

Money & Banking

Economics 231

In this course, we will explore the universe of money, banking, and finance. We will see that this universe does not exist separately from and parallel to the so-called “real economy,” in which the levels of output, investment, consumption, and employment are supposedly determined. Quite to the contrary, as the current subprime mortgage crisis shows, the financial sector both shapes and is shaped by the real economy. Hence, throughout the semester we will focus on the issue of how the financial system influences the determination of employment, investment, and so on. In short, the capitalist economy is complexly monetized, and so we will study the various ways in which money matters.

In order to understand the financial system’s role in the economy, we will examine (1) the structure and behavior of the financial system, (2) the economic process of financial intermediation, that is, the channeling of resources saved by one set of economic actors to others who use those resources for capital investment or other activities, and (3) the structure and economic functions of the Federal Reserve System, the central bank of the United States. We will then be in a better position to discuss major issues involving the financial system as an integral component of the U.S. economy. These issues include the following:

- How have the financial deregulation and financial innovation since the mid-1970s contributed to financial and macroeconomic instability? Have deregulation and innovation left the banking system on stronger or shakier ground, and what are the implications for macroeconomic performance? Is the current subprime crisis a result of these changes?
- How has the proliferation of financial institutions outside the Fed’s regulatory purview compromised the safety and soundness of the financial system and macroeconomic performance?
- Is the current regulatory structure obsolete?
- What do the savings & loan debacle, stock market near-crash of the 1980s, and the recent financial upheaval reveal about capitalist economies?
- How have bank mergers reshaped financial markets? What are the social and economic consequences?
- What are the implications of the Fed’s recent bailout of investment banks and mortgage companies?
- What are the social-equity issues in financial markets? Are borrowers of color, women, and small businesses served equitably?

Our class meetings will combine lectures and discussions. Students will lead some of the discussions. Three exams and a research paper will be required. Econ 231 is part of the College’s Writing Infusion program. Therefore, the research paper will be written using a process writing approach, and the course will be supported by a Writing Assistant. Students with documented learning issues should notify the instructor in a timely way; the instructor will make appropriate accommodations.

R E S O U R C E S

Required

- Mishkin, Frederic. 2006. *The Economics of Money, Banking, and Financial Markets, Alternate Edition*. Reading (MA): Addison-Wesley.
- *Real World Banking*. 2008. *Dollars and Sense Magazine*. Somerville (MA): Dollars and Sense Collective.
- Shiller, Robert. 2008. *The Subprime Solution*. Princeton: Princeton U. Press.

Other/Recommended

- *Wall Street Journal*
- Dymski, Gary. 1999. *The Bank Merger Wave: The Economic Causes and Social Consequences of Financial Consolidation*. Armonk (NY): M.E. Sharpe.

COURSE REQUIREMENTS

Three exams, a short (8-10 pages) research paper, and class participation, weighted as follows:

Midterm exam 1	15 percent
Midterm exam 2	15 percent
Final exam	15 percent
Research paper	40 percent
<u>Class participation</u>	<u>15 percent</u>
Total	100 percent

Exams. All of the in-class exams will draw from class discussions and the Mishkin text. I will supply a study guide at least one week prior to each exam. For the sake of fairness to all, the final exam must be taken during the Final Exam Period as scheduled by the Office of the Registrar.

Class participation. Fifteen percent of your grade will consist of my evaluation of your presentation and discussion of certain readings, general participation in class, and attendance to class. Full attendance will be expected; missed classes will be penalized.

Research paper. The research paper will be written in several stages as indicated in the table below. Although we will make adjustments to the schedule as necessary, once the due dates are finalized, they will be strictly enforced; each missed deadline will result in a loss of five points (from a total of 100). The Writing Assistant for this course will be available for individual tutoring. She will also comment on the topic essay and the first draft of the paper, although she will not assign any grades. Her role will be to help students develop their writing skills in the context of producing the research paper. The Writing Assistant will work collaboratively with the course instructor in providing this assistance. While you may work in small groups at the research and outlining stages, you must produce and submit your own individual papers.

