

History and evolution of fiat money economics essay



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A fiat money is a medium of exchange and known as the paper money. As we all know that fiat money is money that is declared to have value even if it does not. Fiat money is valued by the people that use it so there is no any production cost to the fiat money and the supply of fiat money can never be limited. Normally, the value of fiat money is always depending on the economy of each country. (History of Fiat Money)

As mentioned that, fiat money no production cost and supply of a fiat money can be unlimited so that hyperinflation will be occurred if there are too much of the fiat money flow in the market and cause the purchasing power of the money is lower compare with past. As a result, issuers such as central bank should control and supervise the volume of the fiat money. The United States has prevented hyper-inflation by shifting between a fiat money and gold standard over the past 200 years.

In Malaysia, the paper money we called it as ringgit Malaysia which consists of different value on each fiat money as others countries. The currency for our paper money is stable compare with foreign countries because our Central Bank manages the monetary stability well and lower down the fluctuation of currency value.

Evolution of Fiat money:

910AD- China is the first country experiments with the paper money- The fiat money is nearly used around hundred years but the paper money is rejected due to the hyper-inflation as the supply of the money more than the production.

1500'S- Spain becoming the richest nation in the world after collected gold from Mexico and the new world. After that, Spain spent most of their resources to extinguish pirates and then their excessive consumption cause the shortage of gold hoard. Then, they changed to financing the war with debt, finally bankrupted.

1716- John Law persuaded France to use the paper money in the market and declared all taxes necessary paid with it gain acceptance. The paper money becomes more popular than coin and cause to no limitation in printing, excessive moneymaking and planning and fraud. Overvalues in printing the excessive paper money eventually destroyed the system as well.

1791-The French Government again tries to use the paper money as country currency. However, the French Government issued out the " assignata" which is the interest rate for every personal own properties after they confiscated the land owned by aristocrats Some land was auctioned off in order to exchange for these new interest rate, inflation increased rapidly to 13, 000% by 1795. After that, the " assignate" had been replaced by gold franc due to the Napoleon ended up the revolution, which set up over a century of development for France in that period of time. In the 1930's, Bank of France transform fully into the Government after the Socialists had brought the bank. They eliminated the gold backing of the currency as fast as possible and made the franc as the determinate of fiat money in France. The currency value had dropped 99% during the past 12 years.

1853- In Argentina, the development of gold standard is around 100 years. After that, the central bank of Argentina was formed in 1932; the downfall of

the Argentina economy was started afterward. Then, Juan Peron involved in 1943 revolution and exhausted of reserves causing economy collapse in the year. Argentina continued on this line of paper money usage. As a result, the ranking of Argentina economy is falling from the eighth largest to deepest in the world, which it has no financial power to recover until today due to the serious impact to their country economic.

1862-The 16th President of United States Abraham Lincoln succeed to pass the Legal Tender Act and then allowing the United States Government to issue out their own paper money. The decision was supported by the government without any of promises so that a tremendous inflation occurred that caused the practice fall down rapidly out of grace until year 1913 in which the Federal Reserve System was developed.

1923 - Weimar Republic was established in 1919 in Germany in order to lower down from its total loss result from the world war because Germany needs to take the responsibility to payback the war reparations which are huge amount. The huge amount of debt caused the country was devoid so found no other alternative but to simply print the money in large amounts to make the payments on the reparations. The consequence was absorbed most of the income from whole middle class in the society, total value of savings had been destroyed, and paying to fulfill the reparations in front of the angry society in whole Germany.

The US dollar eliminates the gold standard in stages below:

1934-First of all, President Roosevelt was 26th President of the United States revalued gold to print out more paper money in the United States market, <https://assignbuster.com/history-and-evolution-of-fiat-money-economics-essay/>

with the expectation to increase the GDP of the United States current economy so that can eliminate the depression in the society.

1944- One of the steps that US try to substitute the gold by dollar is offered out the Bretton Woods Agreement. The price of gold is around \$35 per ounce of dollar so that every foreign nation is available to obtain their own paper currency if they could afford either gold or US dollar because the US dollar and gold are the determinate of the world financial instrument. For the other point of view is meant that each nation's volume of currency was depended on the amount of gold and US dollar.

1971- President Nixon ended up the gold trading and no more ending convertibility of dollars to gold. This scenario happened because of the US World Bank was printing excessive dollars and living standard beyond its means. As a result, most of the foreign nations which led by France discovered this benefit and began to require to get the payment of gold, collapsing the system because US faced major outflow of gold. (J. Greene, 2004)

Relationship between IMF and World Bank:

As we all know that, the International Monetary Fund (IMF) is an intergovernmental organization function in the management role of international financial system. The main purpose is achieved by controlling exchange rates and balance of payments global market in the world.

Besides that, IMF also supports financial aids and technical assistance to member nations when they are facing financial crisis. For example, IMF will combine with the World Bank provide the financial support funds to the poor

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countries such as some of the poor Africa countries which is facing the bad economy crisis and the collapse of economy. However, the funds that loan out by IMF and World Bank are considered as the debt trap because of the high compound interest rate charge by IMF to the poor countries and cause them unable to payback their loan. In fact, the cooperation between IMF and World Bank to loan out the funds to poor countries is aimed to absorb their natural resources in that indebted countries if they are unable to cover the repayment of debt.

