

# The debate between gold and bitcoin in 2023

*The FTX scandal has thrown the future of cryptocurrencies into doubt. Supporters of bitcoin, which has proved to be remarkably robust at a time when the whole cryptocurrency ecosystem is threatened by scandal and a systemic collapse, are still asserting that it is the future money.*

*This article addresses a number of issues that next year will make or break bitcoin's claim over gold. Besides the interest of governments to prevent it having any monetary role, hodlers ignore the legal status of gold as money, and the different treatment likely to be accorded to bitcoin in criminal law. Furthermore, bulls of bitcoin are mainly only that: speculators hoping for a profit measured in their fiat currencies.*

*This is not to deny bitcoin's virtues: only to question its monetary future relative to gold at a time when the period of declining interest rates, which played a large part in fuelling the cryptocurrency phenomenon, appears to have ended. Furthermore, the financial considerations in the geopolitical context centre on the dollar's relationship with gold, leaving cryptocurrencies as wallflowers in the financial conflict between east and west.*

## Introduction

If there is one uncontroversial fact in the science of economics, it is that the central issue is the inflation of currency and credit and has been increasingly so since the First World War. The debasement of the circulating medium has always been western governments' principal monetary policy. The last British attempt to stand in the way of the inflation steamroller ended in 1931, when economists, such as Keynes, pointed out that a gradual and automatic lowering of real wages that results from a reduction of the currency's purchasing power would be less strongly resisted "than attempts to revise monetary wages downwards".

This statement was economical with the reality. The error was found in the difference between pre-war and post-war gold standards. It should be remembered that the UK's 1925—1931 gold standard was a bullion standard, as opposed to the sovereign coin standard which existed prior to 1914. From 1925 when the new standard was introduced, the issue of sovereign coin was no longer at the option of banknote holders, but at the Bank of England's. The Bank was not interested in redeeming its own notes for coin. Therefore, only the very wealthy would be able to redeem currency and credit sufficient to obtain 400-ounce bars, which valued in today's sterling is about £586,000 (\$714,000). The ordinary person was disenfranchised by this arrangement, compared with the pre-war coin standard when a single sovereign could be obtained for a single paper pound. The result was that abandoning the bullion standard in 1931 was the political option of least resistance.

Instead of a bullion standard, if the British government had resurrected the pre-war coin standard, public opposition to inflationism would have most probably ruled against monetary debasement; and crucially, the government's room for economic intervention would be severely restricted. But so entrenched is the ideology of interventionism that no British economist today would agree with this analysis.

Not only can inflationism not be easily refuted today, it is lionised as being an essential policy. Nearly a century of inflationism has conditioned establishment economists to reject the restrictions of gold as money and as the sheet anchor for the valuation of credit. But the few of us conscious of the true cost of monetary debasement are increasingly aware that the commitment to inflation of fiat currencies and credit is rushing us all towards a final crisis. It is this awareness that has also fuelled speculation in cryptocurrency alternatives to gold. But as interest rates began to rise thereby expected to stabilise fiat currencies, the cryptocurrency bubble has deflated.

An interesting debate is whether cryptocurrencies, particularly bitcoin, can secure advantage over government currencies if their purchasing power continues to diminish at an accelerated rate. Bitcoin and those of its stablemates claiming a currency role will have to overcome the consequences of a reversal of falling interest rate trends towards higher levels in future. The debate will almost certainly intensify between parties for and against, none of which have a life experience of sound money, of its role as a stabiliser of credit values, and how this might be achieved under a cryptocurrency regime.

Assuming the reader of this article is aware that after a near four-decade decline to the lower bound, interest rates may have entered a new phase of rising rates, we should address the gold versus cryptocurrencies debate first, before looking at the consequences of rising interest rates for currencies, and therefore gold and bitcoin in 2023.

### The problem with bitcoin as money

The supreme cryptocurrency standard is widely acknowledged to be bitcoin. It is bitcoin which is currently promoted as the private sector replacement for government currencies. But even to talk of bitcoin as a currency is to mislabel it. A currency is a form of credit, where there is a counterparty risk. This risk is absent when a bitcoin is both owned and possessed by a person or business. It is therefore a competing form of money, which legally is physical gold and silver coin, the international legal position for which is laid out in the Appendix to this article. If it is anything, then bitcoin is not currency but a competing form of money.

