

ADVANTAGES AND DISADVANTAGES OF COUNTERTRADE *

Jacques de MIRAMON **

1. Introduction

Countertrade practices have expanded during the past decade. Long associated primarily with East–West trade, they appear to be spreading to other areas. The international community, however, has not been effective in addressing these practices which are, in large measure, contrary to the basic tenets of free and multilateral trade. The Eastern countries had refused to discuss the matter with their trading partners until a meeting with Western countries at the U.N. Economic Commission for Europe (Geneva) in November 1981. Unfortunately, this meeting ended in a deadlock.

In light of the fundamental differences between centralized Eastern European economies and the decentralized Western markets, it is not surprising that the two sides have divergent opinions on countertrade. The Eastern European countries are almost unanimously in favor of such deals, the inference being that they find countertrade mainly to their advantage. Western opinion of countertrade, however, has been mostly unfavorable.

2. Reasons why the Eastern European countries find countertrade attractive

With few exceptions (*e.g.* Hungary), there has been no public discussion of the advantages and disadvantages of countertrade in the Eastern European countries. The ambiguity of the terms used, especially the confusion between industrial and commercial compensation, hinders constructive discussion. East-

* This note presents a brief outline of the main advantages and disadvantages of trade in the form of compensation deals. The arguments for and against this type of trade are discussed in greater detail in an OECD publication: *East–West Trade – Recent Developments in Countertrade* (Paris, 1981). The views expressed in this paper are those of the author and should not be attributed to the OECD.

** Head of Division II, Trade Directorate, Organization for Economic Cooperation and Development, Paris, France.

ern European countries support countertrade by invoking general arguments stressing its mutual advantages.

One underlying reason for support of countertrade by Eastern European countries is the nature of their governmental system. Countertrade facilitates management of the centralized system of planned economies and approximates the trading methods of the Council for Mutual Economic Assistance (COM-ECON) which operate chiefly by reference to volume indicators. It mitigates the unpredictable behavior of Western markets. Countertrade makes it easier to achieve a balance by industry or by country, enabling fulfillment of planned norms and resulting in bonuses for the responsible Eastern civil servants.

The unduly high demand for investment in Eastern countries requires imports of Western capital goods that lead to an imbalance of trade flows with the West. Countertrade enables the central government agencies to strengthen their control over economic transactors. By laying down fairly stringent countertrade ratios, Eastern European countries hope to moderate orders of capital goods payable in convertible currencies, and to encourage the centralized foreign trade agencies or firms to search more actively for market outlets for their goods. Countertrade is also a form of insurance against unforeseen events. If unplanned imports are required, the financial equilibrium will not be impaired if there is a requirement of compensation by sales.

Another reason why Eastern European countries favor countertrade is because it allows them to gain a foothold in the international trading network. In the context of restoring the trade balance, Eastern European countries use countertrade to overcome the poor competitiveness of their goods in the international marketplace. Pressure to link sales with purchases will continue until the Eastern European countries substantially improve the variety, quality, and marketing of the goods they seek to export.

Compensation can also help to resolve certain problems of access to markets in Western countries. The goods are marketed by an intermediary, sometimes in a third market, which may make it more difficult to allege "dumping" when the offered prices are low. Similarly, producers hope that Western distributors will find ways of avoiding import restrictions.

Eastern European countries stress that the industrial cooperation that results from countertrade contributes to the stability of trade relations with Western countries. It allows a greater degree of economic interchange with market economy countries without altering the centralized economic systems. Hence, industrial countertrade is promoted as a means through which Westerners may "invest" in Eastern Europe. In certain industries, countertrade deals facilitate the development of a complex subcontracting network, controlled by Western providers of technology and assistance. It should be recognized that these transactions may prove to be advantageous to the Western countries. This is clearly the case when the goods offered in exchange

by the Eastern European countries are raw materials and energy-intensive products.

3. Reasons why countertrade is unattractive to Western countries and their firms

Government authorities, as guarantors of the national interest, view countertrade differently than private exporting firms. Whereas exporters evaluate countertrade according to its ability to broaden their markets and increase profit, government authorities are concerned with trade policy implications.

