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The Bulletins of N.Y.U.'s Institute of Finance, 1926-1970: A Review Article

This paper reflects the personal opinion of the author and must not be interpreted as representing the opinion of the Board of Governors.

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A Review Article[1/]

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The Institute of Finance of the Graduate School of Business Administration of New York University has been releasing Bulletins at the rate of four to eight numbers a year for the past 45 years on financial and economic developments in foreign countries and in the United States. Some 208 reports were released between 1926 (when a staff was originally assembled under the late Marcus Nadler's distinguished leadership to work exclusively on the credit situation in foreign countries on behalf of the Investment Bankers Association) and 1959 when the Institute was reorganized and a "New Series" was introduced.[2/] Until 1938, about 90 per cent of the Bulletins were related to the creditworthiness of foreign countries; but international problems of a broader interest and then domestic financial topics gradually replaced the country studies. (See Table 1.) The most drastic change in the contents of these Bulletins occurred around

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1/ The conclusions in this paper represent the personal opinions of the author and do not reflect the views of the Board of Governors of the Federal Reserve System. The article is scheduled to be published in the Journal of Economic Literature of the American Economic Association, March 1971.

2/ The titles of the "New Series" are listed in each Bulletin and will not be reproduced here. We will deal only with the "New Series" papers and individual Bulletins will be referred to in this review by number and date as follows: [57, 1969] refers to George G. Kaufman, "Current Issues in Monetary Economics and Policy: A Review," The Bulletin, No. 57, May 1969.

Table 1

<u>Bulletins</u> of the Institute of Finance by Subject, 1926 to 1969.

	1926 to 1931	1932 to 1938	1939 to 1946	1947 to 1958	1959 to 1969	TOTAL
Foreign Subjects:						
Country studies	41	16	10	18	3	88
Securities in default	3	22	0	0	0	25
Foreign dollar bonds	0	4	9	12	1	26
U.S. balance of payments and role of dollar	0	0	0	0	5	5
Financial markets abroad	1	0	0	0	4	5
International financial system	0	0	4	5	7	16
Other international subjects	3	0	8	1	3	15
Total foreign	48	42	31	36	23	180
Domestic Subjects:						
Credit and stabilization policies	0	2	2	15	5	24
Banking and bank structure	0	0	5	3	9	17
Other financial institutions	0	0	0	0	2	2
Domestic financial markets	0	0	4	5	3	12
Other domestic subjects	0	0	3	2	2	7
Total domestic	0	2	14	25	21	62
Total <u>Bulletins</u> during period	48	44	45	61	44	242

Note: Individual <u>Bulletins</u> after 1959 have sometimes been assigned two and, in some cases three numbers depending on their length, so that the number of <u>Bulletins</u> listed in the "New Series" exceeds the number shown in this table.

1964 when, under a new editor (Arnold W. Sametz), the unsigned products of the Institute's research staff were replaced by original papers prepared by identified scholars, increasingly from outside the New York University community. This review is primarily concerned with the output over the past six years, a period during which the quality has improved and the frequency and size of issues have increased.

General characteristics

The Institute's close association with the educational program of the Graduate School of Business Administration and with the New York financial community have, no doubt, shaped the character of the published materials. Even though outside manuscripts have been welcomed, perhaps one-third of the authors of the "New Series" publications since 1964 have been associated with the School of Business Administration as teachers or students giving the *Bulletins* a local flavor which contrasts with the cosmopolitan flavor of, say, the Princeton *Essays in International Finance*. On the other hand, nine out of the last dozen papers in this series have been written by scholars not connected with New York University.

There has also been an increasing emphasis in recent years on monograph-size papers: that is, studies too long for the scholarly journals and too technical for the more popular publication outlets. In addition, there has been a shift from the earlier emphasis on international finance to allow equal opportunity for domestic finance pieces. Half of the last 12 Bulletins have dealt with domestic subjects.

