Session 1: How Banks Work, Or, Where Willie Sutton Stole The Money From

The economy of the United States is a seemingly complex (but actually simple) engine for continuous growth, driven by fluctuations in the amount of money that exists. Because of this deceptive disguised simplicity, relatively few people actually understand how our economy operates. Inherent to an understanding of the American economy is an understanding of the nation's banking system, and modern banking in general.

When the famous thief Willie Sutton was asked why he robbed banks, the replied "That's where the money is". Everyone knows that banks are where the money is. The Federal Reserve, to be discussed in later sessions, is the national bank for the United States. But what of the thousands of "National Banks", the ones found in every city and town where people deposit money and cash checks and pay mortgages and take out loans. What is a bank anyway?

Many people maintain a serious false image of banks. A bank is more than a place to save money. A bank isn't even primarily a place to save money. A bank is a vehicle for investment. There is, in the public mind, the image of a bank vault, full of bags of cash or Fort Knox filled with bars of gold. In fact very little money consists of printed notes, and most is held (in banks and other institutions) as checkable deposits. People think you take money to a bank, hand it over to the teller who puts it into a big vault, and it stays there (in bags) for you until you withdraw it.

This may have once been the way things worked, but not any more, not anywhere except in Hollywood. Some businesses do deal with cash, and every once and a while one sees an armored car, but there was a time when every bank in town would be visited periodically by a Brinks Truck to handle a missive influx of cash from big corporations and from other banks. Nowadays this only happens in TV cop shows and gangster movies.

When you deposit money into a bank, the bank doesn't keep it until you need it; the bank invests it—either in securities (this is one reason why banks fail when securities prices fall to hard and too fast) or in the form of loans (this is one reason why banks fail when too many people can't repay their loans, as happened during the 2007-8 crisis). When many banks fail at the same time, this is known as a "Bank Panic". Between the signing of the US Constitution and 1929 there was a bank panic about every seven to twelve years. Intensive regulation after the 1929 catastrophe prevented further collapses, until reckless disregard of these regulations brought about our most recent financial disaster