Theoretically, as opposed to the legal position, it is not up to an economist to choose what is money. Ultimately, it is the public that decides. Undoubtedly, for some enthusiasts, bitcoin might be money to be hoarded, and spent as a last resort. This is precisely the established role which gold coin fulfils. But there is good reason to believe that the majority of devotees are in it for speculative profits. In other words, they do not intend to ever spend bitcoin, but to sell it for national currency. Now that interest rates have risen from the zero bound, the test will be whether bitcoin turns out to be no more than a speculative counter, aping the performance of high-flying technology stocks, and correlating more with the Nasdaq index instead of discounting the inflation of state currencies and associated bank credit.

To its credit, through all the cryptocurrency scams and collapses, bitcoin has retained its integrity. There is no doubt that in its construction bitcoin is remarkably robust. And for the international traveller it retains the advantage of not yet being subject to extensive regulations and restrictions on capital transfers. But the belief that it is a realistic form of money must be based on either the ability of bitcoin to work alongside the fiat currency system or in the event of a total breakdown of the monetary system that it will be replaced

by bitcoin. And supporters seem to think that the established international legal definitions of money can be ignored.

Where this is a particular problem is in the different property rights accorded to money and currency from other forms of property. In criminal law, if, say, a painting is stolen from you and you manage to trace it to a new owner, you can reclaim it as your property, even if the current possessor acquired it in good faith. This is what allows Jewish families to recover artwork stolen from them in the Second World War.

If, however, someone steals money, currency, or access to your bank account and transfers your property in them to another party, so long as that party was not acting in concert with the criminals, you cannot reclaim this form of property. But when we consider the case of bitcoin, it does not appear to fall into the categories of money and credit for the purpose of the law. Through the blockchain, the trail of previous owners is recorded pseudonymously, so property rights can be established.

This means that the authorities can also trace the ownership of bitcoin. If you have left them on an exchange wallet, they can be identified as having come into your possession. Even if you have moved them into your own wallet (pseudonymous ownership) the know-your-client and anti-money laundering regulations which would have been completed by you before you opened an account on an exchange would trace possession to you.

If the authorities know or suspect that at an earlier stage of its ownership, your bitcoin were the proceeds of crime, then they can be confiscated. This means that unlike the possession of money, cash, or bank credit you cannot be certain that you do indeed own your bitcoin acquired in all innocence.

It might not be beyond the bounds of possibility for the state to use this criminal law to attack bitcoin as a rival to its own currency. So far, this form of attack has not been deployed, but the threat remains.

In addition to ignoring its legal status, bitcoin enthusiasts do not appear understand the implications of entire economies operating on credit, being central bank credit in the form of banknotes and bank deposits in the commercial banking system. If bitcoin is to act as money, it must support the existence of related credit, and in doing so it will have to provide price stability to goods and services over the long term. But bitcoin's hard limit of issue makes it more likely that its purchasing power would increase significantly if commonly adopted as money. Furthermore, so far it has proved to be extremely volatile valued in fiat currencies. Both the hard limit to its quantity and its volatility makes it unsuited as a reference point for credit, which is the lifeblood of every economy. It would be impossible for businesses to calculate financial returns for commercial investment, a problem made more acute by today's borrowers used to their miscalculations being rescued by continual credit debasement and suppressed interest rates.

Even if they were permitted to do so — which is difficult to envisage — banks will almost certainly not wish to extend credit based on bitcoin. A bitcoin anarchist might respond that the entire banking system should fail with the end of fiat currencies. But this assumes that in this extreme event, the state will not come up with a solution which allows it to maintain control over credit. The best we can hope for in these extreme circumstances is that central banks and the political class learn the painful lessons of inflationism and vow to return to a credit system based on sound money — which is legally, and always has been gold.

