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Terms of Trade of India's Foreign Trade

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ABSTRACT

Terms of trade (TOT) refers to the relative price of imports in terms of exports and is defined as the ratio of export prices to import prices. It can be interpreted as the amount of import goods an economy can purchase per unit of export goods. An improvement of a nation's terms of trade benefits that country in the sense that it can buy more imports for any given level of exports. The terms of trade may be influenced by the exchange rate because a rise in the value of a country's currency lowers the domestic prices of its imports but may not directly affect the prices of the commodities it exports. In this paper secondary data is used and also bifurcated into pre and post reforms period. In the last portion of the paper present scenario is India's foreign trade is also explained.

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1. TERMS OF TRADE

When trade takes place between two open economies, certain goods are offered for sale by both the countries. The physical exchange ratio at which goods are exchanged for each other is often termed as 'terms of trade'. The terms of trade refer, to the rate at which the goods of one country exchange for the goods of another country. It is a measure of the purchasing power of exports of a country in terms of its imports and is expressed as the relation between export prices and import prices of its goods. When the export price of a country increases relatively to its import prices, its terms of trade are said to have improved. The country gains from trade because it can have a larger quantity of imports in exchange for a given quantity of exports. On the other hand when its import prices increase relatively to its export prices, its terms of trade are said to have worsened. The country's gain from trade is reduced because it can have a smaller quantity of imports in exchange for a given quantity of exports than before.

2. POST REFORMS MEASURES OF TRADE POLICY

The massive trade liberalization measures adopted after 1991 mark a major departure from the relatively protectionist trade policies pursued in earlier years. The new trade policy reforms seem to have been guided mainly by the concerns over globalization of the Indian economy, improving competitiveness of its industry, and adverse balance of payments situation.

Main feature of trade policies (trade reforms) since 1991 are as follows

3. FREER IMPORTS AND EXPORTS

Substantial simplification and liberalization has been carried out in the reforms period. The tariff line wise import policy wise first announced on March 31, 1996 and at that time itself 6161 tariff lines were made free. Till March 2000, this total had gone up to 8066. The Exim Policy 2000-01 removed quantitative restrictions on 714 items and the Exim Policy 2001-02 removed quantitative restrictions on the balance 715 items. Thus, in line with India's commitment to the WTO, quantitative restrictions on all import items have been withdrawn.

A. Rationalisation of Tariff Structure

Acting on the. recommendations of the Chelliah Committee, the government has, over the years, reduced the maximum rate of duty. The 1993-94, Budget had reduced it from 110 per cent to 85 per cent. The successive Budgets have reduced it further in stages. The peak import duty on non-agricultural goods is now only 12.5 per cent.

B. Decanalisation

A large number of exports and imports used to be canalized through the public sector agencies in India. The supplementary trade policy announced on August 13,1991 reviewed these canalized items and decanalised 16 exports items and 20 import items. The 1992-97 policy decanalised imports of a number of items including newsprint, non-ferrous metals, natural rubber, intermediates and raw materials for fertilizers. However 8 items were to remain canalized. The Exim Policy, 2001-02 put 6 items under special list - rice, wheat, maize, petrol, diesel and urea. Imports of these items were to be allowed only through state trading agencies.

C. Devaluation and convertibility of Rupee on Current Account

The government made a two-step downward adjustment of 18-19 per cent in the exchange rate of the rupee on July 1 and July 3, 1991. This was followed by the introduction of LERMS i.e. partial convertibility of rupee in 1992-93, full convertibility on the trade account in 1993-94 and full convertibility on the current account in August 1994. Substantial capital account liberalization measure have also been announced. The exchange rate of the rupee is now market-determined. Thus, exchange rate policy in India has evolved from the rupee being pegged to a market related system.

D. Trading Houses

The 1991 policy allowed export houses and trading houses to import a wide range of items. The government also permitted the setting up of trading houses with 51 per cent foreign equity for the purpose of promoting exports. The 1994-95 policy introduced a new category of trading houses called Super star trading houses. These houses are entitled to membership of apex consultative bodies concerned with trade policy and promotion, representation in important business delegations, special permission for overseas trading and special import licenses at enhanced rate.

