Unit 6 Notes

Money and the Role of Financial Institutions

Money

<u>Money</u> - Anything that is widely accepted in exchange for goods and services.

<u>Barter</u> - Exchange of goods or services for goods or services without the use of money.

Functions of Money

Medium of Exchange - Money is accepted because people and businesses know they will be able to spend it.

Example -

Store of Value - It can be saved over long periods of time without losing much value.

Example -

Unit of Account - Allows consumers to measure and compare the value of items.

Example -

Characteristics of Money

Durable - Money must be long-lasting.

Portable - Money must be easy to carry around.

Divisible - Money must be easily broken down into smaller amounts.

Stable in Value - Its value must not change rapidly.

Scarce - The fewer the dollars there are in circulation, the more valuable each dollar is.

Universally Accepted - Businesses and workers must be willing to accept is as payment.

Types of Money

Commodity Money - Money that has value apart from its use as money, such as fish, furs, or precious metals.

Representative Money - Money that has no value of its own, but it can be exchanged for something of value, usually gold or silver.

Fiat Money - Money that has value because the government has ordered that it must be accepted as payment.

Which definition describes the system of currency currently used in the United States?

The Money Supply

The Money Supply - The amount of money available for the purchase of goods and services.

Remember that the Federal Reserve adjusts the money supply (monetary policy) to achieve the nation's economic goals: (steady growth, low unemployment, low inflation).

There are three common measures of the Money Supply: M0, M1 and M2.

June 2013: M0=$1.2 trillion.
June 2013: M1=$2.5 trillion.
June 2013: M2=$10.5 trillion.

The Money Supply

M0 is a measure of the money supply that includes only currency in circulation.

The M0 definition of the money supply contains the following categories:

- Bills
- Coins

The Money Supply

M1 is a measure of the money supply that includes only the forms of money that are readily available to spend.

The M1 definition of the money supply contains the following categories:

- Currency in circulation (bills and coins)
- Deposits in checking accounts
- Traveler's Checks

