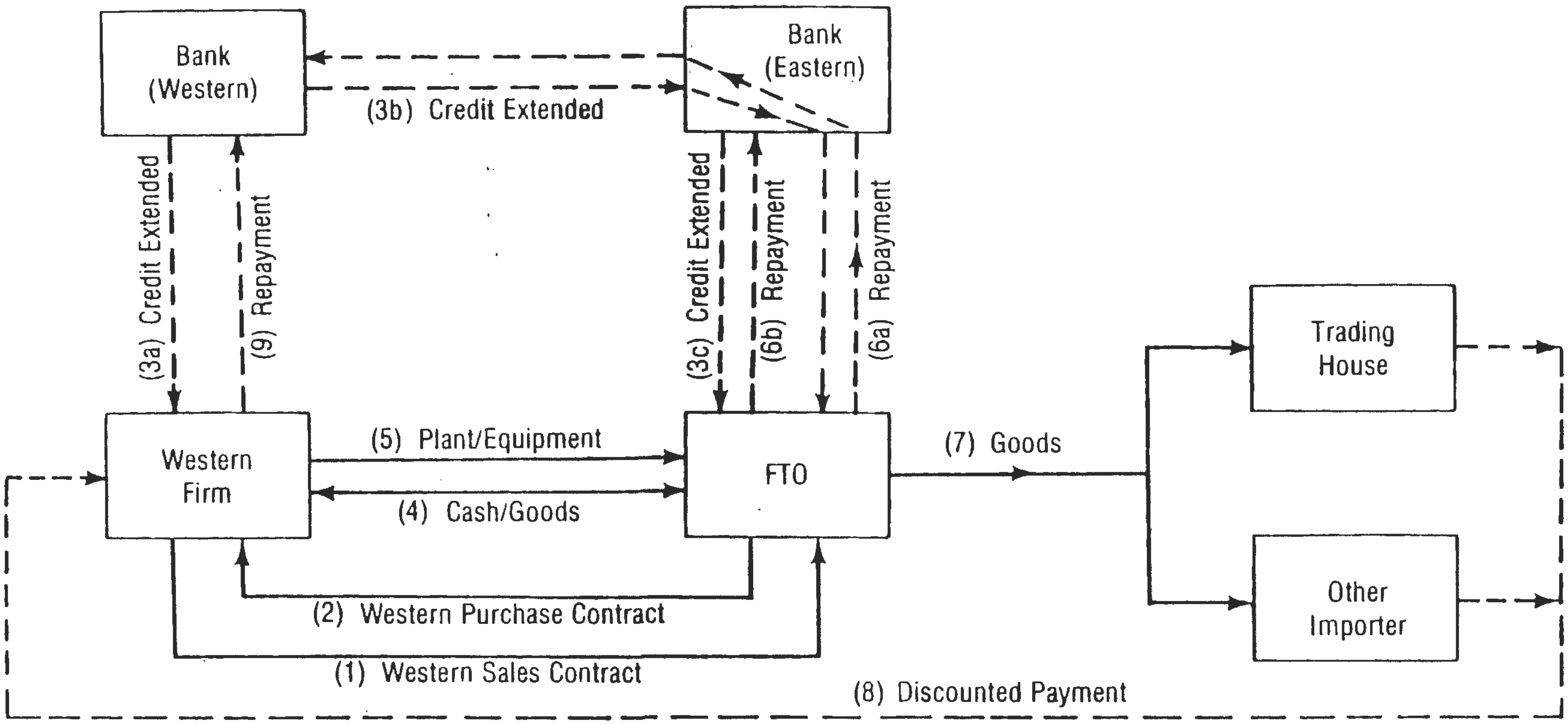
of its prevalence range from 'almost non-existent' to 10-15% of all countertrade transactions.[40] Barter is a short-term contractual agreement to engage in direct exchange of goods and /or services between two parties. Figure I illustrates how a typical barter transaction is carried out. Barter is an inflexible form of trade as it necessitates a double coincidence of wants, i.e., for both trade partners to **want** one anothers products and to **want** these at the same time. Typical Western exports traded are capital goods, commodities, consumer goods and services in exchange for international graded commodities, raw materials and manufactured goods. Opportunity for gains from barter arise due to the presence of cartels and monopoly prices. Very often, cartel members are known to have disposed of goods supposedly at official prices while actually selling at a discount in order to dispose of their surplus merchandise.

A slight variation of the pure or classical barter is **closed-end** barter. This trade tool involves the presence of a third party or intermediary to dispose of imported goods for a commission or discount before the contract is signed. The diagram presented in Figure II, demonstrates the utility of closed-end barter in reducing risks associated with marketing unwanted imports by a Western supplier. Despite the advantages of a closed-end deal, its widespread use is questionable as it fails to provide adequate opportunities for product or market diversification.

Counterpurchase:

Counterpurchase, also known as counterdelivery, parallel or reciprocal trade is the most widely practiced form of countertrade. Counterpurchase involves a contractual agreement by a Western exporter to make reciprocal purchases from the importing organization within a designated period of time. Reciprocal deliveries in these transactions do not involve

Figure III–Model of a counterpurchase/[33]

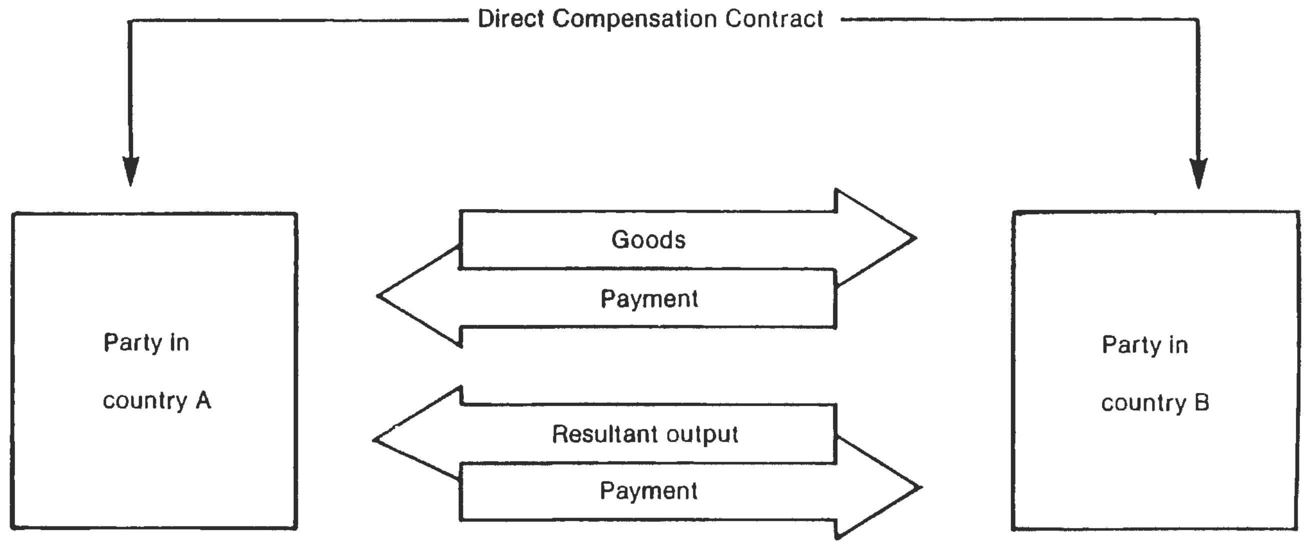


Note – – – Indicates payment and credit lines 'non-resultant' products, i.e., goods counterdelivered are not produced by, derived from, or related to the Western exports of technology, production, plant or equipment, but are chosen from among a list of goods offered by the importer. The duration of the entire transaction falls between 1-3 years. The commitment for a reciprocal purchase varies from 10-100% of the original sale, and is almost always less than the full value of the original sale.

Counterpurchase is carried out under two separate contracts linked by protocol. In the first contract the Western exporter's sale of products is consumated, and in the second contract the exporter agrees to purchase and /or market the importers products. Figure III diagrammatically explains a complete cycle of a counterpurchase transaction. The obligations of a supplier to market goods acquired in a counterpurchase transaction may be transferred to a third party or intermediary such as a trading house for instance. A discount or commission is paid to the intermediary for the services rendered. The commission ranges from 5% for raw materials to 40% for hard-to-market manufactured goods. Counterpurchase is besieged by numerous problems, which need to be resolved before it becomes more popular. One of the problems involves synchronizing multiple transactions with the various number of channels that are involved, namely the Western exporter, trading house, importing organization and banks. The transactions are risky due to the volatility of currency and commodity prices. The second major problem is concerned with non-performance of either of the trading partners. Considerable trading experience is necessary to protect the parties from these risks.

