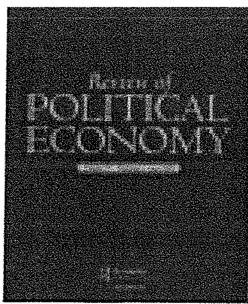


Taylor & Francis Grou

Review of Political Economy

ISSN: 0953-8259 (Print) 1465-3982 (Online) Journal homepage: http://www.tandfonline.com/loi/crpe20

The Political Economy of Real Exchange Rate Behavior: Theory and Empirical Evidence for Developed and Developing Countries, 1960–2010

Francisco A. Martínez-Hernández

To cite this article: Francisco A. Martínez-Hernández (2017): The Political Economy of Real Exchange Rate Behavior: Theory and Empirical Evidence for Developed and Developing Countries, 1960–2010, Review of Political Economy

To link to this article: http://dx.doi.org/10.1080/09538259.2017.1382060

View supplementary material

Published online: 13 Nov 2017.

Submit your article to this journal

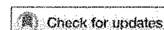
View related articles

View Crossmark data

Full Terms & Conditions of access and use can be found at
http://www.tandfonline.com/action/journalInformation?journalCode=crpe20

REVIEW OF POLITICAL ECONOMY, 2017
https://doi.org/10.1080/09538259.2017.1382060

Routledge
Taylor & Francis Group



The Political Economy of Real Exchange Rate Behavior: Theory and Empirical Evidence for Developed and Developing Countries, 1960–2010

Francisco A. Martínez-Hernández

State University of New York, New Paltz, USA

ABSTRACT

Empirical results of testing the PPP hypothesis have constantly shown that relative prices do not converge to the same level, either in the short or the long run. Therefore, the PPP explanation of the real exchange rate does not provide a reasonable measure of competitiveness at the international level. This article puts forth a different approach based on the works of Ricardo, Marx, Harrod and Shaikh. It argues that the real relative unit labor cost is the main factor explaining the long-run behavior of the real exchange rate. The second section of the article explains the theoretical underpinnings of our approach. The third section analyzes the role of the real interest rate differential in explaining real exchange rate misalignments. In the fourth section, we present a graphical analysis of the interrelation among the real effective exchange rate, the real unit labor cost ratio, the short-run real interest rate differential and the trade balance for 16 OECD countries, Taiwan and three developing countries for the period 1960–2010. The fifth section investigates the long-run relationship between the latter three indexes through co-integrating and error correction models using the ARDL–ECM framework. The last section provides our conclusions.

ARTICLE HISTORY
Received 28 February 2014
Accepted 16 September 2017

KEYWORDS
Real adjusted unit labor cost; real effective exchange rate; real interest rate differential; trade balance; ARDL-ECM models

JEL CODES
B12; B51; F50; F31; F41; C32

Downloaded by [74.64.90.231] at 06:00 13 November 2017

1. Introduction

World trade and international finance have evolved since the time of the classical political economists. Yet mainstream economists have ignored some key lessons of Karl Marx, Roy Harrod and John Maynard Keynes with regard to understanding the uneven national and international competitive conditions under capitalism (e.g., the role of differences in technology, wage rate differentials, price rigidities and the role of money in production). Overall, the consequences of an unequal international trading system have been unbalanced trade and high international levels of indebtedness, which have imposed an expansionary bias for trade surplus countries and a deflationary bias for trade deficit countries (especially for small economies).

This article adopts a Classical grounded theory of price, which takes into consideration the role of intra- and inter-industry competition (real competition), productivity and real wages in the tradable sector. Standard monetary and trade theories assume that

CONTACT Francisco A. Martínez-Hernández fmartinezh17@gmail.com

Supplemental data for this article can be accessed at doi:10.1080/09538259.2017.1382060

© 2017 Informa UK Limited, trading as Taylor & Francis Group