How Bartering Works

by Jane McGrath


Trading lunches is commonplace at grade schools because bartering comes so naturally to kids.

Introduction to How Bartering Works

Remember back in school when kids would swap juice boxes for chips, or cookies forTwinkies? Even children have an innate sense that the comparable value of cookies to Twinkies is in the eye of the beholder. To the kid who gets cookies every day, the elusive cream-filled cake treat is worth more than a few, and he realizes his friend might feel differently.

Trading goods and services without the use of money is called **bartering**. Early civilizations relied on this kind of exchange. Even cultures in modern society rely on it. Think of people inprison who commonly trade cigarettes for protection or extra food. For the most part, they don't have cash. So, like people in pre-currency economies, they work with what they have.

But, since the advent of money-based systems, bartering is an option that most of us dismiss as soon as we get that first paycheck or allowance. Not so for a guy named Kyle MacDonald. He drew a media frenzy when, in a matter of one year and 14 trades, he bartered his way from a paper clip to a house [source: NPR]. Although he had a lot of help from his local government and some people in show business, his story offers dramatic evidence of today's existing market for bartering. MacDonald is one of many people who have taken advantage of the growing phenomenon of bartering over the Internet. This ancient practice is also alive and well in services that facilitate bartering and companies that swap favors.

In the next few pages, we'll take a look at the process of bartering, including whether it can work as a practical protection against inflation, and whether you can use it to avoid taxes.

Trade you: We'll explain the art of bartering for a simple click to the next page.


Fruit and grain merchants in the marketplace.

Tit-For-Tat: Barter Exchanges

As we saw in the cookies and Twinkies example, the value of something is relative. It depends on a person's needs, wants and preferences. For example, someone living in Texas would probably value an air conditioner more than someone in Alaska would. Bartering can be a sweet deal when the Alaskan happens to own an air conditioner and the Texan owns a heater, and each would gladly exchange one for the other.

Timing is another important factor. Take Shakespeare's Richard III, who offers "my kingdom for a horse" in the heat of battle. That's why if you get a flat tire on a dark night, you'll offer a lot more than the market value for a spare.

Historically, bartering was especially useful after humans dropped their nomadic ways and settled down to farming and living in communities. A wheat farmer can't live on bread alone, but he can trade some of his surplus yield to a cattle rancher in exchange for some meat. Or, the farmer can sell wheat to a hungry worker who has the skills to build him a new plow. With the new plow, the farmer can grow even more wheat for the next harvest with, and he can trade for more stuff. In these exchanges, each gets something he considers more valuable than what he gives up.

The plot thickens when the farmer needs something in particular, such as an ox for pulling that plow, and the only person who has oxen to trade doesn't need wheat -- but is willing to trade for corn. At this point, the farmer tries to find a corn farmer who's willing to trade for wheat and then use that corn to trade for the ox. Trading between three parties is called **triangular barter**. It would be further complicated if the corn farmer doesn't like wheat either, and the wheat farmer enters into a**multilateral barter** with even more people to eventually get an ox. Or, what if the farmer runs out of wheat and must resort to promising shares of next year's harvest?

Pure forms of the bartering economic system are extinct. Earlier in history, large economies relied widely on a barter system, but modern economies don't. Sure, you'll find remnants of it in rural areas or in developing countries, but much of the world has turned its back on bartering. It turns out the old-school system has a slew of shortcomings that makes currency a more preferable option. Read on to find out why.

Bartering for dummies

One form of ancient bartering is dumb bartering. Although some may argue how smart it is, the name refers to how it's a silent process -- in this trade, no one need exchange a word. It worked like this: two parties meet in a designated trading location. One party puts down all the items he wants to trade, then signals to the other party that it's his turn. Next, the second party inspects the items and puts down items that he feels will constitute a fair trade. Then, the first party comes back and either accepts this as a fair trade, or holds out for more [source: Groz].

In the barter system, traders must decide on fair exchanges, which can be difficult. In this depiction, one woman holds a scale to compare weights.

Disadvantages of Bartering

The barter system sustained early economies for millennia, and it probably predates recorded history. But, that doesn't mean it always works well. It has a lot of disadvantages that the invention of currency solved.