Compensation:

Figure IV—Model of a Direct Compensation Transaction [32]



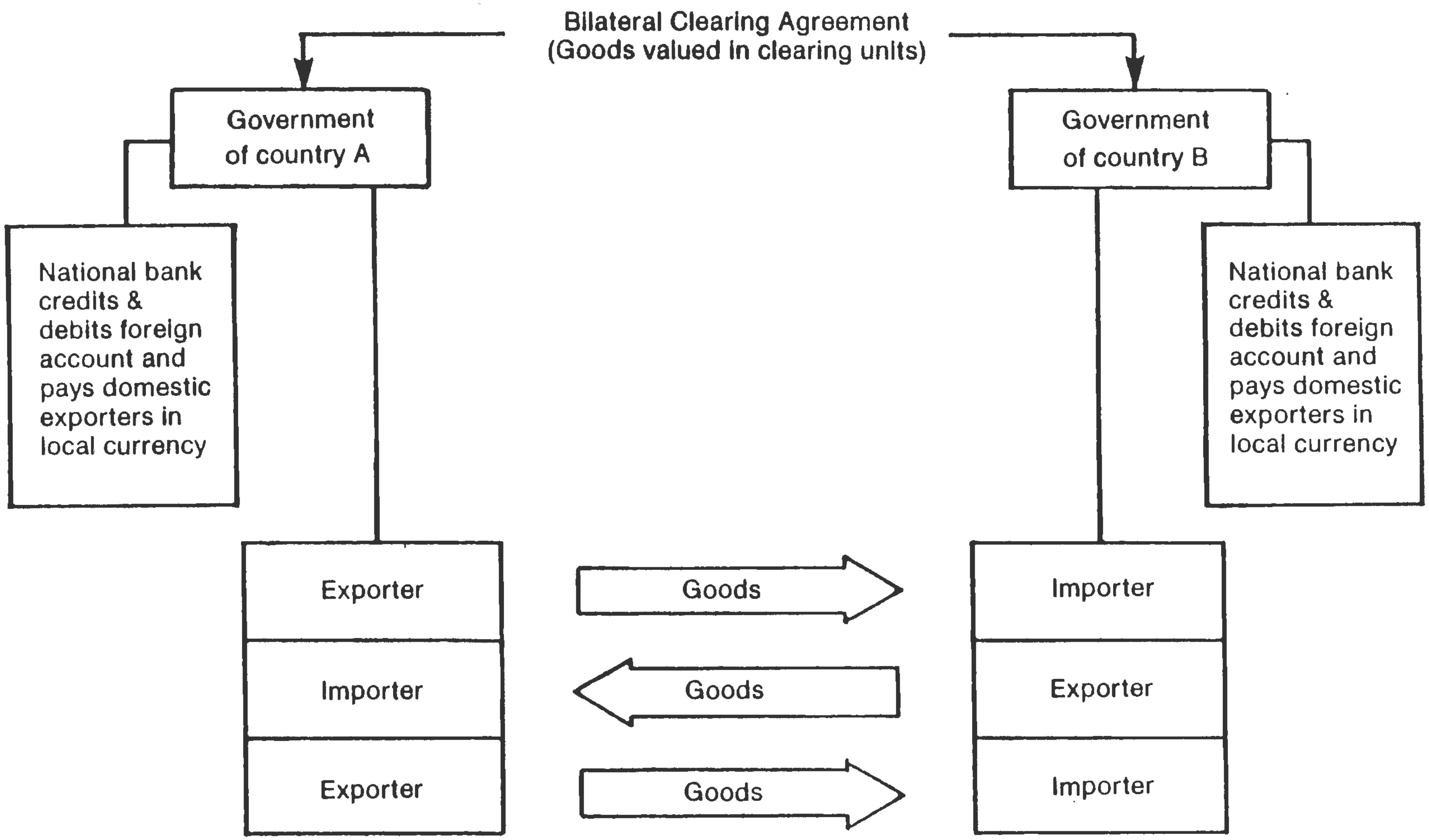
Compensation often called buy-back, involves the sale of technology or a plant with a contractual commitment on the part of a seller to purchase a certain quantity of products that are produced by or derived from the original sale.[40] These arrangements take as long as 10-20 years to be concluded. Compensation is conducted under two separate and parallel contracts. Figure IV schematically traces a model of compensation. In the first contract the supplier agrees to build a plant or provide equipment along with technological know-how to the foreign party. In the same contract the foreign party agrees to pay a certain proportion of the original sale as down payment. In the second contract the supplier agrees to take back a certain portion of the resultant products, which may or may not be related to the Western supplier's industry. The contractual separation between the two legal instruments provides for flexibility in financing, maturity of payments and guarantee coverages. It also facilitates the transfer of marketing obligations from primary exporter to designated third party intermediaries.

The Western supplier profits from a compensation arrangement by securing access to otherwise impenetrable markets. The risks however are immense, such as confiscation and expropriation of investment, besides creating potential competitors who would cannibalize established markets[19] and also generate disputes over product quality.

Clearing Arrangements:

Under a bilateral clearing arrangement goods and /or services are exchanged between two nations over a specified period of time (usually one year). The central bank of the country pays the respective exporter in the domestic currency the entire monetary value of the transaction. The value of the goods exchanged are denominated in artificial accounting units (e.g. the

Figure V – Model of a Bilateral Clearing Agreement [32]



clearing dollar, Swiss franc etc). Exchange of goods stop if the specified trade imbalance limits are overstepped. This imbalance or 'swing' is set at 30% of annual trade volume in bilateral clearing accounts. Figure V illustrates a model of a bilateral clearing agreement. At the end of the contractual period trade imbalances can be settled either in the specified currency or converted into cash by 'switching' rights to interested third parties at discounted prices.[32]

Clearing agreements require a great deal of negotiation before they become effective, but once established may run for years without much administration. The disadvantage arises when trade imbalance occurs and countries find themselvės saddled with unwanted surpluses. Secondly, as there is no interest charge accruing to the defaulting nation, incentive to reduce the deficit is not present. It is for these reasons that the number of bilateral clearing agreements transacted over the last decade have decreased significantly.

Evidence Accounts:

The term evidence accounts covers any arrangement between a government entity and a Western exporter. Purchases under this arrangement are automatically credited against the company or country sales. The agreement must be partially or fully balanced over a specified period of time, usually 1-3 years, in the form of cumulative payment turnovers in cash. Trade flows are monitored and financial settlements are made by the central bank of the country and a bank specified by the Western supplier. Figure VI illustrates schematically a model evidence account.

Disadvantages associated with evidence accounts are attributed to the increased costs of monitoring individual transactions by the two assigned banks, to the difficulties in assembling an appropriate export-import mix, and

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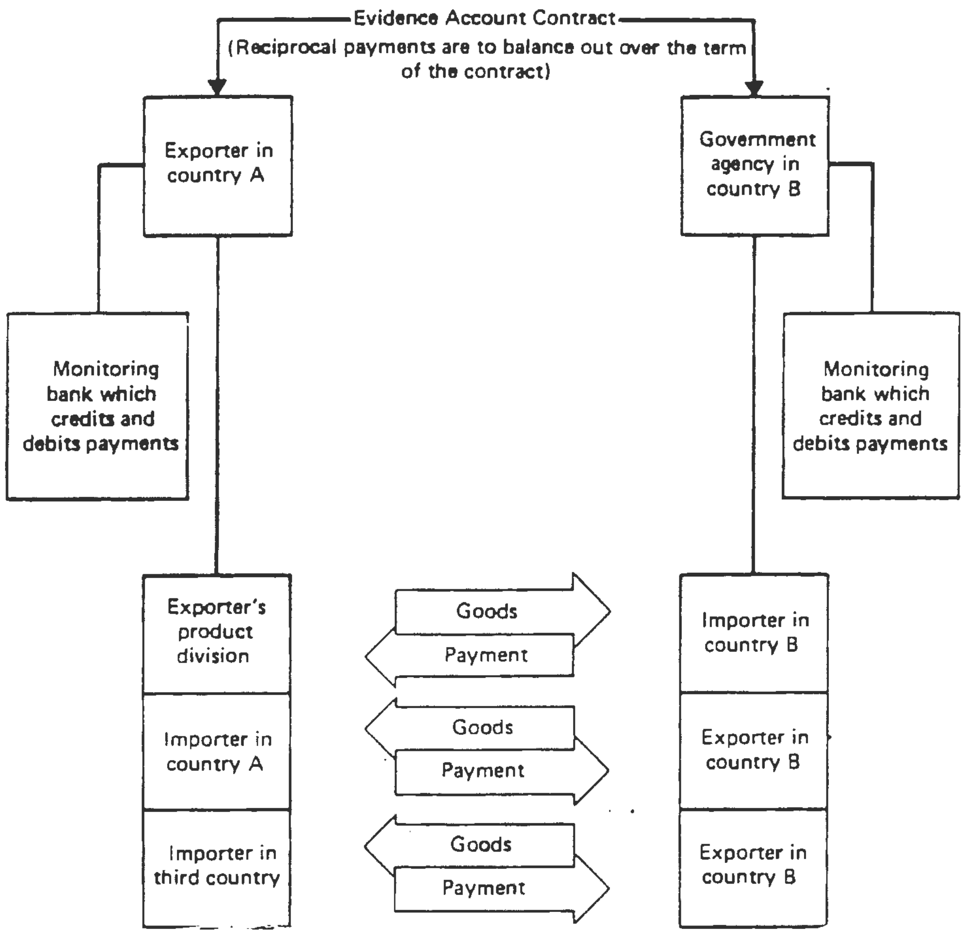
FIGURE VI

EVIDENCE ACCOUNTS



to a lack of incentive to follow the trade levels set by the agreement terms.

Offsets:

Government acquisitions of major defense procurements (e.g. commercial aircraft, telecommunication systems etc) are often tied to requirements to purchase local goods and services of the importing nation. The range of requirements offered in reciprocation is known as 'offsets'. Direct offsets require coproduction requirements based on production technology transfer to the importing country. Indirect offsets comprise of local subcontracting, investment in facilities or counterdelivery agreements.

As many as three contracts are negotiated to formalize the Western supplier's export sales, import purchases from the foreign party and subcontracting from the foreign party if compensation trading is tied to offsets arrangements.[17] Offset requests range from 20-50% of the value of the Western supplier's products and may increase to 100% if goods supplied face intense competition in world markets.

For the Western exporter, offsets support company objectives in market penetration and development. On the other hand, foreign governments seek offsets to decrease capital outflows for large-scale industrial or defense projects. The major risk associated with offsets for Western companies is, inadvertently creating future competitors. For both the parties the risk of 'non-performance' by either trade partner is ever present.

Evolving Forms of Countertrade:

As the practice of countertrade emerges from the confines of East-West trade to encompass many of the Third World nations, the old forms are taking on new twists to adapt to the different environment.

Advance Purchase:

This new variation of countertrade is particularly popular in LDCs which are faced with problems of strict foreign exchange allocation regulations and hard currency shortages. Advanced purchases are made by Western exporters on the strength of the commitment by the importing organization to make reciprocal purchases within a stipulated period of time. The value of the two-way transaction is balanced, but this is not always necessary as illustrated in Figure VII. This form of countertrade helps Western companies to circumvent the necessity of purchasing unwanted goods from their trading partner. Advance purchases by the Western exporter enable him to secure advance payment for his own deliveries later. The sales proceeds from the foreign company or country are retained to cover future sales to that trading partner. In this manner, most of the Western companies are taking the initiative to obtain goods that they need or can easily market. Despite the apparent simplicity of this approach, such ideal circumstances do not always present themselves. In reality, finding suitable LDC goods to use for advance payments are difficult.

