

Summary:

The main objective of this paper is to evaluate whether changes in the real exchange rates, as a proxy of external competitiveness affect the trade balance in four peripheral Southern European countries (Greece, Italy, Portugal and Spain). To this purpose, these authors apply the method of Dynamic Ordinary Least Squares because this methodology has two advantages: it provides a robust correction to the possible presence of endogeneity in the explanatory variables and also for possible serial correlation in the error terms of the OLS estimation. This paper estimates trade balance equations both for total trade and for the trade with the European Union and for both cases the null of deterministic cointegration is not rejected indicating the existence of a long-run relationship between the trade balance and their explanatory variables. The estimated coefficients on national and foreign real incomes have always the expected signs and are clearly significant. However the trade balance is not clearly related to changes in the real exchange rate in all countries and only for a few cases they detect a weak evidence of a J-curve. These authors justify this results showing empirical evidence of “new trade theories” in which the specialization and productivity have an important role predicting a lower influence of prices on the trade balance.

Correctness and strengths:

- ✓ Given that in a common currency context, the real exchange rate depends on changes in relative prices between countries it happens that in a country with low competitiveness needs a real depreciation to become its domestic products cheaper than the foreign goods and finally to reduce the current account deficits. So given the important impact on the economy this paper considers one of the most important topics for its policy implications. Besides the Dynamic Ordinary Least Squares method is a very powerful methodology to implement.

Comments:

- ✓ Knowing that the dynamic contributions instead of providing just elasticities, combines such elasticities with the evolution of the explanatory variables it is an interesting method in order to quantify their impact in any given period. See for instance Allard (2009) in which she analyzes the cumulative growth and the contribution of trade determinants (such as the world demand, foreign direct investment, price competitiveness among others) for four Central-Eastern Europe countries during the period 2002-2007.
- ✓ Your main conclusion in your paper is that the trade balance is not clearly related to changes in the real exchange rates and you justify this result using the “new trade theories”, because countries can show an increase in their shares of world markets not by reducing the relative prices of the products that they produce but increasing the productivity of firms and also the number of varieties. As a way of testing this hypothesis it is possible to consider some explanatory variable in your specification in order to analyze how the degree of

product differentiation capturing quality effects allow greater scope for pricing differentials (Rauch, 1999). In the same vein, Fabrizio *et al.* (2007) investigate whether the real exchange rate is not relevant or if there are other factors which can compensate the fact that despite the appreciation of the exchange rate in eight CEE countries can explain that they have achieved an important export growth increasing their market shares. These authors argue that a relevant shift in product quality and in the technological intensity of exports can help to understand the increase in their market shares.

- ✓ In the literature review you must emphasize the traditional trade theory and the new trade theory trying to develop the main contributions of each of them and providing also some empirical papers. You should focus on the four critical channels to improve the country trade balance as they are important sources of competitiveness. I mean the accessibility, the market size, the Ricardian technological advantage and finally, the institutional and political framework [see for instance Ottaviano *et al.* (2007), Di Mauro and Forster (2008), Ilzkovitz *et al.* (2008), among others]
- ✓ In your paper when you want to measure the evolution of the competitiveness of Greece, Italy, Portugal and Spain, you use the real effective exchange rate computed using consumption price indices, using export prices and using unit labor costs. Perhaps it is better to define with more detail this relevant variable in your analysis saying that the latter for example is calculated as the ratio of unit labor costs in the domestic country to unit labor costs in its trading partners, multiplied by the nominal effective exchange rate to express all in a common currency.
- ✓ In order to test the order of integration of the variables in Table 1 you use the Phillips-Perron test (Phillips and Perron, 1988), perhaps it should be tested the Kwiatkowski *et al.* (1992) test because it is more powerful in small samples in which the null hypothesis is a stationary process against the alternative of unit root.

References:

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