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EXPORT MARKETING: THE CASE OF COUNTERTRADE

L'EXPORTATION ET LE COMMERCE DE COUNTREPARTIE

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Countertrade Terminology

One person's "countertrade" is another person's "barter". For a third person it is "reciprocal trading", for a fourth it is "parallel transactions". For those interested in more exotic nomenclature, the terms "contrapartida", "plata in produse", "otplata u naturi" will convey the meaning of a reasonably common commercial practice in Eastern Europe. As long as there are people doing countertrade and writing about it, the descriptive terms will continue to proliferate. Countertrade discussions often produce a semantic Rubik's cube with the subject being made more complex and confusing than necessary. East European supporters of countertrade tend to exploit the lack of precise definitions in order to subsume countertrade or compensation under the more acceptable category of "industrial cooperation".

The definitions offered below are based on an appreciation of the more common terms used to define this method of trading and should allow for distinctions between countertrade and industrial cooperation.

A. Countertrade

This is the generic term covering all transactions where a potential purchase by an importer is made conditional on a reciprocal purchase by the prospective exporter or a third party acting on his behalf. A straight cash transaction is thus complicated by the introduction of goods or services as partial, or total, payment. Countertrade does not necessarily remove the requirement for financing the original export sale, except in the case of barter. In practice, export financing and countertrade often coexist on the same business transaction. There is an element of coercion associated with the countertrade, as the exporter is obliged to consider a countertrade arrangement as a precondition for the export sale. Countertrade deals are often associated with officially-backed credits for export contracts.

B. Barter

At the commercial level, barter indicates a one-time exchange of goods without the introduction of any cash payment (i.e. jute for melons).

A barter transaction is covered in one contract, and the mutual deliveries of goods and services (specified in the contract) take place over a relatively short term. Barter is no longer a common feature of East-West trade but, with the high cost of money and depressed commodity prices, barter-type arrangements are not unknown.

At a national level, barter can be interpreted in the form of bilateral payments or quantitative arrangements wherein specified quantities (and/or values) of goods and services are exchanged over a period of time, with deficits equalized by supplementary deliveries. The annual intra-CMEA trading arrangements and arrangements between the CMEA countries and certain LDCs are examples of what might be called national barter agreements.

C. <u>Switch</u>

The use, by the East European country, of a surplus with an LDC as a countertrade condition against a potential exporter from the Industrialized West is known as a switch deal. Trade under bilateral payments arrangements is stalled until the East European country reduces its surplus by accepting additional goods from the LDC partner. With no requirement for these goods, the East European country can transfer the amount of surplus (or portion thereof) to a Western supplier of goods or services required in the East European country. A switch deal usually requires the services of a switch trading house specialist to complete the deal.

Payment for the East-West transaction is usually made to the Western supplier by the switch trading house that markets the LDC commodities, often at a discount.

D. <u>Counterpurchase</u>

As partial payment for the sale of goods or services, the Western exporter agrees to accept a given percentage of the contract value in counterdeliveries of goods and/or services.

The transactions are usually separated into two contracts, linked by a protocol of intent. The Western supplier usually receives full cash payment for the original contract but must, within a certain period, purchase (again for cash) the requisite amount of goods, 'non-resultant' in the sense of not being a product from the original sale.

Counterpurchase obligations are negotiable, and generally represent less than 100% of the original contract value (although 100% - plus counterpurchase is not unknown). The obligation can be transferred to a third party (i.e. trading house) and the conclusion of reciprocal arrangements is normally within two or three years, with extensions negotiable.

Junktim (also known as linked anticipatory transactions), where the countertrade obligation is taken up in advance of the export sale, is a form of counterpurchase.

E. Large-Scale and Long-Term Compensation Arrangements

Compensation arrangements are similar to counterpurchase with the following variations:

(a) the dollar value is much greater, with the Western partner supplying capital equipment or a complete facility;

(b) the time frame is longer, and compensation deals can commit the Western supplier (or third party) to compensatory purchases over many years (i.e. 10 - 20);

(c) the goods counterdelivered are usually 'resultant' in that they derive from equipment and/or technology of the original contract;

(d) the cumulative value of the buyback contract can be much greater than the original sale (i.e. Pepsi-Cola's 200% compensation deal in Bulgaria).

Compensation deals usually involve large-scale multinational corporations or major public utilities with the marketing structure and internal requirements to absorb the compensation obligations.

These basic countertrade definitions are not exhaustive but, they serve as introductory guideposts to the maze of terms applicable to countertrade.

Countertrade along the East-West axis has received increasing attention as a result of the large compensation deals involving Western Governments and firms with energy and resource projects in the Soviet Union. The US $15 billion Yamburg-Urengoi pipeline negotiations, that have sparked such political controversy and which represent an impressive mega-project, is a more recent example of a compensation deal, or, series of deals. Compensation arrangements have figured largely in the East-West trade of the Soviet Union and Poland during the 1970's and have represented billions of dollars in trade. Various forms of counterpurchase agreements have been more common in trade with the smaller East European countries.

Countertrade is a trading practice that exists in the shadows of industrial cooperation. It is debatable whether the large-scale compensation arrangements, which sometimes appear to reflect a community of interests, can be classed as a form of industrial cooperation. It is equally true that counterpurchase arrangements can lead to a longer term, mutually advantageous, industrial cooperation.

However, it should be underlined that the techniques of negotiating countertrade contracts, (the initiative resting with the Eastern partner in an estimated 90% of the occasions when countertrade is demanded), and the lack of shared interest in countertrade proposals tends to distinguish countertrade from industrial cooperation.

One other definitional question that should be addressed is whether or not industrial offsets represent countertrade, or industrial cooperation or some other category of trade transaction. The recently published "Analysis of Recent Trends in U.S. Countertrade" (No. 1232, March 1982), by the United States International Trade Commission considers offsets as a type of countertrade. On the other hand, the work of the ECE, OECD and the two studies by the Canadian Commercial Corporation all exclude offsets from their definitions of countertrade.

If offsets are not considered countertrade, there are similarities in application and objectives. There is a Government purchaser that attempts to secure as favourable a benefit package as is negotiable using the leverage of competing suppliers and a large contract. These benefits can include industrial spinoffs, technology transfer or even guaranteed purchase commitments by the foreign-based defence contractor. Under this latter condition, offsets do resemble obligations found in counterpurchase arrangements.

However, by limiting the area of analysis to East-West trade and the significant features of countertrade as applied there, it is still possible to make a distinction between offsets and countertrade. There appear to be three important differences.

i) Military procurement serves both national security and national economic interest. In terms of overall trade, major military purchases are infrequent and, with taxpayers' money at issue, a comprehensive package of benefits is always demanded.

ii) In offset deals, the purchasing country presumably pays cash or arranges its own financing. Most East-West countertrade deals involve official credit support, for the original Western exporter.

iii) Many of the capital projects in Eastern Europe having significant Western content require offsets in addition to countertrade.

Here are some additional terms associated with countertrade:

A. Transfer Clause - The freedom for the exporter to transfer his countertrade obligation to a third-party intermediary of his own choosing. This clause will allow the exporter to pass his countertrade obligation on to a trading house or other appropriate third party without the interference of the East European partner.

B. Linkage Clause - This condition facilitates access to a range of countertrade goods selected from various Foreign Trade Organizations under the same industrial Ministry or falling under the jurisdiction of other Ministries. In this way, if an exporter of capital equipment does not want to accept similar equipment from the contract partner, he can seek the appropriate goods from other sources.

C. Credit Clause - This condition applies to occasions where, despite serious efforts by the Western exporter, the countertrade goods cannot be delivered as agreed by the East European partner or are of less-than-acceptable standard. A credit clause allows the exporter to benefit from having attempted to source countertrade goods, thereby reducing the overall countertrade obligation, according to an agreed formula.

D. Non-fulfillment Penalty - The penalty in lieu of non-fulfillment of a countertrade obligation being a known contingency, the exporter should attempt to accommodate it in his pricing structure. The penalty clause in any countertrade contract should hold that, on payment of the penalty, the exporter is completely absolved from any further countertrade obligation within the terms of the specific contract.

E. Cancellation Clause - The linking of the countertrade contract to a specific export contract so that, if for any reason, the export contract is not fulfilled, the countertrade contract is immediately cancelled. The cancellation provision should only have a one-way application and, under no circumstances, should the fulfillment of the export contract be tied to the countertrade arrangement.

F. Letter of Release - Upon fulfillment of the countertrade commitments or upon payment of the requisite penalty, the East European contract partner should provide a suitable letter releasing the exporter from further obligations. This is a particularly relevant document to consider when establishing payment terms with an intermediary acting on behalf of the exporter.

G. Negative File - As it is generally thought that paying a non-fulfillment penalty can prejudice an exporter's hopes for future business it is important to keep track of failed attempts to source countertrade goods. This "negative file" can keep an exporter in good standing with his East European business partner and forms the basis for claims under any credit clause (as described above).

The Trading House and Countertrade

Canadian exporters faced with a countertrade situation can turn to an experienced trading house for assistance in discharging the responsibility for the purchase commitment.

Why use a trading house? An experienced third-party intermediary can be of great assistance in concluding a profitable sales contract even when countertrade is a condition of sale. There is a certain convenience in turning over the countertrade portfolio to another entity and there is some truth in the opinion that manufacturers shouldn't buy what they don't understand in terms of products. A trading house will have a wide knowledge of dealing in a variety of products. Their sales network for countertrade goods will be already established. A trading house can assist in bid preparations by giving prompt countertrade cost estimates (i.e. subsidy). By combining the countertrade commitments of a number of individual exporters the trading house may gain access to higher quality goods for export at cheaper prices through volume purchases. By leaving it to a trading house, a manufacturer avoids risk to his reputation or financial position from selling goods that may be of low quality, lacking in spare parts and without the necessary after-sales service.

Although there are these obvious advantages to engaging the services of a countertrade specialist, there are problems associated with this approach. In a long-term marketing sense, regular use of a trading house may prevent the exporter from developing an in-house countertrade knowledge that can be beneficial in improving overall export competitiveness. Some East European countries may resent the participation of a trading house, preferring direct dealings with the Western business partner. Negotiating countertrade on a face-to-face basis may lead to the reduction in the overall countertrade commitment whereas use of a trading house may impede any such reduction. Trading house services cost and this cost must be calculated in the selling price. Too high a service charge can make the exporter's price uncompetitive.

On this last point, a trading house fee is composed of two parts: 1) commission, and 2) subsidy. The commission covers such things as financing charges, commitment fee, cost of penalty guarantee, general operating expenses and profit. The commission is usually in the range of 3-5% of the gross value of the countertrade commitment.

The second part, subsidy, (or discount, or disagio), represents the difference between the East European selling price and the price required to move the goods on Western markets. The amount to which the Western exporter must subsidize the marketing of countertrade goods varies with the type of goods offered and the country or origin. Some machine tools can include a subsidy estimate of 35% although this would be an exceptional case. The subsidy plus trading house commission could lead to a sizeable premium built into the export price. A worst case scenario could have 40% of the countertrade values being added as additional costs. A more optimistic scenario might drop this estimate to between 15-25%.

If a decision were made by a Canadian exporter to use the services of a trading house he would be advised to:

1. Comparison shop (range of services and costs may vary greatly).
2. Haggle over the fee structure to guard against exorbitant trading house profit margins.
3. Be satisifed that the third party arrangement cannot be blocked by the contract partner. (Attention should be paid to the wording of the general countertrade documents and they should include the requisite transfer clause.)
4. Determine what, if any, countertrade liability remains with the exporter once a trading house has been recruited.
5. Include the trading house representative in discussions of general negotiating strategy, (without disaggregating pricing information),unless fully confident of your business relationship with the trader.
6. Line up a trading house early before entering into pricing negotiations.

An arrangement with a trading house can be a tremendous asset when faced with a countertrade demand; however, like most aspects of countertrade, selecting the proper intermediary is not a simple process, free of complications. It is something the exporter should do with care. You will find attached a list of trading houses specialized in countertrade. Although these trading houses are known to operate in Eastern Europe, some of them also have expertise in countertrade in other areas.

TRADING HOUSES SPECIALIZED IN COUNTERTRADE IN EASTERN EUROPE

AUSTRIA

Allgemeine Finanz-und Waren-Treuhand AG
Schottenring 12
A-1013 Vienna
Tel: 63-36-06
Telex: 747-87

Agentur Für Export, Import, Transit GmbH
Marokkanergasse 8, A-1030 Vienna
Tel: 73-13-30, 72-58-69
Telex: 131-030

Austost Handels-und Treuhand-Gesmbh
Fleischmarket 1/III
A-1010 Vienna
Tel: 63-33-31
Telex: 133-394

Centro Internationale Handelsbank AG
Tegetthoffstrasse 1
A-1010 Vienna
Tel: 524-5100, 524-5200
Telex: 136-990/96

Centropa Handelsgesellschaft mbH*
Seilerstätte 15
A-1010 Vienna
Tel: 52-51-48, 52-81-98
Telex: 113-498

F.J. Elsner & Co.
Kohmarkt 11
A-1011 Vienna
Tel: 52-67-71
Telex: 111-949

Evidenzbüro für Aussenhandelsgeschüfte (EFAG)
Brucknerstrasse 4
A-1040 Vienna
Tel: 65-13-06, 65-51-31
Telex: 133-166

F.C.H. Gesellschaft mbH
(Finanzierungs, Compensations-und Handels-Gesellschaft mbH)
Fleischmarkt 1/III
A-1010 Vienna
Tel: 63-33-32
Telex: 131-748

Handelsverkehr GmbH
Tuchlauben 8
A-1040 Vienna
Tel: 63-96-86
Telex: 740-08

P. Heinrich Export-Import GesmbH
Nussdorfer Strasse 4
A-1090 Vienna
Tel: 34-56-61
Telex: 763-29

A. Johnson & Co Wisen GmbH
Taborstrasse 13, A-1020 Vienna
Tel: 26-65-56
Telex: 134-208

Gebrüder Schoeller OHG*
Renngasse 1 , A-1011 Vienna
Tel: 63-56-71, 66-35-01
Telex: 134-207

Unico Trading Handelsgesellschaft mbH
Jasomirgottstrasse 3
A-1010 Vienna
Tel: 63-32-41
Telex: 136-385

Voest-Alpine Intertrading GmbH
Schmiedegasse 14/IV
A-4040 Linz/Donau
Tel: (0732) 3-83-31/49
Telex: 222-21

Krainz & Co. KG
Herrengasse 6-8
A-1010 Vienna
Tel: 63-23-34, 63-04-62
Telex: 743-64

FRANCE

ACECO
(Association pour la Compensation des Échanges Commerciaux)
28 avenue Hoche
F-75008 Paris
Tel: 563-0200
Telex: 640-912

COOPINTER
(Société de Coopération Internationale)
22 rue d'Aguesseau
F-75008 Paris
Tel: 266-6440
Telex: 650-475

Crédit Lyonnais
Section "Contreparties"
at the International Branch
16 rue du IV Septembre
F-75002 Paris
Tel: 295-1018
Telex: 612-400

Dreyfus Herschtel & Cie
3 avenue du Coq
F-75009 Paris
Tel: 280-6166, 874-0745
Telex: 280-513

Greficomex
58 avenue Marceau
F-75008 Paris
Tel: 720-0607
Telex: 613-365

Lafitte International SA*
21 rue Lafitte
F-75009 Paris
Tel: 523-4747
Telex: 290-290

Merkuria SA*
133 Champs Elysées
F-75008 Paris
Tel: 723-5577
Telex: 611-688

Secopa SA*
22 rue d'aguesseau
F-75008 Paris
Tel: 266-6400
Telex: 650-475

Société Coprosid
54 avenue Marceau
F075008 Paris
Tel: 723-3613
Telex: 611-983

SORICE
79-81 avenue Danielle Casanova
F-94200 Ivry-sur-Seine
Tel: 670-1182
Telex: 270-002

Sorimex
(Société de Représentation Internationale Import-Export)
F-92100 Boulogne-Billancourt
Tel: 604-9174
Telex: 203-758

WEST GERMANY

Bafag AG
Lindwurmstrasse 11
D-8000 Munich 2
Tel: 23-60-51
Telex: 522-778, 522-455

Comex Aussenhandelsgesellschaft mbH
Immermannstrasse 40
D-4000 Düsseldorf
Tel: 3-61-71
Telex: 858-1806/07

Commerciale Link & Co
Jülicherstrasse 17
D-5000 Cologne
Tel: 21-68-83

Contact Aussenhandelsservice
Bismarckstrasse 73
D-1000 Berlin 12
Tel: 313-6095
Telex: 183-682

Handelsverkehr GmbH
Rossertstrasse 2
D-6000 Frankfurt/Main
Tel: 71-71-71
Telex: 411-471

Kieling & Co
Martinistrasse 24
D-2800 Bremen 1
Tel: 32-58-68, 32-11-90
Telex: 244-766

Franz Kirchefeld GmbH KG
Königsallee 17
D-4000 Düsseldorf
Tel: 8-39-81
Telex: 858-1999

Wihelm Schulz KG
Martinistrasse 24
D-2800 Bremen 1
Tel: 32-58-68
Telex: 244-766

THV Handels-und Verwaltungs GmbH
Neupfarrplatz 15
D-8400 Regensburg
Tel: 56-10-71
Telex: 657-37

UNITED KINGDOM

Alcon (Compensation Trading) Ltd.
Devlin House
36/37 St. George Street
London W1R 9F4
Tel: 499-2591, 491-2721
Telex; 895-4135

Anglo Austrian Trading Co Ltd*
39 St. James's Street
London SW1A 1JH
Tel: 493-1206
Telex: 282-62

Brewster International Trading Co. Ltd.
46 Berkeley Square
London W1X 5DB
Tel: 629-7222
Telex; 281-22

M. Golodetz (Overseas) Ltd.
Aldwych House
71/91 Aldwych
London WC2B 4HN
Tel: 242-8888
Telex: 235-67

Guinness Peat Group Ltd.
(Biddle Sawyer)
32 St. Mary at Hill
London EC3 8DH
Tel: 623-9333, 623-3311
Telex: 887-973/4

Hibtrade Limited
Princes House
95 Gresham Street
London EC2V 7LU
Tel: 606-5371, 606-0237
Telex: 881-1512

Leopold Lazarus Ltd*
Gotch House
20-34 St. Bride Street
London EC4A 4DL
Tel: 583-8060
Telex: 265-544

Bremar Holdings Ltd.
Bremar House
27 Sale Place
London W2 1PT
Tel: 262-2271
Telex: 219-69

Emerson Associated Ltd.
41/42 Berners Street
London W1 P3AA
Tel: 580-5441
Telex: 881-1936

