Return to Roots: the Origins of Money and the Current Financial Crisis

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Abstract. The company's current financial situation is the result of evolution over thousands of years and money is a primary component of the economic system that is in constant change. The importance of money and the role they play in the economy it can be considered the "cornerstone" of economic life, so that while there were several schools of thought, located on opposite positions. The problem of the monetary doctrines dispute, is the causal relationship between money and economics, respectively, if the money is just a product of economic life over which changes in the economy works, or they directly influence these changes.

Keywords: money, credit institutions, banking risks, economic cycles, financial crisis.

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1. Introduction

The Money history is stretching over thousands of years, during which money has evolved in various forms, moving from commodity money to coins, then paper money and fiat money currently. The importance of money and the role they play in the economy it can be considered the "cornerstone" of economic life, so that while there were several schools of thought, located on opposite positions.

This development led to a continuous change in monetary theory, based on the quantity theory of the classic school of money, the neoclassical school approach, the Keynesian and Neo-Keynesian theory, and, after the 70's of the last century, the monetarist theory.

The issue that caused the dispute between the monetary doctrines is the causative relationship between money and economics, respectively, if the money is just a product of economic life over which the changes in the economy work, or they directly influence these changes. Or, in other words, money is the result of economic conditions, or their cause. According to Professor Tiberiu Brailean "many of the economic crisis could have been avoided or mitigated if they had acted effectively and timely and that economic theory would have provided solutions, remedies and necessary means of action." [1, p. 17] In fact, historically speaking, most of the economic crisis were being caused by money. The proof is being the present financial and economic crisis, that, just as the great crisis of the years 1929 - 1933, arises from the same cause - credit expansion - and as a paradox, it all started in the U.S., so that it would globally propagate through the financial system .

2. State of knowledge

The literature on the origin of money, its evolution and causes of the outbreak of financial crises, includes numerous treaties, books and papers, most books of economics with at least a chapter on money and monetary systems.

Over time, the complex issue of money and its evolution has been addressed by many famous economists, but due to the large area coverage of the subject, we will limit the work developed by representatives of the Austrian school of economics, among which are worth mentioned Ludwig von Mises, Friedrich von Hayek, Murray Rothbard Newton, and their present continuer, Jesus Huerta de Soto.

Among the Romanian authors, the Academician Kirițescu Costin, is, undoubtedly, the person who left most works related to currency and its evolution. Ludwig von Mises, the foremost representative of the Austrian school, who is Carl Menger's successor, founder of this school, was a professor at several universities, including New York University. He formulated the first Austrian cycle theory in 1912, the English translation being published in the second edition of its treaty "The Theory of Money and Credit"

(theory of money and credit) in 1924, but the most important work remains "Human Action. A treaty of economic theory ", published in 1949, a book that can be accessed at Internet Institute Ludwig von Mises Romania, http://mises.ro/43/; The central idea of the Austrian business cycle theory is that credit expansion by banks economic crisis is causing the outbreak. Friedrich von Hayek, Nobel laureate for economics in 1974, successor of Ludwig von Mises, with whom he founded the Austrian Institute of Economic Cycles Research in 1972, professor at several universities, in the latter part of life at the University Freiburg. Among the main works, we mention "Monetary Theory and the Trade Cycle", published in 1933, "The Road to Serfdom" (Road to Serfdom) published in 1945, "The Constitution of Liberty" (Constitution of Liberty), published in 1960, "denationalization of money" published in 1976. In "Denationalization of money", he demonstrates that free competition among private producers of currency is the only way for having a sound currency.

Murray Newton Rothbard, in "What Has Government Done To Our Money?" shows that the abandoning of the gold standard and the creation of central banks is leading to bank credit expansion and inflationary phenomenon, which ultimately determines the onset of economic crisis. Jesus Huerta de Soto, professor at the University of Madrid, with the Treaty "Dinero, y credito bancário cycler economically," published in 1998 (Romanian version "Currency, bank credit and economic cycles", "Alexandru Ioan Cuza" University Publishing House, 2010). Based on the legal nature of the irregular deposit contract money (deposit), the author makes a complex analysis of the banking evolution, of the monetary theories, the theory of economic cycles, and a proposal for banking reform, respectively the 100 % banking stocks theory. As causes of the outbreak of financial crisis, like its predecessors in the Austrian School, de Soto said that the origin of the crisis is excess money in circulation, in his case this excess is generated by fractional reserve banking.

