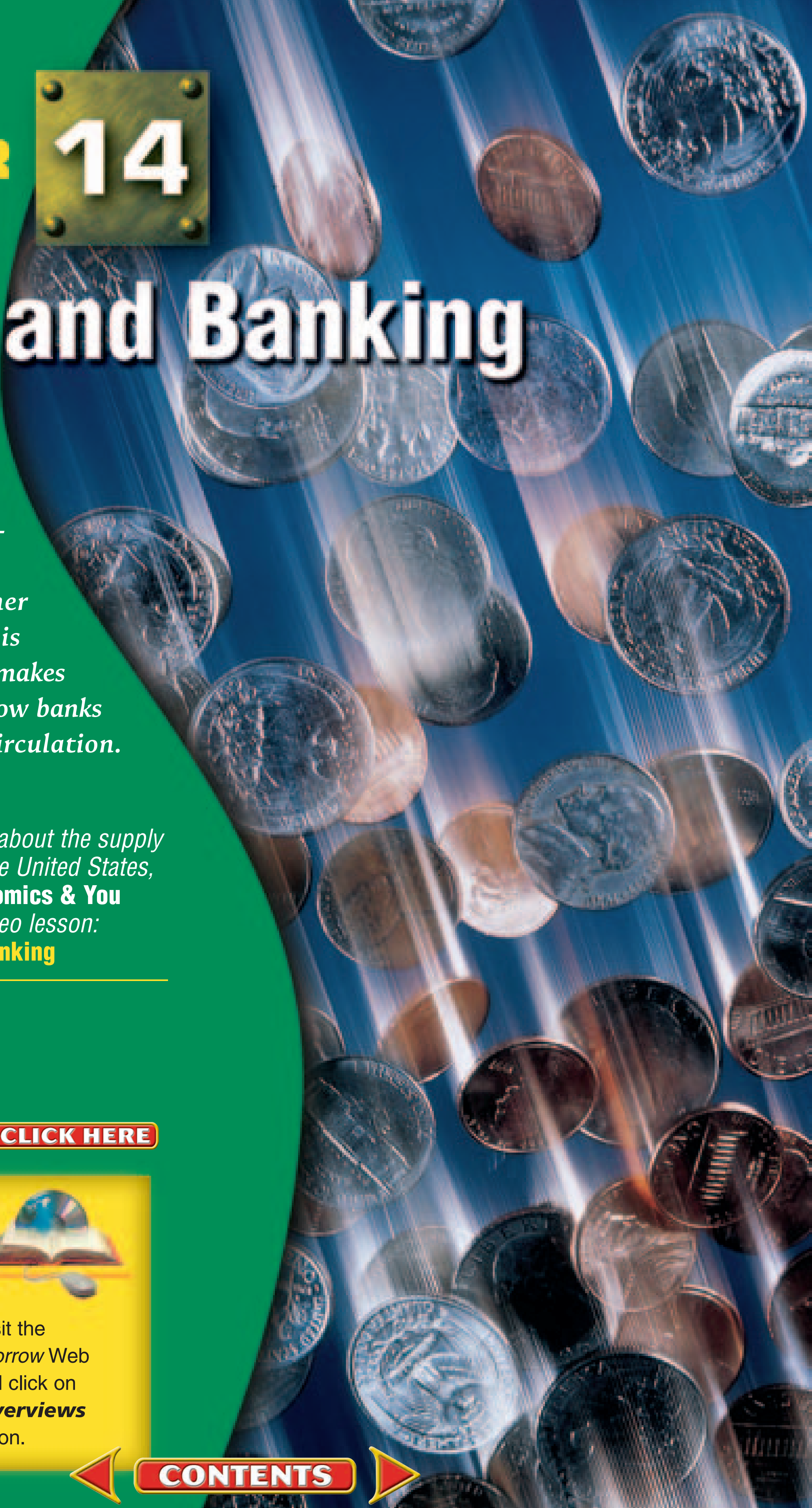
CHAPTER 14

Money and Banking



Why It's Important

Why are these coins considered money? Besides coins and cash, what other kinds of money exist? This chapter will explain what makes our currency money and how banks work to keep money in circulation.

To learn more about the supply of money in the United States, view the **Economics & You** *Chapter 18 video lesson:* **Money and Banking**

CLICK HERE

ECONOMICS Online

Chapter Overview Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 14—Chapter Overviews*** to preview chapter information.

SECTION 1

The Functions and Characteristics of Money

COVER STORY

DISCOVER, OCTOBER 1998

[W]ealthy citizens [in Mesopotamia] were flaunting money at least as early as 2500 B.C. and perhaps a few hundred years before that. "There's just no way to get around it," says Marvin Powell, a historian at Northern Illinois University in De Kalb. "Silver in Mesopotamia functions like our money today. It's a means of exchange. People use it for a storage of wealth, and they use it for defining value."

READER'S GUIDE

Terms to Know

- money
- medium of exchange
- barter
- unit of accounting
- store of value
- commodity money
- representative money
- fiat money
- legal tender

Reading Objectives

1. What are the three functions of money?
2. What are the six major characteristics of money?

For thousands of years, money has made it possible for businesses to obtain easily what they need from suppliers and for consumers to obtain goods and services. What, however, is money? As you read this section, you'll learn the answer to this question.

The Functions of Money

The basis of the market economy is voluntary exchange. In the American economy, the exchange usually involves money in return for a good or service. Most Americans think of money as bills, coins, and checks. Historically, though, and in other economies, money might be shells, gold, or even goods such as sheep.

money: *anything customarily used as a medium of exchange, a unit of accounting, and a store of value*

medium of exchange: *use of money in exchange for goods or services*

barter: *exchange of goods and services for other goods and services*

unit of accounting: *use of money as a yardstick for comparing the values of goods and services in relation to one another*

Figure 14.1 shows several items that have been used as money. For example, Native Americans used wampum—beads made from shells. People in the Fiji Islands have used whales' teeth.

