COUNTERTRADE

1. One of the most important achievements of international economic co-operation in the early post-war period, was the dismantling of the tangled web of bilateral payments arrangements which had been constricting and distorting international trade since the early 1930s. This permitted the effective multilateral liberalization of international trade within the GATT, and the unprecedented growth in world trade that followed. In recent years, however, there has been evidence of a rise in commercial arrangements with a barter content which are reminiscent of the inter-war bilateral agreements. These transactions began in East-West trade, but seem to be spreading to trade relations between market economies, including many GATT members. This has raised a number of questions about the nature, incidence, economic effects and legality of these practices. This report is intended to provide the basis for a discussion of these issues at the general trade policy level.

2. The report is in two parts. Part I describes the different forms of countertrade and addresses some of the empirical and economic issues involved. Part II examines the consistency of various countertrade practices with the General Agreement and some of the codes supplementary to it.

PART I: THE ECONOMICS OF COUNTERTRADE

Definitions

3. The word countertrade initially entered the commercial vocabulary to describe a range of bilateral trade practices which became common in East-West trade in the 1970s. A new word was perhaps justified by the
fact that the existing one - barter - was predominantly used and understood to refer to trade without money, whereas barter-type transactions in East-West trade had evolved in forms which used money in three ways: (a) as a means of pricing goods (in the customary way), (b) to provide finance to one or both of the parties during the transaction period, and (c) as outright payment, to cover any differences in the exchange value of imports and exports. Lifting the "veil of money", however, it becomes clear that these transactions constitute barter all the same.

4. A second general characteristic of "countertrade" is that there has almost always been an element of necessity behind such transactions, in the sense that at least one party has believed that if it had refused to take goods in place of money the deal would have fallen through. The nature of the compelling force can vary from such direct measures as national laws or administrative decrees, to indirect ones such as disorder in exchange markets.

5. There appear to be three more or less distinct types or groups of countertrade transactions, differing from each other principally in relation to the nature of the goods traded, the extent to which the trade flows offset one another and the length of time needed to complete both transactions. The first type is closest to the traditional pure barter, and will be here referred to as "classical" barter. It involves a once-only transaction, bound by a single contract, specifying the goods to be exchanged to an equivalent value. A given deal can involve just one commodity on each side (say, oil for lamb) or a bundle of goods (oil and refined petroleum products for lamb, wool and butter). A number of financial procedures can be employed to protect the interests of each party (such as 'trustee' accounts in independent banks). The need for bridging finance is minimized, however, by the approximate simultaneity of the trade flows. Such transactions can be between private parties, but often involve state-trading agencies on one or both sides. The type of products exchanged in 'classical' barter deals are usually homogeneous ones, such as agricultural or mineral commodities, where quality and volume can be readily verified.
6. The second type - **counter-purchase** transactions - may take five or more years to be completed, the initial exporter undertaking to buy some quantity of the purchasing country's goods during this period. The two sales agreements are negotiated together, but while the first one is typically a standard sales contract indistinguishable from those used in normal foreign trade transactions, the second one can take a variety of forms - ranging from a similar 'standard' contract with merchandise type, quantity, quality and price all specified, to a general commitment to buy any goods among those which may be available. The agreement generally specifies that the value of the second transaction should be a certain percentage of that of the first one and provides a pricing formula (such as "the recognized international price at the time of purchase"). Given the lags involved, the availability of trade finance is an important precondition for a counter-purchase transaction, but in virtually all cases the two sides of the transaction are financed separately, as in conventional trade. Counter-purchase deals are usually between a government or state-trading organization and a private firm.

7. A variant of counter-purchase can sometimes be found as one element of what is known as **offset** arrangements. These usually apply to government purchases of military equipment and commercial aircraft, where the private corporation selling these items agrees to "offset" some of the cost to the buyer by (a) purchasing or producing components for these goods in the local market, or (b) purchasing components for other related products, not included in the immediate sale, or (c) agreeing to purchase outright, or find buyers for, a range of local products which are unrelated to the military or aircraft industries. The third obligation is similar to other forms of counter-purchase, described above, except that the commitment is generally not legally binding. Also, the choice of products is usually much greater (it may be unlimited) and no marketing constraints are placed upon the buyer.  

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1Counter-purchase is sometimes also an explicit feature of investment performance requirements, where firms undertaking some stages of their global production in a given country are contractually required to export goods from the host country equal to a certain value of their imports.
8. Finally, the third broad category of countertrade, known as **buy-back**, involves repayment in products which are derived from those in the initial sale. This typically arises in connection with a sale of industrial or mining plant, equipment or technology, with the exporter undertaking to acquire part of the resulting output. Apart from the 'derived' nature of the trade, buy-back deals generally differ from counter-purchase in that the sums involved are much larger and the contract period longer (10 to 20 years). In addition, the value of the 'buy-back' commitment is usually greater than that of the original export transaction, whereas in counter-purchase, this is not normally the case. The contractual arrangements are the same, however, with the two transactions linked but financially separate. Buy-back transactions need to be distinguished from **co-production** arrangements (or "industrial cooperation agreements") which for Western firms are essentially a substitute for direct investment in state-controlled economies, and do not fall within the definition of countertrade as used here.

9. The three groups of countertrade transactions just described, while differing in some respects from each other, all share the characteristic of being **ad hoc** (monetized) forms of barter, related to a specific transaction. **It is important to distinguish countertrade from comprehensive bilateral trade and payments arrangements**, which are a systematized form of barter binding all trade between two countries, and usually originating from the inconvertability of at least one country's currency. These trade-balancing arrangements commonly make use of clearing accounts, which permit trade to take place without the need for foreign exchange.¹ Under such inter-governmental arrangements, one partner's trade surplus is in effect held by the other - and can be spent only on that country's goods and services.

