Divisia Monetary Aggregates: Theory and Practice

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novice and something to offer to the expert. In spite of some minor shortcomings, its presentation is well-balanced and covers a wide field of questionnaire-experimental work in inequality measurement and distributional economics. I will recommend it to my students and use it as material in my lectures as well.

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E Macroeconomics and Monetary Economics

Divisia Monetary Aggregates: Theory and Practice. Edited by Michael T. Belongia and Jane M. Binner. New York and Houndmills, U.K.: Palgrave, 2000. Pp. xv, 321. $79.95. ISBN 0–312–22300–5. *JEL 2000–0974*

Money, our undergraduate textbooks tell us, serves three functions: it is a unit of account, a store of value, and a medium of exchange. The monetary models we study in graduate school, however, tend to emphasize the third, medium of exchange, role. In those models, money appears in a cash-in-advance constraint or enters into a utility function, capturing the idea that it is useful in trade. Either way, the transactions services that noninterest-bearing money provides allow it to be valued in equilibrium, despite being dominated in pecuniary rate of return by interest-bearing bonds.

Of course, the real world appears more complicated than our models might suggest. In place of the models' simple dichotomy between noninterest-bearing money and interest-bearing bonds, we see in the U.S. economy a wide range of monetary assets, of varying degrees of liquidity; a few even pay interest at rates that approximate those available on nonmonetary assets. Thus, the Federal Reserve's M2 monetary aggregate sums up across assets as diverse as currency and money market mutual fund shares.

Still, economic theory does provide us with a way of accounting for these differences, to form better measures of money. In a series of papers published during the late 1970s and early 1980s, William A. Barnett explained how the absence of arbitrage opportunities implies that the transactions service flow provided by any monetary asset can be measured simply by subtracting its own rate of return from the return on a benchmark, nonmonetary asset. Building on this insight, Barnett proposed an alternative to the Federal Reserve's official, simple-sum aggregates: a class of Divisia aggregates, in which each asset is weighted according to the volume of transactions services it provides.

The new Belongia-Binner volume presents the latest round of work on the Divisia aggregates. Each of the volume's 13 chapters was originally prepared for a conference on the Divisia aggregates that was held at the University of Mississippi in October 1994. Since many of the chapters are co-authored, the book contains contributions from 24 researchers, from universities and central banks around the world.

The volume's first chapter, by William A. Barnett and Yi Liu, shows how the concept of the Divisia monetary aggregate can be extended, in theory, to cases where risk-averse agents with rational expectations make decisions under uncertainty. Although much of the material from this chapter will be familiar to readers of Barnett's recently-published journal articles, the rigor and sophistication of its analysis surely will impress newcomers to this branch of the literature. Equally impressive from a technical point of view is the second chapter, in which Robert E. Dorsey employs artificial neural networks to develop models for forecasting inflation with the Divisia monetary aggregates.

The volume's remaining 11 chapters contain empirical studies, each of which compares the performance of simple-sum and Divisia monetary aggregates in postwar data from a country in Europe, the Pacific, or North America. Although the results of these studies are sometimes mixed, on balance they confirm the enhanced usefulness of the Divisia aggregates over their simple-sum counterparts: for most countries, money demand equations are more stable, and forecasting equations for output and inflation are more useful, when the Divisia aggregates are employed. Without exception, these 11

papers are clearly and honestly written. At no time in reading the book did I find myself struggling to understand the authors' arguments; at no time did I find myself disbelieving their econometric results. In the few cases where, to the authors' surprise, the results favor the simple-sum aggregates over the Divisia measures, this conclusion is stated candidly and without apology. Another nice feature: many of these eleven chapters contain brief, but highly informative, historical accounts of the monetary policy-making process in the countries under consideration, with special emphasis on the changing role of the monetary aggregates in each economy.

The quantity theory of money motivates virtually all of the empirical work in this volume. Thus, money demand equations are estimated and tested for stability, and forecasting models are developed for predicting output and inflation using past observations of money. While I greatly respect and admire this sort of work, I would have preferred to see a little more diversity in the empirical approach. Only one of the chapters, by Fluri and Spoerndli on the Swiss experience with Divisia aggregates, considers the role of money in a Keynesian, Phillips-curve model for inflation; it would have been interesting to see comparisons between quantity-theoretic and Phillips-curve inflation equations for the other countries as well. Similarly, Benjamin M. Friedman and Kenneth N. Kuttner's work from the early 1990s, which casts doubt on the usefulness of the quantity-theoretic framework for understanding the U.S. data, is scarcely mentioned here; I would have liked to see at least a few of the authors take a serious stab at rebutting Friedman and Kuttner's arguments.

But another way of stating these objections would simply be to say that more work on the Divisia aggregates remains for future research efforts. As an economist who—to borrow a phrase from the chapter by Leigh Drake, K. Alec Chrystal, and Jane M. Binner (p. 76)—"uses 'money' in his research," I learned much from reading this volume and, as a consequence, am more likely to consider the Divisia aggregates in my own work. Certainly, I am looking forward to the next round of contributions on the Divisia monetary aggregates.

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The Causes and Consequences of Increasing Inequality. Volume 2 in the Bush School Series on the Economics of Public Policy. Edited by Finis Welch. Chicago: The University of Chicago Press, 2001. Pp. vi, 379. ISBN 0–226–89301–4.

There can be few topics in economics that have received as much attention as have recent changes in inequality. The *Causes and Consequences of Increasing Inequality* brings together leading figures for their latest thoughts on the subject. Title notwithstanding, most of the papers are descriptive, and most are concerned with cause, not consequence.

Following an introduction by the editor, Finis Welch, *Causes and Consequences* is divided into 12 substantive chapters. The first, by Donald Deere, is purely descriptive. Relying on various CPS micro-data files, Deere documents recent changes in hourly and weekly earnings inequality. Not surprisingly, Deere's findings mimic those found by other scholars in earlier work. Some cursory attention is also paid to race and gender differentials.

Chapter 2, by Claudia Goldin and Lawrence Katz, is the best chapter in the book. Drawing on their ongoing project on the history of American education, Goldin and Katz significantly extend the available data on the structure of wages prior to World War II. Their basic finding is that the returns to schooling declined substantially from roughly 1890 to 1940. They attribute the decline largely to growth in the relative supply of high school graduates after the turn of the century.

Chapter 3, by James P. Smith, is concerned with rising wealth inequality. Relying on the Panel Study of Income Dynamics and the Health and Retirement Survey, Smith shows that wealth inequality rose dramatically since at least the mid-1980s. After dismissing rising income inequality as quantitatively unimportant, he attributes the increase to the "uneven receipt both within and across income