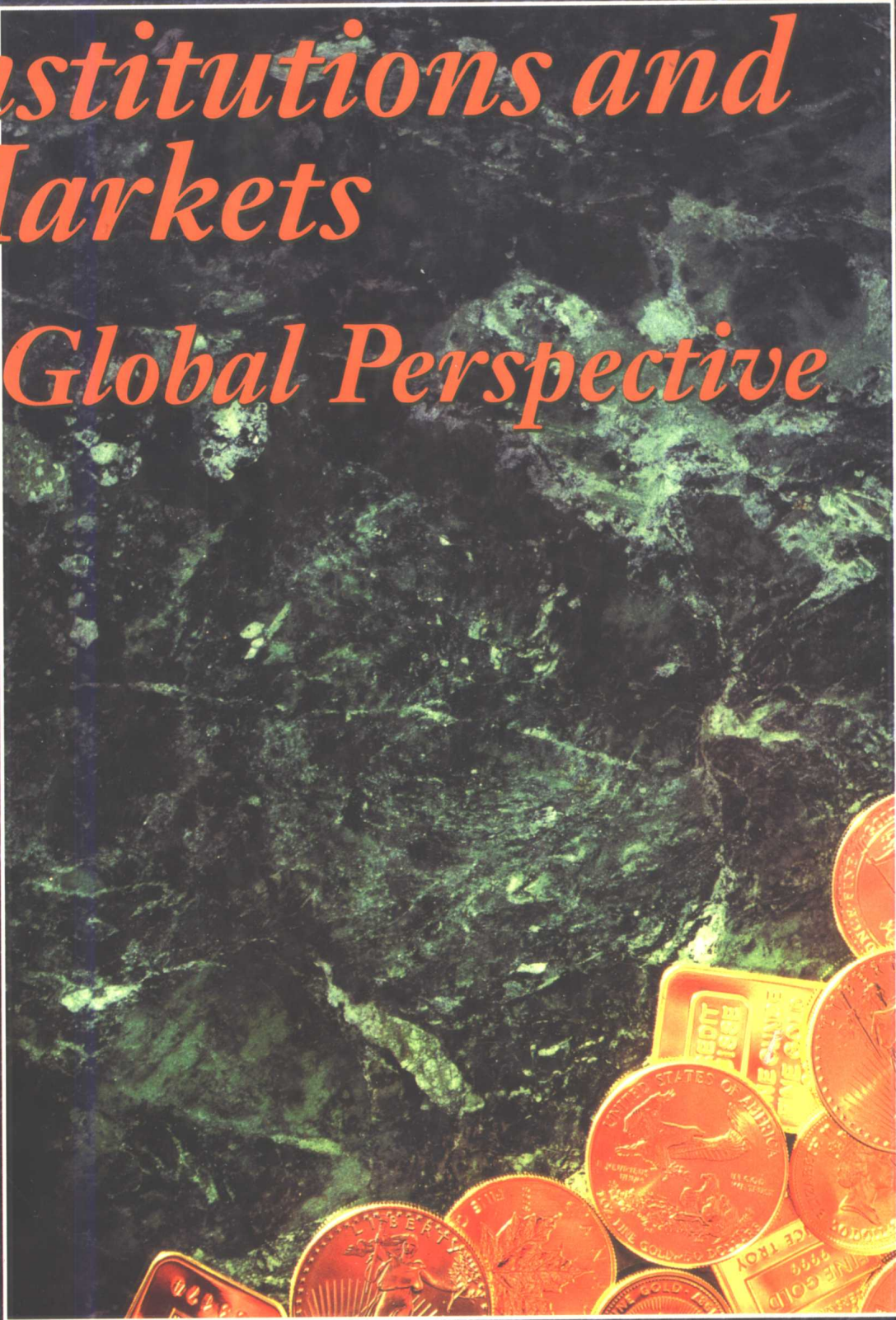


*Financial
Institutions and
Markets
A Global Perspective*



Hazel J. Johnson

FINANCIAL INSTITUTIONS AND MARKETS

A Global Perspective

Hazel J. Johnson

University of Louisville

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A Global Perspective

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*In loving memory of
Ida W. Kelly and Lucille V. Johnson*

PREFACE

Financial markets make it possible for resources to be devoted to productive uses for the benefit of society. These financial resources are made available for the short-term or for longer periods of time. Some of the most familiar financial institutions that help accomplish this allocation are commercial banks, mutual funds, pension funds, and insurance companies. This book describes financial institutions and markets in the United States. It also outlines the challenges faced by U.S. institutions—the consolidation of the banking industry, the savings and loan crisis, the strong competition among financial institutions as they diversify into new lines of business, and the regulatory environment that sometimes helps and sometimes hurts the process of advancement in the financial sector.

