DOLLARS & $ENSE

A Kid's Guide to Using—Not Losing—Money

Elaine Scott

Illustrated by
David Clark

DOLLARS

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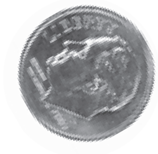

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For the bankers in my family—my brother,
George J. Watts III, and my daughter Cindy Scott.
With love and appreciation

—E. S.


THE UNITED STATES OF AMERICA
IN GOD WE TRUST
ONE

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Introduction

B*read. Dough. Cabbage. Clams*. These are just a few of the hundreds of slang terms that people use for money. Notice how much of this slang is based on food? That's probably not a coincidence. Food is necessary to sustain life, and so—in a way—is money.

In the classic film *Cabaret*, Liza Minnelli and Joel Grey sing a duet with these words: "Money makes the world go around, the world go around, the world go around." Yet a famous Bible quote says, "The love of money is a root of all kinds of evil" (I Timothy 6:10).

So which is it? Does money make the world go around? Or is the love of money the root of all evil? Surprisingly, both statements can be true.

A business cannot operate without money. Sometimes the owners provide the necessary funds, and at other times people **invest**, or put their money into, a business they think will be successful. Once established, most businesses hire people and pay them a salary. With the money they earn, these employees buy food, clothes, and perhaps a car or house. They go to the movies. They take a vacation. They give gifts to their children. They may be so busy working that they hire a teenager to mow their lawn or to babysit—even kids can make money!

Meanwhile, the businesses that sell the food, clothes, cars, and houses, or that run the movie theaters and the hotels at the

seashore—all of them are making money. So they hire more people, who in turn buy more goods and services. These are some of the ways in which money makes the world go around, which is another way of saying that money is needed to make an **economy**—the way a country uses and produces goods and services—work for everyone.

On the other hand, what people do with their money can hurt an entire economy, too. Greed—the desire for more and more of anything, especially money—can become a root of evil. Driven by greed, people have come up with schemes to cheat other people out of their money.

Enron was a giant energy company with headquarters in Houston, Texas. In February 2001, *Fortune* magazine named it "America's Most Innovative Company." Enron claimed to be earning more than one hundred billion dollars every year! That is one hundred thousand million dollars, and it's written like this: $100,000,000,000. That's a lot of money. People were eager to work at Enron and to invest their money in the company.

