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Raising the Standard of the Trade and Barter Industry Since 1979

RATIONALE, BENEFITS, AND PUBLIC POLICY CONSIDERATIONS OF COMMERCIAL BARTER EXCHANGES

WHAT WOULD YOU SAY IF YOU WERE CALLED UPON TO TESTIFY BEFORE YOUR NATIONAL LEGISLATURE ON THE ECONOMIC RATIONALE FOR BARTER AND WHETHER IT SHOULD BE ENCOURAGED AS A MATTER OF PUBLIC POLICY. IN THIS THINK-PIECE, IRTA'S FOUNDER PAUL SUPLIZIO TACKLES A QUESTION THAT THE BARTER INDUSTRY MUST ANSWER AS IT CONTINUESTO GROW INTERNATIONALLY.

To understand the role of commercial barter in the modern world, let us look at barter's role at four distinct levels: the firm, the community, and the national and international economies.

WHY BARTER IS AN EXCELLENT ALTERNATIVE FORM OF COMMERCE

Business people barter because they are able to finance the purchases of things they need out of additional sales of their own product or service. When a merchant buys something using barter credits, he knows that the purchase will be paid for by his sales to other businesses in the marketplace.

In a cash situation, the cash spent by the merchant for the same purchase would have to come out of existing sales, not new sales. He has no assurance, when he makes a cash purchase, that this will result in additional sales of his own product. His prospects for making additional sales increase when he participates in the barter marketplace, because barterers will go out of their way to buy from other barterers. This is because they are paying with their own unused inventory or spare capacity.

The economic advantages of barter hinge on the fact that barter brings in new business and conserves cash. Barter sales are an increment over and above cash sales. They are a supplement to a firm's cash business, usually amounting to not more than 20 percent of total business. All firms can take advantage of barter to bring in new business. Those firms with spare capacity or excess inventory have strong incentives to do so.

Financing purchases through additional sales of its own product or service is often the cheapest method of finance available to a business. This is because it is paying for its purchases with the profit margin on its extra sales or unused capacity.

Incremental barter sales yield trade dollars or trade credits which may be spent with the barter company or other members of the barter system. Trade dollars are units of account denominated in dollars representing the right to receive, or the obligation to pay, in goods or services available through the barter system. These accounting units are maintained by the barter exchange, which acts as a central clearinghouse. The cost of one trade dollar is the inventory, labor, or other cost of producing an additional dollar's worth of barter sales. A firm buys with trade dollars which cost it less than the revenue it earns from extra sales. In textbook economics, so long as incremental revenue exceeds incremental cost, there will be an economic incentive to make the extra sale.

As an example, take an auto parts supplier who does a good deal of direct mail advertising. He joins a barter exchange and notes that several printers are members. Other things being equal, he has an incentive to buy his printing from the barter printers because (a) he won't have to reduce his cash flow for this business expense, but instead, (b) he can finance this expense out of trade dollars earned from barter sales of his own products and services to other members of the barter system, at a price that exceeds his incremental cost.

Barter aids the businessman who has reached a certain level of cash sales and still has the capacity to expand output; or who has excess inventory or unproductive assets. Few and fortunate, indeed, are the business people who, having made an investment in plant and equipment, find themselves operating at full or over-full capacity. For most firms, spare capacity and obsolescent or unused inventory are a normal occurrence, with a powerful economic plus: they permit additional sales at relatively low incremental cost.

Examples are the printer, with large sunk costs in equipment, but relatively low cost of additional output; the hotel with rooms unfilled; the dentist with time to take more patients; the radio or television station with unsold advertising. These firms are foregoing income from their unused capacity. If shown how to stimulate additional sales through barter, they have a strong incentive to make those sales as long as they can cover their costs. The price at which they can sell on barter will either be the same as the normal cash price, or as a minimum, a price greater than the cash liquidation value of inventory. Firms with high cash Inventory costs will find barter even more advantageous if they are able to receive some cash in the transaction to apply to the cost of their inventory.

Income taxes take away part of the extra profit from barter sales. However, even at the highest bracket rate, a firm makes money after taxes on its additional sales. While reducing the extra profit, the income tax should not affect a firm's decision to make sales to reap that profit. This applies whether the additional sales are cash sales or barter sales. Since passage of the Tax Equity and Fiscal Responsibility Act of 1982 in the U.S., barter exchanges are required to report the barter income of their clients to IRS on Form l099-B.

The economic advantages of barter can be seen by comparing a firm's position before and after barter. We see that barter results in additional revenue, hence added profit; barter enables a firm to conserve cash, resulting in better liquidity and a saving equal to the going cost of money. Firms also gain from an intangible web of referrals, advertising and associations that generate both additional cash and barter business.

The barter company's commission charges must be included in a firm's cost calculation, but these charges are normally not a deterrent to barter. Indeed, the largest cost a firm can experience is the income foregone by not selling on barter. In many cases, firms might find it profitable to pay an even higher commission in order to have the opportunity to reap additional profits through barter sales.

BARTER INCREASES COMMERCE WITHOUT DISPLACING PRIOR CASH BUSINESS

Barter would benefit an economic community even if the barter system consisted of firms who had previously been each other's cash customers. This is not to say that barter sales should replace cash sales at the same selling price--they should not. But the reality is that cash sales are limited by the cash incomes of firms in the community, resulting in some firms having excess capacity. These firms do more business with each other if they can barter because of their ability to (1) make additional sales out of excess capacity, earning "new" money in the form of trade credits, and (2) paying for what they buy with these additional trade credits whose cost to them is the incremental cost of their own product or service.

Establishing a barter exchange results over-all in new business for the community rather than displacement of pre-existing cash business. This conclusion stems from the existence of surplus inventory or excess capacity in the cash economy, and the ability of firms to make extra sales and earning "new" money in the form of trade credits. The new money supply adds to the cash money supply, and the extra liquidity finances a higher level of real trade.

BARTER AND THE NATIONAL AND INTERNATIONAL ECONOMY

By increasing demand for final goods and services in an economy, barter generates additional employment, production, and purchasing power. It results in a higher rate of capacity utilization, and enables firms to spread their overhead costs over more units of output, thereby reducing average cost sand lessening inflationary pressures. Textbook economics tells us that when an economy is operating at full capacity, costs shoot up dramatically because of resource shortages and bottlenecks. But it is clear that there is a range between current capacity utilization (about 80 percent in the U.S.) and full capacity within which firms can expand output at constant or even declining cost. It is within this range that commercial barter transactions take place.

The reality is that a modern economy lacks a fully elastic currency, capable of expanding with the growth of production and providing the liquidity needed to clear product and service markets. Because monetary fluctuations have contributed to economic instability in the past, a nation's money supply is not permitted to expand to meet the demand for money to finance an increase in gross domestic product. Instead, the money supply is controlled by monetary authorities who have their eyes fixed on particular economic objectives: curbing inflation, ensuring full employment, protecting the value of the currency in foreign exchange markets, and so on. Balancing between these sometimes conflicting objectives often leads in advanced economies to a policy of monetary restriction. This restrains the flow of spending in the cash economy, limiting demand for output, and creating excess capacity.

Barter and its modern counterpart, the creation of trade credit to finance greater demand for goods and services, helps alleviate monetary stringency, puts unutilized capacity to work, and speeds up the flow of goods and services to their most productive uses. It thus adds an important measure of flexibility to the trade and payments system and market adjustment mechanisms of the domestic and international economies at a period in history when global economic organization is undergoing a dramatic restructuring. Commercial barter should therefore, as a matter of public policy, be encouraged.