



Money

Financial Institutions

and the Economy

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and the Economy

William B. Harrison

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Preface

Organization and Intended Audience

After signing the contract to write this textbook, we constructed and distributed to more than a hundred business schools and economics departments a simple questionnaire. Among the questions asked were, What is your present money and banking text? What is its best feature? . . . its worst feature? What is the makeup of your classes? What are the most important features in a successful text?

This text was written with the desires and preferences of 76 respondents in mind. One need cited more frequently than any of the others was for a readable writing style. The survey also indicated that money and banking classes were composed of about equal numbers of finance and economics majors, with smaller proportions of business administration students, and some accounting majors. This distribution is consistent with my own experience, and this text is written for this mix of students.

Money, Financial Institutions, and the Economy is a standard one-semester money and banking text. In many schools, money and banking is the only course offered which instructs students in the comprehensive relationships between financial markets, instruments, and firms. Therefore, this text emphasizes these interrelationships. Theory is not emphasized except in discussing the connection between money and economic activity.

Organization is an outstanding feature of this text. While most money and banking texts proceed quickly to commercial bank deposit expansion and Federal Reserve functions, roughly the first third of this text is devoted to the environment in which banks operate. Such early and extensive treatment of the entire financial sector of the economy is crucial in light of the blurring of distinctions between money and other financial assets, and between banks and other financial institutions. The postwar financial structure is vanishing. Texts which acknowledge these changes often append discussion of them to the old money and banking framework. This is inadequate and inaccurate. Recent developments in financial markets and institutions are of far-reaching significance and must be integrated into any valid money and banking discussion.

In addition to thorough coverage of financial markets, instruments and institutions, this book includes other material frequently omitted from texts. Among these topics are: the deregulation and restructuring of the savings and loan industry (Chapter 2); framework for analyzing flow of funds (Chap-

ter 6); the U.S. payments system (Chapter 8); techniques for evaluating bank performance (Chapter 10); new methods of bank balance sheet management (Chapter 11); new insights on the day-to-day work of managing the Federal Open Market account (Chapter 14); a simplification and improvement on existing pedagogy of the IS-LM model (Chapter 17); and a treatment of the obstacles to achieving economic goals with monetary policy and fiscal policy (Chapter 20). In addition, there are many other topics that are new simply because they represent recent changes in the field. These include electronic funds transfer systems, interstate banking modes, asset-based lending, innovations in financial markets, and foreign debt service problems of U.S. banks, for example.

While the topical sequence may vary with each instructor's syllabus, the book's five parts correspond with the major areas of most money and banking instruction. Part One, Money and the Financial Structure; Part II, Commercial Banking; Part III, Central Banking; Part IV, Monetary Theory; and Part V, Goals of Monetary Policy. This organization reflects the way I generally teach a one-semester course in money and banking. For those who wish to begin with the structure and functions of banks, Chapter 1 may be followed with Chapters 7 through 11.

Emphasis on financial markets and institutions may be cut by skipping flow of funds instruction in Chapter 6, paring the section of Chapter 2 dealing with problems of the savings and loan industry, and eliminating discussion of the issue and exchange characteristics of money instruments in Chapter 5.

With only these chapters on Federal Reserve purposes, organization and instruments of monetary policy, there is not much central banking material that can be eliminated; however, some instructors may want to omit the new material on operation of the New York Fed's Trading Desk.

Because this is likely to be a first-time experience for many students in modeling the money-economy relationship, three chapters are absolutely necessary to cover the subject: Chapter 15, Evolution of Monetary Theory; Chapter 16, A Supply-Side Classical Model; and Chapter 17, A Demand-Oriented, Short-Run, Nominal Income Determination Model. Chapter 18, which begins to synthesize aggregate supply and aggregate demand, may be omitted if the instructor has an alternative approach which is more suitable for his or her non-economics students. Based on the experiences of the 1970s and 1980s, treatment of inflation and unemployment in Chapter 19 is standard fare. Time spent on Chapter 20 may be reduced by eliminating the latter part which deals with the history of policy implementation, though my students seem to enjoy a respite from theory at this point. I personally feel that instruction in the international monetary system is vitally important as the economies of all nations become inescapably interrelated.

Bill Harrison

Department of Economics
Virginia Commonwealth University

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B. H.

