

CHAPTER

11

# Money and Banking

## Economics & You



Why do you accept money in exchange for a good or service? Why were so many different kinds of money used around the world? In **Chapter 11**, you will learn about the development of money. To learn more about how our money and banking system works, view the Chapter 18 video lesson:

**Money and Banking**

**ECONOMICS**  
*Online*



**Chapter Overview** Visit the *Economics: Principles and Practices* Web site at [app.glencoe.com](http://app.glencoe.com) and click on **Chapter 11—Chapter Overviews** to preview chapter information.

**CLICK HERE**

To carry out its economic functions, money must be acceptable, divisible, portable, and stable in value.

**CONTENTS**



# The Evolution of Money

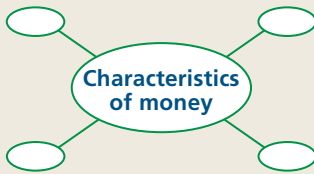
## Study Guide

### Main Idea

Money is any substance that functions as a medium of exchange, a measure of value, and a store of value.

### Reading Strategy

**Graphic Organizer** As you read the section, complete a graphic organizer similar to the one below that illustrates the characteristics of money.



### Key Terms

barter economy, money, medium of exchange, measure of value, store of value, commodity money, fiat money, specie, monetary unit

### Objectives

After studying this section, you will be able to:

1. **Explain** the three functions of money.
2. **Identify** four major types of money used in early societies.
3. **Describe** the four characteristics of money.

### Applying Economic Concepts

**Money** Did you trade items when you were younger? Read to find out more about trade and how the use of money makes it easier.

## Cover Story

### To the Colonies

The enterprising colonists being generally destitute of families, Sir Edward Sandys, the treasurer, proposed to the Virginia Company to send over a freight of young women to become wives for the planters. The proposal was applauded, and ninety girls, “young and uncorrupt,” were sent over in the ships that arrived this year (1620) and the year following, sixty more, handsome and well recommended to the company for their virtuous education and demeanor. The [cost of transport] was one hundred pounds of tobacco; but as the number became scarce, [it] increased to one hundred and fifty pounds; the value of which in money was three shillings per pound. . . .

—Holmes' *American Annals*, 1620



Virginia Company insignia

It may seem odd to you that people once used a plant like tobacco as a form of money. Frequently, people used things that were easily available and valued by others as a form of money. Money is something we all take for granted, but without it—as we saw in the cover story—life would be quite different.

Think what life would be like in a **barter economy**, a moneyless economy that relies on trade. Without money, the exchange of goods and services would be greatly hindered because the products some people have to offer are not always acceptable or easy to divide for payment. For example, how could a farmer with a pail of milk obtain a pair of shoes if the cobbler wanted a basket of fish? Unless there is a “mutual coincidence of wants”—which means that two people want exactly what the other has and are willing to trade what they have for it—it is difficult for trade to take place.

Life is simpler in an economy with money. The farmer sells the milk for cash and then exchanges the cash for shoes. The cobbler takes the cash and looks for someone selling fish. Money, as it turns out, makes life easier for everybody in ways we may have never even thought about.

## Functions of Money



**Money** can be any substance that serves as a medium of exchange, a measure of value, and a store of value. If it satisfies these three functions, it will be accepted and used by everyone in a society.

### Medium of Exchange

For something to function as money, it must serve as a **medium of exchange**—something accepted by all parties as payment for goods and services. Throughout history, societies have used many materials as a medium of exchange, including gold, silver, and even salt. In ancient Rome, salt was so valuable that each soldier received an annual salt payment called a “salarium.” The modern term for an annual income—or “salary”—is based on this Latin term.

### Measure of Value

For something to serve as money, it must be accepted as a **measure of value**, a common denominator that can be used to express worth in terms that most individuals understand. This is what we observe whenever we see a price tag on something—a value that we can use to make comparisons with other products. In the United States, our measure of value is expressed in dollars and cents.

### Store of Value

For something to function as money, it must also serve as a **store of value**, the property that allows purchasing power to be saved until needed. For example, goods or services can be converted into money, which is easily stored until needed. Money enables a period of time to pass between earning and spending an income.

## CYBERNOMICS SPOTLIGHT

### The Future of Money

*As you have learned, money must have certain characteristics to perform its functions in the economy. Money must be accepted. This means that everyone in the economic system must agree that the money has value and be willing to take it as payment for debts. Money must also be divisible. This means that units of money can be divided into smaller units without losing their relative value. Money must be portable. This means that it must be possible to move the money from one place to another with ease. In addition, money must have a reasonably stable value. This means that a person will be able to buy about the same number or value of products today, next week, or next year.*

Despite the widespread use and advantages of currency, some analysts predict that the use of electronic payments will grow tremendously. Have you heard of cybercurrency? Smart cards? Electronic money? One analyst defines cybercurrency as the use of microchip-based electronic money for financial transactions, via smart cards and the




Smart cards

Internet. Some economists and analysts contend that cybercurrency has the potential to assume an important place in domestic and worldwide payment systems.

Nobel Prize-winning economist Milton Friedman noted that paper and coin eventually will give way to electronic money. Walter Wriston, the former president of the financial institution Citicorp, estimates that in the not-too-distant future, one in every four Americans will have a smart card. Smart cards are wallet-sized plastic cards that serve three purposes: as data carriers, for identification,




## Money in Early Societies

 The use of money developed because it makes life easier for people. Money comes in an incredible variety of forms, shapes, and sizes. Tea leaves compressed into “bricks” comprised money in ancient China, and compressed cheese was used in early Russian trade. The East African Masai used a currency made of miniature iron spears fastened together to form a necklace.

Today, this money would be classified as **commodity money**—money that has an alternative use as an economic good, or commodity. For example, the compressed tea leaves could be made into tea when not needed for trade. Other items became **fiat money**—money by government decree—such as the tiny, metallic coins used in Asia Minor in the seventh century B.C. These coins served as money largely because the government said they were money.

The use of money became accepted because it served everyone’s best interests to do so. In this sense, money was then—and is now—a social convention, much like the general acceptance of laws and government.

## Money in Colonial America

 The money used by early settlers in America was similar to the money found in early societies. Some of it was commodity money, and some was fiat money.

Many products—including gunpowder, musket balls, corn, and hemp—served as commodity money. It could be used to settle debts and make purchases, or could even be consumed if necessary.

### Did You Know?

**Dollars and Cents** The United States decimalized monetary system, based on dollars and cents, was adopted in 1784. The units of the monetary system were the mill (1/100th of a cent), cent, dime, dollar, and eagle (\$10).

and for financial transactions. Wriston notes that “people will use an ATM or home computer to download the money from their bank accounts to the cards.”

**Features** Do these new forms of money meet the characteristics of useful currency? Supporters say they do and, additionally, provide an added feature—transfer velocity—almost instantaneous transfer of funds from point to point. Another advantage is reduced transaction costs. Merchants pay credit card transaction fees, and those fees usually include a minimum that can erase profit margins on low-cost items. Research analyst Heather Aston says, “It doesn’t make a lot of sense to have to process something that costs \$2 the same way you process something that costs \$50.” Micropayment schemes eliminate the expensive step of asking the credit card issuer to confirm the card holder’s ability to pay for each transaction. What is needed is confirmation that the encrypted serial number is valid.