Economists identify money by certain functions. Anything that is used as a medium of exchange, a unit of accounting, and a store of value is considered **money.** See **Figure 14.2.**

Medium of Exchange To say that money is a **medium of exchange** simply means that a seller will accept it in exchange for a good or service. Most people are paid for their work in money, which they then can use to buy whatever they need or want. Without money, people would have to **barter**—exchange goods and services for other goods and services.

Barter requires what economists call a double coincidence of wants. Each party to a transaction must want exactly what the other person has to offer. This situation is rare. As a result, people in societies that barter for goods spend great amounts of time and effort making trades with one another. Bartering works only in small societies with fairly simple economic systems.

Unit of Accounting Money is the yardstick that allows people to compare the values of goods and services in relation to one another. In this way, money functions as a **unit of accounting.** Each nation uses a basic unit to measure the value of goods, as it uses the foot or meter to measure distance. In the United States, this base unit of value is the dollar. In Japan, it is the yen; in much of Europe, the euro. An item for sale is marked with a price that indicates its value in terms of that unit.

By using money prices as a factor in comparing goods, people can determine whether one item is a better bargain than another. A single unit of accounting also allows people to keep accurate financial records—records of debts owed, income saved, and so on.

FIGURE 14.1

Selected Items Used as Money These items are just a sample of the various things that have been used as money.

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FIGURE 14.2

Three Functions of Money All money serves three functions. The money this woman holds is serving as a medium of exchange; the vendor will accept it in exchange for a pizza. The money is also a unit of accounting—the products in the market are all priced in dollars, so the woman can compare values of different items. Finally, the money serves as a store of value—the woman has stored her purchasing power in the form of dollars.

Store of Value Money also serves as a **store of value.** You can sell something, such as your labor, and store the purchasing power that results from the sale in the form of money for later use. People usually receive their money income once a week, once every two weeks, or once a month. In contrast, they usually spend their income at different times during a pay period. To be able to buy things between paydays, a person can store some of his or her income in cash and some in a checking account. It is important to note that in periods of rapid and unpredictable inflation, money is less able to act as a store of value.

store of value: *use of money to store purchasing power for later use*

Characteristics of Money

Anything that people are willing to accept in exchange for goods can serve as money. At various times in history, cattle, salt, animal hides, gems, and tobacco have been used as mediums of exchange. Each of these items has certain characteristics that make it better or worse than others for use as money. Cattle, for example, are difficult to transport, but they are durable. Gems are easy to carry, but they are not easy to split into small pieces to use.

Figure 14.3 on page 378 lists the characteristics that to some degree all items used as money must have. Almost

Global Economy

Russia's Barter Economy

Because Russian currency is not trusted, real money plays a fairly small part in Russia's economy today. Most business is conducted by barter or with IOUs. For example, workers rarely receive wages in the form of cash. A bicycle factory outside the city of Perm pays its workers in bicycles! To get cash, the workers have to sell their "paychecks." More often than not, they simply trade the bicycles for the products they want. ■

FIGURE 14.3 Characteristics of Money

Characteristic	Description
Durable	Money must be able to withstand the wear and tear of being passed from person to person. Paper money lasts one year on average, but old bills can be easily replaced. Coins, in contrast, last for years.
Portable	Money must be easy to carry. Though paper money is not very durable, people can easily carry large sums of paper money.
Divisible	Money must be easily divided into small parts so that purchases of any price can be made. Carrying coins and small bills makes it possible to make purchases of any amount.
Stable in Value	Money must be stable in value. Its value cannot change rapidly or its usefulness as a store of value will decrease.
Scarce	Whatever is used as money must be scarce. That is what gives it value.
Accepted	Whatever is used as money must be accepted as a medium of exchange in payment for debts. In the United States, acceptance is based on the knowledge that others will continue to accept paper money, coins, and checks in exchange for desired goods and services.

any item that meets most of these criteria can be and probably has been used as money. Precious metals—particularly gold and silver—are especially well suited as mediums of exchange, and have often been used as such throughout history. It is only in more recent times that paper money has been widely used as a medium of exchange.

Types of Money

Mediums of exchange such as cattle and gems are considered **commodity money.** They have a value as a commodity, or good, aside from their value as money. Cattle are used for food. Gems are used for jewelry.

commodity money: *a medium of exchange such as cattle or gems that has value as a commodity or good aside from its value as money*

representative money: *money that is backed by an item of value, such as gold or silver*

Representative money is money backed by—or exchangeable for—a valuable item such as gold or silver. Typically, the amount of representative money in circulation, or in use by people, was limited because it was linked to some scarce good, such as gold.

At one time, the United States government issued representative money in the form of silver and gold certificates. In addition, private banks accepted deposits of gold bars or silver ingots

Economic Connection to... History

A Chocolate Lover's Dream

The Aztec in Central America used cacao beans, from which chocolate is made, as money. Prices varied from a few beans for a piece of fruit to several thousand for an enslaved person.

Aztec merchants had to take care when selling expensive items. Payment usually came stored in sacks, and the sacks might contain counterfeit money—bean husks filled with mud. ■

(called bullion) in exchange for paper money called banknotes. The notes were a promise to convert the paper money back into coin or bullion on demand. These banks were supposed to keep enough gold or silver in reserve—on hand—to redeem their banknotes. That did not always happen, however.