From a trade policy standpoint, countertrade is a retreat from the progress achieved in the area of trade liberalization since World War II. It is a return to bilateralism at the very time when the international community is seeking to safeguard and promote a multilateral trading system. Countertrade, in essence, is a modernized barter system which disregards the progress achieved in international settlements. Moreover, it is a body of practices reminiscent of the war economies and partitioned markets. It is contrary to present policies that aim to secure the openness of markets and to facilitate the expansion of trade opportunities.

An increase in countertrade would lead to the creation of a special system in which the terms and conditions of trade would be decided unilaterally by the Eastern European countries. This system could result in discrimination and distortion since it would not be subject to either international rules or multilateral supervision. Because the bargaining power of the partners would depend largely on their economic muscle, large firms and powerful countries would have a distinct advantage. Moreover, the proliferation of countertrade deals could bring about more direct intervention by Western governments in trade negotiations with Eastern Europe in order to support their national firms. Once this occurs, a drift toward legitimizing countertrade by laying down operating standards is likely to follow.

Western government authorities must weigh these disadvantages against the possible advantages of countertrade. It is true that Eastern European countries may have few means other than countertrade to restore their trade balances and to improve their level of production. The pivotal question is whether the risk of spreading an undesirable trading system to countries outside of Eastern Europe is greater than the possible benefit to East–West trade.

Most Western firms view countertrade as a constraint imposed by the Eastern parties. The system complicates export procedures and increases the risks and costs of exporting. Apart from very large firms, exporters often do not wish to assume merchant functions in the resale of goods which lie outside their area of marketing expertise.

4. Arguments against Eastern European defenses of countertrade

Eastern European countries argue that countertrade stimulates reciprocal trade flows which, in turn, encourages the expansion of trade. This argument presents countertrade as a new trading technique or “new form of international economic relationship” which helps preserve the buoyancy of East–West trade. It is, of course, dangerous to conclude from a few specific examples of favorable countertrade transactions between East and West that countertrade is, *per se*, productive.

There is no proof that countertrade stimulates foreign trade. In practice, it tends to restrict such transactions to large firms that are able to accept compensatory imports as payment for exports. Insofar as the compensation requirement and ratio are laid down unilaterally by the Eastern European countries, the volume of reciprocal trade is determined by the exporting capabilities of those countries. Given the present constraints on these economies, it is difficult to see how countertrade could enable Western countries to expand their exports to Eastern Europe.

The hope for continuity in trade relations may be a justification for initial sacrifices when entering a market. Industrial compensation deals generally provide for delivery over extended periods of time. Commercial compensation deals, however, are less likely to foster continuous trade flows because Western exporters generally feel that such practices are not in their best interests. Whenever possible, they will opt for the markets that do not impose countertrade obligations. If the Western partner feels that it is not making a sufficient profit from the deal, it will find it difficult to continue in the relationship.

Countertrade practices do not appear to help Eastern European countries overcome the chief problems responsible for their poor trading performance. Other methods are far more effective than compensation in improving product quality, ensuring regular updating of technology, training Eastern European manufacturers to market their goods in the West, and making their systems of economic management more flexible. By abandoning control over the marketing of their products to third parties which are basically interested in making short-term profits, Eastern European firms are not creating long-term markets. There is even the risk that countertrade goods will compete with their direct exports. Moreover, it is difficult for an Eastern European country to determine whether a deal will be profitable because the prices set in each transaction are interdependent, and it is not always possible to determine whether they will settle at the right level. Furthermore, it is illogical to choose a supplier on the basis of his ability to become a purchaser. The countertrade system therefore will prevent Eastern European countries from developing a more rational cost and pricing structure. Finally, the intervention of a Western intermediary slows down the flow of information on market trends and delays the adaptation of

production in Eastern European countries.

Countertrade is a regression towards bilateralism. In certain countries, such as Hungary and Poland, there has been increasing support for the idea that opening up foreign trade requires the establishment of multilateral trading relationships. The expansion of compensated trade encourages orthodox thinking in the Eastern leadership and discourages management reforms essential to the improved efficiency of these countries' economies.