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Gerhard Maier\*

# Costs and Benefits of International Barter

*International barter transactions are becoming increasingly important in world trade. The following article examines the reasons for this as well as its implications for competition and the international division of labour, and presents an assessment of future developments.*

Compensation deals and other forms of barter, in which Soviet natural gas, for example, may be traded for German steel pipes, Argentine beef for Italian shoes or Iranian oil for Japanese computers, are now widely estimated to account for around 20% of world trade.<sup>1</sup> Observers are almost unanimously assuming that the trend is upwards,<sup>2</sup> and some even expect its share to have risen to 50% by the end of the century.<sup>3</sup>

This trend gives pause for thought, since hitherto few people have questioned that the use of money brings considerable advantages. Not for nothing does the pure barter economy belong to the dim and distant past; thousands of years before Christ it began gradually to be replaced by economic systems based on the use of money and increasingly sophisticated payment techniques.<sup>4</sup> Does the rising popularity of barter now mean that the benefits of money were overestimated and that the trend is being reversed? That is the question this article seeks to answer.

International compensation deals are not generally a pure exchange of "goods for goods", in other words barter, but purchases that are settled in money but which also commit the supplier to undertake a counter transaction in one form or another.<sup>5</sup> In fact countertrade appears in many guises, since transactions are often tailored to the needs of the parties. The best-known variants are:

- Counterpurchase: the imported goods are paid for in money, but the seller undertakes to spend at least part of the proceeds buying goods from the importing country. As a rule two contracts are concluded.
- Buy-back: such deals are often concluded in connection with the supply of industrial plant to the

Soviet Union. The plant supplier undertakes to purchase part of the factory's future output and to export it to specified third countries.

- Offset: the exporter of goods to a particular developing country makes a simultaneous offsetting investment in the country concerned.

## Genesis of the New Barter Deals

Barter deals in one form or another were not unusual in past centuries, for the money economy was never able to suppress them entirely.<sup>6</sup> However, they underwent a veritable renaissance immediately after the second world war.<sup>7</sup> No wonder, for the desolate state of the international financial markets, and especially the inconvertibility of currencies and lack of internationally accepted payment instruments, often left businessmen no choice but to make deals on a physical basis. The

<sup>1</sup> See Aloys Schweitert: Durch Tauschhandel aus der Devisenklemme, in: Schweizerischer Bankverein (ed.): Der Monat, May 1986, p. 13; Anon.: Vom Countertrade zum Seidenhandel, in: Börsen-Zeitung, 24th September 1987.

<sup>2</sup> Cf. Frank Gray: Important tool for exports, in: Financial Times, 7th February 1985; Walter Engelmann: Kompensationen sind heikle Gegengeschäfte, in: Blick durch die Wirtschaft, 16th January 1987.

<sup>3</sup> Cf. Anon.: Gegengeschäfte: Ansteckender Virus, in: Wirtschaftswoche, No. 26, 22nd June 1984, p. 41.

<sup>4</sup> Cf. Hugo Godschalk: Die geldlose Wirtschaft – vom Tempeltausch bis zum Barter-Club, in: Bankhistorisches Archiv, Vol. 10, No. 1, July 1984, pp. 54 ff.

<sup>5</sup> Cf. Frank Gray: No business for faint hearted, in: Financial Times, 7th February 1985; Adrian E. Tschögl: Modern Barter, in: Lloyds Bank Review, October 1985, pp. 32 ff.; Aloys Schweitert, op. cit., pp. 12 ff.; Heinrich Binder: Praxis des Außenhandels. Kompensation im Außenhandelsgeschäft, in: Mitteilungen der Bundesstelle für Außenhandelsinformation, supplement to Nachrichten für den Außenhandel, June 1987, No. 10.215.87.000.

<sup>6</sup> Cf. Rainer Schaad: Kompensationsgeschäfte als Außenhandelsform, in: Neue Zürcher Zeitung, 30th November 1987.

<sup>7</sup> Cf. for example Norman S. Fieleke: Barter in the Space Age, in: Federal Reserve Bank of Boston: New England Economic Review, November/December 1983, pp. 34 ff.

