Counter-Trade: The Malaysian Experience

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ABSTRACT

A detailed explanation of the various types of counter-trade is presented, ranging from barter to counter-purchase to buy-back to offset. Apart from outlining the framework agreement on counter-trade, actual case examples of counter-trade deals undertaken in Malaysia are also highlighted. In this respect, counter-trade deals involving government-to-government transactions as well as deals entirely transacted on the basis of private sector involvement are also elucidated. By doing so, further explanations are given to explain modifications that need to be done to the existing counter-trade models, taking into account the peculiarities of each varying trading environment.

INTRODUCTION

The term counter-trade covers a multitude of different trade relations. These range from straight barter - say, oil for machinery - to complex industrial co-operation agreements between Western companies and Eastern European state agencies and of late, for transacting trade deals between developing countries intending to save the outflow of foreign exchange.

DIFFERENT TYPES OF COUNTER -TRADE

Barter

Goods and/or services are exchanged against other goods and/or services of equivalent value, and no money changes hands between the buyer and seller. In the simplest case, the goods being offered in payment are delivered to the exporter, and he tries to sell them. Often a third party - typically a specialist in this type of operation - agrees to take the goods and pay their value, less a discount, to the exporter. In a barter trade deal, the goods may come direct from the importer or from an exporting company in his country with which he has an arrangement.

Barter is generally described as being the earliest form of trade in history. Before money was invented, people traded by swapping goods. This simple idea lies at the base of many modern counter-trade techniques, although the detailed procedures adopted are more

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sophisticated, and typically involve actual or notional transfers of money as well as exchanges of goods and services.

Government-to-government clearing account arrangements often closely resemble barter deals in their practical operation and effects, but governments prefer to use other terms to describe them such a bilateral agreements and clearing accounts.

Nowadays, *pure* barter arrangements are relatively rare, although when concluded, they can cover transactions of considerable worth. Often such agreements are concluded on a government-to-government basis, and the motives for entering into them may be more political than economic or commercial.

Barter deals struck for commercial reasons include those in which commodity traders swap deliveries of equivalent products for delivery to their respective customers in different locations around the world, hence achieving savings on transportation costs.

Counter-Purchase

The seller undertakes to buy goods from the importer or from a company nominated by the importer, or agrees to arrange for their purchase by a third party. The value of the counter-purchased goods is an agreed percentage of the price of the goods originally exported. This type of agreement is the most widely used of all the counter-trade techniques. It is found particularly in the key industrial sectors - machine tools, transport supplies, and chemical and metallurgical products, for instance.

Separate contracts are concluded for the original export sale and for the counter-purchase. The second agreement sets out the general agreements to buy and the time period for performance. Usually, it does not specify the goods to be bought. Its entry into force should be linked with performance of the initial contract. Failure of the exporter to carry out his counter-purchase obligations is sanctioned by a penalty clause.

Buy-Back

Under such a scheme, an exporter of equipment agrees to buy the products produced by that equipment. This type of arrangement has developed rapidly since the late 1960s, mainly in long and medium-term projects, such as the supply of turnkey factories and mining materials.

Buy-backs are often known in the US as *direct compensation agreements*. It is essential that the buy-back agreement should contain precise particulars of the products to be bought - amount, type and delivery periods, for instance. A particular problem for the exporter is that he cannot control the production and quality of the products that he is obliged to buy.

Offset

The popularity of offset, a trading technique practiced by governments, has been increasing in recent years. Offset agreements usually cover government acquisitions concerning military and major civil procurements. In the civil sector, commercial aircraft and telecommunications deals frequently involve offset trading.

Typically, offset agreements are demanded in cases where countries are seeking to squeeze the maximum benefit from their investment in high-value areas. Purchases frequently are tied to requirements by the importing country for domestic content. Such demand may cover co-production arrangements involving transfers of advanced skills and technology, and include investment in manufacturing plant and undertakings to train and employ local technicians and other personnel.

Offset arrangements may be divided into two sub-categories-direct offset and indirect offset. Direct offset involves co-production arrangements based on transfers of production technology to the importing country. Such deals are used by the importing state as a tool for industrial development, domestic employment generation and as a means to finance payment balances.

Indirect offset occurs when the selling country agrees to purchase unrelated products from the country of the purchasing government. Such arrangements help the buying country - typically a Third World state - to claw back some of the cost of the imports.

Direct offsets are most often extracted by the governments of industrialized countries and Third World states at a relatively advanced stage of development. The technique is popular and frequently used by the governments of Australia and New Zealand.

