
A comment on the article

“(In)Effective tax enforcement and demand for cash”

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The issues addressed here are quite relevant and current. Based on the experience of Mexico, the authors explore the relationship between a specific aspect of fiscal policy, tax enforcement, and money demand. As a starting point, they took a standard currency demand equation where real cash holdings are a function of the nominal interest rate and a measure of economic activity. However, the model in this article controls for the tax enforcement measures faced by people. Besides, as in Rogoff (1998), money may be used to reduce the agent's tax burden. The innovation here is that this function depends on the quality of tax enforcement, which is included in the theoretical model and in the estimation. Previous studies on this issue, such as Cagan (1958), Tanzi (1980, 1983) and Rogoff (1998), focused instead on capturing the effect of a higher tax burden on cash holdings.

The methodology used to estimate the model, VEC, is quite adequate for this case given that it allows for not only a long term relationship between the variables included, but also a short term one, which is in turn important to determine elements that could be considered in the design and application of alternative policy measures.

In sum, the general quality of this article is high given that it addresses a very relevant issue for every country, and particularly for Mexico, because of the measures implemented in mid-2013 to try to raise tax revenues by enrolling more taxpayers and toughening tax enforcement. In doing so, an appropriate methodology is used to estimate a relationship between tax enforcement and money demand. The results suggest that tougher tax enforcement may explain large increases in cash holdings in Mexico. Furthermore, this effect seems to depend on the quality and efficiency of the tax collection authority and the country's institutions in general, among other factors. That stands, as the authors argue, as their main contribution to the literature concerning estimation of cash demand.

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