Ralli Trading Finance Ltd.
46 Berkeley Square
London W1
Tel: 629-7222
Telex: 281-22

SWITZERLAND

AFICO SA
Avenue de la Gare 52
CH-1001 Lausanne
Tel: 20-25-21
Telex: 259-70

André & Cie SA*
7 chemin Messidor
CH-1000 Lausanne
Tel: 20-11-11
Telex: 241-01

Aussenhandel AG
Dufourstrasse 51
CH-32-38-15
Telex: 523-59, Tel: 32-38-15

Contraco Holding und Finanz AG
Gartenstrasse 2, CH-6300 Zug
Correspondence:
c/o Kaspar Marti
3 chemin du Cap
CH-1006 Lausanne
Tel: 28-71-22/23
Telex: 247-55

Siber Hegner Holding Ltd.
Bellerivestrasse 17
CH-8034 Zürich
Tel: 47-89-90
Telex: 556-46

Unitrac SA
PO Box 4033
Galeries Benj. Constant 1
CH-1002 Lausanne
Tel: 23-72-55/56
Telex; 241-68

Bank fuer Handel und Effekten
Talacker 50
CH-8039 Zurich
Tel: 27-46-90
Telex: 528-81

NETHERLANDS

Hollandsche Bank-Unie NV
POB 554
434-440 Herengracht
NL-1002 Amsterdam
Tel: 29-92-22
Telex: 114-72

Mueller International BV
Startbaan 5
NL-1185 XP Amstelveen (near Amsterdam)
Tel: (020) 47-04-81
Telex: 123-74

Philipp Brothers (Holland) BV
Prinses Irenestraat 39
NL-1077 MV Amsterdam
Tel: 46-12-11
Telex: 110-30

Transmedia BV
Rapenburgerstraat 109
NL-1011 Amsterdam
Tel: 25-57-96, 22-43-55
Telex: 132-23

BELGIUM

Devetra Trade Development Corp
Chaussée de Charleroi 54
B-1060 Brussels
Tel: 538-8175
Telex: 211-65

Hugo Frei & Co.
Samberstraat 50-56
B-2000 Antwerp
Tel: 32-18-52
Telex: 315-88

N.V. Hibogan (Belgium)*
President Building
Fr. Rooseveltpl. 12-bus 22
B-2000 Antwerp
Tel: 33-53-61/2
Telex: 711-62

Interocéan SA*
Chaussée de la Hulpe 181
B-1170 Brussels
Tel: 673-9960
Telex: 217-67

Maas International NV
Klipperstraat 15
B-2030 Antwerp
Tel: 42-01-70
Telex: 348-71

Société Coopérative SOCSER
Avenue Louise 534
B-1050 Brussels
Tel: 649-8068
Telex: 229-99

ITALLY

Coe & Clerici SpA
Via Martin Piaggio 17
1-16122 Genova
Tel: 5-48-91
Telex: 270-680

Compagnia Generale Interscambi SpA
(COGIS)
Corso Venezia 54
1-20121 Milan
Tel: 77-42
Telex: 321-91

Societa per l'Incremento dei Rapporti
Commerciali con l'Estero (SIRCE)
Via Large 23
1-20122 Milan
Tel: 87-70-87, 86-14-51
Telex: 310-288

FINLAND

Kaukomarkkinat OY*
Kutojantie 4
SF-02611 Espoo 61
Tel: 52-37-11
Telex: 124-69

OY Nino Lincoln & Co. Ltd.
Aleksanterinkatu 21 H
SF-00100 Helsinki 10
Tel: 65-88-55
Telex: 124-624

SWEDEN

Sukab AB
Birger Jarlsgatan 2
S-10382 Stockholm
Tel: 23-47-95
Telex: 191-46

AB Transfer
S-17220 Sundyberg 1
Tel: 98-16-20
Telex: 193-39

OTHERS

Panagri Trading Corporation
P.O. Box 3523
Calle Aquilino de la Guardia No. 8
Panama

Also represented in:

Canada
Suite 900
595 Bay Street
Toronto, Ontario
M5G 2C3
Tel: (416) 593-3114, Telex: 06524137

United States
Suite 2612
One Financial Plaza
Fort Lauderdale
Florida 33394
United States of America
Tel: (315) 761-3001/2/3, Telex: 514472

United Kingdom
P.O. Box 140
Kenilworth
Warwickshire CV8 2QJ
England
Tel: (0203) 309216
Telex: 335011 MFPEUR G

Switzerland
Baarerstrasse 110 C
CH-6302 Zug
Switzerland
Tel: (042) 31 55 80
Telex: 868766 MFZG CH

The Trade Exchange Group Ltd.
2490 Bloor St. W., Suite 400
Toronto, Ontario
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Tel. (416) 763-3541
Telex: 06-986766TOR

Individual Country Policies and Practices

With most East European countries there is no published legislation or clearly defined set of guidelines governing countertrade. Trading House representatives in Vienna tend to dismiss the relevance of country-specific countertrade generalizations and underline that each countertrade deal has its own unique characteristics and has to be dealt with on that basis.

Still, it is relatively simple to distinguish general attitudes among the East European countries regarding countertrade. In this as in so many things economic, Eastern Europe is not a monolith, where the policies and practices of the Soviet Union can be taken to represent regional consensus.

Eastern European Governments exercise their countertrade policies by full currency exchange controls and by a comprehensive import and export licensing system. In all cases these two levers of control place the Government, through the Ministry of Foreign Trade and the National Bank/Ministry of Finance, in a primary coordination role, influencing FTO's in their import decisions and ensuring, if appropriate, a requisite countertrade arrangement. It is common, though not always necessary, for representatives of the Ministry of Foreign Trade to participate directly in the negotiations of a countertrade contract. The Ministry will also serve as a type of brokerage operation in dealing with linkage questions or disputes about ratios, penalties, transfer clauses, etc. (This "broker" activity is particularly undefined and inconsistently applied; the experience of Western exporters would tend to the view that they themselves have the difficult task of drawing together the many participants in the countertrade decision-making process for purposes of problem resolution.) It is possible that appeal to the Ministry of Foreign Trade can reduce the level of countertrade demanded or ensure earlier access to more acceptable countertrade products. However, it is generally true that the Ministry of Foreign Trade imposes countertrade requirements on the FTO's and enterprises having import/export authority and is an unlikely ally in an substantial disputes involving the need and type of countertrade demands.

a) Albania

Albania, with its limited and closely controlled contacts with foreign businessmen and its constitutional prohibition of official credit financing, relies on countertrade to generate balanced or surplus hard currency accounts. For significant capital equipment imports, Albanian FTO's require 100% countertrade. Chromium ore, often of an inferior grade, is the major countertrade commodity although other products are becoming available as Albania reorients itself from dependence on a few trade partners to a broader representation of the world's trading nations. With all FTO's reporting through the Ministry of Foreign Trade, coordination of countertrade arrangements across product sectors is possible. On a capital project it is likely that counterpurchase will be required during construction with a compensation deal becoming effective after plant start-up. This compounding of demands will put the aggregate countertrade ratio well in excess of 100%. However, as Albanian prices are low or at least market sensitive, the Western exporter can profit from an Albanian countertrade obligation. Also with the Government's strict bilateral balance policy, the Western exporter may even find himself the beneficiary of a surplus in the Albanian favour - that is, countertrade may be modest or removed altogether if Albanian exports are generating a positive cash flow.

b) Bulgaria

Bulgaria is one of the strongest proponents of countertrade in Eastern Europe, and has made "industrial cooperation" a key theme of its East-West economic relations. Major equipment and capital project imports face initial demands of 100% countertrade. A Canadian exporter has observed that a 40% obligation is the minimum countertrade ratio allowed. Bulgarian countertrade goods have a bad reputation on the basis of price, marketability and availability. Linkage among FTO's is difficult although the Ministry of Foreign Trade can provide a coordinating service on priority transactions. Transportation and materials handling equipment are primary product categories that are featured in the Bulgarian drive for long-term cooperative arrangements using a countertrade lever.

c) Czechoslovakia

Czechoslovakian products are generally easy to market and the country has not been a major practitioner of countertrade. The more restricted recourse to countertrade results from Czechoslovakia's industrial tradition, relatively high level of development, established markets, and low foreign debt. However, with aging capital plants in many sectors, the Western recession and tight credit, Czechoslovak traders will be pressed to expand the low-level and relatively infrequent use of countertrade to maintain production and guard against increased debt. The Czechoslovak economic system is a very centalized one in which few market-type reforms have been introduced. With such an administered economy, countertrade will appear as an appropriate policy option to deal with the current economic downturn.

There is a reluctance by Czechoslovak authorities to agree to third-party intermediaries via a transfer clause in the countertrade contract. This reluctance is a function of the already developed export markets for Czechoslovak goods and the countertrade objective of opening up new markets. Distribution by intermediaries tends to blur the final destinations of countertrade goods.

A Canadian example of the Czechoslovak attitude towards countertrade was provided by the experience of H.A. Simons (Overseas) on the Ruzomberok pulp mill project. The Canadian contractor has the obligation to market 100,000 tonnes of pulp produced by the mill on an annual basis for ten years. Although a Czechoslovak Foreign Trade Organization (Ligna) took over the export contract on the pulp production the Canadian company still retains final responsibility for fulfillment of the multi-year 100,000 tonnes per annum obligation. Pricing on this and other countertrade commitments from Czechoslovakia is not a major problem. By the same token, penalty clauses have tended to be reasonable.

Although countertrade deals can be struck with many Czechoslovak FTO's, Transakta has been established as a go-between operating primarily in the consumer goods area. These are generally small countertrade packages, with Transakta drawing on the production from certain cooperatives and enterprises as well as the difficult-to-sell goods offered by various FTOs. Transakta has been an actor in the switch business as it is the clearing house for bilateral quantitative agreements between Czechoslovakia and selected third-world countries. This activity is diminishing as Czechoslovakia reduces the number of its non-CMEA bilateral agreements.

d) <u>German Democratic Republic (GDR)</u>

The GDR has always pursued countertrade arrangements with Western exporters, particularly under compensation terms for capital projects. This tendency has recently increased to the point where a large steel complex contracted with Voest-Alpine of Austria had provision for compensation and countertrade equivalent to 100% of the contract value plus the interest charges on the project financing. With a relatively burdensome hard currency debt and the prospect of economic retrenchment, countertrade ratios are likely to approach 100% in many significant capital goods transactions.

GDR countertrade negotiations are regarded as being among the most straight-forward of these negotiations in Eastern Europe. Technical goods are of a high quality and easily marketable by regional standards although there are reported problems with pricing. Penalty clauses have not been a particularly onerous part of the GDR countertrade contracts. The State Agency Transinter and the Ministry of Foreign Trade are important organizations within the GDR for the negotiation and fulfillment of countertrade contracts. It is not uncommon for the Western exporter to have to deal, on the countertrade part of his contract, with an intermediary within the GDR who tacks on a commission charge to the price of agreed countertrade goods.

e) Hungary

Hungary enjoys a unique position within Eastern Europe having come out publicly in opposition to certain forms of countertrade. In November 1979, the Ministry of Foreign Trade published a statement outlining the country's general orientation towards countertrade. This document was tabled in the GATT (part of document L/4633). It included the following references, among others:

> "1. Those forms of countertrade transactions - linkage of exports and imports - should be eliminated, where such products are imposed on the partners, which the enterprise itself is unable to sell, or it has no marketing organization for its proper distribution..."
>
> "2. Uneconomical, obsolete, not competitive products of inferior quality should not be offered as counteritems, because it is not desirable to conserve outdated production through countertrade."

It does seem that the Hungarian motivation for countertrade emanates more from a desire to develop the economy than from a rigid adherence to bilateral balancing, or ensure markets for inferior but surplus production. A countertrade arrangement in heavy duty truck axles between Raba Works and International Harvester did develop into a mutually acceptable ongoing industrial cooperation. The Hungarian economy has had many "market" features introduced - (i.e. enterprise management, pricing, accounting, retained earnings, decentralization, indicative non-compulsory plans, export/import rights, etc.) - and it is only logical that the approach to countertrade would be affected from this general economic policy framework.

The Ministry of Foreign Trade retains its all-important licensing function and the Hungarian National Bank still has a monopoly on foreign exchange. There is an infrastructure that encourages buying as well as selling by the Western exporter and a tightening of the countertrade system would be a simple administrative adjustment. Hungary, alone in Eastern Europe, seems to have made attempts to incorporate goods exchanged on the intra-CMEA market into the countertrade goods available to Western exporters.

f) Poland

"All bets are off" in assessing the countertrade policies and practices in Poland. The chronic if undeclared bankruptcy of the last two years has constrained foreign trade to the level of priority items only, carefully monitored by Bank Handlowy. Unless a countertrade deal can be closed with deliveries almost simultaneous, few trading houses, or exporters seem prepared to test the Polish marketplace. Countertrade of 100% is thought to be the inflexible standard. In many respects commodities have to replace money as the medium of exchange. Poland must be regarded as a high-risk, very complex market in which to carry out countertrade deals. Not only are there unusual problems of availability of suitable goods, delivery, pricing, etc., these are compounded by a general uncertainty as to who is in control of foreign trade transactions.

One possibility for successful countertrade in the current circumstances is to operate through the Polish companies active offshore, like Dalimpex in Canada (part of the DAL International Trading Company, headquartered in Warsaw but with affiliates in several foreign countries). These companies can buy on their own account and may be of help in locating and delivering suitable Polish countertrade goods. The ratio is likely to remain at 100% as these companies can have limited buying possibilities from their own cash reserves.

g) Romania

Romania is the East European countertrade nation par excellence. It is the only country that has produced official decrees and legislations dictating strict adherence to countertrade practices and a regular balancing of the trade accounts by all FTO's. The Official Decree No. 276 of July 25, 1979, followed by an Investment Law, a Foreign Trade Law effective January 1981 plus repeated exhortations of President Ceausescu place "contrapartida" at the centre of Romania's trade policy. The Romanian Ministry of Foreign Trade is deeply involved on all countertrade transactions. Full countertrade coverage is expected of almost all imports and Romania may have been the first country to seek countertrade obligations on imports of industrial raw materials and any other priority items. Romanian goods offered for countertrade have a bad reputation for quality, pricing and delivery. With Romanian relative self-sufficiency in engineering there has been few capital turnkey projects supplied from offshore and therefore, few large compensation deals. Counterpurchase has been the form of countertrade most frequently used.

But Romania remains a country with a tradition of haggling and everything is open to negotiation. It is in Romania where Canadians, through the CANDU project, have had the greatest exposure to countertrade conditions, techniques and negotiating tactics. What the CANDU countertrade negotiations proved was that Canadian companies, though loathe to undertake countertrade negotiations commitments, were able to conclude acceptable countertrade deals. There does not appear to have been any uniformity to these arrangements nor resemblence to the initial 100% countertrade requirement by Romenergo, the importer of record. The Organization of CANDU Industries attempted to establish countertrade limits through the negotiation of a protocol. While the conditions of this protocol may also bear little resemblence to the final signed countertrade contracts, the introduction it afforded to the concepts and negotiating pitfalls of countertrade appeared to benefit the major component suppliers.

Romania has the most transparent countertrade system within Eastern Europe but, in many respects, it is the most confused, because it is the most bureaucratic. The Ministry of Foreign Trade, through its economic cooperation branch, maintains an organization expressly for coordinating, and advising on, countertrade deals. The FTO's Terra, Delta and Ilexim are each charged with assisting in the closing of countertrade arrangements. Despite the administrative overlay, the exporter remains charged with the primary responsibility for putting together his own countertrade deal. Once he has identified products and a contractural formula of which he is confident, he can then turn to the Ministry of Foreign Trade, the relevant sector Ministry, and the FTO's and others to seal the arrangements. Anything seems possible with countertrade in Romania. Nothing is easily accomplished.

h) USSR

The Soviet Union has concentrated on the large-scale compensation deals, given the many major capital project opportunities in the country. For the Soviet economic authorities compensation is industrial cooperation. This concept has been enshrined in trade agreements and cooperation programs signed with several Western countries. Western companies have tended to be very receptive to these compensation deals, given the magnitude of the industrial projects and the marketability of the resultant products (from chemical plants built to Western specification; oil; gas; and other commodities).

As a result of this concentration on capital projects, counterpurchase deals affecting individual capital equipment sales have been modest or non-existant. Priority commodity imports have not required countertrade obligations.

One reason posited for this low-level concern with counterpurchase has been the rigidity of the Soviet administrative system. Counterpurchase transactions cause the bureaucracy more trouble than they benefit the economy. Although Soviet counterpurchase goods suffer from the same quality, pricing and marketing weaknesses of similar East European goods, they constitute only an insignificant amount of the Soviet Union's foreign trade and do not affect the country's balance of payments in any meaningful way. Like Canada, energy and resource exports figure largely in the Soviet Union's trade performance and will remain the mainstay of trade activity for that country. The current credit restrictions and concern with foreign debt could lead the Soviet Union to become more preoccupied with counterpurchase transactions than it has traditionally. Since its performance on counterpurchase has been intermittent and cumbersome, a push in this direction would further complicate the exporter's attempts to sell on the Soviet market.

i) Yugoslavia

Yugoslavia is the most decentralized country in Eastern Europe, both politically and economically. Some would argue that Yugoslavia is not part of Eastern Europe and that business is conducted more on a Western format. For purposes of countertrade, Yugoslavia can be classified as East European; one could consider it a bundle of East European countries with its six republics and two autonomous provinces operating more or less independently. Experienced trading house officials consider Yugoslavia to be in some ways the most problematic of the East European countries because of decentralization.

Key organizations in the control of countertrade procedures in the various republics and two provinces are the "Self-Managing Interest Communities for Foreign Economic Relations" (SIZ). Each SIZ carries out monitoring operations of the regional trade in goods under the different import exchange categories. The SIZ grants authorizations for foreign currency which the importing enterprise takes to the Chamber of Economy of Yugoslavia to obtain a document that will free foreign exchange from a commercial bank. Before an import license and the requisite hard currency will be issued, the importing organization must present an export contract for an amount proportional to the planned import (now thought to be approaching 100%). The Federal Executive Council and Federal Trade Secretariat establish the countertrade ratios within the import exchange categories.

While Yugoslav countertrade goods are considered of better-than-average quality and there is a good deal of flexibility in what qualifies as countertrade, there are problems specific to Yugoslavia. The SIZ structure can constrain companies to work within one republic to fulfill the countertrade obligation. Inter-republic linkage is a particularly difficult arrangement to negotiate. The actual commitment to countertrade in many cases has to be finalized in a contract before the original import order can be ratified. Even if a suitable countertrade deal is agreed, foreign currency constraints can still block the Western exporters efforts.

