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Countertrade/Food Aid: Support and Enhancement of Structural Adjustment

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COUNTERTRADE/FOOD AID:
SUPPORT AND ENHANCEMENT OF STRUCTURAL ADJUSTMENT

Abstract

Although food aid has been advocated for countries undertaking structural adjustment policies, political support for increased aid expenditures is lacking. Countertrade is proposed herein as a method for expanding food aid without increasing expenditures. Countertrade allows developing countries to accelerate growth in their export sectors while "financing" increased food assistance.

COUNTERTRADE/FOOD AID: SUPPORT AND ENHANCEMENT OF STRUCTURAL ADJUSTMENT

Concern has been expressed that structural adjustment programs designed to correct balance of payments and debt service problems of Third World Countries (TWCs) create undue austerity and contraction of TWC economies. These austerity policies typically place their greatest burden on the poorest segments of society. Since the structural adjustment programs required by institutional lenders often necessitate measures for some reform of food pricing policies, it has been suggested that food aid may be critical to making these price reforms politically acceptable to the governments and the citizens of food-deficit countries (Shaw and Singer). Food aid can soften the impact of higher producer prices on poor urban consumers and reduce the potential for food riots from dissatisfied urban populations. Thus increased food aid can assist countries in the process of re-structuring to undertake "adjustment with a human face" (Stewart).

While sufficient food stocks exist in the industrialized countries to expand food aid, many donor governments lack the political support for larger food aid budgets. Increasing expenditures for food aid conflicts with domestic political commitments to reduce fiscal deficits and lower taxes. This paper argues that donor countries should explore the use of barter-like exchanges, or countertrade, to complement their food aid programs. By combining countertrade with food aid, donor governments could expand their current level of food aid shipments without a corresponding increase in spending. In addition, a countertrade/food aid (CFA) program could provide the recipient countries with a means of establishing new export industries and accelerating the process of structural adjustment.

The paper begins with a description of countertrade and an historical summary of the U.S. agricultural barter program, followed by a discussion of TWC interest in countertrade and an examination of the legal status of countertrade under the General Agreement on Tariffs and Trade (GATT). Finally, a new approach to Countertrade/Food Aid is proposed, followed by a discussion of further issues to be resolved and problems for future research.

Countertrade Described

Countertrade is a generic term that is used to describe a variety of concessionary transactions used in international trade. Countertrade can be defined as any trading agreement in which each party agrees to buy a specified quantity of goods or services from the other. A number of different types of countertrade exist and will be discussed briefly.[1] Further issues relating to countertrade, such as mechanisms, features, advantages and pitfalls have been discussed in the literature (Banks; Jones; Korth; Khoury; Schuster; and Verzariu) and will not be covered here.

Barter, the most basic form of countertrade, involves an exchange of goods or services without any monetary medium. If the exchange is not simultaneous, the trader that delivers first (hereafter referred to as the "lead" trader) provides the equivalent of an interest free loan to the second (or "counter") trader. As a result, pure barter trades are normally completed very quickly, seldom extending beyond a year. They are also infrequent in international trade because of difficulties in negotiating the terms of trade, the timing of simultaneous exchanges and access to commercial credit.

In virtually all forms of countertrade other than barter, monetary units are used as an intermediate step in the fulfillment of import and export contracts. Counterpurchase is a linked transaction for reciprocal purchases. Two contracts are negotiated, the first setting forth the commercial terms of the lead trader's export good (price, quality, delivery conditions, etc. in much the same fashion as a conventional trade), and the second the terms and conditions for counterdelivery of goods which are normally "nonresultant products" (i.e. unrelated to the imported goods). A protocol agreement links the two contracts and specifies the time frame for completion of the countertrade, penalties for noncompliance, and other details. The normal time frame for a counterpurchase agreement is from one to five years, with the value of countertrade goods usually less than 100 percent of the original contract.

A compensation (or buy-back) arrangement is a specific form of linked transaction in which payment for the original purchase (typically equipment, technology or a turnkey factory) is made in resultant products. The total value of the countertrade always equals or exceeds the original export. The time frame for a compensation agreement can extend over 10 to 20 years.