<i>Item</i>	<i>Submit</i>	<i>Return</i>
Essay (2 pages) on the project's topic: What is the topic? Why is it important? What do you hope to learn about it?	Thurs., Sept. 25	Thurs., Oct. 2 Meet with WA
Draft introductory paragraph including provisional ¹ thesis statement.	Thurs., Oct. 9, to WA	Thurs., Oct 16
(1) Annotated bibliography: for each source, note major themes and what it contributes to your project. (2) Revised intro. paragraph, (3) basic outline (only 2 levels of detail).	Thurs., Oct. 30	Thurs., Nov. 6 Meet with WA
First draft ² of the paper for comment, complete with references, citations, footnotes.	Thurs., Nov. 20	Thurs., Dec. 4 Meet with WA and/or instructor
Portfolio containing revised final paper, first draft and instructor's comments, annotated bibliography, revised introductory paragraph, basic outline, initial draft	Friday, Dec. 12	

¹ You are not obligated to keep this thesis to the end; indeed, your research and writing should subject your thesis to modification: refinement, complication, narrowing, widening, and so on.

² "First draft" does not mean "rough draft." A rough draft is something you write for yourself. It is in need of much editing and revision. The first draft should be as polished and developed as possible within the time allowed. The more developed it is, the more helpful the constructive criticism can be.

introductory paragraph, topic essay.		
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Some possible paper topics are suggested below. If you wish to research and write on a topic that does not appear below, please consult me; I will happy to help you develop a paper topic that interests you.

1. After Alan Greenspan: assessment and prediction
 - a. Under Greenspan, what have been the Fed's main priorities? Employment? Price stability? Soothing wealthy nerves? Have the priorities changed?
 - b. What are Greenspan's greatest achievements? Are his high marks as Fed chair deserved?
 - c. What challenges did Greenspan leave new chair Ben Bernanke?
2. Predatory lending, subprime mortgages, and economic exposure
 - a. What is the nature of the problems created by the subprime lending explosion for borrowers, lenders, investors, and the macroeconomy?
 - b. How would you analyze the causes of the crisis?
 - c. Is the regulatory response sufficient?
3. Nonbanks and financial stability
 - a. How did the Fed recently bail out investment firm Bear Stearns and mortgage companies Freddie Mac and Fannie Mae?
 - b. Why did the Fed recently bail out these nonblank financial institutions?
 - c. What does this policy response reveal about the adequacy of the current regulatory structure?
4. Banking industry concentration: causes and consequences
 - a. What is driving consolidation? What are the major economic and regulatory causes of concentration in the banking industry?
 - b. Will small borrowers suffer? Will megabanks serve all banking clients effectively?
 - c. What are the economic and social consequences of banking industry concentration?
5. Two Americas and monetary policy
 - a. In financial markets, are there two Americas? Are there segmented financial markets?
 - b. Some claim that Fed policy is mainly aimed at helping wealthy bond-holders. Does monetary policy affect American's differently, depending on the segment in which they live and work?
6. Metal, wood, and bytes: the potential and the pitfalls of the digitization of the payments system.
 - a. What are the major technological trends currently affecting the nature and functioning of money?
 - b. What are the possible pitfalls of these trends?
 - c. Will we ever achieve a cashless economy?
7. The 1980s savings & loan debacle: Just bad apples, or was the orchard built on quicksand?
 - a. How low did some S&L executives sink? How rotten were these apples?
 - b. What were the structural causes of the crisis? In what ways was the structure of the S&L market set up for a crisis?
 - c. What does the S&L crisis teach us about capitalism?
 - d. Have all the needed preventative measures been taken?
8. Glass-Steagall: Where did it come from, and will we miss it?
 - a. What are the potential costs and benefits of repealing Glass-Steagall to the U.S. financial system?
 - b. What do the cases of Enron, Merrill Lynch, and Countrywide reveal about the need for Glass-Steagall?
9. Is the Community Reinvestment Act of 1977 working?
 - a. Are banks providing fair and adequate credit to their low-income and minority neighbors?
 - b. Is the CRA keeping the banks' feet to the fire?
10. Discrimination in financial markets

- a. How pervasive is discrimination in home mortgage and commercial lending?
- b. Does the Equal Credit Opportunity Act of 1974 have teeth?
- c. How do banking mergers affect social equity?

COURSE OUTLINE

I. The fundamentals of money, financial markets, and central banking

Readings: Mishkin 1-6, RWB 1

Student presentations of RWB 1

Midterm exam 1 on Mishkin 1-6

October 2

II. Banking industry, management, and regulation

Readings: Mishkin 8-11, RWB 2

Student presentations of RWB 2

Midterm exam 2 on Mishkin 8-11

November 6

III. Deregulation, mismanagement, and the subprime crisis

Readings: RWB 5, Palley, Shiller

Student presentations of RWB 5, Palley, Shiller

IV. Competing approaches to macroeconomics and monetary theory

Readings: Mishkin, pp. 493-98

V. Central banking and monetary policy

Mishkin 12-15

Final exam