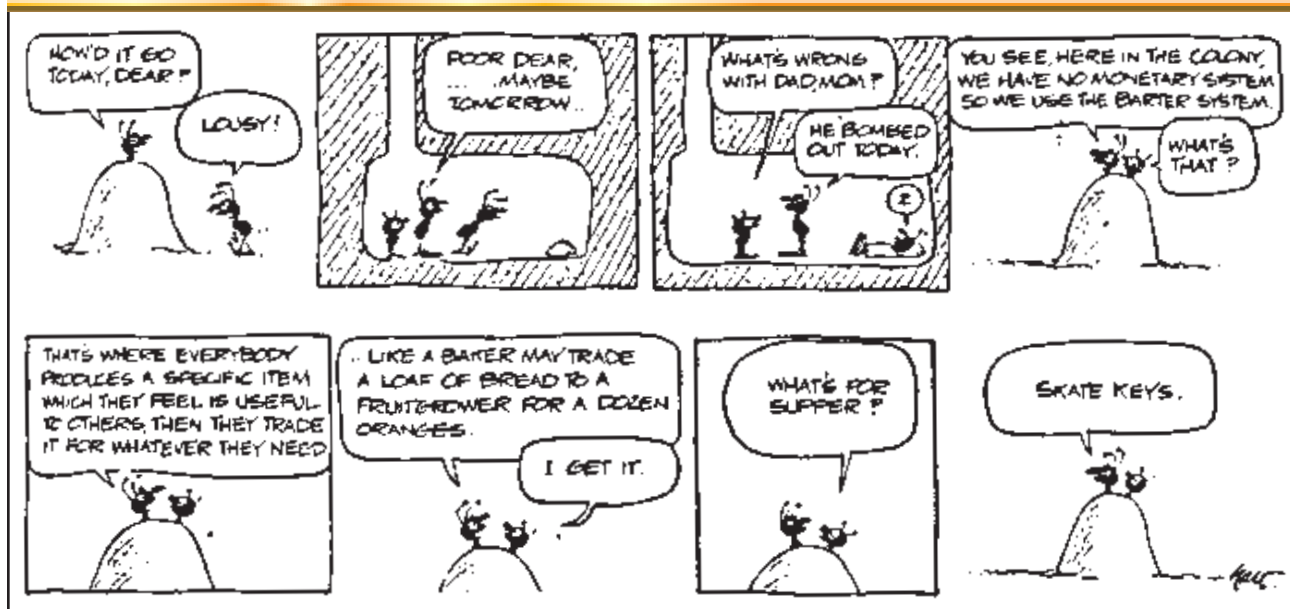
**Will Cybermoney Catch On?** Some economists and analysts believe that the use of U.S. currency and credit cards is too deeply ingrained for new forms to displace them. While technological innovation may make cash less essential, public demand for it is

strong. In addition, coin and paper money provide an advantage in privacy—you are in charge of your money and no one else needs to know. Will cybermoney lead the way to a cashless age? Only the future will tell.



“Key” and sensing pad

## Barter Economy



**Medium of Exchange** As the cartoon shows, a barter economy can cause problems for those wanting to exchange goods for products they may use. **How does money function as a medium of exchange?**

A commonly accepted commodity money was tobacco, with a value set at three English shillings per pound by the governor of colonial Virginia in 1618. Two years later, as you read in the cover story, the colonists used some of this money to bring wives to the colonies.

Other colonies established fiat monies. In 1645 Connecticut set a monetary value for *wampum*—a form of currency the Narragansett Native Americans made out of white conch and black mussel shells. Because white shells were more plentiful than black ones, and because the Narragansett and the settlers used them in trade, one English penny was made equal to six white or three black shells. In 1648 the General Court of Massachusetts passed a law ordering the wampum to be “suitably strung” in lengths of 1, 3, and 12 pennies.

### Paper Currency

As time passed, Americans used other forms of money. In some cases, state laws allowed individuals

to print their own paper currency. Backed by gold and silver deposits in banks, it served as currency for the immediate area.

Most states printed money in the form of tax-anticipation notes that could be redeemed with interest at the end of the year. State governments printed these notes and then used them to pay salaries, buy supplies, and meet other expenditures until taxes were received and the notes redeemed.

Paper money was issued to finance the Revolutionary War. In 1775, *Continental dollars*, a form of fiat paper currency with no gold or silver backing, were printed by the Continental Congress. By the end of the war, nearly one-quarter *billion* Continental dollars had been printed to pay soldiers and buy supplies—a volume so large that it was virtually worthless by the end of the revolution.

### Specie


A modest amount of **specie**—or money in the form of coins made from silver or gold—was also used in the colonies. These included English



shillings, Austrian talers, and various European coins that immigrants brought to the colonies.

Coins were the most desirable form of money, not only because of their mineral content, but because they were in limited supply. By 1776, only \$12 million in specie circulated in the colonies as compared to nearly \$500 million in paper currency.

## Origins of the Dollar

 When George Washington became president in 1789, the most plentiful coin in circulation was the Spanish peso. Consequently, one of Washington's first challenges was to establish a money supply for the new country, a task he assigned to Benjamin Franklin and Secretary of the Treasury Alexander Hamilton.

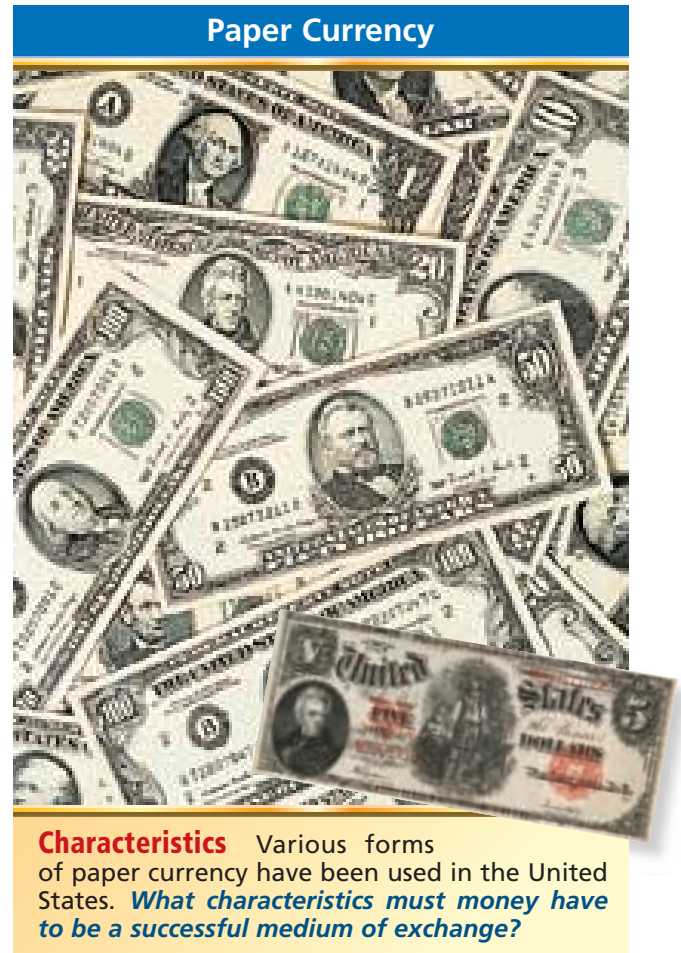
## Pesos in America

Long before the American Revolution had begun, the Spanish were mining silver in Mexico. They melted the silver into bullion—ingots or bars of precious metals—or minted it into coins for shipment to Spain. When the Spanish treasure ships stopped in the West Indies to buy fresh provisions, however, they often became victims of Caribbean pirates who spent their stolen treasure in America's southern colonies.

Meanwhile, the colonies engaged in a profitable exchange known as the triangular trade, which exported rum in exchange for enslaved people and molasses. Molasses from the West Indies was shipped to the colonies where it was made into rum. The rum was shipped across the Atlantic Ocean to Africa, where it was exchanged for enslaved Africans. The Africans were packed into ships and taken across the Atlantic to the West Indies where they were sold for molasses and pesos. The molasses, silver pesos, and some enslaved people were then returned to the colonies to begin the triangle again.

## From "Talers" to "Dollars"


Pesos were known as "pieces of eight," because they were divided into eight sub-parts known as *bits*. Because the pesos resembled the Austrian talers, they were nicknamed talers, which sounds



like the word "dollars." This term became so popular that Franklin and Hamilton decided to make the dollar the basic **monetary unit**, or standard unit of currency, in the U.S. money system.

Rather than divide the dollar into eighths as the Spanish had done with the peso, Franklin and Hamilton decided to divide it into tenths, which was easier to understand. Even today, some of the terminology associated with the Spanish peso remains, as when people sometimes call a 25-cent coin—one quarter of a dollar—"two bits."

## Characteristics of Money

 The study of early money is useful because it helps us understand the characteristics that give money its value. To be successful, money must be portable, durable, divisible, and limited in supply.

## Portability

First, money must be portable, or easily transferred from one person to another, to make the exchange of money for products easier. Most money in early societies was very portable—including dog teeth, feather-stick money, wampum, tobacco, and compressed blocks of tea and cheese.

## Durability

Money must also be reasonably durable so that it lasts when handled and does not deteriorate when being held as a store of value. Most colonial money was quite durable, especially monies like musket balls and wampum. Wampum, for example, did not require special care when being handled, and it lasted a long time. Even the fiat paper money of the colonial period had a type of durability in that it could be easily replaced by issuing new bills when old ones became worn.

## Divisibility

Money should be easily divisible into smaller units, so that people can use only as much as needed for any transaction. Most early money was highly divisible. In the case of the Masai's iron

spear currency, the necklace was untied and some of the spears removed. The blocks of tea or cheese were cut with a knife. Bundles of tobacco leaves were broken apart.

