



Weekly Educational Topics



"TERMS OF TRADE IS A CONCEPT WHICH RELATES PRICES RECEIVED BY A COUNTRY FOR ITS EXPORTS TO THE PRICES IT PAYS FOR ITS IMPORTS."

"CHANGES IN TERMS OF TRADE CAN HAVE SIGNIFICANT CONSEQUENCES ON INCOME DISTRIBUTION IN A COUNTRY AND GLOBAL OUTPUT OF A COUNTRY."

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Terms of Trade

Terms of trade is a concept which relates prices received by a country for its exports to the prices it pays for its imports. It is usually measured in the same currency, considering either domestic or foreign currency for comparison. Similarly, it can also be interpreted as the measure of imports which can be bought per unit of exports.

Increases in prices of exports with no changes in prices of imports implies that more imports can be purchased with the same quantity of exports. This is known as an improvement in the terms of trade. Contrarily, an increase in the price of imports when export prices remain constant, leads to lower quantities of imports being bought with the same amount of exports. This is commonly referred to as a deterioration in the terms of trade.

Ordinarily, if the price of a product increases, countries exporting that good witness improvements in their terms of trade, on the other hand, importing countries experience a deterioration. Likewise, if the world price of a product falls, exporters of the good undergo deterioration in the terms of trade and importers face improvements.

Terms of trade are sensitive to changes in factors affecting international price indices. Changes in terms of trade can have significant consequences on income distribution in a country and global output of a country. Countries with improving terms of trade may have opportunities for growth which may lead to a higher overall standard of living. Additionally, it has impacts on the current account balance. Changes in terms of trade may lead to improvements in the balance of trade if it causes an increase in the value of exports or decreases in the value of imports.