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Current Information Series No. 724

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Countertrade: Is It the Answer For Agricultural Exporters?

James R. Jones, Agricultural Economist

A variety of international trading arrangement known as **countertrade** began spreading in importance after the oil shock of 1973, and it has been gaining further momentum with the recent world recession and international liquidity crisis. Countertrade involves a contractual form of business where exports are tied to reciprocal purchases of goods from the importing country in question.

Countertrade arrangements have been an important element in trade dealings with Eastern Europe and the Soviet Union for several years. Developing countries in Latin America and Asia are also turning increasingly to countertrade. One source estimates that countertrade deals in various forms account for an estimated $400 to $500 billion annually or between 20 and 25 percent of the total value of world trade (U.S. Department of Commerce 1982b).

In today's agricultural export markets where buyers increasingly find themselves strapped for cash, export firms may find that a willingness to accept countertrade commitments is a prerequisite to making sales to an increased number of overseas buyers. Countertrade has had limited application to agricultural export sales, but it can't be precluded from possible future trade dealings. Recently, Indonesia tried to impose such terms on the Australian Wheat Board, and Thailand swapped corn and other feed grain ingredients for fertilizer with the Soviet Union, Romania and South Korea in 1981. U.S. pulse exporters have been approached to import coffee beans. In the future, the ability and willingness to engage in business dealings on such terms may present a competitive edge to an export organization over other potential sellers. The following discussion, however, points out that any party contemplating such a strategy needs to be aware that serious pitfalls in these arrangements are frequently encountered.

Countertrade's Attractiveness To Some Importers

Countertrade is appealing to overseas buyers for several reasons. Countries which transact trade via state trading enterprises such as China, Eastern Europe and many developing countries have stressed use of countertrade in their commercial dealings with firms in the industrialized world for short-term balance of payments and long-term market penetration reasons (Mathson et al. 1977). Countertrade is viewed as a means of generating or conserving hard currency through offset deliveries provisions of countertrade contracts.

Secondly, these countries recognize their own lack of success in penetrating the industrial Western countries' markets. They see countertade as a way to gain access to these markets by using the marketing capabilities and access of export firms located there.

Besides circumventing foreign exchange problems and offering a marketing strategy, countertrade practiced as a direct barter exchange is also a way that countries locked into overvalued fixed exchange rates may bypass exchange rate distortions. By direct trading, the price distorting effects of overvalued fixed exchange rates can be bypassed.

Finally, to the extent that the reciprocal nature of trade is more apparent in bilateral countertrade ar-

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rangements, countertrade might help subdue protectionist sentiments. The offsetting import transaction is obviously a necessary part of the export transaction, and thus the two-way nature of trade might conceivably be more recognizable.

Forms of Countertrade Transactions

Several forms of countertrade transactions exist (Verzariu 1980). The major types of countertrade are counterpurchase, compensation arrangements, switch transactions and barter.

- **Counterpurchase** is a form of countertrade involving matching deliveries of goods as payment for goods exported to foreign buyers. Exports and imports are ordinarily transacted via separate but linked cash contracts. The value of imported goods may be less than the value of the goods sold by the exporting firm depending upon the terms negotiated by the two parties. Counterpurchase is the form that would most likely be relevant to agricultural export organizations.

- **Compensation arrangements** (also referred to as buy back arrangements) involve payment for exports from resultant goods directly derived from goods or technology exported. Counterpurchase arrangements, on the other hand, usually involve nonresultant goods. Compensation arrangements have proven useful in trade transactions where the importing country has raw materials (such as energy and other mineral resources) needed in the exporter country or abundant cheap labor, and the export firm is able to provide technological assistance, capital equipment or other inputs to be used in manufacturing products based upon those inputs. Compensation trading applied to U.S. agricultural exports could involve U.S. firms selling commodities such as grains and oilseeds and buying back livestock products. A broader cooperative arrangement might involve developing energy sources and buying back resulting products such as fertilizer and petroleum products as part of a long-term agricultural export agreement.

- **Switch transactions** are based upon multilateral (more than two countries) use of bilateral clearing accounts. These are essentially financial transactions primarily used between socialist countries or less developed nations whose currencies are nonconvertible.