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¹ A State-run common clearing account (usually at the central bank) is established in each country, say A and B. Importers in country B of goods from A pay their obligations in local currency into the national clearing account, which can then be drawn down to pay exporters in B of goods to A. International currencies may be used for accounting purposes, as a 'clearing unit'.
10. The history of clearing arrangements has been that bilateral trade imbalances frequently arise and can prove impossible to eliminate even over protracted "accounting" periods. In such circumstances, a third party will sometimes take over the purchasing obligations of the surplus country as part of a countertrade deal with that country. This is called switch trading. Being ad hoc in nature, it is properly a form of countertrade, but it arises as a result of the existence (and malfunctioning) of comprehensive bilateral payments arrangements.

Importance in world trade

11. Circumstantial evidence suggests that countertrade has grown considerably in recent years. In the Eastern trading area, trade with industrial countries has always involved some counter-purchases, but the requirements have apparently become more rigid since the mid-1970s and the share of counter-purchase has tended to increase. According to the OECD, buy-back deals began only in the late-1960s, growing rapidly until around 1982; since then, there has apparently been little expansion in Eastern Europe. In the trade of developing countries, counter-purchase is a very recent phenomenon. Only a few countries have imposed counter-purchase requirements in any systematic way, but several are alleged to be proceeding selectively (e.g. in motor vehicles trade) and unofficially. "Classical" barter has been a more traditional, if not predominant, feature of developing countries' trade and there seems to have been some increased reliance on it in the last few years, particularly by indebted oil-producing countries and others with 'surplus' primary commodities.

12. While most observers would agree with this outline of recent trends, considerable disagreement exists about the current magnitude of countertrade. For example, in 1983, estimates of the proportion of world trade accounted for by countertrade ranged from 1 per cent (by the IMF) to 40 per cent. 1 Apart from definitional differences, this large

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variation can be explained by the fact that there are no reliable data available. Countertrade transactions are not distinguished separately in foreign trade statistics and up to now have not been subject to any reporting requirements in developed countries. Available estimates have either been based on selective national surveys, discussions with countertraders, or generalizations from first-hand knowledge of the business.

13. Although it is impossible to estimate, with any reasonable degree of precision, the actual proportion of world trade consisting of countertrade, it is not so difficult to set some upper limits within the constituent regional trade flows, based on the considerable amount of piecemeal information available concerning the countries involved and the sorts of products exchanged. This will still be very imprecise, but should at least provide a better basis than presently exists for evaluating the quantitative importance of countertrade.

14. Counter-purchase and Buy-back: It is generally agreed that these two types of countertrade have taken place mainly in the context of industrial country's trade with the Eastern trading area and developing countries. Most observers would also agree that counter-purchase and buy-back have up to now been much more important in the trade of the former group of countries. Recent estimates of the OECD and the Economic Commission for Europe, based on their own surveys and the work of other researchers, place the proportion of countertrade in East-West trade at around 15 per cent. Doubling this figure, to be on the safe side, and applying it to trade between the Eastern trading area and industrial countries, we come up with 1.7 per cent of world merchandise trade in 1982. Knowledge about these forms of countertrade in other countries is less certain. Buy-back deals are considered to be rare and no more than twelve countries have even been rumoured to have engaged in counter-purchase transactions. In 1982, the total trade (exports and imports) of this group of countries with industrial countries amounted to about 8 per cent of world trade, and it seems improbable that counter-purchase could have accounted for more than 15 per cent of this.
15. We can thus conclude with some confidence that, taking the Eastern trading area and developing countries together, counter-purchase and buy-back transactions may represent a maximum of 3 per cent of world trade. This low proportion deserves emphasis, for it is these two types of transactions that many people have in mind when discussing countertrade.

16. "Classical" Barter: This form of countertrade — involving short-term, offsetting exchanges — is generally thought to be insignificant in East-West trade. In developing countries, however, it has always constituted the predominant form of countertrade and has shown signs of expansion recently. Nevertheless, given available information on the commodities and countries involved (and those not involved, such as the capital surplus OPEC countries) it is most unlikely that transactions of this sort could even now exceed 10 per cent of the total trade of developing countries. This is supported by the observation that most of these deals have involved "surplus" commodities, which by definition are a residual in developing country exports. On this basis, we may thus assume that "classical" barter could presently account for no more than 4½ per cent of world trade.¹

¹To arrive at a figure as large as 4½ per cent of world trade, from 10 per cent of developing countries' total trade, may at first seem surprising, given that developing countries' exports account for only about one-quarter of the value of world exports. Barter-type transactions, however, encompass not only the goods exported by a given country, but also those that are imported by it in exchange. (In the present case of "classical" barter, these two trade flows are of equal value.) Thus, for developing countries, the relevant trade flows are: (a) developing countries' combined exports to the rest of the world; (b) their combined imports from the rest of the world, and (c) developing countries' exports to each other. (Note that their imports from each other could not be included too, for this would involve double counting.) In 1982, these three trade flows amounted to $812 billion, or about 45 per cent of world trade; 10 per cent of this is the figure quoted in the text.
17. **Countertrade in "offset" arrangements:** As already observed, there are two categories of trade where this arises. The first is in sales of **large commercial aircraft** to government-owned airlines. In the period 1980-82, the total value of these exports is estimated to have amounted to only \( \frac{1}{2} \) per cent of world trade, so different assumptions about the extent of counter-purchase are of little consequence. The second category of trade where offsets are common is in exports of **military equipment**. However, this is a rather special category of trade anyway and very little of it appears in national trade statistics. The Secretariat, using unofficial sources, has estimated that trade in arms was roughly equivalent to 2 per cent of total (recorded) world trade in 1981. The extent to which this trade involved counter-purchase obligations in unrelated products is impossible to determine, but experts consider that the "spillovers", while increasing, have so far been a very small proportion of the total. Thus it is not unreasonable to assume that the countertrade element in all offset arrangements is below \( \frac{1}{4} \) per cent of world trade.