## Limited Availability

Finally, if something is to serve as money, it must be available, but only in limited supply. The dog teeth of New Guinea, for example, were extracted from packs of wild dogs. Because the islanders hunted the dogs for their teeth, the wild dog population never grew large. Stones used as money on the Yap Islands were carried in open canoes from other islands 400 miles away. Because navigation was uncertain and the weather unpredictable, only one canoe in 20 completed the round-trip—circumstances that limited the supply of stone money.

Money—like almost everything else—loses its value whenever there is too much of it, a major problem for most types of commodity money. In Virginia, for example, the price of tobacco went from 36 pennies a pound to 1 penny a pound after everyone started growing their own money. Wampum even lost its value when settlers used industrial dyes to turn the white shells into black—thereby doubling its value.

### Section 1 Assessment

#### Checking for Understanding

- 1. Main Idea** How does money advance the exchange of goods and services?
- 2. Key Terms** Define barter economy, money, medium of exchange, measure of value, store of value, commodity money, fiat money, specie, monetary unit.
- 3. Describe** three functions of money.
- 4. Name** four types of early money.
- 5. Explain** how the dollar was adopted as the basic monetary unit.
- 6. Identify** the four characteristics of money.

#### Applying Economic Concepts

- 7. Money** Write a brief critique of the following statement: "Money is our servant, not our master. Those who treat money as the master rather than the servant do not really understand money."

#### Critical Thinking

- 8. Drawing Conclusions** Suppose the color and shape of our currency was changed. How would these changes affect the role money played?



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

# Profiles IN Economics

## A Fingertip Fortune: Dineh Mohajer

(1973–)

It might be hard to believe that a multimillion dollar business started in a bathroom, but that's exactly where Dineh Mohajer's Hard Candy cosmetics company was born.

The year was 1995. Fed up with a life of hard study as a pre-med student, the 22-year-old Mohajer recalls making a conscious decision to make a change. "I used to stare out the window," she said, "and think, 'I wonder what the civilians are doing out there?'" So that summer I told myself, this is my last summer of real life. I'm rebelling! I'm not going to do it!"

### HARD CANDY

Mohajer took a job at a Los Angeles boutique. One night, she decided she needed nail polish to match a pair of sky-blue sandals. In her bathroom, she applied her knowledge of chemistry from her pre-med classes to mix up some nail polish. The unusual color was a hit with her friends, so Mohajer, at the urging of her sister Pooheh, took it to the boutique owner, who agreed to sell it. Mohajer mixed up several more colors of

nail polish, and called the line Hard Candy. The striking colors proved so popular that the boutique couldn't keep Hard Candy in stock. Mohajer took a loan from her parents and went into business full time. It was the start of something big.

### RAPID SUCCESS

The colors Mohajer chose for her nail polishes, with hip names like "Tantrum," "Greed," and "Dork," were bold and hard-edged, unlike the more conservative colors available from the big cosmetics companies. They proved a hit with young, fashion-conscious women in Los Angeles. Hard Candy became the new, cool makeup among trend-setters, and its popularity was reported in national fashion magazines like *Vogue*, *Elle*, *Teen*, and *Seventeen*. Tens of thousands of young

women across the country, eager to stay in style, ordered bottles of the nail polish. Within six months, Hard Candy was grossing more than \$70,000 a month. Within a year, annual sales had topped \$10 million.

The fashion industry, by definition, is volatile: what's "in" today is likely to be "out" tomorrow, so the long-term fortunes of Hard Candy are hard to predict. But there can be no doubt that it has proved a multimillion dollar, overnight success, born in the bathroom of a young woman who parlayed her love of fashion into a big business.

### Examining the Profile

- 1. Identifying Cause and Effect** What factors made Hard Candy successful?
- 2. For Further Research** Conduct research to determine Hard Candy's current condition. Report on its market share and immediate prospects.



# Early Banking and Monetary Standards

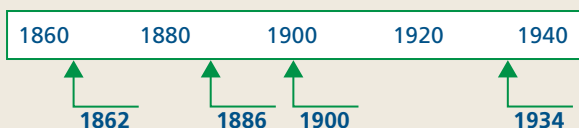
## Study Guide

### Main Idea

Although the monetary standard has changed throughout American history, an inconvertible fiat money standard is used today.

### Reading Strategy

**Graphic Organizer** As you read the section, complete a time line similar to the one below by listing major events in American monetary history in the appropriate spaces.



### Key Terms

monetary standard, state bank, legal tender, United States note, national bank, National Bank note, national currency, gold certificate, silver certificate, Treasury coin note, gold standard, inconvertible fiat money standard

### Objectives

After studying this section, you will be able to:

1. **Explain** the history of privately issued bank notes.
2. **Describe** an inconvertible money standard.

### Applying Economic Concepts

**Money Supply** Managing the money supply is a difficult task. Read to see how we use different methods to keep the dollar strong.

## Cover Story

### Swiss Set to Abandon Gold Standard

Switzerland has always been regarded as a country that “understands” gold. It owns the world’s fifth biggest gold reserves, its big banks still operate their own gold refineries, and the Swiss franc is the last currency still tied to gold.

However, this weekend the Swiss electorate is expected to do what would have been unthinkable a decade ago—abandon the gold standard. . . . [I]n law gold is still set at 142.9 Swiss francs per troy ounce.

The decision to sever the legal link between the Swiss franc and gold, is a reminder that [gold] has lost one of its biggest official cheer leaders. . . .

—*The Financial Times* (London) April 16, 1999



One-ounce gold bar

The week after the article in the cover story was published, the Swiss adopted a new constitution—and abandoned the gold standard. Fortunately, there are other ways to keep the money supply sound so that the economy functions smoothly.

A **monetary standard**—the mechanism designed to keep the money supply portable, durable, divisible, and limited in supply—helps with this task. The United States has had several monetary standards in its history.

### Privately Issued Bank Notes

During the Revolutionary War, nearly 250 million Continental dollars were printed. After the Revolution, Continental currency was worthless, and people did not trust the government to issue anything except coin. Accordingly, Article 1, Section 8, of the United States Constitution states:

*The Congress shall have the power*

*To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures;*

## Monetary Standards



**Fiat Money** The paper money in our economy is “fiat” money: it is money partly because government says it is money. **What part of the Constitution gives Congress the right to coin money?**

*To provide for the punishment of counterfeiting the securities and current coin of the United States; . . .*

*To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the government of the United States, or in any department or officer thereof.*

Article 1, Section 10, further states:

*No State shall . . . coin money; emit bills of credit; make anything but gold and silver coin a tender in payment of debts. . . .*

Because of these clauses, the federal government did not print paper currency until the Civil War. Instead, the paper money supply was left for private banks to produce.

### Growth of State Banking

Banks in the colonial period were allowed to issue their own paper money, a practice not prohibited by the new Constitution. As a result, banking grew in popularity, and by 1811 the country

had about 100 **state banks**—banks that received their charter to operate from a state government.

State banks issued their own currency by printing their notes at local printing shops. The banks then put these notes in circulation with the assurance that people could exchange them for gold or silver if they ever lost faith in the bank or its currency.

### Abuses in Banking

At first, most banks printed only the amount of currency they could reasonably back with their gold and silver reserves. Others, however, were not as honest and became known as wildcat banks—fraudulent banks that printed large amounts of currency in remote areas to make the redemption of their currency difficult. These banks got their name from people who claimed that you had to be a wildcat to get to them.


### Problems With Currency

Even when banks were honest, problems with the currency arose. First, each bank issued its own currency in different sizes, colors, and denominations. As a result, hundreds of different kinds of notes could be in circulation in any given city.

Second, because a bank could print more money whenever it wanted, the temptation to issue too many notes always existed. Third, counterfeiting became a major problem. With so many different types of notes in circulation, many counterfeiters did not even bother to copy other notes. Instead, they just made up new notes.

By the Civil War, the United States had more than 1,600 banks issuing more than 10,000 kinds of paper currency. Each bank was supposed to have backing in the form of gold or silver, but this was seldom the case. As a result, when people tried to buy something, merchants would often check their notes against the latest listing of good and bad currencies before deciding which ones to accept in payment.

## The Greenback Standard

 By the 1850s, the paper currency component of the money supply was badly in need of overhaul. Politically powerful local bankers, however, resisted change until an event came along that was to change banking forever in America—the Civil War.

## Greenbacks

When the Civil War erupted, both the Union and the Confederacy needed to raise enormous sums to finance the war. Congress tried to borrow money by selling bonds, but this did not raise as much money as the federal government needed. As a result, Congress decided to print paper currency for the first time since the Constitution was adopted.