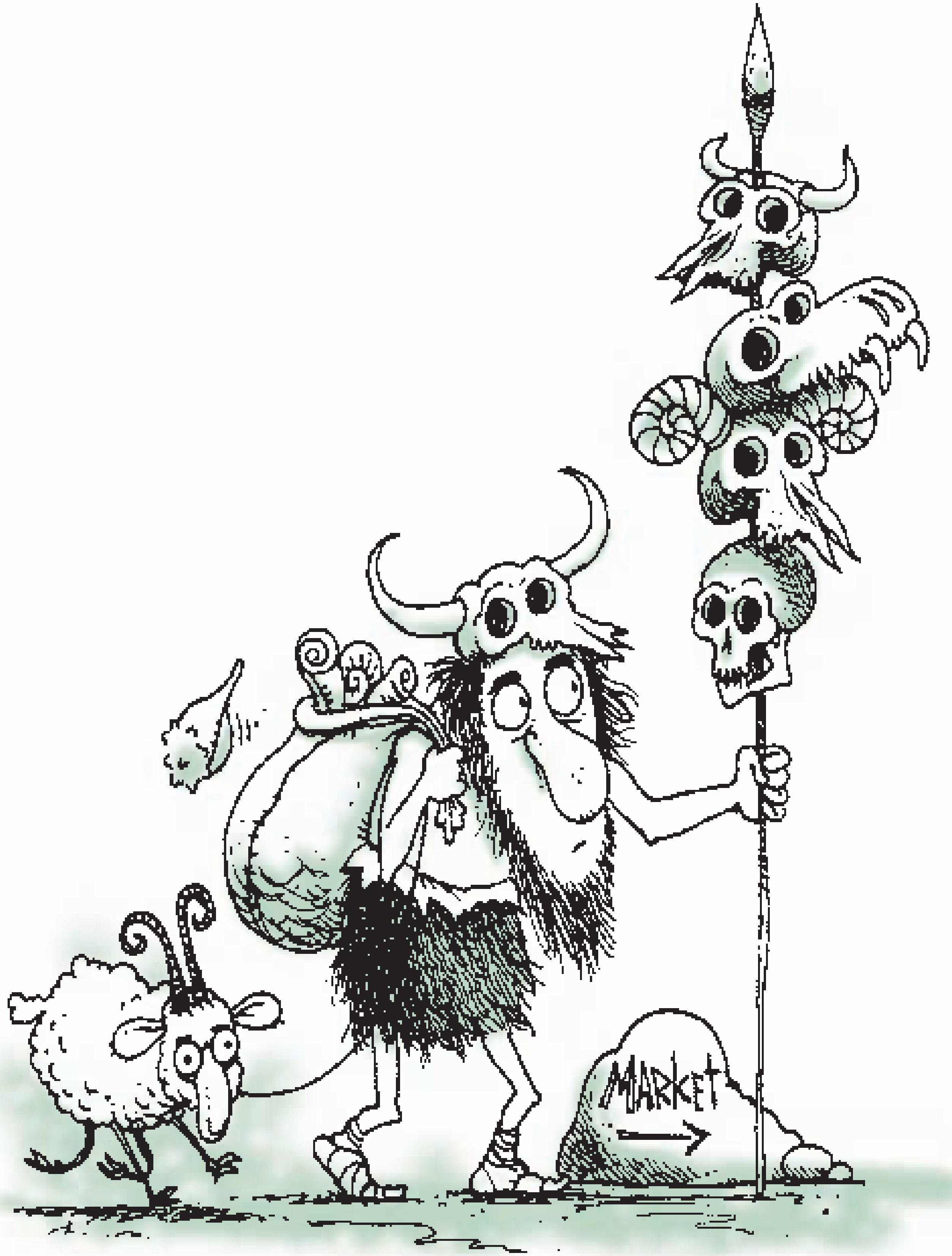
However, just a month later, in March 2001, *Fortune* magazine ran another article, titled "Is Enron Overpriced?" This article raised questions about the true value of the company. The truth was that Enron was not earning one hundred billion dollars a year. In fact, it was deeply in **debt**, owing more than thirteen billion dollars to **creditors** that had loaned it money. The fraud was gradually exposed during a two-month period, from October to November 2001. The company collapsed, and some of its **executives** went to jail. But average people, who had done nothing wrong, suffered, too. Those who had invested their money in Enron lost all of it. More than four thousand employees immediately lost their jobs. Arthur Andersen, a large company that provided accounting services for Enron, was forced to close its doors, causing another twenty-eight thousand people to lose their jobs. Without jobs, these people had no money; without money, they could not pay for food and housing. There were no toys for their children, no trips to the movies, and no dinners at restaurants. In other words, there was no money going back into the economy.

When the spending stops, everyone suffers. Some **economists**—people who study the economy—believe that the

Enron scandal helped bring about the economic decline known as the Great Recession (2007–2009), from which we are all still recovering.

That Bible verse, written around two thousand years ago, is often misquoted as "Money is the root of all evil." That isn't accurate; money itself is neutral, neither good nor bad. But money is important, because in many ways it does make the world go around, depending on how you use it. In 1931 car manufacturer Henry Ford said, "Money is like an arm or a leg—use it or lose it." The question is, how will you use it?

Many items, such as cars, televisions, games, and toys, come with instructions that explain how to operate the product. Unfortunately, money doesn't come with a set of instructions. Many people learn how to use it—or lose it—by trial and error. They make mistakes and learn from their mistakes. The information in this book is a little like basic operating instructions for money. After reading it, you will know more about money, how it came into existence, how it has been used through the centuries, and how it is saved, spent, and sometimes wasted. Once you understand money, you can make wise decisions about your own dollars and cents.


