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The Legal Structure of Offset Transactions – Impact on the National Security

Introduction

Counter trade is a multi-contractual arrangement that consists of two mutually conditioned and linked contracts for supplying goods in opposite directions so that each party to a transaction is both a buyer and a seller at some stage of the fulfilment of the agreement. It could look like a paradox that in the modern era of electronic commerce, when billions of euro and dollars change owners in a second, this type of trade based not on money but on the exchange of mutual fulfilments of the parties is so prevalent in the international trade. The general perception of the counter trade and offset includes the opinion that those transactions were prevalent in centrally planned economies. Most of western legal and economic authors have viewed countertrade as an awkward transaction which is identified with barter. Counter trade has often been described as in-kind exchange of goods and services in the absence of money, as well as a bundling transaction, which is represented with “trade without money” concept of counter trade. After the fall of the Berlin Wall, representatives of that opinion have expected the decline of counter trade and its disappearance from the international trade scene. However, what happened was an unpredictable transformation and proliferation of those multi-contractual arrangements.

Use of the Development’s Function of Counter trade – Genesis of Government Mandated Counter trade

The transformation of planned economies to more market-based economies has not reduced the volume of counter trade transactions as predicted. However, the number and the value of transactions is continuing to increase together with changing their modalities and motivations. At the same time the process of internalisation of counter trade as the transaction started, which is directly connected with the national security issues. More attention has been paid to the strategic possibilities of counter trade.

The impact of the process of countertrade as well as direct offset’s transactions on the national security has started in 1983 in the Far East. Then Indonesia was the first country which has proposed government mandated counter trade for all government’s public procurement contracts excluding petrol and natural gas. This way, Indonesia has proposed by the governmental decree counter trade as a method of international exchange. After Indonesia appeared as a leader in the process of government mandated counter trade, those transactions are increasingly required under new laws of numerous countries with various motives and different ratios.

Most nations which insisted on counter trade were those with debt problems such as Argentina, Mexico, Peru and other Latin America’s countries which have legalized countertrade practises by promulgation of different kinds of legal instruments varying from laws, decrees etc. After Indonesia, other ASEAN countries have started to demand counter trade commitments for all foreign suppliers such as Malaysia, Thailand and the Philippines, and especially South Korea, which, through the exploration of developmental function of counter trade, increased the foreign investments significantly and created the multinational giants such as Hyundai, Daewoo, Samsung etc.

The third category of government-proposed counter trade represents informal offset policy where offset commitment has been prescribed for all government’s procurement or for all import contracts which exceeded certain value. This method of mandated offset represents Australian government’s offset program introduced in the 1980s as well as offset requirements of the world crucial defence importers – the Middle East countries. With the counter trade praxis of the Middle East countries, the development function of counter trade started to grow and those arrangements are used as an instrument which significantly promotes the national security of the importing country. At the same time, the evolution and nature of offset in the Middle East are becoming important as an example which starts to spread beyond defence procurement sellers, and it is becoming the main competitive tool which is increasingly required in major civil or military contracts.

Public Procurements and Defence Equipment Trade as a Tool of Offset Requirements

Using the different methods for introduction of offset requirements in public procurement regulation or imposing informal offset requirements, today numerous countries exploit their purchasing power. What is different is the counter purchase or offset ratio, which presents the prescribed balance between the value of imported goods and the value of transaction demanded by a buyer that will offset the outflow of money required by the contract of sale by a governmental decree. The offset ratio varies from 30% or more, demanded from China, Iran, Israel, New Zealand, Saudi Arabia, South Korea, 50% or more required from countries such as Canada, Denmark, Malaysia, the Philippines, Taiwan, Turkey, UAR, until 100% offset ratio which is demanded from countries such as Austria, Belgium, France, Indonesia, Holland, Norway, South Africa, Spain, Sweden, Switzerland, Great Britain.

Offset is usually associated with major industrialized countries and with contracts for supply of high-tech defence equipment. For example, the most widely cited offset arrangements are two supply agreements which Saudi Arabia concluded with Western armament suppliers for the purchase of defence equipment (the so-called Peace Shield) for the price of 3.8 million US dollars. The offset commitment undertaken by Boeing, which is the biggest exporter in transaction, was 35% from the value of the whole transaction.