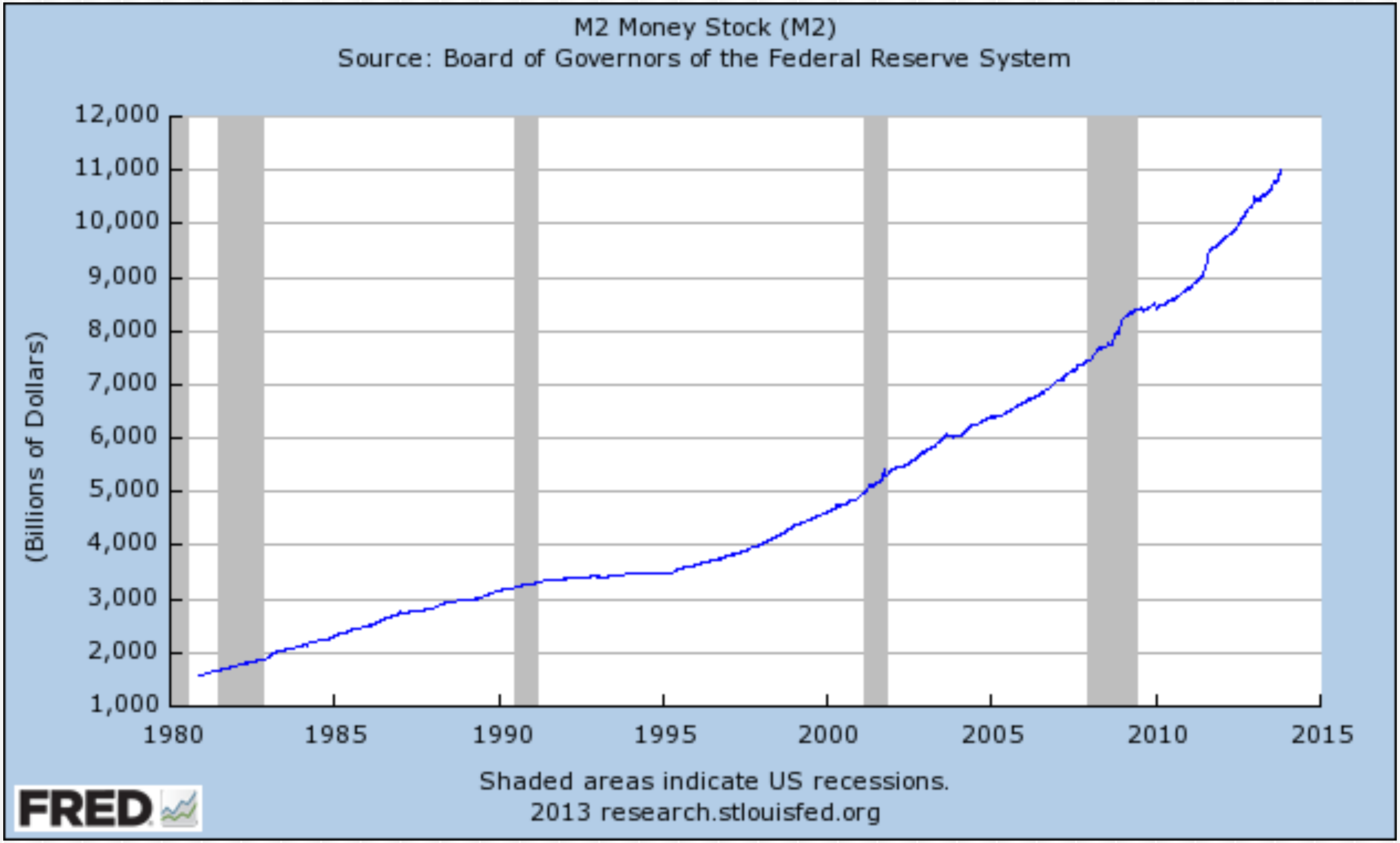
The Money Supply

M2 is a measure of the money supply that includes M1 along with forms of money that are less easily converted to cash.

The M2 definition of the money supply contains the following categories:

- Currency in circulation (bills and coins)
- Deposits in checking accounts
- Traveler's Checks
- Deposits in Savings Accounts
- CD deposits less than $100,000
- Money market deposit accounts
- Balances in money market mutual funds

The Money Supply



Income Inequality

President Barack Obama declared in 2012 that income inequality is “the defining issue of our time”.

Income inequality refers to how evenly or unevenly income is distributed in a country.

The greater the inequality, the greater the income gap between the rich and the poor.

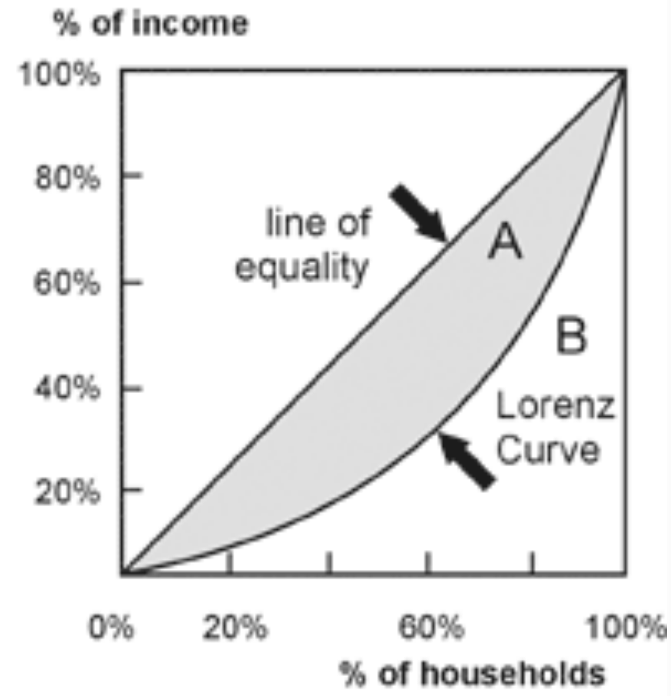
The income gap between the rich and poor in the United States has been growing for years.

Income inequality can be expressed using a **Lorenz Curve** and/or the **Gini Coefficient**.

Lorenz Curve

Lorenz Curve - A graphical representation of income distribution in a country.

The further the Curve is away from the line of equality, the more unevenly income is distributed among the rich and poor.