The choice of shorter-term and policy-related subjects and the effort to make the published materials accessible to the non-technician as well as the academic economist reflect in part an orientation toward the interests of the New York financial community. Recent Bulletins in particular have attempted to present a more rounded and, in some respects, fuller treatment of the problem being explored than the typical article in a professional journal, and to offer the non-technician a broad review of the subject at hand in a single sitting. Unlike the case of readers of the professional journals, surviving readers of the Bulletin from 1960 can follow the 1970 issues without difficulty!

Although they vary in creativity and in sophistication, these papers aim at, and attain, a recognizable standard of professional competence. But their concern with institutional and policy matters mean that the Bulletins are often not heavily theoretical. They also have a verbal emphasis; time series, often unprocessed, and a limited use of regression analysis were characteristic of the statistical materials in the earlier issues of the "New Series"; but the more recent contributions draw much more heavily on quantitative materials. Even in them, however, there is absent the rigorous empirical testing of alternative hypotheses and the exploration of the quantitative relationships among variables through model-building and simulation.

These generalities are intended only to identify the character of the published materials for a professional audience. The earlier papers in this series with the emphasis upon international subjects (which, though unsigned, were known to be largely the work of Dr. Marcus Nadler) can perhaps be explained in terms of geography and of the realities of financial support then available to the Institute. Why should not the Institute have regarded the facilities of the New York money and capital markets as a primary resource and as a unique advantage, much as British economists for centuries have exploited their close ties to financial markets in London?

Studies on international topics

We will attempt to survey the analytical methods used and to summarize the principal conclusions of these pieces by comparing the Bulletins on a few closely-related topics. In the international field, the studies have been concentrated in five main areas: (i) the U.S. balance of payments (5 papers); (ii) problems of the international monetary system (7 papers); (iii) foreign financial markets (4 papers); (iv) Canada's floating exchange rate (3 papers); and (v) international trade problems (3 papers).

(i) U.S. balance of payments - We can pass over three early unsigned papers on this topic [2, 1959], [8, 1960] and [21, 1962] as workmanlike reviews of current trends, topical rather than analytical in content. However, Bruck-Lees' study of the balance-of-payments effects of U.S. direct investment [48-49, 1968] combined a thorough knowledge of available data with an acceptable if not inspiring theoretical underpinning. The first of two (largely unrelated) parts presents statistics on the involvement of each of the FORTUNE 500 firms in direct foreign investment (with appendices giving details by firm for 1965), a compendium available in no other convenient source. But the second part of the text relied too heavily on Bell's earlier work[1/] on the balance of payments impact of direct investment and attempted quantitative estimates of the impact of U.S. direct-investment controls which can only be regarded as superficial, especially by comparison with the more original and more painstaking work by Hufbauer-Adler also published in mid-1968.[2/]

On the other hand, originality in conception does not by itself endow a piece of research with continuing value. Hudson's attempt [61-63, 1970] to recast the U.S. balance-of-payments accounts from a transactions to a payments basis has more merit as an industrious reworking of the standard formats of these accounts than it has as an introduction to the critical difficulties of interpreting the basic accounts. Furthermore,

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1/ Philip W. Bell, "Private Capital Movements and the U.S. Balance of Payments," in Factors Affecting the United States Balance of Payments (Joint Economic Committee, U.S. Congress, 1962, pp. 395-481).

2/ G. C. Hufbauer and F. M. Adler, Overseas Manufacturing Investment and the Balance of Payments (Washington: U.S. Treasury Department, 1968). This comment is not meant to be a judgment about the merits of the conclusions of the two papers.

the conclusions Hudson draws from his work do not strengthen confidence in the usefulness of his approach. For he is led to concentrate on the role of government spending abroad as the decisive element in the U.S. balance of payments problem and to maintain that the classical adjustment mechanism (of price changes which affect private-sector transactions) cannot overcome a disequilibrium caused by government spending -- even though the classical economists had to recognize that Britain's external difficulties between the 1790's and the 1810's were largely rooted in U.K. subsidies to continental allies and other government spending in connection with the wars with Napoleon. It then follows, in Hudson's view, that exchange-rate changes cannot serve as a method of correction since devaluation of the dollar would increase the private sector's surpluses but its effect would be merely

> "to transfer the burden of financing U.S. government overseas spending from foreign central banks to the <u>private</u> sectors of foreign countries," (p. 92)

as though there were no role for exchange rates in international payments adjustment.