- Countertrade is frequently described as a form of sales for which payment is made by some means other than cash, but this is misleading since all of the above arrangements involve swaps expressed in monetary terms. The **barter** transaction is still another method in countertrade. It involves the direct exchange of goods without any money being involved. Barter and countertrade are sometimes used interchangeably, but strictly speaking, barter is a special version of countertrade.

Countertrade Procedures

If a U.S. firm or export organization were to do business with foreign buyers via a countertrade arrangement, it should be aware of certain basic procedures. The complex nature of such arrangements precludes adequately treating all the details and nuances that would be involved in such arrangements, but the more common elements can be summarized to highlight what would or could be involved if countertrade terms were accepted as a basis of selling agricultural products to overseas buyers.

A common and advisable procedure is to draw up separate contracts covering the export and import commitments. A delivery clause should be included to take the U.S. party off the hook if the designated supplier in the buying country fails to meet delivery and/or service conditions on the goods accepted as countertrade items.

Third party trading houses are frequently used in countertrade transactions. Locating products that a U.S. exporting firm could agree to accept as partial or complete payment for a sale to an overseas buyer is difficult since the firm is seldom in the business of selling or using the products imported. Developing the staff and organization necessary to do this may not be feasible. This problem is confronted frequently by firms, and a fairly common way of getting around it is to use third party trading houses that specialize in disposing of goods acquired in countertrade transactions.

If a trading company or some other third party is included in negotiations and/or disposing of goods accepted in countertrade, its role should be spelled out in the contract. For instance a common procedure is for the third party to issue a "serious indication" document indicating its willingness to assume the countertrade commitment of a specified commodity at a designated cost under the condition that certain specifications, clauses and other conditions be followed in drafting the countertrade commitment contract with the overseas buying agency (Business International S.A. 1979b). This permits the seller to proceed with negotiations knowing the terms under which it can dispose of the countertrade items.

Also when a third party trading house is to be involved in locating countertrade goods, the contract should include a "transfer clause" specifying that once the countertrade products are located by the trading house, the purchase contract can be linked explicitly with the original export sales contract and countertrade commitment (Business International S.A. 1979c).

If agricultural export companies are dealing with a product that is high enough on the import priority of the buying country that its foreign trade bank has set aside hard currency to meet the importing foreign trade organizations' needs, legally binding countertrade contracts would usually not be a prerequisite to doing business. An alternative is to sign a "letter of intent." This amounts to a "gentlemen's agreement" be-

tween the buying agency and the U.S. exporter that the latter will undertake to purchase products from the country within a certain time period provided they are available on suitable terms.

Such letters of intent are common in countertrade dealings with Eastern European countries. While the agreement is part of the original sales contract, it is only morally, not legally, binding. This indicates the willingness of the exporter to reciprocate on a sale. Apparently, letters of intent appeal to negotiators representing buying agencies at times since they can demonstrate to their superiors that they have negotiated a purchase that may also enhance the export efforts of their country.

You must be aware, however, that if such an agreement is later construed by the superiors to be a charade, it can seriously damage the reputation of the exporter (Business International S.A. 1979a). For this reason, such a letter of intent should be taken seriously by the U.S. exporter. Indeed since being able to locate suitable goods to be purchased under a legally binding countertrade agreement will be difficult, purchase will less likely be carried out. This raises the danger that the buying country's or agency's authorities will become disgruntled with the firm and even possibly blacklist it in future transactions. Several other pitfalls also exist that can be encountered in countertrade arrangements as the next section points out.

Countertrade's Limitations

While countertrade is becoming a more prevalent form of doing business and conceivably could be a useful export tool for agricultural products, you should not view it as a primrose path to business success. Trade packages of this nature can be difficult to orchestrate because of the problems of arranging reciprocal purchases and the inflexibilities associated with the state bureaucracy in many of the countries that advocate such trade.

The reciprocal feature of these agreements is especially cumbersome because it requires in some sense a "double coincidence of wants" between the buying and selling parties. The awkardness of doing business on a bilateral basis involving payment for goods with goods rather than money was observed by Adam Smith in his *Wealth of Nations* written in 1776. He noted that the "power of exchanging" becomes "clogged and embarrassed in its operation" when limited to a barter basis (Smith 1937).

