

**ST. JOHN'S UNIVERSITY
NEW YORK**

PETER J. TOBIN COLLEGE OF BUSINESS

Department of Economics/Finance
Undergraduate Division

Spring 2018

Money and Banking: ECO 2309 – 10005

Class: T, F 9:05-10:30 am, BENT 322

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Office Hours: T, F - 11 am - 1 pm, SJH B17, or by appointment

DEPARTMENT : Economics and Finance

COURSE NAME : Money and Banking

COURSE NUMBER : ECO 2309

PREREQUISITE : ECO 1301

CREDIT : 3 credit hours

COURSE DESCRIPTION

The objective of this course is to develop a comprehensive understanding of the role of money, credit, banking, and central banks in the modern economy. Topics include the definitions of the money supply and discussion of various financial instruments and the role of financial institutions and financial markets. Students learn the formal structure of the Federal Reserve, its strategy and use of monetary policy, the significance of monetary and fiscal policy in the economy, and an international perspective on capital flows. We study the historical development of monetary policy in the United States to better understand our current banking system. We also look at alternatives to current central bank policies in terms of free-banking and alternative currency issuance and review the Federal Reserve's role in and response to the Financial Crises of 2007 through today and in relation to classical lender of last resort theory.

OBJECTIVES OF THE COURSE

The objective of this course is to develop understanding about:

1. What role money and credit play in an economy?
2. How money supply is defined, and what role the velocity of money plays in regulating the economy?
3. What are the different financial instruments, as well as what role financial institutions and financial markets play in an economy?
4. How to analyze assets and liabilities of banks, and how they affect lending and investment policies?
5. What led to the development of the Federal Reserve System?
6. What is the structure of the Federal Reserve System?
7. What is monetary theory?
8. How does the Federal Reserve use monetary policy to regulate the economy? What are the critiques of this regulation?
9. What is the difference between monetary policy and fiscal policy?

METHODS OF INSTRUCTION:

The methods of instructions will include lectures and reading assignments, discussing day-to-day events - both domestic and international, and student presentations on topics of relevance to monetary and financial policy.

STUDENT PERFORMANCE EVALUATION:

Class attendance and participation	15%
Homework assignment	15%
Midterm exam	15%
In-class quiz	10%
Group presentation	15%
Final examination	<u>30%</u>
	100%

BIBLIOGRAPHY

Main Optional Text

Frederic S. Mishkin, *The Economics of Money, Banking and Financial Markets*, Prentice Hall. Purchase of the text is optional, there is a copy of the 11th edition on reserve at the University library.

In addition, students should stay current on financial events through reading the *Economist* magazine, the *New York Times*, the *Financial Times* and/or the *Wall Street Journal* either in print or on-line versions.

Readings and Sources

Tyler Cowen (2012). "Break Up the Banks? Here's an Alternative," *New York Times*, available on Instructor's website.

James Dorn (2017). "Fed Needs Rules to Avoid Financial Instability," *IBD Weekly*, July 31, available through instructor's website.

Economist magazine (2014). "The slumps that shaped modern finance," available through instructor's website.

Milton Friedman (1962) "The Control of Money" from *Capitalism and Freedom*, available through instructor's website.

F.A. Hayek (1976) *Denationalization of Money: The Argument Refined*, Institute of Economic Affairs, <https://mises.org/library/denationalisation-money-argument-refined>

Carl Menger (1892). "On the Origin of Money." <http://www.monadnock.net/menger/money.html>

Murray N. Rothbard (1978) “Austrian Definitions of the Money Supply” in Spadaro, ed., *New Directions in Austrian Economics* available through instructor’s website.

Vera Smith (1990) *The Rationale of Central Banking*, Liberty Fund, available:
http://files.libertyfund.org/files/1413/0100_Bk.pdf. (Chpts I, V, VII, XI, XII and the Appendix).

Robert Higgs “Regime Uncertainty: Then and Now,”
<https://www.youtube.com/watch?v=f73izHRGIIA>

George Selgin “A Century of Failure: Why It’s Time to Consider Replacing the Fed,”
<https://www.youtube.com/watch?v=yLynuQebyUM>.