Today all United States money is **fiat money,** meaning that its face value occurs through government fiat, or order. It is in this way declared **legal tender.**

fiat money: *money that has value because a government fiat, or order, has established it as acceptable for payment of debts*

legal tender: *money that by law must be accepted for payment of public and private debts*

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 1 Assessment

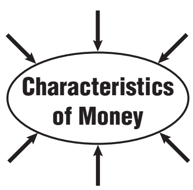
Understanding Key Terms

1. Define money, medium of exchange, barter, unit of accounting, store of value, commodity money, representative money, fiat money, legal tender.

Reviewing Objectives

2. What are the three functions of money?

3. Graphic Organizer Create a diagram like the one below to describe the six major characteristics of money.



Applying Economic Concepts

4. Money Imagine that you live in a bartering society. List 10 items that you use frequently, and then identify alternative goods that you would be willing to trade for them.

Critical Thinking Activity

5. Making Comparisons Make a chart with five columns. In the first column, list Commodity Money, Representative Money, and Fiat Money. In the other four columns, write Description, Example, Advantage, and Disadvantage. Fill in the chart, comparing the three types of money. *(For help in using charts, see page xvii in the Economic Handbook.)*

CRITICAL THINKING SKILLS

Synthesizing Information

Synthesizing information involves combining information from two or more sources. Information gained from one source often sheds new light upon other information.

- Analyze each source separately to understand its meaning.
- Determine what information each source adds to the subject.
- Identify points of agreement and disagreement between the sources. Ask: Can Source A give me new information or new ways of thinking about Source B?
- Find relationships between the information in the sources.

LEARNING THE SKILL

To learn how to synthesize information, follow the steps listed on the left.

PRACTICING THE SKILL

Study the sources below, then answer the questions.

Source A "*At present 60% to 70% of all dollars in circulation are used abroad. Today Panama is the best-known country that is 'dollarized,' but 11 others use the U.S. dollar. The best route for the emerging market countries is to unilaterally dollarize. . . . [T]he dollar could serve as the linchpin of a new global financial architecture, one that would eliminate currency crises, lower interest rates, and stimulate growth.*"

–*Forbes,* May 3, 1999

Source B "*When a country abandons its currency, it surrenders a central symbol of national identity. . . . We are courting trouble if many countries dollarize. They would blame us for their problems; and they would try to influence U.S. policies, pushing for either lower or higher interest rates.*"

–*Newsweek,* May 17, 1999

1. What is the main subject of each source?
2. Does Source B support or contradict Source A? Explain.
3. Summarize what you learned from both sources.

APPLICATION ACTIVITY

Find two sources of information on banking practices. What are the main ideas in the sources? How does each source add to your understanding of the topic?

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 2

History of American Money and Banking

Cover Story

The Economist, August 21, 2003

Who wants to buy a Japanese bank? They are barely profitable, and they are weighed down by $1.25 trillion of bad debts. . . . Yet several, mostly foreign, groups are out shopping. A handful of private-equity groups from America have bought bankrupt regional banks. The best-known foreign purchase was made by Ripplewood Holdings in 2000.

Reader's Guide

Terms to Know

- overdraft checking
- electronic funds transfer (EFT)
- automated teller machine (ATM)

Reading Objectives

1. What are some of the most important events in the history of American money and banking?
2. What are six services provided by banks and savings institutions?
3. How has electronic banking changed banking services?

American banking has included everything from wampum to "virtual" money—banking in cyberspace on the Internet. In this section, you'll learn about the development of and changes in the United States banking industry.

History of American Banking

Because the history of money in the United States is so closely tied to the development of the banking system, the time line in **Figure 14.4** on pages 382–383 describes both. During the colonial period, England did not permit the American colonies to print money or mint coins. Bartering for goods was common.

FIGURE 14.4 Time Line of American Money and Banking

Years	Events
1780s	The new nation has no reliable medium of exchange. National leaders disagree on a type of banking system. One group, led by Alexander Hamilton, believes a national banking system is necessary for development. The opposition, led by Thomas Jefferson, argues that only states should have the right to charter banks.
1791	Congress establishes the First Bank of the United States and gives it a 20-year charter. The bank is a private business, although the government supplies one-fifth of its starting capital. It serves as a depository for government funds, makes loans to the government and private individuals and businesses, and regulates the activities of banks with state charters. It also issues banknotes backed by gold.
1792	Congress passes the Coinage Act, which organizes a mint and establishes the dollar as the basic unit of currency for the nation. The Act also places the nation on a bimetallic monetary standard—the value of the dollar is fixed according to specific quantities of both silver and gold.
1811	Congress refuses to renew the charter of the First Bank because of questions about its legality and fears that it is gaining too much power. Without federal controls, dozens of state-chartered banks lend money and issue banknotes freely, many of which are not backed by enough gold or silver reserves.
1816	Congress establishes the Second Bank of the United States after the financial confusion caused by the War of 1812. Like the First Bank, it brings some order to the banking system. It pressures state-chartered banks to limit lending and to keep enough gold and silver in reserve to redeem their banknotes. Opposition to a strong national bank remains, however. In 1832 President Andrew Jackson vetoes legislation to extend the Second Bank's charter.
1830s–1860s	The end of the Second Bank brings another rapid rise in state-chartered banks. The amount of money in circulation varies widely. Such shifts in the amount of money available result in major fluctuations in business activity and prices.
Civil War	To help pay for the war, the United States issues fiat money—the first time since the Revolutionary War. These United States notes, called *greenbacks,* change in value as confidence in the Union army rises or falls. Difficulties in raising money for the war make clear the need for a better monetary and banking system. In 1863 and 1864, Congress passes the National Bank acts. These acts establish a system of federally chartered private banks, called *national banks.* The government also sets up a safe, uniform currency by requiring that all national banknotes be fully backed by government bonds. The *Comptroller of the Currency* is created to grant charters for national banks and to oversee their activities.

