WHAT KIND OF MONEY IS BEST?: AN INTERESTING NEW INVESTIGATION*

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A review of LAWRENCE H. WHITE, BETTER MONEY: GOLD, FIAT, OR BITCOIN? (Cambridge University Press 2023)

Since the Federalist Society was established forty years ago, its members have debated which aspects of our world and of our economy should be controlled by government and which should be left to the private sector. Perhaps no such aspect has been as hotly debated as money. And now, in this era of endemic inflation, massive budgetary deficits and major Federal Reserve interventions, concerns about our money are particularly important. Should our money be a monopoly of government, or, as the Austrian economist Friedrich Hayek suggested in 1976, should we be free to choose whatever money, government or private, we prefer?

> But why should we not let people choose freely what money they want to use? . . . I have no objection to governments issuing money, but I believe their claim to a *monopoly* or their power to *limit* the kinds of money in which contracts may be concluded within their territory . . . to be wholly harmful. . . . There could be no more effective check against the abuse of money by the government than if people were free to refuse any money they distrusted and to prefer money in which they had confidence.[1]

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* Note from the Editor: The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the author. To join the debate, please email us at info@fedsoc.org.

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[1] F.A. Hayek, *Choice in Currency: A Way to Stop Inflation*, *in* NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS, AND THE HISTORY OF IDEAS 218 (1978).

In *Better Money: Gold, Fiat or Bitcoin,* George Mason University economist Lawrence H. White takes Hayek one step further and examines three types of currencies to determine which one would best serve money users, if we were free to choose our money:

1. So-called "fiat" currencies issued by governments and not backed by any commodity or any explicit promise to pay but only implicitly by the strength of the issuing government, like the U.S. dollar;
2. Commodity-based money, using gold as the example; and, finally,
3. Cryptocurrency, using Bitcoin as the example.

Professor White's comparison provides a well-researched, useful, and highly interesting analytical summary of the arguments for and against using each of these types of currencies. He concludes that we ought to remove regulatory barriers to establishing alternative currencies to fiat currencies and let the market decide which currency is best, while noting that established currencies like the fiat dollar have an inherent advantage, which he refers to as a "network effect,"[2] because they are widely accepted and easy to use. He opines that absent double-digit (or worse) inflation of the sort that has driven some Latin American countries to abandon their own fiat currencies and adopt the dollar or an alternative currency like Bitcoin, incumbent fiat currencies are likely to remain the currency of choice.

By laying out the histories of the use of fiat currency, commodity-based currency, and cryptocurrency, and by summarizing the arguments for and against each of these types of money, Professor White provides an interesting and useful addition to the existing literature on the economics of money. But be warned: this is no easy book for the layman with no background in economics. Professor White's use of charts and supply-demand curve graphs requires a reader to have at least a basic familiarity with macroeconomics to fully understand his technical arguments. Yet the effort required of the reader will be well rewarded by the result.

Professor White begins his study by asking the following questions: "Given that our inherited discretionary fiat monetary regimes have performed imperfectly, and lately seem to be getting worse, might an alternative system—a commodity money or a cryptocurrency—do better? If so, which alternative is the most promising?"[3] In determining what makes a type of money "better," he focuses on money users' preferences, which Professor

[2] Lawrence H. White, Better Money: Gold, Fiat, or Bitcoin? 201, 211 (2023).
[3] *Id.* at 2

White defines as "some combination of (a) serving them individually as a convenient and low-cost medium of exchange, which favors non-declining and predictable purchasing power, and (b) the monetary system as a whole having desired properties like avoiding depressions associated with severe monetary disequilibria."[4] In other words, the best money is one that provides stable purchasing power and avoids excessive inflation and financial crises that lead to depressions. We can probably all agree on that.

