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COUNTERTRADE AS A FORM OF DEBT PAYMENT; PERU'S EXPERIENCE WITH THE SOVIET UNION AND COMMERCIAL BANKS

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Introduction

This study reports on the use of an innovative new form of countertrade by Peru, developed as a means of paying off its international debt to the former Soviet Union and to commercial banks. The first section of the study reviews the types of countertrade typically used in international transactions and the varying motivations for them. The second section looks at some of the uses made of countertrade by developing countries, especially Latin American countries. The remainder of the study closely examines Peru's extension of the concept of countertrade by applying it as a form of debt payment.

What is countertrade?

A great deal has been written about countertrade over the last few years. As the concept has evolved it has taken a broad range of meanings. At present, the term countertrade involves practices that go beyond the simple contractual barter of goods. Countertrade is a particular form of cross-border transaction that is reciprocal in nature and takes on many forms which in turn can be defined in specific terms. Therefore, depending on the agreement we are referring to, countertrade can be a certain type of transaction in the form of barter, offset, compensation agreement, co-production, counterpurchase, compensating trade, switch trade, and so on.

Countertrade has become a significant phenomenon in international trade, particularly since the mid-1970s. By the end of the 1980s, nearly 100 countries were using countertrade and over half the Fortune 500 companies had countertrade divisions (Hammond, 1990). Banks with nonperforming loans in

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Less Developed Countries (LDCs) were also considering countertrade as a means of receiving repayment of these loans.

It is difficult to determine the true magnitude of countertrade in international trade because these transactions are not tabulated in standard national accounts. In addition, some countries are reluctant to report countertrade activity because multilateral organizations like the IMF and GATT disapprove of them. Most estimates of countertrade range from 10 to 20 percent of all international trade; however, some suggest that countertrade may be far more prevalent than previously thought and put the estimates much higher (Maier, 1988; Desta, 1987; The Economist 1986). Although countertrade was popular in the former Soviet Union and Eastern Europe, in recent years the share of countertrade among the LDCs grew faster than that of the now defunct Council for Mutual Economic Assistance (CMEA). As of January 1991, the former Soviet Union began enforcing its regulations against countertrade, particularly barter (Hamilton, 1991). However, even with the demise of Communist rule, countertrade transactions are still important and continue to proliferate. But strapped for cash and failing to meet its foreign debt payment obligations, Russia had to make payments in oil, timber and diamonds (Lesser, 1993). Recently even the U.S. has been encouraging compensatory practices with the former Soviet Union, Eastern Europe, and other LDCs (Neale and Sercu, 1993; U.S. Senate, 1991).

Countertrade has been practiced over the years in a number of formats and variants. Since these aspects concerning its purpose mechanisms and features have been thoroughly discussed in the previous literature (Elderkin and Norquist, 1987; Francis, 1988; Mirus and Yeung, 1993; Zurawicki and Suichmezian, 1991), only a brief review of them is presented here. Although definitions differ somewhat, countertrade arrangements can be grouped into three major categories: direct, indirect, and offset. Indirect countertrade involves unrelated products, are short-term, and have a low dollar value; direct countertrade are compensation deals and buy-backs; offsets are more complex and tend to be long-term involving large amounts of money. As Zurawicki and Suichmezian (1991, p.xi) stress, "given the complexity of countertrade and the creative uses that are possible, no doubt new definitions are likely to emerge."

Countertrade is seen by many as a reaction to a hostile business environment and a symptom reflecting the risks and distortions in international trade. The expansion of countertrade has been encouraged by the debt crises of many LDCs, growing protectionism in the developed nations, falling commodity prices, worsening terms of trade, declining exports, and Northern intransigence toward Southern demands for better treatment in the economic order (Griffin and Rouse, 1986).

Although countertrade is more of a selling technique than a financial tool, it has become a viable financing alternative in international transactions. Most recently, the concept of countertrade has been extended to cover international debt issues. The use of payment-in-kind for debt servicing became a desirable form of not only of canceling part of the outstanding debt but also negotiating future trade deals.

As Okoroafo (1992) has noted, LDCs which resort to countertrade are characterized by declining foreign exchange reserves, commodity terms of trade problems, balance of trade deficits, and increasing foreign debt service ratios. Countertrade has become a way of supplementing traditional finance in trade, and is a mechanism that could enhance the opportunity for liquidating part of the external debt. Debt-for-export deals have been gaining a certain credence and respectability as a means of reducing debt in LDCs. A major concern, however, is whether these deals can generate a sufficient quantity and quality of goods to trade (Berríos, 1993).

Many specific reasons have been offered for the growing use of countertrade agreements. The motivation for a barter transaction is often that one or both parties to the transaction have a nonconvertible currency and lack the hard currency necessary to pay for the transaction. This form of countertrade provides a trade financing alternative to indebted countries with liquidity problems. The decreasing ability of many LDCs to finance their imports through international bank loans has been perhaps one of the most important factors contributing to the proliferation of countertrade in recent years. Countertrade has also now become a means to finance capital projects and other investments (Tuller, 1992).

Since most of the other forms of countertrade involve payments in a hard currency or the use of credit, a shortage of convertible currency is not the only reason for countertrade. Counterpurchase agreements are often made for the purpose of developing markets for nontraditional exports of the original importing country or new markets for their traditional exports. For example, a country which is highly dependent on the U.S. market may use countertrade as a way of cultivating trade relations with other countries.