Handling Blocked Currency:

In Eastern Europe and some Third World countries, where local currencies are totally inconvertible the problem of blocked local currency is significant. Although this problem is not unique to countertrade transactions, some trading houses have developed a means of circumventing this handicap using countertrade practices to generate hard currency.[6]

The problem with this concept, lies in structuring the deal within the legal framework of the country. Also, the central bank of the country may/may not give the required approval for the transaction to be concluded

FIGURE VII[6]

ADVANCE PURCHASE

Phase I

100% goods

Western company ⟵ EE exporter

Western company ⟶ EE exporter

payment in hard currency
against commitment of (e.g.) 150%
EE counterpurchase

Phase II

goods

Original Western advance buyer (or, in his lieu, a third party) ⟶ Original EE (advance) exporter or another importer in the same country

to 150% of the value of the
original Western import

Original Western advance buyer (or, in his lieu, a third party) ⟵ Original EE (advance) exporter or another importer in the same country

full payment in hard currency

successfully.

Factoring, Discounting and Forfaiting:

Although factoring and discounting are old trade methods to generate cash flow by an exporter, a novel twist in this area has been spurred by countertrade. It has led to the creation of an expensive but effective a forfait market that does not require recourse to the exporter by the LDCs. Central banks in these countries are considering endorsement of trade paper to make it negotiable on the a forfait market - the latest example being Mexico. Some of the methods used to trade such endorsed paper are outlined below:

Factoring is the advance sale of an entire category of export documents by a Western exporting company to a factor bank. Sales transactions covered are payable in 180 days.

Forfaiting is used to cover investment goods whose life exceeds the terms of financing. For the paper to be traded on the a forfait market it must be guaranteed by the central bank of the issuing country.

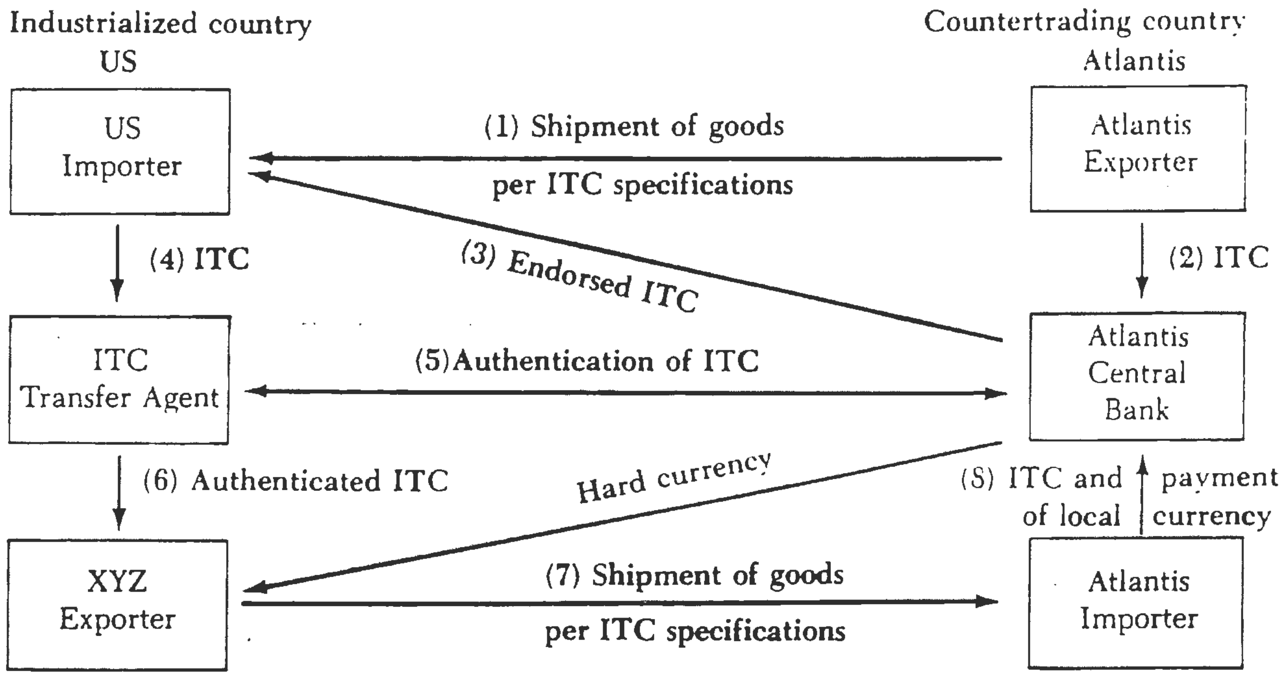
Discounting is the sale of trade paper with the right of recourse on the Western exporter.

The International Trading Certificate (ITC):

A new instrument called the International Trading Certificate (ITC) has been created by the Bank of Boston (BOB) and the General Foods Trading Company (GFTC) to multilateralize countertrade obligations. However, the ITC has yet to receive worldwide endorsement and adoption. The ITC would not act as a transferable documentary instrument once it was endorsed by the appropriate government agency or central bank of the country. The document would assure the Western company or country in possession of the certificate the right to export a stipulated value of goods into the country endorsing the

FIGURE VIII[6]

How International Trading Certificates Could Work



(1) US Importer buys incremental or nontraditional goods or services from a foreign exporter (Atlantis Exporter), on the condition that the exporter cause to have issued an International Trading Certificate (ITC) to US Importer. The certificate, when endorsed by the exporter's central bank, grants the holder the irrevocable right to export goods equal in value to this incremental sale to Atlantis.

(2) Atlantis Exporter has the certificate endorsed by Atlantis Central Bank.

(3) The endorsed ITC is presented to US Importer.

(4) Once US Importer obtains the endorsed ITC, it submits it to the ITC Transfer Agent (in this case, Bank of Boston is the ITC Transfer Agent) for authentication.

(5) The ITC Transfer Agent authenticates the ITC with Atlantis Central Bank.

(6) The ITC can now be offered for resale. At this point, XYZ Exporter enters the picture. It buys the ITC from US Importer, probably at a premium.

(7) XYZ Exporter now has the ability to ship goods to the prospective buyer (Atlantis Importer), provided that the goods being shipped fall within the limitations (if any) specified by the Atlantis government authorities.

(8) The Atlantis Central Bank, having received payment in local currency from the local importer, pays hard currency directly to XYZ Exporter.

certificate. As the ITC would be transferable to any third country, it could be fully traded for hard currency. As illustrated in Figure VIII the companies exporting to LDCs or Eastern European countries would have to pay a premium for the certificates.

Hector-Carum-Andrunet, President of the General Foods Trading Company said, "If the concept of ITCs takes off as we expect it to, it could do for countertrade what letters of credit did several decades ago for the international trade market".[6]

One of the major problems associated with ITCs is that of counterfeiting. The problem can be overcome if one commercial bank, namely Bank of Boston alone was allowed to act as the transfer agent to the issuers of ITCs.

David Cookson, consultant to the Bank of Boston's countertrade operations feels that the success of the multinational instrument depends largely on the willingness of debtor country's government to implement the ITC efficiently, without major restrictions on the types of goods covered, and on the time involved in executing the ITC.[6]

<u>Choice of Products:</u>

A company's choice of countertrade products is contingent on several factors. These factors are: the number of potential customers identified by the company, the nature and scope of the company's operations, and the marketing and financial capabilities of the company. The preferability of product types can be rated as follows:

1. **Raw Materials.**

   These pose relatively low risk and can be marketed through established channels at standardized prices.

2. **Products that can be used internally.**

These products comprise of component parts, machine tools etc which can be absorbed in the company's operations. Payments of commissions to ETCs and expenses to market these goods can thus be avoided.

3. **Goods related to company's product line.**

   Companies find it easy to dispose of goods related to their product lines through their existing marketing systems. Costs associated with intermediaries and separate marketing channels can be avoided.

4. **Manufactured products unrelated to company operations.**

   These types of products are least preferred owing to the costs involved.

Firstly, a company lacks expertise or adequate channels to market such goods. Secondly, costs involved in assigning a trading house or third party to market these goods decreases the profitability of the transaction. Among manufactured goods offered as counterdeliveries, products requiring no after-sales service or spare parts are generally preferred. For example, ball bearings, simple electric hand tools etc.

Figure IX displays the classification of goods offered by the CMEA countries in countertrade negotiations. Generally machinery, vehicles, chemicals and raw materials are the most common items traded in countertrade.

Financing Countertrade:

The phrase "financing countertrade" is a misnomer as countertrade itself represents a special financial arrangement for the exchange of goods and services. Countertrade is not a financial instrument as credit is used in order to enhance the ability of the buyer to pay for the goods purchased. The methods used to finance trade under a countertrade arrangement are not significantly different from those used to finance conventional types of exports.

The particular method selected depends on several factors namely the

FIGURE IX[6]

CLASSIFICATION OF COUNTERTRADE GOODS OFFERED

Exhibit 1. Classification of countertrade goods offered, 1980 (given as percent of total).

	Machinery & Vehicles	*Chemical & Raw Material Products*	*Consumer Products*	*Electrical & Electronic Equipment*
Bulgaria	35	20	15	30
Czechoslovakia	50	20	20	10
GDR	35	25	15	25
Hungary	45	15	25	15
Poland	45	25	10	20
Romania	55	15	15	15
Soviet Union	30	40	10	20

SOURCE: Seminar materials of Business International Institute.

needs of the buyer and supplier, the financial status of both the parties, the duration of countertrade, the cost of countertrade and the traditional credit preferences of the parties involved. The different methods used in countertrade arrangements are :

Government Export Credits:

Government export credit is the most important source for financing compensation projects in countertrade arrangements. Construction of turnkey operations, purchase of civil aircraft or other such major ventures need credit extention for up to twenty years, involving a heavy capital investment. Government export credit finances 85% of the total project cost. The interest rate is fixed and is usually lower than commercial rates. Repayments are in equal semi-annual installments and can extend over a period of ten years for commercial loans and up to ten to twenty years for capital projects. The main disadvantage with this method is the lack of flexibility in procuring credit, as procurements are tied to the country providing the finance.