However, offset is not confined to defence equipment. There are many examples in the civil sector where offset has helped a supplier win a major contract. Many of those sectors are in direct relationship with the national economy and with various aspects of security. These examples are usually within telecommunication, power, transportation and IT sectors. It also a fact that developing countries can build other sectors of their economy through the offset obligations and their subsequent fulfilment. The development of infrastructure projects such as roads, sanitation, medical services as well as other indispensable projects connected with national security such as ecology, defence equipment, could be of extreme importance in structuring the future counter trade policy of the country.

This kind of development can be illustrated by the case of Israel, where informal counter trade policy is by law transformed into government mandated offset. This legislative activity obliged all governmental agencies and state corporations to include an offset commitment in all import agreements on the seller side for countersale of predefined domestic products. All companies which are involved in international public tender for the value over 4 million US dollars are obliged to undertake a commitment of so-called “industrial cooperation” with Israel’s economic subjects for the minimum ratio of 35% of the value of the first concluded contract. An export company could fulfil its offset commitment in various modalities. Many of these varieties intended for realization of foreign seller’s company’s offset obligation are in a close connection with the questions of security. Undertaken offset commitment could be fulfilled by the conclusion of the subcontracts with the local companies, by

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the investments in the local industry, the transfer of know-how or by purchasing of Israel’s products or products which are made by using production or services made in Israel (tourist services). There are numerous arrangements concluded in accordance with Israel’s offset regulation, and today Israel has many bilateral offset arrangements with different countries. Among them the most significant ones are the agreements concluded by Israel with the USA, the EU, as well as with Hungary, Poland and Slovakia during 2000. \(^6\) Sophisticated contracts in multi-contractual arrangements such as counter trade need to be fulfilled by very carefully structured contracts and arrangements together with the installation of major sophisticated instruments for the payment security (stand by letter of credits, crossed letter of credits, independent guarantee, and bill of exchange etc.).

All export-oriented companies today are faced with offset requirements of importing countries. Contrary to the basic stereotype on offset, not only developing, but also developed countries focus special attention on the question of using their own purchasing power. There are many multinationals such as Boeing, Coca Cola and banks which have also established separate divisions to handle offset transactions. There are proliferation of specialized agencies in the field of counter trade and more than that in many countries such as the USA, Sweden, Great Britain, Japan and Austria. In these countries state agencies specialized in counter trade and offset transactions play an important part, and their goal is to supply domestic companies with professional support in international counter trade deals. For this reason, in 1999 in the USA a special President’s Council has been founded by the lex specialis (“Defence Offsets Disclosure Act”) for the offset in foreign trade with the task of informing the Congress about the effects of the offset for the US. The experiences and the importance of this specialized counter trade government body has led to the creation of the parallel agency among the American administration – the so-called National Commission for using offset in the armament equipment trade.

The importance of an offset transaction and its impact on national security has taken the special attention of another agency founded in 2002, the so-called Interagency group. The main task of this body is to follow, supervise and estimate offset policies of other countries, the possibility to use the offset in American export, as well as the needs and possibilities of creating (through OECD and other bodies) agreements on the use of offset and counter trade transactions in international trade. In Sweden there is the Government 2500, according to which employees work on establishing the offset programme. The military industry always take the privileged position among the offset tasks, but in present times prevalent offset transactions are in civil procurement trade, especially in the field of civil procurement, and in the area of telecommunications.

One of the methods for promotion of counter trade and offset activities is the creation of Legal Guide intended as a help to foreign trade subjects to promote export transactions by the creation the legal link between the purchase transactions.

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What is the Essence of Counter trade
- Is Counter trade Really Jeopardizing National Security?

