Comments on: Cheng and Rajan's `Monetary Trilemma, Dilemma or Something in Between?'

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1. Trilemma: **not dead yet**

2. What is being measured?

3. Objectives, N, & endogeneity

1. Trilemma: **not dead yet**.

"…the report of my death was an exaggeration."

–Mark Twain to U.S. Journalist

1. Trilemma: **not dead yet**

– Klein & Shambaugh, *AEJ Macro* 2015

– Obstfeld, Ostry, & Qureshi, *RE Stat* 2017

– Bekaert & Mehl, *JIMF*, 2019

– Ligonnière, *JIMF* 2018

– Han & Wei, (some life left) *JIE* 2018

1. Trilemma: **not dead yet**.

—Cheng & Rajan

- Regimes matter.
- Semi-regimes matter.
- Regimes matter asymmetrically.

  (Direction differs from Han & Wei)

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   Overall message is important, and the pieces are interesting.

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1. Trilemma: not dead yet

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3. Inferences about sovereignty

A simple story
& this strand of the literature.

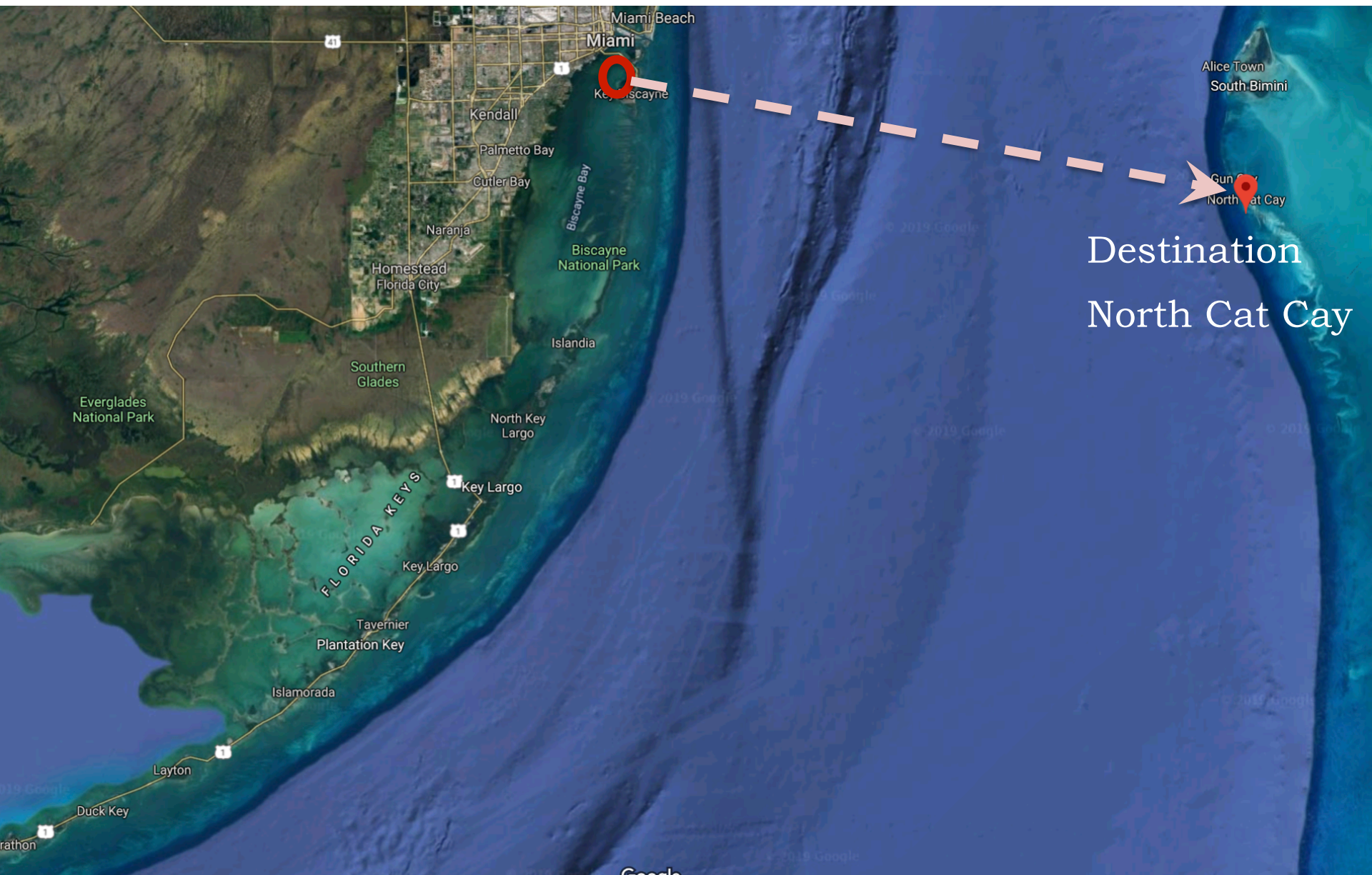# The Little Boat that Sailed to Cat Cay

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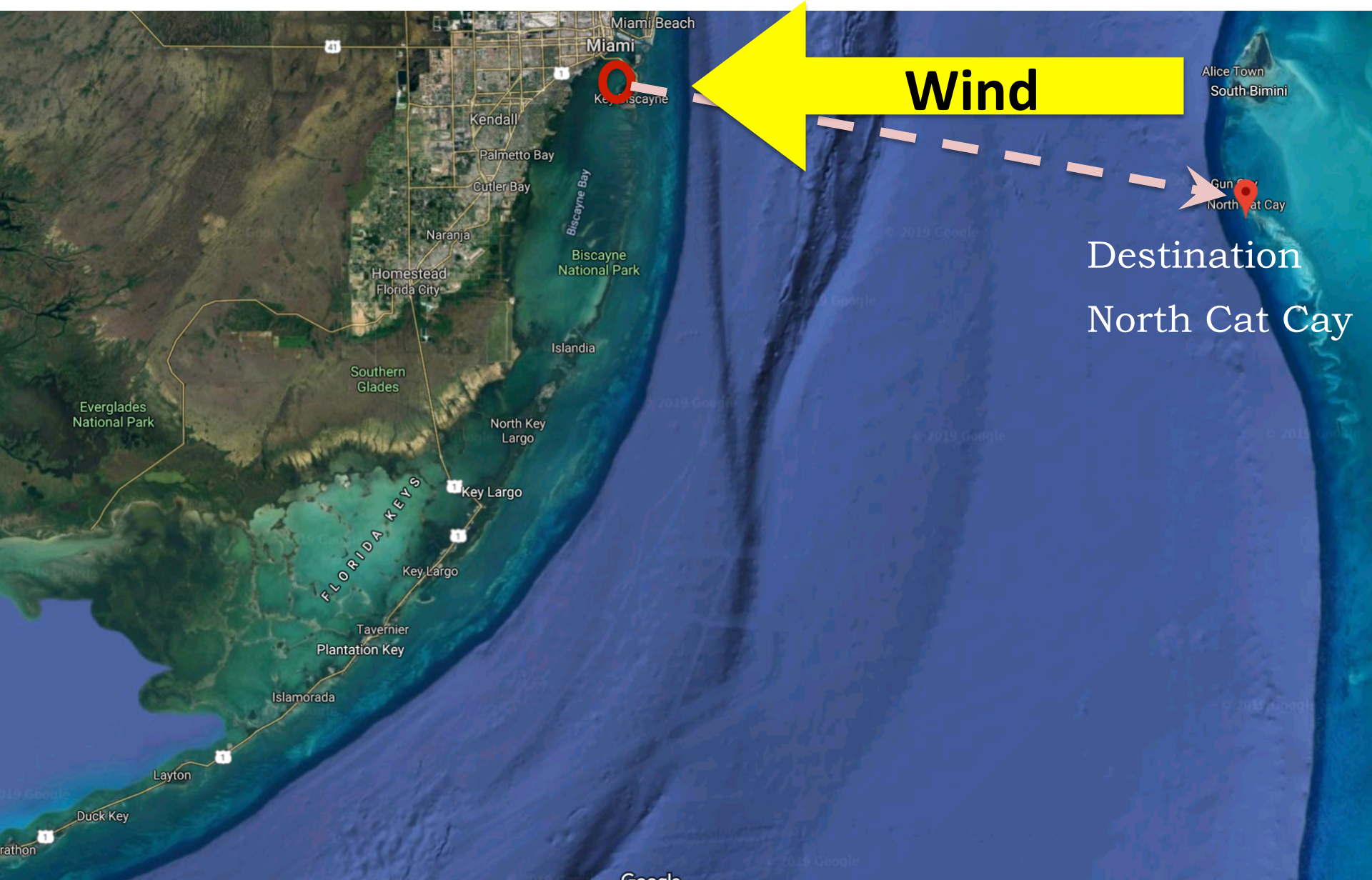

