



STATEMENT ON HR 1098, THE FREE COMPETITION IN CURRENCY ACT OF 2011 SEPTEMBER 13, 2011

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House Committee on Financial Services
Subcommittee on Domestic Monetary Policy and Technology

Chairman Paul, Ranking Member Clay, and members of the subcommittee: Thank you for the opportunity to discuss my views on HR 1098, the Free Competition in Currency Act of 2011 (hereafter “the Act”). As an economist specializing in monetary systems I have studied and written for many years about the role of free competition in currency. Indeed the second book of my three books on the topic, published in 1989 by New York University Press, was entitled *Competition and Currency*.

THE BENEFITS OF CURRENCY COMPETITION

It is widely understood that competition among private enterprises gives us technological improvements in all kinds of products, delivering higher quality at lower cost. For example, the competition of FedEx and UPS with the U.S. Postal Service in package delivery has been of great benefit to American consumers. Currency users also benefit from competition. My research indicates that currency has been better provided by competing private enterprises than by government monopoly. For example, private gold and silver mints during the American gold rushes provided trustworthy coins until they were suppressed by legislation. Scientific appraisals have found that the privately minted coins were produced even more precisely than the coins of the U.S. Mint. Private bank-issued currency was the most popular form of money around the world until government-sponsored central banks, with few exceptions, gained exclusive note-issuing privileges.

We do not rely on the Treasury or the Federal Reserve, but rather private financial institutions, to provide our checking accounts, credit cards, and traveler’s checks. The consumer benefits from the competition in payment services among banks. Consumers would likewise benefit from free and fair competition among coin issuers. Although Federal Reserve Notes and Treasury coins should of course be protected from counterfeiting, there is no good case for them to enjoy monopoly privileges in the market for currency.

HR 1098 would give currency competition a chance. It would not remove the Federal Reserve from the currency market, but it would give the Fed a stronger incentive to deliver the kind of trustworthy money that consumers want. The dollar already faces salutary international competition from gold, silver, the euro, the Swiss Franc, and other stores of value. HR 1098 would allow salutary domestic competition between the Federal Reserve Note and other media of exchange. The Fed will have little to fear from competition so long as it provides the highest quality product on the market. Continuing to ban competition from the domestic U.S. currency market, or keeping it at a legal disadvantage, limits the options of American consumers who use money to their disadvantage.

What sort of competition might we see if currency were free from legislated restrictions? Here is one example. In 1998 a non-profit organization launched the “American Liberty Currency,” a private silver-based currency intended to compete with Federal Reserve currency. In the year 2000 I wrote an article about the project, entitled “A Competitor for the Fed?,” published by The Foundation for Economic Education’s magazine *The Freeman* (vol. 50, July 2000). I was skeptical that the project would attract many users, absent high inflation in the dollar. But I noted then, and I reiterate today, that in a high-inflation environment

“silver-backed currency with widespread acceptance would provide a useful alternative to the Federal Reserve’s product. Then, if you don’t like the way the federal government manages (or mismanages) the value of the fiat dollar, you aren’t limited to complaining. You can switch to the private alternative.” If double-digit inflation should unfortunately return to the United States, then the American public, as I wrote, would “find a very practical advantage in a silver-backed alternative to the free-falling Federal Reserve note.”

The Act offers three reforms. I will comment on them in turn.

SECTION 2

Section 2 of the Act repeals 31 USC, §5103, which presently declares that “US coins and currency (including Federal Reserve notes ...) are legal tender for all debts, public charges, taxes, and dues.”

What are the likely economic consequences of removing legal tender status from US Treasury coins and Federal Reserve notes? The immediate consequences would be minimal. New forms of currency will not be introduced into the market any faster than the public is prepared to accept them. The longer-run consequence will be to enable a more level playing field for competition in the issue of currency.

Legal tender status is more limited in its scope than is sometimes believed. That Federal Reserve notes and Treasury coins have “legal tender” status does not mean that they are the only legal way to pay. Any seller or creditor may (of course) voluntarily accept payment by transfer of bank-account balances, that is, by ordinary bank check, debit-card transfer, direct deposit, or wire transfer. Traveler’s checks or cashier’s checks may be accepted. The seller or creditor may even accept foreign currency or barter. Measured by dollar volume, payments in Federal Reserve notes or coin are a tiny share of all final payments in the United States (less than 20% of consumer payments, nearly 0% of business-to-business and financial payments). The great bulk of payments are electronic transfers of non-legal-tender bank balances.

Nor does legal-tender status mean that acceptance is mandatory when offered at a point of sale in a spot transaction. Large-denomination Federal Reserve notes are refused at many points of sale, and lawfully so. Vending machines refuse pennies. Mail-order sellers may refuse cash of any denomination. Millions of legal-tender one-dollar coins are piling up in the Federal Reserve’s vault in Baltimore because nobody wants them.

Legal tender relates to the discharge of debts. The phrase “Legal tender for all debts” in 31 USC, §5103, quoted above, means that if Smith owes Jones \$125, then Smith’s offering Jones \$125 in US coins or Federal Reserve notes legally extinguishes the debt, even if Jones would prefer payment in some other form (say, a check). In other words, the creditor is barred from refusing payment in legal tender notes or coins.