### The 50 State Quarter Program

#### The First Five Quarters:



#### The 10-Year Release Schedule:

Year	States	Year	States	Year	States	Year	States
1999	Delaware Pennsylvania New Jersey Georgia Connecticut	2002	Tennessee Ohio Louisiana Indiana Mississippi	2005	California Minnesota Oregon Kansas West Virginia	2008	Oklahoma New Mexico Arizona Alaska Hawaii
2000	Massachusetts Maryland South Carolina New Hampshire Virginia	2003	Illinois Alabama Maine Missouri Arkansas	2006	Nevada Nebraska Colorado North Dakota South Dakota		
2001	New York North Carolina Rhode Island Vermont Kentucky	2004	Michigan Florida Texas Iowa Wisconsin	2007	Montana Washington Idaho Wyoming Utah		

**Using Charts** The United States Mint is introducing 50 new quarters over a 10-year period to celebrate individual states' histories and traditions. **In what order are the quarters being released?**



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## ECONOMICS Online



**Student Web Activity** Visit the *Economics: Principles and Practices* Web site at [epp.glencoe.com](http://epp.glencoe.com) and click on **Chapter 11—Student Web Activities** for an activity on the new dollar coin.

In 1861, Congress authorized the printing of \$60 million of demand notes. Although these notes had no gold or silver backing, they were declared **legal tender**—fiat currency that must be accepted in payment for debts. These new federal demand notes were soon dubbed greenbacks because both sides of the notes were printed with green ink to distinguish them from the state notes already in circulation.

In 1862, Congress passed the Legal Tender Act, authorizing the Union government to print \$150 million of **United States notes**, a new federal fiat currency that also had no gold or silver backing. These new notes were also called greenbacks, and they accounted for half of the currency in circulation by 1863. Meanwhile, the Confederacy did essentially the same thing by printing large amounts of paper money to finance its war efforts.

### National Currency

As the war dragged on, people feared that greenbacks—like the Continental dollars used to finance the Revolutionary War—might also become worthless. When the greenbacks did lose some of their value, people avoided using them, forcing Congress to find another way to finance the war.

The solution was to create a National Banking System (NBS) made up of **national banks**—privately owned banks that received their operating charters from the federal government. These banks issued **National Bank notes** or **national currency**, paper currency of uniform appearance that was backed by United States government bonds. The government hoped that rigorous bank inspections and other high standards would give people confidence in the new NBS and its currency.

This backing made the currency seem more secure to the public. It also generated a new demand for war bonds because any group that wanted to set up a national bank had to first purchase government bonds as part of the requirement to get the national charter. The bonds were then put on deposit with the United States Treasury as backing against the currency.

Initially, few state-chartered banks joined the system because it was easier for them to print their money at a local printer than to join the NBS.

Finally, in 1865 the federal government forced state banks to join the National Banking System by placing a 10 percent tax on all privately issued bank notes. Because state-chartered banks could not afford the tax, they withdrew their notes, leaving only the greenbacks and national currency in circulation.

As a result of the need to finance the Civil War, the makeup of the money paper supply shifted from being entirely privately-issued to being entirely publicly-issued.

### Gold Certificates

The removal of more than 10,000 different sizes and denominations of state bank notes simplified the currency system. Before long, however, new types of federal currency appeared.

In 1863, the government issued **gold certificates**—paper currency backed by gold placed on deposit with the United States Treasury. At first, these certificates were printed in large denominations for banks to use when settling differences with each other at the end of the business day. In 1882, the government began printing gold certificates in smaller denominations for public use.

### Silver Certificates

In 1886, the government introduced **silver certificates**—paper currency backed by silver dollars and bullion placed on reserve with the Treasury. Silver certificates were modeled after the highly popular gold certificates, but they were really designed to prop up sagging silver prices for western silver miners.


At the time, the government was already minting silver dollars. However, silver dollars were bulky and inconvenient to use, so the act was amended in 1886

to allow silver dollars to be used as backing for the new silver certificates. This appeased both the silver miners and the public who wanted an alternative to the generally unwanted silver dollars.

## Treasury Coin Notes

In 1890, the federal government printed the fifth, and last, type of paper currency issued before the banking system was overhauled in 1913. The currency came in the form of **Treasury coin notes**—paper currency issued by the Treasury that was redeemable in both gold and silver. The law was repealed in 1893, and further issues of Treasury coin notes were ended.

## The Gold Standard

 In 1900, Congress passed the Gold Standard Act, fixing the price of gold at \$20.67 an ounce. For the first time, the United States was on a **gold standard**—a monetary standard under which the basic currency unit is equal to, and can be exchanged for, a specific amount of gold.

The Gold Standard Act did not affect the type of currency people used. People continued to use the same greenbacks, National bank notes, gold certificates, silver certificates, and Treasury coin notes as they did before. The difference was that these notes could now be exchanged for gold at the Treasury at any time.

## Advantages of a Gold Standard

A gold standard has two major advantages. First, some people feel more secure about their money if they know it can be converted into gold.

Second, it is supposed to prevent the government from printing too much paper currency. In theory, the government promises to print only as much currency as can be backed by, or exchanged into, gold. This keeps the currency relatively scarce and helps to maintain its value.

In reality, the United States never did have enough gold to back all of its currency. This is normally the case whenever a country goes on a gold standard because it is unlikely that everyone will

want to convert all of their currency into gold at the same time. Consequently, it is usually sufficient to maintain the *appearance* of having enough gold to back the paper money.

## Disadvantages of a Gold Standard

One disadvantage of a gold standard is that the gold stock may not grow fast enough to support a growing economy. If new gold supplies cannot be found, the money supply may not be able to expand, thereby restricting economic growth.

A second disadvantage is that people may suddenly decide to convert their currency into gold, thereby draining the government's gold reserves. This can easily happen if a government is trying to maintain the appearance of having enough gold—when in fact it does not.

Third, we know that the price of gold is likely to change dramatically over time if it is not fixed. For example, in Chapter 6 we saw that the price of gold fell from \$850 an ounce in 1980 to \$280 in early 1999. This means that any government that tries to “fix” the price of gold by buying and selling unlimited amounts at an official price will face—and must triumph over—tremendous market pressures.

Finally, there is always the political risk of failure. A government that announces an official price for gold looks ineffective and foolish if it cannot carry out its intentions. When the Swiss abandoned the gold standard, for example, the “official” price of an ounce of gold was 142.9 Swiss francs—or about \$95. Clearly no one was going to sell gold to the Swiss at that price. Nor were the Swiss willing to sell their gold on the open market at that price.

### Did you know?

**Why the Notches?** Why do dimes, quarters, and half-dollars have notched or reeded edges while pennies and nickels don't? The United States Mint notched the edges of coins containing gold and silver to hinder people from shaving off quantities of the precious metals. Since pennies and nickels contain cheaper metal, they have no notches.



## WHY ISN'T THERE JUST ONE CURRENCY?

Some frustrated American tourists who try to communicate in foreign lands by screaming English words at a hundred decibels may wish that everyone just spoke English and used the dollar. Wouldn't that make it easier for international trade? There would be no more standing in line at the bank window waiting for the teller to exchange currencies and take a cut off the top.

That might work well—except for three things. First, most people like their currency. The depictions on paper money and coins reinforce national icons and symbols. Why would the Brits want to trade in Queen Elizabeth's noble chin for George Washington's wooden-toothed grimace? Second, national currencies allow countries to manage their own banking system (though they cannot insulate themselves from the policies of trading partners).

Third, most countries are reluctant to surrender control of their macroeconomic policy to foreigners. Suppose Spain's 20 percent unemployment rate demands urgent attention in the form of lower interest rates, yet Portugal's higher inflation rate makes the authorities nervous about easier money. If Spain and Portugal shared a currency, they would have to share policy prescriptions. That would be like two patients in a doctor's waiting room agreeing to the same medication, even though they suffered from different ailments.

—From *Here to Economy* by Todd G. Buchholz, Dutton, 1995

### Critical Thinking

1. **Analyzing Information** Why does the writer believe countries will not accept a common currency?
2. **Drawing Conclusions** Read to find out about the euro. Is the writer's argument that nations will not accept using the same currency valid? Why or why not?

## Abandoning the Gold Standard

The gold standard remained in force until the Depression of the 1930s when banks began to fail in record numbers. Because of the uncertain times, and because people felt safer holding gold rather than paper currency, they began to cash in their dollars for gold. Foreign governments with large holdings of dollars began to do the same thing.