E. Special Economic Zones

A scheme for setting up Special Economic Zones in the country to promote exports was announced by the government in the Export and Import policy of March 31, 2000. The SEZs are to provide an internationally competitive and hassle-free environment for exports and are expected to give a boost to the country’s exports. The policy has provided provisions for setting up SEZs in the public sector, joint sector or by State governments. It was also announced that some of the existing EPZs would be converted into SEZs.

F. Export Oriented Units Scheme

The Export oriented units scheme introduced in early 1981 is complementary to the SEZ scheme. It offers a wide option in locations with reference to factors like source of raw materials, ports of export, hinterland facilities, and availability of technological skills, existence of an industrial base and the need for a larger area of land for the project. The EOU have put up their infrastructure.

G. Agriculture Export Zones

The Exim policy 2001 introduced the concept of Agri Export Zones to give primacy to promotion of agricultural exports and effect a reorganization of our export efforts on the basis of specific products and specific geographical areas. The scheme is centered on the cluster approach of identifying the potential products are grown and adopting an end-to-end approach of integrating the entire process right from the stage of production till it reaches the market. AEZs would have the state-of-the-art services such as pre-post harvest treatment and operations plant protection, processing, packaging, storage and related research and development. The exporters in these zones can avail of the various export promotion schemes under the Exim policy including recognition as a status holder.

H. Market Access Initiative Scheme

Market Access Initiative Scheme was launched in 2001-02 for undertaking marketing promotion efforts abroad. The key features of the scheme are in -depth market studies for select products in chosen countries to generate data for promotion of exports from India, assist in promotion of India, Indian products and Indian brands in the international market by display through showrooms and warehouses set up in rental premises by identified exporters, display in identified leading departmental stores total exhibitions trade fairs, etc. The scheme shall also assist quality upgradation of products as per requirements of overseas markets, intensive publicity campaigns, etc.

I. Focus on service exports

The amended Export-Import Policy, 2002-07, announced on March 31, 2003, specifically emphasized service exports as an engine of growth. It, accordingly announced a number of measures for the promotion of exports of services. For instance, import of consumables, office and professional equipment, spares and furniture upto 10 per cent of the average foreign exchange export earning has been allowed. The advance license system has been extended to the tourism sector. Under this, firms will be allowed duty free import of consumables and spares upto 5 per cent of their average foreign exchange earnings of the previous three years, subject to actual user condition.

J. Concessions and Exemptions

A large number of tax benefits and exemptions have been granted during the 1990s to liberalise imports and promote exports with the five year Exim Policy 1992-97 and Exim Policy 1997-2002 serving as the basis for such concessions. These policies, in turn, have been reviewed and modified on an annual basis in the Exim policies announced every year. Successive annual Union budgets have also extended a number of tax benefits and exemptions to the exporters. These include reduction in the peak rate of customs duty to 15 per cent; significant reduction in duty rates for critical inputs for the Information Technology sector, which is an important export sector; grant of concessions for building infrastructure by way of 10 years tax holiday to the developers of SEZs. Facilities and tax benefits to exporters of goods and merchandise; reduction in the customs duty on specified equipment for ports and airports to 10 per cent to encourage the development of world class infrastructure facilities etc. A number of tax benefits have also been announced for the three integral parts of the convergence revolution the information technology sector, the telecommunication sector and the entertainment industry.

4. TERMS OF (FOREIGN) TRADE IN PRE-REFORMS PERIOD

The way to analyse the situation of foreign trade for India is with the help of the concept of Terms of Trade (TOT) with different specifications. In general, the conditions of Terms of Trade may either be favourable or unfavourable ones. The favourable TOT may simply be defined as the case when the exports are greater than imports. This can also be interpreted as the case when total values of imports are less than the total value of exports of the country. If conditions stated above are different, the TOT may simply be defined as unfavourable to the economy. The different specifications of TOT used here are Gross Terms of Trade, Net Terms of Trade and Income Terms of Trade as per the availability of the relevant estimates in this context.

During pre-reforms period terms of trade remained unfavourable because the quantity of imports was higher than the quantity of exports. The prices of imported goods also remained higher than the prices of exported goods especially after late seventies.