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Years	Events
Late 1860s–Early 1900s	The nation shifts to a gold monetary standard in 1869. The federal government begins redeeming early 1860s greenbacks for gold coins. Despite the new banking system, problems remain. There is no simple way to regulate the amount of national banknotes in circulation, so periodic shortages of money occur. Financial panics occur in 1873, 1884, 1893, and 1907. Many banks with low reserves are forced to close.
1913	To control the amount of money in circulation, Congress establishes the Federal Reserve System. It serves as the nation's central bank with power to regulate reserves in national banks, make loans to member banks, and control the growth of the money supply. In 1914 the system begins issuing paper money called *Federal Reserve notes*. These notes soon become the major form of currency in circulation.
1929	The Great Depression begins. Stocks and other investments lose much of their value. Bankrupt businesses and individuals are unable to repay their loans.
1929–1934	A financial panic causes thousands of banks to collapse. When President Franklin Roosevelt takes office in March 1933, he declares a "bank holiday," closing all banks. Each bank is allowed to reopen only after it proves it is financially sound. Congress passes the Glass-Steagall Banking Act in June, establishing the Federal Deposit Insurance Corporation (FDIC). This new agency helps restore public confidence in banks by insuring funds of individual depositors in case of a bank failure. The nation switches from a gold standard to a fiat monetary standard. The government stops converting greenbacks into gold, calls in all gold coins and certificates, and prohibits private ownership of gold.
1930s–1960s	Banking reforms of the 1930s allow banks to enter a period of long-term stability, in which few banks fail.
Late 1960s–1970s	Congress passes a series of laws to protect consumers in dealing with financial institutions. The Truth in Lending Act of 1968, the Equal Credit Opportunity Act of 1974, and the Community Reinvestment Act of 1977 make clear the rights and responsibilities of banks and consumers. Banks begin using computers to transfer money electronically and to handle many banking activities. Congress passes the Electronic Funds Transfer Act of 1978 to protect consumers using these new services.
1980s–present	As part of the general move toward deregulation of business, Congress passes the Depository Institutions Deregulation and Monetary Control Act in 1980. Deregulation allows the savings and loan industry to make risky loans. Many S&Ls face bankruptcy. Congress passes the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The full cost of bailing out the S&Ls is $300 billion, or about $4,000 per United States family in future taxes. The FDIC takes over regulation of the thrift institutions industry. Banking continues to evolve, incorporating technology such as e-cash on the Internet.

ECONOMICS Online

Student Web Activity Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 14—Student Web Activities*** to see how online banking works.

CLICK HERE

Though scarce, some European gold and silver coins also circulated in the colonies. The Spanish *dolár,* later called the "dollar" by colonists, was one of the more common coins.

The Revolutionary War brought even more confusion to the already haphazard colonial money system. To help pay for the war, the Continental Congress issued bills of credit, called Continentals, that could be used to pay debts. So many of these notes were issued that they became worthless, and people often refused to accept them. The phrase "not worth a Continental" became a way of describing something of little value.

After the war, establishing a reliable medium of exchange became a major concern of the new nation. The Constitution, ratified in 1788, gave Congress the power to mint coins, although private banks were still allowed to print banknotes representing gold and silver on deposit.

Banking Services

Banks and savings institutions today offer a wide variety of services, including checking accounts, interest on certain types of checking accounts, automatic deposit and payment, storage of valuables, transfer of money from one person to another, and overdraft checking. **Overdraft checking** allows a customer to write a check for more money than exists in his or her account. The bank lends the needed amount and the customer pays the money back, usually at a relatively high rate of interest.

overdraft checking: *checking account that allows a customer to write a check for more money than exists in his or her account*

In general, the types of banking services are the same across the country. The exact terms and conditions of the services, however, vary from state to state according to each state's banking laws. When choosing a bank or savings institution, you should investigate the bank's service charges.

Electronic Banking

One of the most important changes in banking began in the late 1970s with the introduction of the computer. With it came **electronic funds transfer (EFT),** a system of putting onto computers all the various banking functions that in the past had to be handled on paper. One of the most common features

electronic funds transfer (EFT): *system of putting onto computers all the banking functions that in the past were handled on paper*

CONTENTS

of EFT is **automated teller machines (ATMs).** These units let consumers do their banking without the help of a teller.

Today you can even do your banking from home. You can see your account balances, transfer funds from a savings account to a checking account, and often even apply for a loan—all on the Internet.

automated teller machine (ATM): *unit that allows consumers to do their banking without the help of a teller*

EFT Concerns Although EFT can save time, trouble, and costs in making transactions, it does have some drawbacks. The possibility of tampering and lack of privacy are increased because all records are stored in a computer. A person on a computer terminal could call up and read or even alter the account files of a bank customer in any city, if he or she knew how to get around the safeguards built into the system. In response to these and other concerns, the Electronic Fund Transfer Act of 1978 describes the rights and responsibilities of participants in EFT systems. For example, EFT customers are responsible for only $50 in losses when someone steals or illegally uses their ATM cards, if they report the cards missing within two days. If they wait more than two days, they could be responsible for as much as $500. Users are also protected against computer mistakes.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

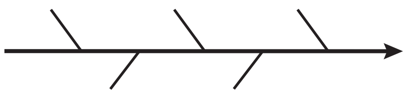
SECTION 2 Assessment

Understanding Key Terms

1. Define overdraft checking, electronic funds transfer (EFT), automated teller machine (ATM).

Reviewing Objectives

2. Graphic Organizer Create a time line like the one below to list and describe at least five of the most important events in the history of American money and banking. See **Figure 14.4** on pages 382–383 for information.