Destination: North Cat Cay

The Little Boat that Sailed to Cat Cay

Destination

North Cat Cay

The Little Boat that Sailed to Cat Cay

Wind

Destination
North Cat Cay

The Little Boat that Sailed to Cat Cay

Wind

Destination
North Cat Cay

Gulf
Stream
Current

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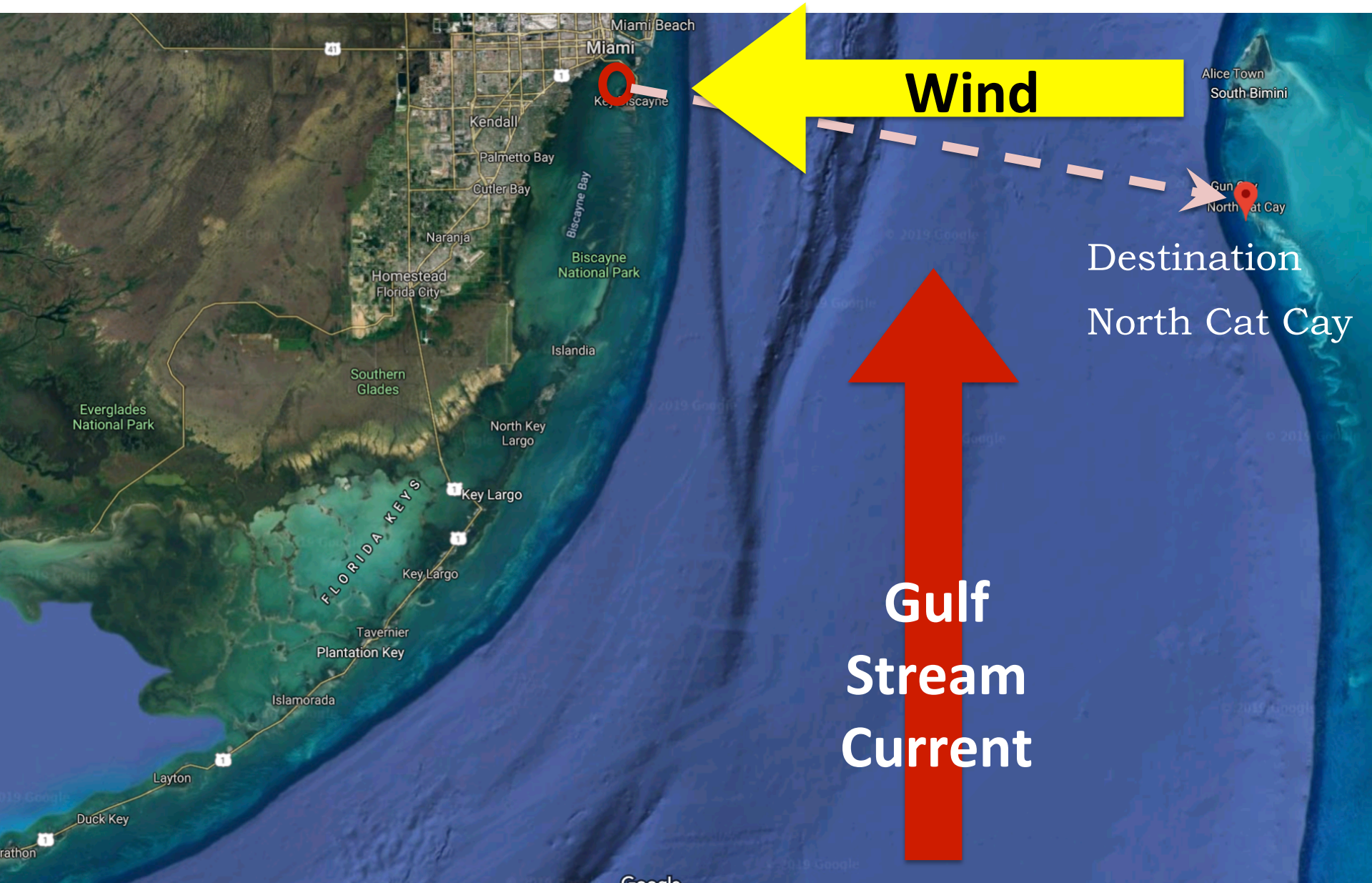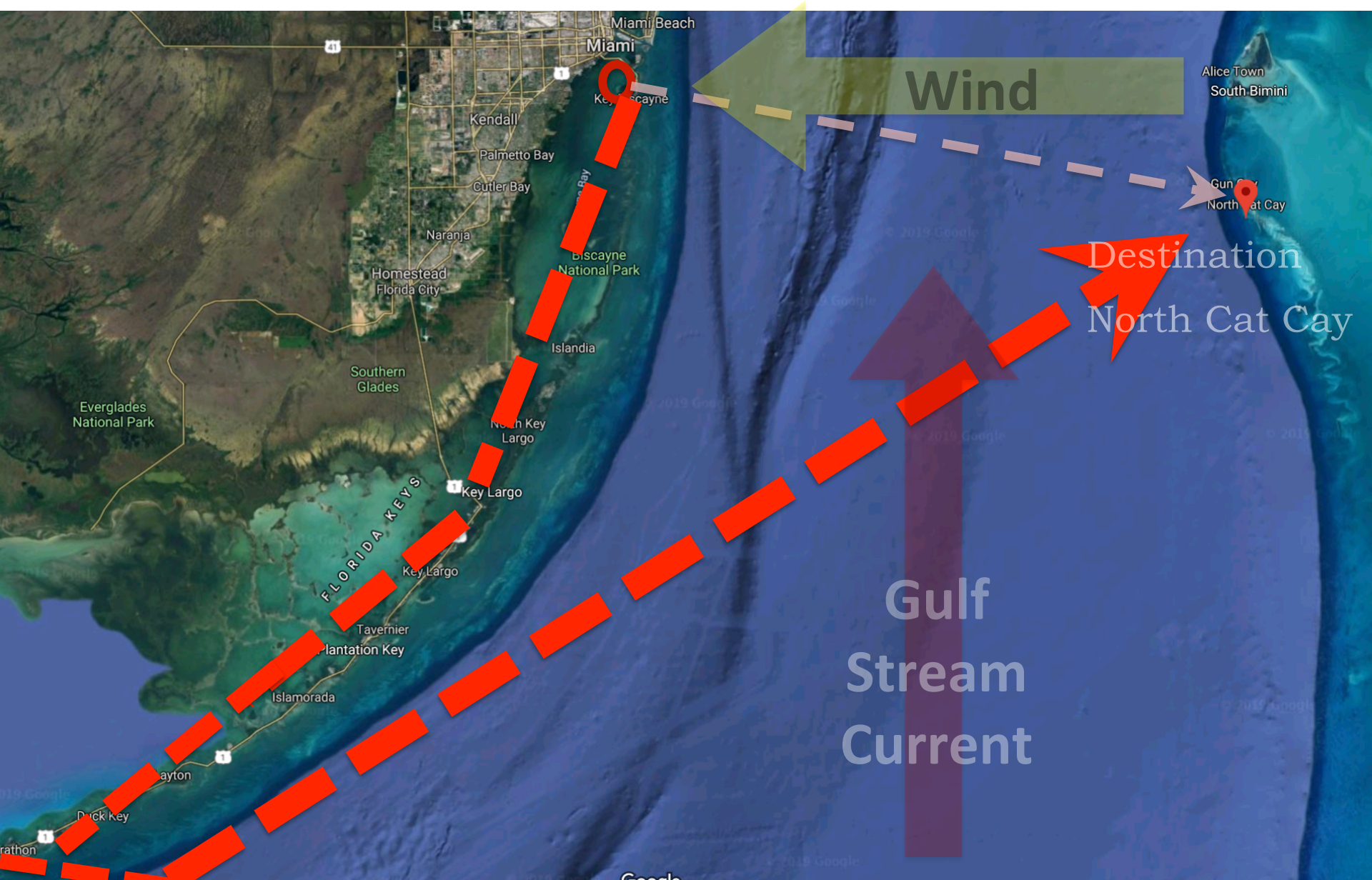
Review the Context
Sailing

