1. Introduction

Businessmen, particularly those engaged in East-West trade, have participated in various forms of countertrade for years, but it is a phenomenon new to United States policy-makers and lawyers. The latter two groups are just beginning to fit this form of international exchange of goods into the framework of their respective disciplines. Interface IV brought together businessmen, policy-makers, lawyers, and scholars to discuss the promise and problems of countertrade, particularly between East and West. This introductory paper is designed to give a brief description of countertrade and to raise some questions for consideration by the Conference participants.

Countertrade is the practice of linking imports of goods (typically by an East European country) to exports to the country of the supplier (typically an OECD country and usually to the same supplier). Countertrade may take the form of barter: goods for goods without the intervention of money. More commonly the transaction does involve money, but conclusion of the import contract is conditional upon conclusion of an export contract. Payment for the imports is often effected, at least in part, through an offset arrangement crediting the value of the goods sold under the linked export contract. When deferred payment or credits are involved, the arrangements become more complicated, but the essential features remain the same [1]. Countertrade can also take the form of “buyback” or industrial compensation arrangements. Such arrangements typically call for a Western enterprise to invest capital in, or lease technology in, Eastern Europe, and then to purchase a certain level of the product of the investment or technology. The most ambitious example of such an arrangement to date is that under which Western nations are to furnish capital, technology and equipment for a transcontinental pipeline linking Siberia with Western Europe, in return for commitments by the Soviet Union to sell natural gas to the West. Countertrade exchanges of capital and
tion, while the more typical countertrade transaction involves a single purchase and counterpurchase or a series of orders and counterorders to be completed within 18 to 24 months.

2. Advantages and disadvantages

2.1. The view from the East

The advantages of countertrade for an Eastern European country are that it enables the country or a trading organization in that country to purchase goods from the West with a saving of foreign exchange, and to sell output that might not otherwise be saleable. One effect of countertrade, whether incidental or intentional, is the recognition and acceptance of Eastern products developed by using Western firms as sales agents. The Eastern country’s hope is that, by the time its Western trading partner’s obligation to purchase and dispose of the tied products terminates, its products will be able to continue their penetration of Western markets without assistance. A third advantage of countertrade may be that it facilitates more accurate long-term planning than sales projections not based on firm buyer commitments. Fourth, buyback arrangements may facilitate obtaining credit for construction of plants, pipelines, etc. from Western banks that, in the absence of such agreements, would not (and in some cases legally could not) be given. Finally, long-term countertrade arrangements may protect the export position of East European countries in the face of Western countries’ (particularly the European Economic Community’s) quotas, dumping investigations, “voluntary restraints”, and the like.

The principal disadvantage of countertrade, stressed, for example, by the Hungarian authorities, is that countertrade enables Eastern goods to be sold in the West without achieving world-competitive quality. If the Eastern goods were fully competitive, the argument goes, there would be no need for tied sales. Furthermore, the Eastern critics of countertrade say that by conditioning their purchases from the West on countertrade, enterprises in the East overpay for the products they purchase and deprive themselves of the full range of possible bidders.

The Eastern nations’ attitudes toward countertrade are far from uniform. Most of the countries of Eastern Europe appear flexible, engaging in countertrade wherever possible, but not excluding other forms of trade. Rumania, on the other hand, made the linkage of exports and imports mandatory for foreign trade enterprises when it faced a large trade deficit and foreign exchange debt in December 1980. Rumania appears to be seeking not only an overall balance of exports and imports, but a balance by sectors and even by industries. The Soviet Union has engaged in huge countertrade transactions, such as its arrangement with Occidental Petroleum exchanging ammonia for superphosphoric acid, and natural gas for assistance in building the natural gas pipeline,
but apparently does not encourage smaller or shorter-term countertrade transactions. Hungary, which has the most decentralized economy of the Eastern European Communist states, has tended to discourage countertrade.

It seems that single enterprise countertrade agreements, except buy-back arrangements, are rarely possible for Soviet-style foreign trade organizations. Yet the binding nature of long-term buyback arrangements is inconsistent with the drive in some countries, notably Hungary, for enterprise autonomy in international trade. Countertrade may be more suitable for foreign trade organizations' management of their obligations under governmental foreign trade plans than it is for individual enterprises’ control of their own ongoing business affairs.

2.2. The view from the West

Between 80 and 90% of countertrade arrangements are made on the initiative of the Eastern partner. Nevertheless, Western firms would not engage in countertrade if they did not, on the whole, find it profitable. The main advantage, of course, is that an export sale is made that otherwise would not be made. To take a striking example, McDonnell Douglas was prepared to accept Yugoslav hams in partial payment for jet aircraft sold to Yugoslavia's national airline. Furthermore, a long-term supply relationship may be established through countertrade that might be foreclosed without such an arrangement.

Countertrade may provide a number of quantifiable benefits to Western trading partners. To the extent that countertrade involves transfer of production to Eastern countries in return for a portion of the output, countertrade may be a way of reducing production costs. Where the countertraded products can be used in the Western firms’ own production, the countertrade may also reduce the Western firms’ input costs. Such arrangements may also provide an additional measure of security for Western banks financing exports to the East. Finally, the ratio of the quantity of goods taken by the West to that of goods delivered to the East is generally negotiable. The stronger the Western firm is, for example as a favored supplier in terms of quality, reliability, or price, the greater is its ability to influence the countertrade quota required by the East.

The disadvantage of countertrade most often cited by Western enterprises is difficulty in selling goods received from the East. In some instances the goods are of inferior quality; in others, the burden of creating a market for the Eastern goods has proved onerous. Some firms seem able to calculate the costs of countertrade arrangements and cover them in their export price. Nearly all firms report that the red tape and delay associated with East–West trade increases when countertrade is involved.

