

” The Conquest of South-American  
Inflation”  
Discussion

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- Question 1: How large are the departures from rational expectations?
- They use asymptotic properties. OK
- In our paper with Albert, we also show that, for Argentina,

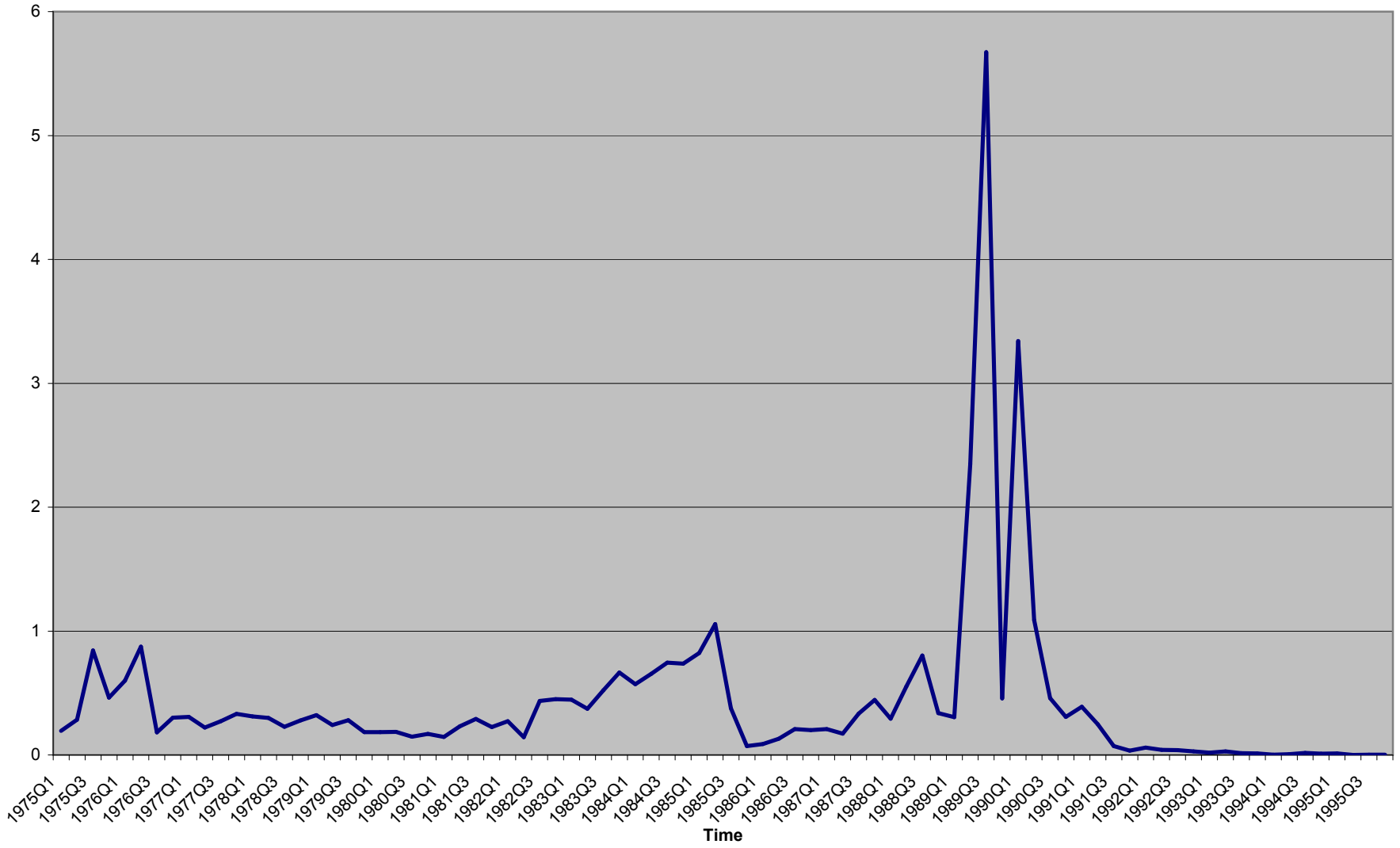
$$E_t[\beta_t - E_t(\frac{P_{t+1}}{P_t})] \leq \varepsilon$$

for values of the gain very similar to the ones they estimate.

