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Congress Should Welcome Cryptocurrency Competition

By Nicholas Anthony

As cryptocurrencies have become more popular, members of Congress have become increasingly concerned about whether they might threaten the dollar's status as the world's reserve currency.[1] To the contrary, the coexistence of cryptocurrencies is beneficial to the dollar. Recognizing this fact and welcoming a competitive market for currencies would strengthen the dollar today and preserve its status as the world's reserve currency for tomorrow.

A BRIEF PRIMER ON CURRENCY COMPETITION

Currency competition is a process in which people are free to choose the currency that best fits their needs and currency issuers compete to meet those needs. As F. A. Hayek has explained, one of the key purposes of currency competition

> is to impose upon existing monetary and financial agencies a . . . much needed discipline by making it impossible for any of them, or for any length of time, to issue a kind of money substantially less reliable and useful than the money of any other.[2]

In other words, welcoming currency competition would introduce market forces to the realm of money. This suggestion may appear unconventional given that many believe only a national domestic government is capable of issuing currency.[3] However, government monopolies on money are only a relatively recent phenomenon: for example, the central banks in the United States and Canada were only created in 1913 and 1935, respectively. And history is rife with examples of private currency issuers.[4] Moreover, even today the countries that have welcomed dollarization are clear examples of how beneficial access to currency competition can be.[5]

In cases where government monopolies have long preserved issuers of bad money, competition would introduce the motivation and inspiration to issue better money. That second feature—the inspiration for issuing better money—is especially important to understand because where alternatives are available, all issuers are able to better observe

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the preferences of the public and improve the attractiveness of their currency. Rep. Byron Donalds (R-FL) described the benefits of currency competition well when he said, "World economies work best when you have a highly interactive . . . marketplace where people can exchange goods, products, and currencies. It's actually to the betterment of all currencies when there are multiple options."[6]

THREE LESSONS FOR THE DOLLAR

Although cryptocurrencies have not yet become a generally accepted medium of exchange in the United States, their initial success provides three key insights into what Americans would like to see change with the U.S. dollar and the traditional banking system. Congress should take note that cryptocurrencies are succeeding partly because of their potential to provide stronger financial privacy protections, faster payments clearing, and better transparency in monetary policy governance. Learning from the success of cryptocurrencies and improving the utility of the dollar would support the dollar's status as the world's reserve currency better than any attempt to restrict the market.

Stronger Financial Privacy Protections

Millions of Americans refuse to have a bank account due to concerns about privacy and trust.[7] Yet, in the fall of 2021, Congress essentially ignored these concerns and tried to lower bank reporting thresholds to just $600, a plan that was opposed by 66 percent of voters.[8] While it is true that the Fourth Amendment to the U.S. Constitution *should* protect individuals from having their privacy violated by the government, that protection no longer extends to most financial records. Due to the third-party doctrine, the mere act of owning an account at a bank or an exchange is treated as a surrendering of one's financial privacy.[9]

The decentralized nature of many cryptocurrencies solves the issue of the third-party doctrine by removing the third party. Therefore, financial investigators must seek permission from the owner of the account or seek a warrant from a judge if they wish to obtain detailed private information about the parties involved in a transaction. This subtle change in how transactions are conducted has ushered in a new era of possibilities for finance, and has also produced a new generation of Americans who are aware of just how little their financial privacy is protected in the traditional system.[10]

To strengthen financial privacy protections, Congress could amend the Right to Financial Privacy Act (RFPA)—an act that established a formal process for obtaining consumer information and restricted the ways in which the government may use that information.[11] Unfortunately, there are extensive exceptions within the act that have severely limited the protections it provides.[12] For example, none of its protections apply to financial information that is collected in accordance with the Internal Revenue Code or other types of government inquiries.[13] Congress should strike these statutory exceptions so that if information is needed for investigations it can only be acquired through a court order.

Faster Payments Clearing

The payments system (i.e., Fedwire) that supports the transfer of the dollar is both inefficient and outdated. George Selgin and Aaron Klein described it well when they wrote, "America's payment system seems more like it belongs to a developing nation than to one of the wealthiest countries on the planet."[14] The problem with the U.S. payments system is that it can take three days or longer for payments, such as a paycheck, to settle and become available in the recipient's account. This delay is partly because Fedwire is closed on both weekends and holidays.

Cryptocurrencies, by contrast, are not restricted by outdated "banker's hours." So long as one has access to an internet connection, funds can be transferred and settled in minutes or less, not days. It's easy to underestimate the advantage of such transfers when one has a reliable or abundant cash flow. However, faster payments can make a big difference for people living paycheck to paycheck and for people caught in natural disasters or other crises.