Countertrade has also become a viable means to acquire new marketing expertise. A counterpurchase may be preferred to the direct use of a trading company for marketing if the purchase of distribution services is subject to high transaction costs such as might occur if there is a need for substantial up-front investment costs. The literature on transaction costs also suggests that firms will vertically integrate when transactions costs involved in establishing long-term contracts are high. If vertical integration across borders is not possible because the host country discourages or prohibits foreign direct investment, then a buy-back arrangement may be the second-best solution (Hennart, 1989).

A variety of other explanations for countertrade have been proposed. A countertrade agreement may result from the desire to conceal the true price at which the goods are being exchanged or to avoid some quantity restriction on trade. For instance, some agreements involving oil may be a way around OPEC quantity and price restrictions. Apparently, countertrade agreements can also be used to get around tariffs and nontariff barriers to trade, as these restrictions are sometimes waived on a countertrade transaction (Hammond, 1990; Martin, 1990). In countries with international debt problems and/or exchange controls, countertrade agreements may be a way of avoiding requirements that all or a portion of export earnings be turned over to the government to service debt or for other uses (Hammond, 1990). For example, it is thought that the reason the former Soviet Union began prohibiting most of its enterprises from engaging in countertrade was that these entities were using it as a way of evading the requirement that they turn over 40 percent of the foreign exchange earned from exports to the central bank (Hamilton, 1991). In a world of generally floating and volatile exchange rates, countertrade techniques may also be less risky than a cash purchase to be paid at an unknown future exchange rate (Hammond, 1990). Finally, there may be political motivations for countertrade that have no economic rationale.

The Latin American experience

Countertrade is not a new phenomenon in Latin America. It has been used in its different variants (except perhaps offsets) in most countries in the region. During the 1980s, countertrade activities grew rapidly. Aside from the developing countries of Asia, Latin American countries have been the most active. Together Latin America and Far Eastern countries account for over half the LDC countertrade activity. East-South countertrade accounted for 21 percent of all developing country deals during the period 1980 to 1989, and nearly 30 percent of the CMEA-LDC countertrade was conducted with Latin America. South-South countertrade has also experienced a rapid increase. The most active LDCs in countertrade deals are Indonesia, China, India, and Brazil (Hammond, 1990). In Brazil, both the public and private sectors have been active countertrade participants since the mid-1970s. It is estimated that countertrade accounts for $2 to $3 billion of its annual trade. The state sector's countertrade transactions have mainly involved oil imports in exchange for exports of soya, steel, cement, textiles, food products, and manufactured goods. In 1983, for instance, Brazil arranged a countertrade deal valued at $4 billion with Nigeria and another at $2.5 billion with Qatar (OECD, 1985; Jones and Jagoe, 1988). The state petroleum company, Petrobas, even established its own trading company in 1976.

Although Argentina has generally followed market-oriented policies, the government established a number of countertrade agreements with the USSR and Eastern Europe, particularly involving energy imports and commodity exports (usually grain and beef). Argentina also has had bilateral clearing arrangements with most Latin America countries (Hodara, 1984).

During the ten years of Sandinista rule, Nicaragua implemented a number of projects with machinery and equipment provided by the former USSR and other East European countries. Some of these agreements involved the sale to these CMEA countries of coffee, cotton, and minerals in the form of clearing agreements. Cuba is perhaps the country that has used countertrade most frequently with its present and former socialist counterparts.

Other countries such as Colombia, Ecuador, Uruguay, Bolivia and Venezuela began encouraging countertrade in the mid-1980s. On the other hand, Mexico, which is sensitive to IMF monitoring and its closeness to its neighbor to the north, has not engaged in much countertrade (Business International, 1984). Interest in countertrade may now be declining in Latin America, though, given recent trends toward liberalized trade regimes and the growing importance of trade blocks such as MERCOSUR and the North American Free Trade Agreement (Verzariu, 1992).

Peru's countertrade experience

The remainder of this study concentrates on the types of countertrade arrangements Peru has conducted with various countries and regions and the motivations for these transactions. An attempt is made to evaluate the effect of these transactions on the Peruvian economy and its perspectives for the near future.

Peru has engaged in the use of compensatory practices on and off as far back as the early 1970s. It has conducted countertrade agreements with Japan, with the former Soviet Union and other ex-CMEA countries, with Western economies, and with other LDCs. The types of countertrade agreements and the motivations for them run the gamut of most described earlier in this study. In addition, Peru has pioneered the use of countertrade as a method of foreign debt repayment. Although strictly speaking this practice may not fit the traditional definitions of countertrade, it qualifies as an extension of the concept of countertrade. Thus, much of the remainder of this study is a description and analysis of this relatively new technique linking debt servicing with countertrade.

Early Countertrade Agreements

One of the earliest Peruvian countertrade agreements dates back to 1973 when, in return for constructing the Paita fishing complex started in 1971, the

Soviets agreed to be paid back partially in fish and fish products. This was a buy-back agreement, commonly used by the Soviets for their technical services and turnkey operations. The Soviets had supplied and installed generating and refrigeration equipment to process fish (Olshany, 1974; Peruvian Times, 1973). Another example of a buy-back agreement took place in 1974 when a consortium of Japanese companies built the $1 billion trans-Andean oil pipeline and, as part of the contract, Peru agreed to supply Japan with oil (Swansbrough 1975, p.123).

