TRADE WITHOUT MONEY:
Barter and Countertrade

Leo G. B. Welt

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INTRODUCTION

The evolution from a simple system of barter to a complicated system of banking occurred over a period of thousands of years. In the process the concept of money—that is, paying cash for goods—evolved, improved, and finally reached the stage where today money is one of society's most important tools.

But our present monetary system is far from perfect. And as the worldwide financial situation worsens, and business risks and uncertainties multiply, it is imperative that we explore improvements and alternatives to the economic assumptions and principles that we have developed over the past millenia. It is the purpose of this book to suggest one such improvement and alternative—countertrade: a term that covers a variety of business arrangements in which payment is made by something other than cash.

What I am proposing here is *not* that we turn the clock back 360 degrees to a primitive system of barter—Manhattan, after all, can no longer be traded for glass beads—but rather that we adjust the dial only slightly, and regard countertrade as simply a new twist on an ancient but practical way of doing business.

Countertrade, unfortunately, has been subject to misinterpretation by bankers, trade commissioners, and government officials. Too often, the term is understood only in its most narrow sense: as a form of barter that is employed principally in East-West trade. Today the direction has changed to a North-South emphasis. Countertrade, as defined here, is really a much broader concept: one that encompasses many forms of compensatory trade—including counterpurchase, buy-back, triangular trade and swap—so long as there is always some kind of asset transfer as a condition of purchase.

Although some members of the world trade community may not like it, countertrade is growing rapidly. Estimates are that countertrade today amounts to one-third of world trade, or more than 700 billion dollars. The U.S. Department of Commerce believes that by the year 2000, one-half of all world trade will be under- taken via some form of countertrade. The companies that will benefit most from this growth will be those that are flexible enough to respond to the realities and demands of the marketplace.

In the pages that follow, I will clarify the different forms of countertrade and explain how the business community can take advantage of both present and future countertrade opportunities. I will describe how each of the major forms of countertrade may best be negotiated. Contract considerations will be discussed, with several case studies presented to illustrate the potential benefits of countertrade. Finally, attention will be paid to current government attitudes toward countertrade, as well as to the specifics of practicing countertrade in the Third World and Eastern Europe.

Countertrade, admittedly, is not the preferred way of doing business. Indeed, there are several problems with countertrade that cannot be ignored: countertrade requires more executive time, thereby increasing the cost of transactions. It creates additional legal work and distorts international trade. So, the obvious question is: why barter and countertrade?

The most compelling reason is that developing and socialist countries are currently unable to pay cash for the imports they need, because they cannot generate sufficient export income. The colossal foreign debt that plagues these countries is no closely guarded secret. It is estimated that their indebtedness currently totals nearly 820 billion dollars worldwide; and at its present rate of growth, will break the trillion-dollar threshold sometime around 1989.

Due to high interest rates on their loans, the developing countries are finding it increasingly difficult to make their interest payments. Many countries have been forced to reschedule their debts, seeking additional credit from the commercial banks in the industrial nations. Yet these banks, growing more and more nervous since August 1982, when Mexico announced it was on the brink of insolvency, have been tightening their lines of credit. International lending to developing nations dropped precipitously during 1983.

As a result, many of the debtor nations—most notably Brazil, Mexico and Argentina—have turned to the International Monetary Fund for assistance. But in order to be eligible for IMF aid, a debtor country must agree to strict guidelines that, while intended to improve international balance of payments and reduce trade deficits, can lead instead to any (if not all) of the following: sharp reductions of imports, shortages of hard currency, high inflation and growing unemployment. The inevitable result will be internal political instability. Throughout Latin America, where the crisis has been most severe, the signs are growing. Venezuela's government was voted out of power and Peru's lost heavily during a key election this year. Financial troubles were central issue in both cases. Brazil's foreign debt and how—or whether—to pay it is the most pressing issue polarizing that country. Trade unionists seeking wage increases may prove to be the most serious threat to Argentina's newly formed democratic government. Even Chile is feeling the debt crunch: the growing movement to unseat Gen. Augusto Pinochet grew this year in large measure to protest worsening economic conditions.

The developing countries are therefore caught in the horns of an explosive dilemma. If they try to meet the large interest payments on their loans from commercial banks, they will be spending a dangerously high proportion of their hard-currency earnings to do so. Brazil, for instance, is spending roughly 80 percent of its export earnings to service its foreign debt.

Moreover, there is growing domestic pressure on the governments of debtor nations not to pay the interest on these loans. In many cases, such as Argentina, the loans were negotiated by regimes that are no longer in power. The electorates of such countries are becoming less and less willing to sacrifice not only their local currencies, but also their jobs, to pay off the interest on debts incurred by a discredited government.

Equally chilling is the fact that the dangers of the debt crisis are by no means confined to debtor countries. Commercial banks in the developed world may be reluctant to extend additional credits to the debtor nations; yet they know that a default on the loans could lead to a collapse of the international banking system. Even the IMF is being challenged; on the one hand for its stiff guidelines that create unpleasant economic conditions in the debtor nations; on the other hand by the citizens of the creditor countries as shown by the recent struggle in the U.S. Congress over additional funding for the IMF. Taxpayers are unprepared to foot the bills for errors of judgement made by the banks. They are also distressed at the IMF's inability to solve the world's financial troubles.