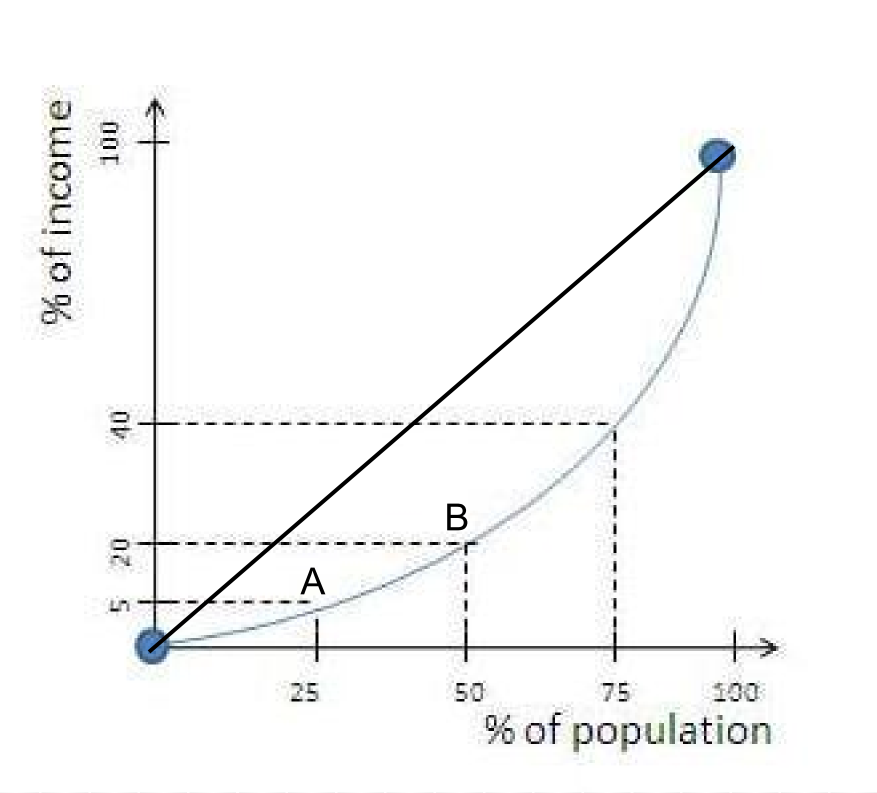
A Lorenz Curve illustrates inequality.

Lorenz Curve

Reading a Lorenz Curve:
Point A: The bottom 25% of the population earns 5% of the income.

Point B: The bottom 50% of the population earns _______ of the income.
Answer:

What percent of income is earned by the TOP 25% of the population?
Answer:



Gini Coefficient

<u>Gini Coefficient</u> - A measure of the income distribution of a country's residents.

The larger the Gini Coefficient, the more unevenly a country's income is distributed.

According to the chart, income is more equally distributed in Egypt than in China. In other words, the gap between the rich and the poor is smaller in Egypt than it is in China.

Gini Coefficient

In which country is the income gap between the rich and the poor the smallest?
Answer:

Is the income gap between the rich and the poor greater in Nigeria or Britain?
Answer:

Income Inequality

Is too much income inequality a problem?