While international counter trade transactions continue to grow as a major force in the world trade (there are some estimates, in the absence of precise data, that counter trade presents approximately 50% of the whole international world trade transactions), the legal theory of counter trade is in the phase of evolution (in statu nascendi). In opposition to the growing importance of counter trade and growing number of studies concerning the phenomenon of counter trade from the economic point of view, there are only few legal analyses of counter trade. Between studies concerning the legal aspects on counter trade there are some significant differences in analyses that help in formation of legal theory of counter trade deals. Nevertheless, until 1993, when UNCITRAL Legal Guide on International Counter trade Transactions has been adopted, there were few consensuses between authors on the question on the legal nature of counter trade transactions. Besides, there were a huge number of controversial opinions and differences which touched upon the majority of questions deriving from counter trade. They were not terminological, but either typological or conceptual consensuses. The majority of these controversies which appeared followed the counter trade derived from the economical and political context of those transactions. Despite its growth, counter trade has been condemned by organisations like the OECD, GATT and IMF and has been the object of criticism of the official US and United Kingdom export trade policies bodies as an instrument which is potentially distortive and disruptive to the growth of trade. However, at the same time US companies committed themselves to the counter purchase obligation in the famous “Jamaica Barter Deal” in spite of the official statements of the Federal Trade Commission that offset and counter trade jeopardize the national security of the country because they cause dumping, they reduce employment, cause the lack of trade balance and potentially are dangerous for industrial and technological benefits that accrue from the US sales of defence articles abroad. In addition, at the same time the Department for Trade and Industry of the UK Government published a Guide for Exporter, where it was stressed that the Government is not prepared to become involved in particular counter trade transactions.

7 Among the authors who analyzed the legal aspects of counter trade transactions, one of the most important figures are: the Polish author prof. Jerzy Rajski, whose most significant studies are: “Some Legal Aspects of International Compensation Trade”, International and Comparative Law Quarterly, Vol 35, January, 1986, pp.128-139; “Counter trade Transactions in International Trade”, Tidskraft utgiven av Juridiska Foreningen, 124, aeraengen, saette haeftet, Finland, 1986, pp.328-341; “International Compensation Trade Transactions”, in International Contracts and Conflicts of Laws, ed. By P. Sarcevic, London, 1990. Besides, there are articles of the French author prof. Cedric Guyot that have also had a big influence on legal studies of counter trade transactions, for example “Counter trade – Recent Legal Developments and Comparative Study” Revue de droit des affaires internationals, No. 8,1986, “Counter trade Contracts in International Business” International Lawyer, ABA, New York 1986. Other important legal authors who analyzed counter trade and helped in evolution of legal consideration of those business praxis are Kaj Hober, Scott Lochner, Thomas McVayPaul Mishkin, Verzariou Pompiliou and other authors whose research helped in the process of establishing the legal theory of counter trade. For the exhaustive list of authors, see the doctoral thesis of Milenkovic-Kerkovic T., Pravni aspekti i pravna priroda medjunarodnih kontratgrovinskih poslova, Beograd, 2003.

9 (“Counter trade is potentially distortive and disruptive to the growth of trade, inasmuch as it replaces the pressures
However, contrary to those explicit statements, another department of the UK Government, the Department for Defence, accepted Boeing's offer for purchasing the defence system instead of domestic NIMROD system, mostly because of the benefits offered by the American partner connected with the participation of the UK Government in the offered offset arrangement. 

Obviously, there are paradoxical differences between the official opinions of the countries opposing counter trade and offset which label those transactions as disruptive and injurious for competition as well as national security questions and counter trade praxis of the same countries or their organizations and companies. Those splits between the official opinions and praxis of the strongest opponents of offset gave reasons to make some ironical statements comparing counter trade and offset with some other activities in which everybody participates but no one talks about it.

The proportion of counter trade in all international trade has remained constant over the years at about 20%. This figure is only an approximation, as no country collects accurate statistics, but it is an estimate agreed upon by most experts in the field.

Today, in the majority of countries, national counter trade or offset agencies have been established (like ACA-American Counter trade Association, GOCA-Global Offset Counter trade Association, Australian Counter trade Association and others). Beside those independent organizations, most Governments establish different kinds of counter trade sectors or units in the structure of Department for Foreign Trade as specialized governmental bodies. The main task of those bodies is to promote offset and counter trade transactions and assist exporters to learn about counter trade, its procedures, and modalities of engagement in those transactions in an effective way. Therefore, counter trade is an important component in international trade, is practiced worldwide, and exporters who neglect it are depriving themselves of entry into new markets and expanding their exports to the existing markets.