Commercial Credit:

This form of credit is usually selected for medium-term (5-10 years) financing. It is a flexible form of financing as the maturity date, interest rates and grace period can be negotiated at the outset and adjusted to specific project requirements. These loans bear a floating interest rate linked to the U.S. prime rate or the London Interbank Offered Rate (LIBOR). Fixed margins are charged over these rates by the commercial establishments for their services. The disadvantage of commercial credit is that interest rates are high as well as floating, which makes economic planning of the transaction difficult. There are several forms of commercial credit available for countertrade transactions. These are as follows:

1. Letters of Credit. They are an important source of financing short-term loans up to twenty-four months. The letter is a promise to pay the invoiced value of the negotiated contract price. It is invoiced against receipt of shipping documents , or against acceptance of the bill of exchange furnished by the Western exporter or against a promissory note issued and accepted by the buyer himself. Payment is made when the contract is fulfilled or on maturity date.

2. Supplier Credit. A series of negotiable notes can be issued by an importer. It matures over a medium-term period (normally 3-7 years). These notes are guaranteed by the foreign trade organization or the central bank of the importer's country and carry a fixed interest rate. These notes can be discounted in a Western commercial bank on a limited or non-recourse basis.

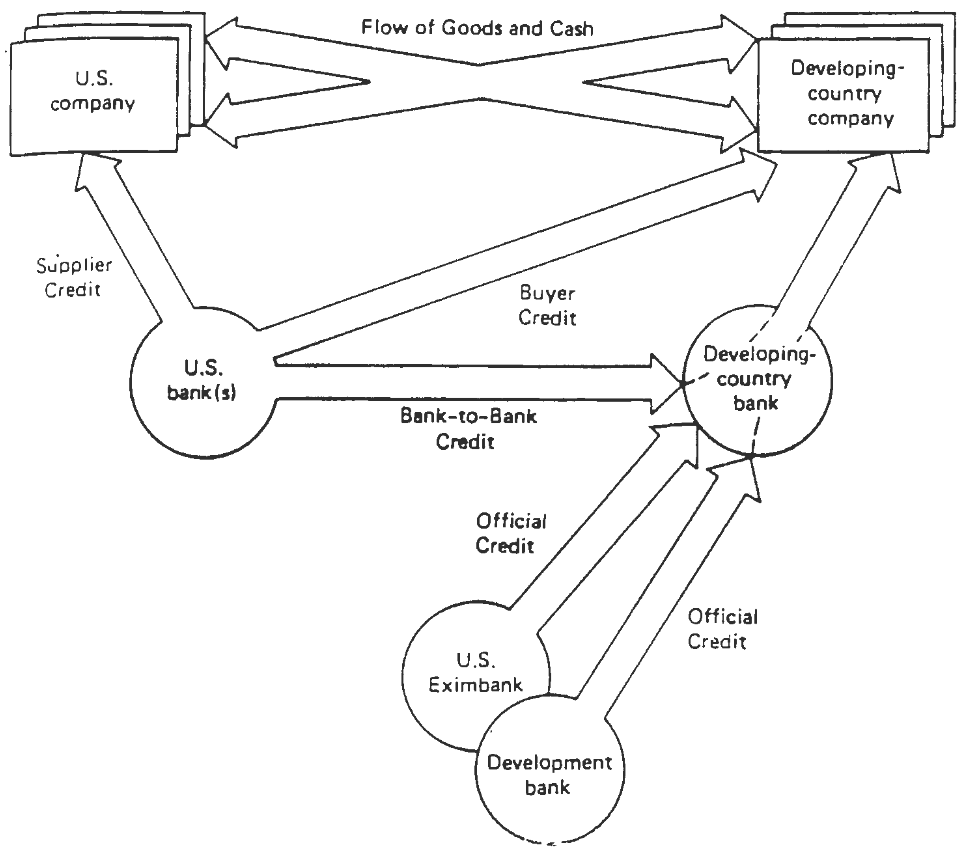
3. Buyer Credit. The bank or commercial enterprise issues credit directly to the buyer in support of an export transaction. Banks however, feel that repayment of credit should not be contingent upon counterdeliveries, hence more paperwork is necessary if credit is for countertrade transactions. Figure XI summarizes the various types of credit available to finance countertrade arrangements.

4. Guaranteeing Transactions. Barter transactions are financed by transfering non-cash or "stand-by"guarantees issued by the banks of the importing company or country. This document entitles the exporting company or country to draw payment in hard currency if the other party fails to meet its obligations. Sometimes, it is difficult to have the bank guarantees confirmed in certain countries, for example the People's Republic of China whose state banking system has not yet accepted the standardized system of international banking.[33]

5. Forfaiting. It is a medium-term method of re-financing supplier's credit

FIGURE XI[33]

VARIOUS TYPES OF BANK CREDIT



on a non-recourse basis. It involves purchase of trade bills and promisory notes at a discount without recourse to the seller by a financial institution. The discount rates vary from about 7% to well over 10%. The discount or commission covers the cost of refinancing a margin to cover risks, and the administration of the transaction. It also covers the cost incurred due to payment delays, non-payment etc. Forfaitable claims usually carry a promise to pay "par aval", i.e., an unconditional and transferable guarantee of payment by a bank. Forfaiting is done at fixed interest rates. Payments are due in semi-annual installments in mainly Euromoney market currencies.

6. Project Financing. It is a method of financing that looks to the cash flows of the project as a source of repayment of the loan. The operations assets are considered as the collateral for issuing the loan. In the U.S. money-center banks like Citibank, Morgan Guarantee, Chase Manhattan (all in New York) and Bank of America (in San Francisco) have cornered the market for project financing. Smaller banks are as yet unable to match the scope of services offered by the major banks.

Motivations to Countertrade:

The compelling competitive reason for engaging in countertrade translates itself into many specific objectives including the following:

1. **To preserve hard currency.**

Countries with non-convertible currencies find countertrade a viable alternative for circumventing the need for procuring imports with scarce reserves of hard currency. Using countertrade arrangements, payments for imports are offset by the foreign countries obligation to purchase domestic goods.

2. **To improve Balance of Trade.**

Nations which face high trade deficits, rely on countertrade as a means to balance bilateral trade ledgers.

3. **To maintain prices of export goods.**

Countertrade is often used as a means of disposing goods at artificially high prices that the market would not support on a cash-for-goods basis. Although the Western seller absorbs the added cost by inflating the price of the original sale, the nominal price of the counterpurchased goods is maintained, and the seller need not concede what the value of the goods would be in the free world market (Welt 1982).

4. **To gain access into new markets.**

Often countertrade demands are imposed when countries lack sophisticated marketing channels to sell their goods for hard currency. Countertrade enables these countries to utilize the marketing organizations and expertise of Western companies to market their goods for them.

5. **To obtain technology.**

Many East European countries encourage countertrade practices in order to acquire Western technology, know-how, management and marketing expertise and capital. Long-term contracts and relationships through countertrade, also ensure that such technology is kept current and responsive to world market demands.

6. **To upgrade manufacturing capabilities.**

Under compensation agreements, LDCs and Eastern European countries obtains a transfer of technology and technical expertise from the Western companies to set up and upgrade industrial facilities and to buy-back the resultant products.

7. **To take advantage of sales opportunities.**

Western firms engage in countertrade arrangements because it affords them the opportunity to export machinery, equipment, and technology to a potentially large market.

8. **To gain a source of supply.**

Countertrade is used by Western suppliers to obtain a long-term, reliable supply of raw material, component parts or finished products that may be inexpensive because of decreased labor costs and lower transportation expenses.

9. **To gain prominence in new markets.**

Countertrade is employed by Western companies as a way of showing good faith in certain markets, and to establish an image of a reliable trading partner. Such an effort can help accomplish two things, namely gain an edge over competition and an opportunity to gain major future sales.

Countertrade may well produce a relationship among the parties extending far beyond the original period and products, thereby allowing the Western firms to better schedule their production runs. It would also enable these companies to cope with the adverse effects of the economic cycles. Benefits from a more stable labor force and steady cash flow are also possible under a long-term arrangement.

Risks associated with countertrade:

Countertrade practices tend to distort 'normal' trade practices entailing unnecessary complications, additional risk and inefficiencies in the exchange process. By accentuating bilateralism, countertrade interferes with the creation of a fully integrated world economy based on multilateral trade flows.

Western perceptions of risks in countertrade arrangements are influenced by several factors. The factors include but are not limited to political stability considerations in individual markets, commercial risks pertinent to the transaction at hand, potential risk resulting from unexpected shifts in official regulatory policies in the importing country, thereby affecting trade arrangements and investments. Exporter's concerns about risks are also highlighted as a result of the decline of creditworthiness of many developing countries and the potential, that transactions under negotiations in such markets may be affected by unexpected budget cuts or changes in the priority of procurements. This atmosphere of uncertainty makes it more difficult for the exporter to obtain desired financing and insurance, thus increasing the risk of doing business overseas. Insurance coverage for countertrade transactions is available only to the established and reputable exporting firms, which makes countertrade a risky and unviable trade tool for small and medium-sized businesses.

One of the potential risks involved in countertrade is caused by delays in counterdeliveries. These delays may arise due to changes in the priority of production or export allocations by LDCs or the EEB. Priority in allocations change due to unavailability of domestic feedstock and raw materials, inadequate transportation facilities or poor production estimates.

Risk is an inherent feature of countertrade because of the differing ways of doing business. These differences have the potential to increase the costs of countertrade assumed by a Western company. **The problems result from:**

1. Shortcomings with the counterdelivered products resulting from design models that do not conform to Western styles and tastes.

