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Los Angeles, CA 90095

RE: MS AER-2014-0926: Identifying Taylor rules in macro-finance models

Dear Mikhail,

Please find attached three referee reports on your paper, "Identifying Taylor rules in macro-finance models," AER-2014-0926. Unfortunately, all three referees recommend against publishing your paper in the *American Economic Review*.

In summarizing their reactions it is useful to adopt the following notation:
Referee 1: "In a 2011 JPE paper…"
Referee 2: "This paper revisits…"
Referee 3: "This paper examines…"

The reports are quite thorough so I refer you to them for details. But the main issues seem to be as follows. First, Referee 1 argues that the key contribution of your paper is to provide an extension to John Cochrane's main result. He focuses on your claim that to achieve identification, either the monetary policy shocks must be observed or that restrictions must be placed on the monetary policy shock that enable it to be inferred, even when the state vector itself is observed. The problem is that this referee claims to provide a counter example to your claim. It's certainly possible that he may have misunderstood some fundamental point. It would be good to know if that is the case.

Referee 2 argues that the value added of the paper relative to Cochrane isn't high enough to pass the bar at the *AER*. He sketches out what seems to me a very elegant strategy for presenting your results that might also allow you to prove some interesting theorems.

Referee 3 raises what seems to me a critical question about the issues that you and John Cochrane are addressing. Are the identification issues that John stresses likely to be important in practice? The referee's perspective is that the fundamental reason that identification fails in the Cochrane framework is that there's a strong correlation between the policy shock and the regressor. This claim has to be correct in the sense that, given the recursiveness assumption in CEE (1999) handbook article, identification is immediate.

The referee discusses the practical importance of this point as well as the robustness of key empirical results in the literature to using monthly data (where the recursiveness assumption may be more palatable) and alternative identification schemes using Fed Funds Futures markets data in ways that don't impose Choleksi-like identification schemes. See his references and recent work by Nakamura and Steinsson. Of course all of these papers could be "buying" identification using assumptions that are incorrect. But that seems to be the key issue. Are the identifying assumptions being made correct and how sensitive is inference to the precise assumptions being made. In sum, from referee 3's perspective, to pass the bar at the *AER*, the paper needs to address the practical significance of the identification issues that you and John raise.

I am sure that you could respond to some of the issues raised by the referees. But fully responding to their concerns would amount to writing a new paper with a very uncertain outcome. Under the circumstances I must reluctantly accept the referees' unanimous recommendation and decline to publish your paper in the *American Economic Review*.

I am really sorry about this outcome. I am sure that a revised version of the paper that addressed the key comments of the referees (particularly Referee 1) would be of interest to a very good field journal.

Sincerely,
Marty Eichenbaum