Countertrade—trade without money—offers an escape from this precarious scenario. Countries that are rich in certain resources but short of cash can use countertrade to market their commodities and gain needed foreign exchange and technology. Jamaica has traded bauxite for needed food. Mexico and Brazil are exchanging oil for capital goods. Countertrade offers a way of paying for a developing country's ambitious program of industrialization without bankrupting its economy or destabilizing its government.

In short, the developing countries are looking toward countertrade as one of the ways to stay afloat in the current doldrums of international trade. Will government officials and members of the business community in the developed world respond to these needs? It is my hope that this book will help provide an answer in the affirmative.

In today's interdependent global economy, the U.S. must export to survive. We must meet the needs and conditions of developing countries for our exports, we must become flexible and plan for their countertrade demands. Members of the business community in Japan, Western Europe, and other parts of the world have already been responding to the realities of the marketplace. They have recognized that countertrade is a force in the world today that can be ignored only at the risk of losing sales to one's competitors. We, too, must be prepared to meet the countertrade challenge.

Chapter 1

THE IMPORTANCE OF COUNTERTRADE IN INTERNATIONAL COMMERCE

What is Countertrade?

When businessmen speak of countertrade, they are usually describing the practice in its simplest terms—trade without money. Although this description distinguishes countertrade from strictly cash-for-goods transactions, it fails to convey the variety and complexity of this mode of trade as it is practiced today.

For purposes of this book, "countertrade" means those modes of trade in which the seller is contractually obligated to purchase goods or services from the party, organization, ministry or country to which a sale is made. Also included under this definition are any commercial arrangements in which purchases are formally considered to offset sales. This includes such practices as evidence accounts and bilateral clearing arrangements as well as individual sales that involve an obligation to purchase.

In a typical countertrade transaction, the seller is a company from an industrialized nation and the buyer (who imposes countertrade obligations) is a trade organization in a communist or developing nation. The buyer will require the seller to take a percentage of the compensation in a form other than cash. The portion of payment in goods can range from five percent of the contract value or less, to 100 percent or greater. Countertrade transactions vary in complexity from seemingly simple direct barter of, for example, pig iron for oil, to extremely complex switches of credit among three or more nations.

However, only in rare instances today is countertrade actually conducted without the exchange of money. To use the analogy of farmers trading their goods, pure barter ("I'll trade you one pig for 20 bushels of corn") is not widely practiced. Rather, international countertrade today involves a countertrade of sales transactions ("I'll buy a pig from you for $20, but only if you agree to buy $10 worth of corn from me.") or a variation of this involving a buy-back of resultant product ("I'll buy a pig from you for $20, but only if you agree to buy $30 worth of pork from me when I slaughter the animal.").

International countertrade is a balancing act. By making sure that a foreign purchase is offset, at least partially, by a foreign sale, a buyer of Western technology, goods or services can limit the depletion of scarce hard currency on a transaction.

For these reasons, and others that will be discussed later in this chapter, developing and communist nations have found it attractive to impose countertrade obligations on Western imports as a solution to some of their most serious economic problems. Companies of the industrialized West, however, are generally less enthusiastic about this complicated and risky mode of business. In addition to the inherent difficulties of negotiations, drafting contracts, financing, risk management and, in some instances, disposing of counterpurchased goods, Western companies also balk at having to purchase goods not of the nature or quality they might otherwise purchase, and at often having to purchase these goods at inflated prices. Furthermore, since countertrade obligations do not always obey the laws of supply and demand, they can result in serious market disruptions. For instance, a manufacturer in the West will, in order to obtain a sale of his products in a developing country, concede to purchasing in return a specified, unrelated product. The Western firm will, subsequently try to sell a product for which there had, in fact, been no demand. The only purpose for selling the product is to dispose of the company's countertrade obligation.

Nevertheless, Western businessmen are overcoming their distaste for countertrade because they simply cannot afford to ignore the enormous markets in which countertrade has become a fact of life.

The Prevalence of Countertrade

Only five years ago, countertrade was an anomaly considered by international traders, particularly in the United States, as a primitive and archaic way of doing business. By 1981, 10 to 20 percent of the $1.2 trillion of international trade was being conducted through countertrade. Currently, some 50 percent of trade between the West and communist countries is tied to some form of countertrade.

Part of this increase is due to the direct correlation between world economic conditions and the use of countertrade. When the economic climate in the industrialized countries worsens, there is an automatic ripple effect on the economies of developing nations, whereby their export markets and, subsequently, their foreign exchange earnings are substantially reduced. In order to maintain some momentum in their development projects, developing countries continue to import technology and goods from the industrialized nations, by requiring the sellers to accept, in most instances, some form of countertrade. Of course, in times of economic prosperity, i.e. full foreign exchange coffers, when conventional methods of trade (cash for goods) are appropriate, the occasions on which countertrade obligations are demanded decrease. For Western exporters, moreover, favorable world economic conditions often help to effectively resist countertrade demands, simply by allowing manufacturers to consider alternative markets.

