Factually, because a variation in terms of

Factually, the link between TT and gains from trade are quite complex and not easy to translate in quantitative terms. Doing so necessitates highly simplifying assumptions and even then the results tend to remain below acceptable level of accuracy; more so because a variation in terms of trade generates several indirect (or spill-over) effects as well. Direct Gains:

(a) Saving in Resource Cost:

Under conditions of unrestricted trade, a country gains from the fact that the resource cost of producing its exports is lower than the resource cost of producing its imports within its domestic economy.

However, there are several difficult problems in estimating this resource cost in quantitative terms, including the following. i. Production of several export items is subject to diminishing returns to scale, so that, at the margin, the advantage of saving in resource cost of production tends to get wiped out. ii.

Even if a country disregards cost considerations, it is seldom in a position to produce all imported items within its domestic economy (import substitution). By implication, the very concept of “ resource-cost of production” loses its meaning. For example, without having deposits of a mineral, it is not possible for a country to produce it.

(b) Price difference:

An attempt may be made to measure trade gains by using the difference in prices of items at which they are traded with their autarky or pre-trade prices. However, even here, the problem is that the autarky prices of goods are not available, and there are several items which the importing country cannot produce.

Indirect Gains: External trade of a country generates several forces which result in an ongoing restructuring of the trading economy leading to a mixture of beneficial and harmful effects. Trade exerts deep influence on its growth process, brings about changes in income and wealth distribution, and exposes it to disturbances originating in rest of the world. However, it is not possible to identify and quantify those components of changes in the economy which are attributable solely to changes in terms of trade.

Immiserising Growth:

Professor Jagdish Bhagwati demonstrates the possibility of a country (particularly a small one) experiencing a rapid growth in the productivity of only its export commodity.’ However, this may lead to such deterioration in its terms of trade that there is a net decline in the nation’s welfare. This phenomenon is termed immiserising growth and is more likely to take place in the process of growth of a developing country than in the case of a developed one, it being highly likely that the deterioration in terms of trade of a country would more than offset the gains of economic growth and result in immiserising grow.

Optimising Terms of Trade:

The inference that “ other things being equal, an improvement in its terms of trade means an increase in economic gains of a country” is not always valid. Such an improvement may be accompanied by a decline in its total welfare.

This can happen due to several reasons which include: i. Worsening of distribution of income and wealth, ii. Immiserising growth, iii.

Unemployment in import-competing industries, iv. Degradation of natural resources, and so on. Therefore, some thinkers are of the view that a country should not try to improve its terms of trade without considering its implications. It should aim at getting the best possible combination of its terms of trade and other economic parameters.