Banking Today

Objectives  You may wish to call students’ attention to the objectives in the Section Preview. The objectives are reflected in the main headings of the section.

Bellringer  Ask students to list the kinds of money they have with them today. Students may list only bills and coins, or some may mention credit cards. Explain that in this section they will learn about the many types of money and banking services that exist today.

Vocabulary Builder  Ask students to read the section to find the meanings of the key terms. Then ask them to create a matching quiz using the terms and their definitions. Have students exchange quizzes, complete them, and return them for correction.

Lesson Plan

Teaching the Main Concepts

1. Focus  Banking in the United States has come a long way since the country was founded. Ask students to identify ways in which banking has changed in the last 20 years.

2. Instruct  Discuss the money supply, including the classifications M1 and M2. Explain that modern banks provide a variety of services, including checking and savings accounts, loans, credit cards, and so on. When discussing loans, be sure that students understand the difference between simple and compound interest. Finally, discuss the differing types of financial institutions that serve customers today and the impact of technology on the banking industry.

3. Close/Reteach  Banking has changed radically in the last half of the twentieth century, and technological innovations continue to promise exciting developments. Ask students to speculate on how banking might change in the twenty-first century.

Objectives

After studying this section you will be able to:

1. Explain how the money supply in the United States is measured.
2. Explain the functions of financial institutions.
3. Identify different types of financial institutions.
4. Understand the changes brought about by electronic banking.

Key Terms

money supply, all the money available in the United States economy
liquidity, the ability to be used as, or directly converted to, cash
demand deposit, the money in checking accounts

Do you have a checking account, credit card, or ATM card? If you don’t, you most likely will in the near future. As this question suggests, people in the United States today use more than just paper currency and coins to pay for purchases.

Measuring the Money Supply

You are familiar with paying for the items you need with currency—the bills and coins in your pocket. Money consists of currency. It also consists of traveler’s checks, checking account deposits, and a variety of other components. All of these components make up the United States money supply—all the money available in the United States economy. To more easily keep track of these different kinds of money, economists divide the money supply into several categories. The main categories are called M1 and M2.

M1

M1 represents money that people can gain access to easily and immediately to pay for goods and services. In other words, M1 consists of assets that have liquidity, or the ability to be used as, or directly converted into, cash.

As you can see from Figure 10.5, about 48 percent of M1 is made up of currency held by the public, that is, all currency held outside of bank vaults. Another large part of M1 is deposits in checking accounts. Funds in checking accounts are also called demand deposits because checks can be paid “on demand,” that is, at any time.

Traveler’s checks make up a very small component of M1. Unlike personal checks, traveler’s checks can be easily turned into cash.

M2

M2 consists of all the assets in M1 plus several additional assets. These additional M2 funds cannot be used as cash directly, but can be converted to cash fairly easily. M2 assets are also called near money.

For example, deposits in savings accounts are included in M2. They are not included in M1 because they cannot be used directly in financial exchanges. You cannot hand a sales clerk your savings account passbook to pay for a new backpack. You can, however, withdraw

Graphing the Main Idea

Economic Institutions  To build understanding of today’s economic institutions, have students complete a tree map graphic organizer like the one shown at the right. Remind students that a tree map shows an outline for a main topic, main ideas, and supporting details. Tell students to place the section title, “Banking Today,” in the top box; the main headings in the next row of boxes; and main ideas and supporting details in the boxes below that.

Section Reading Support Transparencies  A template and the answers for this graphic organizer can be found in Chapter 10, Section 3 of the Section Reading Support Transparency System.
The components of M1 can be used as cash or can be easily converted into cash. M2 consists of the assets in M1 plus assets that can be converted to cash fairly easily. 

**Money** What is the largest component of M1? Of M2?

### Functions of Financial Institutions

Banks and other financial institutions are essential to managing the money supply. They also perform many functions and offer a wide range of services to consumers.

### Storing Money

Banks provide a safe, convenient place for people to store money. Banks keep cash in fireproof vaults and are insured against the loss of money in the event of a robbery. As you read in Section 2, FDIC insurance protects people from losing their money if the bank is unable to repay funds.