Inherently, this is the single greatest obstacle to the success of countertrade. The difficulty of locating acceptable goods to take as payment for exports can be enormous. Unsaleable, out-of-date items often tend to get shuffled into countertrade. It is sometimes just as difficult to identify goods that the buyers might be willing and able to offer in countertrade as it is to identify goods that the seller is willing to purchase.

Typically, governments will not allow goods that are in high demand in industrialized country markets to be used as linkage items for countertrade purposes. Some firms have experienced having items that they previously had purchased to fulfill countertrade obligations suddenly disappear from the available list when the time to renew the annual contract came because that product was no longer deemed difficult to sell in hard currency markets.

If forced to take unwanted, inferior quality products, the exporter would have to sell them at a discount, and this necessitates absorbing the discount in a surcharge in its own sales price. Given the low margins associated with many agricultural sales, this could be particularly difficult unless the buying foreign trade organization made exception to its general rule of buying from the customer offering the lowest price. Foreign trade officials usually insist that they would be unwilling to pay a premium to accommodate such countertrade arrangements. Firms selling goods through countertrade arrangements do sometimes find customers willing to buy at higher prices if they take payment in kind, and this should not be ruled out completely in agricultural product trade since policies are sometimes fluid over time. Nevertheless, the problems for an exporter of working out an arrangement whereby it receives payment in terms of other goods are not inconsequential.

Because countertrade transactions are extremely complicated and require protracted study and negotiations before they can be promulgated, an exporting firm or organization must consider whether it can afford to devote a full-time staff and resources to these activities. Furthermore, larger companies may have an edge since the costs of these marketing activities can be spread over larger volumes of sales. Another reason that larger companies may have an edge is that large government trading agencies are involved normally on the buying side where countertrade is used. While smaller firms are not precluded from successful countertrade operations, they should bear these factors in mind.

Third party trading houses mentioned earlier may be a partial answer to some of the problems discussed, but drawbacks are associated with relying upon trading houses to dispose of countertrade goods. These organizations require a return for their operations that becomes one of the costs of the original sales transactions. Another problem is that in certain cases foreign agencies or governments specify that third parties cannot be used. It has been reported that involvement by trading houses is opposed at times by Eastern European buyers who want to deal directly with the principal because they harbor (mistakenly or unmistakenly) the impression that involvement of the third party increases the cost of their imports (Business International S.A. 1979d). Indonesia and other governments also require that the countertrade purchase be

made on a bilateral basis. In other words, these countries insist that their goods must go to the country from which the original purchase is made. This could restrict a third party trading house's ability to sell the goods. Another drawback is that if they delegate this task to third party trading houses, the seller's own negotiators are unable to master the intricacies of countertrade and are thus perhaps less proficient in conducting negotiations.

Trading houses willing to assume obligations to dispose of countertrade goods are not necessarily easy to locate. Not all trading houses engage in countertrade as their exclusive line of business. They themselves often find it more profitable to be engaged on the sales side of their client's transactions and view the assumption of countertrade obligations as a necessary step to obtain such accounts. In such cases using trade houses as third party intermediaries is sometimes more likely to be possible where the Western firm undertakes longer term commitments than on *ad hoc* deals.

Many of the buying organizations seeking countertrade deals are state trading bureaucracies, and this can be a problem. The rigidity and complexity often encountered in dealing with state trading bureaucracies is sometimes compounded by the fact that the buying agency and the agency providing countertrade goods are separate entities and may even be under the supervision of separate ministries. Such linkage arrangements are not uncommon in countertrade transactions, and in certain cases specialized trade organizations have been set up by overseas agencies to facilitate arrangements involving more than one agency or ministry. Nevertheless, to coordinate separate import-export organizations is a formidable task that can entail considerable resources and risks. In fact the actual buying officials have been known to view countertrade to be wasteful and time consuming, and barring external pressure from higher levels of authority, they themselves prefer to give lip service only to such schemes.

