AN INTRODUCTION TO MONEY AND BANKING

FIFTH EDITION

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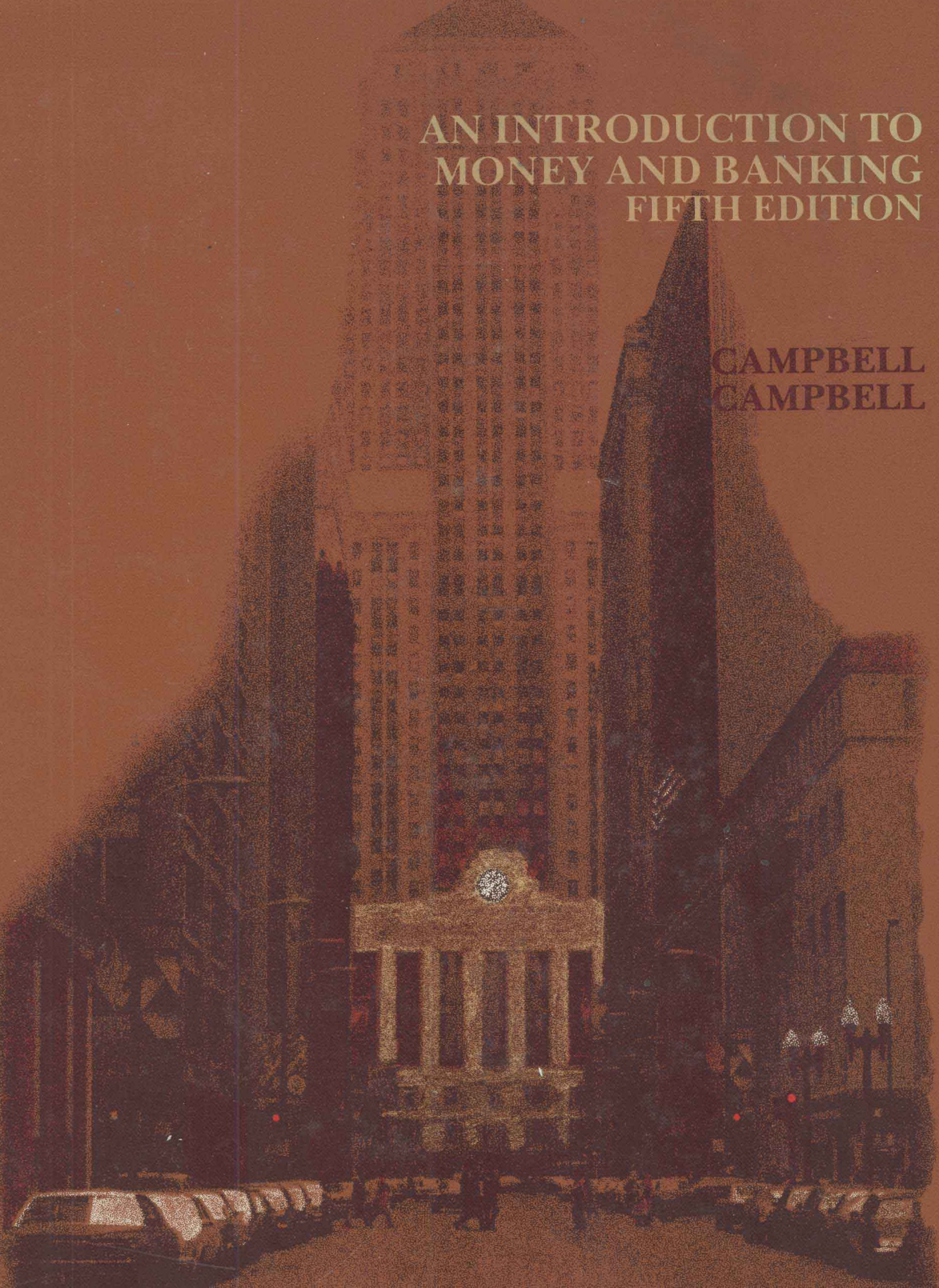

AN INTRODUCTION TO MONEY AND BANKING
FIFTH EDITION

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PREFACE

Monetary policy is currently in the limelight because of the slowdown in the U.S. economy during the early 1980s, the present debate over the appropriate targets of Federal Reserve policy, and the major worldwide problem of how best to deal with inflation. In writing this fifth edition of *An Introduction to Money and Banking*, the authors have attempted to provide college students with a readable introductory text that discusses the field of money and banking—as it relates to recent economic concerns.

The text is designed for a one-semester college course. The book was written both for students majoring in economics and business administration and for nonmajors who wish to take courses in economics beyond the usual introductory course in the principles. The length of the text should allow for some supplemental reading.

The statistical information in the book has been presented in such a way as to stimulate the interest of students in current economic affairs. This approach fits well into a liberal arts program. A useful project in the course is to have students subscribe to a major newspaper for a period of three to six weeks, read and clip articles related to the study of money and banking, place them in a notebook, and write a commentary on them. This project helps students relate the content of the course to current events and gain interests associated with their future careers.

Organization

The 24 chapters of the book are divided into seven parts. These parts cover the nature of money, commercial banks and other financial intermediaries, the Federal Reserve System, monetary theory, the problem of inflation, the international monetary system, and alternative monetary systems.

Part I, called "Money in Our Economy," focuses on defining and measuring money, the different functions of money, the development of the types of currency we use, and the characteristics of the government securities included in some broad measures of the money supply. A detailed analysis of deposit money is deferred until Part II on commercial banking.

