COUNTERTRADE AS A REACTION TO LACK OF LIQUIDITY

Burhan Fatih Yavas, California State University, D.H.
Hamdi Bilici, California State University, Long Beach

Abstract

This research-in-progress is about one of the most prevalent forms of countertrade, a phenomenon which has received considerable attention in recent years. The review of the relevant literature is presented in terms of a theoretical framework similar to the one developed by Verzariu (1987). In so doing, the paper attempts to point out clearly the gaps in the literature. Since there are important differences among various forms of countertrade each countertrade deal should be examined individually (Hennart, 1990). This study singles out "international barter" as the form of countertrade to be investigated. Among the motivations for international barter, perhaps the most frequently mentioned is the lack of liquidity: "When the money game is impossible, countertrade remains the only game in town" (Samonis, 1990 p.121).

The objective of this study therefore is to provide, an example of how lack of liquidity may limit the volume of international trade. This objective is accomplished by using a standard single country neoclassical economic model (referred to in the literature as a"wedge" model) in a two-commodity two-factor setting. Model derivation requires some attention to the background assumptions for a wedge model of the trade balance, such as the role of uses of compensatory financing in international payments, equilibrium in the world as well as within specific countries.. etc.

An earlier attempt to by Bilici and Yavas (1992), which provided an example of the existence of liquidity constraints leading to countertrade, was based on the assumption of perfect competition in both factor and product markets. Even though the assumption of perfect competition is fairly standard in the literature, it seems unrealistic to have liquidity constraints and yet to claim that there is perfect competition in output markets. The present paper expects to remedy that problem. While the main contribution is the appropriate development of the basic analytical framework to incorporate international liquidity, the novelty of the paper is to permit imperfect competition in output markets.

Within the confines of the model being developed, it is shown that countertrade (particularly barter trade) can supplement money-mediated trade and therefore contribute to the growth of international business. Therefore, countertrade, far from being inefficient and cumbersome way of doing business, may be a rational response to conditions which restrict standard trade (Girling, 1992).

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