

The Terms of Trade Debate

John E. Tilton

Colorado School of Mines, and

Pontificia Universidad Católica de Chile

Historical Background

- **Classical view (Malthus, Ricardo)**
 - **TT of primary product producers up over time**
 - **Reason: rising marginal costs due to use of poorer and more costly resources**

Historical Background

- **Prebisch-Singer hypothesis (1950)**
 - TT of primary product producers down
 - empirical evidence
 - reasons (monopoly + demand)
 - policy implications (import substitution and resource curse)
- **Subsequent debate (1950 – 2005)**

Organization

- **Status of the TT debate**
- **Determinants of prices**
- **Policy implications**

Status of the Debate

- **Advances**
 - quality of data
 - modern time series analysis
- **New findings**
- **Still debate continues**

Determinants of Price Trends: Traditional Economics

- **Shifts in supply curve**
- **Shifts in demand curve**

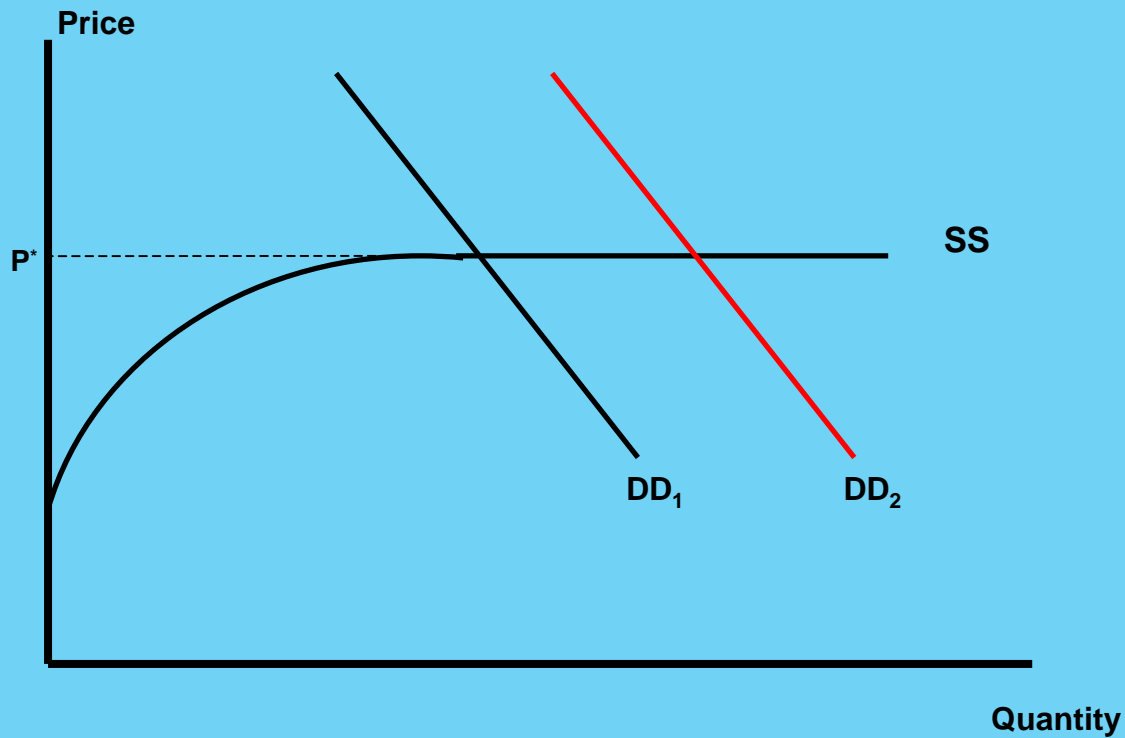
Determinants of Price Trends: Prebisch and Singer

- **Developing countries and primary products**
- **Developed countries and mfgt goods**
 - demand growth in response to rising income
 - market power

Determinants of Price Trends: Role of Demand Growth

- **Shape of supply curve**
 - **upward sloping**
 - **horizontal**
- **Short versus long run**

