

Limitations quite popular, it suffers from certain drawbacks



Limitations of TTC: Even though Commodity (or Net Barter) Terms of Trade measure is quite popular, it suffers from certain drawbacks including the following: Problems Associated with Price Index Numbers: Since this measure is a ratio of two price index numbers, it suffers from all those limitations from which price index numbers themselves suffer. They include, for example, problems associated with the choice of the base period, the assumption that the base period was normal, the choice of weights, and the method of averaging, and so on. Till now, these problems have not yet been solved on a scientific and satisfactory basis. Stock versus Flow Variables: Price is a stock variable, while (like a flow variable) this measure covers a period of time.

This poses some conceptual problems of its own for which only imperfect solutions are available. Causes of Price Changes: TTC measure ignores the forces which affect the demand and supply functions of exports and imports of a country. A detailed study of these forces reveals that the usual conclusions drawn from a change in this measure of terms of trade can become invalid or even misleading. For example, a large number of economies are experiencing a rapid transformation, including adoption of technological innovations, introduction of new products, changes in product quality, changes in production costs, and so on. Similarly, consumer preferences and spending habits are also undergoing rapid changes in response to 'demonstration effect' and various forms of 'non-price competition'. Another noteworthy development is the fact of a growing dependence of some export industries on imported inputs. Product Differentiation: The phenomenon of product differentiation, brand names, and changes in quality and specifications of internationally traded goods has

become widespread and indices of export and import prices are becoming increasingly less representative.

Trade on Non-Economic Considerations: Certain categories of trade transactions (like defence deals) are determined primarily on political and other non-economic considerations, rather than bargaining strength of a country in economic sense of the term. To the extent this happens, this measure of terms of trade becomes non-representative. Gains from Trade: This measure of terms of trade estimates a change in gain per unit of trade.

In most cases, we are interested in estimating a change in total gain from trade. And for that we also need to know the volume of trade. Even with a small per unit gain, a big country is likely to have much larger total gain because of a large volume of its trade than the total gain of a small country with a much larger per unit gain but having a small volume of trade.