CHAPTER 15

Money and Banking

Section 15.1

Understanding Money

Essential Question

How is money used within an economic system?

Objectives

After completing this section, you will be able to:

- **Explain** the concept of money.
- **Identify** the responsibilities of the Federal Reserve.
- **Discuss** the importance of financial exchange.

Section 15.1 Review

Check Your Understanding

1. What are the three functions of money?
   Answer: The three functions of money are medium of exchange, unit of value, and store of value.
2. List five properties of money.
   Answer: The five properties of money are stable, easily recognized, divisible, portable, and durable.
3. List the four core functions of the Federal Reserve.
   Answer: The four core functions of the Federal Reserve are to establish monetary policy, supervise and regulate financial institutions, maintain the stability of the nation's financial system, and provide financial services.
4. List some basic examples of financial exchange.
   Answer: Basic examples of financial exchange include cash, credit cards, debit cards, and electronic funds transfer.

5. Why are laws and regulations necessary regarding financial exchange?
   Answer: Laws and regulations are necessary to help facilitate financial exchanges and protect buyers and sellers from fraud and other illegal behavior.

Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

money
Answer: Anything of value that is accepted in return for goods or services.

banknote
Answer: Document that guarantees the payment of a specific amount of money, either on demand, or at a set time with the payer named on the document.

security
Answer: Type of financial investment issued by a corporation, government, or other organization.

government bond
Answer: Security that pays interest over terms of ten to thirty years.

treasury note
Answer: Security that pays interest over terms ranging from two to ten years.

treasury bill
Answer: Security that matures in a year or less.

medium of exchange
Answer: Money is used in exchange for goods and services needed by individuals, businesses, and governments.

unit of value
Answer: Money is a common measure of what something is worth or price of a good or service.

store of value
Answer: When money can be saved and used at a later date.

monetary system
Answer: Mechanism a nation uses to provide and manage money for itself.

financial exchange
Answer: Process of transferring money from one individual or organization to another.

credit card
Answer: Plastic card that allows the holder to make credit purchases up to an authorized amount.

debit card
Answer: Allows customers to pay for purchases directly from their checking account.

electronic funds transfer (EFT)
Answer: Movement of money electronically from one financial institution or account to another.

Section 15.2

Banking

Essential Question

How do financial institutions serve business customers?

Objectives

After studying this section, you will be able to:

- **Describe** two types of financial institutions.
- **Identify** financial services provided by banks.
- **Explain** the importance of banking regulations.

Section 15.2 Review

Check Your Understanding

1. What are two main types of financial institutions?
   Answer: The two main types of financial institutions are depository and nondepository.

2. List three examples of depository institutions.
   Answer: Three examples of depository institutions are commercial banks, credit unions, and savings and loan institutions.

3. Define general banking services as offered by financial institutions.
   Answer: General banking services are those services offered by financial institutions to all types of customers.

4. Identify four examples of general banking services.
   Answer: Four examples of general banking products are checking accounts, savings accounts, electronic banking, and bank cards.

5. Name the two types of federal regulators that almost every depository institution is a member.
   Answer: Federal Deposit Insurance Corporation (FDIC) and National Credit Union Administration (NCUA).

Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

financial institution
Answer: Any organization that provides services related to money.

depository institution
Answer: Financial institution that accepts money from customers and deposits it into the customer's account.

deposit
Answer: Money placed into an account.

credit union

Answer: Nonprofit financial institution that is privately owned and provides banking services for its members.

savings and loan institution

Answer: Financial institution that offers savings and loan services.

nondepository institution

Answer: Financial institution that does not accept deposits.

securities firm

Answer: Financial institution that is involved in trading securities in financial markets.

investment bank

Answer: Financial institution that provides services for businesses.

finance company

Answer: Financial institution that makes money by issuing loans.

checking account

Answer: Bank account that allows the account owner to make deposits, write checks, and withdraw money.

check

Answer: Written order for the bank to pay a specific amount to the person or organization to which the check is written.

savings account

Answer: Bank account used by depositors to accumulate money for future use.

line of credit

Answer: Prearranged amount of credit that is available for a business to use as needed.

letter of credit

Answer: Document guaranteeing that a buyer will pay the seller the agreed-upon amount and within the time specified.

Chapter Summary

Section 15.1 Understanding Money

- Money is anything of value that is accepted in return for goods or services and allows business transactions to take place and goods and services to be exchanged. Money serves as a medium of exchange, unit of value, and store of value. To be meaningful, money must be stable, recognized, divisible, portable, and durable.
- The Federal Reserve System was created by the United States Congress in 1913 as our nation's central bank. It is responsible for the monetary system in the United States. The Federal Reserve supervises and regulates banks in the country.
- Financial exchange is the process of transferring money from one individual or organization to another. Methods of financial exchange include cash, credit cards, debit cards, and electronic funds transfer. Financial exchanges must be conducted within guidelines established by federal law.

Section 15.2 Banking

- Financial institutions help facilitate financial exchange and keep money moving the economy for consumers, businesses, and government. The two main types of financial institutions are depository and nondepository.
- Financial institutions provide many services to their customers. General banking services checking accounts, savings accounts, electronic banking, and bank cards. For business customers, banks typically offer business checking accounts, business lines of credit, long-term business loans, and international banking services.
- Financial institutions must comply with many federal and state regulations. Regulations ensure that banks provide fair and equitable services to consumers for accounts, loan products, and other services. Regulations also provide for equal opportunity lending.

Review Your Knowledge

1. Explain the concept of money.

   Answer: Money is anything of value that is accepted in return for goods or services. Money can be items that are bartered or currency and allows business transactions to take place and goods and services to be exchanged. Money is easy to use and can be used with confidence for transactions.

