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COUNTERTRADE: A CANADIAN PERSPECTIVE

By

Lawrence Kryzanowski*

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* Professor of Finance, Faculty of Commerce, Concordia University, Montreal, Quebec, Canada.

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DISCLAIMER

All views expressed herein are solely mine and are not necessarily those of External Affairs Canada. All errors, however, remain my responsibility alone.

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CHAPTER 1

INTRODUCTION

Historically, trade began by the simple barter of goods and/or services for goods and/or services. The problems encountered in such exchanges led to the direct need for, and the eventual evolution of money as a medium of exchange, a store of value, and a means of deferred payment. However, the use of money as a medium of exchange is predicated upon the assumption that exchange occurs between parties in similar market structures, and that the monetary unit is acceptable and available to all the parties involved in the exchange process.

While these criteria have generally been satisfied for within-country trade, such has often not been the case for between-country trade. In between-country trade, not only has the standard monetary unit changed over time but it has not been sufficient to ensure that trade is truly multilateral.[1] Numerous trade barriers, commercial and financial practices have been initiated by states in order to bilaterally balance trade between themselves. One of the more important of these practices is countertrade (henceforth CT), which is defined along with various other terms in Appendix A.

The importance of countertrade in world trade is difficult to assess. Although the IMF and GATT have estimated countertrade's share of world trade as being as low as 1 and 8 percent, respectively [OECD (1985), p. 11], most other entities estimate countertrade's share of world trade as being currently between 10 and 20 percent, compared to an estimated 3 to 5 percent only five or six years ago.[2] Countertrade is also believed to account for a minor share of total Canadian trade [External Affairs (1984)], although the percentage has apparently increased during the past five years.

Nevertheless, the factors contributing to the continued growth of countertrade internationally show no sign of subsiding, and some signs of intensifying. From the mid-1970s, traditional East European practitioners of countertrade have increased their requirements for compensation trade as their foreign debt positions and chronic trade deficits with non-Eastern Bloc countries have worsened. As well, by 1979, several developing countries, such as Brazil, Iran and Venezuela, have encountered similar trade imbalances and financial constraints due to a drastic aggravation of their foreign debt positions. Thus, they have increasingly reverted to countertrade in order to sell their products, conserve their foreign exchange, and partially fulfill their import requirements. For example, as part of its economic development plans, Indonesia legally requires that bidders on government projects must export Indonesian products equal to what they import. The developing countries have also used countertrade increasingly as an integral component of their development strategies, whereby countertrade is used to speed up their economic development process by attracting foreign technology and capital to build extraction and production facilities. For example, China is placing a large emphasis on compensation trade in order to accelerate its modernization process. Furthermore, since 1979, countertrade has been used more aggressively by the lesser developed countries in Africa and Asia. However, unlike

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[1] Footnotes appear at the end of each chapter.

the Eastern European and developing countries, the lesser developed countries have more frequently used agricultural or mineral products (and not manufactured or processed goods) as countertrand (defined in Appendix A).[3]

The importance of countertrade to Canada's survival has been aptly stated by Vorbrodt, formerly with the Royal Bank of Canada, as follows [Francis (1983), p. 2]:

> ... Canadians must master the techniques. If not, we may be left behind, mere hewers of wood and drawers of water.

MAJOR PURPOSE OF THE STUDY

The major purpose of this study is seven-fold: first, to determine the extent to which Canadian entities (namely, nontrading house exporters (henceforth exporters) and trading houses (henceforth traders)) have engaged in CT transactions over the five-year period, 1980-1984; second, to provide aggregate descriptive information on various aspects of these CT transactions and their participants; third, to identify and analyze the benefits and problems inherent in the use of CT from the perspective of Canadian entities; fourth, to identify and examine the contractual requirements and responses of the Canadian entities which have engaged in CT; fifth, to assess the level of involvement and capability of the existing and potential sources of CT support services for Canadian exporters and traders; sixth, to determine what role existing private- and public-sector entities can play in assisting Canadian exporters and traders to successfully engage in CT transactions; and seventh, to propose recommendations on what actions could be taken to improve Canadian performance and expertise in CT.

SPECIFIC OBJECTIVES OF THE STUDY

The specific objectives of this study are to examine the following topic areas for Canadian exporters, traders and facilitators.

General Exposure to and Involvement in CT Export Transactions

Specific details to be determined include:

(1) The extent to which Canadian exporters, traders, and facilitators have experienced CT demands;
(2) The extent to which Canadian exporters and traders deliberately avoid countries that make CT demands;
(3) The extent to which Canadian exporters and traders believe that they have lost at least one contract because of their inability or unwillingness to engage in CT;
(4) The extent to which Canadian exporters and traders have been involved in CT export transactions on a continuing basis;
(5) The reasons why Canadian exporters and traders have not been involved in CT export transactions on a continuing basis and why they have terminated sales efforts that have involved CT demands;

(6) The strategies utilized by Canadian exporters, traders and facilitators to avoid CT demands;

(7) The forms of CT obligations that Canadian exporters and traders have signed contracts for;

(8) The extent to which Canadian exporters, traders and facilitators have developed specialized in-house negotiating expertise for pursuing CT opportunities; and

(9) The extent to which Canadian exporters, traders and facilitators have developed specialized in-house expertise for satisfying CT obligations.

Basic Attitudes Towards CT Arrangements

Specific details to be determined include:

(1) Whether or not Canadian exporters, traders and facilitators consider CT to be a normal way of conducting export business;

(2) The importance of various benefits of and problems with CT involvements; and

(3) The importance to the export prospects of individual firms of being willing to accept CT in a number of specific geographic export markets.

Canadian Involvements in CT Transactions

Specific details to be determined include:

(1) The number and the value of export transactions involving CT, and the nature of their growth over the five-year period, 1980-1984;

(2) The types of goods and services (defined in Appendix A) supplied by the parties to the CT transactions;

(3) Whether or not the countertrand received by the Canadian entities were marketed in Canada, the United States or elsewhere; and

(4) The extent to which traditional (foreign) buyers have honoured the the terms of CT agreements in terms of factors such as product quality and date of delivery.

The Mechanics of CT Transactions

Specific details to be determined include:

(1) How Canadian entities assess the relative quality and market value of the countertrand offered by traditional buyers (defined in Appendix A);

(2) Whether or not, and how, Canadian entities (as traditional sellers) reflect the costs and risks of potential countertrade obligations in the final prices they quote for the goods and services they are offering to sell;

(3) How and by whom is the CT liability borne; and

(4) How the CT contractual agreements entered into by Canadian entities have been structured.

Perceptions of Future CT Trends

Specific details to be determined include:

(1) The Canadian exports which would be subjected to increased CT demands during the next five-year period; and

(2) The countertrand which would be increasingly offered by traditional (foreign) buyers over the next five-year period.

ORGANIZATION OF THE REMAINDER OF THE STUDY

The remainder of this study is organized as follows. In the next chapter, the methodology is described. In the third and fourth chapters, the mail questionnaire survey results for the samples of Canadian exporters and trading houses, respectively, are presented and analyzed. In the fifth chapter, the theory and practice of CT from a Canadian perspective (based on all the collected field data) are presented in an integrated fashion. In the sixth and final chapter, the major survey findings and the recommendations of this study are presented.

FOOTNOTES TO CHAPTER 1

[1] The standard monetary unit has changed over time from gold and other precious metals to the British pound, and subsequently to the U.S. dollar and the International Monetary Fund's Special Drawing Rights (or SDRs).

[2] A study published by Business Trend Analysts suggests that countertrade accounted for almost 30 percent of all international transactions in 1983 versus about 2 percent in 1976. According to The Economist, if CT is defined to exclude all bilateral deals between Comecon countries, several Gatt economists have concluded that CT covers no more than nine percent of world trade [Econ. (1985), p. 21].

[3] For example, in 1983, a team of United States Congressmen and agricultural officials visited Kenya to discuss a swap of U.S. grain for Kenyan coffee, tea and organic insecticide. Similarly, a delegation from the U.S.S.R. suggested that the next Canadian-U.S.S.R. wheat agreement would have to be a countertrade arrangement.

CHAPTER 2

METHODOLOGY

SECONDARY SOURCES

An extensive survey of the available literature on CT was conducted in order to determine the type and frequency of such transactions by Canadian entities, and to determine the identities of the Canadian entities which have supposedly been active in CT.[1] In addition, the literature was reviewed in order to determine how exporters, traders and facilitators are structured to handle CT negotiations and carry-outs (including countertrand distributions); which countertrand has been received by Canadian entities, and where it generally has been distributed; how CT contracts are usually structured; the advantages of and the problems with CT; the reasons why specific exporters, traders and facilitators may not be active (or more active) in CT export transactions; the reasons why exporters and traders have terminated sales efforts that involved CT demands; the techniques that exporters and traders have used to avoid CT demands; the direction that CT will probably take in the future; and the public policy initiatives that have been used by other countries to facilitate CT transactions by its exporters and traders. As expected, the knowledge and insights thereby gained proved to be especially valuable in the preparation of both the mail questionnaires and the in-depth personal interview guide.

PRIMARY SOURCES

Preliminary personal/telephone interviews, a mail questionnaire survey, and in-depth personal interviews were used to collect the primary data analyzed in this study.

Preliminary Personal/Telephone Interviews

Since little secondary information appeared to be available on how many and which Canadian entities were involved in CT, the first task was to identify those entities that were so involved, and to obtain some broad preliminary information about product types, foreign countries and volumes involved. To this end, the principal investigator conducted a number of unstructured interviews with selected individuals from the Federal Government, two Provincial Governments, trade associations, Canadian- and U.S.-based banks, and major trading houses in Montreal, Toronto and New York (see Table 2.1 for greater details). The result was a more complete listing of Canadian involvement(s) in CT, and other information pertinent to this study.

Mail Survey

A mail survey was then used to gather information on the CT experiences of Canadian entities because it allowed the investigator to economically gather information on a large number of exporters and trading houses, which were widely dispersed in terms of their geographic locations. Furthermore, it

Table 2.1

Types of Entities Initially Interviewed and Their Geographic Locale

Types of Entities	Geographic Locale Canada	U.S.
Banks	3	2
Government departments		
Federal	2	1
Provincial	4	-
Other (trade associations, etc.)	2	1
Trading houses	2	2
Total	13	6

was the belief of the investigator that these entities would be less reluctant to divulge the required financial information if they were approached using an instrument which allowed them to remain anonymous.

The samples. Two samples were drawn; the first consisted of 275 Canadian exporters, the second consisted of 150 Canadian trading houses. The sample of Canadian exporters was primarily drawn from the following three sources: (1) "The Top 50 Exporters," and "Tops in their own field-agriculture," The Financial Post 500, Summer 1984, pp. 125 and 111, respectively; (2) List of Members, Canadian Export Association, 1983 and 1984 editions; and (3) Export Directory: Agriculture and Food Products, Ontario, Canada, undated.[2] Similarly, the sample of Canadian trading houses was primarily drawn from the following three sources: (1) List of Members, Canadian Export Association, 1983 and 1984 editions; (2) Countertrade Services Available in Canada, Canadian Export Association, undated; and (3) Directory of Canadian Trading Houses, DRIE, 1982 and 1984 editions.[3]

The questionnaires. Two nineteen-page questionnaires, somewhat similar in construction, were developed. The first was for the Canadian exporters; the second was for the Canadian trading houses. Each questionnaire was designed to elicit the information required to meet most of the specific objectives of this study, which were discussed in chapter 1.

Administration of the mail survey. After the pre-test, minor adjustments were made to the style and wording of each of the two questionnaires. During November and December, 1984, a questionnaire, accompanied by a covering letter, was mailed to each of the entities in the two samples being surveyed. From December 1984 through February 1985, reminder letters/telephone calls were sent/made to all non-respondents in order to increase the response rate. Also, during this period of time, many questionnaires had to be remailed to non-respondents for a variety of reasons. These included: the first questionnaire mailed had not been received or had been misplaced; the surveyed entity had changed its location and thus mailing address; and the specific individual to whom the questionnaire had initially been mailed to was no longer employed by the surveyed entity.

In-depth Personal Interviews

Since the analysis of the mail survey responses indicated that a number of issues required further investigation, the principal investigator then conducted a number of in-depth personal interviews.

The sample. The sample consisted of 52 (predominantly Canadian) entities which satisfied one or more of the following criteria: (1) The entity was identified as having been involved in a CT transaction based on its response to the mail questionnaire survey; (2) the entity had been identified in the literature as having been engaged in a CT transaction; (3) The entity had been identified by one or more of the interviewees, and confirmed by an employee of the entity, as having been engaged in a CT transaction;[4] and (4) The entity was required in order to ensure that the resultant sample adequately represented specific product sectors, entity sizes, entity lines-of-business (namely, exporting, trading, facilitating and other), and geographic locations.[5,6] The lines-of-business and the geographic locales of the 52 interviewed entities are summarized in Table 2.2. Of the 52 entities, 31 (20 exporters and 11 trading houses) had participated in at least one CT transaction. Of the 31 entities with actual CT experience, 14 were located in Ontario, 9 in Quebec, 6 in Western Canada, and 2 in the Maritimes.

The in-depth personal interview guide. The ten-page, in-depth, personal interview guide was prepared to elicit the additional information required to satisfy the specific objectives of this study (see chapter 1). The guide consisted of five sections. Section one was designed to obtain some general information on the interviewed entities, such as whether they had developed specialized expertise for pursuing CT opportunities and/or satisfying CT obligations. Section two was designed to obtain information on each entity's experiences with CT. Aspects studied included: (1) the extent of each entity's CT activity over the five-year period, 1980-84; (2) the export markets in which this CT activity occurred; and (3) the goods and services that were supplied by the traditional seller and offered as countertrand by the traditional buyer in these CT transactions. Section three was designed to study specific aspects of CT transactions. Aspects studied included: (1) the motivations of the respective parties (specifically, the traditional buyers and sellers) to the CT transactions; (2) the assessment of the viability of the countertrand offered by the traditional (foreign) buyer; (3) the pricing of the traditional (Canadian) seller's goods and services; (4) the risks encountered and their management from the traditional (Canadian) seller's perspective; (5) negotiations; (6) financing and financial difficulties; (7) disposal of the countertrand received by the traditional (Canadian) sellers; and (8) the extent to which domestic and foreign competitors of the traditional (Canadian) sellers have engaged in CT transactions. Section four was designed to obtain information on the level of CT involvement and capacity of various facilitator organizations, such as trading houses, financial institutions, governments, and other entities (e.g., importers, consultants, lawyers, etc.). Section five was designed to elicit additional information on the fees and CT risk-bearing behaviour of the interviewed trading houses.

Table 2.2

Some Characteristics of the Sample of Interviewed Entities

	CT Involvement		
Line of Business:	Actual Transaction(s)	Demand(s) Only	Total
Exporter	20	11	31
Trader	11	4	15
Facilitator	0	3	3
Other	0	3	3
Location of Entity:			
Maritimes	2	0	2
Quebec	9	3	12
Ontario	14	3	17
West	6	11	17
U.S.A.	0	4	4

The in-depth personal interview guide was pre-tested on three knowledgeable individuals. This pre-testing was designed to improve the construction of the questionnaire by identifying biased or ambiguous questions, and questions that potential interviewees were not likely to answer.

The interview process. The interview process proceeded somewhat as follows. First, the researcher contacted a senior officer (or his or her delegate) for each of the entities to be interviewed. Second, in order to ensure that each entity participated in the study, the researcher took three actions: (a) The researcher explained the purpose of the study to each potential participant and why it was in each participant's best interest to co-operate; (b) The researcher promised to give each interviewed entity a complementary summary of the study as soon as it was available; and (c) The researcher assured each of the potential interviewees that all responses would be treated confidentially and that the findings would be reported in such a manner that the identification of any individual entity would be impossible. Third, the in-depth personal interviews were scheduled and the principal investigator attempted to elicit the required responses from the interviewees.

Between July 1 and October 11, 1985, the researcher conducted all of the interviews with the spokespersons from the 52 entities.[7] The average duration of these interviews was 87 minutes, and their durations ranged from a low of 35 minutes to a high of 195 minutes.

CONCLUSION

In this chapter, the research methodology used in this study was described. In the next chapter, the findings from the mail questionnaire survey of Canadian exporters will be summarized and analyzed.

FOOTNOTES TO CHAPTER 2

[1] See the section, "References", for a listing of the literature which was reviewed by the researcher.

[2] All of the exporters who were listed as being members of the CEA were included in the sample.

[3] All of the trading houses who were listed as being members of the CEA were included in the sample.

[4] Unfortunately, during the subsequent interviews with these entities, it was obvious that four of these entities had never been involved in an actual CT transaction. CT transactions that were identified by one or more of the interviewees and denied by a spokesperson of the identified entity included two CT transactions between the Canadian Wheat Board and Algeria. The first CT transaction allegedly involved Algerian wines for Durham wheat and was for a total value of 75 million dollars, and the second allegedly involved a package of Canadian grains for Algerian crude oil which was sold by a European trading house in France.

[5] An additional ten entities (five trading houses and five exporters) were identified as having each been involved in a CT transaction. They were not included in the interview sample because no mutually convenient interview date, which was also cost effective, could be arranged with each of these entities. Nonetheless, seven of these ten entities had previously responded to the mail questionnaire, and one of the entities had previously been interviewed. These ten entities were geographically distributed as follows: 1 was situated in the Maritimes, 2 were situated in Quebec, 5 were situated in Ontario, and 2 were situated in the Western Provinces.

[6] As part of the sample selection process, most of the trading houses which had the designation, "Countertrade: yes", in the Directory of Canadian Trading Houses were contacted by telephone to determine if they had been involved in actual CT transactions. As expected, few had so been involved.

[7] One spokesperson was interviewed for 45 of the entities, and two or more spokespersons were interviewed for 7 of the entities. For those entities that did not have a specialized unit or department to deal with CT, the interviewed spokespersons generally were the presidents or the vice-presidents of those entities.

CHAPTER 3

MAIL SURVEY RESULTS: CANADIAN EXPORTERS

RESPONSE RATE

By May 1, 1985, 164 of the 275 surveyed exporters had returned partially or fully usable questionnaires, 15 exporters wrote that they could or would not participate in the survey, and 4 exporters indicated that they had returned a completed questionnaire. The two reasons given for not participating in the survey were: (1) the confidential nature of the data requested (especially, from the private companies), and (2) no experience and knowledge of CT and CT practices. The 164 returned questionnaires represented a response rate of 59.6 percent. The characteristics of the respondents are discussed in Appendix 3.1.

EXPORT EXPERIENCE

In their activities outside of Canada and the United States during the past five years, 2 (1.2 percent of the) firms have experienced the seizure of assets, 26 (15.9 percent of the) firms have experienced customer default of a signed contract, 30 (18.3 percent of the) firms have experienced significant depreciation in the financial value of their offshore business activities (exports, assets, etc.) due to currency fluctuations, 25 (15.2 percent of the) firms have experienced unexpected governmental activities which diminished the value and profitability of a foreign business venture, and 17 (10.4 percent of the) firms have had other experiences such as breach of contract (legal action pending), delay in return of demonstration equipment, collection/payment difficulties, non-tariff technical barriers and fluctuations of duty rates, and need for financial intervention by banks or risk insurers.[1] One respondent noted a "significant appreciation of revenues, as these are denominated in U.S. dollars while company's principal cost (salaries) are paid in Canadian dollars".

THE IMPORTANCE OF VARIOUS FACTORS TO A SUCCESSFUL EXPORT SALE

Based on the mean responses given in Table 3.1, competitive price (4.486), followed by attractive credit terms (3.631) and technological advantage (3.733), are the factors that may be important for a successful export sale.[2] Full or partial product payback via CT was not rated as being important (1.957). Other factors that were deemed to be important for an export sale by the respondents were: reliability, quality, on time delivery, credibility/reputation of supplier, availability of export permit, after-sales service/technical support, quality of local business partners, competitive freight/shipping costs, local presence and experience, and willingness to transfer technology. One respondent gave the following response: "graft--we don't do well in countries where graft is common". One respondent went on to note:

Table 3.1

Ratings of Factors That May be Important for a Successful Export Sale
Based on a Scale of 1 (Not at all Important) to 5 (Extremely Important)

Factor	Number of Responses: Not at all Important				Extremely Important	N*	Mean
(a) technological advantage	4	6	34	31	30	105	3.733
(b) import priority assigned to the product	9	10	31	28	20	98	3.408
(c) competitive price	0	1	12	30	68	111	4.486
(d) attractive credit terms	8	5	33	28	29	103	3.631
(e) full or partial product payback via CT	45	20	14	12	1	92	1.957

* "N" refers to the total number of responses.

> "Our company feels that trade is limited often by the various quota systems set up by countries, and that this is as much as anything else the cause of limited export potential. Where quotas are in effect, they are often owned by companies no longer involved in the trade and much time and cost is expended by genuine exporters in attempting to find the available quota in order for them to ship their products."

GENERAL EXPOSURE TO CT DEMANDS

The general exposure of the respondents to CT demands can be summarized as follows:

(1) 62 (37.8 percent of the) respondents have experienced CT demands, 53 (32.3 percent of the) respondents have not experienced CT demands, and 49 (29.9 percent of the) respondents did not respond to this question.

(2) 16 (9.8 percent of the) respondents have deliberately avoided countries that make CT demands, 94 (57.3 percent of the) respondents have not deliberately avoided such countries, and 54 (32.9 percent of the) respondents did not respond to this question.

(3) 21 (12.8 percent of the) respondents believe that they lost at least one contract because of their inability or unwillingness to engage in CT, 87

(53.0 percent of the) respondents believe that they have not lost any contracts because of their inability or unwillingness to engage in CT, and 56 (34.1 percent of the) respondents did not respond.

IN-HOUSE CT EXPERTISE

In-house expertise for negotiating CT export transactions and for satisfying CT obligations for the 164 respondents can be described as follows:

(1) 21 (12.8 percent of the) respondents have developed specialized in-house negotiating expertise for pursuing export opportunities involving CT, 87 (53.0 percent of the) respondents have not developed specialized in-house negotiating expertise, and 56 (34.1 percent of the) respondents did not respond to this question.

(2) 16 (9.8 percent of the) respondents have developed specialized in-house expertise for satisfying CT obligations, 92 (56.1 percent of the) respondents have not developed such expertise, and 56 (34.1 percent of the) respondents did not respond to this question.

BASIC ATTITUDE TOWARDS CT

The basic attitude of the respondents towards CT can be summarized as follows: 62 (37.8 percent of the) respondents enter into these forms of business activity as a last resort, 35 (21.3 percent of the) respondents consider it a time consuming and inefficient way to carry on international trade, 15 (9.1 percent of the) respondents consider it a normal way of conducting export business, and 34 (20.7 percent of the) respondents gave other responses such as "no experience due to no demand", "our type of business is not conducive to CT", "regarded as an option where it may improve our market position", "despite this attitude, we may in some cases offer it (unsolicited) if we think it's the only way to get the deal", "company is too small to consider CT", "considered when required by local legislation and considered when traditional financing not available", "potential for two profits", "as an exporter of a product which is basically a component of consumer goods, we have not been involved in CT, and would not consider it if suggested", "consider accommodation of offset-countertrade demands a way to gain competitive edge in certain export markets", "will consider purchase [of] specialized equipment if competitive in quality, design and price (i.e., will give preference if these conditions are met)", and "CT simply [is] not an element in our business dealings".[3]

PERCEIVED BENEFITS OF AND PROBLEMS WITH CT

The respondents were asked to rate a number of benefits of CT on a scale from 1 (not beneficial) to 5 (most beneficial). Their responses are summarized in Table 3.2. Based on the mean responses, the most beneficial benefit of CT is entry into otherwise closed markets (3.892), followed by maintenance of exports and employment when these are important to the firm and the exporting country (3.321).[4] Interestingly, the benefit, "can be an important

Table 3.2

Ratings of a Number of Perceived Benefits of CT
Based on a Scale from 1 (Not Beneficial) to 5 (Most Beneficial)

	Number of Responses						
Benefit	Not Beneficial				Most Beneficial	N	Mean
(a) the use of excess capacity to make a contribution toward fixed assets and total profit	20	18	18	13	5	74	2.527
(b) maintenance of exports and employment when these are important to the firm and the exporting country	9	10	23	19	17	78	3.321
(c) entry into otherwise closed markets	2	3	20	35	23	83	3.892
(d) gaining governmental goodwill (possibly leading to a privileged position in the future)	11	16	25	20	6	78	2.923
(e) can be an important factor in postponing licensing requests	29	18	15	8	0	70	2.029
(f) to take advantage of tax and tariff laws (by understating the "true" market value of goods/services)	36	18	10	4	1	69	1.783
(g) possible development of new supply sources	24	12	19	15	4	74	2.500

factor in postponing licensing requests", was perceived as being somewhat not beneficial (2.029). The respondents attributed other benefits to CT such as: "to demonstrate the flexibility and ability to deal, even if we don't expect the compensation requirement to stick", "we become final purchaser and thus control both transactions", "may be a stated requirement for buyer to get an import licence", and "improves freight rate by 2-way freight". Some respondents noted that there were no benefits to CT.

The respondents were also asked to rate a number of problems which are encountered with CT on a scale from 1 (not critical) to 5 (most critical). Their responses are summarized in Table 3.3.[5] Based on the mean responses,

Table 3.3

Ratings for a Number of Problems Encountered with CT
Based on a Scale from 1 (Not Critical) to 5 (Most Critical)

Problem	Number of Responses: Not Critical				Most Critical	N	Mean
(a) possibility of a lower return	4	7	22	27	13	73	3.521
(b) risks in handling unfamiliar goods	5	4	6	27	33	75	4.053
(c) possibly longer time before payment is received	3	5	15	29	22	74	3.838
(d) the possibility of conflict with the hard export markets	5	16	17	22	12	72	3.278
(e) long and complex negotiations with buying countries	1	4	11	31	30	77	4.104

the most critical problems encountered with CT are long and complex negotiations with buying countries (4.104), followed by risks in handling unfamiliar goods (4.053) and possibly longer time before payment is received (3.838). The respondents encountered other problems with CT such as: "negotiations with the intermediary (since we don't take the risk)", "continuous negotiations--a signed contract is the beginning", "impact on friendly customers", "conflict with domestic customers", and "cost of assigning CT obligations".

GENERAL INVOLVEMENT/NON-INVOLVEMENT IN CT EXPORT TRANSACTIONS

Eleven (6.7 percent of the) respondents have been involved in CT export transactions on a continuing basis, 149 (90.9 percent of the) respondents have not been so involved, and 4 (2.4 percent of the) respondents did not respond. The reasons for not being involved in CT export transactions on a continuing basis included: 68 (41.5 percent of the) respondents noted a lack of demand, 37 (22.6 percent of the) respondents noted a limited capacity to undertake CT transactions, 15 (9.1 percent of the) respondents noted that CT transactions were too risky, 27 (16.5 percent of the) respondents noted that CT transactions offered insufficient reward to compensate for the added risks involved, and 21 (12.8 percent of the) respondents offered other reasons such as "the frequency is much exaggerated, clients often 'try it on' without serious intent of requiring it", "relatively new exporter", "inability to get government backed insurance on CT based contracts", "unable to agree on items for CT", "we avoid CT through 'laying off' CT demands on experienced traders in CT", and "inexperience at field level, expertise is at head office".[6]

Reasons for Terminating Sales Efforts That Involved CT Demands

Important reasons given for terminating sales efforts that had involved CT demands were as follows: 26 (15.9 percent of the) respondents stated that other export outlets were more attractive, 22 (13.4 percent of the) respondents stated that they had no commitment to CT, 19 (11.6 percent of the) respondents stated that goods offered for CT were perceived as being difficult to market in sophisticated western consumer markets, 20 (12.2 percent of the) respondents stated that it was too costly and time consuming to carry out an effective marketing strategy, 18 (11.0 percent of the) respondents stated that they lacked manpower to pursue such export opportunities, 12 (7.3 percent of the) respondents stated that goods offered for CT were of poor quality, 10 (6.1 percent of the) respondents stated that competitors were offering a price which could not be matched, 8 (4.9 percent of the) respondents stated that the goods offered for CT were of non-competitive price, and 6 (3.7 percent of the) respondents gave other reasons such as "nature of product does not permit us to do CT", and "Canadian partner not ready to implement project".[7] Most of the respondents gave other reasons such as: "have not terminated sales efforts that involve CT; in fact, encourage this avenue", "did not terminate any sales efforts for CT reasons per se", and "have not terminated any efforts; we don't like CT but to have a small competitive advantage in this area".

Strategies Utilized to Avoid CT Demands

Strategies utilized by the respondents to avoid CT demands include: 27 (16.5 percent of the) respondents use financing, 21 (12.8 percent of the) respondents negotiate on a "best-efforts" basis rather than accept a commitment, 18 (11.0 percent of the) respondents use technology transfer and training, 10 (6.1 percent of the) respondents substitute third-country cooperation prospects, 12 (7.3 percent of the) respondents ask foreign parent/partner to handle CT obligations either for its own use or resale, 12 (7.3 percent of the) respondents persuade the other party to the transaction to forgive the CT obligation, 12 (7.3 percent of the) respondents reduce price in lieu of CT obligations, 4 (2.4 percent of the) respondents pay a penalty rather than discharge CT obligations, 4 (2.4 percent of the) respondents use an extension of performance guarantees, 3 (1.8 percent of the) respondents use an extension of the period over which firm prices are guaranteed for spares, and 12 (7.3 percent of the) respondents also use other means to avoid CT demands.[8] These other means include: "use traders", "pass commitment to buy directly to end user", "3rd party risk for a fee", and "put client in touch with potential buyer of his products". One respondent noted that he had: "demanded cash only! Have a 'world-class' product not obtainable elsewhere!".

Types of CT Involvements

With regard to the forms of CT obligations their firms have signed contracts for, 4 (2.4 percent of the) respondents have engaged in barter transactions, 16 (9.8 percent of the) respondents have engaged in countertrade (parallel deal) arrangements, 13 (7.9 percent of the) respondents have engaged in compensation trade (buy-back) arrangements, 5 (3.0 percent of the) respondents have engaged in swap arrangements, 2 (1.2 percent of the) respondents have engaged in switch arrangements, and 11 (6.7 percent of the) respondents have engaged in other arrangements.[9] Other arrangements included offsets, foreign industry participations, third-country co-operations, trade enhancement agreements, royalty arrangement for a grain in a Socialist country, and "have agreed to purchase some equipment in equity holders' countries if suitable and competitive".

EXPORT PROSPECTS IN SPECIFIC MARKETS AND THE WILLINGNESS TO ENGAGE IN CT

The respondents were asked to rank the importance to their firms' export prospects in specific geographic markets of being willing to engage in CT. Their responses, based on a scale of 1 (not important) to 5 (most important), are summarized in Table 3.4.[10] Based on the mean responses, the willingness to accept CT is somewhat important in Eastern Europe (including the U.S.S.R.), and somewhat less important in Asia. Interestingly, ten percent or more of the respondents to this question considered a willingness to accept CT as being "very" or "most" important in all but two non-U.S. export markets; namely, Western Europe, and Australia & New Zealand. These responses seem to be reasonably congruent with both the global and regional importance of CT.

EXPERIENCE WITH ACTUAL CT EXPORT TRANSACTIONS

Before proceeding, it should be emphasized that only respondents who had been involved in at least one actual CT transaction were asked to respond to the questions upon which this section of the study is based.[11]

Frequency and Value

A number of respondents were reluctant and(or) unable to supply statistical data on their actual CT export transactions. The two primary reasons were: first, such information is deemed to be confidential, and second, most firms do not have an internal information system which can readily generate such information. Nevertheless, based on the information provided (by 11 respondents) and summarized in Table 3.5, it is evident that aggregate CT activity has increased markedly over the five-year period, 1980-1984. Specifically, the number of firms engaged in at least one CT transaction on an annual basis has increased from 1 to 6, the number of annual CT transactions has increased from 1 to 27, and the total annual value of CT export transactions has increased from 5.0 to 143.0 million dollars. (This does not include one respondent's offset obligation of 165.0 million dollars over the four-year period, 1982-1986.)

Motivation

The 20 respondents to this question provided the following rationales for their becoming involved in CT transactions: all 20 respondents stated a desire to make sales; 2 respondents stated a desire to "clean up" a bad debt situation; and 6 respondents stated a desire to build customer relationships.

Table 3.4

Rating of the Importance to Individual Firm Export Prospects of Being Willing to Engage in CT in a Number of Specific Geographic Markets Based on a Scale from 1 (Not Important) to 5 (Most Important)

	Number of Responses						
	Level of Importance						
Geographic Market	Not	Less	Important	Very	Most	N	Mean
(a) United States and Mexico	52	8	12	4	7	83	1.867
(b) Latin America and the Caribbean	30	22	22	6	6	86	2.256
(c) Western Europe	54	13	8	2	2	79	1.544
(d) Eastern Europe (including U.S.S.R.)	20	14	15	13	14	76	2.829
(e) Africa and the Middle East	30	19	20	10	5	84	2.298
(f) Asia	32	9	19	18	6	84	2.488
(g) Australia and New Zealand	59	8	6	3	2	78	1.474

Interestingly, no respondents became involved in order to find a lower-cost source of procurement.

The 18 respondents to this question provided the following rationales for why the other party became involved in the CT transactions: 10 respondents attributed such involvements to short-term liquidity problems; 3 respondents attributed such involvements to a desire for breaking into a previously inaccessible market; 3 respondents attributed such involvements to a form of hidden discounting; 5 respondents attributed such involvements to the need to disguise a government-sponsored austerity program; and 8 respondents attributed such involvements to other reasons. These included "shortage of hard currency", "to preserve hard currency", "to be self-financing", and "to improve its balance of trade".

Applicable Export Markets

The respondents committed to the CT transactions in the following geographic markets: Latin America and the Caribbean for 5 respondents; Africa and the Middle East for 3 respondents; Western Europe for 5 respondents; Africa and the Middle East for 3 respondents; Western Europe for 5 respondents; Eastern Europe (including the U.S.S.R.) for 11 respondents; Asia for 4 respondents; the U.S. & Mexico[12], Australia & New Zealand, and other markets (India) for 1 respondent each.