Canada has had reasonable export success in Yugoslavia. It can be expected that Canadian exporters will meet with increasing pressure from Yugoslavia to balance or even exceed their sales with purchases given the country's high hard currency debt. The countertrade process in Yugoslavia, already complex and daunting to experienced Europeans, could be the source of even more difficult marketing problems for Western exporters in the current economic situation.

COUNTERTRADE IN INDONESIA

Countertrade was introduced into Indonesia in January 1982 as a Presidential Policy (referred to as PP1) which imposed a list of requirements on foreign contractors bidding on government funded or state owned company contracts valued at more than Rps 500 million ($800,000).

Each tenderer is required to supplement its bidding documents with a Letter of Undertaking which stipulates a tenderer's pledge to undertake exports on non-oil and gas commodities from Indonesia. Aid loans and services are exempted. The four main provisions of this policy are:

a) the value of Indonesian exports must equal the FOB value of the contract,
b) the purchases must be in addition to the total export transactions normally concluded,
c) the exports should be sold in the supplier's country of origin within the life of the contract,
d) a penalty of 50% of the value of any unfulfilled export undertaking will be imposed.

Exempted from the countertrade regulations are contracts which are financed by soft loans such as the CIDA bilateral aid program and all loan funding from the World Bank, Asian Development Bank, and other multilateral organizations such as the Islamic Development Bank and UNDP. Also excluded are those services requiring specialized knowledge such as foreign accountants, legal specialists, engineering consulting services, and other similar services. The regulation does not affect contracts rendered under private, domestic, and foreign investment firms.

It is now regular practice to include as part of tender calls issued by Indonesian government entities, a requirement for countertrade. Each bid set includes draft Letters of Undertaking and Acknowledgement (see Appendix 1). The Letter of Undertaking has been modified slightly over the past year, for example, the addition of paragraph 4f which obligates Indonesia to review the availability of products, but it does not remove the onus on the exporter to comply. The Letter of Undertaking also makes reference to a "List of Indonesian Export Commodities Available for Additional Exports and other Indonesian Publications". (Appendix 2 is the list of products contained in books A.1 and A.2) Copies of the complete publications can be seen at the Indonesian Embassy or the Office of Trade Development, Asia and Pacific, External Affairs, Ottawa.

Canadian Experience with Indonesian Countertrade

To date, Canadian experience in concluding contracts which require a countertrade obligation is very limited.

In June 1982, Amitrex Corp. of White Plains, New York submitted a letter of undertaking and received a letter of acknowledgement which satisfactorily concluded a sale of 73,000 metric tonnes of MOP to be supplied by the Potash Corporation of Saskatchewan (PCS). Amitrex, a subsidiary of International Commodities Export Company (ICEC) was the sales agent for PCS in this negotiation and supplied the letter of undertaking including the countertrade obligation.

More recently, a number of Canadian companies have addressed the countertrade requirements on a number of bids for rail related components being financed by an EDC loan for the implementation of the Bukit Asam Project in South Sumatra. This project involves the expansion of a coal mine and the development of a transportation system to move the coal to a power plant in West Java. After intensive negotiations, the Indonesian government accepted in 1981, prior to introduction of countertrade, a $180 million EDC/CIDA Canadian financing package at an overall concessional rate. However, the Government insists on applying the countertrade requirement to those components of the project financed by the EDC commercial loan. Canada challenged this position during the Prime Minister's recent visit. However, Indonesia has maintained its stand and threatened to issue tenders on an international basis unless Canadian companies offered to enter into satisfactory countertrade agreements.

The outcome of this negotiation is that 14 companies have submitted bids for a range of rail related equipment, including steel rail, fastenings, a concrete sleeper plant, rolling stock, heavy and light track equipment. All of the bidders have indicated they will be responding to the countertrade requirement. In one case, the contract is for less than $800,000, and the company has been granted an exemption.

It is believed that, in every case, the Canadian bidders have engaged the services of an agent or trading company to assist to meeting the obligations under the countertrade agreement. Appendix 3 is a list of contacts of companies familiar with the Indonesian situation and in each case have expressed an interest in providing countertrade services to companies exporting to Indonesia.

DRAFT LETTER OF UNDERTAKING # Appendix 1

______________, 1983

Department of Trade and Cooperatives
Republic of Indonesia
Directorate General for Foreign Trade
Jalan Abdul Muis 87
Jakarta
INDONESIA

c/o (Insert name of Department, Agency, or Corporation issuing tender)

Dear Sirs:

We refer to (describe subject matter of tender and tender number) issued on ______________, 198_ by (insert name of Indonesian Department, Agency, or Corporation issuing tender) and to our tender document no. ______________ submitted on ______________, 198_ in response thereto.

We hereby irrevocably undertake during the period from the date of award of the contract relating to such tender until final acceptance (or equivalent) of our work and services thereunder or until completion of deliveries thereunder, as the case may be:

1. To purchase or to cause to be purchased by one or more of our affiliated companies in the country or countries## to be confirmed by the Department of Trade and Cooperatives in a letter in the form of Annex A hereto or by third parties located in any other country or countries acceptable to you, agricultural and/or industrial products contained books A.1 and A.2, each entitled "List of Indonesian Export Commodities Available for Additional Exports" published in January 1982 and March 1982, respectively, by the Department of Trade and Cooperatives, and/or such other Indonesian products as you may approve in writing (hereinafter, collectively, the "Products") from one or more of the commodity associations of exporters named in Books B.1 and B.2, each entitled "List of Indonesian Commodity Association and Exporters" published in January 1982 and March 1982, respectively, by the Department of Trade and Cooperatives, and/or from other duly licensed Indonesian exporters (hereinafter, collectively, the "Exporters"), in an amount at least equal to the foreign currency value of all equipment, materials and products to be supplied by us from non-Indonesian sources pursuant to the terms of the above described contract, such value to be agreed with the Department of Trade and Cooperatives and confirmed in a letter in the form of Annex A hereto;

This letter should be signed and submitted by the Tenderer. If the Tenderer is a foreign contractor/supplier, this letter should be signed by the foreign contractor/supplier and not by its Indonesian agent, partner, or representative, if any.

The Department of Trade and Cooperatives will normally only confirm the country of nationality of the contractor/supplier. However, depending upon the circumstances of any given contract, other countries may be confirmed by the Department.

2. To use the products, or to resell the products for use, or to cause the products to be used or resold, in the country or countries to be confirmed as aforesaid, unless with your specific authorization we are permitted to use the products or to resell the products for use, or to cause the products to be used or resold, in any other country or countries;

3. To purchase the products, or to cause the products to be purchased, before the end of the term of the contract relating to the above-described tender and, in any event, to purchase or to cause to be purchased, at least twenty percent (20%) of the total value of Products to be purchased hereunder within six (6) months after the date of award of such contract; and

4. To submit, or to cause to be submitted, to the Department of Trade and Cooperatives the relevant PEB Form and such other evidence of the shipment of products purchased pursuant to this undertaking as will permit the Department of Trade and Cooperatives to monitor compliance herewith.

In connection with our irrevocable undertaking contained herein, this will confirm our understanding that:

a) The commercial terms, including those relating to price and delivery, in respect of each purchase of products from an exporter shall be negotiated by us or by other purchasers thereof at the time of actual purchase;

b) The amount of each such purchase to be applied towards our obligation hereunder shall be equal to the invoiced purchase price of the products purchased, excluding, however, any shipping costs included in such invoice and any taxes or customs duties charged in connection therewith;

c) The amount of each such purchase (if measured in a currency other than the currency in which our obligation hereunder is measured) shall be applied against our obligation hereunder at exchange rates (as quoted by Bank Indonesia) prevailing at the date of the exporter's invoice issued in respect of such purchase;

d) If we or our affiliated companies in the country or countries to be confirmed as aforesaid have traditionally purchased Products from Indonesian exporters, our undertaking contained herein shall be viewed as representing a commitment over and above such traditional level of purchases, it being the spirit and intention of such undertaking the purchases of Products hereunder shall be in addition to such traditional level of purchases;

e) If the contract relating to the above-described tender should be prematurely terminated, our undertaking contained herein shall also terminate without further obligation on our part; and

f) If, during the course of performance of our obligations contained herein, we should be of the view that sufficient products are either not available in Indonesia or are not of suitable export quality or internationally competitive in price, you shall, at our request, review with us the actual circumstances at the time and shall consider, but without obligation, modifying the requirements contained herein (including, without limitation, an extension of the time during whch our obligations contained herein must be satisfied).

If we fail to comply with our undertaking contained herein, we hereby agree to pay to you as liquidated damages an amount equal to fifty percent (50%) of the difference between the total value of products actually purchased pursuant to this undertaking and the foreign currency amount to be confirmed as aforesaid.

In connection with our undertaking contained herein, we hereby represent and warrant to you that (i) we have full power and authority and legal right to enter into this undertaking and to perform and observe the terms and provisions hereof, (ii) we have taken all necessary legal action to authorize, execute, and deliver this undertaking, (iii) this undertaking constitutes our legal, valid, and binding obligation, and (iv) no law, rule, or regulation or contractual or other obligation binding on us is or will be contravened by reason of our execution and delivery of this undertaking or by our performance and observance of the terms and provisions hereof.

This undertaking shall be binding upon our successors.

Very truly yours,

(NAME OF TENDERER)

By ______________________

Name:

Title:

<u>DRAFT LETTER OF ACKNOWLEDGEMENT</u>

(LETTERHEAD OF DEPARTMENT OF TRADE AND COOPERATIVES)

__________________, 198_

(Address of Tenderer)

Dear Sirs:

We refer to ______________ Tender No. ________________ issued on ______ ________, 198_ by (insert name of Indonesian Department, Agency, or Corporation issuing tender) (the "Tender") and to your tender document submitted in response thereto.

We acknowledge receipt of your Letter of Undertaking of ________________, 198_ a copy of which is attached hereto and initialled for identification by the Department of Trade and Cooperatives.

In accordance with the provisions of paragraph number 1 of such Letter of Undertaking, we confirm the following:

1. The foreign currency value of all equipment, materials, and products to be supplied by you from non-Indonesian sources pursuant to the terms of the contract relating to the Tender shall be __________________;

2. The country (countries) referred to in such paragraph shall be __________.

Your signature in the space marked "Agreed" below shall be conclusive evidence of your agreement to be bound by the terms of your Letter of Undertaking of ______________, 198_, as supplemented by the provisions hereof.

Very truly yours,

DEPARTMENT OF TRADE AND COOPERATIVES

By ______________________

AGREED:
(TENDERER)

Appendix 2

List of Indonesian Export Commodities Available for Additional Exports in 1982

Book A.1 January 1982

1. Rubber - 176,000 tons
2. Coffee - 52,000 tons
3. White pepper - 8,000 tons
4. Black pepper - 6,000 tons
5. Tobacco leaf - 2,000 tons
6. Manioc - 150,000 tons
7. Cement - 500,000 tons
8. Sawn timber - 2,000,000 Cum
9. Plywood - 180,000 Cum
10. Other processed woods, 20,000 Cum
11. Textile products - 100,000 tons

Book A.2 March 1982

1. Aluminium - 8,500 tons
2. Asbest cement - 30,000 tons
3. Basketry - 2,000 tons
4. Bauxite - 500,000 m. ton
5. Biscuit - 2,000 tons
6. Canned fish - 1,000 tons
7. Canned fruit and vegetables - 5,000,000 tins
8. Cigars - 2,000,000 stock
9. Clove cigarettes - unlimited
10. Coffee roasted powder - 5,000 tons
11. Essential oil - 1,500 tons
12. Fruit juice - 5,000,000 tins
13. Glass - 5,000 tons
14. Granite - 190,000 m. ton
15. Nickle - 300,000 ton Ore
16. Paper - 20,000 tons
17. Pipes, steel - 200,000 tons
18. Rattan carpet - 550,000 pcs
19. Rattan furniture - 100,000 sets
20. Tires - 1,500,000 units
21. Tinned corned beef - 1,000 tons
22. Tuna fish - 1,000 tons

List of Contacts

Amitrex Corporation
717 Westchester Avenue
White Plains, New York
U.S.A. 10604
Mr. Rudolf Riess, Managing Director, Far East
- Amitrex Corporation is a subsidary of International Commodities Export Company (ICEC)

Balfour Guthrie (Canada) Limited
56 Aberfoyle Crescent
Toronto, Ontario
M8X 2W4
Tel: (416) 233-5861
Telex: 06-967552
Mr. N.A. Strachan, Manager

CITIBANK N.A.
399 Park Avenue
New York, New York
U.S.A. 10043
Tel: (212) 559-6593
Telex: 236066 CIG-WH-UR for International Messages
Mr. Steve Poretzky, Assistant Vice President, Countertrade Department

Interimco Machinery Corporation
Carling Square 1
560 Rochester Street
Ottawa, Ontario
K1S 4M2
Tel: (613) 238-1561
Telex: 053-4425
Cable: Interimco
Mr. J.T. Morris, President

Metallgesellschaft Services Inc. (MG)
520 Madison Avenue
New York, New York
U.S.A. 10022
Tel: (212) 715-5200
Mr. George Horton, Vice President

Noranda Sales Corporation Limited
P.O. Box 45
Commerce Court West
Toronto, Ontario
M5L 1B6
Tel: (416) 867-7041
Telex: 02-2034
Mr. P.B. Warrington, Manager
Mr. Stephen McIntyre

Philipp Brothers (Canada) Limited
1245 Sherbrooke Street West
Montreal, Quebec
H3G 1G9
Tel: (514) 845-4294
Telex: 05-2510
Mr. Anthony D. Frizelle, Vice President
- Philipp Brothers is a wholly owned subsidary of Phibro Salomon of New York, U.S.A.

The following two companies can assist foreign companies in handling the Indonesian side of counter-purchase obligations:

P.T. Dharma Niaga
Division 1
Jl. Abdul Muis 6-8-10
P.O. Box 2028
Jakarta, Indonesia
Ir. Soeparyani Santoso
Tel: 347557 or 347577
Telex: 44312

P.T. Sangakencana International
Wisma Antara Lantai 7
Jl. Merdeka Salatan 17
Jakarta, Indonesia
Mr. Pranoto D.P., Manager
Tel: 342360
Telex: 45401

National Agency for Export Development (NAFED)
Sarinah Building, 6th Floor
11 Jl. M.H. Thamarin
Jakarta, Indonesia
Dr. Soetadi, Chairman
Tel: 320507
Telex: NAFED JKT 46292
(NAFED can assist in supplying lists of products eligible for countertrade.)

Panagri Trading Corporation
P.O. Box 3523
Calle Aquilino de la Guardia No. 8
Panama
Also represented in Canada
Suite 900
595 Bay Street
Toronto, Ontario
M5G 2C3
Telephone: (416) 593-3114
Telex: 06524137

in the United States
Suite 2612
One Financial Plaza
Fort Lauderdale,
Florida 33394
United States of America
Tel: (305) 761-3001/2/3
Telex: 514472

in the United Kingdom
P.O. Box 140
Kenilworth
Warwickshire CV8 2QJ
England
Tel: (0203) 309216
Telex: 335011 MFPEUR G

in Switzerland
Baarerstrasse 110C
CH-6302 ZUG,
Switzerland
Tel: (042) 31 55 80
Telex: 868766 MFZG CH

China-Countertrade

With respect to the People's Republic, the issue of countertrade usually arises in the context of joint ventures or co-operative production undertakings which are becoming an increasingly important factor in expanding Canada-China bilateral trade. While import decisions relating to commodities and semi-finished materials continue to be based principally on normal commercial considerations such as price, quality, delivery and financial terms, this is no longer the case when it comes to fully manufactured goods and particularly for purchases related to major projects. The Chinese now insist that machinery and equipment also be state-of-the-art technologically, be limited to items or components that China is unable to produce internally and in order to ensure the additional benefit of acquiring the latest in manufacturing know-how, be produced in China by a joint venture or co-production undertaking if at all possible.

The basic policy for a co-operative enterprise in China is that (A) the Chinese provide land, buildings, labour and administrative support while the foreign investor provides sophisticated manufacturing equipment or the capital for its purchase, essential raw material, components or parts and modern process/manufacturing technology. (B) Direct control of the enterprise remains with China and on expiry of the contract (normally 10 years), all plant and equipment revert unconditionally to Chinese ownership. (C) Profits and losses are borne proportionally by both participants according to their degree of participation. (D) Foreign participants receive the final product in repayment for their investment. When the investment is considered to have been repaid, foreign participants can continue to obtain products but under a new contract agreeable to both parties. (E) Co-operative production is similar to joint venturing except that the items produced are mainly for export sale on the international market.

Given the criteria, it is not surprising that negotiating a joint venture/co-operative production agreement can be a long and arduous task or that few have been concluded either by Canadian companies or those of other countries.

STATISTICAL TRENDS IN EAST-WEST TRADE
AND THE ROLE OF COUNTERTRADE

To understand the impact of countertrade on East-West commerce, it is useful to know the recent trade volumes between the major industrialized countries and Eastern Europe. Bilateral trade turnover in 1981 eclipsed U.S. $100 billion. While the Western countries posted a surplus of some U.S. $4.5 billion in 1981, the gap was narrowing from the 1978 surplus of approximately U.S. $9.0 billion. A look at relative dependencies based solely on these statistics would suggest that the West, with 4.8% of all exports destined to Eastern Europe in 1981 was far less dependent than was Eastern Europe, with 14.2% of its exports sent to the West in 1981. However, these statistics do not reflect adequately the industry-specific nature of many of the East-West trade exchanges. For example, Eastern Europe, during the 1970's proved to be an important market for capital turnkey projects. A significant percentage of output from Western Europe's steel industry was dedicated to export to Eastern Europe. Key sectors of the Western economies have looked to Eastern Europe as a steady market for goods and services.

How much of this East-West trade results from countertrade is largely unquantifiable. The larger compensation agreements are more easily catalogued, (i.e. the Vodka/Cola deals of Pepsi Co. in the USSR and Bulgaria and the $20 billion arrangement between Occidental Petroleum and the Soviet Union), while many counterpurchase and switch transactions will go undetected. The Paris-based O.E.C.D. has listed 290 firm compensation arrangements which, if counter-deliveries were made as planned and a strict bilateralism were enforced, would represent several billion dollars of imports to Western countries over an extended time-frame. However, attempts at putting a percentage figure on countertrade and Western imports from Eastern Europe are highly speculative. It is generally thought that between 10 and 15% of Western European imports from Eastern Europe may result from countertrade arrangements. If the non-European industrialized countries are factored in, the percentage probably drops due to the high proportion of non-manufactured exports, especially agricultural commodities from Canada and the United States for which countertrade is generally not requested. Still, if a bench-mark figure of 5% were used, it would represent approximately U.S. $4.2 billion in imports in 1981.