MARKET

1 Skulls, Sheep, and Shells

Money as a Medium of Exchange

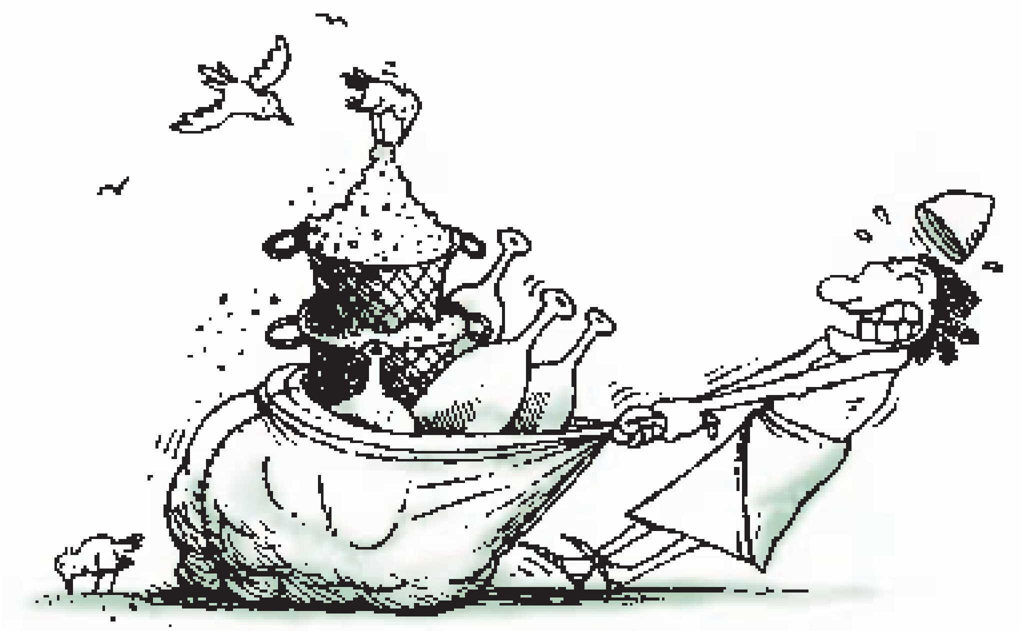
Have you ever traded one item for another? Perhaps a slice of your pizza for a friend's candy bar? Or maybe you've traded services with someone else: "I'll babysit your little sister tomorrow, if you'll feed my cat while I'm away." Exchanging goods (pizza for candy) or services (babysitting for feeding the cat) is a form of **bartering**, or trading. Bartering began long before there was such a thing as money, and it continues today.

Around 10,000 BCE to 4,000 BCE, our ancestors stopped wandering in search of food and began to settle down and live in small communities. Once they had established settlements, they learned how to domesticate, or tame, animals so they could raise herds of cattle and other livestock. Next they learned to grow their own grains and vegetables. People soon discovered they didn't have to do *everything* for themselves. Instead they could barter with each other. For example, someone who had a herd of goats but no seeds to plant could offer a trade: a young goat for several sacks of seeds. Someone else might offer to trade a basket of apples for a clay pot.

The barter system worked pretty well, as long as the person with the seeds wanted a goat, or the person with the pot wanted the apples. But suppose you had seeds, yet you didn't really want my goat? Or suppose I wanted the pot, but my apples weren't yet ripe? How could you trade the pot *now* for my apples that would be ripe *later*? The barter system failed to work at that stage, because the things that were traded simply didn't match up evenly. There was no common **medium of exchange**—no widely accepted item that could be used to pay for goods and services. In short, there was no money.

Once our ancestors came up with the concept of money, things worked better for everyone. A harvest of apples could rot, and clay pots could break. On the other hand, money—or **currency**—would not rot or break. In addition, it could be traded for something else of equal value. For example, the potter could sell his pots to the apple farmer now and be paid with money, which could be used to purchase apples later, when they were ripe. And if the apple harvest failed, the potter still had money to purchase food from someone else. In this way money, as a medium of exchange, helped the ancient world go around.

The first money came in many forms, and none of them looked anything like today's currency. In the earliest times, a medium of exchange could be a type of food, but it had to be something that lasted and wouldn't spoil, such as seeds. Whatever was used as currency had to be in demand year-round, too, so things like a measure of grain, a vat of wine, a portion of salt, or a **precious metal**, such as silver or gold, often served as mediums of exchange. Of course, dragging around vats of wine or bushels of barley was inconvenient, and gold and silver are heavy. What people needed was something that represented these valuable items but was easy to transport.



In 1200 BCE the Chinese began to use cowrie shells as money. They were portable, beautiful, and rare. Before long this medium of exchange spread throughout Asia and to Africa as well. Other cultures developed their own currencies.

Wampum—beads carved from shells—was the first currency used in North America. Developed by Native Americans, wampum remained a legal medium of exchange between Native Americans and New England colonists until the end of the seventeenth century.

Many Pacific Islanders had unique mediums of exchange. On the island of Yap, people once used stones as currency.

I'll Give You Two Goats for That

Mediums of Exchange

Here is a small sampling of mediums of exchange used around the world from ancient times (before the common era, or BCE) to today.

Ancient Times

10000–4000 BCE: Livestock is the primary currency at this time.

