Chapter 10: Money and Banking
Section 2

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ECONOMICS

PEARSON

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Objectives

1. **Describe** the shifts between centralized and decentralized banking before the Civil War.
2. **Explain** how government reforms stabilized the banking system in the later 1800s.
3. **Describe** developments in banking in the early 1900s.
4. **Explain** the causes of two recent banking crises.

Key Terms

- **bank:** an institution for receiving, keeping, and lending money
- **national bank**: a bank chartered by the federal government
- **bank run**: a widespread panic in which many people try to redeem their paper money at the same time
- **greenback**: a paper currency issued during the Civil War

Key Terms, cont.

- **gold standard**: a monetary system in which paper money and coins had the value of certain amounts of gold
- **central bank**: a bank that can lend to other banks in times of need
- **member bank**: a bank that belongs to the Federal Reserve System
- **foreclosure**: the seizure of property from lenders who are unable to pay back their loans

Introduction

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- How has the American banking system changed to meet new challenges?
  - In early days, people distrusted banks.
  - As time passed, banks did much to increase their trustworthiness among American citizens.
  - Over the years, American banking has also developed in such a way as to meet the needs of a growing and changing population.

Banking Before the Civil War

- During the first part of our nation's history, local banks were informal businesses that merchants managed in addition to their regular trade.
- After the American Revolution, the new nation's leaders decided that they needed to establish a safe, stable banking system.
  - This need led to a tireless disagreement on how to organize the national banking system.

Two Views of Banking

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- Federalists wanted a centralized banking system and Alexander Hamilton, as Secretary of the Treasury, proposed a national bank in 1789.
- Antifederalists, like Thomas Jefferson, opposed this plan.
  - They favored a decentralized banking system in which states established and regulated banks within their borders.

The First Bank of the United States

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- Federalists won the first debate and in 1791, Congress established the Bank of the United States. Yet, disagreements over the Bank continued.
  - Antifederalists argued that the Bank was unconstitutional and that it did not benefit ordinary people, only the wealthy.
- The Bank functioned until 1811, when its charter ran out.
  - State banks then took over for the Bank of the United States, which created a great deal of chaos and confusion.

The Second Bank of the United States

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- To eliminate the chaos, Congress charted the Second Bank of the United States in 1816.
- Stability was restored but many were still wary of the Bank's powers.
  - In 1832, when Congress tried to renew the Bank's charter, President Andrew Jackson vetoed the renewal.

GENERAL JACKSON SLAYING THE MANY HEADED MONSTER.

The Free Banking Era

- As state-charted banks flourished once again from 1837 to 1863, the sheer number of banks gave rise to a variety of problems, including:
  - Bank runs and panics
  - Wildcat banks that were inadequately financed and had a high rate of failure
  - Fraud
  - Many different currencies

Stability in the Later 1800s

- Checkpoint: What powers did the National Banking Acts give to the federal government?
- The National Banking Acts of 1863 and 1864 gave the federal government the power to:
  - Charter banks
  - Require that banks hold an adequate amount of gold and silver reserves
  - Issue a national currency
- In the 1870s the nation adopted the gold standard, which set a definite value for the dollar.

Banking in the Early 1900s

- Problems persisted despite the stabilizing efforts of a national currency and adopting the gold standard.
- In 1913, the Federal Reserve Act established the Federal Reserve System, which reorganized the federal banking system to include:
  - 12 Federal Reserve Banks
  - The Federal Reserve Board
  - Short-term loans
  - Federal Reserve notes

Banking and the Great Depression

- The Fed, however, was unable to prevent the Great Depression.
- President Franklin Roosevelt acted to restore the banking system in the 1930s by established the FDIC, which insured customer deposits if a bank failed.
  - FDR also changed the American currency to fiat money so the Fed could adequately control the money supply.

The Savings and Loan Crisis

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- In the late 1970s and 1980s, Congress passed laws to deregulate several industries.
  - This deregulation led to a crisis for the Savings and Loan industry, which was unprepared for the intense competition it faced after deregulation.
  - High interest rates and risky loans added to the crisis.
  - In 1989, Congress passed legislation that abolished the independence of the Savings and Loan industry.

The Sub-Prime Mortgage Crisis

- Checkpoint: How did the rash of sub-prime mortgages endanger the U.S. economy?
  - Mortgage companies and banks began to loan people money who could not afford to pay these loans back.
  - When interest rates rose, many people couldn't afford to pay their mortgages, which led to foreclosures.
  - The ripple effect of the mortgage crisis hit banks and creditors hard and many economists worried that the crisis would send the U.S. economy into a recession.

Review

- Now that you have learned about how the American banking system has changed to meet new challenges, go back and answer the Chapter Essential Question.
  - How well do financial institutions serve our needs?