

THE ORIGINS AND NATURE OF MONEY

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Abstract:

The importance of money and the role they hold in the economy can be seen as the keystone of economic life. For a better understanding of the essence of the monetary phenomena it is especially important to turn to history and see how money was born. By turning to their origins, we discover the real fundamentals of monetary issues. Only after such a systematic analysis we will be able to suggest the appropriate solutions for the current monetary issues. Therefore, in this study I will research the origin of money and their functionality on the market. The aim of this paper is to analyse the origin of money as a social institution. The appearance and use of money has prehistoric roots. People have turned to the usage of money out of need to facilitate trade. During thousands of years money has known different forms going from money as merchandise, to coins and later to paper money and electronic currency. In this study I have analysed the role of natural money, as well as their production and functionality on the market. The main question to be answered is whether the production and functionality of paper money nowadays is the consequence of the free market, having the Austrian's School liberal perspective as a starting point. This methodological approach demonstrates that money is and will remain a social institution and the implication of the authorities in the currency issuing, even from ancient times, has caused distortions in the economic activity.

Key words: money, free market, exchange, liquidity, state intervention

JEL classification: B12, B13, B41, B51

INTRODUCTION

The monetary issue has been a concern for humanity since ancient times. The philosophical position was different regarding the role and function of money in society. In Plato's Ideal City everything belonged to everyone, therefore the exchanges as well as the use of currency are unnecessary in this utopic paradise. Aristotle, on the other hand, by supporting private property, favourable of economic efficiency, encourages trade between citizens and the use of currency: "coined money is a mere sham, a thing not natural, but conventional only, because, if the users substitute another commodity for it, it is worthless, and because it is not useful as a means to any of the necessities of life, and, indeed, he who is rich in coin may often be in want of necessary food. But how can that be wealth of which a man may have a great abundance and yet perish with hunger, like Midas in the fable, whose insatiable prayer turned everything that was set before him into gold?" (Aristotle, 2001, p.19). Aristotle claims that: "money was intended to be used in exchange, but not to increase at interest. And this term interest, which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent." (Aristotle, 2001, p.22). The functions of the coin from Aristotle's point of view addresses two facts: the coin expresses the value of commodities and it represents the instrument through which goods flow inside the market (Velier, 2009, p.14). The market represents a network in which two persons or institutions trade goods (Rothbard, 2013, p.20). Through the market, people voluntarily participate in the trade, respecting private property.

In the economic world the exchange intermediaries are money. For a better understanding of the contemporary monetary phenomena, the periods of economic boom as well as the recession, I have considered essential a historic retrospect of the origins of money and an analysis of the way in which they are naturally formed inside the free market.

The aim of this research is to present the genesis of money from a historical point of view, as a spontaneous output of individual efforts from the members of a society. Following the analysis of the historical and theoretical elements of the origin and natural production of money, I have analysed the types of money on the market as well as the concept of the optimum currency offer

from a liberal point of view, in relation to the Austrian School of thought. The conclusions of the study reveal the fact that the optimal monetary organisation can only be created by the free market, according to the principles of economic liberalism.

1. THE ORIGINS AND NATURE OF MONEY

History demonstrates that money has emerged, as language has, out of objective reasons, out of necessity. In order to facilitate the exchange of goods and services, as well as to favour the international labour division, people have used numerous commodities as means of exchange: tobacco in Colonial Virginia, sugar in the West Indies, salt in Abyssinia, cows in Ancient Greece, nails in Scotland, copper in Ancient Egypt, and also grains, tea, animal skins, fish hooks etc. (Smith, 2010, pp. 36-37).

Money theory necessarily implies a theory of marketable goods (Menger, 1976). The fact that money is characterized by an unlimited liquidity is mainly the result of the difference in goods marketability. On the market, there are goods with different degrees of merchantability. This depends on a series of factors such as: the demand for the goods, the purchasing power of the persons requesting the goods, the divisibility of goods, the degree of market development and, last but not least, the political regulations targeting the consumption of the merchandise.

Deepening the analysis we can notice the existence of goods with different degrees of liquidity. This is determined by a series of factors which Carl Menger (1976) classifies into two categories: space limits and time limits.

The spatial limits of goods liquidity include a series of aggregates like: the possibility of merchandise transportation, transportation cost, the degree of development of the means of transportation for different categories of goods and, last but not least, prohibitive commercial differences imposed to some categories of goods covered on the local market, especially in the case of international trade.

The time limits of goods liquidity depend on: the term of validity, necessary maintenance, storage and warehousing costs, the rate of profit, the fluctuation of demand as well as political and social regulations concerning the possibility of the transfer of goods from time to time.

