Money, bits and banking: Florida case implicates legal status of digital currencies in the US

Introductory level economics textbooks often begin with a discussion of a surprisingly tricky question – what is money? In economics parlance, money is not simply what is in your wallet; rather, it is any asset that functions as a medium of exchange that also facilitates the storing of value for future use.

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Currency, on the other hand, is what is actually in your wallet, government-issued physical money, *i.e.*, cash or legal tender. Economists generally view coins and notes (dollars, pounds, euros, etc.) as both currency and money. In contrast, electronically stored balances maintained in checking accounts are money, but not currency, even though they are denominated in the same manner as currency. Given this distinction, it is understandable that there is uncertainty over the legal status of bitcoin and other digital currencies.

Various US government agencies have classified digital currency as an asset, a commodity, or a medium of exchange that functions like currency. Thus, the legal status of digital currency was already murky when, on July 22, 2016, a Florida State Circuit court held, in *Florida v. Espinoza*, that bitcoin is not "money" within the State of Florida's legal system.

The Legal Status of Money

The need for a legal, reliable and standardized medium of exchange underlies the reason governments create and recognize "money." Without a medium of exchange, transactions are reduced to bartering. Money, as a medium of exchange, solves this problem. For hundreds of years, physical legal tender has enabled parties to transact business based on the inherent value of the legal tender as an exchange medium. Government-issued legal tender enables holders to store value for significant periods of time, as well as to exchange it for goods, services and other assets that store value. Government efforts to manage the supply of money and monitor for forgeries also help to preserve the utility and value of legal tender.

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Bitcoin as money

Bitcoin is not issued by any government authority and, thus, is typically not recognized by governments as currency. The US Treasury Department through its Financial Crimes Enforcement Network (FinCEN) distinguishes between "real" and "digital" or "virtual" currency. Real currency is the coin and paper money of a country that is designated as legal tender, circulates, and is accepted as a medium of exchange. Digital or virtual currency, on the other hand, is a medium of exchange that does not have all the attributes of real currency and, particularly, does not have legal tender status.

Putting aside its legal status, economists can see in bitcoin all the essential attributes of "money." Bitcoin is a medium of exchange that also functions as a store of value. Further, the bitcoin protocol is designed to create new bitcoin at a predetermined rate to maintain the supply and demand. In addition, the bitcoin blockchain is public and there are numerous exchanges where bitcoin can be traded for dollars; thus, there is an exceptional degree of price transparency. As such, bitcoin can be used effectively as a unit of account, and traders can easily compare the values of goods priced in bitcoin.

Thus, while bitcoin may not be viewed as currency or legal tender, it still fulfills the essential functions of money from an economist's perspective. Given this, what are the implications of the Florida court's holding in *Espinoza* that bitcoin is not money?

The legalities of bitcoin

In *Espinoza*, the Florida Circuit Court was not asked to decide whether bitcoin could be money, but whether it is now money within the State of Florida's legal system. The court had to decide the case within the confines of Florida law and against the backdrop of how bitcoin is used in practice.

Unlike federal agencies such as FinCEN and states such as New York and North Carolina, Florida has not enacted any laws or issued any regulations that incorporate or recognize digital currency in its banking and financial legal and regulatory system. While both federal and state law may apply to a bank under the US dual banking system, the issue in the *Espinoza* case was squarely one of state law. *Espinoza* was criminally charged by the State of Florida for the illegal transmission of money and money laundering for selling bitcoin for dollars. In his defense, *Espinoza* argued that bitcoin is not money and, thus, he could not be charged with a crime he did not commit under Florida law. Given the lack of clear statutory authority related to the treatment of digital currency as money under Florida law, the Circuit Court decided the case based on the legalities of bitcoin under Florida law. Specifically, the court considered whether bitcoin functions as money for purposes of the relevant Florida law at issue.

Notably, the court confined its analysis to the treatment of bitcoin as money under the Florida law, but failed to consider the implications of another reference in the same law to "monetary value," which would appear to have altered the court's decision if taken into account and appropriately considered. That is, conceding that bitcoin is not money under the Florida money transmission law, the law also covers the transmitting of "payment instruments," which does not include digital (or virtual) currency, but does include the transfer of "monetary value."

