Executive Summary

The disclosure of information about the policy making process and the release of new databases may add relevant information about the exchange rate to guide the public’s expectation, but may also mislead it. Asymmetric information also reinforces the importance of the learning process for policy makers and financial markets. This dissertation focuses on the role of information in the political economics of exchange rates, and consists of four chapters. The three first chapters provide theoretical and empirical studies of how access to information shapes and constraints the choice of exchange rate policy (official statement and implemented policy). The last chapter considers the question of whether international banks learn from their previous crisis experiences and reduce their lending to developing countries as a result of a financial crisis. It focuses on the experience accumulated with past financial crises.

The first chapter is theoretical, and uses a basic model of monetary policy à la Barro-Gordon to study how the presence of asymmetric information is likely to affect the implemented exchange rate policy (de facto exchange rate regime) and central bank’s official statement (de jure exchange rate regime). In the model, the asymmetry of information directly concerns exogenous shocks affecting the exchange rate. The policy maker possesses private information about the evolution of the exchange rate. Focusing on the media and the external provision of information about the policy maker, it shows that the extent to which the private sector is able to verify the policy maker’s signals directly determines the exchange rate policy and the communication strategy. Increasing the influence of the media results in a more transparent exchange rate policy (whatever the policy). More interestingly, the media also influence the incentives associated with the different exchange rate policy choices. When the private sector is (not) well informed, an improvement of the information provided by the media tends to increase the propensity to implement a floating (fixed) exchange rate regime. Consequently, the media appears as a constraint on the truthfulness of the exchange rate policy. However, two policy makers may reveal to the private sector very different patterns of exchange rate policy if they are initially endowed with different levels of information provision.

The theoretical prediction about the influence of the media on the capacity to conceal a fixed or a floating exchange rate regime is ambiguous. An empirical investigation is necessary to determine which specification is relevant in practice. The second chapter, therefore, assesses the extent to which press freedom and an easy access to information
constrain a country’s declaration of its exchange rate regime (whether it is a floating regime or a fixed one). The empirical analysis combines worldwide data on de jure and de facto exchange rate regimes. Press freedom and access to information are proxied by different indicators such as the Freedom House index or the percentage of Internet users. The evidence confirms that greater press freedom and easier access to information result in a lower probability of untruthfully reporting the de facto regime. This influence is observed both for countries that de facto peg their exchange rate, and countries that de facto let their currency float. The results accordingly provide strong support for the view that the media acts as a “watchdog” that monitors and reveals the authorities’ policies. These findings withstand a large set of robustness checks, including controlling for democracy and for the institutional and political environment, controlling for endogeneity, and using various estimation methods. The results are particularly strong for developing countries.

Another constraint that might also appear for a policy maker in charge of the exchange rate policy is the surveillance of international institutions such as the IMF. Like the media, the IMF improves markets’ information by providing data and releasing analyses. The influence of IMF surveillance could also operate through the implementation and harmonization of international standards, or through the sharing of experience between countries. Following these arguments, IMF surveillance influences negatively the propensity of a policymaker to untruthfully declare his exchange rate regime. In the third chapter, the empirical analysis combines worldwide data on de jure and de facto exchange rate regimes with a measure of IMF surveillance, proxied by the number of IMF publications picking out a specific country or group of countries. The empirical evidence suggests that IMF surveillance significantly reduces the probability to renege on the announced exchange rate regime. Those results seem to be asymmetric, since they are essentially driven by the negative influence of IMF surveillance on the deviation from an announced floating regime but not from an announced fixed regime. Endogeneity concerns are addressed by exploiting the involvement in international non-governmental organizations of the countries to construct instruments for IMF surveillance and the results confirm the initial findings. In the IV estimations, what matters is the fact that the stock of IMF publications related to a given country depends on its political and diplomatic international involvement. A country promoting active international involvement is more likely to be active in many international organizations.

The last chapter focuses on the influence of experienced currency crises and by extension of financial crises on international banks. The key question is whether international banks learn from their previous crisis experiences and reduce their lending in developing countries’ markets as a result of a financial crisis. The empirical analysis combines a bank-level dataset of bank activity and ownership with country-level data on the stock of historical crisis events. We measure the experience of banks with crises by the number of experienced financial crises between 1800 and 2005. To circumvent selection and endogeneity concerns, temporal variations in the relative recency of crises are used as instruments for crisis experience. The evidence shows foreign banks with greater crisis experience reduced their lending significantly more relative to other foreign banks. It tends to confirm the learning effect. A few robustness checks are also performed: alternative measures of crisis experience, additional controls, and decompositions into different types of crises. A natural extension, when attempting to evaluate post-crisis bank performance, is to consider a more direct measure of bank performance (profitability), instead of using an indirect one (loans). The results are consistent with the argument that reduced lending is associated with greater learning from experience and superior bank performance.