Table 1: Terms of (Foreign) Trade in Pre- Reforms Period

(Base Year: 1978-79 = 100)

Years	Unit of Value Index		Quantum Index		Terms of Trade		
	Exports	Imports	Exports	Imports	Gross	Net	Income
1970-71	45.0	35.3	59.0	67.2	113.9	127.5	75.2
1991-72	46.0	32.8	59.2	80.6	136.1	140.2	83.0
1972-73	51.2	34.2	66.5	76.7	115.3	149.7	99.6
1973-74	62.2	48.9	69.5	87.2	125.5	127.2	88.4
1974-75	78.0	84.5	73.7	77.2	104.7	92.3	68.0
1975-76	83.9	99.1	81.7	76.0	93.0	84.7	69.2
1976-77	89.4	96.3	96.8	76.1	78.6	92.8	89.9
1977-78	100.3	88.0	93.2	100.0	107.3	114.0	106.2
1978-79	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1979-80	105.4	114.1	106.2	116.4	109.6	92.4	98.1
1980-81	108.5	134.2	108.1	137.9	127.6	80.8	87.4
1981-82	124.1	133.1	110.1	150.6	136.8	93.2	102.7
1982-83	132.0	136.3	116.7	154.6	132.5	96.8	113.0
1983-84	151.0	125.8	113.0	185.4	164.1	120.0	135.6
1984-85	169.8	161.7	120.8	156.1	129.2	105.0	126.9
1985-86	170.8	158.8	111.3	182.3	163.8	107.6	119.7
1986-87	179.4	139.4	121.3	212.3	175.0	128.7	156.1
1987-88	195.4	160.0	140.0	204.8	146.3	122.1	171.0
1988-89	232.3	185.5	152.1	224.2	147.4	125.2	190.4
1989-90	276.6	228.4	174.9	227.8	130.2	121.1	211.8

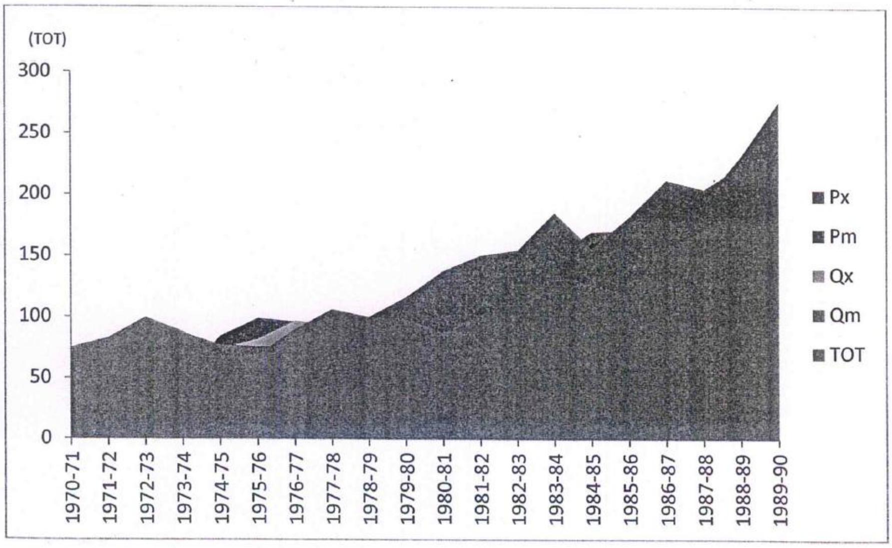
Source: Directorate General of Commercial Intelligence and Statistics, Ministry of Commerce, Kolkata

Note: i Gross terms of trade imply volume index of imports expressed as percentage of Volume index of exports.
ii Net terms of trade imply unit value index of exports expressed as percentage of unit value index of imports.
iii Income terms of trade imply the product of net terms of trade and volume index of exports expressed as a percentage.