All these time and spatial factors influencing the degree of goods liquidity explain why some products can be easily sold, at any time and in whatever quantity, at prices strictly according to the situation of the general economy, while others are sold with more difficulty, often requiring a price decrease in order to meet the expected demand.

On the market every trader is interested in exchanging less marketable goods for ones with a higher degree of liquidity. But this is a gradual process. At first, only a limited number of economic subjects will appreciate the advantage of such procedures. Later, through experience and custom, the highly marketable goods get to be accepted by all individuals, not only favouring the exchange of low liquidity goods, but also of any kind of trade. When the means of exchange becomes generally accepted by the members of a society it is called money (Hulsman, 2012, p.41).

To understand the context of money issuing, it is necessary to analyse how the barter works. In the case of direct exchange, goods are exchanged for goods. The difficulty of the trade resides in the low probability of finding a seller and a buyer who would be willing to exchange an adequate quantity of goods necessary for both sides. This issue increases in difficulty when the tradable goods are undividable. The direct exchange of goods and services between individuals also raises other problems. In addition to the aspects mentioned above, another difficulty ensues from the evaluation of goods that have to be exchanged. Without a standard value, it is difficult to reference products to each other. Barter economy is commercially characterized by stagnation. Because the trades between individuals were unfolding precariously, societies using this type of economic organisation were defined by economic and commercial regression.

Facing these specific obstacles for the barter, in order to enhance the fluidisation of trades and a better evaluation of products and services, people turn to indirect exchange. They interact on the market to exchange goods for goods, which in turn can also be traded for other goods that would

satisfy necessities. Hence we notice that through this indirect exchange process, individuals choose a commodity that serves as a means of exchange. Gradually, this commodity is used more and more as a means of exchange and thus currency arises.

The historic reality has demonstrated that the currency is in fact a commodity that has initially served other purposes on the market and over time has been chosen by individuals because it proved useful as a means of exchange (Rothbard, 2013, p. 30). In time, in different eras and societies, the place of money was taken by different goods like: seashells, animal skins, tobacco, etc. (Rothbard, 2005, p.41).

Inside the natural auto selection process, the market has chosen two precious metals, gold and silver, in the form of coins or bullions, to represent money. This is due to the properties of the two metals: scarcity which gives a relatively stable value, the fact that they were easy to transport and to divide, they were highly demanded, could be easily homogenised and, not least, they were long lasting in time (Rothbard, 2013, p.31). Amongst these features we have to mention that, physically, precious metals were easily distinguished by sound and colour and their quality and weight were fairly easy to control. The scarcity of precious metals and their durability give birth to minimal supply fluctuations. These features contributed to the increase of the metals' material liquidity encouraging them to be adopted and used as money.

Understanding the individual interest determined all the economic developed states to accept using precious metals as money, provided that a sufficient number of coins was collected and introduced in commercial activities.

At origin, money represents a social institution and not a state one. Through state recognition and regulations, the social institution of money was perfected and adopted to commercial needs, such like traditional rights were perfected and adjusted by law (Menger, 1976).

The legal recognition of money has eliminated insecurities and difficulties concerning the conversion of coins within international commerce. These measures have contributed to improving the functioning of precious metals as money, but were not responsible for turning them into money.

2. THE NATURAL PRODUCTION OF MONEY

Any type of money resulting from voluntary cooperation between people is called natural money (Hulsman, 2012, p.43). People's voluntary cooperation takes place while respecting private property inside the free market. A free society, where the individual's choice prevails, will automatically ensure, through a convergence process, the use of the best money inside commercial exchanges. History shows that gold, silver and copper represent natural money because they were deliberately chosen over time by individuals to be used inside commercial transactions as a means of exchange.

Natural money is the result of the best choices of the citizens. Before they are used for monetary purposes natural money must have a market value and a series of previously mentioned physical features in order to facilitate the growth of commercial transactions.

Trading goods on the market takes place based on the weight criteria. Precious metals are included in this category, of natural-commodity money, being evaluated according to their weight. In what concerns their shape, we can notice that that gold has been used inside the trade under different shapes: as coined money, as bullions and even as jewellery. Essential in the case of exchange is the weight of the precious metal and less its shape and form (Smith, 2010, pp.40-41).

The coin minting process involves inscribing a piece of a precious metal in order to certify its weight. We have to mention that coin minting facilitates the exchange of precious metals in that the long process of weighing and melting the metal is dropped out (Aristotle, 2001). Evaluating the weight is done much more easily by counting coins. In the case of daily exchanges, people were using coined money, but for transactions of a higher value they were using bullions. During the gold standard, compared to bullions, coins were traded at a higher value. This is due to the transformation process of coins into bullions and the other way around: it is more costly to produce coins from bullions than it is to melt coins into bullions.