In addition, the Fund that provided by the IMF and World Bank has the purpose of assisting the developing foreign countries to help them to achieve the stability in the economic conditions and reduce the levels of the poverty. The stability in the economic circumstances can led to the high GDP and rise up the living standard in each country so that the poverty will be lesser in the market level. The aim of the International Monetary Fund (IMF) is established to speed up the development and growth of the international economy, provide the stability in the financial sector and avoid the fluctuation in the monetary market. To attain the goals, the IMF plan to:

Promoting worldwide cooperation in the financial sectors.

Facilitating the balanced development in the global trading and stimulating the employment rate and hence reducing the levels of poverty.

Contributing to the exchange rates stability.

Eliminating the restriction that block the global trade.

Providing impermanent financial sources to the member nations and helping them to stabilize their payments' balance.

Besides, the IMF adopts the well policies of economic and financial. It also manages the development of the economies of the regions, countries, and whole worlds.

Solve Economic Crisis:

The primary relationship between IMF and central bank is solve economic crisis and global financial crisis with the central bank. The IMF will contribute and lend funds to the low income countries such as Haiti which needs the most financial support from outside. For example, the focus of IMF involvement in the developing world and run the IMF-supported programmes in some particular countries especially in the low-income countries such as Haiti. In Haiti population is around seven million people, consider as the poorest country in the western hemisphere with the per capita gross domestic product (GDP) if approximately US\$250 compared with the average of US\$3320 for latin America and the Caribbean region (Eirin Mobekk & Spyros I. Spyrou, 2002). As a result, IMF decide to lend a hand to help Haiti by providing some funds to improve the GDP and economic growth. On the other hand, IMF also signs agreement with few central bank and borrowing some funds to them.

For example, some Central Bank in countries will sign an agreement with IMF when their countries incurred economic crisis and the government unable to relief the debt burden. Besides that, some Central Bank will try to enhance their economic and improve the GDP for their economy situation in order to <https://assignbuster.com/history-and-evolution-of-fiat-money-economics-essay/>

avoid the collapse of economy. As a result, some Central Bank force to sign borrowing Agreement with IMF to absorb some external funds assistant so that they countries are able to achieve back the normal living standard like other countries instead of being the under-develop country.

One of an example is Danish Central Bank signs €1. 95 Billion borrowing agreement with IMF in order to get external financial support so that Danish government can survive in the economy crisis. The fund is up to €1. 95 billion which is about US\$2. 9 billion provided by IMF to Danish Central Bank. Most of the IMF's lending funds are provided by the European Union and included in one of the part in the borrowing agreement. The amount of funds is up to €75 billion and listed as a commitment in a borrowing agreement between IMF and Central Bank. Moreover, the expanded new fund's is around €75 billion (around US\$100 billion) added as committed in the borrowing agreement because of the global economy crisis more and more serious nowadays so European Union made the decision of increasing the borrowing funds.

After the agreement had been signed between IMF and Danish Central Bank, the fund will be available for Danish to add into their country resources and the gained the authority to utilize the borrowing fund from IMF. Other than that, the agreements also issue out the additional fund resources that were demanded by G-20 leaders in April 2009. Hence, the International Monetary and Financial committee can provide the payments assistance to its members with timely and effectively in the present crisis.

Another example is Malta Central Bank signs €120 million borrowing agreement with IMF in order to get external financial support so that Danish government can survive in the economy crisis. The fund is up to €120 million which is about US\$165 million provided by IMF to Danish Central Bank.

Analyzing each country capital market development

Basically, IMF is devoting more resources to the analysis of global financial market and their relationship with the macroeconomic policy (International Monetary Fund). However, IMF will publish the Global Financial Stability Report twice a year in order to analyze the current analysis of development in global financial markets.

Besides that, IMF working staffs also work with central bank member in each country to help them identify potential risk and then find the solution to counter the risk as well as reduce the risk. As a result, each member country can achieve the financial stability, including through the Financial Sector Assessment Program. The Financial Sector Assessment Program is jointly and run by the IMF and World Bank to warn countries to concern the risk in their financial sectors.

In addition, the IMF will also offers some training programs to country officials on how to manage well in their financial system operation, monetary and exchange regimes, and capital markets. The main purpose of IMF offers the training programs is to reduce the human error in daily financial operation and improve the quality of work. Therefore, the training programs can help each country development in their financial industry due to the efficient and effective working skills contribute by the staff.

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IMF agreement:

Each country government will sign an agreement with IMF which is shown as below:

(i)

The operation of the International Monetary Fund should follow the agreement which is signed by IMF and Central Bank to avoid any conflicts in financial transaction because of the provisions of the agreement as originally formed and adjusted will protect each side benefits without any fraud will happen in future.

(ii)

The provided fund to practice its daily operations and financial transaction should always constant in a General Department and a Special Drawing Rights Department. However, all of the members in the provided fund shall given a chance to take part in the Special Drawing Rights Department

(iii)

All the transactions and operations authorized by IMF Agreement should be practiced through General Department which has responsibility of enabling the fund available in transaction and operations. Inversely, some of the operations and transactions consisting special drawing rights have the alternative to conduct through the Special Drawing Rights Department instead of General Department.