Bilateral clearing agreements are diplomatic accords that set forth the basic principles of a trading relationship, together with supplementary protocols that include specific trade plans. Bilateral clearing accounts are established in the central banks of the contracting countries to effect payments or establish credits. The time frame of bilateral agreements tends to vary considerably. The Eastern Bloc countries prefer to use three- to five-year agreements that correspond to their plan periods. Amongst the TWCs, one- to two-year agreements with automatic renegotiation and renewal are frequent. Unused credits at the end of an agreement may be sold to third parties (usually at a considerable discount) or can be rolled over into a renewed agreement.

Finally, military offsets are arrangements that include bits and pieces of many forms of countertrade (e.g. compensation, counterpurchase, etc.). The common element which gives offsets a special character is that they are used in military/defense procurement and in some commercial aviation transactions. The time frame for offsets is intermediate in length (two to ten years).

U.S. Government Agricultural Barter

Between 1950 and 1985 agricultural barter was used by the United States to dispose of over $6 billion worth of excess agricultural commodities and food stocks to non-commercial markets, many of which were TWCs. The U.S. agricultural barter program has had three distinct phases. During the first phase (1950 to 1962) excess agricultural commodities held by the Commodity Credit Corporation (CCC) were bartered for strategic materials to supply the National Defense stockpile. In the second phase (1963 to 1973) the emphasis shifted to the procurement of supplies and services for military bases and for projects of the U.S. Agency for International Development (USAID). The barter program was suspended in 1973 because CCC surplus stocks had been depleted, stockpile goals had changed, and the strong commercial demand for exports eliminated the need for barter (Vogt). With the return of excess agricultural stocks, a third phase of the program was initiated. In 1982 and 1983, agricultural barter agreements were signed between the United States and Jamaica. U.S. dairy products (from CCC stocks) were exchanged for Jamaican bauxite which was added to the National Defense stockpile. The U.S. barter agreements with Jamaica were interpreted more as an effort to provide political support for the newly elected Seaga Government in Jamaica, than to reinstate the agricultural barter program (Jones).

With the passage of the Food Security Act of 1985, the U.S. Department of Agriculture was required to undertake a new pilot barter program to trade surplus agricultural stocks. The pilot program was to include at least two countries and was to be completed by September 30, 1987. By June 1987, no barter transactions had occurred and an internal assessment was requested (GAO) in which several problems were identified. First, proposed reductions in the national defense stockpile had limited the scope for barter. Second, interagency disagreements over the timing and terms of payments for the barter exchanges existed between the departments of Agriculture and Energy. Third, philosophical differences regarding the appropriateness and economics of barter worked to give the project a low priority. Although several barter proposals had been developed, no implementation was initiated prior to the end of FY1987.

The main problem with the U.S. barter program is its cumbersome institutional arrangements that constrain the latitude of exchanges and make barter logistically difficult. The government serves as the primary supplier and the principal buyer in its barter contracts. Although private firms may serve as agents, the U.S. government ultimately takes possession of the commodities or services received in exchange for agricultural products. As a result, the scope for barter-like exchange has been highly constrained by the limited range of "eligible" commodities. Moreover, bureaucratic in-fighting and interagency conflicts have made the U.S. agricultural barter program slow and difficult to exercise. Failure to exercise these pilot barters may also be related to the strong anti-countertrade stance taken by the Reagan Administration. It is alleged that the administration's bias against countertrade even led to a dearth of research on the subject by USAID:

> "One of the more significant manifestations of the U.S.'s negative policy toward countertrade is its total exclusion from the agenda of AID, the U.S. Government Agency that administers U.S. assistance for economic development of third-world nations. ... AID has not even examined the implications of countertrade for U.S. foreign assistance policy. Countertrade is not on AID's policy agenda, and expenditures are not made for research or assistance related to countertrade." (Carey and McLean, p. 447)

Third World Countries, the GATT and Countertrade

Most member countries of the Organisation for Economic Cooperation and Development (OECD) reject countertrade on the grounds that it is "inefficient", "trade-distorting" and a retreat toward "bilateralism" that threatens the established multilateral trading system (Banks, Walsh). Although the United States is the most adamant member of the OECD in its condemnation of government-mandated countertrade, like all OECD country governments, it provides advisory services to private corporations that wish to undertake voluntary countertrade (Nugent, Carey and McLean).