During the early 1970s Peru also engaged in several counterpurchase agreements that included switch trading or triangular arrangements. One triangular deal involved the Hungarian Central Bank, Peruvian exports of fishmeal and other commodities, and Western equipment suppliers (Andean Report, 1985). In another example involving a buy-back and switch trading, the Peruvian government contracted with a French firm in the early 1980s to build a petroleum refinery, for which the firm would be paid partly in refinery products. In turn, the French firm, which had built similar plants in Bulgaria, disposed of some of its countertrade obligations from Bulgaria by commissioning a Bulgarian engineering firm to supply and erect storage tanks for the refinery in Peru (Hoffman, 1987). Still another example of triangular countertrade was the arrangement between Peru and the USSR whereby Peru shipped goods to Nicaragua in 1986-87 as part of its debt payment to the Soviet Union in exports[1]. Although Peru did engage in some countertrade arrangements, primarily buy-backs, it did not have a uniform policy on countertrade and most of its trade took place in the traditional manner of exports and imports in exchange for hard currency or financial credit. However, with the prospects of dwindling trade credits and lack of foreign exchange from the West, countertrade took on a higher degree of importance in 1983; in this year the Peruvian government renegotiated overdue debt to the USSR, then registered at $1.1 billion.

Peruvian Trade Relations with the USSR and Eastern Europe

Since Peru's countertrade relations often involved the former Soviet Union and other CMEA countries, a brief review of its trade relations with these countries is presented. Diplomatic relations between Peru and the former Soviet Union were established in February 1969, during the military regime of General Juan Velasco. This opening paved the way for the signing of trade agreements and the formation of bilateral commissions to exchange goods and to find other areas of cooperation. Commercial agreements were generally for three to five years with annual protocol meetings to fix the list of products exchanged. These trading arrangements in most cases did not constitute countertrade (except for a few buy-back arrangements mentioned before) since they were paid for with hard currency or credit. However, compared to the world market, the terms of trade with the Soviets were concessionary: generous grace periods for trade credits, low interest rates (ranging from 2.5 to 7.0 percent), and up to ten years for repayments as well as guaranteed stable prices (Lavigne, 1988).

Initially trade between Peru and the Soviet Union was concentrated in a few commodities. The Soviets basically purchased raw materials from Peru and sold it machinery, scientific equipment, oil, and power generating equipment, fertilizer and chemicals. Thus their commercial relationship was similar to that between Peru and the advanced Western economies. However, Soviet goods were generally cheaper than Western goods, of acceptable quality, and adequate for Peru's development needs (Berrios and Blasier, 1991). Although no clear conclusions can be drawn on the gains from this trade, the Soviets paid world market prices for Peruvian goods.

Trade between the two countries was initially very modest and it fluctuated sharply as it increased during the 1970s. (See Table 1.) It decreased during the Belaunde administration (1980 to 1985), but increased again after the election of Alan Garcia. When Garcia assumed office in 1985, a number of new commitments and trade agreements were signed, which led to a large increase in trade volume during the first two years of his administration. In the latter part of Garcia's tenure when there were serious economic difficulties, trade with the Soviet Union contracted, but it bounced back and reached a peak in 1989. The prospects for strong ties between Peru and the former USSR (now Russia) are not so favorable today under Fujimori as he has sought to realign Peru closer to the West.

One of the factors that may have encouraged Peru to increase trade with the USSR, particularly in the 1980s, was Peru's conflicts over textiles with its largest trading partner, the United States. As in many developing countries, the Peruvian textile and clothing industry represented a dynamic branch of an industrializing economy. Development of the textile industry seemed a particularly logical step for Peru since its traditional exports included cotton and alpaca wool and yarns. By 1989 textiles and garments accounted for one third of Peru's nontraditional exports (Bowen, 1990). However, it appears that U.S. trade policy on several occasions resulted in injury to Peru's textile industry. For instance, in 1983 the U.S. imposed countervailing duties on cotton yarn and sheeting and sateen exports because it claimed that Peru was subsidizing these exports (Journal of Commerce, 22 July 1983). In a more recent case, Peru complained in 1990 that U.S. import quotas on textiles from Peru were very low compared to quotas for other Andean countries. For reasons such as these, Peru turned to the Soviet Union as a possible important new market for its textiles (Bowen, 1990).

TABLE 1

Peru's Trade with the USSR
(millions of US$)

YEAR	EXPORTS	IMPORTS
1970	.1	.2
1971	.2	.1
1972	6.1	.1
1973	15.1	.2
1974	2.1	1.6
1975	126.9	49.6
1976	24.6	7.3
1977	19.8	15.1
1978	21.5	19.7
1979	27.0	24.3
1980	15.9	.9
1981	12.0	2.5
1982	8.2	3.0
1983	15.9	.4
1984	87.3	.8
1985	130.9	.8
1986	84.9	5.6
1987	66.8	91.5*
1988	25.3	2.0
1989	132.9	65.7*

* The bulk of imports from the USSR in 1987 and 1989 was military hardware.

Sources: "Peru: Intercambio comercial con los paises miembros del CAME 1970-1981, "Division de Estadistica, Ministerio de Economia, Finanzas y Comercio, 1982; Oficina Nacional de Estadistica, Instituto de Comercio Exterior, Peru, 1991.

As shown in Table 1, in the twenty years from 1970 to 1989 Peru's exports to the USSR exceeded its imports from it in all but two years, thus maintaining a favorable trade balance for Peru. However, the volume of trade between the two countries remained small compared to Peru's trade with the rest of the world.

