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Dee Linse on Trade Without Money

Trend Toward Countertrade Poses a Delicate Policy Dilemma for U.S.

Foreign exchange-starved nations are turning an interested eye toward a form of international transaction called "countertrade."

Technically, countertrade is a form of international exchange that includes barter. Countertrade takes many forms including: barter, counterpurchase, compensation, evidence accounts, and bilateral clearing accounts, with many variations of each of these types of transactions, (see box 1).

Money is involved in some of these transactions, but usually not. All variations have exchange of goods and/or services of one country for goods and/or services of another. Governments are often involved directly, but not always.

The increased growth in countertrade poses a difficult policy problem for the United States, particularly in view of the traditional U.S. free market approach to international trade. If the United States does not engage in countertrade, it could lose opportunities to export farm and other products. On the other hand, if it participates in countertrade other countries construe this as leaning toward protectionism and away from free trade.

Countertrade arrangements are often associated with transactions among third world and centrally planned economies. However, U.S. involvement in countertrade has also increased. The U.S. International Trade Commission estimates that U.S. imports resulting from countertrade totalled $279 million in 1980, up three fold from the $98 million estimate in 1974. Unfortunately, estimates are not available for years since 1980.

CPEs and LDCs Depend on Countertrade

Centrally planned economies (CPEs) and the less developed countries (LDCs) are the strongest supporters of countertrade. It is a way for these countries to save foreign exchange while still engaging in international trade among themselves and with western developed countries. It bypasses the problem of nonconvertibility of their domestic currencies.

Especially in the 1970's, inflation in western economies stimulated the dependence on countertrade. The CPEs decide on a development, production, and export goal every five years. Unanticipated inflation made planned purchases of western goods more expensive. So the CPEs looked to alternative forms of financing for these planned purchases. Countertrade was one of the answers.

The LDCs support countertrade for very much the same reasons. In order to diversify their industrial base, they mandate countertrade arrangements to promote import substitution, broaden their export product lines, or open new markets for their exports. Thus, the objectives for both sets of countries seem to be somewhat long term and involve the transfer of technology, plants, and equipment from which future production is derived.

More recently the LDCs, especially the heavily indebted countries, have increasingly relied on countertrade. Cutbacks in new bank loans, large debt service payments, and heavy import bills for needed products such as oil, left the LDCs with a shortage of foreign exchange.

Countertrade is one way for these countries to maintain the flow of vital imports without further disruption to foreign exchange balances. Countertrade also provides a way for these countries to meet IMF conditionality agreements to restrict their use of foreign exchange.

Western Countries Oppose Countertrade

The United States, along with West Germany, Canada, and Great Britain have not encouraged countertrade on the grounds that:

—Countertrade leads to a decrease in the volume of trade subject to free markets.

—Prices of imports involved in countertrade into CEP's and LDC's may be artificially high.

—Dumping of CPE and LDC products into western economies is likely to occur.

Here is how some of these conditions develop.

When a company exports to a nation requiring or mandating countertrade, such as Hungary, it must take goods that Hungary may be unable to sell in international markets. To dispose of these goods, the company usually has to cut prices. Since it can't afford to absorb a large loss, it may pad the price of the goods it sells to its countertrade customer, in this case, Hungary.

As a result, Hungary pays above the market price for the imports—making international trade less attractive to Hungary than it should be—and dumps its own goods through back-door price shaving. Some might argue that, lacking hard currency or borrowing power, Hungary has no other choice. In the long run, however, this practice is self defeating.

Having failed to set up continuing relationships with customers, Hungary never learns what the market really wants, or how it might improve its competitiveness. And, in some cases U.S. antidumping legislation has been used to balance the effects of countertrade dumping.

One case involved a dispute over the import and pricing of anhydrous ammonia. The prices, even though advantageous to U.S. farmers, were challenged by other suppliers of anhydrous ammonia. The International Trade Commission (ITC) determined that no injury occurred.

However, in another case, the ITC found that the import of tractor trailer axles in 1980 from Hungary had caused injury to the U.S. truck-trailer axle industry. Dumping duties were not assessed, however, because a separate settlement was reached between the interested parties.