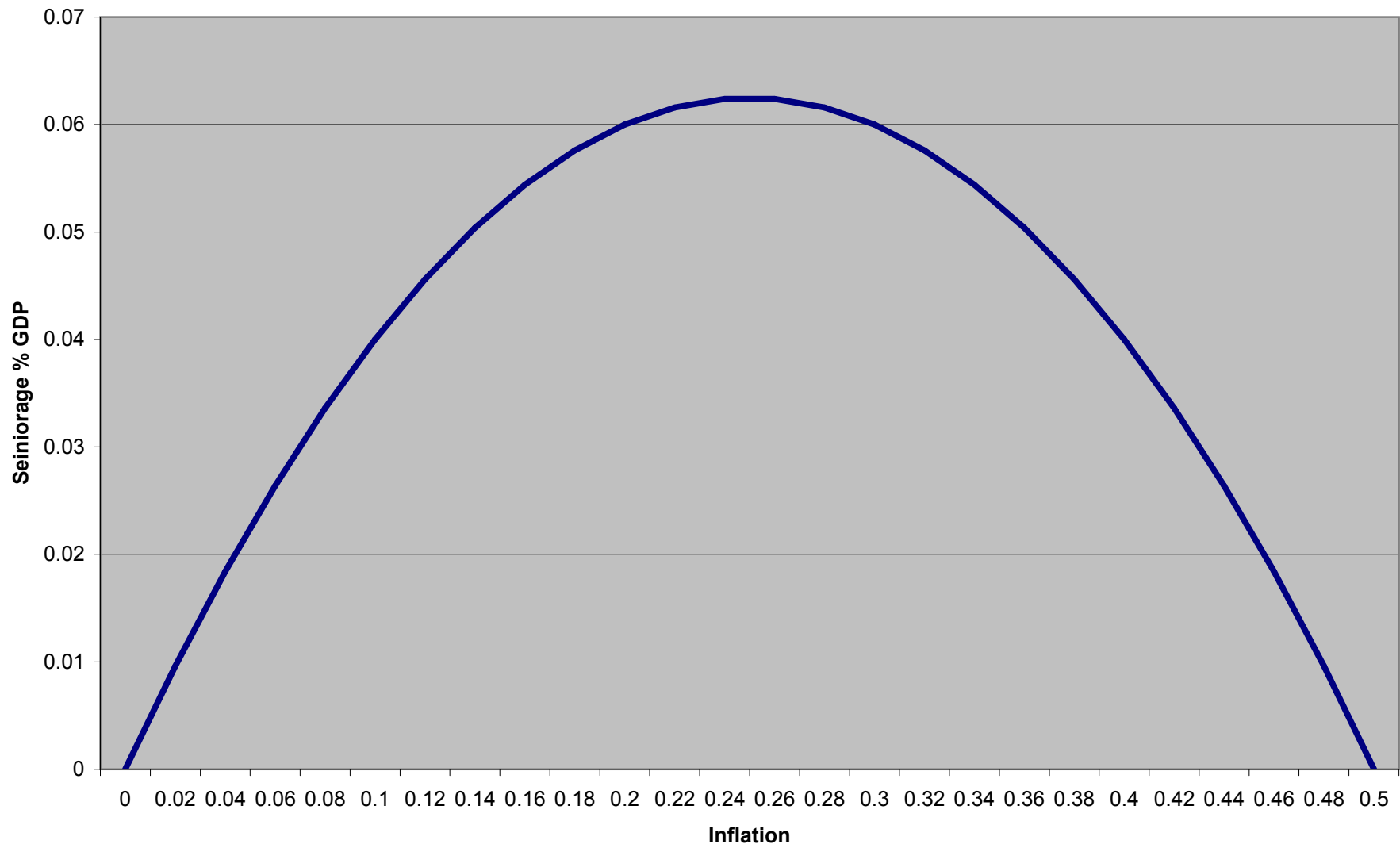
- One could report that expected value or even impose that constraint to the estimation process.