Part II, called "Banking," covers institutional details on commercial banks and other financial intermediaries. Understanding the workings of a commercial bank is essential to an appreciation of the complex process by which our banking system supplies the transaction deposits that make up the bulk of our medium of exchange.

Part III covers "The Federal Reserve System," which supervises and controls the commercial banks and to some extent the other financial intermediaries. The Federal Reserve System has an important part in supplying the economy with currency and transaction accounts, controlling interest rates, and taking actions to promote the desired level of economic activity.

Part IV, called "Monetary Theory," analyzes the causes of changes in the demand for money; compares the mechanisms through which changes in the supply of and demand for money may affect income, employment, and interest rates; and describes the different policies used to attempt to control cyclical changes in these economic variables.

Part V on the problem of "Inflation" has a chapter on inflation's causes and cures and another chapter on its economic effects on individuals, businesses, and the government.

Part VI on "The International Financial System" covers the means of making payments to individuals in other countries and their governments, the changing role of gold in the world, different types of international money and the institutions supplying them, and the U.S. balance of payments.

Part VII is a "Conclusion" that compares three broad alternative types of monetary systems—one based on discretionary actions taken by monetary authorities, past and present systems that function automatically, and proposals for systems tied to a rule that would work more automatically than our present discretionary system.

Special Features

1. One of the main features that sets this book apart from others is the completeness of the statistical data on different aspects of money and banking.

2. Historical material is used throughout the text to contrast past and present policies and problems.

3. Where possible, foreign experience is presented to illustrate the variety of ways in which problems have been dealt with.

4. The topic of interest rates is presented in a realistic way by first applying it to government securities and Federal Reserve policy, and then to monetary theory.

5. Because of the current concern with inflation, there are two chapters on this problem: one on causes and possible ways to control it and one on its economic effects.

6. This text covers fully the monetary explanation of changes in the level of economic activity, an explanation which has been neglected by some texts, as well as the Keynesian explanation.

7. Considerable detail is included on government securities because of their importance in the operations of commercial banks and the Federal Reserve System, their inclusion in broad measures of the money supply, and their influence on market interest rates.
8. T-accounts have been used extensively as a teaching aid throughout the text and particularly in the explanation of the complex subject of the multiple expansion of deposits (in Chapter 9).
9. The text has been written in a style that should be easy for students to follow. The terminology and concepts are the same as in the major texts used in more advanced courses. A glossary has been included to define terms. Words that are included in the glossary are set in bold type the first time they are used. Questions at the end of chapters should help students check on their knowledge of the subject matter.
10. The text is based on a successful college course, which has been developed at Dartmouth College over a period of over 20 years.

Changes in the New Edition

This fifth edition is a substantial revision of the fourth edition:

1. The statistics in tables, charts, and in the discussions have been updated through 1982 where possible.
2. The important changes made by the Depository Institutions Deregulation and Monetary Control Act of 1980 are included—especially in the discussion of the thrift institutions in Chapter 10.
3. The statistical measures of the money supply are up-to-date.
4. The section in Chapter 14 on controlling interest rates has been expanded.
5. The important role of expectations in the determination of interest rates and in determining the effects of inflation is emphasized throughout the book.
6. The discussion of Federal Reserve policy in Chapter 14 has been brought up-to-date with the addition of greater emphasis on the Volcker era.
7. The two chapters on inflation (Chapters 20 and 21) have been reorganized. The topic of inflationary finance has been added, and the problems of adjusting to inflation have been expanded.
8. The chapter on alternative monetary systems was moved to the end of the book and has been rewritten as a concluding chapter that ties many of the important principles in the book together. This concluding chapter critically examines our discretionary monetary system and also evaluates the arguments pro and con in the new debate on the gold standard.

9. The discussion of the development of fractional reserve banking was brought forward to Chapter 12 because of its importance.
10. The discussion of money market mutual funds in Chapter 10 has been expanded to reflect their recent rise to importance.
11. In Chapter 7 the new varieties of savings and time deposits are carefully described.
12. The financial difficulties of the thrift institutions in the early 1980s are discussed.
13. Most of the material on the declining role of gold has been moved from Chapter 3 on currency to Chapter 22 on international finance to centralize the discussion of this topic.
14. The material on velocity, formerly in Chapters 15 and 16, has been consolidated in Chapter 15.
15. The theory chapters (Chapters 17 through 21) have been reworked to further clarify them and to bring them into line with current thinking.
16. New terms have been added to the glossary.

Ancillary Material

An instructor's manual is available. This gives suggestions for presentation (by chapter), multiple choice and true-false questions, essay questions, sources of current data, and suggested supplementary material for students.

Acknowledgments

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In addition, the authors owe much to their own teachers in college and

graduate school and to their colleagues and students. Mrs. Campbell was Instructor of Economics at Iowa State University, Ames, Iowa, from 1948 to 1951, and has done considerable research and writing since that time. Professor Campbell has benefited greatly from his association with the Research Department of the Board of Governors of the Federal Reserve System from 1954 through 1956, and from his membership on the Board of Directors of the Dartmouth National Bank of Hanover since 1961.

Last, but not least, the following at Dryden Press have helped us along to see that everything fell in place: Liz Widdicombe, Judy Sarwark, Jane Perkins, Jan Doty, Clay Doty, Doris Milligan, Christine Timmons, and Karen Hanley.

Colin D. Campbell
Rosemary G. Campbell
Hanover, New Hampshire
September 1983

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