Canada's exports to Eastern Europe have increased from $170 million in 1970 to $2.3 billion in 1981. The facts of Canada's trade with Eastern Europe detail a trade pattern where agricultural commodities have predominated and manufactured exports have enjoyed a fluctuating position (28% in 1978, 34% in 1979, 19% in 1980, 6% in 1981 and 5% in 1982). Canadian trade with Eastern Europe has been in a surplus position for several years, with a 1981 surplus of $2.0 billion. This balance in Canada's favour has been largely due to sales of grains.

Canada's imports from Eastern Europe have gone from $110 million in 1972 to $350 million in 1981. Imports from Eastern Europe are dominated by manufactured goods, representing just over 90% in each of 1978, '79, '80 and '81. A closer look at import composition would place many of the products in sensitive categories, (i.e. textiles, clothing and footwear), where potential sales are limited by quotas and sharply affected by a general economic downturn.

Countertrade has not been a major factor in Canada's overall trade with Eastern Europe due to the traditional role of commodities. Where captial equipment sales prospects have emerged more frequently in recent years, there has been a tendency for countertrade to be demanded, this tendency varying from country to country. As long as the current credit squeeze is applied to Eastern Europe, the concept of imports from the West being self-financing through countertrade will likely influence the chances for success by Canadian exporters.

TABLE A: Exports - Industrialized Countries

EAST-WEST TRADE: RELATIVE SHARES
(US $millions)

	1978		1979		1980		3 Year Average Share of Eastern Europe in Total Exports
	Total Exports	Eastern Europe	Total Exports	Eastern Europe	Total Exports	Eastern Europe	
United States	$166,385	$ 4,153	$ 202,468	$ 6,440	$ 234,710	$ 4,616	2.6%
Canada	40,256	805	47,207	1,031	52,477	1,815	2.6%
Australia	14,001	545	16,387	873	19,751	1,396	5.4%
Japan	70,005	3,340	96,129	3,358	123,915	3,730	3.8%
New Zealand	3,194	114	4,197	247	4,892	282	5.1%
Austria	15,124	2,094	19,091	2,626	23,507	2,683	13.0%
Belgium	47,613	1,010	61,469	1,198	70,240	1,472	2.0%
Denmark	13,914	417	17,106	455	18,472	457	2.7%
Finland	7,166	1,762	10,295	1,829	14,002	2,840	20.9%
France	78,154	3,491	101,216	4,777	128,471	5,349	4.5%
Germany	108,896	10,253	143,771	11,883	170,640	12,320	8.3%
Iceland	622	59	723	70	924	95	9.8%
Ireland	7,341	50	10,183	83	10,888	99	0.8%
Italy	52,691	3,313	73,080	3,913	92,905	3,962	5.3%
Netherlands	60,375	1,177	76,795	1,422	86,764	1,688	1.9%
Norway	10,696	364	12,500	277	14,867	321	2.6%
Spain	17,297	386	23,794	601	31,520	639	2.2%
Sweden	19,048	1,172	26,248	1,439	31,636	1,485	5.5%
Switzerland	26,235	1,376	36,881	1,430	46,176	1,399	4.0%
United Kingdom	68,897	2,184	90,790	2,434	105,635	3,073	2.9%
Totals	$827,910	$38,066	$1,070,331	$46,382	$1,282,392	$49,721	4.3%
% Annual Increase			29.3%	21.8%	19.8%	7.2%	

TABLE B: Imports - Industrialized Countries

EAST-WEST TRADE: RELATIVE SHARES
(US $millions)

	1978 Total Imports	1978 Eastern Europe	1979 Total Imports	1979 Eastern Europe	1980 Total Imports	1980 Eastern Europe	3 Year Average Share of Eastern Europe in Total Imports
United States	$154,018	$ 2,041	$ 194,939	$ 2,409	$ 242,427	$ 2,058	1.1%
Canada	49,582	221	58,460	278	67,769	260	0.4%
Australia	16,498	83	21,214	139	24,898	115	0.6%
Japan	99,456	1,711	107,984	2,247	137,137	2,173	1.8%
New Zealand	4,237	22	5,304	23	6,232	31	0.5%
Austria	12,508	1,524	15,497	1,949	18,083	2,577	13.0%
Belgium	43,482	897	54,675	1,085	63,003	1,679	2.3%
Denmark	12,260	698	14,579	908	17,065	1,043	6.3%
Finland	19,526	1,803	12,328	2,652	15,394	3,842	21.8%
France	77,615	2,715	98,609	3,551	115,501	5,534	4.0%
Germany	140,566	6,795	168,225	9,380	189,290	9,848	5.2%
Iceland	671	70	870	103	1,015	114	11.1%
Ireland	5,928	137	7,292	194	8,894	149	2.2%
Italy	57,835	3,627	73,031	4,705	81,710	6,257	6.8%
Netherlands	51,210	1,373	65,656	2,105	74,706	2,476	3.1%
Norway	11,104	363	14,150	408	19,458	385	2.7%
Spain	14,524	406	18,704	590	22,836	785	3.1%
Sweden	22,403	1,128	28,409	1,856	32,246	1,716	5.6%
Switzerland	28,070	914	32,302	1,235	38,476	1,537	3.7%
United Kingdom	70,179	2,388	86,948	3,175	108,974	3,105	3.3%
Totals	$891,672	$28,916	$1,079,176	$38,992	$1,285,114	$45,684	3.5%
% Annual Increase			21.0%	34.8%	19.1%	17.2%	

TABLE C: Exports - Eastern Europe

EAST-WEST TRADE: RELATIVE SHARES
(US $millions)

	1978		1979		1980		
	Total Exports	Exports to Ind. Countries	Total Exports	Exports to Ind. Countries	Total Exports	Exports to Ind. Countries	3 Year Average Share of Exports to Industrialized Countries
Albania (1)	$ 83	$ 45	$ 176	$ 108	$ 221	$ 98	N/A
Bulgaria (2)	7,478	463	8,869	686	10,372	692	6.9%
Czechoslovakia (2)	11,747	1,900	13,198	2,393	14,891	2,794	17.7%
GDR (2)	13,267	1,187	15,063	1,417	17,312	1,817	9.6%
Hungary (2)	6,345	1,663	7,938	2,205	8,677	2,452	27.4%
Poland (2)	13,471	3,949	16,243	4,577	16,747	5,030	29.2%
Romania (3)	8,077	2,468	9,272	2,708	10,501	2,890	29.1%
USSR (2)	52,393	12,565	64,937	18,089	76,966	22,257	26.9%
Yugoslavia (3)	5,668	1,987	6,492	2,472	8,977	3,101	36.1%
Totals	$118,259	$26,227	$142,187	$34,655	$164,664	$41,131	22.9%
Average Annual Increase			20.0%	32.1%	15.8%	18.7%	

(1) Albania does not publish trade statistics. These figures are based on reports by trading parties and exclude exports to Bulgaria, Czechoslovakia, GDR, Hungary, Poland and the USSR (ROmania and Yugoslavia are included).

(2) Total Export figures drawn from the United Nations Monthly Bulletin of Statistics, July 1981 Vol. XXXV No. 7 as they include intra-CMEA trade in the totals. Figures for the Industrialized Countries are taken from the International Monetar Fund's Directory of Trade Statistics - 1981 Yearbook.

(3) Romania and Yugoslavia report their trade with Eastern Europe and all figures are taken from the IMF Yearbook.

TABLE D: Imports - Eastern Europe

EAST-WEST TRADE: RELATIVE SHARES
(US $millions)

	1978		1979		1980		3 Year Average Share of Imports from Industrialized Countries
	Total Imports	Imports from Ind. Countries	Total Imports	Imports from Ind. Countries	Total Imports	Imports from Ind. Countries	
Albania	$ 97	$ 58	$ 137	$ 79	$ 192	$ 80	N/A
Bulgaria	7,651	1,045	8,514	1,165	9,650	1,531	14.4%
Czechoslovakia	12,565	2,257	14,262	2,681	15,148	2,829	18.5%
GDR (1)	14,572	1,590	16,214	2,560	19,082	2,665	13.6%
Hungary	7,902	3,211	8,674	3,223	9,235	3,496	38.6%
Poland	16,089	5,527	17,584	5,981	18,871	6,330	34.0%
Romania	8,910	3,256	10,233	3,678	11,599	3,733	34.9%
USSR	50,546	15,472	57,744	19,156	68,523	21,500	31.7%
Yugoslavia	9,988	5,553	12,861	7,255	15,101	7,835	54.6%
Totals	$128,320	$37,969	$146,223	$45,778	$167,401	$49,999	30.3%
Average Annual Increase			14.0%	20.6%	14.5%	9.2%	

(1) Intra-German trade included in "Totals" but not under "Industrialized Countries" column. This will undervalue the trading share of the Industrial Countries (i.e. in 1979 total intra-German trade was estimated at 6.5 billion GDR value to marks or U.S. $1.9 billion).

TABLE E

TRADE BALANCES OF THE INDUSTRIALIZED COUNTRIES WITH EASTERN EUROPE

(US $millions)

	1978 Surplus/ (Deficit)	1979 Surplus (Deficit)	1980 Surplus/ (Deficit)	1981 Surplus/ (Deficit)
United States	$ 2,112	$ 4,031	$ 2,558	$ 2,781
Canada	584	753	1,555	1,643
Australia	462	734	1,281	799
Japan	1,629	1,111	1,557	1,914
New Zealand	92	224	249	
Austria	570	677	106	(505)
Belgium	113	109	(207)	(241)
Denmark	(281)	(453)	(586)	(303)
Finland	(41)	(823)	(1,002)	212
France	776	1,226	(185)	(695)
Germany	3,458	2,503	2,472	600
Iceland	(11)	(33)	(19)	(18)
Ireland	(87)	(111)	(50)	(29)
Italy	(314)	(792)	(2,295)	(1,889)
Norway	(196)	(131)	(64)	(106)
Spain	(20)	11	(146)	9
Sweden	44	(417)	(231)	(147)
Switzerland	462	195	(138)	(287)
United Kingdom	(203)	(741)	(32)	204
Totals	$ 9,099	$ 8,073	$ 4,823	$ 4,542
% Change		11.3%	40.3%	6%

TABLE F

EAST-WEST TRADE
OF THE SUMMIT SEVEN
1980
(US $millions)

	Exports to Eastern Europe	Imports from Eastern Europe	Trade Surplus (Deficit)
United States	$ 4,616	$ 2,058	$ 2,558
Canada	1,815	260	1,555
Japan	3,730	2,173	1,557
France	5,349	5,534	(185)
Germany	12,320	9,848	2,472
Italy	3,962	6,257	(2,295)
United Kingdom	3,073	3,105	(32)
Totals	$34,865	$29,235	$ 5,630

TABLE G

CANADA'S TRADE WITH EASTERN EUROPE

(Cdn $millions)

	1975	1976	1977	1978	1979	1980
A. Exports						
i) Total	$666.0	$792.7	$635.0	$922.3	$1,204.0	$2,123.2
ii) As % of total non-U.S. exports	5.8%	6.5%	4.8%	5.9%	5.8%	7.7%
iii) Manufactured Products	105.7	84.1	122.7	257.9	406.9	401.4
iv) % share of manufactured products	15.9%	10.6%	19.3%	28.0%	33.8%	18.9%
v) % share of non-U.S. manufactured exports	1.9%	1.4%	1.9%	3.1%	3.6%	2.6%
B. Imports						
i) Total	$178.4	$205.7	$213.8	$252.7	$ 327.0	$ 306.4
ii) As % of total non-U.S. imports	1.6%	1.8%	1.7%	1.7%	1.9%	1.5%
iii) Manufactured products	156.6	167.7	163.9	228.6	296.7	277.9
iv) % share of manufactured products	87.8%	81.5%	76.7%	90.5%	90.7%	90.7%
v) % share of non-U.S. manufactured imports	2.6%	2.6%	2.3%	2.5%	2.7%	2.3%
C. Balance						
i) Surplus (Deficit) in Total Trade with Eastern Europe	$487.6	$587.0	$421.6	$669.6	$ 877.0	$1,816.8
ii) Surplus (Deficit) in trade in manufactures with Eastern Europe	($50.9)	($83.6)	($41.2)	$ 29.3	$ 110.2	$ 123.5

TABLE H

Canada's Non-U.S. Trade Balances

	1975	1976	1977	1978	1979	1980
Total Non-U.S. Exports	$11,392.1	$12,193.6	$13,143.1	$15,608.1	$20,751.8	$27,403.7
Total Non-U.S. Imports	$11,074.4	$11,731.6	$12,516.2	$14,665.3	$17,304.5	$20,565.3
Surplus/(Deficit)	$ 317.7	$ 462.0	$ 626.9	$ 942.8	$ 3,447.3	$ 6,838.4
Surplus/(Deficit) from Canada's Trade with Eastern Europe	$ 487.6	$ 587.0	$ 421.2	$ 669.6	$ 877.0	$ 1,816.8

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Countertrade - The CEA's Point of View

Presentation to the Export Trade Development Board at their Meeting of December 1st, 1982.

1. The CEA is pleased to respond to the Export Trade Development Board's invitation to address the question of countertrade and provide some suggestions which may assist the Board in considering an appropriate position to recommend to the Government to take vis à vis the countertrade phenomenon. The Board's consideration of the subject is timely as countertrade seems to be growing. Traditionally, countertrade has been perceived by exporters as an undesirable feature of the export business as it imposes an additional and cumbersome obligation which would not otherwise be undertaken; and this position on the part of exporters has been supported by the government's position on countertrade aimed at discouraging and reducing the practice. However, as countertrade by all accounts is developing into a more significant characteristic of international trade, taking roots in non-traditional markets and found under an increasing number of variations, a growing number of exporters in industrialised countries, and certainly in Canada, are coming to realise the spread of the problem it presents in terms of export development and the need to adopt a new approach to the phenomenon. We would suggest that this also calls for some adjustments in the government's position on countertrade.

2. Most of the facts about countertrade and its recent developments are known to the Board's members but it may be useful to recall some of the major considerations as well as the key points when considered from a Canadian perspective, starting first by a definitional note. "Countertrade" is usually understood as the general term applied to types of transactions in international trade where a potential purchase by an importer is made conditional on a reciprocal purchase by the exporter or a third party acting on his behalf. Such types of transactions include barter arrangements, countertrade deals, compensation trade and others, which are summarily

described in the appendix of this paper. A countertrade transaction therefore differs from a cash deal in that goods or services are accepted as payment, in part or total. It is understood that of course countertrade is not simply a neutral mode of transaction willingly accepted by both parties; there is indeed an element of coersion associated with it, as the exporter is forced to consider a countertrade arrangement as a precondition for an export sale. In effect, one could say that a countertrade transaction occurs as a result of a trade-off between the importer's desire to pay in kind rather than in cash and the exporter's unwillingness to oblige.

3. The reasons for countertrade are not subsiding and if anything are increasing. For one, traditional practitioners of countertrade such as Eastern European countries are putting added emphasis on this practice as their foreign debt position worsens. As well several developing countries, including oil producing ones, are subject to similar financial constraints due to drastic aggravation of their foreign debt position and are reverting increasingly to countertrade demands in order to fulfill in part their import requirements. Cases in point are Brazil, Iran and Venezuela. Furthermore, in developing countries, countertrade is more and more part of a deliberate strategy of development, whereby the practice is conceived as a means to speed up the economic development process by using foreign technology and capital to build extraction and production facilities, to be paid for at a later date with outputs of these facilities. China among others is counting in a massive way on such compensation deals to accelerate its modernisation process (an order of magnitude of things to come is provided by the recent $500 million compensation agreement signed by an Italian consortium to expand coal mines and modernize a railroad and port facilities in China). As part of its economic development plan, Indonesia has also joined the ranks of countertrade practitioners with a requirement that bidders on government projects must export Indonesian products equal to what they import.

4. An important factor in countertrade developments is that the response on the western exporters to countertrade demands seems to have taken a new turn, away from the traditional unaccommodating stance. Although the great majority of western exporting firms still aim to avoid countertrade obligations, the current squeeze on economies around the world and the resulting crunch on export markets have forced them to be somewhat more receptive to countertrade proposals. There are few western exporters though that would argue this is simply a cyclical and passing phenomenon and, if an economic recovery may help in softening the impact of countertrade demands, many maintain that countertrade is here to stay. An interesting development in the U.S. and symptomatic of this trend has been the recent establishment by several U.S. companies of corporate subsidiaries to handle countertrade products (among the major ones are General Motors Corp, General Electric Co., Control Data Corp, Rockwell International Corp., Sears Robuck & Co. and, in Canada, Massey-Ferguson).

5. The importance of countertrade in world trade is difficult to evaluate but generally estimates place countertrade's share of total world trade today between 10 to 20 percent, which is substantial if compared to the estimated 3 to 5 percent it represented only five or six year ago. The role of countertrade in Canada's trade however is considered to be still marginal. In its study of countertrade carried in 1980, the Canadian Commercial Corporation argued that "Canada's exports to countries involved in countertrade transactions include a large portion of agricultural products and raw materials which are not generally associated with countertrade demand to the same degree as end products or manufactured exports". Moreover for those Canadian exporters who are supplying high-technology products to these countries, "they were able to circumvent countertrade requests since these items have high priority on the list of import requirements". Looking at the long-term potential demands of Canadian firms for countertrade, the CCC concluded that Canada would be relatively less affected by countertrade demands as exports or raw materials and commodities are expected to continue to be less exposed to countertrade, but that "in the

foreseeable future, Canadian exports of high technology products and capital projects would certainly face countertrade demands of significant magnitude". In assessing the existing Canadian capacity in countertrade, the CCC observed that "countertrade demands made to Canadian firms have been few and have been negotiated with minimal countertrade requirements. As a result Canadian firms have not developed the capability in terms of the capital and manpower resources to engage in countertrade transactions".

6. The interjection of a trading house as a third party intermediary can substantially facilitate the successful completion of an export deal conditional on a countertrade requirement and indeed trading houses have come to play a significant role in countertrade. The key advantage of a trading house involvement is that it is able to take over from the exporter the responsibility for the purchase requirement. Trading houses with an expertise in countertrade are mainly located in Europe (Austria, Belgium, Switzerland, France, Italy, West Germany and England). In the U.S. there are some major well established trading companies with capabilities in countertrade. As well, as mentioned earlier, new trading corporations specialised in countertrade are growing in the U.S., established as corporate subsidiairies of large exporters to handle their countertrade obligations, but also offering their services to other exporters. The recent passage in the U.S. of the Export Trading Company Act is expected to result in more countertrade activities being undertaken on behalf of U.S. exporters. In Canada, there appear to be few trading houses that involve themselves on a continuing basis in countertrade transactions, mainly due to a lack of demand for such services on the part of Canadian exporters, but also because of their limited capability to handle countertrade transactions. Since Canadian firms, especially equipment manufacturers, are likely to be more subjected to countertrade demands, it may be desirable to develop a greater degree of expertise in countertrade in Canada. Trading houses should be encouraged to extend their knowledge to assist Canadian exporters in meeting these demands.