Before actually comparing the gold standard to fiat currencies and Bitcoin, Professor White, in chapter 1, conducts a historical survey of the origins of money to demonstrate that most forms of currency derived from private markets and not from state action, echoing Hayek's views. Private money, Professor White argues, was prevalent throughout history. He then traces the rise of gold and silver as the most popular early forms of money because they had the qualities that users look for in currency: portability, durability, divisibility, stability in purchasing power throughout the seasons, and uniformity once trustworthy coinage became common.[5] He discusses the competition between private and government mints, the rise in bank notes promising convertibility to gold or silver as a convenient source of money, and the development of an international gold standard as well as the rise of central banks. Central banks, originally designed to help governments finance themselves by holding a monopoly on the issuance of banknotes, were able to pursue expansionary monetary policies to finance wars by simply printing up more money. After World War II, the Bretton Woods System was imposed under which foreign central banks pegged their currencies to the U.S. dollar, settled their debts in dollars, kept dollar assets as reserves, and could exchange their dollar balances at a fixed rate for gold held by the U.S. Treasury. As the United States pursued an expansionist monetary policy, it feared that it could no longer redeem dollars for gold at the fixed price because its gold reserves were dwindling rapidly. In 1971, President Nixon reneged on the commitment to redeem foreign central banks' dollars for gold since that would have required devaluation, which was judged to be politically inexpedient, and the dollar became a pure fiat currency, no longer backed by gold or any other commodity.[6]

In chapter 2, Professor White examines the workings of the gold system in depth, and in chapter 3, he debunks what he describes as "common

[4] *Id.*
[5] *Id.* at 11-12.
[6] *Id.* at 17-37, 126.

misconceptions about the gold standard."[7] He defines a gold standard as "any monetary system . . . in which a defined mass of gold coin or bullion is the *unit of account* in which prices are posted and accounts kept, and gold coins or bullion are the *medium of redemption* that ordinary currency and bank accounts promise to pay."[8] Thus, under a gold standard, banknotes are denominated in and redeemable for gold. Professor White argues that the international gold standard—in effect from roughly the 1870s until governments abandoned it in 1914 to finance World War I through expansionist monetary policies—had various advantages over fiat currencies, the most important of which was that it resulted in lower inflation.

Echoing Milton Friedman, Professor White believes that inflation is almost always due to expansion in the volume of money; because gold is expensive to mine and refine, the rising marginal cost of gold mining limits its output, thereby restricting increases in the volume of money.[9] This is reinforced by what White describes as the "self-stabilizing character of the purchasing power of gold in response to variations in money demand."[10] Professor White argues that if the demand for gold outpaces its production for a time, this will drive an increase in gold production. But as the purchasing power of gold increases, industrial users will cut back on the amount they require, leading to more gold (the result of increased gold mining) being added to the monetary system. Over time, this added supply will reverse the earlier increase in demand, returning the purchasing power of gold to its norm and limiting the expansion of the money supply, leading to less inflation.[11] This is a very interesting argument and, I believe, an original contribution by Professor White to the literature.

While ostensibly neutral among the gold standard, fiat currency, and Bitcoin, Professor White cannot hide his admiration and intellectual preference for the gold standard. This is apparent from his lengthy third chapter in which he debunks various criticisms of the gold standard. Against those who argue that the gold standard caused deflation in the period after World War I that led to the Great Depression, Professor White attributes the Great Depression to interventions of governments and central banks in pursuit of political goals like full employment and presents data suggesting that the gold

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[7] *Id.* at 76.
[8] *Id.* at 39.
[9] *Id.* at 50.
[10] *Id.* at 51.
[11] *Id.* at 52-53.

standard is not inherently deflationary.[12] He distinguishes the period leading up to the Great Depression from the more economically idyllic period between the 1870s and the first world war when the "classical" gold standard was in effect. He argues that deflation in the period between the first and second world wars is attributable not to the gold standard but rather to efforts by European nations who suspended the gold standard and inflated their currencies to finance the first world war. Then, they attempted to resume the gold standard at pre-war exchange rates without devaluing their national currencies.[13] In Professor White's view, these governments could and should have avoided deflation by devaluing.[14]