The federal government feared it could not continue to back the money supply with gold, so on August 28, 1933, President Franklin D. Roosevelt declared a national emergency. As part of the emergency, the government decreed that anyone holding more than \$100 worth of gold or gold certificates must file a disclosure form with the United States Treasury.

Several months later, the Gold Reserve Act of 1934 was passed, which required citizens, banks, and businesses to turn their gold and gold certificates over to the United States government. Those

who had filed a disclosure had no choice but to surrender their gold holdings. Others simply ignored the government and kept their gold. Regardless, the United States went off the gold standard in 1934 when it confiscated gold from private citizens.

## The Inconvertible Fiat Money Standard



Since 1934 the United States has been on an **inconvertible fiat money standard**—a monetary standard under which the fiat money supply cannot be converted into gold or silver by its citizens.

## A Managed Money Supply

The money supply of the United States, like those of other major industrialized countries in the world, is a managed money supply. In other words,



the government or its designated agent controls the quantity, composition, and even the quality of the money supply.

This task is somewhat easier now that a single currency issued by the Federal Reserve System has replaced the multiple currencies that appeared after the Civil War. National currency and Treasury coin notes were withdrawn from circulation in the 1930s, and gold certificates were confiscated in 1934. The last issue of United States notes (greenbacks) took place in 1968. Silver certificates were also retired, and the government stopped redeeming them for silver dollars in 1968. Americans have been allowed to own gold and silver certificates since 1975, but neither is officially part of the money supply.

Today, the tangible component of modern money consists of coins and Federal Reserve notes. Intangible components consists of traveler's checks along with checking and savings accounts. How well these substances function as money depends on how well the four characteristics of money are satisfied.

## Characteristics of Modern Money

Although money has changed in shape, kind, and size over the years, modern money shares the same characteristics of early money. Modern

money is *portable*. Currency is lightweight, convenient, and can be easily transferred from one person to another. The same applies to the use of checks.

Modern money is reasonably *durable*. Metallic coins last about 20 years under normal use. Paper currency also is reasonably durable, with a \$1 bill lasting about 18 months in circulation. Even the introduction of the new Sacagawea dollar coin is part of an attempt to make the money supply more durable by replacing low-denomination currency with coins.

Modern money is *divisible*. The penny, which is the smallest denomination of coin, is small enough for almost any purchase. In addition, checks can be written for the exact amount.

If anything, modern money has an uneven track record when it comes to *limited availability* and stability in value. The money supply often grew at a rate of 10 to 12 percent a year in the early 1970s, which contributed greatly to the inflation of the period. It slowed considerably after that, contributing to the period of relative price stability in the 1990s.

In the end, the money supply can be managed, and price stability can be maintained—but only if the government and monetary authorities have the political courage to do so.

## Section 2 Assessment

### Understanding Key Terms

- 1. Main Idea** What is the purpose of a monetary standard?
- 2. Key Terms** Define monetary standard, state bank, legal tender, United States note, national bank, National Bank note, national currency, gold certificate, silver certificate, Treasury coin note, gold standard, inconvertible fiat money standard.
- 3. Explain** how privately issued bank notes became part of the money supply.
- 4. List** the five major currencies in use after the Civil War.
- 5. Identify** the advantages and disadvantages of a gold standard.

- 6. Describe** the inconvertible fiat money standard that the United States uses.

### Applying Economic Concepts

- 7. Money Supply** Suppose that Federal Reserve notes did not exist to serve as “legal tender.” What else could be done to establish a suitable money supply?

### Critical Thinking

- 8. Making Comparisons** Some experts have proposed a return to the gold standard. Explain why you think this may or may not be a good idea.



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

## Developing Multimedia Presentations

Your economics teacher has assigned a presentation about how banks operate. You want to develop a presentation that really holds your classmates' attention. How do you go about it?

### Learning the Skill

A multimedia presentation involves using several types of media, including photographs, videos, or sound recordings. The equipment can range from simple cassette players, to overhead projectors, to VCRs, to computers, and beyond.

Multimedia, as it relates to computer technology, is the combination of text, video, audio, and animation in an interactive computer program. You need certain tools to create multimedia presentations on a computer, including computer graphics tools and draw programs, animation programs, and authoring systems that tie everything together. Your computer manual will tell you which tools your computer can support.

### Practicing the Skill

Plan and create a multimedia presentation on a topic found in the chapter, such as the development of money in colonial America. List three or four major ideas you would like to cover. Then think about how multimedia resources could enhance your presentation. Use the following questions as a guide when planning your presentation.

1. Which forms of media do I want to include? Video? Sound? Animation? Photographs? Graphics?



Various equipment that can be used in multimedia presentations

2. Which kinds of media equipment are available at my school or local library?
3. What types of media can I create to enhance my presentation?
4. Which of the media forms does my computer support?

### Application Activity

Choose an economist from the twentieth century and create a multimedia presentation about his or her theories. Use as many multimedia materials as possible, and share your presentation with the members of your class.

# The Development of Modern Banking

## Study Guide

### Main Idea

The Federal Reserve System serves the monetary needs of the federal government and controls the monetary system.

### Reading Strategy

**Graphic Organizer** As you read the section, complete a graphic organizer similar to the one below by listing at least three kinds of depository institutions.



### Key Terms

Federal Reserve System, central bank, Federal Reserve note, run on the bank, bank holiday, commercial

bank, demand deposit account (DDA), thrift institution, mutual savings bank (MSB), savings bank, NOW accounts, savings and loan association (S&L), credit union, share draft account, deregulation, creditor

### Objectives

After studying this section, you will be able to:

1. **Relate** the effects of Depression-era bank failures on deposit insurance creation.
2. **Identify** three other forms of depository institutions.
3. **Describe** the reasons for the S&L crisis in the 1980s.

### Applying Economic Concepts

**Demand Deposit Accounts** You may think that checking accounts are pretty useful. Read to find out how they replaced the carrying of large amounts of cash to make life easier for everyone.

## Cover Story

### Suspicious Internet Banking

Today more and more banks are offering financial services via the Internet. While the vast majority of these are entirely legitimate, the sad fact is that a few unscrupulous people may take advantage of the anonymity of the Internet to perpetuate fraud. . . . [W]e [the FDIC] offer two items you may find helpful in determining . . . suspicious Web sites.



More banks go online.

[The first is a] searchable database [that] will help you determine if an institution has a legitimate charter and is a member of the FDIC.

[The second is a] special alert financial institution letter . . . pertaining to unauthorized banking operations currently identified. . . .

—FDIC, June 10, 1999

**B**anks fulfill two distinct needs. They provide a safe place for people to deposit their money, and they lend excess funds to individuals and businesses temporarily in need of cash. This can only happen if the nation has a strong banking system.


### Revising the Banking System



In 1863, the federal government strengthened the financial system by passing the National Banking Act. It set up a system of nationally chartered and inspected banks. Yet problems persisted as financial crises and recessions marked the next half century. Each crisis led to calls for reform, but when the crisis ended, the protests faded away. Finally, when consumer and commercial credit dried up during the panic of 1907, the need for reform could no longer be ignored. The government set up a commission to formulate a plan for a new system.



## The Federal Reserve System

 Reform came in 1913 when Congress created the **Federal Reserve System**, or Fed, as the nation's first true central bank. A **central bank** is a bank that can lend to other banks in times of need.

To ensure membership in the Fed, all national banks were required, and all state-chartered banks were eligible, to become “members”—or part owners—of the Fed. Because the Fed was organized as a corporation, any bank that joined had to purchase shares of stock in the system, just as a private individual purchases shares in a regular corporation. As a result, privately-owned banks own the Federal Reserve System, not the government.

Despite its private ownership, the Fed is publicly controlled. The president appoints, subject to congressional approval, the Fed's Board of Governors and its chairperson.

Finally, **Federal Reserve notes**—paper currency issued by the Fed that eventually replaced all other types of federal currency—were added to the money supply. Federal Reserve notes were backed by gold when first issued in 1914, but became inconvertible fiat money after 1934.

## Banking During the Great Depression

Despite the reforms many banks were only marginally sound during the 1920s. Part of the reason was the over-expansion in banking that took place

between 1880 and 1921. Although some consolidation occurred between 1921 and 1929, the banking industry was overextended when the Great Depression began in 1929.

As **Figure 11.2** shows, the number of bank failures during the 1930s was staggering. At the start of the Depression, about 25,500 banks existed—none of which had deposit insurance for their customers. As a result, concern about the safety of bank deposits often caused a **run on the bank**—a rush by depositors to withdraw their funds from a bank before it failed. This made the situation even worse and caused more banks to fail.

