The Alternative to the Existing System of the Concepts about Purchasing Power Parity Deviations – Derived from the Estonian Experience

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Abstract

The huge price differences between the former Soviet Union (FSU) and remaining world emerged at the beginning of 1990s. This phenomenon of hundredfold relative purchasing power of foreign currencies in the republics of FSU is not systematically explained by the traditional system of the Purchasing Power Parity (PPP) deviations’ causes – by monetary, real demand side and real supply side shocks. In this context, the paper examines the traditional causes of price differences and derives the improved system of the PPP deviations’ causes. We show that both the basic causes of PPP deviations are determined by potential investors’ imagination about the usefulness of the countries’ assets.

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1. Introduction

One of the central issues facing all former Soviet Union (FSU) republics at the beginning of 1990s was the huge deviation from the PPP. The consumer prices, wages and real estate prices in the FSU formed only ca 1 % in comparison with the developed countries (1 US cent purchasing power in FSU = 1US$ purchasing power abroad). During the period 1992-2001 the fast price convergence emerged between the FSU and remaining world. The concrete amount of this convergence was different in different republics of FSU – but the rise of consumer prices, wages and real estate prices was at least tenfold almost everywhere. The phenomenon of so high purchasing power of
foreign currencies and the following collapse is unprecedented (also in the remaining transitional countries) and hard to explain.

The phenomenon of foreign currencies' huge purchasing power in the FSU is not explainable with the traditional system of the PPP deviations' causes – with monetary, real demand side and real supply side shocks. The especially hard problem for the traditional approaches of PPP deviations emerged in a small former Soviet republic Estonia, where the prices, foreign trade and investments were liberalized very early – and the nominal exchange rate of domestic currency has been almost constant already from the end of 1991. An important issue is, what was the cause of hundredfold price differences between this small republic and developed countries.

In this context, the purpose of this article is to improve the existing system of the PPP deviations' causes. The article examines the traditional causes of price differences and derives the improved system of the concepts about PPP deviations. We show that both the basic causes of PPP deviations are determined by potential investors' imagination about the usefulness of the countries' assets (perceived business climate).

The organization of the paper is as follows. In the following Section 2, we describe the PPP and the existing system of the causes of PPP deviations. Section 3 shows that the phenomenon of price differences between Estonia (as one rapidly liberalized small republic of the former Soviet Union) and developed countries is not explainable in the traditional theoretical framework. Section 4 presents the new classification of the causes of PPP deviations. In the Section 5, the conception of perceived business climate (the shift from productivity to image as the main explanatory factor of PPP deviations between countries) is developed and explained. The paper concludes in Section 6.

2. The PPP and the causes of PPP deviations

The PPP concept argues that once converted to a common currency, national price levels should be equal.

\[ E_{ij} = \frac{P_i}{P_j}, \] (1)

where

\( E_{ij} \) – the exchange rate between the currency of country \( i \) and the currency of country \( j \)
\( P_i \) – the price level of country \( i \) (in local currency);
\( P_j \) – the price level of country \( j \) (in local currency).

PPP was first articulated by scholars of the Salamanca school in sixteenth century Spain (Officer, 1982). Though purchasing power parity had been discussed previously by classical economists such as J. S. Mill, V. Goschen, A. Marshall and L. v. Mises (Rogoff, 1996) – Swedish economist Gustav Cassel was really the first to treat PPP as a practical empirical theory. In a series of influential articles published in 1921-1922 Cassel promoted the use of PPP as a best means for setting relative gold parities (MacDonald et al., 2001).

Nowadays, there are several variants of PPP, used in accordance with the concrete aim.

PPP variants are:

- **The Law of One Price (LOP).** LOP states that the same good should sell for the same price in different countries (once prices are converted to a common currency).
• Absolute PPP. Absolute PPP is the LOP for the broader basket of goods. Frequently there is a need for broader measure of prices, when you want to investigate the price differences between different countries.

• Relative PPP. Relative PPP is the reduced form of absolute PPP. It states, that the price changes of the same basket of goods must be the same in different countries. Consequently: the nominal exchange rate between two countries will adjust exactly by the amount of the inflation differential between two countries (Rogoff, 1996).

Though the empirical investigations confirm the relationship between the prices and the nominal exchange rate in a very long run (Rogoff, 1996), the prices of most goods are not equal in different countries. During the 20th century the economists have postulated the main causes of PPP deviations (the causes of price differences).

