

A Revised Test of the Law of One Price Using Rational Price Expectations

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Abstract

The law of one price (LOP) is an important ingredient in theories of international trade. Typical analyses of the LOP assume that parity should hold contemporaneously. This assumption overlooks temporal elements of trade. Recognizing this fact, we expect parity to hold for expected prices. Two empirical procedures are utilized to consider the LOP in international markets for U.S. agricultural commodities. The first utilizes econometric procedures to test an expectations augmented version of the LOP. A second approach uses nonparametric procedures to provide an alternative consideration of expectations. In each case, results provide support for a rational expectations view of the LOP.

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