Of Romanian authors who have tackled the complex issue of money and its evolution, the Academician Kirițescu Costin left most of the work related to currency. Among his works are: "The lion's money and his precursors," three-volume work published in 1964, republished Encyclopedic Publishing House in 1997, "A Century of monetary turmoil," published in 1996, includes a collection of studies and articles published by the author in a number of periodicals of the period 1945 - 1996, "Currency - small encyclopedia", co-author, published in 1998, and others.

3. Brief history of money and monetary systems development

We live in a society where money is omnipresent, everyone uses it to buy goods they need, but it is not easy to give a definition of money. What is actually money? According to Costin Kirițescu academician, "money is a generic name for all kinds of coins and currency signs, while the currency is only one type of money" and also "money is a social tool, a particular form of immediate mobilization social wealth, a communicable embodiment of the purchasing power, which gives the holder the right to a share in social product of that country. " [2, p.54] The Ludwig von Mises's formulation: "Money does not represent any cash abstract no standard value or price. They are not necessarily an economic good and, as such, are assessed and estimated based on their own merits, that the services they expect from the man holding cash "[3, p.418] A simpler definition could be that money is any means of payment, accepted as such, for the purchase of goods and services. Currently, the term money is broadly used, so it is considered that the notions of money and currency can be considered similar. [4, p. 24]

The emergence of money is closely linked to the development of society, when, following the specialization of activities, people were engaged in trading of goods. The exchange of goods appeared at the level of decomposition of the primitive communal system, following the social division of labor, and, as a result, people began to produce more food than needed, so some of this surplus was exchanged for other goods. [2, p.55]

The original form of the direct exchange, called barter, supposed the yielding of a commodity against another, for example, exchange of wheat for livestock or fur. A major difficulty was that certain goods for exchange were not divisible, and the transport of goods, was also a problem. To address this situation, certain goods began to be used as a medium of exchange, so-called money - commodity. Thus, after a long evolutionary process in which many goods were used as means of exchange, remained only two, gold and silver, which served as currency.

The first metal coins were circulated in China since the 10th century BC, and in Europe, the 7th and the 6th century BC, when ancient Greeks and then Romans began to produce silver and bronze coins.

Currency is linked to the emergence of weighing pieces of metal for use as payment. These coins contain a certain amount of precious metal, which determine the amount of money, and they were issued by the State based on monopoly payment, being received not only at home but also in other countries. The coin was engraved with the seal of the king, of the issuing country or city, ensuring the security value, which was once the amount of precious metal, so there was no need for them to be weighed in order to be

accepted. The advantages are that coins could be counted without requiring the weighing, they were easily transportable and durable. But with all these advantages, forging them, wear, and robberies, impose certain issues, so that, along with the evolution of society the use of paper money appeared - banknotes - convertible into gold on demand. Paper money appeared in the 17th century, in the same time with the first banks, which stored in exchange issued paper certificates that were used in trade as evidence of the currency. In Europe, paper money began to be used by Italian merchants, who instead of the amount of money, used bills - securities used as a medium of exchange, their value being given by the amount of money (precious metal) that was stored the bank. This primitive form of "note" was rather ugly, because it only looked round and was reimbursed only amounts due, so it was only used by large retailers, substituting coin circulation.For three centuries, from the 17th century until 1914, there was a transition phase in which coins were used as its own value, gold and silver, and worthless money signs, banknotes, which represented the circulation of gold and silver and because of that were fully convertible into gold and silver. [2, p.55]

After the First World War until present, we talk about the so-called fiat money, which can exist both in the form of banknotes and coin shaped. The money no longer reflects the value of a quantity of precious metal and occurred with the centralization of monetary policy. Based on fiat money monetary systems, relies on user confidence in the actions they take the central bank, the only institution that can legally multiply or restrict the money supply in circulation. The importance of money is the result of their functions, of which the most representative are:

1. medium of exchange;
2.means of measuring value or standard of value;
3. means of preservation of value.