FRAMEWORK AGREEMENT

The most common approach is for the parties to set out their general agreement to a counter-trade deal in a framework agreement. This will include as many details of the intended operation as practicable. When this method is used, the parties will normally adopt one of three basic schemes:

i. The framework agreement is entered into prior to the conclusion of any definitive supply contract or works contract. Typically, the agreement covers such matters as the following:

    - the total value of the purchases to be made in each direction;
    - the general types of goods to be bought or services to be supplied;
    - the currency in which the

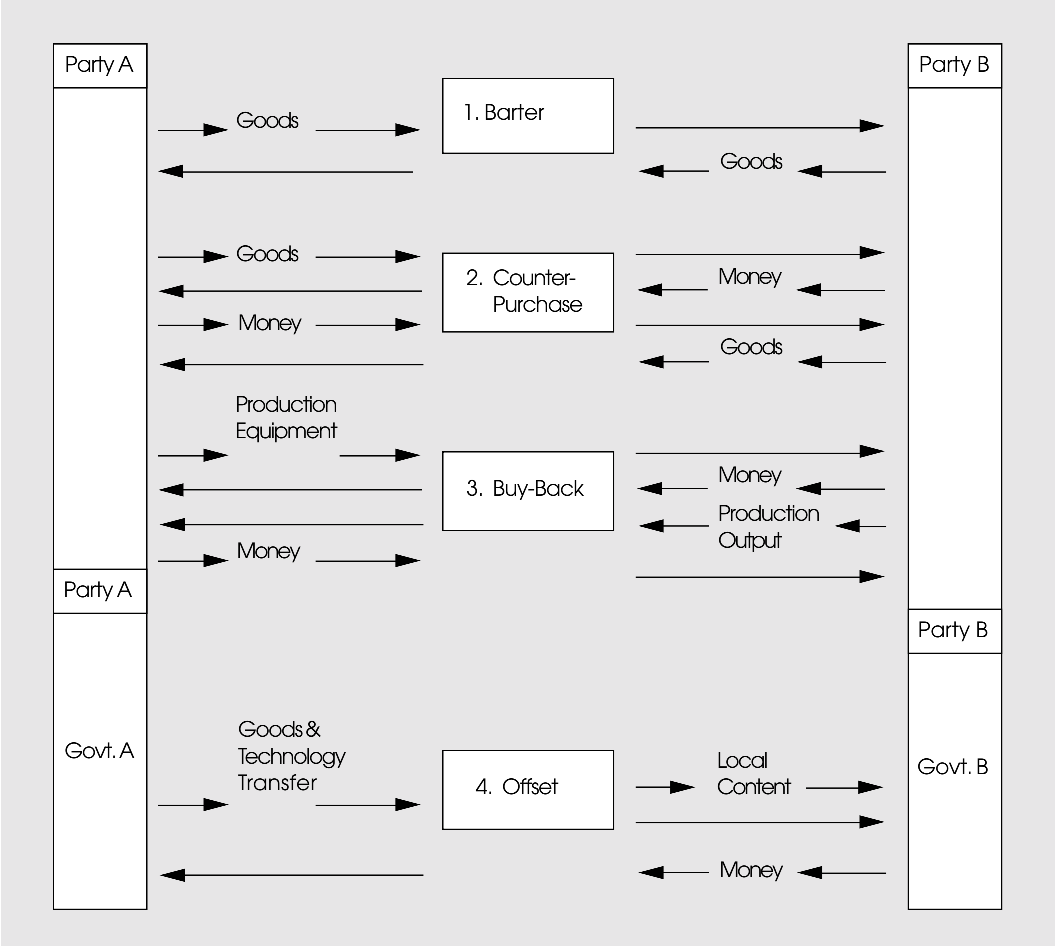

Figure 1. Various forms of counter-trade.

price is to be expressed and payment is to be made; and

- the payment procedures to be used.

Often when this approach is adopted, the agreement includes a provision that brings about the conditions stipulated on the suppliers to conclude counter-purchase contracts, since it is only when they have both bought and sold the counter-purchase goods that disposable cash will be obtained.

ii. The original supply/works contract and the framework agreement are concluded together. The framework agreement will usually be set out in a separate document, although it may be included in the original export or other supply/works contract.

iii. The framework counter-trade agreement, the original supply/works contract and the counter-supply/works contract are concluded at the same time. In this case, the framework agreement will contain only those provisions that link the other two contracts.

CASE EXAMPLES OF MALAYSIAN EXPERIENCES IN COUNTER-TRADE

Government Sector Collaboration

Ministry of Transport (MOT)/ MPOB /IRCON. This counter-trade deal involved the participation of the government of Malaysia and its related agencies/corporations.In this regard, MOT, on behalf of the government of Malaysia, agreed to offer the construction of a railway link in Tanjung Pelepas, Johor to the Indian Railway Company, *i.e.* IRCON International Ltd. (IRCON),a government of India undertaking.

This rail construction project, valued US$ 120 million (RM 450 million), is to be completed within 30 months.Payments to IRCON will be done by supplying palm oil with the same value equivalent of the contract.