Table 3.5

Aggregate Export Transactions Involving CT for Each of the Years, 1980-1984

Transactions	Year 1980	1981	1982	1983	1984 est.
(a) Number	1**	6	12	14	27
(n*)	(1)	(2)	(3)	(4)	(7)
(b) Total Value ($ millions)	5.0	2.3	25.2	100.4	143.0
(c) Number of Firms with Total Value:					
Less than $10 million	1	1	2	1	1
$10 million to less than $25 million	0	0	1	2	2
$25 million and over	0	0	0	2	3
(d) CT as % of Total Transaction Value					
Low	-	10	5	5	40
High	-	10	30	80	100
(e) Number "bought out" (penalty clause used)	0	0	0	0	0

* "n" refers to the number of firms that reported on this measure.

** At least one. One respondent gave the total value but not the number of CT transactions that it had been involved in during 1980.

The Goods and Services Involved

The goods and services supplied by the 19 respondents to this question, as traditional sellers in the CT transactions, were as follows: 1 respondent supplied unprocessed natural resources; 2 respondents supplied semi- or processed natural resources; 8 respondents supplied intermediate industrial goods; 0 respondents supplied consumer goods; 4 respondents supplied services such as manufacturing process equipment, telecommunications, and engineering/procurement/construction; and 8 respondents supplied other goods and services such as transportation product, industrial goods/apparatus/machinery, and capital goods/investment projects.

The goods and services received as countertrand by the 18 respondents to this question were as follows: 6 respondents received unprocessed natural resources; 9 respondents received semi- or processed natural resources; 4 respondents received intermediate industrial goods; 7 respondents received final industrial goods; 4 respondents received consumer goods; 2 respondents received services such as engineering, and manufacturing components for own use; and 4 respondents received other goods and services such as agricultural products. Two of these 4 respondents answered "switched rupies to U.S. dollars through third party" and "unknown, handled by countertrade house".

The 16 responses to the question, "How did your firm assess the value of the commodities/goods/etc. offered for CT?", were as follows: Western or world market prices (5 responses); competitive quotations or bids from others (2 responses); "fair market value and must meet quality criteria"; actual sales value; open market; ability to market commodity; through a third party such as a trading or countertrade company (3 responses); "prearranged marketing agreement with a trading house"; and "goods in question are currently available in Canada".

The 16 responses to the question, "How did your firm reflect the costs and risks of the CT obligations into the final price that it quoted for the original export sale?", were as follows: "cost plus 5 percent", "added a proportion of the CT obligation to the price (approx. 15%)", "simply a percentage, i.e., 5 percent plus small contingency", "3% price adder", "slightly higher margin", "included them", "by adding the trader's fee", "the cost of CT obligations plus a margin for negotiations are added to the price quoted", "by pricing in penalties", "available in normal profit margin", "pre-determined quotation from countertrade house", "on advice from a CT outfit", "back to back letters of credit--no risk", "not done--didn't buy for own account", "do not assume risk of not selling exchanged commodities", and "none, the two transactions are separately priced".

Criteria Used for Choosing Countertrand

Since exporters must either use or re-sell the countertrand, the choice of what to take is important. In making such decisions, 4 of the 17 respondents selected semi-finished products or raw materials which could readily be used in their own production processes; 3 respondents selected finished goods which were compatible and complementary to their existing product line and thus could be marketed as such; 11 respondents selected products which had to be independently marketed and(or) transferred to a third party for subsequent sale; and 4 respondents provided other responses. These included: "selected equipment used in our firm", "assigned CT obligations to a trader", and "unknown, handled by a countertrade house".

Employment of In-house CT Specialists

Seven of the respondents employ in-house CT specialists. The duties of these specialists were as follows: 4 respondents use in-house CT specialists to determine whether or not the CT costs will offset the profits derived from the firm's sales in export markets; 6 respondents use in-house CT specialists to locate outside buyers (i.e., trading houses) for products that can not be used internally; 5 respondents use in-house CT specialists to assist in identifying financial institutions that provide credit for CT transactions; and 1 respondent uses in-house CT specialists to "help cope with the obligation after the fact".

Locale of Countertrand Payment Distribution

The countertrand was distributed in Canada by 9 of the 15 respondents, or their agents; in the United States by 6 respondents, or their agents; and in other markets by 9 of the respondents, or their agents. These "other markets" included "Western & Eastern Europe", "world-wide", "Far East, Middle East &

Europe", "self use", "incorporated in basic products for sale to all markets", "assigned to trader", and "handled by countertrade house".

Method of Distribution

The countertrand was marketed by the regular staff of 2 of the 13 respondents to this question; by the specialized personnel or associated separate corporate entity/department for 4 respondents; by an external Canadian body (such as Phibro, other trading houses and distributors) for 3 respondents; and by an external international entity (such as previously-identified customers, normal trade and countertrade houses) for 4 respondents. Of the three respondents who disclosed the average fee paid to the external body, two respondents paid an average fee of 5 percent, and one respondent paid an average fee of 25 percent.

Net Price of CT and Non-CT Export Transactions

Of the 12 respondents to this question, only 5 respondents felt that the final net prices to their firms for the CT transactions were significantly different from those derived from their typical export transactions that involved cash. Two of the respondents felt that the final net CT prices were lower (discounted) on average by 8 and 10 percent, respectively; and three respondents felt that the final net CT prices were higher (marked-up) on average by 3, 15 and 25 percent, respectively.

Effective Timing of the Cash Payments from CT and Non-CT Export Transactions

Of the 15 respondents to this question, only 5 respondents felt that the effective timings of their firm's (cash) payment receipts for their CT transactions were different from their typical export transactions that involved cash. One respondent felt that they were shorter by less than six months, one respondent felt that they were longer by less than six months, and three respondents felt that they were longer by more than six months. One of these latter respondents noted that it was "longer by more than six months in the sense that the offset program is for a period of 4 years". The diversity of these responses is due primarily to the different cash payment patterns of the different types of CT transactions.

Contractual Clauses

Of the 13 respondents to the question on the contractual clauses contained in their CT commitment contracts, five firms had a transfer clause, 3 firms had a linkage clause, 3 firms had a credit clause, 2 firms had a cancellation clause, and nine firms had a non-fulfillment clause.

Post-implementation Problems

Eleven firms responded to the question dealing with post-implementation problems. Two respondents had experienced problems with pricing; 4 respondents had experienced problems with identifying appropriate products; 7 respondents had experienced problems with marketing countertrand, and 2 respondents had experienced other problems such as the need for co-operation with foreign exporters, and the need for constant supervision to ensure success.

How the Foreign Parties Honoured Their Countertrade Commitments

Seven respondents rated how the foreign participants to the CT transactions fulfilled their commitments on a scale from 1 (very unsatisfactory) to 5 (very satisfactory). Their ratings are summarized in Table 3.6. Based on the mean responses, the respondents found that the commitments in terms of product quality and of delivery dates, were honoured slightly more satisfactory than unsatisfactory. One respondent stated that "quality, price and delivery are prerequisites, otherwise CT goods are rejected".

PUBLIC POLICY CHANGES/INITIATIVES

The Desirability of Implementing Various Institutional Approaches for Dealing with CT in Canada

A number of Western countries have encouraged the establishment of private-sector, non-profit organizations to deal with countertrade matters. The respondents' ratings of the desirability of implementing four such institutional approaches in Canada on a scale from 1 (strongly disapprove) to 5 (strongly approve) are summarized in Table 3.7. Based on the mean responses, the respondents marginally approved of approaches (b) and (c), and marginally disapproved of approaches (a) and (d). Some specific comments advanced by the respondents were:

> "All these solutions are good if properly managed."
>
> "Any would be great boom to exports."
>
> "I still believe that there is a role for trading houses in this type of activity related to Canada. However, the Mitsui, Mitsubuishi, etc., are more interested in Japanese-Canada trade rather than a more global approach of countertrade and other forms of trade into Canada from many sources not just Japan."
>
> "Current established trading houses are sufficient."
>
> "I feel that the seller should consult a countertrade expert in Switzerland, Hong Kong, Singapore, etc. and work out his own problems and not rely on government assistance."

Table 3.6

Rating of How the Foreign Participants to the CT Transactions Honoured Various Aspects of the CT Transactions
Based on a Scale of 1 (Very Unsatisfactory) to 5 (Very Satisfactory)

	Number of Responses						
Aspect	Very Unsatisfactory			Very Satisfactory		N	Mean
(a) Product quality	0	2	2	3	0	7	3.143
(b) Delivery dates	0	1	3	3	0	7	3.286

Establishment of a Non-profit, Private-sector Association

Based on the 82 completed responses, 52 (61.9 percent of the) respondents felt that Canada's capacity to handle CT transactions would be greatly enhanced if a private-sector, non-profit organization was established to advise member firms in negotiating CT demands, and 32 (38.1 percent of the) respondents felt that Canada's capacity would not be greatly enhanced by the establishment of such an organization. Based on the 88 completed responses, 60 (68.2 percent of the) respondents felt that Canada's capacity to handle CT transactions would be greatly enhanced if a private-sector, non-profit organization was established to select appropriate Canadian or offshore trading houses to assist in closing a CT transaction, and 28 (31.8 percent of the) respondents felt that Canada's capacity would not be greatly enhanced by the establishment of such an organization. Some specific comments advanced by the respondents were:

> "We don't need such help. Can it speak for others."

> "We now have the CEA."

> "There are already many trading houses equipped to handle CT. 'Non-profit' involves government intervention. That is not the answer."

> "Our experience is based on one project which involved CT with Indonesia. However, we were unsuccessful competitively in obtaining a contract. We did find great difficulty in obtaining advice on how to proceed with our CT offer at that time."

Based on the 81 completed responses, 34 (42.0 percent of the) respondents felt that the source of funds for the establishment of such a private-sector, non-profit association should only come from the private sector, 6 (7.4 percent of the) respondents felt that it should only come from the public sector, and 41 (50.6 percent of the) respondents felt that it should come from both the private and public sectors.

Table 3.7

Rating of the Desirability of Implementing Four Institutional Approaches for Dealing with Countertrade in a Canadian Context Based on a Scale of 1 (Strongly Disapprove) to 5 (Strongly Approve)

Approach	Number of Responses						
	Strongly Disapprove	Disapprove	Neutral	Approve	Strongly Approve	N	Mean
(a) government sponsorship of an information centre on CT, as in the United Kingdom	13	23	23	22	7	88	2.852
(b) creation of a private, non-profit association specializing in coordination of the activities of private-sector exporters with established trading houses, as in France	7	14	20	37	12	90	3.367
(c) creation of a private non-profit association with the power to transact countertrade business and which, in addition, offers advisory services, as in Austria, Sweden & Finland	9	18	20	26	16	89	3.247
(d) creation of a private/public association with the power to transact CT business	18	21	21	11	17	88	2.864

Based on the 99 completed responses, only 19 (19.2 percent of the) respondents stated that they would seriously evaluate an equity investment in such a private-sector, non-profit organization; 5 (3.1 percent of the) respondents stated that they might seriously evaluate such an equity investment; and 75 (75.8 percent of the) respondents stated that they would not seriously evaluate such an equity investment. Specific comments for not seriously evaluating such an equity investment are summarized in Table 3.8.

Table 3.8

Some of the Reasons Given for Not Seriously Evaluating an Equity Investment in a Private-Sector, Non-Profit Organization Dealing with CT

"Not of significant value to our company. Not in line with our goals and strategies. We have other more pressing needs internally for capital!"

"Inefficient use of funds."

"Not involved in CT and not interested in becoming involved."

"Very little expected benefits to our firm."

"Currently our export business is insufficient to justify the costs."

"Crown corps. not empowered to take equity in private company."

"There are an adequate number of CT firms available to help Cdn. companies."

"Little interest. Opportunities virtually nil. Return relatively poor."

"It need not be restricted to no profit and thus could be self-supporting."

"Volume insufficient and ample business services in CT area."

"Not related at all to our business."

"Have corporate capacity. May make financial contribution."

"Do not, at this stage, see benefit to us."

"Yes or no depending on our estimation of their capability as proposed compared to private companies already doing CT as a service."

"Would prefer an organization that would operate on a fee for service basis."

"Inadequate usage--no return on investment."

"We do not make equity investments as a matter of policy."

"We have specialists handling CT demands and with the expertise to approach trading houses. If we were to invest in a trading corporation, it would be with a profit objective."

"We do not see a need for CT in our export program. We sell 40% of our total production to the U.S.A."

"Because [government leader] screwed up our domestic market. Doubtful we'll survive much longer to pursue exports."

Table 3.8 (Cont'd)

"It would represent too small a contribution to our total business to be worthwhile."

"We are not prepared for that kind of investment."

"We don't need such an organization. Users of the organization should set this up!"

"Because of the nature of our products we would not face many (if any) demands for CT, and would thus not need such a service ourselves."

"Private business and banking are perfectly capable of making their own countertrade arrangements."

"All our export marketing is done by the [federal agency] in Ottawa."

"We have our own CT operations."

"We have sufficient in-house expertise available."

"We are not in a position due to our size and the nature of our product and services to be able to avail ourselves of the services of such an organization."

"We believe that the service can be adequately handled without the non-profit requirement, i.e., Phibro, MGS, etc."

"Meat is a "spot" commodity. Don't think it would assist in placing meat in export markets (although this should be studied)."

"It has been our experience that a private-sector, non-profit organization is not a good vehicle to sell abroad."

"Revenue should be derived on a per transaction basis for services rendered."

The Government's Role in CT Export Transactions

Based on the 103 respondents that answered at least one question on public policy changes/initiatives, 60 (58.3 percent of the) respondents agreed that it would be unacceptable for an agency or corporation of the Government to bring products into the Canadian market which would compete with those produced domestically; 62 (60.2 percent of the) respondents agreed that it would be inconceivable for the Government to import goods which may be in competition with products from Canadian firms receiving assistance from Government to increase exports; and 73 (70.9 percent of the) respondents agreed that Government and government organizations do not possess sufficient product knowledge, nor do they have sufficient contacts in a particular

Table 3.9

Canadian Exports Subjected to Increased CT Demands During the Next Five Years and Goods and Services Which will be Increasingly Offered as Countertrand by Traditional Foreign Buyers Over the Next Five-Year Period

Goods and Services	Subjected to	Offered as
(a) agricultural goods and services	31	38
(b) raw materials	20	37
(c) end products	21	31
(d) high tech manufactured goods	35	9
(e) other manufactured goods	35	23
(f) capital projects	45	5
(g) services	26	10
(h) other (defence industry)	1	0

industry sector to successfully dispose of the imported products accepted as part of CT transactions.

FUTURE CT TRENDS

The surveyed firms were asked which Canadian exports would be subjected to increased CT demands during the next five years, and which goods and services would be increasingly offered as countertrand by traditional foreign buyers over the next five-year period. Their responses are tabulated in Table 3.9. For Canadian exports which would be subjected to increased CT demands during the next five years, the greatest number of responses were received for capital projects, followed by high tech and other manufactured goods. For goods and services which would be increasingly offered as countertrand by traditional foreign buyers over the next five years, the greatest number of responses were received for agricultural goods and services, followed by raw materials.

CONCLUSION

In this chapter, the findings from the mail questionnaire survey of Canadian exporters have been summarized and analyzed. In the next chapter, the findings from the mail questionnaire survey of Canadian trading houses will be summarized and analyzed.

FOOTNOTES TO CHAPTER 3

[1] There were 70 respondents that reported one or more of these experiences.

[2] There were 113 respondents to one or more parts of this question.

[3] There were 109 respondents to this question.

[4] There were 84 respondents to this question.

[5] There were 79 respondents to this question.

[6] There were 104 respondents to this question.

[7] There were 64 respondents to this question.

[8] There were 65 respondents to this question.

[9] There were 36 respondents to this question. Some of these respondents had not signed contracts during the past five-year period.

[10] There were 92 respondents to this question.

[11] There were 20 respondents to this set of questions.

[12] There were 17 respondents to this question.

APPENDIX 3.1

CHARACTERISTICS OF THE RESPONDENTS TO THE SURVEY OF CANADIAN EXPORTERS

The characteristics of the respondents can be summarized as follows:

(1) With regard to total sales volume in Canadian dollars for 1983 (1982 and 1984 for 2 and 6 respondents, respectively),[1] 38 (23.2 percent of the) firms had sales of less than 25 million dollars, 24 (14.6 percent of the) firms had sales of 25 to 99 million dollars, 15 (9.1 percent of the) firms had sales of 100 to 249 million dollars, 13 (7.9 percent of the) firms had sales of 250 to 500 million dollars, 25 (15.2 percent of the) firms had sales of more than 500 million dollars, and 49 (29.9 percent of the) firms did not disclose their sales volume.

(2) With regard to their primary type(s) of business activities, 12 (7.3 percent of the) firms were engaged in natural resource extraction; 28 (17.1 percent of the) firms were engaged in the production of intermediate industrial goods; 51 (31.1 percent of the) firms were engaged in the production of final industrial goods; 33 (20.1 percent of the) firms were engaged in the production of consumer goods; 1 (0.6 percent) firm was engaged in the retailing of consumer goods; 49 (29.9 percent of the) firms were engaged in the provision of a service such as engineering consulting, commercial aviation services, ship repair, procurement, construction, and seed brokerage; and 28 (17.1 percent of the) firms were engaged in "other" activities such as wholesale grocery distribution, construction, distilled spirits, electricity generation and transmission, livestock export and sales, and marketing white pea beans.[2]

(3) With regard to the ownership of their Canadian-based operations, 28 (17.1 percent of the) firms were widely held by a majority of Canadian interests; 10 (6.1 percent of the) firms were widely held by a majority of non-Canadian interests; 44 (26.8 percent of the) firms were controlled by a limited number of Canadian interests; 17 (10.4 percent of the) firms were controlled by a limited number of non-Canadian interests; 17 (10.4 percent of the) firms gave "other" ownership structures such as Crown corporation, wholly-owned subsidiary of non-Canadian parent company, entirely owned by company employees (all Canadian citizens), corporation without share capital, subsidiary of large Canadian company, and owned by [large number] producers; and 48 (29.3 percent of the) respondents did not respond.

(4) With regard to the percentage of total Canadian sales volume generated in countries outside of Canada and the United States, 24 (14.6 percent of the) respondents had percentages that were less than 5 percent, 14 (8.5 percent of the) respondents had percentages of 5 to 9 percent, 17 (10.4 percent of the) respondents had percentages of 10 to 19 percent, 17 (10.4 percent of the) respondents had percentages of 20 to 29 percent, 24 (14.6 percent of the) respondents had percentages of 30 to 49 percent, 26 (15.9 percent of the) respondents had percentages of 50 percent or greater, and 42 (25.6 percent of the) respondents did not respond to this question.

(5) With regard to the percentages of the firms' total assets which were located in countries outside of Canada and the United States at the end of 1983, the percentages were less than 5 percent for 97 (59.1 percent of the) respondents, 5 percent or greater for 18 (11.0 percent of the) respondents, and not disclosed for 49 (29.9 percent of the) respondents. Thus, 84.3 percent of the firms that responded to this question had total assets of less than 5 percent located in countries outside of Canada and the United States.

(6) During the past three years, 101 (61.6 percent of the) respondents exported to the United States and Mexico, 78 (47.6 percent of the) respondents exported to Latin America and the Caribbean, 75 (45.7 percent of the) respondents exported to Africa and the Middle East, 71 (43.3 percent of the) respondents exported to Western Europe, 27 (16.5 percent of the) respondents exported to Eastern Europe (including the U.S.S.R.), 80 (48.8 percent of the) respondents exported to Asia, 46 (28.0 percent of the) respondents exported to Australia and New Zealand, and 11 (6.7 percent of the) respondents exported to other geographic areas such as S.E. Asia and Pacific, Japan and Pacific Rim countries, and St. Pierre and Miquelon.[3]

(7) With regard to the types of foreign (i.e., non-Canadian and non-American) business activities that these firms have been engaged in, 10 (6.1 percent of the) firms have been engaged in equity investments; 90 (54.9 percent of the) firms have been engaged in the export of goods; 41 (25.0 percent of the) firms have been engaged in the provision of services such as consultancy (engineering, etc.), installation, construction and related sevices, support of exported goods (maintenance, etc.), training and support, research, and management contracts; 18 (11.0 percent of the) firms have been engaged in the provision of turnkey projects; 19 (11.6 percent of the) firms have been engaged in the provision of project management; and 9 (5.5 percent of the) firms have been engaged in other activities such as technology transfers, licensing sales, and export of electrical power.[4]

FOOTNOTES TO APPENDIX 3.1

[1] The firms were advised not to include the sales (primary types of business activities, etc.) of their parent companies if they were Canadian subsidiaries/affiliates of foreign multinationals/entities.

[2] There were 115 respondents to this question.

[3] There were 114 respondents to this question.

[4] There were 113 respondents to this question.

CHAPTER 4

MAIL SURVEY RESULTS: CANADIAN TRADING HOUSES

RESPONSE RATE

By May 1, 1985, 67 of the 150 surveyed trading houses had returned partially or fully usable questionnaires, 7 trading houses wrote that they could or would not participate in the survey, 2 trading houses indicated that they had returned a completed questionnaire, and 1 trading house requested to be paid to complete the questionnaire. As was the case for the exporters, the two reasons given for not participating in the survey were: (1) the confidential nature of the data requested (especially, from the private companies), and (2) no experience and knowledge of CT and CT practices. The 67 returned questionnaires represented a response rate of 44.7 percent. The characteristics of the respondents are discussed in Appendix 4.1.

TRADING EXPERIENCE

In their trading activities outside of Canada and the United States during the past five years, 2 (3.0 percent of the) trading houses have experienced the seizure of assets, 17 (25.4 percent of the) trading houses have experienced customer default of a signed contract, 10 (14.9 percent of the) trading houses have experienced significant depreciation in the financial value of their offshore business activities (exports, assets, etc.) due to currency fluctuations, 20 (29.9 percent of the) trading houses have experienced unexpected governmental activities which diminished the value and profitability of foreign business transactions, and 7 (10.4 percent of the) trading houses have had "other" experiences such as "government agencies and their suppliers eliminating us as exporters and(or) suppliers", late payment, Iran-Iraq war, and "as numerous as the imagination can develop".[1]

THE IMPORTANCE OF VARIOUS FACTORS TO A SUCCESSFUL EXPORT SALE

Based on the mean responses given in Table 4.1, competitive price (4.640), followed by attractive credit terms (3.978) and technological advantage (3.500), are the factors that may be important for a successful export sale.[2] Full or partial product payback via CT was not rated as being important (2.342). Interestingly, both the ordering of the factors and their mean responses are similar to those presented in the previous chapter for the Canadian exporters. Other factors that were deemed to be important for an export sale by the respondents were: currency fluctuations; personal contact (5 responses); trust (2 responses); credibility of trading partners (2 responses); maintained presence on a given market by continued supplies (2 responses); smooth and prompt execution of trades (both buying and selling); quality (4 responses); service (3 responses); meeting delivery dates (2 responses); meeting specifications; reliable record; tenacity and patience; supplier support and education; agents locally; shipping service and costs (2 responses); protection of the trading company from the manufacturer going direct; feasibility study; compliance to customer requirements; and dependability of delivery.

Table 4.1

Ratings of Factors That May be Important for a Successful Export Sale
Based on a Scale of 1 (Not at all Important) to 5 (Extremely Important)

Factor	Number of Responses: Not at all Important				Extremely Important	N*	Mean
(a) technological advantage	2	7	10	14	9	42	3.500
(b) import priority assigned to the product	4	8	12	7	11	42	3.310
(c) competitive price	0	0	4	10	36	50	4.640
(d) attractive credit terms	1	1	12	16	16	46	3.978
(e) full or partial product payback via CT	15	7	8	4	4	38	2.342

* "N" refers to the total number of responses.

GENERAL EXPOSURE TO CT DEMANDS

The general exposure of the respondents to CT demands can be summarized as follows:

(1) 17 (25.4 percent of the) respondents have dealt with Canadian clients who have experienced CT demands, 31 (46.3 percent of the) respondents have not dealt with Canadian clients who have experienced CT demands, and 19 (28.4 percent of the) respondents did not respond to this question.

(2) 4 (6.0 percent of the) respondents have deliberately avoided countries that make CT demands, 44 (65.7 percent of the) respondents have not deliberately avoided such countries, and 19 (28.4 percent of the) respondents did not respond to this question.

(3) 12 (17.9 percent of the) respondents have at least one Canadian client who lost a contract because of the inability or unwillingness to engage in CT, 36 (53.7 percent of the) respondents do not have at least one Canadian client who lost a contract because of the inability or unwillingness to engage in CT, and 19 (28.4 percent of the) respondents did not respond to this question.

IN-HOUSE CT EXPERTISE

In-house expertise for negotiating CT export transactions and for satisfying CT obligations for the 67 respondents can be described as follows:

(1) 14 (20.9 percent of the) respondents have developed specialized in-house negotiating expertise for pursuing export opportunities involving CT, 34 (50.7 percent of the) respondents have not developed such expertise, and 19 (28.4 percent of the) respondents did not respond to this question.

(2) 17 (25.4 percent of the) respondents have developed specialized in-house expertise for satisfying CT obligations, 30 (44.8 percent of the) respondents have not developed such expertise, and 20 (29.9 percent of the) respondents did not respond to this question.

Not unexpectedly, the proportion of Canadian trading houses with specialized expertise for negotiating (and satisfying) CT obligations is substantially higher than the proportion of Canadian exporters with such specialized expertise (see previous chapter).

BASIC ATTITUDE TOWARDS CT

The basic attitude of the respondents towards CT can be summarized as follows: 24 (35.8 percent of the) respondents enter into these forms of business activity as a last resort, 19 (28.4 percent of the) respondents consider CT a time consuming and inefficient way to carry on international trade, 11 (16.4 percent of the) respondents consider it a normal way of conducting export business, and 11 (16.4 percent of the) respondents gave other responses such as: "it is here to stay--we must and will participate", "tool of Eastern Europe and some oil producing states"; "becoming normal in some markets--definitely time consuming and tricky!"; "unable to respond quick enough"; and "if need seen may study the possibilities".[3]

PERCEIVED BENEFITS OF AND PROBLEMS WITH CT

The respondents were asked to rate a number of benefits of CT on a scale from 1 (not beneficial) to 5 (most beneficial). Their responses are summarized in Table 4.2. Based on the mean responses, the most beneficial benefit of CT is entry into otherwise closed markets (4.051), followed by maintenance of exports and employment when these are important to the firm and the exporting country (3.556).[4] Interestingly, the benefit, can be an important factor in postponing licensing requests, was perceived as being somewhat not beneficial (2.700). The respondents attributed other benefits to CT such as: "disposal of a product not easily sellable against a product a little easier to sell"; and "general expansion of business (volume, contracts, etc.)". One respondent replied: "As business people, we look at business opportunity only as a profitable enterprise. We are not in politics or crime. We reject your direction of questions."

Table 4.2

Ratings of a Number of Perceived Benefits of CT
Based on a Scale from 1 (Not Beneficial) to 5 (Most Beneficial)

	Number of Responses						
Benefit	Not Beneficial			Most Beneficial		N	Mean
(a) the use of excess capacity to make a contribution toward fixed assets and total profit	3	9	9	6	8	35	3.200
(b) maintenance of exports and employment when these are important to the firm and the exporting country	1	3	13	13	6	36	3.556
(c) entry into otherwise closed markets	2	2	3	17	15	39	4.051
(d) gaining governmental goodwill (possibly leading to a privileged position in the future)	3	5	8	11	8	35	3.457
(e) can be an important factor in postponing licensing requests	2	12	10	5	1	30	2.700
(f) to take advantage of tax and tariff laws (by understating the "true" market value of goods/services)	6	12	7	3	4	32	2.594
(g) possible development of new supply sources	5	2	11	9	8	35	3.371

The respondents were also asked to rate a number of problems which are encountered with CT on a scale from 1 (not critical) to 5 (most critical). Their responses are summarized in Table 4.3.[5] Based on the mean responses, the most critical problems encountered with CT are risks in handling unfamiliar goods (4.179), followed by possibly longer time before payment is received (3.976) and long and complex negotiations with buying countries (3.951). The respondents encountered other problems with CT such as: "government stability"; "quality of trades (products) does not meet customer's expectation"; "often obscure and unreliable"; and "double exposure to credit risks".

Table 4.3

Ratings for a Number of Problems Encountered with CT
Based on a Scale from 1 (Not Critical) to 5 (Most Critical)

	Number of Responses						
Problem	Not Critical				Most Critical	N	Mean
(a) possibility of a lower return	2	6	16	6	8	38	3.316
(b) risks in handling unfamiliar goods	0	4	3	14	18	39	4.179
(c) possibly longer time before payment is received	1	4	6	14	16	41	3.976
(d) the possibility of conflict with the hard export markets	5	5	13	10	6	39	3.179
(e) long and complex negotiations with buying countries	0	4	10	11	16	41	3.951

The mean responses for the trading houses, and their relative orderings, are somewhat similar to those reported in the previous chapter for the exporters.

GENERAL INVOLVEMENT/NON-INVOLVEMENT IN CT EXPORT TRANSACTIONS

Eleven (16.4 percent of the) respondents have been involved in CT export transactions on a continuing basis, and 56 (83.6 percent of the) respondents have not been so involved. The reasons for not being involved in CT export transactions on a continuing basis include: 20 (29.9 percent of the) respondents noted a lack of demand, 16 (23.9 percent of the) respondents noted a limited capacity to undertake CT transactions, 10 (14.9 percent of the) respondents noted that CT transactions were too risky, 12 (17.9 percent of the) respondents noted that CT transactions offered insufficient reward to compensate for the added risks involved, and 11 (16.4 percent of the) respondents offered other reasons such as: "too much time involved between initial set-up to time of delivery or receipt of goods"; "products offered by buyer for CT not easily marketable"; "the requirement for CT has 'evaporated' prior to final negotiations"; "insufficient time and staff"; "average company does not know risk taking"; "we deal with CT situations as they develop"; and "no contacts, would like CT contacts".[6]

Reasons for Terminating Sales Efforts That Involved CT Demands

Important reasons given for terminating sales efforts that had involved CT demands were as follows: 21 (31.3 percent of the) respondents stated that other export outlets were more attractive, 20 (29.9 percent of the) respondents stated that it was too costly and time-consuming to carry out an effective marketing strategy, 19 (28.4 percent of the) respondents stated that goods offered for CT were perceived as being difficult to market in sophisticated western consumer markets, 13 (19.4 percent of the) respondents stated that goods offered for CT were of poor quality, 10 (14.9 percent of the) respondents stated that goods offered for CT were of non-competitive price, 9 (13.4 percent of the) respondents stated that they lacked manpower to pursue such export opportunities, 8 (11.9 percent of the) respondents stated that they had no commitment to CT, 7 (10.4 percent of the) respondents stated that competitors were offering a price which could not be matched, and 2 (3.0 percent of the) respondents gave other reasons such as: "management, a lack of education in such trade formats".[7] The only notable difference between these responses and those reported in the preceding chapter for the exporters was that a much lower proportion of the trading houses considered "no commitment to CT" as being an important reason for terminating sales efforts.

Strategies Utilized to Avoid CT Demands

Strategies utilized by the respondents to avoid CT demands include: 18 (26.9 percent of the) respondents use financing, 9 (13.4 percent of the) respondents persuade the other party to the transaction to forgive the CT obligation, 8 (11.9 percent of the) respondents negotiate on a "best-efforts" basis rather than accept a commitment, 8 (11.9 percent of the) respondents reduce price in lieu of CT obligations, 7 (10.4 percent of the) respondents use technology transfer and training, 6 (9.0 percent of the) respondents pay a penalty rather than discharge CT obligations, 5 (7.5 percent of the) respondents substitute third-country cooperation prospects, 5 (7.5 percent of the) respondents ask foreign parent/partner to handle CT obligations either for its own use or resale, 3 (4.5 percent of the) respondents use an extension of performance guarantees, 1 (1.5 percent) respondent uses an extension of the period over which firm prices are guaranteed for spares, and 1 (1.5 percent) respondent uses other means to avoid CT demands such as "appointing foreign-Canadian trading houses to deal with CT".[8] Other comments included: "we have not been approached"; "not involved with Canadian clients"; "we are principals and have not entered into CT transactions"; and "we trade as principals, buying and selling for our own account. Those from whom we buy have no interest in our trades." Given the line-of-business and ownership differences between the two samples, some minor differences would be expected in the strategies used to avoid CT demands. Based on the responses analyzed herein, trading houses appear to display a greater preference for two strategies (namely, reduce price in lieu of CT obligations, and persuade the other party to the transaction to forgive the CT obligation) and a lesser preference for two strategies (namely, substitute third-country cooperation prospects, and ask foreign parent/partner to handle CT obligations either for its own use or resale) than the exporters.

Types of CT Involvements

With regard to the forms of CT obligations their firms have signed contracts for, 9 (13.4 percent of the) respondents have engaged in barter transactions, 11 (16.4 percent of the) respondents have engaged in countertrade (parallel deal) arrangements, 7 (10.4 percent of the) respondents have engaged in compensation trade (buy-back) arrangements, 2 (3.0 percent of the) respondents have engaged in swap arrangements, 6 (9.0 percent of the) respondents have engaged in switch arrangements, and 4 (6.0 percent of the) respondents have engaged in other arrangements.[9] These other arrangements included: "limited amount in cash, remainder in merchandise (usually with COMECON states since they are usually short of Western currency)"; "we are third party who buys 'offered material' of foreign buyer (Far East) for resale in our markets (Mid East). We buy from Central European trader who sells East European machinery."; "partial compensation (positive countertrade, credit allocation)"; and "informal countertrade (i.e., agreement to purchase as much as possible, and offset purchases to hedge receivables)". One respondent noted: "No idea how you place varying transaction possibilities into neat little boxes. We will do countertrade in whatever form it materializes subject to meeting our objectives without trying to categorize it as above. Each situation is different." Compared to the exporters, a higher proportion of the trading houses have engaged in barter transactions, and in countertrade, compensation, and switch arrangements.

