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How Costly Are Business Cycle Volatility and Inflation? A Vox Populi Approach

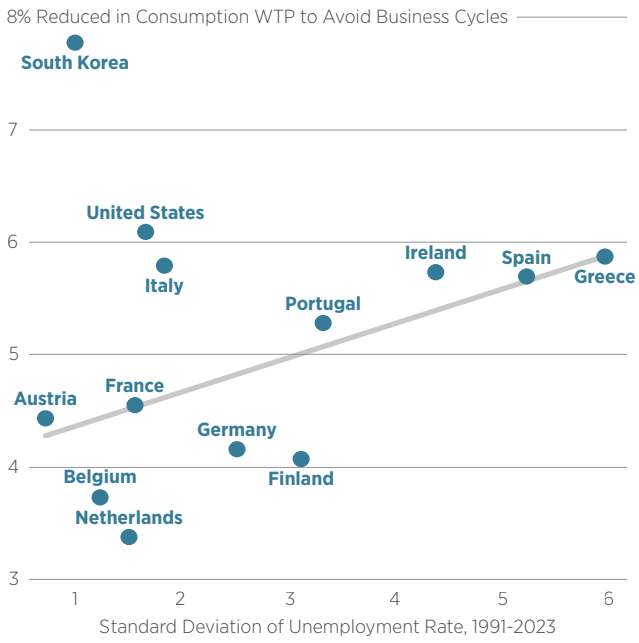
Based on BFI Working Paper No. 2025-34, "How Costly Are Business Cycle Volatility and Inflation? A Vox Populi Approach," by Dimitris Georgarakos, European Central Bank and CEPR; Kwang Hwan Kim, Yonsei University; Olivier Coibion, University of Texas at Austin; Myungkyu Shim, Yonsei University; Myunghwan Andrew Lee, New York University; Yuriy Gorodnichenko, New York University; Geoff Kenny, European Central Bank; Seowoo Han, Yonsei University; and Michael Weber, University of Chicago

Households are willing to forgo approximately 5–6% of their lifetime consumption to eliminate business cycle fluctuations and around 5% to achieve their desired inflation rate. This amount is higher among consumers whose consumption is more pro-cyclical, those facing greater economic uncertainty, and those living in countries with a history of higher economic volatility.

Many economists, early among them UChicago Nobel Laureate Robert Lucas, have explored the cost of business cycles, advancing theories about how much consumers would be willing to sacrifice to avoid market fluctuations. The consensus view, based on work by Lucas and others, is that households are willing to sacrifice very little to eliminate business cycles, while inflation appears much more costly. In this paper, the authors provide the first *direct* estimates of consumers' self-reported **willingness to pay (WTP)** to eliminate business cycle risk as well as their willingness to pay to bring inflation to their ideal level. Understanding public perceptions of economic conditions is essential for crafting policies that are not only effective but also widely supported.

The authors administer a series of large, nationally representative surveys in the United States, Korea, and the eleven largest euro area countries: Austria, Belgium, Germany, Greece, Spain, Finland, France, Ireland, Italy, Netherlands, and Portugal. The survey collects respondents'

Figure 1 · WTP and Historical Experience



Note: This figure shows the relationship between economic uncertainty, proxied by the standard deviation of the employment rate between 1991 and 2023, and consumers' WTP to avoid business cycles.

willingness to pay (WTP): the maximum price a customer is willing to pay for a product or service (or in the case of this research, for a certain economic outcome).

sociodemographic information and measures their risk aversion, micro-and macroeconomic expectations, exposure to business cycles, and WTP to avoid macroeconomic risks.

The authors validate survey responses by showing that self-reported WTP measures are consistent with theoretical predictions. For example, respondents in crisis-scarred countries like Korea and Greece report a higher WTP for macroeconomic stability, and those in countries that experienced high inflation in the past report a higher WTP for reduced inflation.

The survey yields the following results:

- Consumers are willing to permanently reduce their consumption by 5-6% to eradicate macroeconomic volatility. Consumers are also willing to reduce their consumption by roughly 5% to bring inflation to their desired level. Both figures are much higher than those implied by traditional theory.
- Individuals with more cyclical earnings and who are more uncertain about their future consumption are willing to pay more to eliminate business cycles as well as to reduce inflation. In addition, greater uncertainty about the macroeconomic outlook (e.g. uncertainty about GDP growth) raises people's WTP to reduce macroeconomic volatility, even after controlling for their individual consumption uncertainty. This result indicates that people seem to care about business cycle volatility above and beyond their implications for individuals' own consumption.

While many scholars have theorized on the cost of business cycles, this work provides the first direct test of consumers' willingness to pay to reduce inflation and avoid business cycle fluctuations. The authors find that people perceive business cycles and inflation as very costly overall—roughly two orders of magnitude more costly than what is proposed by traditional theory. These perceptions, whether they are ultimately correct or incorrect, matter for their peoples' decisions, for elections, for trust in institutions, and for the success of many policies that rely on confidence. Ignoring them is a recipe for designing policies that may well succeed in theoretical models, and perhaps even in practice, but may yet fail in the polls and ultimately be replaced by populist alternatives.

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