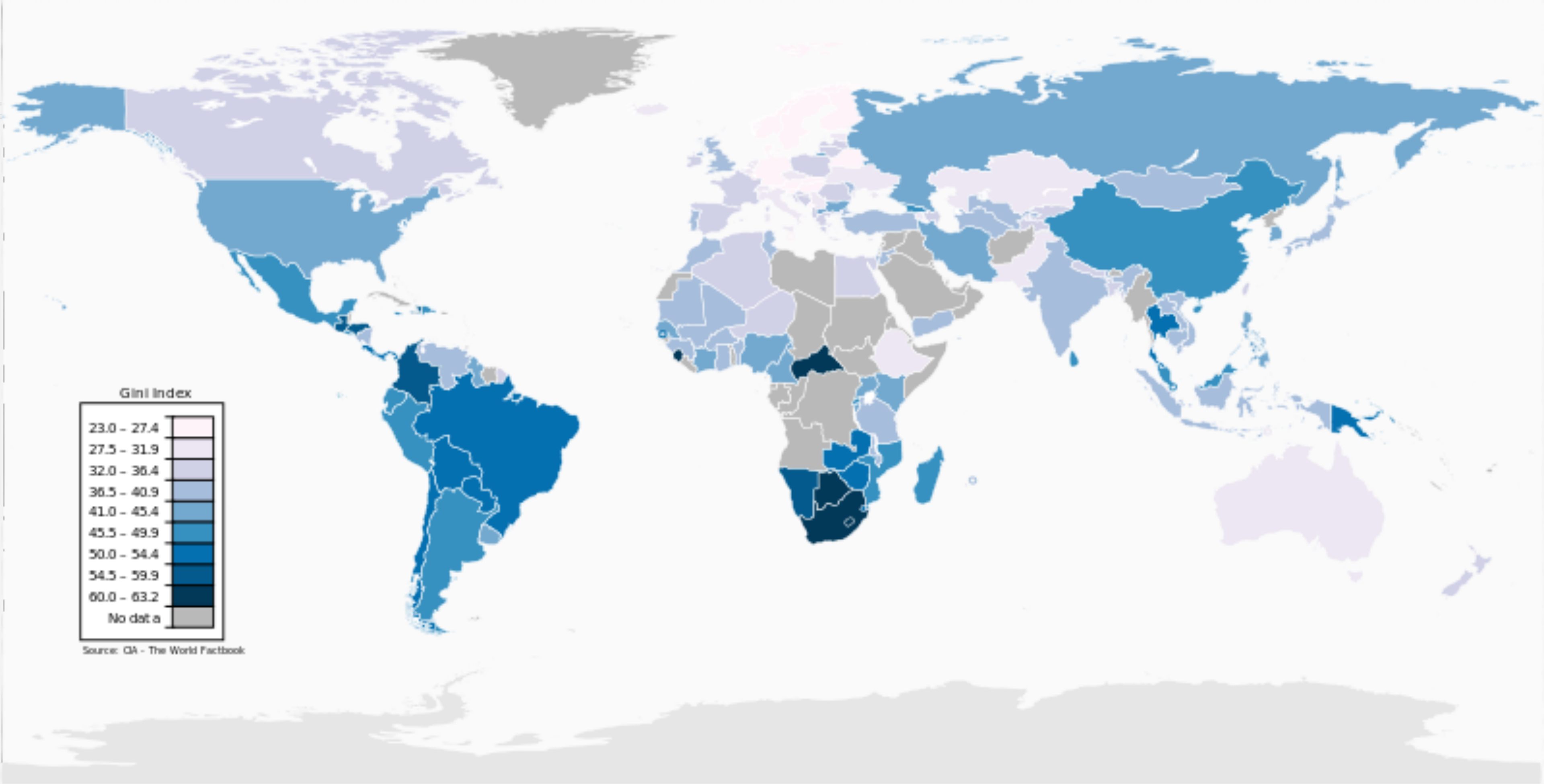
Yes…

- Class differences expand...people stop seeing each other as equals
- Economic growth is hindered
- It becomes harder for the poor to escape poverty

No…

- Economic differences are a natural product of capitalism
- Economic differences provide incentives for people to compete and innovate

Gini Coefficient



Income Inequality

What can a nation do to reduce the level of income inequality?

- Increase income taxes on the wealthy
- Limit executive pay
- Raise the minimum wage
- *Any other ideas?*

Financial Institutions

Banks and other financial institutions help put financial resources to their best use by connecting people that do not have an immediate use for their money with people who do.

Institutions we will be discussing today:

- Central Bank (Federal Reserve)
- Commercial Banks
- Credit Unions
- Investment Banks
- Stock Market

Financial Institutions

Federal Reserve - Uses monetary policy to help the nation achieve its goals of steady growth, low unemployment, and low inflation.

Commercial Banks -

Provide a place with individuals to save their money.
Loan money to spenders (people and businesses).
Local Example -

Credit Unions - Not-for-profit institution owned by their members, who are also their customers.

Provide the same services as commercial banks.
Local Example -

Financial Institutions

Stock Market - The place where ownership shares (stock) of companies are traded.

Investors provide companies money with which they can expand.

Companies provide investors with a share of the profits.

Investment Banks - Institutions that assist people that want to invest their money.

Local Example -

Circular Flow of Income & Output