CHAPTER 1

INTRODUCTION AND PURPOSE OF STUDY

1.1 INTRODUCTION AND PROBLEM STATEMENT

One of the biggest problems facing the South African economy is unemployment. Each day, some 1000 people enter the labour market and the formal sector of the economy sheds 200 jobs. The South African Reserve Bank estimates that total unemployment is rising by one or two percentage points each year. Unless the economy can grow much faster than its current plod of one to two percent a year, South Africa will find that its starkest divide is no longer between black and white, but between those in work and those who despair of ever legally making a living (The Economist, 1998:45). In the eighties, South Africa's official unemployment was still relatively manageable at 12,4 percent. In 1991 it rose to 19 percent but since the ANC took over the reins of government in 1994, it has ballooned more than 30 percent, although new methods of measurement try to put the rate lower (Mittner, 1998:49). According to the last Census in 1996 the total population of South Africa was 40 583 573 (Statistics South Africa, 2000:8). A total of 33,9 percent of the population between the ages 15 and 65 are unemployed. This figure includes the informal sector (Statistics South Africa, 2000:41).

Furthermore compared with other countries at a similar stage of development, South Africa's education budget is generous, but much is squandered. Over 90 percent of the spending goes to teacher's salaries, leaving little for books or buildings. A rowdy atmosphere dating back to the 1970s (when disrupting classes was a form of political protest), persist to this day. South Africa came bottom out of 41 countries in a resent assessment of proficiency in science and math. About 30 percent of adults are functionally illiterate (The Economist, 1998:46).

With this in mind the South Africa government is aiming to utilise the instrument of international government procurement to leverage economic benefits and develop South African industry (Department of Trade and Industry, 1997: 2). Through the use of countertrade the South African government is hoping to create sustainable economic growth, increase foreign investment, create job opportunities and develop South Africa's human resources (Department of Trade and Industry, 1997: 2). Countertrade being an umbrella term that encompasses a variety of methods to conduct trade where, in varying degrees, purchases are required to offset sales (Coetzer, 1995: 82). In South Africa however the term Industrial Participation is used instead of the term countertrade (Van Dyk, 2000).

According to Fletcher (1998: 519) countertrade isn't something new. Between 1987 and 1996 there were 2581 cases of countertrade reported worldwide. In South Africa all government and parastatal purchases or lease contracts with an imported content equal to or exceeding US$10 million (or the equivalent thereof) have been subject to countertrade since 1 September 1996 (Department of Trade and Industry, 1997: 2) and Armscor who is responsible for defence procurement, acquisitions and related services in South Africa also has been using countertrade for the past 10 years (Armscor, 1999: 14).

South Africa's national carrier (South African Airways) for example used countertrade in 1999 when they purchased two Boeing 747-200s worth R1, 3 billion, as well as with the purchase of a new short haul fleet worth R4, 9 billion. The negotiations are however still under way to determine the type of offsets required from Boeing, but South African Airways are pushing for offsets relating to training in particular. The Department of Trade and Industry's main focus is however on trading economic projects that would provide jobs for people once they were trained (Bailey, 2000: 6).

However, recently the South African Government announced that it had signed a R30 billion deal to purchase defence equipment. In return, South Africa hopes to gain industrial participation benefits worth more than R104 billion over the next eleven years (Campbell, 2000:16). According to Trade and Industry Minister, Alec Erwin the countertrade deal would help focus people's minds on what South Africa had to offer, and would contribute very considerably to the country's skill capacity. He described the programme as "an important injection which will strengthen South Africa's manufacturing capacity", creating viable and sustainable projects within the country. In addition to the jobs created directly - an estimated 65 000 sustainable jobs- the programme will also have an indirect impact on the labour market. The demand for raw material, the spending of incomes earned from employees and spending by government from its tax revenue will all contribute to economic growth and job creation (Stuart and Loock, 1999: 4). According to Kamm (2000) due to the size of the countertrade – R104 billion in countertrade for purchases of R30 billion – this South African arms deal is the benchmark setting countertrade deal for the rest of the world.

It is however widely agreed that successful countertrade programmes depend on careful monitoring and the enforcement of the various conditions attached to them to ensure that they achieve specific aims. In similar offset (countertrade) programmes elsewhere, the benefits that have eventually accrued to equipment purchasing countries have been closely related to their government's capacity to successfully manage the implementation of these offset (countertrade) programmes (Loxton, 1999: 3). Adding to this Barrell and Streek (1999: 4) writes that similar offset deals reached between smaller countries and the major arms producing nations have more often than not failed to produce the benefits promised. The question now arising is whether South Africa can successfully implement and carry out this benchmark setting countertrade arms deal? If not the promised jobs, new enterprises and growth in existing enterprises won't materialise.

As this can be seen as one of the benchmark setting countertrade agreements in the world this study will thus answer the following question: Was the countertrade portion of the arms deal successfully implemented, in order to ensure the success of the countertrade deal and in doing so, creating and growing enterprises in South Africa?

1.2 RESEARCH OBJECTIVES

As stated in the previous section the purpose of this study is to determine if the countertrade portion of the South African arms deal was successfully implemented in order to create and grow enterprises in South Africa? This question can however be broken down into more specific research questions, namely:

- Was proper policies developed for the implementation of countertrade?
- Were procedures put in place to ensure the attainment of the countertrade obligations from the suppliers?
- Which countertrade obligations were negotiated with the suppliers that will ensure the creation and growth of enterprises in South Africa?

1.3 LITERATURE REVIEW

The majority of research on countertrade focuses on research into the different types of countertrade such as the research by Anyane-Ntow and Harvey (1995: 48 – 50) who identifies ten different types of countertrade namely:

- Barter
- Counterpurchase
- Offsets
- Buy-backs
- Swap transactions
- Switch trading
- Evidence Accounts
- Blocked Currencies
- Bilateral Clearing
- Cooperative ventures

This study will also as part of the literature study focus on the different types of countertrade but it is not the main aim of this study to classify countertrade into different types.

Other research into countertrade have focussed on the main points to be included in a countertrade policy such as the research conducted by Okoroafo (1994: 230 – 233) and Korth (1987: 95) but this research has focussed on the development of countertrade policies from the perspective of private enterprises or the selling enterprise, and this research was looking more specifically at the implementation of countertrade by the South African government. An author that has however looked at the development of a countertrade policy from the perspective of the buying government was Schaffer (1989:38 – 107). As a result his research can contribute greatly to the identification of guidelines for the formulation and evaluation of a South African countertrade policy.

Other authors such as Coetzer (1995) have researched the legal aspects of the use of countertrade especially the contractual aspects of countertrade agreements, however he has also researched the influence of the World Trade Organisation (WTO) on the use of countertrade. This aspect of Coetzer's research is of particular importance as the WTO Agreement on Government Procurement (GPA) can have a significant effect on the arms procurement deal. Other authors whose research also contributes to this area of the study is Hoekman and Mavroidis (1990) who researched the law and policies of public procurement, and especially important to this study also looked at the influence of the WTO's GPA on the use of countertrade.

One of the most comprehensive pieces of research on countertrade has come from Fletcher (1998: 511 – 528), who evaluated all the reported cases of countertrade between 1987 and 1996. Each transaction was analysed in terms of those aspects that reflected the pattern of the countertrade:

- Regions in which the countries are based – developed; low-income developing countries; middle income developing countries; organisation of petroleum-exporting countries; and former centrally planned economies.

- The value involved – less than US$ 500 000; US$ 500 000 to US$1000 000; US$1000 000 toUS$10 000 000; US$10 000 000 to US$100 000 000 and above US$100 000 000.

- The type of countertrade deal – barter, counterpurchase, offsets, buy-back, and debt.

- The group of products countertraded – food products and raw materials; fuels and petroleum products; simple transformed manufactured products; sophisticated manufactures; and services/other items.

1.4 RESEARCH DESIGN

The following research design was used:

- **Degree of problem crystallisation.** This is an exploratory study, as this study attempts to determine how countertrade is applied in South Africa, as well as determine what role countertrade plays in the current arms procurement deal and how it will help with the development and growth of enterprises in South Africa. The study aims to determine hypotheses and questions for further research as most of the current arms procurement deals countertrade is still in the infant stages and will only materialise in the long-term.

- **Method of data collection.** The study was conducted using both monitoring and survey processes. The study began with a literature study to identify and crystallise the field of countertrade as well as determine how countertrade is implemented in South Africa. A literature study was also undertaken to identify policy guidelines against which the South African countertrade policies could be evaluated. A survey was then conducted to support the literature study as well as identify the importance of the policy guidelines identified in the literature study (the methodology of this survey will be discussed in chapter 7).

- **Control of variables.** This is an ex post facto study as there was no control over the variables and the study only attempts to report the current countertrade situation in South Africa.

- **The purpose of the study.** This is both a descriptive as well as a causal study, as the study firstly focused on determining how countertrade is applied in South

Africa and what countertrade has been negotiated as part of the arms deal, and secondly the study is causal because it attempted to determine if countertrade could lead to the development and growth of enterprises in South Africa.

- **Time dimension.** This is a cross-sectional study as it looks at how countertrade is currently being applied as well as which countertrade obligations have been negotiated. It will not attempt to track countertrade or the arms procurement deal over time to see how it develops.

- **The topical scope.** This was both a statistical study and a case study. The arms deal and the use of countertrade in the arms deal was written up as a case study, while a statistical study was undertaken to evaluate the thoroughness of the current South African countertrade policy.

1.5 LIMITATIONS OF THE STUDY

The South African arms procurement deal consists of two sections (contracts), the procurement of the arms and the allocation of the arms procurement contracts on the one hand and the determination and implementation of the countertrade obligations on the other hand. This study will make mention of the procurement of the arms and the allocation of the arms procurement contract, but will focus on the implementation of countertrade in the arms procurement deal. The research is however hampered by the fact that the allocation of contracts in the arms procurement deal and to a lesser extent the countertrade obligations is being investigated by the government for charges of nepotism as well as material deviations from acceptable practice in the awarding of contracts. These procedures were however constantly monitored to determine any influences that the findings might have on the study.

A further limitation of the study is that not all the countertrade obligations have been determined yet, and that the negotiations that are currently under way in order to determine the countertrade obligations are treated as confidential as the negotiations are at a sensitive stage.

Lastly a lot of the countertrade practitioners – both countries and enterprises – do not freely admit to using countertrade and as such it is difficult to determine the size and location of the population for the survey. Most of this population are situated internationally and as such it was difficult to collect information from them.

1.6 STRUCTURE OF THE STUDY

This study consists of eight chapters. Chapters two to five is a literature study looking at the background for the research, while chapter six is a case study that shows how countertrade is applied in South Africa and shows what has happened with the South African arms procurement deal. Chapter seven shown the survey findings, while the last chapter consists of a summary, conclusion and recommendations of the research. The following gives a brief overview of the chapters in this study.

- **Chapter two.** This chapter looks at the historic development of countertrade, the different types of countertrade being used throughout the world and the advantages and disadvantages of using countertrade.

- **Chapter three.** This research deals with the South African arms deal and countertrade, and as South Africa is seen as a developing nation this chapter looks at the role that countertrade plays in developing nations and especially the amount of countertrade taking place in and with developing nations.

- **Chapter four.** The WTO's main aim is the encouragement of free international trade and globalisation. One of the WTO's agreements, the GPA especially prohibits the use of offsets – a type of countertrade – so this chapter takes a look at the influence of the WTO and its agreements on the use of countertrade.

- **Chapter five.** This chapter determines what the literature recommends should be included in a successful countertrade policy, as well as gives guidelines for the formulation of a countertrade strategy. With the aid of these policy guidelines the South African countertrade policies can be evaluated to determine their thoroughness, potential success or failure.

- **Chapter six.** This chapter is a case study that looks at which policies are in place in South Africa to ensure the successful implementation of countertrade. It also looks at the South African arms deal and the countertrade (Industrial Participation) that was negotiated with the successful suppliers. Finally this chapter looks at the criticism against and advantages of the South African arms deal and countertrade.

- **Chapter seven.** Before the South African countertrade policies in chapter six were evaluated against the policy guidelines identified in chapter five, these guidelines were evaluated to determine their relevance for inclusion in a countertrade policy. This chapter presents the finding of the survey conducted amongst countertrade practitioners to determine the relevance of those policy guidelines.

- **Chapter eight.** The last chapter consists of a summary and conclusion of the research and finally makes recommendations for potential further research identified during the course of this research.

1.7 ABBREVIATIONS

The following abbreviations will be used in the text:

- Communist economy (Comecon)
- Centrally Planned Economies (CPE)
- Defence Industrial Participation (DIP)

• Department of Defence	(DoD)
• Department of Trade and Industry	(DTI)
• General Agreement on Tariffs and Trade	(GATT)
• Gross National Product	(GNP)
• Agreement on Government Procurement	(GPA)
• Health and Usage Management Systems	(Hums)
• International Monitory Fund	(IMF)
• Industrial Participation	(IP)
• Industrial Participation Control Committee	(IPCC)
• Industrial Participation Secretariat	(IPS)
• International Trade Organisation	(ITO)
• Less Developed Countries	(LDC)
• Low Income Developing Countries	(LID)
• Most Favourite Nation	(MFN)
• Middle Income Developing Countries	(MID)
• Ministry of Defence	(MoD)
• National Industrial Participation	(NIP)
• National Industrial Participation Programme	(NIPP)
• Organisation of Petroleum Exporting Countries	(OPEC)
• Request for Information	(RFI)
• Request for Proposals	(RFP)
• South African National Defence Force	(SANDF)
• United States	(US)
• World Trade Organisation	(WTO)

1.8 REFERENCE TECHINQUE

The Harvard reference technique was used in this study.

CHAPTER 2
COUNTERTRADE THEORY

2.1 INTRODUCTION

According to Coetzer (1995:80-82) there is such an abundance of definitions of countertrade, but no universally agreed upon definition. Many authors on the subject are, therefore, in agreement that it is quite difficult to give a clear and concise definition of countertrade. In order to get an overall idea of the general traits and characteristics of countertrade, reference could in a somewhat tedious manner be made to some typical examples of attempts at defining countertrade:

- Countertrade is an international sale, which is conditional on a sale in the opposite direction.
- A technique by which one can obtain goods or services without necessary having to use money.
- It is also seen as an innovative financing technique.
- International trading transactions in which purchases are made to offset sales as a means of reducing the flow of hard currency.
- Countertrade as traditionally understood is the exchange of goods – a kind of international barter.
- Countertrade is an umbrella term for various forms of international transactions in which the seller is obligated by the buyer to accept full or partial payment in goods.

- Countertrade is an umbrella term that encompasses a variety of methods to conduct trade where, in varying degrees, purchases are required to offset sales.

