VI COUNTERTRADE AND THE ROLE OF CANADIAN TRADING HOUSES

Introduction

Much has been said recently about countertrade and its impact upon Canadian exporters. To properly place into perspective the role of Canadian trading houses in this renewed and updated trade dimension, it is necessary to proceed through a brief examination of the global trends in countertrade (in its various forms), an examination of its impact upon Canadian exports, and a look at how Canadian exporters are coping with countertrade.

For the purposes of this chapter, the term countertrade shall assume a broad generic definition covering transactions where the purchase of a product and/or service by a company or country is linked to a reciprocal purchase (namely counterpurchase, compensation, buyback, barter, and switch) by the seller or some other form of offset against the original sale, such as technology transfer, licensing, industrial co-operation, joint ventures, local content or domestic investment. The rationale and reasons for demanding countertrade by various entities is developed below.

The current developments in countertrade and the future trends now evident are the result of economic changes and activities that have taken place over the last 10 to 15 years. To understand properly the current scenario and predict future developments in this area, a brief review of factors leading to the present situation is required.

Global Perspective

In the 1960s and 1970s countertrade was typically found in the domain of East-West trade and primarily undertaken in major capital projects where countertrade of the compensation and buyback variety was entered into for the purpose of financing such projects by marketing the resulting products.

The tenfold increase in oil prices during the years of 1973 to 1980 created major balance of payment problems for developing countries and resulted in hard currency shortages. OPEC surpluses generated from oil price increases during these years were deposited with international banks who in turn recycled these funds to the oil importing developing nations (a large majority of them recently independent and with little expertise in international financial matters). In turn, the developing nations used these moneys for large capital projects and to refinance, at least partially, the balance of payment deficits created by the need to import oil and to sustain economic growth.

By continuing on this path, developing nations drew deeper into debt. This already onerous situation was further exacerbated by the dramatic increase in interest rates which took place towards the end of 1980. In 1982, interest payments by the less developed countries accounted for up to 45 per cent of their total exports of goods and services.

The conditions created by these factors alone were enough to give rise to more countertrade demands. Developing countries recognized, however, that despite the cry by industrialized countries that countertrade was a regressive practice and contrary to the multilateral free trading system, they too engaged in various forms of restrictive economic activity such as tariff and non-tariff barriers, export subsidies, and other measures which restricted export markets for developing countries.

Thus, developing nations have had to resort and are resorting to countertrade for a number of reasons including: to finance imports; to gain access to western markets, marketing services and new technology; and to induce foreign investment and commitments to other forms of future national economic development. For these countries, the options are few, because the consequences of inflation and unemployment are frequently social unrest and revolution.

In addition to the greater involvement of less developed countries (LDCs) and newly industrialized countries (NICs) in countertrade, industrialized nations, as a result of internal political and social pressures, have added to this proliferation by demanding "offsets" in circumstances of substantial capital goods purchases, major projects, and military procurement. This practice is seen by some as being of much greater future importance than the "traditional" commodity-oriented countertrade mentioned above. Capital goods and services exporters must now consider as part of their business strategy the implications of purchasing foreign-made goods for internal use and external disposal, subcontracting production, overseas joint ventures in R&D and manufacturing, the potential loss of domestic employment, and the transfer of technology. This form of countertrade is now considered almost a standard requirement in tendering for overseas projects.

A major growing problem in coping with countertrade (and offsets) is the ability to place manufactured products, both internally and externally. External placement is plagued by the lack of sufficient companies offering this form of countertrade service. Some may offer this service, but few have any true "hands-on" experience.

Internal placement requires a level of sophistication found only in a number of multinationals with a large and diverse purchasing base who are able to absorb products from foreign suppliers as a consequence of this "forced" linkage. This area is plagued by quality-level problems, particularly with LDCs, but including some industrialized nations.

The development of the causes of countertrade has been reflected in the growing number of countries practising the various forms of countertrade. In 1972, 15 countries, mostly of East European origin, were involved in countertrade. In 1979, this had increased to 27 and by 1983 expanded to over 88. Current reasonable estimates of countertrade range from 5-15 per cent of world trade depending upon the definition and assumptions made. A recent report prepared by the GATT Secretariat for the "Consultative Committee of 18" placed an upper limit for the proportion of countertrade in world merchandise trade in the region of 8 per cent. It also mentioned estimates ranging from 1 to 40 per cent.

Global Perspective: Conclusion

Indebtedness and hard currency shortages on the part of LDCs and NICs will likely continue to create demands for countertrade transactions into the next decade.

Countries involved in such trade, however, are quickly recognizing the price reduction and market displacement effects of using their commodities in countertrade and, where possible, will be insisting upon more offset-type arrangements involving foreign investment and technology transfer.

Offset practices by industrialized nations on the other hand, have established themselves and will probably continue as a permanent feature of international trade.

The conclusion one can draw is that in order to stay competitive, exporters of capital goods and manufactured products will need to develop capabilities to deal with countertrade in semi- and fully-manufactured goods, and