<u>International monetary system</u> - As a group, the <u>Bulletins</u> on aspects of international monetary reform combined an attention to factual and institutional detail with a scholarly appreciation of broader theoretical and policy considerations. The paper on "The Gold Problem" [13, 1961] recommended that the gold-reserve requirement against Federal Reserve liabilities be altered and rejected a higher official gold price and devaluation of the dollar as appropriate policies for the United

States. A study on "The Key Currencies" [17, 1961] recognized the critical weakness of the reserve-currency system which Triffin first made clear -- that additions to international liquidity can undermine confidence in the key currencies. But it also emphasized that liquidity-creating proposals do not in themselves "get to the heart of the problem" (p. 21) because the "basic problem of the reserve currencies ... lies not only in ... the deficits of the United States and Great Britain but also in the policies of those countries which ... have rapidly expanded their international reserves" (p. 25); the surplus countries have not invested a major part of their payments surpluses in long-term foreign assets but have instead converted their gains into gold or into short-term dollar assets.

Hawkins-Rolfe prepared two companion pieces on proposals for international monetary reform: an academic evaluation of the advantages and limitations of each proposal in [35, 1965] and a compendium in [36-37] in which each of them is described. These two papers are valuable not only as exposition but because the proposals are viewed against the need to improve adjustment performance, so that the authors concluded with doubts that reserve creation alone will "prove sufficient in the long-run ... if exchange rates remain rigid." (p. 78.)

The recent papers by Mintz on "Monetary Union and Economic Integration" [64, 1970] and Schloss on "The Bank for International Settlements" [65-66, 1970] underscore the continuing interest of the editors in problems of the international monetary system.

<u>Foreign financial markets</u> - Four studies on foreign financial markets: Japan [19, 1962]; Switzerland [29, 1964]; France [32-33, 1965]; and the Euro-dollar market [39, 1966] illustrate the use of the <u>Bulletin</u> as an outlet for the work of graduate students and younger faculty. These papers presented an accurate and, for their size, comprehensive survey of these financial markets. However, Bloch's treatment of the Euro-dollar market [39] suffered from a lack of clarity between the effects of Euro-dollar borrowings on the liquidity of an individual Eurobank and on aggregate credit supplies in a European country. When a Eurobank converts a Euro-dollar deposit "into domestic 'high-powered' money," Bloch suggested, it is engaged not in "velocity-increasing intermediation" but in "money-increasing banking." But he recognized that "a conversion of E$ into (local) high-powered money by individual Eurobanks may permit them to expand their loan volume much more rapidly than a mere pass-through of E$ funds, <u>if the central banks permit</u>." 1/ So long as the domestic monetary effects of Euro-dollar borrowings depend on how central banks react to them, then such transactions can be regarded essentially as a balance-of-payments, rather than as a "money-increasing," phenomenon. Further, their domestic monetary effects are no more, and no less, "money-increasing banking" than any other form of short-term capital inflow by the Eurobank, including the repatriation of any money-market assets it held abroad.

1/ <u>Ibid.</u>, p. 8. This clause is <u>not</u> italicized in original text.

Canadian exchange-rate policy - The papers on the Canadian experience with a flexible rate between 1950 and 1962 have a refreshing emphasis on theory and on empirical testing. McLeod [34-35, 1965] leaned heavily on exchange-rate theory in a brief against Canada's flexible-rate policy which produced "an unjustified appreciation" (p. 38) and failed to provide "the supposedly greater freedom of domestic monetary policy under a fluctuating-exchange-rate system." (p. 47.) On the other hand, Mellish and Hawkins [50-51, 1968] sought to determine why the Canadian dollar had been relatively stable. Mellish tested the role of official intervention by measuring daily changes in the exchange rate and in official reserves. When these two variables moved in the same direction, as they did in nearly 80% of the months observed, the official intervention was regarded as cushioning in its effect on exchange quotations. Hawkins' companion piece regressed short- and long-term capital flows against several independent variables and found, as earlier studies had pointed out, that private flows (especially trade credit and speculative movements) had "exerted major stabilizing influences ... in the short-run." (p. 42.)