Businesses in the OECD countries have become more adept at using countertrade to their advantage. While it is unlikely ever to be the preferred method of trade, countertrade has gained a degree of legitimacy concurrent with the development of corporate countertrade skills (Carey and McLean). The controversy surrounding countertrade is also reflected in the divergence of business attitudes toward countertrade. A study of the opinions of practitioners and non-participants concluded: "the preconceptions and worries of non-countertraders are by no means generally borne out by the actual experience of those who do countertrade." (Neale and Shipley, p. 69).

TWCs have been actively promoting countertrade despite the criticisms of OECD countries. Since most TWCs are not signatories to the GATT, they are not bound by its Articles. Moreover, even those who have signed the GATT are often subject to special exemptions that permit them to engage in countertrade (Nugent). Countertrade has been widely accepted by the TWCs as a workable means of overcoming shortages of foreign exchange and as part of a broader strategy for promoting economic development. Countertrade has also helped the TWCs to diversify and expand markets for traditional exports, especially in countries with centrally-planned economies (Outters-Jaeger). In fact, so many TWCs have established formal countertrade policies that it is now becoming recognized as a permanent feature of international trade. This opinion was recently enunciated by an organ of the FAO:

> "... countertrade whose expansion in recent years has usually been considered as a reflection of economic necessity, seems now to be steadily surrounding itself with the trappings of a permanent institution. A growing number of developing countries have been introducing legislation designed not only to give formal recognition to the practice, but also to establish norms by which it may operate. Such measures cast doubts upon the argument that countertrade was a cyclical phenomenon that would thrive only in periods of economic crisis." (Cerescope)

The most important aspect of countertrade from the GATT point of view is the nature of the "linkage" that requires the seller (lead trader) to accept an obligation to purchase goods from the buyer. The linkage of countertrade can take two forms: voluntary and government-mandated. Under government-mandated countertrade lead traders must accept a countertrade offer/obligation by the importing country government in order to gain access to the importer's market. A voluntary linkage is a countertrade obligation that is accepted by the lead trader without coercion or interference from the state. There is a general consensus that voluntary countertrade does not contravene any of the GATT Articles (Liebman; Nugent; Roessler; Zarin). Although opinion on the use of mandated countertrade is mixed (see Liebman and Roessler), there is general agreement that countertrade conducted under the auspices of the Government Procurement Code is exempt from the Articles of the GATT. As a result, GATT signatories can use countertrade to undertake military procurement or "tied aid" programs, and <u>not</u> contravene either the spirit or the letter of the GATT. Consequently, there is no binding "commercial policy" argument to restrict any OECD country from pursuing a countertrade approach to food aid.

Proposed Countertrade/Food Aid Model

The hypothesis underlying structural adjustment is that market-determined foreign exchange rates and reduced government expenditures will stimulate TWC export industries and economic growth. A major problem for outward-oriented development strategies, however, is the time lag between implementation of structural adjustment policies and the realization of benefits of these policies in the form of enhanced economic growth. A program which expedites the structural adjustment process by helping TWCs find new export markets while also providing more abundant food supplies to reduce the interim hardships would respond to both felt needs in TWCs.

