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Sacrifice Ratios with Long-Lived Effects†

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Abstract

This paper is a theoretical and empirical study of sacrifice ratios—that is, the cost of reducing inflation during periods when disinflation produces long-lived effects on output or unemployment. New methods are developed for measuring sacrifice ratios. Sacrifice ratios that take into account long-lived effects are larger than sacrifice ratios calculated using Ball's (1994) ‘standard method’. The ‘standard method’ also has a larger downward bias for countries experiencing larger long-lived effects. The sacrifice ratio for the United States falls somewhere in the middle of those for G-7 countries when long-lived effects are taken into account, while it is at the top when calculated using the ‘standard method’. Finally, there is a negative relationship between sacrifice ratios and initial inflation rates, and the cost of reducing inflation is generally lower when the speed of disinflation is faster.

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