On the Role of Profits-Wages Ratios in the Determination of the Long-Run Behavior of International Relative Prices

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This paper reconstructs and evaluates the theory of international relative prices (IRP) based on the theory of real competition, one of the approaches to international trade based on the principle of absolute advantages. The main thesis of this theory is that the long-run behavior of IRP of any pair of tradable commodity bundles is determined solely by their relative total unit labor costs (RTULC). This thesis relies on the hypothesis that the total profits-wages ratios (TPWR) of commodities within countries are sufficiently similar. The theory provides several theoretical and empirical arguments supporting that hypothesis.

We identified a set of problems that questions the long-run neutrality of the TPWR on IRP. Firstly, due to accounting reasons, the proposed hypothesis cannot constrain IRP to depend solely on the RTULC â€“that is, they end up depending on the TPWR between countries. Secondly, the theoretical and empirical arguments advanced to constrain the TPWR are weak â€“none of these arguments can make the TRWR of any two commodities, within and between countries, to be sufficiently similar. Thirdly, the paper conducts a large-scale study of industriesâ€™ TPWR and reports that the variability (i) of these ratios and (ii) of their central tendencies, although limited, do not support the constraints necessary for the validity of the theoryâ€™s main thesis. The paper argues for the use of full production prices for the study of IRP based on the principle of absolute advantage.