Alexandrides and Bowers (1987: 5) add that there is a great deal of confusion over the definition of countertrade and it's various forms in the government and business communities. Governments of developed countries that have practiced countertrade for many years call it by some euphemism such as "industrial benefits programs" and reserve the term "countertrade" for the practices of developing countries and centrally planned economies. The segment of the business community that is new to countertrade does not know what to think. The business press persists in describing countertrade as "trade without money" which understandably frightens many companies; however, in most forms of countertrade, there is at least a partial payment of hard currency. Moreover, in countertrade between developed countries, full payment is usually made in cash, with the countertrade or offset obligation satisfied under a separate contract.

Elderkin and Norquist (1987: 1-2) write that countertrade is an umbrella term referring to any transaction where payment is made, at least partially with goods instead of money. In all its forms, countertrade links two transactions – normally independent under a free trade system – into one agreement. These transactions are the sale of a product by the multinational corporation into a country, and the sale of goods out of the country.

As can be seen from the numerous different definitions it is very difficult to define countertrade especially as it is used as an umbrella term for different types of countertrade. These different types of countertrade as well as the reasons for using countertrade will be discussed in the next sections. It should however be noted that throughout the study whenever the dollar sign is used it refers to US dollars unless stated otherwise.

2.2 THE MODERN DEVELOPMENT OF COUNTERTRADE

It is a fair assumption that trading practices founded on barter or variants of barter have existed since time immemorial. However, due to the appearance of monetary systems, pure barter dwindled and gradually made way for conventional trade. Notwithstanding the gradual advent of conventional trade, barter based trading practices have all along shown a temporary increase whenever international trade channels have been disrupted by economic upheaval and a decline when trade liberalisation has been in the ascent. In time of trade liberalisation barter or barter related practices give way to multilateral trading where settlement is normally effected in money.

Countertrade, it appears, was utilised by several governments since the 1920s. In the 1920s and 1930s United States corporations were largely responsible for the development of the Middle Eastern oil industry, mainly because these corporations offered technology and know-how in exchange for oil. Between the First and Second World Wars, Germany used countertrade in the expansion of its heavy industries. After the Second World War countertrade once again assisted Germany, but this time to overcome its post war recession.

Countertrade, however, only became a real influence in international trade after the Second World War, chiefly because the former Soviet Union and its allies in the Eastern bloc used countertrade mainly to bypass economic and political restrictions on East-West trade at the time. At that stage countertrade was also used in the West as an informal arrangement based on the rendering of mutual assistance between friendly nations in the West because Western bank credit was generally hard to obtain (Coetzer, 1995: 84-86). According to Osmanczyk (1990: 246) East – West is an age-old international term, which after World War Two became a synonym of world division. Shafritz, Williams and Calinger (1993: 237) add to this when writing that the East - West term is used to symbolize the Cold War-era division of Europe. The East consisted of the Soviet Union and its Eastern European satellites; the West consisted of the United States and its Western European allies plus Japan.

As far as the United States was concerned, The Department of Agriculture started a barter programme in 1950 with the aid of a government-financing organisation for United States agricultural exports, called the Commodity Credit Corporation. The objective of this barter programme was to trade agricultural surpluses held by the Commodity Credit Corporation for so-called strategic and critical materials needed for the American National Defence Stockpile. At that stage the United States Government also had a domestic price-support programme through which the Commodity Credit Corporation acquired agricultural commodities, which were then made available for purposes of the international barter transactions. This American programme lasted for a period of seventeen years, thus until 1967.

In the mean time, from the late 1940s to the late 1950s, more than 70% of trade amongst the Latin American countries consisted of countertrade, where extensive use was made of clearing account agreements.

With the advent of the 1960s, countertrade became important for Eastern block governments, as they started to promote countertrade as a reaction to limited foreign exchange, alternatively, as a way of disposing of surplus commodities in order to finance imports. Moreover, since the late 1960s some governments, not only Eastern European governments, required industrial countertrade arrangements which involved joint venture production sharing.

The next boost for countertrade came during the 1970s with the sharp rise in oil prices by the Organisation of Petroleum Export Countries (OPEC), an event that had a profound effect on the world trading system. Furthermore due to the sharp rise in oil prices, the terms of trade in non-oil exporting Third World countries deteriorated and had to be compensated for and the method used for this compensation was countertrade. In addition, during the 1970s there was a significant growth in industrial production in the former Soviet Union and in the East bloc countries. However, notwithstanding this growth, these countries could not achieve positive trade balances by capturing a meaningful market share in the West. With a view to reducing these imbalances and also to preserve their hard currency reserves and, furthermore, to promote their exports, these countries increasingly required the purchase of Eastern European goods in return for their Western purchases.

These occurrences resulted in an expansion of countertrade activities by United States firms during the 1970s, which coincided with an increase in trade between the United States on the one hand and the Third World and the East bloc on the other hand.

The 1970s was also a period, which Eastern Europe and the Third World became increasingly indebted to the West and during which their currencies were to a relatively large extent overvalued. Sequential there upon, Third World and East bloc countries groped at countertrade in an effort to bring their economies into equilibrium.

As regards the employment of countertrade during the 1980s, it seems that countertrade is coming out of the closet. Today a growing number of countries formally demand countertrade.

This statement is especially true for developing countries, as countertrade plays a new role for these countries in that since the 1980s they have increasingly turned to countertrade as an emergency measure (Coetzer, 1995: 86-88). The term developing nation that was mentioned previously is seen as an anomaly, for there is an implication that a developing nation is not developing, but decaying. But there is also an implication that this decay is not necessarily permanent; it may be a stage through which a nation is passing, a temporary setback. We are defining a developing nation here in terms of its effects on individuals or, more exactly, families. Those effects have to do with a stable personal environment; to experience this, an individual's housing, cultural setting, job, and education must all be in balance. Good education and poor job, low income and expensive house, affordable house but hostile neighbourhood, good job with insecure future – all result in imbalances. A stable personal environment requires enough food to eat, housing that is affordable and satisfying to live in; neighbours and cultural facilities with which he or she feels comfortable; a job offering a modicum of satisfaction, continuity, and above-subsistence income; and an educational system which can promise children the same advantages. A person with no monitory income can have this as well as one with high income; the key lies in the balance of the parts. Modernisation creates imbalances in these parts and also provides means to correct those imbalances. Some nations, which we term developed nations, have already achieved such environmental balance for a majority, or at least increasing percentage of, their citizens. Other nations once (usually before the advent of nationhood) had such balances for a majority of their people; today, a decreasing minority of their total populations experience such stable personal environments, though this trend may be reversed in the future. These are the developing nations; specifically, those in Latin America, the South Pacific Islands, Southeast Asia including Australia and New Zealand, South Asia, the Middle East excluding Israel, and Africa. All the other nations on the globe are classified as developed (Gamer, 1976: 8-9). The emergency situation in which these developing countries found themselves since the early 1980s related to the long-term structural changes in the international economy which includes matters such as the debt overhang, the sluggish growth of international trade, the decline of multilateralism and growing protectionism.

This concise contemporary history of countertrade leaves one with the distinct impression that the countertrade agreement, which in some quarters is looked down upon, has time and again been the lifeline that enabled even developed countries to haul themselves to safer international trade positions (Coetzer, 1995: 88).

2.3 FORMS OF COUNTERTRADE

So far the term countertrade has been used as an umbrella term for different types of international trade. It however represents a number of different types of possible international trade techniques that is available to enterprises and governments. The most well known and frequently used types of countertrade is:

- Barter
- Counterpurchase
- Compensation/Buy-back agreements
- Offset agreements

- Clearing account agreements
- Switch trading

2.3.1 Barter

Barter takes many forms. However, the essence of any type of barter transaction is simply the exchange of one product (whether a good or a service) for another (e.g., one antelope hide for so many ears of maize, or a shipload of oil in exchange for fertiliser). This type of exchange is what is known as simple barter (or straight barter, or pure barter).

- *Deferred payment*: Traditionally, barter transactions occurred simultaneously. However, even in primitive markets, deferred-payment arrangements could be made (e.g., one sheep a month in exchange for 100 bushels of wheat after the harvest). This type of agreement created a type of barter credit.

- *Multiproduct trade*: The barter transaction could involve not simply the exchange of one item or service by each seller but several, or many on either side (e.g., beaver skins and deer pelts in exchange for grain, coffee, blankets, and tobacco). Since many products are not readily divisible (e.g., a dairy cow) and the seller's demand for the other's principal product may be limited (e.g., eggs), the expansion of the trading to include a variety of products greatly increases the flexibility of barter. When combined with the afore mentioned barter credit, multiproduct trade becomes even more flexible.

- *Multilateral barter*: Another method in addition to multiproduct barter for circumventing some of the inherent limitations of barter caused by the restricted need each party commonly has for the other's goods or services is multilateral barter: several parties exchange goods. For example, company A's wheat could be shipped to Company B, whose corn goes to Company C in exchange for fruit that is, in turn, shipped to company A.

With simple barter, there is a direct exchange of goods between two parties. Only a single contract is signed (in many of the informal deals, no contract is signed). The agreement (whether written or oral) will specify both the specific type and the quantity of the goods or services to be traded. No middlemen are typically required. The goods or services will not be transferred to third parties. No money is involved (except indirectly, since in monetary economies both parties will tend to bear in mind some approximate monetary value for both products offered and products received)(Korth, 1987:2-3).

Anyane-Ntow *et al* (1995:48) support this view when they write, "Barter is the simplest form of countertrade. It is a one-time, direct exchange of goods of equal value. The exchange is executed under a single contract between two parties and is consummated simultaneously or over a period of up to one year".

Examples of pure barter agreements are the following (Coetzer, 1995:100-101):

- After the fall of the Shah of Iran that country was unable to sell its crude oil in the international market, it therefore entered into pure barter agreements with various countries. In 1982 New Zealand delivered to Iran \$200 million worth of frozen lamb in exchange for crude oil. Iran, furthermore, entered into a pure barter agreement with Romania in 1981 for locomotives, tractors, oil, equipment, spare parts and consultancy services, with China in 1983 for meat and with Thailand in 1982 for rice.

- The bizarre is also sometimes present in this type of agreement. For instance, the Swedish rock and roll music group, ABBA, performed in the Soviet Union at one stage and was paid in various kinds of Russian products including chemicals.

2.3.2 Counterpurchase

A counterpurchase or parallel barter agreement could be defined as, a contract whereby an exporter undertakes to:

- sell to an importer, goods or services for cash or on credit, or partly for cash and partly for goods or services;
- to counterpurchase goods or services from that importer to the value of a stipulated amount; or
- to market such goods or services on behalf of that particular importer,

and which obligation to counterpurchase could be assigned by the exporter (Coetzer, 1995:105).

According to Hammond (1990:9), this is an agreement whereby the initial exporter buys or undertakes to find a buyer for a specified amount or value of unrelated goods from the initial importer during a specified time period. Where the arrangement involves goods only it is often referred to as "parallel barter". Such transactions often involve cash plus products under separate contracts for each item and hard currency.

Examples of counterpurchase agreements are (Coetzer, 1995:113-115):

- In 1984 Pakistan bought six aircraft from the American Boeing Company. For its part Boeing undertook to purchase Pakistani products at a countertrade ratio of 20%.

- In 1977 Volkswagen of West Germany sold 10,000 Volkswagen motorcars to East Germany and in return undertook to buy selected East German goods such as coal oil and machinery, over the ensuing two years for an equivalent value.

- In 1982 the government of Indonesia established an extensive counterpurchase scheme, which required all foreign exporter selling to the Indonesian Government to purchase Indonesian goods at a counterpurchase ratio of 100%.

The first transaction under the scheme was concluded in August 1982 with the purchase of $128 million worth of fertiliser by the Indonesian government.

2.3.3 Compensation/Buy-back agreements

The next type of countertrade is a very special form that has evolved primarily in response to the reluctance of Communist countries to permit ownership of productive resources by the private sector-especially by foreigners. The typical buy–back arrangement involves a company from abroad building a manufacturing or processing facility in a Communist country. The local government would own the factory. The assistance that the private-sector company provides may take forms such as the inflow of equipment, financial capital, patents, technical and managerial assistance, or distribution assistance. In exchange, the contract provides that the company will "buy-back" some of the output from the new facility at a reduced price (or even free) as its compensation.

From the viewpoint of the Eastern European host government, this arrangement provides valuable Western assistance without sacrificing control and sometimes with little or no commitment of local capital. Also, continued Western assistance in quality control, technical training, and so on is frequently required.

From the viewpoint of the Western company, this "buy-back" arrangement could provide access to untapped market in the former Communist world (e.g., many of the contracts involve the company receiving a share of the gross revenues from all sales by the local government as well as from what the company itself sells) and could provide an alternative source of low-cost production for Western markets (Korth, 1987:4-5).

Anyane-Ntow *et al* (1995:49) supports this description of buy-back when they write, "Buy-back is the fastest growing form of countertrade in terms of dollar value. Under this deal, the seller (usually an industrial firm) exports equipment and technology and agrees to buy back, over a period of time, a quantity of the products manufactured. The value of a buy-back is equal to or greater than the value of the original contract.

Although the original purchase may be made in cash, settlement is always the product. Buy-backs is transacted under two contracts and may involve a third party such as a trading house".

Some examples of compensation/buy-back agreements are (Coetzer, 1995:127-128):

- During the 1970s, a United Kingdom company, Guinness and Peat, contracted with Bulgaria in regard to the building of a furfural alcohol plant in Bulgaria. In respect of the relevant secondary contract, the UK company apparently still takes delivery of alcohol produced at that facility.

- In the early 1970s, an American company sold technology and equipment to Romania, which enabled Romania to build a tyre plant, and at the same time undertook to purchase a certain portion of the production of the particular plant.

2.3.4 Offset agreements

According to Coetzer (1995:130) an offset agreement could be defined as a medium term transaction under a protocol whereby an exporter sells goods to an importer under a principle contract, subject to the condition that the initial exporter undertakes, in terms of a secondary contract to:

- purchase from the importing country any components necessary for the manufacture of the particular goods;
- manufacture components of the imported goods in the importing country;
- allow the importing country to co-produce some of the components of the goods concerned;
- assemble the specific goods in the importing country;
- transfer technology to the importing country; or
- market a commodity of the importing country.

According to Hammond (1990:7) offset agreements are contemporary, reciprocal trade agreements for industrial goods and services mostly used in military-related export sales and services. It is in effect, countertrade in the defence sector. It is also used in the purchase of civilian aircraft and has grown to be the norm in the aerospace/defence sector. The purpose is to compensate the buyer for the consequence, economic or political, of acquiring a foreign good or service. There are two principle kinds of offset:

- *Direct offsets*: Involve compensation in related goods and usually involve some form of co-production, licensing or joint venture.