“The Federal Reserve American Dream Explained,”
<https://www.youtube.com/watch?v=t1NVPEg1jrQ>

“Quantitative Easing Explained,” <https://www.youtube.com/watch?v=PTUY16CkS-k>

Hayek v Keynes, youtube.com, Pts. 1 and 2, <https://www.youtube.com/watch?v=d0nERTFo-Sk>

Douglas French “Inflation's Winners and Losers,”
<https://www.youtube.com/watch?v=Gu9o0Eii0gI>

Other References

Walter Bagehot (1873) *Lombard Street: A Description of the Money Market*,
<http://www.econlib.org/library/Bagehot/bagLom.html>

D.I. Prychitko (2010) “Competing explanations of the Minsky moment: The financial instability hypothesis in light of Austrian theory,” *Review of Austrian Economics*, available through instructor’s website.

Murray Rothbard (2008) *The Mystery of Banking*, available
<http://mises.org/Books/mysteryofbanking.pdf>.

George A. Selgin (1988) *The Theory of Free Banking: Money Supply under Competitive Note Issue*, Roman and Littlefield, <http://oll.libertyfund.org/titles/selgin-the-theory-of-free-banking-money-supply-under-competitive-note-issue>

Roger Garrison (1990), *Southern Economic Journal*, review of Selgin (1988),
<http://www.auburn.edu/~garrir/r12selgin.htm>

Some Useful Websites:

Financial Times: ft.com

International Monetary Fund: imf.org

Information on key interest rates:

<http://www.bloomberg.com/markets/rates/index.html>

A financial calculator for computing the current price of a discount bond:

<http://www.publicdebt.treas.gov/sav/savcalc.htm>

Historical information about inflation:

<ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt>

To compute what goods would have cost at some point in the past after adjusting for inflation:

<http://mortgages.interest.com/content/calculators/index.asp>

To view information on bank regulation

<http://www.ny.frb.org/banking/regulations.html>

To find specific information on the FOMC, its schedule of meetings, statements, minutes, transcripts, members, and the “beige book”: <http://www.federalreserve.gov/fomc/>

To read the most recent annual report of the Federal Reserve:

<http://www.federalreserve.gov/boarddocs/rptcongress/>

To review what the Federal Reserve reports as its primary purposes and functions:

<http://www.federalreserve.gov/pf/pf.htm>

For alternative statistics: shadowstats.com and mises.org

TOPICAL MODULES:

Chapters referred to are from the Mishkin text, 11th edition (see Bibliography)

Prequel: Review of “thinking like an economist”

- I. Keynesian vs. Hayekian ideal-types: aggregate modeling vs. growth economics
- II. Keynesian vs. Hayekian ideal-types: differing views on business cycle, economy as a system vs. economy as process, stability vs. creative destruction, monetary effects on capital structure
- III. Supply and Demand, effects of intervention: Loanable funds market and sovereign debt “crowding-out,” relationship between monetary & fiscal policy; payday/pawn loans interest rate caps, shift in supply due to regulation, central bank intervention in ForEx markets, George Soros example on fixed exchange rates

Lecture, Hayek vs. Keynes youtube, Quantitative Easing Explained youtube, shadowstats.com, *Hardfire TV* “The Problem with Macroeconomics”

PART I: Introduction to Money and Banking

- I. Properties of money Ch.3, Menger 1892, Lecture
- II. Money and capitalism in historical context; early capitalism and the gold standard, modern capitalism, Bretton Woods and fiat money
Ch.s 2 & 19, Lecture
Hardfire TV “Central Banking”
- III. Relationship between money and the real economy; classical equation of Exchange ($MV=PQ$); velocity of money; Keynesian, Monetarist, Austrian views on money supply effects; “skyscraper index” Ch.s 3 & 20, Lecture
“Inflation is at all times a monetary phenomenon”
- IV. Distributional effects of inflation Doug French youtube, Lecture
- V. Evolution of payments system; commodity money, fiat money, checks, electronic payments, e-money Ch. 3
- VI. Discussion on Bitcoins and other digital currency, Suppression of New Economy by Vested Interests Lecture
- VII. Definition of money supply, M1, M2, MZM, M3? Rothbard 1978, Ch.s 3, 15, Lecture
- VIII. Introduction to fractional reserve banking; money multiplier, Federal Open Market Committee (FOMC) operations Ch.s 14-17, Lecture