1200 BCE: Cowrie shells become the earliest money used in China. They are brought to Africa in the thirteenth century CE and are still used in some parts of that continent into the mid-twentieth century.

1000 BCE: The Chinese begin to make metal coins in the shape of cowrie shells. Coins are made of common and inexpensive metals, such as tin or lead.

550 BCE: During the reign of King Croesus, the country of Lydia (modern-day western Turkey) produces coins made from pure gold and silver. Today the expression "rich as Croesus" refers to this ancient ruler.

118 BCE: China distributes the world's first folding money in the form of one-foot-square pieces of decorated white deerskin.

Common Era

I'll Give You Two Goats for That

Mediums of Exchange *(continued)*

Common Era

806 CE: Once again China leads the world in currency creation by making paper money. Too much paper money is printed, however, and it loses its value. By 1455 paper currency has disappeared in China, and it doesn't reappear for hundreds of years. By the middle of the eighteenth century, paper money is once again common in China and Europe.

1791: Congress authorizes the creation of the First Bank of the United States.

1792: The Coinage Act of 1792 establishes the silver dollar as the first basic unit of currency in the United States. Originally, American coins ranged in value from a gold eagle worth ten dollars down to a copper half-cent. Today the US mints in Philadelphia and Denver make billions of new pennies, nickels, dimes, quarters, half-dollars, and dollar coins each year.

1816: Gold becomes the standard for currency in Great Britain. A paper banknote represents a specific amount of gold.

1900: The United States enacts the Gold Standard Act, making gold the **standard** for US currency.

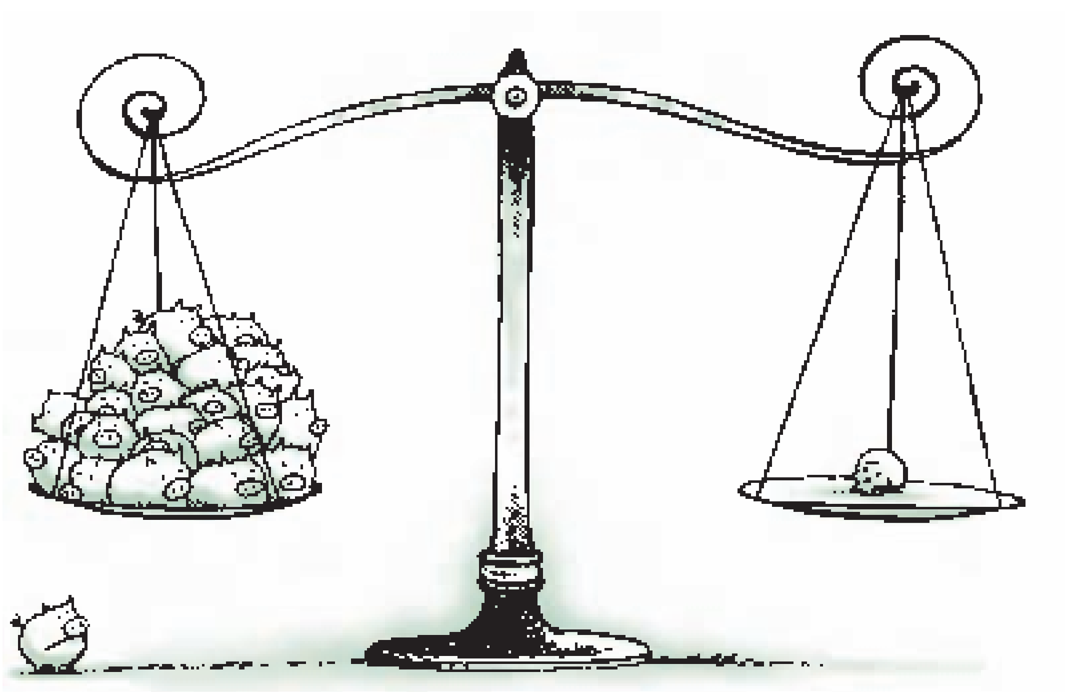
1967: Automatic teller machines (ATMs) are introduced. Money becomes electronic, allowing machines, rather than people, to handle financial transactions.

1971: President Richard M. Nixon ends the trading of gold for dollars. The gold standard disappears.

Today: Paper money, coins, and **checks** are less prevalent as electronic banking grows in popularity.

