The Distributional Impact of Inflation: Tax Incidence and Financial Strategies of Argentine Households: A Discussion

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Short Summary

- The paper looks into two main questions:
  1. How large is the incidence of the inflation tax across the income distribution in Argentina?
  2. How do households adapt their financial strategies to changes in the inflation tax?
- The paper's main findings are twofold:
  1. Inflation tax along the income distribution:
     - The inflation tax is **regressive**: incidence on low-income households about $\times 2.5$ larger than on high-income households.
     - Inflation tax on low-income households rises from 1% to 11% of disposable income as monthly inflation increases from 2% to 25%.
  2. Households' financial strategies:
     - Low-income households respond to higher inflation tax by **increasing borrowing from family and friends**.
     - High-income households respond to higher inflation tax by **increasing payments in instalments**.
     - Bank borrowing seem unrelated to inflation tax incidence.

The inflation tax: a quick reminder

- The inflation tax corresponds to the real resources the government obtains by issuing money:

$$\frac{M_t}{P_t} - \frac{M_{t-1}}{P_t} = m_t - m_{t-1} + m_{t-1}\frac{\pi_t}{1+\pi_t}$$

- Inflation rates π_t + money holdings m_{t-1} by income
  $\Rightarrow$ incidence of the inflation tax along the income distribution.

	Household Survey 3Q-24	Households expenditure survey 2017-18		Households expenditure survey 2017-18			Monthly inflation 25.0%		Monthly inflation 2.0%	
Average household income quintiles	Average household icome (pesos)	Household expenditure as % of income	Monthly household expenditure (pesos)	% of expenditure paid in cash	Use of cash during the month (pesos)	Monthly average cash holdings (pesos)	Purchasing power loss (pesos)	As % of household income	Purchasing power loss (pesos)	As % of household income
1	318,411	100%	318,411	86.0	273,860	136,930	34,232	10.8	2,739	0.9
2	629,587	92%	578,150	80.4	464,866	232,433	58,108	9.2	4,649	0.7
3	926,983	80%	738,305	75.7	559,229	279,615	69,904	7.5	5,592	0.6
4	1,377,553	71%	980,744	68.8	674,656	337,328	84,332	6.1	6,747	0.5
5	2,832,502	60%	1,701,744	55.2	938,536	469,268	117,317	4.1	9,385	0.3
						Quintile 1/quintile 5 ratio		2.6		2.6

The inflation tax

Inflation tax regressivity:

- The inflation tax naturally increases with the inflation rate π_t and the more so the larger the real money balances m_{t-1}
- Low-income households hold larger real money balances as a ratio of disposable income $\Rightarrow$ inflation tax is regressive

Two questions here:

- The minor question: inflation tax schedules are linear in the inflation rate, should not they be concave?
- The more important question: assumption of linear exhaustion of money balances over the month matters since we are considering monthly inflation.
  - In reality, big ticket payments, e.g rents, loan repayments, take place early in the month
  - Inflation tax incidence may be over-estimated, especially for those with low income.

The money demand equation

- The paper estimates money demand using household survey data based on standard equation:

$$\ln m_{it} = \alpha + \beta \ln y_{it} + \gamma \pi_t^e + \epsilon_{it}$$

- Data includes about 4200 households and five data points per household: 2017q1 and 2018q1-q4.
- Results seem reasonable: income elasticity about 0.5 and negative coef. on inflation expectations.

Three comments/suggestions on these estimates:

1. Limited time series $\Rightarrow$ hard to estimate the impact of macroeconomic variables.
2. Relevant price level and inflation expectations differ massively across households. $\Rightarrow$ Household-specific variables likely more appropriate.
3. Argentina is an open economy. Would make sense to have the exchange rate (level, change, expectation,...) on the RHS.

How do households change their financial strategies?

- The paper estimates a set of probit regressions:

$$\Pr(S_{i,t} = s_j) = \alpha_{j,t} \frac{\pi_t}{1+\pi_t} \widehat{m_{i,t}} + \beta_{j,t} y_{it} + \epsilon_{ijt}$$

- where s_j can be *in-family borrowing*; *payment in instalments*; etc...
- Main empirical result: $\alpha_{fam} \geq 0 \geq \alpha_{ins}$

My questions/comments on these specification/estimates:

- Did I get it right you are using the predicted money balances from the money demand equation?
- Legacy matters for financial decisions/strategies. For instance, a household's outstanding debt may limit/constraint the ability to tap banks or even friends or family.
- The probit specifications are estimated as cross-sectional regressions. So time series interpretation is a bit of stretch
- Maybe more appropriate to estimate these regressions as a multinominal logit, with no action as a the baseline.