Counter trade is not the Synonym for Compensation Deals – Can Counter trade Substitute the FDI (Direct Foreign Investment)?

The majority of authors who identified counter trade and offset with barter and barter-like transactions (those opinions represent the so-called "trade without money" concept of counter trade) claim that this institutes the necessary evil and
The Legal Structure of Offset Transactions – Impact on the National Security

an archaic phenomenon in international trade which will disappear together with the condition which caused them. Nevertheless, the truth is different. Researching the legal aspects of counter trade, the legal structure of transaction, multi-contractual arrangement, and especially the obligation law circumstances and the effects of the offset and counter trade, together with the questions of consideration of the contracts and their legal connections, the different visions of the offset and counter trade are beginning to express themselves.

Using results deriving from the legal analysis and improving this analysis with research in counter trade done by economic authors13 - especially the economic research which explains counter trade as a method of solving the problem of double moral hazard when subjects are tied in “lock” in the transaction - the new vision of counter trade develops. Counter trade transactions presents a completely new legal instrument of the law of international trade. The frequency in conclusions of offset and the proportion of various forms of counter trade in global world trade presents the proportion of entropy of international finance system. Numerous critics of counter trade deals are mostly the circumstance of misunderstanding of the essence and legal nature of those transactions. The majority of these opinions identified counter trade with so-called compensation deals. The truth is that this opinion is supported with terminological divergences derived from the past years when counter trade deals were a political way of doing business with the countries of planned economies during the existence of the Iron Curtain. Those deals (for example “Pepsi Co-Stolichnaya” transaction, “Levi Strauss –Hungary” buy-back deal etc.) were nominated as “compensations deals”. Authors have explained the use of this term with the need to accentuate the fact that in those transactions commitment of one party deriving from the contract in one direction has been set off with the commitments of another party from the contracts concluded in another direction.

Compensation, as a matter of fact, is not some specific contract in commercial law, and compensation (set-off) is one of the methods for ending the obligations of the parties deriving from the different contracts. Real compensation that deals with real consideration is to exclude monetary payment and instead of monetary payment parties exchange the goods or services. It exists only in the form of barter. The essence of compensation deals is in exchange of goods without money changing hands. Those transactions could not been identified with the original counter trade transactions. The essence of counter trade transactions is linkage of transactions and mutual conditioning of different and legally independent contracts.

However, in order to present complete facts it will be useful to notice that counter trade originated in the process of evolution of real compensation deals. Namely,

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barter deals have changed during the development of commercial needs of the parties. So, during the process of change of the so-called parallel barter (where parties exchange the goods through two different barter contracts), at one point parties decided to link those two independent barter contracts by implementing the new and original quality of relationships which is embodied in the so-called counter trade commitment.

Counter trade commitment was a new element and its ratio was to oblige the seller party in one contract to conclude another contract. The position and role of the purchaser in the new, linked contract will depend on the agreed commitment and type of obligations which this commitment contains. This counter trade commitment is intended to introduce the conclusion of a new, but linked transaction, and as such it is an emanation of the idea of the economic use of the contractual position of the purchaser. So, the contractual position of the purchaser from one contract is used as a competitive advantage in relation with other business subjects, in the way that the purchaser from one contract is empowered to set obligations which commit another contract party – the ex-seller from the first contract – to do something. The content of counter trade commitment determines a variety of specified counter trade arrangements.

Therefore, the type of concrete counter trade transactions has been directly determined by the type of obligation of the seller in the future agreement contained in the counter trade commitment, which at the same time presents a legal link between these two transactions. This counter trade commitment is \textit{differentia specifica} of each counter trade transaction. At the same time, this specific linkage points out the difference between counter trade transactions and the compensation deal whose ratio is the exchange of goods.