2. Increased costs arising from the need to repackage or refurbish counterdeliveries before marketing them.

3. Poor quality control standards used in the manufacture of products.

4. Unavailability of spares and components.

5. Uncompetitive pricing and unreliable delivery schedules.

6. Inability to provide after-sales service to customers.

7. Long-reaction times to Western requests for information and the slow

pace in reaching decisions.

8. Bureaucratic impediments in developing countries, which impose limitations on the range of goods available as counterdeliveries and restrictions on procurements from more than one manufacturer or trading organization in the same country.

Risk of using countertrade increases as the number of countertrade deals that are successfully completed are very small, making the entire exercise extremely costly. Similarly owing to problems of product valuation and administrative costs and delays, countertrade is viewed as an inefficient way to finance international trade.

Thus, any evaluation of results of a Western company's involvement in countertrade should weigh the costs and problems of such operations against benefits resulting from related sales of the firm's goods, know-how, services, technology and spares. It should also note the indirect benefits such as familiarization with the export market, with company goods, with forestalling competition, with using existing production overcapacity and spin-off trade opportunities.[33]

Philosophical Objections To Countertrade:

The spread of countertrade practices and pressures throughout the Third World has generated strong reactions from multilateral trade and financing institutions. What is at the heart of the growing controversy is the cumulative impact of countertrade on international trade and derivatively on individual countries.

International Monetary Fund's Perspective (IMF):

The IMF is one of the strongest critics of government supported countertrade transactions. Ironically however, it is precisely due to IMFs insistence on rapid balance of payments that has caused the LDCs to engage in countertrade activities. The IMFs position on countertrade has been most clearly articulated in it's 1983 annual report on Exchange Arrangements and Exchange Restrictions:

> "The fund is generally concerned with the proliferation of countertrade practices as they may be seen as undermining the objective of multilateral trading system, the promotion of which was the basic objective for the setting up of the fund___".[6]

The World Bank's Emerging Position:

The World Bank feels that "Countertrade is better than no financing at all, but it is essentially inefficient because it reduces the benefits of comparative advantage".[6] The Bank has yet to formulate an official policy either supporting or opposing countertrade.

The European Economic Community's Concern (EEC):

The EECs efforts to develop an effective policy in controlling countertrade, especially in the context of East-West trade has proved to be futile to date. It understands the need for East European countries and LDCs to use countertrade as a means to solve their problems of hard currency and balance of trade payments - but only as a temporary measure. The EEC feels that despite possible short-term advantages, countertrade creates more problems than it solves in the long-run.

General Agreement on Tariffs and Trade's report on Countertrade:

General Agreement on Tariffs and Trade (GATT) regards countertrade as a regressive form of trade and a temporary phenomenon. GATT does not believe that countertrade is a growing phenomenon and feels that due to its inherent inefficiencies, countertrade will be abandoned by the end of the century. Its primary concern with countertrade is that it is used to hide subsidies which GATT considers to be an unfair trade practice.

U.S. Government Policy:

The U.S. Government views countertrade as contrary to open, free trade. However, as a matter of policy it will not oppose U.S. companies participation in countertrade arrangements, unless such arrangements have a negative impact on national security. The U.S.government will exercise caution in the use of its barter authority, reserving it for those situations that present advantages not offered by conventional market operations.

The view that the industrialized nations are being forced into countertrade disregards the lack of consensus in countertrade in the East and South. Though East Europe as a whole favors countertrade, Hungary has publicly questioned the notion that it automatically brings big benefits to countries practicing it. Some Third World Countries on the other hand, believe countertrade to be an important if not the prime tool to improve balance of trade positions. Other governments value countertrade but consider it to be only one of the many ways to improve creditworthiness. In the West, few governments have officially staked out a clear position on countertrade. As a matter of fact several governments including the U.S., tend to speak with many voices on the subject.

CHAPTER THREE

A survey was conducted with Bank Export Trading Companies across the United States. A list of these companies was obtained from three different sources - namely the "Export Trading Company Guidebook", published by the U.S. Department of Commerce in 1984, a listing obtained from the American Banker September 1984 issue and, from the United States General Accounting Office February 1986 report titled, "Export Promotion: Implementation of the Export Trading Company Act of 1982".

Since October 1, 1985, forty ETCs have been formed by forty Bank Holding Companies (BHCs). Thirty of these newly formed ETCs are wholly-owned subsidiaries of the BHCs, while two of these were outright purchases of an ongoing ETC. Eight of the BHCs are organized as joint ventures - one between three BHCs and a private investor, one between the same three BHCs and an ongoing ETC, one between a BHC and a manufacturing concern and the other five, are formed between BHCs and ongoing ETCs. In several of the joint ventures the controlling interest was not retained by the BHCs. Appendix I provides an overview of the newly formed ETCs.

The forty ETCs are geographically disbursed. Thirteen lie in the U.S. Northeast, eleven in the U.S. West, six in the U.S. Mid-West, nine in the U.S. South and one lies overseas. Due to constraints of time, the ETC overseas was not included in the study.

The size of the BHCs which have invested in the ETCs varies considerably. The total authorized investment in the forty companies is about \$ 84 million, ranging from a high of \$ 18 million to a low of \$ 10,000. Exhibit 1 compares size of the BHC with the amount of authorized investments and shows that nine multinational money center banks, accounting for 10 ETCs,

EXHIBIT 1[6]

BANK HOLDING COMPANIES AND THEIR INVESTMENT IN ETCs

Dollars in thousands

Size of bank holding company	Number of ETCs	Total approved investment Amount	Total approved investment Percent
Money center banks[a]	10	$71,103	84
Assets over $5 billion	13	6,573	8
Assets between $1 billion and $5 billion	5	3,250	4
Assets below $1 billion	8	1,275	2
Joint venture of three banks	2	702	1
Dissolved ETCs	2	1,150	1
Total	**40**	**$84,053**	**100**

[a]The Federal Reserve Board has classified 17 U.S. bank holding companies as multinational or money center bank holding companies—large organizations located in major financial centers in the United States.

have made the bulk of the investments.

The objective of the questionnaire that was mailed to the population of forty ETCs, was to obtain concise information on the nature and extent of countertrade transactions conducted by these companies. The questions focused on five issues. The first was the extent of countertrade activities and the nature of bartering ETCs. The second issue was to identify the motives and perceptions of these ETCs. The third issue dealt with the reaction of these ETCs to their countertrade transactions. The fourth issue was the intention of the ETCs towards future countertrade activities. Lastly the respondents were asked to identify the specific difficulties faced by their companies in transacting countertrade deals. The respondents were also requested to suggest the special skills needed by their respective companies to successfully negotiate countertrade agreements.

In the early stages of the study, it was believed that countertrade agreements were transacted by all U.S. banks with separate international divisions. The Liberty Federal Bank of Oklahoma, Oklahoma City, Oklahoma - a bank with a separate international division was selected to pretest the questionnaire. The pretest revealed that countertrade agreements were only transacted by a select group of banks, who had obtained a Certificate of Review from the Federal Reserve to organize Export Trading Companies and thereby conduct countertrade activities. The results of the pretest were not significant as the selected sample was deemed inappropriate for the study.

In order to identify the senior executive with the most knowledge and experience in using countertrade tools at the selected bank ETCs, a list of names was compiled from the Standard and Poor's Banker's Directory of 1985. Questionnaires were mailed out in mid-April to the senior executives at these ETCs. In mid-May, a follow-up questionnaire was mailed to non-respondents. A copy of the survey instrument is placed in Appendix II and III.

CHAPTER FOUR

The survey was designed to explore the awareness level and attitudes of Bank ETCs towards countertrade. Questions were structured so as to enable even non-participants to answer some of the general questions about countertrade. Research indicated that only twenty-three Bank ETCs were actively involved in countertrade, yet forty questionnaires were mailed out in the hope that the reasons for non-participation would be revealed. Eleven of the twenty-three active Bank ETCs, i.e., 48% of the targeted sample responded to the survey, while seven of the other seventeen Bank ETCs sampled conveyed their inability to participate in the study due to various reasons:

1. Lack of involvement with countertrade.
2. Involved in early stages of countertrade, but had not completed a single transaction.
3. Considered countertrade options but had not been approached yet.

Only 1% of the questionnaires were returned as non-deliverable, indicating an up to date sampling frame.

Among the Bank ETCs sampled, 45% were aware of the concept of countertrade and its various forms. The general definition of countertrade as communicated by the respondents leaned towards compensation or buy-back terms.

The growing importance of countertrade was assessed along a five-point scale where respondents either strongly agreed (1) on one end of the scale or strongly disagreed (5) on the other end. The assessment of those who agreed to its importance was typical of those who reported:

1. Involvement with export trading.
2. Experience with countertrade.

3. Special departments and qualified personnel to handle countertrade.

This correlation between involvement and experience of Bank ETCs and their perception that countertrade is growing more popular is diagrammed in Tables I,II,III, IV and V. Of the respondents sampled, 91% felt that countertrade had increased in popularity over the last ten years. Countertrade had become an attractive alternative form of doing business overseas, especially in developing countries according to 55% of the Bank ETCs. An sizable percentage, i.e., 73% of the Bank ETCs had separate departments for their export trading and countertrade activities involving one to three qualified officers to handle the operations. Experience with handling export trading activities ranged from one to three years for 63% of the sample, whereas 45% of the banks were involved in countertrade activities since 1980. Only 18% of the banks had negotiated countertrade deals prior to 1980. Some of the respondents, i.e., .09% had negotiated over twenty transactions whereas the other ETCs had completed between one to three deals so far. The estimates of increasing importance given by respondents are consistent with recently published reports that barter and countertrade are evolving from a regional to a worldwide phenomenon

Ironically, these ETCs did not perceive banks to become the leading export intermediaries of the 1980s and 1990s. The reasons for such a dismal future are attributed to:

1. Margins of profit in countertrade are small and uncertain, whereas other areas are more profitable.

2. There is no Bank ETC in the country that can serve as a model to be emulated.

3. Constraints on bank's capital investment in ETCs and the strength of the U.S. dollar have made the climate for countertrade uncertain.