1. The Great Bahama Bank, with Cat Cay, is a popular destination.

2. Boats, small and large, share headwinds & currents.

3. Big boats are faster than small ones, other structural differences.

Individual boats moving in a similar pattern across the Gulf Stream at different speeds, with many correlated, small corrections along the way.

Wind

Destination

Gulf Stream Current
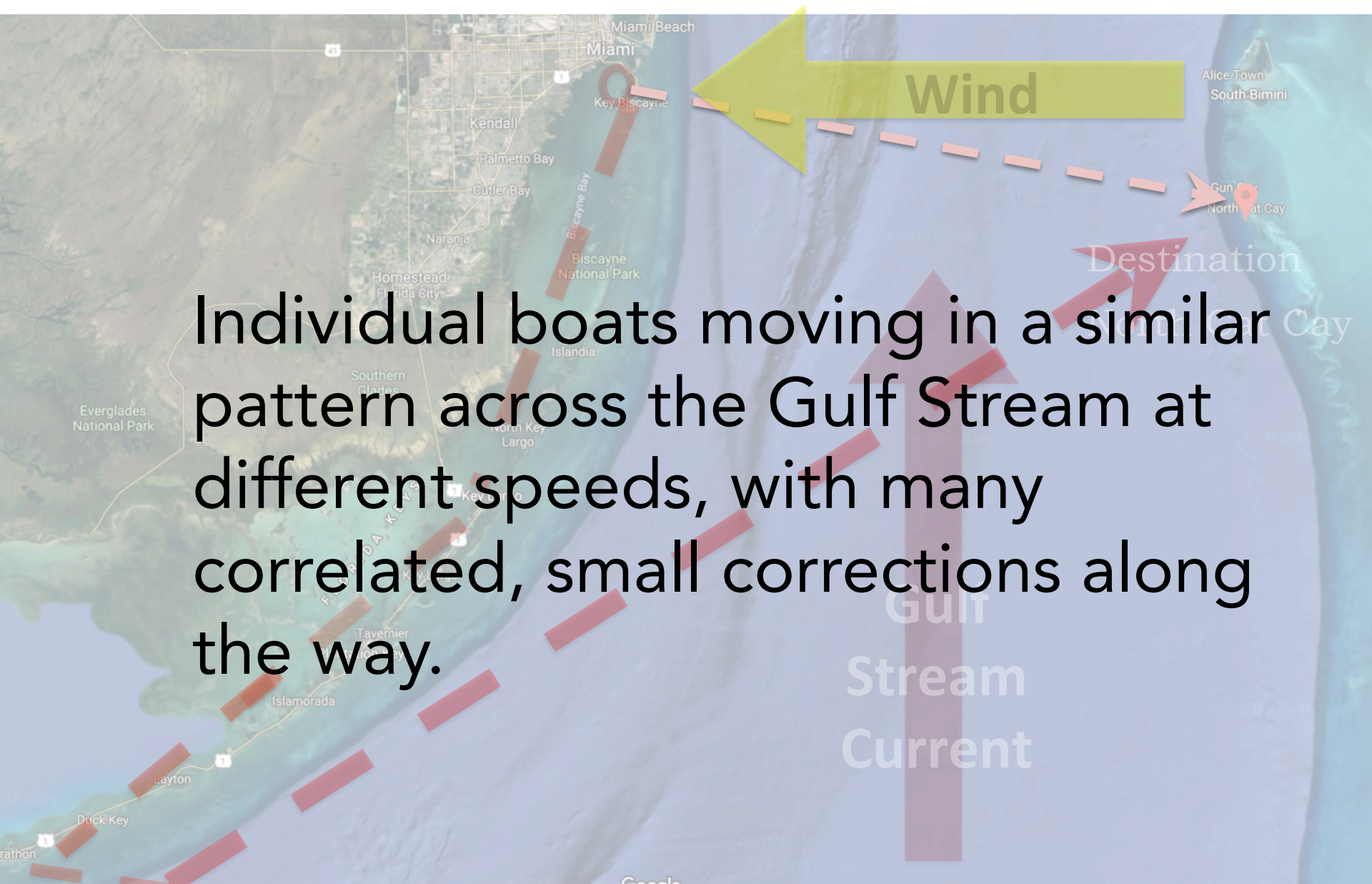
The Econometrics Exercise