The function medium of exchange is the result of exchange of goods for an amount of money. This function is the result of their utility given by their purchasing power. According to Rothbard, the main function of money is a medium of exchange, other functions, namely calculation unit or the "measure of value", the "book value", etc.., are simple corollaries of the main function. [5, p.26] Currency or money in general as a measure of value, requires a standard that is comparable with other goods and services. This function was given its own value for money of the beginnings of their existence, namely the amount of precious metal. The transition from full coverage gold or silver money, to the money with partial coverage (after 1914) and now the money without coverage, should not lead to the idea that money no longer function as measure of value, because money is not effectively determine the market value of other goods, but the price at which they change (value of property is determined by its usefulness for the owner and the rarity of the asset). Expert opinions on the issue differ. Some authors consider that, when the money does not have intrinsic value, they can not act as measure of value. In terms of preserving the value function, money ensures the accumulation and retention to the holders of currency value, for future consumption, so that this function "transfer the today buying power in the future." [4, p. 30]. The emergence and widespread use of money with intrinsic value have led to monetary institutions governing the organization of relations and paved the way for development of national monetary systems.

Essentially, a monetary system is a set of rules and institutions that regulate, organize and supervise the monetary relations of a country. The academician Costin Kirițescu defines national monetary system as a "monetary organization established by state laws, in which circulation of coins is expected to complete its own value." [2, p.247]. Organizational forms of currencies of different countries and internationally is a reflection of a long process of changes in monetary plan, which led in time to the dissociation of the gold money systems and dematerialisation of money market instruments. "[4, p. 52]

The defining elements of a monetary system are: standard monetary unit, monetary coin minting and circulation with and without intrinsic value, issue and circulation of banknotes, paper money, respectively. The standard monetary unit represents a value or the basic material conventionally adopted by the monetary system, which defines the monetary unit. The function of the monetary standard was materialised, at the beginning, by normal goods, then precious metals, and later by currencies and currency. Currently, the role of this function is taken by the purchasing power standard.

Within the classic monetary systems, the definition of the national monetary unit was made by law, and the currency issued represented an attribute of national sovereignty.

The applying of the principle of free batteries and free coin with intrinsic value hoard their internal mechanism of self-assured of money, the balance between supply and demand report. There is a close link between monetary standard monetary unit, so that the currency was a certain amount of precious metal.

Depending on the adopted monetary standard, over time, several types of monetary systems worked:

- Monetary systems based on metal currency

- Combined standard monetary system (gold - currency)
- Nemetaliste systems or purchasing power systems

At he base of the organization of national monetary systems, were the precious metals, gold or silver, under monometalist system, or both metals within the bimetalist. After abandoning bimetallism, most countries have used gold as the basis of national monetary systems. Monetary systems based on gold were as follows:

- Monetary system based on gold-coin standard, called the "Gold Standard Species";
- Monetary system based on gold-bullion, "Gold Bullion Standard" which was actually a limitation of the gold standard;
- Monetary system based on gold-exchange standard "Gold Exchange Standard".

In time, our national monetary systems were confronted with numerous crisis periods of increasing volume of transactions requiring more and more money and limited amount of precious metal reserves located in banks. This problem was solved with the advent of notes convertible into precious metal. The general application of this new payment instrument, was due to maintaining the link between volume of the issue of banknotes and precious metal stock of the issuing bank. The transition from paper money convertible to nonconvertible notes, or so-called fiat money, was made after the First World War when they stopped the minting and the circulation of gold coins, but the convertibility of banknotes was assured. Over time, this convertibility was suspended, so that after the Bretton Woods system, established in 1944, the U.S. dollar remained the only currency convertible into precious metal, and later in 1971, the convertibility into gold was eliminated.

The appearance of paper money showed that the movement of money and coins can be made without full value while maintaining a balance between the amount of currency and economic needs. The issuing by the state of these currencies with force quatation and without value has some advantages [4, p.58]

- Elasticity - no currency value depends on the amount of precious metal;
- Sufficient to cover the needs of state money and help reduce traffic costs money.