While focusing on the "money" reference in deciding the case, the Florida court noted that bitcoin is not commonly used as a means of exchange. In this regard, while there is no doubt that bitcoin use is growing in popularity, including several major online retailers accepting bitcoin as well as several websites dedicated to chronicling brick and mortar stores that accept bitcoin, such that bitcoin may be deemed money in the economic sense, it has not achieved the ubiquitous nature of currency or legal tender in our everyday transactions. That there are websites that track bitcoin acceptance demonstrates that bitcoin is not widely circulated and, thus, is not treated as currency, or even as money in the legal sense. For now, most individuals convert bitcoin into local currency before using it for everyday purchase and similar transactions.

Where bitcoin most clearly does not function as money is in its reliability as a store of value. While bitcoin is designed to be a store of value, and the bitcoin protocol is structured to produce price stability, the value of bitcoin remains volatile. On this point, bitcoin proponents note that, over the past three years, the value of a bitcoin has increased favorably from roughly US$115 to US$575. While perhaps sound as an investment, this type of price volatility does not bode

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well for bitcoin as a currency. The rate of bitcoin inflation during this three-year span was approximately 70 percent, compared to inflation of the US dollar for the same time span at approximately one percent annually.

To be treated as money, it appears that an asset must do more than retain value; it must not gain too much value relative to external inflationary measures. Price stability over the long term is essential for a currency to be viable, or at least price stability relative to external inflationary pressures. Perhaps more concerning about the excessive long-term inflation of bitcoin is the extreme short-term volatility in bitcoin prices over the same three-year period. During the past three years, the price of a bitcoin exceeded US$1,000, plunged back to US$200 and within 12 months of that low climbed back up to US$750. As Judge Teresa Pooler noted in *Espinoza*, bitcoin is estimated to be 18 times more volatile than the US dollar.

For now, it appears to many that those who transact via bitcoin may be speculating that the bitcoin they accept today will be worth close to the same amount next year, next month, or even the next day. And the issue is not just downward price volatility for those who accept bitcoin, but upward price volatility for those who spend bitcoin. No one want to wake up 30 days later to discover the couch they bought for three bitcoin can now be purchased with two bitcoin… if they had only been a little more patient. In fact, if this mentality were take hold, price volatility in bitcoin could actually discourage transactional activity. If someone believes they would be better off holding bitcoin and using legal tender for purchase, then bitcoin has suddenly been designated clearly as a commodity, rather than a currency.

The reality today is that bitcoin does not function in the classic sense as money or, more accurately, as currency or legal tender. In fact, many who transact in bitcoin do so to profit on its rapid price appreciation and high volatility. They treat bitcoin not as money, but as a traded commodity, similar to gold, which explains in part why the US Commodities Futures Trading Commission has treated bitcoin as a commodity since September 2015. Although the use and function of bitcoin may eventually change—any many bitcoin advocates believe that future is inevitable—Judge Pooler had no choice but to conclude that bitcoin does not have the legal status as money within the State of Florida, in part, because it still does not function in all important respects as currency or legal tender so as to have the legal status as "money" under Florida law.

Implications of Espinoza

Ultimately, the *Espinoza* case does not appear to be particularly problematic for the treatment of Bitcoin as money in Florida because, as noted above, the court had a way to get there simply by noting that bitcoin has monetary value. Thus, the same case brought in a different Florida court could go the exact opposite direction with the defendant found criminally liable for transmitting a payment instrument that has "monetary value." Similarly, the Florida Legislature may decide to resolve the issue simply by including bitcoin and digital course as money under relevant Florida laws.

Perhaps the far more significant implications of the *Espinoza* case are rooted in the court's analysis of why bitcoin does not have the legal status of money because bitcoin functions more as a commodity than a currency, particularly with respect to price volatility. This reasoning remains a significant challenge to overcome for the bitcoin and digital currency industry to be able to gain wider acceptance and adoption of bitcoin not just as money, but more importantly as a functional currency that can be used to store value for significant periods of time, as well as to exchange for goods, services and other assets that store value.