The Ministry of Primary Industries(MPI),on behalf of the Malaysian Government involved in implementing this project, has appointed the Malaysian Palm Oil Board (MPOB) as its managing agent for disbursing payments to be made to selected Malaysian palm oil exporters for palm oil delivery to IRCON.Payments are disbursed based on work progress carried out under the works agreement. For the smooth functioning of this deal, MOT will transfer adequate funds based on progress payments into MPOB's account and MPOB, in turn, will pay six selected Malaysian palm oil suppliers the equivalent value in Ringgit Malaysia

The above counter-trade deal is a modified version of an offset arrangement, with expert technical services (the construction of a railway line) provided in exchange for the purchase of a commodity/ goods (*i.e.* palm oil). In this case, there is no outflow of foreign exchange.

Malayan Railway Berhad / Ministry of Transport (KTMB / MOT) / Pasir Gudang Edible Oils Group Sdn. Bhd. (PGEO) / General Electric Trading (GE Trading). In this project, KTMB / MOT has agreed to purchase locomotives from General Electric Transportation Systems, valued at US$ 64.5 million (RM 244.9 million). At the same time, PGEO Group Sdn. Bhd., on behalf of the Malaysian Government and a consortium of Malaysian palm oil exporters concluded a parallel counter-trade agreement with GE Trading. Under this counter-trade deal, payment will be made by GE Trading to the nominated consortium of Malaysian palm oil exporters by buying palm oil and palm kernel oil to the equivalent value of the locomotives.

MPOB has been entrusted with the responsibility of co-ordinating and verifying the exports done between the exporters and GE Trading towards fulfilling the contractual obligations as outlined in the GE Counter-trade Agreement.

This counter-trade arrangement can be considered as a modified version of barter trade technique, with the goods exchanged being locomotives for palm oil, but involving a tripartite arrangement, *i.e.* GE Trading, PGEO and KTMB / MOT.

Entirely Private Sector Collaboration

Padiberas National Bhd. (BERNAS)/ Vietnam Southern Food Corporation (VINAFOOD)/National Company for Vegetable Oils, Aromas and Cosmetics of Vietnam (VOCARIMEX). Another form of counter-trade deal is one that involves two parties entirely from the private sector. An example of this approach is a counter-trade deal that Padiberas National Bhd. (BERNAS) entered into with two companies in Vietnam to undertake counter-trade in rice and palm oil.

The companies are Vietnam Southern Food Corporation (VINAFOOD) and VOCARIMEX. For the purpose of this agreement, VINAFOOD will supply Vietnamese rice to BERNAS, while BERNAS will supply palm oil, including crude palm olein, crude palm stearin and RBD palm oil to VOCARIMEX.

Padiberas National Bhd. (BERNAS)/Federal Flour Mill Bhd. (FFM)/China, P.R National Cereal Oils and Foodstuffs Import and Export Corporation (COFCO). Malaysian companies, namely, BERNAS and FFM Bhd., have entered into counter-trade arrangements with China, P.R National Cereal Oils and Foodstuffs Import and Export Corporation (COFCO) to buy rice and maize (corn) in exchange for palm oil. This exercise has helped China, P.R to export some of its surplus rice and maize. The import quota for this exercise was over and above the normal annual (import) quota given to palm oil by the Chinese Government.

Both cases above can be signified as a typical form of barter trade, wherein goods are exchanged for goods, *i.e.* in the former case rice for palm oil, whilst the latter involves rice and maize in exchange for palm oil.

IMPLICATIONS OF COUNTER -TRADE

Counter-trade is one of the trading tools which not only alleviates the problem of foreign exchange shortages faced by developing countries, but which also helps to increase bilateral trade, especially amongst these countries.

But most important of all, by linking exports to imports, governments can select the volume and nature of imports entering their countries. This serves the purpose of obtaining only those imports considered desirable to the development strategy of the nations.

In the case of the Malaysian palm oil sector in particular, the adoption of a counter-trade arrangements is not only targeted at locking-in specific markets (namely India and the US) for a fixed amount of Malaysian palm oil intake, but also to generate additional export revenue for the palm oil industry through the development of new users coupled with new applications/uses for palm oil.

CONCLUSION

In the era of increasing globalization and trade liberalization, new and innovative methods for doing businesses must be adopted to stay ahead of the competition. To merely depend on the conventional mode of doing business will not be adequate to expand the export market for palm oil products as Malaysia is poised to see increased production of palm oil in the coming years.

Counter-trade, therefore, is one good example of innovative methods of trading, especially when dealing with or influenced by countries facing foreign exchange (forex) difficulties or are influenced by the policies of government, which restrict the outflow of much-needed hard currency.

In fact, involvement in counter-trade is a form of smart partnership that mutually benefits not only Malaysia,but also the counterpart countries as in the case of China, P.R and India. Whilst Malaysia was able to export a fixed quantum of palm oil to these markets, these countries in return successfully managed to sell their goods and services, which otherwise would not have easily made their way into Malaysia arising from the competitive nature of these products/ services.

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