

CHAPTER

10

Money and Banking

SECTION 1

Money: Its Functions and Properties

SECTION 2

The Development of U.S. Banking

SECTION 3

Innovations in Modern Banking

CASE STUDY

Student Loans

CONCEPT REVIEW

Macroeconomics is the study of the behavior of the economy as a whole and how major economic sectors, such as industry and government, interact.

CHAPTER 10 KEY CONCEPT

Money provides a low-cost method of trading one good or service for another. It makes the system of voluntary exchange efficient.

WHY THE CONCEPT MATTERS

What were the last three economic transactions you completed using money? Perhaps you put four quarters in the fare machine on the bus to school or bought a slice of pizza and a drink in the cafeteria at lunch. Or maybe you caught an early movie after school yesterday. To gauge the importance of money to the economy, imagine trying to make such transactions without the familiar paper bills and coins.

Online Highlights

More at ClassZone.com

Economics Update

Go to **ECONOMICS UPDATE** for chapter updates and current news on student loans. (See Case Study, pp. 312–313.) ▶

Animated Economics

Go to **ANIMATED ECONOMICS** for interactive lessons on the graphs and tables in this chapter.

Interactive Review

Go to **INTERACTIVE REVIEW** for concept review and activities.



How important are student loans in the U.S. higher education system? See the Case Study on pages 312–313.

Money: Its Functions and Properties

OBJECTIVES

- In Section 1, you will
- outline the functions that money performs and the characteristics that money possesses
 - explain why the different types of money have value
 - describe how the money supply in the United States is measured

KEY TERMS

money, p. 288
 medium of exchange, p. 288
 barter, p. 288
 standard of value, p. 289
 store of value, p. 289
 commodity money, p. 291
 representative money, p. 291
 fiat money, p. 291
 currency, p. 293
 demand deposits, p. 293
 near money, p. 293

TAKING NOTES

As you read Section 1, complete a cluster diagram summarizing key information about money. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**



Functions of Money

KEY CONCEPTS

What do the following things have in common: cattle, corn, rice, salt, copper, gold, silver, seashells, stones, and whale teeth? At different times and in different places, they have all been used as money. In fact, **money** is anything that people will accept as payment for goods and services. Whatever it is that people choose to use as money, it should perform three important functions.

FUNCTION 1 Medium of Exchange

Money must serve as a **medium of exchange**, or the means through which goods and services can be exchanged. Without money, economic transactions must be made through **barter**—exchanging goods and services for other goods and services. Barter is cumbersome and inefficient because two people who want to barter must at the same time want what the other has to offer. For example, suppose you want to trade two T-shirts for a pair of jeans. One classmate might have the jeans but not want your shirts; another might want your shirts but not have jeans to trade. It is much easier for you to buy a pair of jeans by giving money to the seller who, in turn, can use it to buy something else. Money allows for the precise and flexible pricing of goods and services, making any economic transaction convenient.

A World of Money Currencies come in a wide variety of colors and sizes. This is a collage of the currencies of South America.

QUICK REFERENCE

Money is anything that people will accept in exchange for goods and services.

A **medium of exchange** is a means through which goods and services can be exchanged.

Barter is the exchange of goods and services without using money.



FUNCTION 2 Standard of Value

Money also serves as a **standard of value**, the yardstick of economic worth in the exchange process. It allows people to measure the relative costs of goods and services. A \$20 T-shirt is worth two \$10 phone cards, four \$5 burritos, or twenty \$1 bus rides. The basic monetary unit in the United States is the dollar, which serves as the standard by which the economic worth of all goods and services can be expressed and measured.

FUNCTION 3 Store of Value

Finally, money acts as a **store of value**, that is, something that holds its value over time. People, therefore, do not need to spend all their money at once or in one place; they can put it aside for later use. They know that it will be accepted wherever and whenever it is presented to purchase goods and services.

One situation where money does not function well as a store of value is when the economy experiences significant inflation—a sustained rise in the general level of prices. For example, in Argentina in the first half of 2002, prices rose by about 70 percent. Basic goods that cost 150 pesos in January cost 255 pesos in June. In other words, in that time period, Argentina's money lost over two-thirds of its purchasing power. You'll learn more about inflation in Chapter 13.

QUICK REFERENCE

A **standard of value** determines the economic worth in the exchange process.

A **store of value** is something that holds its value over time.

Economics Update

Find an update on the functions of money at ClassZone.com

ECONOMICS ESSENTIALS

FIGURE 10.1 Functions of Money



ANALYZE CHARTS

You've read that salt was used as money in the past. How effectively do you think salt would function as money? Use the three functions of money in the chart to frame your answer.

APPLICATION Applying Economic Concepts

A. How does money help to make clear the opportunity cost of an economic decision?

Properties of Money

KEY CONCEPTS

To perform the three functions of money, an item must possess certain physical and economic properties. Physical properties of money are the characteristics of the item itself. Economic properties are linked to the role that money plays in the market.

PROPERTY 1 Physical

The following are physical properties of useful money:

Durability Money should be durable, or sturdy, enough to last throughout many transactions. Something that falls apart when several people handle it or that spoils easily would not be a good item to use as money.

Portability Money needs to be small, light, and easy to carry. It's easy to see why paper bills are preferable to cattle as money.

Divisibility Money should also be divisible so that change can be made. For example, the dollar can be divided an endless number of ways using different combinations of pennies, nickels, dimes, or quarters. Divisibility also allows flexible pricing.

Uniformity Lastly, money must be uniform, having features and markings that make it recognizable. Coins that are used as money look different from other flat metal disks. Paper money is a consistent size and uses special symbols and printing techniques. All money that represents a certain amount in a given country has distinctive characteristics that help identify its value. These distinctive markings also make it more difficult to counterfeit.



Chinese Coins
Bronze, spade-shaped coins,
8th–7th century B.C.

PROPERTY 2 Economic

Useful money must also have the following economic properties:

Stability of Value Money's purchasing power, or value, should be relatively stable. In other words, the amount of goods and services that you can buy with a certain amount of money should not change quickly. Rapid changes in purchasing power would mean that money would not successfully serve as a store of value.

Scarcity Money must be scarce to have any value. As you recall from Chapter 7, when the supply of a product outstrips demand, there is a surplus and prices for that product fall. Similarly, when the supply of money outstrips demand, money loses value, or purchasing power.

Acceptability People who use the money must agree that it is acceptable—that it is a valid medium of exchange. In other words, they will accept money in payment for goods and services because others will also accept it as payment.

APPLICATION Applying Economic Concepts

B. Describe how U.S. dollars serve each of the three functions of money.

Types of Money

KEY CONCEPTS

In the discussion of the functions and properties of money, one theme recurs—value. Money draws its value from three possible sources. **Commodity money** derives its value from the type of material from which it is composed. **Representative money** is paper money backed by something tangible—such as silver or gold—that gives it value. **Fiat money** has no tangible backing, but it is declared by the government that issues it, and accepted by citizens who use it, to have worth.

TYPE 1 Commodity Money

Commodity money is something that has value for what it is. Items used as commodity money have value in and of themselves, apart from their value as money. Over the course of history, for example, gold, silver, precious stones, salt, olive oil, and rice have all been valued enough for their scarcity or for their usefulness to be used as money.

However, the most common form of commodity money throughout history has been coins made from precious metals. Such coins contain enough of the precious metal that if each was melted down it would be worth at least its face value. One problem with commodity money is that if the item becomes too valuable, people will hoard it rather than circulate it, hoping it will become more valuable in the future. Commodity money is rarely used today.



Commodity Money Until recently, cattle was an important medium of exchange for the Masai people of East Africa.

TYPE 2 Representative Money

Representative money is paper money that can be exchanged for something else of value. The earliest forms of representative money were seen in the Middle Ages, when merchants, goldsmiths, and moneylenders began issuing receipts that promised to pay a certain amount of gold or silver. This came about because it was not always convenient or safe to transport large quantities of those precious metals from place to place for the purpose of trading. These practices signal the beginning of the widespread modern use of paper money.

Eventually, governments got involved with representative money by regulating how much metal needed to be stored to back up the paper money. One problem with representative money is that its value fluctuates with the supply and price of gold or silver, which can cause problems of inflation or deflation—a sustained rise or fall, respectively, in the general level of prices.

QUICK REFERENCE

Commodity money has intrinsic value based on the material from which it is made.

Representative money is backed by something tangible.

Fiat money is declared by the government and accepted by citizens to have worth.

A GLOBAL PERSPECTIVE


The Euro as a Common Currency

On January 1, 2002, a new currency—the euro—was put into full use in 12 European countries, each a member of the European Union (EU). The symbol for the euro is €. Each country that adopted the euro gave up its own national currency.