The type of counter trade contracts has been conditioned with the character of the commitment which is taken from the seller. If the commitment taken by the exporter (seller) from the first contract related to the purchase of goods or services from the ex-purchaser (whose role changes in the second contract to the role of counter-seller, counter-exporter), it will be a so-called counter purchase contract. Buy-back contracts have originated from the parallel barter arrangements where counter trade commitment is legally linked to contracts and it contains the buying of goods which derive from the equipment supplied in the first contract. Offset contracts contain various types of obligations of the ex-seller, apart from the obligation to purchase from the ex-importer. Such offset commitment embraces investments in the economy of the buyer’s country, the transfer of franchising, know-how, licence, conclusion of B.O.T. and other specific foreign investment arrangements, as well as other quite different performances. This type of counter trade is most appropriate for the governmental mandated counter trade and it conditions the import to the country with the obligation of the exporter to invest or bring another benefit to the country of the buyer. Counter trade is becoming the solution to the direct foreign investments to the country and in the form of offset it could substitute it to a large extent.

The first contract in the multi-contractual counter trade transactions is always a sale-purchase contract. The next contract can take a variety of forms, and this form causes a variety of counter trade transactions.
The Varieties of Offset Transactions – Offset is not Barter

There are many controversies about counter trade transactions. Apart from the criticism and denying of the whole counter trade concept, there is also confusion with the counter trade varieties. One of them stresses the differences between barter and counter trade contracts. This question is still unresolved in spite of the fact that UNCITRAL (Legal Guide on International Counter trade Transactions) has ambitions to offer a solution to the terminological and typological confusion in counter trade deals. Counter trade transactions are being distinguished in the Legal Guide on the basis of their commercial or technical features and their contractual structure. There are the following varieties of counter trade: barter, counter purchase, buy-back and offset which could be direct or indirect.

Barter in practice often refers to counter trade transactions in general (compensation deals), or to the transactions in which trans-border flow of currency is eliminated or reduced, or to the transactions where a single contract governs the mutual supply of goods. The guide considers barter in its strict legal sense as referring to a contract involving a two-way exchange of specified goods in which the supply of goods in one direction replaces, entirely or partly, the monetary payment for the supply of goods in the other direction.14

However, counter trade transactions consider monetary payments in both directions. Counter transaction is legally linked and its legal nature is not to be a compensatory equivalent for the performance made in the first contract. This is the difference that can be explained only by the comparison of counter trade with compensatory deals. Barter is a typical compensatory deal (switch, clearing accounts and other payment techniques represent other kinds of compensation deals).

The barter and the counter trade have different legal nature and despite the fact that Legal Guide involves barter in the varieties of the counter trade, these two transactions do not represent the same legal instrument. First, barter and counter trade differ in the number of contracts which they embrace: barter is one contract and counter trade (counter purchase, buy-back and offset) are multi-contractual arrangements. The nature of performances (obligations) also differs in these two transactions: in barter obligations of the contractual parties could be marked as typical “do ut des” (I will give you and you will give me) and in the counter trade transactions the nature of the obligation is “facio ut facias” (I will perform for you, if you perform for me). Different types of the counter trade differ so much that sometimes it is hard to find any element common to all of them (for example a specific arrangement of offset or counter purchase), but the main characteristics of every type of the counter trade always stay the same. This main characteristic shows that the party which is on the part of the purchaser in the first contract in the counter trade transaction uses its contractual position to enforce the seller to commit itself with specific obligation which is in the purchaser’s interest. The types of counter trade differ only as far as the content of the countertrade commitment is concerned, which is consequently expressed in the second contract in the counter trade transaction. Exploitation of the purchasing power is the economic essence of the each counter trade transaction and

its essential characteristic could provide an explanation to many disputes and misunderstandings which are remarkable features of counter trade.

There are many critically oriented views on the issue of counter trade (some people view counter trade as a "bad business", "double edge sword", "an inherent parasitic relationship"). However, the biggest problem which countertrade creates is the legal problem which could be expressed as the interdependence of obligations from different contracts which constitutes the whole counter trade transactions. This question remains unanswered in the legal theory, even after issuing of the UNCITRAL Legal Guide. But we should bear in mind the fact that the most significant principle in the contract law nowadays is the principle of interdependence of obligations in one contract – the non adimpleti contractus principle which enables the contractual party to refuse performing of its contractual obligation unless the other party performs its obligation. This principle is also a product of development of the contract law. These developments move towards the recognition of interdependence of obligation - even of the ones originating from two contracts if those contracts are connected with the same causa, the same intention of the parties and the purpose of the whole counter trade transaction.