18. **Summing these estimates, we arrive at an upper limit for the proportion of countertrade in world merchandise trade of 8 per cent.** It should be stressed that this is the **maximum** that it could represent; the **actual** proportion could be considerably smaller. It is probable that the much larger estimates quoted in various sources encompass trade flows occurring under the bilateral payments arrangements which bind all trade within the Eastern trading area (ETA) and a proportion of that of some developing countries. But total intra-ETA trade accounts for only 5 per cent of world trade and the IMF estimates that bilateral clearing arrangements among Fund members now account for less than \( \frac{1}{2} \) per cent of world trade, while those between developing countries and the Eastern trading area might add at most another 1 per cent.

**Reasons for countertrade**

19. The growth of countertrade practices is commonly explained by severe shortages of foreign exchange in the countries involved. There has certainly been a coincidence between the two phenomena.
Nevertheless, foreign exchange shortages per se do not provide a sufficient rationale for countertrade. As long as (a) export supplies are available – as they eventually must be if barter is to take place – and (b) a foreign supplier is willing to accept those goods in payment, then it follows that those exports could also be sold for cash, or used to secure a loan, which can then be used to purchase imports. Similar reasoning applies to the proposition that countertrade permits a country to conserve its existing foreign exchange reserves for priority needs. Barter neither draws down, nor adds to, a country's foreign exchange holdings.

20. Thus, to find the underlying causes of countertrade it is necessary to look beyond the foreign exchange shortage to those circumstances surrounding it which may make countertrade a preferred option for one or both parties.

21. In a number of countries, liquidity problems have been triggered by a delayed policy response to external events (the oil price hike, decline in export demand, increased interest rates on foreign debt). During this period, some have felt obliged to impose strict exchange controls rather than reduce domestic expenditure directly or devalue their currencies. There are two clear motives for countertrade in these circumstances. First, it can permit local firms to continue trading when allocations of foreign exchange are no longer forthcoming. Second, it can facilitate an appropriate de facto devaluation of the currency on a transaction-by-transaction basis. In essence, the country with an overvalued currency ends up paying an abnormally high price for its imports to offset the existing abnormally high price for its exports at the official exchange rate.

22. A second situation in which countertrade may be preferred to conventional trade is where there is a wish to disguise the real prices in a transaction. This may explain the importance of 'surplus' commodities in countertrade. A surplus arises when the price is too high to clear the market. While this would only be a temporary phenomenon in competitive markets, many primary commodities are not sold
in competitive markets, domestically or internationally. For a whole range of commodities, international competition is restricted by cartel-type agreements. Countertrade offers member countries in financial difficulty the prospect of disposing of their surplus export goods either at undisclosed prices, or at nominal prices which conform to international agreements, but which nevertheless involve an effective discount in terms of the goods received in exchange. Countertrade could be similarly used to achieve a result equivalent to dumping and export subsidization. (This is not to say that the effective selling price cannot be determined, only that it is considerably less transparent than in normal trade.)

23. It is also argued that countertrade can benefit individual countries in circumstances other than those just described. For example, countertrade is often justified as a marketing device, which is especially appropriate for goods that are difficult for a particular country to sell abroad or those for which export markets have yet to be established. Producers in some countries may suffer from a lack of information about export opportunities, or perhaps find marketing activities too difficult or costly. Countertrade could be of assistance by placing the onus on foreign suppliers to market local goods. This is more likely to be advantageous where foreign firms are large and diversified, or have marketing expertise in the relevant area. It frequently happens, however, that foreign suppliers are unable to market countertrade items themselves, and are obliged to sell them (at a discount) to specialist trading firms. The services of these firms could presumably be made directly available to the country concerned at a lower cost. If the country's goods are such that they cannot profitably be marketed in conventional transactions (because of poor quality or high domestic costs) then the same is likely to be true within a countertrade deal.

1 Note that by increasing world supply, such countertrade transactions undermine the prevailing world price of the commodity in question.
24. A related argument is that countertrade can allow a country to obtain a higher price for its exports than would otherwise be possible. This confuses the ability of a government to link import and export transactions, with monopoly or monopsony power – the power to influence the prices at which it trades. Unless the country can exploit a dominant position in world trade, the higher nominal prices that it receives for its exports in a countertrade deal will normally be offset by higher prices for the associated imports. Where a foreign firm does give the country a price discount, there is no reason why the same discount (or more) could not have been obtained in a cash transaction.

25. It has been suggested that in lending to countries with a poor credit rating, repayment in goods can be less risky than that in hard currency. This is relevant, for example, to buy-back transactions involving private firms, where a supplier of capital equipment may propose this form of repayment itself. Nevertheless, default in goods can be as feasible as default in cash, as the experience of some longer-term countertrade deals has shown. Indeed, countertrade transactions have some special risks of their own, apart from the availability of goods; these include problems of quality control, delays in delivery and disruptions stemming from changes in trade policy, all of which can create additional uncertainty about the eventual value of the "repayment". For such reasons, trade credit insurance institutions do not provide cover for contracts stipulating countertrade commitments.

