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
  o Simple time-series Markov model would be interesting, probably successful

• Economic: were choices optimal? Low persistence implies not
  o Account for learning/changing preferences?
  o Were political preferences important (Frieden and redistribution)?
  o 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?
  o 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
  o One cell may always be missed