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# Inventory Method Choice and Product Market Competition

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Innovative Tax Research Session**

**Discussant comments**

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# Innovative

Firm's inventory decision not made in isolation.

Different after-tax wealth effect of inventory choice depending on elasticity of demand for 'industry product'.

'New' LIFO costs – equilibrium production and pricing. Could help explain inventory choice.

Prop 1 – profit max to select FIFO if  $e < 1$



# Predictions

Inventory choice = - Concentration

(LIFO=1, FIFO=0) + Elasticity of demand

More competitors – increase chance of LIFO

More elastic demand - More likely use LIFO

Demand elastic ( $e > 1$ ) revenue decrease as output decrease

Demand inelastic ( $e < 1$ ) revenue increase as output decrease



# Model Limitations

Assumes all firms in an industry are identical (p. 6) and producing an identical product.

Do firms within an industry view competitor products as ‘identical’?  
For example are Porsche and Ford substitutes.

Include discussion of (1) product differentiation within an industry and (2) industries with inelastic and elastic demand functions.



# Models ability to predict equilibrium outcomes

Model implies that once a firm within an industry adopts LIFO the other firms within the same industry will follow. Why do we see industries with small and varying number of LIFO adopters?

p. 13 – LIFO varies between 0-100% within industries with a median of 10%.



# Empirical Analysis

Should analysis include an interaction of CONC and ELAST?

Critical value of 'N' (number of firms where it is possible to maintain a FIFO equilibrium) is decreasing in  $e$ .



# Link to IFRS and Elimination of LIFO

LIFO repeal could increase or decrease firm value.

(LIFO) firms in industries with inelastic demand will have larger after-tax profits if LIFO is eliminated because industry level production level will shrink and prices rise.

What happens to the welfare of consumers? Is society better or worse off with elimination of LIFO.