- *Indirect offsets*: Involve goods and services unrelated to the defence material being sold. These may involve raw materials, investments, technology transfers or tourism.

Coetzer (1995:131–133) adds that an important factor is that importers under offset agreements usually are foreign governments in those cases where governments buy from foreign companies on a large scale and where such governments insist that the seller offset the prices concerned in some way or another. Thus, these agreements are mainly used in connection with some form of government procurement contracts where the importing country considers it a priority to purchase the relevant goods. Offsets are primarily used in sales relating to military equipment and commercial aircraft. Virtually without exception countries want to build their defence systems, maintain those systems, build their own aircraft or ships, or their own high tech equipment. Offset agreements are also used by governments for the purchase of items other than military equipment and commercial aircraft.

An offset agreement operates in a manner similar to that of a counterpurchase agreement, but with the difference that the goods acquired by the exporter could always be used by it in his business.

Some important practical implications are that the conclusion of offset agreements certainly:

- enhances industrial development and domestic employment,

- facilitates technology transfer, and
- attracts foreign investment.

Consequently these agreements are particularly attractive to those developing countries which are more advanced and which are in a position to undertake technology intensive production.

It is important that whether the exporter markets the product of the sovereign country, or whether the firm manufactures part of its output in that country, both contribute to the hard currency supplies of the country concerned.

Some examples of offset agreements are (Coetzer, 1995:134):

- A United States aircraft manufacturer, McDonnell Douglas, agreed in 1982 to an offset transaction with Canada whereby Canada's 15 year obligation to purchase jet aircraft to the value of $2,4 million was offset by Mc Donnell Douglas agreeing to buy airframe components from Canadian suppliers as well as to find buyers for other Canadian products.

- During the 1980s, New Zealand called for tenders in connection with a major railway electrification project. Offers were made by many of the bidding consortia to purchase certain design, engineering and construction services locally, including the substitution of locally produced components for those items, which they would have imported into New Zealand.

- In 1987 the American aircraft manufacturer, Boeing, sold to the French government a number of AWAC (airborne early warning systems) aircraft with the offset condition that such aircraft should be fitted with Snecma engines built in France.

2.3.5 Clearing account agreements

A clearing account agreement is defined by Coetzer (1995:141-142) as a bilateral agreement between two governments, which is contained in a single document, concluded for a definite or indefinite period and in terms of which the parties agree to:

- open a common bank account
- extend to one another a line of credit
- purchase from one another, goods to a specified value or quantity within a specified period, which goods are valued in terms of a particular clearing currency or valued in terms of any other internationally acceptable unit, and
- balance the said account at the termination of the agreement or at certain intervals, as the case may be.

Korth (1987:4) describes clearing account barter as a more flexible format than either straight or parallel barter. With clearing account barter, each party agrees in a single contract to purchase a specified value of goods or services from the other country over a specified, often lengthy, period. Thus trade may be out of balance at the end of the first or even several years but will balance over the term of the contract.

Furthermore this clearing currency credit can often be used only within one country (although it can often be sold or transferred or switched to a third party). It is, in effect, a line of credit of a fixed amount, which is matched by a compensating line of credit in the other country. No money is actually involved in the trade in such barter. Each company or government thus provides the other with barter credit.

Frequently, clearing dollars can be used to purchase any of a variety of products. In other cases they can buy only a specified product. Nevertheless, clearing account barter generally allows greater flexibility to either or both parties in terms of both time of drawdown on the "lines of credit" and types of products available. This form of barter occurred mostly between former Communist countries or between former Communist and a less developed country (LDC). It is, however, becoming more common between LDCs. However there is nothing in the nature of clearing account barter that would logically prevent it from being used by two private sector companies in industrialized countries.

Information in regards to examples of clearing account agreements on a global basis is not easy to obtain, but in 1989 it was estimated by the Institute on Switch and Barter trade, New York, that approximately 83 countries had entered into at least one clearing account agreement each.

It further gauged that quite a number of those countries are engaged in numerous clearing account agreements. For instance at that stage the former Soviet Union was engaged in 30, Mexico 19, Brazil 17, and France in 12 such agreements. At the time of the assessment, 1989, the following agreements were, amongst others current:

- Morocco oranges for capital equipment from Soviet Russia;
- Egyptian cotton for Hungarian electrical equipment;
- In 1983, the Peoples Republic of China concluded a clearing account agreement with East Germany in order to exchange rice, canned fruit, vegetables and textiles for German scientific instruments, printing machines, trucks and chemical fertilizer (Coetzer, 1995:147-148).

2.3.6 Switch trading

Switch trading refers to the use of specialised third-party trading house in a countertrade agreement. When a firm enters into a counterpurchase or offset agreement with a country, it often ends up with what are called counterpurchase credit, which can be used to purchase goods from that country. Switch trading occurs when a third-party trading house buys the firm's counterpurchase credit and sells them to another firm that can make better use of them. For example, a United States (US) firm concluded a counterpurchase agreement with Poland for which it receives some number of counterpurchase credit for purchasing Polish goods. The US firm cannot use and does not want any Polish goods, however, so it sells the credit to a third-party trading house at a discount. The trading house finds a firm that can use the credit and sells them at a profit.

In one example of switch trading, Poland and Greece had a counterpurchase agreement that called for Poland to buy the same US-dollar value of goods from Greece than it sold to Greece. However, Poland could not find enough Greek goods that it required, so it ended up with a dollar-denominated counterpurchase balance in Greece that it was unwilling to use. A switch trader bought the right to 250 000 counterpurchase dollars from Poland for \$225 000 and soled them to a European sultana (grape) merchant for \$235 000, who used them to purchase sultanas from Greece (Hill, 1997:456-457).

Iran and Poland entered into a clearing account agreement to buy from one another \$1 million worth of goods per annum. Iran had to deliver oil and Poland shoes. At the end of the first year Iran had in fact delivered \$1 million worth of oil but Poland had only delivered shoes to the value of \$800 000. Trade between the two countries stopped at that stage, because the swing had reached its limit in terms of the bilateral contract. A switch trader then came into the picture. The switch house offered Iran \$160 000 in hard currency, which Iran accepted for its "purchasing position". Before making the offer, however, the switch house found a buyer in Africa who was willing to pay \$165 000 in hard currency for Polish shoes, which was allegedly worth \$200 000. As a consequence all parties were satisfied. Poland received oil, Iran received shoes and hard currency and the Africans acquired shoes for only \$165 000 (Coetzer, 1995:156–157).

2.3.7 The use of the different types of countertrade

In a resent study, which would be elaborated more upon in the next chapter Fletcher (1998: 517-519) gives us a break down of the use of the different types of countertrade between 1987 and 1996 in table 2.1 and figure 2.1.

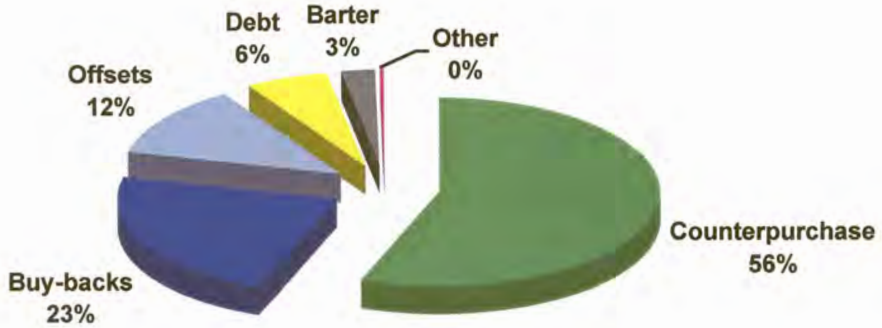
Table 2.1 Countertrade usage by type 1987-1996

	1987-90	1990-93	1993-96	1987-96
	(*n*=963)	(*n*=1114)	(*n*=503)	(*n*=2580)
Type	(%)	(%)	(%)	(%)
Counterpurchase	63,3	55,6	42,3	55,9
Buy-back	21,4	28,0	14,5	22,9
Offsets	7,2	10,4	25,8	12,2
Debt	6,9	4,1	9,6	6,2
Barter	0,4	1,9	7,8	2,5
Other	0,8	—	—	0,3
Total	100,0	100,0	100,0	100,0

Source: Fletcher (1998: 519)

From the information in table 2.1 it can be seen that world wide between 1987 and 1996 2580 cases of countertrade had been reported. Off these reported cases the majority namely 55,9 percent was through the use of counter purchase agreements followed by buy-back agreements with 22,9 percent. Third was offset agreements with 12,2 percent of the transactions, fourth was debt with 6,2 percent, barter with 2,5 percent and the other forms of countertrade with 0,3 percent of the reported countertrade transactions. Fletcher (1998: 519) also identified a form of countertrade which is not normally mentioned in studies on countertrade as a type of countertrade namely debt. Debt is of interest if a firm is owed or has frozen assets it wants to liquefy. So a country would exchanges goods or services in return for debt reduction.

Figure 2.1 Countertrade usage by type 1987-1996



Source: Fletcher (1998: 519)

Figure 2.1 gives a graphic presentation of the information discussed in table 2.1. It can be seen that counter purchase was the most popular form of countertrade worldwide between 1987 and 1996, followed by buy-backs.

2.4 ARGUMENTS FOR AND AGAINST COUNTERTRADE

2.4.1 Positive aspects

The arguments for countertrade may be summed up as follows (Townsend, 1986:21):

- For the Western exporter the prime advantage of countertrade is the possibility of gaining access to markets otherwise closed to him by virtue of a dearth of foreign currency. The problem of absence of credit facilities for the finance of this trade is also overcome. This is clearly an advantage for the importing country as well, since it gives access to goods sometimes highly essential to its economic progress, which would normally be beyond its reach.

- It is sometimes possible for the exporter to obtain a permanent foothold in the markets as a result of the initial delivery, obtaining repeat orders or supplementary orders for extensions or spare parts. These subsequent orders, especially spare parts, will not necessarily be subject to countertrade deals.

- Not all countertrade goods are difficult to dispose of and it may be possible for the Western exporter either to make use of them himself or sell them profitably to another Western user. In some cases it occurs that the countertrade merchandise delivered enjoys a demand in excess of the contractual value with the result that, more Western goods can be sold against further countertrade deliveries and a regular trade can be developed.

- Countertrade has given some developing countries the opportunity to increase exports and also to develop exports of products, previously little known, but nevertheless acceptable in Western markets. At the same time, particularly in the case of co-operation deals, countertrade has provided the means for developing countries to make significant strides forward in their domestic economies.

- Less scrupulous countertrade advocates see it as a means of enforcing Western investment in third world countries and overcoming trade barriers set up to protect Western markets.

Hill (1997:457) sees the main attraction of countertrade in that it can give a firm a way to finance an export deal when other means are not available. Given the problems that may develop and Third World nations have in raising the foreign exchange necessary to pay for imports, countertrade may be the only option available when doing business in these countries. He ads that even when countertrade is not the only option for structuring an export transaction, many countries prefer countertrade to cash deals. Thus if a firm is unwilling to enter into a countertrade agreement, it may lose an export opportunity to a competitor that is willing to make a countertrade agreement. Countertrade allows US firms to remain competitive with large Japanese and European trading companies, which for historic reasons are the masters of countertrade.

2.4.2 Negative aspects

The arguments against countertrade may be summed up as follows (Townsend, 1986:20-21):

- The system of countertrade promotes a departure from conventional commercial dealings, payment terms, and pricing, undermining the progress made in the field over decades while simultaneously the free market economy is sabotaged by a practice which inhibit free trade.

- Uncertainty and risk are increased particularly in view of the limited number of experienced and /or suitable personnel available and the rarity of experts with knowledge of the various techniques, which may be employed in a market, which has grown so rapidly.

- The practice is criticized on the grounds that it often leads to the dumping of countertrade products on Third World markets to the detriment of newly developed industry. The same could be alleged in respect of developed countries, but in their cases anti-dumping legislation and control tend to be more sophisticated.

- Countertrade is sometimes seen as a means by which those countries with foreign currency problems avoid facing up to their basic economic problems. Equally it is alleged that over the long term the system does not help developing countries as much as, for example, Comecon (communist economy) countries because the Third World lacks experience in this field.

- Somewhat unjustly the system is accused of, primitive, inefficient and even sinister dealing techniques. Although it is fair to argue that it has the effect of increasing costs and prices and thus distorting markets, nobody with practical experience of the modern countertrade market can seriously suggest that it has not achieved a high degree of professionalism and sophistication. Allegations of sinister or semi-illegal practices tend to relate back to post 1945 days when even conventional methods of trading were often suspect.

- The lack of international control and supervision of countertrade movements has led to suspicion and confusion regarding the actual volume of trade being transacted along these lines and its effect on the world economic system. There is undoubtedly some justification for this charge. Large multi-national companies are not required to divulge such information to any international authority and are most unlikely to volunteer such statistics even in the unlikely event that they could produce really accurate information.

- Seen from the point of view of the supplier of the countertrade merchandise there are not purely advantages but also problems, notably:
    - The normal pattern has been for such countertrade deals to be of a non-recurring nature; hence no long-term trade pattern is established. This is an important consideration, bearing in mind that the first countertrade is usually the most difficult to negotiate and that subsequently deals between the same partners for similar merchandise are much less complicated.

    - The rarity of voluntary repeat orders from the western recipient of the countertrade goods does not encourage a countertrade merchandise supplier to improve the quality of the range of goods offered, but instead results in lethargy.

    - The increasing tendency for Western recipients to resell the countertrade goods into third markets at low prices subsidised by the original exporter may ruin previously acceptable markets for the countertrade goods supplier. This occurs especially when the countertrade goods supplier has been inefficient or lacked experience when drawing up the countertrade contract, i.e. failing to adequately restrict resale of the goods in third markets.

According to Hill (1997:457) the drawbacks of countertrade agreements are fairly substantial. Other things being equal, all firms would prefer to be paid in hard currency. Countertrade contracts may involve the exchange of unusable or poor quality goods that the firm cannot dispose of profitably. For example, a few years ago a US firm lost money when 50 percent of the television sets it received in a countertrade agreement with Hungary were defective and could not be sold. In addition, even if the goods it received are of high quality, the firm still needs to dispose of them profitably. To do this countertrade requires the firm to invest in an in-house trading department dedicated to arranging and managing countertrade deals. This in itself can be expensive and time consuming.

According to Hammond (1990:47), an American George Schultz, once supposedly remarked that countertrade is "a communist way of doing business and the US government won't get into it". Hammond (1990:48-53) lists the following as possible arguments against countertrade:

- **Unlikely natural occurrence of "double coincidence of wants":** Countertrade rests on the concept of barter. Barter is an inferior method of exchange because it relies on the unlikely "double coincidence of wants". It is highly unlikely that two enterprises or nations will stumble on each other to exchange efficiently the things each has that the other desires. Hence money as a medium of exchange offers greater flexibility, for with it one can purchase nearly anything and exactly what one wishes, without intermediate barter to finally get what you want. An example of this is the Swedish rock group, which gave a concert in Poland and was paid in coal. They presumably sold the coal for cash rather than lugging it home to burn for heat.

