Discussion on "Impact of Inflation Surge on Euro Area and Government Compensation Measures"

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Tax and benefit microsimulation in an inflationary environment: applications and methodological issues
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Objective and Methodology

- **Objective**:
  - assess the distributional impact of the government measures in the euro area aimed to compensate for the inflationary shock in 2022
  - countries: Germany, Greece, Spain, France, Italy, Portugal
- **Methodology and Data**:
  - pan-European tax-benefit microsimulation model **EUROMOD** and its Indirect Tax Tool extension => adjusted household disposable income (after **direct taxes**, **cash transfers** and **indirect taxes**)
  - **combining** microdata sources: detailed income information (EU-SILC) and household consumption information (HBS 2010)
  - adjusts the latest available data (EU-SILC 2020 reporting on 2019) to reflect income in 2021 and 2022, using external uprating factors
  - consumption tax liabilities for households - based on reported consumption (2010) by applying the excise duties and VAT rates from national tax codes (2021 and 2022)

Key Findings

- While inflation would have had a more detrimental impact on lower-income households, government measures significantly reduced the purchasing power gap caused by inflation
- Government measures have helped to close the purchasing power gap between the lowest and highest income decile by 80%.
- Most fiscal measures were not targeted at low-income households, implying a high fiscal burden. More targeted income measures could have closed the purchasing power gap at a lower fiscal cost.
- EUROMOD and its extensions, the Policy Effects Tool (PET) and Indirect Tax Tool - useful tool to evaluate the impact of inflation compensation measures on disposable income and household expenditures respectively.

Main Strengths

- Analyzes data from multiple Euro area countries, representing 80% of the Euro area population, making the findings generalizable to a significant extent.
- Use of the EUROMOD tax-benefit simulator and its extensions for an in-depth harmonized analysis
- Provides comprehensive insights into the impacts of inflation and government fiscal measures on different income deciles across several Euro area countries, thereby aiding understanding of the dynamics between inflation, governmental policy responses, and their effects on households' purchasing power

Areas for Improvement/Questions

- More information need on the methodology used for linking income and consumption data: was HBS 2010 matched with the nowcasted 2020 EU-SILC?
- Ceteris paribus nature of the exercise: focus on household income and consumption, but not reactions to changes in labour supply or consumption
  - the static microsimulation approach does not consider changes in labour supply or household consumption behaviors in response to changes in income, the welfare system, or prices of goods
- Data limitations: dependence on the 2010 wave of the HBS which may not completely represent current consumption patterns and preferences.
- Anchoring in the existing literature: comparison with other studies

Areas for Improvement/Questions

- Broader Implications and Policy Considerations
  - The paper suggests that government measures could have been more targeted towards low-income households to reduce the fiscal cost, indicating some inefficiency in policy implementations.
  - While valuable analysis of the effects of inflation and government responses on households in selected Euro area countries, there is a limitation in its exploration of the policy strategies employed.
  - Further reflections on policy strategies in the studied countries
    - Comparisons of policy effectiveness across countries: an in-depth comparison might reveal which approaches were more successful in mitigating the impact of inflation on households, potential lessons for future policy decisions.
    - Potential alternative strategies that were not adopted
    - A richer understanding of how governments can respond to economic crises and protect their citizens, particularly those in the lower-income brackets.

Thank you!