However, besides these advantages, the system assumes some risks, inflation being the most common result of excess paper money. Being eliminated the objective limits of the money issue put into circulation by the State to cover non-productive costs or expenses, such as deficits, the financing of military spending, etc., which have led to increased inflationary phenomenon worldwide.

4. Banking, money and business cycles

In the countries with market economy, the economic activity has no uniform trend, and it records periods of growth followed by periods of stagnation or decline - economic cycles - in other words, alternating steady state of imbalance.

Cyclical fluctuations are determined by factors related to the functioning of the economy, they occur with some regularity and may not be assigned to certain standards. According to the authors, the cycle either contains two phases (expansion and recession) for long cycles or four phases: revival - which corresponds to a slow resumption of activity; momentum - increasing activity to a maximum level, the crisis - decreased activity economic, and depression - the negative peak economic development, where medium-term cycles.

Ludwig von Mises has shown that credit expansion lead to errors in capital investment and over-consumption, which ultimately affects the economic equilibrium and causes economic crisis. "Ludwig von Mises has the great merit of being the first economist who, in 1912, showed that credit expansion creates booms and a wave of optimism that, sooner or later, will surely collapse."
[6, p. 376] We must note that Mises distinguishes between real credit and circulation credit. Thus, while the actual credits are determined by savings, loans of movement are the result of multiplying the credit, the equivalent of newly created fiat money (currency changeover). "Discretionary currency is a currency that is made of simple notes and coins, which can not be employed neither for industrial purposes, nor is a claim on anyone." [3, p. 430]

In the expansion phase it is mainly notable the increasing production and investment and profit growth as a direct consequence of entrepreneurs, on the one hand, and employment of labor, on the other.The household incomes are increasing, leading to an increase in consumption, and entrepreneurs launche new investment projects to cover demand. Optimism is a feature for both businesses (entrepreneurs), who operate bank loans in order to cover the increasing resorts, but also for individuals whose needs, real or artificial, are becoming more expensive, and thus, they also make credit. During this period, there is a permanent stimulation of demand, the banks grant loans with relative ease, even customers in normal circumstances would not qualify for a loan and accept a higher degree of indebtedness of borrowers, both agents businesses and individuals. In these circumstances, there is a

reduction in the saving process and general euphoria caused by a sharp rise in asset prices (land, houses) - phase "boom", which determines that part of the loans obtained from banks, by both entrepeneurs and individuals, to have such an investment destination (unproductive).

"The boom can continue only as long as the credit expansion progresses at an ever faster pace. ... But he could not last forever even if inflation and credit expansion would continue without stopping. In this case, it would be limited by barriers that prevent unlimited expansion of credit circulation. It would lead to economic collapse (crack-up boom) and the collapse of the entire monetary system. "[3, p. 556]

Reducing savings causes a reduction in credit supply, so that some investments started by entrepreneurs are not finalized and some of them begin to experience difficulties in paying the loans, with direct consequences for business and employees of the company. This creates prerequisites for entering a new phase - crisis, when there are the following phenomena: the reduction of entrepreneurs profit growth due to production costs, rising unemployment, increasing inventories due to reduced demand. Also, signs of reduced confidence in the economy begin to show off, there is a reduction in credit supply, along with an increase in interest rate which affects more than economic and social effects. The first part is a decrease in demand for durable goods, and later the demand for consumer goods. "The collapse manifests itself in the moment when the banks begin to fear the accelerating pace of the boom and start to refrain from further credit expansion. Boom can only last as long as the banks are prepared to provide seamless all the needed loans for the implementation of their projects business, that are in a complete disagreement with the real situation of the input supply and consumer evaluations. "[3, pp.562-563].

5. The causes of the global financial crisis

The problems facing countries today from a large part of the world, are based on a variety of causes, and the economic and social effects manifesting today, will affect their population on a medium and long term. With the current economic and financial crisis began in U.S. in 2007, and made its presence felt in our country since October 2008, it is becoming more evident that in the context of globalization, the complexity of financial products, the inadequate business models, the regulatory framework (regulatory and prudential supervision) and monetary policy are the main causes leading to it.

