Chapter 2 GENERAL ISSUES AND CHOICE OF STRATEGY

2.1. Why Countertrade?

It should never be assumed that countertrade necessarily involves benefits for developing countries and the reasons why any country engages in countertrade should be examined very closely.

At a greatly simplified level it is often possible to distinguish developing countries which:-

(a) countertrade in order to export
(b) countertrade in order to import.

Obviously, every countertrade transaction, by its very nature, involves both import and export but it is often possible to distinguish a country's primary motivation.

Case (a) is typified by countries which use the "muscle" of their purchasing power to force trading partners to take out some of the country's exports. This particularly relates to counterpurchase.

Case (b) is typified by countries which are in a severe financial position in terms of balance of payments deficit, debt, foreign exchange shortage and non-availability of credit facilities. Such countries have enormous difficulties in financing imports through conventional channels and turn to countertrade as a means of paying for imports. This is why countertrade is sometimes referred to as an alternative form of trade finance.

In fact, the idea of a spectrum could be developed with the motivation to export at one end and the motivation to import at the other. A country such as Indonesia, which operates a mandatory counterpurchase policy, would be placed well towards the "export end" whereas many countries in sub-Saharan Africa would be placed more towards the "import end".

The various perceived objectives of countertrade are described in the following paragraphs in greater detail and are grouped under three headings. A country may pursue one or several of the objectives at any one time. The extent to which the perceived objectives are actually realistic is discussed in greater detail in later sections.

(i) Export Related Objectives

(a) To increase exports by using the country's import purchasing power to "twist the arms" of foreign suppliers by making the award of import contracts conditional upon an agreement to take some reciprocal exports.

(b) To increase exports by countertrading with "cash-poor" trading partners (perhaps in other developing countries or in the Eastern bloc) which would not be in a position to purchase the country's goods for foreign exchange.

(c) To increase exports of "distressed commodities" which the country is having difficulty in selling because of depressed world market conditions.

(d) To achieve incremental exports by insisting that countertraded exports are destined for "new" markets or for "new" customers in established markets.

(e) To encourage increased exports of "non-traditional" export items.

(f) To use countertrade to help in the establishment of new markets for the country's exports which will later be replaced by commercial export sales.

(ii) Import Related Objectives

(a) To enable countries experiencing severe foreign exchange shortages to import raw materials, spare parts and other goods which it would not be able to purchase on usual commercial terms. In this case countertrade is viewed, primarily, as a means of financing imports.

(b) Further to (a), to enable local industries which are in danger of closing down because of shortages of raw materials and/or spare parts to obtain those imports and thereby stay in existence.

(c) Further to (a), to avoid using some export earnings for debt repayments by tying these export earnings to an equivalent value of imports.

(d) To develop a wider range of sources of imports.

(iii) Other Objectives

(a) To achieve a balance of import and export trade with particular countries.

(b) To encourage foreign investment in the country by allowing the export revenues from the sales of the output of the project to repay the invested funds (buy-back).

(c) To encourage increased local production by requiring foreign suppliers to source components or other products within the purchasing country (offset).

(d) Further to (c), to secure technology transfer objectives.

(e) To enable trade to take place with foreign partners and/or countries which are only prepared to trade on a reciprocal basis.

(f) To contribute to debt repayments (when debt is paid in export products).

(g) To develop intra-regional trade, either through bilateral arrangements or regional clearing houses.

2.2. Strategy Options

As already noted, the motivation for engaging in countertrade is involved with one or more of the aims of increasing exports, ensuring a supply of imports or achieving broader development objectives. It is important for developing countries to have a clear idea of the objectives they are trying to pursue and then to consider the various strategy options, set out below, in the context of the best way of achieving those objectives.

However, in the first place, it is important to question whether or not the objectives can be achieved without countertrade. If an alternative course exists it is likely that it will be preferable to countertrade. A maxim adopted in some countries is "if our exports can be sold for cash then they should be sold for cash". In other words, it is argued that exports should only be allowed for countertrade if they are products that the country faces some difficulty in selling.

On the assumption that countertrade is seen to offer the possibility of certain benefits, there are a number of basic strategic issues which policy-makers in developing countries must confront prior to making the appropriate policy decisions.

(i) Proactive or Reactive Policy

In practice, most developing countries adopt a combination of the two policies, whereby they both go out in search of countertrade opportunities as well as responding to suggestions for deals from other countries and/or organisations.

(ii) Mandatory or Non-mandatory Policy

This particularly applies to countries which operate the counterpurchase form of countertrade (refer to section 3.3.1). An example of a mandatory policy is that introduced by Indonesia in 1981, profiled in Appendix 5, which stipulates that all non-aid funded imports exceeding a value of 500 million Rupiah by Indonesian government organisations must include an agreement by the supplier to take out an equivalent value of Indonesian goods.