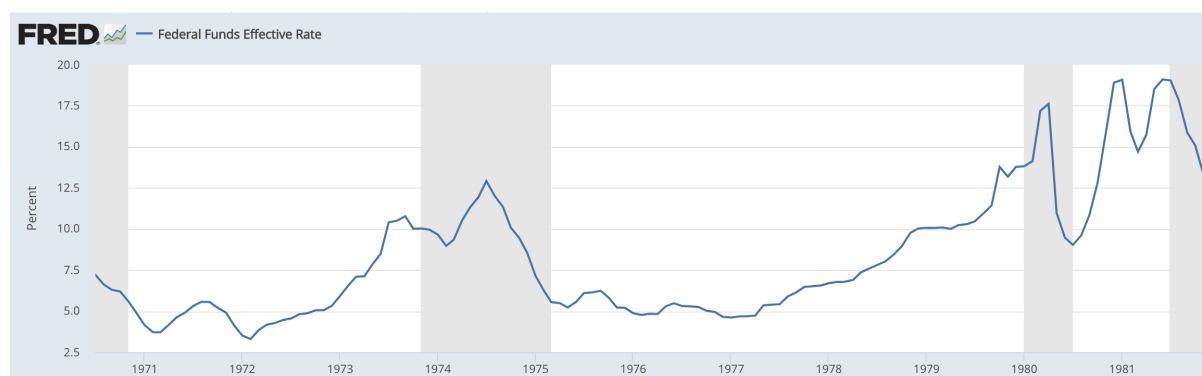
## Gold and rising interest rates

It has been pointed out above that bitcoin's value has declined along with rising interest rates. In derivative markets, rising interest rates are also seen as being disadvantageous to gold and favourable to fiat. Indeed, for most of 2022 rising dollar interest rates have seen gold decline, at least until recently, when expectations for higher interest rates softened. It has been that way for gold because the dominant players in derivative markets believe it to be so, and they account for their financing costs in fiat currencies. But while admitting to the accounting issue, the belief in the relationship between interest rates, gold, and currencies is based on a common misconception.

Both Keynesians and monetarists claim that interest rates are the price of credit, so if interest rates are raised, they say that demand for credit will be reduced. It is on this understanding that central bank interest rate policies are based. But empirical evidence shows that this relationship is incorrect. The explanation is simple. As a reflection of time preference, interest rates compensate creditors for loss of possession of currency or credit in the form of bank deposits. To the loss of use value and a risk that the borrower might default must be added the expectation of any changes in the currency's purchasing power.

Unless this last factor is recognised by rate-setters who lean towards suppressing rates, a currency will suffer on the foreign exchanges accordingly. And if policy makers for other fiat currencies are similarly suppressing interest rates below their time preference values, then it will be reflected in higher gold prices rather than exchange rate adjustments. With respect to gold, it is not the fact that gold yields a low interest rate on loan: that is a function of gold's stability relative to that of a fiat currency. Therefore, what matters in the relationship between gold and a fiat currency is the degree to which the interest rate demanded in the market for the currency reflects the prospects for its purchasing power.

However, traders account in fiat currencies. So understandably, they are more interested in maximising nominal interest rates and view the lower rate on gold as a cost. But as we can see from the chart below, in the 1970s official rates (in this case the Fed funds rate) rose and at the same time the gold price rose as well.



The day the Bretton Woods gold peg was finally abandoned in 1971, the dollar price of gold was \$43. Between 1971—1972, the Fed funds rate had varied between 3.3% and 5.5%. By the end of the decade, on 21 January 1980 at the PM fix gold was priced at \$850, an increase of nearly nineteen times. At that time, the Fed funds rate was at 14%, clearly forced higher by the markets in accordance with time preference theory. Chairman Volcker subsequently increased the funds rate to 17.5% by April, and then to 19% in January 1981 to

slay the inflation dragon. At that rate, the Fed's dollar was yielding more than warranted by time preference, which in effect was Volcker's policy objective.

For derivative speculators, the condition which breaks the accounting relationship between gold and dollar interest rates is when markets begin to take the inflation threat seriously. Today, that does not yet appear to be the case. We can say this because derivative markets impose a relationship between fiat currency interest rates and that of gold which denies the existence of time preference. It is an important conclusion which begs the question: will 2023 see a return to time preference considerations for the relationship between gold and fiat currency values, and how will bitcoin's price behave in these circumstances?