Countertrade is the term used to describe transactions that exchange goods and/or services of one country for goods and/or services of another. Its continuation as an approach to world trade poses a difficult dilemma for the United States—to do or not to do—as described by Dee Linse, an economist with the Foreign Agricultural Service, USDA.

U.S. Participates in Countertrade

Both the U.S. Department of Defense and the U.S. Department of Agriculture have participated in agreements that could be characterized as countertrade. Such agreements have been used to provide or sell U.S. weapons, obtain strategic materials, promote U.S. farm commodities, and support foreign governments friendly to the United States.

In 1982 and 1983 three accords were signed with Jamaica. These accords provided for the exchange of bauxite for U.S. farm products of nonfat dry milk, butter oil, wheat and long grain rice.

Four basic legislative acts provide the authority for the U.S. Government, distinct from U.S. private traders, to engage in barter transactions: (1) Section 310 of the Agricultural Trade Development and Assistance Act of 1954 (Public Law 480); (2) Section 32 of the Foreign Assistance Act of 1974; (3) Subsection 6(c) of the Strategic and Critical Materials Stockpiling Act of July 30, 1979; and (4) Section 301 of the Commodity Credit Corporation Charter Act of 1949.

Government programs to barter U.S. farm products have not been widely used since 1973. It was at that time that CCC-held stocks of farm products declined sharply. At the same time, U.S. strategic stockpile goals also were lowered.

The government barter programs for farm products were never very large. In fact, from 1950 to 1975 the export market value under these programs totaled only $6.65 billion. Between a fourth and a third of these farm products were exchanges for strategic materials. The rest went for off-shore U.S. Government procurement of supplies and services.

Reactivation of government barter programs for farm commodities would require the establishment of procedures for reimbursing CCC for farm products and the related administrative costs involved with the operation of the program.

Procedures also would need to be consistent with the rules applicable to the release of CCC-held stocks. These are contained in current farm legislation which also specifies that bartered commodities may not disrupt world market prices, replace cash sales, or interfere with long-term commercial markets. One reason that U.S. farm interests have supported government barter programs is that it permits cutting the price of U.S. farm products below "market prices."

Other countries that repudiate it also take part in countertrade. OPEC countries, for example, try to avoid countertrade. However, as petroleum prices dropped below cartel-agreed price minimums, some of these oil exporters made countertrade agreements. It permitted them to "sell" petroleum at a discount but still appear to be in compliance with OPEC pricing agreement.

American industry also has a stake in countertrade. General Motors, General Electric, and Sears have reorganized their corporations in ways that allocate extensive resources to subsidiary trading companies that can deal with countertrade. The high demand for marketing services for the products received by U.S. companies in countertrade transactions is partially responsible for the Export Trading Company Act of 1982. Banks were the proponents of the legislation that gave them the opportunity to take title to imported goods. This authority in turn permits them to become merchandisers not just lenders to others.

A Policy Dilemma

Participating in countertrade while at the same time espousing free trade policies points up the important policy dilemma for farm and trade groups and for U.S. Government policy makers.

To engage in countertrade can be viewed as inconsistent with a "free" market stance. Participation in such trade may weaken, in some instances, U.S. at-

Countertrade Examples

	Exchanges of goods or services	Exchanges of money	Normal time frame of transactions
Barter The U.S. firm provides machines to China and receives gloves in exchange	Yes	No	Specified in agreement
Counter purchase McDonnell Douglas provides air craft to Yugoslavia and receives canned ham and U.S. dollars in exchange.	Yes	Yes	1 to 3 years
Compensation or buy back deals Stieger provides equipment, technology, and advice for manufacturing tractors to Hungary and receives tractor axles in exchange.	Yes	No	5 to 10 years
Evidence accounts Canada's Sper Aerospace and Hughes Aircraft provide space satellite and related services to the Government of Brazil and receives Brazilian products in exchange. (Similar to counter purchase but a larger number of products and services involved.	Yes	No	1 to 2 years
Bilateral clearing account Government of Rumania provide transport equipment and other products to Government of Ghana and receives exotic wood and other products in exchange.	Yes	Yes	Up to 1 year

tempts to obtain more liberal trade conditions around the world. But, to ignore opportunities in some instances and, in other instances, not create opportunities to participate in countertrade will not necessarily lead to abandonment of countertrade by other countries. The nonconvertibility of currencies of other countries and the shortage of hard foreign exchange currencies by many countries compel them to seek countertrade arrangements. International trade negotiations are not going to change these conditions quickly and may not at all. C

A Short Definition of Dumping

According to the General Agreement on Tariffs and Trade (GATT), dumping is a means "by which products of one country are introduced into the commerce of another country at less than the normal value of the products."