4. ETCs are considered non-traditional use of bank managements time.

Among the other factors known to inhibit ETCs from accepting countertrade is government involvement. Of the respondents 91% felt that government involvement in countertrade was increasing. The entire sample, i.e., 100% of the respondents felt that having the right government contacts can help in negotiating countertrade arrangements. Experience and knowledge of a particular governments countertrade regulations was cited to be of crucial importance by 81% of the respondents. It was also believed that understanding the politics of a country was important in concluding a deal. Countertrade arrangements were undertaken to fulfill government trade policy or program requirements as revealed by 64% of the sample.

The extent of government involvement in countertrade was expected and proves to be consistent with the research carried out earlier by other researchers. Tables VI, VII, VIII, and IX provide an overview of the sample's responses to government participation in countertrade.

There was no clear-cut choice in countertrade forms that respondents selected. Most were inclined to comment that forms of countertrade used depended greatly on the particular deal. While 64% of the Bank ETCs ranked counterpurchase as primary choice, 45% favored clearing arrangements. This preference was closely followed by 36% in support of offsets and compensation and 27% in favor of evidence accounts. The form of classical barter was ranked sixth and was considered as an alternative only if no other choices were available. Table X provides an overview of the choices selected by the respondents.

The responding Bank ETCs dealt with a wide range of countertrade products from raw materials, industrial equipment and machinery, consumer goods, chemicals, agricultural commodities to transportation parts and equipment.

The products most frequently countertraded were 45% raw materials, 36% industrial equipment, 27% agricultural commodities and 18% chemicals. Table XI provides detailed information. Compared to conventional international trade, the majority of the products countertraded were commodities or low technology products. High technology goods were more likely obtained by conventional methods of exchange.[16]

The third issue of the survey was to determine the countries in which countertrade was more prevalent. Bank ETCs were asked to rank the countries in order of decreasing importance. Latin America was ranked first, by 55% of the respondents, while 27% indicated Western Europe as well as U.S.S.R. and the East European Bloc. Countertrade was no longer perceived to be predominantly important in the East European nations. The study thus supported the view that countertrade has shifted from a East-West trade focus to a North-South one. Table XII indicates the involvement of countries in countertrade.

The forms of credit used to finance countertrade operations were revealed to be similar to conventional export financing. Letters of credit were most popular. They received 53% of respondent support, while 27% preferred a forfait credit. The support for other forms of credit was evenly divided between buyer, supplier and bank-to-bank credit. One of the respondents, namely the Bank of Boston has pioneered an attempt to introduce International Trading Certificates as a viable alternative to financing countertrade. ITCs have yet to receive endorsement from any country or Bank ETC. Table XIII illustrates the forms of credit used by the respondents.

The advantages of countertrade for EEBs and LDCs cluster around three subjects: market access, foreign exchange and pricing. Among the many advantages related to market access, 54% of banks specified opportunities to gain access in new markets. The advantage of preserving hard currency was supported by 91% of the executives while 73% felt that countertrade helped improve balance of trade. The other advantage that involves maintaining prices of exports received endorsement from 27% of the respondents. Acquisition of technology ranked high as a motivating factor for LDCs and EEBs gathering support from 82% of the respondents. Bank ETCs opinions about the advantages of countertrade for Western managers revolve around the issues of profitability and market access. Countertrade as a means of increasing profits was preferred by 73% of the ETCs, while 27% felt that countertrade can be used by Western companies to gain access to new markets. Tables XIV and XV indicate the motivating factors and advantages of countertrade to both EECs, LDCs and Western countries.

Some of the respondents, i.e., 82% see these countertrade alternatives as adding time, complexities and costs to international transactions, particularly for banks with elaborate trading arrangements. (See Table XVI.) The estimate by an experienced European trading specialist, that only 5-10% of negotiations result in a final deal explains the respondent aggravation with the lengthy negotiation process.[16] The time required to complete countertrade transactions was reported by 36% of the respondents to be four to six months. For 27% of the respondents it took seven to twelve months to complete a single transaction. Table XVII illustrates the time required to complete countertrade deals.

The complexities in countertrade deals are linked to handling negotiations, disposing goods, acquiring trading expertise and finding qualified personnel. About 81% of the respondents find it hard to dispose of goods and negotiate the terms in a countertrade arrangement. Some of the ETCs, i.e., 63% had trouble finding qualified staff to head the countertrade division, while 54% felt that they lacked the trading expertise needed to successfully complete a countertrade transaction. Table XVIII indicates the difficulties perceived by Bank ETCs in transacting countertrade deals.

Banks felt that there existed a great deal of confusion around several aspects of countertrade. Contrary to earlier research findings 45% of the responding firms did not feel that countertrade is a mechanism for circumventing trade restrictions. Many of the respondents, i.e., 36% were not sure if GATT had any policy decisions regarding countertrade. However, almost all the respondents, i.e., 73% felt that there was a paucity of objective information on countertrade that was available to them. Thus, the need for more academic research by practitioners and academicians is highlighted by the responses in this study.

The expertise developed by ETCs in countertrade was either through actual experience or on the job training. Experience was ranked by 73% of the respondents, while 54% felt on the job training was the most important source of training for countertrade. The experience of ETCs towards countertrade has been mixed. While 36% of the respondents felt satisfied, 45% were dissatisfied with countertrade arrangements. Surprisingly, none of the respondents chose the extremes of either excellent or bad experience as a choice.

The final purpose of the survey was to determine the special skills or resources that respondents felt were necessary in order to deal with countertrade. The skills mentioned by respondents were varied, ranging as follows:

1. Qualified, dedicated staff.
2. Expertise in disposing goods and selecting products as counterdeliveries.
3. Extensive International branch networks.

4. Willingness to take risk.
5. Legal expertise.
6. Extensive customer base.
7. Negotiation skills.

This study confirms the growing importance of countertrade and the change in focus of countertrade from a East-West trade tool to a North-South one. Perpetuation of this trend can be expected given the continued hard currency shortages, inferior quality of exports of LDCs and EEBs, and the need of developing countries to acquire sophisticated Western marketing expertise. However, the need for qualified personnel, and objective information must be met. Clarification of the legal implications of non-monetised trade and various conflicting government policies must be made if countertrade is to be extensively used in the future.

TABLE I

Countertrade has experienced an increase in popularity over the last ten years.

	Frequency	Percent
Strongly Agree	5/11	45
Agree	5/11	45
Not Sure	-	-
Disagree	1/11	09
Strongly Disagree	-	-

Total percent who agreed:	**91**
Total percent who disagreed:	**09**

TABLE II

Countertrade has become an attractive alternative form of doing business overseas in developing countries.

	Frequency	Percent
Strongly Agree	2/11	18
Agree	4/11	36
Not Sure	-	-
Disagree	5/11	45
Strongly Disagree	-	-

Total percent who agreed:	55
Total percent who disagreed:	45

TABLE III

For how many years has your bank been involved in Export Trading activities.

Years of involvement	Frequency	Percent
None	1/11	09
1-3	8/11	73
4-9	2/11	18
10-19	-	-
More than 20	-	-

TABLE IV

How many countertrade agreements has your bank assisted in the following years?

		Frequency		Percent
1985-1986	0-1	-		-
	2-5	3/11		27
	6-9	1/11		09
	10-19	-		-
	20 or more	1/11		09
			Total	45
1980-1984	0-1	-		-
	2-5	3/11		27
	6-9	1/11		09
	10-19	-		-
	20 or more	1/11		09
			Total	45
1970-1979	0-1	-		-
	2-5	2/11		18
	6-9	-		-
	10-19	-		-
	20 or more	-		-
			Total	18
1960-1969	0-1	-		-
	2-5	1/11		09
	6-9	-		-
	10-19	-		-
	20 or more	-		-
			Total	**09**
Before 1960	0-1	-		-
	2-5	1/11		09
	6-9	-		-
	10-19	-		-
	20 or more	-		-
			Total	**09**
			Pre 1979 Total	**18**

TABLE V

How many officers assist in countertrade activities?

	Frequency	Percent
None	1/11	09
1-3	8/11	73
4-9	2/11	18
10-19	-	-
More than 20	-	-

TABLE VI

Government involvement in countertrade is increasing.

	Frequency	Percent
Strongly Agree	4/11	36
Agree	6/11	55
Not Sure	-	-
Disagree	1/11	09
Strongly Disagree	-	-

Total percent who agreed: **91**

Total percent who disagreed: **09**

TABLE VII

Having the right government contacts can save negotiating time.

	Frequency	Percent
Strongly Agree	3/11	27
Agree	8/11	73
Not Sure	-	-
Disagree	-	-
Strongly Disagree	-	-

Total percent who agreed: 100

TABLE VIII

Inexperience with a government's countertrade regulations can be expensive.

	Frequency	Percent
Strongly Agree	4/11	36
Agree	5/11	45
Not Sure	1/11	09
Disagree	1/11	09
Strongly Disagree	-	-

Total percent who agreed: 81

Total percent who disagreed: 09

TABLE IX

Countertrade arrangements are undertaken to fulfill government trade policy or program requirements.

	Frequency	Percent
Strongly Agree	1/11	09
Agree	6/11	55
Not Sure	2/11	18
Strongly Disagree	-	-

Total percent who agreed: 63

Total percent who disagreed: 18

TABLE X

Which of the following forms of countertrade are preferred by your bank? (Please rank choices if more than one is used.)

	Rank	Frequency		Percent
Counterpurchase	1	3/11		27
	2	4/11		36
			Total	**64**
Compensation	1	3/11		27
	3	1/11		09
			Total	**36**
Classical Barter	6	5/11		45
			Total	**45**
Evidence Accounts	1	1/11		09
	2	2/11		18
			Total	**27**
Offsets	1	3/11		27
	2	1/11		09
			Total	**36**
Clearing Agreements	3	4/11		36
	4	1/11		09
			Total	**45**

TABLE XI

Which of the following categories of goods are transacted in countertrade? (Please rank the appropriate choices.)