To affirm its status as money, bitcoin will have to obey the laws of time preference. In other words, its current relationship with interest rates must change, so that rising interest rates reflecting fiat currencies' loss of their purchasing power should become reflected in rising values for bitcoin. We will not try to guess this future. But we can say confidently that if the debasement of currencies accelerates, gold's relative value will increase accordingly while that of bitcoin might not.

## The geopolitical wildcard

To the extent that there is a financial war between the American-led western alliance and the Russian Chinese nexus, gold plays a far greater role than any cryptocurrency. Since the early 1980s, China has embarked on a policy of secretly acquiring unknown quantities of bullion none of which has been permitted to leave the nation's territory. It has financed gold mining, so that for over a decade it has become the largest national producer in the world. And when it was decided that the State in various accounts had accumulated sufficient bullion, it set up the Shanghai Gold Exchange and encouraged its own citizens, previously banned from gold ownership, to accumulate large quantities —so far, totalling over 20,000 tonnes.

And Russia, implementing gold accumulation policies more recently, has declared that between reserves and holdings in other state accounts it has about 12,000 tonnes. Legislation has been passed in the Dumas which will allow some or all of this gold to be transferred into official reserves, when they could easily exceed the reserves declared at the US Treasury. Moscow is setting up a new bullion exchange. Other Asian central banks have been accumulating gold as well. And tellingly, European central banks refuse to admit to any reduction in their reserve positions.

The battlefield in this financial tussle is over the US dollar. Russia and China, with the members of the Shanghai Cooperation Organisation, the Eurasian Economic Union, and BRICS (shortly to be joined by Saudi Arabia) either want to dispose of the dollar for the purpose of trade settlement entirely or want to become less dependent upon it. How is that to be achieved? The actions of Asian powers and their central banks are signalling to us that they will do so with gold.

This could become increasingly relevant in the months ahead. With Europe entering a continental winter, fuel and food shortages risk splitting the western alliance. The ascendancy of gold-backed Eurasia over a divided western alliance can be expected to lead to further dollar weakness, reflected in the value of true money, which legally is only gold.

## Appendix — The legal position of gold

As a medium of exchange, the function of money is to adjust the ratios of goods and services, one to another. Thus, the price expressed is always for the goods, money being entirely neutral in transactions. It is therefore an error to think of money as having a price, but it has a value relative to exchangeable items. This should be borne in mind when considering the relationship between legal money, which is habitually given a price nowadays in fiat currencies, and the fiat currencies themselves which, given the status of legal tender, are erroneously assumed to have the status of money. The magnitude of this error becomes clear with understanding what legally is money, and what is currency. And this understanding starts with Roman law.

Roman law became the basis for legal systems throughout Europe, and by extension those of European settled regions, from North America, Latin America through Spanish and Portuguese influence, and the entire British Empire. In common with the Athenians, Rome held that laws were the means whereby individuals would protect themselves from each other and the state. But it was Rome which codified law into a practical and accessible body of reference.

The first records of Roman statutes and case law were the Twelve Tables of 450BC. These became the basis upon which individual jurors expounded, developed, and evolved their rulings over the next thousand years. The whole legal system was then consolidated into the Emperor Justinian's *Corpus Juris Civilis*, otherwise known as the Pandects. When the empire relocated to Constantinople, the *Corpus* was translated into Greek and eventually reissued in the *Basilica*, at the time of the Basilian dynasty in the tenth century. It was that version which became the foundation for European law in the Middle Ages, except for England. As an eminent nineteenth century lawyer specialising in banking put it, the reason common law differed in England was that:

“The Romans abandoned Britain at the end of the fifth century and the common law of England on the subject of credit was exactly as it stood in *Gaius* which was the textbook of Roman law throughout the empire at the time when the Romans gave up Britain. But on the 1st of November 1875, the common law of England relating to credit was superseded by equity which is simply the law of the Pandects of Justinian.”<sup>i</sup>

In all, two thousand years of legal development had elapsed between the Twelve Tables and the reaffirmation of Justinian's Pandects in Dionysius Gottfried's version in Geneva of the *Corpus Juris Civilis*, translated back into Latin in 1583AD from the Greek *Basilica*.