3. What are six services offered by banks and savings institutions?

4. How has electronic banking changed banking services?

Applying Economic Concepts

5. Money In 1934 the government stopped backing paper money with gold. Some experts have proposed a return to the gold standard. Do you think this would be a good idea? Why or why not?

Critical Thinking Activity

6. Drawing Inferences Why do you think coins have been a more desirable form of money than paper currency throughout American history?

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BusinessWeek

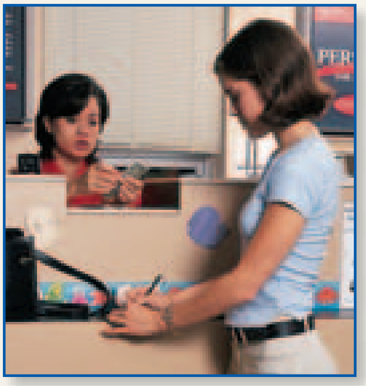
Spotlight on the Economy

How Higher Fees Hurt Banks

Check It Out! In this chapter you learned about banking services. In this article, read to learn how consumers are reacting to higher bank fees for those services.

Anyone who has maintained a checking account over the past decade knows that the rules of the game have been dramatically changing. Specifically, your once friendly bank or thrift institution has probably been imposing a lot more fees and restrictions on your account—in an understandable effort to save money and wring even more profits from your need for its services.

Among other things, many banks now try to save money on handling canceled checks—either by not returning them at all or, more likely, charging either a set monthly amount for all returned checks or a per-check fee. Some also charge customers for using live tellers instead of ATMs. And many have been raising their fees considerably for handling bounced checks and for using other banks' ATMs.



Ironically, reports economist Joanna Stavins in a recent issue of the Federal Reserve Bank of Boston's *New England Economic Review*, most of the gambits don't seem to be paying off. In a study of checking accounts at some 250 banks around the nation in 1997, she found that only two of the features described above appeared to be producing higher revenues: increased charges for bounced checks and higher fixed monthly fees for returning canceled checks.

In all other cases, raising fees or tightening restrictions tended to induce depositors to switch to other institutions—thus lowering the banks' take. Consumers, it seems, are a lot more sensitive to such practices than banks realize.

Think About It

1. **What actions are banks taking to earn more profits?**
2. **Analyze the consequences of a bank's decision to raise its fees.**

SECTION 3

Types of Money in the United States

COVER STORY

KIPLINGER'S PERSONAL FINANCE MAGAZINE, JULY 2000

To get its new Sacajawea dollar into circulation, the U.S. Mint has issued more than 500 million of the golden coins since the end of January, not only to banks, but also to Wal-Mart and Sam's Club stores. But in what may be the greatest coin trick ever, the dollars have all but vanished. People are making them into jewelry, auctioning them off on eBay, and leaving them under pillows on behalf of the tooth fairy—anything but spending them. . . . The Mint expects Sacajawea to be back in circulation by year-end, when more than a billion of the dollars will have been minted and the novelty, it hopes, will have worn off.

READER'S GUIDE

Terms to Know

- checking account
- checkable deposits
- thrift institutions
- debit card
- near moneys
- M1
- M2

Reading Objectives

1. What is the difference between money and near moneys?
2. What does the M2 definition of money include?

Randy L'Teton, model for the Sacajawea coin

When you think of money, you may think only of coins and paper bills. As you read this section, you'll learn that money is more than just cash.

Money and Near Moneys

Money in use today consists of more than just currency. It also includes deposits in checking and savings accounts, plus certain other investments.

Currency All United States coins in circulation today are token coins. The value of the metal in each coin is less than its exchange value. A quarter, for example, consists of a mixture of copper and nickel. The value of the metal in a quarter, however, is much less than 25 cents. The Bureau of the Mint, which is part of the Treasury Department, makes all coins. About 5 percent of the currency in circulation in the United States today is in the form of coins.

Most of the nation's currency is in the form of Federal Reserve notes issued by Federal Reserve banks. The Bureau of Engraving and Printing, also part of the Treasury Department, prints all Federal Reserve notes. They are issued in denominations of $1,

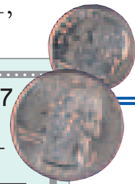


FIGURE 14.5

Writing a Check and Balancing Your Checkbook

Always fill out your checks completely and clearly in ink. See the sample check in Part A. After you write a check to someone or make a deposit into your checking account, write the number, date, and amount in your check register. See the sample register in Part B.

Then, when you receive your monthly bank statement, balance your checkbook by following these steps:

1. Sort your checks by number. Check off each one in your checkbook.
2. Check off your deposit slips.
3. Deduct service charges and bank fees from your checkbook balance.
4. Add to the bank statement balance any deposits that have not cleared.
5. Total the amount of checks that have not cleared. Subtract this total from the amount on your bank statement.

The sample checkbook register in Part B shows that you have a running total of $191.36 in your account. Balance this total against the bank statement in Part C.