26. Countertrade has also been used as an instrument of industrial policy, to favour particular industries or the export sector generally. As already noted, the extra cost imposed on a foreign supplier, by requiring it to find an outlet for local goods and perhaps charging it a higher price than that in the world market, will normally be reflected in higher prices for that supplier's goods. In these circumstances, the industry which benefits from a government-mandated countertrade requirement implicitly receives a subsidy financed from a tax on
imports. The size of the 'subsidy' (and 'tax') will vary according to the marketability of the local product and the price which the foreign firm must pay. This would appear to be a very costly and inefficient way of supporting domestic industry, even for a country with an inadequate domestic tax base. It is characterized by a lack of transparency, however, which in certain situations (again involving export industries, for example) may not be considered a disadvantage.

27. Finally, in some countries there may be administrative or political reasons for engaging in countertrade. This applies in particular to non-market economies, where countertrade may be favoured (a) as a device to facilitate long-term economic planning, or (b) as a means by which Foreign Trade Organisations can exceed their budget allocations. While it may be natural for central planning administrators to seek "stability" through barter commitments - that is, to attempt to minimize fluctuations in export revenue, particularly unexpected shortfalls - a number of empirical studies of barter-type trading arrangements have found them to be less stable in practice than regular trade.¹

**Economic effects**

28. Bilateral trading practices give rise to two sorts of cost. First, there is the cost derived from restriction of choice. By tying import and export transactions, it becomes impossible to choose the cheapest source of supply and the most profitable outlet, except in the unlikely event that they happened to coincide. Second, there are the increased transaction costs associated with searching for, negotiating and coordinating, viable pairs of transactions. All else being equal, these two costs will rise with the degree of rigidity in the bilateral trade

requirements. They will result in a reduced volume of world trade and distortions in its pattern, such that income losses will be experienced by all trading countries. These losses will generally fall most heavily, however, on those countries whose choice is most restricted.

29. It follows that the costs of countertrade practices will vary considerably. At one extreme, there are transactions which are voluntarily entered into by private firms - because they suit their investment, production or marketing strategies - and which need impose no additional costs at all. Even among those which are mandated by governments, it is possible to find some which involve very little restriction of choice or inefficient transacting. For example, as already observed, the counter-purchase provisions in offset agreements can sometimes be very flexible. The original exporter may simply undertake to try to find buyers for any goods produced by the country concerned. He will normally charge the country an implicit marketing fee, but from a global perspective this mainly represents a transfer of income from the country to the firm, rather than a cost, because marketing expenditures would be incurred anyway.

30. From this lower extreme, the costs of countertrade begin to escalate when any of the following features are present: (a) high 'coverage ratios' (the value of the import commitment expressed as a proportion of the value of the initial export transaction); (b) large penalties for non-compliance; (c) restrictions on resale or use of traders; (d) regional limitations on marketing; (e) short transaction periods; and (f) unpredictability of the final requirements themselves. At the upper extreme, where all these features are present, the costs of countertrade could become so high as to virtually bring a country's trade to a standstill, especially if it refused to accept the consequences of its actions for the terms of exchange. It should be apparent, however, that when the costs of countertrade rise the heaviest loser is the country itself. It will not only be obliged to bear the heavy transaction costs of any deals that do go through - costs that will include a large uncertainty premium, in addition to the value of
marketing, administrative and legal inputs—it will also bear a continuous burden of search and negotiation costs for many deals that are not realized. Of course, the private firms involved in futile negotiations will waste resources as well.¹

31. Nevertheless, it should be recognized that where access to the multilateral trade and payments system is inhibited by rigid exchange controls and overvalued exchange rates, certain countertrade practices may naturally emerge as a second-best solution, allowing some additional trade to take place and improving economic welfare. This proposition has most force when it applies to transactions entered into by private firms as a means of dealing with the exchange market distortions. In these cases, only trade that is beneficial to both parties could be expected to take place, at relative prices that will approximate those in the world market. When governments mandate countertrade, however, additional costs will generally be incurred, introducing the possibility that the country will suffer net losses in trade and welfare. Thus, countertrade cannot in itself provide a solution to balance-of-payments problems that require action at a broader policy level.

¹While it is clear that the more rigid forms of countertrade can prove costly, especially to the country requiring it, and that they will result in some diminution of world trade, it remains true that countertrade is a problem of a lower order than that of bilateral payments agreements between governments. The most important distinction between the two is that countertrade (counter-purchase and buy-back) is generally imposed unilaterally on foreign private firms, which can choose to sell their goods elsewhere if they find the conditions too onerous. (This in itself is a check on how onerous these conditions can become.) Bilateral payments arrangements, in contrast, can only be made to work by regulating trade in both countries. To prevent the imbalances which inevitably arise in any two countries' trade, traders must eventually be constrained to buy and sell in particular markets. The restriction of choice is much greater under these pure forms of bilateralism than in countertrade, and discrimination becomes essential.
PART II. COUNTERTRADE AND THE GENERAL AGREEMENT

32. Given the many forms countertrade takes, the great diversity of governmental measures concerning countertrade, and the differences in the legal obligations of the various contracting parties, it is difficult to examine the consistency of countertrade with the General Agreement in the abstract. The following paragraphs therefore list concrete but hypothetical cases involving countertrade followed by references to the most relevant provisions of the General Agreement and some of the codes supplementary to it. These case studies are not meant to be exhaustive legal analyses but are intended to give an indication of the basic legal issues involved. While the first part of this paper concentrated on the various forms of countertrade and their economic effects, this part of the paper concentrates on the governmental measures that entail, or react to, countertrade since it is this aspect of countertrade that is relevant from the perspective of the General Agreement.

33. The Secretariat does not have the authority to interpret the General Agreement and the codes. The views expressed below should therefore not be taken as official interpretations of these legal instruments. They are meant to serve as points of departure for a discussion of the Consultative Group on the many as yet unresolved legal questions to which countertrade gives rise.