Contents

Part One Money and the Financial Structure 2

1. Introduction: An Overview of Money and Its Place in the Financial System 5

- Money and the Economy 5
- Functions and Qualities of Money 8
- The Use of Money by the American Colonies and After U.S. Independence 9
- The United States and the Gold Standard 12
- The Quantity of Money 13
- Cash and the Underground Economy 14
- Electronic Funds Transfer Systems 16
- Financial Institutions and the Economy 17
- Questions 21. End of Chapter Notes 21. Selected References 21

2. Financial Intermediaries 22

- Intermediaries and the Economy 23
 - Intermediation and Growth 23. The Allocative Efficiency of Intermediation 24.*
 - The Operational Efficiencies of Economic Intermediation 24.*
- Deposit-Type Intermediaries 25
 - Commercial Banks 26. Nonbank Depository Institutions 26.*
- Questions 41. Selected References 41

3. Financial Intermediation: The Nondepository Institutions and the New Competition 42

- Contractual Intermediaries 43
 - Life Insurance Companies 43. Pension Funds 47.*
- Investment-Type Intermediaries 52
 - Open-Ended Investment Companies 52. Closed-End Investment Companies 54.*
- Finance-Type Intermediaries 54
 - Sales Finance Companies 55. Consumer Finance Companies 56.*
- Insurance Guarantees of Intermediary Accounts 56
- New Sources of Competition in the Financial Services Industry 56
- Questions 59. End of Chapter Note 59. Selected References 59

4. The Determination of Interest Rates	60
A History Lesson: Interest and Usury	62
The General Concept of Interest Rates	63
<i>Nominal versus Real: Interest and the Purchasing Power of Money</i>	
63. Consumer Choice and Saving	65.
<i>The Supply of Loanable Funds</i>	69.
<i>The Demand for Loanable Funds</i>	72.
Prices of Securities and Rates of Interest: An Inverse Relationship	73
The Term or Time Structure of Interest Rates	74
<i>The Expectations Theory</i>	76.
<i>The Liquidity Premium Theory</i>	80.
<i>The Market Segmentation Theory</i>	81.
The Risk Structure of Interest Rates	82
<i>Assigning Risk Premiums to Interest Rates</i>	83.
Questions	86.
End of Chapter Notes	86.
Selected References	87
 5. Instruments of Financial Markets	 89
Market Opportunities and Choice	90
Risk Classification	92
Market Efficiency	94
The Money Market	95
<i>Distinguishing Features of Money Markets</i>	95.
<i>Participants in Money Markets</i>	97.
<i>Money Market Instruments—Issue and Trading Characteristics</i>	98.
The Capital Market	107
<i>Functions of Capital Markets</i>	107.
<i>U.S. Government Financing</i>	108.
<i>The Government Securities Market</i>	110.
<i>Corporate Issues</i>	111.
<i>State and Local Government Bonds</i>	113.
Innovations in Financial Markets	114
Forward Trading, Hedging, and the Financial Futures Market	116
Questions	121.
End of Chapter Notes	121.
Selected References	122
 6. Flow of Funds: A Framework for Forecasting	 123
Analyzing Financial Flows	124
<i>A Preview of the Procedure</i>	125.
<i>Development of a Sources and Uses Statement</i>	125.
<i>A Flow of Funds Matrix and Credit Market Summary for the Economy</i>	129.
Forecasting Loanable Funds Flows and Interest Rates	138
Questions	138.
End of Chapter Notes	138.
Selected References	139
 Part Two Commercial Banking	 140
 7. Commercial Bank Structure and Regulation	 142
State and Federal Chartering—Safety in Numbers?	143
Types of Banks and Their Origins	145

<i>State Banks</i>	145.	<i>National Banks</i>	146.	<i>Federal Reserve Membership</i>	149.	<i>FDIC-Insured Banks</i>	150.
The Competitive Structure in Banking	150						
<i>Bank Concentration and Its Measure</i>	151.	<i>Economies of Scale in Banking: Is Bigger Better?</i>	155.				
Banking Combination and Regulatory Constraints	156						
<i>A Capsule History</i>	156.	<i>State Branching Laws</i>	158.	<i>Interstate Banking</i>	158.		
Bank Regulation: Supervision and Examination	165						
<i>Who Does What</i>	165.	<i>The Bank Examination</i>	166.	<i>Bank Rating and Performance</i>	167.	<i>Bank Failures</i>	169.
<i>The Indirect Consequences of a Bank Failure</i>	169.	<i>The Direct Consequences of Bank Failure</i>	172.	<i>Why Do Banks Fail?</i>	174.		
Appendix—Trust Services of Banks	177						
<i>Personal Trust and Estate Accounts</i>	177.	<i>Agency Accounts</i>	177.	<i>Employee Benefit Accounts</i>	177.	<i>Corporate Trust Services</i>	177.
Questions	178.	End of Chapter Notes	178.	Selected References	179		