- Question 2: How reasonable is to ignore money data?
- They do not trust it.....but I do!
- The way money data (or seiniorage) behaves is what gives learning a chance.
- Let me remind you the way the estimation goes

Argentina: Quarterly Inflation Rate

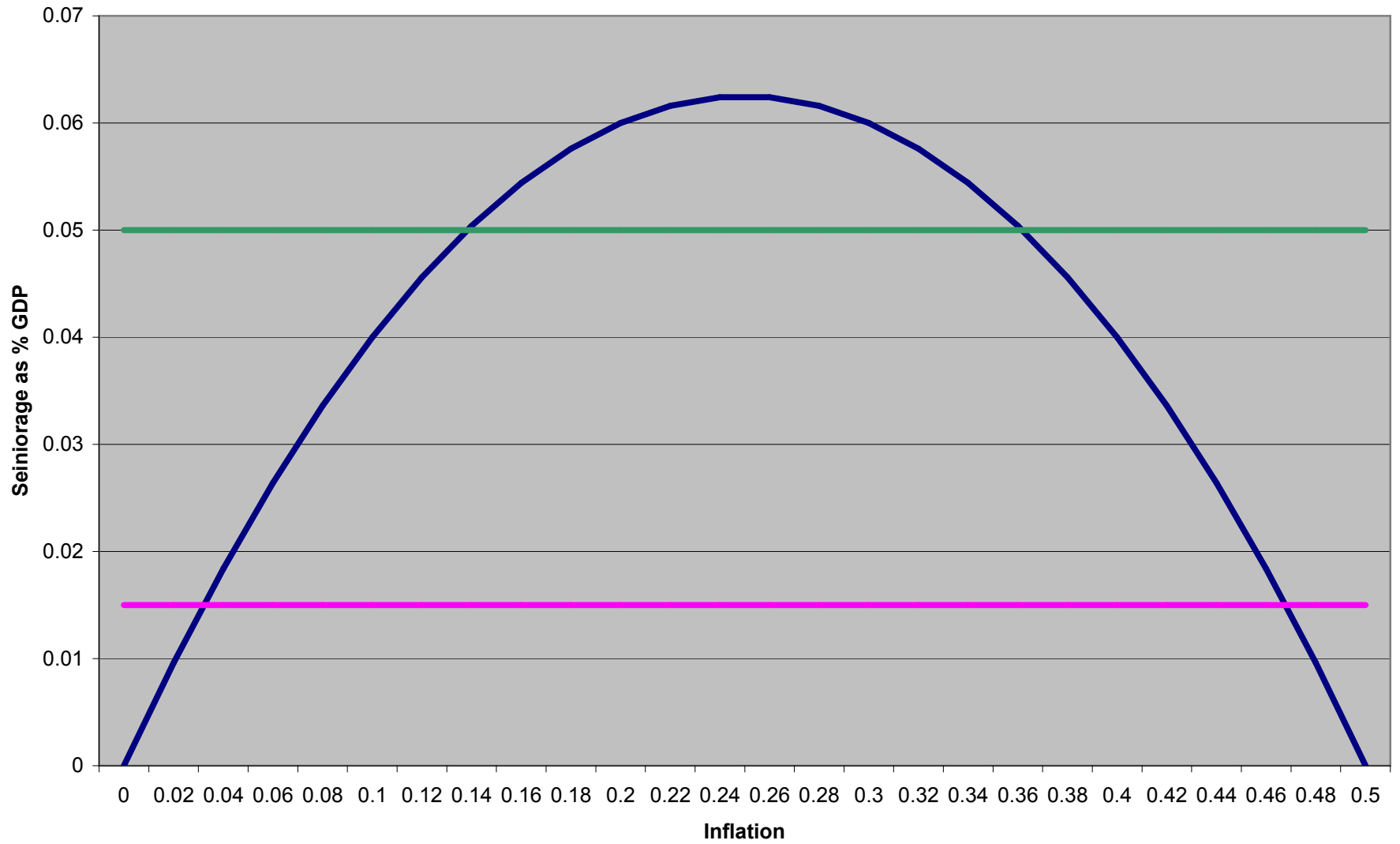


### Laffer Curve



- If no restriction is imposed on the process for seiniorage (or constraints on the value for  $\frac{M_t}{P_t}$ ), the observed inflation rates can be perfectly matched, provided the maximum of the curve is high enough.
- That is why they constrain the process to be Markov

