values are plotted to trace out an efficiency locus in Figure 1. As one would expect, the tradeoff curve is downward sloping with small values of \( \lambda \) giving points on the upper part of the curve. The minimum value of \( \sigma_y \) is .8 per cent but is not reached

![Diagram](image)

**Figure 1**—Output-inflation variation tradeoff.

**Source**: See Table 2. The points on this tradeoff curve represent the optimal standard deviations of quarterly output and inflation rates stated at annual rates in per cent. Output is measured as a deviation from a “full-employment” output.

for finite \( \sigma_y \); the minimum value of \( \sigma_y \) is 1.44 per cent and is reached when \( \sigma_y \) is 6.37 per cent. Hence the tradeoff becomes vertical when output fluctuations reach a standard deviation of slightly over 6 per cent.

A striking characteristic of the tradeoff curve is its sharp curvature: its slope increases from about \(-1/4\) to \(-4\) as \( \sigma_y \) increases from 1 to 2 per cent. Hence, only extremely uneven concerns about inflation or unemployment (i.e., only very steep or very flat indifference curves) would lead policymakers to choose a monetary rule which generates output variability outside this 1 to 2 per cent range.

6. **Efficient Rules Versus Actual U.S. Performance and Constant Money Growth**

It is informative to compare this estimated tradeoff curve with actual U.S. economic performance over the sample period and with the simulations of a