The EU seeks the economic and political integration of Europe, and the euro is a key step toward this goal. The common currency makes trade among member nations easier and cheaper. As the EU expands, new members must meet specific economic standards before they can adopt the euro. Several small European countries that are not members of the EU have also begun using the euro.

Like all modern currencies, the euro is categorized as fiat money. Its value is derived from public confidence in the EU. Control of the supply of euros is maintained by the European Central Bank, located in Frankfurt, Germany. Each member nation of the EU has a seat on the Central Bank's decision-making board.

EU Members That Adopted the Euro in 2002

	Austria
	Belgium
	Finland
	France
	Germany
	Greece
	Ireland
	Italy
	Luxembourg
	Netherlands
	Portugal
	Spain

CONNECTING ACROSS THE GLOBE

- 1. Making Inferences** How do you think having a common currency might benefit the EU?
- 2. Recognizing Effects** Why does the euro have value as currency?

TYPE 3 Fiat Money

Unlike representative money, fiat money has value only because the government has issued a fiat, or order, saying that this is the case. The value of the U.S. dollar was linked to the value of gold until 1971. Since then, a \$10 bill can no longer be exchanged for gold; it can only be converted into other combinations of U.S. currency that also equal \$10.

In fiat money, coins contain only a token amount of precious metal that is worth far less than the face value of those coins. Paper money has no intrinsic value, and people cannot exchange it for a certain amount of gold or silver. Fiat money has value because the government says it can be used as money and because people accept that it will fulfill all the functions of money.

Dollar bills in the United States carry the statement “This note is legal tender for all debts, public and private.” This statement assures people that sellers will accept such money from buyers as payment for goods or services and lenders will accept it as payment for debts. A crucial role of the government in maintaining the value of fiat money is controlling its supply—in other words, maintaining its scarcity.

APPLICATION Analyzing Cause and Effect

- C. Which type of money's value would be most affected by political instability? Why?

Money in the United States

KEY CONCEPTS

In this section so far, you have learned what has been used as money, what functions money performs, what properties it possesses, and why money has value. But what serves as money in the United States today? In its narrowest sense, money consists of what can be used immediately for transactions—currency, demand deposits, and other checkable deposits. **Currency** is paper money and coins. Checking accounts are called **demand deposits** because funds in checking accounts can be converted into currency “on demand.”

There are other monetary instruments that are almost, but not exactly, like money. Known as **near money**, it includes savings accounts and other similar time deposits that cannot be used as a medium of exchange but can be converted into cash relatively easily.

QUICK REFERENCE

Currency is paper money and coins.

Demand deposits are checking accounts.

Near money is savings accounts and time deposits that can be converted into cash relatively easily.

Money in the Narrowest Sense

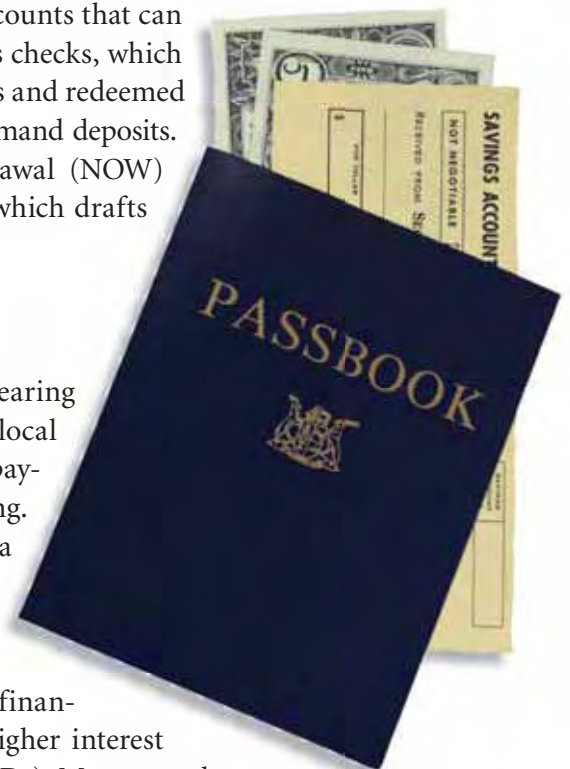
In the narrowest sense, money is what can be immediately used for transactions. This definition of money sometimes uses the term *transactions money*. Most of the money that you and your friends and family spend is transactions money. About half of such money is currency, both paper money and coins, that is used by individuals and businesses.

Most demand deposits are noninterest-bearing checking accounts that can be converted into currency simply by writing a check. Traveler’s checks, which are drafts that can be purchased in a number of money amounts and redeemed in many parts of the world, represent a small share of overall demand deposits. Other checkable deposits include negotiable order of withdrawal (NOW) accounts, which are interest-bearing savings accounts against which drafts may be written.

Are Savings Accounts Money?

Near money, such as savings accounts and other interest-bearing accounts, cannot be used directly to make transactions. Your local sporting goods store will not accept a savings passbook as payment for a new basketball or for your tennis racket to be restrung. But money in a savings account can be easily transferred into a checking account or removed directly from an automatic teller machine and put toward a desired good or service.

Near money takes many forms in addition to traditional savings accounts. Time deposits are funds that people place in a financial institution for a specific period of time in return for a higher interest rate. These deposits are often placed in certificates of deposit (CDs). Money market accounts place restrictions on the number of transactions you can make in a month and require you to maintain a certain balance in the account (as low as \$500 but often substantially more) in order to receive a higher rate of interest.



Near Money A savings account contains money but is not, strictly, money.

How Much Money?

How much money is in supply in the United States? Economists use various instruments to measure the money supply, but the most often cited are M1 and M2. M1 is the narrowest measure of the money supply, consisting of currency, demand deposits, and other checkable deposits. It is synonymous with transactions money. The elements of M1 are referred to as liquid assets, which means that they are or can easily become currency.

M2 is a broader measure of the money supply, consisting of M1 plus various kinds of near money. M2 includes savings accounts, other small-denomination time deposits (CDs of less than \$100,000), and money market mutual funds. You will learn about these financial instruments in Chapter 11.

Figure 10.2 shows the amounts of the different forms of money that make up M1 and M2. You can see that M1 is almost evenly split between currency and checkable deposits. Notice that more of M2 comes from savings than from M1. You will learn the importance of the money supply in the economy and how the government manages it in Chapter 16.

Economics Update

Find an update on measures of the money supply at ClassZone.com

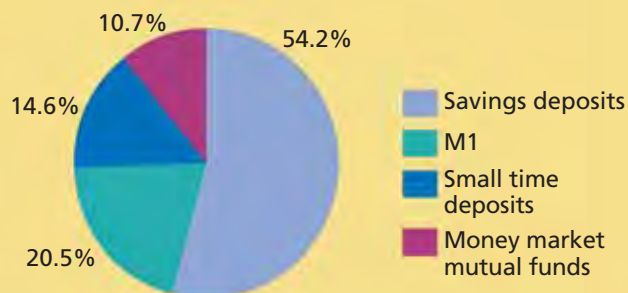
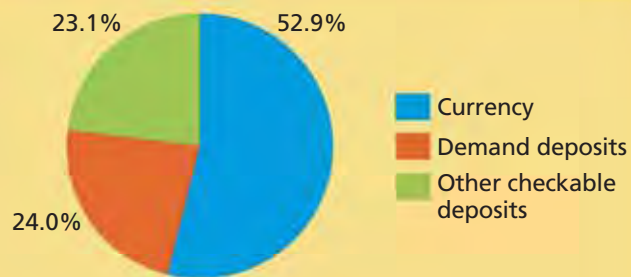
FIGURE 10.2 COMPONENTS OF THE U.S. MONEY SUPPLY

M1 (in billions of dollars)	
Currency	723.8
Demand deposits*	328.2
Other checkable deposits	316.9
TOTAL	1,368.9

* includes traveler's checks

M2 (in billions of dollars)	
Savings deposits**	3,620.5
M1	1,368.9
Small time deposits	973.7
Money market mutual funds	717.4
TOTAL	6,680.5

**includes money market accounts



Source: U.S. Federal Reserve Board (data from 2005)

ANALYZE TABLES

1. What amount of M2 does not come from currency and checkable deposits?
2. If currency is 52.9 percent of M1, and M1 is 20.5 percent of M2, what percentage of M2 is currency?

APPLICATION Applying Economic Concepts

- D. Classify each of the following as M1 and M2: **a.** dollar bill; **b.** savings account; **c.** money market account; **d.** traveler's check; **e.** \$50,000 CD.

