Comments on “The Efficiency of Global Markets for Final Goods and Productive Capabilities”
by Georg Strasser

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Contributions of the paper

• Extends Dumas (1992) model of real exchange rate to allow for differences in mean productivities of capital across countries
• Develops novel measure of real exchange rate in terms of “productive capabilities”
• Uses ESTAR model to capture drift and diffusion of the exchange rate process
• Obtains measure of relocation costs of final goods and productive capabilities
The Model

- One good model of trade with
  - AK production technology
  - Country specific shocks to depreciation of capital
  - Cost of trading goods across countries
  Arbitrage trade is triggered if relative capital stocks are sufficiently far from parity level

Value Function

\[ V(K, K^*) = K^{*\gamma} I(\omega) \]

\[ \omega = \frac{K}{K^*} \]

Real Exchange Rate

\[ p(\omega) = \frac{V_K(K, K^*)}{V_{K^*}(K, K^*)} \]
Real Exchange Rate

1. Goods market interpretation: WPI

2. Productive Capabilities
   Interpretation: M/B
Role of Knowledge capital

- Public good nature of knowledge capital that may be reflected in foreign investment
- M&A activity may reflect firms specific productivity advantages, rather than capital market returns
How reasonable is the relocation cost model?

- Are the measures correlated with things that we think represent transactions costs
- Is arbitrage trade associated with the level transactions costs

What does $r_{WPI}$ represent?

- Trade costs
- Transport costs
- Administrative costs
relocation costs and tariff rates

relocation costs and distance
What does $r_{\text{CAP}}$ measure?

- Presumably greater costs of moving capital than of moving goods
- Does M and A activity represent arbitrage?
Things I’d like to see

• Comparisons with predictions in terms of real interest rate differentials
• Modeling with differentiated products