On New Hebrides (now Vanuatu), they used feathers. These are the heaviest and lightest currencies ever developed. The most disgusting currency ever has to be the human skull, which was used by the warrior headhunters of Borneo. Although they also used pigs and palm nuts as mediums of exchange, the warriors considered the skulls of their enemies so valuable that a skull became the standard for their currency.

A standard is something that other things are measured against. For example, inches are measured against a standard foot to show length. Twelve inches equals one foot, so we know immediately that something that measures six inches is shorter than a foot. It's the same with money. In Borneo it may have taken one hundred pigs or one thousand palm nuts to equal one human skull. Using the skull as a standard, it's easy to see that pigs were more valuable than palm nuts.



Fortunately, skulls did not become a common standard for currency around the world! Gold did. In other words, countries measured their currency against a standard amount of gold. They backed up that currency with actual gold, held somewhere in their treasuries. The United States adopted the **gold standard** in 1900. Each American dollar was now worth a set amount of gold, and gold was the only standard for redeeming paper currency. But how could the United States keep all that gold safe?

In 1937 the United States built an army post—complete with a vault—in Fort Knox, Kentucky. The nation's gold supply was shipped there on a nine-car train armed with machine guns on the roofs of the cars—and with soldiers who knew how to use them. Backed by such carefully guarded gold, American dollars seemed like a safe bet.

The delegates to Bretton Woods certainly seemed to think so. In 1944, toward the end of World War II, delegates from forty-four nations met in Bretton Woods, New Hampshire, to discuss how to regulate money exchanges between nations. The dollar replaced gold as the standard in the international financial market, where currencies are bought and sold. In turn, the United States agreed to fix the value of its dollar at a rate of $35 per ounce of gold. Theoretically, anyone holding a single US dollar anywhere in the world could exchange that dollar for its equivalent in gold.

But what if everyone in the world suddenly wanted to exchange their dollars for gold? There wasn't enough gold in Fort Knox to redeem them all. Fearing an economic disaster, President Richard M. Nixon announced on August 15, 1971, that the United States would no longer trade dollars for gold. The gold standard had come to an end.

Today the value of the American dollar and the currencies of other nations **fluctuates**—moves up and down—according to many factors. How much confidence people have in a country's government affects the value of its currency. To an extent, so does the price of an ounce of gold. But because the price of gold is no longer regulated, or set by law, its value is determined by **supply and demand**. If there's a lot of gold (a big supply) but not many people want to buy it (a low demand), then the price will go down. On the other hand, if there's a big demand and not much supply, then the price will go up.

YOU'VE GOT IT AND I WANT IT

The Law of Supply and Demand

Supply and demand is a basic rule of **economics** that states that the price of any resource, such as gold or oil or sugar, is determined by how much of the item is available (supply) and how many people want to buy it (demand). Usually, as demand for any item increases, the price for it rises.

But when the demand increases, others start to produce the same or similar items, increasing the supply, so the price drops. In the late 1970s, when a very simple home computer was new and rare, it cost thousands of dollars. Today you can purchase a powerful home computer in stores across the country for hundreds, not thousands, of dollars.

Computer prices fell because of competition, but prices can also fall due to little or no demand for a product. Few people want to buy last year's computer; however, if they do, the price will be a bargain.

When the demand for an item is equal to the supply of the item, an economist would say the price has reached **equilibrium**. In other words, the price is steady and probably fair.

No Matter What You Call It, It's Still Money

A Sampling of Today's Currencies

Here are just a few of the approximately 182 currencies circulating in the world at this moment:

Afghanistan: afghani
Angola: kwanza
Australia: Australian dollar
Bolivia: boliviano
Brazil: real
China: yuan renminbi
European Union: euro
Haiti: gourde
India: Indian rupee
Israel: new shekel
Japan: yen
Mexico: Mexican new peso
Russian Federation: Russian ruble
United States: American dollar

Currency operates in a similar manner. Economists talk about "strong" and "weak" currencies. As the name implies, a strong currency has more purchasing power than a currency that is considered weak. When the US dollar is strong compared to, say, the euro, it takes fewer dollars to purchase an equivalent amount of euros. With a strong dollar, you might be able to buy a single euro for about $1.30. But if the dollar is weak, then it might take as much as $1.60 to buy that same euro. Currency values fluctuate daily around the world.

Many countries still tie their currency to the US dollar. They have confidence in the basic economic systems of the United States—in the rules and regulations that govern its financial institutions, including banks. However, American banking regulations didn't happen overnight; they had their beginnings in the ancient world.