A

Bernadette C. Dabney
12 Vico Lane
Haddonfield, NJ 08033

137

Date December 1 20 04

Pay to the order of Rental Agency $ 462.50

Four Hundred Sixty-Two and 50/100 Dollars

FIRST NATIONAL BANK OF CHICAGO

Memo

Bernadette C. Dabney

5:5555555: 555 555555:0137

B

Number	Date	Description	Payment of Debt	Fee	Deposit of Credit	Balance
						$ 827 91
132	10/25	Fashion Shop	$ 73 16		$	$ 754 75
133	11/1	Rent	462 50			292 25
134	11/7	Phone	83 00			209 25
135	11/14	Cash	50 00			159 25
136	11/15	J.W. Little	10 00			149 25
—	11/22	John's check			4 00	153 25
—	11/23	Paycheck			500 61	653 86
137	12/1	Rent	462 50			191 36

C

FIRST NATIONAL BANK OF CHICAGO

Bernadette C. Dabney
12 Vico Lane
Haddonfield, NJ 08033

123-456-7	Account Number
1 Dec. 2004	Statement Date

Summary of Accounts

Account Number	Previous Balance	Total Credits	Total Debits	Total Charges	Current Balance
123-456-7	827.91	504.61	674.66	3.00	660.86

Previous Balance	827.91	Current Balance	660.86

Debits	Credits	Balance
Nov. 4 132 73.16		754.75
8 133 462.50		292.25
15 134 83.00		209.25
135 50.00		159.25
	Nov. 22 4.00	163.25
	23 500.61	663.86
SC 3.00		660.86

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$2, $5, $10, $20, $50, and $100. (Larger notes used to be printed, but the practice was stopped to make it harder for criminals to hide large amounts of cash.)

The Treasury Department has also issued United States notes in several denominations. These bills have the words *United States Note* printed across the top and can be distinguished from Federal Reserve notes by a red Treasury seal. United States notes make up less than 1 percent of the paper money in circulation. Both Federal Reserve notes and United States notes are fiat money, or legal tender.

Careers

Bank Teller

Job Description

- Cash checks, accept deposits, and process withdrawals
- Sell savings bonds, process CDs and money market accounts, and sell traveler's checks

Qualifications

- High school education
- Must feel comfortable working with computers

Median Salary: $19,150

Job Outlook: Below average

—*Occupational Outlook Handbook,* 2002–03

Checks A **checking account** is money deposited in a bank that a person can withdraw at any time by writing a check. The bank must pay the amount of the check on demand, or when it is presented for payment. Such accounts used to be called *demand deposits.* Today we call these **checkable deposits,** and a variety of financial institutions offer them.

Commercial banks used to be the only financial institutions that could offer checkable deposits. Today all **thrift institutions**—mutual savings banks, savings and loan associations (S&Ls), and credit unions—offer checkable deposits. In addition, many brokerage houses offer the equivalent of checking accounts. Merrill Lynch and Fidelity Investments are two examples.

The largest part of the money supply in the United States consists of checkable accounts. **Figure 14.5** shows how to write a check and balance a checkbook.

checking account: *account in which deposited money can be withdrawn at any time by writing a check*

checkable deposits: *money deposited in a bank that can be withdrawn at any time by presenting a check*

thrift institutions: *mutual savings banks, S&Ls, and credit unions that offer many of the same services as commercial banks*

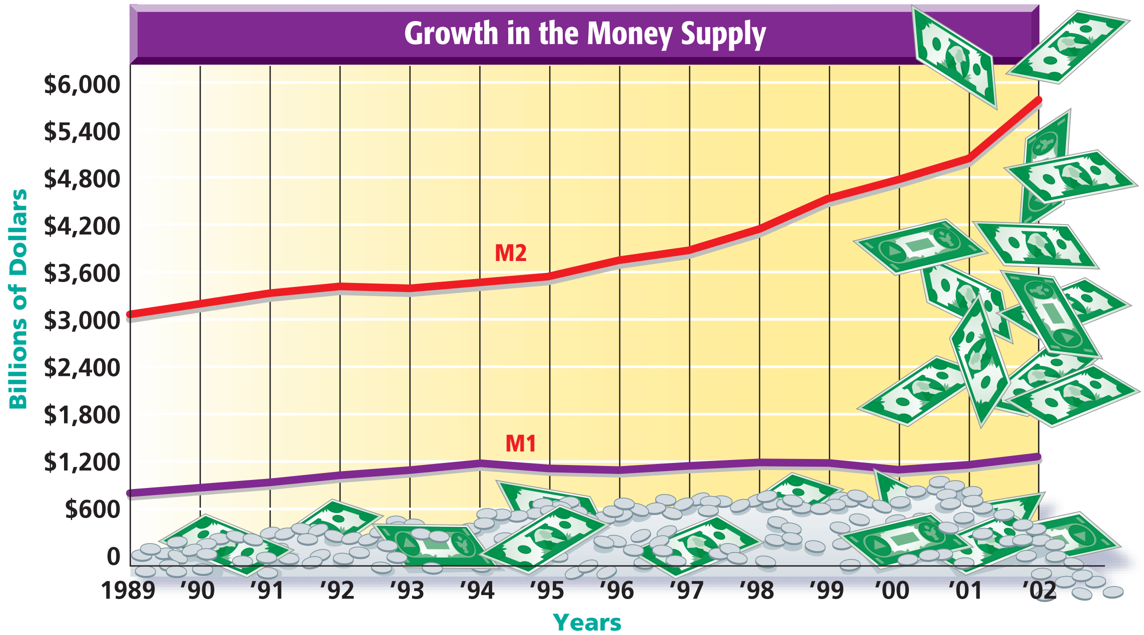
Credit Cards and Debit Cards Even though many people use their credit cards to purchase goods and services, the credit card itself is not money. It acts neither as a unit of accounting nor as a store of value. The use of your credit card is really a loan to you by the issuer of the card, whether it is a bank, retail store, gas company, or American Express. Basically, then, credit card "money" represents a future claim on funds that you will have later. Credit cards defer rather than complete transactions that ultimately involve the use of money.

A **debit card** automatically withdraws money from a checkable account. When you use your debit card to purchase something, you are in effect giving an instruction to your bank to

debit card: *device used to make cashless purchases; money is electronically withdrawn from the consumer's checkable account and transferred directly to the store's bank account*

FIGURE 14.6

M1 and M2 With the deregulation of banking services in the early 1980s, the definition of the money supply was enlarged to include the new types of accounts.