It can be said that the current manifestation of the economic crisis stems from mortgage loans of "subprime", a term also used in order to name the value of real estate loans secured on property purchased in the U.S., granted to customers who did not meet certain conditions of reliability. These loans, processed through the mechanism of securitization bonds CDO - Collateralized Debt Obligations - (packed in bond debt unit), were then transferred to credit institutions and investors worldwide. When some of these loans could not be reimbursed, the credit institutions started selling mortgages, so that real estate prices began to fall, thus resulting in losses for both credit institutions and investors in securities based on credits of "subprime".

But the underlying causes of financial crisis are deeper, such as macroeconomic and microeconomic nature, which is mentioned by several analysts: Altman (2009), Buiter (2008), Blanchard (2009). [7] The abundant liquidity created by major Central Banks around the world, through very low interest rates and monetary policy and their reduced volatility, represents the main cause of deep financial crisis. Regarding the business model, we see that the system manages to boost credit institutions and companies in general, depending on short term results, and led to taking additional risk.

On regulatory and supervisory framework, it is confirmed that the existing regulations have certain deficiencies and that they have contributed in some extent to the emergence of global crisis, but the introduction of new restrictions, by strengthening regulations, has not been demonstrated. [[8, p. 79]

"Rapid expansion of credit, especially when it is driven by strong growth in demand for credit risk assessment, makes it difficult the risks evaluation and the cautious supervision." [9, p.10] The difficulties faced by identifying ways to improve the regulatory framework of financial activity, is that it faces not only risk but also the inherent uncertainty of the future, difficulties in measuring risk that have direct consequences for activity regulation of credit institutions. The cyclicality of lending can be encouraged or discouraged by the financial regulations, however, the often impose of restrictions amplifies the phenomenon.

The financial crisis showed that in the context of globalization, the vulnerability of an economy rapidly spreads to other economies, even if their financial systems are sound, and it showed that the economic cycle favors the appearance of macroeconomic risks. Thus, in periods of economic growth, almost all financial institutions appear to be solid, while in bad times, almost all of them are vulnerable. [10]. Even since before the crisis, the supervision was excessively based on micro-prudential supervision of financial institutions and on country-level monitoring of macroeconomic indicators, the literature contains numerous studies in recent years about the need for consolidated supervision credit institutions, namely macro-prudential approach, in order to ensure a stable financial system, to reduce systemic risk.

[11] The multiplication of the global credit led to excess liquidity in the market, that are looking for bigger returns, through banks and multinational companies, led to an explosion of sources for the banking system in less developed countries. In the period before the financial crisis the credit has becaome a means of increasing the wealth of many investors. Most businesses have become overly dependent on credit, and real estate sector offered an opportunity to invest funds obtained through loans, which led to an explosion in prices in this market in many countries.

6. Conclusion

The data presented can draw the following conclusions:

Money is an ongoing evolution, they are changing due to the development of society.

In assessing the Austrian School of Economics, although gold is not a perfect standard, it would be a solution to solve problems arising from the crisis. Gold standard was a natural barrier in the path of credit expansion, so that banks should not exceed the limits determined by the amount of gold;

Free banking competition is the only method available to prevent the dangers inherent in credit expansion. The economic cycle is a purely monetary phenomenon, caused by errors of banks, the result of cyclical developments of credit policies adopted by central banks. Among the solutions to the crisis, it is recommended the temporary reduction of incomes and consumptions, until the capital, wasted due to the poor investments, would be recovered;

The return to the gold standard is not a reasonable solution. It should be seen as transition from gold standard, monetary systems with combined standard (gold - currency) and then nemetaliste systems (purchasing power systems), was determined by certain historical conditions. Thus, after the First World War, due to the war costs in the European countries, approximately 60% of world gold was in the U.S.;

The credit expansion causes the onset of financial crisis, but this is not the result of the existence of central banks, but the result of abuse of dominant position of the strongest countries in the world (USA), so in terms of capital market liberalization, fiat money emitted by However, it is transmitted globally via the banking system, affecting most countries;

The individual measures taken by central banks are not enough to stop this phenomenon, requiring concerted efforts of several states, or state union. It should be taken into consideration that at the European level, the most affected were the Eastern European countries (former socialist countries).

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