Offset is a typical counter trade transaction which normally involves the supply of goods of high value or technological sophistication and may include the transfer of technology and know-how, the promotion of investments and facilitating access to a particular market. When a national governmental body considers offset transaction that is of commercial or trade character, the question matter of the offset is always connected with the national interests of the country and it often stresses the questions of the national security.

There are two types of offset. Under “direct offset” the parties agree to supply each other with goods that are technologically or commercially related (for example component parts or products that are marked together – in export of an aircraft the seller has obliged itself to buy spare parts from manufacturers from the buyer’s country). “Indirect offset” refers to a transaction where a governmental agency that procures, or approves the procurement of goods of high value requires from the supplier that the counter-purchases are made in the procuring country in the form of investment, technology or assistance in third markets. The counter-export is not technologically related to the exported goods. Another characteristic is that a governmental agency often draws guidelines for the offset in which specified industrial sectors or geographical regions are marked appropriate for negotiation of the counter-export contract. Within such guidelines the party committed to do the counter purchase or committed to assist the national company in marketing promotion is normally free to choose the contracting partners. Sometimes the offset is mentioned as industrial participation or industrial cooperation.

There are many objections to the offset practices. Some of them pointed that transactions may be detrimental to the strength of the national economy and the defence industry, particularly to small- and medium-sized defence subcontractors, as well as other non-defence sectors of the economy which is affected by indirect offset.

Offset has been originally used as a tool for rebuilding the devastated economies and infrastructures of the post World War II countries but now it is used primarily by foreign governments to achieve new economical and political goals. Developed countries with established defence industries are primarily using offsets to channel work
or technology to their domestic defence or aerospace companies, while other developed countries with limited defence industries are using offsets to enhance the competitiveness of their commercial sectors. Countries with newly industrialized economies use both military- and commercial-related offsets that involve the transfer of technology and know-how, together with obligation of seller to invest, research, train the personnel, advertise, buy or market national products. The promotion of tourist services of one country is often developed through offset arrangements, especially between economies with payment deficit. There is, for example, an offset arrangement between Moscow and Shanghai considering mutual commitments in tourist exchange and promotion.

Legal Structure of the Offset Arrangement According to the Legal Guide on International Counter trade Transactions

The legal problems of entering counter trade transactions are numerous. Offset is a multi-contractual arrangement which, according to the UNCTAD Legal Guide, belongs to the contract structure of counter trade transaction which is an embodied obligation of parallel shipments of goods and services in both directions in separate contracts. There are three legal instruments and business practices often used for separate contracts for supplying goods (services) in both directions, and the link between these two legal instruments is expressed by the conclusion of the third instrument – the protocol or the frame agreement. The legal nature of this legal instrument is disputable. Multi-contractual form of the arrangement in an offset transaction causes different legal problems such as the legal relationships between the first sale-purchase contract, protocol and counter purchase (offset) contract which involves the obligation of performances of the offset commitment. Different legal systems could have different solutions, stressing forms of contract, establishing interdependence of obligations through different methods, such as payment methods, parallel documentary credits, the legal nature of counter trade commitments (where the counter trade commitment represents duty to achieve a specific results or duty of best efforts)\(^\text{15}\) and many other legal issues created by the multi-contractual structure of the counter trade arrangement. Offset is often considered a tool of economic exploitation of the purchasing power which enables the purchaser to commit the seller by the counter trade commitment in the interest of the buyer. Such consideration is the unique way of using advances of those transactions and, not less important, to escape big legal problems which could emerge because of the immanent multi-contractual form of counter trade.

The following solutions were presented in the Legal Guide. From them three approaches in structuring an offset transaction emerge:\(^\text{16}\)

(a) The export contract (sale contract) and the counter trade agreement (protocol) are concluded simultaneously and the counter-export (offset) contract is concluded subsequently;

\(^{15}\) See, UNIDROIT Principles of International Commercial Contracts, Article 5.5.