Countertrade's Potential To U.S. Exporters

Given the emphasis that many buying countries may place upon firms to agree to countertrade, exporters contemplating using this tool need to be familiar with the possibilities and drawbacks of such arrangements. The willingness and ability to accommodate or even initiate such arrangements could present a powerful marketing strategy to gain access to that market. The complexity, however, of such arrangements — together with the less than satisfactory record of many countries involved in being able to provide satisfactory quality, service and delivery terms alluded to above — would suggest that extreme caution should be exercised before entering into such arrangements. In short countertrade may be a "second best solution" at a time when payments problems preclude doing business otherwise. Under these circumstances, it offers a way of gaining access to markets which would otherwise not exist. Of course, to be profitable, countertrade, like any method of doing business, requires careful marketing research, evaluation and managerial skill in planning and timely execution.

Given the lack of countertrading experience on the part of most U.S. agricultural exporters, new arrangements may need to be considered to facilitate countertrading. A possible arrangement that might warrant study to see if it would facilitate U.S. export firms doing business overseas could involve a farmer's cooperative organization or an export trading company forming a counterpart foreign trade organization or department for purposes of dealing specifically with goods acquired in countertrade transactions. The organization could handle direct sales, countertrade, barter, switch deals, cooperative arrangements including technical assistance, joint ventures and other trade matters. This would permit pooling of resources and development of specialized trading skills to meet the unique needs of the trade. At the same time, it would allow member cooperatives or firms to spread the high cost of acquiring the expertise and facilities needed to carry out countertrade and other trading activities. It would expedite an export-import combination that could be useful in light of the hard currency problems and bilateral tendencies of many buyers. Such a centralized organization would perhaps also be in a better position to countervail any bargaining advantage possessed by overseas state agencies which act as centralized buyers and sellers. Farmland, the nation's largest farm marketing cooperative, has entered a joint venture (Farmland-Eaton World Trade headed by former Secretary of Agriculture Bob Bergland) that apparently is moving in this direction.

Private export trading companies with countertrade departments or similar trading capacities also may be willing to undertake such joint ventures with U.S. agricultural businesses. Many established firms and trading houses are entirely concerned with disposing of goods taken in countertrade or have special departments assigned to this task. Vienna, Austria, which is a center of East-West trade, harbors several trading houses that specialize in countertrade. Several other locations including Chicago, New York and San Francisco serve as headquarters for firms engaging in such transactions. These organizations for the most part have limited experience in agricultural trade since historically they have primarily focused upon manufactured goods and raw materials. Some multinational firms, however, are equipped to do countertrade that have organized separate departments or subsidiaries to deal with grain sales also.

The Swiss grain firm, Andre, created a subsidiary called Finco after World War II that specialized in barter, switch and other arrangements. A U.S. firm, Phillips Brothers, Inc., which has entered the grain

trade relatively recently, has an autonomous department that specializes in countertrade deals. The Japanese international trading houses (Sogo Shosho) are at times involved in grain and countertrade transactions also. Some speculation has occurred that similar U.S. trading houses that will handle countertrade will develop under the auspices of the Export Trading Act of 1982 (U.S. Department of Commerce 1982a).

A recent announcement said a Portland bank is forming what would be the first export trading company in the Pacific Northwest (Pacific Rim Intelligence Report 1983). The bank has merged with an established export management company to form a new trading company exporting agricultural products such as fruits, vegetables, canned goods and seafood along with forest products and other products. It also plans to engage in imports. Several other Northwestern banks, ports and national corporations are forming or proposing formation of export trading companies with countertrade departments. Thus a number of options may avail themselves to agricultural exporters in the future.

In summary, world economic trends and practices coupled with new export trading organizations have brought countertrade arrangements to the forefront as a possible marketing strategy to be exploited by agricultural exporters. Since this form of trading is associated with many idiosyncrasies, however, careful study and planning must be combined with skillful management if countertrade is to be successfully implemented.

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Acknowledgment

This publication is based upon research and interviews supported partially by funds from the USDA Farmers' Cooperative Service and Oregon State University, Sea Grant Project R/UI-5.

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1500 12-83

45 cents per copy