- **Creates monopsony:** In that countertrade is essentially bilateral and restricts sales of a commodity, output of a plant or the exchange of specified goods and services to one purchaser, it is anti-market and promotive of monopsony. A monopsony is an economic system where there is only one buyer. From the seller's perspective, there can be no competition, no market; the seller has no control over the purchaser. How can a monopsonic arrangement increase trade and improve economic performance? Rarely is the entire output of a single product consigned to any one purchaser, but within the confines of a particular transaction, monopsony certainly exists.

- **Trade restrictive, not expansive:** There are many claims that it creates more trade than otherwise would have been. Such claims are impossible to verify and rests on the notion that the two-way trade that would have occurred if one of the items involved in countertrade had been bought for cash. But if the purpose of the transaction was to export something and import something else, both of which were needed, then it is merely another way of doing what would have occurred through the use of cash anyway. There is the possibility that one or the other of the items in a countertrade deal was neither desirable nor usable by one of the purchasing parties. If that is the case, then the inefficiency is obvious, for the purchase of unwanted or unneeded goods or services is unnecessary and uneconomical. If this is so, then additional trade may be created in unwanted or unneeded items.

- **Increase inherent transaction costs:** Though hidden, the cost of financing countertrade is higher than if access to regular credit markets was available. Telephone and travel, hotel and meal expenses during prolonged negotiations, translation fees, insurance – are all likely to be higher because of the time it takes to negotiate a countertrade deal. The lags and leads in the exchange process, increased marketing expenses, the duration of the contract or side agreements and the unforeseen costs that may be entailed in the transaction all means the cost of conducting countertrade are higher than a cash sale.

2.5 REASONS FOR USING/CONSIDERING COUNTERTRADE

The reason why nations and enterprises make use of countertrade can be classified into two categories. These are negative reasons, constraints and imperatives, which force nations and enterprises into considering or using countertrade whether they wish to or not. Then, there are positive incentives, opportunities and profitable initiatives available to enterprises and countries, which make countertrade an attractive option. According to Hammond (1990:28-33) the reasons why enterprises and countries become involved with countertrade are:

2.5.1 Negative incentives for countertrade

- **Large debt:** The number of basically insolvent nations who have had their debt "rescheduled", normally a euphemism for being in default of interest payments, alone grows annually. Given a lack of ready cash, countertrade becomes an increasingly attractive way of attempting to obtain needed imports without aggravating an already bad situation.

- **Trade imbalances:** If a country's trade is heavily skewed towards only a few trading partners and there are large trade imbalances, countertrade may be used to insure that the trade deficit does not grow any larger. In requiring exchanges of goods and services that can be arranged in advance, the deficit may be frozen. While not an answer to the basic dilemma, it allows some breathing space in order to attempt to get ones finances back in order. It also serves as a signal of determination to insure that things will not get worse and may, thus, be a spur for further debt restructuring. Alternatively it may be reduced by specifying certain joint ventures, licensing or co-production in the host country and thereby producing what may have been imported from abroad before.

2.5.2 Positive incentives for countertrade

- **Expanding markets and export promotion:** For countries of whatever circumstances confronted with difficulties in expanding markets and promoting exports, using countertrade as a vehicle whereby others must undertake to penetrate and create new markets may be a desirable strategy. Exports may be targeted into new markets or seek expanded market share through such devises as offset requirements, or long-term raw material supply via countertrade.

- **Effective management techniques in an increasing competitive environment:** In that countertrade has a follow-on impact, an element of additionality, business creation that would not have occurred in a purely cash transaction, then it becomes an effective marketing tool and management device to compete in an international environment. If one firm offers cash and another countertrade with a longer time commitment and "extra" opportunities in the same purchase, the latter may well be favoured over the former. Countertrade is good management in so far as it compels diversification, both in products, services and financial arrangements that would likely not exist in a cash sale environment.

- **Securing market expertise:** In effect, one is using another nation, company or countertrade broker as a marketing consultant and gaining marketing expertise and expansion in the process. This will work well only if the supplier country has its own personnel take advantage of the marketing training in conjunction with the host nation's efforts. Otherwise, no expertise is gained and no net marketing capability accrues. Seeing countertrade as a vehicle to enhance one's human capital is a critical requirement for it to work well.

- **Creative development strategies:** As has occurred with numerous countertrade and offset deals in countries as diverse as Belgium and South Korea, the national government may target the location of a particular joint venture plant to create development in a certain region, promote employment in a distressed area, encourage investment of a particular type, etc. the way in which this can be done requires some political and economic sophistication on the part of the country receiving the investment in plant and equipment as part of an overall internal development strategy.

- **Clearing out surplus goods:** Getting rid of an oversupply of a particular product or commodity is a business strategy which can be assisted through countertrade. Obviously, where the product may be inferior or non-competitive, as is often alleged in countertrade deals, this may be only delaying the inevitable. Much of what is offered for countertrade is an inferior quality of goods in large supply. Avoiding this is necessary for both the buyer and the seller if the strategy is to be mutually advantageous in the long run.

- **Less costly sources of supply:** If one is engaged in consummating a long-term deal for commodities, one may get a fixed price over a set period of deliveries. This price may be high or it may be low, but there is at least the possibility of locking in a particular volume at a fixed price. This simplifies pricing in what may be a volatile market. It may or may not redound to the advantage of both parties. For instance, a depressed agricultural commodity or mineral resource may be overvalued in the near term and undervalued in the long. The length of one's planning horizons the time for amortizing the investment is critical.

- **Upgrading manufacturing capabilities:** It may be technology transfer, training or obtaining necessary machinery that is most important in boosting exports and earning foreign exchange. Modest deals and marginal assistance in manufacturing processes, machine tools, quality control, packing or transport may make a major difference in one's ability to compete in certain markets or product sectors. Expansion of existing plant and equipment in a given area may be possible because of a long-term or high-volume contract as part of a countertrade deal.

- **Guaranteeing raw materials or component supply**: Guaranteeing sources of scarce or expensive commodities and components are an important concern in an increasingly competitive international environment. Long-term arrangements for components can be made an effective part of countertrade deals.

- **Taking advantage of political or military, rather than economic, incentives**: The rational for states to deal with each other may have nothing to do with short-term initial profitability or economic rational. They may be politically inspired as desirable for a number of reasons in pursuit of some large-scale purpose, or for tangential access, influence or control of some kind. We frequently forget that countertrade is as much politically inspired as economically necessary for many.

2.6 CONCLUSION

This chapter showed that countertrade is an umbrella term used to describe different types of reciprocal trade agreements. The six most common types of countertrade were shown to be: barter, counterpurchase, compensation/buy-back agreements, offsets, clearing account agreements, and switch trading. It was also shown that of the different types of countertrade used throughout the world, counterpurchase is being used the most followed by buy-back agreements. It was also shown that countries don't always have a choice in whether they want to use countertrade or not. Negative incentives like large debt and trade imbalances some times leave a country no choice other than to use countertrade if they want to trade internationally. On the other hand countries aren't always forced into using countertrade. Positive incentives such as expanding markets and securing market expertise make a country want to use countertrade when trading internationally.

The term developing nation was also defined in this chapter. In the next chapter it would be shown why South Africa is seen as a developing nation, and as South Africa is the focus of this study it is important to determine the role of developing nations in worldwide countertrade transactions.

CHAPTER 3
DEVELOPING COUNTRIES AND COUNTERTRADE

3.1 INTRODUCTION

In chapter two numerous reasons were given why enterprises and countries would want to make use of countertrade, for example large debt, expanding markets and export promotion, securing market expertise (Hammond, 1990:28-33), to mention but a few. This study however deals with countertrade in South Africa, and as a developing nation it is important to focus on the situation in the developing nations and why and to what extent they are using and are involved in countertrade.

South Africa can be classified as a developing nation according to Brink (1991: 100-101) who compared South Africa to the characteristics normally associated with developed and developing nations and found that South Africa compares most favourably with the characteristics of a developing nation. In the previous chapter Gamer's (1976: 8-9) definition of developing nations was mentioned and the entire African continent was listed as developing including South Africa.

According to Osmanczyk (1990:223*)* "developing countries are those in which large segments of the economy are still comparatively underdeveloped and the majority of the population very poor, although there are wide variations of gross national products (GNP) and per capita income".

3.2 THE PROBLEMS OF DEVELOPING NATIONS

According to Elderkin & Norquist (1987:32) the growth of countertrade is the result of three major trends at work since the Second World War:

- production overcapacity,
- international debt and
- the long-term impact of technology.

But the one that seems to have had the greatest impact on the growth of countertrade in Third World Nations is international debt.

The international debt of the Third World and especially that of Latin America is closely tied to the recent history of oil prices. Until 1973 low oil prices permitted the world economy to grow rapidly. But in 1973 the world experienced not only an oil embargo, but also a fourfold increase in the price of oil, which caused a recession in the West and an imbalance in the flow of oil payments.

In the years that followed the OPEC countries began receiving massive payments for their oil. Some countries used the money for public works projects and military hardware. But the money simply came in to fast. Not wishing to lose interest on the funds these nations deposited their money in Western banks, which then reused it to finance loans to the Third World. The banks looked upon Third World countries as an acceptable risk promising a high return.

Looking back, it is hard to believe that levelheaded bankers would have made many of these loans. At the time, however, the picture looked different. The growth rate of many Third World nations had been strong for a number of years, interest rates were high, and the loans were backed by "Sovereign" guarantees. Sovereign entities could not go broke, or so the bankers thought. If the growth rate of these countries had continued as projected and the money was used well, there would have been no debt crises. Net foreign exchange and the growth of the GNP would have been enough to offset the size of the debt in percentage terms. Furthermore, the projected increase in foreign exchange would have been enough to cover the interest and pay down the principle, thus avoiding a turnover of loans.

The Third World and Eastern bloc countries experienced a boom in economic growth in the mid-1970s. However, that growth was financed by borrowed funds. Meanwhile, in the Developed World the recession wore off, industry adjusted, and the entire economic system began to grow at an unprecedented rate.

In 1979 OPEC raised the price of oil by a factor of three, thus making the price of oil twelve times what it had been at the beginning of 1973. Even more money began to flow into OPEC coffers, money that OPEC nations again could not absorb. The money went back to Western banks, which in turn reinvested it in further loans to Third World countries. Only this time, the world never recovered from the oil price rise. Inflation in the Developed World was exacerbated by increased oil prices. When the economy of the Developed World slowed, demand for exports of Third World commodities slackened and prices plunged. Inflation forced up prices on many products and services, especially petroleum products. High inflation led to high interest rates, and high interest rates slowed the economy.

At the same time as oil prices rose, consumers conserved to a far greater extent than exporters had thought possible. Also, non-OPEC countries produced more oil. Thus, the rate of flow of dollars into OPEC accounts began to diminish. This reduced flow, coupled with the fact that OPEC countries were now spending more money on their own needs, slowed investment from these countries into Western banks. Suddenly the flow of new loan money into Third World countries was reduced to a trickle. At the same time, the recession in the developed world sharply decreased exports from the Third World. Increasing amounts of foreign exchange from Third World countries were needed to pay off oil imports. But Western banks no longer were willing to extend loans beyond rolling over outstanding debts. A number of Third World countries found themselves in dire straits. Growth rates had dropped to zero. In some instances growth rates even reversed themselves and descended into negative percentages. Against this backdrop, interest payments became so large that often there was no foreign exchange to import the goods and services needed to invest in industry and expand exports. Additionally, instability caused massive flights of capital and decreased internal investment.

In early 1986, the price of oil slid to below $15 per barrel. If it remained in this area, countertrade for some countries like Brazil might decrease as cash formerly used for petroleum is freed for other items. However, countertrade by oil producing countries may well continue due to competition. The irony is that countries, such as Iran and

Nigeria that once required those who sold to them to take overpriced oil as payment, may now be asked by their customers to be paid in goods rather than cash.

Not all the crises are attributed to oil prices. Good portions of Third World countries' problems are of their own making. Investments and loans made to the Third World in the 1970s were in many cases not effectively used. Stories abound about billions of dollars in investment and foreign aid being squandered on luxury items or siphoned back to personal bank accounts in the Developed World by social and military elite. Mr. Marcos of the Philippines and Baby Doc Duvalier of Haiti are but the most recent examples of this kind of activity.

European and Japanese society emerged from the Second World War with the educational and organisational talents of its people fairly intact. Third World people, on the other hand, begin with handicaps. These are:

- lack the pre-existing industrial base,
- advanced education,
- disciplined work force,
- technological skill,
- cohesive culture, and
- work and business ethics that made rapid rebuilding in Western Europe and Japan a reality.

Cultural constraints and ideology, likewise, have restricted economic growth in many parts of the Third World. This is especially true in Latin America, an area strongly influenced by socialism, centrality of the state, and mercantilism. Given Latin America's resources, these nations should be amongst the richest on earth. Other Third World countries run by elitist governments obsessed with large industrialisation projects, state controls of enterprises and oligopolistic industries have fared similarly. In fact, for the most part, only in those countries where the ruling classes highly supportive of business-as in the Pacific Rim-have the prospects dramatically improved. This has put the Third World in the position of being susceptible to financial distress in hard times and thus more likely to have to use countertrade (Elderkin & Norquist, 1987:33-36).

Hill (1997:310) supports this when writing, Third World economic growth was slowed and even stopped in the early 1980s by a combination of factors, including:

- Rising short-term interest rates worldwide (which increased the cost of debt).
- Poor microeconomic management in a number of Third World countries, in particular, inflationary growth policies.
- Poor use of funds borrowed by Third World governments (to finance consumption rather than investment).
- A slowdown in growth rate of the industrialised West, the main markets for Third World products.

The consequence was a Third World debt crisis of massive proportions. At one point it was calculated that commercial banks had over $1 trillion of bad debt on their books, debt that the debtor nations had no hope of repaying. If any major country had defaulted at this time, the shock waves would have shaken the world financial system. Many feared that if this were to occur, the resulting bank failures in the advanced nations would turn the widespread recession of the 1980s into a deep depression.

Against this background, Mexico, long thought to be the most creditworthy of the major Third World debtor countries, announced in 1982 that it could no longer service its $80 billion in international debt without an immediate new loan of $3billion. Brazil quickly followed, revealing it could not meet the required payments on its borrowed $87 billion. Then Argentina and several dozen other countries of lesser credit standing followed suit. The international monetary system was facing a crisis of enormous dimensions.