Table 1. incorporates the estimates of Index Number and Terms of Trade of foreign trade for Indian economy taking 1978-79 as the base year (1978-79=100) for the year 1970-71 to 1989-90. Estimates of index number of exports and

imports are reported here across Unit value index and Quantum Index. The table shows Gross/Net/Income Terms of Trade of India since 1970-71 to 1989-90. The TOT improved from 1970-71 to 1972-73 significantly and thereafter TOT started turning unfavourable/ hostile for the next three years because not only the prices of imported items increased but also the quantity of imports during these years. Thereafter TOT improved for two years because exports exceeded imports. In the year 1976-77, the prices of imports were higher than those of exports but despite that TOT improved because of higher exports. In the very next year TOT again improved but this year the prices of exports were higher than the prices of imports. In the year 1979-80 and 1980-81 TOT became unfavourable because both the prices of imports and the quantity of imports were higher than before. After that there was slight improvement in the TOT from 1981-82 to 1983-84. There after TOT deteriorated for two years. During these years although prices of exported goods were higher than the prices of imported goods but the size of imports was higher than the exports. After 1986-87 TOT kept increasing upto 1989-90. During this period in spite of the size of imports which was high, the prices of exported goods kept increasing.

The graph 1. verifies the facts stated vide table 1. The terms of trade are not smooth in the pre-reforms period. The ups and downs are an indicator of unstable TOT during this period. The quantum index of imports has remained higher than the quantum index of imports. The higher quantity of imports is visible in the graph represented by navy blue colour.



Graph 1: Terms of (Foreign) Trade in Pre-reforms Period

5. TERMS OF (FOREIGN) TRADE IN POST-REFORMS PERIOD

After the economic reforms were introduced in the Indian economy the terms of trade improved from 1990-91 to 1995-96. During this period although imports were higher than the exports yet due to better export prices TOT kept improving. In the year 1996-97 TOT became unfavourable because the size of imports was much higher than the exports. From 1997-98 to 2010-11 TOT kept improving but after that TOT again became unfavourabe in the year 2011-12. From the very next year TOT started improving. By and large, it can be said that economic reforms have improved Terms of Trade.

Table 2: Terms of (Foreign) Trade in Post- Reforms Period

(Base Year: 1978-79 = 100)

Years	Unit of Value Index		Quantum index		Terms of Trade		
	Exports	Imports	Exports	Imports	Gross	Net	Income
1990-91	**292.5**	**267.7**	**194.1**	**237.7**	**122.5**	**109.3**	**212.1**
1991-92	369.5	309.1	208.6	228.0	109.3	119.5	249.4
1992-93	421.5	331.0	222.9	282.0	126.5	127.3	283.8
1993-94	474.1	327.2	257.5	329.1	127.8	144.9	373.1
1994-95	494.6	324.6	292.7	408.3	139.5	152.4	446.0
1995-96	484.2	351.0	384.3	514.8	134.0	137.9	530.1

