The New York Times

OP-ED COLUMNIST

Paul Krugman
Go to Columnist Page »
Blog: The Conscience of a Liberal

Bits and Barbarism

By PAUL KRUGMAN

Published: December 22, 2013

This is a tale of three money pits. It's also a tale of monetary regress — of the strange determination of many people to turn the clock back on centuries of progress.

The first money pit is an actual pit — the Porgera open-pit gold mine in Papua New Guinea, one of the world's top producers. The mine has a terrible reputation for both human rights abuses (rapes, beatings and killings by security personnel) and environmental damage (vast quantities of potentially toxic tailings dumped into a nearby river). But gold prices, while down from their recent peak, are still three times what they were a decade ago, so dig they must.

The second money pit is a lot stranger: the Bitcoin mine in Reykjanesbaer, Iceland. Bitcoin is a digital currency that has value because ... well, it's hard to say exactly why, but for the time being at least people are willing to buy it because they believe other people will be willing to buy it. It is, by design, a kind of virtual gold. And like gold, it can be mined: you can create new bitcoins, but only by solving very complex mathematical problems that require both a lot of computing power and a lot of electricity to run the computers.

Hence the location in Iceland, which has cheap electricity from hydropower and an abundance of cold air to cool those furiously churning machines. Even so, a lot of real resources are being used to create virtual objects with no clear use.

The third money pit is hypothetical. Back in 1936 the economist John Maynard Keynes argued that increased government spending was needed to restore full employment. But then, as now, there was strong political resistance to any such proposal. So Keynes whimsically suggested an alternative: have the government bury bottles full of cash in disused coal mines, and let the private sector spend its own money to dig the cash back up. It would be better, he agreed, to have the government build roads, ports and other useful things — but even perfectly useless spending would give the economy a much-needed boost.

Clever stuff — but Keynes wasn't finished. He went on to point out that the real-life activity of gold mining was a lot like his thought experiment. Gold miners were, after all, going to great lengths to dig cash out of the ground, even though unlimited amounts of cash could be created at essentially no cost with the printing press. And no sooner was gold dug up than much of it was buried again, in places like the gold vault of the Federal Reserve Bank of New York, where hundreds of thousands of gold bars sit, doing nothing in particular.

Keynes would, I think, have been sardonically amused to learn how little has changed in the past three generations. Public spending to fight unemployment is still anathema; miners are still spoiling the landscape to add to idle hoards of gold. (Keynes dubbed the gold standard a "barbarous relic.")

Bitcoin just adds to the joke. Gold, after all, has at least some real uses, e.g., to fill cavities; but now we're burning up resources to create "virtual gold" that consists of nothing but strings of digits.

I suspect, however, that Adam Smith would have been dismayed.

Smith is often treated as a conservative patron saint, and he did indeed make the original case for free markets. It's less often mentioned, however, that he also argued strongly for bank regulation — and that he offered a classic paean to the virtues of paper currency. Money, he understood, was a way to facilitate commerce, not a source of national prosperity — and paper money, he argued, allowed commerce to proceed without tying up much of a nation's wealth in a "dead stock" of silver and gold.

So why are we tearing up the highlands of Papua New Guinea to add to our dead stock of gold and, even more bizarrely, running powerful computers 24/7 to add to a dead stock of digits?

Talk to gold bugs and they'll tell you that paper money comes from governments, which can't be trusted not to debase their currencies. The odd thing, however, is that for all the talk of currency debasement, such debasement is getting very hard to find. It's not just that after years of dire warnings about runaway inflation, inflation in advanced countries is clearly too low, not too high. Even if you take a global perspective, episodes of really high inflation have become rare. Still, hyperinflation hype springs eternal.

Bitcoin seems to derive its appeal from more or less the same sources, plus the added sense that it's high-tech and algorithmic, so it must be the wave of the future.

But don't let the fancy trappings fool you: What's really happening is a determined march to the days when money meant stuff you could jingle in your purse. In tropics and tundra alike, we are for some reason digging our way back to the 17th century.

A version of this op-ed appears in print on December 23, 2013, on page A29 of the New York edition with the headline: Bits and Barbarism.