8. The U.S. Payments System 180

The Development of Check Use	181
Nuts and Bolts of Check Clearing	183
Afloat on a Sea of Paper	183
Electronic Funds Transfer systems (EFTS)	186
<i>Privacy and EFTS</i>	188.
<i>Paying the Piper—Who Pays for EFTS?</i>	188.
<i>Interbank Transfer Networks</i>	189.
<i>Wholesale EFTS</i>	191.
<i>Retail EFTS for Consumer Payments</i>	196.
Questions	199.
End of Chapter Notes	199.
Selected References	200

9. The Process of Money and Credit Creation 202

Plan of Attack	203
The Banking System	204
<i>Some Preliminary Assumptions</i>	204.
<i>The Organizational Stage with Outside Money</i>	204.
<i>Credit Extension and Inside Money</i>	205.
<i>Payment and Redeposit</i>	207.
<i>Expansion of Bank Deposits</i>	207.
<i>The Simple Money Multiplier</i>	207.
Money and Credit Creation by the Single Bank	209
<i>A Case of Overextension</i>	210.
<i>The Limiting Case</i>	212.
<i>The Multiplier Again</i>	213.
Leakages from the Deposit Expansion	215
<i>Currency Withdrawals by the Public</i>	215.
<i>Excess Reserves</i>	216.
<i>Demand Deposits Converted into Time Deposits</i>	218.
Extension of Money Multiplier Analysis to Broader Definitions of Money	220

Can Banks Alone Determine the Supply of Money?	222
Questions	227.
End of Chapter Notes	228.
Selected References	228

10. Bank Performance: Sources and Uses of Funds 229

Stocks and Flows 230

Assets 233

Primary Reserves (Cash and Due from Banks) 233. Loans and Securities as Secondary Reserves 233. Bank Loans—An Overview 234. Types of Commercial and Industrial Loans (Business Lending) 235. Consumer Installment Payment and Other Loans 237. Financial Loans and Other 239. Securities 240.

Liabilities and Capital Accounts 241

Bank Demand Deposits 243. Other Transactions Accounts 244. Time Deposits 245. Liabilities for Borrowed Money 248. Equity Capital 249.

Performance 250

Ratio of Total Loans to Total Assets 250. Interest on Loans to Total Assets 252. Interest Paid on Deposits and Borrowed Funds to Total Assets 252. Income to Equity Capital 252. Loan Losses to Total Loans 253. Capital Accounts and Reserves to Total Risk Assets 253.

Functional Cost Analysis 254

Questions 256. End of Chapter Notes 256. Selected References 257

11. Managing the Bank Balance Sheet 258

Theories of Bank Market Behavior 259

The Commercial Loan Theory 260

Shiftability Thesis 261

The Theory of Asset Allocation 262

Liability Management 263

Comprehensive Balance Sheet Management: Both Sides Together 264

Conversion of Funds 265

Interest Sensitivity Method 268

Questions 272. End of Chapter Notes 273. Selected References 273

Part 3 Central Banking 274

12. Central Banking: Federal Reserve Structure and Functions 276

Early Central Banks 277

Federal Reserve Organization 279

<i>Division of Powers</i>	279.	<i>Monetary Reform and the Federal Reserve</i>	286.
Federal Reserve Functions	289		
<i>Money and Credit Control</i>	289.	<i>Supervisory Functions of the Federal Reserve</i>	294.
<i>Banking Functions of the Federal Reserve</i>	295.		
Pricing of Federal Reserve Services and Float	297		
The Independence of the Federal Reserve	298		
Questions	299.	End of Chapter Notes	300.
	301	Selected References	

13. Determinants of the Monetary Base and Instruments of Monetary Policy 302

How Is Money Growth Regulated in the United States?	303
<i>An Example: An Operation in the System's Open Market Account</i>	305.
<i>Linkage between the Monetary Base and Accounts of the Fed and Treasury</i>	307.
Determinants of the Monetary Base	309
<i>Factors Affecting Bank Reserves</i>	309.
<i>Factors Supplying Reserves</i>	309.
<i>Factors Using Reserves</i>	312.
Administration of Monetary Policy	315
<i>Reserve Requirements</i>	315.
<i>The Discount Mechanism</i>	319.
Questions	325.
End of Chapter Notes	326.
Selected References	326