Into the breach stepped the International Monetary Fund (IMF). Together with several Western governments particularly that of the United States, the IMF emerged as the key player in resolving the debt crises. The deal with Mexico involved three elements:

- Rescheduling of Mexico's old debt
- New loans to Mexico from the IMF, the World Bank, and commercial banks.

- The Mexican government's agreement to abide by a set of IMF-dictated macroeconomic prescriptions for it's economy, including tight control over the growth of the money supply and major cuts in government spending.

Orchestrating this agreement required the IMF to persuade approximately 1600 commercial banks that had already lent money to Mexico to increase the amount of their loans by 8 percent. The IMF's success in pulling this off, first for Mexico and later for other debt ridden Third World countries was no small achievement. However the IMF's solution to the debt crisis contained a major weakness: It depended on the rapid resumption of growth in the debtor nations. If this occurred, their capacity to repay debt would grow faster than their debt itself, and the crisis would be resolved. By the mid 1980s, it was clear this was not going to happen. The IMF-imposed macroeconomic policies did bring the trade deficit and inflation rates of many debtor nations under control, but it was at the price of sharp contractions in their economic growth rate.

By 1989 it was obvious that the debt problem was not going to be solved merely by rescheduling debt. In April of that year, the IMF endorsed a new approach that had first been proposed by Nicholas Brady, the U.S. Treasury secretary. The Brady Plan as it became known, stated that debt reduction-as distinguished from debt rescheduling-was a necessary part of the solution and the IMF and World Bank would assume roles in financing it. The essence of the plan was that the IMF, the World Bank and the Japanese government would each contribute $10 billion to the task of debt reduction. To gain access to these funds, a debtor nation would once again have to submit to a set of imposed conditions for macroeconomic policy management and debt repayment. The first application of the Brady plan was the Mexican debt reduction of 1989. The deal, which reduced Mexico's debt of $107 billion by about $15 billion, has been widely regarded as a success.

Thus when taking the debt crisis of most of the Third World countries into consideration with Hammonds (1990:28) view that given a lack of ready cash, countertrade becomes an increasingly attractive way of attempting to obtain imports without aggravating an already bad situation. It seems that countertrade is a very attractive procurement tool for Third World Nations.

3.3 PROTECTING LOCAL ENTERPRISES

In a Developing Country, it is sometimes necessary for a government to regulate the economy to a certain extent. Whilst government regulatory policy should aim to achieve its goals in the international trade context and environment, it must also take into consideration:

- the support and development of local industry;
- the creation of employment; and
- other key issues of national priority such as the upliftment of previously disadvantaged sections of the community.

Therefore governments need to consider ways to protect local enterprises in the process of internationalisation. According to Bennett (1996:105-108) the following techniques for protection exist:

- **Imposition of restrictive tariffs.** The most common form of protection is the import tariff, namely a tax or customs duty imposed on goods crossing international frontiers. A tariff can be calculated as a specific amount of money per item imported or as a percentage of the value of the imported goods (ad valorem tariff). Tariff systems in general may be "single column" or "double column". The former apply the same duty to imports of a particular product no matter where the goods come from, the latter allow for the imposition of different tariff rates on imports of the same item from different countries.

- **Quantitative restrictions.** Import quotas impose definite limits on the number or total value of a certain item imported into a country. A quota system may operate on a "first–come first-serve" basis whereby any goods arriving after the quota limit is exceeded, are refused entry, or through the issue of licenses to certain companies and only allowing these businesses to import relevant products up to a specified amount.

- **Other non-tariff barriers.** These might include complex customs procedures and deliberate delays in processing documentation by customs officers, or customs authorities deliberately classifying products into inappropriate high-tariff categories so that the exporter has to initiate a time consuming and expansive appeal.

- **Other "hidden" barriers**. Other "hidden" barriers to the importation of goods can take any of the following forms:
    - insistence by the customs authorities that imported products undergo several safety checks, each one having to be conducted by an official from a different government department;
    - complex rules on packing and labelling;
    - restrictive specifications of technical product standards;
    - local content rules, namely requirements that in order to avoid import duties certain proportions of a product's inputs have to be sourced locally rather than being imported; and
    - state subsidies to domestic companies to help them compete with imported products.

- **Exchange controls.** Exchange controls can also be used to restrict or discourage imports. Exchange control can be done in different ways:
    - allocation of foreign exchange to selected importing firms;
    - the issue of foreign exchange licenses;
    - imposing queues and waiting lists for foreign currency distribution.

- **Countertrade.** Countertrade is an alternative to the aforementioned methods and can be used to great effect by governments to develop "infant" industries and to save domestic jobs. It was however already discussed in great depth in chapter two.

3.4 THE ROLE OF DEVELOPING NATIONS IN WORLD COUNTERTRADE

Using the research done by Fletcher (1998:519) it is possible to identify the Developing Nations role in international countertrade for the time period 1987 to 1996. Fletcher analysed the worldwide reported countertrade transactions between 1987 and 1996 (nine hundred and sixty-three (963) countertrade transactions from September 1987 to August 1990, one thousand one hundred and fifteen (1115) from September 1990 to August 1993, and five hundred and three (503) from September 1993 to August 1996).

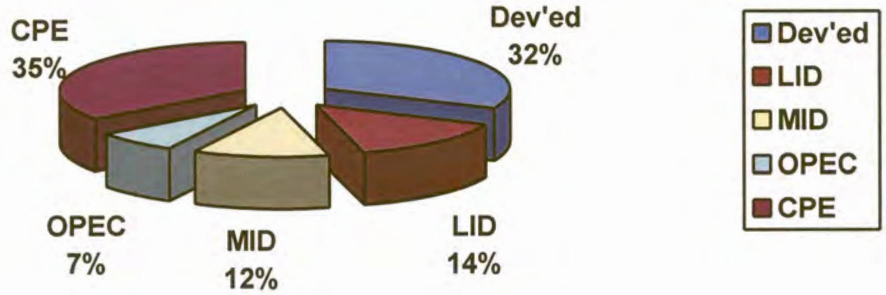
Table 3.1 and Figure 3.1 shows the regions in which the countries involved in countertrade between 1987 and 1996 are based - developed (Dev'ed); low-income developing countries (LID); middle-income developing countries (MID); Organisation of Petroleum-exporting Countries (OPEC); and formerly Centrally Planned Economies (CPE).

Table 3.1 Global Pattern of Countertrade Transactions

	1987-90	1990-93	1993-96	1987-96
	(*n*=1926)	(*n*=2264)	(*n*=1027)	(*n*=5217)
	(%)	(%)	(%)	(%)
Developed	**32,9**	**29,8**	**33,0**	**31,6**
LID	**20,5**	**13,1**	**5,3**	**14,3**
MID	**10,5**	**12,0**	**13,5**	**11,8**
OPEC	**7,6**	**6,7**	**8,3**	**7,4**
CPE	**28,4**	**38,3**	**39,9**	**34,9**
Total	**100,0**	**100,0**	**100,0**	**100,0**

Source: Fletcher, 1998:519

Figure 3.1 Global Pattern of Countertrade Transactions 1987-1996



Source: Fletcher, 1998:519

This gives us an indication of the amount of countertrade that the Developing Nations account for. With a combined total of 26,1 percent for all Developing Nations (both low income and middle income Developing Nations) of all the reported international countertrade transactions from 1987 to 1996.

Table 3.2 (Fletcher, 1998:522) shows the extent to which countries in one group countertrade with countries in another group.

Table 3.2 Comparison of Countertrade between groupings of countries

Table 3.2(a) Between Groupings of Countries 1987-1990

	Dev'ed	LID	MID	OPEC	CPE	Avg
	n=531	*n*=174	*n*=123	*n*=69	*n*=90	*n*=987
	(%)	(%)	(%)	(%)	(%)	(%)
Dev'ed	7,9	16,7	19,5	30,4	18,9	13,5
LID	15,1	26,4	23,6	31,9	48,9	22,4
MID	7,7	9,8	13,0	8,7	5,6	8,6
OPEC	4,9	13,2	14,6	____	15,6	8,2
CPE	64,4	33,9	29,3	29,0	11,1	47,3
Total	100,0	100,0	100,0	100,0	100,0	100,0

Source: Fletcher, 1998: 522

Table 3.2(a) indicates that out of their 174 reported countertrade transactions the LID countries had 16,7 percent of their transactions with developing countries, 26,4 percent with other LID countries, 9,8 with MID countries, 13,2 with OPEC countries and 33,9 with CPE countries for the period 1987-90. It seems that the bulk of the LID countries countertrade transactions between 1987 and 1990 was with the CPE countries.

The table also shows that the MID countries in the same period out of a total of 123 reported transactions had, 19,5 percent of their transactions with developed countries, 23,6 with LID countries, 13 percent with other MID countries, 14, 6 percent with OPEC countries and 29,3 percent with the CPE countries. Also in their case the majority of countertrade transactions were with the CPE countries.

Table 3.2(b) Between Groupings of Countries 1990-1993

	Dev'ed	LID	MID	OPEC	CPE	Avg
	n=582	*n*=112	*n*=177	*n*=63	*n*=181	*n*=1115
	(%)	(%)	(%)	(%)	(%)	(%)
Dev'ed	8,2	14,3	6,2	11,1	6,6	8,4
LID	14,4	22,3	18,1	20,6	17,1	16,6
MID	8,4	10,7	5,1	15,9	8,3	8,5
OPEC	5,7	8,9	12,1	6,3	10,5	7,9
CPE	65,3	43,8	58,5	46,0	57,5	58,6
Total	100,0	100,0	100,0	100,0	100,0	100,0

Source: Fletcher, 1998: 522

Table 3.2(b) shows the comparison of countertrade between groupings of countries between 1990 and 1993. In the table it can be seen that in this period the LID countries reported 112 countertrade transactions, of which 14,3 percent was with developed countries, 22,3 with other LID countries, 10, 7 percent with MID countries, 8,9 with OPEC countries and 43,8 percent with CPE countries. So for this time period as well, the majority of the LID countries countertrade transactions were with the CPE countries.

The MID countries had 177 reported countertrade transactions. Of these 6,2 percent was with developed countries, 18,1 percent was with LID countries, 5,1 percent with other MID countries, 12,1 percent with OPEC countries and 58,5 percent with CPE countries. So for the MID countries as well in this time period the majority of their countertrade transactions was with the CPE countries.

Table 3.2(c) Between Groupings of Countries 1993-1996

	Dev'ed	LID	MID	OPEC	CPE	Avg
	n=233	*n*=21	*n*=67	*n*=24	*n*=158	*n*=503
	(%)	(%)	(%)	(%)	(%)	(%)
Dev'ed	**20,3**	**42,9**	**20,9**	**37,5**	**12,7**	**19,7**
LID	**6,0**	**4,8**	**10,4**	**8,3**	**4,4**	**6,2**
MID	**9,1**	**4,8**	**29,9**	**16,7**	**11,4**	**12,7**
OPEC	**14,3**	**19,0**	**3,0**	____	**13,3**	**11,9**
CPE	**50,3**	**28,6**	**35,8**	**37,5**	**58,2**	**49,3**
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

Source: Fetcher 1998: 522

Table 3.2(c) shows the comparison of countertrade between groupings of countries between 1993 and 1996. Here it can be seen that the amount of countertrade transactions have decreased from the previous two periods. The LID countries had only reported 21 transactions. Off these transactions 42,9 percent was with developed countries, 4,8 percent was with other LID countries, 4,8 percent was with MID countries, 19 percent was with OPEC countries and 28,6 percent was with CPE countries. Thus in this time period the LID countries had the most countertrade transactions with the developed countries.

The MID countries reported 67 countertrade transactions, which also show a decline from the previous two periods. Off these transactions 20,9 percent was with developed countries, 10,4 percent was with LID countries, 29,9 percent was with other MID countries, 3 percent was with OPEC countries and 35,8 percent was with CPE countries. Again the majority of transactions were with the CPE countries.

Table 3.2(d) Between Groupings of Countries 1987-1996

	Dev'ed	LID	MID	OPEC	CPE	Avg
	n=1355	*n*=307	*n*=367	*n*=156	*n*=429	*n*=2614
	(%)	(%)	(%)	(%)	(%)	(%)
Dev'ed	10,1	17,6	13,4	23,7	11,4	12,5
LID	13,1	23,5	18,5	23,7	19,1	16,8
MID	8,2	9,8	12,3	12,8	8,9	9,4
OPEC	6,6	12,0	11,4	2,6	12,6	8,8
CPE	61,9	37,1	44,4	37,2	48,0	52,5
Total	100,0	100,0	100,0	100,0	100,0	100,0

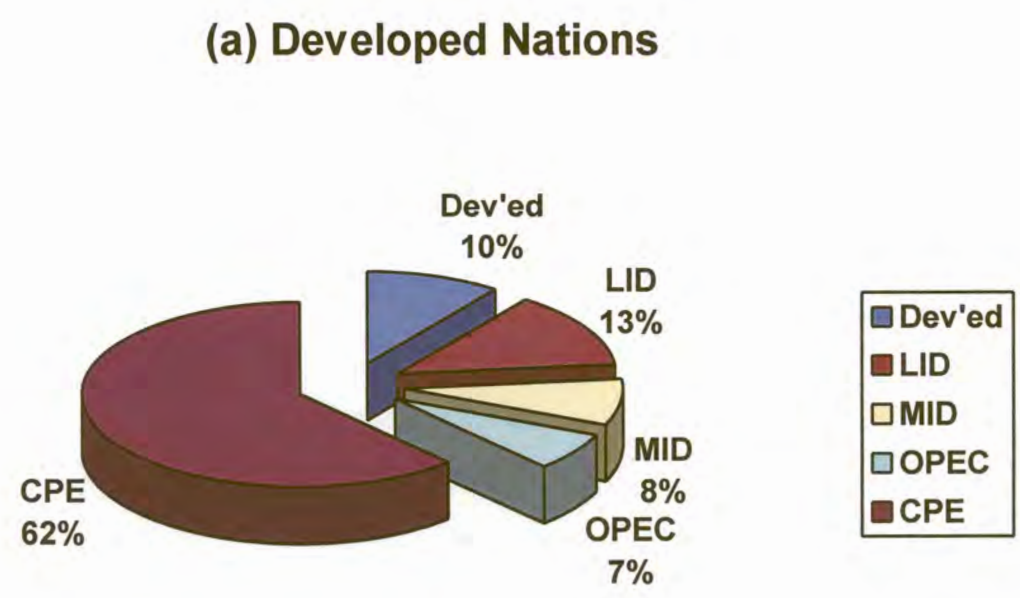
Source: Fletcher, 1998: 522

Table 3.2(d) gives a summary of countertrade between groupings of countries between 1987 and 1996. In this table it can be seen that the LID countries had a total of 307 reported countertrade transactions in this time period. Off these 17,6 percent was with developed countries, 23,5 percent was with other LID countries, 9,8 percent was with MID countries, 12 percent was with OPEC countries, and the majority of transactions between 1987 and 1996 was with CPE countries with 37,1 percent of the transactions.