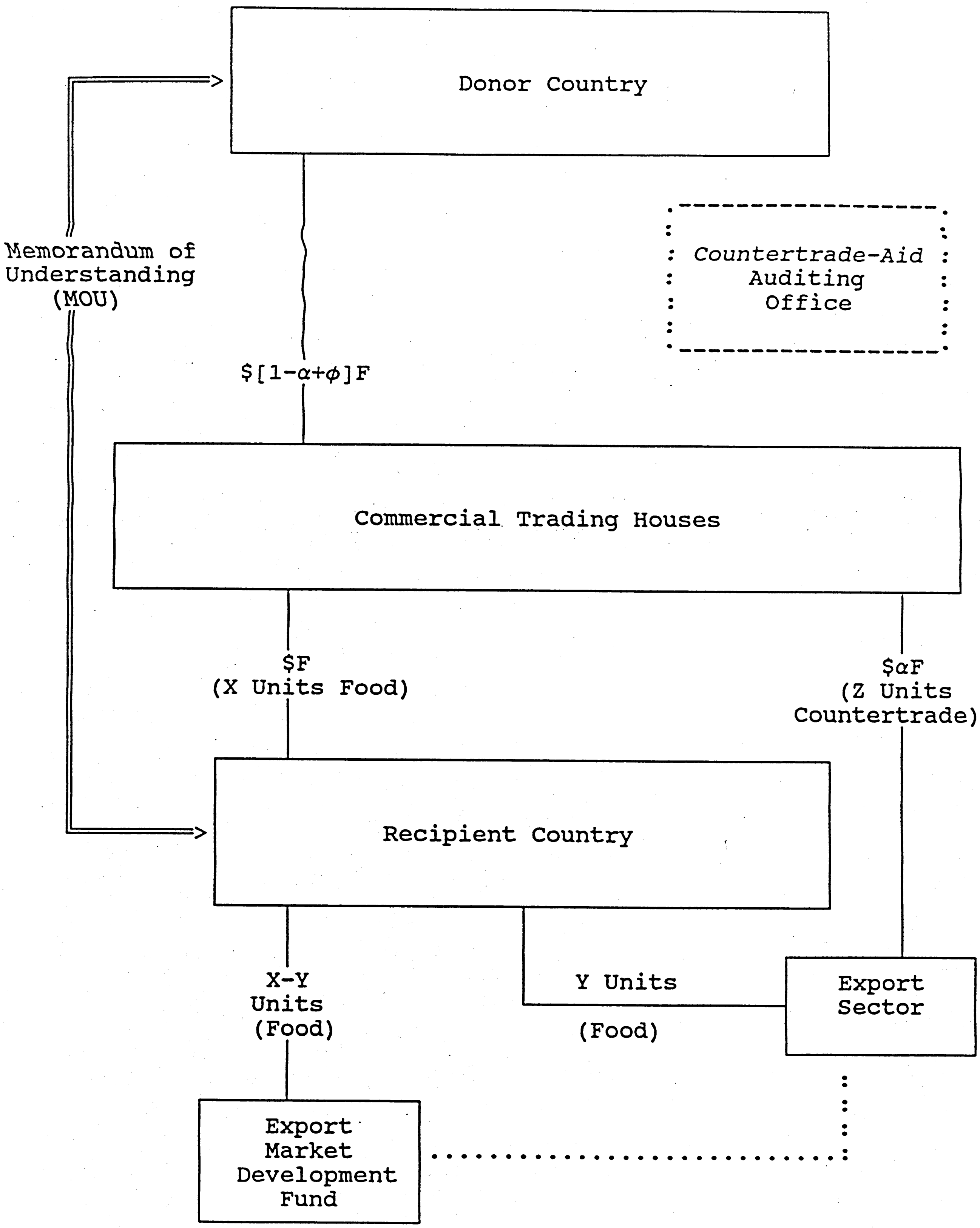
On the "donor" side, most OECD countries have neither strategic material stockpiles nor an extensive system of foreign military bases that could serve as a market for countertrade products from TWCs. Hence, outlets for goods received in countertrade would have to be found in normal commercial markets. Similarly, many OECD countries have only small government-owned stocks of food products and must acquire these supplies through the private sector in order to make food aid donations. These considerations suggest a role for private sector trading houses in implementing a CFA program.

