

Iavorschi, Mihaela; Gradinaru, Andreea

Article

The Healthy Currency – An Alternative to Stable Currency

CES Working Papers

Provided in Cooperation with:

Centre for European Studies, Alexandru Ioan Cuza University

Suggested Citation: Iavorschi, Mihaela; Gradinaru, Andreea (2014) : The Healthy Currency – An Alternative to Stable Currency, CES Working Papers, ISSN 2067-7693, Alexandru Ioan Cuza University of Iasi, Centre for European Studies, Iasi, Vol. 6, Iss. 3, pp. 43-52

This Version is available at:

<https://hdl.handle.net/10419/198337>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.



<https://creativecommons.org/licenses/by/4.0/>

THE HEALTHY CURRENCY – AN ALTERNATIVE TO STABLE CURRENCY

Mihaela IAVORSCHI*
Andreea GRADINARU†

Abstract: *In the current historical and economic context of the globalised world, sensitive to fluctuations and liable to economic crisis, we find it especially important to analyse the concept of monetary stability. The purpose of this paper is to critically analyse the concept of monetary stability, from the merchandise-currency point of view as well as regarding the fiduciary currency. Through the contributions of the Austrian economists, that underlined the mutations that occur after the inflationary processes in the allocation of resources, revenue distribution and in the evolution of entrepreneurial activities, we understand the necessity to use a healthy currency. The conclusions of the study reflect the undisputed virtues of the gold standard whose stabilizing mechanisms can only function on a free market, guaranteed by economic freedom and without the state's intervention.*

Keywords: monetary stability; free market; gold standard; stable currency

JEL Classification: B13; E42; E52

INTRODUCTION

Since Antiquity up until the present day, money has been considered the measure of all things. The approach on the concept of monetary stability is essential and necessary in order to understand and achieve a fair evaluation of goods and services inside the market economy.

The concept of monetary stability involves determining the purchasing power of the monetary unit. In the gold standard era, the decrease of the purchasing power of the currency intervenes when the quantity of precious metal in a society increases while directly determining price variations. According to the classical doctrine, the stability of the merchandise-currency can be obtained through the market forces without resorting to the authority's control regarding the monetary supply.

Inside the inflationist paradise of paper money, the parameters of monetary stability modify. Monetary stability involves the possibility of maintaining the purchasing power of the currency in time. In the national economy, the stability of the purchasing power is equivalent to the balance between the effective demand and the production of goods and services offered on the market. The common denominator of the two components is the price. This is why the concern for ensuring stability to the purchasing power of the currency is dependent on ensuring price stability.

The researchers' opinions concerning the features that determine monetary stability were synthesized into three elementary theories: the mentalist theory, the nominalist theory and the

* Ph.D Student at Alexandru Ioan Cuza University of Iasi, Romania; e-mail: mihaela.iavorschi@gmail.com.

† Ph.D Student at Alexandru Ioan Cuza University of Iasi, Romania; e-mail: gavrilitaandreea@yahoo.com.

monetarist theory. The question which the Austrian School's representatives are trying to answer is whether an institution can adjust the purchasing power of the currency and if this type of intervention is fundamental.

The essence of the study represents a synthesis of the monetary views supported by the Austrian School's important representatives like Ludwig von Mises, Friedrich von Hayek and Murray Rothbard.

The school's proposals are in compliance with laissez-faire principles. They argue for the healthy merchandise-currency, the only one capable to offer stability to the economic system in order to counteract the cyclical crisis.

1. ABOUT MONETARY STABILITY

The concept of monetary stability is widely spread in the economic theory. The idea according to which money has to offer a stable framework for economic activities has known different stages of evolution according to the era, circumstance and different economic thought trends.

First of all, we find necessary to analyse the concept of monetary stability from two points of view. The first aspect covers the idea of physical monetary stability, of the integrity of the merchandise-currency over time (Hulsman, 2012, p.99). This type of stability implies the equivalence between the amount of precious metal in a coin and what is stamped on the coin; the merchandise-currency stability also represents a mandatory condition for a good functioning of the economic activities. Monetary stability, in the sense of physical integrity of the merchandise-currency, directly determines the stability of the purchasing power of the monetary unit. The decrease of the purchasing power of the currency under the gold standard circumstances occurs when the quantity of gold and silver in a society increases. This happens when new precious metals deposits are found and are easy to exploit. In Europe's history this event followed the great geographical discoveries when, for two centuries (XVI-XVII), the gold quantity increased by up to 500% (Hulsman, 2012, p.101). Mathematically speaking, the increase of the currency supply during that time occurred with an average between 0.3%-3.3% per year. With reference to the current situation, in the fiduciary currency era, the annual increases of the currency supply ranges somewhere between 5-10%.