CASE 1: Countertrade not linked to governmental measures

An enterprise in the country Tramontana agrees to deliver a fertilizer plant to a farmers' cooperative in the country Patria against the delivery of half of the output of the plant during a ten-year period. The farmers' cooperative in Patria insisted on paying in kind rather than money not because of any governmental requirements or inducements but to give the manufacturer in Tramontana a direct interest in delivering an efficient plant producing high quality fertilizer.
Relevant GATT provisions:

34. The General Agreement regulates only governmental, not private, actions. Since the barter was not agreed as a result of governmental requirements or inducements, and has not given rise to any governmental reactions, the case does not raise any issues of conformity with the General Agreement.

CASE 2: Exemptions from import duties conditional upon countertrade

Patria levies import tariffs ranging from 10 to 30 per cent. The government decides to abolish import tariffs for goods imported as part of a complete plant provided the exporter of the plant undertakes to buy 50 per cent of the plant's output during ten years or more.

Relevant GATT provisions:

35. Article I of the General Agreement obliges the contracting parties to grant unconditionally most-favoured-nation treatment in respect of their import duties. In 1973 a GATT Working Party discussed the question of whether tariff reductions for goods imported in the framework of cooperation contracts were "unconditional" in the sense of Article I. The Secretariat, asked by the Working Party for a legal opinion on this matter, stated "that the prerequisite of having a cooperation contract in order to benefit from certain tariff treatment appeared to imply conditional most-favoured-nation treatment and would, therefore, not appear to be compatible with the General Agreement" (BISD 20S/36). The Working Party took note of this view without taking a position on it.

CASE 3: Import licensing conditional upon countertrade

The government of Patria decides to issue import licenses for certain categories of goods only to those importers who can show that they have an export sales contract of a value at least equivalent to that of the imports.
Relevant GATT provisions:

36. According to Article XI:1, restrictions on the importation of any product, whether made effective through import licenses or other measures, are in principle prohibited. The only instruments of protection permitted under Article XI:1 are duties, taxes and other charges. The grant of import licenses on the condition that a certain export value be achieved by the importer restricts trading opportunities through a method other than duties, taxes or charges and hence constitutes a restriction within the meaning of Article XI:1.

37. The practice of Patria would therefore be in conformity with the General Agreement only if the restrictive régime were to fall under one of the exceptions to the general prohibition of import restrictions, for instance the exceptions permitting restrictions to safeguard the balance of payments (Articles XII and XVIII:B) and emergency actions on imports of particular products (Article XIX). According to Article XIII restrictions applied under these exceptions must be administered non-discriminatorily. This is to be achieved by aiming at a distribution of trade in the restricted products that approaches as closely as possible the shares which the various contracting parties might be expected to obtain in the absence of the restrictions. This principle would not be observed if the countertrade requirement were to lead to a distribution of trade substantially different from that which would prevail in the absence of the restrictive régime (for instance by redirecting trade towards countries with firms equipped to deal with countertrade) and Patria were to take no measure offsetting the redistributive effect of the countertrade requirement.

CASE 4: Countertrade by state-trading enterprises

The government of Patria establishes a state-trading enterprise which is given the exclusive right to export passion-fruit and to import beer. Following a government
directive, the state-trading organization balances its trade by buying beer only from those overseas suppliers who agree to buy passion-fruit of an equivalent value. As a result of the countertrade requirement beer imports decline substantially and the domestic breweries' output and profits rise.

Relevant GATT provisions:

38. According to Article XVII:1(a), state-trading enterprises shall, in their purchases or sales involving either imports or exports, act in a manner consistent with "the general principles of non-discriminatory treatment" which the General Agreement prescribes for governmental measures affecting imports or exports by private traders. According to Article XVII:1(b), this obligation is understood to require state-trading enterprises to make their purchases and sales solely in accordance with "commercial considerations".

39. It is an open interpretative question whether the obligation of state-trading enterprises to observe the General Agreement's principles of non-discriminatory treatment by acting solely in accordance with commercial considerations was meant to prevent only discrimination among countries or also discrimination between domestic and imported goods. A panel report recently adopted by the CONTRACTING PARTIES has left this issue undecided but the Panel stated that it saw great force in the argument that Article XVII:1 was meant to establish only the obligation to avoid discrimination among contracting parties (L/5504, paras. 3.14, 3.16 and 5.16). If that view is accepted, the mere fact that Patria restricts imports by linking imports of beer to exports of passion-fruit in a manner not corresponding to commercial considerations would not constitute a violation of Article XVII:1.

40. According to the interpretative note to Articles XI, XII, XIII, XIV and XVIII of the General Agreement, the term "import restrictions" includes restrictions made effective through state-trading operations. An import licensing régime imposing countertrade on private importers constitutes an import restriction within the meaning of Article XI:1 (see case 3). A governmental order imposing countertrade on an import monopoly has the same restrictive
effects as the issuing of import licenses conditional upon countertrade. The directive given to the exclusive importer of beer is therefore an import restriction made effective through state-trading operations and hence in principle prohibited by Article XI:1. The directive would therefore be consistent with the General Agreement only if it were to fall under one of the exceptions to Article XI:1 (see case 3).

CASE 5: Discriminatory countertrade as a condition of the grant of import licenses

The government of Patria, having introduced quantitative import restrictions for balance-of-payments purposes in accordance with Article XII, decides to issue licenses for imports from Tramontana, with which it has a bilateral trade deficit, on the condition that the importer requesting the license demonstrate that the imports are linked to exports to Tramontana and the export value is equal to, or exceeds, the import value.

