BARTER TRADE: SOLVING LACK OF LIQUIDITY

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Abstract

In the times of an economic downturn, people usually begin to search for alternative business models, which could help them to sustain the crisis. The paper argues that barter transactions could prove to be useful in the case of lack of liquidity. But the barter in its historical form, requiring the double coincidence of wants, would be most likely rather cumbersome to apply in today's day and age. Computer-facilitated barter exchanges allow overcoming this burden using an alternative exchange media - trade credits. This way no cash is needed, while the transaction can be asynchronous. Of course, distribution costs may limit the extent of barter transaction. On the other hand, people do not tend to save trade credits as fiercely as cash. Therefore, promotion of barter trade may lead to a greater exchange of goods and services. Moreover, if it gets properly measured, in may also increase GDP.

Keywords: *barter; liquidity*

JEL codes: *E42, F13*

1. Introduction

The paper is motivated by the recent crisis, which is a kind of a liquidity crisis (although e.g. Roubini (2007) argues that it is not only a liquidity crisis but rather a credit crisis and crunch). Although the crisis has been approached using quantitative easing, it may be still worth to investigate any tool, which could be used in a similar situation. The paper tries to argue that barter trade, used in a larger extent, could bring some benefits in an economic downturn. It is worth mentioning that, according to Cresti (2005), although developed countries have their own barter industries, barter as such did not attract the interest of the economic literature.

In a last few months, there has circulated a humorous chain e-mail describing a situation in a small town and how a short visit of a tourist solved their debt issues. The chain e-mail is presented in Figure 1.

Figure 1 Text of a recent chain e-mail

> *A rich tourist came to a small town in the middle of the financial crisis. He went into the local hotel, placed a 200-dollar bill on the counter and went upstairs to check out what kind of rooms the hotel had to offer. In the meantime the hotel manager grabbed the bill, walked over to the butcher and used the bill to pay his debt. The butcher then took the bill to the cattle farmer and paid his debt to him. Next, the cattle farmer took the bill to the cattle feed supplier and paid his debt there. The cattle feed supplier then paid his debt to the local prostitute. The local prostitute brought the bill back to the hotel and paid her debt to the hotel manager. The hotel manager put the bill back on the counter. Then the rich tourist returns down the stairs and proclaims that he didn't like the any of the rooms. He grabs the bill and leaves the city. A pity, but more importantly, the town was now debt free and optimism was back.*

Source: http://organizationsandmarkets.com/2009/09/04/whats-wrong-here/

There could be two lessons learned from the humorous story:

- There may exist circles in graphs with a small number of edges. In other words, there may exist a small group of people (or of companies), in which everybody owes everybody. And since they are used to use cash (and also loans in case of companies) in everyday situations, they do not consider compensating their mutual debts as it is described e.g. in (Gazda, 2000).
- Even fake/worthless "money" may be used as exchange media (there is nothing like a $200 bill). This may imply that even other than government-backed (or commodity-backed) exchange media could exist and be accepted by people (or companies).

The rest of the paper is structured as follows: the second section discusses barter in a narrow and broad meaning, the third section focuses on barter exchanges, and last section concludes the ideas presented in the paper.

2. Barter

Bartering is a process, in which goods and/or services are directly exchanged for other goods and/or services without a common unit of exchange (without the use of money). This narrow definition describes barter rather from a historical perspective. There is no reason why some kind of value could not be assigned to bartered goods and services. The expressed value may be linked to a common denominator, which would serve as exchange media, such as length of work, or an existing currency. Of course, there might be drawbacks, e.g. a different qualification needed in the former case and a higher inflation rate in the latter case.

There is a large body of barter literature focused on Russia. Out of 344 Web of Science journal articles, which contain the word "barter" (some of which fall within chemical engineering and polymer science subject areas), 38 contain the word "Russia". But barter should not be considered connected only to developing countries. Organized barter trade between companies in the U.S. originated in the 1950s (Cresti, 2005). It is estimated that the U.S. domestic barter transactions generate $12 billion annually (Whitney, 2009). According to Williams (1996), organized barter is also used in the U.K., Canada, Australia, and New Zealand. The statement that barter becomes more important can be supported by the fact that many countries already imposed tax on barter transactions.