Source: Board of Governors of the Federal Reserve System

ECONOMICS Online

For an online update of this graph, visit ett.glencoe.com and click on ***Textbook Updates—Chapter 14.***

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transfer money directly from your bank account to the store's bank account. The use of a debit card does not create a loan. Debit card "money" is similar to checkable account money.

near moneys: *assets, such as savings accounts, that can be turned into money relatively easily and without the risk of loss of value*

Near Moneys

Numerous other assets are almost, but not exactly, like money. These assets are called **near moneys.** Their values are stated in terms of money, and they have high liquidity in comparison to other investments, such as stocks. Near moneys can be turned into currency or into a means of payment, such as a check, relatively easily and without the risk of loss of value. For example, if you have a bank savings account, you cannot write a check on it. You can, however, go to the bank and withdraw some or all of your funds. You can then redeposit these funds in your checking account or spend it all as cash.

Time deposits and savings account balances are near moneys. Both pay interest, and neither can be withdrawn by check. Time deposits require that a depositor notify the financial institution within a certain period of time, often 10 days, before withdrawing money. Savings accounts do not usually require such notification.

The Money Supply

How much money is there in the United States today? That question is not so easy to answer. First, the definition of *money supply* must be agreed upon. Currently, two basic definitions are used, although others exist. The first is called M1, and the second M2.

M1 includes all currency (bills and coins), all checkable deposits, and traveler's checks. **M2** includes everything in M1 plus savings deposits, time deposits, small-denomination certificates of deposit, money market deposit accounts, money market mutual fund balances, and other more specialized account balances. **Figure 14.6** shows the growth of M1 and M2 from 1989 to 2002.

M1: *narrowest definition of the money supply; consists of moneys that can be spent immediately and against which checks can be written*

M2: *broader definition of the money supply; includes all of M1, plus such near moneys as money market mutual fund balances, certificates of deposit, and Eurodollars*

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 3 Assessment

Understanding Key Terms

1. **Define** checking account, checkable deposits, thrift institutions, debit card, near moneys, M1, M2.

Reviewing Objectives

2. **Graphic Organizer** Create a chart like the one below to explain the difference between money and near moneys.

Money	Near Moneys	Differences

3. What does the M2 definition of money include?

Applying Economic Concepts

4. **Exchange, Money, and Interdependence** What various forms or types of money and near moneys do you use?

Critical Thinking Activity

5. **Summarizing Information** Use a search engine to find the Bureau of Engraving and Printing Web site. Find out how currency is printed and what security measures are taken to avoid counterfeiting. What steps would you suggest to minimize counterfeiting?

People & Perspectives

- Administrator of the United States Small Business Administration (SBA)
- Served as chairman of the board for the Latin Business Association and as a board member for the Minority Business Opportunity Committee in Los Angeles
- Founded his own company, Barreto Insurance and Financial Services, which specialized in providing financial services to California's Latino population

Hector Barreto

GOVERNMENT OFFICIAL (1961-)

In 2001 President George W. Bush appointed Hector Barreto as Administrator of the Small Business Administration (SBA). The SBA oversees the development and delivery of financial and business programs to aid small businesses. Barreto outlined some benefits of small businesses:

"*. . . Small business in the United States remains the swiftest and surest way of achieving the American Dream, regardless of your beginnings. [It] is the largest employer in the United States. [It] remains the most effective market laboratory for new ideas and innovations. Small business is the place where ideas are conceived, tested, and proved. Small business tax revenues are the backbone of our local, state, and national governments, and the reason our nation can do so much for so many.*"

Barreto shares the impact of small business on his life:

"*. . . I have always lived the benefit of small business on a personal level. It has empowered my family to achieve the American Dream. Through my national small business relationships, I have come to appreciate the power and importance of small business on a national and international level.*"

Barreto believes the SBA will evolve to meet the needs of U.S. small businesses:

"*. . . Through my small business ownership and relationships, I have [spoken] with many entrepreneurs. I have gained some insight into the special challenges and barriers to entry that negatively impact today's entrepreneurs.... [S]uccessful small business requires a sound business plan, relationships, and opportunity.... A successful Agency empowers small business to achieve its goals.*"

Checking for Understanding

1. **According to Barreto, what are some of the benefits of small businesses?**
2. **How does Barreto plan to help small businesses achieve their goals?**

CHAPTER 14 Summary

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Chapter Overview Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 14—Chapter Overviews*** to review chapter information.

SECTION 1 The Functions and Characteristics of Money

- **Money** has three functions. It can be used as a **medium of exchange,** a **unit of accounting,** and a **store of value.**
- Anything serving as money must be durable, portable, divisible, stable in value, scarce, and accepted as a medium of exchange in payment for debts.
- Money that has an alternative use as a commodity—cattle, gems, and tobacco, for example—is considered **commodity money.**
- Money that is backed by—or can be exchanged for—gold or silver is known as **representative money.**
- Today all United States money is **fiat money,** or **legal tender.**

SECTION 2 History of American Money and Banking

- Throughout American history, people have used commodity money, European coins, privately printed banknotes, and many other forms of notes.
- To control the amount of money in circulation, Congress established the Federal Reserve System in 1913. It serves as the nation's central bank. In 1914 the system began issuing paper money called Federal Reserve notes, which soon became the major form of currency.
- The Constitution of the United States gave Congress the power to mint coins. It was not until the Civil War that the government set up a safe, uniform currency.
- In 1934 the nation switched from a gold standard to a fiat money standard.
- **Electronic funds transfer** has revolutionized the banking industry, with customers using **automated teller machines** and even the Internet to do their banking.