Relevant GATT provisions:

41. The practice of the government of Patria constitutes a discriminatory import restriction and is therefore contrary to Article XIII. Article XII, which Patria is invoking to justify its restrictions, does not permit discriminatory restrictions to balance bilateral trade deficits.

42. Article XIV:1 of the General Agreement contains one of the exceptions in the General Agreement to the rule of non-discrimination. According to this provision a contracting party invoking Article XII may deviate from the provisions of Article XIII in a manner having equivalent effect to restrictions on payments and transfers for current international transactions which that contracting party may apply under Article VIII or XIV of the Articles of Agreement of the International Monetary Fund. The right of Patria to introduce bilateral trading arrangements under the General Agreement thus depends on the right of Patria to introduce bilateral payments arrangements under the Fund Agreement.
43. In its 1983 report on Exchange Arrangements and Exchange Restrictions (p.44) the Fund states the following on the right of Fund members to resort to bilateral payments arrangements:

"Bilateral payments arrangements maintained between Fund members constitute restrictions under Article VIII of the Fund's Articles of Agreement to the extent that they involve exchange restrictions or multiple currency practices. A basic feature of bilateral payments arrangements, which gives rise to a restriction on the making of payments and transfers to current international transactions, is that balances in the bilateral account, which is typically established to settle bilateral trade transactions, can be used only to make settlements between the two partner countries and cannot be transferred into another currency or be used to make payments to a third country. Even where the transferability of balances in the bilateral account is allowed, an exchange restriction within the meaning of Article VIII, Section 2(a) may be involved if the period between transfers is unduly long. A discriminatory currency arrangement within the ambit of Article VIII, Section 3 of the Fund's Articles may also be involved if credit balances in the bilateral account are not remunerated at the prevailing representative interest rate or if transfers of balances are made at exchange rates whose cross rate differentials exceed more than 1 percent."

44. In September 1982 the Fund's Executive Board reviewed the Fund's policy with respect to bilateral payments arrangements and the use of countertrade arrangements. Among the conclusions of this review were the following:

"The Fund's policy of not approving the maintenance of bilateral payments agreements and of encouraging their termination in the context of Article IV consultations has contributed to a decline in the use of bilateral payments arrangements. The approach set out in Executive Board Decision No. 955(59/45), adopted on October 23, 1959, remains appropriate; that is, that (a) there is no justification on balance of payments grounds for discrimination by members whose current receipts are largely in externally convertible currencies, (b) where such discriminatory restrictions have long been maintained, a reasonable amount of time may be needed to eliminate them, but this time should be short, and (c) in the case of payments relations with countries having centrally planned economies in which limitations exist on convertibility, the Fund would be prepared to consider whether balance of payments considerations would justify the
maintenance of some degree of discrimination. The number of members continuing to maintain bilateral payments arrangements at present suggests that the policy in (b) should continue to be implemented."

CASE 6: Countertrade related to government procurement, dumping and export subsidies

The Government of Patria passes a law which obliges governmental agencies purchasing imported goods for governmental purposes to obtain assurances from each supplying company that it produce and export goods of a value equivalent to one-half of the value of any imported goods delivered by it. As a result of this law, suppliers sometimes

(a) offer domestic rather than foreign goods in their bids for government contracts to avoid the export performance requirement;

(b) dump part of their production abroad to meet the export performance requirement; and

(c) charge prices for the goods supplied to the government that are higher than those they charge to other customers so as to cover the cost of meeting the export performance requirement.

Patria is a signatory of the Agreement on Government Procurement and the Subsidies Code.

Relevant GATT provisions:

(a) Government procurement

45. The law gives goods produced in Patria more favourable treatment than goods produced in other contracting parties in the procurement of the government because the suppliers of domestic goods, unlike the suppliers of foreign goods, need not meet the export performance requirement. This is contrary to the national treatment principle of Article III. However, according to Article III:8(a), the national treatment principle does not apply to the procurement by governmental agencies of products purchased for governmental purposes. Thus, if the goods purchased are not bought by the government with a view to commercial resale or with a view to use in the production of goods for commercial sale, Patria does not violate its obligations under Article III when it gives suppliers of domestic goods more favourable treatment in awarding contracts by exempting them from the export performance requirement.
46. If Patria has included the entity making the purchase in its list of entities annexed to the Agreement on Government Procurement, Article V:14(h) of the Agreement becomes relevant. According to this provision, the procuring entities should normally refrain from awarding contracts "on the condition that the supplier provide offset procurement opportunities or similar conditions". It further states that, "in the limited number of cases where such requisites are part of a contract", the Parties concerned "shall limit the offset to a reasonable proportion within the contract value". While this provision does not exclude offset procurement altogether, the general offset requirement introduced by law in Patria would not appear to be in conformity with the obligation to normally refrain from engaging in such practices. If Patria is a developing country the note to Article V:14(h) of the Agreement on Government Procurement would be relevant according to which developing countries may require offset procurement as a criterion for award of contracts.

(b) Dumping

47. The General Agreement does not prohibit dumping nor does it oblige governments to prevent dumping. However, Article VI gives contracting parties the right to levy anti-dumping duties if dumping causes or threatens material injury.