Nowadays, there are two major approaches in this field – the sticky-price view and the equilibrium view. The first stresses on the importance of the nominal exchange rate fluctuations in the conditions of (especially in the short run) sticky prices, consequently monetary shocks. The second stresses the real economical shocks.

The real shocks themselves are divided as demand side and supply side shocks. The demand side shocks are (for example) the demand shift from tradables to non-tradables, the country’s incomes growth and the growth of government expenditures. The supply side shocks are changes in technologies, changes in relative productivities and changes in material production factors. Some shocks (for example formal and informal trade barriers) are classified in accordance with their predicted impact both under demand shocks and under supply shocks.

Such classification of the causes of price differences – monetary shocks, demand shocks and supply shocks – is the basis of existing empirical research also.

The majority of researches (De Gregorio et al., 1994; Clarida et al., 1995; Rogers, 1995; Weber, 1997; Carstensen et al., 1997; Bjornland, 1998; Cheung, 2000; Akram, 2002) treats the concrete causes of price differences just as the representative of the entire class of shocks – for example the Balassa-Samuelson effect as the representative of supply side shocks, the growth of country’s income as the representative of demand side shocks and so on.

Though, some researches (Faruqee, 1995; Coorey et al., 1996; Rose et al., 2001) concentrate on the sole cause of price differences also, without the wish the generalize the results to the entire class of shocks.

There are literally hundreds of hypotheses and the hypotheses’ components derived on the purpose to explain the price differences between countries. As following, the author of the present article is exhibited the most influential ones – the ones, that are found most notation and empirical improvement (among them in transitional countries).

The traditional causes of PPP deviations:

1. Real causes

Transportation costs and custom barriers
There are plenty of researches about their impact on price differences (Frenkel, 1981; Backus et al., 1993; Engel et al., 1994; Froot et al., 1995; Goldberg et al., 1997; Obstfeld et al., 1997; Rogoff et al., 2000), among them on the basis of transitional countries (Kaminski et al., 1995; Landesmann, 1995; Kaminski, 1996). The transportation costs and custom barriers can be classified both under supply side factors and demand side factors – depended on the exact aim on the concrete research.
1.1 Supply side causes

**Balassa-Samuelson effect**
The Balassa-Samuelson effect\(^1\) (says that the productivity growth in tradables sector increases the country’s price level) has found most interest and research – more than any other possible cause of price differences (Hsieh, 1982; De Gregorio et al., 1993; De Gregorio et al., 1994; Alexius et al., 1997; Chinn et al., 1997; Pfadt, et al., 1997; Alexius, 1999; Inflation..., 1999; Begum, 2000; MacDonald et al., 2001).

The Balassa-Samuelson effect is intensively investigated in the transitional countries also (Richards et al., 1995; Halpern et al., 1996; Coorey et al., 1996; Halpern et al., 1997; Krajnyak et al., 1998; Maliszewska, 1998; Jakab et al., 1999; Capriani, 2000; Fidrmuc et al., 2000; Rother, 2000; De Broeck et al., 2001; Halpern et al., 2001; Jazbec, 2001; Randveer, 2001).

1.2 Demand side causes

**The income differences**
The differences in countries incomes as the possible cause of the differences in countries prices is heavily investigated (Kravis et al., 1983; Bhagwati, 1984; Hansson et al., 1990; Heliwell, 1990; Bergstrand, 1991; De Gregorio et al., 1994; Rogoff, 1996; Chinn et al., 1997; Alexius, 1999; European..., 2000; De Broeck et al., 2001), among them on the basis of transitional countries’ experience (Richards et al., 1995; Sepp, 1996; IMF, 2000; Randveer, 2000; De Broeck et al., 2001).

2. Monetary causes

**The changes in the nominal exchange rates**
The effect of the changes in the nominal exchange rates on price differences is researched deeply (Dornbush, 1976; Manzur, 1991; Lastrapes, 1992; Clarida et al., 1995; Rogers, 1995; Rogoff, 1996; Papell, 1998; Aslund et al., 2001; Rogoff et al., 2001), among them on the basis of transitional experience (Coorey et al., 1996; Halpern et al., 1997; Grubacic, 2000).

During the recent years, the economists have shown special interest on the causes of price differences between transitional countries (among them former Soviet republics) and developed economies. The following mechanisms, that can explain the very low price level of transitional countries, have worked out. These mechanisms do not always belong to one concrete class of shocks – they are rather the combination of different (supply side, demand side, monetary) shocks, which all amplify each other.