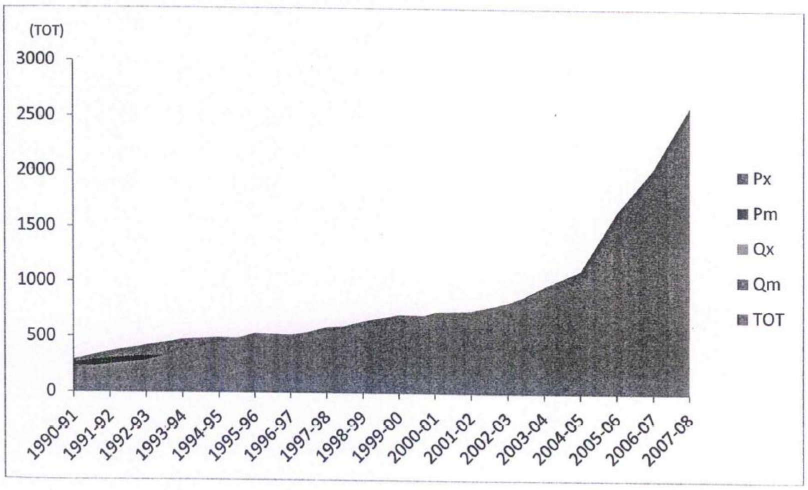
1996-97	504.7	399.8	411.8	511.8	124.3	126.2	519.8
1997-98	589.4	404.2	386.0	562.1	145.6	145.8	562.9
1998-99	611.7	407.8	399.0	644.0	161.4	150.0	598.5
1999-00	604.0	450.0	461.0	705.0	152.9	134.2	618.8
2000-01	624.0	487.0	571.0	698.0	122.2	128.1	731.6
2001-02	618.0	493.0	593.0	733.0	123.6	125.4	743.4
2002-03	620.0	546.0	722.0	802.0	111.0	114.0	819.9
2003-04	672.0	545.0	765.0	970.0	126.8	123.3	943.3
2004-05	732.0	663.0	899.0	1113.0	123.8	110.4	992.6
2005-06	798.0	592.0	1005.0	1649.0	164.1	134.8	1354.7
2006-07	863.0	608.0	1164.0 I	2047.0	175.9	141.9	1652.2
2007-08	939.0	575.0	1227.0	2603.0	212.1	163.3	2003.7
1999-00	100	100	100	100	100	100	100
2000-01	102	109	125	99	79	94	117
2001-02	103	112	126	103	82	92	115.9
2002-03	106	128	150	109	73	83	124.2
2003-04	114	132	161	128	80	86	139.0
2004-05	131	157	179	150	84	83	149.4
2005-06	139	179	206	174	84	78	160.0
2006-07	158	206	227	191	84	77	174.1
2007-08	166	210	245	218	89	79	193.7
2008-09	194	239	267	262	98	81	216.7
2009-10	196	215	264	288	109	91	240.7
2010-11	223	243	304	311	102	92	279.0
2011-12	268	425	331	246	74	63	208.7
2012-13	284	459	357	261	73.1	62	220.9
2013-14	312	518	378	233	61.6	60.2	227.7
2014-15	300	518	397	235	59.2	57.9	229.9

Source: Directorate General of Commercial Intelligence and Statistics, Ministry of Commerce, Kolkata

Note: I Gross terms of trade imply volume index of imports expressed as percentage of Volume index of exports.
ii Net terms of trade imply unit value index of exports expressed as percentage of unit value index of imports.
iii Income terms of trade imply the product of net terms of trade and volume index of exports expressed as a percentage.

The table 2 incorporates the estimates of Index Number and Terms of Trade of foreign trade for Indian economy taking 1978-79 as the base year (1978-79=100) for the year 1990-91 to 2007-08 and also from 2000-01 to 2014-15 taking 1999-2000 as the base year (1999-00= 100). Estimates of index number of exports and imports are reported here across Unit value index and Quantum Index. A look at the estimates of the table reveals the fact in terms of value-index, both the estimates of exports as well as of the imports register a general rise from 1990-91 to 2014-15 except negligible minor variations. However, both these estimates seem to rise in general year over year basis from 1990-91 to 2014-15. It is pertinent to note that the value-index of exports is always estimated over the value-index of imports from 1990-91 to 2007-08. Contrary to it, the estimates of quantum-index of imports seem to exceed always the quantum-index estimates of exports between 1990-91 and 2007-08. But the situation reversed when the base year was changed from 1999-2000.

A further look at the estimates of Gross Terms of Trade (TOT) of the table reveals the fact that these are observed as marginally changing on higher side indicating the fact of gains from the trade to the domestic economy during 1990-91 to 2007-08. These are estimated between 122.5 and 212.1. Similar facts are evidenced from the estimates of Net TOT and Income TOT from 1990-91 to 2007-08 of gains from trade to some extent in the economy. But after the world wide recession in the year 2009 the Gross and Net Terms of Trade started declining. The data also reveals that the Income terms of trade improved throughout the post-reforms period with minor fluctuations.



Graph 2: Terms of (Foreign) Trade in Post-Reforms Period

The Graph: 2. also shows the improving tendency of TOT in the postreforms period. The TOT is increasing throughout in the graph whereas in Graph: 6.l there are ups and downs because TOT were not stable throughout in the pre-reforms period. Basically, the higher ratios of different specifications of terms of trade across gross, net and income TOT are considered favourable to the economy as per the established theories in international economics. Thus the estimates of terms of trade show some comfortable picture of the impact of Economic-reforms on the foreign trade in India.