48. In a recent case before a panel, the contracting party which had brought the complaint argued that the export levels of companies which had to meet a government-imposed export performance requirement could not be assumed to be determined by commercial considerations and that such export requirements were therefore contrary to Article XVII:1(c). (This provision stipulates that no contracting party shall prevent any enterprise under its jurisdiction, including private enterprises, from acting in accordance with the principles laid down in Article XVII:1(a) and (b) for state-trading enterprises, which are to observe the GATT principles of non-discriminatory treatment by making their purchases and sales "solely in accordance with commercial considerations".) The Panel rejected this contention with the following arguments:
Article XVII:1(b) "does not establish a separate general obligation to allow enterprises to act in accordance with commercial considerations, but merely defines the obligations set out in the preceding sub-paragraph. The commercial considerations criterion becomes [therefore] relevant only after it has been determined that the governmental action at issue falls within the scope of the general principles of non-discriminatory treatment prescribed by the General Agreement ... The Panel found that there is no provision in the General Agreement which forbids requirements to sell goods in foreign markets in preference to the domestic market. In particular, the General Agreement does not impose on contracting parties the obligation to prevent enterprises from dumping ... Article XVII:1(c) is for these reasons not applicable to the export [requirements] at issue" (L/5504, paras. 5.16 - 5.18).

(c) Export subsidies

49. According to Article 9 of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (Subsidy Code) "Signatories shall not grant export subsidies on products other than certain primary products". The Illustrative List of Export Subsidies annexed to the Code states that one type of export subsidy is "the provision by governments of direct subsidies to a firm or an industry contingent upon export performance". If the government of Patria pays to a domestic enterprise prices that are higher than the normal market prices contingent upon that enterprise's exports of non-primary products, it acts inconsistently with Article 9.

50. Developing country signatories of the Subsidy Code are obliged to avoid export subsidies on non-primary products only if, and to the extent that, they have entered into commitments to reduce or eliminate export subsidies (Article 14). If Patria is a developing country, it

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1 The certain primary products are defined as "any product of farm, forest or fishery, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade".

2 Article III:8(b) exempts from the General Agreement's national treatment obligations "subsidies effected through governmental purchases of domestic products". It is clear from the drafting history that this exemption was not meant to override the provisions on export subsidies (see GATT, Analytical Index, Third Revision - March 1970, p.28).
would therefore act inconsistently with the Subsidy Code only if it had committed itself to refrain from granting subsidies. Whether or not Patria is a developing country, other signatories could, in accordance with the procedures laid down in Part I of the Code, levy countervailing duties to offset the export subsidy provided the subsidy causes injury to a domestic industry.

CASE 7: Valuation of bartered goods for customs purposes

The customs authorities of Patria, a signatory of the Customs Valuation Code, enquire on which basis they should determine the value of the imported goods for customs purposes in the following two cases:

(a) Pure barter. 110 tons of green coffee from Patria are exchanged for 10,000 barrels of crude oil from Tramontana. The transaction is neither expressed nor settled in monetary terms.

(b) Barter expressed in monetary terms. A manufacturer in Patria has the opportunity of selling electrical equipment in Tramontana provided an equivalent value of goods produced in Tramontana is bought and exported from that country. After an arrangement between the manufacturer and a trading company also in Patria, the trading company imports plywood from Tramontana and the manufacturer exports electrical relays to Tramontana.

The relays are invoiced at $100,000. The invoice presented on importation of the plywood into Patria also shows a value of $100,000. No financial settlement is, however, made between trading company and the seller in Tramontana the payment for the plywood being covered by the exportation of the relays by the manufacturer.

Relevant GATT provisions:

51. According to the Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade (Customs Valuation Code) the "customs value of imported goods shall be the transaction value, i.e. the price actually paid or payable for the goods when sold for export to the country of importation" subject to certain specified adjustments and conditions (Article 1.1). This rule, however, cannot apply if there has been no sale, the term being taken in its widest sense. Moreover, it does not apply if the sale or price is "subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued" (Article 1.1(b)).
According to an interpretative note to this provision, this is, inter alia, the case when:

- "the price of the imported goods is dependent upon the price or prices at which the buyer of the imported goods sells other goods to the seller of the imported goods"; or
- "the price is established on the basis of a form of payment extraneous to the imported goods, such as where the imported goods are semi-finished goods which have been provided by the seller on condition that he will receive a specified quantity of the finished goods".

52. If for one of these reasons the transaction value rule does not apply, the customs authorities must use one of the other methods of valuation provided for in the Agreement—taken in the specified sequence.

53. The two cases described above have been analysed by the Technical Committee on Customs Valuation in an Advisory Opinion on the Treatment of Barter or Compensation Deals under the Agreement (Advisory Opinion 6.1). The opinion of the Technical Committee as to the case of pure barter was as follows:

"Disregarding the question as to whether a sale has occurred in cases of pure barter, where the transaction is neither expressed nor settled in monetary terms, and there is no transaction value or objective and quantifiable data for determining that value, the customs value should be established on the basis of one of the other methods set out in the Agreement, taken in the sequence prescribed".

54. As to barter expressed in monetary terms, the Technical Committee found that:

"Under the legislation of some countries barter transactions expressed in monetary terms can be regarded as sales. Such transactions however will of course be subject to the provisions of Article 1, paragraph 1(b)".

55. The Technical Committee noted that this would also apply in regard to cases of partial barter where part of the transaction involves a money payment.

CASE 8: Countertrade induced by exchange controls

Patria, a member of the International Monetary Fund, introduced a tax on the purchase of foreign exchange for import purposes varying between 10 and 30 per cent depending
on the type of good imported. The Fund regards the tax as a multiple currency practice and has approved it for a period of one year in accordance with Article VIII, Section 3, of the Fund's Articles of Agreement. Five years before introducing the exchange tax, Patria had negotiated with Tramontana tariff concessions which were included in the GATT schedules of concessions of the two countries. Patria had agreed to a maximum tariff of 10 per cent on skis and Tramontana to a zero tariff on deep-freezers. After the introduction of the exchange tax, importers of skis in Patria not only have to pay 10 per cent customs duty but also a 30 per cent tax on the purchase of the foreign exchange needed to pay for the skis. In order to avoid the exchange tax, many importers in Patria engage in countertrade.