SECTION 1 Assessment

REVIEWING KEY CONCEPTS

- Explain the difference between the terms in each of these pairs.
 - standard of value* *commodity money* *demand deposits*
 - store of value* *representative money* *near money*
- Why are economic transactions easier with money than with barter?
- Why is it important that money be divisible?
- Why are checking accounts called demand deposits?
- What aspect of fiat money allows it to have more stability than representative money?

6. Using Your Notes How are the economic properties of money related to its functions? Refer to your completed cluster diagram.



Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

CRITICAL THINKING

- 7. Categorizing Economic Information** Which of these forms of money are included in M1:
 - checking accounts
 - coins
 - money market accounts
 - paper money
 - savings accounts
 - time deposits
 - traveler's checks
 - NOW accounts
- 8. Making Inferences** The U.S. government has tried to get people to use dollar coins rather than dollar bills. Most consumers prefer to use dollar bills. Which physical properties of money are involved in these different preferences?
- 9. Applying Economic Concepts** Maria's parents told her that for the ten years prior to her high school graduation, they saved \$200 per month for her college education—\$24,000 (plus interest). Which function of money does this example best illustrate? Why?
- 10. Challenge** Why is there more near money than transactions money in the U.S. money supply?

ECONOMICS IN PRACTICE



Evaluating Economic Decisions

In the past, indigenous people of Central and South America used cacao beans (the source of chocolate) as currency.

Evaluate Money In Section 1, you learned that money should function as a medium of exchange, a standard of value, and a store of value. Use what you've learned about these functions to evaluate how useful cacao beans might be as money today. Show your answer by filling in the table below.

Function	Possible Problems
Medium of exchange	
Standard of value	
Store of value	

Challenge How well do cacao beans exhibit each of the physical and economic properties of money?

The Development of U.S. Banking

OBJECTIVES

- In Section 2, you will
- describe how banking developed in the United States
 - identify the banking institutions that operate in the United States

KEY TERMS

- state bank, p. 296
national bank, p. 299
gold standard, p. 299

TAKING NOTES

As you read Section 2, complete a chart using the key concepts and other helpful words and phrases. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

Development of U.S. Banking		
Origins	19th Century	20th Century

The Origins of Banking

KEY CONCEPTS

Modern banking arose in Italy in the late Middle Ages. Italian merchants stored money or valuables for wealthy people and issued receipts that promised to return the property on demand. They realized that they did not have to hold all the deposits, since all depositors did not reclaim their property at the same time, but could lend some of the deposits and earn interest on those loans. This was the beginning of fractional reserve banking (see Section 3), the practice of holding only a fraction of the money deposited in a bank and lending the rest.

In colonial America, many merchants followed the same practice. However, these banks were far from secure. If a merchant's business failed, depositors lost all of their savings. After the Revolutionary War, many **state banks**—banks chartered, or licensed, by state governments—were established. Some of these banks, however, followed practices that tended to create instability and disorder. Many issued their own currency that was not linked to reserves of gold or silver held by the bank.



Early “Bankers” The Italian word *banco*, means “bench.” From benches in the street, Italian merchants used some practices that are part of banking today.

QUICK REFERENCE

A **state bank** is a bank chartered by a state government.

Alexander Hamilton: Shaping a Banking System

Imagine what it would be like if every bank issued its own currency. How would buyers know if sellers would accept their money? How would sellers know if the money they received was worth anything? That was the confusing situation that Alexander Hamilton faced when he became Secretary of the Treasury in 1789. He immediately set to work to bring stability to U. S. banking.

The First Bank of the United States

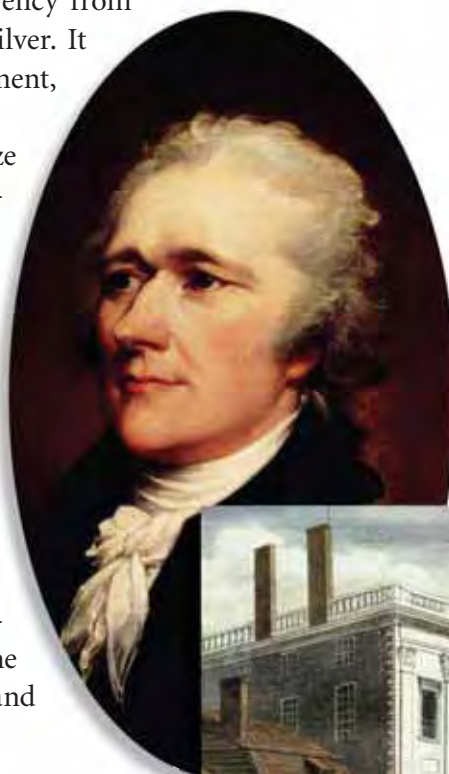
Hamilton was a leading Federalist who believed in a strong central government. He proposed chartering a privately owned national bank to put the government on a sound financial footing. This bank would issue a national currency and help control the money supply by refusing to accept currency from state banks that was not backed by gold or silver. It also would lend money to the federal government, state banks, and businesses.

The Constitution did not specifically authorize Congress to charter a national bank. The Anti-federalists, led by Thomas Jefferson and James Madison, interpreted the Constitution strictly and feared putting too much power in the hands of the central government. Hamilton argued that the Constitution implied that the federal government had the authority to create a national bank to carry out its duty to regulate the currency.

Hamilton won the fight, and the First Bank of the United States was chartered in 1791. Over time, it achieved the financial goals that Hamilton had set. However, opponents argued that the bank's policies restrained economic growth, and Congress refused to renew the charter in 1811.

The fact that Hamilton was the architect of the bank was always a strike against it, as he had made many enemies during his career. (One, Aaron Burr, killed him in a duel.)

Maybe Hamilton was right when he said, "Men often oppose a thing merely because they have had no agency in planning it, or because it may have been planned by those whom they dislike."



Alexander Hamilton (above) and the First Bank of the United States (right)



FAST FACTS

Alexander Hamilton

Position: First Secretary of the Treasury (1789–1795)

Born: January 11, 1755 in Nevis, British West Indies

Died: July 12, 1804

Writings: *The Federalist Papers* (1787), with James Madison and John Jay; *Report on a National Bank* (1790)

Major Accomplishment: Strengthened the national government and established the First Bank of the United States

Hamilton's Visible Legacy: Portrait on the \$10 bill

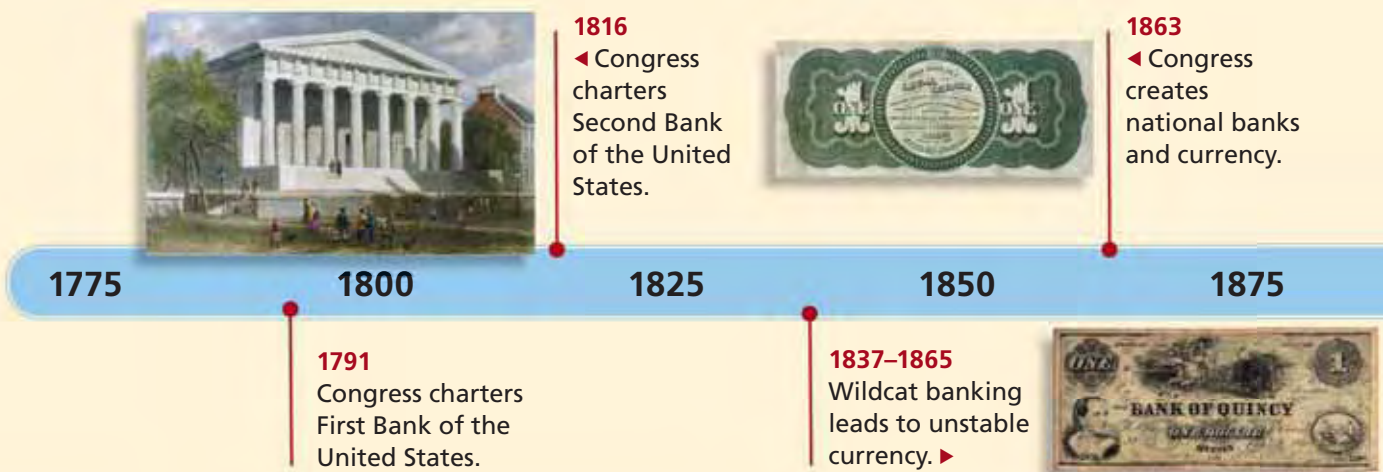
APPLICATION Making Inferences

A. How did the First National Bank force state banks to become more stable?



Learn more about Alexander Hamilton at ClassZone.com

FIGURE 10.3 Major Developments in American Banking



19th-Century Developments

KEY CONCEPTS

Without a central bank, the government had difficulty financing the War of 1812 against Britain. Furthermore, state banks soon returned to the unrestrained issuing of currency that was not linked to reserves of gold or silver held by the banks. The resulting increase in the money supply led to inflation during the war.