2. Explain each of the properties of money.

   Answer: Money must be stable, meaning it must maintain its value over time. Money must be recognized, meaning it must be easily identified. Money must be divisible, meaning there must be a way to divide money into smaller units. Money must be portable, meaning people must be able to carry money with them. Money must be durable, meaning it must be able to last a long time.

3. Describe the responsibilities of the Federal Reserve.

   Answer: The Federal Reserve is responsible for establishing monetary policy by taking action to manage the supply of money and interest rates in an economy. It supervises and regulates financial institutions by working with the Federal Deposit Insurance Corporation and the Consumer Advisory Council to protect consumers. The Fed maintains the stability of the nation's financial system by monitoring the economy and making necessary adjustments to interest rates and other financial areas. It provides financial services to the government and depository institutions and lends money to member banks.

4. Explain legal responsibilities associated with financial exchanges.

   Answer: The legal responsibilities of financial exchange cover many areas, including privacy, disclosure, fraud, consumer rights, and interest rates. The terms of exchange in a financial transaction are determined by state and federal laws. In a business transaction, the buyer trades money in return for goods or services. A buyer and seller must reach a legal agreement when trading money for goods or services. This is known as a contract and is legally enforced. Buyers must pay the agreed upon amount for a purchase of goods or services. It is illegal and unethical for a buyer to write a check that has insufficient funds or pay with counterfeit money. Sellers must provide the agreed upon product or service. They cannot sell stolen or illegal items and cannot write sales contracts that contain terms that violate the law. Financial institutions also have legal responsibilities related to financial exchanges. These financial exchanges may include checks, electronic fund transfers, and credit cards.

5. What is the difference between credit card and debit card financial exchanges for the consumer?

   Answer: When a consumer uses a credit card to make a purchase, it is like borrowing money from the financial institution that issued the credit card. There are fees and interest charges that apply to purchase. A bank-issued debit card allows customers to pay for purchases directly from their checking account. The money is taken out of the owner's checking account when the transaction is complete.

6. Differentiate between the two main types of financial institutions.

   Answer: The two main types of financial institutions are depository and nondepository. A depository institution is a financial institution that accepts money from customers and deposits it into the customer's account. A nondepository institution is a financial institution that does not accept deposits. These institutions generate profits by selling services.

7. List and describe four major types of nondepository institutions.

   Answer: Four major types of nondepository institutions are insurance companies, which are for-profit businesses that primarily sell insurance products; securities firms, which are involved in the trading of securities in the financial market; investment banks, which provide services for businesses; and finance companies, which make money by issuing loans.

8. What financial services are commonly available to business customers?

   Answer: Some common services provided by financial institutions to business customers include savings accounts, electronic banking options, bank cards, business checking accounts, business lines of credit, long-term business loans, and international banking services.

9. Explain why a business would need international banking services.

   Answer: Businesses that sell goods or service in the global market require special banking services. International business requires special documents, currency exchange, and other legal processes that require the services of a bank.

10. Explain the importance of banking regulations.

    Answer: Financial institutions are regulated to be sure they are financially sound and comply with consumer protection laws. The FDIC or NCUA are independent government agencies that provide deposit insurance in the event of a bank failure. The FDIC also examines and supervises financial institution policies and operations help maintain consumer and business confidence in the banking system. Many consumer protection laws ensure that banks provide fair and equitable service to consumers. Another area of bank regulation involves equal opportunity lending. The Federal Reserve reviews the efforts of financial institutions in meeting these regulations.

Apply Your Knowledge

1. Create a chart with three columns. In the first column, list the following forms of exchange: cash, credit, debit, electronic funds transfer. In column two, describe each item. In column three, give an example of each.

   Answer: Student answers will vary. Evaluate each response individually.

2. List the primary types of currency and define each. What do they all have in common? Which do you use most often?

   Answer: Student answers will vary. Evaluate each response individually.

3. List three financial institutions in your area. Identify each as depository or nondepository. For each, give examples of the services and financial products the institution provides.

   Answer: Student answers will vary. Evaluate each response individually.

4. Assume you are planning to open a checking account and trying to decide which bank to use. What banking services do you consider most important in making that decision?

   Answer: Student answers will vary. Evaluate each response individually.

5. The FDIC was established in 1933 as a result of legislation put in place during the Great Depression. How does the FDIC help ensure that the citizens of the United States will always have their money available to them?

   Answer: Student answers will vary. Evaluate each response individually.

You Do the Math

Problem Solving and Reasoning

When solving word problems, you must identify the elements of the math problem and solve it. However, an important key to solving word problems is to make sure enough information has been provided to solve the stated problem. If some information is not provided, the problem cannot be solved.

Solve the following problems.

1. A business sells smartphones across the nation. Each phone comes in packaging that measures 6 inches by 4 inches by 1 inch. The products are shipped to resellers in cartons that measure 18 inches by 12 inches by 12 inches. The cartons can hold a maximum of 15 pounds. The company wants to know how much each full carton weighs. Is there enough information to solve this problem? If not, what information is missing?

   Answer: No. To calculate the weight of a full carton, the weight of a smartphone must be known.

2. Darren orders office supplies every Monday. This week he must order 23 reams of paper, 2000 envelopes, and 12 boxes of tape. He wants to know how much this will cost. Is there enough information to solve this problem? If not, what information is missing?

   Answer: No. To find the total cost, the prices of each product must be known.

3. Laura travels for work. On Monday, she drove 48 miles. On Tuesday, she drove 37 miles. On Thursday, she drove 76 miles. She is reimbursed for gasoline at a rate of 53 cents per mile. Laura wants to determine how many miles per gallon she averaged while traveling. Is there enough information to solve this problem? If not, what information is missing?

   Answer: No. To calculate what Laura should be reimbursed, the average miles per gallon for each of her trips must be known.