

BOSTON COLLEGE  
DEPARTMENT OF ECONOMICS

EC 360  
MWF 1 p.m.  
Fall 1997

Joe Peek  
Office: Carney 141, 2-3686  
Office Hours: M&W 2:00-3:30  
and by appointment

## **Economics of Financial Intermediation**

Texts: Frederic S. Mishkin, *Financial Markets, Institutions, and Money*, HarperCollins, 1995 (available at bookstore); Kenneth Spong, *Banking Regulation: Its Purposes, Implementation, and Effects*, FRB Kansas City, 1994 (available from professor).

In addition to the set of articles included in the course outline, I will hand out in class numerous short articles from current newspapers and magazines that are particularly relevant to the topic being discussed. All assignments are to be read before the class during which they will be discussed.

This course applies the standard tools of financial analysis and economics to issues in the operation and regulation of financial intermediaries. The primary focus will be on commercial banks, although other intermediaries will be discussed. Emphasis will be placed on the continuing innovation and evolution of financial markets and financial institutions and on their interaction both with the changing regulatory environment and the conduct of monetary policy. We will cover chapters 1-6 and 8-16 in Mishkin and chapters 1-6 in Spong. Because the economics of financial intermediation is a rapidly changing field, a number of supplementary readings will be assigned.

Method of Evaluation: The course has two major components, one based on course lectures and assigned readings and the second based on a group term project. The lecture component will have two exams and one assignment. The first exam will be on October 6, and the second exam will occur at the end of the lecture portion of the course. The assignment will be due on Monday, November 10. The term project component will continue throughout the semester, culminating in a presentation to the class. The presentations will occur during the meetings at the end of the course, following the second exam. Course grades will be calculated using the following weights: first exam 30%; second exam 30%; assignment 10%; project 20%; class participation 10%.

## **OUTLINE**

- I. Introduction  
Mishkin, Chs. 1-2.
- II. Financial Markets  
Mishkin, Chs. 3-6 & 8.
- III. Financial Structure  
Mishkin, Chs. 9-10.

- IV. Financial Innovation  
Mishkin, Ch. 11.
- V. The Banking Industry  
Mishkin, Ch. 12.  
Joe Peek and Eric Rosengren, "Have Borrower Concentration Limits Encouraged Bank Consolidation?," *New England Economic Review*, Jan/Feb 1997, pp. 37-47.
- VI. Bank Regulation  
Spong, Ch. 1-6.  
Mishkin, Ch. 13.  
George J. Benston and George G. Kaufman, "FDICIA After Five Years," *Journal of Economic Perspectives*, Vol. 11, No. 3, Summer 1997, pp. 139-58.  
Joe Peek and Eric Rosengren, "How Well Capitalized Are Well-Capitalized Banks?," *New England Economic Review*, Sept/Oct 1997.
- VII. Nonbank Financial Institutions  
Mishkin, Ch. 14.  
Edward S. Prescott, "Lending Groups as Financial Intermediaries: An Example," Manuscript, August, 1997.  
John P. Caskey and Brian J. Zikmund, "Pawnshops: The Consumer's Lender of Last Resort," *FRB Kansas City Economic Review*, March/April 1990, pp. 5-18.  
John P. Caskey, "Check-Cashing Outlets in the U.S. Financial System," *FRB Kansas City Economic Review*, Nov./Dec. 1991, pp. 53-67.  
Mitchell A. Petersen and Raghuram G. Rajan, "Trade Credit: Theories and Evidence," *The Review of Financial Studies*, Fall 1997, pp. 661-91.
- VIII. Bank Management  
Mishkin, Chs. 15-16.
- IX. Banks and Economic Activity  
  
Mitchell Berlin, "For Better and For Worse: Three Lending Relationships," *FRB of Philadelphia Business Review*, Nov./Dec. 1996, pp. 3-12.  
Bharat Trehan, "Bank Lending and the Transmission of Monetary Policy," *FRBSF Weekly Letter*, September 3, 1993.  
Anil Kashyap and Jeremy C. Stein, "Monetary Policy and Bank Lending," in N. Gregory Mankiw, ed., *Monetary Policy*, University of Chicago Press, 1994, 221-61.  
Joe Peek and Eric S. Rosengren, "Bank Lending and the Transmission of Monetary Policy," in Joe Peek and Eric S. Rosengren, eds., *Is Bank Lending Important for the Transmission of Monetary Policy?*, FRB Boston Conference Series No. 39, 1995, pp. 47-68.
- X. Trends and Issues in Banking  
  
Mark E. Levonian, "Why Banking Isn't Declining," *FRBSF Weekly Letter*, January 20, 1995.