In addition to its trade with the Soviet Union, Peru developed trade relations with the other six Eastern European nations (Hungary, Poland, GDR, Bulgaria, Czechoslovakia, and Romania) as well as Yugoslavia. Although trade with these countries was modest, economic cooperation was used regularly in project development and in providing lines of credit.

Debt Crisis with the Soviets

The Soviet practice of extending credit on the basis of a contract to deliver a certain quantity and quality of goods to its larger LDC trade partners had obvious economic motivations. The Soviets used this mechanism as an important avenue to expand trade and, for LDCs, it was an important way of reducing foreign exchange disbursements. For instance, the Soviet Union extended credits to Egypt for military equipment in exchange for high quality cotton (Abdel-Latif, 1990; Valkenier, 1983). A similar pattern has been experienced in Indo-Soviet trade relations (Mehrotra, 1990). India had been paying the Soviets under a clearing scheme through which it delivered manufactured and primary goods. Given this practice in Africa and Asia, it is not surprising that Peru was able to pursue a payment in kind form of debt repayment with the Soviets.

Despite its trade surplus with the Soviet Union, Peru incurred a growing debt with the Soviets and other Eastern European countries. Some of this debt with the Soviet Union was for military equipment purchased by the Peruvian Army and Air Force in the 1970s. Other debt with the Soviets and the CMEA nations resulted from their generous trade credits offered to Peru to finance imports and for development projects. By the end of 1984, Peru's debt to the CMEA countries amounted to $1.2 billion, the lion's share of which was owed to the Soviet Union. This debt represented about eleven percent of Peru's total public external debt (Akaishi et al, 1988).

Between 1978 and 1983, Peru made four refinancing agreements on its debt with the Soviets and in 1983 the Soviets were demanding payment. A potential barter deal had been discussed with the Soviets in October 1982 when Peru failed to make a payment on debt that had already been refinanced in August 1981. Although the 1982 barter deal was not consummated, in November 1983 a refinancing agreement was reached with the Soviet Union in which Peru would pay part of the debt in kind and the rest in cash. With that agreement, Peru became one of the innovators in making debt-for-export deals.

Repaying foreign debt with goods does not correspond strictly to the types of countertrade discussed earlier in this study, but it forms part of an innovative new form of countertrade practice in the substitution of products for hard currency and because there is a priori agreement by the sellers to accept goods prior to the exchange. These agreements also serve as a complementary form of promoting exports beyond those required to meet debt amortization. For example, except for the initial agreements with the USSR, Peru was able to persuade the USSR and CMEA countries to take primarily nontraditional exports (e.g., copper wire instead of ore, shirts instead of cotton) as payment and to accept the "ratio concept" in which only part of each export shipment was used to amortize the debt. The ratio concept means that these countries purchased an additional amount of Peruvian goods equal in value to or double the value of debt payment.

The logic for promoting nontraditional exports and the ratio concept is essentially the following. Peru wished to find ways of increasing its foreign exchange earnings or reducing its need for foreign exchange. If it used traditional exports for payment of debt, it would be giving up their earnings of foreign exchange in amounts equal to the value of the debt payment (or perhaps more since countertrade is generally considered a less efficient payment mechanism). Thus there would be no net gain in foreign exchange. Instead, Peru wished to export in payment for debt nontraditional exports (usually semimanufactured and manufactured goods) that had not yet found a niche in world markets.

With respect to the ratio concept, Peru argued that even the value of nontraditional exports used in debt payment did not represent an equivalent net reduction in foreign exchange requirements. For example, suppose Peru shipped $300 worth of garments to Hungary in payment for the debt. It could be argued that on average one third or $100 of the value of those shirts represented inputs to produce the garments for which foreign exchange was expended. It was also estimated that perhaps another third of the value of the shirts could have been exported to traditional markets where it would have earned foreign exchange. Thus the net foreign exchange saving to Peru for making the debt payment in kind would only be $100, or one third of the value of the shirts. The innovative ratio concept is a way of allowing Peru to gain (or save) foreign exchange equal to the full value of the debt payment. Under the two-for-one (2 +1) formula the country receives approximately $2 cash for every $1 of debt retired. For example, Peru would sell $900 worth of shirts to Hungary. Only $300 would be used for debt payment and Hungary would pay Peru $600 for the other shirts; the net hard currency saving to Peru would thus be $300, meaning this debt payment in kind would theoretically not cause Peru to lose any of its foreign exchange[2]. Although the use of nontraditional exports and the ratio concept later became important parts of Peru's debt-for-goods agreements, in 1984 only 24 percent of Peru's exports to the USSR to repay the debt consisted of nontraditional products; however, they increased to 80 percent in 1985 and to 86 percent in 1986. The nontraditional products exported by Peru included mainly processed products from the textile, metallurgical and fishing industries.

The first debt payments to the USSR also did lot employ a ratio scheme. Beginning in 1987 or 1988 a ratio scheme was used in Soviet debt payments, but it was only a 1 + 1 scheme. In contrast, debt-for-goods agreements with other creditors usually employed a 2 + 1 scheme and occasionally even larger ratios. (See Tables 2 and 3.)

