CHAPTER 10

Money and Banking

SECTION 1 *MONEY*

TEXT SUMMARY

THE BIG IDEA

Money serves as a medium of exchange, a unit of account, and a store of value.

Money is anything that serves as a medium of exchange, a unit of account and a store of value. A **medium of exchange** is anything used to measure value during the exchange of goods and services. As a **unit of account** money is a way to compare the value of goods and services. Money can also be used as a **store of value**. This means money keeps its value if you hold on to it.

The coins and paper bills used as money in a society are called **currency**. Currency must have six characteristics: durability, portability, divisibility, uniformity, scarcity, and acceptability. It must have durability, or be able to withstand a lot of use. It must have portability, or be easily carried and transferred. It must be divisible, or easily divided into smaller units. It must have uniformity, meaning that people must be able to count and measure money accurately. Currency must exhibit scarcity, meaning it must have a controlled supply. Finally, it must have acceptability, the ability to be accepted by all people in society.

Representative money represents an object of value for which it can be exchanged. For example, paper receipts for gold or silver were an early form of representative money. The United States today uses **fiat money**. This type of money has value because the government states that it is an acceptable means to pay debts.

GRAPHIC SUMMARY: *The Three Functions of Money*

Medium of Exchange	Unit of Account	Store of Value
		

Money has three basic uses. It enables people to exchange goods and services. It provides a way to compare prices of goods and services. It allows people to store value if they hold on to it instead of using it.

REVIEW QUESTIONS

1. Explain the difference between representative money and fiat money.
2. **Chart Skills** Which are the three functions of money?

SECTION 2

THE HISTORY OF AMERICAN BANKING

TEXT SUMMARY

A **bank** is an institution for receiving, keeping, and lending money. In 1791, Congress set up the Bank of the United States. It lent money to the federal government and issued bank notes, a form of representative money backed by gold and silver. The Bank brought stability to American banking. However, many people were opposed to it. They worried that a centralized bank would respond only to the needs of wealthy individuals and large businesses. It ceased to exist in 1811, when its charter, or license, expired. A second central bank had the same fate, expiring in 1836. The period between 1837 and 1863 is known as the Free Banking Era. This period was dominated by state-chartered banks. Many did not have enough gold and silver to back their paper money.

During the Civil War, Congress enacted important bank reforms. These laws gave the federal government the power to charter banks. Banks were now required to hold adequate gold and silver reserves. The government also established a uniform national currency.

In 1913, Congress established the **Federal Reserve System**. It served as the nation's first true **central bank**, or bank that can lend to other banks in times of need. In the 1930s, the severe economic decline called the **Great Depression** led to new laws regulating banks. One established the **Federal Deposit Insurance Corporation (FDIC)**, which insures customer deposits if a bank fails.

THE BIG IDEA

Banking in the United States has shifted between centralized and decentralized systems, leading to the stable banking system of today.

GRAPHIC SUMMARY: *Developments in American Banking*

Date	Development
1780s	Federalists and Antifederalists disagree about a banking system.
1791	First Bank of the United States is established.
1811–1816	Period of instability follows expiration of First Bank's charter.
1816	Second Bank of the United States reestablishes stability.
1830s–1860s	President Jackson vetoes recharter of Second Bank in 1832, giving rise to Free Banking Era.
1861–1863	Civil War makes clear the need for a better monetary and banking system.
1863–1864	National Banking Acts of 1863 and 1864 establish national banking system and uniform national currency.
1907	Panic of 1907 leads to creation of the Federal Reserve System.
1913	President Wilson signs the Federal Reserve Act.
1929	The Great Depression begins.
1933	President Roosevelt helps restore confidence in the nation's banks by establishing the FDIC.
1980s	Period of deregulation; S & L's face bankruptcies.
1990s	Banks enter a period of financial health and mergers.

The modern American banking system began to take shape with the creation of the Federal Reserve System in 1913 and the Great Depression reforms of 1933.

REVIEW QUESTIONS

1. What is the purpose of the Federal Deposit Insurance Corporation?
2. **Chart Skills** What events led to the creation of the Federal Reserve System?

SECTION 3 *BANKING TODAY*

TEXT SUMMARY

The **money supply** is all the money available in the United States economy. The money supply is divided into categories called M1 and M2. M1 is money that people can easily use to pay for goods and services, such as currency and deposits in checking accounts. These are assets that have **liquidity**, which means they can be used as cash or easily turned into cash. M2 consists of all the assets in M1 plus several other assets which have less liquidity, such as savings accounts and **money market mutual funds.** These are funds that pool money from small investors to purchase government or corporate bonds.