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situation improved in the fifties, but the Comecon countries clung to the practice. When importing goods from the West they very often continued to insist that the supplier undertake to purchase certain eastern bloc goods in return.

The practice then spread to other regions, however, and long ago it found many imitators. Since the early seventies barter deals have flourished, especially in trade with those developing countries which are primarily oriented towards agriculture. An increasing proportion of Third World imports are being tied to compensation deals. The purchase of machinery, cars and aircraft is coupled with the sale of tobacco, rubber, cane sugar, and so forth.<sup>8</sup> Sometimes more complicated deals are struck; a new variant, called debt-equity swaps, entails the exchange of debt for stakes in industrial enterprises, plantations, hotels and the like.<sup>9</sup>

Barter transactions are also gaining importance among newly industrialising countries, in other words developing countries in the process of joining the ranks of the industrial countries. In Singapore, for example, which for years had rejected barter deals as an offence against the pure teachings of the market economy, an increasing number of transactions are being concluded on an exchange basis.<sup>10</sup> This change of heart stems mainly from the desire not to be left behind by developments in world trade.

In many industrialised countries too, however, barter deals are enjoying a certain popularity. The USA is showing an active interest in such transactions. In the past the Americans were keen to exchange surplus farm produce (mainly wheat) for strategic goods (such as oil) and, according to press reports, are now attempting to resume the practice.<sup>11</sup>

### Reversion to Barbarism?

At first sight, it appears that fundamental economic aspects are being neglected. The recrudescence of the barter economy is therefore often seen as a reversion to barbarism. After all, the replacement of the barter economy by the money economy was an important prerequisite for the modern economic system based on the division of labour. The archaic practices of pure

<sup>8</sup> Cf. Peter Truell: Barter Regains Favor in Developing Nations Wrestling with Debt, in: *The Wall Street Journal*, 11th August 1983.

<sup>9</sup> Cf. for example Gerhard Maier: Debt-Equity-Swaps – Ein Ausweg aus der Schuldenkrise?, in: *Sparkasse*, Vol. 104, No. 11/1987, pp. 504 ff.

<sup>10</sup> Cf. Anon.: Singapur entwickelt den Barterhandel, in: *Börsen-Zeitung*, 28th August 1987.

<sup>11</sup> Cf. Anon.: Zurück zum Tauschhandel?, in: *Frankfurter Allgemeine Zeitung*, 22nd August 1987.

exchange in kind are simply so costly that they could not have permitted the growth we have experienced in the last hundred years. It was the introduction of money – in other words a widely accepted means of payment, unit of account and store of value – that made a dynamic economy as we know it today possible, for it reduced costs substantially and hence released resources for other purposes.<sup>12</sup>

In view of these circumstances, the renaissance of barter in international merchandise trade seems an anachronism. However, the growing importance of such deals suggests that they offer advantages that outweigh the known disadvantages. What is the motivation behind barter deals?

The motives of barterers in the eastern bloc are not difficult to fathom. Ideological considerations are an important factor. The general distrust of the market and its mechanisms, which are unfamiliar and incomprehensible to many people there, triggers a flight into alternative trading methods. The eastern bloc's interest in barter is also heightened by its chronic shortage of foreign exchange. Since they do not have enough dollars, Deutsche Mark and other currencies widely recognised as international payment instruments, it is difficult for them to import products from the West. Instead, eastern bloc traders generally try to pay for the imports they want by swapping them either directly or indirectly (via compensation deals) for goods produced in their own countries.<sup>13</sup>

This is a very costly exercise – for both sides. Those who enter into compensation deals with the eastern bloc suddenly find themselves having to market eastern bloc goods. They are therefore forced to find buyers for goods that are often difficult to sell because of poor quality.

### Breakdown of Exchange Chains

In many cases the goods cannot be "placed" immediately; a trader must often approach many potential purchasers if he wants finally to be rid of the goods. Intermediate deals will often be struck in which the goods are exchanged for others, which in turn are swapped until eventually the trader makes the final switch into money.<sup>14</sup> Very long exchange chains can develop in which, for example, Ukrainian textiles are

<sup>12</sup> Cf. Gerhard Maier: Die inlandswirksame Geldmenge in einer interdependenten Welt, Berlin 1987, pp. 41 ff. and the literature listed therein.