Categories of Goods	Rank	Frequency		Percent
Raw Materials	1	3/11		27
	2	2/11		18
	3	1/11		09
	4	1/11		09
			Total	**45**
Industrial Equipment	1	2/11		18
	2	2/11		18
	4	1/11		09
	5	1/11		09
			Total	**36**
Consumer Goods	2	1/11		09
	5	3/11		27
			Total	**36**
Industrial Chemicals	3	2/11		18
			Total	**18**
Agricultural Commodities	1	3/11		27
	2	2/11		18
	3	1/11		09
	4	1/11		09
			Total	**45**
Transportation Equipment	2	1/11		09
			Total	**09**
None	1	1/11		09
			Total	**09**

TABLE XII

Has your bank negotiated countertrade transactions with companies located in the following countries? (Please rank the choices if more than one is appropriate.)

Country	Rank	Frequency		Percent
Latin America	1	6/11		55
Western Europe	2	3/11		27
Caribbean Basin	2	1/11		09
	3	1/11		09
			Total	18
Indian Subcontinent	-	-		-
African Nations	5	1/11		09
Middle East	2	1/11		09
East Europe & U.S.S.R.	2	1/11		09
	3	2/11		18
			Total	27
Far East	4	2/11		18
Australia & Oceania	3	1/11		09

TABLE XIII

Which of the following forms of credit are preferred by your bank to finance countertrade? (Please rank the following preferences if more than one is appropriate.)

Forms of Credit	Rank	Frequency		Percent
Letters of Credit	1	7/11		53
			Total	**53**
A Forfait Credit	1	1/11		09
	2	1/11		09
	3	1/11		09
			Total	**27**
Bank to Bank Credit	2	1/11		09
			Total	**09**
Supplier Credit	1	1/11		09
			Total	**09**
Buyer Credit	1	1/11		09
			Total	**09**
None of the above	-	2/11		18
			Total	**18**

TABLE XIV

What are the motivating factors for a country to seek countertrade? (Please rank appropriate choices.)

Motivating Factors	Rank	Frequency		Percent
Preserve hard currency	1	10/11		91
			Total	**91**
Improve balance of trade	2	6/11		55
	3	2/11		18
			Total	**73**
Gain access in new markets	2	3/11		27
	3	2/11		18
	5	1/11		09
			Total	**54**
Upgrade manufacturing capabilities	4	1/11		09
	5	2/11		18
			Total	**27**
Acquire Technology	3	3/11		27
	4	6/11		55
			Total	**82**
Maintain prices of exports	3	1/11		09
	5	2/11		18
			Total	**27**
To obtain needed products	1	1/11		09
			Total	**09**
To dispose unsaleables	3	1/11		09
			Total	**09**
Maintain employment	4	1/11		09
			Total	**09**

TABLE XV

Which of the following best describes the motivating reasons for your bank to participate in countertrade? (Please rank the appropriate choices.)

Reasons	Rank	Frequency		Percent
Gain source of supply	3	1/11		09
			Total	**09**
Entry into new markets	1	1/11		09
	2	1/11		09
	3	1/11		09
			Total	**27**
Sales Opportunities	1	1/11		09
	3	1/11		09
			Total	**18**
Avoid higher taxes	-	-		-
Reduce risk of non-payment of exports	1	1/11		09
	2	1/11		09
			Total	**18**
Increase profits	1	8/11		73
			Total	**73**

TABLE XVI

Countertrade in all its forms is a complicated and costly process.

	Frequency	Percent
Strongly Agree	3/11	27
Agree	6/11	55
Not Sure	-	-
Disagree	1/11	09
Strongly Disagree	1/11	09

Total percent who agreed: **82**

Total percent who disagreed: **18**

TABLE XVII

What is the usual time required to complete a countertrade transaction?

Months	Frequency	Percent
1-3	1/11	09
4-6	4/11	36
7-12	3/11	27
Over 12	2/11	18
Don't know	1/11	09

TABLE XVIII

Which of the following are areas of difficulty in countertrade? (Please rank the choices.)

Areas of Difficulty	Rank	Frequency		Percent
Negotiating Terms	1	4/11		36
	2	4/11		36
	3	1/11		09
			Total	**81**
Disposing Goods	1	5/11		45
	2	3/11		27
	4	2/11		18
			Total	**81**
Acquire trading expertise	1	3/11		27
	2	2/11		18
	4	1/11		09
			Total	**54**
Financing Countertrade	3	3/11		27
	5	1/11		09
			Total	**36**
Finding Qualified People	2	7/11		63
	3	2/11		18
			Total	**63**
Identifying Foreign Potential	3	3/11		27
			Total	**27**
Maintaining Overseas Agents	-	-		-

CHAPTER FIVE

Several conclusions can be drawn from this study. Firstly, the countertrade phenomenon is growing in importance. The focus has shifted from an East-West trade feature to encompass about ninety countries in the world. Secondly, the varying forms of countertrade are adapting to the peculiar needs of its trading partners. The methods used to finance countertrade are developing new twists to serve the special requirements that countertrade demands. International institutions like the GATT, IMF and World Bank are conducting special studies to see how the negative effects of countertrade can be controlled so as to avoid harming the free trade structure. Governments of United States and Western Europe have begun to shift their previous ambivalent stand on countertrade to a more positive supporting one.

It is believed that "the countertrade phenomenon will not subside at least not in the current decade, nor through most of the next. Slow and uneven recovery in commodity prices, ongoing oil price decreases, relatively stiff interest rates, stagnant commercial modes of financing and continued population growth and urbanisation will clearly exarcerbate pressures for countertrade. Moreover, as long as the fear exists that one or more countries may default on their international debt obligations, countertrade will continue to be seen as a viable option."[6]

Countertrade appears to have three futures in international trade. Among the Western countries it will follow major crises such as wars and depressions. It will be used as a transitory and short-term mode of doing international business. In the case of LDCs, countertrade will move along the world business cycle, albeit on a declining curve. The role of countertrade will decline in the long-run because of two reasons. Firstly, dependence on raw material exports by LDCs will decline as these countries continue to grow and diversify. Secondly, development of world capital markets will give these countries the financial means to smooth their foreign exchange earnings.[28] However, in the short-run, countertrade would prove to be the best alternative to the LDC problems of heavy foreign debt and balance of trade. Countertrade is expected to remain a permanent part of the future trade in the case of the People's Republic of China (PRC), and the East European Bloc. The trend in EEBs has been to reduce emphasis on central planning. In the long run this could result in freeing their economies. However the process is likely to be a very slow one since it must take place under the wary eye of the U.S.S.R..

Countertrade when used responsibly can be an effective tool of international trade. However, a great deal of confusion and uncertainty about countertrade exists in the academic and business world. It is felt that if countertrade arrangements between countries were brought under international surveillance, much of this confusion could be resolved. Countertrade arrangements arising from government policies should be examined carefully by GATT as to their impact on world trade. Secondly, GATT should enforce certain rules to ensure settlement by countertrading parties as well as adherence to certain free trade principles.

In sum, the data gathered from this survey is an effort to fill the gap of empirical information about countertrade activities. However, the study revealed that the Bank ETCs sampled were still in the formative stages - organising, looking for personnel, identifying markets and potential customers. Most expect to incur losses during their start-up phase and only a few have engaged in countertrade transactions which have been small. The challenge lies in advancing and communicating the logic underlying countertrade, in developing a comprehensive model of the marketing flows associated with countertrade and in formulating a general theory of countertrade that adequately supports the strategic planning function (Waldron 1984). A need for such research is clearly evidenced by an almost total lack of scholarly research on the topic.

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APPENDICES

Export Trading Companies Owned by Bank Holding Companies (As of Oct. 1, 1985)

Bank Holding Company	Export Trading Company	Date of Board action	Comments
Security Pacific Corp., Los Angeles, CA	Security Pacific Export Trading Co.	05/09/83	Wholly-owned subsidiary
Citicorp, New York, NY	Citicorp International Trading Co., Inc.	05/31/83	Wholly-owned subsidiary
Walter E. Heller International Corp., Chicago, IL	Heller Trading Co.[a]	06/13/83	Wholly-owned subsidiary
First Interstate Bancorp, Los Angeles, CA	First Interstate Trading Co., Inc.	06/15/83	Wholly-owned subsidiary
First Kentucky National Corp., Lousville, KY	First Kentucky National Trading Co.	07/25/83	Wholly-owned subsidiary
Union Bancorp, Los Angeles, CA	StanChart Export Services Co., Inc.	07/25/83	Wholly-owned subsidiary
Crocker National Corp., San Francisco, CA	Crocker Pacific Trade Corp.	08/30/83	Wholly-owned subsidiary
Ramapo Financial Corp., Wayne, NJ; Ultra Bancorporation, Bridgewater, NJ; and New Jersey National Corp., Trenton, NJ	Bankers International Trading Co.	09/14/83	Joint venture of three bank holding companies and three private investors
State Street Boston Corp., Boston, MA	State Street Trade Development Co., Inc.	09/19/83	Bank has controlling interest in the ETC
International Bancshares Corp., Laredo, TX	IBC Trading Co.	10/04/83	Wholly-owned subsidiary
United Midwest Bancshares, Inc., Cincinnati, OH	United Midwest International Corp.[a]	10/26/83	Joint venture with an ongoing ETC (equal ownership)
U.S. Bancorp, Portland, OR	U.S. World Trade Corp.	11/17/83	Wholly-owned subsidiary
First Chicago Corp., Chicago, IL	First Chicago Trading Co.	11/22/83	Joint venture with Sears World Trade, Inc. (equal ownership)
Rainier Bancorp., Seattle, WA	Rainier International Trading Co.	12/07/83	Wholly-owned subsidiary
Shawmut Corporation, Boston, MA	Shawmut Export Corporation	12/12/83	ETC purchased wholly-owned subsidiary named Techexport Inc
Hongkong and Shanghai Banking Corp., Hong Kong	Equator Trading Co., Ltd.	12/27/83	Wholly-owned subsidiary
BankAmerica Corp., San Francisco, CA	BankAmerica World	02/02/84	Wholly-owned subsidiary
Bankers Trust New York Corp., New York, NY	Bankers Trust International Trading Co.	02/02/84	Wholly-owned subsidiary
First National State Bancorp., Newark, NJ	First International Trading Co.	02/13/84	Wholly-owned subsidiary
Chase Manhattan Corp, New York, NY	Chase Trade Inc.	02/21/84	Wholly-owned subsidiary
Society Corp., Cleveland, OH	Export Partnership for Intercontinental Trade, Inc.	03/02/84	Joint venture with a manufacturer shares will be offered to 15 area exporters.
Fleet Financial Group, Inc. Providence, RI	Fleet Trading Co.	03/19/84	Wholly-owned subsidiary
First National Bankshares, Inc., Houma, LA	First Export Corp.	04/06/84	Wholly-owned subsidiary
Manufacturers Hanover Corp., New York, NY	C.I.T. International Sales Corp.	04/24/84	Bank purchased company which had a wholly-owned subsidiary
First Union Corp, Charlotte, NC	First Union Export Trading Co.	05/07/84	Wholly-owned subsidiary