The Second Bank of the United States

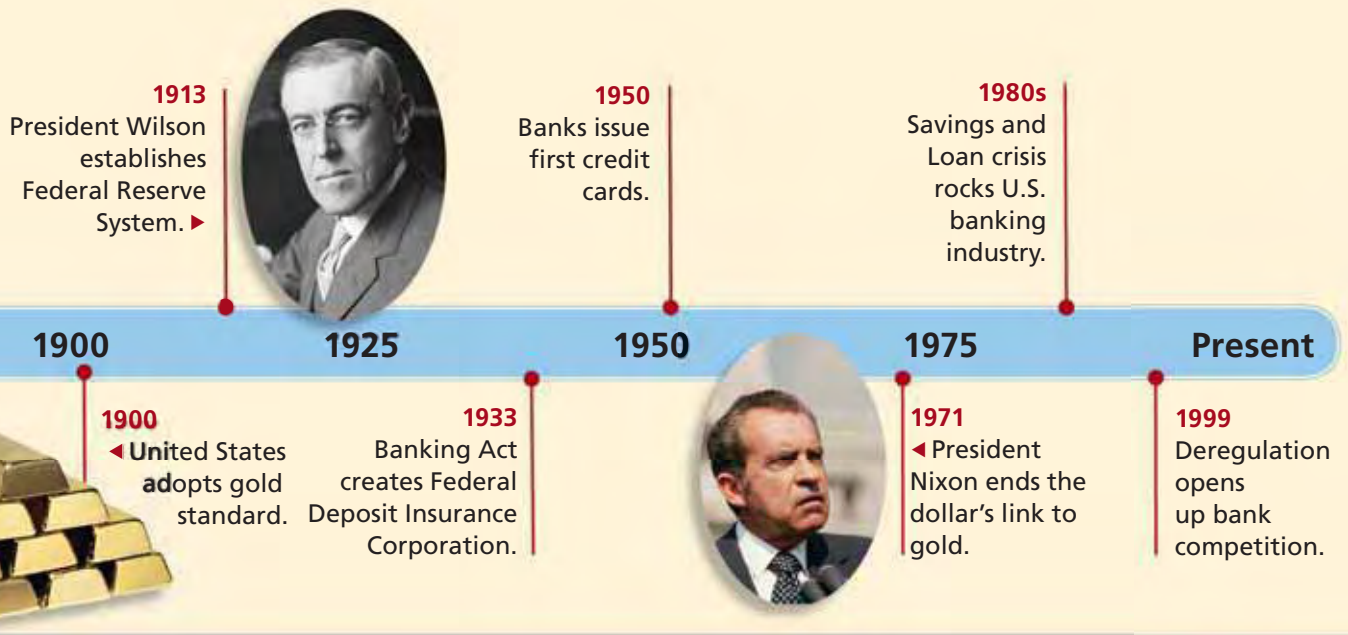
Congress finally agreed to charter the Second Bank of the United States in 1816. The new bank had greater financial resources than the First Bank and succeeded in making the money supply more stable. Opponents continued to see the central bank as too powerful and too closely aligned with the wealthy. President Andrew Jackson was an outspoken critic who mistrusted banks and paper money. He vetoed the renewal of its charter in 1832.

Wildcat Banking

After the Second Bank's charter lapsed in 1836, there was no federal oversight of the banking industry. During this period, all banks were state banks, each of which issued its own paper currency, called bank notes. States passed free banking laws that allowed individuals or groups that met its requirements to open banks.



Jackson and the Second Bank This 1828 cartoon lampoons Jackson's battle against the bank.



Some of these banks were located in remote areas to discourage people from redeeming their bank notes, which were often worth less outside the region where they had been issued. It was this practice, along with the questionable quality of many bank notes that resulted in the term *wildcat bank*. In addition, such banks were susceptible to bank runs when depositors demanded gold or silver for their currency. Since the banks often did not have sufficient reserves of these precious metals, financial panics and economic instability were common results.

The Struggle for Stability

During the Civil War, it was particularly difficult for the government to finance its operations without a national currency and a federal bank. The government's first solution to this problem was to issue a new currency backed by government bonds. These U.S. bank notes, called greenbacks, were printed with green ink.

In 1863, Congress passed the National Banking Act, which led to the creation of a system of **national banks**, banks chartered by the national government. The act provided for a national currency backed by U.S. Treasury bonds and regulated the minimum amount of capital required for national banks as well as the amount of reserves necessary to back the currency. Congress taxed state bank notes issued after 1865, effectively eliminating these notes from circulation.

In 1900, the government officially adopted the **gold standard**, a system in which the basic monetary unit—for example, one dollar—is equal to a set amount of gold. The national currency and gold standard helped to bring some stability to the banking system. Money was now uniform throughout the country, backed by something of intrinsic value, and limited by the supply of gold.

QUICK REFERENCE

National banks are banks chartered by the national government.

The **gold standard** is a system that backs the basic monetary unit with a set amount of gold.

APPLICATION Analyzing Effects

- B. How did the National Banking Act of 1863 attempt to eliminate the problems caused by wildcat banking?

20th-Century Developments

KEY CONCEPTS

The system of national banks and a national currency linked to the gold standard initially brought stability to U.S. banking. Yet the economy still experienced periods of inflation and recession and financial panics. This economic instability was largely due to the lack of a central decision-making institution that could manage the money supply in a flexible way to meet the economy's changing needs.

A New Central Bank

In 1913, Congress passed the Federal Reserve Act, which established the Federal Reserve System (commonly known as the Fed)—a true central bank. It consists of 12 regional banks with a central decision-making board. The Fed provides financial services to the federal government, makes loans to banks that serve the public, issues Federal Reserve notes as the national currency, and regulates the money supply to ensure that money retains its purchasing power. You'll learn more about the structure and functions of the Federal Reserve in Chapter 16.

The Great Depression and the New Deal

At the start of the Great Depression in 1929, many banks failed due to bank runs, as consumers panicked and withdrew all of their money. When the banks failed, many more depositors lost their money. Part of President Franklin Roosevelt's New Deal program was the Banking Act of 1933, which instituted reforms such as regulating interest rates that banks could pay and prohibiting banks from selling stocks. The Federal Deposit Insurance Corporation (FDIC) provided federal insurance so that if a bank failed, people would no longer lose their money. This legislation set the tone for almost 50 years by increasing the regulation of banking in the United States.

Deregulation and the S&L Crisis

In 1980 and 1982, Congress passed laws that lifted government limits on savings interest rates. This allowed savings and loans associations (S&Ls) to operate much like commercial banks. Deregulation encouraged the S&Ls to take more risks in the types of loans they made. As a result, many S&Ls failed and lost their depositors' money. Congress agreed to fund the S&L industry's restructuring in order to protect consumers, which cost taxpayers hundreds of billions of dollars.



The S&L Crisis Depositors camp out to withdraw their money in May 1985.

APPLICATION Comparing and Contrasting

C. How are the First Bank of the United States and the Federal Reserve different?

Financial Institutions in the United States

KEY CONCEPTS

The term *bank* is used to refer to almost any kind of financial institution that takes in deposits and makes loans, helping individuals, businesses, and governments to manage their money. In the end, though, the goal of a bank is to earn a profit.

All financial institutions receive a charter from the government, either state or federal. Government regulations set the amount of money the owners of a bank must invest in it, the size of the reserves a bank must hold, and the ways that loans may be made. The term may refer to commercial banks, savings and loan associations, or credit unions.

In the past, these institutions provided very different and distinct services. Today, however, because of the deregulation of banking, these distinctions are much less apparent. The distinctive characteristics of each type of financial institution are described in more detail below. Figure 10.4 on page 302 compares the three types of banks based on numbers of institutions and total assets.

TYPE 1 Commercial Banks

Privately owned commercial banks are the oldest form of banking and are the financial institutions most commonly thought of as banks. As their name implies, commercial banks were initially established to provide loans to businesses. Now they provide a wide range of services, including checking and savings accounts, loans, investment assistance, and credit cards to both businesses and individual consumers. You will learn more about these services in Section 3.

In 2003, there were about 2,000 national commercial banks and about 5,800 state-chartered banks insured by the FDIC. All national commercial banks belong to the Federal Reserve System, but only about 16 percent of state-chartered banks choose to join the Fed. About 1,500 of these commercial banks are large ones with assets of \$300 million dollars or more. In 2005, the seven largest banks in the United States held 50 percent of the total assets controlled by all these large banks.

