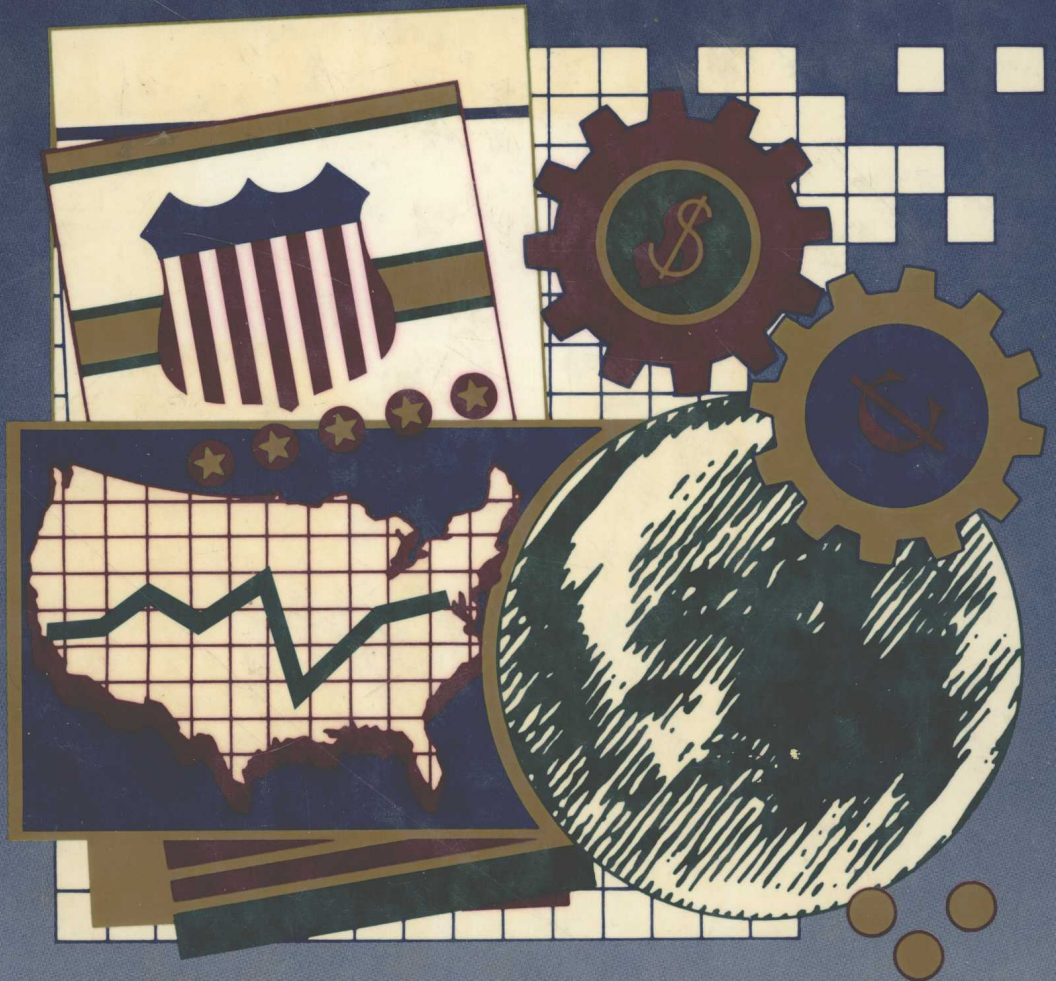


THE FINANCIAL MARKETPLACE

T H I R D E D I T I O N

Cooper/Fraser



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T H I R D E D I T I O N

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*For our wives, Maryvonne
Lyn
and kids, Chris and Danielle
Eleanor*

Preface

This third edition of *The Financial Marketplace* appears at the end of a decade of sweeping change in the financial system of the United States and the world. Throughout the 1980s, financial innovation and deregulation were at center stage in the economic arena, and virtually all financial markets and institutions were affected in varying degrees. These changes are incorporated into the discussion of each of the chapters in the new edition. This edition also features a “postscript” describing the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The “postscript” not only reflects the authors’ desire to have the new edition of the book as up-to-date as possible, but also is symbolic of the rapid pace of change in the financial marketplace in recent years.

MAJOR CHANGES IN THE THIRD EDITION

Developments such as continuing financial innovation, economic change, and regulatory and legislative developments required the addition of new material and the reorganization of entire chapters. All tables, charts, and other data have been updated as much as possible. Other changes have been made to improve exposition and to enhance treatment of especially significant material. Brief descriptions of some of the major changes, by chapter, follow.