Alaska Mutual Bancorp., Anchorage, AK	Mutual International Corp.	06/06/84	Wholly-owned subsidiary
Frontier Bancorp. Los Angeles, CA	Interbank Export Trading Co.	07/30/84	Shares may be purchased by export service providers & exporters. Bank will retain at least 51 percent ownership
Florida Park Banks, Inc. St. Petersburg, FL	Park Services International, Inc.	09/19/84	Wholly-owned subsidiary
Capital Bancorp Miami, FL	Capital Trade Services, Inc.	09/20/84	Wholly-owned subsidiary
CoreStates Financial Corp., Philadelphia, PA	CoreStates Export Trading Co.	10/13/84	Wholly-owned subsidiary
North Valley Bancorp. Redding, CA	North Valley Trading Co., Inc.	10/18/84	Trading company entered into joint venture with ongoing ETC
Maryland National Corp., Baltimore, MD	MN Trade Corp.	12/18/84	Wholly-owned subsidiary
The Marine Corp., Milwaukee, WI	Marine Financial Services Corp.	12/31/84	Wholly-owned subsidiary
Ramapo Financial Corp. Wayne, NJ Ultra Bancorp., Bridgewater, NJ; and New Jersey National Corp, Trenton, NJ	Florida Interbank Trading Co., Inc.	01/07/85	Joint venture of three bank holding companies and ongoing ETC.
First Wisconsin Corp., Milwaukee, WI	Intercontinental Trading Co., Inc.	02/11/85	Ongoing ETC and bank holding company jointly purchased Intercontinental Trading Co., Inc.
Commerce Union Corp., Nashville, TN	Commerce Trading Corp.	03/22/85	Wholly-owned subsidiary
Valley National Corp., Phoenix, AZ	Valley International Trading Co.	04/16/85	Joint venture with an ongoing ETC (equal ownership).
Manufacturers Hanover Corp., New York, NY	Manufacturers Hanover World Trade Corp.	04/20/85	Wholly-owned subsidiary which took over activities of the banks' other ETC
Marine Midland Banks, Inc. Buffalo, NY	Marine Midland Trade, Inc.	04/20/85	Wholly-owned subsidiary
United Bankcorp of Arizona Phoenix, AZ	United Bank Export Trading Co.	07/15/85	Wholly-owned subsidiary

[a]According to the Federal Reserve Board, this ETC has been dissolved.

Source: Information obtained from copies of bank holding companies' notification letters on file in the Federal Reserve Board's Freedom of Information Act reading room.

OSU

Oklahoma State University

CENTER FOR INTERNATIONAL TRADE DEVELOPMENT

STILLWATER, OKLAHOMA 74078
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(405) 624-6256

Faculty of the Center for International Trade Development at Oklahoma State University are currently conducting a study of the countertrade activities in the United States. As you are aware, countertrade activities are very limited. It is thought that as few as 25 banks have substantial experience in countertrade activities.

Your bank has been identified as one of those few banks that is involved in countertrade activities. Therefore, your participation in this study is vital to its accuracy and credibility.

The purpose of this questionnaire is to determine the current involvement, perceptions, and attitudes of international bankers towards countertrade. This survey is being conducted on a national basis and your response is critical to obtaining a statistically accurate report.

Would you kindly give this questionnaire to the person most involved with any type of countertrade activities in the last two years. A complete copy of this study will be made available to your bank prior to publication. Your cooperation in this important international trade issue is most appreciated.

Cordially,

B. Curtis Hamm
Professor of
International Business

Gerald M. Lage, Director
Center for International
Trade Development

CENTENNIAL
DECADE
1980 • 1990

The questionnaire will take about 5-10 minutes of your time. Please use the enclosed, stamped envelope to mail the questionnaire as soon as possible. You willingness to participate is greatly appreciated and important to the publishing of the final results.

1. What does the concept of countertrade mean to you?

____

____

____

Please circle the most appropriate interval for each item.

Strongly Agree	Agree	Not sure	Disagree	Strongly disagree
1	2	3	4	5

2. Countertrade is a cyclical activity (i.e. it flourishes during periods of stagnation and diminishes during times of growth.	1	2	3	4	5
3. Countertrade is predominantly used in Eastern European countries.	1	2	3	4	5
4. Countertrade is a short-term mode of doing business.	1	2	3	4	5
5. Countertrade appeals to a wide range of users.	1	2	3	4	5
6. Government involvement in countertrade is increasing.	1	2	3	4	5
7. Countertrade has experienced an increase in popularity over the last ten years.	1	2	3	4	5
8. There is a lack of objective information on countertrade.	1	2	3	4	5
9. Countertrade has become an attractive alternative form of doing business overseas in developing countries.	1	2	3	4	5

10.	Countertrade in all its forms is a complicated and costly process.	1	2	3	4	5
11.	Having the right government contacts can save negotiating time.	1	2	3	4	5
12.	Understanding a nation's politics is essential to completing a deal.	1	2	3	4	5
13.	Inexperience with a Government's countertrade regulations can be expensive.	1	2	3	4	5
14.	Countertrade can be viewed as a substitute for foreign direct investment.	1	2	3	4	5
15.	Countertrade is a mechanism for circumventing trade restrictions.	1	2	3	4	5
16.	Countertrade arrangements are undertaken to fulfill Government trade policy or program requirements.	1	2	3	4	5
17.	Countertrade falls under the General Agreement on Tariffs & Trade (GATT)	1	2	3	4	5
18.	Banks are expected to become the leading export intermediaries of the 1980's and 1990's.	1	2	3	4	5

19. Which of the following forms of countertrade are preferred by your bank? (Please rank choices if more than one is used.)

counterpurchase ______
compensation (buy back) ______
pure/classical barter ______
evidence accounts ______
offsets ______
clearing agreements (switching) ______
None of the above. ______

20. Has your bank negotiated countertrade transactions with companies located in the following countries? (Please rank the choices if more than one is appropriate.)

Latin America	______
Western Europe	______
Caribbean Basin	______
Indian Subcontinent	______
African Nations	______
Middle East	______
East Europe and U.S.S.R.	______
Far East	______
Australian and Oceania	______

21. Which of the following forms of credit are preferred by your bank to finance countertrade? (Please rank the following preferences if more than one is appropriate.

Letters of Credit	______
A Forfait Credit	______
Bank to Bank Credit	______
Supplier Credit	______
Buyer Credit	______
None of the above	______

22. Which of the following categories of goods are transacted in countertrade? (Please rank the appropriate choices.)

Raw Materials	______
Industrial Equipment and machinery	______
Consumer goods	______
Industrial chemicals	______
Agricultural commodities	______
Transportation equipment and parts	______
None of the above	______

23. What are the motivating factors for a country to seek countertrade? (Please rank appropriate choices)

To preserve hard currency	______
To improve balance of trade	______
To gain access into new markets	______
To upgrade manufacturing capabilities	______
To acquire technology	______
To maintain prices of exports	______
None of the above	______

24. Which of the following best describes the motivating reasons for your bank to participate in countertrade? (Please rank the appropriate choices.)

To gain a source of supply	_____
To gain prominence in new markets	_____
To take advantage of sales opportunities	_____
To avoid paying higher tariffs	_____
To reduce the risk of non payment of exported goods	_____
To increase profits	_____
None of the above	_____

25. Which of the following are areas of difficulty in countertrade? (Please rank the choices in order of importance.)

Negotiating terms of contract	_____
Disposing of goods obtained	_____
Acquiring trading expertise	_____
Financing the operation	_____
Finding qualified personnel	_____
Identifying foreign potential	_____
Maintaining overseas agents	_____

26. For how many years has your bank been involved in export trading activities?

None	_____
1-3 years	_____
4-9 years	_____
10 or more years	_____

27. How many countertrade agreements has your bank assisted in the following years?

	0-1	2-5	6-9	10-19	20 or more
1985-1986	____	____	____	____	____
1980-1984	____	____	____	____	____
1970-1979	____	____	____	____	____
1960-1969	____	____	____	____	____
Before 1960	____	____	____	____	____

28. How many officers assist in countertrade activities?

None	_____
1-3	_____
4-9	_____
10-19	_____
More than 20	_____

29. What is the usual time required to complete a countertrade transaction?

0-3 months	_____
4-6 months	_____
7-12 months	_____
Over 12 months	_____

30. How did you develop expertise in countertrade? (Rank the following choices if appropriate)

Seminars ______
In house training ______
Actual experience ______
On the job training ______
None of the above ______

31. Has your experience with countertrade been

Excellent ______
Good ______
Satisfactory ______
Unsatisfactory ______
Bad ______

32. What kind of special skills or resources do banks require in order to deal with countertrade?

____

____

____

Thank you for assisting us in our study.

L-23

VITA

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