14. Federal Reserve Strategy: Linking Policy to Goals 327

<i>Legislative Basis for Policy</i>	328.
<i>Federal Reserve Targets: Standing between Policy and Goals</i>	329.
The Policymaking Process	331
<i>The Federal Open Market Committee Agenda</i>	332.
Federal Reserve Operations in the Open Market	337
<i>Dynamic Open Market Operations</i>	338.
<i>Defensive Open Market Operations</i>	342.
<i>Trading Procedures</i>	343.
<i>Daily Routine at the Trading Desk</i>	343.
<i>Transactions in the System Open Market Account</i>	345.
Choosing Targets for Monetary Policy	347
<i>A Brief History</i>	347.
<i>The Search for Better Targets Continues</i>	349.
Fed-Watching: Targets as Indicators	351
<i>Targets as Outside Indicators</i>	351.
Questions	352.
End of Chapter Notes	352.
Selected References	353

Part Four Monetary Theory 354

15. Money and Economic Activity 358

Early Monetary Theory 358

Mercantilism and the Commodity Theory of Money 359. The Specie Flow Theory of Cantillon and Hume 359.

Development of the Classical Quantity Theory of Money 360

The Cantillon Effect 360. Money, Prices, and Interest Rates 361. The Currency School versus the Banking School: Early Debate on the Real Bills Doctrine 361. Irving Fisher's Exchange Equation and the Classical Neutrality of Money 362. The Cambridge Cash Balances Approach 365. A Caveat about the Word Money 367.

Modern Quantity Theory—A Theory of Demand for Money 367

Arthur Pigou (1877–1959) 368. Knut Wicksell (1851–1926) 369. John Maynard Keynes (1883–1946) 369. The Demand for Money Illustrated 371. Milton Friedman's Modern Quantity Theory 372.

Questions 374. End of Chapter Notes. 375. Selected References 376

16. The Supply Side: A Classical Economic System 378

Say's Law of Markets 379

Other Classical Tenets 380

Flexible Wages and Prices 381. Absence of Money Illusion 382. The Nature of Markets and Flexibility 383. The Loanable Funds Market 383.

The Determination of Aggregate Supply 385

A Production Function for the Economy 385. The Labor Market 386. Equilibrium Employment and Aggregate Supply 388.

The Determination and Limited Role of Aggregate Demand 391

Models—What They Are and What They Can Do 391.

The Classical System in Comparative Statics 392

The Configuration of the Model 392. A Change in the Labor Supply: Immigration 394. Raw Materials "Scarcity" 394. Inflexible Wages 397. Expansionary Monetary Policy to Preserve Employment 398.

Long-Run Supply, Short-Run Demand: A Summary of Distinctions 399

Appendix 16-A—Planned Income and Expenditure—Nonprice

Adjustments to Disequilibrium 402

Questions 405. End of Chapter Notes 405. Selected References 406

17. A Short-Run Nominal Income Determination Model 407

Keynesian Criticisms of Neoclassical Economics 409

The Monetary Sector Framework for the IS-LM Model 412

The Consequence of Disequilibrium in the Monetary Sector	415
The Supply and Demand for Loanable Funds in the Real Sector	419
<i>Determinants of the Supply of Loanable Funds</i>	422.
<i>Determinants of the Demand for Loanable Funds</i>	423.
<i>Marginal Efficiency of Capital</i>	423.
The Real or Loanable Funds Sector Framework for the IS-LM Model	425
Synthesizing <i>IS</i> (Loanable Funds) and <i>LM</i> (Money) Sectors	427
<i>An Increase in the Supply of Money</i>	428.
<i>An Increase in Demand for Loanable Funds and Investment</i>	430.
Questions	431.
End of Chapter Notes	432.
Selected References	432

18. Aggregate Supply and Demand: The Determination of Real Output and the Price Level 433

The Short-Run IS-LM Model with Flexible Prices	436
Derivation of Aggregate Demand	437
<i>Increasing the Money Stock: A Shift in Aggregate Demand</i>	437.
<i>An Increase in Money Demand</i>	440.
<i>Aggregate Demand and the Determination of Output</i>	440.
Derivation of Short-Run Aggregate Supply: Wage and Price Setting	442
<i>Wage Setting</i>	442.
<i>Price Setting</i>	444.
Interaction of Aggregate Demand and Aggregate Supply: A Structural Approach	445
<i>The Oil Shock: Price Increases of Materials at Full Employment</i>	445.
<i>Policy Choices of the 70s</i>	447.
The Role of Expectations in Supply and Demand	448
<i>Expectations and Supply</i>	449.
<i>Expectations and Demand</i>	449.
How Do Interest Rates Incorporate Price Expectations?	450
<i>The Gibson Paradox</i>	450.
<i>Expectations and Output</i>	451.
<i>The Formation of Price Expectations</i>	452.
Questions	454.
End of Chapter Notes	455.
Selected References	455