Tramontana complains in the GATT about the countertrade-inducing exchange tax of Patria which, in its view, is contrary to the letter and spirit of the General Agreement. It acknowledges that the tax can be avoided through countertrade but feels that, given the costs and risks of countertrade, the exchange tax impairs the commercial value of the tariff concession on skis.

Relevant GATT provisions:

56. According to Article II:1(b), items included in a GATT schedule of concessions shall be exempt from ordinary customs duties in excess of those set forth in the schedule "and from all other duties or charges of any kind imposed on or in connection with importation". Unlike the most-favoured-nation clause of Article I, Article II does not apply to "charges imposed on the international transfer of payments for imports". This raises the question of whether the tax introduced by Patria is a charge on importation contrary to Article II or a charge on the transfer of payments not covered by this provision.

57. If the distinction between import charges and payments charges were made on the basis of the effect of the action, the tax would be both a trade and an exchange measure since it has an impact both on the payment for imports and the importation itself. If, however, the distinction were made on the basis of the restrictive technique used, the tax would have to be regarded as an exchange measure since it is formulated and operated as a requirement to be fulfilled for the purchase of foreign exchange rather than for importation.
58. The Executive Directors of the International Monetary Fund have decided in 1960 that, for the purposes of Article VIII of the Fund Agreement, the criterion for distinguishing between trade and exchange measures should normally be the technique used. "The guiding principle", they determined, "in ascertaining whether a measure is a restriction on payments and transfers for current transactions under Article VIII Section 2, is whether it involves a direct governmental limitation on the availability or use of exchange as such" (Decision No. 1034-(60/27) of 1 June 1960).

59. The CONTRACTING PARTIES have never taken a formal decision on how to distinguish between trade and exchange controls. A special sub-group set up in 1954 during the Review Session, which carried out an examination of GATT provisions on balance-of-payments restrictions and GATT-IMF relations, concluded that "in many instances it was difficult or impossible to define clearly whether a government measure is financial or trade in character" (BISD 3S/196). The sub-group, however, noted that the division of work between the CONTRACTING PARTIES and the Fund was in practice "based on the technical nature of government measures rather than on the effect of these measures on international trade and finance" (BISD 3S/196). According to that practice, the exchange tax of Patria constitutes an exchange and not an import tax and is therefore not covered by the obligation under Article II to refrain from levying charges in excess of the bound tariff.

60. Article XV:4 stipulates that "contracting parties shall not, by exchange action, frustrate the intent of the provisions of the [General] Agreement". The tax on the purchase of foreign exchange clearly frustrates the purpose of the tariff concession on skis. However, Article XV:9(a) exempts from all GATT obligations "the use ... of exchange controls ... in accordance with the Articles of Agreement of the International Monetary Fund". The tax is in accordance with Patria's obligations under the Fund's Articles because the Fund has approved it. Whether the general exemption of Fund-authorized exchange actions relieves contracting parties also of their obligation not to frustrate the General Agreement's intent
through such actions, was discussed in the 1954 sub-group, which however reached no conclusion. It agreed that the question should be left "over for empirical consideration if and when particular points arose which had a bearing on it" (BISD 38/198). It is therefore uncertain whether or not the exchange tax in Patria conflicts with the provisions of the General Agreement.

61. According to Article XXIII, the government of Tramontana can bring a complaint against Patria not only if its trade suffered as a result of a failure of Patria to carry out its obligations under the General Agreement but also if a benefit accruing to Tramontana under this Agreement is nullified or impaired as a result of the application by Patria of "any measure, whether or not it conflicts with the provision of the [General] Agreement" (Article XXIII:1(b)).

62. It has been recognized in past GATT practice that a nullification or impairment of the benefits arising from a tariff concession exists if the following two conditions are met:

- a measure was introduced after the tariff negotiations, which upsets the competitive relationship between the products concerned;

- the measure could not have been reasonably anticipated at the time the tariff concession was negotiated (see the report of the Working Party on the Australian subsidy on ammonium sulphate (BISD Vol.II/193) and the report of the Panel on the treatment by Germany of imports of sardines (BISD 1S/58)).

63. When the tariff concession on skis was negotiated, Patria did not apply exchange controls and presumably the exchange tax could not reasonably have been foreseen. The tax upsets the competitive relationship between domestically produced skis and those imported from Tramontana because it applies only in the case of imports but not in the case of domestic purchases. In accordance with Article XXIII:2, Tramontana could therefore request the CONTRACTING PARTIES to
investigate the matter and to make recommendations to Patria, for instance a recommendation to remove the exchange tax. Such a recommendation would not create a legal obligation on the part of Patria to abolish the exchange tax; but, if Patria did not eliminate it, the CONTRACTING PARTIES could re-establish the negotiated balance of benefits by authorizing Tramontana to suspend GATT obligations vis-à-vis Patria, for instance the obligation to levy a zero duty on deep-freezers (cf. BISD II/195).

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64. The case studies have shown that countertrade as such is not contrary to GATT or to any of the codes supplementary to it. However, depending on the circumstances of the particular case, governmental measures that require, stimulate or take the form of countertrade, or that react to countertrade, can be inconsistent with obligations under the General Agreement or the codes. With the exception of Article V:14(h) of the Agreement on Government Procurement, none of the provisions examined specifically refers to countertrade. However, the rules of the General Agreement and of the codes relating to the use of restrictive import measures and export subsidies appear to be sufficiently broad to cover also those cases in which protection or export subsidization results from a requirement or inducement to engage in countertrade.