It is the *Digest* section of the *Corpus* which is relevant to our topic. The Digest is an encyclopaedia of over nine thousand references of eminent jurors collected over time. Prominent in these references are those of Ulpian, who died in 228AD and was the juror who did most to cement the legal position of money and credit. The Digest defined property, contracts, and crimes. Our interest in money and credit is covered by rulings on property and contracts.

The regular deposit contract is defined by Ulpian in a section entitled *Deposita vel contra* (on depositing and withdrawing). He defined a regular deposit as follows:

“A deposit is something given another for safekeeping. It is so called because a good is *posita* (or placed). The preposition *de* intensifies the meaning, which reflects that all obligations corresponding to the custody of the good belongs to that person.”<sup>ii</sup>

Another jurist commonly cited in the Digest, Paul of Alfenus Varus, differentiated between the regular deposit contract defined by Ulpian above and an irregular deposit or *mutuum*. In this latter case, Paul held that:

“If a person deposits a certain amount of loose money, which he counts and does not hand over sealed or enclosed in something, then the only duty of the person receiving it is to return the same amount.”<sup>iii</sup>

So, a *mutuum* is taken into the possession of the receiver and in return for a right of action in favour of the depositor to be exercised by him at any time with the receiver having a matching duty to return the same amount, it becomes the receiver’s property to do with as he wishes. This is the legal foundation of modern banking.

Clearly, the precedent in the *Digest* is that money is always metallic. While anything can be deposited into another’s custody, it is the treatment of fungible goods, particularly money, which is the subject of these legal rulings. It is only through an irregular deposit that the depositor becomes a creditor. By laying down the difference between a regular and irregular deposit, the distinction is made between what has always been regarded as money from ancient times and a promise to repay the same amount, which we know today as credit and debt.

There is one issue to clarify, and that is to do with credit rather than money. As noted above, Justinian’s Pandects were compiled a century after the Romans had abandoned Britain. From what was subsequently unified as England and Wales out of diverse kingdoms, common law differed in that debts were not freely transferable as property. The transferee of a debt could only sue as attorney for the transferor. This placed debt as property in a different position from other forms of transferable property. Justinian took away this anomaly as a relic of old Roman law (the laws of Gaius, referred to above), allowing the transferee to sue the debtor in his own name.

The anomaly in English law was only regularised when the Court of Chancery merged with common law by Act of Parliament in November 1875. Since then, the status of money and credit in English law has conformed in every respect with Justinian’s Pandects.

While the legal position of money is clear, the economic position is technically different. Jean-Baptiste Say pointed out that money facilitates the division of labour. Technically, money is unspent labour, and is therefore a credit yet to be used. Various other classical economists made the same point. Adam Smith wrote that a guinea might be considered as a bill for a certain quantity of necessaries and conveniences upon all the tradesmen in the neighbourhood. Henry Thornton said that money of every kind [including credit] is an order for goods. Bastiat and Mill opined similarly.<sup>iv</sup>

But it is the legal difference which is of overriding importance because it was founded on the principal that there is a clear distinction between metallic money and a duty to pay. Money is permanent while credit is not. Money has no counterparty risk, whereas credit does. By way of contrast with money, we can define credit: *credit is anything which is of no direct use but is taken in exchange for something else in the belief or confidence in the right to exchange it away again.*<sup>v</sup>

So far, in this article we have established that gold has a legal status as money, which bitcoin lacks. We can also rule out legislation to raise bitcoin to a legal monetary status, even if law makers are prepared to consider doing so — which is unlikely. From the rulings in the Roman Pandects, we can see that a regular deposit differs from an irregular deposit because it is identified as the depositor's property. Identity is the key to property's recovery, and in bitcoin's case the blockchain provides this identity. Attempts to classify a blockchain based cryptocurrency as money fall foul of the established legal position.

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<sup>i</sup> See HD Macleod's *The Elements of Banking*, Longmans Green & Co, 1877

<sup>ii</sup> See de Soto's *Money, Bank Credit, and Economic Cycles*, Chapter 1.

<sup>iii</sup> *ibid*

<sup>iv</sup> Listed in HD Macleod's *The Elements of Banking*.

<sup>v</sup> *ibid*