Decision Letter:

This is a useful paper and, with minor revisions, would be acceptable to be published in the E-journal. The authors should follow up on suggestions that they agreed to in their responses to the associated editor report and to the referee.

To be specific, in response to the referee, the authors should:

1) Respond to comments 2 and 6. The response to point 2 might note that inflation targeting countries have typically—almost universally—chosen the same target from one year to the next once an acceptable low level was achieved. The other supporting fact is the multiyear inflation forecasts seem to be concentrated around this one year inflation target.
2) Respond to all of the 'three technical imperfections.'

In response to the associate editor report, the authors should:

1) Delete the regression; expect perhaps to add the regression line in the chart. The results should be deemphasized or, at the very least, the small sample problem should be emphasized. The Gray model is incomplete. In her model, the output trend is a random walk, while the standard model assumes that output has a predictable component that may provide a motive for longer term contracts.
2) The authors should reconsider the dismissal of the real uncertainty effect. At least they might reorient the 'dismissal.' Gray and these authors assume that society wants long contracts because of the cost of contracting. If there is a benefit to contracting associated with insuring income for risk-averse or borrowing-constrained households, it may be that inflation uncertainty makes optimal contracts infeasible. By lowering inflation uncertainty, society may be able to form such contracts. The Azariadis implicit contracting model idea is complementary to the model in the paper, not a competitive theory.
3) The authors should be clear about the implications for a nominal anchor for each of the regimes, but especially for the floating rate and full employment regime.