TYPE 2 Savings Institutions

Savings and loan associations (S&Ls) began in the United States in the 1830s. They were originally chartered by individual states as mutual societies for two purposes—to take savings deposits and provide home mortgage loans. In other words, groups of people pooled their savings in a safe place to earn interest and have a source of financing for families who wanted to buy homes.

The S&Ls continue to fulfill these purposes, but they now also offer many of the services provided by commercial banks. Since 1933, the federal government may also charter S&Ls, and since 1982, many federally chartered S&Ls have chosen to call themselves savings banks. Many savings institutions are now financed through the sale of stock, just as commercial banks are.

Economics Update

Find an update on U.S. financial institutions at ClassZone.com

In 2003, there were about 800 federally chartered savings institutions and 600 state-chartered institutions. These institutions are now insured under a specific fund of the FDIC as part of the reforms that followed the S&L crisis of the 1980s.

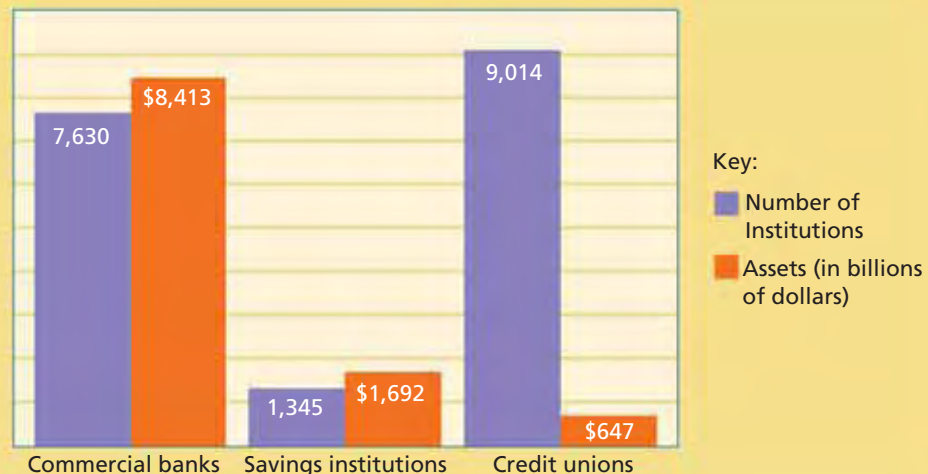
TYPE 3 Credit Unions

Credit unions are cooperative savings and lending institutions, rather like the early S&Ls. They offer services similar to commercial banks and S&Ls, including savings and checking accounts, but specialize in mortgages and auto loans.

The first credit union in the United States was chartered in 1909. The Federal Credit Union Act of 1934 created a system of federally chartered credit unions. In 2003, there were about 5,800 federally chartered credit unions and about 3,600 chartered by the states. Most credit unions have deposit insurance through the National Credit Union Association (NCUA), similar to the FDIC.

The major difference between credit unions and other financial institutions is that credit unions have membership requirements. To become a member, a person must work for a particular company, belong to a particular organization, or be part of a particular community affiliated with the credit union. Credit unions are cooperatives—nonprofit organizations owned by and operated for members, who numbered more than 80 million nationwide in 2003.

FIGURE 10.4 BANKING INSTITUTIONS IN THE UNITED STATES



Source: *Statistical Abstract of the United States, 2006* (Data from 2004)

ANALYZE CHARTS

1. Which type of bank has the largest number of institutions? Why?
2. How do the assets held in savings institutions compare to the assets held in commercial banks?

APPLICATION Analyzing and Interpreting Data

- D. Which type of bank described above has the largest percentage of its institutions chartered by the federal government? Why might this situation have developed?

SECTION 2 Assessment

REVIEWING KEY CONCEPTS

- Use each of the three terms below in a sentence that illustrates the meaning of the term.
 - state bank
 - national bank
 - gold standard
- Explain the relationship between the gold standard and the concept of representative money.
- How does the Federal Reserve System serve as a central bank?
- What is the difference between a national bank and a state bank?
- How did the FDIC make fractional reserve banking less risky for consumers?

- 6. Using Your Notes** What role did state banks play in the era of wildcat banking? Refer to your completed chart.

Development of U.S. Banking		
Origins	19th Century	20th Century

Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

CRITICAL THINKING

- 7. Creating Graphs** Use the information in Figure 10.4 to create two pie graphs, one showing the percentage that each type of bank contributes to the total number of financial institutions and another showing the percentage that each type of bank contributes to total bank assets. State one conclusion that you can draw from the two graphs.
Use **SMARTGrapher @ ClassZone.com** to complete this activity.
- 8. Synthesizing Economic Information** On the basis of what you learned about the history of U.S. banking in the 19th and 20th centuries, were Alexander Hamilton's ideas about the need for a central bank and a national currency shown to be mostly accurate? Cite specific examples to support your answer.
- 9. Applying Economic Concepts** Suppose that Mariel deposits \$100 in her local bank. If the Fed's reserve requirement is 15 percent, how much can the bank loan out on the basis of Mariel's deposit? What concept does this scenario illustrate?
- 10. Challenge** How do banks facilitate saving and borrowing in the same way that money facilitates buying and selling?

ECONOMICS IN PRACTICE



Constructing Graphs

Consider what you have learned about different types of financial institutions. The table below shows how the numbers of commercial banks and savings institutions have changed over time.

Year	Commercial Banks	Savings Institutions
1985	14,417	3,626
1990	12,347	2,815
1995	9,942	2,030
2000	8,315	1,589
2004	7,630	1,345

Create Line Graphs Use the information in the table to create two line graphs that show the changes in the numbers of each type of bank.

Use **SMARTGrapher @ ClassZone.com** to complete this activity.

Challenge On the basis of this information, what trends can you identify? Which type of financial institution experienced a greater percentage loss from 1985 to 2004?

Innovations in Modern Banking

OBJECTIVES

- In Section 3, you will
- describe the services that banks provide
 - discuss the changes that deregulation has brought to banking
 - explain how technology has changed banking in the United States

KEY TERMS

automated teller machine, *p. 308*
 debit card, *p. 308*
 stored-value card, *p. 308*

TAKING NOTES

As you read Section 3, complete a hierarchy diagram to track main ideas and supporting details. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**



What Services Do Banks Provide?

KEY CONCEPTS

Banks offer a number of services that allow them to act like “money stores.” In other words, just as stores are places where goods are bought and sold, banks are places where money can be bought (borrowed) and sold (lent). By using these services, customers are able to do three things—store money, earn money, and borrow money. Banks are businesses that earn money by charging interest or fees on these services.

SERVICE 1 Customers Can Store Money

As you read in Section 2, banks began as safe places to store money and other valuables. They still serve the same purpose today. Customers deposit money in the bank, and the bank stores currency in vaults and is also insured against theft and other loss. Customers’ bank accounts are also insured in case the bank fails. Banks are also a safe place to store important papers and valuables—through the use of safe deposit boxes.

SERVICE 2 Customers Can Earn Money

When customers deposit their money in bank accounts, they can earn money on their deposits. Savings accounts and some checking accounts pay some level of interest. Banks offer other accounts, such as money market accounts and certificates of deposits (CDs), that pay a higher rate of interest. You will learn more about saving and investing in Chapter 11 and in Consumer and Personal Finance, which begins on page 574.

