Chapter 6 COUNTERTRADE COSTS

6.1. Introduction

It should be emphasised that countertrade is very often a high cost way of trading compared with conventional trade, and it is important that the costs and benefits of particular deals should be carefully weighed. It is sometimes argued that countertrade involves no incremental costs over and above the costs involved in conventional trade. Although this may be true in particular cases, it is important to know which additional costs may be incurred through countertrade so that checks can be made.

6.2. The Incremental Costs of Countertrade

The incremental costs of countertrade which may be additional to those incurred in conventional trade can take many direct or indirect forms. A common difficulty is the so-called lack of "transparency" of countertrade deals, which means that actual prices and costs are often not easily identifiable. A list is provided below of some of the possible costs which may arise in particular cases.

(i) Disagios (discounts) often have to be offered to the final buyers of countertraded exports in order to provide a purchasing incentive. In the case of traditional or long-established export items such as coffee, tobacco or metals, the discount offered to the final buyer may be very low or nil (in other words, sold at the prevailing world price), but in the case of non-traditional items or "difficult-to-move" exports the percentage figure is likely to be much higher. Discounts of up to 20 per cent or more may be required in order to dispose of some manufactured products, handicrafts or other items. Very often the developing country concerned will have no knowledge of the level of the disagios because the trading part of the deal is in the hands of intermediaries.

(ii) Lower export prices may be offered by some developing countries. It is usual for developing country exports to be invoiced at the prevailing world price for the product in question. Indeed, the countertrade contract may well contain some formula relating to the world price on a particular market, such as the London commodity market, on the day of shipment. However, there may be occasions when the developing country concerned, in realisation of difficult market conditions for a particular product, may be prepared to accept a lower contract price in order to advance a countertrade deal.

(iii) Higher import prices are the usual way in which developing countries "pay" countertrade costs. Very often the disagios and other costs are loaded on to the price of the import. It is common, for example, for the exports from the developing country to be priced at the world price level, but a higher price is paid for the countertraded imports in order to cover all the incremental countertrade costs. A possible alternative is for the foreign partner to absorb some or all of the costs.

(iv) Miscellaneous costs are usually incurred at various points in a countertrade deal. These may be incurred by various parties within the deal but, as noted in (iii), it is common practice for these costs to be passed on in the form of higher import prices for the developing country. The incremental costs which may be incurred by the foreign partner or by intermediaries include banking charges for special services, legal fees, consultancy fees and commissions paid to trading houses or other intermediaries. Within the developing country there may be similar expenses.

(v) Financing costs may often be incurred by developing countries, particularly for barter-style deals. These involve financing the interval between the export and the import. This can be an extremely important cost item; we know of one parastatal trading organisation in an African country, which is involved in many barter deals, which regularly has 50 per cent of its current assets tied up in countertrade arrangements and which pays substantial interest charges to cover the interval between its own export and the eventual receipt of funds after the import products have been received in the country. This is illustrated in the example of a deal using an escrow account in section 3.4.

In addition to the costs we have described, there are also many indirect or hidden costs of countertrade which should not be forgotten. There are costs involved in establishing and maintaining special units or committees. On the export side, a number of possible hidden costs relating to the displacement of commercial sales have already been noted in section 4.1. On the import side, there may be hidden costs involved in the loss of purchasing flexibility that results from engaging in reciprocal trading arrangements. For example, a country that enters a medium or long-term agreement to import oil as part of a countertrade deal may pay "the world price" for oil at that time but the flexibility to make cheaper purchases, perhaps on the Rotterdam spot market, is effectively removed if all the country's requirements are being supplied through the barter deal. Also, on occasions, there are the hidden costs of importing second level technology. Finally, there are all the costs involved in the time and effort of dealing with the large number of countertrade proposals which do not progress beyond the discussion and negotiation stages.

6.3. Ways of Limiting Countertrade Costs

Looked at from the point of view of developing countries, there are a number of ways of attempting to limit or eliminate incremental countertrade costs. There is considerable overlap between the points mentioned below.

(i) It is sometimes possible to negotiate deals where incremental countertrade costs are absorbed by the foreign partner, particularly if that foreign partner is fairly desperate to obtain the contract in question. An occasion is known, for example, where a Western tractor manufacturer faced the possible closure of one of its plants if a particular order was not won and, therefore, was prepared to sell tractors at the usual "conventional trade" price and absorbed the countertrade costs involved in the deal by reducing margins.

(ii) Some countries, such as Malaysia and India, have introduced a non-mandatory counterpurchase system based on tendering for contracts, the argument being that the authorities can choose the most advantageous bid, with or without countertrade, thereby making it unlikely that those which include countertrade in their bids will heavily load their prices with incremental countertrade costs. However, since the foreign suppliers who do offer countertrade are likely to incur some extra costs, it is also likely that they will try to include at least some of those costs in their bid.

(iii) Careful attention should always be paid to the pricing of both the export and, particularly, the import under countertrade deals. This point is repeated in section 10.2.

(iv) The level of disagios can be kept quite low by concentrating on the export of traditional export items. It is often claimed that basic commodities can be included in countertrade deals at no discount to the final purchaser, whereas quite large discounts may be required for selling non-traditional exports. (The counter-arguments relating to the advantages of countertrading non-traditional items and the disadvantages of countertrading basic commodities were presented in section 4.1.)

(v) Some opportunities for raising money within countertrade deals may arise which can be used to offset incremental countertrade costs. For example, interest is paid on the funds held in escrow accounts and partners in developing countries should be sure that they receive their full entitlement in such cases.

(vi) Countertrade costs are generally lower for deals in developing countries which are well organised for countertrade (as described in Chapter 8) and much higher in those countries which are badly organised. If the system works smoothly it is likely that the countertrade costs for all parties will be reduced.

6.4. Costs and Benefits

In nearly all cases, countertrade involves incremental costs which must be borne by somebody within the transaction, and in most cases the developing country bears at least some of the cost. Therefore, it is necessary to check whether the benefits of the deal outweigh the costs. Non-countertrade alternatives should always be assessed. For example, it may be economically more efficient to sell exports at a discount through conventional trade, and retain the freedom to purchase imports from whichever source is the most advantageous, rather than engage in countertrade.

On the other hand, there will almost certainly be occasions when the incremental countertrade costs are considered to be worthwhile. The attractions of selling an export and receiving an import with no net expenditure of foreign exchange may be considerable.