"The Conquest of South-American Inflation"
Discussion

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• The paper estimates both the money demand and the stochastic process for seniorage using inflation data only.

• (I read) This (as) is a methodological paper. Making a case for bounded rationality.

• The hyperinflation episodes have two features: changing environment and failure of RE (?).

• I like this a lot!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!
• 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
• 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

Inflation

Seiorage as % GDP

Inflation
• 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

[Graph showing the relationship between Deficit and Inflation from 1966 to 2004.]
• My numbers for seniorage do not look like what their estimates suggest.

• Granted: it is hard to measure seniorage.

• But without some measure of seniorage, 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 seigniorage 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 seiniorage, and which is evidence of Escape Dynamics?

• Imagine the truth is that seiniorage 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 seiniorage but inflation going up because of escape dynamics.