In the years ahead, however, countertrade will continue to be a fact of life regardless of short-term economic conditions in the West. Because of the economic policies pursued during the past decade by Third World and East European nations, whereby they maintained high levels of imports from the industrialized countries in the face of sharply increased energy costs, conditions that foster a need for countertrade will continue to prevail.

In addition, the practice of making countertrade demands on foreign imports is expanding geographically to the potentially enormous markets of the People's Republic of China and to the centrally planned economies of many developing countries in Africa, Latin America, and the Middle East.

Economic Pressures for Countertrade

Countertrade, especially in the form of pure barter, is certainly the oldest form of international trade known to man. Long before international monetary systems were developed, commerce was conducted through trading that took many of the forms of countertrade now in use, including barter, evidence accounts and bilateral clearing arrangements. Among the Mesopotamia clay tablets on which are inscribed the ancient Sumerian characters, one will find accounts of barter transactions.

Countertrade has been used to conduct international business when monetary systems break down under the pressures of war, extreme inflation, or other conditions that render trade in currency impractical or undesirable for a national economy.

The practice of countertrade first emerged on a large scale in this century after World War I. Germany used it during the Weimar Republic when its currency had become too unstable to use as a medium for foreign exchange and, by this method, helped nurse its war-ravaged economy back to health. Similarly, national economies of Europe reverted to barter and international clearing arrangements as a means to help recover from the devastation of World War II. In exchange for machinery components, for example, Germany was able to provide manufactured goods. France, in turn, was able to use its large agricultural base to provide food stuffs as payment for technology and equipment to rebuild its manufacturing industries.

The current era of countertrade is primarily a phenomenon of the past decade in the communist countries of Eastern Europe. With their non-convertible currencies, trade on a large scale with nations of the industrialized West is difficult under normal cash-for-goods terms. In addition, the central economic planning of these countries encourages policies that direct industrial and economic sectors to demand countertrade obligations on foreign imports. The reason is simple: inherent in centralized economies are production targets of all kinds, including exports. By requiring foreign trade organizations to demand countertrade in their contracts with Western companies, central planners are able to control the amount of imports relative to exports. The result of this control is a greater likelihood of meeting export target levels, enhancing prestige.

As the Soviet Union and other East European countries adopted ambitious industrialization plans in the mid-1960's, their need for capital goods from the West surged. With the expansion of trade relations with the West during the period of detente in the early and mid-1970's, these plans held the promise of increased exports to the industrialized world. The failure of their export capacity to keep pace with their foreign expenditures, coupled with the general slump of trade in the West, resulted, however, in serious balance of trade problems for most East European countries. By 1982, the combined hard currency trade deficit of the USSR and Eastern Europe had reached an estimated $12 billion.

With extremely lean hard currency reserves, East European countries turned increasingly to foreign credit in order to finance their deficits. The result was a five-fold increase in the net external debt of the countries in the Council for Mutual Economic Assistance from approximately $12 billion in 1973 to $58.5 billion by year-end 1978. By the end of 1981, Council for Mutual Economic Assistance (CMEA) net external debt reached $88 billion—an annual debt growth of 38 percent since 1973.

Although the imports of advanced plant and equipment (some 35 percent of total CMEA imports) and vital raw materials failed to bring about the desired increase in exports, CMEA countries have been unable to significantly cut back these imports. They are essential to the accomplishment of their much-publicized five-year plans, and are vital to the advancement of industrial modernization programs that have proceeded too far to abandon.

Faced with these grim economic conditions—serious trade imbalances with the West, soaring hard currency debts, the need for continued imports from the West, and a failure to increase hard currency exports—East European nations have had to limit hard currency imports to those of the highest priority, or those that are guaranteed to result in hard currency export earnings. Under these conditions, stern economic messages have come down to the foreign trade organizations of many CMEA countries to demand countertrade.

The same economic pressures that have led to the widespread practice of countertrade in Eastern Europe are increasingly having the same effect in developing countries and the People's Republic of China. For both non-oil exporting developing nations and China, aspirations toward industrial modernization are out of proportion to the ability to pay for it with hard currency. These countries' only recourse is to pay for hard currency imports with earnings from domestic exports. It is logical that they demand, when possible, import transactions that "pay for themselves," that is, foreign joint ventures and countertrade.

Lesser Developed Countries

Along with economic pressures, trends in industrial development in lesser developed countries (LDC's) have spurred demands for countertrade. Characteristic of these trends is a shift from agriculture and raw material production to the manufacture of light industrial goods, basic chemicals and steels, and relatively unsophisticated machinery. Total exports of manufactured goods from the developing world grew 11 percent annually from 1960-1975, according to World Bank figures, and are expected to grow steadily at a similar rate through the 1980's. This compares to a growth of the same product exports of only 7-8 percent in the industrialized West. Markets for these goods in the developing world, however, have not grown proportionately, and LDC's have not been able to capture needed market shares in the West.

At the same time, LDC's have suffered severe depletion of hard currency reserves caused by the enormous rise in oil prices. As a result, LDC's foreign debts have soared. At the end of 1978, the public hard currency debt of the 96 non-oil