

8-1 Banks and Other Financial Institutions**OBJECTIVES**

- Describe the history and development of banking in the United States.
- Explain the organization and activities of commercial banks and other financial institutions.

BANKING SYSTEMS

People often overlook the fact that a bank is a business and they are its customers. Similar to stores and factories, a bank is a business that sells services such as savings accounts, loans, and investments. Banks are regulated more strictly than most other businesses. If a business fails, some people lose money. If a bank fails, thousands of people are affected.

U.S. BANKING HISTORY

Banking in the United States has evolved from local companies in small towns to multinational corporations. The activities of banks have been affected by historic and economic events.

Federal Currency. During Colonial times and just after the American Revolution, several types of currency circulated. In use were the British pound and shilling along with a Spanish coin called the real. In 1792, the Mint Act authorized gold coins in the amounts of \$10, \$5, and \$2.50 along with \$1, 50¢, 25¢, 10¢, and 1¢ silver coins, and 1¢ and ½¢ copper coins. In 1861, paper currency was first issued by the U.S. government. Prior to that, paper money in the form of banknotes was issued by individual banks. Between 1793 and 1861, over 1,500 private banks were allowed to print their own paper currency, which was backed by the gold in their vaults. During this time, more than 7,000 different state banknotes were in circulation.

First and Second Banks of the U.S. In 1791, despite varied political opinions, a Bank of the United States was chartered. This bank was privately owned, with the federal government owning about 20 percent of its capital. During its existence, the first Bank of the United States helped stabilize the value of currencies in circulation. Continued political differences resulted in not renewing the bank's charter when it expired in 1811. As conflicting state bank policies and changing economic conditions continued, a second Bank of the United States was created in 1816. The bank functioned to better regulate credit and the money supply. State banks, however, viewed these actions as a threat. In 1836, this bank also went out of existence when its charter expired.

National Banking Act of 1864. During the U.S. Civil War, many monetary and banking issues surfaced. The National Banking Act of 1864 created the office of the Comptroller of the Currency with the purpose of chartering national banks. As national banknotes were issued, a high tax was imposed on state banknotes. This action resulted in the elimination of state bank currencies and stabilized the value of U.S. banknotes.

Federal Reserve Act. After years of economic crises, in 1913, Congress created the Federal Reserve System. This central banking network was designed to be flexible for the changing economic needs of the country.

THE FEDERAL RESERVE SYSTEM

A bank that will not allow you to make deposits is a Federal Reserve Bank, which is a bank for banks. The Federal Reserve System (The Fed) was created to supervise and regulate member banks to help them serve the public efficiently. All national banks are required to join the Federal Reserve System, and state banks may join as well.

Organizational Structure. Banks that join the system are known as member banks. The United States is divided into 12 Federal Reserve districts, with a central Federal Reserve Bank in each district, as shown in Figure 8-1 on the next page. These district reserve banks serve various functions such as handling banking activities for government agencies and implementing Fed policies. Each regional district bank is governed by a nine-member board of directors.

The Board of Governors of the Federal Reserve System consists of seven members, appointed by the President, who serve a 14-year term. The chair of the Board of Governors, also selected by the President and confirmed by the Senate, serves a four-year term. There is no limit on the number of terms a chair may serve.

Federal Reserve Activities. A Federal Reserve Bank serves member banks and the economy in several ways. One service provided by the Fed is the holding of reserves. Banks cannot lend all of the money they receive from customers. They are required to keep a part of the money they receive from customers on deposit with the Federal Reserve System. The

percentage of funds that a bank is required to hold is the reserve requirement. This amount cannot be used for loans. These funds are held in case additional funds are needed to meet daily customer demand. The current reserve requirement in the U.S. is 10% for transaction account deposits (mainly checking accounts); CDs, savings accounts, and other time deposits are not subject to the reserve requirement.

As a result of reserve requirements, a bank will lend only a certain percentage of deposits. For example, if a customer deposits \$1,000 and the bank is required to hold 10 percent of all deposits in reserve, the bank can lend 90 percent of the new deposit, or \$900 (100% - 10% = 90%). This regulation is designed to help the banking system and the economy operate efficiently and to protect depositors.

Another service of the Federal Reserve System is clearing checks in different cities. Clearing refers to paying checks among different banks in different cities. The Fed processes millions of checks each day to make sure that the correct amounts are added to and subtracted from the appropriate bank accounts.

