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September 5, 2023

Russell Cooper
European University Institute

Re: MS# 2406, "Indirect Inference: A Local Projection Approach"

Dear Professor Cooper:

Thank you for submitting your paper to *Quantitative Economics*. Attached please find reports from three reviewers. The referees and I are sympathetic to the overall idea of your paper. There is a large literature comparing local projection with other estimators for purposes of estimating forecasts or IRFs. I agree that there is room for a complementary paper that compares estimators for purposes of uncovering structural parameters.

That said, my reading of the literature is that the answer to the forecasting questions posed by earlier researchers is, "it depends." The way earlier authors arrived at that conclusion was by examining a large range of different data sets, true models, and estimation methods. The latter include full-information Bayesian or frequentist estimation of the models, approaches to shrinkage and parsimony, decisions about lag length, number of variables, etc. You seem not to have arrived at the answer of the earlier related literature. I can't help but wonder if the reason might be because your investigation is so narrowly focused.

The referees and I are also not enthusiastic about your approach of acting as though structural shocks can be inferred using other methods. I think the most natural example for a paper like yours would be to use external instruments. The results on p. 971 of Plagborg-Moller and Wolf (2021) might give you a way to directly relate your version of "it depends" to the large previous literature that has focused purely on forecasting questions, insofar as they show that a structural VAR and structural local projection are just different ways to answer the same forecasting question.

Finally, the referees feel that the mission of Section 5 of the paper could be somewhat at odds with the rest of the paper. I could imagine Section 5 as a separate paper, whose message is, here's a feature of the data that is inconsistent with the Smets-Wouters model, and here's a modification of the model that could fix this problem.

I have no idea how either of those radical redirections from your original vision for your paper would work out. I do know that any such attempt would be a very different paper from the one you submitted. I therefore regret that the decision we must make is a clean rejection of your paper.

One path you could consider would be to make the minor modifications suggested by the referees and try another more specialized journal. Frankly that is probably what I would do if

I were the author. If you instead contemplate a more radical reworking of your investigation, any new submission to *QE* would be treated as an entirely new submission.

I nevertheless thank you much for giving us the opportunity to consider your paper.

Sincerely,

James D. Hamilton
Co-Editor, *Quantitative Economics*