EXPORT PROSPECTS IN SPECIFIC MARKETS AND THE WILLINGNESS TO ENGAGE IN CT

The respondents were asked to rank the importance to their export prospects in specific geographic markets of being willing to engage in CT. Their responses, based on a scale of 1 (not important) to 5 (most important), are summarized in Table 4.4.[10] Based on the mean responses, the willingness to accept CT is somewhat important in Eastern Europe (including the U.S.S.R.) (3.514), followed by Africa and the Middle East (2.879). These responses for the trading houses differ from those presented in the previous section for the exporters in two respects. First, the exporters considered the willingness to accept CT as being more important in Asia than in Africa and the Middle East. Second, ten percent or more of the trading house respondents considered a willingness to accept CT as being "very" or "most" important in all non-U.S. markets (including Western Europe, and Australia and New Zealand). However, given the differences between exporters and traders, these responses seem to be reasonably congruent with both the global and regional importance of CT.

EXPERIENCE WITH ACTUAL CT EXPORT TRANSACTIONS [11]

Frequency and Value

As was the case for the exporters, a number of trading house respondents were reluctant and(or) unable to supply statistical data on their actual CT export transactions. The two primary reasons were: first, such information is

Table 4.4

Rating of the Importance to Individual Firm Export Prospects of Being Willing to Engage in CT in a Number of Specific Geographic Markets Based on a Scale from 1 (Not Important) to 5 (Most Important)

Geographic Market	Not	Less	Important	Very	Most	N	Mean
	Number of Responses						
	Level of Importance						
(a) United States and Mexico	14	8	4	4	3	33	2.212
(b) Latin America and the Caribbean	4	8	11	6	1	30	2.733
(c) Western Europe	14	6	5	4	2	31	2.161
(d) Eastern Europe (including U.S.S.R.)	5	3	5	13	9	35	3.514
(e) Africa and the Middle East	5	8	9	8	3	33	2.879
(f) Asia	8	7	11	2	3	31	2.516
(g) Australia and New Zealand	16	10	2	3	1	32	1.844

deemed to be confidential, and second, most firms do not have an internal information system which can readily generate such information. Nevertheless, based on the information provided (by 10 respondents) and summarized in Table 4.5, it is apparent that aggregate CT activity involving Canadian "client(s)" has increased markedly over the five-year period, 1980-1984. Specifically, the number of trading houses engaged in at least one CT transaction on an annual basis has increased from 2 to 7, the number of annual CT transactions has increased from 5 to 72, and the total annual value of CT export transactions has increased from 1.5 to 180.5 million dollars. According to one respondent: "we basically buy all the products in Canada from our clients and then have our partners handle the barter transaction with the customers (buyers)".

Before proceeding, it is important to emphasize that the figures given in Table 4.5 do not include the potentially large number of CT transactions that may have been handled by Canadian trading houses but were neither sourced from nor distributed in Canada (e.g., a CT transaction involving the exchange of oil, which was sourced in Algeria and sold in France, for coffee, which was sourced in Brazil and sold in the United States, and for which a Canadian trading house was either the agent or principal).

Table 4.5

Aggregate Export Transactions Involving CT for Canadian "Client(s)"
For Each of the Years, 1980-1984

Transactions***	1980	1981	1982	1983	1984 est.
	Year				
(a) Number	5	19	30	46	72
(n*)	(2)	(5)	(5)	(7)	(7)
(b) Total Value ($ millions)**	1.5	8.1	9.1	46.8	180.5
(c) Number of Firms with Total Value:					
Less than $10 million	1	4	3	4	1
$10 million to less than $25 million	0	0	0	0	4
$25 million and over	0	0	0	1	1
(d) CT as % of Total Value					
Low	40	5	15	30	65
High	40	20	100	90	100

* "n" refers to the number of firms that reported on this measure.
** Understated because one large trading house, which reported that it had been engaged in a large number of CT transactions, noted that it could not disclose the annual aggregate values of such transactions.
*** Understated because the largest Canadian-based trading house would provide no data on its CT transactions.

Motivation

The 13 respondents to this question provided the following rationales for their/their clients' becoming involved in CT transactions: 12 respondents stated a desire to make sales; 2 respondents stated a desire to find a lower-cost source of procurement; 4 respondents stated a desire to "clean up" a bad debt situation; 5 respondents stated a desire to build customer relationships; and 4 respondents provided other rationales such as "to penetrate closed markets", "to develop CT as a 'marketing tool'", "to seek financial freedom", and "to buy cheaply". As expected, these motivations differed from those given by the exporters in the previous chapter.

These 13 respondents provided the following rationales for why the other party(ies) became involved in the CT transactions: 7 respondents attributed such involvements to short-term liquidity problems; 9 respondents attributed such involvements to a desire for breaking into a previously inaccessible market; 1 respondent attributed such involvements to a form of hidden discounting; 4 respondents attributed such involvements to the need to disguise a government-sponsored austerity program; and 2 respondents attributed such involvements to the other reasons, "surplus supply" and "hard currency shortage". Thus, unlike the exporters, the trading houses attributed a greater importance to the foreign party's desire to break into a previously inaccessible market.

Applicable Export Markets

The 13 respondents committed to the CT transactions in the following geographic markets: Africa and the Middle East for 7 respondents; Asia for 6 respondents; U.S. and Mexico for 3 respondents; Eastern Europe (including U.S.S.R.) for 3 respondents; Latin America and the Caribbean, and Western Europe for 2 respondents each; and Australia and New Zealand for 1 respondent.

The Goods and Services Involved

The goods and services supplied by the 13 respondents, as traditional sellers in the CT transactions, were as follows: 6 respondents supplied unprocessed natural resources; 5 respondents supplied semi- or processed natural resources; 7 respondents supplied intermediate industrial goods; 6 respondents supplied consumer goods; 2 respondents supplied services (namely, consultation, and management & engineering); and 1 respondent supplied other goods and services (namely, high tech). Thus, the trading house respondents were more active in the provision of natural resources and consumer goods than were the exporter respondents.

The goods and services received as countertrand by the 13 respondents were as follows: 6 respondents received unprocessed natural resources; 5 respondents received semi- or processed natural resources; 4 respondents received intermediate industrial goods; 6 respondents received final industrial goods; 6 respondents received consumer goods; 3 respondents received services such as bilateral clearings, financial arrangements, and transportation (all forms); and 1 respondent received other goods and services (namely, engineering).

The 12 responses to the question, "How did your firm assess the value of the commodities/goods/etc. offered for CT?", were as follows: market comparison (2 responses); "current world market less discounts"; "with fair markup"; "market prices from other origins and normal supply"; "bulk weight and also type of product"; "rating scheme"; "very carefully"; "international brokers"; "by countertrade experts"; and "used experts in the field". One respondent stated: "We gave good merchandise for shabby unprocessed resources".

The 11 responses to the question, "How did your firm reflect the costs and risks of the CT obligations into the final price that it quoted for the original export sale?", were as follows: "80 percent of estimated value"; "included costs of interest, finance, political risk insurance, and performance guarantees"; "20 percent"; "increased margin"; "experience, political risk analysis, priority, plus numerous other policy factors"; "break even"; "previous forecast, and present & future"; "percentage given by CT experts"; "experience"; and "did not trade till checked out parties".

Remuneration for CT Services Rendered

Nine trading houses provided full or partial data on the fees they received for the provision of CT services. Their average fees, which ranged from 3 to 25 percent, had a mean and median value of 9.4 and 5.1 percent, respectively. The lowest fees they ever charged, which ranged from 1 to 10 percent, had a mean and a median value of 3.6 and 2.3 percent, respectively. The highest fees they ever charged, which ranged from 4 to 38 percent, had a mean and a median value of 15.8 and 10.5 percent, respectively. Examples of the lowest and highest fees they ever charged for the provision of CT services involved: 2 percent for oilfield equipment and 38 percent for general finished goods; 5 percent for products and 20 percent for services; 3 percent for natural resources and 27 percent for consumer goods; 2 percent for raw materials and 4 percent for semi- or refined products; and 5 percent for semi-processed and 8 percent for consumer goods. All but one respondent replied that no liability remained with the "client" after their trading houses had been engaged to market countertrand. The one exception replied that it was "subject to negotiations".

Employment of In-house CT Specialists

Only four of the 13 respondents employ in-house CT specialists.

Locale of Countertrand Distribution

The countertrand was distributed in Canada by 4 of the 13 respondents (or their agents); in the United States by 7 of the respondents; and in other markets by 8 of the respondents. These "other markets" include: internationally; Europe (4 respondents); Asia; Africa and the Middle East; and South America and Asia.

Pricing of Countertrand

Seven of the 13 respondents were involved in CT transactions which used "set purchase prices" for the countertrand; 7 of the respondents were involved in CT transactions which used "the pricing formula, 'the acceptable international price at the time of purchase'," for the countertrand; 5 of the respondents were involved in CT transactions which used "the pricing formula, 'the fair market value of goods in first party's country'," for the countertrand; and 3 of the respondents were involved in CT transactions which used "other pricing formula" for the countertrand. These "other" pricing formula include: "U.S. dollars on commodity trades as of a certain date"; "market less percentage discounts"; and "subject to negotiation as each CT transaction stands alone, and will dictate the final results".

Net Price of CT and Non-CT Export Transactions

Of the 13 respondents to this question, 7 respondents felt that the final net prices to their firms for the CT transactions were significantly different from their typical export transactions that involved cash. Three of the respondents felt that the final net CT prices were lower (discounted) on average by 5, 5 and 12 percent, respectively; two respondents felt that the final net CT prices were higher (marked-up) on average by 9 and 10 percent, respectively; and 2 respondents did not specify either the direction or the magnitude of the difference.

Effective Timings of the Cash Payments from CT and Non-CT Export Transactions

Of the 11 respondents to this question, 7 respondents felt that the effective timings of their (cash) payment receipts for their CT transactions were different, on average, from their typical export transactions that involved cash. One respondent felt that they were shorter by more than 6 months, 4 respondents felt that they were shorter by less than 6 months, and 2 respondents felt that they were longer by less than 6 months. Thus, unlike the exporters, nearly one-half of the trading houses felt that the effective timings of their (cash) payment receipts were shorter on average than for their typical export transactions that involved cash.

Contractual Clauses

Of the 12 respondents to the question on the contractual clauses contained in their CT commitment contracts, 4 trading houses had a transfer clause, 3 trading houses had a linkage clause, 7 trading houses had a cancellation clause, and 6 trading houses had a non-fulfillment clause. Thus, it appears that the contractual CT agreements entered into by the trading houses, unlike those entered into by the exporters, are more likely to contain credit and cancellation clauses and less likely to include a non-fulfillment clause.

Post-implementation Problems

Eleven trading houses responded to the question dealing with post-implementation problems. Six respondents had experienced problems with pricing; 4 respondents had experienced problems with identifying appropriate products; 8 respondents had experienced problems with marketing countertrand; and 1 respondent had experienced "other" problems (namely, educational). With one exception, these experiences are similar to those of the exporters. The one exception is that a greater proportion of the trading houses than the exporters experienced problems with pricing.

How the Foreign Parties Honoured Their Countertrade Commitments

Twelve respondents rated how the foreign participants to the CT transactions fulfilled their commitments on a scale from 1 (very unsatisfactory) to 5 (very satisfactory). Their ratings are summarized in Table 4.6. Based on the mean responses, the trading houses found that the commitments in terms of product quality were honoured in a marginally satisfactory manner and that the commitments in terms of delivery dates were honoured in a marginally unsatisfactory manner. This latter finding differs from that for the exporters, who felt that the commitments in terms of delivery dates were honoured by the foreign participants in a marginally satisfactory manner.

Table 4.6

Rating of How the Foreign Participants to the CT Transactions
Honoured Various Aspects of the CT Transactions
Based on a Scale of 1 (Very Unsatisfactory) to 5 (Very Satisfactory)

	Number of Responses						
Aspect	Very Unsatisfactory				Very Satisfactory	N	Mean
(a) product quality	0	2	6	4	0	12	3.167
(b) delivery dates	0	3	7	1	0	11	2.818

PUBLIC POLICY CHANGES/INITIATIVES

The Desirability of Implementing Various Institutional Approaches for Dealing with CT in Canada

A number of western countries have encouraged the establishment of private-sector, non-profit organizations to deal with countertrade matters. The respondents' ratings of the desirability of implementing four such institutional approaches in Canada on a scale from 1 (strongly disapprove) to 5 (strongly approve) are summarized in Table 4.7. Based on the mean responses, the respondents marginally approved of approaches (a) and (b), and marginally disapproved of approaches (c) and (d). According to one respondent: "If firms or individuals do not have capabilities within themselves to be in this business we should in no way create crutches to bring incompetence into business. We have enough of that now!" These findings differ from those for the exporters in that the exporters marginally disapproved of the establishment of an information centre on CT [approach (a)], and marginally approved of the establishment of an association to transact CT business [approach (c)].

Establishment of a Non-profit, Private-sector Association

Based on the 33 completed responses, 20 (60.6 percent of the) respondents felt that Canada's capacity to handle CT transactions would be greatly enhanced if a private-sector, non-profit organization was established to advise member firms in negotiating CT demands, and 13 (39.4 percent of the) respondents felt that Canada's capacity would not be greatly enhanced by the establishment of such an organization. Based on the 34 completed responses, 24 (70.6 percent of the) respondents felt that Canada's capacity to handle CT transactions would be greatly enhanced if a private-sector, non-profit organization was established to select appropriate Canadian or offshore trading houses to assist in closing a CT transaction, and 10 (29.4 percent of the) respondents felt that Canada's capacity would not be greatly enhanced by the establishment of such an organization. These findings are nearly identical to those presented in the previous chapter for the exporters.

Table 4.7

Rating of the Desirability of Implementing Four Institutional Approaches for Dealing with Countertrade in a Canadian Context Based on a Scale of 1 (Strongly Disapprove) to 5 (Strongly Approve)

	Number of Responses						
Approach	Strongly Disapprove	Disapprove	Neutral	Approve	Strongly Approve	N	Mean
(a) government sponsorship of an information centre on CT, as in the United Kingdom	7	3	10	12	8	40	3.275
(b) creation of a private, non-profit association specializing in coordination of the activities of private-sector exporters with established trading houses, as in France	5	1	12	13	9	40	3.500
(c) creation of a private non-profit association with the power to transact countertrade business and which, in addition, offers advisory services, as in Austria, Sweden & Finland	11	10	10	4	3	38	2.421
(d) creation of a private/public association with the power to transact CT business	18	8	4	3	7	40	2.325

Some specific comments advanced by the respondents were:

> "It wouldn't work. How would they 'select'?"
>
> "Already underway in Ontario."
>
> "Exists 'C.E.A.'."
>
> "The private sector can take care of itself. It is only constrained by interference, especially from government sources."

Based on the 33 completed responses, 17 (51.5 percent of the) respondents felt that the source of funds for the establishment of such a private-sector, non-profit association should only come from the private sector, 2 (6.1 percent of the) respondents felt that it should only come from the public sector, and 14 (42.9 percent of the) respondents felt that it should come from both the private and public sectors. Thus, the trading houses were slightly more adamant than the exporters that funding should only come from the private sector for such an association. Specific comments advanced by two respondents were:

> "Since I believe that 'private-sector, non-profit' is self contradictory, I must answer this question as 'none'."

> "The only real requirement is for an association to promote the use of trading houses and CT, and to develop greater recognition of the benefits to industry and the economy as a whole. Above all we must avoid the use of tax monies to support non-private sector firms to enter this field. The use of non-private sector firms (Crown corps. or government depts.) in such undertakings leads to inefficiencies, misuse of taxpayers' monies, unaccountability and destructive competition to efficient private sector firms. Private sector firms only survive due to good business practices developing profits. Publicly funded corporations reach into the private sector pockets to support inefficiencies leading to a general deterioration. Also those who would transact the agreement would not be accountable for their disastrous transactions which could negatively rebound on the private sector and Canadian taxpayers."

Based on the 40 completed responses, 15 (37.5 percent of the) respondents stated that they would seriously evaluate an equity investment in such a private-sector, non-profit organization; 1 (2.5 percent) respondent stated that it might seriously evaluate such an equity investment; and 24 (60.0 percent of the) respondents stated that they would <u>not</u> seriously evaluate such an equity investment. Thus, compared to the exporters, the trading houses appear considerably more receptive towards seriously evaluating such an equity investment. Specific comments for not seriously evaluating such an equity investment are summarized in Table 4.8.

The Government's Role in CT Export Transactions

Based on the 42 respondents that answered at least one question on public policy changes/initiatives, 21 (50 percent of these) respondents agreed that it would be unacceptable for an agency or corporation of the Government to bring products into the Canadian market which would compete with those produced domestically; 23 (54.8 percent of these) respondents agreed that it would be inconceivable for the Government to import goods which may be in competition with products from Canadian firms receiving assistance from Government to increase exports; and 36 (85.7 percent of these) respondents agreed that Government and government organizations do not possess sufficient product knowledge, nor do they have sufficient contacts in a particular

Table 4.8

Some of the Reasons Given for Not Seriously Evaluating an Equity Investment in a Private-Sector, Non-Profit Organization Dealing with CT

"Lack of funds."

"Not beneficial to our interests."

"Big problem is with third world countries. U.S. and Europe are no problem. Should be some type of insurance fund to guarantee a person of a bad trade concerning CT."

"'Non-profit' feature does not warrant equity investment. Choice of partner very delicate."

"If it was of real benefit we would be more active and do it ourselves."

"In the near future there will be no demand for countertrade deals in footwear."

"No funds at present for such an investment."

"Because we wish to make a profit."

"No excess capital at present."

"If we can see the potential, we will do it ourselves."

"We have our own windmills at which to tilt!"

"CT may be done directly between the involved parties only."

"CT can apply in those areas where we as trading houses are not at all active. We may do business where CT is not warranted, whereas others must depend on it!"

"Do not think that it will serve a useful purpose."

"What's the benefit? Cronies will skin the good ones and leave the pits for the rest!"

"We see no need for it."

"Not seriously. Do not believe its needed."

"Too much risk."

industry sector to successfully dispose of the imported products accepted as part of the CT transactions.

Table 4.9

Canadian Exports Subjected to Increased CT Demands During the Next Five Years and Goods and Services Which will be Increasingly Offered as Countertrand by Traditional Foreign Buyers Over the Next Five-Year Period

Goods and Services	Subjected to	Offered as
(a) agricultural goods and services	16	19
(b) raw materials	8	14
(c) end products	13	14
(d) high tech manufactured goods	19	13
(e) other manufactured goods	16	15
(f) capital projects	17	7
(g) services	10	6

FUTURE CT TRENDS

The surveyed trading houses were asked which Canadian exports would be subjected to increased CT demands during the next five years, and which goods and services would be increasingly offered as countertrand by traditional foreign buyers over the next five-year period. Their responses are tabulated in Table 4.9. For Canadian exports which would be subjected to increased CT demands during the next five years, the greatest number of responses was received for high tech manufactured goods, followed by capital projects, other manufactured goods, and agricultural goods and services. For goods and services which would be increasingly offered as countertrand by traditional foreign buyers over the next five years, the greatest number of responses was received by agricultural goods and services, followed by other manufactured goods. These responses are similar to those reported in the previous chapter for the exporters.

CONCLUSION

In this chapter, the findings from the mail questionnaire survey of Canadian trading houses have been summarized and analyzed. In the next chapter, the theory and practice of CT from a Canadian perspective will be presented.

FOOTNOTES TO CHAPTER 4

[1] There were 37 respondents to this question.

[2] There were 50 respondents to this question.

[3] There were 47 respondents to this question.

[4] There were 43 respondents to this question.

[5] There were 42 respondents to this question.

[6] There were 39 respondents to this question.

[7] There were 32 respondents to this question.

[8] There were 28 respondents to this question.

[9] There were 23 respondents to this question. Some of these respondents had not signed contracts during the past five-year period.

[10] There were 40 respondents to this question.

[11] Only respondents who had been involved in at least one actual CT transaction were asked to respond to the questions upon which this section of the study is based. There were 13 such respondents.

APPENDIX 4.1

CHARACTERISTICS OF THE RESPONDENTS TO THE SURVEY OF CANADIAN TRADING HOUSES

The characteristics of the respondents can be summarized as follows:

(1) With regard to total sales volume in Canadian dollars for 1983 (1982 and 1984 for two firms each), 13 (19.4 percent of the) trading houses had sales of less than one million dollars, 13 (19.4 percent of the) trading houses had sales of 1 to 4 million dollars, 8 (11.9 percent of the) trading houses had sales of 5 to 9 million dollars, 6 (9.0 percent of the) trading houses had sales of 10 to 24 million dollars, 12 (17.9 percent of the) trading houses had sales of more than 25 million dollars, and 15 (22.4 percent of the) trading houses did not disclose their sales volume.

(2) With regard to their primary type(s) of business activities, 13 (19.4 percent of the) trading houses dealt in resource commodities; 16 (23.9 percent of the) trading houses dealt in semi- or processed natural resources; 29 (43.3 percent of the) trading houses dealt in agricultural goods and services; 20 (29.9 percent of the) trading houses dealt in food products; 9 (13.4 percent of the) trading houses dealt in high-tech manufacturing goods; 26 (38.8 percent of the) trading houses dealt in other manufacturing goods; 8 (11.9 percent of the) trading houses dealt in capital goods, 16 (23.9 percent of the) trading houses dealt in services such as consulting, engineering, project management, negotiation/commission brokers, and financing; and 3 (4.5 percent of the) trading houses dealt in "other" such as footwear, software, raw furs, senega root, and distribution.[1]

(3) With regard to the ownership of their Canadian-based operations, 14 (20.9 percent of the) trading houses were widely held by a majority of Canadian interests; none were held by a majority of non-Canadian interests; 27 (40.3 percent of the) trading houses were controlled by a limited number of Canadian interests; 2 (3.0 percent of the) trading houses were controlled by a limited number of non-Canadian interests; 8 (11.9 percent of the) trading houses specified "other" ownership structures such as sole proprietor (4 responses), 100 percent foreign owned, and wholly-owned subsidiary of U.S. firm; and 16 (23.9 percent of the) trading houses did not respond to this question.

(4) With regard to the percentages of total Canadian sales volume generated in countries outside of Canada and the United States, 6 (9.0 percent of the) respondents had percentages that were less than 5 percent, 3 (4.5 percent of the) respondents had percentages of 5 to 9 percent, 1 (1.5 percent) respondent had a percentage of 10 to 19 percent, 2 (3.0 percent of the) respondents had percentages of 20 to 29 percent, 4 (6.0 percent of the) respondents had percentages of 30 to 49 percent, 34 (50.7 percent of the) respondents had percentages of 50 percent or more, and 17 (25.4 percent of the) respondents did not respond to this question.

(5) During the past three years, 27 (40.3 percent of the) respondents facilitated exports to or imports from the United States and Mexico, 29 (43.3

percent of the) respondents facilitated exports to or imports from Latin America and the Caribbean, 38 (56.7 percent of the) respondents facilitated exports to or imports from Africa and the Middle East, 31 (46.3 percent of the) respondents facilitated exports to or imports from Western Europe, 13 (19.4 percent of the) respondents facilitated exports to or imports from Eastern Europe (including the U.S.S.R.), 40 (59.7 percent of the) respondents facilitated exports to or imports from Asia, 16 (23.9 percent of the) respondents facilitated exports to or imports from Australia and New Zealand, and 6 (9.0 percent of the) respondents facilitated exports to or imports from "other" geographical areas such as the Far East, Peoples Republic of China, and Indian sub-continent.[2]

(6) The geographic areas and products the trading houses specialize in are very diverse. Some representative responses include: "Caribbean and W. Europe. Food commodities in bulk."; "Developing countries. Medical, educational, small fisheries and agricultural projects."; "World-wide. High technology test facilities."; "Middle East and Asia. Peat moss, perlite, and play structures."; "Pacific Rim and China. Industrial and technical products and services."; "No geographic area. Fertilizers, crude oil, vegetable oils, rice, corn starch, sugar and peanuts."; "North Africa and Middle East. Truck parts and after-sales service."; and "Canada and world-wide. Fish."

(7) With regard to vintage, three (4.5 percent of the) respondents commenced operations in Canada prior to 1900 (between 1850 and 1890), 9 (13.4 percent of the) respondents commenced operations in Canada between 1900 and 1950, 9 (13.4 percent of the) respondents commenced operations in Canada between 1951 and 1970, 21 (31.3 percent of the) respondents commenced operations in Canada between 1971 and 1980, 8 (11.9 percent of the) respondents commenced operations in Canada after 1980, and 17 (25.4 percent of the) respondents did not respond to this question.

FOOTNOTES TO APPENDIX 4.1

[1] There were 50 respondents to this question.

[2] There were 51 respondents to this question.

CHAPTER 5

COUNTERTRADE: THEORY AND CANADIAN PRACTICE

In this chapter, the theory and Canadian practice of countertrade (CT) are compared and integrated. The observations on Canadian CT practice are based on the findings of the mail questionnaire survey (see chapters 3 and 4) and on the in-depth interviews with 52 (predominantly-Canadian) entities. Before proceeding, the reader is advised to review the definitions presented in Appendix A of this study.

THE PRIMARY CAUSE OF THE RECENT GROWTH OF COUNTERTRADE TRANSACTIONS

The primary cause of the recent growth of CT transactions has been the need for the use of some type of financial-marketing innovation in international trade in order to circumvent international product market imperfections and/or failures.[1] According to the OECD, the general aim common to most of the CT transactions undertaken by the developing countries has been to export one or more goods or services which have been difficult to sell for cyclical or structural reasons [OECD (1985), p. 17]. Since the consequences of breakdowns in the efficiency of product markets are generally fully reflected in the more efficient financial markets (including that for foreign exchange),[2] the primary cause of the growth of CT transactions has mistakenly been attributed to the primary symptom [see Assaad (1984), amongst others] and <u>not</u> to the real cause of such growth (or CT itself).

Thus, by utilizing a sequence or simultaneous set of normal, somewhat independent and separate, commercial transactions, a CT transaction can facilitate two- (or multi-) party trade in those situations where: (a) the breakdown in the efficiency of product markets is such that an assignment of a shadow price is necessary, either in terms of a new price specified in a CT agreement or in terms of physical quantity allocation, because a realistic, market-based appraisal of the value of a good or service is no longer possible; (b) the actual (or perceived) abilities of the traditional buyer and seller to circumvent the consequences of such inefficiencies differ; and (c) all of the involved parties expect to benefit by entering into their respective transactions. Typically, CT is consummated when the advantage of efficiency is (or is perceived to be) with the traditional seller, his agent or his assignee. Thus, it is not surprising that many practitioners refer to CT as being "financial engineering", "creativity using escrow accounts" or "a marriage-type arrangement".

SOME GENERAL CHARACTERISTICS OF COUNTERTRADE TRANSACTIONS

Some general characteristics of countertrade transactions include:

(1) CT transactions generally involve two or more commercial transactions (or "sales") between two or more parties;

(2) With the exception of pure barter, CT transactions do not in reality do away with the use of money;

(3) Unlike non-CT transactions, CT transactions involve two- (or more) way trade between the participating parties;

(4) CT transactions can (and often do) require a direct linkage between the goods and services being exchanged;

(5) CT can be a requirement imposed by the traditional buyer (or its government) or it can be voluntarily offered by the traditional seller to the export transactions;[3]

(6) Unlike non-CT transactions, CT transactions often involve substantial political considerations which are closely interwoven with commercial considerations, primarily due to the greater apparent involvement of governments in CT activities and the number of government-to-government and government-to-private sector CT transactions;

(7) Unlike non-CT transactions, CT transactions reveal more noisy market information on the prices at which goods and services are transacted (and hence about equilibrium or "true" market values);

(8) Like project financings, CT transactions are partially or fully self-financed from the sale of countertrand by the traditional buyer, and compensation transactions, in particular, are generally fully financed from the use of the goods and services purchased by the traditional buyer; and

(9) CT transactions generally modify somewhat the traditional role of the banking sector from one of providing export financing or credits to one of safekeeping and/or control (e.g., the administration of escrow or evidence accounts).

ALLEGED ADVANTAGES AND DISADVANTAGES OF COUNTERTRADE

From the Perspective of the Traditional Private-sector Buyer[4]

Some of the alleged advantages of CT from the perspective of the traditional private-sector buyer include:

(1) The traditional buyer can use the traditional seller's warehouse and distribution network to sell its goods and services in unfamiliar markets;

(2) The traditional buyer can use CT to hide discounting and subsidizing of goods and services when openly doing so would antagonize relations with existing customers or lead to a price war with competitors [Yoffie (1984a), p. 9]; and

(3) The traditional buyer can use CT to purchase goods and services when the government of the traditional buyer's home country will not permit the use of foreign exchange for such purchases.

One of the alleged disadvantages of CT from the perspective of the traditional private-sector buyer is:

(1) The traditional buyer finds it difficult to be sure that it is obtaining the full real value for the goods and services used as countertrand.

From the Perspective of the Traditional Seller

Some of the alleged disadvantages of CT from the perspective of the traditional seller include:

(1) The traditional seller not only has to deal with goods and services that it would not have taken back before but these goods and services may be sub-standard, incorrectly priced, and relatively nonmarketable;

(2) Unless the traditional seller transfers the risk of profitably concluding all but one of the transactions to a third party (e.g., trading house), the traditional seller must bear two or more commercial risks instead of the traditional one;

(3) If the traditional seller does not respond to a CT request from a frequent traditional buyer, then the traditional flow of trade between the two parties may be broken;[5]

(4) Like the traditional buyer, the traditional seller can spend most of its time trying to cope with CT commitments and/or circumvent possible CT demands;

(5) Except for some forms of CT (such as barter), the traditional buyer may experience long delays before receiving delivery of countertrand;

(6) The traditional seller may find it difficult to assure the quality and servicing of the countertrand;

(7) The traditional seller may find that CT involves procedures that are more complex, more risky and ultimately more costly than those for the same number of entirely separate, commercial transactions, financed in the conventional way; and

(8) CT reduces the traditional seller's flexibility since the seller may have to choose countertrand on factors other than price, quality and delivery [Gottlieb (1984), p. 41].

Some of the alleged advantages of CT from the perspective of the traditional seller include:

(1) Since the traditional seller is exposed to two or more commercial risks instead of one, the traditional seller has the opportunity to earn two or more profits instead of one;

(2) The traditional seller, as both buyer and seller, may gain additional "leverage" over the traditional buyer (e.g., the traditional seller as buyer can withhold payment for purchases until it is paid as a seller);

(3) The traditional seller may be able to use CT (especially, compensation trade) as a substitute for the provision of guarantees, especially for large turn-key projects;

(4) The traditional seller can use some forms of CT (such as compensation trade) to add to its productive capacity at costs which are lower than doing so domestically [Weigand (1979a), p. 38];

(5) By agreeing to CT, the traditional seller may gain early entry into a huge closed market which is expected to become more open over time and for which there is no possibility of penetration by other means;

(6) The traditional seller can develop powerful allies within the government or the domestic industry of the traditional buyer's home country by helping to sell their goods and services abroad;

(7) For countries with overvalued currencies and/or foreign exchange rationing, the traditional seller may be able to use CT to overcome or bypass such constraints;

(8) By developing a willingness to be flexible (or becoming pro-active) towards CT, the traditional seller may be able to compensate for incomplete products, inadequate financing, and other traditional problems in winning export contracts;

(9) In certain developing countries that have become incapable of meeting their payments for industrial and civil engineering projects that were initially begun on the basis of over-optimistic projections of their export earnings, the traditional seller may find it preferable to take delivery of products against repayment of outstanding debt;[6]

(10) The traditional seller can use CT to maintain its market share and the presence of its brand names in countries that have interrupted normal imports; and

(11) When financial and product markets are unstable, the traditional seller may find that engaging in CT transactions may be the least expense way of hedging against the instability of prices, price distortions and the availability of foreign exchange.

From the Perspective of the Government of the Traditional Buyer

Some of the advantages of CT from the perspective of the government of the traditional buyer include:

(1) CT allows a country to trade when it is short of foreign exchange and/or it lacks the creditworthiness to arrange normal trade finance;[7]

(2) Countries, if heavily indebted (as is the case for most Latin American countries), may actively encourage CT in order to maintain the flow of vital imports without damaging their trade balances and to circumvent agreements with the International Monetary Fund that restrict their usage of foreign exchange [Sender (1984), p. 77];

(3) Countries can use CT to promote exports and to circumvent non-tariff barriers in the developing countries;

(4) Some countries find that the use of CT is politically-useful domestically because it appears to give them leverage in their dealings with the MNEs [Sender (1984), p. 77];

(5) Governments can impose tough CT regulations in order to disguise government-sponsored austerity programs, since such regulations make it more difficult to import into their markets [Yoffie (1984a), p. 9];

(6) For countries that have created excess domestic capacity due to their attempt to become industrial economies, CT may facilitate the disposal of poor quality goods and services, with no sales organization, in a highly competitive world product market;

(7) CT can be used to control imports by tieing imports to the goods and services which the traditional seller can choose as countertrand;

(8) Governments of planned and centralized economies find CT useful because "it makes trade with market-economy countries less random, facilitates greater balance between sectors and countries and helps achieve targets laid down in national plans" [Miramon (1980), p. 14];

(9) Governments can use CT to disguise the offer of goods and services for sale on preferential terms in either the sale, purchase, or both parts of the CT transaction from other competitors;

(10) Based on the knowledge that the traditional seller will want to obtain regular deliveries of quality products, governments can reasonably expect the traditional seller to provide current technology, to set up and monitor, and to subsequently update the technology to ensure that the compensation trade arrangement remains internationally competitive;

(11) Governments of developing countries may use CT to foster exports of non-traditional goods and services which are little known internationally or are in keen competition with those of other countries with better market penetration;

(12) Governments can use CT to alleviate the pressure to find markets for surplus goods and services, which resulted from their promotion of import substitution through growth of domestic manufacturing;

(13) Governments can use CT to secretly lower the prices of their goods and services without officially contravening producer agreements (such as international commodity agreements or producer cartels) or disrupting trading on international commodity exchanges [OECD (1985), p. 17];

(14) CT may be the means for countries with little economic weight to obtain greater reciprocity from their trading partners [OECD (1985), p. 13];

(15) CT may be a means of correcting the distortions introduced by an unsuitable exchange rate by allowing for a selective, case-by-case devaluation; and

(16) For countries chiefly dependent on earnings from sales of primary products, CT may be perceived as being a method to increase and regularize commercial trade flows [OECD (1985), p. 16].