FIGURE 8-1 The Federal Reserve System



Monetary Policy. Maintaining an appropriate amount of money in circulation is necessary to avoid inflation and encourage economic growth. The Fed influences the money supply in three ways.

1. **Setting Reserve Requirements** As the Fed adjusts the portion of the deposits that banks must hold, the amount that may be lent out will increase or decrease.
2. **Changing the Discount Rate** The discount rate refers to the rate the Fed charges on loans to member banks. An increase in this rate will usually increase the cost for mortgages and other loans, resulting in reduced borrowing.
3. **Buying and Selling Government Securities** The process of buying and selling government securities is called open market operations. The sale of government bonds to banks, for example, results in fewer funds available for lending. This action reduces the money supply.

Measuring the Money Supply. Various measures used by the Federal Reserve to add up components of the money supply:

- **M1.** Also known as the “base” money supply. Money that can be spent immediately. M1 includes currency (paper and metallic) and various types of checking accounts, including nonbank travelers' checks, standard checking accounts, and NOW (interest-bearing) accounts.
- **M2.** All the money in M1 plus short-term investments, such as small savings accounts, money market accounts, and money market mutual funds.
- **MZM.** Money at zero maturity. Represents all available liquid money. It is M2, minus time deposits, and includes all money market funds.

OTHER BANK REGULATORY AGENCIES

In addition to the Federal Reserve System, two other federal government agencies actively monitor the banking industry.

Federal Deposit Insurance Corporation. The FDIC was created in 1933 to protect the bank deposits of consumers. During the difficult economic times of the early 1930s, many banks failed. The FDIC provides a federal government guarantee of deposits and maintains stability and public confidence in the nation's banks. Today, the FDIC insures deposits up to \$250,000 per depositor, per bank. By using combinations of individual, joint, and trust accounts in different financial institutions, you can

obtain federal deposit insurance covering amounts greater than \$250,000. Be careful, however, since different branch offices count as the same institution, and mergers in the financial service industry may bring accounts from different banks together.

Comptroller of the Currency. Regulation of national banks is the main duty of the Office of the Comptroller of the Currency (OCC). The major activities of OCC are:

- Examination of the loans and investments of national banks with regard to liquidity, risk, and banking laws
- Review of the bank's internal controls
- Evaluation of bank management's ability to identify and control risk
- Approval or denial of applications for new bank charters, branches, capital, or other changes in corporate or banking structure
- Rules and regulations governing bank investments, lending, and other banking practices

FINANCIAL INSTITUTIONS IN ACTION

The banking system in the United States has become fairly complex as a result of the demand for services by a growing number of consumers and business customers.

BANKING DEPARTMENTS

Banks are usually organized as a corporation. The business elements of the bank are handled by various departments.

Loan Department. Reviewing credit applications and approving loans are the primary functions of the loan department. Employees must decide if an applicant is likely to repay the amount borrowed based on past borrowing activity, future income, and any assets pledged as collateral.

Personal Banking. Individuals and households usually represent a significant portion of a bank's customer base. Bankers must provide service before and after an account is opened to ensure customer satisfaction. Consumers commonly seek savings, checking, and borrowing services.

Commercial Banking. Business clients are a major source of revenue for most banks. Loans, processing cash receipts, making payments, and transferring funds are some of the many commercial banking services.

International Banking. More and more banks are working with companies that do business around the world. These customers expect foreign exchange services, international money transfers, letters of credit, and export loans.

Trust Department. The control and management of money, investments, or other property on behalf of customers commonly occurs. This relationship, called a trust, is an important activity for most banks.

FORMS OF FINANCIAL INSTITUTIONS

While a wide variety of financial institutions exist in the United States, these organizations are commonly viewed in two major categories.

Depository Financial Intermediaries. Most people say they are "going to the bank" even if they are referring to another type of financial institution. Depository intermediaries have the main functions of storing money and making loans to stimulate economic growth.

1. Commercial banks most often offer the widest range of services to both individuals and business customers.
2. Savings and loan (S&L) associations traditionally specialize in savings accounts and home mortgages.
3. Mutual savings banks, also specializing in savings and mortgages, are owned by depositors rather than by stockholders.
4. Credit unions are nonprofit financial organizations that offer services to meet the needs of their owner-customers.

Non-Depository Financial Intermediaries. Customers needing financial services are also served by non-depository financial intermediaries.