7. Having briefly set some of the major considerations about countertrade, let's turn to the Canadian Government's position on the subject. The Canadian Government generally adheres along with other industrialized countries to the belief that countertrade, from a policy standpoint, is a retrograde trade practice that should be discouraged and, if possible, contained. It is a cumbersome and inefficient way to bring together buyers and sellers; it distorts the working of the international market by putting a bilateral emphasis on trade and by the pricing discounts that are often required to make a transaction possible; it inhibits the development of export business, especially for small and medium sized firms; it is largely an ineffective attempt to bring a solution to problems prevailing in countertrade practicing countries that are usually due to deficiencies in the industrial structure, product quality, productivity and marketing; finally, it is a form of protectionism. The Government has argued this line and pressed those points in its discussions with countertrade practicing countries as well as in multilateral fora where it shares with other western governments the need to come to some agreement on the course of action that should be taken to conteract the negative effects of countertrade (this government position however may be weakened by the fact that its large scale use of "offset" agreements associated with its purchase of foreign defence equipment is seen internationally as a form of countertrade).

8. As to the private sector's involvement in countertrade, the Government has adopted in principle a somewhat non-committal position, neither supporting it nor condemning it, treating it as a strictly private business decision, the risk of which to be fully assumed by the exporter. In practice though, its approach to countertrade has been somewhat ambivalent, denying its support at times (e.g. at the prospect of CCC's involvement in a countertrade arrangement in a bid for a meat processing plant in Hungary in 1978), and lending it at others (e.g. EDC financed bid on a pulp mill project in Czechoslovakia in 1978 which had an associated countertrade obligation). The Government has however been willing to provide interested exporters with advice on countertrade on a continuing basis.

9. Opinions among the export community appears divided as to what position the Government of Canada should embrace vis à vis countertrade. On the one hand, those who believe that countertrade is a dead-end argue that the Government should try to enforce a policy of discouragement and non-involvement. We would suggest that in view of the foreseeable expansion of countertrade as a means of doing business in international trade, a too rigorous pursuit of such a policy could significantly undermine our competitive position by depriving Canadian exporters of the ability to respond successfully to countertrade demands. On the other hand, those who believe that countertrade is the way of the future argue that the Government should adopt an open policy towards countertrade and its practitioners. We believe that the government in discussion with other governments bilaterally or multilaterally should not take a position which would encourage other governments to believe that Canada favours extension of countertrade;to do otherwise could have the effect of submitting Canadian exporters to increased pressure from importing countries to accept countertrade arrangements or to expose them to higher countertrade ratios. We do not believe that countertrade practitioners need any encouragement. As well, we would agree with the Canadian Government's intention to continue its participation in working towards a multilateral agreement on countertrade (a code of conduct) that would have the benefit of limiting some of most negative effects of countertrade. We would like to caution though that such an attempt to regulate an activity largely dominated by the private sector may prove difficult, or succeed at the price of a too costly and undesirable enforcement process directed against exporting firms. We would also suggest that the degree with which Canada supports the proposal for a code of conduct would have to take into consideration the sensitivities of some of our trade partners involved in countertrade; too high a profile for Canada in the negotiation process may prejudice our export opportunities in those countries.

10. We would urge the government to squarely address the problem countertrade creates from a marketing point of view. Canadian exporters are at a

disadvantage when faced with countertrade demands because of their relative unfamiliarity with the requirements and techniques involved, having not been as exposed to countertrade as perhaps some of their foreign competitors. Most Canadian exporters do not know where to turn to dispose of their countertrade obligation as only a few trading houses in Canada appear to have capability in the field and as specialized trading firms abroad may be unknown to them. The CEA would suggest that the Department of External Affairs, as part of its trade development programme, concern itself with seeing that more and better information is made available to Canadian Exporters on countertrade. The Canadian exporter needs to know more about the policies and practices related to countertrade prevailing in specific importing countries so that he is better equipped when seeking export opportunities in those countries, knowing what to expect in terms of countertrade demands and the techniques of negotiation. More importantly, the Canadian exporter must know where to turn, when he is looking for professional assistance on countertrade or seeking a third party intermediary capable to help in discharging his countertrade obligation.

11. We would suggest that External Affairs:

a) give higher priority to the development of better understanding of the impact which a growing trend towards countertrade will have on Canadian export potential;

b) as part of its market access information program, develop detailed information on the policies and practices of each country employing countertrade techniques, including the extent of such practices, and have this information readily available to exporters;

c) produce a practical handbook on countertrade for exporters, which should include a directory of reliable countertrade specialist firms, both the Canadian and international;

d) based on the success of its first experience in holding a seminar on countertrade in co-sponsorship with the CEA in April 1982, cooperate in further seminars across Canada;

e) stimulate Canadian trading houses to be more involved and active in assisting exporters in meeting countertrade demands;

f) examine carefully means by which exporters can be assisted in identifying proper third party intermediaries to discharge their countertrade obligations. Presently this information is not readily available to exporters and there is a clear need for a well identified source of information to which exporters can refer. The Canadian Commercial Corporation in its 1980 study on countertrade suggested the establishment of a private sector, non-profit organization to advise member firms in negotiating countertrade demands and in selecting appropriate Canadian and foreign trading houses to assist in closing deals. We would suggest External Affairs consider seriously the desirability and feasability of such a facility; the CEA would be receptive to an approach to assist in setting up a facility of this kind. In this regard, External Affairs would be well advised to study similar existing facilities abroad, such as the Association pour la compensation des échanges commerciaux in France and Evidenzbiro, a countertrade problem-solving non profit organization in Austria and others.

12. We believe that the Canadian government in acknowledging countertrade as a marketing problem and in activating its counselling activities on countertrade would be approved of by the Canadian export community. We also believe that it would not unduly compromise its position vis à vis other industrialised countries in their common goal to limit the extent of countertrade practice as several of these countries including the U.S., have already taken steps to increase the support to their exporters in facing the ever-growing challenge of countertrade.

CEA - 11/26/82

COUNTERTRADE - A CANADIAN PERSPECTIVE

Canadian Commercial Corporation
March 18, 1981

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COUNTERTRADE - A CANADIAN PERSPECTIVE

EXECUTIVE SUMMARY

BACKGROUND

Countertrade (CT) has become a way of doing business with many countries of the world, particularly with the Soviet Union and Eastern Europe, the People's Republic of China and an increasing number of developing countries.

Given this trend, Canadian exporters may possibly be faced with an increasing number of proposals to become involved in countertrade contracts.

To determine the impact of these developments on Canadian exporters, the Canadian Commercial Corporation and the Department of Industry, Trade and Commerce agreed in January 1980 to collaborate on a study of countertrade (CT).

STUDY OBJECTIVE

The objective of this study is fivefold:

1. to review the growth of CT and determine the extent to which it is expected to play a role in Canadian trade in the future

2. to develop an up-to-date understanding of the extent to which Canadian exporters encounter countertrade demands
   - the types of countertrade proposals presented to them will be reviewed

3. to evaluate existing capability in the private sector to respond to countertrade demands
   - this will include both manufacturers as well as Canadian trading houses

4. to determine the extent to which any gaps in Canadian capabilities to respond to countertrade demands have prevented firms from successfully exporting or could deter them from doing so in future

5. to propose means to improve Canada's ability to deal with CT

Note: A second study, entitled Countertrade - A World Perspective, is available on request. It summarizes:

1. the problems and practices of exporters in other countries participating in countertrade proposals

2. the various ways in which a number of Western countries have improved their capability to discharge countertrade obligations.

FINDINGS

1. In the 1980's, it is expected that 10 to 20 per cent of world trade and 38 per cent of East-West trade will be accounted for by countertrade transactions.*

2. CT arrangements take a wide variety of forms, i.e., barter, counterpurchase, compensation, swap and switch. A list of definitions of CT terms is included as Appendix A.

3. Eastern Bloc and some developing nations rely on CT as a mechanism to reduce trade deficits, enhance exports and conserve scarce hard currency.

4. The percentage of the contract value to be purchased from Eastern European countries in the form of CT varies from country to country. It depends on the type of CT transaction, the priority assigned to Western products imported, and the type of goods exported. Negotiations are conducted with the foreign trade organizations (FTO) in the appropriate ministries. The "linking" of counterpurchases from more than one FTO is usually a difficult task. Financing, technology transfer and training, extension of performance guarantees, and/or the period over which firm prices of spares apply, can often be bargained against initial high CT demands.

5. Only a few Canadian firms have actually engaged in CT transactions with Eastern Bloc countries. None of them used a trading company to assist them.

6. The strategy of the limited number of Canadian firms faced with CT requests is to offer price reductions and other concessions in lieu of fulfilling CT obligations. Some firms will accept counterpurchase obligations and then pay a penalty stipulated in the contract for not purchasing goods from the customer country. In these cases, the penalty is built into the selling price by the Canadian firm.

7. The general attitude of Canadian businessmen to CT is that it is a time consuming and inefficient way to carry on international trade. They enter into these forms of business activity only as a last resort.

8. Firms surveyed by the Canadian Commercial Corporation indicated that they did not intentionally avoid a market area because of known CT demands.

9. These firms indicated that they had never lost contracts because of the unwillingness to take on CT obligations although they may not have been awarded contracts for other reasons, e.g., price, financing.

10. Few Canadian trading companies involve themselves on a continuing basis in CT transactions. This is in part due to lack of demand: Canadian exporters have not approached them concerning CT transactions. It is also due in part to the limited capability of Canadian trading companies to undertake CT transactions: they do not have the extensive international marketing networks operated by many Japanese and European trading companies (a number of them with subsidiaries in Canada).

11. A central information system on CT in either the government or the private sector is not readily available to Canadian exporters, i.e., information on the different forms of CT, the current policies and regulations of different countries and their CT requirements.

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* United States Department of Commerce, Countertrade Practices in Eastern Europe, the Soviet Union and China: An Introductory Guide to Business.

12. A number of Western countries have encouraged the establishment of private sector, non-profit organizations to deal with countertrade matters, in some cases supported by public funds. The various institutional approaches include:

    a. government sponsorship of an information centre on CT, as in the United Kingdom

    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

    c. creation of a private non-profit association with the power to transact countertrade business and which, in addition, offers advisory service, as in Austria, Sweden and Finland

CONCLUSIONS

1. The volume of CT demands, particularly with Eastern Bloc countries and China, is likely to increase. Companies able to accept CT will certainly enhance their export prospects in these countries.

2. Canadian firms do not appear to have lost any business because of their inability or refusal to meet countertrade demands but some difficulties have recently been encountered, e.g., potential suppliers of equipment for the CANDU reactor in Romania.

3. Private sector trading companies in Canada do not participate extensively in countertrade transactions primarily because Canadian manufacturers facing countertrade requests have not considered it desirable or necessary to accept CT conditions and involve the trading companies.

4. Since Canadian firms, particularly equipment manufacturers, will be increasingly affected by CT demands, Canadian trading houses should be encouraged to assist exporters in meeting these demands.

5. While the need for assistance in CT transactions appears limited to date, Canadian firms, particularly those exporting manufactured products, may find difficulties in meeting the expected increase in requests by countries involved in this form of trade.

6. The role of Government in responding to countertrade requests by foreign customers is subject to a number of constraints and limitations: (a) it would be unacceptable for an agency or corporation of the Government to bring products into the Canadian market which compete with those produced domestically; (b) 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; (c) Government and government organizations do not possess sufficient product knowledge, nor do they have sufficient contacts in a particular industry sector to successfully dispose of the imported products accepted as part of CT transactions.

7. Canada's capacity to handle CT transactions would be greatly improved if a private sector, nonprofit organization were established to advise member firms in negotiating CT demands, and in selecting appropriate Canadian or offshore trading houses to assist in closing a deal.

RECOMMENDATION

The Canadian Chamber of Commerce, the Canadian Exporters Association, the Canadian Manufacturers' Association, and other trade associations should be approached by the Department of Industry, Trade and Commerce to determine their interest in setting up a private sector, nonprofit organization to advise member firms on CT. Such an organization could be given the power to contract on behalf of its members. Alternatively, it could simply serve as a resource information centre for Canadian firms dealing with CT demands.

COUNTERTRADE - A CANADIAN PERSPECTIVE

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COUNTERTRADE - A CANADIAN PERSPECTIVE

I. INTRODUCTION

A countertrade (CT) transaction is one in which a seller (a Western exporter) provides a buyer (a communist importing enterprise) with deliveries (eg. technology, know-how, finished product, machinery and equipment) and contractually agrees to purchase goods from the buyer equal to an agreed upon value or percentage of the original sales contract value.

The value of the CT goods offered by the importing FTO may offset partially, fully or in some cases even exceed 100% of the Western export contract value (this most often occurs in compensation arrangements). CT transactions normally involve three separate documents:

1. a contract between the Western exporter and the importing FTO;

2. a financial agreement; and

3. a contract between the exporting FTO and the Western firm purchasing the counter-deliveries. Contracts normally include the provision that the Western firm can transfer its CT obligations to a third party, i.e., a trading house or another foreign buyer.

For the purpose of this study, the term countertrade (CT) is used to cover barter, compensation (buy-back), counterpurchase, switch and swap. Definitions of these forms of countertrade are listed in Appendix A on page 17.

II. ECONOMICS OF COUNTERTRADE*

In an economic sense, the benefits of further development of world trade lie not so much in the quantitative expansion of world trade, but rather relate directly to the ability to increase the qualitative division of labour among countries. In this sense, CT transactions may be seen as forces disrupting the free market system. Production is shifted to facilities and labour pools which do not operate on the basis of economic comparative advantage. As a consequence, market disruptions may occur which would increase pressure for protectionism to the detriment of international trade.

A number of disadvantages are associated with countertrade. These include:

a. CT transactions increase the price of goods imported from the West because the Western exporter must inflate his price to offset the cost of distribution and anticipated losses on the subsequent sale of low-quality "soft goods" which cannot readily be marketed for hard currency. The higher immediate cost of Western imports, and the lower price of subsequent Comecon exports offset, in large part, the immediate exchange advantage to countries requesting CT transactions.

b. A danger exists that the successful sale of a particular product will be regarded as an indication of further Western demand for the product when this is not the case.

c. Adaptation to modern requirements by means of structural adjustment and quality improvement is delayed by compensation trading.

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*Charles J. Gmuer, "Barter, Compensation and Cooperation", <u>Export Financing</u>, part IV, September 1978.

Recognizing the foregoing disadvantages, the Comecon countries continue, nevertheless, to believe that CT demands do contribute to a reduction of trade deficits with the West and to their longer term involvement in world trade. They believe that the quality, delivery, and after-sales service of Comecon goods will be improved over time so that Western importers will not have to reduce the price of Comecon products on world markets. In requiring CT, the Comecon countries believe they will not be forced to reduce prices as a result of the difficulty in disposing of their goods on international markets in competition with Western distributors. But they would be hard-pressed to answer the questions: When and if your products and services meet world standards, why will you have to resort to countertrade pressures? Would you not be able to dispose of your production directly?

From a Western point of view, as long as the laws of free trade do not apply between East and West, Western industry should not be exposed to danger from cheap subsidized Comecon products. Such exposure can only lead to the growing trend in many countries towards trade protectionism. The erection of more and more trade barriers, albeit rationally motivated, leads to increasing repercussions in other nations. This benefits no one.

CT represents an attempt by Comecon and some of the less industrialized nations to balance their trade deficits and to create employment in their countries and for some managers of Comecon foreign trading organizations to improve the appearance of their performance. On a world scale, some forms of CT, particularly compensation deals, can lead to better capacity utilization and distribution of labour when components manufactured in less industrialized countries and supplied to Western factories are incorporated in an end product which is marketed under the same trademark as before. Similarly, East and West specialization in the manufacture and exchange of given products within a product line can result in cost reductions through specialization and longer production runs. Nevertheless, in the short and medium term, it is hard to make a sound economic argument to support most CT demands.

III. GROWTH OF COUNTERTRADE

Countertrade Forces - World

Although CT is not a legislated requirement in most of the Eastern Bloc nations, all indications are that this form of trade will grow in importance in the long-term economic planning of these countries. At the FTO level, ministerial directives regarding CT are being implemented with increasing rigidity and complexity and applied to a wider range of Western goods.

Supported by inadequate export marketing networks, facing lagging demand and protectionistic attitudes towards a number of their exports in Western markets, and beset by scarce hard currency in their own and other developing nations' markets, many developing countries are pressing CT demands as a means of creating a market for their exports and as a substitute for cash payments for needed imports. Further, developing countries are expected to average, in the 1980's, an annual growth domestic product increase of around five per cent, compared to less than three per cent for the industrialized nations.* This growth is expected to create real market opportunities for Western exporters which can meet the CT requirements.

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* United States Department of Commerce, "Countertrade practices in East Europe, the Soviet Union and China", An Introductory Guide to Business, April 1980.

TABLE 1

CANADIAN EXPORTS TO PRINCIPLE COUNTRIES INVOLVED IN COUNTERTRADE TRANSACTIONS

1979

COUNTRY	TOTAL EXPORTS	END PRODUCTS INEDIBLE	% END PRODUCTS INEDIBLE TO TOTAL EXPORTS	GRAINS	% GRAINS TO TOTAL EXPORTS
SOVIET UNION	$762,953	$77,702	10.2%	$416,905	54.6%
PEOPLE'S REPUBLIC OF CHINA	591,907	14,016	2.4	411,498	69.5
POLAND	261,623	66,596	25.4	170,695	65.2
YUGOSLAVIA	52,702	17,708	33.6	7,173	13.6
GERMANY (EAST)	35,858	81	.002	17,905	49.9
CZECHOSLOVAKIA	35,226	21,383	60.7	-------	-----
ROMANIA	32,153	12,386	38.5	9,162	28.5
HUNGARY	14,083	2,053	14.6	-------	-----
BULGARIA	9,323	636	6.8	2,700	28.9
TOTAL/SHARE	1,795,828	212,561	11.8	1,036,038	57.7

(dollar amounts in thousands)

Source:

Statistics Canada
Exports by Countries. January - December 1979.