Trading houses have developed the expertise needed to market countertrade goods and are able to seize new commercial trade opportunities as they arise. A partnership between governments and the private trading houses could help to simplify the logistical and legal aspects of countertrade transactions for the government aid agencies. Under the proposed approach to CFA, all commercial, logistical and marketing functions would be handled through private trading houses, with the government retaining its traditional role of financing the food aid donation and negotiating the agreement with the recipient country.

Conceptual Model

A model for a CFA program which expands the role of private trading houses in bilateral food aid is presented in Figure 1. In this illustration, the donor agency has agreed to provide \$F of bilateral food to the government

Figure 1. Conceptual Model of Countertrade/Food Aid



of the TWC. The conditions of the CFA are set out in a Memorandum of Understanding (MOU) between the donor and the recipient. The MOU specifies the quantity (X units) and value ($F) of the food products, and the amounts of countertrade (α) and concessionary food aid ($1-\alpha$) expressed as proportions of the total food export. In addition, the MOU identifies the agents involved, stipulates a time frame for implementation, and makes explicit the various safeguard and performance guarantees. The CFA contracts are monitored by an independent government department which oversees the actions of contracting trading houses and serves as an ombudsman in the case of contract disputes.

The trading house is responsible for purchasing and arranging transport for the food shipment according to its contract with the donor agency. Payment for the food aid portion, $\$(1-\alpha)F$, is made from the donor agency to the trading house, together with a commission (ϕ) for handling the logistics and operations. The portion of the total shipment not given as food aid (α) is to be made up by the TWC as countertrade. Thus, $\$\alpha F$ must be recouped by the trading house in countertrade products from the TWC. The donor agencies are eliminated in the countertrade portion of the contract, except that their CFA auditing offices have the power to investigate exchanges to ensure that the trading houses do not abuse their powerful position vis a vis the TWCs.

The countertrade portion of the contract involves only the trading house and the TWC. There are a number of ways in which the TWC can provide the countertrade products. The most appealing method is for the TWC government to sell Y units of imported food for local currency, and then pay one of its exporters this amount to complete the contract (supplying Z units of countertrade products to the commercial trading house). The government then has a net of X-Y units of the imported food to dispose of as it sees fit. Alternatively, an escrow account could be set up that would pay out funds to local suppliers as export contracts are fulfilled to the commercial trading house. Payment-in-kind to the exporter is a third possibility.

The remaining X-Y units of food can be used in the same manner as untied food aid has always been used: the food itself can be used for diet enhancement or revenues from the sale of the food can be treated as regular development assistance. Alternatively, more in the spirit of structural adjustment programs, the excess revenues could be deposited in a special fund to be managed by the government ministry responsible for export market development. These revenues could be designated for training labour or for the development of the export marketing infrastructure, such as the construction of roads, ports, warehouses and loading facilities, or the elimination of bottlenecks in the export production sector.

Problems and Further Issues

The CFA model presented above represents only a skeletal framework that requires further development in the form of a pilot study. There are a number of further issues that need to be addressed, some of which relate more to TWCs and others which relate more to donor country concerns. Problems related to donor country interests include the various forms of countertrade to be considered and the financing of the countertrade portion of the contract. The model set forth above represents a simple counterpurchase. This may not be the most useful or practical form of countertrade for the purposes of assisting the TWCs to develop self-sustaining export industries. A more appropriate type of countertrade might be a "buy-back" form involving a joint venture or "turn-key" manufacturing operation, with significant capital investment and technology transfer. The issue for research is how to develop these other forms of countertrade into practical, workable programs.

As presented, the model implicitly assumes that the private trading house finances the countertrade portion of the contract. This may be possible if the trading house is large and the period of time before the countertrade products are received is relatively short. Under most circumstances, however, some arrangement for the donor agency to assist in financing the countertrade portion would also be necessary. The research issue is to determine the appropriate method to finance the countertrade portion of the exchange, and the time frame for permitting the trading house/TWCs to complete the transaction.