**The causes of PPP deviations specific to the transitional countries:**

**The cost-recovery hypothesis**
The cost-recovery hypothesis (Zavoico, 1995) argues that the convergence of certain capital-intensive service prices (housing, utilities, transportation) can take place gradually. These services are distinguished by a capital stock that not only was

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\(^1\) From the standpoint of the Balassa-Samuelson effect there is urgent need to distinguish not only the spatially tradable and nontradable goods – but also temporally tradable and nontradable goods. The increasing productivity in the spatially traded goods’ sector must influence the price of temporally tradables much more quickly (with much smaller lag) than the price of temporally nontradables (the prices of spatially traded goods are anyway paritetic). It is so, because the price of temporally traded goods must better react to its predicted (by the Balassa-Samuelson mechanism) future price rise.
inherited, with no associated debt, from the pre-transition era, but also is large relative to the PPP-adjusted per capita income of these countries. Initially, when consumer wage levels are low, such service prices would be set to cover only current costs. Maintenance costs may not be covered because it is optimal initially to consume the excessively large stock. As incomes rise and the capital stock that can be supported by these incomes also rises, the prices of these services would be raised, at first to cover the maintenance costs and then to cover (future) capital costs, until they reach a level at which new investments can take place (Coorey et al., 1996).

The cost-recovery belongs to the class of real causes of price differences – it is the combination of demand side and supply side shocks. The cost-recovery hypothesis has found also empirical verification (Coorey et al., 1996).

**The hypothesis of temporary distortions in asset markets**

The hypothesis of temporary distortions in asset markets argues that the nominal exchange rate of transitional countries’ currencies can be affected by the temporary distortions in asset markets (Coorey et al., 1996). The distortions in asset markets will occur (in transitional countries) if the long-repressed pent-up demand for foreign assets (previously reflected in the black market premium) faces a negligible supply or if the freeing of prices in the presence of a monetary overhang (met by a sudden burst of inflation) creates the flight from domestic currency (Halpern et al., 1996). For instance, with negative real interest rates on bank deposits and no other liquid inflation hedges, foreign exchange can become the most important form of liquid wealth holding and can drive the exchange rate far from its PPP level (Coorey et al., 1996). The distortions in asset markets are amplified by the fact, that the demand for foreign assets was extremely unsatisfied in the Soviet Union – import goods were not only the substitutes of domestic goods but also cult objects (Raim, 2001a).

The temporary distortions in asset markets are the combination of monetary, demand side and supply side shocks. There are no empirical investigations of the hypothesis of temporary distortions in asset markets. In addition to the two mentioned mechanisms of price differences, the author of present article exhibits also the third possible mechanism.

**The capital-information mismatch hypothesis**

The capital-information mismatch hypothesis argues that there was systematic mismatch between capital and information owners in the transitional countries – especially in the republics of the (former) Soviet Union. Due to the long-term isolation of transitional countries, the (potential) foreign investors lacked information about transitional countries’ products, prices, trade conditions and risks – and domestic entrepreneurs lacked capital. As a result, there was no demand for products and production factors in transitional countries in spite of their very low prices (Raim, 1999).

This situation was amplified by the problem of asymmetrical information (Akerlof, 1970). It was extremely hard for local entrepreneurs to deliver their business information backage to the potential foreign investors, because this information was so multidimensional and complex. Due to this complexity the potential investors were not convinced in the local information’s rightness without the real experience in local business (Raim, 2001a). The capital-information mismatch belongs to the class of real demand side causes of price differences. There are no empirical investigations of the capital-information mismatch hypothesis.
3. How to explain the price differences and price convergence between Estonia and the European Union during the 1990-s?

If there has ever been in the world the persuasive example of both monetary, demand side and supply side shocks’ powerless in explaining the PPP deviations, then it is just the case of (former) Soviet Union republics during the 1990s. Even the most superficial studies reveal, that the above-mentioned shocks were too weak to explain the huge price differences\(^2\) (and the following price convergence) between the former Soviet Union republics and the developed economies.

The especially hard problem for the traditional approaches of PPP deviations emerged in Estonia, where the prices, foreign trade and investments were liberalized very early – and the nominal exchange rate of domestic currency has been almost the same already from the end of 1991\(^3\) (see Table 1).