Part Five Goals of Monetary Policy 456

19. Inflation and Unemployment 459

Some Definition and History of Inflation	459
Inflation Classified	462
<i>Adaptive Expectations</i>	465.
The Phillips Curve Controversy: Can Unemployment Be Reduced by Inflationary Policies?	467
<i>The Empirical Facts</i>	467.

The Expectations-Augmented Phillips Curve	470
<i>The Natural Rate of Unemployment</i>	471. <i>A Numerical Example</i>
471. <i>The Fundamental Question: Do Demand Shifts Change Real Output?</i>	473. <i>Emphasizing the Structural Economy</i>
474. <i>Rational Expectations: A Denial of Even Short-Run Trade-Offs in Unemployment and Inflation</i>	476. <i>Criticism and Rebuttal of the Rational Expectations Theory</i>
477.	
Unemployment: Perspective on a Policy Variable	478
An Anatomy of Unemployment	479
<i>Frictional Unemployment</i>	479. <i>Structural Unemployment</i>
480. <i>Estimates of the Natural Rate</i>	480.
Questions	482. End of Chapter Notes
483.	483. Selected References
	483
20. Stabilization Policy and Its Limitations	485
The Premises for Stabilization Policy	486
<i>What Are the Economic Goals of the United States?</i>	486. <i>Causes of Instability in the Economy</i>
487. <i>Stabilization Policies and Goals</i>	491.
Controversies about Stabilization Policy	494
<i>Problems with Discretionary Fiscal Policy</i>	494. <i>Problems with Discretionary Monetary Policy</i>
497.	
Interrelationships between Monetary and Fiscal Policies	505
<i>How the Public Debt Is Financed</i>	505. <i>Fiscal Effects of Monetary Policy</i>
506.	
An Overview of Stabilization Policies: The Great Depression to the Present	507
<i>The Great Depression: 1929–1940</i>	507. <i>Wartime and the Aftermath</i>
509. <i>The Korean War and the Eisenhower Years</i>	510. <i>The New Economics</i>
512. <i>The Waning of Policy Performance</i>	514. <i>Supply Side Shocks and a Change in Direction for Policy</i>
515.	
Questions	519. End of Chapter Notes
521.	520. Selected References
	521
21. International Payments	522
International Trade and Capital Transactions	524
The Determination of Exchange Rates	526
<i>Flexible Rates Determined by Trade and Capital Flows</i>	527.
<i>Quantities Supplied and Demanded with Flexible Price Adjustment</i>	527. <i>Some First Principles of Exchange Rate Determination</i>
529. <i>Exchange Rates as a Political Issue</i>	532. <i>Other Factors Affecting Exchange Rates: Shifts in Supply and Demand</i>
533. <i>Why and How Do Governments Intervene in Foreign Exchange Markets?</i>	534.
Types of International Monetary Regulation	536
<i>The Gold Reserve Standard</i>	536. <i>The Gold Reserve, Currency-</i>

<i>Convertible Standard with Adjustable Peg</i>	536.
<i>Was the Gold Standard at Fault or Did the United States Not Observe the Rules?</i>	537.
<i>The Joint Float: The European Monetary System</i>	539.
<i>The Arguments for Fixed or Floating Exchange Rates</i>	541.
Forward Exchange Rates and Hedging Foreign Exchange Risk	544
<i>Arbitrage</i>	546.
Questions	547.
End of Chapter Notes	548.
Selected References	548

22. International Financial Institutions 550

International Credit and Banking **550**

The International Monetary Fund as a Lender **552**

Other International Lending Agencies **556.**

International Commercial Banking and the Debt of Developing Countries **559**

Edge Act Corporations **559.** *International Banking Facilities (IBFs)* **560.** *Major International Lending Banks* **560.** *Debt Servicing Problems of Developing Countries* **560.**

A New International Monetary Order? **563**

Questions **564.** End of Chapter Notes **565.** Selected References **565**

Glossary 567

Index 585

Money

Financial Institutions

and the Economy