International trade problems - Finally, several Bulletins, heavily institutional in nature, deal with such problems as international commodity agreements [40, 1966], economic integration in developing areas as reflected in the Central American Common Market [44, 1967] and a case study of international price discrimination [58-60, 1969]. The monograph on the formation of U.S. trade policy just released [68-69, 1970] is particularly timely in view of the current debate over import policy.

Studies on domestic topics

The Bulletins on domestic topics have concentrated on problems of commercial banking (5 papers) and of banking structure (5 papers). The impressive improvement in the quality of the published materials can be seen by comparing early and late studies in these fields.

Banking structure and banking markets - The Guttentag-Herman study on "Banking Structure and Performance [41-43, 1967] provides a reliable summary and comprehensive review of the professional literature in the field of banking markets around 1967. The important contributions in the field have been included, each of them being summarized and carefully evaluated. The paper provided a general survey and bibliography but it also presented the judgment of two qualified economists who have assembled an impressive variety of statistical evidence in this specialized field. There are 56 separate tables, each composed of processed data. The authors attempted to measure concentration of banking facilities in terms of "concentration ratios" in national and then in local markets and brought together the sparse evidence available on competitive behavior in banking markets. They then attempted to measure how banking structure was related to the principal elements of banking performance: (i) the price of banking services; (ii) operational efficiency or the real cost of a given service; and (iii) the allocational efficiency of resource use from the community's point of view.

This impressive contribution can be contrasted with the unsigned paper on bank mergers [18, 1962] which was purely descriptive and the Backman-Sametz analysis [22, 1962] which, though much more analytical, made only limited use of empirical materials.

<u>Sources of banking funds</u> - This same shift away from the essay toward the technical monograph is found in the comparison of the Paul S. Nadler study of time deposits and debentures [30, 1964] with the Heebner paper on the negotiable certificate of deposit [53-54, 1969]. After reviewing the motives for issuing and holding CD's and the workings of the secondary market, Heebner attempted to test hypotheses about the determinants of the volume of CD's -- though the R^2 are unfortunately low -- and explored the implications of CD's on monetary policy. By contrast, the early Nadler piece seemed aimed primarily at commercial bankers and emphasized the ways the new CD's were affecting the commercial banks.

<u>Other domestic financial studies</u> - The attempt in the published materials to achieve a compact and rounded penetration of a major financial topic is illustrated by several recent <u>Bulletins</u>. Ritter's paper [52, 1968] presented the fundamentals of flow-of-funds accounting, probably as a teaching document, in view of its detailed treatment of simple accounting principles and its cursory concern with the underlying financail relationships which the accounts summarize. A Sametz-edited survey of the outlook for the savings and loans industry [46-47, 1968] (an industry-financed study by an N.Y.U. faculty team) combined: a summary of the impact of government policies on the housing industry; a forecast of mortgage flows in 1975 based on a model of the mortgage market; and a

series of practical proposals to help the S and L's meet their cyclical and secular difficulties. Finally, Mitchell [45, 1967] contributed a careful analysis of the effectiveness of debt limitations on state and local government borrowing in which he developed an "evasion" hypothesis (that the restrictions are not significantly altered in periods of excess demand pressures and that local governments employ "financial innovations -- i.e. 'extralegal' methods -- ... to bypass the laws" (p. 7)). He tested the hypothesis statistically by measuring how government units with restrictive laws issued less general-obligation debt and more non-guaranteed debt than governments similarly situated but with debt limitations of lesser degrees of restrictiveness. The conclusion that these government units would turn to costly substitutes seems to be borne out by the experience of the past three years.

Review of present state of monetary economics - Kaufman's review of the current issues in monetary economics and policy [57, 1969] is a collation of the recent literature -- drawn from a bibliography of 137 items -- which is distinguished by an even-handed description of the major points of view in a field marked in recent years by polarized and, too often, intemperate professional controversy. This survey is undoubtedly an effective introduction to these materials for teaching purposes and for the interested non-specialist as well. The author covers a wide ground with accuracy and good judgment.