Exchange media are a kind of "products for which the utility that a user of the good derives from [use] of the good increases with the number of other agents [using] the good" (Katz and Shapiro, 1985). Selgin (2003) describes two reasons for the positive network effects:

- Indirect. The more agents who employ a particular medium of exchange, the more likely it is that prices will be quoted in terms of that medium of exchange, i.e., that the medium of exchange will also serve as the economy's principle medium of account.
- Direct. The more persons who use a particular exchange medium, the better its quality or performance.

It is possible to argue that the main condition for establishing a new/alternative exchange media is achieving a critical mass of users (people and/or companies). The easiest way to achieve it is to establish as institution. The next section focuses on barter exchanges.

3. Barter exchanges

According to (Marvasti and Smyth, 2001), domestic barter is likely to flourish during economic downturns as companies attempt to reduce excess business inventories through barter transactions instead of selling their products to liquidators at less than wholesale prices.

A description of the state of barter exchanges in the U.S. about a decade ago can be found in (Marvasti and Smyth, 1998). According to Cresti (2005), there exist two forms of barter:

- Corporate barter. Corporate barter companies (kind of brokerage houses) help large companies to exchange their products; trades often require part of the settlement in cash.
- Retail barter. Barter networks (barter clubs/trade exchanges) coordinate barter trade among their members – predominantly small and medium enterprises.

According to Alchian (1977), the most important deterrent to barter transactions used to be the cost of gathering information about the characteristics and attributes of goods available for exchange. Retail barter benefited from advances in computer science. Computers allowed establishing a multilateral basis for retail barter already at the end of the 1970s. These barter networks work via a system of mutual credit. (Meyer, 1999a) This relaxes the condition of synchronous bilateral exchange. Barter networks act as neutral third record keepers and charge a membership fee and a transaction fee in cash for their services.

One of the largest barter networks in the U.S. is International Monetary Systems, Ltd. (imsbarter.com). It acquired several independent barter networks in its 25 year history, so its growth was to a certain degree extensive. On the other hand, the size is of essence when it comes to benefiting from network externalities.

It is open only to companies. So, one could see a limitation in comparison with cash in the fact that individuals cannot take advantage from the barter network. On the other hand, if individuals had anything to offer on a regular basis, they could easily become sole entrepreneurs and join the barter network.

Their trade credit is denominated in “trade dollars”. The term “dollar” in the name of trade credit may, through a mental link to the U.S. dollar, introduce inflation from cash economy into the barter exchange. Otherwise the trade credit could preserve value even better than cash during a higher inflation period.

There is a limit to the variety of goods and services exchanged. On the other hand, retail barter is not meant to replace the cash economy, only to allow for exchanges, which would probably not happen otherwise.

There are also some geographic limitations - distribution costs are a burden, especially for goods. The best suitable for international trade are services related to tourism. More about international barter can be found in (Marin and Schnitzer, 2002).

It is worth mentioning that some U.S. barter networks provide members with a dual credit card, which gives users the possibility to decide whether to settle a transaction either in cash or in trade credit. Actually, the card is able to distinguish between cash and barter transactions and settle it correctly (Meyer, 1999b). The ability to flexibly decide between the type of a settlement may offset the finding of Engineer and Shi (2001) that barter transactions are less efficient than cash ones under certain circumstances.

Last but not least, as Marvasti and Smyth (1999) point out that barter networks are able to create barter money through the same process as the banks are able to create bank money, i.e. by providing loans. But barter networks are not regulated in barter money creation.

4. Conclusion

Barter allows conducting exchange of goods and/or services without cash. Unlike in the age of the first labor division, barter trade may be complemented by cash or trade credit. Barter exchanges allow for multilateral trades, which may be asynchronous. The computer platform also makes it easier to communicate what is offered and what is requested.

Trade credit may preserve value better than cash in a case of a higher inflation, in case it is not connected to a local currency. Moreover, ability of barter networks to create barter money is not regulated in any sense, so they have a potential to provide additional liquidity in the period of liquidity crisis.

It may be expected that people do not tend to save trade credits as fiercely as cash. Therefore, promotion of barter trade may lead to a greater exchange of goods and services. Moreover, if it gets properly measured, in may also increase GDP. To sum up, as Cresti (2005) puts it, retail barter is complementary, not competitive, to the cash economy.

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