- Life insurance companies provide financial protection for the dependents of people who purchase the policies.
- Investment companies focus their efforts on pooling funds from many people to select investments with growth opportunities.
- Consumer finance companies emphasize loans to individuals for motor vehicles, appliances, and other major purchases.
- Mortgage companies have the primary function of lending money for home buying.
- Credit card companies mainly offer buying convenience for consumers who want to delay payment for their purchases.

Changing Competitive Environment. Non-deposit financial institutions have expanded the services they offer. For example, insurance companies often provide financial planning and investment advice. In addition, services of non-depository intermediaries have been added to many depository companies. Many banks sell various investments to customers in addition to traditional savings plans. Most credit unions provide mortgages along with other types of loans.

For several years, the concept of a financial supermarket has existed. These financial institutions offer a complete range of services. Often these financial supermarkets started as a traditional financial business and expanded their services. One advantage of financial supermarkets is one-stop shopping. This convenience must be weighed against possible higher costs and reduced personalized service. Also, some of these financial institutions are not covered by federal deposit insurance.

Another activity to attract customers is offering an all-in-one account, also called an asset management account or a cash management account. For a single fee, investment brokers and others provide a checking account, a debit card, a credit card, online banking, as well as a line of credit for obtaining quick cash loans. These accounts also provide access to stock, bond, mutual fund, and other types of investments.

The competitive environment of financial institutions has been influenced by online banking activities. Electronic banking with virtual branch offices has changed the expectations and behaviors of bank customers. In the past, banks were only open from 9 a.m. to 3 p.m., Monday through Friday. Today, customers have 24-hour access to banking activities anywhere in the world.

Comparing Financial Institutions. Always balance your needs with the conditions imposed upon you. When you are not satisfied, shop around! To obtain the best value for your financial services dollar, consider the following guidelines.

- **Services Offered.** In general, select the checking account with the lowest costs. Locate the best interest rate on your savings. Find the lowest interest rate for loans.
- **Safety.** Be sure your financial institution is insured by the FDIC or by the National Credit Union Share Insurance Fund for credit unions. When doing business with an investment broker, look for Securities Investor Protection Corporation (SIPC) coverage. The SIPC exists to protect investors when their brokerage firm is closed due to bankruptcy or other financial difficulties.
- **Convenience.** Decide if you want 24-hour banking or branch offices near your home. A tradeoff usually exists between more convenience and higher costs.
- **Fees and Charges.** Financial services have costs. Compare your needs with the price you pay. A small ATM fee or checking account service charge can add up to hundreds of dollars in a short time.
- **Restrictions.** Costs are not always measured in dollars. If you must keep \$500 on deposit for a "free" checking account, you may lose the opportunity to earn interest on those funds at a better rate elsewhere.

FOCUS ON: High-Cost Financial Service Companies

Some people pay \$8 to cash a \$100 check, or they pay \$20 to borrow \$100 for two weeks. Many people without access to traditional financial institutions, especially low-income consumers, use financial service businesses that are very expensive. Pawnshops make loans based on the value of tangible possessions such as jewelry. Many low- and moderate-income families use these companies to obtain cash loans quickly. Pawnshops charge higher fees than other financial institutions. While states regulate the interest rates charged by pawnshops, 3 percent a month or higher is common. Check-cashing outlets are used to obtain cash by people who do not have a bank account. The more than 6,000 check-cashing outlets (CCOs) in the U.S. charge anywhere from 1 to 20 percent of the face value of a check; the average cost is between 2 and 3 percent. For many families, that can be a significant portion of the total household budget. CCOs also offer other services, including electronic tax filing, money orders, private postal boxes, utility bill payment, and the sale of bus and subway tokens. Payday loans are also referred to as cash advances, check advance loans, postdated check loans, and delayed deposit loans. Desperate borrowers pay annual interest rates that sometimes exceed 1,000 percent to obtain needed cash. Payday loans are most commonly used by workers trapped in debt. In a typical payday loan, a consumer writes a personal check for \$115 to borrow \$100 for 14 days. The payday lender agrees to hold the check until the next payday. This \$15 finance charge for the 14 days translates into an annual percentage rate of 391 percent. Some consumers "roll over" their loans, paying another \$15 for the \$100 loan for the next 14 days. After a few rollovers, the finance charges can exceed the amount borrowed. Rent-to-own centers allow consumers to obtain televisions, computers, furniture, and appliances with a low initial payment. The leased products may be owned after a certain number of payments. One case in Wisconsin, with more than 10,000 complainants, accused the rental chain of illegally charging interest rates as high as 100 percent to rent televisions and other appliances, often to customers in low-income areas.