Market Price with a Horizontal Supply Curve



Determinants of Price Trends: Market Power

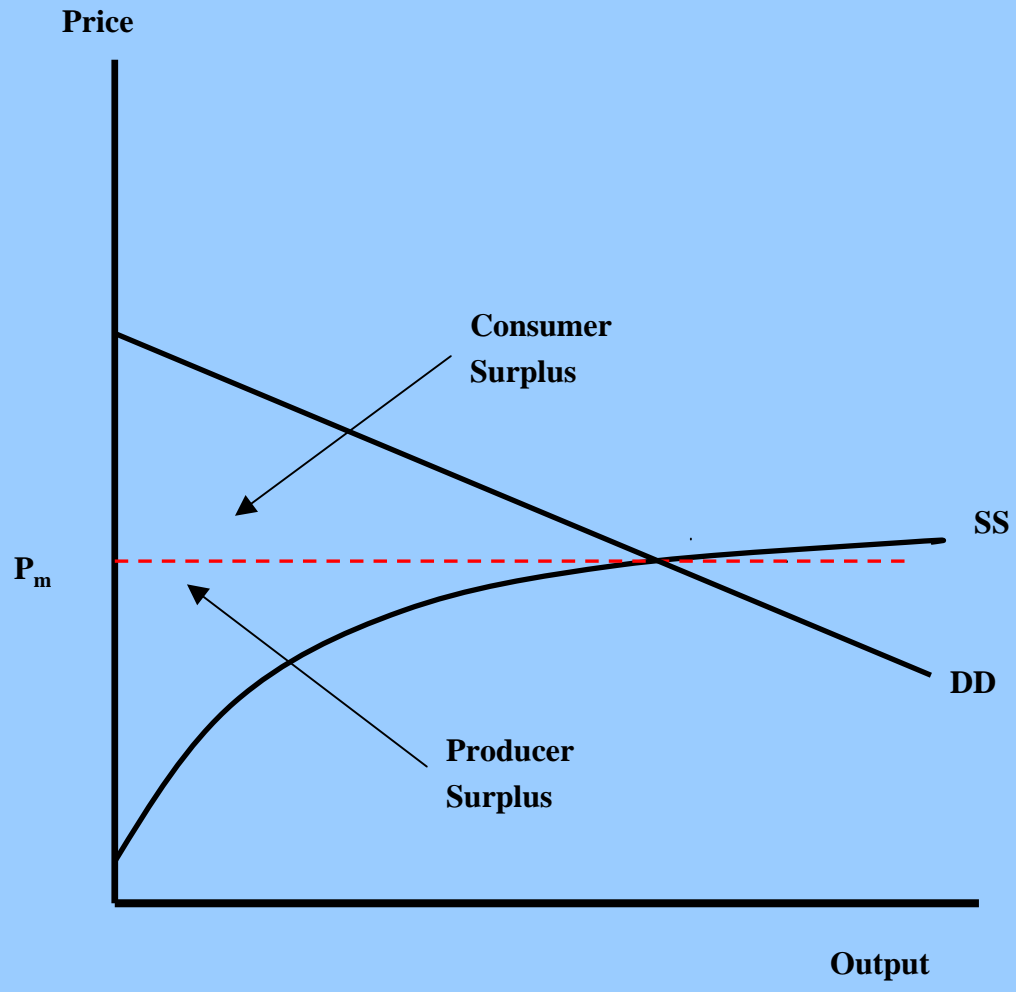
- **World in the late 1940s**
 - **concentration of manufacturing**
 - **size of GDP**
 - **international trade**
- **World in 2005**

Determinants of Price Trends: Role of Production Costs

- **Competitive industries**
 - shifts in supply curve
 - industries with rising prices
- **Non-competitive industries and cost-plus pricing**

Implications for Policy

- **Net barter TT**
- **Purpose of govt policy**
 - **social welfare**
 - **wealth created and retained**
 - **consumer and producer surplus**