Most developing countries, however, have opted for a non-mandatory policy whereby countertrade is accepted as a possibility but is not obligatory. Two countries which have introduced a non-mandatory counterpurchase policy, whereby foreign suppliers may include countertrade in their tender bids but are not required to do so, are Malaysia and India, both of which are also briefly profiled in Appendix 5.

(iii) Long Term Agreements or Ad Hoc Deals

Many developing countries become involved in both long term and ad hoc transactions whereas others have a distinct preference for one or the other. Zimbabwe, for example, has refused to become involved in long term arrangements, arguing that it wishes to retain trading flexibility for its exports according to changing market conditions. On the other hand, some countries, such as India, have entered into several long term agreements.

Long term may be regarded as in excess of one year. For example, many government to government agreements, such as those favoured by Eastern bloc countries, run for a term of five years. Ad hoc deals, typically, are organised on a "one-at-a-time" basis. Increasingly there are also a number of medium term arrangements, often based on one year agreements, for example, State Trading Agreements, which are described in section 3.3.3(b).

Several arguments can be advanced for and against long term arrangements, some of which are outlined in section 3.3.3(a).

(iv) Limited or Large Scale Involvement in Countertrade

Policy-makers should confront the question of what level of countertrade is considered desirable and realistic. There is some evidence to show that countries which attempt a massive transfer from conventional trade to countertrade suffer severe problems, not least the inability of the administrative system to cope with the changes. Some commentators both inside and outside Nigeria have suggested that the transfer to a countertrade policy in the period prior to August 1985 was attempted on such a large scale that it was likely to cause severe trading disruption.

Many countries, including Zimbabwe for example, have specified that they wish countertrade to account for only a small percentage of total external trade.

(v) Other Strategic Issues

There are a number of other issues of government policy to be resolved, most of which are discussed in greater detail elsewhere in the guidelines and are only mentioned here.

- Whether to establish specific government machinery for countertrade or to adopt an entirely case by case approach (refer to Chapter 8).

- Whether to engage in countertrade purely as a public sector activity or also to involve the private sector.

- Whether or not to specify countertrade partners by geographical or economic type, for example, Eastern bloc only.

- Which exports to allow for countertrade (refer to Chapter 4).

- Which imports to allow for countertrade (refer to Chapter 4).

- Whether or not to use the services of countertrade advisers and intermediaries (refer to Chapter 9).

2.3. Are all Developing Countries Suited to Countertrading?

The arguments for and against countertrade should be viewed in terms of the circumstances of particular countries. A countertrade policy suitable for one country may be entirely unsuitable for another. Having said that, it is possible to distinguish groups of countries, grouped on the basis of their economic characteristics, which are more suited to countertrading than others.

(i) Countries in a Favourable Position

- Countries with a diversified production/export base which can offer a wide range of possible export products for countertrade.

- Countries with a substantial import absorption capacity.

- Countries in a strong financial position so that all countertrade options are open. (Counterpurchase, for example, is not usually a possibility for "bankrupt" countries; refer to section 3.3.1.)

- Countries which import many goods and projects on commercial terms as opposed to aid-financed or soft loan terms.

(ii) Countries in a Less Favourable or Unfavourable Position

- Countries with a mono-product or limited production/export base which have very few products to offer for countertrade.

- Countries with a limited import absorption capacity.

- Countries in a very weak financial position.

- Countries which have accepted IMF loans and conditions which may be influenced by that organisation against countertrade. (In addition to a general antipathy to reciprocal forms of trade and a preference for multilateral trade, the IMF is also "anti-countertrade" because of the possibility that foreign exchange earnings, part of which might be used for repaying debts, may be held offshore and used instead for financing imports within countertrade arrangements. The extent to which the IMF or other international institutions have actively dissuaded developing countries from countertrading is not known.)

- Countries which receive most of their imported projects and capital goods from aid funds or soft loans where countertrade would, in nearly all cases, be inappropriate.

In summary, it appears that the developing countries which may be in the best position to benefit from countertrade are those with fairly developed economies (perhaps Malaysia and India might be examples), whereas those in the weakest position are those which are indebted, small and with a very limited production/export base. The dilemma is that the latter group may have the greatest need to discover and utilise unconventional forms of trading such as countertrade but, at the same time, may be in the weakest position to implement such policies successfully. Countries which turn to countertrade in desperation rather than in a planned and logical manner may well derive no real benefits.

However, as described in Chapter 3, the term countertrade covers a multitude of forms of reciprocal trading, and although some countries may be in a weak position to benefit from countertrade in general, they may still be able to select particular variants of the practice which offer genuinely beneficial opportunities.