Some of the alleged disadvantages of CT from the perspective of the government of the traditional buyer include:

(1) The use of CT may dislocate traditional trade patterns;

(2) The use of CT may not be consistent with the commitments that have been made by the country's central bank to the I.M.F.;

(3) The use of CT can usurp the power of the country's central bank to manage the country's foreign exchange and monetary policy;

(4) The use of CT can affect the nature and timing of a country's cash flows;

(5) For CT-user countries, CT is probably not an efficient, long-term solution to their financial and trade imbalances;

(6) A country's indicators of international economic recovery such as international payments can be substantially distorted by CT;

(7) National taxation authorities may experience difficulties in assessing the tax implications of CT;

(8) Governments will not conserve foreign exchange by engaging in CT transactions unless their deliveries of countertrands are "additional" or "incremental" to normal sales patterns [OECD (1985), p. 27];

(9) By using CT, governments may neither correct the basic causes of their mediocre export performance nor implement the economic reforms needed for more active participation in international trade; and

(10) Countries will find it difficult to establish stable and ongoing commercial relationships in "new" markets if the marketing of their goods and services is done by third parties who are mainly concerned with short-term profits [Miramon (1980), p. 15].

From the Perspective of the Government of the Traditional Seller

Some of the advantages of CT from the perspective of the government of the traditional seller include:

(1) CT may facilitate a country's exports to certain countries; and

(2) CT (especially in the form of buy-back) may be a means of both securing reliable sources of essential raw materials and exporting domestic equipment and technology which has become outdated.

Some of the disadvantages of CT from the perspective of the government of the traditional seller include:

(1) CT may be perceived as shipping domestic technology and employment opportunities abroad;

(2) CT hides the impact of trade balances since the involved parties usually do not disclose the dollar amounts, terms or time periods over which goods and services are exchanged;

(3) CT can encourage inefficient production and subsidization since a country's traditional sellers usually must choose countertrands that are either in oversupply or not selling well;

(4) CT may force a country's traditional sellers to take back countertrand which can not be used internally and thus may be dumped in the domestic market;

(5) CT agreements may lead to one or more anticompetitive effects, such as distortion of purchasing criteria, market foreclosure, market concentration and sales at unreasonably low prices; and

(6) When CT agreements are the outgrowth of mandated CT, the anticompetitive results of such coercive conduct may be a distortion of allocative efficiency and the foreclosure of other same-nation competitors [Griffin (1983a), p. 238].

COUNTERTRADE PROBLEMS ENCOUNTERED BY TRADITIONAL SELLERS

General

Some of the problems which have been encountered with CT transactions by traditional sellers include:

(1) The provision of cross-guarantees on CT transactions is costly and risky;

(2) The traditional buyer often wants the traditional seller to buy goods and services that: (a) the traditional seller feels uncomfortable to deal with, (b) the traditional seller is already selling internationally with difficulty, and (c) are difficult to resell without sizeable price discounting;

(3) Traditional sellers sometimes find it difficult to get traditional (especially, East European) buyers to pay a penalty when such buyers have been responsible for the delay, the cancellation of a delivery, or other such lack of conformity with a contract;

(4) Sufficient local production may already be in place in countries where CT could be used effectively;

(5) Due to a lack of experience and knowledge, tender closing dates may not provide sufficient time to properly structure a CT bid proposal on a "fixed commitment" basis;

(6) It is difficult to compete for a CT transaction when one or more of the other bidders are consortia which have governments as members;

(7) The consummation of potential CT transactions are often prevented by operational inefficiencies such as the "fees of the middlemen";

(8) The priorities for CT transactions seem to be assigned by decree and not by the market system;

(9) Although a traditional buyer may insist that the traditional seller of high tech products accept components as countertrand, the traditional buyer may not accept the inclusion of these components in the products being purchased from the traditional seller.[9]

Offsets

Some of the problems which have been encountered with offsets by traditional sellers include:

(1) Goods and services that are required to satisfy offset obligations in highly developed countries often can not be sourced in such countries at competitive prices;

(2) Since suppliers in the country of an offset obligation are really not interested in procuring contracts to satisfy such offset obligations, their deliveries are often unreliable;

(2a) While "double booking" orders has been a typical response to (2), this augments a traditional seller's costs-of-doing-business in that country;

(2b) While co-production has been a response to (2), especially when the required goods and services are sophisticated, co-production requires that the traditional seller make a capital investment in and a transfer of technology to the country of the offset obligation;

(2c) While "conditioning" local suppliers has been a response to (2), especially when the required goods and services are not too sophisticated, such conditioning has necessitated the costly provision of tooling and quality control procedures by the traditional supplier to the local suppliers;

(3) Determination of incremenality in order to determine how offset obligations are being satisfied has been difficult and contentious;[10]

(4) The satisfaction of offset obligations is often perceived by traditional suppliers as being a "bureaucratic mess";

(5) In satisfying offset obligations, difficulties are often encountered with value-added and shelf goods; and

(6) If part of a good or service is sourced locally in order to satisfy an offset obligation, the traditional seller may be establishing a potential competitor.[11]

PRIMARY FACTORS FOR SUCCESSFUL CT TRANSACTIONS

According to the interviewees, the primary factors for the successful carry-out of CT transactions by traditional sellers include: (1) having the knowledge of, and the ability to operate in the country of the traditional buyer, (2) having an effective local agent, (3) having the required resources (financial and personnel), (4) displaying the required staying power, (5) developing strong linkages between the goods and services being exchanged, (6) having a knowledge of the government, politics, regulations and culture of the home country of the traditional buyer, and (7) knowing where the decision-making power resides in the home country of the traditional buyer.

EXPERIENCES OF CANADIAN ENTITIES WITH ACTUAL CT TRANSACTIONS

Activity

Aggregate. There are essentially two measures that can be used to quantify the aggregate dollar value of CT activity. The first measures the dollar value of the export sales of traditional (Canadian) sellers that were subject to CT obligations, the second measures only the dollar value of the countertrands which were taken back by traditional (Canadian) sellers and/or their designates. While the second measure has a certain theoretical appeal, it is more difficult to operationalize. Specifically, difficulties are encountered with CT obligations which are contractually on a best-efforts basis, and with the high probability of subsequent default on their fulfillment. Since the weighted-average percentage of countertrands-to-exports for all CT transactions in any given year is generally less than 100 percent, the second measure will generally result in a lower CT dollar value than the first measure. Nevertheless, as in chapters 3 and 4, the first measure will be used in this section of the study.

The data on the CT activity of traditional Canadian sellers (both exporters and traders) over the five-year period, 1980-1984, from both the in-depth interviews and mail questionnaire survey were pooled and aggregated. Based on the data summarized in Table 5.1, it is evident that CT activity has increased markedly over this five-year period for both the Canadian exporters and the Canadian trading houses. With regard to the Canadian exporters, the number of entities engaged in at least one CT transaction (i.e., export transaction involving CT) on an annual basis has increased from 2 to 11, the number of annual CT transactions on an annual basis has increased from 2 to 31, the total annual value of CT transactions has increased from 12.2 to 376.0 million dollars, and the average value of a CT transaction has increased from 6.1 to 12.1 million dollars.[12] With regard to the Canadian trading houses, the number of entities engaged in at least one CT transaction on an annual basis has increased from 3 to 10, the number of annual CT transactions has increased from 11 to 94, the total annual value of CT transactions has increased from 71.5 to 439.5 million dollars, and the average value of a CT transaction has decreased from 6.5 to 4.7 million dollars.

With regard to the grand total of Canadian CT activity, the number of entities engaged in at least one CT transaction (i.e., export transaction involving CT) on an annual basis has increased from 5 to 21 over the five-year period, 1980-1984. Since a specific CT transaction can involve a Canadian

Table 5.1

Aggregate CT Export Transactions During Each of the Past Five Years, 1980-1984

Statistic	1980	1981	1982	1983	1984
Exporters (E):					
Number of E	2	4	4	6	11
Number of CT Transactions	2	8	13	16	31
Dollar Value of CT Transactions*	12.2	68.3	135.2	216.4	376.0
Average Dollar Value of CT Transactions*	6.1	8.5	10.4	13.5	12.1
Trading Houses (TH):					
Number of TH	3	7	7	10	10
Number of CT Transactions	11	28	41	66	94
Dollar Value of CT Transactions*	71.5	118.1	162.1	282.8	439.5
Average Value of CT Transactions*	6.5	4.2	4.0	4.3	4.7
Exporters & Trading Houses (E & TH):					
Number of E & TH	5	11	11	16	21
Number of CT Transactions	13	36	44	82	125
Dollar Value of CT Transactions*	83.7	186.4	297.3	499.2	815.5
Average Value of CT Transactions*	6.4	5.2	8.3	6.1	6.5

* In millions of dollars.

Source: Mail questionnaire survey, personal interviews, telephone conversations, and verifiable secondary sources.

exporter and/or a Canadian trading house, a combination of the numbers of CT transactions and the dollar values of such transactions for the Canadian exporters and trading houses produces an inflated estimate of both of these measures of total Canadian CT activity. Furthermore, no reliable estimate of the extent of such double counting could be obtained because only incomplete data was available on the specific identity of the trading houses used for Canadian exporter-initiated CT transactions due to the confidentiality agreements that existed between these two parties. Nevertheless, annual estimates of both measures are bounded at the lower end by the higher of the component values (i.e., for exporters and for trading houses), and are bounded at the higher end by the combined respective total values of the exporters and the trading houses. Thus, the total number of CT transactions on an annual basis has increased from between 11 and 13 to between 94 and 125, and the total value of CT transactions on an annual basis has increased from between 71.5 to 83.7 million dollars to between 439.5 and 815.5 million dollars over the five-year period, 1980-1984.

Significance. Based on total Canadian exports of goods and services of 131.3 billion dollars in 1984, it would appear that the CT share of total Canadian trade is minuscule (0.33 to 0.62 percent). If Canadian trade with the United States and Japan (two non-CT countries) of 101.8 billion dollars is deleted from Canada's total trade, then CT's share of the remaining dollar value of Canadian exports of goods and services in 1984 increases dramatically (1.49 to 2.77 percent).[13] Thus, even when Canadian exports to its two largest trading partners are removed, CT represents a relatively insignificant portion of Canadian trade with its other trading partners.

Many of the interviewees argued that the proper measure of CT's share of Canadian trade is the one based on non-U.S., non-Japanese exports of goods and services. While this line of argument has some merit, it incorrectly presupposes that the combined American and Japanese shares of Canadian exports could not have been significantly altered if Canadian entities had not more aggressively pursued trade opportunities with the rest-of-the-world.

Small- and medium-sized Canadian trading houses. Despite their specific product knowledge, market expertise and contacts, few small- and medium-sized Canadian trading houses have been involved in at least one CT transaction either to support their trading activities for regular clients or to facilitate the export activities of occasional clients. Thus, based on the information gathered for this study, there appears to be little evidence to support the general belief that many small- and medium-sized Canadian trading companies have engaged in actual CT transactions.[14]

Types of CT Transactions

Of the 31 interviewed entities that had been involved in at least one actual CT transaction, five were primarily involved in offsets and trade enhancement agreements;[15] 9 had transferred technology as part of their CT transactions (generally with export market restrictions and no royalty arrangements); and five were involved in CT transactions in which they agreed to distribute or aid in the distribution of countertrand for the traditional buyer on a "best efforts" basis.

The Applicable Export Markets

The Canadian entities have consummated CT transactions in a variety of export markets, including: Latin America (e.g., Guatemala and Brazil), Eastern Europe (e.g., Yugoslavia, Romania, Hungary, Czechoslovakia and East Germany), S.E. Asia (e.g., Thailand, Indonesia, Malaysia and Philippines), China, Africa (e.g., Egypt and Nigeria), Middle East (e.g., Israel and Iran), Western Europe (e.g., Denmark, Netherlands, Spain and Italy), and Australia.

Goods and Services Supplied

By the traditional seller. The goods and services supplied by the traditional sellers have included: telecommunications equipment; trucks and truck parts; tractors and tractor parts; icemakers; farm implement technology; arms; steel rails; aircraft and related products; "overside" fish; textiles and surplus textile manufacturing equipment; key stamping machines; turn-key production processes for pulp and paper and mineral extraction; commodities (sulphur, potash, etc.); and agricultural products (potatoes, milk products, etc.).

By the traditional buyer. The goods and services supplied by the traditional buyers have included: hams; jams; mangoes; fish and fishing rights; sesame seeds; rice; sugar; coconuts; oils; canned and frozen foods; spices; foodstuffs; bag sorgham; wines and beers; other commodities (such as cotton, rubber, and bauxite); shipping; rock salt; pulp; woods (teaks, etc.); wood furniture; keys; (small) machine tools; electric motors; medical equipment; truck axles; fire fighting and light house equipment; construction material; and industrial products. The mix of goods and services supplied by traditional buyers to traditional sellers have varied. Some interviewed entities only took back one specific good or service as countertrand, while others took back a wide assortment of related and/or unrelated goods and services as countertrand. For example, one interviewed trading house revealed that 50 percent of the countertrand it received typically consisted of one specific good or service and the remainder consisted of a broad assortment of other goods and services.

Countertrand Disposal in Canada

Most of the countertrand purchased by the interviewed entities has not been sold in the Canadian market. According to the interviewees:

> "It is a fallacy that [countertrand] will be disposed of in Canadian markets. Little will be so disposed, due to their pricing, style and quality."
>
> "We sell little in Canada. We are sensitive to local firm concerns. We do not want to make any waves."
>
> "We have never sold countertrand in either the U.S. or Canadian markets."
>
> "We do not sell much [countertrand] in North America [and numerous variants of this statement]."

Their Use of Third Parties

Most of the interviewed entities revealed that they had used one or more third parties to gain information about CT and/or to facilitate their CT contract pursuit and/or to fulfill their CT obligations. Some of their specific comments follow:

> "We had an exclusive agreement with one trading house which was a disaster."
>
> "We sought information from the government (External Affairs, etc.) and various third-party exporters that were operating in French-speaking Africa. We had to hire a representative to do some 'back-street negotiating'. We made no approach to a CT house."
>
> "We were helped by the CMA and we used the CT unit in External Affairs."
>
> "We went to two trading houses to learn about CT costs and methods of CT operation. It would have been easier to discharge our CT obligation through a trading house if we could have afforded that."

"We have used trading houses and the CT people in large industrial groups of companies such as Noranda."

"Our first reaction when faced with CT was to run away from it. We had a briefing on CT from MG Services. The ... division of [U.S. trading house] now supplies us with technical counselling for our dealings with the U.S. government."

"We had a person from Phillips talk to us in-house."

"[Large number] of corporate brokers are used by our U.S. parent. Such services have been used by us."

"We are not a member of the CEA and thus can not use its CT service."

"We phoned the banks. A company from [European country] sent us a telex and then followed up twice. The [traditional buyer] put us in contact with an importer."

"[U.S. B-O company] is acting as a consultant to our firm."

Motives

Traditional sellers. The CT motives attributed to traditional Canadian sellers, which were identified in the mail survey, were discussed in chapters 3 and 4. Additional CT motives, which were revealed by the interviewees, included:

"CT is a marketing tool or lever which can be used to win contracts."

"Accommodation of offsets and other CT demands is a way to gain a competitive edge in certain export markets."

"Canadian entities (like ours) have become involved because of bottom-line considerations."

"CT was financially motivated in that a purchasing department was given a world mandate for sourcing, and was given tough cost reduction targets."

"CT provided an opportunity to gain revenues from North American technology. We peddled technology, which was worth money, abroad."

"Unlike our firm, our suppliers had good profit margins. CT (and the threat of CT) allowed us to put pressure on our suppliers to share some of their profitability."

"CT was imposed by decree and was not negotiable. Although no one really wants to do it, we either had to accept to do it or back away from that opportunity."

"Since we had been buying from the Orient and [country] for a long time, it was only natural that we develop the efficiency of our traditional suppliers."

- "We were short of cash, the credit-worthiness of the potential buyer was not that good, and, frankly, we needed the business."

"We are increasingly being drawn into it. We have lost a market which we traditionally supplied in [country] for the past 14 to 15 years. So have all of our Canadian competitors in that market."[16]

Traditional buyers. The CT motives attributed to traditional foreign buyers, which were identified in the mail survey, were discussed in chapters 3 and 4. Additional CT motives, which were put forward by the interviewees, included:

"CT (especially compensation trade) forces the [traditional seller] to supply the most modern and efficient technology to the traditional buyer."

"CT is considered to be the lowest cost source of financing for what is essentially perceived as being a financing decision by some traditional buyers."

Five Actual CT Transactions

First CT transaction. Approximately eleven years ago, this internationally-active Canadian entity entered into its first compensation arrangement with a state-owned entity in an Eastern European country. The Canadian entity contractually committed itself to supply a processing plant on a turn-key basis, and to take back and market a certain volume of semi-processed product at a "saleable" world market price.

According to the terms of the compensation arrangement, the Canadian entity was responsible for marketing the output from the new plant. Since the Eastern European entity had to be paid for the output shipped from the plant within two weeks, the Canadian entity was responsible for the collection of all accounts receivable. For the provision of these services, the traditional (Canadian) seller received a commission based on the value of the product sold.

Over the life of the agreement, the Canadian entity has taken back and marketed over 200 million dollars of the product. This represents over one hundred percent of the value of the turn-key plant which was initially supplied by the Canadian entity.[17] Although some legal difficulties were initially encountered by the Canadian entity in receiving final payment from the Eastern European entity for supplying the processing plant on a turn-key basis, the Canadian entity felt that the compensation arrangement had been "mutually beneficial".

Second CT transaction. In early 1981, a Canadian MNE signed a compensation trade agreement with a state-owned enterprise in a Eastern European country for a total value of approximately 180 million dollars. The Canadian entity provided technology in return for 50 to 60 thousand units of a heavy-duty component which was to be used in the manufacture of one of its products. The components were to be shipped to a central location in the

United States over a three year period. Each of the Canadian MNE's North American production plants were to buy components from that central location.

The Canadian entity's motivation for entering into such an arrangement was an attempt to minimize its purchase costs. In fact, the value of the purchases from the traditional (Eastern European) buyer replaced those from North American suppliers who could not match the price at which the Eastern European entity supplied the components.

Although the component was of a size that was already used in Canada and the United States, the component was only rated as being a "6" or "7" on a ten-point scale. After continuous monitoring and prodding, corrective actions were slowly implemented by the state-owned enterprise to bring the component up to North American standards.

Under the terms of the compensation agreement, the Eastern European state-owned enterprise was restricted from selling the components to any of the competitors of the Canadian entity which were situated in North or South America or in Western Europe. Thus, the state-owned enterprise was pre-empted from becoming a competitor or aiding a competitor of the Canadian entity.

<u>Third CT transaction.</u>[18] In 1982, PCS International Ltd., the marketing arm of Potash Corp. of Saskatchewan sold seven million dollars of fertilizers in Indonesia. In accordance with Indonesia's CT legislation, PCS agreed to buy coconuts, oils and other Indonesian products. PCS's advisor on the transaction was the Toronto-based Trade Exchange Group, which helped PCS structure the CT transaction.

<u>Fourth CT transaction.</u>[19] In 1982, Spar Aerospace won a major contract to supply a 165 million dollar satellite system to the state-owned Brazilian agency, Brasilsat. In return, Spar morally committed itself to develop export markets for an equivalent dollar value of Brazilian goods and services by attempting to match Brazilian exports with non-Brazilian importers (i.e., by acting as a trade match-maker). Subsequently, Spar has aided in the sale of Brazilian-made spare parts for the Volkswagen Beetle in the United States and mangoes in Canada. Spar will also help Brazil's largest beer company, Brahma, break into the Canadian market [Gooding (1983)].

<u>Fifth CT transaction.</u>[20] In 1985, Capsule Technology International (CTI) Ltd., a Windsor (Ontario)-based entity signed a 6.2 million dollar contract to export a gelatin-capsule manufacturing plant to East Germany. Under this compensation trade deal, CTI was to be paid hard currency for the sale of the turn-key plant, and it was to buy approximately 130 percent of the contract value in capsules at a fixed price over a six-year period.[21] CTI also promised to purchase certain specified equipment for the plant from local East German suppliers, and to make a best-efforts attempt to source similar equipment from East German suppliers for subsequent turn-key plants in other countries.

The East German demand for compensation trade was neither unexpected nor a first for CTI. Nevertheless, signing the contract was apparently highly dependent on CTI's willingness to enter the compensation arrangement, although CTI had faced few serious competitors for the contract and had offered an unusual and highly desired product to the East German authorities.

REASONS FOR THE LEVEL OF CANADIAN CT ACTIVITY

Reasons offered for why Canadian entities have not been more actively involved in CT transactions include:

> "A combination of the nature, type and destination of Canadian exports as well as the structure of the Canadian economy has had a major influence on the relatively low level of countertrade encountered and engaged in by Canadian exporters to date." [External Affairs (1984), p. 32].

> "Canadian companies seem frightened of countertrade. Maybe its the huge dependence on the U.S. market, but certainly there are few aggressive international traders compared to the U.S. or Britain." [Gherson (1985c), p. 37].

> "Unlike non-Canadians, Canadians are too risk averse for CT. They are afraid to bear the consequences of large swings in the prices of the products they would receive in payment."

> "Canadians are lazy and not aggressive. Canadian firms look at CT but do not get involved."

> "A lot of good business can be done in a normal manner. However, if firms were hungry for business, their attitudes would be different."

> "It is difficult to do CT contract execution in 'big bag' countries such as [country]. When the bag man is out, you are out."

> "Only about 5 to 10 percent of Canadian trade could involve CT. Most of Canada's exports are to markets where CT is not used or needed. About 6 billion dollars of potential CT and we are alleged to do about 1 billion dollars of CT. 300 million is probably more accurate. Our problems in the markets where CT is used are caused by our manufacturing structure. For our third tier of companies (those with no import restrictions), there is a lack of management depth. The second tier of companies are mostly branch plants that have export restrictions. The third tier consists primarily of foreign-owned MNEs. Thus, our manufacturing structure is not really conducive to vigorously pursuing export prospects, especially using innovative marketing and financing techniques. Furthermore, much of our technology and plants do not meet international criteria of efficiency."

Furthermore, based on the incorrect premise that most countertrand must be sold in the relatively limited and sophisticated Canadian market, many Canadian entities have avoided CT involvements.

THE PERCEIVED CT ACTIVITY OF COMPETITORS

The majority of the interviewed entities perceived themselves as being approximately as active as their competitors in offering and engaging in CT. Most of the remaining entities perceived themselves as being marginally or considerably less active than their competitors in offering and engaging in CT. Some of the specific comments of those who perceived their entities as being approximately as active as their competitors follow:

"Our competitors are [list of international firms]. All of these competitors offer some sort of offset package which is, on average, similar to ours."

"CT has not been used much by our competitors, although some have relied on credit mixte to our detriment."

"[Competitor] is more involved in CT, [competitor] is less involved. However, all of us should probably be more involved in CT."

"Our [Canadian] competitors are not that much better equipped to do CT than us."

"If considered properly, they are not more active in offsets. Our major competitors, the French firms, concentrate on public (and not commercial) sales. We concentrate on commercial sales where offset demands occur less frequently."

"We do not have many international competitors. They do not use CT much either."

"We follow non-American competitors and lead our American competitors in the use of CT. The Americans are too busy with internal markets to bother about using CT in export markets."

"Our competitors and us have about the same CT exposure. Nobody wants CT but most of us have more and more frequently had to accept it."

Some of the specific comments of those who perceived their entities as being less active than their competitors follow:

"We operate differently from our competitors. We are not very aggressive."

"Our competitors are more active. Our main competitor is [foreign entity], which often uses CT."

"There is always an offset obligation on a large ticket item. However, since our orders are small, we often do not have a request for an offset. Thus, we are less active than most of our competitors [in CT]."

"Our competitors, the Japanese, Russians and East Europeans, are not afraid to use and offer CT. Although we are often the promoters of a project, Canada does not have an integrated approach to exporting or to CT. Since many subsidiaries must dance to the parent's music, and in certain cases can not even compete internationally, it is difficult to get the players in Canada to put forward a CT proposal, never mind put forward a winning proposal."

"Unlike our firm, [list of competitors] are heavily involved in CT."

"Our competitors are foreign--the Swedish and the British. They are heavily involved in CT activities."

"Our major competitors are either more active or are becoming more active than us in the use of CT. Our biggest competitor, however, is U.S. AID financing."

"Our competitors, mainly European, use it more frequently. However, they can readily take back natural gas as a [countertrand]."

"Our [trading house's] international competitors are more active. Through their international affiliates, they are more familiar with CT, and thus can easily compete against us when CT is involved."

"Our competitors, especially the Japanese, are much more active. Of course, they get a 150 percent tax credit for chasing new business. In fact, they make more than a dollar from tax credits for each dollar they spend on business development."

"Unlike us, about 30 percent of our Canadian competitors are very aggressive. Our largest competitor [a large U.S. MNE] is extremely aggressive. It will even provide financing, using its own resources, if that is necessary to win a contract."

Some of the interviewed entities revealed that there had been no competition for their particular CT transaction(s). Some of their comments follow:

"Our [technology] was unique. We had no competition, and there was no indication from the buyer that others were bidding for this CT deal."

"Because the project was financed with Canadian funds (including aid), and we were the only Canadian firm that produced that type of [product], we had no competition for that CT deal."

THE RESPONSE OF CANADIAN ENTITIES TO CT INVOLVEMENTS AND DEMANDS

The Installation of In-house Specialized Expertise for Pursuing and/or Satisfying CT Obligations

One of the options that is available to a traditional seller for dealing with CT demands and obligations is to install specialized expertise for pursuing and/or satisfying CT obligations within the entity's organizational structure. Of the 31 interviewed entities that have been in at least one CT transaction, 7 exporters and 7 trading houses were identified as having installed such in-house expertise for satisfying CT obligations.[22,23] With the exception of two exporters who had installed such in-house expertise in Canada for pursuing and not satisfying CT obligations, the in-house expertise for the other 12 entities were located in Canada for 3 exporters and 4 trading houses, in the United States for 1 exporter and 1 trading house, and outside of North America (namely, in Munich, Milan and Tokyo) for 1 exporter and 2 trading houses.

Reasons given by the interviewed entities for not installing such specialized expertise in-house included:

"Too small of a company [exporter] to have such specialization. Management attention is too scarce of a resource to become too involved in such endeavours."

"Lack of depth to be highly proficient or specialized in CT pursuit or delivery."

"Too costly given the infrequency of such pursuits and deliveries by our entity."

"We would have to have a large volume of CT transactions before we set up our own trading unit. It takes a certain structure and size to be effective in handling CT in-house."

"We weighed the costs of setting up a trading department and the difficulty in getting new people with CT experience. We decided that it was not workable to set up a trading department."

Internal (Intra-Corporate) Organizational Responses

There are three principal types of internal (intra-corporate) organizational responses which traditional sellers have adopted to cope with CT demands and obligations. The first principal type of internal response has been to designate one or more individuals within the entity (for example, in sales or purchasing) as being responsible for amassing knowledge on CT techniques and practices, for developing contacts with practitioners (including facilitators) of CT, for employing CT specialists to assist in the negotiation and discharge of CT obligations, and for evaluating and co-ordinating the entity's CT activities. Such an organizational response has been adopted by such Canadian exporters as Sydney Steel, SNC and Polysar.

The second principal type of internal response has been to establish an internal CT standing (sub)committee, unit, department, or other such designation, which is responsible for arranging CT transactions and for actively disposing of countertrands internally and externally. For example, the standing committee of one large Canadian exporter of technically-sophisticated equipment, which was established during 1985, is responsible for evaluating the costs and benefits, and implications of all concessions to be used by the corporation to win export contracts. For this committee, concessions are deemed to include: (a) offsets, (b) "cost indicated prices", and (c) "anything else beyond normal terms and conditions of sale". These organizational vehicles operate either on a cost recovery or profit earning basis. A similar organizational response has been adopted by Spar Aerospace, which has a trading division consisting of three people (namely, a director, a trader and another specialist). The division provides a match-making or brokerage function on a strictly commercial basis for the CT obligations which have been incurred by Spar. The division neither takes title to countertrand nor does it provide its CT expertise for the CT obligations of other entities.

The third principal type of internal response has been to establish a trading company subsidiary. Such an organizational response has been adopted by such Canadian exporters as Massey Ferguson.[24] It will be discussed more fully in the next section of this study.

Which of these three organizational responses is chosen by the traditional seller depends upon a number of factors. These include the level and frequency of CT demands/transactions, the level of control which the traditional seller wants to retain over the pursuit and fulfillment of CT transactions, the risk-taking profile of the traditional seller, and the investment merit and general effectiveness of each internal option compared to other internal and various external options.

The Corporate Trading Company [25]

Functions. For a large geographically-dispersed and diversified corporate entity, the most important functions that can be performed by a corporate trading company (CTC) are the support of existing operations, the identification, evaluation and development of new commercial opportunities; and the collection of intelligence on markets, market opportunities, trade and corporate practices, and the actions of competitors.

1. The support of existing operations and new business ventures: The CTC can provide export-related and trade-development services either exclusively for the entity or (as is more common) jointly with the operating divisions or units of the entity. Such services include:

(1) The provision of export management and co-ordination for all exports and export markets (or just for new exports and new export markets), and for all cash transfers and foreign exchange;

(2) The development of relationships with suppliers from various international locales and the co-ordination of purchases from such suppliers by the divisions (or subsidiaries) of the parent entity;

(3) The provision of expertise on export financing, credit, guarantees and insurance, and the arrangement of such when required;

(4) The assumption of the responsibility for transportation logistics, documentation, and so on;

(5) The assumption of CT obligations and/or responsibility for their discharge for the divisions (or subsidiaries) of the parent entity;

(6) The co-ordination of activities to maximize the benefits obtained from government export support programs;

(7) The purchase or license (or co-production) of new technology to (with) existing divisions and the sale or license (or co-production) of old or new technology to (with) foreign entities; and

(8) The identification, evaluation, development and direction of new corporate activities, such as international diversification through direct investment, joint ventures, licensing arrangements, and so forth.

2. The provision of market intelligence: The CTC can assist the parent entity and its operating divisions and subsidiaries by systematically gathering, processing, evaluating and disseminating market intelligence that is both timely and reliable. To illustrate, the General Electric Trading Company (GETC) has developed a fairly sophisticated data-information-intelligence (D.D.I.) system called "D.D.I. KNOWLEDGE".[26]

The role of corporate headquarters. If a CTC is to successfully perform its functions, corporate headquarters must:

(1) Provide a strong commitment to the purpose, operation and functioning of the CTC;

(2) Establish specific guidelines for the evaluation and use of intelligence by the CTC; and

(3) Ensure divisional or subsidiary co-operation with the CTC by acting as an arbiter between the conflicting parties (e.g., by effecting "side or settlement" payments to the internal party who does not earn its required rate of return on the CT transaction).[27]

To illustrate the importance of (3), one interviewed spokesperson from a CTC noted that there was a divergence of views within his company on the functions of the CTC with regard to the within-country selling units. The spokesperson also noted that top management strongly supported the functions of the CTC while middle management strongly opposed them.

Operational constraints. Typical constraints on the operations of CTCs is that they operate at a profit, and that they do not offer their services to non-parent entities.

An illustration.[28] The U.S.-based Combustion Engineering (CE) created a facilitator cost center or CTC (called CE Trading) during the fall of 1980. CE Trading is to serve as a clearing house for all CE transactions involving bilateral trade and CT, and to develop and co-ordinate corporate CT strategies. CE Trading "facilitates" the sales of the parent and its subsidiaries in countries with CT requirements by negotiating and fulfilling CT obligations. To enhance cost effectiveness, CE Trading relies extensively on CE's trading expertise and personnel. According to its charter, CE Trading's agreements are normally restricted to the sale of CE goods or services. For normal dollar-valued transactions, CE Trading is essentially autonomous operationally. Each of CE's purchasing units or subsidiaries can evaluate and refuse to buy for their own internal use any countertrand taken back by CE Trading. CE Trading and all CE purchasing units or subsidiaries are credited for assisting any related corporate export.

The Effect on Export Marketing and Sourcing Strategies

Many interviewees felt that their CT exposures had had little or no effect on their export marketing and sourcing strategies. Also, many firms indicated that CT was not used aggressively because of their competitiveness in terms of price and quality. Others felt that, like it or not, they must learn to handle CT if they want to stay or become internationally competitive.

The entities, whose export marketing and sourcing strategies were so affected, commented that:

"CT has alerted our trading house to the need to be very pro-active."

"Our firm has begun to 'tie in' purchasing with exporting."

"As part of a CT commitment, we agreed to put an Eastern European, non-qualified bidder on the bid list for a project."

"CT has not only made us more aware of what was going on but it has given us a greater appreciation of what was happening in international trade."

"CT has resulted in a divergence of views within our firm, especially about the role of our internal trading house vis-à-vis our firm's regular within-country selling units."

Becoming Pro-active

Due to market experiences, approximately 35 percent of the 31 interviewed entities with CT experience have begun to use CT pro-actively or have seriously considered doing so. Some specific comments offered by the interviewees included:

"After losing a sizeable project in Central America to a higher-priced Japanese bid which included a CT offer, we started to think about proposing CT in some bids as a marketing sweetener."

"Our firm is moving away from reactive to proactive CT over time. I see a much more proactive philosophy for our firm in the future. If it is going to be required by the end of the negotiations, you might as well start off with it at the beginning."

"We have not used CT in a proactive way, although we probably should. A firm needs margins to be proactive as is the case for firms in the aircraft industry. There are a paucity of such industries in Canada."

"We used CT to get 'off tender' for a hydro electric project in [South American country]."

"Using a FTZ to generate countertrand would be a proactive move which would require extra money to develop the infrastructure."

"We have done both. We have lost out on projects where our competitors have offered it [CT] up front and we did not."

"If we think that CT will be required, we offer it early so that it can be priced in the price of our offering."

"We use it [CT] as a marketing tool in the East Bloc."

"We use CT actively."

"We initiated the CT proposals. We were the driving force behind the CT transactions. We wanted the business."

"We use CT on a proactive basis at times."

