Comments on Berka and Devereux's *What Determines European Real Exchange Rates?*

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Summary

- Mostly an *empirical characterization* of European real exchange rates (RERs)
  - Also a theoretical model to rationalize key results
- Key: Valuable New Data Set
  - Prices, not indices, somewhat dis-aggregated
  - Many countries

Strong Results: 1

- Big Persistent differentials of RERs from PPP
  - These are *absolute* (not relative) PPP deviations
  - Bigger for flexible rate countries than fixers/EMU
  - Small EMU effect
  - Bigger for non-tradeables than tradeables

Strong Results: 2

- Strong Correlation of RERs with Real GDP ratios
  - Consistent with "Penn effect"/BS effect
  - 1% increase in relative GDP → .4% appreciation
    - Sensible, since more dispersion in GDP p/c than prices
  - Quantitatively large – explains *half* of individual RER variation
  - True across space *and time*: cross-section, time-series, panel (with FE)
- RERs positively correlated with relative non-tradeable/tradeable price

Frustrating Paper to Discuss

- All Bases Covered
  - Nice horse-race between theories
- Very careful data work
  - Ex: Prostitution is non-tradeable
  - Different Statistical Metrics for Deviation Size
- Emphasis on Persuasion
  - Figures as well as regression tables
  - Lots of Sensitivity Analysis

Conventional Wisdom Ratified

- Ex: Deviations from PPP big, persistent
  - Many, notably Engel and co-authors
  - But debate exists
    - Crucini et al: PPP works *well* dis-aggregated
    - Imbs et al: PPP deviations have *short* half-lives (≈18 m)
  - Thus data confirmation of CW a serious contribution
- Striking Consistency of Results
  - Usually data delivers more nuanced/muddied results

Still … Data Set not Perfect

- Annual
  - Finer would be better, given PPP strikes back controversy
- Aggregation
  - Not very dis-aggregated; EIU is contrast
  - All consumer prices, so non-traded distribution component non-trivial
  - Thus no natural comparison (e.g., commodities where LOP holds well)
- Span
  - Some countries enter late
  - 15 years not much, given PPP-deviation half lives

Suggestions, 1

- Add trade barriers to list of alternative hypotheses in Table 3
  - Measure a la Leamer deviations (gravity model)
  - Unlikely to change much
  - Also, most usual suspects (institutions) sluggish over 15 years (institutions)
- What about the cyclic properties?
  - Markups are cyclic; what about the RERs here?
    - One small (2001), one large (great recession) downturn

Suggestions, 2

- Can twist data to use price deviations in gravity model to take account of more characteristics bilaterally?
  - Parsley and Wei *Limiting Currency Volatility to Stimulate Goods Market Integration: A Price Based Approach*
- Would like overwhelming confirmation of Mussa fact at micro level
  - Real ≈ Nominal exchange rate volatility

Suggestions, 3

- More serious model evaluation
  - Data evaluation much more rigorous than that of model
  - But model may not be that important
- Eventually: Need to make progress on *causes* for RER/y correlation at micro-level
  - Need more structure, data on productivity, wages, demand, etc.

Small Suggestions

- Add *both* country and time FE (table 3)
  - Also time FE in Table 5
  - Probably little effect
- Use dynamic panel model?
- Scale ordinate on figures similarly
  - Especially figure 4

Bottom Line

- Valuable Contribution to the Agenda
- But Plenty Remains!
  - Critically: *Why* the "Penn effect"?
  - Would like reconciliation of where we stand
    - Many conflicting results demand "encompassing" explanation
    - Especially important given potential aggregation biases