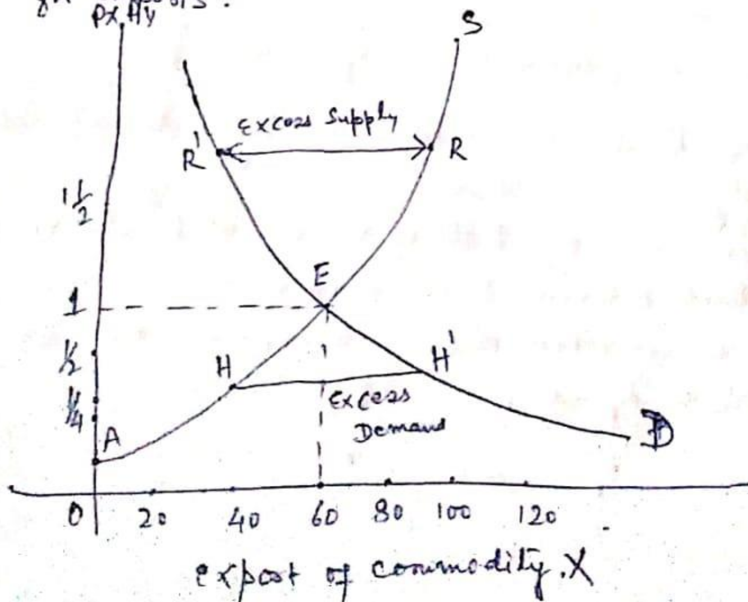
Terms of Trade – Its measurement

= The terms of trade of a nation are defined as the ratio of the price of its export commodity to the price of its import commodity.

= In the world of many traded commodities, the terms of Trade of a nation are given by the ratio of the price index of its exports to the price index of its imports.

= As supply and demand considerations change over time, offer curves will shift, changing the volume and the terms of trade.

= An improvement in a nation's terms of trade is usually regarded as beneficial to the nation in the sense that the prices that the nation receives for its export rise relative to the prices that it pays for imports.



J.S. Mill's View on Terms of Trade

- = Reciprocal demand Theory
- = Equation of international demand or Price Quantity eq.
- = It is that situation where the quantity of imported goods are equal to exported goods.

$P = Q$ (Price and Quantity both are equal)

= $P_1 Q_1 = P_2 Q_2$

where

P_1 = Con Price of commodity I

Q_1 = Quantity of commodity I

P_2 = Price of commodity II

Q_2 = Quantity of commodity II

or $\frac{P_1}{P_2} = \frac{Q_1}{Q_2}$

A. Marshall → (Marshall's Offer curves)

- = Terms of trade is determined by international demand and supply
- = Marshall focused on rate of wages while determining the terms of trade between two countries.
- = Marshall incorporated money costs in the determination of terms of trade