

Comments on
*De Facto and Official Exchange Rate
Regime in Transition Economies*
by von Hagen and Zhou

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Motivation: Unfinished Business

1. Why is this an interesting question?

a. We care about what drives exchange rate regime choice

b. But why should we care about the fact that governments dissemble about the exchange rate regime?

2. Why is an interesting data set to answer this question?

a. Are TEs different from other economies?

3. Why is this an appropriate technique to answer this question?

Regime Determination: Success from the Ashes?

- Close relationship to von Hagen and Zhou on regime choice
- All the usual suspects are included (good!)
- Results look mostly reasonable (better!)

Still ...

- Regime choice literature has a history of failure
 - Measurement error a problem (expected shocks, latent credibility, financial market depth, ...); here too
 - The Baxter-Stockman/Flood-Rose “exchange rate disconnect” across regimes (relevance?)
 - Endogeneity another serious problem
 - Flood-Rose: no estimation \Rightarrow no Endogeneity problem
 - Here, need instrumental variables
 - Lags unlikely IVs with autocorrelation
 - Persistent regime choices suggest this violated

- Puzzle: *Results are better for official than actual regimes*
 - Hard to understand

What is the Alternative? Modeling Regime Discrepancies

- Statistical: no clearly defined alternate hypothesis
 - Simple time-series Markov model would be interesting, probably successful
- Economic: why should authorities dissemble?
 - Were choices optimal? Low persistence implies not
 - Account for learning/changing preferences?
 - Were political preferences important (Frieden and redistribution)?
 - Calvo-Reinhart: credibility is critical to actual regime
 - Suggests more emphasis on domestic institutions

- Fixing is a monetary policy, but floating is not; what's the monetary policy for floaters?
 - Should those determinants enter?
- In sum: bivariate model of exchange rate regime choice not an obvious way to model regime discrepancies.

Loaves and Fish: the Sample Size

- 154 observations for a 3-cell bivariate ordered probit with over 20 regressors, a covariance matrix, ...
 - A stretch for conventional asymptotics
- 10 years x 25 countries = 250; but 154 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 multiple cells (then combined into three), is ordered probit really necessary?
 - Would SUR/OLS on a continuous measure be worse?
- Lots of dependence across countries (and time); covariances?
- Some questions about data construction (better description please!)
 - Is the “fourth cluster” (low volatility) important?

- A matrix of actual/predictions is better than percentage of correct predictions
 - One cell may always be missed
- Are all rates dollar rates? Seems odd