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RBI Working Paper Series 1: Estimating Sacrifice Ratio for Indian Economy – A Time Varying Perspective

The Reserve Bank of India today placed on its website a Working Paper titled "[Estimating Sacrifice Ratio for Indian Economy – A Time Varying Perspective](#)" under the Reserve Bank of India Working Paper Series*. This paper is authored by Pratik Mitra, Dipankar Biswas and Anirban Sanyal.

This paper estimates sacrifice ratios for the post liberalization period for India. Around the late 1970's, tight monetary policy created a disinflationary situation resulting in recession for many advanced economies. This highlighted the cost of reducing trend inflation in the interim period. In this context, the concept of 'Sacrifice Ratio' was introduced as the loss of output sustained by the economy to achieve reduction in the long-run inflation by one percentage point. Recent literature has argued that one may consider the cases where the monetary policy is involved in a sacrifice of living with higher trend inflation to reduce unemployment and pull people above the poverty line through temporary cumulative income gains.

Sacrifice ratio estimation from the slope of the aggregate supply curve has been mostly used across literature. However the sacrifice ratio using this method remains time invariant for the entire period of consideration. This paper tries to overcome the time invariant criticism of aggregate supply curve framework and thereby adds value to the existing literature of sacrifice ratio by introducing time varying feature on aggregate supply curve framework so that the trade-off between growth and inflation can be tracked over time and sacrifice ratio can be estimated by identifying suitable episodes.

The authors observe that the sacrifice ratio estimate is higher during phases when average inflation remained lower and economy was working below potential. Similarly, when average inflation was high and output gap was positive, the sacrifice ratio estimate was found to be lower. Such trade-off behavior points to the existence of convexity in Philips Curve.

** The Reserve Bank of India introduced the RBI Working Papers series in March 2011. These papers present research in progress of the staff members of the Reserve Bank and are disseminated to elicit comments and further debate. The views expressed in these papers are those of authors and not of the Reserve Bank of India. Comments and observations may kindly be forwarded to authors. Citation and use of such papers should take into account its provisional character.*

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