The growing importance of CT in East-West trade is reflected in the following statements:

- the hard currency earnings of the U.S.S.R. from compensation deals are estimated to increase from $1.5 billion in 1978 to nearly $4 billion in 1985

- in 1977, more than $18 billion in East Bloc debt to the West was paid off through CT transactions

- Poland expects that in the 1980's CT will account for 40 to 50 per cent of its electrical products and machinery exports to the West

- the U.S. Commerce Department estimates that in 1981 thirty-eight per cent of all East-West trade will be in some form of countertrade.

CT transactions are forecast to account for ten to twenty per cent of world trade in the 1980's. Willingness to engage in CT will increasingly become a necessary condition for exports to those countries, particularly for manufactured products.

China, as compared to other state trading countries, is still in the initial stages of introducing CT policies. Over the past two years, a series of major changes have taken place in its foreign trade apparatus including the pursuit of compensation arrangements. Because of China's ambitious industrialization program, the country will have extensive import requirements, many involving CT.

Countertrade Forces - Canada

Canadian exports to the principal countries involved in countertrade transactions include a large portion of agricultural commodities and raw materials which are not generally associated with countertrade demands to the same degree as end products or manufactured exports. Hence the impact on increasing countertrade requirements on future Canadian exports may be less than on exports from those countries which consist primarily of manufactured goods.

As Table I shows, about fifty-eight per cent, or over half of Canadian exports to eight of the principal countertrade countries consist of grains. The share of end-product or manufactured exports amounts to only twelve per cent. In the two largest markets, the Soviet Union and the People's Republic of China, the share of end-product exports is only ten per cent and two per cent respectively. The share is greater in Poland, Czechoslovakia and Romania where pulp and paper equipment accounted for a significant amount of end-product exports in 1979. However, the firms involved were able to avoid participation in countertrade transactions either by persuading the customer to accept the sale without countertrade requirements or by accepting countertrade requirements and then paying a penalty stipulated in the contract if these requirements were not met. The penalty would, of course, be incorporated in the selling price.

In general, CT demands are more often associated with the supply of equipment and/or technology from Western sources. Examples of Canadian firms which have faced countertrade proposals are included in Appendix B. It illustrates that, relative to American and Western European firms, Canadian companies have not participated to the same extent in countertrade. Reasons for the relatively small role CT plays in Canada's trade with Eastern Bloc countries include:

1. Canadian firms engaged in East-West trade are generally smaller than Japanese, American, and European multinationals whose large size allows them to more readily accept CT transactions

2. agricultural products and raw materials account for more than half of Canadian exports to these countries and these exports do not generally involve CT transactions to the same extent as manufactured products

3. many Canadian manufacturers, particularly those supplying high technology products, are able to circumvent CT requests since these items have a high priority on the list of import requirements. They avoid CT by:

   a. reducing price in lieu of CT obligations

   b. paying a penalty rather than discharging CT obligations

   c. substituting third-country cooperation prospects

   d. negotiating on a "best-efforts" basis rather than accepting a commitment

   e. persuading FTO to forgive CT obligation

   f. asking foreign parent/partner of Canadian company to handle CT obligations either for its own use or resale

In summary, only two Canadian cases of CT obligations actually involved the movement of goods: importing Yugoslav wines as agent (CIL Chemetics Ltd.) and the purchase of $50,000 of machine tools (Combustion Engineering). It appears that most Canadian contracts can be handled without accepting a significant obligation to purchase unwanted goods.

It is difficult to forecast the long-run potential demands of Canadian firms for CT. A number of factors suggest that the impact may not be as great as one might initially consider:

1. after firms in state trading nations develop their manufacturing capability under CT, they often extend their expertise to include the marketing function -- a trend which eventually leads to a reduced requirement for CT

2. CT demands are more important in export of manufactured goods and capital projects; Canadian exports of raw materials and commodities may continue to be relatively unaffected by CT demands

The reasons why state trading companies and developing nations have promoted CT continue to exist -- most particularly the scarcity of hard currency and trade deficits of the East Bloc countries and China. Hence, in the foreseeable future, Canadian exports of high technology products and capital projects will certainly face CT demands of significant magnitude. A Canadian capability in CT would likely enhance Canadian participation in world trade. By the same token, an inability to deal with countertrade could possibly inhibit exports to these countries.

TABLE 2

SURVEY OF SELECTED CANADIAN EXPORTERS

FIRM	A	B	C	D	E	F
Combustion Engineering	Yes	Yes	No	No	No	No
Babcock-Wilcox Canada	Yes	Yes	No	No	No	No
Sandwell Engineering	Yes	No	No	No	No	No
G&B Automated Equipment	Yes	No	No	No	No	No
MacMillan-Bloedel Ltd.	Yes	No	No	No	No	No
Kaiser Resources Ltd.	Yes	Yes	No	No	No	No
Dilworth, Secord, Meagher & Associates (DSMA)	Yes	Yes	No	No	No	No
Denison Mines Ltd.	Yes	No	No	No	No	No
H.A. Simons	Yes	Yes	No	No	No	No
C.C. Chemicals	Yes	No	No	No	No	Yes
Jamesway Co.	Yes	No	No	No	No	No
Canadair Ltd.	Yes	Yes	No	No	No	No
GMC Canada Ltd.	Yes	Yes	No	No	Yes	No
Klockner-Stadler-Hurter	Yes	No	No	No	Yes	No
Electrovert Ltd.	Yes	No	No	No	No	No
G. Kelk Ltd.	Yes	No	No	No	No	No
Rockwell International of Canada Ltd.	Yes	Yes	No	No	Yes	No
Electrolyser Corporation	Yes	Yes	No	No	No	No
CIL Chemetics Ltd.	Yes	Yes	No	No	No	No

Legend: The following are questions posed to company officials in the telephone survey:

A: Have you experienced countertrade demands?

B: Have you signed any contracts with countertrade obligations?

C: Have you deliberately avoided countries that make countertrade requests?

D: Did you lose any contracts because of your inability or unwillingness to engage in countertrade?

E: Do you have any specialized personnel or corporate organization to handle countertrade?

F: Have you used Canadian or international trading houses on countertrade transactions?

IV. ASSESSMENT OF EXISTING CANADIAN CAPABILITY IN COUNTERTRADE

Overview

The comments in this section are based on the findings of two surveys: a survey carried out by CCC in August 1980, and the other a comprehensive survey conducted by the Institute of Soviet and Eastern European Studies as part of the East-West Project in 1979.

CT demands made to Canadian firms have been few and have been negotiated with minimal CT requirements. As a result, Canadian firms have not developed the capability in terms of the capital and manpower resources to engage in countertrade transactions. Similarly, most Canadian trading houses do not appear to have sufficient resources and expertise to meet countertrade requirements.

CCC Survey

In this survey, nineteen companies known to have faced countertrade proposals were contacted by telephone. A series of six questions related to the firm's countertrade experiences was presented to representatives of the companies (See Table II on page 6 for the questions and their replies). The results of this survey are summarized as follows:

1. Of the nineteen firms which experience CT demands, five supplied electric and electronic equipment, four were engineering firms, three were in the natural resources sector, two sold boilers and turbines, two specialized in transportation equipment, two in chemicals and one in agricultural equipment.

2. The majority of firms were exporting high technology equipment and services and specialty items.

3. Canadian companies signed contracts that had a countertrade provision in only ten cases. Of these, only two firms actually have taken CT goods, i.e., Combustion Engineering in Romania and CIL Chemetics in Yogoslavia. Several of the remaining firms have included "best-effort" clauses in their contracts and are still searching for the appropriate goods.

4. Of the nineteen firms which experienced CT demands, five were involved in EDC-financed projects.

5. Almost all cases involved counterpurchase forms of countertrade; there are no examples of barter, switch or clearing agreements. Simons, on a turnkey pulp mill project in Czechoslovakia, was originally supposed to market 100,000 tons of pulp annually (compensation or buy-back) but in the latter stages of negotiations the FTO Ligna took over the responsibility to market the pulp overseas.

6. No company indicated that it had avoided certain market areas because of CT obligations.

7. No company admitted that it had lost any contracts because of its inability or unwillingness to engage in CT.

8. Three companies, all foreign subsidiaries (GMC, Klockner Stadler Hurter, and Rockwell International) indicated they had specialized CT organizations. In each of these cases the CT organization was located with the parent company. For example, GMC sold terrex trucks to Yugoslavia in 1979, but the CT obligations were handled by the World Trading Corporation, a trading subsidiary of GM in the U.S.A. In all other cases, officials stated that their company's size and volume of CT business were too small to establish any specialized organization.

9. Only one company made use of an international trading house, i.e., CC Chemicals. No firm indicated they had used the services of a Canadian trading house on a CT transaction.

10. Most companies found negotiating with Eastern European FTO's time-consuming and irksome; the majority stated they were unsuccessful in finding high-quality, price -competitive goods. Officials indicated that they would try to get out of CT obligations through tough bargaining, though not to the extent that they would lose the deal.

11. No CT deals have as yet been signed by Canadian Firms in the People's Republic of China, although several are now being negotiated.

East-West Project Survey[1]

In the 1979 survey of the 137 firms which responded to questionnaires, seventy-eight indicated that they had sold products or services in the U.S.S.R. and Eastern Europe. Only five of the responding firms indicated they had acquired Eastern products under counterpurchase commitments. The firms in each case were from an engineering or closely related industry (fabricated metal products, machinery and equipment). The counterpurchase arrangement was a vital element for the successful sale of three of the five firms. None of the five firms indicated the use of a trading house suggesting that these firms either used the commodities internally or sold the goods through their own marketing channnels.

With regards to compensation-type arrangements, the report states:

> "In general Canadian firms have not shown any indication of entering into long-term business arrangements with Eastern enterprises, involving enterprise-level cooperation in research and development, production or marketing. However, a few Canadian firms have demonstrated a capacity to act as prime contractor for capital projects in the region."[2]

1 Carleton University, Institute of Soviet and East European Studies, East-West Commercial Relations Services, The Participation of Canadian Firms in East-West Trade: A Statistical Profile (Ottawa)

2 Ibid., p. 36.

Willingness of Canadian Firms to Engage in CT

Most Canadian companies prefer to do business with cash or letters of credit. Businesses engage in different forms of CT only as a last resort. There are several factors behind this attitude.

- most Canadian firms are relatively uninformed about CT practices and are unaware that specialized help is available through export trading houses
- goods generally offered for CT often suffer from poor quality, non-competitive prices and are difficult to market in sophisticated Western consumer markets
- in general, Canadian firms feel that the factors most responsible for a successful sale in Eastern Europe are, in order of perceived importance: (1) technological advantage (2) import priority assigned to their product (3) competitive price (4) attractive credit terms. Full and partial product payback was seen as least important
- the most important reason for terminating sales efforts were, in order of importance: (1) too costly and time-consuming to carry out an effective marketing strategy (2) other markets more attractive (3) limited manpower to pursue opportunities and competitors were offering a price which could not be matched. Overall commitment to counterpurchase was not considered important in the decision to terminate sales efforts.

Capital Availability

The availability of capital plays a vital role in CT arrangements, especially when proceeds from the disposal of counter deliveries occur only after the Western goods have been exported. In the intervening period, the Western exporter may have to absorb the costs associated with the credit extended to the importer as well as those that could occur from the late deliveries of CT goods.

In the East-West project survey, most firms indicated that existing official credit and insurance programs were adequate. The majority of firms, however, thought that attractive credit terms were, on average, only marginally important as a reason for sales success in Eastern Europe. The consensus among the firms was that the relatively small size of Canadian firms with limited managerial and capital resources restricted their activity in time-consuming CT markets.

Export-finance houses, international trade-finance houses and confirming houses are relatively new and unknown in Canada and could possibly fill the gap in financing facilities provided by EDC, governments and chartered banks.*

In-House Personnel for CT

When a company decides to involve itself in CT transactions on a permanent basis, it needs to assess the capabilities of its in-house personnel to handle CT transactions. This may involve upgrading or training new personnel or bringing in outside specialists on a permanent basis. The functions of the CT staff will be to:

- determine whether or not the CT costs will offset the profits derived from the company's sales in export markets;
- locate outside buyers, i.e., trading houses, for products that cannot be used internally; and
- assist in identifying financial institutions that provide credit for CT transactions.

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* Some recently-established confirming houses in Canada are: Long American Export Finance Ltd.; Hastand Canada Ltd.; Forbes Canada Ltd.; TKM (Canada) Ltd.; and Tozer, Kemsley and Millbourn Ltd.

In the CCC survey, no companies (except the subsidiaries of three multinationals) have specialized in-house personnel, or hire temporary consultants to help in CT negotiations. Most firms did not see full or partial counterpurchase as an important reason for their sales success in Eastern Europe or the volume of this type of trade large enough to warrant taking steps to organize for CT on a permanent basis. Also, the strategy of offering concession in lieu of assuming CT obligations has not necessitated recruiting specialized personnel or setting up separate corporate CT organizations.

Only large multinationals, such as General Data Corporation, Coca Cola Co., Rockwell International, General Motors, and General Electric Corporation have set up trading company subsidiaries to market CT goods. Among Canadian manufacturers, separate trading house subsidiaries have been established by Canada Wire and Cable, Alcan Ltd., and Canada Packers Ltd.

Capacity to Handle CT Goods

When a firm decides to involve itself in CT transactions on a long-term basis, it will have to decide on one of the following options:

1. to select goods and services that can be absorbed within their own organization or clients; in the East-West Project survey of the five firms which had acquired Eastern products under CT arrangements, all indicated they had absorbed the goods internally or disposed of them through their own marketing channels;

2. to form its own CT unit; or

3. to transfer CT obligations to a third party, e.g., a trading house; trading houses are most useful to a company when:
    - it has no experience with CT obligations;
    - the volume of CT products is too large or varied for handling by the company alone;
    - the CT products cannot be used by the company; and the company is not prepared to establish its own CT unit.

Generally, involvement by commodity-oriented trading houses in another firm's CT obligations is peripheral to their normal transactions. As long as profits are commensurate with the risks, trading houses will provide useful services to companies facing CT transactions in the following areas:

1. as principal in CT transactions on behalf of an exporter, provided the goods are not out of their field of specialization

2. as adviser to exporters on the type of products that are marketable on world markets

3. as an authority on the market value of the CT goods offered and price quotations on the exporters' products and/or services

There are several hundred trading houses in the trading centers of Western Europe, Japan and the U.S.A. The majority are one to two-person organizations which specialize in a certain commodity range or geographic area. The Canadian trade commissioners in Canada and abroad are in a position to suggest names of firms that are involved in this business in the countries to which they are assigned. Many of these firms are located in Austria and Switzerland. Globally, there are probably no more than 30 major trading houses with operations covering a wide range of commodities and diverse geographical areas.

The trading houses with the strongest financial base in Canada are subsidiaries of large multinational Japanese and European trading firms. They focus on importing consumer products and industrial equipment to Canada and exporting Canadian agricultural foodstuffs and industrial raw materials. The larger Canadian companies are mostly involved in commodity exports: Agro Company of Canada and James Richardson (grain), Seaboard Lumber Sales (forest products), Cansulex (sulphur), Clouston Foods (fish and fish products), Ronald Chisholm (livestock, groceries and fish products), and Canpotex (potash).

For the most part, Canadian manufacturers have to rely on trading houses that have one or two officers, lack sufficient financial capacity and technological expertise and are specialized in narrow product fields (i.e. foodstuffs and raw materials) and geographic markets. These characteristics help to explain the low utilization of trading houses by Canadian firms. According to a Discussion Paper on Tradng Houses in Canada, put out by the Distribution Services Branch of Industry, Trade and Commerce, "..a selected number of trading houses, such as Agro Company Canada Ltd., Enex International Enr., Intrafina Ltd., Canalux Ltd., and Gibbs, Nathanial (Canada) Ltd., have developed some capacity to enter into international barter arrangements and third country trading....".

A group of companies has established the Canada-China Trade Council to actively market Canadian products of its members and to assist them in their dealings with China, but the extent to which it will assist Canadian exporters in discharging CT obligations remains to be seen. Little has been done to date by public and/or private--sector bodies to assist Canadian exporters to discharge CT obligations.

A list of Canadian trading houses with international experience and an interest in barter is included as Appendix C. Only a few of them have the technical ability and worldwide communications network which permits them to assume CT obligations. This may inhibit the effectiveness of Canadian marketing efforts.

In a discussion of the capacity in a country to handle CT goods, the role that Government may play is often based on the idea that it would directly involve itself with CT transactions. Such a role is subject to a number of constraints and limitations.

1. It would be unacceptable for an agency or corporation of the Government to bring products into the Canadian market which compete with those produced domestically. In recent years, the Government has instituted a number of policies involving both global and bilateral quotas for products associated with such "soft" industries as shoe manufacturers, apparel and textile production. In many cases, it is precisely these products that form the basis of demands for CT transactions by many countries in both Eastern Europe and the Third World. Given the attempt by the Government of Canada to regulate the volume of imports of these products, it would be most difficult to have an agency or corporation of the Government in the position of seeking to market these "protected" products as part of CT demands.

2. It is inconceivable that Government or a Government organization involve itself in importing products that could be in competition with products from domestic firms receiving Government assistance to export. Such involvement could in many cases result in a conflict of interest.

3. It would be difficult for a Government organization without sufficient product knowledge or sufficient contacts in a particular industry sector to successfully dispose of the imported products accepted as part of CT transactions. Trading companies in the private sector which undertake the marketing of CT goods are characteristically highly specialized in a limited number of specific industry sectors. They depend on a highly developed network of contacts built up over the years to sell the products which manufactureres have accepted as part of CT transactions. A government organization, in contrast, is not sufficiently specialized in one product, nor does it possess the required network of contacts of specialized trading companies.

V. CONCLUSIONS

The issues surrounding the types of institutional arrangements which could be established to promote Canadian trade are being addressed by the Parliamentary Committee on a National Trading Corporation.

The primary purpose of this report has been to examine the extent of actual and anticipated countertrade practices and demands, and to evaluate Canada's capability in dealing with countertrade. In this spirit, the report's conclusions are:

1. The volume of countertrade demands in Eastern-Bloc countries and China is likely to increase due primarily to a continuing scarcity of hard currency and ever increasing international competition.

2. From a Canadian point of view, while an increased demand for countertrade would impinge on Canada's manufacturing and capital project export potential, Canada's trade balance will not be as seriously affected as other, more highly industrialized countries. This is due to the preponderance of Canada's commodity exports which are not associated to the same degree with CT requests.

3. The Canadian requirement for assistance in countertrade transactions has been limited to date. Increased international competition may make it more difficult to avoid CT obligations in the future.

4. Since Canada has limited resources to deal with countertrade, its capacity to deal with it may be prejudiced - particularly in the capital project and equipment manufacturing sectors.

5. CT demands are likely to grow, but the Government is not a suitable vehicle toparticiate directly in countertrade transactions.