Sometimes bartering is just plain **impractical** because it takes a lot of time and work. Consider what life would be like in a barter economy. If you were a skilled artisan who made tables, then you'd barter tables for the things you need, like food. It's not a bad living, but what do you do when you want meat, and the herders don't use tables? You'd have to search for someone who is both in need of a table and has meat he's willing to sell. This takes a lot of time, and you're hungry now. You can always resort to orchestrating triangular or multilateral trade that we learned about earlier, but that also takes time. And, throughout the process, you're traveling from place to place and lugging heavy tables. This takes energy that you can be using more efficiently to make more tables. After all this hassle, you may be ready to quit the whole table business and instead fulfill your dreams of becoming a wine merchant.

Let's take another hypothetical situation: What happens when you want something small, like some tomatoes, and the tomato vendor asks you for a table in return? You'd probably argue that a table is worth a lot more than a few tomatoes. Unfortunately, the vendor can't do much with a single table leg, and you don't want hundreds of tomatoes that will spoil before you can eat them all. When you just have a few very valuable items, you'll have trouble making exchanges for several less valuable ones. Or, if you trade perishable goods, time becomes more of a factor -- you must trade them quickly or watch your assets rot into worthlessness. Because of this, you might be pressured into taking unfair deals.

Another problem barterers run into is deciding on an **equal trade**. You've probably heard the expression, "It's like comparing apples to oranges." But even apples and oranges, with all their differences, are both fruit of relatively equal size and shape. Can you imagine how difficult it would be to decide how many cows are worth how many pieces of wood?

When a society agrees on an acceptable form of currency, however, these problems either disappear or severely diminish. You no longer have to find people who have what you want and are willing to barter their stuff for what you're offering. Carrying coins is also easier than carrying tables. What's more, you can sell a table for 100 coins and then use one of those coins to buy a few tomatoes. With money, you don't have to compare apples and oranges. Even if you still have to negotiate how many coins an apple is worth, the matter is much simpler.

But money isn't always superior to bartering. Read on to find out why bartering is far from defunct.

Kyle MacDonald bartered an afternoon with Alice Cooper for a KISS snow globe – one of 14 barters he made from his way to a paperclip to a house.

Bartering Networks

We've seen how the barter system isn't as easy or as practical as money. But bartering has some advantages that make it a viable means of trade in some circumstances.

Like the saying goes, money isn't everything. **Inflation** can cause a unit of currency to lose value -- meaning that, while 50 cents could buy a bushel of apples last year, it may only buy a single apple this year. These fluctuations can hurt a society, causing stress, uncertainty and disaster to its economy. If things get bad enough, bartering, with all its disadvantages, can become an attractive alternative. This is why people resort to bartering in situations of great poverty or disaster.

Even in relatively healthy economies, folks barter. If you recall, one of the difficulties of bartering is finding someone with wants and possessions that are precisely the opposite of your own. With the advent of the

Internet, this is now easier than ever. People have resurrected the ancient practice of bartering using the Internet to swap things.

Bartering networks that specialize in helping barterers find each other have popped up. For a fee, a bartering network helps you find someone who is interested in what you have to offer or someone who has what you want. Along with breaking down geographical barriers, these services also simplify the timing problem with bartering. You can find what you want quicker. Also, instead of needing to complete both sides of a transaction at one time with one other person, you can accept **trade credits**. If you offer goods and services for barter, instead of accepting something back immediately, you can accept trade credits. Later, when you need something, you can use trade credits to purchase it.

Businesses also find some advantages by bartering. First, when they have surplus inventory or idle workers, they sometimes trade them for other goods and services. With this type of exchange, a business reserves its cash to use for other important things like paying down debt [source: IRTA].

Marketing is steeped in bartering as well. For instance, a business can always trade services for advertising space. Newspapers offer ad space, shops offer the side of their building for billboard space, film producers offer product placements -- the opportunities are virtually limitless. Sponsorships and promotions work the same way. If Coca-Cola buys the uniforms for a little league baseball organization, the teams can agree to put the Coca-Cola logo on each jersey and hang banner ads in their ballpark.

Bartering is everywhere. You're bartering when you promise to bake someone brownies if he helps you move into your new place. The same goes for when you take a tenant who agrees to pay his rent by doing home maintenance and yard work. No money is changing hands, but each party is giving and getting something in return.

From http://money.howstuffworks.com/bartering1.htm