The second aspect of the monetary stability implies the stability of the purchasing power of the monetary unit. Scholastics like Toma d'Aquino and later John Locke, David Ricardo and Irving Fisher have adopted this fundament of the stable purchasing power of the monetary unit. On a free market there is a natural tendency of selecting the best currencies in terms of purchasing power

stability. With the freedom to choose any currency they wish inside trades, the citizens can protect themselves against fluctuations of the purchasing power resorting to other currencies that are accepted in the exchange. The stability of the merchandise-currency can be obtained through market forces without turning to the control of the authorities in terms of monetary supply.

In the current context, monetary stability implies the possibility of maintaining the purchasing power of the currency in time (Horwitz, 2011). Relating to a state's economy, the purchasing power stability implies the balance between the effective demand and the supply of goods and services on the market. Both the demand and production of goods and services are interconnected through price. Therefore it can be stated that ensuring the stability of the purchasing power of the currency depends on ensuring price stability. In case the demand on the market is higher than the monetary supply, it is known as the inflation phenomenon. Otherwise, an insufficient solvable demand caused by monetary reasons produces deflation.

A controversial situation analysed by the monetary theory is linked to the fundamentals of monetary stability. The researchers' focus is on establishing if the purchasing power of money comes from their essence, in other words if monetary stability is inherent or extrinsic. In this respect, three main directions have been established:

The *mentalist theory* suggests manufacturing the money out of an adequate quantity of precious metal or covering the issue of money with precious metal from reserve funds. The stability of the purchasing power of money is offered by the value of the precious metal. The thesis was outlined in the 16th-17th century through the writings of Thomas Mun in England and J.B. Colbert in France, who claimed that the stability of the currency is determined by the existence of gold and silver coins.

The *nominalist theory*, supported by the writings of Steward, Muller, Knapp, Schumpeter (1942), proves that the value of the coin is either of judicial or socio-economic nature. According to this principle, money represents merely a symbol acknowledged by society. The purchasing power of the coin is a nominal, conventional determinative that is regulated through the state's intervention in the administrative establishment of the exchange ratio. We have to mention that the genesis of money was an objective process, money being eminently a social institution. Therefore, we allow ourselves to claim the nominalist economists' point of view overstates the judicial nature of the coin.

The *monetarist theory* claims the purchasing power and the monetary stability depend on the appropriate regulation of the currency supply in circulation, which is why a monetary system, well applied in the economic realities, is required. The monetarists claim that the monetary stability and a balanced growth of the economy can be obtained only by referring to an official, rigorous control of

the monetary mass in circulation and by admitting an annual increase of the money quantity by a certain percentage that comes under the economy's long term trends.

The monetarists argue that the coin is represented by any object that is constantly and generally accepted for the exchange of goods and services. The coin is accepted in the trade because it represents a temporary reserve of the purchasing power (Friedman, 1993, p.31). The ideas advanced by the Chicago School have determined a rebirth of the interest in currency and supported theoretical and practical debates in this area. The state's role exclusively targets the intervention in sizing the monetary mass, because through this leverage a normal functioning of the economy is ensured. It is obvious that quantifying the monetary supply is nearly impossible to achieve nowadays.

The currency, through its function as a measure for value, must ensure a stable standard value. For the classics, the currency stability is maintained when the money supply is constant. David Ricardo (2002, pp.240-244) claims that the currency stability is maintained when it conserves its purchasing power.

The Austrian School, through the works of Mises, underlines that the essence of the entrepreneurial estimation is comparing different courses of action (Mises, 1996, pp.401-402). For instance, let us assume that an entrepreneur owns 100.000 euro, which he decides to invest, having to choose between a textile factory and a restaurant. The expected yield for the textile factory is 110.000 euros, that is a 10%, and for the restaurant is 120.000 euros which means a 20% output. Therefore, the investor will compare and will choose the area in which to place his money. We notice that the stability of the purchasing power does not influence the investor's choice. He can still perform calculations even if the purchasing power varies. The calculations of the economic agents can keep their accuracy even if the money supply drops, increases or stays constant (Hulsman, 2012, p.106).