6. A number of Western countries have encouraged the establishment of private-sector, nonprofit organizations to deal with countertrade matters in some cases supported by public funds. The various institutional approaches include:

    a. government sponsorship of an information centre on CT, as in the United Kingdom;

    b. creation of a private, nonprofit association specializing in coordination of the activities of private-sector exporters with established trading houses, as in France;

    c. creation of a private, nonprofit association with the power to transact countertrade business and which, in addition, offers advisory service, as in Austria, Sweden, and Finland.

7. Canada's capability to handle CT transactions would be greatly improved if a private-sector, nonprofit organization were established to advise member firms in negotiating CT demands, and in selecting appropriate Canadian or offshore trading houses, or other institutions, to assist in closing a deal.

VI. RECOMMENDATION

To respond to the above conclusions concerning the future impact of CT on Canadian exporters, the report recommends that:

- The Canadian Chamber of Commerce, the Canadian Exporters Association, the Canadian Manufacturers Association, and other trade associations be approached by the Department of Industry, Trade and Commerce to determine their interest in setting up a private-sector, nonprofit organization to advise member firms on CT. Such an organization could be set up with or without the power to contract on behalf of its members. Alternatively, it could simply serve as a resource information centre for Canadian firms dealing with CT demands.

DEFINITIONS: FORMS OF COUNTERTRADE (CT)

1. BARTER

Barter is the oldest and perhaps easiest form of countertrade to understand. A barter transaction is a one-time, direct exchange of goods between two nations, having offsetting values, without the exchange of money and with deliveries taking place over a short period of time.

Barter is the least used of the countertrade methods because of the improbability of mutual coincidence of wants bringing together two or more parties. An example of a barter deal is the 20 year agreement whereby Occidental Petroleum Corporation will annually ship one million tons of phosphate rock to Poland in exchange for the annual shipment of one-half million tons of Polish molten sulphur. Barter can also be triangular, as was the case where Israel sent potash to Poland, which sent an equal value shipment of sugar to Brazil, which in turn completed the transaction by sending an equal value shipment of coffee to Israel. No money changed hands.

2. COUNTERPURCHASE (PARALLEL DEALS)

Counterpurchase is the predominant form of CT with Eastern Europe and the U.S.S.R.

With a counterpurchase transaction, the Western exporter agrees to buy products from an Eastern FTO equivalent to a fixed value or percentage of his own deliveries. The exchange is normally separated into two contracts linked by a protocol of intent. Both sides in the transaction pay cash for the goods and services they receive at the time the deliveries are made. This is advantageous for the Western exporter since he has time to look around for suitable goods with which to fulfil his counterpurchase obligations. The counterpurchase obligations take place over a relatively short period of time, i.e. one to five years, generally represent less than 100% of the original contract value, can be transferred to a third party (trading house), and normally contain a penalty clause applicable if the counterpurchase is not concluded on time.

A recent example involves Brazil's agreement to buy $6.5 billion worth of oil from Iran over five years, paying for 30% of the oil with beans, rice, sugar, corn and other agricultural products, and the remaining 70% in hard currency. In another example, Frederick Krupp Huttenwerke AG of West Germany successfully bid a $9 million contract in exchange for Soviet machine tools and equipment. A Canadian illustration is General Motors (Canada) which sold four rear-dump haulers to Yugoslavia and agreed, through the World Trading Corporation, a trading subsidiary of its parent company, to buy a certain percentage of the contract value in Yugoslavian products.

3. COMPENSATION TRADE (BUY-BACK)

Compensation arrangements in dollar volume are the most rapidly growing form of CT and are usually part of an industrial cooperation agreement or joint venture without equity. Under this type of arrangement, a Western firm sells machinery, equipment, technology or a turnkey plant and obtains the resultant products as full or partial repayment. Obligations under compensation agreements are the most complex of all forms of CT. Projects are usually large in dollar value, require extensive negotiations and financing, take place over a long period of time (10 to 20 years is not uncommon), present extreme difficulties in fixing the value of the resultant products over the life of the agreement, and sometimes provide for cumulative value of the buy-back contract which is greater than the original sale.

A good Canadian example of a compensation deal is H.A. Simon's (Overseas Ltd.) agreement in 1978 in which the firm took turnkey responsibility for the Ruzomberok sulphate pulp mill in Czechoslovakia and in return took on a CT obligation to purchase 100,000 tons of pulp annually. In another example, International Harvester Co. sold technology for the manufacture of crawler tractors to the Polish FTO, Bumar. As payment, International Harvester agreed to buy back at a discount a percentage of the components made at the Polish plant. Lastly, the British toy manufacturer, Dunbee-Combex-Marx Ltd., supplied $50 million worth of toy machinery and moulds to the People's Republic of China. As payment, the company will receive half the value of the export contract in hard currency and half in finished toys.

4. SWAP

In swap transactions, bulk products such as sugar, chemicals, ore and oil from diverse geographic locations are traded to save transportation costs.

An example is the swap of Soviet oil bound for Cuba and Mexican oil heading for Europe. In the 1978 agreement, the U.S.S.R. supplied oil to Mexico's customers in Greece, Eastern Europe and Turkey. Mexico supplied oil to Cuba. Differences in the quality of the goods being substituted were worked out in the swap contract.

5. SWITCH

This method of countertrade is useful when international currency flow is weak or when a country has accumulated surplus credits in blocked currencies as a result of clearing arrangements. A switch arrangement involves two nations with a bilateral clearing agreement whereby if one country realizes an imbalance of clearing at the end of a period it can transfer its balance of clearing to a third nation or individual party, i.e., a switch trading house specialist.

COUNTERTRADE

FROM A WORLD PERSPECTIVE

Canadian Commercial Corporation
February 1981

COPY NO. ____

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Appendices

I. REASONS FOR COUNTERTRADE (CT)

A. Eastern European and Third-World Countries

Eastern European and some developing countries make demands for countertrade (CT) arrangements for a number of reasons:

1. They wish to minimize their outlay of scarce "hard" currency. (1).

   - in 1977 more than S18 billion in East Bloc debt to the West was paid off through CT transactions

2. Developing countries, in the face of widely fluctuating world market prices for their commodity exports, look at CT arrangements as one possible way of stabilizing production and prices.

3. CT transactions, particularly compensation deals which extend over several years, help to stabilize swings in the trade turnover with Western countries.

4. Countertrade is a means of penetrating new markets in the West. Many export enterprises which require CT lack the needed skills and techniques to successfully market their manufactured products abroad. Compensation agreements with Western firms with their established market networks make it possible to sell products at more stable prices and over a longer period of time than would be the case if Eastern Bloc export enterprises attempted to sell their products on world markets themselves.

5. CT techniques may serve to disguise price discrimination and dumping or to circumvent foreign exchange controls since transactions can be made without actual price disclosure.

6. Eastern Block countries prefer bilateralism to multilateralism, for economic and ideological reasons. The different forms of countertrade reflect this preference for bilateralism.

7. Countertrade arrangements are seen by many Eastern Bloc foreign trade organizations (FTO's) as a valuable psychological bargaining weapon. Officials in the FTO's feel they stand a better chance of gaining further price discounts by asking for counterpurchase rather than by directly asking for an additional price reduction. Then they try to trade off the elimination of the counterpurchase requirement for a lower price.

8. State trading officials can point to countertrade successes as indicators of their good performance in improving exports.

B. Western Firms

Western firms, even if reluctantly, accept countertrade arrangements for the following reasons:

1. Acceptance of countertrade commitments can be an important factor in postponing licensing requests by importing Communist FTO's.

2. The willingness of Western firms to accept CT arrangements usually allows a sale to take place and perhaps gain an edge on competition.

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(1) The estimated debt of the non-OPEC LDC's is US$300 billion and the overall debt service is approximately US$50 billion

3. Countertrade arrangements may offer Western firms alternate sources of supply of scarce resources (i.e., oil, natural gas, precious metals, etc.), intermediate products and manufactured goods.

4. Countertrade deals in the form of compensation agreements may provide added utilization of a multinational's marketing system.

II. COUNTERTRADE PRACTICES AND POLICIES IN EASTERN EUROPE, THE U.S.S.R. AND PEOPLE'S REPUBLIC OF CHINA (1)

A. Initial Demands

Experienced sellers estimate that most of the initial Eastern European countertrade requests can be lowered by at least one third. Initial requests deviate most dramatically from final CT percentages in the import of top priority high technology products.

Initial requests are thought to be most reasonable in the U.S.S.R., Hungary, Czechoslovakia (for technical products) and the German Democratic Republic (except for turnkey plant imports). The highest initial CT requests will be encountered in Romania, Poland, Bulgaria and Yugoslavia.

The trend is for an increasing proportion of Western sales to Eastern Bloc countries to become subject to countertrade obligations. Furthermore, all these countries are increasing the percentage of the value of the Western sale that is to be paid for by CT arrangements. Generally, for a particular transaction, the percentage of CT demanded will depend on:

- the policies of the country requiring the countertrade transaction and those of the negotiating state enterprise
- the skill and tenacity of the Western negotiators
- the priority assigned to the Western products and their price, i.e. high priority imports

Case studies of international firms involved in CT are illustrated in Appendix A. A checklist of practical tips in negotiating countertrade deals is included as Appendix B.

B. Exports Offered By Countries Requesting Countertrade

The choice of export goods made available for CT vary with each country and depend on the following three factors:

1. the volume and type of goods produced by the country (FTO's prefer to offer finished goods rather than raw materials)

2. the demand for the goods and hard currency export markets (goods saleable for hard currency -- raw materials, semi-processed goods and certain chemicals -- are not usually available for CT)

3. the time of year (the last quarter of the calendar year is the best time to buy since most FTO's are under pressure to fulfil their export targets).

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(1) Much of the material in this section is taken from Countertrade Practices in East Europe, the Soviet Union and China: An Introductory Guide to Business, U.S. Department of Commerce (Cuba is also included)

Commodities scheduled to fulfil counterpurchase commitments generally have low priority in the production planning of Eastern Bloc countries. Therefore, these goods suffer from low quality, inflated prices, lack of spare parts and after-sales service, inadequate packaging and delivery delays. In many instances, products such as raw materials and semi-processed goods which could be sold in hard currency markets appear on lists of goods offered for export but in the majority of cases are no longer available when the Western firms ask for them.

C. Institutional Arrangements for Countertrade

In all Eastern Bloc countries, foreign trade organizations (FTO's) are responsible to, and supervised by, a corresponding industrial ministry. National banks supervise financial transactions with foreigners. The ministry of foreign trade (MFT) is generally responsible for setting policy guidelines and for coordinating CT activities. However, in the majority of countries the MFT does not have a special department for CT transactions or participate directly in CT negotiations.

Officially Western firms are supposed to be able to purchase goods from a wide variety of FTO's under several different industrial ministries. In practice, the "linking" of counterpurchases from more than one FTO is a cumbersome and time-consuming procedure. Often officials will seek to restrict counterdelivery commitments to the original importing FTO or the industrial ministry to which the FTO is responsible. Some countries though, such as Poland, have specialized FTO's, i.e., DAL, which will arrange the linkage of counterpurchases among several FTO's.

Generally, the more centralized the administration and clearer the CT policy guidelines of the country, the easier it is for the Western firm to engage in CT. In Yugoslavia, for example, the decentralized system and lack of clear policy guidelines involve Western firms in tedious and lengthy negotiations while searching for suitable counterpurchases. In China, the lack of experience in CT has led to a cautious and vague approach to CT policy formulation, making the problem even worse.

D. Negotiations

Negotiating techniques and styles vary among countries requiring countertrade and the FTO's of each country. In Hungary and China CT demands and negotiations are clear-cut and simple, while in Romania CT demands are complicated and may not be introduced until the very last minute of signing a contract (to extract more favourable terms). In most countries, initial and final CT percentages for compensation and counterpurchse deals can diverge substantially -- except in the German Democratic Republic (GDR), where there is very little haggling about the proportion of CT requirements. Usually, if the FTO is acting under strict ministerial guidelines for CT percentages and export quotas, Western firms will not be able to reduce CT percentages substantially or choose to pay the prescribed penalty for non-fulfilment of the CT obligation.

Western firms should try to establish close and permanent business relations with FTO personnel to get an indication of both the priority of the Western imports and the necessary CT level required to conclude a deal. In the actual negotiations, Western firms should ascertain very early whether the deal will involve CT obligations and how much these requirements are likely to be, only quoting final prices for their goods after the terms, conditions and product range offered for CT are identified. This strategy is essential since, if a firm chooses to accept a CT deal, its price quotation will have to reflect the added costs of the CT obligation.

Western firms can pursue several strategies to negotiate lower CT terms by offering any one of the following:

- an extentsion of the repayment on the export contract
- an extension of the performance guarantees
- an expansion of training programs for the customer's personnel
- guaranteed fixed prices over a longer time period for part of the spares to be supplied

The risk of non-fulfilment of the CT obligation is open to negotiation and varies between 10 per cent and 20 per cent of the CT value or the non-fulfilled portion. (1)

III. COUNTERTRADE INSTITUTIONAL ARRANGEMENTS IN SELECTED WESTERN COUNTRIES

Western exporters facing CT demands must dispose of goods taken in exchange for their own exports. This problem has been addressed by:

- selecting semi-finished products or raw material which can be readily used in the exporter's production;
- selecting finished goods which are compatible and complementary to an existing product line and can be marketed as such; and
- selecting products which must be independently marketed and/or transferred to a third party for subsequent resale.

Only large Western exporters with diversified product range are likely to take back goods for their own use. Major problems arise for smaller and less diversified firms which can often be faced with the disposition of unwanted merchandise. To assist firms, organizations in a number of Western countries have been established by private and/or public-sector interests to provide an advisory or information service to firms faced with CT requests.

As well, a number of private-sector trading companies have been formed which specialize in CT with Comecon countries - the more prominent being located in Western Europe. A listing of such organizations is included in Appendix C.

A good example of a private-sector organization specializing in CT is Centro Internationale Handelsbank Aktiengesellschaft, a consortium of major banks and trading companies from Italy, Spain, Austria, Poland, France, Great Britain, and Japan. Shareholders are: Banco di Sicilia, Italy; Banco Popular Espanol, Spain; Bank fuer Arbeit und Wirtschaft Ag, Austria; Bank Handlowy w Warszawie S.A., Poland; Banque Occidentale pour l'Industrie et le Commerce S.A., France; Kleinwort, Benson Limited, Great Britain; and the Bank of Tokyo Ltd., Japan. Its services fall into three categories:

- Banking
  - Credits
  - Acceptances
  - A-forfait finance
  - Guarantees
  - Letters of Credit
  - Foreign Exchange and Deposits
  - Industrial Project Financing

- Commercial
  - Consulting
  - Fulfillment and financing of CT obligations
  - Consultancy services for imports and exports
  - Market research and industrial representation
  - Organization of the delivery of know-how and machinery equipment

(1) Election to pay the penalty may jeopardize future relations with the FTO.

Trading
- Agricultural products
- Industrial goods
- Foodstuffs
- Chemicals
- Minerals
- Metals
- Switch transaction

Similar organizations are predominantly centered in various countries in Western Europe - sometimes, but not always having particular specialties as to type of transaction, product range, and/or market penetration. Canadian Posts in each country can advise which organization should be approached under varying circumstances.

The assistance provided by public authorities, export promotion organizations, national chambers of commerce, national banks and manufacturing associations has taken a variety of forms with different degrees of public involvement, scope and organizational structure: advisory services in the U.K., France and Sweden, and commercial-type trading companies in Austria and Finland. The principal characteristic of these countertrade services is their non-profit, public service orientation.

A. Federal Republic of Germany (F.R.G.)

In the F.R.G., the Working Group for Trade with the German Democratic Republic (G.D.R.) issues periodically to its member associations a catalogue of West European trading houses which specialize in CT transactions -- particularly their product specialties.

B. Sweden

Sweden's Export Council′ is in the process of organizing a special CT department to provide advisory and intermediary services for its smaller members. The new body will be jointly funded by the public and private sectors. Operating funds will be raised by regular membership dues and charging members for specific costs incurred for them by the organization.

C. Finland

Finland's export sales organization, Metex, was established in 1948 to represent both private and public-sector engineering firms on a world-wide basis. The organization, through a specialized trading subsidiary, handles members' and other firms' CT transactions.

D. United Kingdom

The Export Policy Branch of the U.K. Department of Trade provides assistance in the form of publications and advisory services. This branch has published an information package which summarizes the various forms of CT, provides guidance for exporters and summarizes government regulations that may apply in regard to certain types of CT. Furthermore, the branch counsels firms concerning problems arising in CT negotiations and issues lists of trading firms in the U.K. that are known to handle CT transactions.

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* The material is a summary of a note by the Secretariat of the Committee on the Development of Trade, UN Economic and Social Council, "Institutional Arrangements at the National Level for Counter-Trade in Selected Western Countries".

E. United States

The U.S. government does not have an official policy, guidelines or a special agency designed to cope with the CT obligations faced by American companies. Officials in the U.S. Department of Commerce state the policy towards commercial CT deals is neither to actively encourage nor discourage them unless sensitive commodities are involved. The pervasive attitude is that the growth of CT is a regressive trade development -- a deviation from the ideal of multilateral trade relations rather than simply a tool in a country's export policy.

The U.S. Department of Commerce publishes an information guide for businessmen and periodically organizes seminars at which executives exchange views on their countertrade experiences. Two major pieces of legislation, now before Congress, the Stevenson and Danforth bills, are designed to encourage export trading houses to become an important vehicle of U.S. trade expansion. Specifically, the bills would:

- allow U.S. banks to own equity in trading companies, giving trading houses links with the banks expertise and overseas market intelligence networks
- provide advance antitrust clearing for trading companies, making it possible for the formation of export consortia of U.S. manufacturers capable of absorbing a wide range of CT goods
- make available Export-Import Bank guarantees on their accounts receivable and export inventories
- allow trading companies to defer taxes on part of their profits
- authorize state and local authorities to form or participate in trading companies

F. Austria: Liaison Office for Foreign Trade (Evidenzburo)

1. Origin: Austria's Evidenzburo was established in 1968 as a private, non-profit and independent association of exporters, transit dealers, bankers and other institutions interested in improving east-west trade. The three founding official bodies were:
   - the Austrian Federal Chamber of Commerce
   - the Minister of Trade
   - the Austrian Association of Industrialists

2. Objective: The principal objective of the Evidenzburo is to provide a wide variety of services to its members when they are faced with unexpected difficulties in their export business. Related to this general aim is the strategy of helping its members to increase their countertrade with the socialist countries and with other world markets, preferably in cooperation with other competent institutions.

