

**TOPIC: BALANCE OF TRADE AND TERMS OF TRADE**

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## **Balance of Trade (BOT)**

Balance of trade (BOT) is the difference between the value of a country's exports and the value of a country's imports for a given period. Balance of trade is the largest component of a country's balance of payments (BOP).

The balance of trade is also referred to as the trade balance, the international trade balance, the commercial balance, or the net exports.

### **Key factors**

- 1) Balance of trade (BOT) is the difference between the value of a country's imports and exports for a given period and is the largest component of a country's balance of payments (BOP).
- 2) A country that imports more goods and services than it exports in terms of value has a trade deficit while a country that exports more goods and services than it imports has a trade surplus.

### **Calculating the Balance of Trade**

A country's balance of trade is calculated by the following formula:

$$\text{BOT} = \text{Value of Exports} - \text{Value of Imports}$$

Where

- **Value of Exports** is the value of goods and services that are sold to buyers in other countries.
- **Value of Imports** is the value of goods and services that are bought from sellers in other countries.

### **Understanding the Balance of Trade (BOT)**

- The formula for calculating the BOT can be simplified as the total value of exports minus the total value of its imports. Economists use the BOT to measure the relative strength of a country's economy.
- A country that imports more goods and services than it exports in terms of value has a trade deficit or a negative trade balance. Conversely, a country that exports more goods and services than it imports has a trade surplus or a positive trade balance.

## Difference between Balance of Trade and Balance of Payments

<b>Basis for Comparison</b>	<b>Balance of Trade</b>	<b>Balance of Payment</b>
Meaning	Balance of Trade is a statement that captures the country's export and import of goods with the remaining world.	Balance of Payment is a statement that keeps track of all economic transactions done by the country with the remaining world.
Records	Transactions related to goods only.	Transactions related to both goods and services are recorded.
Capital Transfers	Are not included in the Balance of Trade.	Are included in Balance of Payment.
Which is better?	It gives a partial view of the country's economic status.	It gives a clear view of the economic position of the country.
Result	It can be Favorable, Unfavorable or balanced.	Both the receipts and payment sides tallies.
Component	It is a component of Current Account of Balance of Payment.	Current Account and Capital Account.

## Terms of Trade (TOT)

Terms of trade are defined as the ratio between the index of export prices and the index of import prices. If the export prices increase more than the import prices, a country has a positive terms of trade, as for the same amount of exports, it can purchase more imports.

Terms of trade (TOT) represent the ratio between a country's export prices and its import prices. TOT indexes are defined as the value of a country's total exports minus total imports. The ratio is calculated by dividing the price of the exports by the price of the imports and multiplying the result by 100.

- Terms of trade (TOT) is a key economic metric of a country's health measured through what it imports and exports.
- TOT is expressed as a ratio that reflects the number of units of exports that are needed to buy a single unit of imports.

- TOT is determined by dividing the price of the exports by the price of the imports and multiplying the number by 100.
- A TOT over 100% or that shows improvement over time can be a positive economic indicator as it can mean that export prices have risen as import prices have held steady or declined.
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### **Definition of Terms of trade**

Terms of trade are defined as the ratio between the index of export prices and the index of import prices. If the export prices increase more than the import prices, a country has positive terms of trade, as for the same amount of exports, it can purchase more imports.

### **Importance of BOP and BOT**

#### **1. Balance of payment**

The balance of payments of a country is a systematic record of all economic transactions between its residents and residents of the foreign countries during a given period of time.

#### **2. Current account**

It records imports and exports of goods and services and unilateral transfers.

#### **3. Capital account:**

Capital account is that account which records all such transactions between residents of a country and rest of the world which cause a change in the asset or liability status of the residents of a country or its government.

#### **4. Foreign Direct Investment**

It refers to purchase of an asset in rest of the world, such that it gives direct control to the purchaser over the asset.

#### **5. Portfolio Investment**

It refers to the purchase of financial asset by the foreigners that does not give the purchaser control over the asset.

#### **6. Balance**

It means difference between the sum of credits and sum of debits.

## **7. Balance of trade**

The term “balance of trade” denotes the difference between the exports and imports of goods in a country. Balance of trade refers to the visible items only.

## **8. Balance on Current Account**

It is the difference between sum of credits and sum of debits on current account.  
Balance on Current Account = Sum of credits on current account – Sum of debits on current account

## **9. Balance on Capital Account**

It is the difference between sum of credits and sum of debits on capital account.  
Balance on capital account = Sum of credits on capital account – Sum of debits on capital account

## **10. Autonomous items**

It refer to those international economic transactions in the current account and capital account which take place due to some economic motive such as profit maximisation.

## **11. Accommodating items**

It refer to the transactions that are undertaken to cover deficit or surplus in autonomous transactions, i.e., such transactions are determined by net consequences of autonomous transactions.