Against arguments that the price of gold is too volatile to allow it to be a monetary standard, Professor White offers two responses: first, that volatility in the price of gold is far less than fiat dollar volatility caused by the machinations of central banks; and second, that gold price volatility during the current era of fiat currencies and central banks is due to people buying gold as a hedge against the higher inflation caused by central banks' expansionary monetary policies and is far higher than it was during a period when there was an international gold standard in effect.[15] Similarly, Professor White refutes the contention that the resource cost of mining gold required by adoption of a gold standard is too high by arguing that under a traditional gold standard with reasonable reserve requirements, the resource cost is less than the resource cost attributable to people purchasing gold to hedge against inflation under modern fiat currency regimes.[16]

Professor White is certainly in the minority among modern economists in his support for a gold standard. Remember the fairly recent vilification of Trump Federal Reserve nominee Judith Shelton for having had the temerity to say nice things about the gold standard and to criticize expansionist Federal Reserve policies.[17] This is only the most recent example of a sound, conservative economist being falsely portrayed as a quack by progressive economists and by many in the media. Professor White performs a major service to economic literature by cogently organizing and marshalling empirical evidence

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[12] *Id.* at 76-91

[13] *Id.* at 85-86.

[14] *Id.*

[15] *Id.* at 92-96.

[16] *Id.* at 69-75, 101.

[17] *See, e.g.*, Rich Barlow, *The Gold Standard is a Terrible Idea*, WBUR COGNOSCENTI, June 3, 2019, https://www.wbur.org/cognoscenti/2019/06/03/gold-standard-trump-judy-shelton-fed-rich-barlow.

to support the utility of a gold standard. We should all remember that there are alternatives to having our economic well-being governed by an unelected group of economists sitting as central bank governors. This view is reinforced by Professor White's examination of fiat currencies in chapter 4 of his book.

With respect to fiat currency regimes, Professor White first points out that that they have never arisen through free-market driven evolution, but always through government legislation.[18] A fiat currency provides a government with the economic benefit of being able to borrow and to finance the borrowing by printing currency—a profit that is called "seigniorage."[19] To summarize, a fiat currency regime is what we currently have in the United States with the dollar. The dollar is a medium of exchange that is not backed by a commodity like gold and has no intrinsic value other than its implied backing by the economy of the United States. In describing the origins of fiat currency, Professor White amusingly cites humorist Dave Barry, who wrote, "Over the years, all the governments in the world, having discovered that gold is, like, rare, decided that it would be more convenient to back their money with something that is easier to come by, namely: nothing."[20] A fiat currency is typically managed by a central bank with the authority to manage monetary policy, like the Federal Reserve. One can summarize Professor White's views about modern fiat currency regimes as follows: While in an ideal world a central bank has the power to manage money to achieve whatever prudent targets the central bank deems appropriate for the economy, it almost never works out this way in practice. With fiat money, governments have the ability to finance their political goals by issuing debt and asking the central bank to print up more money to pay for it. This is a great temptation and is what central banks have in fact done. Professor White provides data to support the notion that the adoption of a fiat currency regime usually results in an expansion of the monetary supply and thus in increased inflation. He goes on to point out that all instances of hyperinflation have happened under fiat currency regimes.[21]

While Professor White does not cite this example, the U.S. federal government, in response to the Covid-19 crisis, issued trillions of dollars of debt, and the Federal Reserve printed up money to purchase much of that debt, resulting in the high inflation that the Federal Reserve today is trying to

[18] White, *supra* note 2, at 123-24.
[19] *Id.* at 144-46.
[20] *Id.* at 126.
[21] *Id.* at 145.

reverse. As I will point out later, this type of reaction is an appropriate response to a financial crisis provided that the monetary expansion stops when the crisis ends; unfortunately, this limit on expansion does not always happen, as in the Covid example. High inflation generated by monetary expansion in response to a crisis is exacerbated when a central bank picks an arbitrary inflation target other than zero. Such a target preprograms some level of inflation into the system, as the Federal Reserve has done with its announced target of 2 percent inflation—a target rate that it adopted on its own without any congressional action. The problem with fiat currency-central bank regimes is that even *prudent* monetary policy can be overridden by imprudent *fiscal* policy—as when a government wishes to spend money for programs that exceeds the amount of its tax receipts. Under a fiat money standard, it is just too easy for the central bank as part of the government to print more money to fuel its excesses, and this will always lead to harmful inflation.