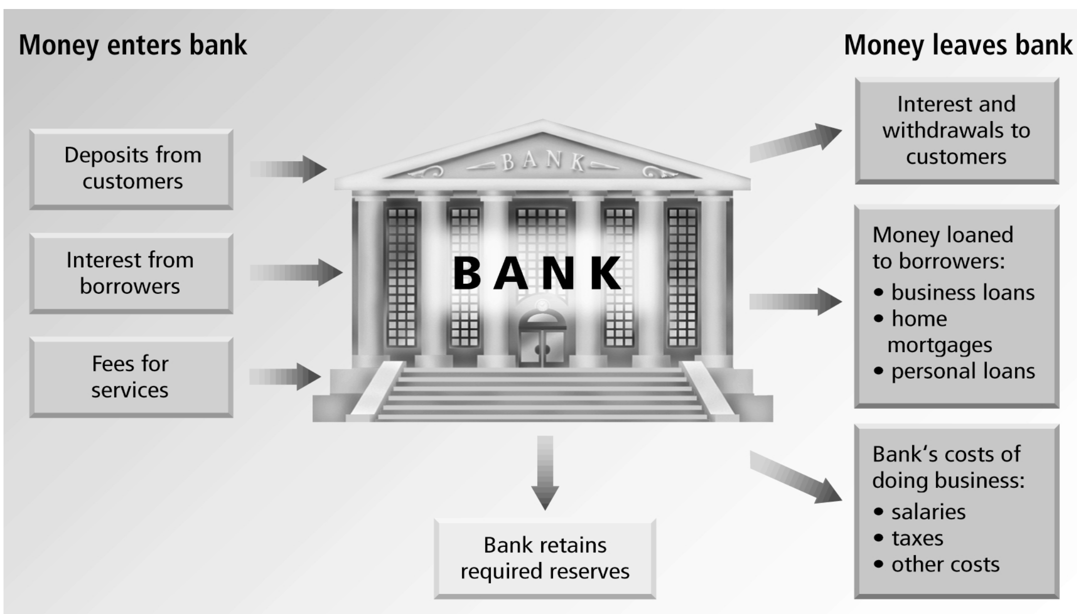
The basic service banks provide is a safe way for people to store and save money. Banks offer savings accounts, checking accounts, money market accounts and certificates of deposit. Most of these accounts pay **interest**, the price paid for the use of borrowed money. Banks also provide loans, mortgages, and credit cards. A **mortgage** is a loan used for real estate. When banks lend money, they make a profit by charging interest. The borrower also has to repay the **principal**, the amount borrowed.

Computers are rapidly changing the world of banking. Automated Teller Machines (ATMs) are computers that customers can use to deposit money, withdraw cash, and obtain information. Many people are starting to use the Internet to handle their finances. A growing number of financial institutions allow people to check account balances, transfer money between accounts, and pay their bills by computer.

THE BIG IDEA

Over the years banks have added more services. Today the Internet and the computer have made it easier for people to manage their money.

GRAPHIC SUMMARY: *How Banks Make a Profit*



Although banks use the money they get from depositors for loans, they are required by law to set aside a certain amount of money as reserves.

REVIEW QUESTIONS

1. What are included in the two categories of the money supply?
2. **Diagram Skills:** What are the three ways that money enters a bank?

Name ____ Class ______________________ Date __________

CHAPTER 10 Test

IDENTIFYING MAIN IDEAS

Write the letter of the correct answer in the blank provided. (10 points each)

____ **1.** Which of the following is NOT a use of money?

A. as a medium of exchange
B. a unit of account
C. a store of value
D. a means of barter

____ **2.** Uniformity of currency means that it is

A. easily divided.
B. easy to count and measure.
C. accepted by everyone in society.
D. scarce.

____ **3.** Representative money gets its value from the fact that

A. it represents objects of value for which it can be exchanged.
B. it is backed up by silver or gold.
C. the government states that it is an acceptable means to pay debts.
D. it is a valuable commodity.

____ **4.** The United States today uses which kind of currency?

A. representative money
B. fiat money
C. scarce money
D. gold and silver

____ **5.** A bank is an institution

A. owned by merchants.
B. that collects taxes for the government.
C. for receiving, keeping, and lending money.
D. that regulates interstate commerce.

____ **6.** The Free Banking Era between 1837 and 1863 was dominated by

A. federal banks.
B. state-chartered banks.
C. savings and loan banks.
D. the Bank of the United States.

____ **7.** The nation's first true central bank was the

A. Federal Reserve System.
B. Federal Deposit Insurance Corporation.
C. Bank of the United States.
D. federally-chartered bank of the Civil War.

____ **8.** Assets that have liquidity are

A. easy to borrow or lend.
B. easy to convert to silver and gold.
C. easy to turn into cash.
D. difficult to turn into cash.

____ **9**. The most basic service a bank provides is

A. a safe way to store and save money.
B. to pay interest.
C. to provide credit cards.
D. to provide mortgages.

____ **10.** ATMs are computers that are

A. used to buy merchandise on the Internet.
B. used to obtain mortgages.
C. used to make long-distance telephone calls.
D. used by customers to conduct their banking business.