

Comments on
The Choice of Exchange Rate Regimes:
An Empirical Analysis for Transition Economies
by von Hagen and Zhou

Andrew K. Rose

UC Berkeley, CEPR and NBER

A Valiant Attempt

- Interesting question: “What drives exchange rate regime choice?”
- An interesting set of countries (European/FSU “transformers”)
- All the usual suspects are included

Success from the Ashes?

- This literature has a history of failure
 - Endogeneity a serious problem
 - Measurement error another problem (expected shocks, latent credibility, financial market depth, ...)
 - The Baxter-Stockman/Flood-Rose “exchange rate disconnect” across regimes
 - Flood-Rose: no estimation \Rightarrow no Endogeneity problem
 - Here, need instrumental variables
 - Lags are unlikely to be good without white-noise errors
 - Persistent regime choices suggest this violated

What is the Alternative?

- Statistical: no clearly defined alternate hypothesis
 - Simple time-series Markov model would be interesting, probably successful
- Economic: were choices optimal? Low persistence implies not
 - Account for learning/changing preferences?
 - Were political preferences important (Frieden and redistribution)?
 - Strength of domestic institutions?

Loaves and Fish: the Sample Size

- 140 observations for a 3-cell ordered logit with over 20 regressors, a covariance matrix, ...
 - A stretch for conventional asymptotics
- 10 years x 25 countries = 250; but 140 in regressions
 - Even with late breakup of Yugoslavia and Soviet Union, some observations missing
 - Sample selection bias?
- Could the analysis be stretched by adding observations from other comparable developing countries?
 - Can then test for homogeneity

Technical Issues

- Is multilateral analysis clearly best?
 - Bilateral against Germany/Russia?
- With eight cells (which are then combined into three), is ordered logit really necessary?
- Lots of dependence across countries (and time)
- Would like to compare regimes with Levy Yeyati-Sturzenegger, Reinhart, ...
- A matrix of actual/predictions is better than percentage of correct predictions
 - One cell may always be missed