- Simon Kwan, "The Economics of Merging Commercial and Investment Banking," *FRBSF Weekly Letter*, May 19, 1995.
- Simon Kwan, "Cracking the Glass-Steagall Barriers," *FRBSF Weekly Letter*, March 21, 1997.
- Joao Cabral dos Santos, "Glass-Steagall and the Regulatory Dialectic," FRB-Cleveland *Economic Commentary*, February 15, 1996.
- Elizabeth Laderman, "The Rhyme and Reason of Bank Mergers," *FRBSF Weekly Letter*, November 17, 1995.
- Jerry L. Jordan, "The Future of Banking Supervision," FRB-Cleveland *Economic Commentary*, April 1, 1996.
- Simon Kwan, "Efficiency of U.S. Banking Firms--An Overview," *FRBSF Weekly Letter*, February 28, 1997.
- Jerry L. Jordan, "The Functions and Future of Retail Banking," FRB-Cleveland *Economic Commentary*, September 15, 1996.
- James J. McAndrews, "Making Payments on the Internet," FRB Philadelphia *Business Review*, Jan/Feb 1997, pp. 3-14.

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### Assignment

Each student will select a chartered commercial or savings bank in the U.S.; no duplications, first come, first served. The assignment involves doing a case study on the selected bank. The study should give a brief history of the bank, a review of its balance sheet over the past five years, branch information, holding company information (if in a holding company), merger activity, internet home page, and other information you believe to be important. In addition, you should make an assessment of the bank's competitive future.

### Suggested Outline

Name of institution

Address

Home page on WWW

FDIC certificate number

Bank type

History--including

Bank environment

Merger/acquisitions

Assets and Liabilities (5 years)

Performance

Income and Expenses (5 years)

Assessment of competitive position today and in the future. (This will involve a comparison of peer institutions.)

### Useful Sources

Mishkin, Chs. 15-16.

bank's home page

[www.fdic.gov](http://www.fdic.gov)

[www.ots.treas.gov](http://www.ots.treas.gov)

<http://lamar.colostate.edu/~rphillip> has a lot of useful internet links

### Due date and page limit

The assignment is due (on or before) Monday **November 10**.

The page limit is **5 pages**, double spaced with 12 point font and 1 inch margins on all sides.

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### Project/Paper Guidelines

Project groups will consist of 3 or 4 students. I am willing to let you select your groups, but am also willing to randomly assign students into groups. The method of group formation will be decided at the first class meeting. Each group will be responsible for selecting a topic, but the topic must be approved by me. Each group will make a presentation of their research to the class and respond to questions. The presentations will be in the second half of the course.

The schedule for the project is as follows:

Sept. 3 (W)	Open Season
Sept. 10 (W)	Submit names in your group
Sept. 19 (F)	Submit brief description of the topic (1-2 pages)
Nov. 14 (F)	Submit first draft of paper
Nov. 24-Dec. 8	Presentations (dates approximate)
Dec. 8 (M)	Submit final draft of paper

All due dates should be read as "No later than...." You can, of course, complete any and all tasks (other than the presentation) prior to the recorded due date.

The key word for the paper/project is analyze. A literature review (summary) or historical description alone is not sufficient. I expect a research paper that makes use of economic and finance arguments and analysis, and includes a bibliography. Some general topics are listed below, many others would be satisfactory. The primary limitation is that the topic should be related to financial intermediation **and not be covered in class**. I want each of the projects to be on a different topic, although there may be some overlap. In case more than one group selects the same specific topic, the first group turning in their topic selection gets the topic. However, several of the listed topics are broad enough to allow more than one project without serious overlap.

#### Possible Topics

- U.S. Bank Consolidation--causes, implications
- Reducing the number of bank regulators
- Off-balance-sheet activity of banks
- Credit card operations
- Payment systems--Internet banking, electronic money
- Critique of bank efficiency studies
- Risk management at banks
- Integrating banking markets in the EC
- Continental Bank bailout
- Separation of banking and commerce
- Section 20 subsidiaries--recent changes and implications
- Junk bonds
- Commercial paper
- Third-party credit enhancements, e.g., letters of credit
- Securitization
- Imploding Japanese financial system

Japan's "Big Bang"

Comparison of bank- (Japan, Germany) vs. market-centered (US) financial systems

Lending groups--e.g., Grameen Bank

Investment banking

Finance companies

Insurance companies

Venture capital

Index fund--performance, advantages, disadvantages relative to conventional mutual funds

Closed-end funds--Why the persistent discounts from NAV?

There are many sources that will provide useful information for your project. The BC library subscribes to numerous economic and finance journals and trade publications. The economic reviews of the various regional Federal Reserve Banks often have relevant articles, as do the proceedings of the annual FRB Chicago bank structure conference. Additional bibliographic sources include the *Business Periodicals Index*, the American Bankers Association *Banking Literature Index*, the *American Banker Index*, the *Wall Street Journal Index*, and the *Journal of Economic Literature*. *The Fed in Print*, distributed by the FRB of Philadelphia and available on the WEB, lists articles and working papers produced within the Federal Reserve System.

Pearl Alberts and Barbara Mento are excellent reference librarians at O'Neill. They are quite knowledgeable and very helpful.

Finally, once you select your topic I may be able to help get you started with a few relevant articles or data sources.