Coins were circulating on specific geographical territories because their value depended on the trust given by the coin issuer. From a historical point of view, the beginning of coin minting consisted of private initiatives, the government having later implications in this field (see Burns, 1965).

Since the Middle Ages until the present day many specialists in monetary theory have considered that it was the kings', princes' and governments' obligation to issue coins. The explanation was that the kings and princes were considered divine messengers with a universal vocation to govern society (Hulsman, 2012, p.58). Medieval scholars were aware of the fact that kings and people's leaders were abusing the trust given to them and most of the times they were altering the quantity of precious metal in the coins in order to cover their personal expenses.

The coin production in a competitive regime is the best way to keep trust in the means of exchange of precious metal. Making money out of precious metals by private mints supports the consumer's sovereignty on the monetary market. Money is the property of a community (see Oresme 1956, p. 16), and through the market people are free to choose which currency to use in trades. The obvious consequence will be choosing a stable currency, regarding the quantity of precious metal that is acceptable inside commercial transactions.

The state's intervention through a monopoly over coin minting changes the parameters of the equation. Using coercive laws, the authorities have obtained a monopoly in coin minting as a symbol of national sovereignty. The governments' actions weren't limited only to coin minting. By obtaining control over currencies, princes and kings falsified their value. Through state intervention they have made citizens use devalued currencies inside the trade (the value on the coin did not correspond with the real amount of gold or silver in the coin) and later only simple paper money.

The arguments in favour of a government monopoly on coin minting is based on the wrong interpretation of Gresham's law according to which "bad money drives out good money". In reality, Gresham's law states that "the undervalued money will leave the country or disappear from circulation into hoards, while the overvalued money will flood into circulation". To illustrate this, we are considering the following example: on the market there are gold coins circulating, which weigh one ounce. After many years of use their weight drops to 0,8 ounces. On the free market these coins will circulate at their real value of 80% out of the full coin value. The consequence will be eliminating these weak coins from the market. If the authorities intervene and by a decree they decide citizens should use these used coins, inside transactions, at an equal value with the newly issued ones, it is obvious the government overvalues the used coins and undervalues the newly issued coins.

The consequences of such behaviour consist in the following: individuals will use undervalued coins inside trade and new coins will either be treasured up or they will be exported. This situation reflects Gresham's postulate in that the bad money will drive away good money, following the government's intervention on the market.

To avoid this situation which affects the real economy through the monetary channel, money production must be entrusted to the free market. Through competition, private entrepreneurs will produce and market the best currencies mutually accepted by all citizens inside exchanges. The parallel production and use of more precious metal coins represents the natural condition of a free economy (Hulsman, 2012, p.69).

3. MONEY IN THE CONTEXT OF FREE MARKET

The market is not a place, a thing nor a collective entity. The market is a process set in motion by the actions of individuals cooperating under labour division conditions (see Mises, 2002). The exchange intermediary in the market process is money. In the previous chapter I have analysed the concept of natural money and natural production of money and what are the optimal conditions for it to develop so that the consumer's sovereignty is not endangered and the economy functions efficiently.

In the present day, on the market, there are other types of money besides natural money outlined in the previous chapters. We are talking about credit money, paper money and electronic money. Alongside the analysis of the optimum money supply, in this chapter I will analyse the shapes currency takes inside the market.

3.1 THE MONEY SUPPLY

The money supply is made of all the monetary units at a certain moment in a certain geographical area. Over time, researchers have tried to discover the lapse in which the optimum monetary supply in a society should frame and how this influences the other aggregates in the economy. The originality of commodity-money is that it offers major social benefits by fluidizing the transactions and contributes to the progress of civilization. But an increase of the money supply does not have the same consequence as the supply increase of a different commodity.

Economic theory demonstrates that, on the market, an increase of the quantity of a commodity leads to its price drop (Ignat et al, 2002, p.94, p.162). This does not apply to the case of money (Rothbard, 2013, p. 28-29). There is a simple and rational explanation: an increase of the amount of money cannot solve the inequality of limited resources/ unlimited needs. Only an increasing supply of goods and services is the one that contributes to progress and economic development. The issue of the resources' scarcity cannot be solved through the increase of the money supply as some monetarists think. The consequences of this growth are the decrease the purchasing power of the currency, resulting in prices increase. When a commodity has acquired the currency status on the market, increasing its quantity does not bring social benefits therefore we can consider that any amount of money is optimal (Rothbard, 2013, p.29).

