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Testing purchasing power parity hypothesis for transition economies

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³ Note that the results we get from this exercise would neither be meaningful nor powerful since the period in question is 12 unbalanced years.

⁴ Levin and Lin (1993) indicated from simulation exercises that the problem of limited power in unit root tests is severe for small samples: 'For example, if 50 observations are generated by a stationary univariate model with first-order autocorrelation of 0.9, the augmented Dickey-Fuller (Dickey and Fuller, 1981) test procedure (allowing for intercept and time trend, and using a 5 percent confidence level) rejects the unit root hypothesis in only 8 percent of the replications.'

⁵ If a deterministic element like an intercept and/or a time trend is present in the data but not included in the model, the unit root test will be inconsistent (Levin and Lin, 1992).

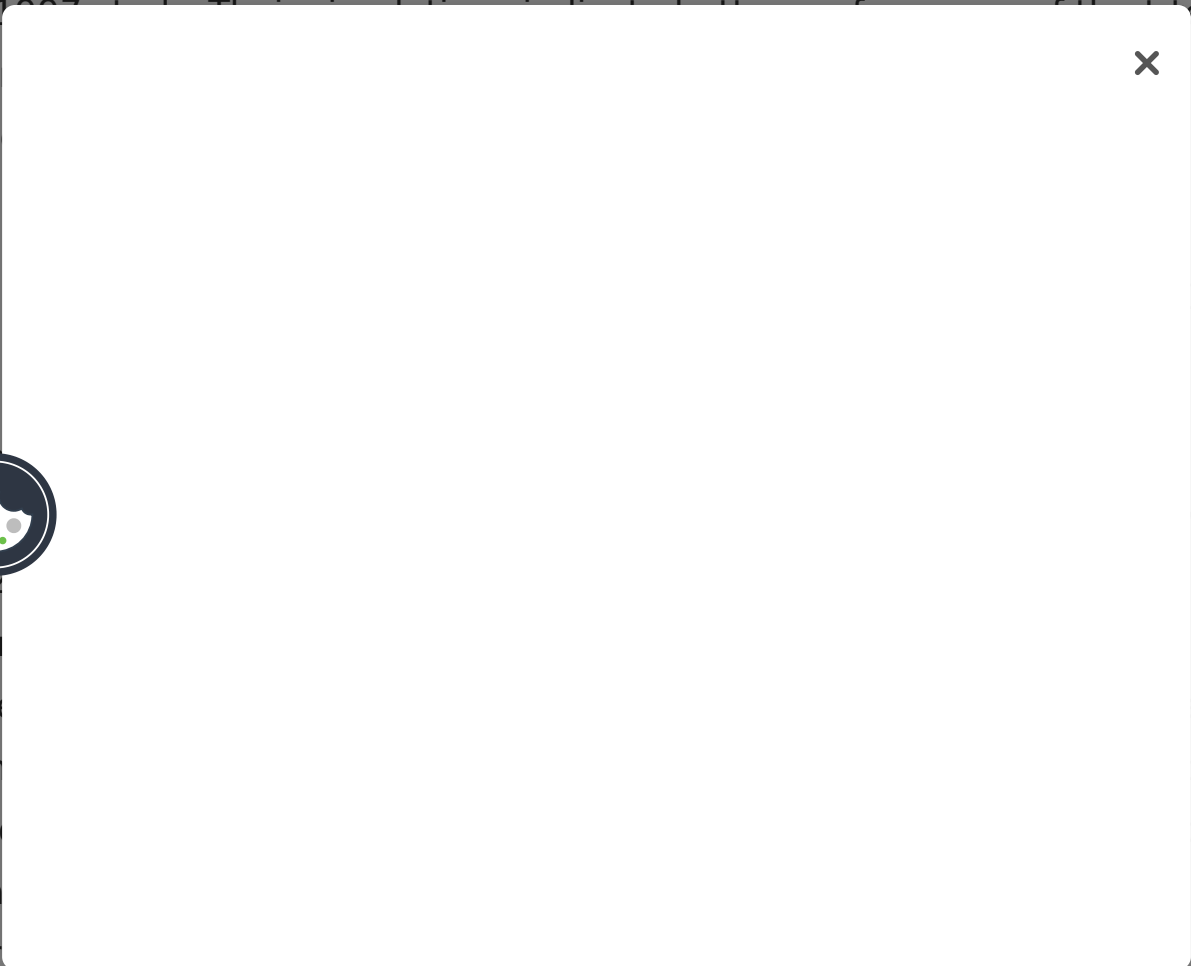
⁶ As most of the univariate tests for transition countries suggested, an augmented Dickey-Fuller (ADF) test is conducted for one lag ($k = 1$).

⁷ The Im, Pesaran and Shin test procedure estimates each equation separately by OLS as in univariate tests, and test statistics are obtained by taking the averages of ADF t-statistics for each equation. In addition, Im, Pesaran and Shin perform the LM test, which is based on the standardized cross section average of the individual LM statistics

in their 1997 test. The test statistics indicate that the ADF test and LM test are better than the LM test.

⁸ Nickell ρ , where, $A_T = -(1 + \rho)(T - 1)$.

⁹ Karlsson $T = 10$, two LL tests in and Lin results, we can focus on the LM test (LL2) (T = 12, N = 21). So Levin and Lin tests, and with the Fisher tests. Also see Im, Pesaran and Shin tests for



¹⁰ Note that some studies argue that rejection of unit root by a single country is enough to reject the unit root for the whole panel. Although time series for this study is too short to further discuss the unit root statistics for each country, we conducted a panel test on countries for which we do not reject a unit root, and obtained similar results to those above.

¹¹ Wu ([1996](#)) found the speed at which real exchange rates restore to equilibrium taking approximately two and a half years for one-time deviation from parity to be reduced by a half while supporting the long-run PPP for eighteen countries during the post-Bretton Woods period. Frankel and Rose ([1996](#)) found this speed to take approximately four years for a panel of 150 countries for a longer and unbalanced period (from 1948 to 1992).

¹² Score definitions are detailed under EBRD, annual transition reports, [Section II](#).

¹³ Note that report adds another level of score described with a plus and minus signs to all categories. Plus and minus signs are treated by adding 0.3 and subtracting 0.3 from the full value. Therefore the highest score for an element would be 4.3, totalling to 12.9 for three elements.

¹⁴ Notice that Bulgaria with a score of 10.9 is at the margin. Also note that it is an acceding country which joined the EU in 2007. With a score of 10.9, it is the lowest test placing Bulgaria in the lowest category.

¹⁵ The data for the first period is estimated using the data from the first period and truncated to the first period.

¹⁶ Note that the data for the first period is estimated using the data from the first period and truncated to the first period. The data for the first period is estimated using the data from the first period and truncated to the first period.



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