"We have become very aggressive. We have moved from reactive to pro-active. When we know that CT is a possibility, we include it in our bid proposal in order to determine what the other party's position is."

"By being proactive in selected markets, we [trading house] can make big money."

ASSESSING THE LIKELIHOOD AND GENERAL VIABILITY OF A FIRM CT DEMAND

Assessing the Likelihood

A traditional (Canadian) seller should first investigate if some form of CT is likely to be proposed or required by the traditional seller. The expected probability of a CT demand (or a large CT percentage) will be low, if the traditional seller's sale is part of an aid program (e.g., CIDA-funded) or is financed by a multilateral financing agency (such as the World Bank). For new markets or new customers, the traditional seller should assess the probability of a CT demand after consulting with traders, export consultants and/or government officials (both with officers with External Affairs, Canada, at the specific regional desk in Ottawa and at the applicable foreign post).

It is also difficult to determine if and when a traditional buyer's CT demand is firm or not. In fact, making such an assessment is much like calling a bluff in a game of poker. To illustrate, one of the interviewed Canadian entities, which had been exporting [product] to a particular market for approximately 15 years, was first confronted with an allusion to CT in late 1983. In late 1984, the traditional buyer insisted on CT, the traditional seller called its bluff and won, since the traditional buyer subsequently "backed off" on its CT demand. However, in late 1985, the traditional buyer again insisted on CT, the traditional seller called its bluff and lost, since the traditional buyer subsequently was firm on its CT demand. Subsequently, the traditional (Canadian) seller, along with all other Canadian sellers, were replaced by sellers from Western and Eastern Europe who consented to the traditional buyer's CT demand.[29]

Assessing the General Viability

Before conducting a detailed micro evaluation of a potential CT transaction and entering into serious negotiations with the traditional buyer, the traditional seller will want to assess the general viability of a particular CT transaction. The assessment methodology used can be either informal or formal.

Informal rating schemes. Most of the interviewed entities used informal schemes for rating the commercial merit of engaging in CT with a specific client in a specific export market. To illustrate, the spokesperson of one interviewed entity stated that two key criteria were used to determine whether or not the entity should do a CT deal with a specific country. These criteria were: (1) the import priority assigned to the good or service by the traditional buyer's country, and (2) the strength of the linkages required between the goods and services supplied by and the countertrand made available to the traditional seller.

Formal rating schemes. Spokespersons from two of the interviewed entities indicated that they occasionally used formal rating schemes to evaluate the general viability of a potential CT transaction. One such five-point, 20-factor rating scheme for the Eastern European countries is detailed in

Exhibit 5.1, and illustrated for the fictitious country, "Easteuropa", in Exhibit 5.2. The final outcome of the rating scheme is an equally-weighted overall factor score that runs from the least and most favourable ratings of 1 and 5, respectively. In some applications, a continuous [1, 5] rating scheme may be used for each of the 20 factors (e.g., a rating of 4.3 or 4.5 may be used instead of just using 4 or 5).

NON-CT OPTIONS

According to a number of the interviewees, CT, the provision of financing, joint venturing, and so forth, are somewhat interchangeable. They are however not perfect substitutes. In fact, a number of the interviewed entities have on occasion avoided taking back countertrand by providing other benefits to the traditional buyer, such as: (1) introducing the traditional buyer or entities from the traditional buyer's country to potential purchasers in the traditional seller's country (i.e., match-making); (2) sourcing from domestic entities that buy goods and services from the traditional buyer or the traditional buyer's country; (3) lobbying domestic entities (both public and private) to purchase from the traditional buyer or the traditional buyer's country; (4) joint venturing with or allowing the traditional buyer or some other entity from the traditional buyer's country to compete competitively for sub-contracts; (5) guaranteeing 100 percent, medium-to-long-term financing; (6) agreeing to source from the traditional buyer or entities in the traditional buyer's country for other export sales; (7) providing free service for x months; (8) selling know-how and technology at a reduced cost; and (9) taking back local currency, which cannot be transferred or physically taken out of the given country or converted into hard currencies, and using such currency to buy countertrands and to pay for domestic operating expenses in the given country.

An option which has not been used by a Canadian entity is to import one or more of its goods and services into an industrial zone in the traditional buyer's country, add value to those goods and services within the industrial zone, and then re-export those goods and services to satisfy a CT obligation. For example, goods and services re-exported from an industrial zone in Mexico can be considered as being acceptable countertrand if the Mexican content is at least 30 percent.

In general, the traditional seller often can not use one of these other options because the traditional buyer is adamant about the use of CT or the traditional seller finds that CT is the most preferable of the available options. For example, in countries where the only other available option is to take back unconvertible local currency, traditional sellers have generally found CT to be both less risky and preferable.

MECHANICS OF CT TRANSACTIONS

Negotiations

The traditional seller's bargaining strength. The traditional seller's bargaining strength is generally heightened as:

Exhibit 5.1

A Specific Five-point, Twenty-factor Rating Scheme for Assessing CT Opportunities

Points Assigned	Factor/Classification
	Advance Purchases (F01):
1	permitted, linkage without problems
2	permitted, limited linkability
3	not appreciated
4	permitted, linkage with problems
5	not recommended
	After-sales Service (F02):
1	excellent network
2	available
3	partly available
4	scanty availability
5	not available
	Contract Implementation (F03):
1	reliable
2	acceptable
3	somewhat problematic
4	somewhat unreliable
5	unreliable
	Contract Phrasing (F04):
1	very precise
2	precise
3	fair
4	ambiguous
5	unacceptable
	Final CT Commitments (F05):
1	0 - 25%
2	25 - 40%
3	40 - 60%
4	60 - 85%
5	over 85%
	CT Negotiating Practices (F06):
1	extremely fair
2	fair
3	tolerable
4	difficult
5	disagreeable
	Delivery Problems (F07):
1	none
2	delays only (but tolerable)
3	delays (tolerable) and other problems
4	delays and other problems
5	erratic and unreliable
	Documentation (F08):
1	no problems
2	few problems
3	rigorous to rigid
4	difficult
5	confusing
	Evidence Accounts (F09):
1	operate perfectly
2	limited applicability
3	accepted but not advantageous
4	difficult to negotiate and use
5	not used
	Letters of Release (F10):
1	issued, no problems
2	issued, after multi-requests
3	issued if pressed
4	issued seldomly
5	never issued
	Linkage (F11):
1	achievable, many ministries/many industries
2	achievable, 1 ministry/many industries
3	achievable, 1 ministry/1 industry
4	general bilateral
5	only bilateral with difficulties
	Market(ing) Restrictions (F12):
1	none
2	few
3	some
4	many but can be traded-off
5	unacceptable
	Original Length of Fulfillment Period (F13):
1	at traditional seller's discretion
2	two years or more but limited
3	one to two years
4	up to one year
5	immediate
	Penalties (F14):
1	none requested
2	less than 5%
3	5 to 10%
4	10 to 15%
5	15% or more
	Penalty Guarantees (F15):
1	none requested
2	requested but can be waived
3	required near end of fulfillment period
4	difficult to waive
5	can not waive
	Pricing of Countertrand (F16):
1	true world market
2	close to world market
3	slightly excessive
4	moderately excessive
5	very excessive
	Product Availability/Salability (F17):
1	ample and salable
2	medium and salable
3	sparce and salable
4	ample but relatively unsalable
5	sparce and relatively unsalable
	Renewal/Extension of Fulfillment Period (F18):
1	discretion of traditional seller
2	achievable with "negative file"
3	difficult to achieve
4	achievable after penalty payment
5	achievable at a severe cost
	Services Choice (F19):
1	more than 6 alternatives
2	4 to 6 alternatives
3	2 to 4 alternatives
4	up to 2 alternatives
5	no alternatives
	Transfer Clause (F20):
1	easy to achieve
2	achievable with few problems
3	achievable with moderate difficulty
4	difficult to achieve
5	not achievable

Exhibit 5.2

An Illustration of the Assessment of the General Viability of CT in "Easteuropa"

Factor	Assessment	Points Assigned
Advance purchases	permitted, limited linkability	2
After-sales services	partly available	3
Contract implementation	acceptable	2
Contract phrasing	fair	3
Final CT commitments	70 to 85% (initial: 50 - 110%)	4
CT negotiating practices	difficult	4
Delivery problems	delays and other problems	4
Documentation	few problems	2
Evidence accounts	accepted but not advantageous	3
Letters of release	issued, no problems	1
Linkage	general bilateral	4
Market(ing) restrictions	few	2
Original length of fulfillment period	18 month maximum	3
Penalties	5 to 10%	3
Penalty guarantees	requested but can be waived	2
Pricing of countertrand	slightly excessive	3
Product availability/salability	sparce and salable	3
Renewal/ext. of fulfillment period	difficult to achieve	3
Services choice	3 alternatives	3
Transfer clause	achievable with few problems	2
	Total points assigned	56
	Overall score assigned	2.8

(1) the goods and services from which the traditional buyer must choose become more differentiated;

(2) the level of import priority in the traditional buyer's country given to the goods and services offered by the traditional seller increases;

(3) the urgency (or necessity) for the traditional seller to make the sale decreases and/or for the traditional buyer to make the purchase increases;

(4) the traditional seller's political marketing ability increases; and

(5) the number of alternative suppliers of the goods and services decreases (in fact, one spokesperson noted that in all their CT negotiations they "had acted from a position of strength since they were a monopoly supplier").

The importance of (1), (3) and (5) can be illustrated by examining the current export market for major capital projects. Contracts for such projects have increasingly become more difficult to win as their number has decreased, and the demands and financing problems of their purchasers have increased. Success in winning such contracts has shifted from the technical value of the goods and services offered to ancillary factors (such as financing) which result in the lowest explicit cost. According to the spokesperson of one of the interviewed entities, "financing is now often the most important aspect for export sales in these markets". Thus, traditional sellers who have offered goods and services with comparable technical value, but unlike their competitors have offered to take back countertrand, appear to have been more successful in winning such export contracts.

CT terms. Canadian entities have found that most components of a CT contract are negotiable. These components include:

(1) the ratio of the total value of the CT obligation to the total value of the primary sales contract (i.e., the percentage of countertrand);

(2) the deemed prices of the goods and services to be exchanged (i.e., the deemed prices for CT);

(3) the length of time over which the CT obligations are to be fulfilled;

(4) the nature of the goods and services offered or to be offered;

(5) the penalty(ies) for nonfulfillment; and

(6) the point in time at which the CT obligation has been met.

While most traditional buyers initially insist on firm CT commitments backed by stiff penalties, a high ratio of countertrands-to-exports, and a short fulfillment period, most traditional sellers can improve on these initial terms. To illustrate, a number of Eastern European foreign trade organizations (FTOs) almost always initially demand that one dollar of countertrand be taken for each dollar of exports subject to a 100 percentage penalty for nonfulfillment. In most cases, Western exporters reduce the penalty to 10 to 15 percent, and negotiate a lower percentage of countertrand-to-exports with a longer fulfillment period.

1. The percentage of countertrand-to-exports: Once a precedent of x-percent countertrand-to-exports has been set for the sale of a given product or service to a specific traditional buyer, the percentage will become the traditional buyer's minimum (or floor) demand for subsequent purchases from the same traditional seller. Thus, for first-time sales, the traditional seller's negotiators should attempt to keep x as low as possible.

Specific comments offered by the spokespersons of the interviewed entities included:

> "We have concluded two transactions for which the CT ratio was 100 percent. On the first transaction, we never tried to decrease the ratio and instead concentrated on process and delivery. On the second transaction, they kept referring to the first."

> "They started with the demand that we should take 25 percent. Over repeated bargaining sessions, their demand was worked down to 0 percent. Of course, we had to compensate by providing other benefits."

2. The deemed prices of the goods and services exchanged: Although the actual rate of exchange in a CT transaction should reflect the "true" competitive market price of each good or service, the prices actually used will depend on the relative negotiating positions and skills of the respective parties to the CT transaction. Generally, the traditional seller will attempt to negotiate in such a manner that the "deemed" price of each good or service corresponds to its "true" market price, or failing that, so that the ratio of the "deemed" prices of the goods and services offered and received correspond to the ratio of their "true" market prices. For exchanges that occur over an extended period of time, the "deemed" prices of the goods and services should be periodically adjusted so that they accurately track the stochastic nature of the underlying "true" market prices.

3. The length of the fulfillment period: Most CT transactions not only involve multiple deliveries of goods and services over an extended period of time but the net value of the goods and services sold and purchased by each party at each discrete point in time is seldom zero.[30] Thus, either the traditional seller and/or buyer may require (bridge) financing during the entire term, or portions thereof, of the CT contract.

Typically, the traditional seller will attempt to negotiate a CT transaction in which it first exports to and is paid by the traditional buyer, and then it subsequently purchases countertrand from the traditional buyer over an extended period of time. To illustrate, one of the interviewed entities had successfully negotiated a two-year fulfillment period for the delivery of its technically-sophisticated goods and services, and a eight-year fulfillment period over which it was to discharge its CT obligations. Whether or not the traditional seller will require bridge financing under such circumstances will depend upon whether or not the proceeds from its export sale are placed in an escrow account. In contrast, the traditional buyer will require (bridge) financing under such circumstances irrespective of whether or not the funds from its purchases are put in an escrow account.

Thus, the positions of traditional sellers and buyers on what constitutes an appropriate fulfillment period for the purchase of countertrand differ. Typically, the traditional seller will argue for an unlimited time period with no with-in period targets, while the traditional buyer will argue for a fixed, short time period with several with-in period targets. The positions of the two parties can however be more closely aligned by assigning the interest earned on any escrow account balances to the party with the unfavourable net balance over the term of the CT contract.

4. Penalties for nonfulfillment: Traditional buyers often set their nonfulfillment penalties based on their experiences with laggard or nonfulfilled CT commitments. Thus, as their unfavourable experiences have mounted, some Eastern European FTOs have demanded larger penalties. However, while they ask for such guarantees, Eastern European FTOs are seldom willing to reciprocate.

The traditional seller should be suspicious if the requested penalties are either too high or too low based on past experiences. A traditional buyer's demand for a penalty of more than, say, 20 to 25 percent, may indicate that it has no interest in actually effecting the delivery of countertrand. In fact, its real intention may be to obstruct the committed traditional seller from fulfilling its CT commitments so that it can collect the penalty.

Similarly, a traditional buyer's demand for a penalty of only five percent of the CT commitment may indicate that it intends to obtain a price reduction. Since penalties are calculated on the value of the countertrand obligation and not on the value of the primary sale, the traditional buyer knows that few traditional sellers will bother to find markets for the disposal of countertrand if their CT commitment can be settled by paying such a modest penalty.

The nature of CT negotiations. CT contract negotiations are habitually hard-nosed, complex and lengthy. These characteristics tend to be extenuated in jurisdictions (such as Mexico and Brazil) where CT requests originate from the private sector and no efficient CT regulations exist.

1. The learning curve: A number of the spokespersons for the interviewed entities felt that there was a learning curve associated with the seasoning of CT negotiators. Some of their comments follow:

> "There is a learning curve. One develops a feel for whether something is salable and at what price."

> "It helps to know, or at least have an idea, what they will be asking for. While there is a learning curve in terms of doing CT, each situation is both unique and dynamic. Thus, experience helps but does not make it that much easier."

2. The length of negotiations: Most of the spokespersons for the interviewed entities felt that CT negotiations are more protracted than their traditional trade negotiations. Some of their comments follow:

> "While our normal negotiations may take a week, a CT transaction typically, takes 2 to 3 weeks. One CT transaction in China took 6 weeks of hard bargaining."

> "CT takes much more time to conclude."

> "Not only are negotiations longer but so is the gestation period."

> "It is longer but its actual length depends upon who you are negotiating with. If both parties are prepared, negotiations cease when someone is willing to throw in the towel. With experience, the time required to conclude a negotiation decreases unless the negotiator for the other side just likes to negotiate."

> "Yes, negotiations are longer since they involve so many agencies and parties."

"Negotiations for all transactions are difficult. CT negotiations are longer because there are more considerations. They are not longer or more difficult if both parties are in a business position."

"Yes, time consuming and tedious."

"Yes. They are more complex, there are more parties and more risks. There is an extreme amount of detail. However, for us, they [the other party] moved quickly after we gave them the green light on CT."

"They are longer because there are more parties involved."

"They [the other party] look at it as a sport or they want it for nothing. Four or five months or longer is not unusual."

"Yes, it takes longer when the required laws are not in place, especially, with respect to the exchange rate. Also, the long required lead time is very frustrating."

"Yes. Very complicated, time consuming, and many parties involved. Lawyer costs are high."

"Longer time frame. One has to seek expertise and most CT deals involve governments."

"Our standard non-CT negotiations take one year. Our CT negotiations up to contract negotiations took almost four years. Negotiation of the CT contract itself did not take long."

"Yes, twice as long to make the deal because it is more complex. There are many surprises. When you are ready, they are only partly into their own agenda."

"We argued for two years. We found that we had no choice but to accept CT."

3. The use of third parties: A number of the interviewed entities used third parties (such as trading houses, corporate trading companies (CTCs) and government officials) to assist in their CT negotiations. In fact, one entity used the New York office of an international accounting firm for assistance in structuring its CT transaction and in providing advice on who could use what in their production processes. The spokesperson of another entity noted that they had "used political pressure since it is easier to pull products if you know the right people."

Negotiating with Eastern European FTOs. Spokespersons from the interviewed entities that have negotiated with Eastern European FTOs for compensation trade arrangements noted that such negotiations generally involve at least two phases. The first phase, which involves a technical inquiry by the FTO, is generally expensive and time consuming. The phase terminates with what is called a "technical signing-off". The second phase, which involves commercial considerations such as price and financing, is generally one where "time is of the essence" for the FTO.

According to the interviewed entities, common negotiation ploys used by the Eastern European negotiators include:

> "A [unnamed and probably nonexistent] competitor is offering a price which is 40 percent less. If you want to win the contract you will have to match it."

> "They change negotiators often. The new negotiators start from the beginning. They try to wear you down over time."

> "They state that financing is required over 5, 8 or 10 years. They usually also ask for a grace period."

> "Since the negotiators are not the decision makers, they will leave the negotiations to check if something is possible. They will invariably come back, apologize, and advise you that their superiors would not agree to it."

> "The East Europeans always maintain that there are a large number of suppliers willing to supply the same product at a much lower price. They also resort to changing their team of negotiators frequently. However, each team uses an identical set of arguments."

> "You need astute negotiators when dealing with the Eastern European countries. When everything is ready to go, they demand financing and 100 percent CT."

The spokespersons of the interviewed entities identified the following strategies as being useful in such negotiations:

> "Break off the negotiations abruptly. The FTO's negotiators will have trouble explaining why the negotiations were terminated."

> "Provide benefits to the East Bloc participants, such as presents, trips to the West, and so on. The best way is to include such 'benefits' in the bid as being technically necessary for the project's success."

> "Since the negotiators have to justify the choice of deal to someone else who has to make the decision, it is important to help the negotiators formulate a good justification."

> "When dealing with the negotiators' superiors, make sure you do not do something to discredit or similarly hurt the negotiators. It could fatally hurt your chances for success on other projects."

> "The important thing is to determine what their real objective is. Generally, price is secondary since they have volume quotas that need to be fulfilled. Meeting their production goals results in bonuses being paid to them."

Protective actions.

1. Deferring final price quotes: The traditional seller's negotiator must protect himself from various ploys by deferring a price quote for a primary sale until an agreement has been reached on the terms and conditions of such a sale. Or, as aptly stated by the spokesperson at one of the interviewed entities: "We try to keep some margin that we can give up as negotiations progress". If the terms and conditions are agreed to early in the negotiations, they should be embodied into a written protocol agreement. If the traditional buyer declines to effect such a protocol, this may imply that they will ask for CT at a later stage of the negotiations.

2. Applying reverse pressure: The traditional seller can also put pressure on the traditional buyer by advising that, unless agreement is soon reached, the traditional buyer's preferential position in the traditional seller's manufacturing queue will be lost.

Negotiation impediments. Some of the major impediments encountered in negotiating CT contracts include:

(1) The traditional buyer's government may not sanction the export of a local good or service because of the fear that this would jeopardize the cash market for that good or service;

(2) The banks and the IMF may have a prior claim on the goods and services desired as countertrand;

(3) The offered CT terms may be perceived as being completely unrealistic in that they are excessively priced, their fulfillment periods are too short, the percentage of CT is too high, and the penalties for nonfulfillment are onerous;

(4) The range of countertrand offered may be extremely limited;

(5) The countertrand offered may be of dubious worth, quality and/or marketability; and

(6) The traditional buyer may be ignorant about the preferences and the sophistication of consumers in the traditional seller's country.

Other impediments identified by the interviewees included:

"Subjects are often not put to bed after they have been dealt with."

"The lack of one man in charge for each side. The lack of strict guidelines for each side. No surrender of contracting rights to the negotiators for each side. Negotiators cannot obtain responses within a 24 hour period."

"The lack of agreement in chosing time levels. Since some products have a seasonal nature, time and price releases are important."

"A reluctance to provide certain powers of attorney to the respective negotiators. For each negotiator to be 'holding the pen', a release is required from each of the principals."

"Joint and several liability for CT obligations for consortium participants."

"The other party's bargainer has no power of attorney".

"There are more parties to deal with. Three parties [including the trading house] have to be satisfied and kept happy."

"Government involvement. Product you can accept. Fictitious prices. You have to go through the Ministry that is doing the importing."

"The kickbacks required in some East Block countries."

"Not having the central players always involved in the CT negotiations."

"CT negotiations are very tough. People renege on verbal commitments and nothing is finally settled until the contract is actually signed."

"Developing countries follow colonial traditions. They tend to buy from their former rulers."

CT Take-up Rate

Based on the interviews, it would appear that no more than 10 (and as low as 1) out of every one hundred CT prospects passes an initial screening. CT prospects do not pass this initial screening for a variety of reasons, such as:

> "A detailed evaluation of a CT lead is costly, both in terms of dollars spent and opportunity costs. Many offers are quickly found to be unrealistic."

Furthermore, no more than 2 or 3 (and as low as 1) out of every 10 CT prospects that have passed the initial screening result in a signed CT contract. In fact, a number of the trading houses emphatically stated that they did (and would) not commit to a CT transaction unless they were certain that they could fulfill the CT obligation, and were reasonably sure that it would be financially successful.

Some of the potential CT transactions that did not come to fruition, and the primary reason(s) for such, are as follows:

- sale to Mozambique for shrimp and lumber (both salable countertrands were over-offered to other parties)

- sale of engineering services to Algeria for oil (oil priced at OPEC which was about 10 percent higher than the spot price)

- sale of aircraft to Jamaica for bauxite (countertrand was offered at an inflated price)

- sale of military equipment to Nigeria for oil (countertrand was offered at an inflated price and potential Canadian purchasers of the countertrand were afraid of angering their traditional suppliers)

- sale of a small turnkey cement plant to Yugoslavia for machinery, wines and spirits (guaranteed disposal of the countertrands could not be arranged)

- sale of maintenance services to Gabon for magnesium (market for countertrand was too soft)

- sale of wood products to Tunisia for phosphate rock (countertrand was of poor quality and could not be sold in Canada)

- sale of coal to Mexico for shoes, wines and steel (countertrands were basically unsalable given their qualities and prices)

Evaluation of the Total Cost of Fulfilling CT Obligations

The considerations. Some of the important considerations in determining the cost of fulfilling CT obligations are: (a) the opportunity cost of the time expended by the entity's personnel, (b) the total cost of travel and communications, and all associated costs, (c) incremental general expenses, (d) carrying and storage charges (if applicable), (e) transportation and other related expenses, (f) the ratio between the deemed price(s) of the countertrand and their current market price(s), (g) the required subsidy on the countertrand [which is very dependent on (f)], (h) the risk and required loading for nonfulfillment, (i) the cost of bonds, (j) the cost of interim financings, (k) the incremental costs of operating in the traditional seller's country if specialized external expertise is required, since "each country has a certain set of expertise which has to be searched out", (l) the incremental impact on traditional exports, markets and clients, (m) the time sequence of products and cash flows for each side of the CT transaction, (n) whether or not the countertrand can be laid off back-to-back beforehand, and (o) the required reward to bear the loss of "authorship pride" for manufacturers. As a general rule, a full (entire) quantification of these costs is required prior to negotiations if an attempt is to be made to include the appropriate loading in the traditional seller's offered prices.

Quantifying the required subsidy. The required subsidy is based on such factors as: (a) country of the traditional buyer, (b) total value and type of countertrand, (c) whether the countertrand is known to the traditional seller or its assignee, (d) the time frame for fulfillment of the CT obligation, (e) the type of CT obligation, (f) the availablility and marketability of the countertrand offered, (g) whether or not the countertrand is in oversupply, (h) the market or markets in which the countertrand can be sold, (i) the penalty(ies) for nonperformance, and (j) the amount and cost of required performance bonding.

Quantification of other costs. Two interviewees quantified their other costs as follows:

> "Our [trading house] costs were $50,000 for air travel and $50,000 for general expenses to conclude a fairly small CT transaction."

> "For a trading house like ours, the risks are substantial. For example, if the amount at risk is $500,000, its total loss would totally wipe out the annual profit of most trading houses."

One interviewee noted that there were also some cost savings associated with CT, namely:

> "On most traditional export deals, we have to hire a local representative. On a CT deal, this is not required. Thus, on a CT deal, we save the 5 or 6 percent that we typically pay to a local representative."

Evaluation methods. The evaluation methods used by the interviewed entities varied from ad hoc, subjective evaluations to formal, reasonably objective financial evaluations. The latter types of evaluations were typically used to evaluate multi-million dollar compensation trade arrangements for natural resource development projects. For example, according to one interviewee:

> "We are mostly in mining. We do a detailed study based on market prices and various scenarios. We run the cash flows. We determine the scenario or scenarios that give us our break-even position."

Choice of Countertrand

In a competitive economy, a buyer bases its purchasing decision on the best combination of low price, high quality, service availability and financial responsibility. In a CT transaction, these traditional purchasing criteria are replaced, in whole or in part, by criteria such as the traditional (foreign) buyer's purchasing power and the availability of substitutes for the goods and services offered by the traditional (Canadian) seller. Thus, based on its bargaining strength, the traditional seller many agree to purchase goods and services of higher price or lower quality than it would have done in a competitive situation [Griffin (1983a), p. 238].

Eastern European countries. In the Eastern European countries (such as Romania), the traditional seller is usually given two lists from which to select countertrand; namely, a list of industrial products and a list of general (predominantly, agricultural) products. To illustrate, one interviewee stated:

"We did not have much choice. We had to take a high percentage of machinery and a lower percentage of general goods. All were hard to sell products. Also, price, delivery, service, and so on, just were not there."

Commonly, these lists are compiled so that they include:

(1) Only countertrand offered by the traditional buyer (e.g., state trading organization);

(2) Only countertrand from the industrial ministry that controls the traditional buyer;

(3) Any countertrand offered by the traditional buyer's country;

(4) A fixed proportion of the countertrand offered by the traditional buyer and the remainder from other entities under the same ministry; or

(5) A fixed proportion of the countertrand offered by the traditional buyer and the remainder from the countertrand offered by the traditional buyer's country.[31]

Generally, most (if not all) of the products on each list are difficult to sell at their deemed market values. Furthermore, Eastern European state trading organizations rarely offer top quality countertrand which they could easily sell themselves for cash. Exceptions occur when the traditional seller's distribution network is required to develop new markets, and when compensation trade is involved. Thus, the exceptions are generally not available to small firms. According to one interviewee:

"East Block countries insist on certain products and certain areas for resale. They want you to buy items that they cannot sell. Items that do not have the quality and for which they do not have the marketing expertise."

Considerations. While in the negotiation phase it is necessary to bargain for the broadest choice of possible countertrands, the range of countertrands and/or potential suppliers should be specifically designated in the commitment phase. The preferability of various possible countertrands can generally be rated as follows:

(1) Commodities with terminal markets are ranked first in preference. Generally, they can be marketed through established channels at known spot (and sometimes future) prices, known quality and with relatively low risk. Within this category, registered brands are preferred, and all other brands sell at a premium or discount from the price of the registered brands to reflect quality differences. Also, within this category, commodities not subject to quota restrictions are preferable. However, except for unique situations such as buy-backs, nonquota commodities are seldom offered as countertrand by traditional buyers.

(2) Commodities with no terminal markets (such as copper concentrates) are ranked second. Generally, they can be easily marketed if their purchaser or the purchaser's assignee has prior knowledge about the commodity's market.

(3) Countertrand that can be used in the traditional seller's own operations are ranked third. Generally, no cost is incurred to market this type of countertrand. However, most of the interviewees have not found and/or been offered countertrand of sufficient quality that it could be used internally. According to the interviewees:

> "If you look at the structure of manufacturing, firms only buy what they do not manufacture themselves. In our industry that is generally only about 15 to 25 percent of our production."

> "We can not fit take-back products into our [product]. It has a unique design and substantial substantiating documentation is required for quality control assurance."

> "We took back [product] which we used in [product] that we were making. Our problem was with quality, although it was starting to come."

(4) Countertrand related to the traditional seller's own product line is ranked fourth. Generally, it can be disposed of through the traditional seller's existing marketing channels or suppliers, without incurring expenditures for purchases and/or disposal by third-party buyers and/or intermediaries.

(5) Countertrands unrelated to the traditional seller's operations are ranked fifth. They must be either assigned at a cost to a trading house for disposal or marketed at a cost to a third party. Among this category of countertrands, those that require no after-sales service or parts generally are preferred.

Furthermore, the above preference order may be altered based on two factors. The first factor is the fungibility of the countertrand. Generally, fungible countertrands such as copper ore are preferable to nonfungible countertrands such as jams and tractors. Also, among the nonfungible countertrands, more standardized nonfungible countertrands such as phosphate rock are generally preferred to less standardized nonfungible countertrands such as tractors which may require after-sales service. The second factor is the timing of the deliveries and payments for the sales that constitute the CT transaction. For example, the desirability of a specific countertrand would increase substantially if it could be laid off back-to-back beforehand.

Some specific considerations identified by the interviewees included:

> "Availability and marketability of the countertrand, which should not be in oversupply and should be priced close to world market prices."

> "Every industry has a roll-over time. This is important when picking and assessing products."

> "Product has to be salable worldwide. It has to sell at world prices plus or minus some small amount."

> "Availability of the product and of samples are important considerations. Without samples, large [food] brokers lose interest in making purchases."

> "All products have a life cycle. We check competing products in the [disposal] market of interest. If product is competitive and there is a shortage, we are interested. If there is a surplus, we are not interested."

> "[Countertrands] have to be marketable, and the transaction has to be profitable."

Linkage and other restrictions. Depending upon the relative priority of the goods and services offered by the traditional seller and other factors, the range of potential countertrands from which the traditional seller can choose can be expanded (linked) to include those offered by entities other than the traditional buyer or its ministry (see earlier discussion for the various possibilities). Generally, the traditional seller will bargain for the widest possible set of linkages, and the traditional buyer will bargain for no or few linkages or for limits on the use of such linkages.

A number of spokespersons for the interviewed entities stated that their choice of countertrand was constrained as follows:

> "We will take what will not kill the Canadian market for the product."

> "We would never deal with a product competitive to Canadian products."

> "The distribution of the products should not affect our normal exports."

> "We look at all [countertrands]. We eliminate restricted exports, that is, those that are used for debt repayment. We eliminate traditional exports, often for the same reason."

> "If our export involves sophisticated technology, the buyer may decide that the choice of [countertrand] should also be from high-tech products."

Assessment of value and marketability. The spokespersons of the interviewed entities assessed the value and marketability of offered countertrands in the following fashion:

> "Most products, or their close substitutes, already have a market. Using this as a base, and the anticipated market where the product will be sold, we then reflect factors such as grade, durability, etc. We can estimate the market price in 24 hours for any product."

> "Since we have to sell the [countertrand] in Canada, we first assess Canadian market possibilities and what is available. We conduct our own market study using sources such as Statistics Canada. We look for high volume items with the right price and assured delivery."

> "We use the commercial criteria that we use for any normal transaction."

> "Given our good contacts, we can assess marketability quickly. We have developed a feel for whether something is salable overtime."

> "If the product is manufactured for own need, then the assessment is easy since the market for it is clearly defined."

> "We are well experienced in assessing value and marketability. We have computerized data bases containing such information. Also we get intra-corporate information circulars twice a month."

> "We assess the market through others, particularly trading houses."

> "We have no criteria because we use our U.S. affiliate."

Assessment of quality. The spokespersons of the interviewed entities assessed the quality of offered countertrands in the following fashion:

> "For us quality is first in importance. We take test samples and we look at the production facilities. We help to organize, and if need be, staff quality control departments. We put in our own man to supervise manufacturing and quality control."

> "We get samples and test them in a working environment."

> "We assess delivered products according to our universal quality control standards. We negotiate to get rejects, beyond a certain fixed percentage counted towards the satisfaction of our offset obligations."

> "We do not ask for quality assurances. We use product specifications and government tests, and the quality sheets of wholesalers, to determine the ratio of the specific item's quality to the quality of a reference item. This relative comparison is a very important consideration in choosing product to take back."

> "We [trading house] can assess the relative quality within 24 to 48 hours. We will get the products tested if need be."

> "We do quality tests. We have inspectors on site. We feel that we are responsible for the quality even though we are re-selling it to someone else. After all, our reputation is on the line."

> "To evaluate what we essentially took back [in this compensation arrangement], we first put it through a rigorous test procedure which it initially failed. We suggested, and they accepted changes to North Americanize the [product] by putting skilled people and the latest technology into quality control. We sent design engineering and quality control people to [country] to help in establishing their quality control procedures. The objective was to upgrade the [product] so that it could register at least a 70 on our 100-point quality assurance index."

The case of wine. A number of interviewees expressed their frustration in their attempts to have new wines listed by the provincial liquor control commissions. For example, according to one interviewee:

> "We tried to pursue one deal involving 50 million bottles of wine. It was a major equipment sale to Italy. It would have resulted in $10 million of sales for the Canadian exporter [their client]. No provincial LCB was willing to take on the wine, because they were afraid that it would disturb existing connections."