There is already an important exception, however. Debts in gold-clause contracts, made since 1977, are *not* unilaterally discharged by offer of US coin or Federal Reserve notes. 31 U.S.C. §5118(d)(2) reads: “An obligation issued containing a gold clause or governed by a gold clause is discharged on payment (dollar for dollar) in United States coin or currency that is legal tender at the time of payment. This paragraph *does not apply* to an obligation issued after October 27, 1977.” [emphasis added] That is, the holder of a gold-clause bond is free to insist on receiving payments in gold, or in an amount of dollars indexed to the price of gold, whichever the bond contract specifies.

Removing legal-tender status from U.S. Treasury coins and Federal Reserve notes generally, as Section 2 of the Act does, essentially broadens the gold-clause exception to allow contractual obligations to specify payment in, or indexed to, any medium that is an alternative to Treasury coins and Federal Reserve notes. It opens the competition not just to private checks and banknotes, but also to gold units, silver units, units of foreign currency, Consumer Price Index bundles, wholesale commodity bundles, Bitcoins, and whatever else a lender and a borrower might agree upon. If they prefer a unit for denominating their debt contract other than the Fed or Treasury dollar, they would be free to write a specifically enforceable contract in the unit of their choice.

Hand-to-hand currency does not need legal tender status to make it circulate easily. In jurisdictions where private commercial banks may issue circulating currency notes or “banknotes” (found today in Scotland, Northern Ireland, and Hong Kong), banknotes have the same legal status as checks. That is, they do not have legal tender status. Any creditor *might* refuse them if he preferred to be paid in another medium. (In Scotland and Northern Ireland, only pound sterling coins are legal tender.) I have spent a fair amount of time in Northern Ireland, visiting the Finance Department at the Queen’s University of Belfast, and have observed the circulation of banknotes there first-hand. There are four private banks that issue notes, and all of their notes are universally accepted. Legal tender status is clearly not necessary to have currency that circulates widely and is commonly accepted for payment of debts. Currency notes do not need legal tender status any more than credit cards, checks, debit cards, or traveler’s checks.

SECTION 3

Section 3 of the Act rules out federal or state taxes on precious-metal coins, whether minted by a foreign government or by a private firm. This section would allow precious-metal coins to compete with the US Treasury’s token coins (made of base metals, and denominated in fiat US dollars) without tax disadvantages (sales taxes on acquisition and capital gains taxes on holding, from which Federal Reserve Notes are exempt), and thereby a level playing field for competition among monetary standards.

SECTION 4

Section 4 of the Act repeals Title 18 §486 (relating to uttering or passing coins of gold, silver, or other metal) and §489 (making or possessing likeness of coins).

Section 486 is a relic of the Civil War, part of an effort to bolster the use of the wartime paper “greenback” currency by banning competition from the private gold coins I previously mentioned. The repeal of §486, combined with the previous section, would allow silver and gold coins to compete with the Treasury and the Fed on a level playing field.

I previously mentioned the American Liberty Currency project. The mover of that project, Bernard von Not Haus, was convicted in March 2011 of violating §486, and presently awaits sentencing, for the victimless crime of producing one-ounce silver coins, of original design, that he hoped would compete with the Federal Reserve’s currency. Regarding this case I commend to your attention the article by Seth Lipsky, “When Private Money Becomes a Felony Offense,” *Wall St. Journal*, 31 March 2011.

The repeal of §486 would avoid a repeat of the injustice done to Mr. von Not Haus. I share Mr. Lipsky’s view that “it’s a loser’s game to suppress private money that is sound in order to protect government-issued money that is unsound.”

Title 18 §489 of current law outlaws making or possessing “any token, disk, or device in the likeness or similitude as to design, color, or the inscription thereon of any of the coins of the United States or of any foreign country issued as money, either under the authority of the United States or under the authority of any foreign government”. Von NotHaus was also charged with violating this section. In my view §489 is redundant at best and over-reaching at worst. It is redundant at best because if there is any fraudulent intent in making or passing such a device, it is already outlawed under §485, which bans the counterfeiting of US coins. To outlaw “likeness or similitude as to design, color, *or* the inscription” [emphasis added] in cases where it is not counterfeiting and has no fraudulent intent, is far too sweeping. Taken literally, §489 outlaws all commemorative silver medallions—and if you go on eBay, you’ll find that there are thousands of them for sale—because it says that you are in violation of the law if you make or own any disk that merely has a color similar to that of a US quarter.


CONCLUSION

Competition in general creates incentives to provide a high quality product by taking business away from low-quality producers. Competition in currency is a practical idea that offers sizable benefits to the public when the quality of the incumbent currency becomes doubtful. In particular, US citizens would benefit from freedom of choice among monetary alternatives though the removal of current legal restrictions and obstacles against currencies that could compete with Federal Reserve Notes and US Treasury coins. HR 1098 would give currency competition a chance.

United States House of Representatives
Committee on Financial Services

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