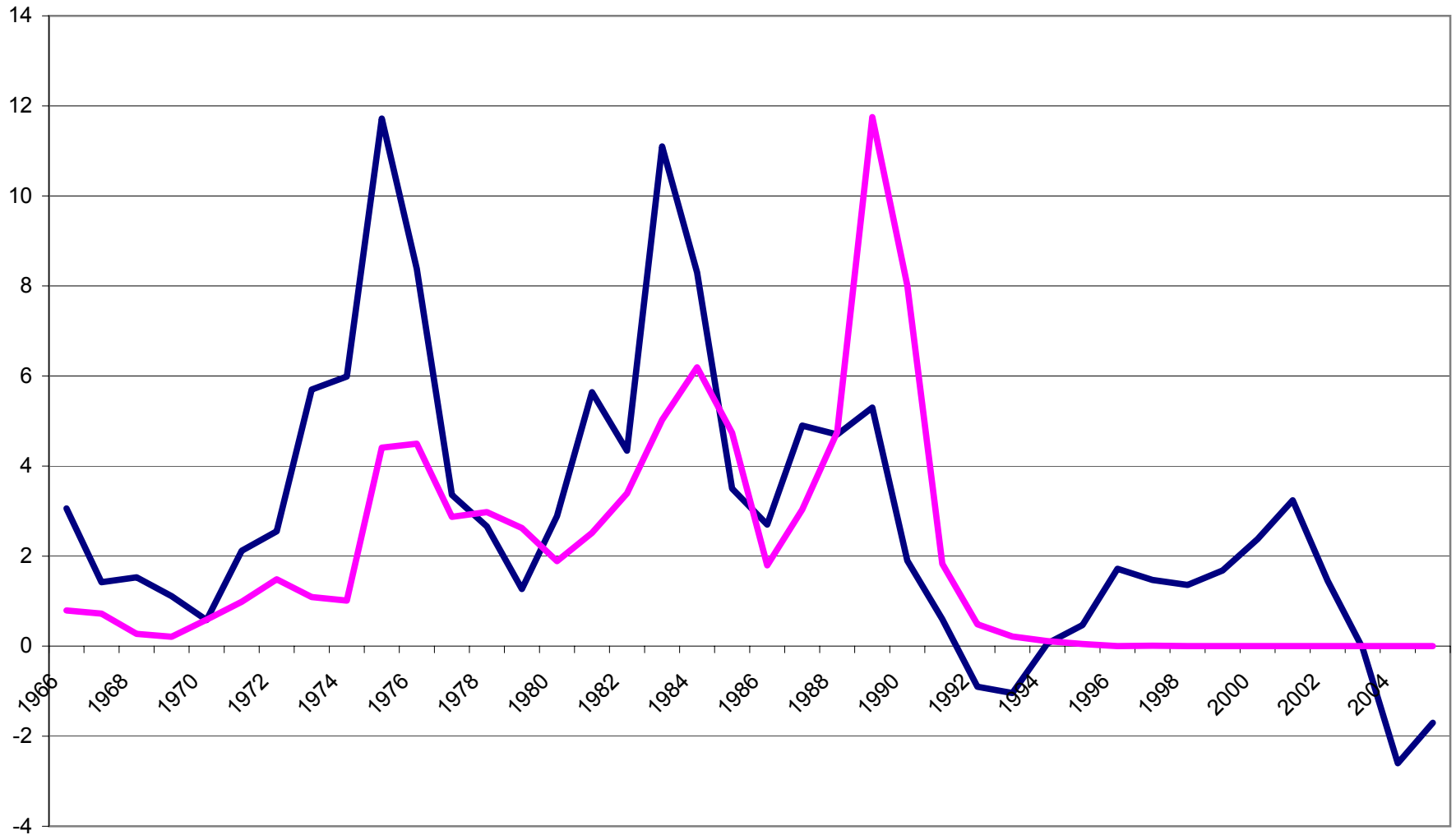
Laffer Curve with Two States



- Still, nothing in the data constrains the maximum of the Laffer curve.
- Recall that the higher the maximum of the curve, the easier it is for the RE model to match the observed inflation rates.
- The Escape Dynamics distinguish the learning model from the RE version.
- (There is a discussion in the paper on identification of parameters, but this is a different problem)
- For Bolivia and Argentina 75 and 85, (no escape dynamics), the value for seiniorage must be 10% of GDP on average.