2.THE AUSTRIAN SCHOOL'S PROPOSAL: THE HEALTHY CURRENCY – AN ALTERNATIVE TO STABLE CURRENCY

Liberalism has manifested as a permanent presence and companion of capitalism, in a pure, ultraliberal form, through the contribution of philosopher - economists like Ludwig von Mises and Friedrich von Hayek, the main representatives of the Austrian School of Economy (Pohoata, 1996, p.77). Therefore, the Austrian School is an economic flow of liberal origins that centres its analysis on human action in order to explain the evolution and the laws of economy. The Austrian economists argue for economic freedom which stands at the origin of all other freedoms and can be maintained by an appropriate legal framework. They argue that only the free market, unlike socialist economy, can offer a favourable response to the unlimited needs/ limited resources issue. I found necessary and

representative for this study to analyse the position of the philosopher-economists Ludwig von Mises, Murray N. Rothbard and Friedrich von Hayek regarding the currency's role and functions in the economy.

The monetarism of the Austrian School synthesizes a new pattern of economic thought that integrates the liberal theory by refusing the intervention of the central bank on the market and a new economic concept that shows the recurrence of the economic processes through the study of the correlation between investments, credit and production. The fundamental contribution of the Austrian economists focuses on the presentation and analysis of the microeconomic effects of the monetary growth, particularly on the mutations occurring as a result of the inflationist processes in resource allocation, income distribution and the evolution of the entrepreneurial activity.

The Austrians consider the coin to be first and foremost a merchandise whose main role is to intermediate the exchange of goods and services. The currency's functionality comes from this reasoning. Throughout history, in the auto selection process, the market has chosen money to be represented by two precious metals, gold and silver, due to their properties: scarcity which gave 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, [1991], 2013, p.31). Also, in the case of the gold standard, the stability of the balance of payments is automatically restored: a surplus of the balance of payments causes inputs of precious metal in the country which will determine an increase of the monetary mass, hence a price increase. This contributes to the decrease of exports, followed by a drop of precious metal inputs in the country, which will eventually restore the stability of the balance of payments and of the monetary mass. In case of a deficit of the balance of payments the situation is the other way around. The automatic operation mechanism, the gold standard, offers stability in terms of the amount of money in circulation as well as regarding the international transactions, the state's intervention being unnecessary in this case.

The gold standard, for which the Austrian School pleads, is the only one capable to ensure the stability of the exchange rates. If the national currency of a state increase in value (the exports are higher than the imports), the external commercial partners will rather export gold towards the reference country. Through this rational behaviour, an upper limit of the exchange rate of that country is created known as the gold's entry point, and a lower limit known as the gold's exit point. The lower point intervenes when the national currency depreciates (the import > the export) meaning that the country's importers choose to send the gold abroad. The gold's entry and exit points represent tight limits between which the exchange rates can vary, offering stability to the currency.

Regarding the Keynesian and monetarist approaches on currency, both schools of thought are against the gold standard. Monetarists, as well as Keynesians, argue for a monetary system founded on the discretionary fiduciary currency (Rothbard, [1991], 2013, p.12). The difference between the two sides is that the Keynesian doctrine supports the US dollar's convertibility into gold, while the monetarists favour the free fluctuation of the fiduciary currencies of each state and relinquishes the US dollar's convertibility into gold.

Under these conditions, the Austrian Schools, through Mises, insists on the inseparable link between gold and paper money. Suppose this link broke, the Austrian economists claim that the value of the precious metal would increase proportionally with the extra amount of dollars that would be put into circulation. The reality of economic facts proved that after the fall of the Breton Woods system and the complete renouncement on the gold standard, the price of the precious metal did not drop, on the contrary, it began to get increasingly higher (Rothbard, [1991], 2013, p.13-15).