To fix the speed of payments, the Federal Reserve (Fed) should expand the operating hours of Fedwire to better accommodate the economy.[15] Although the Fed has tried to expand access to faster payments with the FedNow program (a real-time settlement service), that system has yet to launch. And worse, the Fed's plan to enter the market as both a regulator of, and competitor to, settlement providers has stalled private sector innovations in faster payments.[16] Expanding the operating hours of Fedwire, though, is something that can quickly and efficiently improve the speed of payments in the United States. Ideally, the Fed would reverse its decision to compete with the private sector on faster payments and shut down its FedNow program.[17]

Better Transparency in Monetary Policy Governance

Monetary policy has long been a subject of unnecessary mystery in the United States. It was not until 2011—nearly 100 years after its inception—that the Fed first started holding press briefings to present and explain the monetary policy decisions made by the federal open market committee.[18] Yet the public is still mostly in the dark. For instance, what should be a simple equation—under the Fed's new average inflation targeting regime—that anyone can calculate is, instead, anyone's guess because the Fed has yet to share the time horizon or variables it uses in calculating the average. In fact, the Brookings Institution found that 50 percent of Fed watchers believe the Fed has not provided enough information about its strategy.[19]

Cryptocurrencies, like Bitcoin, are often far more transparent regarding the rules that govern their supply. The popularity of open-source code in the cryptocurrency community has made it so that virtually anyone may verify the status of a particular cryptocurrency. As noted by Norbert Michel and Gerald Dwyer,

> Virtually any rule for determining the quantity of a cryptocurrency is possible. The major requirement is that adherence to the rule be exactly verifiable at virtually zero cost by anyone interested in using the cryptocurrency.[20]

To improve the transparency of monetary policy governance in the United States, Congress should require the Fed to adopt an explicit monetary policy rule that specifies targets and the consequences for failing to meet those targets.[21] In theory, average inflation targeting is a step in the right direction because mistakes must be accounted for. However, in practice, the new framework appears to have only given the Fed more discretion. Whether it be with the current framework or a new one, Congress should require an explicit rule that anyone can observe and specify clear penalties for failing to meet the rule.

AN UNEXPECTED ALLY IN STABLECOINS

The initial success of cryptocurrencies does not just offer lessons for improving financial privacy, payments speeds, and transparency in monetary policy governance, though. A market that is free to compete and innovate will also lead to goods and services that complement one another. Notably, stablecoins that are pegged to the dollar are an enhancement, not a challenge, to the dollar's status as the world's reserve currency.

In fact, many officials have already recognized that stablecoins can benefit the dollar.[22] In a speech in 2021, Federal Reserve Vice Chair for Supervision Randal Quarles said,

> In my judgment, we do not need to fear stablecoins. The Federal Reserve has traditionally supported responsible private-sector innovation. Consistent with this tradition, I believe that we must take strong account of the potential benefits of stablecoins, including the possibility that a U.S. dollar stablecoin might *support* the role of the dollar in the global economy. For example, a global U.S. dollar stablecoin network could encourage use of the dollar by making cross-border payments faster and cheaper, and it potentially could be deployed much faster and with fewer downsides than a CBDC [central bank digital currency].[23]

Representatives Blaine Luetkemeyer (R-MO), Andy Barr (R-KY), Ritchie Torres (D-NY), and John Rose (R-TN) have all echoed similar points.[24] Although other members continue to call for a crackdown on cryptocurrencies, a crackdown risks endangering this new advantage for the dollar. The problem that still lingers is that cryptocurrencies exist within an uncertain legal framework, but this problem is something that Congress can fix.

CRAFTING BETTER POLICY FOR COMPETITION

Legal Tender Laws

Legal tender laws are commonly misinterpreted to mean that anyone is required to accept, for example, the U.S. dollar, whenever it is presented as payment (this is known as "forced tender"). In reality, the dollar's legal tender status only denotes its acceptability for the payment of taxes, fines, and contracts (unless another medium of exchange is agreed to in that contract). The Fed formally addressed the ambiguity over legal tender on its frequently asked questions page by stating, "There is no federal statute mandating that a private business, a person, or an organization must accept currency or coins as payment for goods or services."[25]

To avoid confusion between the U.S. legal tender laws and the forced tender laws in authoritarian regimes, Congress should clarify the statutes in the U.S. code on legal tender. For instance, 31 U.S.C. Section 5103 is titled "Legal Tender" and currently states,