3. Organization: The head office is located in Vienna with branch offices in Bucharest, Sofia and Warsaw. All members are entitled to the services of the office free of charge but are obliged to pay a prescribed membership fee and reimburse costs. With a small staff, Evidenzburo does not specialize in any one product or country. Since it is not backed by any financial institution, members are referred to the various local banks for the financial aspects of trade transactions.

4. Functions: Evidenzburo operates in a number of differing ways:

   a. participates in official negotiations between Austrian authorities and the various East European governments, particularly in the establishement of agreements and cooperation

   b. serves as an intermediary between its members and East European FTO's; in particular, it advises member firms on the product choices when they are presented with lists of products for CT by FTO's and with the disposal of these goods either in Austria or in other countries

   c. may transact countertrade business on behalf of its due-paying members, whether Austrian or foreign firms

5. Specialization: Due to its strong links with the Association of Austrian Industrialists, Evidenzburo at its inception tended to concentrate on the disposal of capital equipment, i.e., machine tools and other metal-working equipment. It has now, however, diversified its product interests into consumer goods fields.

   Despite its strong interests in capital equipment goods, Evidenzburo will consider a CT proposal by any of its members outside of its product interests. In such a case, it will rely on its network of contacts in Asia, Latin America, and the Middle East to find markets for these products.

6. Membership: All organizations dealing with export, import or transit trade can become members after paying an annual membership due: Austrian firms pay 15,000 Austrian schillings, non-Austrian firms, 25,000 Austrian schillings.

7. Record: Since its foundation in 1968, Evidenzburo has negotiated (as of 1979) CT obligations worth US$270 million on behalf of its members.

G. France: Association for Compensation of Commercial Exchanges (ACECO)

1. Origin: The French organization ACECO was established to overcome the relative weakness in numbers and economic power of the trading house sector to engage in countertrade. This semi-official, non-profit advisory body, established by four national trade and industry groups and five banks, was designed expressly to assist its members in transactions involving some form of countertrade:

   - National Council of French Employers
   - National Federation of Foreign Trade Associations
   - Chamber of Commerce and Industry of Paris
   - Federation of Mechanical & Metalworking Industries
   - Banque Nationale de Paris
   - Crédit Lyonnais
   - Société Générale
   - Banque Française du Commerce Extérieur
   - Banque de Paris et des Pays-Bas

2. Objective: ACECO has as its objective service as an intermediary between government administration and private and public-sector firms and banks. Specifically its aim is "..to facilitate in a co-ordinated manner export channels with those countries that make use of countertrade, commonly called compensation, by bringing together French businessmen who are faced with this type of obligation, trading houses and specialized importers, the latter two being in a position to assist with these transactions..."

3. Organization: ACECO operates from one central office in Paris and is directed by a Managing Board of sixteen founding members elected for a term of three years. The Board is responsible for establishing the day-to-day regulations which guide the organization. The Executive Office is directed by a president, who is assisted by two permanent committees: Business Committee composed of representatives from the four national trade and industry groups and five banks, and a Consultative Committee composed of specialists in countertrade. The Business Committee includes two ex officio representatives from the Ministry of Foreign Trade who only have observer status.

4. Functions: ACECO, by statute, can only play an intermediary role in an advisory capacity and cannot become involved in actual transactions. Specifically it:

   (a) responds to requests for assistance from firms domiciled in France

   (b) accepts requests from members for assistance with regard to any product or country, but is concerned predominantly with CT obligations involving industrial equipment and chemical products

   (c) advises members on negotiating CT contracts, advises on disposing CT products, drafts guidelines for French exporters to maintain some consistency in the terms of trade, and finally upgrade the professional capabilities of the trading house sector

   (d) presents purchase obligations resulting from CT transactions first to French firms which have the right of refusal. Only when a French importer or trade cannot be found to take over a particular obligation is ACECO free to turn to foreign importers and trading houses

5. Membership: In mid-1979, ACECO had about 150, mostly large, member firms which came primarily from the metalworking/machinery and chemical sectors. Included were such large firms as Dussault, Citroen and Thompson-Brandt. Almost all French trading companies were included. About 66 percent of ACECO's present members conduct most of their CT (mostly counterpurchase) with Eastern Europe and the U.S.S.R. Close to 40 percent of the members' CT in this market area is in the plant and equipment sector of the chemical industry.

   To finance its activities, ACECO charges annual dues which vary from FF2,500 to FF5,000, depending on such variables as the member's annual trade turnover and the share of exports accounted for by CT operations. Also members must reimburse any charges incurred on their behalf by ACECO, i.e., telex costs, telephone calls, etc.

6. Record: By the spring of 1979, 49 out of 151 dossiers on proposed CT transactions were executed with the assistance of ACECO. This represented a value of about FF 2.75 billion. About 55 percent of these transactions with Eastern Europe and the U.S.S.R. involved machinery, chemicals and industrial equipment.

Appendix A-1

CASE STUDIES OF INTERNATIONAL FIRMS

The majority of countertrade arrangements with Eastern European countries, the U.S.S.R. and China involve medium to large multinational corporations, particularly those based in Western Europe and Japan. Due to the complex nature of compensation arrangements, i.e., large dollar volume, 10 to 20-year maturity period and the transfer of sophisticated technology, know-how and equipment coupled with the preference of these Eastern Bloc countriees for dealing with reliable, financially stable Western firms with world-wide marketing networks, the large multinational firm is the ideal vehicle for this type of business transaction. For purely counterpurchase arrangements, the size of Western firms ranges from small to large.

The following eleven brief case studies are presented primarily to provide an overview of the nature and extent of the involvement of international companies in all types of countertrade arrangements. (1)

INTERNATIONAL HARVESTER (IH) - HUNGARY

Business between IH and the Hungarian organization, Raba, began as a licensing and sourcing arrangement whereby licensed axle production was restricted to the expected needs of the Hungarian market. Later IH entered an agreement for Hungary to supply one-third of its requirements for medium duty truck axles. International Harvester gave Raba a "target price" without disclosing the prices of the other suppliers. Success on the high quality Hungarian-produced axles led to a cooperation deal on farm machinery. The total long-term cooperation amounted to a ten-year turnover of approximately US$1 billion.

OCCIDENTAL PETROLEUM - U.S.S.R.

In 1974 Occidental Petroleum signed a barter agreement with the U.S.S.R. to exchange fertilizer materials over a 20-year period, starting in 1978. Between 1980 and 1987, Occidental will deliver 1,000,000 tons of superphosphoric acid a year and take back 2.1 million tons of ammonia, 1 million tons of urea and 1 million tons of potash annually. The first shipment of 350,000 tons of ammonia arrived in the U.S.A. in January, 1979. Prices governing the exchange are to be set periodically on the basis of world prices, with the Soviets giving Occidental a small discount on what it is buying. During the life of the deal, approximately US$10 billion worth of materials are expected to move in each direction.

LEVI STRAUSS & CO. - HUNGARY

In 1977 Levi Strauss & Co. sold Hungary a turnkey plant (US$400,000) and the design of its blue jeans. In payment it will receive a portion of the plant's production. Levi gets royalty on the 40 per cent marketed in Hungary.

McDONNELL DOUGLAS CORPORATION - YUGOSLAVIA

On the sale of DC-9 passenger jets to Yugoslavia, McDonnell Douglas Corp. agreed to a partial counterpurchase payment consisting of canned hams, tools and other products. The corporation's CT in Yugoslavia now includes the company encouraging its employees to fly on JAT-Yugoslav airline and to vacation on the Adriatic seashore of that country.

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(1) For an exhaustive listing of CT agreements with Eastern Bloc countries, the U.S.S.R. and China, see Appendix B, pp. 78-102, in Countertrade Practices in East Europe, the Soviet Union, and China.

MANNESMANN - U.S.S.R

A consortium of West German steel pipe manufacturers, energy companies and financial institutions is negotiating a compensation deal with the U.S.S.R. involving a 3,000-mile gas pipeline project estimated at US$9-13 billion. The gas pipeline is expected to supply Western Europe with an additional 40 billion cubic meters of gas by the mid-1980's. Mannesmann heads the pipe manufacturers, Ruhrgas the gas companies, and Deutsche Bank of Frankfurt will lead the banking group. The U.S.S.R. would pay for its part of the project with resultant gas deliveries.

BORG-WARNER - POLAND

Borg-Warner became involved with the Polish organization, Bumar, as a component supplier (power shift transmissions) for the equipment manufactured under a compensation deal signed by International Harvester with Bumar. Countertrade requests, though not part of the initial contracts, began to emerge during the last two years. Borg-Warner agreed to an annual purchase of components from Poland for its road-building machinery. The company generally delivers on open-account terms, with the bilateral warranty arrangements being such that the supplier covers the cost of any rejected shipments.

PEPSICO INC. - HUNGARY

Pepsico Inc. signed a compensation agreement with Hungary to provide syrup. Due to currency restrictions, the company could not negotiate funds and, as a consequence, paid the production costs of the movie "The Ninth Configuration" made in Hungary. The government accepted the spending of these funds in lieu of its countertrade obligations. Pepsico owns half of the movie rights and will receive royalties from box office receipts. *

3M COMPANY - BRAZIL

Brazil and Hungary had a bilateral trade agreement, so 3M shipped industrial adhesives to Hungary where they were repacked and sent to Brazil as Hungarian exports. 3M benefited in that it was able to work within Brazil's import restrictions, and Hungary benefited by a commission on the sale. Both countries, Brazil and Hungary, could claim the bilateral agreement was adhered to.

SIEMENS

Siemens has a centre with 100 employees near Nuremberg to handle countertrade on a world-wide basis, and, with 320,000 employees in 129 countries, it has the marketing network to discharge most of its CT obligations. The company is reluctant to become involved in compensation arrangements where electrical equipment would be built into Siemens product lines. This policy is the result of a bad experience with Medicar, an Hungarian FTO which manufactured X-ray equipment. Siemens sold this equipment under its own label to Brazil but had to wait on one occasion for ten months to get spare parts.

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* This is becoming a very popular method for dealing with the problem of blocked currencies.

PEPSICO INC. - U.S.S.R

This celebrated counterpurchase case involved Pepsico exporting its syrup from a British subsidiary to the Russian FTO, Soyuzplodo-import in return for Russian vodka. Under the original agreement, an annual production of 72 million bottles of Pepsico's soft-drink products were produced in a plant in Novorossigk on the Black Sea under the American company's supervision. Payment to Pepsico Inc. for the syrup, training and supervision of the Soviet workers, and for the use of the Pepsico trade mark was made in Stolichnaya vodka, which Soyuzplodoimport was responisble for exporting. Pepsico had previously acquired a major U.S. Liquor distribuor, Monsieur Henri, and so was able to promote and distribute the Russian vodka within its own organization. Increased production and sales of Pepsi-Cola in the U.S.S.R. were made contingent on Pepsico's ability to market more vodka in the U.S.A. The agreement has worked very well, with more bottling plants being built in Moscow, Leningrad and Tallinn.

VOLVO-CHINA

The Swedish car and truck manufacturer, Volvo, has signed a trading agreement with the Chinese province of Canton. The deal will result in the Swedish company supplying cars, trucks and construction machines to the province in return for various Cantonese goods which Volvo will then sell on world markets. In order to do this, Volvo is to carry out these trading operations through two trading houses, one in Britain and one in Hong Kong. The total value of the agreement is in excess of US$575 million.

CHECKLIST OF PRACTICAL TIPS ON NEGOTIATING COUNTERTRADE DEALS

1. Be clear about your reasons for considering countertrade (CT). Are you interested in securing long-term supplies of Eastern European finished products or materials? Do you want to develop supplies of components (presumably at advantageous prices) for assembly into finished products in the West? If your company is more interested in selling than buying, what is the maximum CT percentage you will accept, and what type of products do you prefer? Also, will your firm settle the CT commitment or pass it on to a third party, such as a trading house?

2. Businessmen negotiating contracts should be aware of the foreign trade oganization (FTO) official's motivations. In addition to the overriding need to save foreign exchange, it is a matter of personal prestige for him to gain as great a CT commitment as possible -- his year-end bonus and career advancement depend on it. The Eastern European supplier's prestige is also enhanced if his products are marketed in the West. However, if the Western products are priority items, the CT request may simply be a pro forma demand made to satisfy the FTO negotiator's superiors.

3. When entering into preliminary sales discussions with a government negotiator, do not give any price quotations until you ascertain what the CT requirement will be, how payment will be made and whether the Eastern European buyer expects some type of financing assistance. Be sure protocols (minutes) are kept on all payment negotations.

4. CT demands often do not surface at the beginning. The FTO negotiator actually may not know the priority status of the proposed import and what, if any, CT will be required. On the other hand, be aware that he may try to lull you into quoting a sales price based on the assumption of a low CT request or none at all, only to spring a hefty demand on you at the last minute. If the Eastern European negotiator seems vague about the issue, expect a CT requirement to come up later.

5. Try to determine the country's need for your product, because the higher the priority, the lower the CT demand. Eastern European imports fall into four categories:

   - priority (which will permit the country to generate or save foreign exchange)
   - planned
   - extra-plan (goods needed because of poor initial planning)
   - non-planned

   For the first two categories, all or some of the hard currency has already been allocated; thus they are subject to the lowest CT requirements. Extra-plan goods are usually subject to stiff CT demands, but, because of their emergency nature, sellers are offered CT products readily marketable in the West. Non-planned imports, usually consumer goods, are generally subject to 100 per cent CT.

   Do not expect the Eastern European negotiator to let you in on the category. This is one of his best bargaining tools. You will have to rely on educated guesswork. Look at the five-year plan and annual import schedules for clues. You may also determine the priority by ascertaining the use to which your product will be put.

   Unless your goods fall into the non-planned category, you will probably be able to cut the initial CT demand, sometimes in half. Generally, firms entering an Eastern European market are expected to accept a higher CT percentage than those with established relationships.

6. Be sure that your final CT commitment is stated as a specific figure, not as a percentage of your sale.

7. It is vital to have separate contracts covering your sales to the country and your purchase of Eastern European goods. Two contracts are not only regarded as independent legal instruments, but allow for different settlement maturities and for higher Western export-risk insurance and financing. Also, in the event of a dispute over the CT goods, the details of your sales contract will remain secret. A single document leaves the Western seller vulnerable to manipulations on the part of the FTO.

8. When drafting the CT contract, be sure to include a provision for its possible transfer to a third party.

9. Finding suitable CT products is one of the trickiest parts of the negotiations. The canny MNC bargainer should avoid showing enthusiasm when he finds a product with good sales chances, otherwise the Eastern European side may decide to market the product itself and make it unavailable for CT. Furthermore, do not disclose the name of the final buyer for the CT goods (assuming you will not use them in-house), so that the FTO cannot approach him directly.

10. When negotiating products selection, ask the FTO for its own list of CT goods. It may contain only ten to twenty products, but they will probably be available. Do not negotiate on the basis of standard printed lists because these are usually out-of-date. If you want products handled by more than one FTO, you will have to get a list from each.

    It is important to negotiate as wide a choice as possible. Do not accept products from a single Eastern European supplier unless the availability of specific goods at competitive prices is guaranteed in writing. Avoid products that require registration or after-sales service.

    Explore the possibility of buying services to fill your CT commitment. Tourism, transportation, design, drafting, and printing services are becoming available.

11. Make sure that the validity of your CT commitment is contingent on the execution of your primary sales contract and on the availability of suitable CT products at competitive world market prices within a stipulated period after the order is placed.

Source: Business International, May 16, 1980.

CANADIAN TRADING HOUSES WITH INTERNATIONAL EXPERIENCE AND INTEREST IN COUNTERTRADE

1)	Alcan Trading Ltd.	- barter silicon, electrolytic manganese and other products
2)	Agro Company Canada Ltd.	- barter in oil seeds, oil nuts, cereals, and animal foods to CMEA, Hong Kong, Taiwan, Korea and Sri Lanka
3)	Bethune Import-Export Ltd.	- barter in food commodities
4)	British Metal Corporation (Canada) Ltd.	- Considers barter transactions involving <u>any</u> natural resource commodity
5)	Calkins-Burke Ltd.	- interested in all Asian markets, preferably in food products
6)	Canadian Packers Ltd. - International Trade Division	- interested in barter
7)	Canada Wire & Cable (International) Ltd.	- barter can be negotiated on request
8)	Canficorp (Overseas Projects) Ltd.	- has experience in barter with Eastern Europe, Middle East, Far East and other markets
9)	Canalux Ltd.	- will barter all products in Communist countries
10)	Commodity Trading (Canada) Ltd.	- experience in barter
11)	Chisholm Ltd. R.A.	- bartering experience mostly in agricultural products
12)	Cometals (Canada) Ltd.	- experience in bartering metal in Eastern Europe
13)	Cotts (canada) Ltd.	- bartering experience in agricultural products, tea, coffee, cement, oil
14)	Coutinho, Caro & Co. (Canada) Ltd.	- East Germany - capital goods supplied, steel received
15)	Gibbs Nathaniel (Canada) Ltd.	- foodstuff to the U.K.
16)	Hollander Canada Ltd.	- experience in bartering all general commodities and manufactured goods with Eastern European countries
17)	IMPECO Foreign Trade Company Ltd.	- barter experience in South America and Eastern Europe
18)	Imex	- foodstuffs and baking products to Middle East, Africa, and Far East
19)	Intercenti Trading Ltd.	- some experience
20)	Interimco Ltd.	- interested in barter
21)	Interstock Industries Ltd.	- experience in bartering agricultural products
22)	Intrafima Ltd.	- experience in barter
23)	C. Itoh & Co. (Canada) Ltd.	- experience in barter in all products

*The firms listed may not undertake all types of countertrade transactions.

24)	Kaiser Trading Inc.	- experience in bartering chemicals and metals world-wide
25)	Kar Wah Trading Co.	- experience in Asia and West Indies
26)	Landspan International of Canada Ltd.	- experience in barter
27)	Lewis & Peat (Canada) Ltd.	- experience in bartering fine chemicals, machinery and equipment
28)	Marlyn International Trading Ltd.	- experience in barter
29)	Nemec Agricultural Consultants Ltd.	- experience in barter for clover and seed
30)	Neos Forest Products Ltd.	- barter experience in lumber
31)	Phillipp Brothers (Canada) Ltd.	- barter experience in metals, chemicals, minerals and related products
32)	Richardson & Sons Ltd.	- some experience in barter
33)	Tat Trading & Transport Corporation Ltd.	- experience in crude oil and petroleum products
34)	Tatex Ltd.	- experience in bartering electronic calculators and office equipment with Eastern European countries
35)	Trans World Distributors Corporation	- experience in barter
36)	Universal Marketing Agencies	- experience in bartering textile materials and consumer goods in Caribbean
37)	Webster Limited, G. Stephen	- barter experience in perishable products

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