Alongside with the Keynesian policies implementation after the 1929-1933 crises, but mostly after the collapse of the Breton Woods system, each state has the right and the unlimited power to create paper money in its own geographical area. The state's monopoly on currency emission had adverse repercussions ever since the gold standard era. If the Ancient and Middle Age kings used to put into circulation, at a legal higher rate, devalued coins in order to cover their deficits, in the present day, governments, by the power of the monetary monopoly to create money using the printing press, hold a special and also a very profitable privilege. The result is the inflationist paradise in which the contemporary economies grow, recurrently and systematically affected by economic crisis.

The best known representative of the Austrian monetarism is Friedrich von Hayek. Hayek's ultra-liberalism targets the decisive role of the market in establishing the social bond. The market is the manifestation of spontaneous order and has self-regulation capacities (Velier, [2005], 2009, pp.126-127). Following the principles of liberalism determines Hayek to refuse the state's intervention unless it is for watching over the preservation of economic freedom. In his scientific approach, Hayek demonstrates that only under free competition between private currency manufacturers a healthy currency can be obtained (Hayek, [1976], 2006). This is possible by eliminating the central bank's monopoly over currency issuing. In his view, the currency supply has to be the responsibility of private banks that, through competition, will offer citizens the possibility to choose the best currency. Hayek's idea consists in emitting private bills with different new names so that afterwards they are accepted and used as money.

One of Ludwig von Mises's most important contributions regarding the monetary theory is the regression theorem (Mises, 1953, pp. 170-186). Using the regression method, Mises underlines that

money cannot be created only out of rationality by emitting paper bills without an existential fundament. The currency, according to its own definition, has to come out of a commodity used for non-monetary purposes. History showed that precious metals like gold and silver, which have a high and stable demand conditioned by weight, have acquired the status of money before other commodities. Therefore, Mises's regression theorem demonstrates that the origin of money has to be in a non-monetary merchandise used and traded inside the free market. The central idea of the Austrian theory of the business cycle is that the main cause of the economic crisis is represented by credit growth.

Murray Rothbard's proposal regarding the monetary issue is unique. In his scientific approach he agrees with Mises's view on the origin, nature and functionality of money. He finds Hayek's suggestion of emitting new paper money with other names, to be managed by private entrepreneurs, unrealistic. There are consistent reasons for this approach. During the gold standard era the name of pound sterling or dollar were units of measurement for the two precious metals' weight. After abandoning the convertibility into gold, dollars and pounds became simple dividable papers. We have to mention that in time people got accustomed with these names. Therefore, the author suggests the dollar and other national currencies to be privatized by linking them to gold. By changing the definition of the national currency from paper money emitted discretionarily by the government, to a weight unit of a traded commodity, the currency minting feature can be passed in a permanent and absolute way from the state to private entrepreneurs (Rothbard [1991], 2013).

The Austrians demonstrate through the subjective value theory that the social relationships involving the currency are abstract and difficult to understand in that they produces the biggest, complex and most subtle volume of knowledge. This is why the authority's intervention in this field can be found responsible for the consecutive and regular economic recessions.

CONCLUSIONS

This study is dedicated to the monetary analysis from the Austrian School's point of view that supports the healthy currency arising on the market and that originates in a commodity. Using the qualitative approach I have analysed the benefits of a healthy currency and the way it is implemented in society according to Austrian philosophers and economists.

By understanding the concept of monetary stability and in retrospect over the presented theories, we gather that through the coin minting monopoly the central bank will always generate inflation. The Austrians claim that the only possibility to move from the "stable" currency managed

by the central bank to a healthy currency is returning to the gold standard by linking national currencies with the precious metal.

In the present context of huge financial and monetary levels of the national economies, turning to the gold standard does not appear easily achievable. We must remember that the Austrian Schools' suggestions and solutions are in compliance with the principles of classic liberalism. Only the healthy merchandise-currency does not generate inflation and does not run on a legal monetary rate established by the authorities. The healthy currency is the fruit of the free market and it is the only one capable to offer stability to the monetary system and to the citizens using it.

ACKNOWLEDGMENT

This work was supported by the European Social Fund through Sectoral Operational Programme Human Resources Development 2007 – 2013, project number POSDRU/159/1.5/S/134197, project title “Performance and Excellence in Doctoral and Postdoctoral Research in Economic Sciences Domain in Romania”.