The conditions of the November 1983 refinancing agreement with the USSR included $280 million of the debt, of which $180 million were to be paid in kind. The payment in products was to be made at the rate of $7.2 million a month from November 1983 through the end of 1985. This amount covered only the fourth refinancing of Peru's debt service falling due before 1983. Payments in cash were to consist of $22 million annually starting from 1984 through 1987. This amount of about $88 million covered amounts falling due in 1983 that had not been refinanced. According to central bank figures, Peru only met half of the first cash payment in February 1984, and shipped products worth $38.2 million by the end of that year (Choy Chong, 1987). The reasons for delay in payment in kind in the first year apparently had to do with bureaucratic problems on both sides and delays in delivery. For instance, the Soviets worked with contracts instead of letters of credit and this sometimes delayed payments for months (Andean Report, 1985). A Peruvian mission including the Minister of Industry, the Minister of Economics, and representatives of exporters travelled to Moscow in March 1984 to offer a wide range of goods Peru was eager to sell. Reports are fuzzy on the exact nature and figures resulting from the talks. Peru's Ministry of Industry announced that exporters had signed new contracts for $200 million, but the Ministry of Finance said that the Soviet Union had agreed to receive $170 million in products that year and that 75 percent of the goods to be exported for debt repayment would be nontraditional goods. This was a substantial increase over the original amount agreed on in 1983. In April of 1984, a Soviet mission presided over by the Vice-Minister of Commerce came to Peru with a delegation of 12 people to inspect some 20 textile companies. They were impressed with the quality of the products and signed for another $20 million worth of textiles. The deal included T-shirts, cotton fabrics, made-up jeans, pajamas, underwear, polyester rope, and jute sacks. The earlier deal signed in Moscow had included candy, processed wood, zinc cells for batteries, goatskins, tiles, frozen chicken, and protein concentrate from fish (Andean Report, 1985).

Meanwhile Peru also renegotiated its debt with some of the other CMEA countries. It exported $5.58 million in its countertrade agreement with Romania, which included mainly cacao paste, but also protein concentrates and fishmeal. A $7.2 million debt to Czechoslovakia was refinanced with the first shipment including $800,000 of refined silver and bismuth. Hungary received shipments of coffee and protein concentrates to cover most of its $4.1 million countertrade debt program. The total arrangements with these three Eastern European countries was for $16.9 million (Andean Report, 1985). In 1985, total debt payments in kind to the USSR was $125 million and to Romania, Czechoslovakia, Hungary, and Yugoslavia, a total of $20.3 million (Choy Chong, 1987).

It was not long before other foreign creditors began to see countertrade deals as the only way to collect on debt from old business and possibly as a path to new business. For example, the Energoprojekt Construction and Contracting Company of Yugoslavia, which had been working on the Chira-Piura irrigation project since 1971, had been unsuccessfully trying to collect $65 million from the Peruvian government for some time. In 1985 it finally agreed to a countertrade arrangement and then sold the promissory notes resulting from the arrangement at a discount to two trading companies, which agreed to market the products where they could. In another case, the Israeli government accepted a countertrade agreement in 1984 in payment for communication equipment it had sold Peru. Israel sold the promissory notes to Merhav MNF Ltd., an Israeli trading company, which used them to purchase canned fish, palm oil, copper wire, alpaca tops, cooper concentrates, woolen yarns, and fishmeal (Moreno, 1988).

Between 1983 and 1985, Peru basically suspended repayments of most of its debt and was subsequently overdue on payment of interest to banks. In 1983 banks received only a small part of the interest due them while the 1983 agreement with the Soviet Union included some payment on principal as well as interest. In effect, the Soviets and the Yugoslavians were among the select few receiving payments on their foreign debt.

While some would argue that the deal with the Soviets and Yugoslavians cost Peru large amounts of foreign exchange that could have been earned in Western markets, others would stress that since three quarters of the goods exported in this manner were nontraditional, these were items that had limited access to international markets. Moreover, most companies in the textile industry and companies in other sectors indicated that they benefited from the new market[3].

In 1986 another round of talks with the Soviets took place. From the original deal in 1983 through July 1986 Peru had paid the equivalent of $205 million to the Soviets (Durr, 1987, p.3A). The Soviets had been paying little or nothing in cash for the Peruvian goods, canceling one-fifth of their debt through these arrangements. In this sense, the Soviets had become Peru's most favored creditor given the limited debt payments the country was making. Deals with Western banks at that time had been put off. President Alan Garcia had also announced in July 1985 that Peru would limit debt payments to commercial banks and multilateral organizations to 10 percent of Peru's export earnings.

Countertrade had also converted the Soviet Union into one of Peru's most important trading partners. The Soviets had shown imaginative accounting and flexible trading practices. For instance, in 1986 the price of coffee collapsed and Peru was stuck with 18,000 tons of unsold coffee. The Soviets took 13,000 tons, paying full or precollapse market price in cash for half of the total. The Soviets in effect paid 25 percent over the market value, knocking off a few million dollars of debt and scoring points for their good public relations (Andean Report, September 1987).

Although the debt to the Soviets was decreasing, in 1987 Peru again increased its debt when it acquired a squadron of Antonov-32 transport aircraft to replace the Antonov-24 aircraft purchased ten years earlier. Later, the Air Force purchased more MI-24 attack helicopters (Diehl, 1984; Andean Report, September 1987, May 1989). In addition to these, in October 1988 the Soviets provided a $150 million credit line to Peru for the purchase of machinery and equipment (La Republica, October 7 1988). According to one source, from November 1983 to June 1987, $368 million worth of Peruvian goods were shipped to the USSR and its Eastern European neighbors (Czechoslovakia, Hungary, Romania, and Yugoslavia) under the payment-in-kind scheme. At the end of 1987, Peru signed a new $27 million debt deal with Czechoslovakia under which Peru was to pay $9 million toward the $58 million owed the Czechs, and the Czechs would buy an extra $18 million of Peruvian products in a 2 + 1 ratio scheme (Durr, 1987b). Similar deals had been signed earlier in the year with East Germany and Hungary. These and later agreements are shown in Table 2.