A similar explanation, based on decreasing marginal utility law, is offered by the contemporary philosopher and economist Guido Hulsman: our material, financial and time resources are limited. This condition of the resources' scarcity, indirectly determined a hierarchy of choice. Hence, under shortage conditions, we have to choose what we want to use according to the available resources. From an economical point of view, using any commodity or service on the market stands under the decreasing marginal utility law; according to this, increasing the quantity of a used commodity leads to its marginal utility decrease (Hulsman, 2012, p.65-67).

The decreasing marginal utility law also applies to the monetary field: increasing the production of an additional unit of money will lead to the value decrease of each monetary unit of the currency holder. In other words, the currency becomes less and less valuable compared to other goods and services, and the seller tends to ask for bigger money supplies. This phenomenon will gradually spread into the economic system until the new prices will adjust to the increased money supply. There are a series of goods for which the increase of the money supply leads to a decrease of their prices (Ignat et al., 2002, pp.111-113), but the general tendency on the market is to increase prices, which leads to a diminished purchasing power of the currency. Increasing the money production is a time demanding process, and the price increase occurs gradually.

The effects shown in the economy after such behaviour affects, as we mentioned, the prices increase, the decrease of the currency purchasing power and the distribution of income. It is obvious that the direct exchange as barter, as well as the indirect exchange through the currency involves an alteration of the resource distribution between individuals and trade participants. Modifying the way in which wealth and incomes are being distributed favours the first holders of the newly minted money. They will benefit from the additional supply of money and will acquire goods and services increasing the suppliers' incomes. The immediate consequence is the prices increase which disadvantages the citizens with fixed incomes that couldn't benefit from the newly issued money. By extending its monopoly on the monetary system, the state controls the whole economic system causing severe mutations at income distribution level.

3.2 CREDIT MONEY

Known as currency credit, this type of money used on the market favours indirect exchange through financial instruments. Let us assume citizen Y borrows 15 gold ounces from citizen X. To validate his debt, citizen Y offers his creditor a certificate according to which he acknowledges the total amount and the due date of his credit. If the participants in the exchange trust the commitment of citizen Y, the creditor can use this certificate to pay for goods and services. Hence, the paper issued by citizen Y becomes credit money.

The use of currency credit involves a series of risks as well, the main one being the possible bankruptcy of citizen Y who will be unable to honour his debt. The liquidity of credit money is limited, therefore they are nothing else but a derived type of currency which depends on the borrower's reliability and reputation.

3.3 PAPER MONEY AND ELECTRONIC MONEY

In the present day all the states in the world use paper money. They are different from credit money because they can be converted into a commodity currency. While credit money has coverage in gold or silver, paper money does not have this advantage. It is essential for this step to see if paper money is the result of the individual's free choice in the market process.

History proves that paper money did not occur spontaneously on the market (see Dowd, 2001 and Selgin, 1994). At its origin, paper money consisted in simple bank notes attesting the existence of certain quantities of gold and silver in the bank's treasury. In other words, bank notes were used as a monetary substitute. The owner of such a document could come at the banks cashier's office anytime and take the amount of gold inscribed on the bill. Bank notes, emitted by the FED, were certified with gold coverage on August 15th 1971 when the system of Breton Woods collapsed. Alongside the Breton Woods collapse, bank notes became simple paper money, unconvertible to gold, which circulated on the market at a legal rate of exchange.

By nature, bills only have monetary functions. Natural money, alongside its exchange value, also has a non-monetary value as a merchandise. Therefore, natural money is superior to paper money. Without an authority's coercion, paper money would not have withstood on a free market competing with natural money.

In the era of new technologies, human innovation has developed a series of instruments to access the transfer and efficient use of electronic money. Except the bitcoin, electronic money is a different form of paper money. Created and used electronically, at the central authority's request, electronic currency remains, as well as bills, a state monopoly. What we need to remember is that the difference between electronic money and the instruments used for their transaction are the result of innovation and technical progress.

CONCLUSIONS

In this research I have systematically analysed the origin and evolution of the coin, as well as the way in which the market, during hundreds of years, has chosen money to be represented by precious metals due to their features. Having obtained a monopoly on currency issuing as a sign of states' sovereignty, the authorities have distorted economic activity by releasing devalued coins at a superior legal rate than the one on the market. The consequences of this behaviour affected the economic life, as the money issuing would have been better handled at the free market level through the competitiveness of private mints.

The history of economic facts demonstrates that on a free market in order to produce money you have to produce commodities beforehand. The produced goods are then sold on the market resulting in incomes. In the era of paper money, the government increases its revenues without producing and selling goods, without an effort, only by printing paper money or issuing electronic currency. The effects of the inflation and of the bank regulations regarding currency issuing based

on fractional reserves, are known from the consequences arising on the market: the cycles of the economic crisis which the contemporary economy faces.

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