To ease the situation, on March 5, 1933, President Roosevelt announced a **bank holiday**—a brief period during which every bank in the country was required to close. Several days later, after Congress passed legislation that strengthened banking, most banks were allowed to reopen. The Great Depression took its toll, however, and by 1934 more than 10,000 banks had closed or merged with stronger partners.

## Federal Deposit Insurance

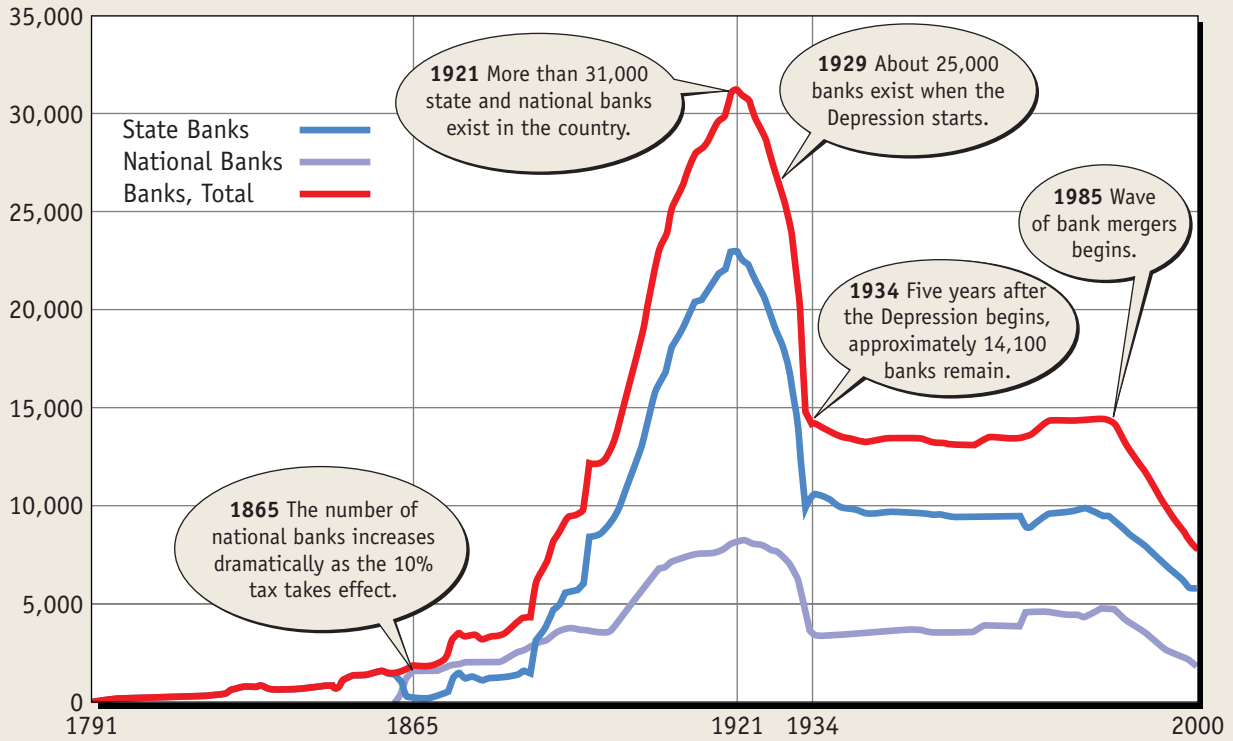
When banks failed during the Depression, depositors lost almost all their savings. The Banking Act of 1933, also known as the Glass-Steagall Act, was passed to strengthen the banking industry. The act also created the Federal Deposit

### Banks



**Purposes** From early times on, banks provided safe storage facilities, interest payments on deposits, money transfers, and loans. *What is the purpose of the Federal Deposit Insurance Corporation?*

### Number of State and National Banks



Source: Federal Deposit Insurance Corporation and *Historical Statistics of the United States, Colonial Times to 1970*

**Using Graphs** The number of banks in the United States grew rapidly after 1880 and peaked in 1921. A period of mergers and consolidations took place from 1921 to 1929, after which the Great Depression took its toll. The number of banks remained relatively constant from 1933 to 1985, when another wave of mergers took place. **What can you infer about the ratio of state banks to national banks?**

**ECONOMICS Online**  
 Visit [epp.glencoe.com](http://epp.glencoe.com) and click on *Textbook Updates—Chapter 1* for an update of the data.

**CLICK HERE**

Insurance Corporation (FDIC) to insure customer deposits in the event of a bank failure. The initial coverage was only \$2,500 per account, but it has since been increased to a maximum of \$100,000 for one person at one bank.

The insurance did little for those who lost their savings before 1934, but it has provided a sense of security in banking ever since. After the FDIC was

created, people worried less about the safety of their deposits, reducing the number of runs on a bank.

Today, protection provided by the FDIC goes far beyond deposit insurance. As you read in the cover story, the FDIC aggressively pursues ways to protect consumers against fraudulent banks—even those not insured by the FDIC.

## Other Depository Institutions



Most of the early U.S. banks were **commercial banks**—banks that catered to the interests of business and commerce. They had the power to issue checking accounts. Checking accounts are also called **demand deposit accounts (DDAs)**—accounts whose funds could be removed by simply writing a check without prior approval from the depository institution. Other financial institutions, called **thrift institutions**, or thrifts, accepted the deposits of small investors but did not have DDAs until the mid-1970s.

### Savings Banks

One of the oldest thrift institutions in the United States is the **mutual savings bank (MSB)**, a depositor-owned financial organization operated only for the benefit of its depositors. Later, many MSBs decided to sell stock to raise additional financial capital. These institutions then became **savings banks** because they were no longer mutually owned by depositors.

Mutual savings banks got their start in the late 1700s. At that time, commercial banks were not interested in the accounts of small wage earners. Savings banks emerged to fill that need and became very popular with consumers.

By the mid-1800s, commercial banks, along with the savings and loan associations, began to compete more heavily with the savings banks. As a result, savings banks did not spread beyond their foothold in the industrial northeast and the Pacific northwest.

STANDARD  
& POOR'S

INFOBYTE

**Interest Rates** Interest rates represent the time value of money. In other words, a dollar today is worth more than a dollar one year from now. To compensate investors for the risks of investment, interest rates must take into account inflation, liquidity, credit, and other risks.

Even so, savings banks had a powerful influence. In 1972, the Consumer's Savings Bank of Worcester, Massachusetts introduced Negotiable Order of Withdrawal, or **NOW accounts**, a type of checking account that pays interest. Because commercial banks held most checking accounts at the time, they strongly opposed NOW accounts. NOW accounts proved popular, however, and they were offered nationwide after 1980.

### Savings and Loan Associations

Another type of financial institution is the **savings and loan association (S&L)**—a depository institution that invests the majority of its funds in home mortgages. S&Ls began as cooperative clubs for home-builders in the 1800s. The association's members promised to deposit a certain sum regularly into the association. Members then took turns borrowing money to build a home.

Later, in the 1930s, the Federal Home Loan Bank Board was created to supervise and regulate individual savings and loan associations. The Federal Savings and Loan Insurance Corporation (FSLIC), a federal government agency like the FDIC that serves commercial bankers, was also created to insure savings and loan deposits.

### Credit Unions

A fourth type of depository institution is the **credit union**—a nonprofit service cooperative that is owned by, and operated for, the benefit of its members. Costs are generally low because a sponsor such as the members' place of employment often provides management, clerical help, and office facilities.

Because most credit unions are organized around an employer, contributions generally are deducted directly from a worker's paycheck. More recently, **share draft accounts**—or interest-earning checking accounts issued by credit unions—were introduced to compete with NOW accounts.

## Crisis and Reform in the 1980s



Because of the massive banking failures during the Great Depression, financial institutions were closely regulated from 1933 through the 1970s. The regulations even applied to maximum



rates of interest that could be paid on checking and savings accounts, as well as to restrictions on how and to whom the institutions could lend their funds.

By the late 1970s, most financial institutions were calling for relief from federal regulations. When Ronald Reagan was elected president in 1980, the political climate changed, allowing **deregulation**—the removal or relaxation of government restrictions on business.

Deregulation reduced the differences between competing financial institutions. First, the requirement that set maximum interest rates on savings accounts was phased out. This action eliminated the advantage that savings banks and S&Ls had over commercial banks when it came to paying higher interest rates on savings accounts.

Second, NOW accounts could be offered on a nationwide basis by any type of financial institution. This provision eliminated the advantage that commercial banks had with their check-issuing powers.