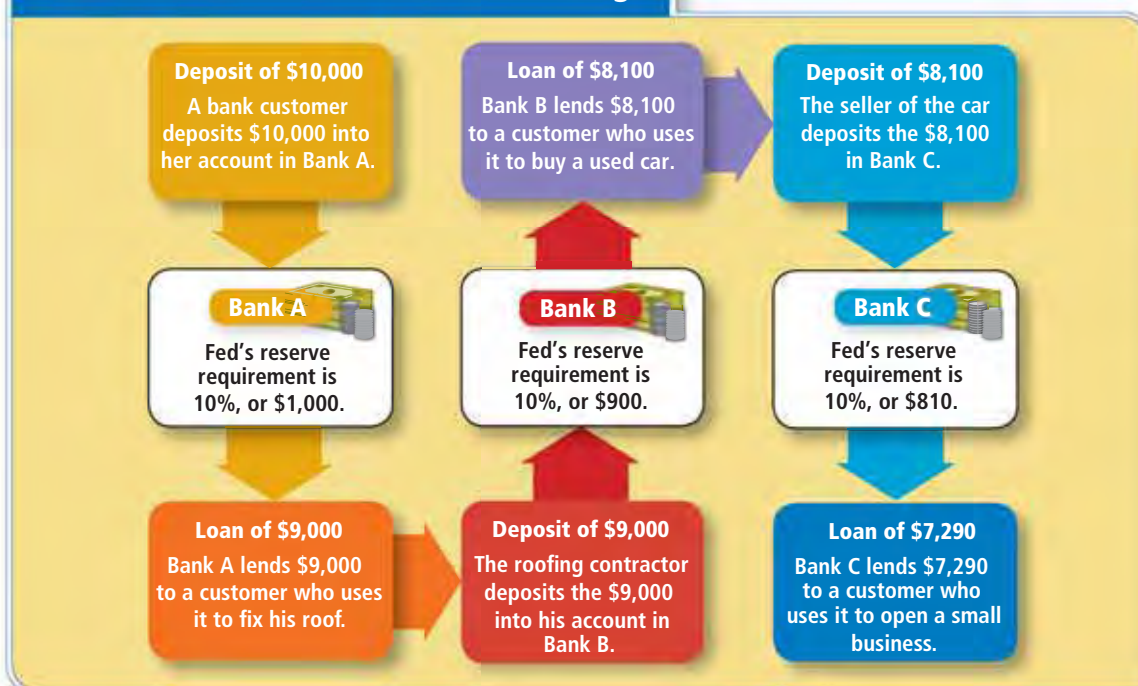
SERVICE 3 Customers Can Borrow Money

Banks also allow customers to borrow money through the practice of fractional reserve banking. (See Figure 10.5.) The percent of deposits that banks must keep in reserve is set by the Fed.

Banks provide customers, each of whom must be approved by the bank, with different loans for different circumstances. One common loan is a mortgage. A mortgage loan allows a buyer to purchase a real estate property, such as a house, without paying the entire value of the property up front. The lender and the borrower agree on a time period for the loan (often up to 30 years) and an interest rate to be paid to the lender. From this, a monthly mortgage payment amount is settled. In this arrangement, the real estate property acts as collateral. So if the borrower defaults on the loan (stops making the payments), the lender takes control of the property. It can then be sold by the bank to cover the balance of the mortgage.

It may not seem so, but a purchase made on a credit card is a loan too. Credit cards are issued by banks to users who are, in effect, borrowers. When you use a credit card to buy a new skateboard or a tank of gasoline, the issuing bank pays the seller and lends you the money. When you pay the bank back, you're repaying a loan. And if you don't pay it back within a month, you'll owe the bank extra in interest.

FIGURE 10.5 Fractional Reserve Banking



ANALYZE CHARTS

The customer who deposited \$10,000 in Bank A can withdraw her money even though a loan may have been made based on her deposit. This is known as creating money. Why?



Use an interactive fractional reserve banking chart at ClassZone.com

APPLICATION Applying Economic Concepts

A. Explain the ways in which bank transactions are beneficial to customers and banks.

Banking Deregulation

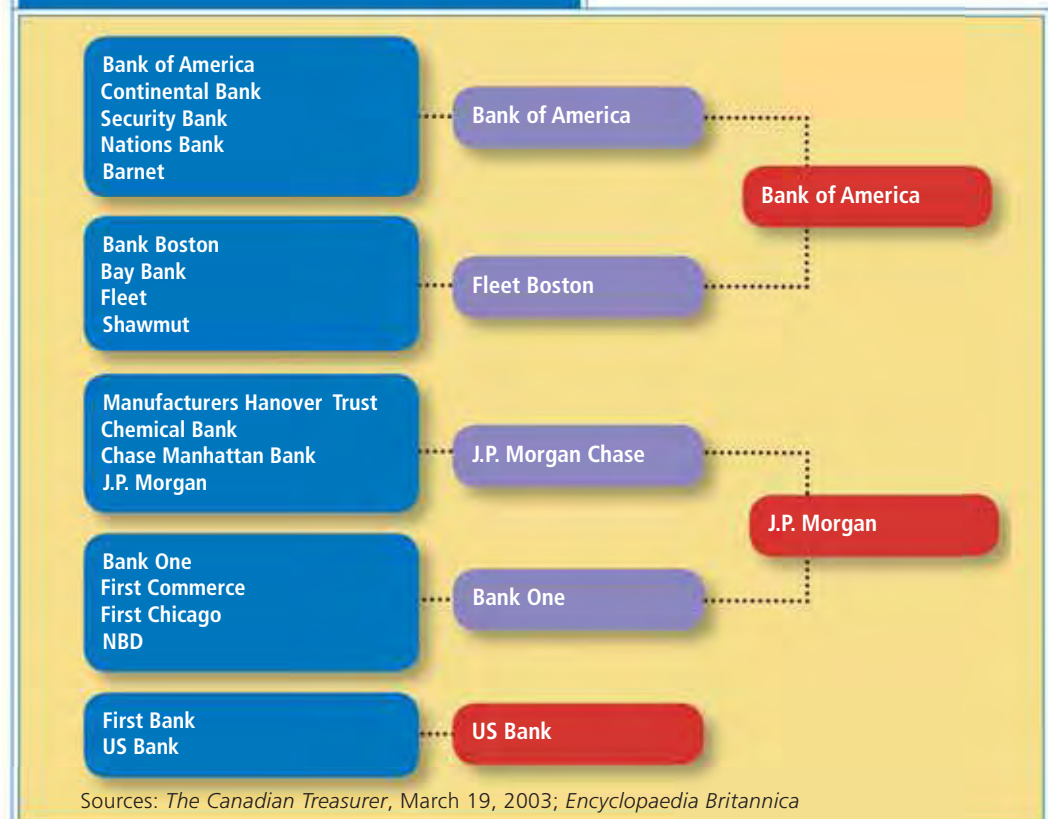
KEY CONCEPTS

Prior to the 1980s, government tightly regulated the amount of interest that banks could pay on deposits and could charge on loans. Regulations also prevented banks from operating in more than one state. Several states also had limitations on the number of branches that a bank could have within a state. Deregulation in the 1980s and 1990s ended these restrictions and brought major changes to what we think of as banks and how they operate.

Bank Mergers

The end of restrictions on interstate banking led to a large number of mergers, as larger banks acquired smaller ones and smaller ones joined together to be able to enter different geographic markets. The number of mergers has steadily declined since 1998, when there were almost 500, to less than 200 in 2003. Yet as Figure 10.6 shows, mergers that created very large banking organizations continued. In 2004,

FIGURE 10.6 Major Bank Mergers



ANALYZE CHARTS

In most of the mergers shown here, the acquiring banks hoped to increase their customer base by gaining offices in regions where they had no presence. What reasons might target banks (the banks acquired) have for entering into a merger?

Bank of America Investment Services Inc. and J. P. Morgan Chase & Co. became two of the largest banks in the United States, with assets of around \$1 trillion each. In contrast, some 95 percent of commercial banks have assets of \$1 billion or less.

One benefit from the mergers has been increased competition that has kept interest rates low and resulted in more consumer services. There has also been an increase in the number of bank branches, even while the number of banks has declined. Larger banks and more branches offer customers greater availability of services. Many banks also cite economies of scale made possible by the mergers, as banks are able to spread their costs, especially for new technology, over more customers. However, some see potential problems associated with mergers. Although competition between these merged banks has heated up, there are increasingly fewer banks to choose from. Further, it is feared that larger banks may show less interest in small customers and local community issues. If this is the case, consumers will choose a bank that provides them with what they want, and the large banks will either respond or lose customers.

Banking Services

The Financial Services Act of 1999 lifted the last restrictions from the Banking Act of 1933 that had prevented banks, insurance companies, and investment companies from selling the same products and competing with one another. This change allowed banks to sell stocks, bonds, and insurance. At the same time, some investment companies and insurance companies began offering traditional banking services.

The change in banking services was based on the idea that consumers would prefer to have a single source for all their financial services needs—something that might function as a kind of “financial supermarket.” However, banks have not always been able to effectively realize the benefits they had envisioned from offering this array of services. While banks establish relationships with customers through deposit accounts and loans for homes and autos, they have not been as successful in selling insurance or in helping customers to buy and sell stocks and bonds. Most bank customers continue to look to traditional insurance companies for their insurance needs and investment brokers and mutual fund companies to meet investment desires.

Financial Freedom
President Clinton signs the bill that eliminated restrictions in place since 1933.



▲ Roosevelt and the Banking Act of 1933



▲ Clinton and the Financial Services Act of 1999

APPLICATION Analyzing Effects

B. How did deregulation change the ways that banks competed?

Technology and Banking

KEY CONCEPTS

QUICK REFERENCE

An **automated teller machine** (ATM) is an electronic device that allows bank customers to make transactions without seeing a bank officer.

