INTRODUCTION

The object in preparing this primer is to arm the Canadian exporter with a basic knowledge and understanding of countertrade and to give some direction on additional sources of assistance prior to being confronted with countertrade demands. The text has been structured so as to provide the exporter with the following:

- — an understanding of the different forms of countertrade;
- — global and Canadian perspectives on its growth and impact;
- — suggested ways and means for exporters to better cope with countertrade.

This is supplemented by a list of trading houses offering services in this area (Appendix I), and profiles of the countertrade practices of 44 countries (Appendix II).

DEFINITIONS

Countertrade, as used in this text, is a generic term encompassing all transactions where a sale to an importer (public or private sector) is conditional upon a reciprocal purchase or undertaking by the exporter. The common forms of countertrade include barter, counterpurchase, advance purchase, offsets, buyback, and bilateral agreements. The terms and definitions provided are based upon a review of widely accepted definitions.

A) Barter

Barter is commonly referred to as payment in kind. Therefore, it does not involve the use of money and is bound by a single contract between the trading partners which specifies the quantity of goods to be exchanged. In such transactions, third parties can be involved, but are precluded from signing the barter agreement. A variation of barter may call for partial payment in goods, with the balance in hard currency.

True barter deals are uncommon due to a myriad of problems primarily attributable to the valuation of goods in terms of each other. These problems include variations in the quality of the merchandise; quantities involved in each shipment; the achievement of a 100% balance of trade on both sides; and prices agreed to under the contract differing substantially from prices on the world market because each party wants to establish his asking price in relation to the price asked by the other.

B) Counterpurchase

Counterpurchase is the most common form of countertrade in which the exporter undertakes to purchase goods or services from the importer to a given percentage of the value of his sales contract. This can range from 5% to over 100% depending on the circumstances. The commitment may also vary from "best efforts" to a fixed percentage with a penalty clause if conditions are not met.

A major feature of counterpurchase is that two separate contracts should be signed and linked: one for the sale by the exporter and the other representing the counterpurchase obligation which can be fulfilled over a certain period of time. This period can be negotiable or fixed depending on the circumstances. Unlike barter, each contract should have its own financing arrangements and not involve payment in kind. This overcomes the valuation problems found in barter and enables the exporter to be paid on delivery of his goods. In addition, the exporter is given a certain amount of time to find a suitable product for his purchase obligation. It is common for such obligations to be transferred to a trading house by the exporter. (Further comments on the advantages of separate contracts in counterpurchase can be found in the section on Contract Considerations).

C) Advance Purchase

The major purpose of advance purchase is to secure payment in advance for the exporter's goods and thereby eliminate the risk of non-payment. The hard currency generated by the advance purchase is placed in an escrow account outside the customer's country to ensure access to it.

Advance purchase is a technique increasingly being used in dealing with severely indebted countries. This technique can be used to generate hard currency for the importer, to circumvent foreign exchange regulations or to avoid time-consuming, cumbersome, central bank foreign exchange procedures.

The major problem in this approach is identifying or, in some cases, assisting in developing appropriate products to use for the advance purchase. In many cases, the goods being exported have to be considered incremental to existing trade in order to receive approval from the central authorities for the advance purchase. The introduction of new products offshore or new markets for existing exports seem to be normal or sufficient criteria to justify advance purchase.

D) Offsets

Offsets are normally found in large capital projects or where there is substantial government procurement of military goods. They are normally required of the exporter in such cases so that some incremental industrial or economic benefit is derived from the expenditure.

Offset activities are normally considered to be directly related to the product or services being purchased. In a number of cases, counterpurchase of unrelated goods or commodities, promotion of tourism, and the export marketing of unrelated products may form part of an "offset" package, but they are considered to be indirect offsets. Direct forms of offsets include the following:

Coproduction — Overseas production based upon a government-to-government agreement that permits a foreign government or producer to acquire the technical information and know-how to manufacture all or part of an item. It includes government-to-government licensed production. It excludes licensed production based upon direct commercial arrangements by manufacturers.

Licensed Production — Overseas production of all or part of an item of equipment based upon transfer of technical information and know-how under direct commercial arrangement between a manufacturer and a foreign government producer.

Sub-contractor Production — Overseas production of a part or an item of equipment. The subcontract does not involve the license of technical information or know-how and is usually a direct commercial arrangement between the manufacturer and a foreign producer.

Overseas Investment — Investment arising from the offset agreement, taking the form of capital invested to establish or expand a subsidiary or joint venture in the foreign country.

Technology Transfer (other than licensed production and coproduction) — Transfer of technology occurring as a result of an offset agreement that may take the