**Table 1. Estonian consumer prices, average monthly wages and real estate prices relative to European Union (at the end of the year)**

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<tr>
<td>Consumer price level (%)</td>
<td>1.5</td>
<td>15</td>
<td>20</td>
<td>28</td>
<td>35</td>
<td>39</td>
<td>43</td>
<td>45</td>
<td>47</td>
<td>48</td>
<td>49</td>
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<tr>
<td>Wage level (%)</td>
<td>0.5</td>
<td>3</td>
<td>4</td>
<td>8</td>
<td>10</td>
<td>12</td>
<td>14</td>
<td>15</td>
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<td>18</td>
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<tr>
<td>Real estate price level (%)</td>
<td>1.5</td>
<td>3</td>
<td>7</td>
<td>10</td>
<td>13</td>
<td>14</td>
<td>15</td>
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**Sources:** Author’s own calculations based on Eurostat data; Statistical Office of Estonia data; Bank of Estonia data; Bank of Finland data; Egert, 2003; Raim et al., 2001; Eesti Statistika, 2003; Hinnainfo, 1992.

**Note:** The price of real estate refers to apartments in Tallinn (the capital city of Estonia) relative to Helsinki (the capital city of Finland); in satisfactory condition: inhabitable, partly in disrepair, no changes to the subdivision, no improvements to the building made, area ca 50m\(^2\).

During the first half of 1990s, Estonia was surely one of the most economically liberal countries in the world – nevertheless there was ca 5 times convergence of consumer prices between Estonia and the European Union (during the period from June 1992 to December 1995) in conditions with the Estonian relative labour productivities\(^2\) (as the traditional representative of supply side shocks) and incomes\(^2\) (as the traditional

\(^2\) The Estonian consumer price level and average wage level were at the end of 1991 respectively 1.5% and 0.5% in comparison with the European Union’s corresponding indicators – and the price of apartments in Tallinn (the capital city of Estonia) was 1.5% in comparison with the Helsinki’s (the capital city of Finland) corresponding indicator (Raim et al., 2001). The situation was quite similar in the remaining territory of former Soviet Union: the relative price levels were there (e.g. in Latvia and Lithuania) even a bit lower (Raim, 2001b).

During the years from 1992 to 2001 both the Estonian relative consumer price level and relative wage level increased more than 30 times – the relative price level of Tallinn’s apartments increased 15 times (Raim et al., 2001). The concrete amount of this relative price rise was different in different republics of FSU, but the price rise was at least tenfold almost everywhere (Raim, 2001b).

\(^3\) The selling price and the buying price of 1DEM were respectively 67 roubles and 65 roubles (in Tallinn) at the end of 1991. This rate fluctuates during the first half of 1992 only until 20% both upside and downside, and was 1DEM=73roubles in the end of June 1992 (in the time of the Estonian monetary reform). With the Estonian monetary reform, the nominal exchange rate of the Estonian new domestic currency (Estonian krown) was fixed (in DEMs) so, that there was continuity with the nominal exchange rate of the rouble (1DEM=8EEK, 1EEK=10roubles, 1DEM=73roubles). Consequently, there was no undervaluation or overvaluation during the Estonian monetary reform (Raim, 2001b).
representative of demand side shocks) decrease in comparison with the European Union (Raim, 2001a) (see graph 1). Therefore, the actual price convergence was just opposite to the predictions of both the Balassa-Samuelson effect and the conception about the positive relationship between the countries’ incomes and price levels.

During the more recent period (1996-2001) the Estonian relative labour productivity and relative GDP (both in comparison with the EU countries’ average) rose respectively 20% and 13% – but the relative price level rose 40% (Raim, 2002). Since one percent increase in relative labour productivity generates, on average, a 0.7 percent increase in the relative price of nontradables (De Broeck et al., 2001), and since the proportion of nontradables is ca 50% in the Estonian average consumer basket – then, taking into account the lag, the Balassa-Samuelson effect to the EU candidate countries’ (among them Estonia) inflation remains in the range of one percentage point (De Broeck et al., 2001). However actually, the Estonian annual inflation (in comparison with the European Union) was 2-12% during these years (Raim, 2004).

Although the empirical investigations, that are carried through during the second half of 1990s on the purpose of explaining the price differences (and price convergence) between the former Soviet Union republics and remaining world, already confirmed sporadically both the Balassa-Samuelson effect (Capriani, 2000; De Broeck et al., 2001; Halpern et al., 2001; Jazbec, 2001; Randveer, 2001) and the conception about the positive relationship between the countries’ incomes and price levels (Randveer, 2000; De Broeck et al., 2001) – the above-mentioned shocks are though not powerful enough to explain the phenomenon. Furthermore, the cause of productivities’ and incomes’ rise remains unclear.

