

2. A high level of time deposits relative to M_1 reduces the demand for M_1 . Time deposits are seen to be a substitute for M_1 , as one would expect. This conclusion can be reached also by observing (in the regression in Table 1), that the R^2 of the variables explaining M_2/Y is practically the same as that for $(M_1 + M_2)/Y$, and both are substantially above that for M_1/Y . If the better R^2 were the result solely of adding a more fully explained relationship to a less fully explained, the result should fall somewhere in between. The fact that the $(M_1 + M_2)/Y$ relation does better suggests that the combination of M_1 and M_2 removes an element of instability which presumably is the substitution of M_2 for M_1 .¹³

Definition of Money

The appropriate definition of money, especially the inclusion or exclusion of time deposits, depends partly on the theoretical approach chosen, for example, income (transactions motive) versus wealth (asset motive) as chief determinants of demand for money. But it can also be viewed pragmatically as determined by the quality of the fit that alternative definitions give with respect to the explanatory variables.

1. Regressions omitting one or more of the explanatory variables appearing in Table 1 generally yield a higher R^2 for the broad than for the narrow definition of money, as do the regressions in Table 1.

2. Whereas $(M_1 + M_2)$ is clearly a heterogeneous composite, the previous finding that currency circulates more rapidly than demand deposits implies that M_1 also consists of two significantly different components. Not too much weight should be placed on this conclusion, since the various denominations of currency, as well as demand deposits of different magnitude, probably also behave differently. Broad aggregates inevitably tend to be heterogeneous. But the usual objection to the broader definition of money, that it combines two different variables, is somewhat weakened by similar observations with respect to the narrow definition. None of these findings, of course, can be regarded as in any way decisive for a choice among definitions of money.

¹³ I am indebted to William Dodson for pointing this out to me.