### Saving Money

Banks offer a variety of ways for people to save money. Four of the most common ways are the following:

- **Savings accounts**
- **Checking accounts**
- **Money market accounts**
- **Certificates of deposit (CDs)**

Savings accounts and checking accounts are the most common types of bank accounts. They are especially useful for people who need to make frequent withdrawals. Savings accounts and most checking accounts pay a small amount of interest at an annual rate.

Money market accounts and certificates of deposits (CDs) are special kinds of savings accounts that pay a higher rate of interest than do savings and checking accounts. Money market accounts allow you to save and to write a limited number of checks. Interest rates are not fixed, but can move up or down. CDs, on the other hand, offer a guaranteed rate of interest over a certain period of time. Funds placed in a CD, however, cannot be removed until the end of a certain time period, such as one or two years. Customers who remove their funds from a CD before it matures are charged a penalty.

### Differentiated Instruction

**Reteaching** Ask students to classify each of the following as M1, M2, neither, or both: a savings account, a dollar bill, a personal check, a new car, a traveler’s check, a 1-carat diamond, a certificate of deposit (CD), a savings bond, and an Individual Retirement Account (IRA).

**Answer to . . .**

**Building Key Concepts** The main component of M1 is currency. The main component of M2 is savings deposits.
Savings Rates

To help students understand M1 and M2, ask them to find illustrations or examples of each type of money and use these to create an M1/M2 collage.

Organize students into groups of three or four. Tell each group to create a fact sheet that lists and briefly describes the various services that banks provide: storing money, saving money, loaning money (including mortgages), issuing credit cards, and so on. Suggest that the fact sheet can be organized around questions (What if I need to borrow money?) or descriptive headings (Storing Money). Remind students that they are creating a fact sheet, so the information should be brief and to the point.

Building Key Concepts

In a fractional reserve system, banks keep only a fraction of funds on hand and lend out the remainder is called fractional reserve banking. Like the early banks, today’s banks also operate on this principle. They lend money to homeowners for home improvements, to families to pay for college tuition, and to businesses. The more money a bank lends out, and the higher the interest rate it charges borrowers, the more profit a bank is able to make.

By making loans, banks help new businesses get started, and they help established businesses grow. When a business gets a loan, the loan money is lent out and the interest rate is determined by the bank. The bank retains a percentage of the loan money to cover demand for withdrawals.

Fractional Reserve Banking

Deposit of $10,000
A customer deposits $10,000 into his or her account

Loan of $6,400
The bank lends $6,400 to a customer who uses it to buy furniture

Deposit of $6,400
The seller of the furniture deposits the $6,400 in a bank

Fractional Reserve Banking

Deposit of $10,000
A customer deposits $10,000 into his or her account

Loan of $8,000
The bank lends $8,000 to a customer who uses it to buy a car

Deposit of $8,000
The seller of the car deposits the $8,000 in a bank

Loan of $5,120
The bank lends $5,120 to a customer who uses it for college tuition

Fractional Reserve Banking

Deposit of $10,000
A customer deposits $10,000 into his or her account

Loan of $6,400
The bank lends $6,400 to a customer who uses it to buy furniture

Deposit of $6,400
The seller of the furniture deposits the $6,400 in a bank

Fractional Reserve Banking

Deposit of $10,000
A customer deposits $10,000 into his or her account

Loan of $8,000
The bank lends $8,000 to a customer who uses it to buy a car

Deposit of $8,000
The seller of the car deposits the $8,000 in a bank

Loan of $5,120
The bank lends $5,120 to a customer who uses it for college tuition

Fractional Reserve Banking

Deposit of $10,000
A customer deposits $10,000 into his or her account

Loan of $6,400
The bank lends $6,400 to a customer who uses it to buy furniture

Deposit of $6,400
The seller of the furniture deposits the $6,400 in a bank

Fractional Reserve Banking

Deposit of $10,000
A customer deposits $10,000 into his or her account

Loan of $8,000
The bank lends $8,000 to a customer who uses it to buy a car

Deposit of $8,000
The seller of the car deposits the $8,000 in a bank

Loan of $5,120
The bank lends $5,120 to a customer who uses it for college tuition

In a fractional reserve system, banks keep only a fraction of funds on hand and lend out the remainder. Money Why does the bank retain a percentage of the money it receives from depositors?