The irrelevance of the Balassa-Samuelson effect on the Estonian (as one former Soviet Union republic) relative inflation is due to the fact, that in the beginning of transitional period there were no internationally traded goods in Estonia – in spite of
successful liberalisation. The huge relative inflation was caused by the rapid emergence of tradable goods (and the tradable goods’ sector) – that itself was caused by the rapid elimination of formal and especially just informal (lack of business information) arbitrage barriers. In addition to the lack of information (about Estonian products, prices, trade conditions and risks), the other arbitrage barriers had also important effect on price differences and price convergence (for example the Estonian staying out of trade unions (MFN, GSP, FTA) caused the developed countries’ import barriers (Kaminski, 1996); and local export barriers (Coorey et al., 1996; Kaminski, 1996)).

Of course, the arbitrage barriers can not affect the price differences without the local specific influences on local demand and/or supply (for example cost recovery or temporary distortions in asset markets).

Therefore, the phenomenon of price differences (and price convergence) between Estonia (as one part of the former Soviet Union) and developed countries is not interpretable in the traditional theoretical framework – with monetary, demand side and/or supply side shocks. The lack of business information has too decisive role here, to treat it only as one shock in the classes of demand side or supply side shocks. We need to bring the (formal and informal) arbitrage barriers into the system as new different class of shocks.

4. The new classification of the causes of PPP deviations derived from transitional experience

The author of the article classifies the causes of PPP deviations (the causes of international price differences) to the two following basic classes:

1) The causes of products’ immobility (the effects that explain immobility = the arbitrage barriers). Both the formal arbitrage barriers (custom barriers) and the informal arbitrage barriers (transportation costs; differences in languages, legal systems and currencies; differences in the products’ subjective quality; the costs connected with hunting information about prices, risks and trade conditions etc.) belong to this class.

2) The causes of local differences in the products’ supply and/or demand (the effects that are based on immobility = the local differences). Both the monetary (the official undervaluation of nominal exchange rate), the demand side (the incomes’ growth, the demand shift from tradables to nontradables) and the supply side (Balassa-Samuelson effect, the cost recovery) shocks belong to this class.

It is worth mentioning, that neither the effects that explain immobility nor the effects that are based on immobility are alone able to explain the price differences. The mutual relationship of the effects is revealed as following: due to international immobility of the products, the differences in the countries’ local supply and/or demand transform into the price differences between these countries.

Therefore, it is not possible to research the basic classes (nor the sole hypotheses of these classes) confusedly. The effects, that belong to one basic class, are independently totally meaningless – just as the fraction’s numerator (without the denominator). At the basis of one basic class’ effects it could be possible to make conclusions about the price differences only on the assumption, that the second basic class’ effects are known and constant both in time and space (in the all countries, that

4 For example the statement, that 60% of the price differences between Estonia and the European Union is explained by the income differences, is entirely without any substance.
are under research) – this assumption was especially strikingly wrong just in the context of the former Soviet Union republics in the 1990s.

But the combined research of both basic classes is very difficult. The author of the present article has to admit, that both from the standpoint of the empirical analysis and the resulting real economical policy, the concentration to one certain effect is much easier.

5. The conception of perceived business climate (the shift from productivity to image)

Due to the lack of business information, transportation costs, custom barriers and cultural-institutional heterogeneity (as the main effects that explain products’ immobility) the Estonian low labour productivity (as the main effect that is based on products’ immobility) got the power to produce the price differences between Estonia and developed countries. But the low productivity of Estonian labour (and land) itself was not caused so much by its inner quality but rather by the lack of important complementary good – capital (and the know-how that moves with capital). The low labour productivity was directly caused by the lack of capital, the low capital-intensity of the economy. Which itself was caused by the immobility of business information.

The driving force behind the price convergence between Estonia and developed countries is the decrease of Estonian products’ and production resources’ immobility – the vanishing of material and especially informational barriers from the way of capital. The capital inflow to the products and assets causes the local prices’ increase both directly and through raising the local labour productivity (see graph 2).