The MID countries reported a total of 367 countertrade transactions in this time period. Off which 13,4 percent was with developed countries, 18,5 percent was with LID countries, 12,3 percent was with other MID countries, 11,4 percent was with OPEC countries and the majority of transactions was with CPE countries.

Thus both the LID and the MID countries conducted the majority of their countertrade transactions between 1987 and 1996 with the CPE countries with the exception of the 1993-96 period in which the LID countries traded more with the developed countries.

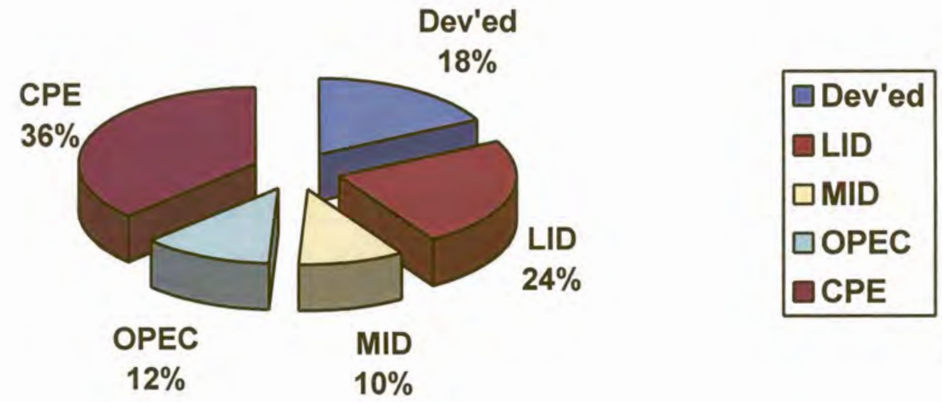
Figure 3.2: Comparison of countertrade between groups of countries 1987-96



Source: Fletcher, 1998: 522

Figure 3.2(a) – (e) gives a representation of the findings in table 3.2(d). According to figure 3.2(a) the developed countries had the majority of their countertrade transactions with the CPE countries 62 percent while their trade with the LID accounted for 13 percent and with the MID only 8 percent.

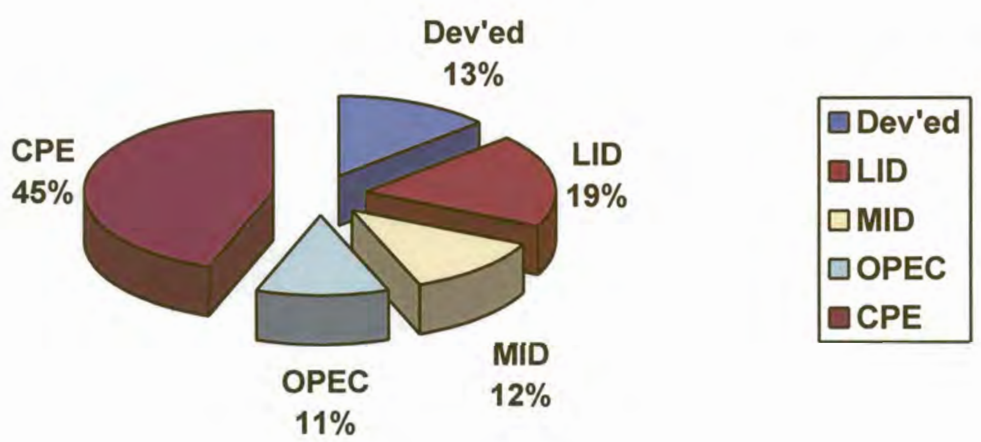
(b) LID



Source: Fletcher, 1998: 522

Figure 3.2(b) represents the earlier findings that indicated that the LID countries had the majority of their countertrade transactions with the CPE countries namely 36 percent and second most with other LID countries.

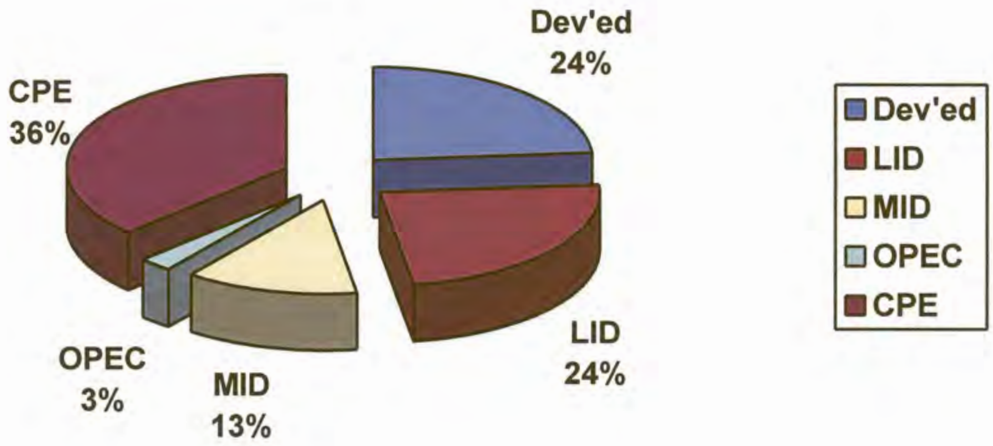
(c) MID



Source: Fletcher, 1998: 522

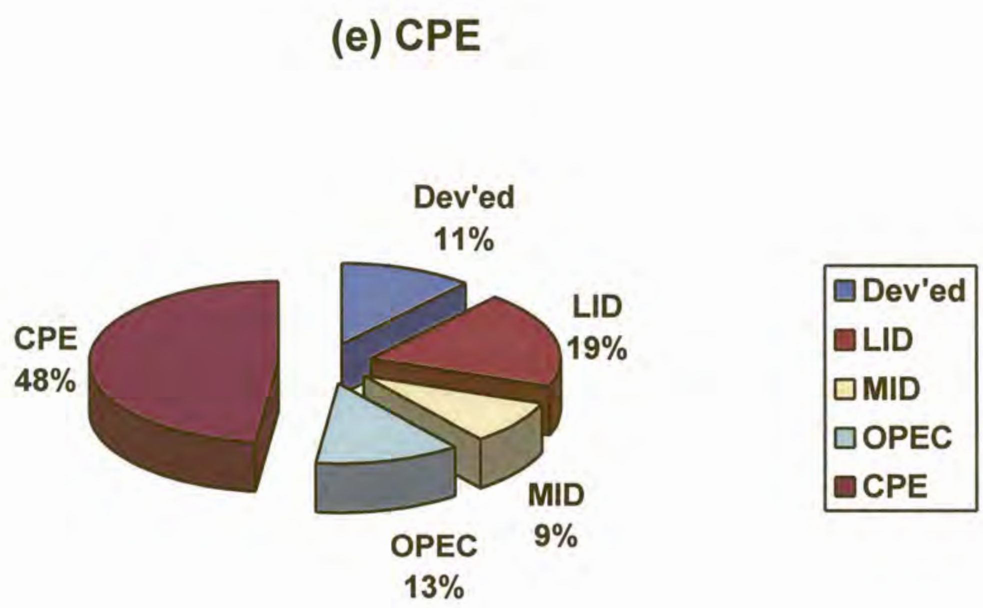
Figure 3.2(c) shows with the aid of an illustration that the MID countries conducted the majority of their countertrade transactions with the CPE countries namely 45 percent, just as the LID countries did, and that the second most transactions was with LID countries namely 19 percent.

(d) OPEC



Source: Fletcher, 1998:522

In figure 3.2(d) the OPEC countries countertrade transactions are broken up into different groups indicating that they also had the majority of their countertrade transactions with the CPE countries namely 36 percent followed by the developed and LID countries in joint second place on 24 percent each.



Source: Fletcher, 1998: 522

Figure 3.2(e) gives a graphic representation of the CPE countries countertrade transactions. In the figure it is clear that the CPE countries conducted the majority of their transactions with other CPE countries namely 48 percent while the transactions with the LID countries came in second with 19 percent. It seems from this information that the LID and MID countries do use countertrade extensively, but that the majority of countertrade is conducted by the CPE countries.

In conclusion Fletcher (1998:527) is of the opinion that the LID countries are more likely to use countertrade to:

- dispose of surplus, obsolete or perishable products;
- secure government contracts;
- gain entry into new or difficult markets;
- circumvent an overvalued or blocked currency.

Whereas the MID countries are more likely to use countertrade to:

- line up sources of supply;
- increase sales volumes;

- increase profit;
- generate goodwill for the firm/country.

3.5 CONCLUSION

Countertrade is used by Developing Nations throughout the world as can be seen in the reported cases of countertrade between 1987 and 1996. However it seems that the majority of countertrade with the Developing Nations has come from the former Centrally Planned Economy countries or former East bloc countries, as they are also known. The use of countertrade can be attributed to three major trends since the Second World War namely: production overcapacity, international debt and the long-term impact of technology. Especially the impact of international debt after the international oil crisis has led to the increased use of countertrade by developing countries. Developing countries make use of countertrade extensively as can be seen from the reported cases of countertrade between 1987 and 1996 where developing countries accounted for 26,1 percent of the reported 5217 cases of countertrade worldwide. It however seems that the amount of countertrade used has been declining in the last couple of years from 1993 to 1996. One of the reasons for this can be the implementation of the WTO's GPA, which came into effect on the 1st of January 1996. The object of the GPA is to subject government procurement to international competition by extending the General Agreement on Tariffs and Trade (GATT) principles of non-discrimination and transparency to the tendering procedure of government entities. It applies however only to WTO members who have signed the agreement (Hoekman & Mavroidis, 1997:13). This agreement as well as the influence of the WTO on countertrade will be discussed in the next chapter.

CHAPTER 4
THE REGULATORY ENVIRONMENT OF COUNTERTRADE

4.1 INTRODUCTION

Chapter three dealt with Developing Nations and their role in countertrade. It was mentioned that there are certain techniques that the Developing Nations can use in order to protect its local economy. These techniques are however being fazed out by the World Trade Organisation (WTO) and are not as available to countries for economic protection. Established in 1995 as the successor to the General Agreement on Tariffs and Trade (GATT), the WTO is an international organisation that is "writing the constitution of a single global economy", according to the former WTO Director Renato Ruggiero. The WTO aims to increase global trade by reducing restrictions on cross-border commerce, such as tariffs (taxes on imports)(Alpert, 1999). One of the WTO agreements in particular was mentioned in the previous chapter as a possible reason for the declining use of countertrade in the last couple of years, namely the Agreement on Government Procurement (GPA). This chapter will deal with the WTO and the GPA and consider their influence on countertrade in particular.

4.2 THE HISTORY OF THE WORLD TRADE ORGANISATION

During the early 1930's, the world's leading trading nations were deep in recession. They reacted to the situation by introducing a series of highly protectionist measures. These measures, far from resolving the situation, merely served to undermine international trade.

Near the end of the Second World War, the United States and the United Kingdom, mindful of the negative consequence of uncontrolled trade protectionism, and seeking to avoid the economic events of the 1930's, began to discuss plans for a post-war system of regulating world trade.

These bilateral discussions were broadened in 1946 when a Preparatory Committee was set up, under the auspices of the United Nations Economic and Social Council, to produce a draft constitution for the International Trade Organisation (ITO). The ITO was intended, in conjunction with the World Bank and the International Monetary Fund (IMF), to form part of a trio of multinational organisations pledged to furthering economic development. More specifically, it was intended to put into place rules designed to discipline world trade whilst, in addition implementing regulations relating to such divers areas as employment, commodity agreements, restrictive business practices, international investment and services.

Whilst discussions about the ITO were taking place, a group of 23 participating countries began to negotiate a series of tariff concessions and certain free trade principles designed to prevent the introduction of restrictive measures amongst themselves. During a six-month period in 1947, significant tariff reduction negotiations were held which resulted in 45 000 binding tariff concessions from the participant countries affecting about $10 billion in trade. Pending the establishment of the ITO, these binding tariff concessions and certain trade liberalisation principles became an integral part of the GATT signed in Geneva on October 1947 by these 23 countries.

GATT was not intended to be a fully independent legal body. Its function was to act as an interim measure to put into effect the commercial policy provisions of the ITO. However, although 53 countries finally signed the ITO Charter in March 1948, the decision of the US Congress to vote against its ratification left GATT as the sole (interim) framework for regulating and liberalising world trade.

The GATT mandate was to oversee international trade in goods and to gradually liberalise that trade by means of progressive reductions in tariff barriers. The furthering of trade liberalisation was to be achieved by negotiation "Rounds" held between various GATT contracting parties on a regular basis. The establishment of the WTO could bring the need for GATT "Rounds" to an end. In the future, discussions about the liberalisation of trade will be ongoing, under the day-to-day direction of the General council of the WTO. Major policy decisions will then be adopted at the Ministerial Conference - the top tier of the WTO structure - every two years. A new negotiations round may however be necessary if the broadening of the WTO to cover such areas as labour, standards, environment and competition is deemed desirable.

The setting-up of the WTO should, in time, permit a greater degree of liberalisation of trade than under the GATT "Round" system of negotiations and with less of the accompanying trauma. The General Councils and Committees will be permanently engaged in monitoring and rendering effective the Uruguay Round Trade Agreements. As part of their function, they will discuss ways of further improving world trade. Although the General Council cannot itself take major policy decisions, it can discuss and instigate discussion about them. The advantage of this continuous negotiating forum is that by the time the Ministerial Conference take place (every two years), many ideas for liberalising trade will already have been thoroughly debated and a consensus agreed. These strengthened WTO structures will make it easier for final decisions to be made at the Ministerial Conference itself. It was precisely this lack of advance planning and consensus that caused the later GATT rounds to become increasingly tied down and contentious (Adamantopoulos, 1997:1-4).

Not everyone is however completely satisfied with what the WTO is doing. The Economist (2000:91) writes that diversity is generally a good thing, not least in international trade. It is precisely because countries are different that free trade makes all of them richer, since each benefit from what others do better. So it is odd that, in one important respect, the WTO is trying to make its member countries more alike. It enforces minimum intellectual property standards, not only in rich countries, but also, since 1st January 2000, in many developing ones. If Thailand, say, fails to stamp out counterfeit Louis Vuitton handbags and pirated Viagra, France and the United States can seek WTO approval to retaliate by imposing trade sanctions. This sets an unfortunate precedent. After all, outlawing products made in ways that are copyrighted by others is not very different from banning goods made by children or shrimp caught in ways that harm endangered sea turtles. So if intellectual-property standards are applied, why should the WTO not also enforce minimum labour and environmental standards too?