Consider these suggestions to take advantage of extended class time:

- Conduct an in-class tour of Internet sites created by financial institutions: banks, credit unions, brokerage houses, and so on. Ask students to speculate about the advantages and disadvantages of banking in cyberspace. Use the links provided in the Economics: Principles in Action segment in the Social Studies area at the following Web site: www.phschool.com

To reinforce a discussion of credit cards, bring a credit card application to class and work with students to fill it out for a fictitious applicant. Help students to understand what types of information are asked for and why. Discuss with students how credit cards can be used responsibly. Then discuss irresponsible ways in which they are sometimes used.
Figure 10.7  Compound Interest

<table>
<thead>
<tr>
<th>Start of year</th>
<th>Principal amount</th>
<th>Interest earned at 5%</th>
<th>Principal at end of year</th>
</tr>
</thead>
<tbody>
<tr>
<td>–</td>
<td>$100.00</td>
<td>$5.00</td>
<td>$105.00</td>
</tr>
<tr>
<td>1</td>
<td>$105.25</td>
<td>$5.25</td>
<td>$110.50</td>
</tr>
<tr>
<td>2</td>
<td>$110.50</td>
<td>$5.50</td>
<td>$116.00</td>
</tr>
<tr>
<td>3</td>
<td>$116.00</td>
<td>$5.80</td>
<td>$121.80</td>
</tr>
<tr>
<td>4</td>
<td>$121.80</td>
<td>$6.08</td>
<td>$127.88</td>
</tr>
<tr>
<td>5</td>
<td>$127.88</td>
<td>$6.38</td>
<td>$134.26</td>
</tr>
<tr>
<td>6</td>
<td>$134.26</td>
<td>$6.70</td>
<td>$140.96</td>
</tr>
<tr>
<td>7</td>
<td>$141.29</td>
<td>$7.04</td>
<td>$147.93</td>
</tr>
<tr>
<td>8</td>
<td>$147.93</td>
<td>$7.39</td>
<td>$155.32</td>
</tr>
<tr>
<td>9</td>
<td>$155.32</td>
<td>$7.76</td>
<td>$162.80</td>
</tr>
<tr>
<td>10</td>
<td>$162.80</td>
<td>$8.14</td>
<td>$171.04</td>
</tr>
<tr>
<td>11</td>
<td>$171.04</td>
<td>$8.55</td>
<td>$179.59</td>
</tr>
<tr>
<td>12</td>
<td>$179.59</td>
<td>$8.98</td>
<td>$188.57</td>
</tr>
<tr>
<td>13</td>
<td>$188.57</td>
<td>$9.43</td>
<td>$198.00</td>
</tr>
<tr>
<td>14</td>
<td>$198.00</td>
<td>$9.90</td>
<td>$207.90</td>
</tr>
<tr>
<td>15</td>
<td>$207.90</td>
<td>$10.39</td>
<td>$218.29</td>
</tr>
</tbody>
</table>

This chart shows the money earned on a $100 deposit when interest is compounded yearly at 5 percent.

**Income** How many years does it take for the original deposit to double?

**Preventing for Standardized Tests**

Have students read the section titled “Simple and Compound Interest” and then answer the question below.

Which of the following best describes compound interest?

- A interest paid on the principal of borrowed money
- B interest paid by mortgage lenders
- C interest paid on the principal and interest of borrowed money
- D interest paid on bank profits

**Background**

**Common Misconceptions**

Beth has just returned from the bank with a savings account deposit receipt tucked inside her wallet. What will happen to the money Beth has deposited? Contrary to what some people think, it isn’t put into a vault and simply stored until Beth wants it again.