Graph 2. The causes of price convergence between Estonia and developed countries

The capital inflow to the Estonian products and production resources is affected by many factors connected with Estonian products international mobility. Though the terms 'lack of information' or 'information immobility' are too narrow to specify these factors entirely – because in addition to direct lack of business information
the heterogeneity in laws, manners and languages as well as custom barriers and transportation costs affected potential foreign investors. Much better seems to be the term 'perceived business climate', that reflects all world potential investors' imagination about the concrete country’s and its assets’ usefulness.

Since the perceived business climate is not only the trigger mechanism of the effects that are based on products’ immobility (differences in productivities, differences in incomes) but it determines also these effects’ absolute value – then, as a simplification, it is worth trying to explain price differences (between countries) only with the perceived business climates differences (between these countries). It is clear, that potential investors’ better imagination about the assets’ usefulness increases directly their demand and price. Just as every economically thinking family acts consistently with the view of increasing its assets’ (force, knowledge, enterprise, real estate etc.) market price – so the price level of the country’s resources’ reflects the country’s success.

But the consumer prices’ level is not the best measure for assessing country’s success, because many consumer goods (for example quickly spoiling food products and services) can be investment objects only indirectly – as the complementary goods for real investment objects (working force, real estate, products). The direct measure of country’s (or smaller area’s) perceived business climate is nevertheless the level of real estate prices and wages. This "two-horse team" of image indicators reflects also shocks (connected with information immobility and environment heterogenity – the factors, that discourage potential foreign investors), that are not reflected in the traditional success indicator – 'the real income per person'.

Since the difference between 'the (relative) level of real estate prices and wages' and 'the (relative) real income per person' was much bigger in the former Soviet Union republics than anywhere in the world (see table 1 and graph 1) – then the economical importance of subjective business climate became known in the basis of just these countries. But the (potential) foreign investors’ subjective imagination, what is reflected in the level of real estate prices and wages, is important for remaining world as well.

Therefore: though the traditional causes of PPP deviations are much stronger in the developed countries (because both the basic groups’ effects are more known and constant there both in time and space) in comparison with the former Soviet Union republics, the use of the concept of perceived business climate can create better results in the world scale also – and give the logical solution to the well-known PPP puzzle. The big disadvantage of the concept of perceived business climate is the fact, that it is very hard to quantify it (unlike the factors, that are traditionally used as explanatory factors of price differences – labour productivities and incomes) directly – probably there is a need for some indirect indicator (for example capital inflow).

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5 For example the statement, that 60% of the price differences between Estonia and the European Union is explained by the differences in perceived business climates, is logical.
6 The purchasing power parity puzzle means, that the economists are in trouble reconciling the enormous short-term volatility of PPP deviations with the extremely slow rate at which shocks appear to damp out. Consequently the causes of PPP deviations can be neither real (because real economical factors do not change abruptly) nor monetary (because prices’ nominal stickiness is not so long-lasting) in nature (Rogoff, 1996).
Contrary to the real and monetary factors the country’s perceived business climate (or image) can change very quickly but relapse very slowly – especially if we take into account its effect on the real economy through capital flows and productivity.
6. Conclusions

The huge price differences between FSU and remaining world were one of the central issues facing all former Soviet Union republics (among them Estonia) at the beginning of 1990s.

In this context, the article examined the traditional causes of price differences and derived the improved system of the concepts about PPP deviations from Estonian experience during the 1990s. We showed that both the basic causes of PPP deviations are determined by potential investors’ imagination about the usefulness of the countries’ assets – the perceived business climate.

The main conclusions of the study are as follows:

1) The phenomenon of price differences (and price convergence) between Estonia (as one rapidly liberalized small republic of the former Soviet Union) and developed countries is not explainable in the traditional theoretical framework – with monetary, demand side and/or supply side shocks.

2) Neither the effects that explain immobility nor the effects that are based on immobility are alone able to explain the price differences. PPP would hold in the world if there were no arbitrage obstacles (all products and information are internationally mobile) or if the regional supply and demand levels of all products were exactly equal.

3) It is not possible to research the basic classes (nor the sole hypotheses of these classes) of the causes of PPP deviations confusedly. The effects that belong to one basic class are independently totally meaningless.

4) The 'perceived business climate', that reflects all world potential investors’ imagination about the concrete country’s and its assets’ usefulness, determines the country’s relative price level.

The results of this article refer to the continuing necessity to include alternative explanatory variables (derived from the transitional experience) in the relative inflation explaining and forecasting process. We just cannot any more ignore the huge correctives "the bright transitional moment" (the unprecedented transition from a planned to a market economy) has brought into the economic theory.

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