The third form of currency that Professor White examines is Bitcoin, as a stand-in for cryptocurrency in general. Bitcoin is an intangible digital asset. It is not issued by a government so is not even implicitly backed by a government's strength or its ability to tax an economy. To take Dave Barry's humorous quip a step further: If fiat currencies are backed by nothing, then Bitcoin is backed by less than nothing. Professor White begins his Bitcoin discussion by providing a useful timeline for the development of Bitcoin.[22] Professor White concludes that Bitcoin has done better as an investment—a store of value—than as a currency.[23] Despite having some advantages over fiat currencies in a modern banking system—namely, greater privacy protection for its users—its price is simply too volatile to serve as a reliable currency.[24] Intraday price swings in Bitcoin can mean that the price of a transaction made in the early part of a day can fluctuate greatly before the transaction is settled later in the day. This type of price change is not suitable for a form of currency. In light of Bitcoin's volatility, one can question whether Professor White should have chosen another cryptocurrency to highlight and evaluate as a form of currency. Stablecoins that are backed by fiat currencies, such as Ethereum, or by commodities like gold are designed to be less volatile in price than Bitcoin and are better suited to be currencies. While not as large in market cap as Bitcoin, Ethereum has enough of a track record as a currency to have made it a better choice for Professor White's analysis. The unsuitability of Bitcoin as

[22] *Id.* at 157-65.
[23] *Id.* at 175.
[24] *Id.* at 170.

a form of money is evidenced by its unpopularity in El Salvador, where it was accepted as legal tender but failed to achieve widespread use as a currency, a phenomenon discussed by Professor White.[25]

Professor White concludes by urging governments to eliminate regulatory constraints on ownership and transfer of non-fiat currencies such as gold and Bitcoin, thus allowing various currencies to compete and enabling consumers to choose the currencies they prefer. This echoes Hayek's 1976 wish, with which I began this review. Professor White concedes that current fiat currency regimes are protected by network effects and that, absent hyperinflation, they are not likely to be replaced. If they were to be replaced, he compares the pluses and minuses of gold or Bitcoin as a replacement. Gold has two advantages over Bitcoin: it is less volatile, and it has a larger ownership base. Bitcoin has two advantages over gold. First, the Bitcoin blockchain has proven to be a reliable way of making payments, while online gold transfer systems are new and unproven. Second, Bitcoin can be self-custodied (although most users use a third-party custodian) and can be transferred user-to-user without the need for a third-party financial intermediary (although, again, many Bitcoin transfers are made through a third party).[26]

Better Money is an extremely interesting and well-written book. At a time when various forms of cryptocurrencies have appeared and created a trillion-dollar market that aspires to compete with the U.S. dollar,[27] it is worthwhile to look at the utility of substitutes for the U.S. dollar. Professor White's defense of the gold standard is lucid and well-supported by data. It is a useful summary and an important addition to economic literature. But there are two reasons why gold and Bitcoin are unlikely to replace fiat currencies.

First, with respect to gold, as indicated earlier, Professor White's views are very much in the minority among modern economists. I will not try to summarize the views of the many economists who are critical of the gold standard but will raise a few questions suggested by Professor White's own analysis. First, intuitively it seems problematic to base a currency on the amount of an underlying commodity that has a physical limitation, such as gold. The same point can be made for Bitcoin, the amount of which is limited, not by

[25] *Id.* at 203.