Foremost among the issues concerning TWCs are the types of exports which TWCs can offer as countertrade (and their potential for self-sustaining growth) and distributional impacts within the TWC. Most TWCs would very likely offer as countertrade those goods that are not among their traditional group of export commodities. Traditional goods such as rubber or metals offered as countertrade might be sold at considerable discounts by the trading houses, leaving the TWCs competing with their own products or displacing other TWCs in established markets (Walsh). However, if TWCs focus primarily on non-traditional products to meet CFA commitments they may be distorting their economy away from the sectors in which they have a true comparative advantage. In general, the TWC would likely receive more benefits by expanding its range of export products than by resorting to already established trade goods to fulfill the countertrade requirement. Logical candidates for export under the CFA program would be products that have been exported in small quantities in the past but have not developed into regular export markets. Naturally, if the TWCs can obtain hard currency for their exports, there is no advantage in using countertrade.

A related issue is whether a CFA program would assist TWCs in identifying products in which they have a real comparative advantage. The proposed model relies on the commercial trading houses to act in their own self-interest to identify goods in the TWC that have a dynamic comparative advantage. Profits for the trading house are made by establishing import/export transactions that can be easily replicated, without further investment of time and resources. As a consequence, the trading houses would be motivated to search out and establish products in the TWCs that have the potential for ongoing world trade.

In terms of the distribution of benefits within the TWC, the CFA approach is non-targeted. The beneficiaries of the program would depend on whether the countertrade goods were of urban or rural origin, and whether they were produced by local or multinational firms. Given the multiplier effects of export activities, and the income elasticity of demand for food in TWCs, the distribution effects of CFA could be very broad. In some respects the CFA concept is equivalent to a "food-for-work" form of food aid, since workers receive a money wage for producing countertrade goods and can subsequently exchange that wage for food that is financed by the countertrade.

Concluding Remarks

Most forms of food aid provide balance of payments support to TWCs. Unfortunately, this support offers, at best, only temporary relief. Given the growing populations in TWCs and their continuing needs for industrial goods and capital investment, it is difficult to foresee a time when they will not have their demand for food imports constrained by a lack of convertible currency. While some development-related food aid projects may lessen the reliance of the TWCs on food imports, these projects are unlikely to eliminate the chronic balance of payments problems.

The CFA approach, on the other hand, offers a great deal of flexibility in providing not only balance of payments support but also for assisting in structural adjustment problems in TWCs. The CFA approach differs radically from other food aid development efforts in that it attempts to increase the

TWC's capability to develop its export capacity. It also provides a mechanism to gradually diminish the aid portion of food imports and to shift the TWCs away from food aid dependence. During the initial periods of structural adjustment the donors could set low countertrade percentages. Then as more industries became established and the TWC developed more export capacity and could support more food imports through countertrade, the percentage of countertrade could be increased. Eventually, the TWCs could reach the point at which all food imports would be financed by countertrade. Given its cumbersome nature, countertrade would no doubt be dropped at this juncture, in favour of conventional commercial cash transactions.

The key institution for implementing a CFA program is the private trading house sector. Conceptually, the program operates by using the services of trading houses to identify potential countertrade products and opportunities. Commissions earned on food aid procurement and shipment (as well as the potential profits from countertrade) would generate further incentives for trading houses to expand into new TWC markets and to develop expertise in handling new products. The assistance provided to these trading houses could have long term benefits for the food donor as well, since trading houses represent both exporters and importers. By helping trading houses to become more established in TWCs, both the donors and the trading houses would broaden their total trade presence in these markets.

Probably the most important advantage of the CFA approach is that all donors could expand their current volumes of food aid shipments, without increasing their budgetary outlays. There can be little question that the need for food aid is as great now as at any time in history. Moreover, the support needed to assist those TWCs confronted with structural adjustment far exceeds the available supply of food aid. When used in conjunction with a "tied aid" program, countertrade is not contrary to the GATT. It is time for the United States and other OECD Governments to move beyond their ideological rejection of the practice and to update their policy in view of the benefits that countertrade could have for TWC development.

Endnote

1. This discussion draws heavily from Prentice and Tyrchniewicz.

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