8-2 Financial Services**OBJECTIVES**

- Describe financial services commonly used by consumers.
- Identify types of commercial banking services.

CONSUMER SERVICES

The financial services available to consumers are continually evolving as a result of technology, changing laws, and new competition. As shown in Figure 8-2, these services may be viewed in five major categories.

FIGURE 8-2**Consumer Financial Services**

Electronic Banking	Savings Services	Payment Services	Lending Services	Other Services
ATM	savings accounts	checking accounts	credit cards	safe-deposit boxes
debit cards	certificates of deposit	debit cards	auto loans	investment advice
point-of-sale payments	money market accounts	online payments	mortgages	trust management
direct deposit	retirement accounts	stored-value cards	education loans	
online banking		smart cards	small business loans	

ELECTRONIC BANKING

Electronic funds transfer (EFT) refers to the use of computers and other technology for banking activities. Electronic banking services include the use of automated teller machines, point-of-sale transactions, direct deposit, and automatic bill payment. Online banking with a computer allows a customer to access many financial services.

Automatic Teller Machines. An automatic teller machine (ATM), more commonly called a cash machine, allows many banking services. A debit card, or cash card, is used for ATM transactions. A debit card is different from a credit card. With the debit card you are obtaining or using money that is in your account. With a credit card, you are borrowing to pay later. A lost or stolen debit card can be expensive. If you notify the financial institution within two days of the lost card, your liability for unauthorized use is \$50. After that, you can be liable for up to \$500 of unauthorized use for up to 60 days.

ATM services have expanded to provide other types of transactions. These machines can be used to buy bus passes, postage stamps, and gift certificates. Be aware that many banks charge fees for ATM usage. To minimize these fees, compare rates at different financial institutions. Use your bank's ATMs to avoid surcharges. Withdraw larger amounts to avoid fees in several small transactions.

Point-of-Sale Payments. In a point-of-sale transaction, merchants accept debit cards to pay for purchases. Most gas stations, stores, and restaurants accept this type of payment. Vending machines that accept debit cards are becoming more common.

Direct Deposit. Many persons use direct deposit for paychecks and government payments. Funds are deposited electronically and available automatically.

Automatic Bill Payments. Each month, many people pay their rent, mortgage, loans, utilities, and other bills without doing anything. Automatic bill payment requires a bank customer to authorize preset amounts for monthly expenses. The payments are deducted from the specified account and transferred to the appropriate companies.

Online Banking. Computers and many cell phones have become bank branches. Developments in technology have created a cyber-banking network that allows customers to check balances, transfer funds, and make payments anywhere, anytime. While most traditional financial institutions offer online banking services, Web-only banks also exist. For example, GoBank and E*Trade Bank operate only online while also providing customers access to ATMs.

SAVINGS SERVICES

Safe storage of funds for future use is a common need. One of the main services that financial institutions offer is accepting money from customers for safekeeping. Various types of savings plans are available for this purpose. These range from basic savings accounts and certificates of deposit to money market accounts and various types of retirement accounts.

PAYMENT SERVICES

The ability to transfer money to others is necessary for daily business activities. Money deposited in a checking account can be used by writing a check. Other types of payment services include debit cards and online automatic withdrawals.

Checking Accounts. While the number of checks written each year declines, checking accounts are still important for businesses and individuals. A variety of types of checking accounts exist to serve the needs of individuals and businesses. When selecting a checking account, you should consider these factors.

- Minimum balance required to avoid a service charge
- Interest rate earned on the account, if any
- Monthly service charge
- Amount of other fees, such as for printing of checks and stop payment orders
- Availability of other services, such as online banking

Today, stores and other businesses process a check at the time of purchase using an electronic check conversion (ECC) system. The check moves through an ECC reader to obtain the amount, account number, and bank information. After processing, the paper check may be returned to the customer marked "void."

Debit Cards. Most retail stores, restaurants, and other businesses accept debit cards issued by Visa and MasterCard. When the debit card transaction is processed, the amount of the purchase is deducted from the checking account. Most debit cards work in two ways.