[26] *Id.* at 205-06.

[27] For example, when Facebook (now Meta) announced that it would sponsor a stablecoin called Libra that would be available worldwide to its billions of users, many within the U.S. government and in governments worldwide feared its potential to replace the dollar as the world's reserve currency. HOWARD B. ADLER & ALEX J. POLLOCK, SURPRISED AGAIN! THE COVID CRISIS AND THE NEW MARKET BUBBLE 68-78 (2023).

physical limitations, since it is not a physical asset, but by its own governing protocols. This inelasticity in supply necessarily imposes restrictions on the ability to expand the currency. Professor White might say that this is a good thing because permitting currency expansion leads to inflation, and we can all agree that inflation beyond a small amount is a bad thing; it is harmful macroeconomically and to consumers.

There are times, however, when currency expansion is desirable and even necessary. One such time is when a financial crisis occurs and the price of every asset plummets as it has many times in economic history, and most recently during the initial phase of the Covid crisis in 2020. At such times, the tried-and-true government response (which has been proven to work) has been that articulated by the 19th-century English banker and financial sage Walter Bagehot. His rule for central banks to follow in a financial crisis has been stated as follows: "To avert panic, central banks should lend early and freely (i.e., without limit), to solvent firms, against good collateral, and at high rates."[28] The lend freely part of Bagehot's prescription was followed by the Trump administration in 2020 when the Covid health crisis became a financial crisis with the price of every asset plummeting.[29] These actions ended the crisis, reinflating assets to pre-pandemic levels, but doubtless increasing the amount of inflation. The increase in inflation was greatly exacerbated by President Biden's decisions to continue pumping money into the economy after the crisis abated, particularly through the American Rescue Plan, which spent an additional $1.9 trillion (and probably far more), and also in subsequent pro-inflationary spending legislation.[30]

This example illustrates two relevant points. First, without a fiat currency that can be expanded rapidly, Bagehotian financial crisis intervention is not often possible. For this reason, during times when a gold standard was in effect and a financial crisis occurred, governments often suspended the gold standard or took actions that were the functional equivalent. For example, the British government suspended the Peel Act—which required Bank of England notes to be fully backed by gold—three times in the 19th century to deal with financial crises. The suspension of the Peel Act enabled the bank to issue currency not backed by gold, in other words, fiat currency. Professor White would argue, based on his research, that under a gold standard, financial crises arising from the actions of the financial system occur less frequently than they

[28] White, *supra* note 2, at 30.
[29] *Id.* at 13-29.
[30] *Id.* at 128.

do under fiat currency regimes. Even conceding this point, financial crises still occur for reasons that do not have to stem from the financial system itself. For example, one of the times the Bank of England suspended the Peel Act in the 19th century was in response to the financial crisis of 1847.[31] The 1847 crisis was precipitated by the Great Famine in Ireland rather than by activity in the financial system and demonstrates that financial crises can occur even under a gold standard.[32] The Covid crisis is another example. It began as a health crisis and morphed into a financial crisis. Had the United States been on the gold standard, it would have happened anyway. We would have had to suspend the gold standard in 2020 to follow Bagehot's prescription and pump money into the economy. Professor White argues that the Federal Reserve had sufficient gold reserves to follow an expansionist policy to combat the Great Depression without having to suspend the gold standard. But that will not always be the case. The problem is that, under a gold standard, the monetary expansion needed to combat a depression or financial crisis is dependent on the amount of gold reserves, which may or may not be sufficient. Under a fiat system, the central bank can always implement Bagehot's prescription and print money to alleviate the crisis.

Another type of situation in which governments have almost universally chosen to suspend the gold standard is when they are involved in a war where national survival is at stake. At such times, governments are forced to borrow heavily to finance the war. The constraints imposed by a gold standard on a government's ability to print money to fund such debt have led governments to suspend the gold standard and adopt fiat currency at such times. As Professor White notes, this is what European central banks did during World War I (and it is what the U.S. government did during the Civil War). In fact, Professor White attributes the Great Depression in part to the misguided efforts of central banks to reintroduce the gold standard after World War I without devaluing their national currencies.