Some of Beth’s money is loaned to people who want to buy houses or cars. Because these borrowers pay interest, Beth’s money earns revenue for the bank. Some of Beth’s money is invested in government securities. These also pay interest. When Kelvyn takes $20 out of a cash machine, some of that money comes from Beth’s deposit, too.

But how does Beth profit from her hard-working money? Banks pay interest on savings accounts and sometimes on checking accounts. Interest is the bank’s way of thanking Beth for letting it use her money. When Beth is ready to borrow money for college or to finance her new business, someone else’s money will be there to help her out.

**Math Practice Activity**

Comparing Credit Cards Payments, allows students to examine the effects of interest rates and time on credit card payments.

**Preparing for Standardized Tests**

Have students read the section titled “Simple and Compound Interest” and then answer the question below.

Which of the following best describes compound interest?

- A interest paid on the principal of borrowed money
- B interest paid by mortgage lenders
- C interest paid on the principal and interest of borrowed money
- D interest paid on bank profits

**Answer to . . .**

Building Key Concepts It takes 14 years for the amount to double.

**261**
You may wish to have students add the following to their portfolios. Ask them to create a pamphlet that explains the functions of the financial institutions covered in the section: commercial banks, savings and loan associations, savings banks, and credit unions. Suggest that they provide an overview of each type of institution, its function, and how it differs from the other institutions. Have students share their pamphlets with peers to review important concepts.

**Economics Assessment Rubric**

Economics Assessment Rubrics folder, pp. 6–7 provides sample evaluation materials for a writing assignment.

**Differentiated Instruction**

(Enrichment) Explain to students that some banks are global in nature. Ask students to research the origins and purposes of the World Bank and the International Monetary Fund and to write an expository essay explaining how each functions. Essays should include a real-life example of each institution in action.

**Answer to . . .**

**Building Key Concepts**

Sources of income are deposits from customers, interest from borrowers, and fees for services.

---

**Figure 10.8 How Banks Make a Profit**

After customers deposit money, a bank lends it to businesses and other borrowers and collects interest. The bank uses this income from interest to cover its costs and make a profit. The largest source of income for banks is the interest they receive from customers who have taken loans. Banks, of course, also pay out interest on customers’ savings and most checking accounts. The amount of interest they pay out, however, is less than the amount of interest they charge on loans. The difference in the amounts is how banks cover their costs and make a profit.

**Types of Financial Institutions**

Several kinds of financial institutions operate in the United States. These include commercial banks, savings and loan associations, mutual savings banks, and credit unions. During the 1990s, these financial institutions became more similar than dissimilar, although differences still remain.

**Commercial Banks**

Commercial banks, which traditionally provided services to businesses, offer a wide range of services today. Commercial banks offer checking services, accept deposits, and make loans. Some commercial banks are chartered by states and are regulated by state authorities and by the Federal Deposit Insurance Corporation (FDIC). About one third of all commercial banks are national banks and are part of the Federal Reserve System. Commercial banks provide the most services and play the largest role in the economy of any type of bank.

**Savings and Loan Associations**

Savings and Loan Associations (S&Ls), which you read about in Section 2, were originally chartered to lend money for building homes during the mid-1800s. Members of Savings and Loan Associations deposited funds into a large general fund and then borrowed enough money to buy their own houses. Savings and Loans are also called "thrifts" because they originally enabled “thrifty” working-class people—that is, people who were careful with their money—to save up and borrow enough to buy their own homes. Over time, Savings and Loan Associations have taken on many of the same functions as commercial banks.
Savings Banks
Mutual savings banks (MSBs) originated in the early 1800s to serve people who made smaller deposits and transactions than commercial banks wished to handle. Mutual savings banks were owned by the depositors themselves, who shared in any profits. Later, many MSBs began to sell stock to raise additional capital. These institutions became simply savings banks because depositors no longer owned them.

Although savings banks were traditionally concentrated in the Northeast, they had an important influence on the national economy. In 1972, the Consumer’s Savings Bank of Worcester, Massachusetts, introduced a Negotiable Order of Withdrawal (NOW) account, a type of checking account that pays interest. NOW accounts became available nationwide in 1980.