\(^{16}\) Legal Guide, p.15.
(b) The counter trade agreement (protocol) is concluded prior to the conclusion of any definite supply contracts in either direction;

(c) The separate supply contracts for the shipment in each direction and the counter trade agreement establishing a relationship between them are concluded simultaneously.

The guide offers a detailed explanation of problems which can arise in such situation (a) and this contractual approach has often been exploited from the economically stronger party for the purpose of achieving the primary export goal while the counter export (offset) is seen as a secondary obligation. In this option the biggest legal problem is how to ensure a legal link between these two contracts. Is the counter-export (offset) contract legally binding if the export contract is cancelled or void? In some legal systems if the following offset contract has been concluded later in another document, it may be viewed in the legal system as a separate legal instrument which is binding independently of the validity or fulfilment of the first contract in the transaction. It could be treated as an independent obligation which is not connected to the obligation stemming from the previous contract. Therefore, a breach of annulment of the primary contract may not automatically invalidate the secondary contract. However, there is another approach. Contracts in an offset transaction could be viewed as legally linked and could be treated as the mutual obligation in one contract. This approach favours the view that contracts in an offset transaction are mutually interdependent and legally connected.

The second situation is problematic from the legal point of view because the protocol is not a legally binding instrument in most legal systems. Even if the protocol is considered as a contract (legally binding), the question arises at the level of all specified questions in the agreed counter trade (offset) transaction - for example the question about the kind of performances, the list of goods, the prices, the quality or quantity of goods or services which are going to be supplied as fulfilment of the offset commitment.

The situation where contracts for the shipment of goods (or services) in both directions are concluded at the same time is the best from the point of view of legal certainty because it is possible to negotiate and reach a mutual consensus on all the important elements of the contract.

In the situation when counter trade agreement (protocol) is a legally binding instrument, the essential feature of this approach is that this document contains a counter trade commitment, which is differentia specifica of the counter trade transaction. An offset commitment is a stipulation by which the parties undertake to conclude one or more supply contracts in one or two directions where, as a consideration of the first sale, the seller obliges itself to fulfil some act asked from the previous buyer. In order to add definiteness to the commitment and increase the likelihood of its fulfilment, parties often include in the agreement provisions concerning terms of the anticipated contract, sanctions for non-performance of the conclusion of the counter-export (offset) contract and other provisions for insuring the fulfilment and the legal certainty of the whole transaction. The offset agreement usually contains the following elements: type, quality and quantity of goods, pricing of goods, participation of third parties, payment clauses, restrictions on resale of goods, provisions of possi-
bility of assignment of the offset commitment, liquidation of damages and penalties, security of performance, failure to complete counter trade transactions, choice of the law clause, settlement of disputes.

What are the Political Risks in Offset Transactions

Political risk insurance is carefully planned in the process of negotiation of an offset transaction. The risks exist in the following areas: debt risks in the situation of non-payment by the buyer, or non-fulfilment of the agreed offset performance, an embargo on the exchange transfer, non-honouring by the grantor. There are also some other risks: trade risks: non-delivery by the supplier, failure to process, toll or refine; government risks: import or export embargoes, cancellation of license, termination through Force Majeure, unfair call guarantees; confiscation: the risk of confiscation includes storage and tolling; riots, strikes and civil commotion, war on land.

Those risks can be handled in many ways. The most important method is the conclusion of reasonable offset contract with competent and reasonable partners. Using traders and specialized trading houses which are experienced, in the country or with goods/services to handle all difficult parts of the offset transaction. Using insurance instrument is reasonable means against political risks, and it has broader coverage applications. Getting guarantees, performance bonds or stand-by letters of credit are excellent ways of risk management in offset transactions.

Conclusion

Despite the objections and criticism of economists and in spite of the official policy of developed countries which discourage them, offset transactions are here to stay but are shrinking in importance. Government-mandated offset is an increasingly useful and beneficial way for a foreign buyer to acquire the necessary defence equipment and services while gaining important progress in its domestic industrial and national security development goals. Countries that need to gain new market access and shares have the option to achieve them through offset programmes which are growing in frequency and size as well as increase the diversities in government mandated offset performances of the different countries.