<sup>13</sup> Cf. for example Gerald B. Leyer: Probleme bei Kompensationsgeschäften, in: *Blick durch die Wirtschaft*, 16th May 1986.

<sup>14</sup> Cf. for example Anon.: Too much Barter is bad for you, in: *The Economist*, 9th May 1987, p. 64.

exchanged for Philippine rice, which is swapped for tea from Sri Lanka, which is swapped for lamb from New Zealand, and so on.

It is therefore not surprising that one constantly hears of cases in which the chain has broken down, so that exporters who have let themselves in for barter deals are left with the goods on their hands or can dispose of them only at a substantial discount. The cost of such deals therefore consists not only in the quality difference in relation to the world market level and the losses incurred if the trader wishes to sell the goods in the West but also in the considerable administrative costs entailed by such transactions.<sup>15</sup>

Compensation dealers are well aware of these disadvantages and thus demand substantial price

<sup>15</sup> Cf. Hans-Jürgen Müller, Hans-Andreas Siemann: Bei Kompensationen nimmt die Variationsbreite ständig zu, in: Handelsblatt, 27th September 1985.

discounts. With pure barter deals, they will generally demand to be paid in goods whose nominal value is higher than that of the goods they are supplying. The difference is intended to cover the costs, but this means that the costs of the operation are passed back to the originator of the deal. But if eastern bloc states derive no direct benefit from barter deals because of the lower prices they receive, the question arises why they do not market their goods themselves and use the foreign exchange received to pay for imports. The answer lies in the indirect advantages.

#### **New Market Openings**

If one examines barter deals closely, it becomes clear that as a rule they are used in an attempt to create new openings in the world market. In many cases eastern bloc counterparts credit the compensation dealers with having the knowhow to sell the goods at a better price than they could themselves.

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Indeed, some of the large companies operating worldwide have very shrewd barter departments that carry out exchanges on a global basis. Specialised organisations have also emerged over the years, often as subsidiaries of multinational concerns, and have accumulated essential experience of compensation deals and established the necessary information networks and business contacts.<sup>16</sup> The comparative advantages achieved as a result of specialisation often enable such brokers to hold down the costs of international barter deals and at the same time to stimulate trade.

Banks have also entered the field, in some cases initially out of necessity.<sup>17</sup> Involvement in worldwide barter deals can be highly profitable for multinational banks, provided they exercise skill. One important factor is the business relationship with customers active in barter trade.

The question also arises why developing countries do not sell their wares in the world market direct and use the foreign exchange earned to pay for their intended purchases. Since what they are offering in the world market is generally raw materials and food, in other words more or less homogeneous goods that do not usually require special marketing efforts, the reason can hardly be doubted about their ability as a seller in the world market.

The explanation probably lies less in the shortcomings of the goods than in the imperfections of world markets. In fact, barter deals are often a means of circumventing protectionist barriers in the form of quantitative import limits or non-tariff barriers.<sup>18</sup> Potential importing countries are obviously more inclined to allow trade barriers to be breached if their imports are linked to exports. Furthermore, it appears that western exporters are more interested in such compensation deals than they admit, since they often face politically motivated marketing problems.

### **Implications for Competition**

The compensation deals by various OPEC members are a rather delicate matter.<sup>19</sup> The exchange of oil for industrial goods, including arms, plays a prominent role. The oil prices on which they are based often undercut OPEC's reference price or the volumes of oil delivered under barter deals cause oil production to exceed the quotas agreed within the organisation. This happens because such complex operations are difficult for third parties to reconstruct and are thus almost impossible to monitor. They therefore enable OPEC members to circumvent the cartel's rules. If this possibility is

exploited intensively, it cannot be ruled out that the supply of oil on the world market will be larger and oil prices lower than they would have been without barter deals.

