

THE BARTER SYSTEM

Before the evolution of money, exchange was done based on the direct exchange of goods and services. This is known as barter. Barter involves the *direct exchange of goods for some quantity of another goods*.

In the case of Goods exchanged for goods, for example, a horse may be exchange for a cow or 3 sheep or 4 goats.

Under a barter system for a transaction to take place, there must be a *double coincidence of wants*. For instance, if the horse owner wants a cow, he has to find out a person who not only possesses the cow but wants to exchange it with the horse.

In other cases, goods are exchanged for services. A doctor may be paid in kind as payment for his services. For example, he may be paid cock, or some wheat or rice or fruits. Thus, a barter economy is a *moneyless economy*.

It is also a simple economy where people produce goods either for self-consumption or for exchange with other goods which they want.

DIFFICULTIES OF BARTER

The barter system is the most inconvenient method of exchange. It involves a loss of time and effort on the part of people in trying to exchange goods and services. As a method of exchange, the barter system has the following difficulties and disadvantages:

1. Lack of Double Coincidence of wants:

The functioning of the barter system requires a double coincidence of wants on the part of those who want to exchange goods or services. It is necessary for a person who wishes to trade his goods or services to find some other person who is not only willing to buy his goods and services but also possesses those goods with the former wants.

For example, suppose a person possesses a horse and wants to exchange it for a cow. In the barter system, he has to find out a person who not only possesses a cow but also wants a horse. The existence of such a double coincidence of wants is remote probability.

2. Lack of Common Measure of value:

Another difficulty under the barter system relates to the lack of a common unit in which the value of goods and services should be measured. Even if the two-person who want each other's good meet by coincidence, the problem arises as to the proportion in which the two goods should be exchanged. There being no common measure of value, the rate of exchange will be arbitrarily fixed according to the intensity of demand for each other's goods, consequently, one party is at a disadvantage in the terms of trade between the two goods.

3. Difficulty in storing value:

Another problem of the barter system is that a person must store a large volume of his good in order to exchange for his/her desired goods with others on day to day basis. Take the example of a farmer who has produced wheat. Obviously, he will use some amount of wheat for his own consumption and keep some amount to get other necessary items by trading with others. If he wants furniture, then he will go to a carpenter who is willing to trade furniture in return for his wheat. Similarly, if he wants cloth, then he has to trade with a weaver who is ready to give cloth by receiving wheat and so on. So the farmer must construct a warehouse first to keep a stock of his wheat in order to carry out the transactions at the time of need for his desired good. But constructing and maintaining a warehouse was itself a very difficult task in the early days of civilization.

4. Lack of division of goods:

Certain goods are not physically divisible into small pieces. Suppose, a person possesses a cow and he wants items, such as cloth, food grains, etc. Then how much of cow can be traded for cloth; how much of cow can be traded for food grains? It was very difficult to determine because a cow cannot be divided into several pieces.

5. Difficulty in Making Deferred Payment:

In a barter economy, it is difficult to make payments in the future. As payments are made in goods and services only. The lack of durability in goods posed many problems in future payments.

Due to the above problems, the barter system could not continue for long. As human civilization progressed people realized that there has to be some common medium of exchange that can be easily carried, stored, and used to express the value of a good. So money came into being. Hence the need for money arose due to the failure of the barter system.

Questions:

1. Define double coincidence of wants?
2. Give two difficulties associated with the barter system?
3. Discuss the principal difficulties faced by a barter economy.