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3. Interpret $\beta > 0$.

   β reflects related destinations, and common headwinds & currents.

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3. **Can the captain respond individually to changing conditions? (Yes)**

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2. Could the captain choose the destination? (Yes.)

3. Can the captain respond individually to changing conditions?

4. **So, did the captain have an independent policy?**
   (Yes.)

The Little Central Bank that Sailed to its Target

Review the Context
Monetary Policy

1. A stable inflation rate is a popular objective.

2. Economies share headwinds & currents.

3. Some monetary authorities move faster than others; and there are other structural differences.

The Econometrics Exercise

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   β reflects related objectives, and common headwinds & currents.

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2. Can the monetary authority choose the objective?

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3. **Can the monetary authority respond individually to changing conditions?**

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4. **Does the monetary authority have its own sovereign policy?**

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2. Can the monetary authority choose the objective?
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4. **Does the monetary authority have its own sovereign policy?**

Does β measure monetary sovereignty? (No.)

Not merely a conceptual problem

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  Sovereignty rose,

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- UK after the sterling crisis
  Sovereignty rose,
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- HKMA vs. New Zealand's 90s inflation target
  Sovereignty glaringly different,
  But, β says roughly the same.

Other approaches

- Identify in a full model or an empirical system.

    Dedola, Rivolta, & Stracca, *Journal of International Economics* 2017

    Davis & Presno, *Journal of Monetary Economics* 2017

    Dees & Galesi, Working Paper, 2018

- Include an objective function.   *(More on that...)*

    Han & Wei, *Journal of International Economics* 2018

    (& Cheng and Rajan)

- Focus on policy *effectiveness*.

    Georgiadis & Mehl, *Journal of International Economics* 2016

- Use the trilemma to measure sovereignty.

    Popper, Mandilaras, & Bird, *European Economic Review* 2014

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2. What is being measured?

3.
   - Central bank objective function
   - N
   - Endogenous regime choice

Central bank objective function

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Macroeconomics is all about simultaneity.

A single equation estimate is misleading.
Use a model or empirical system or both.
(Parsley & Popper, *JIMF* 2014)

- Central bank objective function
- N
- Endogenous regime choice

Table 2. Two by Two Classification of Exchange Rate and Capital Control Regimes (First-difference)

		PEG			
		Yes		No	
		Coef. (s.e.)	N [R²]	Coef. (s.e.)	N [R²]
CAPITAL CONTROLS	Yes	0.31*** (0.09)	426 [0.05]	0.09 (0.07)	956 [0.00]
	No	0.94*** (0.08)	277 [0.42]	0.48*** (0.11)	353 [0.10]

Note: Cluster-robust standard errors are reported.
*** Significantly different from 0 at the 99% level. ** At 95% level. * At 90% level.

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Small-N cells

- Say something about individual countries.
- How does what we know about them, as economists rather than statisticians, jive with this?

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Standard errors: Off the shelf clustering?

Converges at √N

(not √NT, Villacorta Gonzales, 2014)

- Central bank objective function
- Inferences: $\sqrt{N}$ vs. $\sqrt{NT}$
- Endogenous regime choice

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- Choices to peg or control capital are related to objectives, conditions, & base country fundamentals.

- So, observed β differences conflate sovereignty and the choice landscape.

Conclusion

This paper—not dead yet & more

- Regimes matter.
- Semi-regimes matter.
- Regimes matter asymmetrically.

Challenges in the literature

- Correlation isn't sovereignty.
- Small *N,*
  - Opportunity to examine individual countries
  - Off-the-shelf clustering is challenging.
- Regime choice is endogenous.