- You sign a receipt, similar to when you use a credit card
- You are asked to provide your personal identification number (PIN), similar to when you use an ATM

Online Payments. Banks and Internet companies serve as third parties to facilitate online bill payments. Some of these include PayPal, CheckFree, and Paytrust. When using these services, be sure to consider the monthly charge as well as online security and customer service availability. Also on the Web are "cyber cash" or "e-cash" services designed to serve as financial intermediaries. These organizations create their own e-money that serves as a medium of exchange for online transactions.

Other Electronic Payment Methods. Stored-value cards are prepaid cards for such items as cell phone service, transit fares, highway tolls, laundry service, and school lunches. While some of these stored-value cards are disposable, others can be recharged with an additional amount. Smart cards, also called "electronic wallets," are similar to ATM cards. An imbedded microchip can store prepaid amounts as well as information about account balances, transaction records, insurance information, and medical history.

LENDING SERVICES

Most people, businesses, and governments borrow money at some time. For example, a business may want to borrow money to build a new warehouse or buy products to resell. Individuals may borrow to buy a car or pay college tuition. Interest earned on loans is a major source of bank income.

Banks offer various types of lending services. These include auto loans, business loans, and mortgages. Credit cards allow users to buy items such as clothing or sports equipment. When a bank issues the credit card, the user is borrowing money from the bank.

Another way that banks lend money is by sending a few checks with a customer's credit card statement. The customer can use one of the checks to obtain cash or to pay a bill. If the customer uses the checks, the amount of each check is charged to the customer's credit card account. In effect, the amount of the check is a loan. Be aware that this type of loan is often more expensive than other kinds of credit.

OTHER FINANCIAL SERVICES

Banks and other financial institutions offer other services to individual consumers and households.

Storage of Valuables. Banks offer safe-deposit boxes where customers can store valuables. Because these boxes are in well-guarded vaults, they are safe places to keep valuables such as jewelry, rare coins, investment certificates, birth certificates,

wills, and insurance policies. The box can be opened only by the customer or by someone who has been given the right to open it. Not even a bank has the right to open a safe-deposit box unless it is ordered to do so by a court. Safe-deposit boxes are rented by the year and come in a variety of sizes.

Investment Advice. Many financial institutions help customers by offering financial advice and investment services. These advisors can assist customers about whether it is wise to buy a certain house, how to manage money better, or how to exchange U.S. funds for foreign currency. Most banks offer advice on investing savings to earn more money. Types of investments include government bonds, stocks, and mutual funds.

Management of Trusts. Many banks manage investments on behalf of customers. A trust is the legal agreement for one party to control property for the benefit of another. When this situation exists, the money or other property that is turned over for the bank to manage is said to be held in trust. This service can be offered through a trust company or through trust departments in banks.

Trusts are used by people of all ages, but they are especially useful for young people and for some elderly people. A young person who inherits money may not have the skill and experience to manage it wisely. Elderly people who are ill may ask the trust department of a bank to manage their money. The bank makes investments and keeps the customers informed about what is happening to their money.

COMMERCIAL BANKING

In addition to consumers, banks and other financial institutions serve the needs of business organizations.

CASH MANAGEMENT

The inflow and outflow of funds is a vital element of every business. Banks provide services to assist with cash receipts and payments.

Cash Receipts. Collection of cash, checks, and other receipts is a common commercial banking service. A lock box is a secured postal box used to receive customer payments. A bank collects receipts from the lock box and deposits the funds into the company's account. The business is then notified of the total amount received. A bank may collect receipts from the lock box several times in a business day.

Cash Payments. Most often, a checking account is the basis of a company's cash disbursements. In addition, electronic payment systems are gaining in popularity for payment activities and transfer of funds.

BUSINESS LOANS

Every business organization will likely use credit at some point. Commercial lending refers to loans to businesses.

Commercial Loan Purposes. Business loans include:

- Real estate in the form of buildings or land
- Construction of new or expanded buildings or other facilities
- Equipment needs, such as new machinery or replacement of depreciated vehicles
- Operations, such as financing for repairs, additional inventory, or covering unexpected business costs

Types of Commercial Loans. Common commercial lending activities include:

- Term loans, usually from one to five years, used to obtain cash for the purchase of equipment, buildings, land, or to update business facilities
- A line of credit allowing a business to obtain additional funds up to a certain amount without a new loan application
- Company credit cards, which may be used by employees when traveling on business or for other company-related expenses
- Contract financing to finance a project from which income will not be received until it is near completion
- Bridge loans for temporary borrowing between a loan and longer-term financing
- Asset-based lending, a secured business loan in which the borrower pledges a specific company asset to serve as collateral

BUSINESS ASSISTANCE

Banks work with businesses, both large and small, to improve their ratio of success. Continued financial growth of companies also benefits banks. As businesses grow, they will increase their use of banking services. In an effort to help companies succeed, banks offer several services.