In assessing barter deals, however, it should not be overlooked that as a rule they only involve two parties, so that other market participants are normally excluded. This may lead to price discrimination, since they are not based on world market prices. Hence in many cases barter deals can restrict competition and distort international trade relations.<sup>20</sup>

### **Stimulus to World Trade?**

Barter transactions are so varied that it is difficult to pinpoint their effect on the economy as a whole. What is not in dispute, however, is that they entail costs that do not arise with pure monetary transactions. They therefore raise the question whether they damage the world economy as a whole by tying up resources that could be used in other ways. The funds spent on administering such operations can be neither invested nor spent on consumption.

This cost assessment is too one-sided, however, since it ignores the fact that many exports would not come about without barter deals. Barter therefore has an essentially stimulatory effect on exports,<sup>21</sup> so that the volume of world exports would probably be lower without such deals. The cost in the shape of administrative expenses must be set against the benefits, in other words the trade-creation effect. The benefits could ultimately lie in the stimulus barter gives to the international division of labour and hence to economic growth worldwide. Such a cost-benefit approach is possible in abstract terms only, since the problems of data collection are too great, but the dynamism of barter trade seems to suggest that at present the benefits outweigh the costs.

Another question is whether a substantial increase in the proportion of world trade transacted via barter deals

<sup>16</sup> Cf. John W. Dizard: The Explosion of International Barter, in: *Fortune*, 7th February 1983, pp. 88 ff.

<sup>17</sup> See for example Günter Hackenschmidt: Gegengeschäfte und Leistungsangebot der Kreditinstitute, in: *Mitteilungen der Bundesstelle für Außenhandelsinformation*, op. cit., pp. 9 ff.

<sup>18</sup> Cf. Anon.: Der Realtauschhandel im Widerstreit zwischen Exportindustrie und Wirtschaftspolitik, in: *Neue Zürcher Zeitung*, 12th May 1987.

<sup>19</sup> Chris Cragg: Damaging influence to the cohesion of OPEC, in: *Financial Times*, 7th February 1985.

<sup>20</sup> Cf. Jacques de Miramon: Countertrade: An Illusory Solution, in: *The OECD Observer*, No. 134, May 1985, pp. 27 f.; Norman S. Fieleke, op. cit.

<sup>21</sup> Cf. Rainer Schaad, op. cit.

could also be assumed to have a positive net effect. The stimulus to trade from an expansion in barter would presumably be small, since the costs are ultimately reflected in the prices of the goods in question and hence would tend to dampen demand. There are grounds for believing that costs would rise by a disproportionate amount, since not only the volume of bartered goods but also their variety would increase. Whereas the exchange of homogeneous goods (wheat, beef, steel) presents relatively few problems, swaps involving so-called high-tech goods (computers, aircraft, power stations) are virtually intransparent and hence are extremely costly.

#### Outlook for Barter Trade

The importance of barter trade in the world economy must be taken into account in any attempt to reach an overall assessment. A significant increase in barter might prove a burden to the world economy. If barter exceeds a reasonable proportion of total trade it will dampen economic growth worldwide, because costs will then outstrip the trade-creation effect. Moreover, its tendency to distort competition will outweigh the stimulus it gives to greater competition.

There can be no doubt that world trade would be crippled if it were conducted entirely on a barter basis. The danger that things will go that far is slight, however. The cost of barter deals should act as a natural regulator. At the very latest, the relative growth in the barter economy will halt when the additional costs of such operations exceed their additional benefits. For that reason, the trend towards the rationalisation of payments that has been under way for millenia will not be reversed; the money economy will not become obsolete. It is to be expected that barter deals will remain confined to niches created by market imperfections, such as protectionism, incomplete information on the nature of markets, preferences, political animosity, and so forth.

As long as barter does not exceed the "tolerable" level at which its advantages turn into disadvantages it presents no difficulties and may be regarded as the "lubricant" of the international division of labour. It is therefore the task of economic policy-makers to dismantle protectionist barriers, especially within the framework of GATT, and thereby ensure that no additional incentives are created for switching to costly barter transactions.

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