6. LATEST INDIA'S FOREIGN TRADE: 2017

EXPORTS (including re-exports)

Exports have been exhibiting positive growth for the last eight months. In continuation with growth indicated by exports since September 2016, exports during May 2017have shown growth of 8.32per cent in dollar terms valued at US$ 24014.62million as compared to US$ 22170.62 million during May 2016. In Rupee terms, during May 2017 exports were valued at Rs. 154713.69crore as compared to Rs. 148336.31crore during May,2016, registering a positive growth of 4.30 per cent.

During May 2017, Major commodity groups of export having a share of 72.09% in total export basket which have shown positive growth over the corresponding month of last year are Engineering Goods (8.25%), Gems& Jewellery (6%), Petroleum Products (24.92%), RMG of all Textiles (8.06%), Organic & Inorganic Chemicals (15.34%),Rice (27.08%), Marine Products (44.58%) and Electronic Goods (8.57%).

Cumulative value of exports for the period April-May 2017-18 was US $48649.71 million (Rs 313627.48 crore) as against US $42739.47 million (Rs 285056.42 crore) registering a positive growth of 13.83 per cent in Dollar terms and 10.02 per cent in Rupee terms over the same period last year.

Non-petroleum and Non Gems & Jewellery exports in May 2017 were valued at US$ 17514.36million against US$ 16404.31million in May 2016, an increase of 6.77 %. Non-petroleum and Non Gems and Jewellery exports during April -May 2017-18 were valued at US$ 35233.23 million as compared to US$ 31540.72 million for the corresponding period in 2016-17, an increase of 11.71%.

7. IMPORTS

Imports during May 2017 were valued at US$ 37856.34 million (Rs. 243888.74 crore) which was 33.09per cent higher in Dollar terms and 28.16per cent higher in Rupee terms over the level of imports valued at US$ 28443.52 million (Rs. 190306.19crore) in May, 2016. Cumulative value of imports for the period April-May 2017-18 was US$ 75740.62 million (Rs. 488269.26 crore) as against US$ 53857.24 million (Rs. 359229.90 crore) registering a positive growth of 40.63 per cent in Dollar terms and 35.92 per cent in Rupee terms over the same period last year. Major commodity group of imports showing high growth in May 2017 over the corresponding month of last yearare

Petroleum, Crude &products (29.54%),Gold(236.69%), Electronic goods(34.16%), Pearls, precious & Semi-precious stones(37.61%) and Machinery, electrical & non-electrical(6.42%).

8. CRUDE OIL AND NON-OIL IMPORTS:

Oil imports during May, 2017 were valued at US$ 7692.71 million which was 29.54percent higher than oil imports valued at US$ 5938.59million in May 2016.Oil imports during April-May, 2017-18 were valued at US$ 15051.98 million which was 29.82 per cent higher than the oil imports of US$ 11594.51 million in the corresponding period last year.

In this connection it is mentioned that the global Brent prices ($/bbl) have increased by 7.94% in May 2017 vis-à-vis May 2016 as per World Bank commodity price data (The pink sheet).

Non-oil imports during May, 2017 were estimated at US$ 30163.63 million which was 34.03per cent higher than non-oil imports of US$ 22504.93million in May, 2016. Non-oil imports during April-May 2017-18 were valued at US$ 60688.64 million which was 43.60 per cent higher than the level of such imports valued at US$ 42262.73 million in April-May, 2016-17.

CONCLUSIONS

In nutshell, it can be concluded that terms of trade of India's foreign trade were unfavourable during pre-reforms period because India was exporting mainly primary and agricultural commodities during that time period. The experience shows that TOT of these products remained unfavourable most of the time as the quantity of imports was always higher than the quantity of exports. Most of the time prices of imported goods were also higher than the prices of exported goods. But after economic reforms TOT have improved. This improvement is because of improvement in the quality of the product and diversification of exports i.e. exports of non-traditional products and manufacturing commodities. In the post-reforms period quantity of exported goods has increased and the prices of those goods have also improved. This gives some comfortable picture of the economy.

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