A **debit card** can be used like an ATM card or like a check.

A **stored-value card** represents money that the holder has on deposit with the issuer.

Deregulation is not the only thing that has changed the nature of banking. Technology—particularly computer technology—has changed the way customers use banks, producing a system generally referred to as electronic banking. For example, banks have begun using **automated teller machines** (ATMs), electronic devices that allow bank customers to make deposits, withdrawals, and transfers and check their account balances at any time without seeing a bank officer. Other innovations include **debit cards**, cards that can be used like an ATM card to withdraw cash or like a check to make purchases, and **stored-value cards**—cards that represent money that the holder has on deposit with the issuer, such as a department store. These cards give customers the ability to use the money in their accounts in more convenient ways. (You'll learn more about ATM and debit cards in Consumer and Personal Finance.)

Automated Teller Machines

Between school, sports practice, and a part-time job, you might find it difficult to get to the bank while it is open to deposit your paycheck and to withdraw spending money. The ATM solves that problem. ATMs are the oldest and most familiar of the developments in electronic banking. They began to be used widely in the 1970s and are now located not just at banks but also at retail stores, workplaces, airports, and entertainment venues, such as movie theaters and sports stadiums.

ATMs are basically data terminals that are linked to a central computer that is in turn linked to individual banks' computers. The bank provides you with a plastic ATM card with a magnetic strip on the back that contains your account information. You insert your card into the ATM, enter your personal identification number (PIN), and follow the instructions on the screen. You may check your account balance, make deposits, withdraw cash, transfer money between accounts, and make loan payments through the ATM.

All ATM networks are connected so that consumers can use their ATM cards at any machine, no matter what bank owns it. Some banks charge fees for ATM use, especially to consumers who do not have an account at the bank that owns the particular ATM. ATMs allow people to bank even when the bank is closed and to avoid waiting in line for simple transactions. Many drive-through ATMs allow customers to bank from their cars. ATMs save banks money because it is much less expensive to process ATM transactions than transactions that involve a teller. They also allow banks to provide services at more locations without constructing complete bank branch offices.



ATM Boom Between 1998 and 2003, the number of ATMs in the United States nearly doubled, from 187,000 to 371,000. By 2007, there were over 1.5 million ATMs worldwide.

Debit Cards

Debit cards are similar to ATM cards but offer additional benefits. Like ATM cards, debit cards can be used to withdraw cash and make other transactions at ATM machines. Debit cards are sometimes called check cards because they are linked to bank accounts and can be used like checks to make purchases at many retail outlets. Retailers often prefer debit cards because they avoid the problem of people writing checks with insufficient funds in their accounts.

Debit cards often look like credit cards, and they are similar in that they can be used to make purchases at stores. An important difference is that credit card purchases involve getting a loan. Your money stays in your account until you pay your credit card bill. With a debit card you make an immediate payment, since the price of your purchase is deducted from the account that is linked to your card. Therefore, it is important to keep track of debit card purchases along with checks so that you know how much money is available in your account at any given time.

Because of the way debit cards work, they are often seen as safer ways to manage your money than with credit cards. With credit cards, if you do not pay your balance in full each month, you pay interest on the outstanding balance and can build up considerable debt. With debit cards, you can only spend money that you actually have in a bank account.

YOUR ECONOMIC CHOICES

CREDIT CARD VS. DEBIT CARD

Which one should you use?

You have \$250 in your checking account, and you don't get your next paycheck for a week. You want to buy a \$75 birthday gift for a friend, and you have to pay \$225 for a car repair. With your classmates, talk through each of the ways to handle the situation to find out what works best.



Signing for a credit card



Entering a PIN for a debit card

Stored-Value Cards

Stored-value cards, which represent money that the holder has on deposit with the card issuer, give consumers another convenient way to use electronic banking. These cards are sometimes called prepaid cards because customers have paid a certain amount of money for the card and can then use it to make payments for various goods and services. Some examples of stored-value cards include transit fare cards, gift cards from retail stores, and telephone cards. Consumers benefit from using transit fare cards and telephone cards because they do not have to worry about having the exact change needed each time they ride the bus or use a pay phone.

In 2004, there were more than 2,000 different stored-value card programs in the United States with about 20 million users. The number of users was expected to be 49 million by 2008. The \$42 billion in transactions in 2003 was expected to grow to more than \$72 billion by 2006.

Multipurpose stored-value cards—cards that can be used like debit cards—are becoming more popular. This type of card may take the place of a checking account, especially for people who have not traditionally used banks. While stored-value cards are a convenient way for people to make purchases and pay bills, consumers need to evaluate the fees involved in using such cards to determine whether they are less expensive than having a checking account or using a check-cashing service. In addition, the money paid into such cards is not always covered by FDIC insurance to protect customer deposits in case of a bank's failure.

Electronic Banking

Electronic banking allows customers who have set up accounts with a bank to perform practically every transaction without setting foot in a bank. Indeed, some banks are virtual banks with no physical buildings at all. Through the use of the Internet, customers can arrange for direct deposit of their paychecks, transfer funds from account to account, and pay their bills.

Most bank Web sites allow customers to review the most recent transactions on their accounts, view images of canceled checks, and download or print their periodic statements. Through electronic fund transfers, consumers can pay a credit card bill at one bank with funds from a checking account at another bank. Recurring bills, such as mortgage payments, may be paid automatically from a customer's checking account each month or through their bank's bill paying service.

However, electronic banking presents several challenges. Information security and identity theft are related, high-profile issues for the industry. Electronic banking allows banks to amass large amounts of information about their customers. Banks contend that this allows them to provide customers with better service. New laws require that banks make customers aware of privacy policies and offer them the opportunity to decide what information may be shared with others. Consumer concerns have led banks to developing increasingly sophisticated information security systems. (For information on identity theft, see Consumer and Personal Finance, which begins on p. 574.)



Online Convenience Online bill paying cuts time and expense by eliminating the need to mail checks.

APPLICATION Contrasting Economic Information

C. How are debit cards different from most stored-value cards?

SECTION 3 Assessment

REVIEWING KEY CONCEPTS

- How are these three terms related? How are they different?
a. *automated teller machine* b. *debit card* c. *stored-value card*
- What are two reasons that people deposit money in banks?
- It is said that fractional reserve banking allows banks to create money? What is meant by this?
- How did deregulation lead to a decrease in the number of banks between 1980 and the present?
- How are debit cards related to automated teller machines?

- 6. Using Your Notes** How does computer technology support home banking? Refer to your completed hierarchy diagram.



Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

CRITICAL THINKING

- 7. Analyzing Data** Over the course of one year, Hometown Bank paid Mary Lee 3 percent interest on a \$1,000 deposit and charged Owen's Bakery 8 percent interest on a \$900 loan. How much net income did Hometown bank make? Show your calculations.
- 8. Applying Economic Concepts** Suppose that Liz inherits \$2,000 from her grandmother and deposits it into her college savings account at Hamilton Savings Bank. Assume that the reserve requirement is 20 percent. Create a chart showing five successive loans that could be made from this initial deposit.
- 9. Making Inferences** Some parents think that allowing teenagers to use a debit card prepares them for using a credit card. What are the possible reasons behind this thinking? Do you think this reasoning is sound? Why or why not?
- 10. Challenge** Look again at Figure 10.5, Fractional Reserve Banking, on page 305. Suppose that when Bank A made the \$9,000 loan to the man with the leaky roof, it turned out the job cost only \$7,000. The contractor deposited that money into Bank B. How much could Bank B then lend to the used-car buyer? If she bought a car for that amount, and the seller of the car deposited the money in Bank C, what size small-business loan could Bank C then turn around and make?

ECONOMICS IN PRACTICE



Starting a Bank

Think about what you have learned about the services that banks provide and how banks make money. Imagine that you are starting a bank for the other members of the class. Consider the following questions:

- What services would you provide? Why?
- How would your bank make a profit?
- What challenges might you face in making your bank profitable?

Write a Proposal Answer the above questions in a one-page proposal outlining what your bank would be like. Share your proposal with a classmate.

Challenge Include a section in your proposal about what you would do to make your bank more attractive to customers than the other banks run by your classmates.

Student Loans

Background In the United States, the cost of higher education may still be affordable to some, but it certainly is not cheap. Because of rising costs, more and more students (and their parents) borrow money to finance at least part of their college education. According to the U.S. Department of Education, about 10 million students take out Stafford loans each year, while about 800,000 parents take out PLUS loans.

