

Transmission of terms of trade shocks to the trade balance in the short and long term

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Abstract

Improvements in the terms of trade have different effects in the short and long term. According to Harberger (1950) favorable terms of trade promote surplus trade balances because the consumption of imported goods usually reacts less than proportionally to the increase in real income, caused by a better position in international trade. According to Sachs (1981), the result on the trade balance depends on the transience or permanence of the relative price shock. The evidence would be in favor of the previous result if returns of terms of trade were transitory. On the other hand, when this is permanent, the result on the trade balance would be indeterminate.

In the case of Bolivia, through a econometric cointegration model, using quarterly frequency information for the 1992-2017 period, it is found that the terms of trade and the real exchange rate explain the long-term evolution of the trade balance, and that increases of income are reflected in its short-term changes.

JEL Classification: C3, F32, F41

Keywords: Trade balance, terms of trade, structural autoregressive vectors