One might ask, of what use is the gold standard when its built-in limitations will require it to be suspended whenever financial crises occur and during wartime? It is no coincidence that President Nixon jettisoned the gold standard during the Vietnam War. So two major problems with a gold

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[31] *See* Rudiger Dornbusch & Jacob A. Frenkel, *The Gold Standard Crisis of 1847*, 16 J. INT'L ECON. 1 (Feb. 1984).

[32] But financial crises occurred due to financial system breakdowns even under the gold standard. For example, the panics of 1857 and 1866 in England, also leading to suspensions of the Peel Act, resulted from the failure of financial institutions.

standard not addressed by White are that a financial crisis can only be alleviated by a rapid expansion of currency which can in most cases only occur under a fiat system. Secondly, the gold standard does not work when a country is at war and has to finance the massive expenditures that war requires. It is unreasonable to expect that a nation would jeopardize its national survival to keep the gold standard in place. Any nation facing a war of national survival will choose to jettison a monetary system that cannot be expanded easily.

The second issue with Professor White's arguments in favor of private money—whether commodity-based or Bitcoin—is that they ignore the benefits that we Americans receive indirectly through our government as a result of our fiat currency. Ever since Bretton Woods, the U.S. dollar, backed by the strongest economy in the world, has been the world's reserve currency, which means that foreign central banks keep most of their foreign reserves in dollar assets—usually U.S. Treasury debt. This creates a large demand for Treasury debt, which enables the Treasury to borrow more cheaply—a subsidy that benefits the lifestyle of every American. If we had a purely private currency, untethered to government, this "exorbitant privilege" as the French so eloquently called it, would be lost to us, and our economy would no longer be subsidized by foreign central banks. This would have a cost to every American citizen.

So we return to the question presented at the beginning of this review. Should money fall within the government's domain or within that of the private marketplace? Professor White makes a strong case that Hayek was correct and that we should be free to choose our own money. There is no question that central banks have made many mistakes over the years in managing fiat currency regimes—subordinating sound monetary policy to political fiscal policy by funding currency expansions that have resulted in excessive inflation. Our own Federal Reserve has been guilty of this though its ill-conceived quantitative easing policy that resulted in its ginning up its balance sheet to almost $9 trillion by buying government debt and mortgage securities; its purchase of the latter facilitated an inflationary housing bubble.

But, despite these excesses, it is no accident that virtually all monetary systems in the world today are based on fiat currency. Governments derive great benefits from controlling money, and not all of these benefits are bad for the economy. Governments' ability to finance themselves during times of war and financial crisis is only guaranteed by a fiat currency that can be expanded without regard to the existence of an underlying commodity or to size restraints written into the governing rules of a cryptocurrency. Moreover,

in the United States, a fiat currency that is the world's reserve currency provides tangible dollar benefits in lower borrowing costs to the U.S. government, benefits that could be passed on to each American citizen in the form of lower tax rates and other subsidies. I generally regard myself as a free market proponent, but I am not convinced that we ought to follow Hayek on this matter. Like operating an army or navy, the operation of a currency system seems to me one of the very few areas of our world that ought to be controlled by government, despite the many mistakes governments and central banks have made—and will doubtless continue to make—in both monetary and fiscal policy.

Other Views:

- James Pethokoukis, *The Case for the Gold Standard is Really Pretty Awful*, AMER. ENTERPRISE INST. (Sep. 10, 2014), https://www.aei.org/economics/monetary-economics/the-case-for-the-gold-standard-is-really-pretty-awful/.
- Matthew Yglesias, *7 Reasons the Gold Standard is a Terrible Idea*, VOX (Jul. 16. 2014), https://www.vox.com/2014/7/16/5900297/case-against-gold-standard.