Third, all depository institutions could borrow from the Federal Reserve System in times of need, a privilege previously reserved for commercial banks. In return, all depository institutions were required to set aside a larger part of their customers' deposits in the form of reserves.

## The Savings and Loan Crisis

An S&L crisis unfolded slowly but surely during the 1980s. In 1980 the United States had 4,600 S&Ls. By mid-1988, bankruptcies and mergers reduced the number to about 3,000. By the early 1990s, fewer than 2,000 institutions survived.

Deregulation was one of the reasons for the crisis. Savings and loan institutions were used to having the government set their interest rates and determine what types of loans they could make. Most S&Ls, therefore, were not well prepared to face real competition in the marketplace.

Another problem was high interest rates. Most S&Ls made long-term, low-interest loans to homeowners in the early 1970s. When interest rates reached record levels in the early 1980s, S&Ls ended up paying more on funds deposited with them than they earned on the loans they already made.

A third problem was the relatively small capital reserves kept by the S&Ls to absorb bad loans—reserves about half the size that commercial banks kept. This meant that several bad loans could force an S&L to go out of business, rather than be absorbed by the capital accounts.

Deregulation also resulted in fewer federal inspectors to make sure the rules and regulations were followed. As a result, a few institutions were able to engage in fraud on a scale seldom seen before.

## Reforming the Thrift Industry

The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) was passed in 1989. This act abolished the independence of the savings and loan industry and is regarded as the most significant financial legislation since the Depression.

Many S&Ls were profitable during the crisis. These institutions were allowed to continue operations, and many even kept the words *savings and loan association* in their titles. Others, however, chose to

## Careers



### Bank Teller

When you go to a bank, a bank teller often handles your money. The bank teller's job is to process a customer's transactions.

#### The Work

Bank tellers handle a wide range of banking transactions, including cashing checks, accepting deposits and loan payments, and processing withdrawals. Bank tellers may

sell savings bonds and traveler's checks, and handle foreign currencies or commercial accounts. They are trained to explain the various types of accounts and financial services the bank offers.

#### Qualifications

Tellers need an aptitude for using computers, and they must be quick, accurate, and honest. Good numerical, clerical, and communication skills are a must. A bank teller's job is an entry-level position. After a few years, a bank teller can be promoted to be a personal banker or into a management position.

change their name to distance themselves from the crisis that had tarnished so many reputations.

Even so, the cost of the thrift crisis to taxpayers was enormous, amounting about \$300 billion. This amounted to approximately \$1,200 for every man, woman, and child in America.

## Dealing With Failed Banks

Bank failures were also a problem in the 1980s. If a bank is in danger of collapse, the FDIC can seize the bank and either sell it to a stronger one or liquidate it and pay off the depositors. The forced sale or liquidation is done in secrecy to prevent panic withdrawals and to prevent shareholders from selling their worthless stock to unsuspecting investors.

Either way, depositors have little to fear because they are covered up to the \$100,000 FDIC insurance limit. If an account has more than this, the depositor may go to court as a **creditor**—a person or institution to whom money is owed—and sue the bank's owners to recover the rest.

Banks fail for many reasons, but poor management is the primary cause. Some banks make loans

without adequate collateral, others fail to keep expenses under control, and still others may be victims of a weak economy. The reforms instituted as a result of the S&L crisis, however, have made all financial institutions safer.

## Change in the 1990s

The 1980s were so turbulent that caution became the watchword of the 1990s. The thrift crisis was largely over, and the surviving financial institutions adopted more conservative lending policies, which helped them return to profitability.

Along with stronger federal regulations, all financial institutions were required to strengthen their capital reserves. The FDIC, as we saw in the cover story, even provides innovative ways to help the public discover and prevent abuses by fraudulent financial institutions.

Two trends that emerged at the beginning of the decade were in full swing by the end of the century. One was the improving health of all financial institutions. The second was the continued erosion of historical differences among the commercial banks, savings banks, S&Ls, and credit unions.

### Section 3 Assessment

#### Checking for Understanding

- 1. Main Idea** Why was the Federal Reserve System created?
- 2. Define** Federal Reserve System, central bank, run on the bank, bank holiday, commercial bank, demand deposit account (DDA), thrift institution, mutual savings bank (MSB), savings bank, NOW accounts, savings and loan association (S&L), credit union, share draft accounts, deregulation, creditor.
- 3. Explain** why the National Banking System was created.
- 4. Explain** why deposit insurance developed in the 1930s.
- 5. Identify** three depository institutions.
- 6. Describe** four factors contributing to the S&L crisis.

#### Applying Economic Concepts

- 7. Demand Deposit Accounts** Adam Smith argued that a competitive economy functions best when everyone pursues his or her own best interests. Explain how the self-interest of state-chartered banks in 1865 led to the development of demand deposit accounts.

### Critical Thinking

- 8. Drawing Conclusions** The FDIC insures deposits up to \$100,000. What would you do if you had \$400,000 you wanted to deposit and insure?
- 9. Summarizing Information** What is a demand deposit account?



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# BusinessWeek

JULY 19, 1999

## Newsclip

*Technology now exists for businesses to bill their customers over the Internet and for the customers to return payment over the Internet. Bankers are hoping that this electronic billing will allow banks to continue managing money for companies.*

## The Battle To Be Your Online Bill Collector

Every year, American business sends out 29 billion bills. And by any measure, the exercise isn't much fun. For companies, printing, processing and posting a typical consumer bill runs about 90¢. . . .

But for banks trying to make it on the Internet, bills are cool. Bankers see bills as sure-fire eyeball-grabbers in an environment where it's tough to command consumer attention—and a key to protecting their existing business managing cash for big companies. Increasingly, banks are battling high-tech competitors for control of Internet billing, or electronic-bill presentment, as it is called. . . .

The question is who will become the bill collector on the Net. Bankers reckon that if they can turn their Web sites into mailboxes for electronic bills, they can become key entry points on the Net—portals even. That would enable them to sell other financial services online. The fear is that existing portals, such

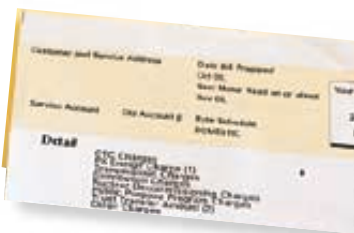
as Yahoo! or even America Online, will become centers of bill payment and, in turn, siphon off existing bank businesses. . . .

Banks have their advantages. They can offer customers simultaneous access to their bills and their money. Banks have long relationships with billers, such as utilities and retailers, and centuries of experience in protecting people's money. . . .

Big banks also are worried that technology companies offering bill presentment could muscle into one of their fastest-growing businesses—managing cash for big companies. After all, distributing and collecting bills is a close cousin to cash management. . . .

At this point, predicting how the industry will shake out is premature. Banks and technology companies already have formed several alliances aimed at delivering bills on the Net. More combinations are likely. What's clear, though, is the banks know they are running out of time to get their Internet billing act together.

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### Examining the Newsclip

- 1. Making Comparisons** What are some advantages that banks can offer customers compared to Internet companies?
- 2. Analyzing Information** Why are banks concerned that Internet companies will become bill payment centers?



## Chapter 11 Summary

### Section 1

#### The Evolution of Money (pages 285–290)

- **Money** is any substance that serves as a medium of exchange, a measure of value, and a store of value.
- **Commodity money**, wampum, **specie**, and paper currency were used extensively in colonial America.
- The Continental Congress issued large amounts of **Continental dollars** to finance the American Revolution, but excessive issue made the money worthless by the end of the war.
- The U.S. dollar was based on the Spanish peso, which was imported from the West Indies.
- All successful monies have portability, durability, divisibility, and limited availability.

### Section 2

#### Early Banking and Monetary Standards (pages 292–298)

- From the American Revolution to 1861, paper currency was issued by state-chartered, privately owned banks. The federal government issued coins but no paper currency.
- The variety of private notes eventually made the money supply difficult to use, and fraudulent wildcat banks often abused the privilege of printing currency.
- The government sold bonds and then printed **greenbacks** to finance the Civil War.
- In 1863 the National Banking System was set up to strengthen the banking system and to generate new demand for government bonds. Later, other federal currencies became popular, including **gold certificates**, **silver certificates**, and **Treasury coin notes**.
- The **gold standard** was adopted in 1900, which made all currencies, including **Federal Reserve notes**, convertible into gold on demand. However, the country left the gold standard in 1934 because gold stocks ran low during the Great Depression.