Of course, the United States is only one participant (albeit a major participant) in the financial market place. Increased competition among the United States and its trading partners means that the functions of U.S. markets cannot be fully understood unless analyzed in an international context. Accordingly, this book includes descriptions of the financial sectors of other countries, including Japan, the United Kingdom, Germany, Canada, and others. With this coverage, students can begin to appreciate the similarities or common themes throughout the world. They will also gain insight into the differences—many of which are tied to economic or political factors. Japan, for example, has become a leading financial market because of large trade surpluses (exports in excess of imports) in recent years. As its 12 members work to form a single European Market, the European Community is being reshaped into one unified financial market instead of 12 separate groups of laws and practices. History, economic circumstance, and political orientation have molded financial institutions and markets to varying degrees in different countries. The international material included in this book is integrated throughout the text with the country coverage indicated at the beginning of the chapters.

The book is organized into six parts:

	<i>Chapters</i>
I Money and Capital Markets	1–9
II Bank Regulation	10–12
III Bank Management	13–15
IV Banks Around the World	16–18
V Nonbank Depository Institutions	19–20
VI Contractual Nonbank Financial Institutions	21–24

Part I describes money or short-term markets (Chapter 3) and capital or long-term markets (Chapters 4 and 5), including derivative securities. It begins with a discussion of

the process of financial intermediation (Chapter 1) and the characteristics of money (Chapter 2). The operation of foreign currency markets is covered in Chapter 6, and Euromarkets in Chapter 7. Interest rates are essentially compensation for providing short-term and long-term funds; foreign exchange rates have a significant impact on cross-border transactions. Chapters 8 and 9 discuss these issues.

Part II is devoted to bank regulation, first in the United States (Chapters 10 and 11) and then in other countries (Chapter 12). In the United States, the system of state and nationally chartered commercial banks is a byproduct of the country's historical development. The creation of the Federal Reserve System was the response to an unsatisfactory monetary system and the Federal Deposit Insurance Corporation (along with other banking reform) was intended to help restore order to a banking system that was seriously out of control. Today, the issue of U.S. bank regulation is not at all resolved, but the systems of other countries provide a useful frame of reference for further refinement of the U.S. system.

Part III addresses bank management. The profitability of a bank, or any financial intermediary, is tied to its assets and liabilities (Chapter 13). At the same time, an adequate level of liquid and low-yielding assets must be maintained to meet deposit withdrawal requests and loan demand, creating a trade-off between profitability and liquidity. The composition of investment and loan portfolios helps a bank to manage this profitability/liquidity trade-off (Chapter 14). Ultimately, the management of bank assets and liabilities is reflected in the bank's equity (Chapter 15). Since the viability of an institution is directly related to the size of this equity base, asset-liability management is a critical consideration.

Part IV compares commercial banks to noncommercial banks (Chapter 16) and U.S. commercial banks to those in other countries (Chapters 17 and 18). Within a given country, commercial banks help to facilitate the payments system and economic development. Noncommercial banks, such as the Bank for International Settlements, the International Monetary Fund, and the World Bank, promote the orderliness of markets and the proper allocation of capital in a worldwide context. Domestically, other countries' commercial banks serve many of the same functions as U.S. banks. However, the structure and scope of banking activities varies considerably. These differences often create competitive advantages for non-U.S. banks.

Part V contains material that describes other depository institutions. Savings and loan associations and mutual savings banks are often referred to as thrift institutions (Chapter 19). The thrift industry has been subject to considerable restructuring as failures and mergers have severely reduced the number of institutions. On the other hand, credit unions have been spared much of the disruption noted in the thrift industry, primarily because of a strong self-help tradition and favorable legal status (Chapter 20).

Besides depository institutions, investment companies or mutual funds (Chapter 21), pension funds (Chapter 22), insurance companies (Chapter 23), and finance companies (Chapter 24) are major forces in the financial market place. They receive funding from nondeposit sources, but still provide important intermediation functions as they channel resources for productive purposes. All four categories of institutions provide long-term financing for industry and important products for individuals. Investment companies purchase the short-term obligations of industrial firms, making it possible for industrial firms to bypass commercial banks. Investment companies even offer their own investors transactions accounts that compete with bank checking accounts. In fact, as the scope of activities of nondepository financial institutions broadens, differences between their services and traditional bank services continue to blur.

The evolution of financial services is far from complete. As long as there are economic development needs here and abroad, financial institutions will create improved products and innovations to meet those needs.

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