

Measuring international competitiveness

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The measurement of international competitiveness using the real exchange rate based solely on the Purchasing Power Parity (PPP) theory and the law of one price is flawed. Productivity differentials as explained by the Harrod- Balassa -Samuelson productivity differential effect, terms-of -trade shocks, and net foreign assets or the sustainability of the current account of the balance payments can also cause significant long run deviations of the real exchange rate from the PPP benchmark. The paper will present a more comprehensive theoretical framework that overcomes the narrow confines of the real exchange rate based on the PPP bench-mark and empirically validate it using time series data and co integration techniques.

Keywords: International competitiveness; Purchasing power parity ; Real exchange rate; Productivity; Balance of payments