REFERENCES

- Brunner, K., Meltzer A. H. (1971) *The Uses of Money in the Theory of an Exchange Economy* American Economic Review 61 (Dec.), pp. 784-805.
- Burns, A. [1927] 1965 *Money and Monetary Policy in early times*, New York: Augustus M. Kellez, pp. 75-77, 442-444.
- Friedman M. (1993) *La monnaie et ses pieges*, Dunod Paris.
- Hayek F.A. [1976] *The Denationalization of Money*, London: The Institute of Economic Affairs, traducere în limba română (2006), *Denaționalizarea banilor*, Editura Libertas Publishing .
- Hayek, F.A. (1976) *Free choice in currency*, London: The Institute of Economic Affaires.
- Horwitz S. (2011), *Do we need a distinct monetary constitution?* Original Research Article Journal of Economic Behavior & Organization, Volume 80, Issue 2, October 2011, Pages 331-338.
- Huerta de Soto, J. [2006] *Money, Bank Credit, and Economic Cycles*, Auburn, Ala.: Ludwig von Mises Institute traducere în limba română (2011) *Moneda, Creditul Bancar și Ciclurile economice*, Iași: Editura Universității „Alexandru Ioan Cuza”.
- Hulsman G. (2012) *Etica producției de bani*, Editura Universității Alexandru Ioan Cuza, Iași.

- Hulsmann, J.G. (2003) *Has fractional- Reserve Banking Really Passed the Market Test?*, Independent Review 7, no. 3.
- Hulsmann, J.G. (2003) *Optimal Monetary Policy*, Quarterly Journal of Austrian Economics 6, no. 4.
- Keynes, J.M. (1970) *Teoria generală a folosirii mâinii de lucru, dobânzii și banilor*, Editura științifică, București, 1970.
- Menger C., [1976] *Principles of Economics*, Institute for Humane Studies, rev. ed. (2007) Ludwig von Mises Institute, Auburn Ala 36832, U.S.A.
- Mises L. (1951) *Socialism: An Economic and Sociological Analysis*. New Haven: Yale University Press.
- Mises L. (1953) *The Theory of Money and Credit*, 2nd ed. New Haven, Conn.: Yale University Press.
- Mises L. (1996) *Human Action: A treatise on Economics*, Fox&Wilkes, 4rd rev. ed., San Francisco, U.S.A.
- Mises L. (1998) *Capitalismul și dușmanii săi. Ce înseamnă laissez-faire?*, București: Editura Nemira.
- Mises L. (2011) *Intervenționismul. O analiză economică*, Iași: Editura Universității „Alexandru Ioan Cuza”.
- Pohoată I. (1996) *Doctrine economice volumul II*, Iași: Editura Fundației Academice Gheorghe Zane.
- Ricardo D. (2002) *Principiile de economie politică și de impunere*, Editura Antent, București
- Rothbard M. N. [1991] *The Case for a 100 Percent Gold Dollar*, Ludwig von Mises Institute, Auburn, Ala., traducere în limba română (2013), *Pledoarie pentru o monedă sănătoasă*, Iași: Editura Liberalis.
- Rothbard M. N. [1994] *The Case against the FED*, Ludwig von Mises Institute, Auburn, Ala., traducere în limba română (2013), *Împotriva băncilor centrale*, Iași: Editura Liberalis.
- Rothbard M.N. [1993] *Man, Economy, and State: A Treatise on Economic Principles*, ed. a III-a, Ludwig von Mises Institute, Auburn, Ala., (2004) The Scholar's Edition, *Man, Economy, and State with Power and Market*, Ludwig von Mises Institute, Auburn, Ala.
- Rothbard M.N., [1990] *What Has Government Done to Our Money?*, Auburn, Ala.: Ludwig von Mises Institute traducere în limba română (2006), *Ce le-a făcut statul banilor noștri?*, București: Editura Libertas Publishing.
- Schumpeter J.A. (1942) *Capitalism, Socialism and Democracy*. New York: Harper.
- Smith A. (2010) *Avuția națiunilor*, București: Editura All.

Velier J. [2005] *Brève Histoire de la pensée économique d'Aristote à nos jours*, Edition Flammarion, Paris, Traducere în limba română (2009), *Scurtă istorie a gândirii economice de la Aristotel până astăzi*, București: Editura Compania.