Reserve banking

Finance

Banking System: The banking industry is a very important financial sector within an economy. This is mainly because the industry plays a significant role, in determining whether an economy would grow or not. This is based on the fact that the banks are responsible for issuing out credit and loans, to business personalities, which in turn can help in the growth of the economy (Quagliariello, 13). However, if the industry is left unchecked, it can also lead to the exploitation of people, and the decline of an economic system. An example is the sublime crisis, which was created because of the unregulated lending of the banking organizations in the mortgage sector. There are two types of banking system that is the fractional banking system, and the 100% reserve banking system. This paper is a comparison and a contrast of these two types of banking system.

The 100% reserve banking system is a practice whereby the full amounts of the funds of a depositor are made available to him or her at any given time. In the current global business environment, this system of banking does not exist. This is ever since the 1800s. The major reason is because banking organizations need to make profits, and having a 100% reserve banking system makes it difficult for these organizations to make money (Quagliariello, 17). Therefore, banking organizations and institutions would trade with the deposits in their vaults, for purposes of making profits. These trades involves, issuing of loans, mortgages, and involving themselves in the money market. However, in order to make some money, banking organizations that operates under a 100% reserve banking system, are involved in charging their customers some money, just for purposes of making them to be able to access their services.

Lending in this kind of a system normally occurs when there is a separate arrangement, between the depositor and the banking organization, where the depositor is required to authorize the banking organization to lend some of his or her money. This is in direct contrast to the fractional system of reserve banking (Quagliariello, 27). Under this type of banking system, only a fraction of the depositor's money is able to stay in the banking vaults, and the rest of the rest of the money are used for purposes of trade. Banks normally loan out these money, at an interest. Banks normally carry out this activity, through a vehicle referred to as a certificate of deposit.

This system normally works, when the banking organization takes the money that is not needed by the customer, and it invests it in a specific profit centered venture. The depositor and the banking organization would share some level of risks, and also some level of gain. This type of arrangement does not exist in the 100% reserve banking system. When compared to the fractional system, the 100% reserve banking system does not create a financial crisis, or a systematic risk (Quagliariello, 33). Furthermore, this type of a banking system eliminates the need of creating a central bank that can act as a regulatory banking organization. However, just like the fractional banking system, this system does not eliminate lending. However, it is able to create a long term view, of this concept of lending. Under the 100% reserve banking system, banking and investing are two different concepts (Quagliariello, 33). Banking does not have any risk, and does not have any gain, while investing, has some elements of risks, and gains.

In conclusion, the major different between the 100% reserve banking system, and the fractional system, is on what they do with the money from depositors. In the 100% system, this money is placed in the banking vaults, while in the fractional system, some of this money are kept in the banking vaults, and the rest are invested. However, one similarity is that they are involved in the lending services, but the degree and the method used varies.

Works Cited:

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