- After 1934 Americans could not convert dollars into gold.
- Today, most governments manage their currencies with respect to quality, size, composition, and availability. Most modern money functions well as a medium of exchange and is portable, durable, divisible, and reasonably stable in value.

### Section 3

#### The Development of Modern Banking (pages 300–305)

- The National Banking System brought uniformity to banking. National banks also issued their own currency known as **National Bank notes**. State-chartered banks that chose not to join gave up printing currency in favor of **demand deposit accounts**.
- The **Federal Reserve System** (Fed) was established in 1913, giving the country a true **central bank**. All **national banks** were required to join the Fed, and all **state banks** were also invited to join.
- Despite the Fed, massive banking failures occurred during the Great Depression.
- Other depository institutions—mutual savings banks, credit unions, and savings and loan associations—appeared to cater to the small investor ignored by commercial banks.
- Deregulation, high interest rates, inadequate financial reserves, and fraud reduced the numbers of S&Ls by half in the 1980s.
- The financial crisis was largely over by the end of the decade, and the 1990s saw the continued growth of similarities between commercial banks, savings banks, and S&Ls.



# Chapter 11 Assessment and Activities

## ECONOMICS Online



**Self-Check Quiz** Visit the *Economics: Principles and Practices* Web site at [epp.glencoe.com](http://epp.glencoe.com) and click on **Chapter 11—Self-Check Quizzes** to prepare for the chapter test.



**CLICK HERE**

## Identifying Key Terms

*On another sheet of paper, place each of the vocabulary terms in its correct historical period(s). Some terms will appear under more than one period.*

### Historical Periods:

- Colonial: 1607–1776**
- Pre-Civil War: 1789–1861**
- Civil War–Pre-Depression: 1861–1929**
- Depression: 1929–1939**
- World War II–FIRREA: 1940–1989**
- 1989–present**

- United States note \_\_\_\_\_
- commercial bank \_\_\_\_\_
- Continental dollar \_\_\_\_\_
- deregulation \_\_\_\_\_
- Federal Reserve System \_\_\_\_\_
- gold certificate \_\_\_\_\_
- gold standard \_\_\_\_\_
- inconvertible fiat money standard \_\_\_\_\_
- legal tender \_\_\_\_\_
- mutual savings bank \_\_\_\_\_
- national bank \_\_\_\_\_
- NOW account \_\_\_\_\_
- savings and loan association \_\_\_\_\_
- silver certificate \_\_\_\_\_
- specie \_\_\_\_\_
- Treasury coin note \_\_\_\_\_

## Reviewing the Facts

### Section 1 (pages 285–290)

- List** the three functions of money.
- Describe** five types of early money.
- List the four characteristics that give money its value.

### Section 2 (pages 292–298)

- Describe** the paper currencies used from the period of the American Revolution to the time of the Civil War.
- Explain** the importance of the greenback during the Civil War.
- Describe** four disadvantages of a gold standard.
- Evaluate** modern money as a medium of exchange.

### Section 3 (pages 300–305)

- Describe** the main difference between the Federal Reserve System and the National Banking System.
- Explain** why many banks failed during the Great Depression.
- Describe** two evolutionary trends in banking that emerged in the 1990s.

## Thinking Critically

- Understanding Cause and Effect** How did high interest rates affect the S&L industry in the early 1980s?
- Making Comparisons** Why were coins a more desirable form of money than paper during the colonial period? Create a table like the one below to help you organize your answer.

Kinds of Money	Advantages	Disadvantages
Coins		
Paper		

## Applying Economic Concepts

- 1. Money** Ask your friends, parents, and neighbors if they have any examples of old currency. If so, make a note of (a) the name of the currency (gold certificate, silver certificate, United States note, etc.); (b) the date on the currency; and (c) any mention of backing (silver certificates backed by silver dollars). Describe the role this money played in United States history.
- 2. Barter** Assume that you live in a barter society. Organize a list of 10 items that you use frequently, and then identify alternate goods of comparable worth that you would be willing to trade for them.

## Math Practice

The table below provides information on the number and total assets of FDIC-insured commercial banks. Study the data and then design a graph to present this information.

Total Assets	Number of Institutions
Less than \$25 million	1,404
\$25 to \$50 million	2,107
\$50 to \$100 million	2,598
\$100 to \$300 million	2,937
\$300 to \$500 million	585
\$500 to \$1 billion	393
More than \$1 billion	537
<b>Total Institutions</b>	<b>10,561</b>

## Thinking Like an Economist

Over time different financial institutions—state banks, national banks, S&Ls, MSBs, and credit unions—have lost some of their individual identities and have become more and more like each other. Is this an outcome that could have been predicted by an economist?

## Technology Skill

**Using the Internet** The money supply of the United States, much like that of the major industrialized countries, is a managed money supply. The government or its designated agent tries to control the quantity, composition, and even the quality of the money supply. The two agencies that make United States currency are the Bureau of the Mint and the Bureau of Engraving and Printing. What are the roles of these two agencies? Use the Internet to find out about the operations of one of these two currency-making institutions.

To begin, log on to the Internet and access a World Wide Web search engine. Search by selecting one of the listed categories or by typing in the subject you want to find, such as *Bureau of the Mint* or *Bureau of Engraving and Printing*. Next, enter words like the following to focus your search: *currency*, *United States Mint*, and *counterfeiting*.

Gather your findings. Using the findings, create a pamphlet that could be distributed by either bureau to describe its role in the creation of American currency.

## Building Skills

### Developing Multimedia Presentations

Examine the list of topics below. Choose one of the topics and explain how you would use at least three types of media in a presentation to best teach the topic to your class.

- Trade in colonial America
- Origins of the dollar
- Establishment of a national bank—Alexander Hamilton's view and Thomas Jefferson's view
- Currencies around the world
- Banking during the Civil War
- Roosevelt's bank holiday during the Great Depression



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.



# ECONOMICS WORKSHOP IN ACTION

## Buying a Home

*From the classroom of . . .*

*Hal Kraynek*

*Valley High School*

*Santa Ana, California*

*The ability to buy a home is usually the result of proving to a lending institution that your salary is sufficient to make the monthly mortgage payments. Also, the lending institution will demand evidence that the amount you will pay for the house is a reasonable amount for the neighborhood, the size, and the condition of the house. Buying a home is usually a lengthy, complex process.*

*Select a partner to work with. Imagine that you and your partner have completed your education and successfully acquired jobs in your respective fields. You both have saved money all those years and are now ready to purchase a home. You will combine your salaries to buy this home.*

### Setting Up the Workshop

Prepare a report on the process you would follow to purchase a home. The report will be five pages long. This will include a cover sheet, three pages of text, and a bibliography on the fifth page. The outline of your report should be similar to the following:

- I. Title page, including title, date, student's name, and class
- II. Background
  - A. Education
  - B. Occupation
- III. Price of house
  - A. Payments
  - B. Taxes
- IV. Procedure followed and paperwork involved
- V. Location of home
- VI. Decisions
  - A. Reason for home location
  - B. Insurance choice
  - C. Payment plan
- VII. Bibliography, including names and titles of people who helped you, Internet Web sites, title companies, newspapers, banks, county tax collector, flyers, realtors, and so forth

The report will contain at least the following information:

#### REQUIRED:

- Occupation (both you and your partner)
- Salary (yours and partner's)
- Education (yours and partner's)
- Mortgage rates
- Lending institute
- Taxes
- Loan amount
- Interest rate
- Down payment
- Type of loan
- Savings and loan companies, credit unions
- Number of years
- Procedure followed to acquire the loan



- Qualifications needed for loan
- Examples of paperwork involved in the application process
- Location of home

**OPTIONAL:**

- Other interesting information
- Visual aids
- Pamphlets/brochures

## Procedures

### STEP 1

Establish your education and professions. List any specialized training, and degrees or certificates achieved.

### STEP 2

Describe your job, city or locale of employment, what company, if you are self-employed, and your salary.

### STEP 3

Based on your salaries and where you work, decide where you want to live, and what price range of house you can afford.

### STEP 4

Compile places you might go for information and help. This might include Internet sites, title companies, friends, family, newspapers, and all types of lending institutions, and real estate advertising sources in your area.

### STEP 5

Research to find out what is involved with purchasing a house: what papers are needed; time spent in escrow; fees; charges; interest rates for 15-, 20-, and 30-year mortgages; payment rates; types of homeowners' insurance; notes; differences in buying a new home or an older home; repair expenditures; landscape costs; location of schools and shopping; and the type of neighborhood you are interested in.

### STEP 6

Write and submit your report, following the criteria outlined above.

## Summary Activity

Discuss with the other groups what problems you encountered and how you solved them.