The Minister of Economics, Gustavo Saberbein, announced in January 1988 that in talks held in Moscow the Soviets had agreed to restructure $905 million of Peru's debt in order to reschedule part of it and to extend the proportion of reimbursement in kind. The interest rate on the restructured debt was lowered from 7.5 percent to 3 percent. Peru was to repay in products from 1988 through 1990 less than half the annual payments of the past few years. Repayments were to rise though in 1991 and 1992 (El Peruano, 7 February 1988, 24 July 1988; Durr, 1988; Cavanagh, 1987).

In July and August 1989 there was yet another meeting between representatives of Peru and the Soviet Union to evaluate the debt issue. As Table 2 shows, of the $100 million assigned to be paid in 1988-1989, only $52.38 million had been executed. The 1989 figure increased slightly but in 1990 it dropped to an insignificant amount of $2.02 million. However, this may reflect transactions that had not been executed at the time the tables were prepared. The Soviets indicated that the low figures were mainly due to delays in delivery as a result of problems in Eastern Europe and the USSR. Peru's industry was also undergoing a severe recession.

TABLE 2

Debt Payments to CMEA Countries with Products betwen 1987 and 1991
(millions US$)

COUNTRY	PERIOD	SCHEME	DEBT PAYMENT	PMT AGAINST F. C.	AMOUNT AUTHORIZED	TOTAL EXECUTED	PERCENT
USSR	1988	1 + 1	50.00	50.00	100.00	52.38	52.38
	1989	1 + 1	50.00	50.00	100.00	57.17	57.17
	1990	1 + 1	47.00	47.00	94.00	2.02	2.15
Hungary	1987	2 + 1	2.15	4.30	6.45	6.46	100.19
	1988	2 + 1	2.15	4.30	6.45	6.96	107.95
	1989	2 + 1	2.50	5.00	7.50	5.89	78.60
	1990	2 + 1	1.00	2.00	3.00	2.58	86.13
Czecho-slovakia	1987-88	2 + 1	9.00	18.00	27.00	20.81	77.11
	1989	2 + 1	5.50	11.00	16.50	10.98	66.56
	1989	2 + 1	2.00	4.00	6.00	5.28	88.08
	1990	2 + 1	5.50	11.00	16.50		
GDR	1987	4 + 1	3.11	11.99	15.10	10.08	66.78
	1988-89	3 + 1	6.20	20.10	26.30	23.29	88.54
	1990-91	3 + 1	3.90	11.70	15.60		
TOTAL			192.51	255.38	447.89	206.40	46.08

Source: Departamento de Mecanismos Especiales, Instituto de Comercio Exterior, February 15th, 1991

Table 2 also shows that the 2 + 1 and 3 + 1 schemes used with some of the other so-called socialist countries were even more favorable to Peru than 1 + 1 agreements with the USSR. Between 1988 and 1990, Peru was able to cancel $192.5 million in debt to these countries and it received $255.3 million in new foreign exchange. At the end of the decade, Peru's debt to the former USSR was still around $1 billion but the accords had enabled Peru to achieve the region's most diverse export profile with the USSR.

Although Peru began paying goods for debt in 1983 and had other countertrade arrangements going back to at least 1971, it was not until December 1985 that it set up a general framework for approving countertrade. In this month the government authorized the creation of a Countertrade

Committee to approve payments of goods and services in kind, including various forms of barter, triangular trade, counterpurchases, buy-backs and other trading systems. Any countertrade agreements had to be approved by the Ministry of Commerce, the central bank, and the Banco de la Nacion. The committee's duties included drawing up a list of products to be used in countertrade. The law also stated that the central bank should provide the funds to be channeled through the Banco de la Nacion to cover payments to local exporters for shipments made on debt payments[4]. Since the government is the source of cash and the real intermediary, it restricted countertrade commitments and at first only authorized countertrade for debt repayment, banning its use for new purchases.

Peru's Debt Relations with Western Banks

Of Peru's $15 billion in external public debt, approximately $6 billion was owed to Western commercial banks in 1987. These banks had not received any payments on their debt since 1984 except for one $17.3 million payment in the spring of 1986 (Jones, 199). Although some banks continued to insist on orthodox methods of repayment of their loans, other banks such as First Interstate of California and Britain's Midland Bank observed that the Soviets were being paid by the debt-for-goods approach and became interested in seeing whether this technique could be applied to bank debt as well. According to a Euromoney article, it was in fact First Interstate's Lima representative Luis Jose Giove who first devised the ratio concept in early 1986. Peruvian officials the reworked the concept to come up with the idea that the ratio of debt to cash should be based on the proportion of exports that represented a net gain of foreign exchange (Zuckerman, 1988). Since that average was estimated to be about 33 percent, that led to the common 2 + 1 formula.