So it seems that the WTO is not without controversy, according to Alpert (1999) in general, the WTO has adopted rules, which are in the interest of trans-national businesses and rejected rules opposed by business. Representatives of "civil society", such as unions, consumer activists, environmentalists, indigenous people, and women's groups, have protested WTO policies. In Mexico, where a currency crisis threw the nation into depression shortly after implementation of NAFTA, small business owners were in the streets too, opposing "free trade". Poor countries of the global south, which disagree with northern unions over labour protection, agree the WTO is not working in the interest of most people. Since the 1996 Singapore summit, which concluded the "Uruguay Round" of negotiations, the WTO has ruled against provisions of the US Clean Air Act, which would have blocked the use of dirty imported gasoline. The WTO ruled against European laws, which banned the sale of beef raised (in the US) with artificial growth hormones. Laws that ban the import of products made by child labour could be ruled illegal as well.

Bradley (2000:11) adds to this when he writes that the 135-member WTO is intended to ensure that member nations trade with one another fairly, and its rules are supposedly designed for that purpose. But fairness, like beauty is in the eye of the beholder. Many opponents of the organisation believe the rules are skewed if favour of big business and against workers and environmental protection. Conservative critics contend that the WTO infringes on national sovereignty, and unions argue that the rules make it easy for businesses to export good jobs.

4.3 THE WTO AND COUNTERTRADE

Multilateral trade - trade between more than two parties -, which is enforced by the WTO, is crucial for the enhancement of international trade. It seems, therefore, that to continue with lucrative international trade, the international trading community has no option other than to uphold the multilateral trading system. The crucial question that now has to be examined is whether or not countertrade agreements which is normally a form of bilateral trade, or trade between two parties, undermine the multilateral trading system?

At the outset it should be mentioned that countertrade agreements are, in principle acceptable in terms of GATT rules, provided that such agreements are not entered into on a discriminatory basis for non-economic reasons and in response to governmental policies and programmes. The conclusion of international countertrade agreements could, under particular circumstances, have disruptive and detrimental effects on international trade (Coetzer, 1995:384-386). In the next section the acceptability of countertrade will be examined against the Articles of the General Agreement on Tariffs and Trade.

4.3.1 The Most-Favoured Nation treatment

This rule is what is called the Most-Favoured-Nation clause or MFN clause, which is Article I of the Agreement. The term Most-Favoured-Nation (MFN) means that all GATT Members are bound to grant each other MFN treatment. The result is that no country could grant privileged trading advantages to another Member or discriminate against another such party. In practice this means that should country A, for example, cut its import tariffs on electrical appliances manufactured in country B by 10%, the resultant tariff will apply to the like electrical manufactured goods of all other Members. Thus, as far as tariffs are concerned, the general rule regarding MFN treatment means that the same tariff rate is charged with respect to a given product, notwithstanding the country of origin of the product.

When the language of Article I is examined closely, it is evident that nothing prevents a government from imposing any conditions falling within the provisions of Article 1 to the conclusion of international countertrade agreements. What is important, however, is that such conditions should be applied equally to all other Members, making them all subject to the same conditions. This could be illustrated in the following way.

Assume, for instance, that country X is a developing country with extensive tin reserves and that it purchases large amounts of grain from country Y. Country Y, on the other hand, is a developed Western country with a vast amount of marketing technology. As a condition for purchasing grain from country Y, country X requires that country Y must market some of its tin. Country A also sells grain to country X, but because country A has no marketing technology, country X does not require that country A should market any of country X's tin. The countertrade requirement imposed by country X against country Y is discriminatory, as it does not apply to country A as well. This conduct by country X constitutes preferential treatment of country A.

It is also quite possible, for example, for a government in regard to a particular countertrade agreement, to allow the entry into its territory of the countertraded goods concerned at a lower customs tariff than would have been the case under the conventional trade agreement. Should other Members be allowed to export like products into that country at the reduced customs tariff there would be no contravention of the provisions of Article I. However where the lower tariff only apply in regards to that specific countertrade agreement, in other words, where such tariffs are discriminatory against the other Members, such action would technically be in contravention of the GATT (Coetzer, 1995:386-388).

4.3.2 Tariff protection

Article II of the General Agreement pertains to the Schedules of Tariff concessions annexed to the General Agreement which set out the tariff concessions each of the Members make with respect to the products imported into their territories. The Schedule of Concessions comprises a Part I and Part II. Part I contains those concessions made with respect to the commerce of other Members who do not receive any preferential treatment. Part II contains the concessions made to countries eligible for preferential treatment, such as Developing Countries under the Enabling Clause. These concessions are the result of tariff negotiations in terms of Article XXVIII or renegotiations under Article XXVIII.

Paragraph 1 of Article II, which contains the crux of the Article, stipulate that:

- each Member shall accord to the commerce of all other Member treatment not less favourable than that which has been set out in the said Schedule of Concessions;
- the product imported into the territory of a Member shall "...subject to the terms, conditions or qualifications set forth" in Part I of the Schedule of Concessions of the importing country, be exempted from ordinary customs duties in excess of that stipulated in the said Part I; and
- the products imported into the territory of a Member and originating in a country that qualifies for preferential treatment, shall likewise "...subject to the terms, conditions or qualifications set forth" in Part II of the Schedule of Concessions of the importing country, be exempted from ordinary customs duties in excess of that stipulated in the said Part II.

Paragraph 1 further stipulates in subparagraph (b) and (c) that the products involved are also exempt from any "other duties and charges" pertaining to importation, in excess of those duties and charges imposed on the date of the General Agreement, "...or those directly and mandatory required to be imposed thereafter by legislation in force in the importing territory on that date".

The above stipulation entail that a Member is prohibited from affording protection to a particular domestic product other than the tariff which it had negotiated in regard to that product and which is contained in the Tariff Schedule of that Member.

Should a country therefore, provide protection to its domestic industries by the imposition of countertrade requirements, such measures would be inconsistent with the principle contained in paragraph 1 of Article II. On the other hand, should the country concerned include the relevant countertrade requirements as a condition in its GATT Schedule, such action would be acceptable. The apparent reason is that it would have been negotiated on a multilateral basis. This situation is now influenced by the provisions of the GPA that will be dealt with later (Coetzer, 1995:389-391).

4.3.3 The general elimination of quantitative restrictions

The general elimination of quantitative restrictions is dealt with in Article XI of the General Agreement on Tariffs and Trade. A quantitative restriction refers to a limitation placed on the amount of products that are permitted to be imported into the country that imposes the quantitative restriction. Quotas are, therefore, the primary target of Article XI. This Article accordingly prohibits the imposition of such restrictions on imports as well as on exports, irrespective of the fact that these restrictions are made effective through quotas; imports licences or export licences or what is called "other measures". The prohibition does not, however, pertain to taxes and what is called "Other charges".

From the above it is clear that Article XI deals with restrictions other than tariffs. At this point it would be appropriate to make a distinction the practical effects of quantitative restrictions and that of tariffs. In the case of the latter, international trade could continue irrespective of the rate of tariffs concerned, while in the case of quotas trade in the product involved, could come to a standstill.

A mandated countertrade requirement could thus prevent a particular enterprise from exporting to another country unless that enterprise accepts the said countertrade requirement. Moreover, as was pointed out above, such a requirement is in effect no different from a conventional import quota and when it is adjusted to particular circumstances, it could limit imports, for example, a particular amount of hard currency export. Say, for instance, that a country has imposed an import quota on the importation of a particular product and thereafter adjusts the quota in order to bring it into line with its level of exports, that quota would then contravene the provisions of Article XI. Accordingly, when the conclusion of countertrade agreements under mandated countertrade requirements have similar effects on private enterprises as quotas, such requirements is in violation of Article XI. Hence, governmentally mandate countertrade is nothing other than a trade restriction. It should, therefore, be said that whether a quota as mentioned above has been adjusted or not, is irrelevant, as any import quota is, in principle, contra the provisions of Article XI. To illustrate the point further, when government imposes a countertrade requirement, such a requirement inevitably has a detrimental effect upon international competition as prospective purchasers are forced to choose between a transaction based upon normal market factors and a transaction based upon the willingness of a seller to accept the mandated countertrade terms.

As far as the reference to import licensing in paragraph 1 of Article XI is concerned, it is quite clear from the wording of the paragraph that should the granting of an import license be conditional upon exports, for instance, by way of the conclusion of a countertrade agreement, such practice would be a restriction within the meaning of Article XI: 1 (Coetzer, 1995: 396 – 397).

These are however just some of the General Agreement on Trade and Tariff's Articles that the use of countertrade could be in contravention with. The other Articles that the use of countertrade could be in contravention of are (Coetzer, 1995: 392 – 407):

- Article III National treatment of internal taxation and regulation
- Article XIII Non-discriminatory administration of quantitative restrictions
- Article XV Exchange arrangements
- Article XVI Subsidies
- Article XVII State trading enterprises

It should be kept in mind that the rules of the General Agreement regulate the behaviour of governments and not that of private individuals or of private business enterprises. Consequently, should a private enterprise, for example, decide to import on a discriminatory basis, or, on the other hand, to impose one or other discriminatory condition to its international trade, such an action would fall outside the ambit of the provisions of the General Agreement (Coetzer, 1995: 408).

So GATT deals only with governments and their involvement in international trade and as was said previously, this research deals with countertrade or more specifically governmental countertrade. The involvement of governments in international countertrade agreements can take a variety of forms in that governments can impose countertrade requirements either directly or indirectly. Governments can, for example, be on the lookout for countertrade opportunities in order to impose countertrade requirements for purposes of improving trade balances (Coetzer, 1995: 386). But according to Evans *et al* (1994: 61) government procurement policies were explicitly excluded from GATT jurisdiction by Article III (national treatment) provisions of the original treaty. The State Trading article contains a little on the control of government policy, but otherwise government favouritism in procurement was not constrained by the original GATT. Dodds (1995: 8) adds to this when writing that the GATT allows favouritism of local industries in government procurement by explicitly exempting government procurement contracts from the core GATT obligation of non-discrimination against imported goods.

We can thus see that even though the WTO and GATT is apposed to the use of countertrade as it is a technique to protect local enterprises restrictive to international trade, government procurement, and thus governmental use of countertrade is excluded from the GATT. The WTO is however attempting to fill this gap with the GPA and through the GPA is trying to limit tie use of countertrade.

4.4 THE AGREEMENT ON GOVERNMENT PROCUREMENT

The GPA - originally negotiated during the Tokyo Round - was renegotiated for the second time during the Uruguay Round (1986-94). The revised GPA, signed in Marrakech on 15 April 1994, entered into force on 1 January 1996. It is one of the WTO's so-called Annex IV or Plurilateral Agreements, signifying that it applies only to WTO Members that have signed it (Hoekman *et al*, 1997:13).

Evans *et al* (1994:60-61) adds to this when writing the plurilateral agreements contained within the GATT are separated from the rest of the agreements negotiated under the auspices of the GATT, yet are part of the overall results of the Uruguay Round. These agreements are unique because they operate under the principle of "conditional MFN", rather than the principle of unconditional MFN in the rest of the GATT. This difference is essential to the operation of the agreement. Conditional MFN allows the negotiating parties to plurilateral agreements to operate separate "clubs" within the GATT. Under previous rounds no country could discriminate between other countries regarding access to its markets. Under the plurilateral codes a country is allowed to limit access to its markets to those countries, which have signed up to the code in question.

The objective of the GPA is to subject government procurement to international competition by extending the GATT principles of non-discrimination and transparency to the tendering procedure of government entities. The GPA only applies to those entities listed in schedules (Annexes) of each signatory nation. Over time, the entity coverage has been expanded through periodic negotiations, which are explicitly called for in Article IX: 6(b) of the Agreement.

These negotiations were relatively successful in expanding the reach of multilateral disciplines. The GPA initially exempted purchases of scheduled entities with a value of Special Drawing Rights (SDR) 150,000. According to Dodds (1995:10) SDRs are a basket of currencies used as an international unit of account. This threshold value was lowered to SDR 130,000 in 1988. At this time the Agreement was also extended to cover rental and leasing contracts, the time allowed for bid submissions was increased, and publication of information on winning bids became required. During the Uruguay Round the GPA was extended further to cover non-central government entities and the procurement of services, including construction. The enforcement provisions of the Agreement were also substantially strengthened. Despite these advances, membership of the GPA has largely remained limited to high-income countries (Hoekman *et al*, 1997:13).

4.4.1 Basic elements of the agreement

The objectives of the GPA are to contribute to greater liberalisation and expansion of world trade; eliminate discrimination among foreign products, services or supplies; and enhance the transparency of relevant laws and practices. The Agreement applies to any law, regulation, procedure, or practice regarding any procurement by entities listed in Appendix 1 of the Agreement. Procurement covers all contractual options, including purchase, leasing, rental and hire purchase, with or without the option to buy. A so-called positive list determines the reach of the GPA; it applies only to entities that are listed in Appendix 1 of the Agreement. The Appendix contains five Annexes of each signatory. There are three entity Annexes: Annex 1 lists covered central government entities; Annex 2 lists sub-central government entities; and Annex 3 lists all other entities that procure in accordance with the provisions of the Agreement. Annex 3 is a catchall category that includes entities such as utilities. The term entity is nowhere defined, reflecting the absence of consensus on what constitutes a public undertaking or entity. The entities that are listed in the three Annexes are subject to the rules and disciplines of the GPA with respect to their procurement of goods and services if:

- the value of the procurement exceeds certain specified thresholds; and
- the goods or services being purchased are not exempted from the coverage of the Agreement.

Annex 4 lists covered services, and Annex 5 covered construction services. The GPA covers only services expressly indicated by the signatory. Table 4.1 sets out the various thresholds that apply to the procurement of goods and services for the three types of entities.

Table 4.1 presented on the next page

Table 4.1: Thresholds in Annexes 1, 2 and 3 of the GPA (SDR thousands)

Category	Canada	EU-15	Israel	Japan	Korea	Norway	Switzer-land	US
Annex 1								
Goods	130	130	130	130	130	130	130	130
Services	130	130	130	130	130	130	130	130
Construction	5000	5000	8500	4500	5000	5000	5000	5000
Annex 2								
Goods	355	200	250	200	200	200	200	355
Services	355	200	250	200	200	200	200	355
Construction	5000	5000	8500	15000	15000	5000	5000	5000
Annex 3								
Goods	355	400	355	130	450	400	400	400
Services	355	400	355	130	450	400	400	400
Construction	5000	5000	8500	15000	15000	5000	5000	5000

Source: Hoekman *et al*, 1997: 15

As mentioned previously Annex 1 consists of central government entities; Annex 2 sub-central government entities; Annex 3 all other entities which are scheduled by Parties. In general Annex 3 comprises public enterprises or public authorities or public enterprises, including utilities.