Although banks, S&Ls, and credit unions are the primary lenders of money in the United States, this is not the case for student loans. Students and parents have the option of borrowing wherever they choose, but federally guaranteed loans are their main source of funding.

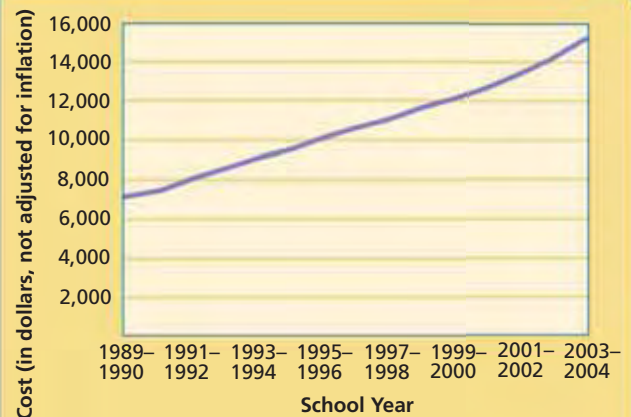
What's the issue? What is the current situation with student loans? What are the future ramifications of the increasing cost of paying for college? Study these sources to learn about student loans.

A. Online News Story

This story explains a change in the way the government figures the interest rate on student loans.

Text not available for electronic use. Please refer to the text in the textbook.

FIGURE 10.7 AVERAGE COST OF TUITION, ROOM, AND BOARD AT A FOUR-YEAR INSTITUTION



Source: National Center for Education Statistics

Thinking Economically If interest rates hit 10 percent, would the new fixed rate established by Congress still harm student borrowers? Why or why not?

B. Cartoon

Ralph Hagen drew this cartoon about student loans as a factor in higher education.



Thinking Economically

What does the cartoon suggest about student reliance on college loans? Explain your answer.

C. Newspaper Article

This article discusses the problems associated with debt and loan repayment after college graduation.

It's Payback Time

More student loans increase debt pressure on graduates.

Student loans are two-edged: the more money a student can borrow, the more schooling falls within reach. But of course, the more debt a student has, the more painful repayment becomes. . . .

"More students will be required to take out more money from the federal government and from private lenders," says Jasmine L. Harris, legislative director at the United States Student Association, a student advocacy group in Washington. Over time, she continues, "It's a great formula for unmanageable levels of debt and hence higher default rates." . . .

The consequences of defaulting, too, are worse than they have been in years past.

A provision of a law that took effect last year, for example, makes it next to impossible to discharge private student loans in personal bankruptcy proceedings (federal loans were already barred). . . .

[Theresa] Shaw of the Education Department advises that a struggling borrower should try to make a payment of any kind, however small, to avoid default.

Source: *The New York Times*, April 23, 2006

Thinking Economically Explain in your own words why you think the article calls student loans "two-edged."

THINKING ECONOMICALLY Synthesizing

1. Compare the financial news presented in documents A and C. What bearing do you think the information in document A might have on what you learned from document C?
2. Document B humorously points to the prominence of student loans in U.S. higher education. Specifically, what parts of documents A and C support this view?
3. In document A, what does the federal government seem to be saying about who should pay for a college education? With this in mind, what does Figure 10.7 mean for students and parents?

Review this chapter using interactive activities at **ClassZone.com**

- Online Summary
- Quizzes
- Vocabulary Flip Cards
- Graphic Organizers
- Review and Study Notes

REVIEWING KEY CONCEPTS

Money: Its Functions and Properties (pp. 288–295)

1. What three functions does money serve in the economy?
2. Why do economists make a distinction between M1 and M2?

The Development of U.S. Banking (pp. 296–303)

3. Why does fractional reserve banking leave banks vulnerable to failure if too many consumers demand their money at the same time?
4. How is the Federal Reserve System different from the system of national banks created in the 1860s?

Innovations in Modern Banking (pp. 304–313)

5. How did the automated teller machine change the nature of banking?
6. Which type of stored-value card is most like a debit card?

APPLYING ECONOMIC CONCEPTS

Look at the table below showing changes in use of electronic payments between 1995 and 2001.

7. Which type of electronic banking increased the most among all households between 1995 and 2001?
8. How did education generally affect the use of electronic payments?

FIGURE 10.8 PERCENTAGE OF HOUSEHOLDS USING ELECTRONIC BANKING

Education of head of household	ATM		Debit card		Automatic bill paying	
	1995	2001	1995	2001	1995	2001
All households	61.2	69.8	17.6	47.0	21.8	40.3
No college degree	52.8	63.7	14.3	42.3	18.2	33.7
College degree	80.1	81.6	25.2	56.2	30.1	53.2

Source: *Statistical Abstract of the United States, 2006*

Online Summary

Complete the following activity either on your own paper or online at **ClassZone.com**

Choose the key concept that best completes the sentence. Not all key concepts will be used.

automated teller machine	M2
barter	medium of exchange
commodity money	money
currency	national bank
debit card	near money
demand deposits	representative money
fiat money	standard of value
fractional reserve banking	state bank
gold standard	store of value
M1	stored-value card

1 is anything that people will accept as payment for goods and services. Money makes trade easier by serving as a 2. As a 3, money allows people to compare the prices of goods and services. Money must be a 4, or something that holds its value over time.

Gold coins and salt are both examples of 5. Most money in the world today is 6, which has no tangible value but is declared by the government to have worth.

7 consists of 8, which includes paper money and coins and 9, which is another name for checking accounts. Savings accounts and time deposits are called 10 because they can be converted into cash easily.

11 allows banks to hold only part of their deposits and make loans based on the rest. The Federal Reserve Bank is the central 12 in the nation.

The 13 is the oldest form of electronic banking. A 14 can be used like an ATM card or like a check.

CRITICAL THINKING

9. Analyzing Effects Suppose that the government changes the tax policy so that people pay lower taxes if they save more money. The benefits are significant enough that people shift about 10 percent of their money from their checking accounts into certificates of deposit. How would this change affect the amount of money in M1 and M2?

10. Drawing Conclusions Today, there are about three times as many state chartered commercial banks as there are nationally chartered commercial banks. How does the current U.S. economy avoid the kinds of problems caused by state banks in the 19th century?

11. Applying Economic Concepts One Saturday, four friends go shopping at the local mall. Catherine uses her ATM card to withdraw some cash. Tara has a gift card that she received for her birthday. It is worth \$50 at her favorite clothing store. Charlotte uses a credit card, and Alyssa pays with a debit card.

a. Which of the shoppers has a stored-value card? Why does she have less flexibility in her shopping than the other shoppers?

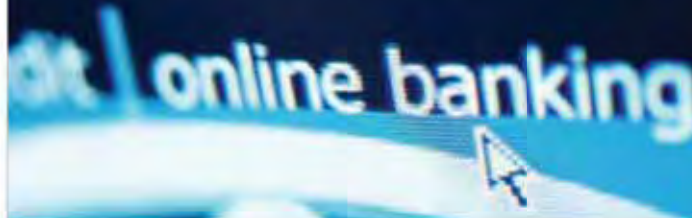
b. If Catherine, Charlotte, and Alyssa each spend \$50, which one has not reduced the amount of money in her checking account at the end of the day? Why?

c. Which shopper may end up paying more than face value for her purchases?

12. Analyzing Causes What are the different motives behind these two mergers: a stock brokerage firm buys a bank; a California bank buys a Florida bank?

13. Challenge Why are credit cards and debit cards not considered to be money?

SIMULATION



Promote Electronic Banking

Step 1 Choose a partner. Imagine that you work for a bank in the late 1990s. Your bank intends to be a pioneer in Internet banking and asks you to design its first Web page. Your boss gives you the following criteria for the Web page:

- Allow existing customers to access account balances and transfer funds between accounts.
- Promote traditional bank products, including checking, savings, CDs, credit cards, mortgages, and auto loans.
- Allow customers to find the most convenient branch or ATM location.

Step 2 Sketch out a design for the Web page to meet your boss's criteria, showing appropriate links.

Step 3 Two years later, deregulation has led to significant changes in the banking industry. In addition, more consumers are interested in Internet banking. Your boss asks you to redesign the Web page with these additional criteria:

- Allow customers to pay bills, apply for loans, buy stocks, and shop for insurance through the bank's Web site.
- Allow customers to view transactions on all their accounts, including credit and debit card transactions, and receive statements and other bank communications electronically.
- Reassure customers that online banking is secure and that their privacy will be protected.

Step 4 Sketch out a new Web page that shows the complete range of services the bank now offers and that meets all six criteria.

Step 5 Share your Web page designs with another pair of students and discuss what aspects would be most important and effective for you as a customer.