

How to Use Import and Export Price Indexes for Contract Escalation

What is Contract Escalation?

Inflation is a general increase in the prices of goods or services over time. To manage the risks of long-term inflation, businesses often include a contract-escalation clause in their contracts. Contract escalation adjusts the price of goods or services covered in the contract based on an inflation index the parties to the contract agree on. The right index to use depends on the goods or services covered in the contract. When exporting or importing goods or services, many businesses use the Export and Import Price Indexes provided by the U.S. Bureau of Labor Statistics.

What are Export and Import Price Indexes?

The U.S. Bureau of Labor Statistics produces Export and Import Price Indexes. The indexes measure changes in the prices of nonmilitary goods and services traded between the U.S. and the rest of the world. These measures show how prices of a market basket of goods and services in international trade change from one period to the next. The indexes are based on nominal, not seasonally adjusted dollar values and do not account for swings in exchange rates between the U.S. dollar and other currencies.

General Guidelines for Creating a Contract Escalation Clause:

The steps outlined below are guidelines to escalate contracts and the tools necessary for doing so. Terms of contracts vary from firm to firm and product to product. The following guidelines are just one possible way to create a contract escalation clause.

1. Establish the base selling price for the contract items.
 - State whether the base price refers to a per-unit quantity or a certain volume of units.
 - State the effective month and year of the base selling price.
 - State how long the base price will remain in effect.
2. Select an appropriate index to use. Specify whether to use the Export Price Index or the Import Price Index for the contract escalation.
3. Specify the name of the index (such as a broad index or one for a specific good or service).
 - When selecting the index, clearly state the official name. BLS publishes several broad versions of the Export and Import Price Indexes based on different trade classification systems.
 - The classification systems for the indexes are the Harmonized Tariff Schedule of the United States Annotated (HTUSA), the Bureau of Economic Analysis End Use, and the North American Industry Classification System (NAICS).
4. State the frequency of the price adjustment. The escalation clause should clearly state how often (monthly, quarterly, annually, etc.) the price escalation will take place.
5. Establish a date for the price adjustments within each time period. The index used should always be the most recent version.

- The International Price Program revises indexes in each of the first 3 months after the indexes are first published.
- Indexes are not seasonally adjusted.

Table 1. Example of Contract Escalation Procedures

A coffee bean importer and a foreign producer agree to a contract worth \$1,000. In the contract, the two parties decide to use the coffee, tea, mate and spices import price index under the Harmonized classification system for annual escalation. The terms of the contract specify that the \$1,000 will be indexed based on the price index's March value each year beginning in 2014 as the base period. Below is an example using a simple percentage method on how to adjust the contract price for 2015.

(a)	Base price	\$1,000
(b)	Index at time of calculation, March 2015	244.9
(c)	Index at time base price was set, March 2014	257.4
(d)	Divide (b) by (c)	0.9514
(e)	Multiply (d) by base price equals adjusted price	\$951.44

The importer would pay \$951.44 for 2015. This adjusted price would then serve as the base price while the March 2015 index value would serve as the base period index for the following year.

Other uses of the Export and Import Price Indexes:

Import and export price indexes are used for a variety of purposes:

1. To convert U.S. trade figures from current dollars to constant dollars in U.S. trade statistics. These statistics include the quarterly Gross Domestic Product from the U.S. Bureau of Economic Analysis and the U.S. Census Bureau's monthly U.S. trade statistics.
2. To assess the impact of international trade on domestic inflation and the competitive position of the United States.
3. As a tool for analyzing fiscal and monetary policy and measuring the impact of exchange rates.
4. To identify industry-specific and global price trends.

The Bureau of Labor Statistics neither encourages nor discourages the use of price adjustment measures in contractual agreements. Also, while BLS can provide technical and statistical assistance to parties developing escalation agreements, we can neither develop specific wording for contracts nor mediate legal or interpretive disputes which might arise between the parties to the agreement.

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