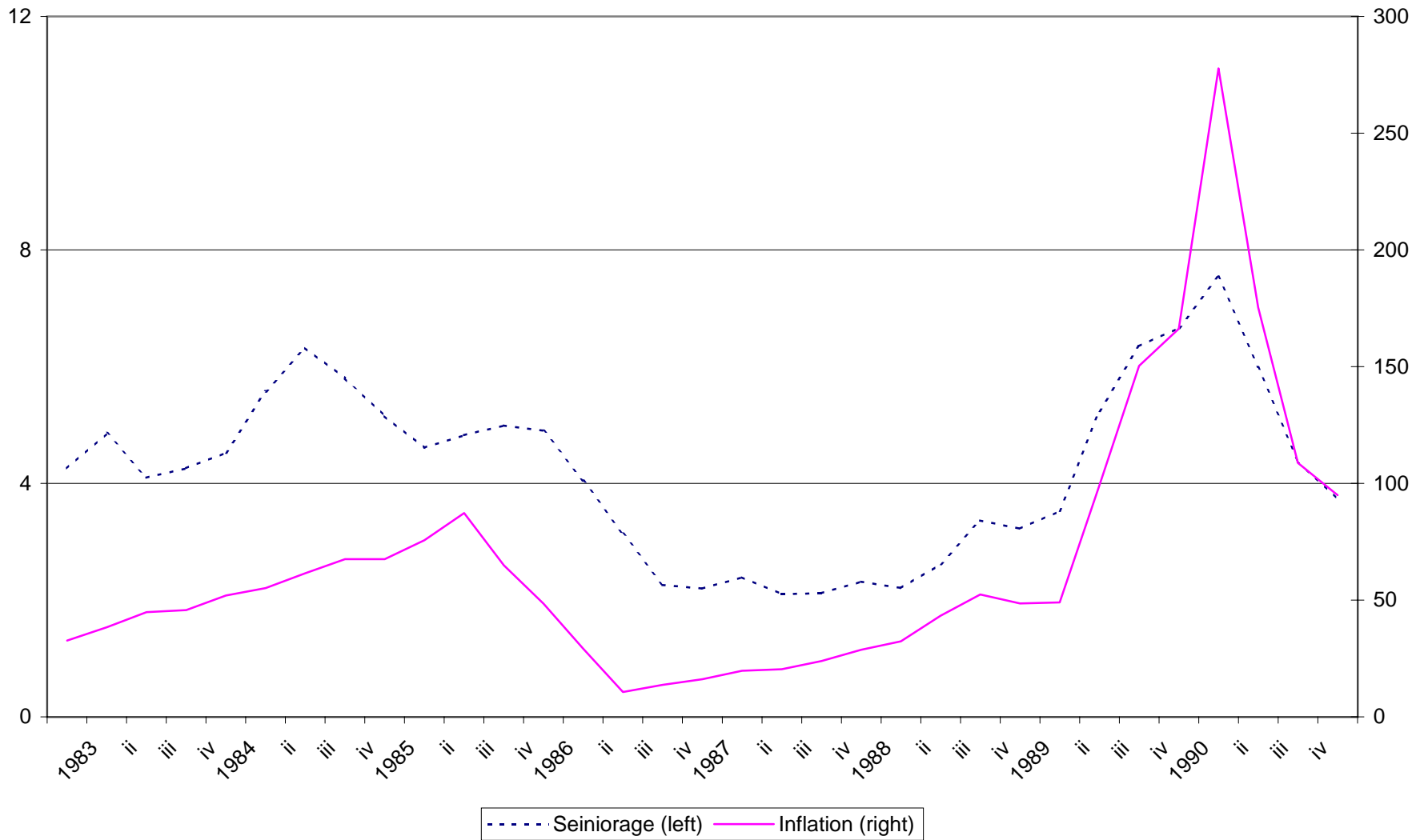
- The 90% confidence interval goes all the way up to 15% for Argentina and close to 20% for Bolivia.
- Let us see some numbers (I trust!) for Argentina

### Deficit and Inflation



— Deficit — Inflation

**Figure 2**  
**Time Series of Inflation Rate and Seignorage**



- My numbers for seiniorage do not look like what their estimates suggest.
- Granted: it is hard to measure seiniorage.
- But without some measure of seiniorage, the model with RE does just fine!

## Conclusion:

- The authors claim that the spikes in inflation in 75 and 85 in Argentina are NOT the result of escape dynamics, but just standard movements on the Laffer curve.
- They require a 10% of GDP seiniorage for this.
- It is hard to believe *with my data*.
- In addition, for Argentina 75 and Bolivia 85, the prediction of the model is way below the data.

- Not imposing a constraint on either the deficit or the money data is giving RE the best chance?
- If this is the case, is the two states Markov chain the most reasonable way of doing it?

- Independent question: which feature of the data is evidence of high seigniorage, and which is evidence of Escape Dynamics?
- Imagine the truth is that seigniorage is constant, it goes up, and very quickly it comes down.
- How do you distinguish this from:
  1. different parameters of the money demand such that you are close to the max
  2. no movement in seigniorage but inflation going up because of escape dynamics.