Information Services. Knowledge of technology, inventory methods, financial planning, economic conditions, and government regulations is a key to success. Banks often offer information to companies through personal contact or group seminars. These programs help small and medium-sized businesses adapt to changing market conditions, expand revenue sources, and reduce costs.

Small Business Administration Programs. Banks often work with the Small Business Administration (SBA), a federal government agency that was created to assist and counsel small companies. SBA guidelines for defining a "small business" are based on the number of employees and amount of revenue. These criteria vary for different types of industries.

The SBA coordinates with banks to implement its loan programs. While some direct loans are provided by the SBA, the majority of its efforts involve guaranteeing bank loans to small businesses. SBA programs also include assistance to obtain federal contracts, business management guidance, and specialized efforts for women, minorities, and armed forces veterans.

Since the SBA started in 1953, about 20 million small businesses have received help from one of its programs. Each year, the SBA backs more than \$12 billion in loans to assist various types of small businesses.

8-3 International Banking

OBJECTIVES

- Describe the development of international banking activities.
- Identify organizations that assist with international finance activities.

GLOBAL BANKING ACTIVITIES

Many of today's financial services started hundreds and even thousands of years ago. As trade took place among geographic regions, savings accounts, loans, and other banking activities developed.

EARLY INTERNATIONAL BANKING

Evidence exists that banking activities have been in operation for thousands of years. In many societies as early as 2000 BC there were financial activities such as bank deposits, loans, and coining of money.

Ancient Civilizations. The valued treasures of ancient Babylonia were the basis of lending money. Religious temples were used as safe-deposit vaults to store valued items. Coins were first used in Greece starting around 500 BC. The Roman Empire took many of these innovations to the next level. Their banking system included receipt of savings deposits and loans for varied purposes.

European Developments. As European explorers expanded trade in the 1400s, banking experienced a renewal. In Italy, moneychangers served the purpose of exchanging currencies from various regions, allowing traders to obtain payment in their home currency. One of the first enterprises to offer an array of banking services, including checking accounts, was the Bank of Barcelona (Spain). Within a few years, similar banks developed in Amsterdam (The Netherlands), Venice (Italy), and Hamburg (Germany). In 1800, Napoleon started the Bank of France, which had a strong financial influence in Europe from that point. In Britain, early banking activities were conducted by goldsmiths. They provided safekeeping of valuables and lent money. Gold and silver served as an assurance that the paper money being used was backed by a tangible, valuable asset.

INTERNATIONAL TRADE AND BANKING

Expanded global trade is accompanied by a growth of international banking. Financing of international transactions is generally handled by banks and other financial institutions. Today, nearly 100 U.S. banks have more than 1,000 foreign branches. In addition, over 250 foreign banks have offices in the United States.

Because of the expansion of foreign banks in the U.S., Congress passed the International Banking Act in 1978. This legislation requires foreign banks operating in the United States to operate under federal banking regulations. These global companies are required to have deposit insurance in order to do business in the United States.

Increased international banking activity has resulted in more standardized regulations across borders. In recent years, over 100 countries agreed to a global standard for evaluating the financial stability of banks. Banks are required to maintain a certain ratio of capital to reduce the risk of bank failure. However, tradition and economic conditions can create differences among the banking activities in various geographic regions.

Africa. Less than half of South Africans have access to a bank and its services, due to distance and lack of documentation of income and address. In addition, the bank fees in the country are some of the highest anywhere. Cell phones in South Africa allow workers to transfer funds hundreds of miles to their families in rural areas. This electronic money can then be used in the local village to buy food and other items. The more than 80 million cell phones users in Africa are able to take advantage of technology to expand business activities and serve family needs.

Asia. After the currency crisis in the late 1990s, profits of Japanese banks declined from a gain of \$7 billion to a loss of \$50 billion. Major banks have realized the need to downsize their scope and focus on specialized services. In contrast to the Asian multinational banks, countries such as Cambodia, Laos, and Vietnam still have areas where more traditional, informal banking takes place. Currency exchange activities and lending can occur with street traders as well as in more formalized bank settings.