From the standpoint of domestic politics and economics, countertrade poses problems in addition to those generally associated with East–West trade. Imports under countertrade arrangements can lead to market disruption by
"unnaturally" affecting price and employment conditions. Dumping, in particular, is made even harder to detect than usual by the absence of clear financial measures and the merging of producer/purchaser rates. Employment conditions, on the other hand, depend as much on the export as on the import of goods, and the impact of countertrade is little different from that of trade in general. Countertrade offers a mixed blessing from the perspective of the domestic economist, and its evaluation may depend upon whether the evaluator is more inclined to view trade as a political tool or a system for efficient allocation of resources. As a matter of national policy, countertrade offers a substantial avenue for creating and strengthening East-West economic relationships. On the other hand, countertrade may well work to distort the market's function as an indicator of comparative advantage, in part because countertrade is bilateral rather than multilateral, and in part because countertrade masks differences in price and quality as well as the cost of credit.

Apart from these general considerations of trade and financial policy, countertrade or compensation agreements may affect supply and demand for particular goods in a manner of great political concern. For example, the Soviet pipeline countertrade arrangements create a degree of risk weighted differently by the United States and the West European nations, arising from the perceived need to safeguard Western technology and to prevent resource dependence upon a nation which might one day use them to the West's disadvantage.

3. Countertrade and the Western firm

Western advisers often suggest that countertrade sale and purchase arrangements be embodied in separate contracts. They fear that if both sets of obligations are contained in a single contract, even an excused failure by the Western purchaser to carry out its obligation to the Eastern seller might be deemed by the Eastern purchaser to entitle it to withhold payment for goods already received from the Western seller. On the other hand, single contracts may be advantageous if one party is wary of the reliability of the other and wishes just such an escape mechanism expressly added to the agreement.

All persons experienced in countertrade advise that both parts of a countertrade arrangement be negotiated simultaneously. If the export transaction from the West is negotiated first, and price, credit, and delivery terms are established, it may become impossible to incorporate the costs of the subsequently proposed counterpurchase into the calculation of the export price.

Simultaneous negotiation can result in adjustment of other terms of a countertrade agreement. For example, the percentage of the value of the Western firm's sales that must be balanced by a counterpurchase, the compensation ratio, generally is negotiable. A study of intra-German trade re-
ported that in two-thirds of reported cases the East German party demanded a compensation ratio of 75%, but that such a ratio ultimately was agreed upon in only 10% of the cases. In more than half the cases the final figure stood at about 20–30%. Trade between West Germany and other East European countries showed less disparity between initial demands and final figures, with the final compensation ratio typically agreed to somewhere between 20 and 30% [2].

Eastern European foreign trade organizations often have been willing to make quite general counterpurchase arrangements (like the protocols between Foreign Trade Organizations of different COMECON countries) requiring the Western trading partner to purchase a stated dollar value of products offered by the Eastern party within a given time period, without specifying the products or their prices.

Western firms not experienced in East-West trade may have little basis for judging the quality of counterpurchase products. A growing number of West European international trading companies are filling this information gap by acting as consultants on the quality, reliability, and saleability of products offered by East European countries and by agreeing to sell or buy products involved in the proposed arrangement.

4. The policy options

As indicated earlier, one can recognize two types of countertrade agreements: very large-scale arrangements, typically with the Soviet Union, for natural resource production; and smaller-scale industrial products arrangements, typically with one of the six European members of COMECON. Policies regarding the former go well beyond the scope of this paper or this Conference, to the very heart of the cold war/detente dilemma, the relation of East-West trade to the Middle East crisis, and unity in the Western Alliance. In the early 1970s, the United States considered large deals for natural gas combined with cryogenic conversion plants and freezer ships, but discarded the idea. As of 1982, Western Europe seemed to favor such deals, with or without United States technology.

One policy option would be to adopt no governmental policy, letting firms make their own decisions. The latest OECD study on Recent Developments in Countertrade warns against such a policy:

It is...possible...that the decisions each firm takes according to its own interests will not be coherent, and that they will not be in line with what might have been the general interest of OECD countries in their relations with the centralised economy countries. The question therefore needs to be raised whether Western countries can remain passive in the face of a development whose rate is beyond their control and which might ultimately strengthen the trading position of the Eastern countries without the latter having had to give anything adequate in return. In addition, it may be
wondered if, by adopting a passive attitude to this phenomenon, industrialised countries would not indirectly encourage its extension to areas of international trade other than East-West [3].

In addition to the concerns expressed by the OECD study, toleration of individual decision-making on countertrade may lead to additional areas of competition among the industrialized countries, for example competition for extended credit terms. On the other hand, attempts to regulate countertrade in nonstrategic commodities would involve commercial decision-making philosophically distasteful to Western governments.

Consideration might be given to developing uniform policies within the West, possibly in the form of standard countertrade guidelines among the OECD countries. Such guidelines might address a variety of concerns: the types of items which should be excluded from countertrade arrangements (e.g. items being supported in the West, items subject to import restraints, or items subject to dumping/subsidy investigations); the mechanisms for measuring the real price of counterpurchase items for purposes of import duties, dumping/subsidy laws, or market disruption analysis; the means of measuring and comparing credit terms, when associated with counterpurchase agreements, etc.

Each of these questions raises issues of policy not yet resolved in individual countries, let alone on a multilateral basis. The hope of Interface IV is to make a start at addressing these issues, as well as others which will be raised in the course of discussions of this and other papers presented.

Notes

[1] We do not deal here with the various forms of offset arrangements that have become common in respect to major arms purchases among the parties to NATO. The similarity of such arrangements to countertrade in East-West commercial arrangement is apparent.