But so broad a review of a major field in economics is an ambitious undertaking and the specialist will find Kaufman's monograph, judged as a general survey, more a ramble through familiar materials than a stimulating summary of the present state of monetary economics. There is missing a sustained creative insight on the part of the author so that familiar materials will appear in a fresh light. From this point of view, Goodhart's recent paper on "The importance of money"[1/] is a more stimulating and more original introduction to many of these problems.

Furthermore, Kaufman is able to report more "agreement on the major issues" and much more optimism in the "great promise of exciting results from additional empirical testing" (p. 48) than the more skeptical among us would accept. The impressive gains in empirical testing and in pure theory have not been translated into equivalent advances in applied theory and in agreement upon guides for monetary action. Goodhart is more to the point when he concludes: "We are not able to estimate the effects of [monetary] policy, even in normal circumstances, with any precision." (p. 180.) We have in fact been passing through a period when yields in financial markets -- perhaps the highest in U.S. history -- were substantially beyond the range which monetary economists and financial specialists would have predicted, or even conceived of, earlier in the decade. It would appear that uncertainty and expectational and variable-lag factors are likely to be much more serious sources of disturbance than Kaufman's optimism seems to imply.

1/ C. A. E. Goodhart, "The importance of money," Bank of England Quarterly Bulletin, June 1970, pp. 159-89.

The question of what we can regard as substantive advances in our understanding of monetary phenomena was called sharply to my attention recently in looking over Alfred Marshall's extemporaneous testimony before the Committee on Indian Currency in 1899 for another purpose. Where Kaufman records that contemporary economists have recently regained an interest in the importance of price expectations on market interest rates (p. 38) and Goodhart concludes his paper with: "the level of nominal interest rates is not a good indicator of the stance of monetary policy" (p. 180), Marshall had freshly learned from Irving Fisher that:

> "The whole theory of discount [interest rates] is full of paradoxes, because the increase of prosperity sometimes raises discount, and sometimes lowers it. No interpretation can be given of a rise in discount, unless it is known to what cause the change is due." 1/

On the other hand, Marshall would not encourage the monetary economist to a narrow concentration on the direct relations between monetary variables and final spending, for

> "This so-called 'quantity theory of the value of money' is true in just the same way as it is true that the day's temperature varies with the length of the day, other things being equal; but other things are seldom equal." 2/

Instead, he challenged the monetary economist to search -- within the little black box -- for the linkages through which monetary actions are transmitted from financial to real economic aggregates.

1/ Alfred Marshall, Official Papers, (Macmillan: London, 1926), p. 273.

2/ Ibid., p. 267.

For their studies of the ways "other things are constantly changing" (p. 267) to be effective, economists will probably have to be pluralistic in their analytical methodology, with a balanced use of both traditional business-cycle and econometric approaches, and not commit disproportionate amounts of resources in the search for -- in the words of the "Foreword" of the Kaufman monograph -- "the dramatic breakthrough in empirical testing to prove once-and-for-all that one theory is better than another." (p. 3.) Thus, Poindexter's review [67, 1970] of the assumptions customarily made about the currency-holding behavior of the non-bank public in estimating the effectiveness of monetary policy is an encouraging sign.

Concluding observations

The encouragement in recent Bulletins to recognized scholars to prepare a compact and reliable introduction to an important economic or financial area for the student, for the practicing banker and for the specialist has undoubtedly given a renewed vigor to what may well be the most venerable series of private studies, at least in international finance, in the United States. The editors of the Bulletin, perhaps because of the Institute's traditions and location, are interested in materials which might be regarded as too pluralistic in their institutional, historical or policy aspects to meet the increasingly mathematical-statistical focus of articles in the professional journals in the current phase of editorial fashion. The profession can be grateful that part of this transformation of the Bulletin is to solicit contributions from economists anywhere in the United States or abroad. For the editors appear concerned to carry out the Institute's historical function of acting as intermediary between the workaday world of commerce and finance and the frontiers of monetary and international economics, a project in which all economists can join with enthusiasm.