Europe. Expansion of the European Union (EU) to 25 member nations and attempts to completely integrate financial services created several banking challenges. Conflicting banking regulations in various countries reduce the opportunity for standardization. Many local financial markets are set in their traditions, creating an additional barrier to EU banking integration. The use of the euro as the official currency is another area of diversity. Long-time EU members Britain, Denmark, and Sweden have opted not to use the euro. Recently admitted members, including the Czech Republic, Hungary, Poland, Slovenia, and Slovakia, hope to meet the economic requirements that will allow them to become part of the euro zone.

Latin America. Banking customers in Brazil usually do business with one of the three large banks in the country: Itau, Bradesco, and Unibanco. These organizations dominated the industry with their thousands of *agencias* ("storefront" agencies) and *postos* ("customer-site" agencies) along with *caixas automaticos* (ATMs). These many branches resulted when local areas desired a banking office as a status symbol for their region. Brazilians do not usually mail checks. Most bills come printed with a bank payment slip. Customers may walk in to a bank branch and pay with a check, cash, or a bank card. Or, the payment may be made at an ATM using the bar code identification on the form. More and more Brazilians are using the Internet to make payments.

Middle East. No formal money and banking system existed in the Middle East until 1952 when the Saudi Arabian Monetary Agency (SAMA) was created. Previous to that, foreign coins served the monetary needs of the region. Most of the coins had a value based on their gold or silver content. The main function of SAMA was to maintain a stable currency value. This central bank used various monetary policy actions, including the setting of interest rates that commercial banks may charge and selling government securities to cover budgetary and balance of payments needs. SAMA also regulated various financial institutions (commercial banks, exchange dealers, and moneychangers) and handled receipts and payments of government funds.

GLOBAL FINANCIAL ORGANIZATIONS

International banking transactions go beyond financial institutions. Several international agencies exist to promote business activities and economic development.

WORLD BANK

The International Bank for Reconstruction and Development, more commonly called the World Bank, was created in 1944 to provide loans for rebuilding after World War II. Today, the World Bank has the main function of providing economic assistance to less-developed countries. These funds are used to build communications networks, transportation systems, and utility plants.

The World Bank, with over 180 member countries, has two main divisions. The International Development Association (IDA) makes funds available to help developing economies. These loans can be paid back over many years (up to 50) and have very low interest rates. The International Finance Corporation (IFC) provides capital and technical assistance to businesses in nations with limited resources. The IFC encourages joint ventures between foreign and local companies to stimulate capital investments in the developing nation.

INTERNATIONAL MONETARY FUND

The International Monetary Fund (IMF) is an agency that helps promote economic cooperation by maintaining an orderly system of international trade and exchange rates. The IMF was established in 1946, when economic interdependence among nations was escalating at a greater pace than ever before in history. Before the International Monetary Fund, a country could frequently change the value of its currency to attract more foreign customers. Then as other countries lost business, they would impose trade restrictions or lower the value of their currency. As one nation tried to outdo another, a trade war often resulted. Today, cooperation among IMF nations creates a more orderly trade and monetary exchange.

The IMF, with over 180 member nations, is a cooperative deposit bank that provides assistance to countries experiencing balance of payment difficulties. When a nation's debt increases, its currency declines in value, resulting in even more debt. High debt payments mean less money is available for the country to improve its economic development. To prevent this situation, the International Monetary Fund has three main duties:

1. **Analyze Economic Situations.** In an attempt to help countries avoid economic problems, the IMF will monitor a country's trade, borrowing, and government spending.
2. **Suggest Economic Policies.** After analyzing the economic focus of a nation, the IMF will suggest actions to improve the situation. If a country imposes restrictions that limit foreign trade, for example, the IMF may recommend changes to encourage global business activities.
3. **Provide Loans.** When a country has high foreign debt, the IMF lends money to help avoid major economic difficulties. These low-interest loans can keep a country from experiencing an escalating trade deficit and a declining currency value.

ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT

Created in 1961, the Organization for Economic Cooperation and Development (OECD) has 30 member countries. These industrialized nations have a commitment to democratic government and the market economy. In addition to its members, OECD works directly with 70 other countries to expand free trade and encourage economic development among developing economies. OECD also identifies policies to develop appropriate governance by both governments and corporations. Recommendations are offered to promote sustainable development and scientific innovation.

REGIONAL DEVELOPMENT BANKS

Other regional organizations exist to help less-developed countries reduce poverty and expand economic activities. A development bank is an organization of several countries created to provide financing for economic development to countries in a region.