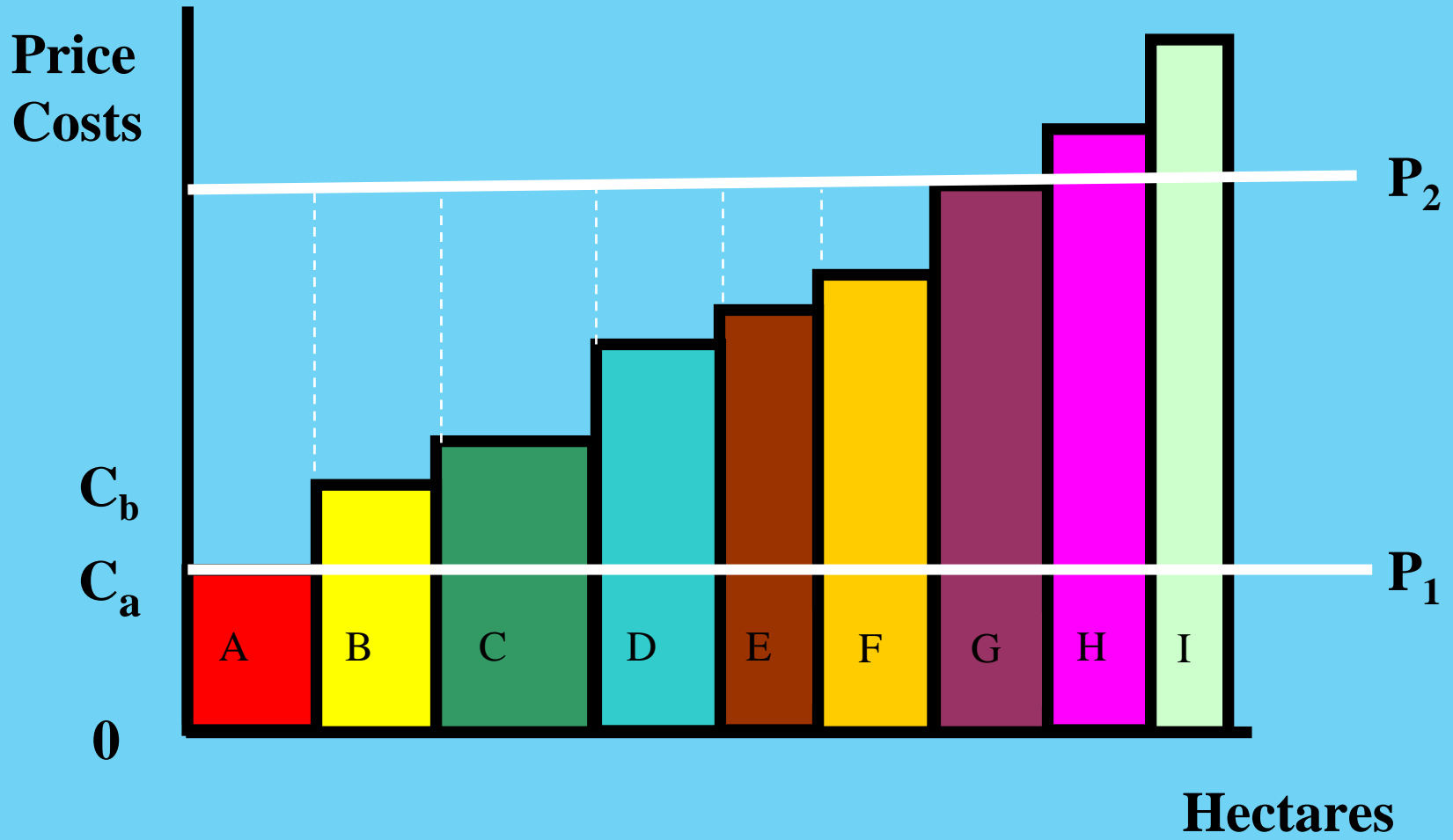


Implications for Policy

- **Prices falling with constant costs**
- **Prices falling with falling costs**

Conclusions

- **TT trends up? Down?**
- **Does it matter?**
 - **Probably not**
 - **But, if people think it does, public policy could suffer**



Nature of Supply