A few interviewees indicated that listing of wines was "just a matter of preparation" if the wines are of acceptable quality and are reasonably priced, and if the supplier can guarantee a continuous supply.[32] In fact, one interviewee, who had gotten a foreign wine listed in a Western province, complained that the foreign supplier had not yet performed. According to these interviewees, the real problem is not listing but the quantity of wine that must be imported to have a total value of even one or two million dollars.

Pricing

In CT transactions other than barter, the deemed spot and/or future prices of the goods and services delivered by the traditional seller and/or buyer are important.

Goods and services delivered by the traditional seller. Since the price(s) of the goods and services delivered by the traditional seller are often fixed over the term of the CT transaction, these prices should reflect the incremental costs associated with CT, such as any negative differences between the deemed market spot prices of the countertrand to be purchased, any stochastic variation in this difference over time, the time spent in negotiation, the time spent in searching for suitable countertrands, and so on.

For countries where CT demands are common, most of the interviewed entities have learned not to advertise a two-price system for their offerings (i.e., prices with and without CT). This is based generally on their experiences in Eastern Europe where they have been held to the lower price when CT was not used. Most of the interviewed entities have also learned that, whenever possible, their quoted prices should include all or part of the expected incremental costs associated with CT. The success of the interviewed entities in including the incremental costs associated with CT in their quoted prices has varied. At one extreme, there are those entities who have been successful in doing so. Generally, they are experienced traditional sellers of technically-sophisticated goods and services (such as aircraft) who do not have standard prices or price lists, because their prices can vary significantly depending upon the product support, training, financing and options (e.g., "fit-ins") included in their product offerings. According to their spokespersons:

> "We pass these costs on to the customer through customer engineering charges."

> "We can build these costs into our prices since we have no list prices for our products."

> "We [trading house] have to incorporate them into our price. We are experienced at what discounts are needed to sell the products received as CT payment."

> "We [trading house] discount the commodity taken back. The required fee is then added to the price of the goods we are selling."

> "We have a high margin built into the services portion of our turnkey projects. In the price tag for products and services, we build in a 2 to 5 percent contingency to cover a potential CT demand."

> "If you are working with a standard product, then this can be a problem because profit margins are well defined. But, in our case, we work with a customized product where the margins are not well defined."

> "We figure out the cost of making the transaction plus the required subsidy. Then we build that into the price of the product we are selling."

> "We work with the correlation coefficients between the prices of the products to be exchanged."

> "We work the differential between the relative prices of the products to be exchanged in order to get a satisfactory margin."

In the middle, there are those entities who could have incorporated more of the incremental costs associated with CT in their quoted prices but did not because of inexperience. According to their spokespersons:

> "We, like most other firms in [country], signed trading house contracts after we had priced our exports and signed a contract with the other party. Thus, at the time of the signing [of the CT contracts with the other party], we did not know what discount should have been included in our export price. While our loading was built in and was fixed, the fees for product disposal were more than we had anticipated and they have gone up over time. Our quoted prices should have changed as we gained experience with product disposal."

"We under-estimated both the time involved in negotiating the contract and the discount that would be required to sell the product we took back. As a result, we under-estimated the loading we included in the prices of our offering."

At the other extreme, there are those entities who could incorporate little (or none) of the expected incremental costs associated with CT in their quoted prices. According to their spokespersons:

"We can not build such costs into our prices. We have enough problems already meeting our competition."

"The expected subsidies and fees for a CT transaction can not be built into our product's price. The price lists for our standardized product are public information and thus are readily available to any potential client."

"If the [countertrand] is over-priced, we can not add that amount to the goods we are supplying. Thus, we can not take oil back at the OPEC price because it is about 15 percent above its true price."

"We can only add so much, and generally not enough to the prices of our exports to compensate for the over-pricing of the [countertrand] offered."

"On an initial sale, it is hard to jack up the price enough to cover the required CT discount. For repeat business, it is even harder to add the CT discount to the price of the goods we are supplying."

"To be competitive, we have to eat the discount solely or split it with the distributors."

<u>Goods and services delivered by the traditional buyer</u>. Many of the interviewed entities used current market prices of the countertrand or close substitutes to establish spot prices, and pricing formulas to establish the future prices of the countertrand which they were obliged to buy from the traditional buyer. Their specific comments included:

"We use a pricing formula for establishing the [future] prices of commodities and natural resources. For current prices, we use our computerized data base."

"We use pricing formulas that are based on a fixed permissable deviation from a reference price. We always contract to buy a dollar equivalent of the product at a cash price less a small discount."

"We use tranches that fix the price for 6 to 9 months out. For example, if our delivery of [countertrand] is for one year, we would contract for 2 6-month periods. In other words, the [future] price would be set at the beginning of the first tranche and then negotiated and reset prior to the second tranche. Since there is some possibility that the future negotiations could fail, we protect ourselves by taking the product out quickly."

"We work with correlation coefficients between the prices of the products to be exchanged."

"We negotiated a differential [spot and future] price which was the world price less a discount. This helps us recover our initial investment in this [compensation arrangement]."

"We do not ourselves use any pricing formula for manufactured goods. Instead, we use the prices of 'compensation of the same quality'."

Altering Other Terms of Sale

Almost all of the interviewees felt that they had little flexibility in altering their nonprice terms of sale in order to compensate for the cost of CT (including the inflated costs of countertrands). Some of their specific comments included:

"We can make up little here. There is nothing to shave off."

"We can manoeuvre somewhat on a turnkey project. Nothing can be done on a straight sale of engineering services."

"We can do little of this. It really does not apply."

"All [terms] were already in the [entity's] basic or standard contract. Thus, there was no flexibility [for us] to do this."

"We do some if possible. However, what is done is immaterial."

"Given a fixed margin, we try to make minor adjustments to the quality of what we supply. However, to protect our integrity, we can not adjust quality downward much."

Financing

As noted earlier in this chapter, short-term (bridge) financing, which can either be self-financed (by selling the countertrand before taking delivery of it and putting the funds into an escrow account) or can be raised externally, is needed for many CT transactions. For CT arrangements other than compensation, a supplier of funds will advance such funds based on an assessment of the financial standing of the traditional seller, the transaction's background, and the quality of the contractual agreement(s). On the other hand, for compensation arrangements, a supplier of funds will generally use a "project financing" criterion to assess the viability and financial merit of advancing the required funds. Part of the project financing criterion will be a demand for information on how and where the countertrand will be marketed.

Noncontractual Risk Management

As in any traditional commercial transaction, a party to a CT transaction is exposed to political, commercial and other risks. However, since the primary parties to a CT transaction generally act in the dual capacity of seller and buyer, their potential risk exposures are broader and more intensified than for their traditional commercial transactions. Some of the risks encountered in a CT transaction, which were identified by the interviewees, included:

> "Delivery risk. We minimize this risk by using reputable shippers, that is, we do not deal with shaky companies."

> "Stoppage of delivery risk. We would have to cover the added costs to the third party purchaser if delivery of what we laid off on them was terminated. Also, we face an absolute nondelivery risk due to export embargos and similar such reasons."

> "Risk that the potential buyer of the [countertrand] backs out. Financial risk if the penalties are tough. Risk that we could not fulfill our CT obligations."

> "Risk that we would get a bad reputation if we did not fulfill our CT obligations. The client may no longer believe our statements about the quality of our products, our trade practices, and our reliability in terms of delivery."

> "Inexperience risk. Risk that something was missed. Risk that the trading house would not perform."

> "Product delivery risk, namely, quality, price, delivery date, and so on."

> "Two types of risk, a seller's and a buyer's risk. Price risk is hard to effectively hedge against using futures contracts. Often no hedge is available on the Chicago market. Unfamiliarity risk, since the [countertrand] is often a product we are not familiar with."

> "Risk in moving the product taken back. Delivery and quality risks. Latent defect risk for manufactured products."

> "Price inflation risk on both sides. Penalty-based risk."

> "The major risk is that our company has no marketing or expertise outside what we are currently involved in. Often in CT you have to deal with nontraditional products."

> "Risks in buying and selling as a trader."

> "Nonfulfillment risk which we shift to a trading house."

"Risk that we would not offer enough of an offset package to win the contract."

"Delivery risk. We negotiate a preferred customer status so that we have first right of refusal. Then delivery is not a problem."

"Disaster risk. We cover this risk by buying insurance from AIG or Lloyds."

"Political risk. The best method to reduce this risk is to avoid countries that are highly risky."

"Warranty risk. Financial risk. The first can be laid off with the manufacturer, the second with the banks."

"Financial risk. We examine the consequences of the worst case scenario. We examine our loss exposure if the full penalty has to be paid."

"Financial risk. We minimize this risk by careful screening and by turning the transaction quickly. We have had a 65 to 70 percent success ratio."

Some of the specific risks, and their noncontractual management from the perspective of the traditional seller, are discussed below. Contractual management of risk is dealt with in the next section of this chapter.

Political and commercial risks. Most of the political (P.) and commercial (C.) risks (defined in Appendix A) associated with a traditional export sale are insurable through both public and private insurers. However, the same public insurers generally do not explicitly extend this coverage to the P. & C. risks associated with a CT transaction. For example, EDC maintains that its coverage is unavailable when payment for exports is: (a) to consist of a nonnegligible percentage of countertrand, or (b) dependent on a secondary (purchase or import) contract. Two Canadian companies, Reed Shaw Stenhouse Ltd. and Marsh and McLennan Ltd., are among the many private-sector entities who are willing to underwrite the risks associated with CT transactions.

Based on the interviews, only about 20 percent of the interviewed entities regularly have used external sources of P. & C. risk insurance for their traditional export transactions, and none of the interviewed entities have explicitly used insurance to cover the risks inherent in CT transactions. Some of their comments follow:

"Our insurance is sourced in the U.S. We find that EDC is not flexible."

"EDC will insure a transaction if they get an okay from the Central Bank of that country. However, this usually does not happen for CT transactions."

"We get both P. & C. risk insurance and insurance against repudiation of contract."

"We can obtain insurance but we find it hard to collect. We are looking at self insurance."

"No, due to cost considerations, we self insure [similar response from numerous interviewees (especially, trading houses)]."

"No. Although Lloyds is getting very involved in CT insurance, it is relatively new. The problem is with their country limits."

"We buy all insurance except for CT. We buy delivery risk insurance from a private insurer such as Lloyds."

"AIG P. risk insurance provides implicit CT coverage. Lloyds provides CT insurance on a case-by-case basis. However, their response time is slow and their premiums are unpredictable. Lloyds has difficulty in determining how to price CT risk."

"We have used P. risk insurance and found it expensive. We now self insure."

"As a trader, we use other people's policies."

"We use insurance if an insurer is available and the price is reasonable. We find it hard to get adequate coverage for technical errors and omissions from EDC."

"We often have to use private insurance because EDC has off-covered a country. Also, we find that their coverage period is often much shorter than required for the financing of the [compensation] project. We also buy guaranteed completion insurance which gives us a greater say in running the project."

"P. & C. risk insurance costs 5 to 10 percent from private insurers. We just can not afford that if we are to be competitive."

"P. & C. risk insurance is just too expensive."

"We usually insure against natural disaster. We usually do not buy P. risk insurance. We can not absorb the cost."

<u>Countertrand quality risk</u>. As discussed earlier, much of the countertrand which has been received by the interviewed entities has not been of adequate quality, especially for resale in Western markets. However, according to one interviewee:

"Today, there is still opportunities for derelict merchandise. However, except for the Comecon countries, countries have learnt that offering quality products in CT is important. However, it depends upon the priority of your exports in the importing country."

There are at least three potential methods of coping with this risk. First, buyers in less quality-conscious markets (or sub-markets of a sophisticated market) can be found. Second, quality criteria that must be met by the traditional buyer can be established. This approach is feasible for compensation trade arrangements when an objective measure of product quality is available. The measure must also be easily understood by all the involved parties and the achievement of acceptable quality levels must be almost certain. Third, the traditional buyer can be assisted in achieving and maintaining product quality by stationing technical personnel at the point of production of the countertrand (according to one of the interviewees, "tight quality control can be attained by stationing a full-time co-ordinator there"). Unfortunately, many nonmarket countries (such as the Soviet Union) may not allow such Western quality control personnel to be permanently stationed at their production facilities.

Countertrand delivery risks. A traditional seller can encounter a number of risks associated with the receipt (delivery) of the countertrands needed to fulfill its CT commitments.

1. Unavailability: Given a choice of potential countertrands, traditional sellers often begin to explore sales opportunities within their own entities or within other entities. However, by the time they have asked for selected countertrands to meet their identified market demands, traditional sellers have often been told that the countertrands are no longer available or would only be available after an extended time delay. The traditional seller must then repeat this costly search process for a buyer of some other countertrand.

The interviewees proposed a number of alternatives to increase the certainty that the offered countertrand would be available when it was required by the traditional seller. One alternative was to obtain a written confirmation from the traditional buyer that the offered countertrand would be available for a specific time period. A second alternative is to "obtain a pledge of exclusivity from the [traditional buyer] for a fixed period of time." A third alternative was for the traditional seller to threaten to discontinue future dealings with the traditional buyer if and when promised countertrands were not available. A fourth alternative is to use the traditional buyer's quality inspection and warehousing agents to ensure availability of desired countertrands. A fifth alternative is to "threaten the buyer that this would be the last deal if the desired [countertrand] was not available and the deal did not go well."

2. Delay: Some traditional sellers have found that specific orders for countertrands are never filled or are filled only after considerable delay. Such delays may be caused either by the fault of the traditional buyer (such as carelessness) or by exogenous factors (such as severe transportation bottlenecks). Generally, these risks are best managed contractually.

3. Quality/quantity shortfalls: Traditional sellers may find that the quality and quantity of the countertrand delivered may fall short of that ordered, and thus that the countertrand has to be rejected. Generally, these risks are best managed contractually.

4. Refusal to grant an export licence: Traditional sellers may find that the licence for the export of the countertrand may not be granted by the traditional buyer's government. Generally, this risk is also best managed contractually.

Nonfulfillment risk. A major risk encountered by all of the interviewed entities is the failure to completely and satisfactorily discharge CT obligations. Unless the CT commitment is "best efforts", the traditional seller has to pay a penalty in the event of nonfulfillment (see the earlier discussion on penalties).

While a traditional seller may be tempted to include the penalty in the price of its offering (and subsequently ignore the CT obligation), this can be risky. A traditional buyer may remove the traditional seller's name from the list of approved business partners or bidders if no sustained and serious effort was made to fulfill a CT commitment. This is particularly the case in Eastern Europe where state officials are expected to fulfill export targets through actual exports. Not only is the hard-currency income earned from penalties modest but lost exports may have a negative impact on the bonuses of state officials which are dependent on the achievement of export targets.

When payment of a nonfulfillment penalty can prejudice future business opportunities, one noncontractual response is to maintain a "negative" file of serious (but unsuccessful) attempts to source countertrand. This file may also form the basis for claims under a credit clause (see next section) in an offset or other type of CT contract.

Contractual Arrangements [33]

Separate contracts for each constituent transaction. Generally, a counter-purchase or buy-back transaction involves two or more separate legal agreements (contracts or documents) for the purchase (sale) of goods and services, which are "linked" under a single protocol (or heading or undertaking) agreement. These agreements are kept separate for the purposes of independent settlement in the event of nonfulfillment of the CT obligation. Often, the actual purchase contracts are simultaneously signed only after suitable countertrands have been identified by the traditional seller.

1. Protocol: In the protocol agreement, each party commits itself to enter into the necessary subordinate contracts to purchase for hard currency the goods and services supplied by one or more of the other parties to the CT transaction. Conceptually, a protocol is a contractual framework agreement which specifies who has to act, what actions have to be taken, and when they have to be taken. Generally, the CT commitment in this agreement is kept as general as possible. All general specifications which have been negotiated are embodied in this agreement. The actual countertrands and their prices are not disclosed in this agreement. Each party's commitment may be secured with a standby letter of credit or with a performance bond. The protocol is also designed to assure the traditional seller that its CT obligations under the secondary contract become null and void in the event of nonperformance or cancellation of the primary sales contract. One protective mechanism used by one of the interviewed trading houses is to have a contractual provision in the protocol that stipulates that the secondary sales agreement is activated only if at least 90 percent of the potential CT obligations have been fulfilled.

2. Primary sales contract: This agreement is generally embodied in a traditional sales contract for a traditional export sale. The traditional

seller agrees to provide a certain product, of a given quality, at a specified price, and at a specific time and place of delivery. The form of payment is usually specified as being hard currency at the point of delivery of the goods or services. To protect the traditional seller's unencumbered right to payment for its exports, the primary sales contract contains no reference to the secondary sales contract. Some of the details contained in this contract are listed in Exhibit 5.3.

3. Secondary sales contract: In this contract, the traditional seller (or assignee) agrees to purchase certain countertrands of a certain quality within a specified period of time (usually one to three years for counterpurchases) from the traditional buyer or list of approved suppliers. Any reference to the primary sales contract or its contents in this contract are drafted in such a manner that the primary and secondary agreements do not legally become a single contract. This is commonly accomplished by including a special clause to that effect in the secondary sales agreement. This clause usually appears as a provision that states that the payment of a penalty releases the traditional seller from any further obligations or responsibility in case of nonfulfillment of its CT obligations. While the completion of the purchase of a given quantity of countertrand at a fixed price may have to coincide with the fulfillment of purchases under the primary sales contract, the more typical case is for the maturity for the fulfillment of this contract to exceed that of the primary sales contract. A specimen secondary sales contract, and some of the details contained therein, are given in Exhibits 5.4 and 5.3, respectively.

4. Tertiary contracts: Generally, a CT transaction will involve additional (tertiary) legal agreements between one of the traditional parties to the CT transaction and one or more facilitator entities, such as a trading house or a lending institution. The specific nature of these agreements will not be addressed in this study.

Advantages from having separate contracts. There are at least five important advantages from the traditional seller's perspective of having separate legal contracts, which may or may not be linked by a protocol agreement, for each constituent CT transaction. First, separate contracts allow for differences in the fulfillment maturities of the constituent CT transactions. Second, as independent legal instruments, each contract can be settled by itself in case of dispute, the fulfillment of one contract may not be interrupted if one or more of the other contracts are contested, and the validity of one contract can not be abandoned or made conditional upon the fulfillment of the other contract(s). Third, by having multiple contracts, the traditional seller may be able to obtain (or obtain higher) trade finance/credits and/or risk insurance. For example, if prefinancing or guarantees are required, the primary sales contract will have to be submitted and approved by the appropriate facilitator entity. Since the "uncovered value of an export" is the net difference in value between the traditional seller's export sale and its countertrand purchase in a combined sale and purchase contract, the prefinancing or guarantees that may be available for such a deal is inversely proportional to the percentage of countertrands-to-exports. Fourth, if there is no obligation to become involved in the secondary sales agreement, a financial institution may be more willing to provide bridge financing to the traditional seller because it can advance funds solely on the repayment ability of the traditional seller. Thus, if the CT commitments do

Exhibit 5.3

Some of the Details Contained in a Primary and Secondary Sales Contract

Contract	Contract Details
Primary sales	Parties; recitals; acknowledgement of purchase obligations; description of goods and services to be purchased, their specifications, price and quantity; terms and method of payment; guarantees; delivery times, terms and other details; packing and shipping; insurance; documents and transfer thereof; guarantee of quality and quality control; right to neutral surveyor; determination and settlement of claims; penalties and remedies in the event of late or nondelivery and/or delivery of nonconforming goods and services; force majeure; arbitration; and choice of law.
Secondary sales	Parties; acknowledgement of CT purchase obligations; list of available countertrands, their deemed price, their specifications and description, and their quality; value of countertrand to be purchased; terms of payment and guarantee thereof; guarantee of quantity, availability and quality control; time period over which full CT obligation is to be fulfilled; terms and conditions of delivery; linkage; marketing restrictions; packing and shipping; insurance; documents and transfer thereof; inspection right; right to neutral surveyor; determination and settlement of claims; first party's (traditional buyer's) penalties and remedies; second party's (traditional seller's) penalties and remedies; cancellation of primary sales agreement; third-party transferability of countertrand purchase; force majeure; arbitration; and choice of law.

Source: CMA (1984), p. 7; in-depth personal interviews; amongst others.

not appear in the primary sales contract, the traditional seller can submit a "clean" primary sales contract to the export financing and guarantee agency (such as EDC) for export credits/finance and/or guarantees. Fifth, by having separate contracts, details of the CT transaction are easier to keep confidential from third parties, such as distributors who are being used to satisfy CT obligations. When separate contracts are used, only a copy of the secondary sales contract and the "dossier" number of the primary sales contract need to be revealed to the third party so that countertrand purchases are properly credited against the traditional seller's CT obligation.

Tightness of contract language. Although many of the interviewees maintained that the wording of their contracts should always be tight, others maintained that the tightness of the language of the secondary sales contract should depend on circumstances. Some of their specific comments were:

> "The contract should be tight for Eastern Europe. There should be more flexibility when dealing with Africa and Latin America."

Exhibit 5.4

Specimen Secondary Sales Contract

Countertrade Commitment No.:
concluded between [the traditional seller or TS]
and [the traditional buyer or TB]

Article I

1. [The TB] and [the TS] have concluded contract No. ... on [date] for the purchase of ... by [the TB]. The value of the [TB's] purchase is $ ...

2. [The TS] commits itself to buy, or to have bought by third parties of its free choice, goods suitable to [itself or these parties] at competitive prices and terms of delivery as herein defined by [TS or the third parties].

3. The value of [the TS's] purchases will be ... % of the contract value mentioned in I.1 hereabove, that is, $ ... From this amount, countertrands for $ ... can be taken from [the TB] and countertrands for $ ... from [entities other than the TB].

4. Prices for accepted countertrands under this commitment will be established according to the following method: [The TS] commits itself to order, or have ordered, countertrands qualifying according to I.3 by [exact date].

Article II - Guarantee

1. In case [the TS] fails to fulfill its commitment, either completely or partly, by the date stipulated in I.4, a penalty of ... % of the nonfulfilled value of the commitment is to be paid by [the TS] to [the TB] in [currency].

2. To secure the transfer of this penalty, [the TS] will issue, or cause to be issued by a third party, a bank guarantee for the penalty in question by [exact date, usually 3 to 6 months prior to the time fixed in I.4]. The penalty will be payable to [the TB] through the [TB-designated entity] against presentation of the following documents: ....

   Nondelivery of countertrands contracted by [the TS] or a third party in full or partial fulfillment of this commitment will release [the TS] from its commitment for the amount of the respective nonexecuted orders without penalty, recourse or any other claim at any time by [the TB] or [the TB's would-be suppliers].

Article III - Arbitration

1. Should disputes or disagreements arise concerning the wording or interpretation of this contract or its implementation, all parties will make every effort to resolve such disagreements in an amicable manner. In the event of failure to resolve such disagreements or disputes within a

reasonable period of time, the parties agree to place the issue(s) before the [body such as the Arbitration Commission at the International Chamber of Commerce, Paris], on the basis of its [Deeds of Arrangement and arbitration] rules, and to be bound singly and jointly by its decisions. The seat of any Arbitration Court will be in [locale such as Paris].

Article IV

1. [The TS] and [the TB] agree that only those contracts bearing the clause, "This contract is considered and agreed by both parties to be associated with contract No. ... with [the TB]", will be counted in fulfillment of the commitment made in I.3. Irrespective of their value or subject, no contract will be taken into consideration without the above mention.

2. [The TS] and [the TB] will carry separate books of account on any and all contracts concluded in fulfillment of this commitment. The accounts of both parties will be mutually reconciled quarterly.

Article V

The signatories of the CT commitment agree that the CT commitment will be null and void if [the TS's] sales contract No. ... of [date] with [the TB] does not come into force, irrespective by whose fault.

> "Generally, we believe in having as tight a contract as possible. The choice for any particular transaction however depends upon whether we feel that we may need to slip out of one or more contract provisions."

> "Tight contracts are best. However, this depends upon who you are dealing with."

> "You can only protect yourself with a strict and specific legal agreement."

> "With the Eastern European countries, there is no problem. By getting them to protect themselves through tightly-worded contracts, you are protecting yourself at the same time."

One of the interviewees noted that his entity did not have a written tertiary agreement with the importer of its countertrand because:

> "The importer could stop the arrangement at any time. If we pressed him to sign a contract, he would most likely terminate the relationship."

Assessment of contractual adequacy. Almost all of the interviewed entities rely solely on their primary legal counsel, and independent reviews by secondary legal counsel, to ensure that their interests are adequately protected contractually. Other actions taken by some of the entities to ensure that their interests were adequately protected contractually included:

> "We go over the legal consequences of every possible scenario. We check what protection we would have contractually for each of these scenarios."

> "Over time, we have developed a bank of effective contractual provisions to deal with various types of CT transactions and circumstances."

Some specific clauses in the secondary sales contract.

1. Availability of countertrand: This clause should specify the goods and services which will be available as countertrand, on what basis, and over what time period.

2. Cancellation: This clause should provide a one-way linkage from the secondary sales contract to the primary sales contract. The purpose is to ensure that the secondary sales contract is immediately cancelled in the event that the primary sales contract is cancelled or is not fulfilled.

3. Credit: This clause should provide for the traditional seller to benefit from its unsuccessful and serious attempts to source countertrand. Specifically, if the traditional seller was hampered from doing so because the desired countertrand could not be delivered or agreed upon or was of less-than-an-acceptable standard, then this clause should provide for the reduction of the traditional seller's overall CT obligation according to a specific formula. To ensure that its countertrand purchases are credited towards its CT obligations, the traditional seller should include the following clause, or variants thereof, on all of its individual purchase orders for countertrand:

> "This purchase is made in (partial) fulfillment of the CT commitment contract no. ... entered into by [the traditional seller] with [the traditional buyer] on [date]."

4. Deemed price of the countertrand: This clause should clearly specify a formula for the pricing of countertrand, particularly for countertrands to be selected and/or delivered at a subsequent date. Specific types of pricing formulas used by Canadian exporters and traders were given in chapters 3 and 4.

5. Delivery: This clause should explicitly specify the place at which delivery is considered to be effected.

6. Delivery delays/nonfulfillment: To protect against irregular deliveries, the secondary sales contract should impose various penalties on the traditional buyer. One clause to this effect may read as follows:

> "[The entity which will supply the countertrand] commits itself to pay a penalty of ...% of the value of the countertrand to [the entity buying the countertrand] if delivery of [the countertrand] to [place] has not been effected within [90] days of its contracted delivery date."

If the traditional seller prefers delivery of the countertrand to receipt of penalty payments, the clause may be replaced as follows:

> "[The entity buying the countertrand] orders [countertrand] for delivery to [place] by [date]. Delayed deliveries will be subject to ...% interest payment per annum, calculated on the value of the delayed countertrand, over the period from the date when delivery was due to such date as delivery is actually effected."

To protect against permanent nondelivery (i.e., nonfulfillment), the secondary sales contract should have a clause that states the contract is immediately dissolved in the event of nondelivery, without affecting the obligations of the affected parties under the primary sales contract.

To nullify a traditional buyer's argument that it can not agree to such a penalty clause because it represents a foreign-exchange obligation that must be approved by its government, the specific clause can be modified so that no separate bank guarantee has to be deposited for the stipulated penalty and that the penalty can be payable by reducing the price of the countertrand subsequently shipped to the traditional seller to below its current price and/or by increasing the quantity of the countertrand subsequently shipped to the traditional seller to above that ordered. The surplus value thereby transferred from the traditional buyer to the traditional seller would be deemed to be the penalty compensation.

7. Dispute settlement: This clause specifies, for example, that any dispute between the parties is to be resolved by binding arbitration to be held in the home country of the party complained against, that each party would select one of the arbitrators, and that the two selected arbitrators would select a third. Alternatively, this clause may specify that all disputes are to be brought to an arbitration body (such as the International Chamber of Commerce), and that such arbitration would be held in a "neutral" third country using a set of arbitration rules (such as the U.N. Commission on International Trade Law (UNCITRAL) Arbitration Rules). According to two interviewees:

> "We try to have arbitration in Brussels."

> "We try to have the resolution of all disputes according to our law. If our law is not possible, we try to have the British law as being neutral."

However, resorting to the formal settlement of disputes is not preferable to private resolution of such disputes if the parties have an interest in continuing to do business together. This was aptly stated by the spokesperson of one of the interviewed trading houses as follows:

> "Large contracts have to be worked out through negotiations. Traders don't sue. We depend on repeat business and satisfied clients, and not on legal solutions to problems."

8. Force majeure: This clause states that the traditional seller shall not be held responsible for the purchase or possession of countertrand due to

force majeure. What constitutes force majeure (such as acts of nature) are generally specified in this clause.

9. Linkage: This clause guarantees the traditional seller access to countertrands from other entities under the same or different ministries in the country of the traditional buyer. Linkage is especially important in countries where the production and sale of goods and services is primarily or totally controlled by the government or its agencies. If a linkage clause is omitted, the purchase of certain countertrands will probably not be credited against the traditional seller's CT commitments.

10. Market demand: This clause, which is common in compensation agreements, contains a formula for prolonging the life over which countertrand is taken back depending upon market demand for the countertrand.

11. Marketing restrictions: This clause may stipulate that the traditional seller can market the countertrand with no restrictions as to geographic area or type of purchaser, or it may allow competitive or exclusive distribution of the countertrand only in certain markets and/or to certain types of purchasers.

12. Morals: This clause defines what is considered to be moral behaviour by the parties to the contract.

13. Nonfulfillment penalty: This clause states that the traditional seller is completely absolved, upon payment of a specified penalty, from any further CT obligation under the terms of the specific secondary sales contract, and that the payment of the penalty does not affect the obligations of the parties under the primary sales agreement. As discussed above, a penalty of from 5 to 20 percent of either the initial value of the CT obligation or the unfilled portion of that obligation are commonly specified in this clause. A traditional seller will generally have to provide a bank guarantee as security for the penalty clause.

14. Quality guarantee: Since many types of countertrands (e.g., machinery, equipment parts, etc.) are of little value if they do not conform to detailed specifications, the quality guarantee clause should unequivocally state that nonconforming deliveries will not be accepted, or will be returned for repair at the supplier's expense, or will be repaired by the traditional seller or a third party at the supplier's expense. Alternatively, the remedy under this clause may be to assign penalties or price discounts to the traditional seller (the purchaser) based on the degree of nonconformance of the delivered countertrand with a detailed index of specifications.

If the countertrands to be purchased have not been specified in the secondary sales agreement, then the quality guarantee clause is often specified as being "of export quality", which is itself clearly defined in the clause. A provision for the appointment of a neutral surveyor, agreeable to both parties, for the purposes of rendering binding decisions on product quality, is also usually included in such a clause.

In all such clauses, there should be a provision which gives the traditional seller the right to inspect countertrands before delivery. Such inspections can either occur at the point of manufacture or at the point of shipment.

15. Sudden price change guarantee: This clause protects the traditional seller from sudden price increases for countertrands (e.g., commodities) because the traditional buyer wants to back out of their supply. This clause may state that countertrand purchases will be "at a price which does not deviate more than x percent from the closing price (or mid point between the bid and ask) on the XYZ exchange on the day of the calling in the countertrand" for commodities listed for trading on an international exchange, or "at the prices quoted in XYZ trade journal on the day of the calling in the countertrand" for commodities not so listed.

16. Transfer: This clause gives the traditional seller the right to transfer its CT obligation to a third-party (such as a trading house) either of its own choosing or in consultation with the traditional buyer. Due to unforeseen events, this provision should be included in the secondary sales agreement even if the traditional seller plans to use the countertrand internally or to market the countertrand externally without the assistance of a third party.

Letter of release. Upon fulfillment of its CT commitment or upon payment of the requisite penalty, the traditional seller should receive a letter releasing it from any further obligations under the specific secondary sales agreement.

Restrictions on local currency use. In the section on payment in the primary sales contract, one of the clauses may specify that x percent of the total amount will be payable in local currency, and that y percent of this local currency may be used for the purchase of countertrand and that (100-y) percent of this local currency may be used to cover local expenditures (such as local travel, local accommodation, and exhibition fees). Such a clause may also specify: (a) which countertrands can be purchased with local currency, (b) whether the internal or external (i.e. regular export) price of the countertrands are to be used, (c) whether any unexpended local currency is forfeited after a certain period of time, and (d) whether there is a monthly upper limit on the use of local currency for the payment of local expenses.

Traditional Means of Fulfilling CT Obligations

Exporters. A traditional nontrading house seller can discharge a CT obligation by using in-house personnel and/or an external entity (such as a trading house). Although the payment of a penalty is also possible, most of the interviewed entities did not favour this option. In fact, most of the interviewed entities believed that they had to satisfy their CT obligations even when no penalty was associated with their nonfulfillment. Specific comments included:

> "If we don't perform, we will jeopardize future contracts in that country."

"We have a moral obligation to do it [satisfy the CT obligation] well. Its performance will affect our future chances of winning contracts in that [country] and in that [continent]."

"We have no penalties to pay in case of nonfulfillment. We will continue to attempt to sell in the Canadian market even after the completion date set out in the contract. We need to maintain our credibility for future sales."

The fulfillment of the CT obligation is more likely to be handled internally by a MNE. A MNE is also more likely to use the countertrand internally since most MNEs already source a large dollar value of a variety of products internationally for their own use. However, most MNEs have to overcome a major obstacle before they can place the countertrand internally. Namely, they have to overcome the reluctance of company procurement officers and buyers to change or add new suppliers by convincing them that the potential supplier will be able to provide an assured supply of quality countertrand at competitive prices. Some of the specific comments advanced by the spokespersons of the MNEs follow:

"We have engaged in CT only for products used internally."

"We have never used an external trading house to distribute our [countertrand]."

While the advantages of internally retaining responsibility for the fulfillment of CT obligations are allegedly added control, flexibility and lower cost,[34] the traditional seller needs trading expertise, extensive networks, contacts, and organizational co-ordination to be effective in discharging its own CT obligations. In addition, a traditional seller needs to prevent its sales force from becoming overzealous and thus agreeing to the purchase of nonmarketable countertrands. A traditional (nontrading house) seller should engage the required external CT expertise if: (a) it does not have a suitable organizational structure to deal with countertrands, (b) it does not have a large enough volume of countertrands to justify the high fixed cost of establishing its own countertrand disposal expertise, and (c) it does not have the risk-taking profile required to assume the risks associated with CT.