Inter-American Development Bank. In Latin America and the Caribbean, the Inter-American Development Bank (IDB) was established in 1959. The IDB exists to provide funds and technical assistance programs to enhance economic and social development. The IDB uses a major portion of its resources for the smaller economies in the region. The agency works closely with the IMF and the World Bank, and will often co-finance reforms, projects, and programs. The success of the IDB has resulted in other regions creating their own development banks.

Asian Development Bank. With more than 60 member countries (47 in Asia), the Asian Development Bank (ADB) has the goal of improving economic development and quality of life for people in Asia and the Pacific. A strong emphasis is placed on serving the nearly two billion in the region who live on less than \$2 a day. The ADB provides public policy discussions, loans, technical assistance, grants, and guarantees. With headquarters in Manila and 26 other offices around the world, the organization employs more than 2,000 employees from over 50 countries.

African Development Bank. Dedicated to reducing poverty and improving the lives of people in Africa, the African Development Bank implements a variety of economic and social programs. Loans, equity investments, and technical assistance are the main tools used to achieve its goals. Members in the organization include 53 African countries and 24 non-African countries from the Americas, Asia, and Europe. Established in 1964, every action of the African Development Bank is aimed at creating sustainable economic growth and regional economic cooperation.

Other Regional Development Banks. The reduction of poverty and expansion of economic activities are concerns throughout the world. Other examples of regional development banks include the Caribbean Development Bank, the Central American Bank for Economic Integration, the European Bank for Reconstruction and Development, and the Islamic Development Bank. These organizations attempt to stimulate business development and foreign trade and thereby create jobs and improve quality of life.

FOCUS ON: Central Banks and Government Financial Activities

Every local and national government uses banking services. Like businesses, government agencies must receive, pay, save, and borrow funds. In nearly every country of the world, a central bank exists. These state-owned agencies provide governments with banking services. Every central bank serves one or more of these functions.

1. Maintain a stable money supply using monetary policy tools.
2. Issue adequate amounts of currency to facilitate business activities.
3. Manage the receipts and payments of government agencies.
4. Provide loans for government agencies and other enterprises.
5. License commercial banks operating in the country.

In some countries these financial agencies are called reserve banks or a monetary authority. Names of central banks around the world include the Reserve Bank of India, the Monetary Authority of Singapore, the Brunei Currency Board, the Central Bank of Cyprus, the Czech National Bank, and the Bank of England. In some situations, a central bank may have authority over several countries. The European Central Bank, based in Frankfurt, Germany, is the central bank for the European Monetary Union (EMU), consisting of EU members that use the euro as their official currency. These "euro zone" countries are all served by one central bank. Each member country also has its own central bank that works with the European Central Bank. The Central Bank of West African States issues a monetary unit called the franc for the African Financial Community. This currency is used in eight countries (Benin, Burkina Faso, Guinea Bissau, Cote d'Ivoire, Mali, Niger, Senegal, and Togo). These countries are also referred to as the West African Monetary Union (WAMU). While the primary role of central banks is to provide governments with financial services, they also assist businesses and non-governmental organizations (NGOs). The regulation of banking activities along with a stable currency provides a beneficial economic environment for all participants.

Chapter Summary

- *The First and Second Banks of the U.S. were early attempts to create a stable monetary system. Due to political differences, neither bank had its charter renewed when it expired. The Federal Reserve System was created to supervise and regulate member banks to help them serve the public efficiently. The Federal Deposit Insurance Corporation (FDIC) and the Comptroller of the Currency protect banking customers and regulate the activities of national banks.*
- *The main departments of most banks are the loan department, personal banking, commercial banking, international banking, and the trust department. The two main types of financial intermediaries are depository and non-depository. In recent years, nearly all financial institutions have begun to offer a wider variety of financial services.*
- *The main categories of financial services used by consumers are electronic banking, savings, payments, lending, and other services such as safe-deposit boxes, investment advice, and trust management.*
- *Commercial banking services include cash management, business loans, and business assistance.*
- *As early as 2000 BC, banking activities included accepting deposits, making loans, and coining money. Expanded global trade is accompanied by a growth of international banking. Banking activities in various geographic regions are affected by tradition and economic conditions.*
- *The World Bank has the main function of providing economic assistance to less-developed countries. The International Monetary Fund promotes economic cooperation by maintaining an orderly system of international trade and exchange rates. Regional development banks exist to assist less-developed countries reduce poverty and expand economic activities.*