Comments on “ROADS AND THE REAL EXCHANGE RATE”

by

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Summary of the Paper

- The authors investigate both theoretically and empirically the effect of transport infrastructure on the real exchange rate (RER).
- They find that transport infrastructure is one of the most robust determinants of the RER.
- They also build a model supporting the empirical findings.

Four Major and a Few Minor Comments

(1) Theoretical foundation

(2) An alternative explanation

(3) Validity of instrumental variables

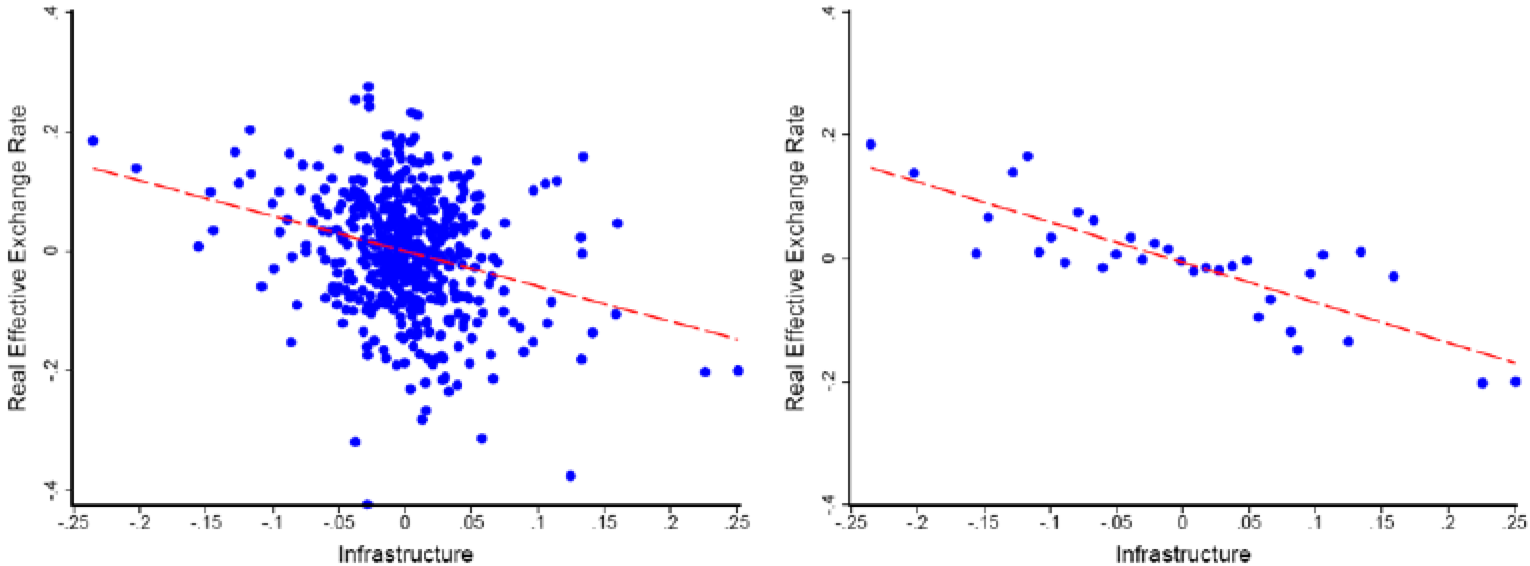
(4) Long run vs. Short run

(5) Minor comments

(1) Theoretical foundation

- The competition channel
  – Improved transport infrastructure => more competition => a lower markup => a reduction in the overall price level
- This relationship should be nonlinear as the markup has to eventually converge to zero.
- The authors also notice this, but the empirical relationship they found is very linear.

Figure 3: Conditional Scatter Plots of log REER on log infrastructure (1988-2007)



(2) An Alternative Explanation

- Recession => interest rate decreases => nominal exchange rate depreciates & price declines => real exchange rate falls

At the same time,

- Recession => government expenditure increases => expenditures on transport infrastructure increase
- Real exchange rate falls when transport infrastructure improves.

(3) Validity of Instrumental Variable

- Earthquake damages as an IV.
- A qualification is that earthquake damages are highly correlated with transport infrastructure but not correlated with the real exchange rate in other channels.
- However there might be another channel.
  - Earthquakes => factories destroyed => supply decreases => price increases => real exchange rate rises

(4) Long Run vs. Short Run

- Like Balassa-Samuelson effect, if the theoretical model holds, its effect should be realized in the long run relationship.
- Cross country evidence vs. time series evidence
- Cointegration?
- The real exchange rate should be decomposed between the price ratio and the nominal exchange rate and the focus should be made on the price ratio.

(5) Minor Comments

- In table 7, transport infrastructure relative to the U.S should be used since the real exchange rate is against the U.S. dollars.
- In table 15, Export should be included as a separate regressor.

Conclusion

- It is a very interesting paper!
- It needs some more work on the empirical side to convince the implications of the model.