Chapter 1, “An Overview of the Financial System,” has been completely rewritten to make it much more substantive and to expand the conceptual treatment of saving, investment, and the role of the financial marketplace. The new Chapter 2, “Financial Assets: Income and Value,” now focuses on the principles of valuation of financial instruments. Chapter 6, “The Level of Interest Rates,” has been revised to reflect more fully the major role that foreign capital inflows now play in U.S. financial markets. Chapter 9, “The Financial Services Industry: Depository Institutions,” has been rewritten to include functions of financial ser-

vice organizations, size and market shares of financial service firms, and a discussion of major factors determining the size and market shares of financial service firms. Chapters 11 and 12, which focus on the federal government's role as financial regulator and lender, have been revised to include discussion of the crises relating to the Farm Credit System, the Federal Home Loan Bank System, and the regulatory (and deregulatory) difficulties of recent years. Indeed, recent developments in regulatory issues have been incorporated into all the chapters concerned with financial institutions, particularly Chapters 9 through 14. Chapter 14, "Issues in the Regulation and Deregulation of Financial Institutions," includes a more extensive treatment of the deposit insurance issue.

The treatment of financial theory in Chapter 15, "Risk, Return, and the Efficiency of Financial Markets," has been expanded to cover arbitrage pricing theory and other theoretical developments. All the chapters concerned with financial markets have been completely updated. Chapter 21, which is concerned with the stock market, features full discussion of the 1987 stock market crash and its implications for market efficiency. Chapter 22, "Futures, Options, and Swaps," has been completely rewritten and offers expanded treatment of these instruments and markets. Chapters 24 and 25, which focus on the international monetary-financial system, have been thoroughly updated to reflect such developments as the trade and external debt problems of the United States, the burgeoning financial power of Japan, and the continuing problem of Third World debt (including a discussion of the Brady plan). Finally, the last three chapters of the book, which are concerned with economic policy, have been updated to reflect both theoretical and institutional developments. Chapter 27, "Fiscal Policy: Federal Taxing, Spending, and Borrowing," includes an updated treatment on the federal budget deficit problem and a thorough discussion of the 1986 federal income tax "reform."

New Applications

To help focus the reader on the most significant innovations and issues, we have added special-interest boxes in most chapters to illuminate significant topics, including "Money, Money, Money" (page 60), "CARs and CARDs: The Securitization of Practically Everything" (page 221), "Property Held by the Deposit Insurance Agencies: The Disposable and the Nondisposable" (page 342), "The Explosion of Junk" (page 453), and "Europe '92: European Economic Integration" (page 567).

USE OF THE BOOK

As with previous editions, *The Financial Marketplace* is designed primarily for use in junior, senior, and MBA courses concerned with the financial system—its components, functions, economic roles, and significance. In such macrofinancial courses, the book is designed to serve as the primary textbook. The book is also

suitable for use as a companion or supplemental text in courses concerned with microfinancial decision-making, such as commercial bank management and financial institutions management courses.

The Financial Marketplace covers the entire spectrum of the financial system in the economy, with special emphasis on financial markets. The sequence and selection of chapters can be easily adapted to suit the background of students, the emphasis and orientation of the instructor, and the course in which the book is used. For example, coverage of Chapter 4, "Money and the Financial System," and Chapter 5, "The Structure and Role of the Federal Reserve System," may be of marginal value for students with a strong background in economics. Also, instructors wishing to devote maximum attention to private-sector financial markets, instruments, and institutions (and less to monetary policy and other macroeconomic influences), may choose to omit or minimize coverage of Chapters 4, 5, 26 ("Monetary Policy: Formulation, Implementation, and Impact"), 27 ("Fiscal Policy: Federal Taxing, Spending and Borrowing"), and Chapter 28 ("The Record of Economic Policy").

As in previous editions, the text material is presented with minimal mathematics and only limited integration with the original literature. Technical terms are carefully defined when introduced and, on occasion, redefined when employed in a subsequent chapter. This facilitates altering the chapter sequence and also helps the student develop a thorough grasp of the terminology of the financial marketplace. A careful balance of description and analysis is attempted for all subjects. It is intended that students using this text will find the descriptive content complete and the analytical aspect useful.

ACKNOWLEDGMENTS

We have received a great deal of help from many individuals on all editions of this book. We are very grateful for their assistance and regret that we cannot acknowledge them all. We are particularly indebted to the following individuals who have served as reviewers on one or more editions: Fuad A. Abdullah, University of Nebraska, Omaha; James C. Baker, Kent State University; William Christiansen, Florida State University; Lawrence Conway, University of Toledo; Inayat U. Mangla, Western Michigan University; David Nawrocki, Villanova University; and Daniel White, Georgia State University.

Finally, we wish to thank the staff at Addison-Wesley Publishing Company, especially Barbara Rifkind, Senior Editor, Christine O'Brien, Associate Editor, and Loren Hilgenhurst Stevens, Production Administrator. We also extend our thanks to Vanessa Piñeiro, text designer, and Terry Presnall, illustrator.

We welcome any suggestions and comments on this text from both students and faculty.

College Station, Texas

S.K.C.
D.R.F.

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