The first bank debt-for-exports agreement was signed by Midland Bank in September 1987. Midland was Peru's second largest bank creditor with a debt reported by various sources as $160 million and $210 million. Midland agreed to buy about $23 million in Peruvian goods under a 1.5 + 1 ratio scheme, meaning it would receive $8.8 million in partial payment of its debt. Under its agreement Midland could choose $23 million worth of products from a list of products worth a total of $40 million, including car parts, clothing, textiles, food and metal products. Midland also agreed to provide a $5 million line of commercial credit, perhaps the reason for the relatively favorable ratio scheme it received (Berg, 1987; Jones, 1988; Zuckerman, 1987c, 1988). First Interstate of California, with Peruvian debt of $100 million, signed an agreement shortly afterwards where under a 2 + 1 scheme it agreed to buy $42 million worth of Peruvian goods in 1987-1988 (Zuckerman, 1987a, p.1). The first payment to First Interstate was to be made in seafood products, clothing, copper wire conductors, vegetables, wood, and engineering and construction services. It later added handicrafts. In both cases, the agreements were to be carried out by bank-owned trading companies (Zuckerman, 1987b, 1988).

As a result of the agreements with Midland and First Interstate, more than a dozen banks were reported to be negotiating with Peru as well as some U.S. manufacturers holding Peruvian debt (Zuckerman, 1987c) Chase Manhattan, Peru's largest creditor bank with an exposure of $200 million, signed a $90 million debt-for-goods agreement with Peru at the end of 1987 (Zuckerman, 1987d, p.2). First Chicago signed an agreement in May 1990 that would reduce Peru's short-term debt with that bank by $20 million. The bank, through its trading company, agreed to accept textiles, beer, canned vegetables, frozen fish, coffee and alpaca. First Chicago also agreed to provide a line of commercial credit to Peru (Commins, 1990; Alexander and Kraus, 1990)

Table 3 shows the agreements with eight banks which Peru had negotiated as of 1990 and the amounts actually executed. Despite concern that Peru would have insufficient exports to consummate these agreements, Table 3 indicates that the amounts executed through 1990 were almost equal to the amounts agreed upon. For the most part, these debt-for-exports agreements have only been used to pay off unilateral working capital loans, since settling syndicated debt with these arrangements would be far more complicated (Jones, 1988; Zuckerman, 1988).

Although lack of enough nontraditional exports did not seem to have been the problem it was once thought it would be, there have been other problems with the implementation of this bank debt-for-goods program. The procedures were very slow and complicated. The debt portion of the value of exports is supposed to be paid by the Banco de la Nacion and exporters have complained that it takes a long time to be paid (Shiguiyama and Vasquez, 1992). In one early deal, First Interstate had to pay a sweatshirt producer directly when the manufacturer was not able to collect from the Peruvian bank (Zuckerman, 1988). In addition, the requirement that the Peruvian government pay the exporter in local currency tended to increase the Peruvian government's fiscal deficit, increasing the money supply and aggregate demand and thus adding to Peru's inflation woes (Garrido-Lecca, 1992).

As a result of the debt-for-goods agreements with the Eastern European countries and with Western Banks, the number of countertrade operations approved by Peru reached a peak of 130 in 1988 but fell off in 1989 and 1990. (See Table 4).

Table 3

Debt Payments to Western Banks with Products between 1987 and 1991
(millions US$)

BANK	PERIOD	SCHEME	DEBT PAYMENT	PMT AGAINST F.C.	AMOUNT AUTHORIZED	TOTAL EXECUTED	PERCENT
Midland	1987-88	1.5 + 1	8.30	13.70	22.00	22.00	100.00
	1989	1.5 + 1	8.30	13.70	22.00	27.71	125.95
	1990	1.5 + 1	8.30	13.70	22.00	20.31	92.79
	1991	1.5 + 1	8.30	13.70	22.00		
First Interstate of California	1987-89	2 + 1	14.00	28.00	42.00	36.03	85.79
	1989-90	2 + 1	10.79	21.58	32.37	20.27	62.62
	1990-91	2 + 1	11.96	23.91	35.87	6.64	18.52
	1991-92	2 + 1	10.96	21.91	32.87		
Banco de Bogota	1988	2 + 1	.86	1.71	2.57	2.03	79.01
Chase Manhattan	1988-89	2 + 1	15.00	30.00	45.00	43.46	76.57
	1990-91	2 + 1	18.20	36.40	52.60		
First National of Chicago	1990	1.5 + 1	3.00	4.50	7.50	6.47	86.32
Capital	1990	2 + 1	1.50	3.00	4.50	4.84	107.51
Skandinaviska Enskilda	1990	2 + 1	7.60	15.20	22.80		
Banco Cafetero	1990	2 + 1	1.50	3.00	4.50		
First National of Boston	1990	2 + 1	4.00	8.00	12.00	0.39	3.21
TOTAL		1.9 + 1	134.56	250.01	384.57	190.25	49.47

Source: Departamento de Mecanismos Especiales, Instituto de Comercio Exterior, 15 February 1991

TABLE 4

Countertrade Operations Approved by Peru
(millions US$)

YEAR	NUMBER OF OPERATIONS	EXPORTS APPROVED(1)	IMPORTS APPROVED(2)	BALANCE (1)-(2)
1986	1	15,2	16,2	-0,4
1987	23	13,2	9,5	2,7
1988	130	133,9	92,6	41,3
1989	24	30,1	25,3	4,7
1990	9	19,7	17,7	2,0
Subtotal	187	211,4	161,0	50,4
Others	26	448,8	397,9	50,9
Total	203	660,2	558,9	101,3

Source: Departamento de Mecanismos Especiales, Instituto de Comercio Exterior, Peru.