If there are nonfulfillment penalties associated with a CT transaction and the countertrand can not "be laid off back-to-back", Canadian (especially nontrading house) exporters generally do not act as principals in the disposal of the countertrands. Some of their comments follow:

"Since we are not traders, we are not interested in bearing that liability."

"We would never be principals because we would never take [the CT obligation] into our books."

"Our contract with [trading house] specifies that they are responsible for everything. Their contract is direct with the [traditional buyer] and does not include the name of [our company]. We pay no money to the trading house until the deal is finalized."

"We [trading house] use third parties whenever necessary, especially for the disposal of [countertrand]."

"We are looking at laying off product through sub-contracts with other trading houses, which have greater specialization. One trading house can not know every product and every market."

If the fulfillment of the CT obligation is being handled externally, the traditional seller should ensure that it is periodically advised of how much of the obligation has been satisfied. It should also receive a letter from the external entity when the CT commitment has been fully satisfied.

Trading houses. As a general rule, most larger trading houses act as (trustee-appointed) principals with the power to sign (i.e., to enter into binding commitments). As principals, they assume total liability for the disposal of countertrands. The spokespersons of these trading houses felt that it was both essential and necessary that they obtain full control over countertrand obligations. According to one of the interviewees:

"We take title and assume responsibility for [countertrand] disposal on a recourse or nonrecourse basis depending upon circumstances. We however do not take responsibility for quality or force majeure."

Nevertheless, according to another interviewee:

"While holding title is important, having trust between the principals is even more important."

Few of the smaller (essentially Canadian) trading houses act as principals. Some take title if they can lay off the countertrand on a back-to-back deal, others share the title with one or more partners, others only act as agents on a commission basis, and still others only introduce the traditional seller to potential buyers of the countertrand. Such introductions can be either on a commission or noncommission basis. Generally, when an introduction is made on a noncommission basis, the trading house will "divorce itself from the CT transaction." According to the spokesperson of one small Canadian trading house:

"Taking title can put a small trading house in a difficult position. By doing so, it assumes responsibiity for everything - damages, maturity, etc. However, taking title is required if the [countertrand] is industrial, consumer or part of a building. Without it, the trading house could lose control over the [countertrand]. A trading house also needs title when something becomes part of something else. In certain countries, when something becomes part of something else, one loses ownership unless it was clearly retained."

Bank-owned trading houses. In theory, most of the U.S. bank-owned (B-O) trading houses will take title to countertrand, and thus bear the risk for its disposal, whenever the assumption of that risk appears to be manageable and prudent. However, in practice, few U.S. B-O trading houses actually take title to countertrand.

Countertrand disposal problems.

1. Lack of experienced external entities for countertrand disposal: In Canada, the external disposal of countertrand by external entities is itself somewhat unfavourably affected by a lack of entities who are willing to provide such services and have had any true "hands-on" experience in so doing.

2. Quota restrictions: The external disposal of countertrands can be hampered if the countertrands are subject to quota restrictions.

3. Market restrictions: A common misconception is that countertrand must be sold in the traditional seller's own home market. Generally, an exporter committed to CT can persuade the traditional buyer to drop its demand that the countertrand be used or sold in the traditional seller's home market. Unlike a trading house, exporters are perceived by traditional buyers as having little domestic opportunities for resale of countertrand.

4. Dumping: A serious problem can arise if countertrand is imported and sold in the Canadian market at prices equal to or below production costs. Such sales are possible because traditional sellers are frequently anxious to "unload" large quantities of often undesirable countertrands within a short period of time. Canadian manufacturers of similar goods and services can challenge such imports under the antidumping laws. If such challenges are substantiated, then the imported countertrands can be assessed substantial countervailing duties. However, dumping may be easier to conceal when a third party is responsible for marketing the countertrand and when the sales channel is complicated.

5. Mandated use of a specific trading house: Some of the interviewed entities expressed frustration with a traditional-buyer-imposed condition that they could only use a traditional-buyer-designated trading house to dispose of the countertrand. Most of these entities felt that the relationship was unsatisfactory. According to one interviewee:

> "In [country], we had to get the co-operation from the government-appointed trading house to source and market [countertrand]. It was a real headache. After a period of frustration, we pressured the government and got a change in trading house. The new trading house is also from [same country] but it is working out much better."

6. Product-specific government regulations: Countertrand disposal in a specific market often requires that the countertrand conform to specific government regulations concerning labeling, packaging, safety, and so on. By merely importing the countertrand for resale to a distributor or end-user, the traditional seller may have to both satisfy these requirements and expose itself to the potential criminal and civil remedies thereunder.

Less Traditional Means of Fulfilling CT Obligations

Replacement of the traditional buyer as the supplier. To fulfill their CT obligations, some traditional sellers have sold the countertrand to an importer who was already purchasing that good or service from the traditional buyer for distribution into a specific geographic market. To induce the importer or distributor to make such a sourcing shift, the traditional sellers have under-cut the traditional buyer's price by selling the countertrand at a discount to the importer or distributor.

Purchase of CT credits. To fulfill their CT obligations, some firms have attempted to trade for or to purchase CT (e.g., offset) credits from brokers, trading houses or other exporters. Typical costs of purchasing such credits have been quoted as being between 1 and 5 percent of the value of the credit. The spokesperson of one of the interviewed entities noted that:

> "It was trying to arrange offset credits with a [developed country] company which had similar [offset] obligations in Canada."

Final Discharge From the CT Obligation

After satisfying a CT obligation, Canadian entities generally receive a letter of release stating that they have fulfilled their CT obligations. To ensure that such letters are issued promptly, the traditional seller can stipulate that they be part of the documentation needed for release of the traditional seller's letter of credit for payment of the countertrand.

FACILITATOR ENTITIES

Trading Houses

Alleged advantages. The alleged advantages of using a trading house include:

(1) A trading house can assume responsibility for most of the problems associated with the discharge of a CT obligation. In fact, in such cases, the traditional seller can choose to remain uninformed about certain details of the CT transaction, such as what specific countertrands were chosen by the trading house, and where and how these countertrands were actually marketed.

(2) The arrangement with the trading house can be used as a shield to prevent disclosure of the information that the traditional seller was associated with the sale of low quality countertrands at subsidized prices.

(3) By utilizing the trading house's acquired knowledge on CT practices, goods and services, and markets, the traditional seller can avoid the cost of acquiring such specialized knowledge.

(4) The trading house is likely to have a more developed network of market contacts than the traditional seller, since the trading house continually deals with a wider variety of wholesalers, importers, trading houses, and end-users than does the traditional seller.

(5) A trading house may be able to achieve economies of scale in distribution and enhanced marketability by repackaging CT commitments into more attractive packages, by economizing on information and search costs, and by operating at optimum scale.

(6) Based on its continuous market presence, the trading house should be in a better position to make prompt and reliable cost estimates for countertrand disposal than a traditional seller.

(7) The risk of countertrand disposal can be transferred from the traditional seller to the trading house if the latter is willing to act as a principal. In turn, the trading house can mitigate its risk exposure by sharing its risk with other facilitators.

Alleged disadvantages. The alleged disadvantages of using a trading house include:

(1) If the traditional seller intends to use CT on an ongoing basis, it will not gain much CT expertise unless it "gets its hands dirty." (This is an implicit cost of using a trading house for CT.)

(2) The explicit costs of using a trading house may exceed those for the use of internal personnel to fulfill CT obligations (see the earlier discussion on this point).

(3) The use of a trading house may impede the amicable resolution of problems such as countertrand modification or extension of the CT fulfillment period. This would be the case if, for example, the traditional buyer was for some reason more receptive to such requests if they are put forward by traditional sellers rather than trading houses.

Services offered. The CT services offered by the trading houses active in Canada include negotiation advice; government and industry contacts and lobbyists in the traditional buyer's country; technical assessment of the quality and the "true" disposal values of the offered countertrands; information on the traditional buyer's countertrand delivery performance; market intelligence and contacts; and countertrand disposal expertise. For example, according to one of the nontrading house interviewees:

> "We find it easier and better to go straight to a trading house for market intelligence."

There are a number of services that individual trading houses will not provide. For example, according to one of the interviewees:

> "We would not touch bail outs due to their excessive cost. My recommendation in such cases is to 'fire the marketing manager'."

Decision-making. As private-sector, profit-oriented entities, trading houses are in the business of making financial decisions based on the underlying objective of maximizing expected return for the level of risk borne. To minimize this risk, trading houses attempt to minimize the length of their uncovered 'inventory' exposures by turning over goods and services quickly, by obtaining advance commitments, and occasionally by hedging using the futures market. Their decision-making is characterized by speed; most decisions have to be made and executed quickly. Furthermore, most (if not all) of their decisions are based on private (and not public) benefits and costs. As such, private-sector trading houses do not (and can not) concern themselves with national concerns and priorities.

Use of other trading houses. A (significant) minority of the interviewed trading houses acknowledged that they used other trading houses for the disposal of goods and services. However, only a few of the (larger) trading houses acknowledged that they commonly used other trading houses for the disposal of goods and services. According to one of these interviewees:

> "Our competitors are the Japanese and European trading houses. Although we compete on the initial contract, and sometimes the contract is won based on the best CT proposal, we often work with the same competitors on product disposal."

Most of the interviewed trading houses noted that there were at least two difficulties in using other trading houses for the disposal of goods and services (including countertrand). First, a "fee give up" is required when a trading house uses one or more other trading houses for partial or full disposal of goods and services. Since this fee-sharing can not generally be passed on to the client, the transaction becomes less attractive to the initiating trading house. Or, according to one of the interviewees:

> "There is only room for one commission. Thus, it is hard for us to use other trading houses."

Second, the initiating trading house has to worry about a "bypass", that is, the other trading house taking all of the business for itself.

Trading house cost. As discussed earlier in this study, a trading house's CT fee consists of: (a) the cost of financing charges, commitment fees, cost of penalty guarantees, travel and accommodation, and general overhead; (b) the subsidy required to cover the difference between the deemed and disposal prices of the countertrand to be moved; and (c) profit. In general, the costs to satisfy a given CT obligation tend to rise as the size of the trading house and/or the transaction become smaller. In fact, according to the spokesperson of one of the interviewed trading houses:

> "There is a lot of paperwork, storage fees and transfer fees involved with the disposal of a small dollar volume of countertrand. We need about 17 percent on a one-shot deal, and about 15 percent if it is reoccurring."

Almost all of the trading houses take no (or a nominal) retainer or up-front fee. However, according to some of the interviewees, up-front fees are becoming more common among the smaller trading houses because clients allegedly "use trading houses as part of their fact-finding missions." Most of the trading houses are renumerated after they have performed, where performance is deemed to have occurred at the point of time at which the shipment of the countertrand has either departed or arrived. Some of the trading houses have a variable rate schedule, where the rate for the first x dollars of countertrand disposal may be higher or lower depending upon competitive conditions and client development considerations.

Choosing a trading house. Criteria used by the interviewees in choosing a trading house to assume the disposal of countertrands include: (a) risk-bearing and distribution capacity; (b) ability to assure a high level of performance; (c) level of financial standing; (d) value-for-money rating;

(e) specific product, country and market knowledge; (f) network of affiliates; (g) whether they have a physical presence in the traditional buyer's country; (h) whether they have had previous "hands-on" experience in CT and/or in the traditional buyer's country, and (i) their relationship with the government of both the traditional buyer's and seller's country. Because the ratings on these criteria can vary significantly across the available trading houses, and can also vary significantly for the same trading house from transaction to transaction, most of the interviewed entities comparison shop. However, a number of the interviewees noted that the trading house bids they received were surprisingly similar. Some of their comments follow:

> "The difference in the bids was 10 to 15 cents a barrel."

> "The difference in their bids was less than one-half of one percent."

The spokespersons for one of the interviewed entities noted that they had short listed three trading houses for one of their CT transactions. Their final choice was influenced by two factors: (1) the traditional buyer's preference, and (2) "the faith and trust that the [traditional buyer] and we had in the people we were dealing with from the trading house."

<u>Obtaining a serious indication</u>. A traditional seller will want an accurate estimate of the total cost of settling a CT commitment from a trading house before signing a final secondary sales contract with the traditional buyer. As an initial step towards forming a business relationship, most trading houses will issue a preliminary understanding, called a "serious indication", to the traditional seller. It may read as follows:

> [The trading house] is, under normal circumstances, prepared to assume CT commitment No ... at a cost of ..., provided our stipulations are met.

The stipulations include a list of specifications and clauses that must be included in the final secondary sales contract. Serious indications are usually valid for a period of up to two months.

<u>Their capacity: actual and potential</u>.

1. <u>Overall</u>: In general, most (particularly, the larger) interviewed entities believe that there are a sufficient number of trading houses with CT experience that can be easily accessed in or from Canada. Some of their specific comments follow:

> "The range of trading houses and services is adequate [and numerous variants thereof]."

> "We have enough trading houses now. Also, a number of U.S.-based trading houses want to get into Canada."

> "A number of large foreign-owned subsidiaries have a presence in Canada. [Trading house], for example, has about 20 people in Canada. It has an overhead of about $1.5 million. It can look at and commit to any deal. It shares information on competition

and CT possibilities with the parent and other subsidiaries on a daily basis. It has a large computerized data base in [city]."

Some services that trading houses could or should provide more adequately, according to the nontrading house interviewees, included:

"The only problem is that none of these [trading houses] provide a full service, where full service includes the provision of financing."

"Some improvement is called for in two areas - the linkage of credits and financing. The linkage of credits has however always been difficult."

2. Small- and medium-sized Canadian trading houses: Although the Directory of Canadian Trading Houses lists some 152 trading houses that offer some form of CT services, most reported that they have never actually been involved in a CT transaction, and many reported that they were not very interested in becoming involved. Furthermore, most of those trading houses who had completed a CT transaction had never completed a CT transaction which involved Canadian exports and/or entities. Most of those trading houses who had completed a CT transaction were also affiliated with one or more foreign-based trading houses. According to the spokespersons of these entities:

"We are associated with the owner of [large MNE] who has a London-based trading house."

"We have set up a joint company with [an Eastern European company] to do mostly barter-type transactions."

According to the interviewees, some of the reasons for this level of performance by small- and medium-sized Canadian trading houses are:

"The laws impede the formation of decent trading houses in Canada."

"Canadian trading houses are mainly interested in commodities, and, thus, are not particularly helpful. Most do not have an office in the country of [countertrand] purchase. Most do not have the marketing contacts. Most are very inflexible in their modes of doing business. Most have little experience with CT. The chances of using Canadian trading houses for CT is thus somewhat dismal."

"Access to credit is a problem for small trading houses. They need easier access to capital. There are too many thinly capitalized trading houses in Canada."

"Most Canadian trading houses are very thinly capitalized. Thus, their capacity is limited. They could also be more informed about markets and market prospects, and they could show a little more innovation."

"Their capacity is very limited due to a lack of contacts. You need contacts for proper [countertrand] disposal."

"Based on our in-house survey, we found that the smaller Canadian trading houses do not have the required product knowledge, and that they do not have the required contacts."

Nevertheless, with some strengthening, small- and medium-sized Canadian trading houses can offer their specific product knowledge, market expertise and contacts to traditional sellers for CT transactions, especially for those transactions that larger trading houses find unprofitable. According to one of the interviewees:

"There is a niche for smaller trading houses, especially for transactions of up to one million dollars."

Furthermore, the capacity of such trading houses needs to be strengthened by increasing their business networks through affiliations with foreign trading houses.

3. The Japanese trading houses: Since most of the Japanese trading houses have traditionally only concentrated on Japanese-Canadian trade, their Canadian subsidiaries have had little experience in conducting CT. While a number of the Japanese trading houses operating in Canada have been advised by their parents to diversify their trade by encouraging Canadian trade with countries other than Japan, many of the interviewees felt that this was happening too slowly. Thus, it would appear that the Japanese trading houses have the potential to play a more dominant role in fostering Canadian trade with, for example, the less developed countries.

The frustrations of small- and medium-sized Canadian trading houses. Some of the frustrations expressed by the spokespersons of the small- and medium-sized Canadian trading houses included:

"We have tried many times [to conclude CT]. We first tried with [Canadian entity] in [pre-1980 date]. They just did not understand that the subsidy and costs of the transaction had to come out of the selling price. Same with selling [product] on a CT basis from [province], which we could have done in [country]. Selling [product] for less than market is a problem for a Crown corporation."

"Many Canadian firms give their wholesale prices as their export prices. They don't realize that that is not good enough internationally."

"Our past experience with Canadian companies is bad. They either can not handle large orders or are not interested in small orders, or their prices are outrageous. Ninety percent of the U.S. subsidiaries do not have the authority to export."

"Canadian manufacturers do not know how to do it [CT]. Also, they do not want assistance on how to do it."

"Canadian businesses are ill financed. We wanted to use Canadian suppliers but they were not competitive. They did not even bid according to specifications."

"Canadian firms are reluctant to pay for the services of a trading house."

"Trading houses have a stigma in business and also, to a lesser extent, in government. This bad perception is only improving slowly."

The supply and training of traders. A small (but significant) number of the interviewees pointed out that there was a deficiency in the formal provision of training for traders. While most of these interviewees felt that traders could be sourced internationally (particularly, in the United States), most felt that there was a deficiency of "Canadian trained" traders. Some of their specific comments follow:

"We have no place for educating traders in Canada. Since other (particularly, European) countries have to trade to survive, they have facilities for educating traders."

"There are not many places in Canada to get trading experience, especially of a general nature. For corporate trading companies, one needs training in business development more than training in trading a few specific commodities."

Bank-owned Trading Houses

Alleged advantages. The alleged advantages of a bank-owned (B-O) trading house in CT are numerous. The B-O trading house should have ready access to its parent's export financing capabilities and expertise; its facilities for letters of credit, guarantees, foreign exchange, and so on; its network for foreign market intelligence; its foreign physical presence through its branch network; its carefully cultivated relationships with foreign governments and lobbyists; its product and market knowledge; its long associations with large corporate entities who are both a source and market for goods and services; and its international reputation and standing.

The situation in the United States. Until 1982, U.S. banks (and other financial institutions) were legally constrained from openly conducting CT on their own account. Under the 1933 Glass Slegall Act, U.S. banks were prohibited from taking positions in commodities or trading for their own account. Under the Sherman Anti-Trust and the Federal Trade Commission Acts, U.S. banks (along with other U.S. firms) were prohibited from engaging in certain foreign activities.

On October 8, 1982, the Export Trading Company Act was signed into law.[35] The Act was drafted with the primary purpose of increasing U.S. exports by encouraging the more operationally efficient provision of export services to U.S. producers, suppliers and exporters, particularly, those of a smaller size. The Act, whose provisions are laid out in four parts, attempts to achieve this primary purpose: (a) by establishing an office within the

Department of Commerce to promote the formation of export trade associations, export trading houses, and export consortia; (b) by permitting bank holding companies, and other specified banking entities to invest in export trading houses; (c) by reducing the restrictions on the trade financing provided by financial institutions; and (d) by amending the Sherman and Federal Trade Commission Acts so that they only apply to activities that have a "direct, substantial, and reasonably foreseeable effect" on either U.S. import commerce or on the export commerce of a U.S. resident [Griffin (1983a), p. 237]. Under the Act, a U.S. bank (or other type of financial institution) may invest up to 5 percent of its capital in the equity of an export trading company, and loan an additional maximum of 10 percent of its capital to the same company.

A number of B-O export trading companies were subsequently established or purchased by such entities as Citicorp Bank, First Boston, Bankers Trust and Security Pacific Bank.[36] The reasons for each bank becoming involved in an export trading company, and their method of funding and operating these entities, vary from one B-O trading company to another.

While sufficient time has not elapsed to fairly judge the success of these B-O export trading companies, it would appear that preliminary results on their financial performance are mixed and somewhat disappointing, since there have been several financial disasters and few of the B-O export trading companies appear to be profitable. Furthermore, no careful assessment of their effectiveness in stimulating incremental U.S. exports of goods and services could be found. Some of the reasons advanced for their lacklustre financial performance include:

(1) Most of the B-O export trading houses are designed to handle a large volume of trading activities. Unfortunately, given the volume of trading business, the number of competitors actively seeking that business, and the high fixed costs of many of these entities, it would appear that many of these entities are still operating on the downward sloping portions of their average cost curves.

(2) The corporate risk profiles and cultures, and the attitudes of bank personnel, would not appear to be conducive to the efficient operation of these entities.

(3) The financial performances have been consistent with those for new business start-ups or entrances into new business fields.

(4) Ex post, it appears that the passage of the Export Trading Company Act, and the entrance of the U.S. banks into the export trading house sector, were poorly timed actions. Specifically, both actions preceeded the unexpected rash of sovereign debt reschedulings which caused a massive, essentially across-the-board retrenchment in the foreign activities of U.S. banks.

(5) The growth and profitable operations of the B-O trading houses have been severely restricted by a number of provisions in the Act and by a number of restrictive rulings dealing with capital adequacy by the Federal Reserve Board. For example, 51 percent of a B-O trading house's income must come from exports, and exports which involve CT are excluded from the export total.

<u>The situation in Canada</u>. According to Section 174 of the Canadian Bank Act, a Canadian bank is precluded from taking title to goods for commercial purposes. The applicable section reads as follows:

> 174(2) Except as authorized by or under this Act and in accordance with such terms and conditions, if any, as are prescribed by the regulations, a bank shall not, directly or indirectly: (a) deal in goods, wares and merchandise or engage in any trade or business;

The Act also contains provisions which limit the ownership of nonbanking companies to ten percent. Also, according to the Combines and Investigation Act, the banks are constrained from pooling their expertise and obligations in CT transactions. However, whether or not a Canadian bank can trade on its own account or participate in a joint venture trading house if that is done through a foreign subsidiary appears to be legally unclear.

While the Canadian Bankers Association (CBA) has lobbied the Federal government to remove these restrictions, the effort has not appeared to be either sustained or rigorous. The probable reason is that the payoffs that the banks expect to receive from the provision of trading house services must not be high.

<u>The situation in the rest-of-the-world</u>. In some European countries (such as the United Kingdom, France, Germany, Holland and Switzerland), the banks have either directly invested in trading houses or they have indirectly invested in trading houses through their nonbank subsidiaries and shareholder networks.[37] For example, Austrian banks apparently have separate barter divisions that take title to goods and services (including countertrand). Similarly, the close relationship between the bank and trading houses in Japan has been adopted in Brazil, South Korea, amongst other countries.

<u>Legislative changes in Canada</u>. With regard to whether the applicable Canadian legislation should be modified to allow Canadian banks to take title to goods and/or to invest more than 10 percent in the equity of a trading house, there was little agreement among the interviewees. Approximately, 40 percent of the interviewees were indifferent to either change, given their perceptions of the current attitudes and risk profiles of the Canadian schedule A banks. The remaining 60 percent were split equally for and against each of the two changes. Those interviewees who did not support the legislative changes advanced the following arguments:

> "The question is whether they want to take risk. I feel that they don't."

> "Bankers and traders are two extremes. They would have to form a separate entity staffed with risk takers. Given the risk profile of Canadian bankers, I just can not see this working well."

> "Canadian banks are the safest. They should not jeopardize that safety by getting involved in trading and in CT."

> "Taking title would be stupid. Ownership would not be advisable since banking and trading are incompatible. There is not enough

volatility in the market for the banks to make their required rate of return. Instead, they should move into merchant banking. [trading house]."

"I think it is a bad idea but they may have to do it for competitive reasons."

"No bank should be involved in CT because the risks are too high. Also, the banks could not operate quickly enough to be profitable in trading."

"Although it is up to the banks, we [trading house] as a bank client would be worried about disclosure and conflict of interest. How transparent would the Chinese walls be?"

"It is against the risk profile of most Canadian charter A banks. So why bother."

"There is a push for financial institutions to become merchant bankers. This can result in a conflict of interest. It is hard to ensure that a trading subsidiary and its parent will operate at arm's length. Also, banks might accept risks that trading houses like ours would never accept."

Those interviewees who supported such legislative changes advanced the following arguments:

"Taking title would lead to a lucrative business for the banks. They would, however, have to become more like merchant bankers and they would have to become more trading conscious. Their ownership of trading companies would help. Their risks would not be high if they dealt in salable products. Trading is a volatile but not that risky business. They would however probably cut into our [trading house] business."

"Taking title will allow the banks to be competitive. It will equalize the competition with the Schedule B banks operating in Canada."

"Yes on both counts. The first to be competitive, the second to allow them to become full service outlets."

"Yes, for both. If they want to do it, they should be allowed to do it."

"It is good that they are restricted because they would become a force to reckon with. They have experience in political and credit risks but not enough experience in international trade law. They would have to set up a subsidiary or purchase an experienced trading house. Ownership would be a means for expanding the business of the banks and for them gaining greater control over export deals. [trading house]."

Critique. The arguments for the retention of the above legal constraints on the activities of Canadian banks appear to be weak in that these arguments have neither a theoretical basis nor empirical support. Instead, they appear to be based on anti-competition motives (primarily market sharing), and on the mistaken notion that a bank will become more risky if its business opportunity set is enlarged. While a case may be made for the formulation of guidelines that ensure that bankers operate prudently as traders (especially when they are acting as principals), what constitutes prudent behaviour in the trading sphere has not yet been determined as the American experience indicates. The conjectures on what could be expected to happen if such legislation is modified are probably valid. Based on interviews with a number of bankers, it would appear that bankers are very reluctant to expand into the provision of full trading house services.

Banks

Services offered. Each bank that operates in Canada provides one or more of the following CT-related services: information on the various forms of CT and specific CT practices in particular countries; consulting; client introductions; market and government contacts; administration of escrow and evidence accounts; bridge and pre-export financing; financing of the non-CT portion of an export sale; and financing of countertrand. Each bank may also assist or take the lead role in negotiations concerning CT arrangements, may assist in locating buyers or appropriate trading houses to discharge CT obligations, and may match-make by bringing two clients (a buyer and a seller) together. While no explicit fee may be paid for some of these services, other services (such as match-making) are likely to involve an explicit finder's fee.

In general, the CT capabilities of the Canadian chartered A banks are limited. With few exceptions, they neither have a specialized unit to provide specialized CT services nor a computerized data base of product- and client-specific information for use in the efficient disposal of countertrand. The Royal Bank is an exception to this latter comment.

In general, the CT capabilities of the charter B banks are greatly superior to those of the chartered A banks. Through their parents and/or parent-owned export trading companies, many of the charter B banks provide all of the above-discussed CT services plus risk bearing by taking title to countertrand. However, one of their major problems at present is that they have not yet become proficient in the pricing of the various risks encountered by a trader of goods and services.

Escrow and evidence accounts. The administration of escrow and evidence accounts is perceived by most of the interviewees as being a very profitable commercial activity for the banking sector. In addition, most of the interviewees perceive the Canadian banks as being a good and safe location for such escrow and evidence accounts. Thus, any proposal for the formation of an international free-banking center in Canada should include provision for the administration of CT escrow and evidence accounts.

Critique. The interviewees (especially, those from the trading houses) were critical of the services provided by the Canadian schedule A banks. In general, they perceived the schedule A banks as being less flexible, less knowledgeable, and less service oriented than the schedule B banks. Some of their specific comments follow:

> "We find the [Canadian bank] very helpful."
>
> "We [trading house] find that the Canadian financial institutions are becoming satisfactory."
>
> "The Canadian schedule A banks are not as sophisticated as the schedule B banks. They are too conservative. They are not as knowledgeable about trading as they could be."
>
> "Canadian banks have had little experience in exotic transactions. Thus, they are of little use for CT transactions."
>
> "The nonschedule A banks are more flexible. The Canadian banks are not geared for export or for CT."
>
> "The foreign banks have corrected the poor banking situation that used to be the case in Canada. Before the schedule B banks set up in Canada, we relied almost exclusively on offshore banks."
>
> "The Canadian banks are just too bureaucratic. They could be more helpful at the lower end of the market [smaller firms]."
>
> "As a trading house, we find the schedule A banks not too helpful. The schedule B banks are better. We generally use the European banks and their in-house CT experts."
>
> "Banks should be more involved. They should do their own confirmation. We find the schedule B banks better because they are less bureaucratic. We find it easier to deal with the U.S. banks."
>
> "We talked to [bank] on our [subsequent] CT deal. They told us to go directly to a trading house, since they could give us little help."
>
> "The Canadian banks are too conservative. We are working more and more with the European banks. Their loan agreements are simple - 1 or 2 pages at most. They are straight and to the point."
>
> "A big change is needed in the position of the Canadian banks. They are just too security conscious, and they are not interested in CT."
>
> "The schedule B banks are better. However, they will only deal with CT transactions bigger than $500,000. Since they are not operating banks, they have to worry about costs."
>
> "Many of the Canadian banks do not have the contacts that are needed abroad. The European banking system has had more experience with CT, and CT-types of arrangements."

> "Banks are much too conservative. Their CT capabilities are poor. They do not understand CT and are not prepared to deal in it."

Governments

Present role of the Federal government. The federal government's policy on CT has been aptly stated as follows [External Affairs (1985), p. 3]:

> From a multilateral policy persective, Canada has traditionally adopted the view, in international forums and in concert with our major trading partners, that countertrade
> - is a regressive trade practice which distorts the multilateral flow of goods and services;. . . .
>
> From a bilateral relations viewpoint, Canada has always made it clear to its trading partners that the Government of Canada will not become directly involved in countertrade deals. It has been the government's position that the initiative and responsibility for entering into countertrade rests with exporters alone.

Nevertheless, the Federal Department of External Affairs will provide CT informational support (including the names of available CT facilitators) to Canadian exporters. The perception among many of the interviewees is that External Affairs realizes that Canada must "meet its competition from the other developed countries" if Canada is to get its share of an ever growing volume of CT business.[38]

Future role of the Federal government. Based on the collected primary data, it is apparent that the preferences of most Canadian entities is for the private sector (and not the government) to discharge CT obligations. Most of these entities believe that the government should continue to fulfill its traditional advisory role by assisting exporters faced with actual or potential CT transactions.

Viewpoints on the Federal government's attitude towards CT. Viewpoints on whether the government should become more involved in the promotion of CT differ. At one extreme are those that argue that the government should actively promote CT in order to match or to exceed the efforts of our major competitors (Treiser, 1985). At the other extreme are those that argue that the government should actively discourage the use of CT because CT is a regressive trade practice that distorts the multilateral flow of goods and services (Fin. Post 1985c). For example, according to one of the interviewees:

> "It would be stupid for the Canadian government to support CT. This is not the role of government. Government should take a position against CT."

If one accepts the assertion of this study that CT is a commercial response to product market imperfections and/or failures, then the proper governmental response is a blending of both positions. Specifically, the government should actively promote the use of the most efficient response to any symptom of product market imperfections and/or failure, whether that is CT or some other financial-marketing innovation, while it simultaneously attempts through multilateral channels to restore the proper functioning of the applicable product market.

Provincial governments. Based on the discussions with the spokespersons of four of the provincial governments, it would appear that the applicable departments of the provincial governments are not well equipped to advise or assist an exporter in CT. Some of their specific comments follow:

> "We have no internal expertise or involvement with CT."

> "We have no tools for dealing with CT. We refer our clients to the private sector, that is, to the banks, trading houses, etc."

> "There is not much department experience with CT because such deals are occurring in geographic areas not being pursued by the department."

> "We [provincial government] have no requests for information on CT. Also, we have little internal knowledge on the subject. We have enough difficulty in getting [province] companies to export, never mind participating in CT."

Use of government advisory services. Spokespersons from only seven of the interviewed entities indicated that they had used the CT advisory services of the federal government. The spokespersons of many of the other interviewed entities stated that their entities would be using such services, especially External Affairs' recently-formed 'Trading House and Countertrade' division, in the future. Some specific comments advanced by the interviewees included:

> "We have good contacts with the embassy in [country] and the Ambassador has been useful. However, the government has not brought any contracts to [our firm]."

> "Yes. Also, we find External Affairs more knowledgeable about CT than EDC."

> "CEA and External are sources of information and are thus useful. The provincial governments have been mute on facilitating CT."

> "We use the Feds as the last resort for leads. We find as traders that the trade commissioners could be more discrete with information on business prospects that we have brought to their attention."

> "No, but the CEA and External are becoming more equipped for CT."

> "Yes. The trading house and CT division of External is becoming much more active and involved."

> "The use of the CEA and External are useful if you have no experience. They can bring you up to a certain basic level of competence."

Federal government entities. There are a large number of Canadian federal and provincial government entities that are engaged directly and indirectly in export business. These include the Canadian Commercial Corporation, the Canadian Dairy Commission, the Canadian Wheat Board, Canadian Saltfish Corporation, and so on. Not surprisingly, a large number of these entities have encountered CT demands, and a smaller (but significant) number of these entities have been involved in export transactions involving CT.

Export Development Corporation (EDC). EDC's policy on CT has been aptly stated as follows [External Affairs (1985), p. 6]:

> The Export Development Corporation, along with all other government-supported insurance agencies, will not cover exports which depend on countertrade for payment. They state that coverage is not available where payment for exports is to be, in whole or in part, in goods, or where payment is dependent on a purchase or import contract.

The level of satisfaction with this policy among the interviewees was generally low. Some of the specific comments advanced by the interviewees follow:

> "We have no problem with EDC with regard to CT. EDC is a good source of market intelligence. One change that would be useful is for EDC to become more flexible in the provision of quick and competitive financing."

> "EDC's co-financing on warehousing and interest is needed on all CT (parallel) deals. We could do a lot more CT in [country] if EDC's country limit wasn't reached. The same applies to a number of other countries."

> "EDC will only finance standard exports and not CT. However, without EDC backing, it is hard to get private-sector financing."

> "EDC is becoming more receptive to CT-type transactions."

> "For a triangular CT arrangement, it is difficult to get EDC financing."

> "We found that [country] was off coverage so we could not get any EDC help [for our CT transaction]."

On the other hand, the mean level of satisfaction with the services provided by EDC among the interviewees was somewhat higher. Some of the specific comments advanced by the interviewees follow:

> "We find EDC easy to deal with."

> "EDC is not always competitive. Export credit guarantees in the U.K. are more flexible than those provided by EDC."