Credit Unions
Credit unions are cooperative lending associations for particular groups, usually employees of a specific firm or government agency. Credit unions are commonly fairly small and specialize in home mortgages and car loans, usually at interest rates favorable to members. Some credit unions also provide checking account services.

Finance Companies
Finance companies make installment loans to consumers. These loans spread the cost of major purchases like computers, cars, refrigerators, and recreational vehicles over a number of months. Because people who borrow from finance companies more frequently fail to repay the loans, finance companies generally charge higher interest rates than banks do.

Electronic Banking
Banks began to use computers in the early 1970s to keep track of transactions. As computers have become more common in the United States, their role in banking has also increased dramatically. In fact, computerized banking may revolutionize

Organize the class into groups of four or five students. Instruct each group to create a technology-based scenario in which a character spends a weekend banking and buying, both in the United States and abroad, without ever actually touching currency in any form. Activities should include money being deposited in a bank, commodities being purchased, money being given to charity, money being transferred to and from checking and savings accounts, loans being arranged, and so on. Each group should prepare an oral, written, or performance-based presentation that shows how various technologies make these transactions possible.

Prepared for Standardized Tests
Have students read the section titled “Electronic Banking” and then answer the question below.
Which of the following transactions cannot be completed at an Automated Teller Machine (ATM)?
A. deposit money in a savings account
B. withdraw money from a checking account
C. check the balance of a checking or savings account
D. withdraw money from a certificate of deposit
Answers to...  

Section 3 Assessment

1. M1 includes all money that is immediately accessible for people to use to pay for goods and services. Examples: cash, money in checking accounts, traveler’s checks. M2 includes all of M1 plus all assets that are easily transferred into M1. Examples: savings account deposits and money market mutual funds.

2. A debit card withdraws money directly from a checking or savings account when it is used to make a purchase, whereas when a credit card is used to make a purchase, it functions as a loan that then needs to be paid off.

3. Students should describe any three of the following: storing money safely, lending money, offering mortgages, or issuing credit cards.

4. The more a bank lends out, the more profit a bank makes. However, the bank must not lend out too much of its money, since it needs to keep some in reserve for withdrawals and for safety. Also, banks cannot make loans to everyone who asks but must assess a person’s ability to pay back the loan.

5. Students may suggest incentives such as premiums, free checking accounts, or initial low interest rates on loans. Profit plans may include investing deposits, collecting interest on loans, and charging user fees for electronic transfers.

6. Students may mention convenience of branch locations, availability of interest on checking accounts, or convenient electronic options.

7. (a) Personal savings as a percentage of disposable income rose through 1975 and then dropped quickly. (b) During the 1970s consumers often spent money as quickly as possible because of inflation. Other explanations include increases in consumerism and in stock and bond trading.

8. Student’s answers will vary, but should include an understanding of loans, savings and checking accounts, mutual funds, ATMs, and credit cards.

Stored Value Cards  

Stored value cards, or smart cards, are similar to debit cards. These cards are embedded with either magnetic strips or computer chips with account balance information. Smart cards include cards issued to college students living in dormitories to pay for cafeteria food, computer time, or photocopying. Phone cards, with which customers prepay for a specified amount of long-distance calling, are also smart cards.

Will stored value smart cards someday replace cash altogether? No one can know for sure, but private companies and public facilities have continued to explore new uses for smart card technology.

Progress Monitoring Online  

For: Self-quizzes with vocabulary practice
Web Code: mna-4107

Using the Databank  

Turn to the graph entitled “Personal Savings as a Percentage of Disposable Income” on page 540. (a) Describe the pattern of personal savings shown on the graph. (b) What factors could have caused the steady drop in savings since the 1970s?

Critical Thinking  

Write a paragraph in which you analyze how financial institutions affect households and businesses.

Go Online  

For: Writing Activity
Visit: PHSchool.com
Web Code: mnd-4103

Progress Monitoring Online  

For additional assessment, have students access Progress Monitoring Online at Web Code: mna-4107