There is some variance between signatories. For central government entities there is a common minimum threshold of SDR 130,000 for purchase of goods and non-construction services. Thresholds can be as high as SDR 15 million for construction services procured by non-central government entities. The product coverage of the Agreement is also determined by the Annexes. As far as goods are concerned, in principle all procurement is covered unless specified otherwise in an Annex. Thus, a negative list approach is used to determine the coverage of the GPA for procurement of non-defence related goods by scheduled entities. The procurement of goods by defence

Ministries or similar entities is often subject to a positive list: only items explicitly scheduled are covered. Procurement of services is also subject to a positive list: only the procurement by covered entities of services explicitly scheduled in Annexes 4 and 5 are subject to the GPA's rules, and then only insofar as no qualifications or limitations are maintained in the relevant Annexes.

Many parties have made explicit derogations to the commitments that are contained in their Annexes. These can be divided into two types. The first consists of a derogation from the non-discrimination requirement. Most signatories have made these. They generally specify that Party X will not apply the non-discrimination rule to the procurement by entities listed in Annex Y to firms originating in Party R, S or T until such time as X has accepted that the Parties concerned give comparable and effective access for X's undertakings to the relevant markets. This reflects a desire to achieve reciprocity on either a product and/or an entity basis. The second type of derogation pertains to commitments on services (Annexes 4 and 5) and specifies that listed services are covered only to the extent that other Parties to the GPA provide reciprocal access to their services. Canada, Finland, Korea, Switzerland and the United States have made such derogations. The mix of positive and negative list approaches for entities, products and services, varying thresholds, and the use of exceptions and derogations make it difficult to determine the effective scope of the GPA (Hoekman *et al*, 1997:14-16).

4.4.2 Non-discrimination

The two basic principles governing the GPA are MFN and national treatment (Article III). The former prohibits discrimination between foreign products; the latter prohibits discrimination between foreign and domestic suppliers. The non-discrimination obligation applies irrespective of the customs treatment of the product or services that affect the procurement contract. That is, they "shall not apply to customs duties and charges of any kind imposed on or in connection with importation, the method of levying such duties and charges, other import regulations and formalities, and measures affecting trade in services other than laws, regulations, procedures and practices regarding government procurement covered by this Agreement (Article III: 3).

Article III: 2 require Parties to ensure that covered entities do not discriminate between locally established suppliers "on the basis of degree of foreign affiliation or ownership" or "on the basis of the country of production of the goods or services being supplied". This provision was introduced during the Uruguay Round renegotiation of the GPA. The Tokyo Round Agreement spoke only of traded goods, i.e. products originating within the customs territory (including free trade zones) of Parties. Under the 1996 GPA, the words "originating within..." were deleted from Article III: 1. Non-discrimination therefore applies to both trade and sale through establishment (Hoekman *et al*, 1997:16-17).

Another description of the term National Treatment comes from Coetzer (1995:363-364): The Members of GATT have agreed that internal taxes, other internal charges, laws, regulations and requirements which could have an effect on the "...sale, offering for sale, purchase, transportation, distribution or use of products" in a domestic market, should not be applicable to products that are imported or to products that are produced locally, so as to afford protection to products domestically. The Members have also agreed that the same principle applies to the use of quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions in such markets. The implication of this is that it would be in order should internal taxes be increased on imported products, provided that the tax on the domestic product is also increased to the extent that the relevant tax would be the same for the imported as well as for the domestic product.

4.4.3 Tendering procedures

Three methods of tendering may be used by covered entities (Article VII and XIV): open, selective, and limited. All three may be complemented by competitive negotiations. Open or selective tendering are the preferred methods. Under open tendering procedures any interested supplier may submit a bid in response to a call for tenders. Selective tendering procedures involve a pre-selection of potential suppliers. This pre-qualification is usually intended to speed up the tendering process by determining a set of suppliers that satisfy the technical criteria required by the procuring entity. Entities that desire to have recourse to selective procedures are required to maintain lists of qualified suppliers. Signatories must publish such lists at least once a year in an agreed publication, specifying their validity and the conditions that need to be satisfied for inclusion of suppliers, including the methods used to verify that requirements are met (Article IX: 9). All suppliers that are qualified must be given the opportunity to bid.

Under limited tendering (previously known as single tendering), an entity contracts specific suppliers individually. This method is only permitted if their was no response to a call for tenders, in cases of urgency, for additional deliveries by an original supplier, or in case of additional construction services not intended to be included within the original contract. Limited tendering procedures may not be used "with a view of avoiding maximum possible competition or in a manner which would constitute a means of discriminating among suppliers of other Parties or protection to domestic producers or suppliers" (Article XV).

Negotiations may be used to complement the tendering process if entities have indicated their intent to do so in the call for tenders, or when it appears from the evaluation that no tender is obviously the most advantageous in terms of the specific evaluation criteria set forth in the notices or tender documentation. Elimination of participants in this context should be carried out in accordance with the criteria set forth in the tender document. In case of modification of the criteria, all remaining participants must be accorded an opportunity to submit new offers.

The GPA pays particular attention to fostering transparency. Article IX requires each entity to publish an invitation to participate for all intended procurement of goods and services covered by the GPA, except in the case of limited tendering. Summaries of procurement notices must be issued in one of the WTO's official languages (English, French or Spanish). Notice of planned or proposed procurement must include information on a minimum set of variables to ensure transparency, including the mode of procurement, its nature and quality, date of delivery, economic and technical requirements, amount and term of payment, etc. In publication of notices (call for tender), entities must specify that the procurement is covered by the GPA.

Article VI (Technical Specifications) require that specifications do not create "unnecessary" obstacles to international trade, "where appropriate" be expressed in terms of performance rather than design or descriptive characteristics and be based on international standards if these exist. The choice of specifications is entirely the responsibility of the procuring entity. The only limit to their discretion is the obligation not to create "unnecessary" obstacles to international trade (Article VI: 1). The question whether the choice of specifications is necessary or appropriate in order to achieve the desired outcome appears to escape judicial review, unless the obligation imposed by Article VI: 1 is interpreted in a wide manner. Similarly, the "appropriateness" test for the use of performance-based and international standards is a potential loophole.

For tenders to be considered for award, they must comply at the time of the opening with the notice and conditions of participation (Article XIII). Entities are legally obliged to award contracts to the tenderer who "has been determined to be fully capable of undertaking the contract" and who is:

- either the lowest tenderer; or
- the tender which in terms of the specific evaluation criteria set forth in the notice or tender document is determined to be the most advantageous (Article XIII: 4b).

Although determination of the lowest tender is clear-cut, procuring entities have substantial discretion in judging the capacity of the tenderer to fulfil the contract and determining who best meets the evaluation criteria. The main constraint on such discretion is what is specified in the notice or tender document. It would violate the Agreement were an entity to consider a tender as the most advantageous on the basis of evaluation criteria that were not specified in the notice tender documentation.

The foregoing requirements do not need to be followed if the procuring entity decides it is in the public interest not to issue the contract (Article XIII: 4B). This is potentially an important loophole in the GPA since the public interest in nowhere defined. The public interest clause could allow industrial policy considerations to be pursued by simply delaying contracts or reformulating them to better suit domestic bidders. The public interest provision has never been interpreted in the GATT case law. In part this may reflect the fact that entities have absolute discretion to formulate notices with respect to technical specifications within the limits of Article VI.

In contrast to other WTO Agreements (e.g. on subsidies), there is no obligation in the GPA to motivate (provide a reasoned explanation for) decisions to award contracts. Two provisions address this issue in substantially different ways. Article XVIII: 2 states that: "Each entity shall, on request from a supplier of a Party, promptly provide: pertinent information concerning the reason why the suppliers application to qualify was rejected, why its existing qualification was brought to an end and why it was not selected; and to an unsuccessful tenderer, pertinent information concerning the reasons why its tender was not selected and on the characteristics and relative advantages of the tender selected as well as the name of the winning tenderer". Article XIX: 2 provides that: "The government of a unsuccessful tenderer which is a Party to this Agreement may seek, without prejudice to the provisions under Article XXII, such additional information on the contract award as may be necessary to ensure that the procurement was maid fairly and impartially. To this end, the procuring government shall provide information on both the characteristics and relative advantages of the winning tender and the contract price. Normally the government of the unsuccessful tenderer may disclose this latter information provided it exercises this right with discretion. In cases where release of this information would prejudice competition in future tenders, this information shall not be disclosed except after consultation with and agreement of the party which gave the information to the government of the unsuccessful tenderer.

The need to motivate decisions therefore becomes operative only upon the request of unsuccessful tenderers or the intervention of the government to this effect. As the publication of the award of contracts require under the GPA merely has to identify the successful tenderer (without any motivation), justification only needs to be elaborated ex post facto following a formal request to the effect. This approach is at odds with other WTO Agreements (e.g. on subsidies and antidumping) and related case law, which require motivation of decision (Hoekman *et al*, 1997: 17-19).

4.4.4 Accession

Article XXIV: 2 GPA states that " Any government which is a Member of the WTO but which is not a Party to this Agreement may accede to this Agreement on terms to be agreed between that government and the Parties". Accession to the GPA therefore involves a negotiation between the interested government and existing members on the list of entities and services that will be scheduled. A Working Party to facilitate accession negotiations can be created upon request by the applicant country or by an existing member.

Article V GPA contains special provisions on special and differential treatment for Developing Countries, requiring that development objectives be taken into account during accession negotiations. Both during and after acceding to the GPA, Developing Countries may negotiate mutually acceptable exclusions from the rules on national treatment with respect to the entities, products or services that they schedule. Although Article V allows for deviation from the national treatment principle, the MFN rule is absolute. Developing Countries may also continue to use offsets as long as this is negotiated at the time of accession. Offsets may only be used as a criterion for qualification to participate in the procurement process and not as a criterion for the award of contracts Hoekman *et al*, (1997: 20).

4.4.5 Enforcement

There are various ways through which entities could avoid GPA obligations. Classic tactics in this regard include splitting of contracts to fall below the threshold value, abuse of technical specifications, short deadlines for submission of tenders, non-publication of calls for tenders, and the use of single or limited tendering. A number of these issues have been addressed in periodic re-negotiations of the Agreement. Thus, in 1996 GPA attempts to reduce the scope for circumventing by imposing deadlines, prohibiting splitting (Article II: 3), and establishing detailed rules on the content of tender documentation and award of contracts. It also embodies a requirement to establish effective bid protest mechanisms to give greater bite to such rules. The introduction of a challenge procedure (Article XX) is arguably the most innovative aspect of the GPA. The nature of procurement is such that most of the time, unless rapid action can be taken, inconsistencies with the Agreement will de facto be tolerated because firms will not have an interest in bringing cases to the WTO dispute settlement body. Even if they do, they risk confronting a situation where less than effective remedies are recommended. The creation of a bid-protest mechanism had long been on the agenda of some GPA members.

According to Article XX: 7, challenge procedure must provide for:

- Rapid interim measures to correct breaches of the agreement and to preserve commercial opportunities. Such action may result in suspension of the procurement process. However, procedures may provide that overriding adverse consequences for the interests concerned, including the public interest may be taken into account in deciding whether such measures should be applied. In such circumstances, just cause for not acting shall be provided in writing.
- An assessment and a possibility for a decision on the justification of the challenge.
- Correction of the breach of the Agreement or compensation for the loss or damage suffered, which may be limited to costs for tender preparation or protest.

These provisions are note worthy in allowing private parties to invoke WTO law before domestic adjudication bodies (Hoekman *et al*, 1997:17-20).

4.4.6 Limitations

Dodds (1995:10) identified the following limitations to the Agreement:

- Although the Agreement strictly forbids offsets, it does not apply to all government contracts by parties. Only those government entities listed in a member's annex that the member has agreed to make subject to the Agreement are covered. During the negotiations over the new Agreement, parties attempted to expand the coverage of the Agreement as far as possible. Some significant areas of government procurement however, remain uncovered. For example, because of the inability of the United States and the European Union to reach an agreement on the procurement of telecommunications equipment, this area is not covered by the Agreement and members have omitted the relevant procuring entities from their annexes.

- In other areas such as services and sub-central government procurement, the parties were able to negotiate coverage, but only on the basis of strict reciprocity. Departing from MFN treatment, parties did not extend equally favourable treatment to all other members. When they found that the offers of other parties were not as complete as their own, they reduced their offers accordingly, on a one-to-one basis.

- Another limit to the Agreement's coverage is that only those contracts above a minimum monetary value or threshold are subject to the Agreement. Thresholds vary slightly from country to country and range from approximately $85 000, or 130 000 SDR for central government suppliers to roughly $3 263 000 (5 000 000 SDRs) for construction services.

- The Agreement also provides some additional leeway for developing countries. Article V of the Agreement permits Developing Countries to negotiate "mutually acceptable exclusions from the rules on national treatment". Article XVI includes a narrow exception for offset use, allowing Developing Countries at the time of accession to the Agreement to negotiate conditions for the limited use of offsets. Offset requirements allowed under the exception may only be used for qualification to participate in the procurement process and not as criteria for awarding contracts. If China for example accede to the GATT/WTO as a Developing Country and, upon signing the Agreement, successfully negotiates conditions for the use of offsets, foreign suppliers could see only partial relief from offsets.

4.4.7 Concluding remarks on the GPA

Special provision has been made in Article XVI of this Agreement for countertrade transactions under the header "Offsets". The fact that this term is used to donate countertrade reiterates the confusion pointed out preciously regarding the use of countertrade terms. In chapter two dealing with the different types of countertrade agreements it was shown that the term offset is not a generic term, but it actually refers to a specific type of countertrade agreement namely, an Offset Agreement (Coetzer, 1995: 409).

4.5 CONCLUSION

Coetzer (1995: 411) writes that apart from the GPA under particular circumstances, the multilateral trading system does not prohibit the conclusion of countertrade agreements. Consequently, such contracts are indeed, largely permissible within the system. The advantage of concluding countertrade agreements are amongst others, that countertrade agreements, in many instances, ensure the international trade flow where conventional trade is not possible. Thus, from this point of view it could be said that although the conclusion of countertrade agreements could, as far as technical aspects of the multilateral trading system are concerned, contravene certain provisions of the various instruments in that system, international countertrade does not necessarily conflict with the overall goal of the system.

As far as the GPA is concerned, the South African government is not a signatory of this agreement and as this agreement is a plurilateral agreement that only affects the signatories it does not affect our government purchases. There are however expectations that the government will come under increasing pressure from its main trading partners to sign this agreement (South Africa, 1997: 99).
As the South African government is still allowed to use countertrade in their purchases it is important to determine what the best practices or procedures are in order to

successfully use countertrade as an economic development tool. These procedures will be discussed in the next chapter.