Under the GATT an importing country may protect its producers against injury by imposing antidumping duties. These can be no greater than the amount by which an existing country's domestic price exceeds its export price.

The United States does not levy antidumping duties unless the U.S. Treasury Department finds that sales are made at less than fair value and the U.S. Tariff Commission finds that there is injury.

Steve Gabriel and Paul Prentice on Macrolinkages

Fundamental Economics (Not Farm Policy) Now Drives Agriculture's Future

In spite of all the hoopla about the 1985 Farm Bill, costly as it is, the most important developments for agriculture in recent months involve major macroeconomic indicators—federal deficit reduction efforts, an accommodative monetary policy, prospects for stronger economic growth at home and abroad, and plunging interest rates, exchange rates, and oil prices.

In fact, these macroeconomic fundamentals are all interrelated. Taken as a whole, they all point to eventual economic recovery for the U.S. farm sector. On the policy front, a tighter fiscal policy (deficit reduction) combined with a loose monetary policy (12% growth in M1 last year) is just the right policy mix for lower real interest rates and a weaker dollar. This is a total reversal of the macroeconomic policy of the early 1980's—fiscal stimulus combined with monetary restraint—that helped to get us into this mess in the first place.

Interest rates are perhaps the single most important macroeconomic linkage variable to agriculture. On the cost side, farm debt at $200 billion and interest payments at $20 billion imply that the 300 basis point drop in rates over the past year will eventually save U.S. farmers $6 billion in interest expenses alone. Just as importantly, lower real interest rates imply higher prices for fixed assets such as farmland. Not necessarily higher land prices than last year, but higher than they would have been if rates had not fallen.

Stephen C. Gabriel and Paul T. Prentice are editors of Farm Financial Conditions Review and partners of Farm Sector Economics Associates, a Washington, D.C. consulting firm specializing in farm finance and macroeconomic linkages to agriculture.

Less Cost, More Demand

Also on the cost side, the 50% fall in crude oil prices will save farmers about $2 billion in direct energy expenses. Fuels, oils and electricity represented about 7% (nearly $10 billion) of total farm production expenses in 1985. The indirect savings will be just as large, as lower energy prices get passed through prices of nearly every other farm input. This is more good news for the future of land prices as this increase in per acre profitability becomes capitalized.

On the demand side, there will be stronger economic growth here and abroad—perhaps as much as 1 full percentage point worldwide—stemming from lower oil prices and interest rates. This is good news for improved domestic demand as well as for world trade. Finally, although the exact impact is arguable, the 30% decline in the dollar (on a trade-weighted basis) over the past year certainly can't hurt exports. Clearly, the macroeconomic fundamentals are now in place for eventual economic and financial recovery of the U.S. agricultural sector.

However, the financial adjustment process that will continue to occur even with farm sector recovery will be painful for many segments of agriculture—farmers, lenders, and other agribusiness firms. And it poses serious social welfare problems that ought to be addressed as just that. Targeted social welfare programs will be more effective than programs which tinker with farm prices, incomes, and credit.

In addition, there will be substantial economic costs associated with these adjustments in the form of loan losses, and income and wealth losses. The question that looms now on the policy front is who should bear these costs and how should they be distributed?

Net cash farm income has dropped over 11% in constant dollars since 1980. But there appears to be some stabilization in the last few years (with a lot of help from Uncle Sam). No doubt, large supplies of crops will exert strong downward pressure on commodity prices. But the changing macroeconomic fundamentals should provide substantial relief on the cost side as well as higher commodity prices than otherwise would have occurred.

Furthermore, don't tell your farm lender or debt-burdened farm neighbor this, but lower farmland prices and debt liquidation are good for agriculture. No question about it, these financial adjustments will lead to considerable misery for those involved and as a society we