SECTION 3 Types of Money in the United States

- Money today consists of more than just currency. It also includes deposits in **checking accounts** as well as **debit cards** and **near moneys.**
- Economists measure the amount of money in the economy by adding up **M1**—currency, all **checkable deposits,** and traveler's checks. Then they calculate **M2**—all the items in M1 plus savings deposits, time deposits, small-denomination certificates of deposit, and other account balances.

CHAPTER 14

Assessment and Activities

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Self-Check Quiz Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 14—Self-Check Quizzes*** to prepare for the Chapter Test.

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Identifying Key Terms

Write the letter of the definition in Column B that correctly defines each term in Column A.

Column A

1. fiat money
2. checkable deposits
3. M1
4. commodity money
5. near moneys
6. legal tender
7. electronic funds transfer

Column B

a. money that by law must be accepted for payment of debts
b. currency in circulation, traveler's checks, plus checking-type deposits
c. money in a bank that can be withdrawn at any time
d. money that has value because the government has established it as acceptable payment for debts
e. computerized banking functions that previously were handled on paper
f. assets that can be turned into money fairly easily
g. money that has value aside from its value as money

Recalling Facts and Ideas

Section 1

1. What is the alternative to using money?
2. Money should be durable and divisible. What other characteristics should money have?
3. Is the type of money used in the United States commodity money, representative money, or fiat money?

Section 2

4. What type of system did the early colonists use when they bought and sold goods and services?
5. When was the most serious banking panic of the twentieth century?
6. Electronic banking is increasingly common today. What form of this system do most consumers use?

Section 3

7. What are the only denominations of paper currency being issued today by the federal government?
8. Why were checking accounts formerly called demand deposits?
9. What is the distinction between money and near moneys?
10. Why is M1 considered a narrower definition of the money supply than M2?

Thinking Critically

1. **Making Comparisons** Create a diagram like the one below to compare the costs and benefits of engaging in barter to the costs and benefits of using money.

	Costs	Benefits
Barter		
Money		

2. **Making Generalizations** Why are debit cards similar to money, whereas credit cards are not?

Applying Economic Concepts

The Functions of Money The three functions of money are as a medium of exchange, a unit of accounting, and a store of value. Keep track of any time you use money, see money used, or see dollar values written out somewhere. Try to determine in each instance what function the money is serving. For example, if you see a headline that says "Microsoft Corporation Sales Increased to $10 Billion," you know that money is being used as a unit of accounting.

Cooperative Learning Project

During the 1930s, the United States underwent a tragic economic depression. Work in groups to research the following aspects of daily life.

- What happened to incomes and prices?
- What happened to savings accounts?
- What happened to the availability of jobs?

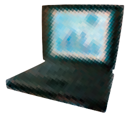
Each member of each group should research one question. Summarize the group's notes to develop a lecture that describes what actually happened during the Great Depression.

Reviewing Skills

Synthesizing Information Imagine that the country is returning to privately issued banknotes. Design the currency you would like to see in circulation.

Use information from the Bureau of Engraving and Printing's Web site to gather data about the exact measurements of existing currency. Then make a list of items, ideas, people, and so on that are important to you. Utilize your list to help create your currency. Share your design with the rest of the class.

Technology Activity



Using a Database Analyze the currency in your possession. List the features that appear on the front and back of each bill or coin, noting the similarities and differences between the various currencies.

Create a database that could be accessed by foreign visitors to describe the specific features and purposes of each bill and coin. Create fields such as portrait, paper/coin, value, Federal Reserve Bank, watermarks, colors, etc.

Analyzing the Global Economy

Analyze several foreign coins and paper currencies. Use a magnifying glass if necessary. Make a chart listing the following items noted on each currency: Country of Origin, Monetary Unit, Year of Origin, Watermarks, Identity of People Pictured, Symbols, Natural Features, Buildings or Animals Shown, Other. Compare the foreign currency to United States currency, and share your chart with the rest of the class.

Global Economy

A Brief History of Money

Over the centuries such items as cattle, salt, large stones, seashells, metals, beads, tea, coffee, tobacco, fishhooks, and furs have served as money. Some of the more important developments in the history of money are described here.

Two Bits

Do you know why people sometimes call a quarter "two bits"? The origin of this term dates back to colonial times. The American colonists used Spanish silver dollar coins called pieces of eight. Each coin was divided into eight pieces—or bits—so that it could be broken to make change. Four bits was equal to half a dollar, while two bits equaled a quarter.

Rings and Ingots

Perhaps as early as 2500 B.C. the people of ancient Egypt and Mesopotamia—the land between the Tigris and Euphrates Rivers—were using gold and silver as money. The money took the form of rings, small ornaments, and ingots, or bars.

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The First Coins

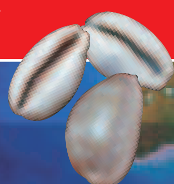
The Lydians, who lived in what is now western Turkey, probably made the first coins during the 600s B.C. These coins were made of electrum, a mix of gold and silver, and were stamped with pictures of gods or emperors. The Greeks, Persians, and Romans adopted Lydian coining techniques and, in time, the use of coins spread throughout much of Western Europe.

The First Paper Banknotes

The Chinese may have begun to make coins around the same time as the Lydians. These coins were made of bronze and often had holes in them so that they could be carried on a string. The Chinese also began using paper banknotes—printed on paper made from mulberry bark—in the A.D. 800s.

Cowrie Shells

Cowrie shells have been used as money throughout Asia, Africa, and Oceania. The cowrie was still in use in some African countries as recently as the mid-1900s. The name for Ghana's monetary unit, the cedi, comes from the Ghanaian word meaning "cowrie shell."



Thinking Globally

1. Where did the use of coins develop?
2. What developments in the history of money took place in China?
3. How is the history of money in Africa reflected in the currency of Ghana?

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