> "Using EDC is always a bad experience. They are arrogant and are not an encouragement to exporting. They should give EDC's mandate to the private sector. They are inflexible. They [EDC] will however bend the rules when they have a problem."

> "Our record with EDC is dismal. EDC is not competitive. We show EDC's exposure fee to the client. Of course, EDC prefers to keep such fees hidden."

> "We find that EDC is too political. There is no rationale given for any of their decisions."

> "EDC wants to bury its financing charges in our selling price. However, this makes our selling price noncompetitive. We like to keep their charges separate and visible."

Government policy initiatives and program changes. Some suggested modifications recommended by the interviewees follow:

> "To get a PEMD for market development, one of the prerequisites should be that the applicant take a one-half day briefing on CT and other such innovative financing techniques. Also, the government funds missions. Thus, why not understandings."

> "Governments could help in providing linkages with buyers."

> "Government needs to provide a better information base to exporters."

> "Government help in match-making would help. They should reduce their red tape when they are involved in a transaction abroad. They could strengthen their information base."

> "Government should stay out of the private sector. The CEA should provide information because one of their functions is to educate their members. External should, on the other hand, not be in that business."

> "Government is doing a good job now."

> "Governments could help in making contacts, and could strengthen their educational process."

> "We need an offset information bank."

> "Philosophically, we prefer private-sector involvement in facilitating CT. However, in practice, public-sector involvement is probably required. There are things that the government can do better as an intermediary, especially in those countries where you have to deal with governmental agencies."

> "The provision of linkages could be useful. We need a data base and incentives for importers to work towards earning and re-selling CT credits. If government should provide more support for such CT activities, this would not lead to an escalation in CT demands. Our trading partners, both existing and potential, are smart people."

"Government should not provide more services, except, maybe for the small guy."

"None. All incentives should come from the private sector."

Legal Counsel

Internal or external. The majority of the interviewed entities have sourced most to all of their required contractual work for CT internally. According to the interviewees:

"We have our own legal staff to do the contractual work [and various variants of this statement]."

"We do our own legal work. However, we get legal input from our U.S. affiliate."

"It is up to the trading house to make sure that there is nothing wrong with a contract. Thus, we get a second opinion from an independent [external] party."

"We do all the drafting internally. We resort to external assistance only for arbitration cases."

"We use in-house and outside lawyers as required."

"We have a standard CT agreement for each country."

"Although we do most of the drafting internally, we do retain private-sector legal expertise in most countries. This is done to ensure that our contracts conform to local customs and practices, and that our contracts are such that the tax implications are minimized."

"We use standard contracts, which are obtained from our parent, as a base. Our contracts are checked over by our own lawyer."

A minority of the interviewed entities regularly sourced their required contractual expertise externally. According to their spokespersons:

"We use a local law firm for all our transactions."

"We rely predominantly on an external firm. However, our in-house counsel, reviews their work."

"Our outside lawyer drafted most of the contract. Our legal person reviewed these drafts."

"We regularly use external assistance. Our contracts are drawn up by one of the large local legal firms. We can also draw on the legal expertise of our two foreign associates."

"We use legal people from New York. A local lawyer is also used for legal and tax advice."

External capabilities. Most of the interviewees evaluated the capabilities of the available external legal counsel to be adequate. Some of their specific comments follow:

"The expertise of the large local legal firms is somewhat lacking. However, these firms can draw on the expertise of their foreign offices which generally have had more experience in drafting CT contracts."

"A lawyer specializing in international trade can easily handle a CT agreement."

"No problem in getting qualified legal counsel in Toronto."

"We use lawyers based in Toronto. They have learnt how to do it and are still learning. Some of their bigger clients have already done CT."

"Their capabilities are poor. Lawyers have severely [messed] things up whenever we have relied on them. They start to impinge very quickly on essentially commercial considerations."

Importers and the Distributive Trades

In Canada, the distributive trades comprise those entities involved in the domestic distribution and sale of goods and/or services. This includes food retailers, other retailers (both mass merchandise and specialty shops), wholesalers (of food and dry goods), and co-operatives.

Previous involvement. Most of the entities contacted by telephone or interviewed in person in these sectors had not been involved (at least not knowingly) in exports and/or the distribution or resale of countertrand. The exceptions were described by the interviewees as follows:

"We use Canadian importers to dispose of [country's] products. We have approached both wholesalers and retailers and they appear to be receptive."

"We have talked to entities who buy internationally for distribution in Canada."

"We used [Canadian distributor] to distribute spices taken in CT in Canada."

"[Distributor] was interested but they wanted a list of the products that were available for import. [Country] would not even come up with a list of what they had to offer."

"We [large retail food operation] are not knowingly involved in any CT deals. However, we are probably actually quite involved in the distribution of such goods. What happens is a trader or importer approaches us with goods for sale that are attractive. Given our extensive network, we could distribute a lot of merchandise provided the quality, price and assurance of supply are there."

Potential involvement. There appears to be no compelling reason why Canadian importers and distributive trade entities could not be more actively involved in export, two-way trade, and the distribution of countertrand. These entities already possess most of the attributes required for success in such activities. These attributes include: (a) extensive product and sourcing knowledge (e.g., about the reputations, financial standings, supply capabilities, and reliability of various suppliers, about the price, quality and market characteristics of various goods and services, and so on); (b) extensive overseas and domestic contacts (partly obtained by frequent overseas travel); (c) substantial financial, physical and human resources (such as fixed assets, solid balance sheets, established banking relationships, specialized personnel for control of inventories and deliveries, and so on); and (d) experience in and the capacity for assuming risk (e.g., in reject product risk on a joint and several basis). According to the interviewees:

> "The day of the pure importer are numbered. An importer is a loner and risk-taker. Importers have a greater role to play in CT. They have many of the skills to trade. They would experience no culture shock, and they know the market well. CT would not be a large leap for an importer."

> "Importers could be used to sell exports. When buying abroad, an importer could also be selling Canadian goods and services."

> "Retailers could be used to sell [countertrand]. However, it is important to realize that our retail fraternity has a limited distribution capacity and is very concentrated in sectors such as food. It is not overly competitive in number at the retail level. The traditional retail sector would not be interested in small, one-shot deals because it has to be assured of consistent supply if it is to take on a product for sale. Thus, it imposes very stringent restrictions on its suppliers. The existing non-traditional distribution channels could also be used to place [countertrand]. For example, if the quantity is small, you may have to sell institutional. If the product packaging is poor, you may have to approach a retailer who specializes in the sale of such items. For example, there are stores who will sell products with minor defects such as partly missing or torn labels."

> "The success of our importers has depended upon staying with normal transactions. However, they could be encouraged to form a division to handle nontraditional transactions. As single family enterprises, importers are always concerned about the transfer of ownership upon the death of a principal. Thus, adding depth through branching could be attractive to them."

Other "Experts"

Although CT is a favourite topic for discussion at North American corporate cocktail parties and is the theme for an amazing number of professional conferences and briefings, most of the information communicated is very superficial and much of it is, in fact, misinformation. There are also an unusual number of CT "experts". Most of these self-professed experts are marginal in that their primary service may be to provide information on which entities can supposedly discharge a CT obligation. Not surprisingly, many of these recommended entities have little or no CT expertise, and most have never engaged in an actual CT transaction. Some of the experiences of the interviewees with such marginal "experts" follow:

> "We were approached by many marginal operators in Canada. Lots of individuals discussed CT with us, and wasted our time. There were a lot of middlemen who tried to get a piece of our CT action."

> "Being a CT expert appears to be a high growth phenomenon in the Canadian service sector. These operators read a few books on CT and attend a few conferences, and then they begin to market. They promote their extensive CT experience and their great connections. In fact, this is becoming one of our fastest growing cottage industries. In fact, there may be more people doing this in Canada than are actually involved in pursuing or fulfilling CT."

INNOVATIONS TO IMPROVE THE OPERATIONAL EFFICIENCY OF CT

Informal Exchanges of CT Credits

Presently, there is only an unorganized, highly inefficient market for the purchase and sale of CT credits which is used on an ad hoc basis by exporters, trading houses and importers. There have also been a number of attempts to organize this exchange process. For example, during 1985, a group of Canadian entities attempted to operationalize a bank of credits for Nigeria. Members, after paying an initial membership fee, supposedly would have been able to purchase credits from the bank for an approximate cost of two percent. Similarly, one of the interviewed MNEs has an internal bank of primarily offset credits which are available on a "first-come, first-served" basis to the numerous divisions and subsidiaries of this firm.

The International Trading Certificate

During 1985, General Foods Trading Co. (GFTC) and the Bank of Boston (BOB) were assessing the merits of creating a new instrument called an International Trading Certificate (ITC), in order to multilateralize CT obligations. This instrument, which would be endorsed by an appropriate agency or by the central bank of a particular country, would be issued to a traditional seller or other party who bought incremental or nontraditional goods and services in that country. The holder-of-record of the instrument would then have an irrevocable right to export a stipulated maximum value of goods and services, in one or more transactions, into that country. As a fully transferable asset, whose registration and control would be administered by BOB on a selective country and client basis, the market value of each ITC would be determined by market forces.

The opinions of the interviewees on the merits of the ITC were that the concept was good in theory but difficult to effectively operationalize. These opinions included:

> "What incentive is there for the government of the [traditional buyer's] country to endorse the ITC or to allow for its free exchange to third parties?"

> "There is not enough involvement for any one product in any one country to ensure that the market for the ITC will be liquid. Without liquidity, the market value of the ITC will not be real. Also, the high transaction cost for the exchange of an ITC may itself further reduce liquidity."

> "Technically, all this does is introduce another risk. In other words, how much of an expected discount on an ITC should you factor into your original selling price? Should it be 3 percent or 6 percent? At the fundamental level, it impinges on the sovereignty of the [traditional buyer's] country."

> "It will be costly to get the fungibility benefits that an ITC is designed to give."

> "It may be a workable concept but it will probably not be acceptable to the countries that demand CT. These countries would have to give up their sovereignty right. Not only will the market for ITCs be fragmented but it will be impossible to control for differences in the quality of the products that can be brought in."

Computerized Trade-facilitating Data Base

A number of the spokespersons for the interviewed entities argued that Canada needed a trade-facilitating data base, which would also facilitate CT execution. According to these interviewees:

> "The problem with Canada is that we need a data bank. One that includes normal trade channels and also the Canadian importers of a given product. Of course, this is done to some extent internally by some of the MNEs. The problem is that, unless it is developed and run by a quasi-public body, all firms do not have access to it."

> "A data bank would help trading houses like ours. Although our margins would decrease, our volumes should increase to more than compensate for the loss in margins."

> "There are only two major problems - cost and the number of products which should be listed."

"There is not enough volume at present. Also, many firms would not want to play their hand."

"While we support efforts to match exporters and importers by the use of an on-line system, it would lead to many fly-by-night operators entering the trade services field."

"There is a need for a general data base. One problem, however, is how do you stop others from using that data base?"

The primary advantages from the introduction and operation of such a data base should be a substantial improvement in the operational efficiency of Canadian sourcing and distribution, and in the fulfillment of CT obligations. The primary disadvantages would be: (a) the cost of establishing and operating such a data base; (b) the fact that Canadian entities would not gain competitively from such a data base since most (if not all) of its information would be "freely" available to non-Canadian competitors, including the parents and subsidiaries of entities with a Canadian presence; and (c) the loss of competitive advantage to some existing Canadian entities due to the public availability of their previously-held, nonpublic information.

CT Exchanges

Batis.[39] Batis was established in London as a counter-purchase credit exchange. The service, available on domestic television sets through the Prestel system, listed: (a) available credits or counter-purchase commodities in various markets, and (b) member's needs. The service also provided advice on structuring deals, and detailed country reports.

Univex. On March 19, 1984, domestic CT began in New York on Univex's computerized trading exchange.[40] Due to its flexibility, the Univex system allows for complicated multi-trades. In addition, members neither have to buy nor sell from each other since debit and credit imbalances can be resolved annually with goods and/or cash. All trades occur at prices which the sellers would have given to wholesalers or other such middlemen.

From an initial membership of 20 companies with annual sales of $75 million or more, Univex's membership had increased to 32 companies by July 1984. Initially, Univex's membership fees were 10 and 5 thousand dollars for the first and subsequent years, respectively.[41]

Atwood Richards Inc. Atwood Richards Inc. (AR) is probably the leader in what its spokespersons refer to as being "reciprocal trade agreements with big name companies." According to its spokespersons, AR is "like a drive-wheel, relating companies to each other."

AR allegedly provides enhanced flexibility by replacing letters of credit and barter credits by changing the form of such credits into something that each client can readily use. AR allegedly provides a liquid market by being a viable computerized trading medium for the goods and services of individual members. Although AR does not profit on each and every transaction, it does derive its profits from the resale of purchased products.

AR deals in corporate barter on a world-wide basis. In fact, 20 to 22 percent of its business can be classified as being international. Its minimum transaction size is one million dollars. Although AR has had no turnkey project involvement to date, it can (and has) dealt with compensation arrangements. In such cases, it deals strictly on commercial terms (i.e., quality, service and price), and does not guarantee pricing to its clients.

CONCLUSION

In this chapter, the theory and Canadian practice of CT were compared and integrated. In the next chapter, the major findings of the mail questionnaire survey will be summarized, and a number of recommendations will be presented.

FOOTNOTES TO CHAPTER 5

[1] International product markets may be prevented from being perfectly competitive in the conventional sense due to the existence of structural conditions (such as the possibility of economies of scale in product distribution), distributional and market ignorance, product differentiation, and non-tariff trade barriers.

[2] In other words, financial markets, as markets for contingent claims on underlying assets, do not operate smoothly when the market which determines the potential payoffs on the underlying assets fails or is expected to fail. This is analogous to the relationship between the 1929 stock market collapse and the subsequent depression. Almost all knowledgeable observers agree that the stock market collapse did not cause the subsequent depression but rather was caused by the market's (correct) anticipation of a collapse in general economic prospects.

[3] From the perspective of the traditional seller, the former is often referred to as "reactive" CT, while the latter is often referred to as "pro-active" CT.

[4] When the traditional buyer is a country or state agency, the perspective of the traditional buyer and of the government of the traditional buyer are one and the same, and, thus, are discussed in a subsequent section of this chapter.

[5] Not unexpectedly, whether a specific firm likes or dislikes CT in such situations depends upon whether it is the "dislocator" or the "dislocatee".

[6] The alternative would be a suspension of payments. In such circumstances, the traditional buyer would have to fund losses, obtain credit and/or bring proceedings against the debtor.

[7] However, this may not be correct since, if the CT deal is fair to all the parties, then all that each party has accomplished is to temporarily reduce its demand for and supply of foreign exchange. Thus, CT bypasses, but does not solve, a shortage of foreign exchange and(or) trade finance.

[8] This has been aptly stated by Rep. John J. LaFola (D-N.Y.) as follows: "Several billion dollars of our foreign military sales are being offset by co-production and purchase requirements. . . . I have a concern that we are shipping American technology and American jobs overseas without weighing the consequences to our economy and industrial base." [Gottlieb (1984), p. 41].

[9] A number of Canadian entities have had such experiences with traditional East European buyers.

[10] Due to a lack of facilities and personnel, most countries can not effectively audit whether or not offset obligations have been satisfied.

[11] To mitigate such possibilities, the offset obligee generally attempts to deliver up-to-date technology and production processes without any commitment to update such.

[12] As was the case in chapter 3, the dollar values do not include one respondent's offset obligation of 165.0 million dollars over the five-year period, 1982-1986.

[13] If exports to other developed (especially OECD) countries are also removed, then the total dollar value of exports involving offsets with these countries should also be deleted from the CT estimates.

[14] The most likely explanation for this discrepancy is our observation that many Canadian trading houses initially maintain that they have been involved in CT transactions in order to promote their services and their firm to external parties and potential clients.

[15] Non-offset CT transactions included counterpurchase, compensation, barter, commodity take-downs, and so on.

[16] The aggregate loss in sales by Canadian firms in this market is expected to be 50 to 60 million dollars during 1986.

[17] A technically correct comparison would have to account for the timing of the cash flows and for the time value of money.

[18] Based on Francis (1983).

[19] Based on Gherson (1985a,c) and Gooding (1983).

[20] Based on Gherson (1985a).

[21] According to the East German state trading company IAI, their basic guideline is that the value of the countertrand be at least equal to the value of the project plus a 30 percent loading to cover the interest charges on export credits.

[22] Based on the mail questionnaire survey, 21 and 16 exporters were identified as having installed in-house expertise for negotiating and satisfying CT transactions, respectively (see chapter 3), and 14 and 17 trading houses were identified as having developed in-house expertise for negotiating and satisfying CT transactions, respectively (see chapter 4).

[23] Before undergoing a drastic retrenchment, one Canadian exporter had such in-house expertise at a U.S. location.

[24] With total dollar volume of approximately 2.5 billion dollars, Noranda Sales is believed to be the largest Canadian-owned trading company.

[25] This is based on a number of primary and secondary sources (in particular, see External Affairs (1984), pp. 45 and 46).

[26] The "D.I.I. KNOWLEDGE" process was developed in 1984 by Frank Horwitz, Manager Trade Intelligence, GETC, New York, N.Y.

[27] Sometimes, one of the internal parties may not even break even on the CT transaction, although the CT transaction in the aggregate satisfies the parent's required rate of return criterion.

[28] Based on Bus. Int. (1983b), p. 354.

[29] A spokesperson for a different interviewed entity speculated that Canada could lose its market for Durham wheat in [country] if it did not soon agree to CT in that market.

[30] Barter is always an exception.

[31] Countertrand purchases must also satisfy the proportions given in (4) and (5).

[32] According to the president of Quebec's SAQ, "Quebec is going to trade water bombers for Spanish wines." The SAQ "will pay Canadair for the planes and get the wine from Spain" (Quig, 1985, p. B-1).

[33] The information contained in this section is for informational purposes only. Any specific legal aspect of a CT transaction should be checked by an entity's own legal staff and/or outside counsel.

[34] According to Yoffie (1984, p. 11), the variable costs of an in-house trading unit are approximately one to two percent below the total costs of using an external trading house.

[35] See Pub. Law No. 97-290, 97th Cong. 2d. Sess. (1982); Senate Rep. No. 97-644, 97th Cong. 2d. Sess. (1982).

[36] As of July 1984, 28 B-O export trading companies had been or were in the process of being approved by the Federal Reserve Board.

[37] During late 1984, a number of British banks were studying the feasibility of establishing a trading house to take title to goods.

[38] During 1985, the government of Belgium supposedly hired a group of consultants to study how the Belgian government could facilitate the CT activities of its firms. According to the consultants, Belgium was "considering the rewriting of its laws for CT."

[39] See Harvey (1984).

[40] International trading was expected to begin by the middle of 1985 [S&MM (1984), p. 20].

[41] To avoid antitrust problems, these types of facilities must be reasonably accessible to all qualified potential members at a reasonable fee.

CHAPTER 6

MAJOR MAIL SURVEY FINDINGS AND THE MAJOR RECOMMENDATIONS OF THIS STUDY

In this chapter, the author presents the major findings of the mail questionnaire survey and the major recommendations of this study. Recommendations that should be of interest to private- and public-sector practitioners of CT and to External Affairs, Canada, for either policy formulation or day-to-day operations are presented below.

MAJOR FINDINGS OF THE MAIL SURVEY

Canadian Exporters

(1) Canadian exporters consider competitive price, followed by attractive credit terms and technological advantage, as being factors that may be important for a successful export sale. They do not consider full or partial product payback via CT as being important.

(2) Thirty-eight percent (or 62) of the exporter respondents have experienced CT demands.

(3) Thirteen percent (or 21) of the exporter respondents believe that they have lost at least one contract because of their inability or unwillingness to engage in CT.

(4) Ten percent (or 16) of the exporter respondents have deliberately avoided countries that make CT demands.

(5) Thirteen percent (or 21) of the exporter respondents have developed specialized in-house negotiating expertise for pursuing CT opportunities.

(6) Ten percent (or 16) of the exporter respondents have developed specialized in-house expertise for satisfying CT obligations.

(7) Only 9 percent (or 15) of the exporter respondents consider CT to be a normal way of conducting business.

(8) The major benefits of CT are perceived to be entry into otherwise closed markets, followed by maintenance of exports and employment when these are important to the firm and the exporting country.

(9) The major problems encountered with CT are perceived to be long and complex negotiations with buying countries, followed by risks in handling unfamiliar goods and possibly longer time before payment is received.

(10) Only 7 percent (or 11) of the exporter respondents have been involved in CT transactions on a continuing basis.

(11) The two major reasons given for not being involved in CT transactions on a continuing basis are: a lack of demand, and a limited capacity to undertake CT transactions.

(12) The two major reasons given for terminating sales efforts that had involved CT demands are: other export outlets were more attractive, and have no commitment to CT.

(13) The two primary strategies utilized by the exporter respondents to avoid CT demands are: financing, and negotiate on a "best-efforts" basis rather than accept a commitment.

(14) Less than ten percent of the exporters have engaged in each of the following: barter, countertrade (parallel deals), compensation trade (buy-backs), swaps and switches.

(15) Aggregate CT activity of Canadian exporters has increased markedly over the five-year period, 1980-1984. Specifically, the number of firms involved, the number of CT transactions initiated, and the total value of such transactions (i.e., export transactions involving CT obligations) have increased from 1, 1 and 5.0 million dollars, respectively, in 1980, to 7, 27 and 143.0 million dollars, respectively, in 1984.

(16) Canadian exporters have used the Canadian and foreign markets to distribute countertrand.

(17) Most of the Canadian exporters perceive the final net price and the effective timing of cash payments to be invariant to whether or not an export transaction involves CT.

(18) Canadian exporters perceive the quality and the delivery of countertrand to be (marginally) satisfactorily honoured by the foreign participants to the CT transactions.

(19) With regard to the desirability of implementing various institutional approaches for dealing with CT in Canada, the exporter respondents marginally approved of: (a) the creation of a private non-profit association specializing in the coordination of the activities of private-sector exporters with established trading houses, and (b) the creation of a non-profit association with the power to transact CT business and which, in addition, offers advisory services. They marginally disapproved of: (a) the government sponsorship of an information centre on CT, and (b) the creation of a private/public association with the power to transact CT business.

(20) Only 19 percent (19) of the Canadian exporter respondents stated that they would seriously evaluate an equity investment in such a private sector, non-profit organization. Their major reason for not doing so was the lack of demand for such CT services by their entities.

(21) Based on the expectations of the exporters, Canadian exports which are most likely to be subjected to increased CT demands during the next five years are capital projects, high tech and other manufactured goods; and the goods and services, which are most likely to be increasingly offered as

countertrand by (traditional) foreign buyers over the next five years, are agricultural goods and services, followed by raw materials.

Canadian Trading Houses

(1) Canadian trading houses consider competitive price, followed by attractive credit terms and technological advantage, as being factors that may be important for a successful export sale. Like the exporters, they do not consider full or partial product payback via CT as being important.

(2) Twenty-five percent (or 17) of the trading house respondents have dealt with Canadian clients who have experienced CT demands.

(3) Eighteen percent (or 12) of the trading house respondents have at least one Canadian client who had lost a contract because of the client's inability or unwillingness to engage in CT.

(4) Six percent (or 4) of the trading house respondents have deliberately avoided countries that make CT demands.

(5) Twenty-one percent (or 14) of the trading house respondents have developed specialized in-house negotiating expertise for pursuing CT opportunities.

(6) Twenty-five percent (or 17) of the trading house respondents have developed specialized in-house expertise for satisfying CT obligations.

(7) Only 16 percent (or 11) of the trading house respondents consider CT to be a normal way of conducting business.

(8) The major benefits of CT are perceived to be entry into otherwise closed markets, followed by maintenance of exports and employment when these are important to the firm and the exporting country.

(9) The major problems encountered with CT are perceived to be risks in handling unfamiliar goods, followed by possibly longer time before payment is received, and long and complex negotiations with buying countries.

(10) Sixteen percent (or 11) of the trading house respondents have been involved in CT export transactions on a continuing basis.

(11) The two major reasons for not being involved in CT transactions on a continuing basis are lack of demand, and a limited capacity to undertake CT transactions.

(12) The two major reasons given for terminating sales efforts that had involved CT demands are: other export outlets were more attractive, and it was too costly and time-consuming to carry out an effective marketing strategy.

(13) The two primary strategies utilized by the trading house respondents to avoid CT demands are: financing, and persuade the other party to the transaction to forgive the CT obligation.

(14) Sixteen, thirteen and ten percent of the trading house respondents have engaged in countertrade, barter, and compensation trade, respectively. Less than 10 percent of the trading house respondents have engaged in each of the following: swaps and switches.

(15) Aggregate CT activity of Canadian trading houses (which involved Canadian "client(s)") has increased markedly over the five-year period, 1980-1984. Specifically, the number of trading houses involved, the number of CT transactions initiated, and the total value of such transactions (i.e., export transactions involving CT obligations) have increased from 2, 5 and 1.5 million dollars, respectively, in 1980, to 7, 72 and 180.5 million dollars, respectively, in 1984.

(16) Canadian trading houses have primarily marketed the goods and services, which were received as countertrand, in non-Canadian markets.

(17) Over one-half of the Canadian trading houses perceived the final net price and the effective timing of cash payments to be dependent upon whether or not an export transaction involves CT. Unlike the exporters, nearly one-half of the trading houses perceive the effective timings of their (cash) payment receipts to be shorter on average than for their typical export transactions that involved cash.

(18) Canadian trading house respondents perceive the quality (but not the delivery) of countertrand as having been, on average, satisfactorily honoured by the foreign participants to the CT transactions.

(19) With regard to the desirability of implementing various institutional approaches for dealing with CT in Canada, the respondents marginally approved of: (a) government sponsorship of an information centre on CT, and (b) the creation of a private non-profit association specializing in the coordination of the activities of private-sector exporters with established trading houses. They marginally disapproved of: (a) the creation of a private non-profit association with the power to transact CT business and which, in addition, offers advisory services, and (b) the creation of a private/public association with the power to transact CT business.

(20) Only 38 percent (15) of the Canadian trading house respondents stated that they would seriously evaluate an equity investment in such a private-sector, non-profit organization. Thus, compared to the exporters, the trading houses were considerably more receptive towards seriously evaluating such an equity investment.

(21) Based on the expectations of the trading houses, Canadian exports, which are most likely to be subjected to increased CT demands during the next five years, are high tech manufactured goods, capital projects, other manufactured goods, and agricultural goods and services; and the goods and services, which are most likely to be increasingly offered as countertrand by (traditional) foreign buyers over the next five years, are agricultural goods and services, and other manufactured goods.

RECOMMENDATIONS

Since the recommendations are based on the analyses presented in earlier chapters, the author suggests that the reader should carefully review those chapters before interpreting or implementing the recommendations presented below.

Government Response to CT

R01

It is recommended that the government support the most efficient response to any symptom of product market imperfections and/or failure, whether that is CT or some other financial-marketing innovation, while it simultaneously attempts through multilateral channels to restore the proper functioning of the product markets.

Export Development Corporation

R02

It is recommended that the Export Development Corporation (EDC) take a more facilitating attitude towards assisting Canadian exporters and traders in their pursuit and discharge of export contracts involving CT obligations.

R03

It is recommended that the Export Development Corporation establish a focal point to develop expertise on innovative financial-marketing techniques (such as countertrade) so that EDC can refine its programs to meet the specific needs and peculiarities of the international marketplace.

Other Governmental Agencies

R04

It is recommended that Canadian Crown agencies and publicly-owned companies, which are already directly involved in export business, should not be restricted or discouraged from actively engaging in export transactions involving CT obligations.

Canadian Trading Houses

R05

It is recommended that External Affairs encourage Canadian trading houses to be more involved and active in assisting Canadian exporters in coping with CT demands and in fulfilling CT commitments.

Strengthening the Standing of Canadian Trading Houses

R06

It is recommended that the federal and provincial governments jointly implement a program to encourage small- and medium-size Canadian trading houses to publicly raise equity capital in order to increase their financial capacity and standing.

R07

It is recommended that small- and medium-size Canadian trading houses be encouraged to affiliate with foreign trading houses in order to enlarge their business network and thereby increase their CT capabilities and capacity.

Corporate Trading Companies

R08

It is recommended that corporate trading companies be strongly encouraged to make their offerings of services externally available, particularly to small- and medium-size Canadian exporters.

Japanese Trading Companies

R09

It is recommended that the Japanese-owned trading houses be strongly encouraged to make their CT and non-CT services readily available to Canadian entities for trade with countries other than Japan.

Training of Traders

R10

It is recommended that the government explore the feasibility of establishing a diploma program in "trading and export market development", on a co-op basis, in conjunction with one or more Canadian educational institutions.

Canadian Chartered A Banks

R11

It is recommended that the appropriate legislation be modified so that the Canadian chartered A banks can take title to goods and services for a maximum period of time for trade purposes, and can operate and invest, subject to certain prudency requirements, in up to 100 percent of the equity and debt obligations of trading houses.

R12

It is recommended that the Canadian Bankers Association (or Institute) develop a course on "innovative export financing arrangements", which would be available to all bank personnel in the international divisions of the chartered banks, and should be available on a fee basis to nonbank members of the private sector.

Importers and Distributive Trades

R13

It is recommended that importers and the distributive trades be encouraged to diversify their business into exporting and trading.

R14
It is recommended that the government study how the importer and the distributive trade sectors of the Canadian economy could be better utilized to foster increased Canadian exports and two-way trade.

Trade-facilitating Data Base

R15

It is recommended that External Affairs conduct a study of the feasibility of introducing and operating a trade-related data base of potential importers, distributors, and foreign traders by product.

Government Information

R16

It is recommended that both the Business Opportunities Sourcing System and the Directory of Canadian Trading Houses be more selective in the trading houses they list as being sources of CT services.

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APPENDIX A

DEFINITIONS

Barter. This is a type of CT transaction which involves a one-time, direct exchange of goods and services between two (or more) trading parties without the exchange of money, and where the exchange is consummated over a relatively short period of time.

Commercial (C.) Risks. Commercial risks include: (1) insolvency of the buyer, (2) arbitrary nonacceptance by the buyer not due to the fault of the seller, and (3) protracted default [Dhawan and Kryzanowski (1978), p. 106].

Compensation (or Buy Back). This is a type of CT transaction in which the traditional seller supplies machinery, equipment, technology and/or a turn-key plant to the traditional buyer and receives the resultant output from their use, or less directly related output, as full or partial payment. Thus, the goods and services counterdelivered by the traditional buyer are usually "resultant" in that they derive from the goods and services supplied by the traditional seller.

Counterpurchases (or Parallel Barter). This is a type of CT transaction in which the traditional seller (or third party) agrees to accept a given percentage of the contract value in counterdeliveries of goods and services as partial or full payment.

CT or Countertrade. This generic term refers to any set of transactions in international trade where a potential purchase by a traditional buyer is made conditional (generally contractually) on a reciprocal purchase, either in full or part, by the traditional seller and/or a third party acting as a principal or agent for the traditional seller. Such types of transactions include barter, compensation, counterpurchase, offset, pre-compensation, swap and switch.

Countertrand. This generic term refers to the goods and services (broadly defined) which are offered or supplied by the traditional buyer, or some designated third party, in a CT transaction.

Framework agreements. These agreements determine the general trading relationship between specific trading parties for a multi-year period of time. The types, quality and relative values of the goods and services to be exchanged, and the nature and timings of such exchanges, are detailed in specific renewable agreements.

Goods and services. This generic term refers to any material objects or considerations, with the exception of money or money substitutes, which are offered or supplied in a trade transaction by the parties to that transaction. It includes, amongst other things, commodities, products, goods, services, patents, goodwill, and knowledge.

Linkage. Linkage is the approval by the traditional buyer to credit countertrand purchased from other entities under the same or different ministries in the traditional buyer's country towards the fulfillment of the traditional seller's CT obligation.

Offset. This is a type of CT transaction in which the traditional (generally public) buyer attempts to secure as favourable a benefit package as is negotiable with the traditional seller by using the leverage of competing traditional sellers and a large (generally, defense-related) contract. These benefits can include industrial spinoffs, technology transfer, and guaranteed purchase commitments by the traditional seller.

Political (P.) Risks. Political risks include: (1) cancellation of an export licence not due to the fault of the exporter, (2) cancellation of previously valid import authority or other restrictions held by foreign government making imports impossible, (3) diversion of shipment caused by political events, (4) outbreak of war, hostilities, civil commotion, or other such occurrence, which prevents payment by the buyer, (5) currency unconvertibility and transfer delay, and (6) requisition, expropriation or other government intervention which prevents payment [Dhawan and Kryzanowski (1978), p. 106].

Pre-compensation (or Anticipatory or Linkage). This is a type of CT transaction in which the delivery of goods and services by the traditional buyer precedes the delivery of the goods and services supplied by the traditional seller. The purchases from the traditional seller are paid for immediately and the proceeds therefrom are entered into an "evidence" account in the name of the traditional seller. The traditional seller subsequently obtains orders from the traditional buyer to use up all or part of the dollar amount in the evidence account.

Proactive use of CT. This refers to those export transactions (potential or actual) where CT has been offered by the traditional seller to the traditional buyer in order to gain a "competitive edge" in procuring an export contract.

Reactive use of CT. This refers to those export transactions (potential or actual) where the use of CT is mandated or stipulated by the traditional buyer, or its government.

Swap (or Cooperative Barter). This is a type of CT transaction in which bulk products from diverse locations are exchanged between two or more parties due to logistical economy or differential quality preferences.

Switches. This is a type of CT transaction in which bilateral clearing imbalances are transferred to a third nation or individual party for their use.

Traditional buyer. This is the party to the CT export transaction which would have traditionally received goods and services in exchange for cash payment.

Traditional seller. This is the party to the CT export transaction, which would traditionally have been the supplier of the goods and services exchanged for cash payment, had the export transaction been a traditional goods-and-services-for-cash transaction.

Trade-related Performance Requirements. This is a type of CT transaction in which the traditional seller supplies machinery, equipment, technology and/or a turn-key plant to the traditional buyer and commits to export a fixed proportion of the output from their use or to use a specified value of locally-sourced inputs in their use. Thus, trade-related performance requirements are a variant of compensation (or buy back) arrangements.