Peru also began to experiment with other debt reduction methods. There was talk of debt-for-tourism packages, debt-for-nature swaps and debt-for-long-term bonds which in turn might be swapped for debt-for-hotels (Jones, 1988; Zuckerman, 1988). In 1989 Midland Bank was involved in a debt-for-investment deal involving $43 million in new hotels, where its converted debt would have been used to finance 70 percent of the local project costs. However, this plus other projects had to be placed on hold in August 1989 because the Peruvian government did not have the local funds to finance the projects (Durr, 1989). In general, there seemed to be a decline in all countertrade activities after 1989, not because it ceased to be practical but mainly due to the severe recession and economic chaos into which Peru had fallen by then. National elections in 1989 became disruptive and in 1990 the new Fujimori administration adopted a neoliberal approach and shock treatment. The sweeping stabilization and liberalization program, also known as "Fujishock," caused a shake up in the foreign trade sector.

The Future of Peruvian Countertrade

It is difficult to assess the overall effect of Peru's countertrade arrangements. It appears that the debt-for-goods agreements, particularly once they were concentrated in nontraditional exports, provided an incentive to the Peruvian export sector to expand and incorporate new markets (Rosell,1989). The increased contact with the Soviets and other former CMEA countries raised the volume of trade and increased the diversity of Peru's exports. Peru was also able to sell goods for which there was a temporary surplus in the domestic market and products that were difficult to market abroad. Also, the debt-for-goods arrangements, especially after implementation of the ratio schemes, allowed Peru to retire some of its external debt while conserving foreign exchange.

However, Peru's objectives for countertrade were only partially achieved. Despite some activity by Western banks, it appears that most of the expansion of Peru's trade was with the USSR and Eastern Europe. These markets have substantially dried up by now given the serious economic contractions in these countries, the disintegration of the Soviet Union, the demise of the CMEA, the use of dollar pricing, and Russia's regulations proscribing some countertrade arrangements (primarily barter). While the Soviets did not prohibit all countertrade agreements with developing countries, Russia recently liberalized the use of some forms of countertrade. Peru, however, now faces great uncertainty with respect to its Eastern European markets as those countries have undergone profound changes in their foreign trade policies (Ring, 1993).

Although the debt-for-goods arrangements led to the retirement of some debt, the reduction of Peru's $17 billion in external public debt was minimal. In addition, it appears that the growing internal economic problems which Peru was experiencing by the end of the decade and the beginning of the 1990s made it increasingly difficult for Peru to maintain its part of the countertrade arrangements.

Countertrade may be growing in importance in many parts of the world, but Peru's experiment with debt-for-goods appears to have diminished in importance. The Fujimori administration as of August 1990 abruptly liberalized its international trade and investment regimes and launched a privatization drive. As a way redirecting its trade, the new economic policy allowed interest rates to rise steeply, eliminated all subsidies, cut public spending, removed all restrictions on foreign investment, and began to put state-owned firms up for sale (Sheanan, 1994). Although licenses and red tape have been slashed, the domestic manufacturing industry was heavily decapitalized. More importantly, the CERTEX program of subsidies for exports, a tax rebate scheme that gave preference to non-traditional exporters, was removed.

The current administration is focusing on privatization of government-owned enterprises as its key policy goal (Portocarreo and Ramaswani, 1993). About a hundred of these enterprises are expected to be sold by end of Fujimori's term in 1995 (Ramaswani, 1993). As part of the privatization process, Fujimori has reluctantly approved debt-equity swaps for some of the money-losing government enterprises. Some of Peru's largest creditors such as Citibank (with $100 million in short and medium term debt) were reported to be putting together groups interested in investing in Peru through debt-equity swaps. As of mid-1992 only $570 million of Peru's debt was eligible for swaps, but the Foreign Debt Commission was reportedly negotiating to make another $5.9 billion of debt eligible for these swaps (Gepp, 1992).

Although countertrade has recently abated due to the policies that have liberalized trade regimes, particularly in the case of Latin America, in other areas of the world countertrade pressures are on the rise. The Peruvian case demonstrated that countertrade was a useful tool that could have reduced part of Peru's external debt. In fact, most reports indicate that countertrade will continue to be an acceptable instrument to supplement traditional finance, but increased pressures under a newly-liberalized Peru have reduced, for now, the importance of countertrade as a viable means of helping to reduce the debt.

NOTES

1. Peru refinanced $11.3 million with the USSR to be paid in products to Nicaragua and opened a $10 million line of credit for that embattled country. See *Andean Report* (Lima) June 1986.
   Confirmed in interviews conducted by Rubén Berríos with Boris N.Drozdov, Commercial Representative of the USSR Embassy in Peru,January 17, 1989 in Lima, and with Mr. Igor Popov, Deputy Chief of the Commercial Representation of the USSR Embassy in Nicaragua, June 16, 1988 in Managua.

2. The logic behind the ratio concept is described in David Shiguiyama and Jose Miguel Vasquez, "Conversión de deuda por productos," en Harman Garrido-Lecca (ed) *Deuda externa: del problema a la posibilidad*, Universidad del Pacifico, 1992. See also Monica Rosell M., *Manual de Comercio Compensado*, Lima: ADEX-Instituto de Comercio Exterior, 1989.

3. Nora Moreno conducted a survey of the textile companies and they responded very favorably to their experience with exporting to the Soviet Union (See appendix in Moreno, 1988).

4. The details of this law can be found in Castro Ramirez, J. and J. Portocarrero Maisch, 1986; Castillo-Gomez, A., 1989. See also Rodriguez Gonzalez Mateo, M., 1988).

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