PART II: Financial Markets

- I. Introduction to interest rates; the “natural rate” of interest, the Loanable Funds market; government borrowing and “crowding out” Lecture, Ch. 5
- II. Forms of business enterprises; sole proprietorship, general and limited Partnerships, corporations; debt and equity capitalization; Initial Public Offerings (IPOs) and secondary markets, Ch. 2, Lecture
illiquidity (s/t) versus bankruptcy (l/t, liabilities > assets)
- III. Introduction to bond term structures and risk classifications; sovereign, Government Sponsored Enterprises (GSEs), corporate bonds Ch.6, Lecture
- IV. Bond yield curves; entrepreneurship, time and ignorance *New York Times*, Lecture
- V. Fisher effects and real interest rates; International Fisher effects and capital flows; portfolio vs. Foreign Direct Investment (FDI) Ch.s 1,2,4,19, Lecture
- VI. LIBOR and variable rate debt instruments
- VII. Bond ratings, asymmetrical information, regulatory capture theory and Madoff case Ch.s 6 & 10, Lecture
- VIII. Debt instrument cash flow analysis: future value, present value; coupon bond; relationship between bond price and market interest rate Ch.s 4 &5
- IX. Marxian “fictitious capital” and relationship to 2007 crisis; Mortgage-backed bonds as fictitious capital Ch.s 6, 12, Lecture
- X. Financialization, tax code and Absentee Ownership Lecture

PART III: Banking and Bank Management

- I. Difference in Balance Sheets between banks and other firms and rationale for bank regulation; timing mismatches and deposit insurance Ch. 9, Lecture
- II. Sources and uses of funds, liquidity and liability management Ch. 9
- III. Trade-offs between profits and capital adequacy; capital requirements and leverage ratio, return on equity, debt/equity ratio Ch. 9
- IV. Risk management: systemic (policy) risk, transaction risk, default / credit risk and risk premia Lecture, Ch. 9

PART IV: Central Banking and Monetary Policy

- I. Historical development of US banking system; “dual banking System”, national and state banks Lecture note, Ch. 11, [Smith 1990], Fed American Dream youtube, [Rothbard 2008, pp: 191-247]
- II. Origination of Federal Reserve System; changes under Great Depression and Great Recession Ch. 12, Lecture, Selgin youtube
- III. “Systemic risk”, Basel Standards & mortgage-backed bonds revisited; “too big too fail,” FDIC, moral hazard, Financial Stability Oversight Council Ch.s 10,11,12,17, Lecture
- IV. Classical lender of last resort theory vs. modern central banking; IMF as LoLR, “hot money” & Tobin Tax Ch.s 16, 19 Lecture, [Bagehot 1873]
- V. Relationship between Keynesian fiscal policy, central banking monetary policy and the business cycle Ch.s 16, 17, 24, Lecture
- VI. Philips curve: price stability, the business cycle and unemployment Ch.s 17, 24, Lecture
- VII. Dual vs. single mandate central banking Ch.s 14, 17, Lecture
- VIII. Monetary policy tools I; Money supply, Federal Open Market Committee (FOMC) operations, reserve ratio, “pushing on a string”, Quantitative Easing Ch.s 15-17
- IX. Monetary policy tools II; Fed Balance Sheet, discount loans/discount rate and monetary base Ch.s 14-17
- X. Monetary policy tools III; Fed Funds Rate and relationship to interest paid on reserves Ch.s 14-17
- XI. Taylor rule Dorn 2017, Ch. 17
- XII. “Living Wills” and hybrid instruments Lecture, Cowan 2012

PART V: Theories of Money and Crises

- I. History of financial crises *Economist* 2014
- II. Financial innovation, subprime bonds and moral hazard Ch. 12
- III. Austrian monetary explanation for the business cycle; capital theory, time structures of production, entrepreneurial decision-making, interest-rates and risk premia Lecture, Higgs youtube [Prychitko 2010]
- IV. Financial Crisis of 2007/8 *Hardfire TV* “Central Banking”

PART VI: Alternatives to Current Banking Regime

- I. Competition in currencies
- II. Free Banking

Hayek 1976
Rothbard 2008

Announcement

If you have a documented disability requiring accommodation in this class, please see me at office hours or by appointment. Thank you.

Class Calendar

First day of class: January 19, 2018

Homework One due: Jan. 30

In-class quiz on Supply and Demand (last 30 minutes of class): Feb. 6

Last day to drop/add without transcription notification: February 6

Spring break (no class): Feb. 20 and 23

Midterm Exam: March 6

Spring break: Feb. 28 and March 3

Last day for voluntary group project sign-up: March 16

Final group assignments: March 20

Easter (no class): March 30

Homework Two due: April 10

Group presentations: April 24 and 27

Study/Snow day: May 1

Final Exam: Scheduled later in the semester by the university, May 4 or 8