> United States coins and currency (including Federal reserve notes and circulating notes of Federal reserve banks and national banks) are legal tender for all debts, public charges, taxes, and dues. Foreign gold or silver coins are not legal tender for debts.[26]

Explicitly stating the limit of legal tender would make it clear that legal tender laws do not prohibit the use of alternative currencies. Such an amendment could take the form of adding the language already noted by the Fed such that the law reads,

> United States coins and currency (including Federal reserve notes and circulating notes of Federal reserve banks and national banks) are legal tender for all debts, public charges, taxes, and dues. Foreign gold or silver coins are not legal tender for debts. **Legal tender status does not require private businesses, persons, or organizations to accept United States coins and currency as payments for goods and services.**

Private Coinage Restrictions

Private coinage restrictions are similarly overdue for clarification. Although the prospect of minting physical coins may seem obscure in the context of cryptocurrencies, it was brought up at the end of 2021 when Sen. Sherrod Brown (D-OH) asked Dante Disparte of Circle, "If you were a traditional finance company, [do you think] you could sell metal coins that say 'U.S. dollar coin' on them?"[27] And this very question was part of the case that the United States Department of Justice made against the NORFED American Liberty Dollar, a privately issued currency produced by the now-defunct National Organization for the Repeal of the Federal Reserve Act and the Internal Revenue Code.[28] As it stands, the private coinage laws present a dangerous steppingstone for enacting a ban on digital coins.

Mending the law should begin with 18 U.S.C. Section 485. Currently, the law prohibits coins that have a "resemblance or similitude" to U.S. coins, but it fails to define the necessary resemblance a coin must have to be considered an unlawful counterfeit of an existing U.S. coin. To clarify the law, Congress should add that a coin must possess some combination of official phrases (i.e., United States of America, Liberty, In God We Trust, and E Pluribus Unum) and imagery. Congress would need to amend 18 U.S.C. Sections 487–491 to accommodate this change, but it would only be a matter of updating the language for consistency.

Congress should also amend 18 U.S.C. Section 486, in which the law specifically forbids not just counterfeit coins, but also coins of original design. This change could be as simple as striking "or of original design" from the record:

> Whoever, except as authorized by law, makes or utters or passes, or attempts to utter or pass, any coins of gold or silver or other metal, or alloys of metals, intended for use as current money, whether in the resemblance of coins of the United States or of foreign countries, ~~or of original design,~~ shall be fined under this title or imprisoned not more than five years, or both.

Capital Gains Taxes

Capital gains taxes act as a deterrent to cryptocurrency use and should be removed, at the very least, where cryptocurrencies are used for transactions, although ultimately Congress should amend the capital gains laws to level the competitive environment for other alternative currencies as well. First, capital gains tax rates are structured to incentivize long-term holding, which clearly discourages what is generally considered "currency use." Second, the complexity of administering the tax creates an additional burden on would-be users of cryptocurrencies. Where a sales tax is usually a flat percentage added on to the bill, capital gains taxes require a cryptocurrency user to report the sales price, cost, timeline, and gain or loss for each transaction to the Internal Revenue Service. Specifically, users must record this information on Schedule D of Form 1040 to calculate the tax owed for each purchase of goods and services.[29]

The capital gains tax should be eliminated from transactions in which one uses cryptocurrencies to purchase goods and services. While not ideal, the Virtual Currency Tax Fairness Act of 2022 would exempt personal transactions made in cryptocurrencies so long as the relevant gains are $200 or less.[30] However, there are three key changes that might improve the bill. The first would be to eliminate the $200 threshold while preserving the condition that a cryptocurrency is used for the purchase of goods and services (rather than to cash out). At a minimum, though, a second change would be to raise the threshold substantially ($10,000 or more) so that larger purchases could be made without additional taxation. Finally, a third change would be to scale the threshold for inflation.

CONCLUSION

By eliminating and updating antiquated laws that have discouraged currency competition, Congress would be welcoming a free, open, and fair financial market that would benefit the U.S. dollar. The initial success of cryptocurrencies has already shown that the American public desires stronger financial privacy protections, faster payments, and better transparency in monetary policy governance. If Congress takes the steps needed to welcome currency competition, it would gain the opportunity to not just create a stronger dollar today, but also to preserve its international status for tomorrow.

NOTES

1. At a House Committee on Financial Services hearing, Rep. Blaine Luetkemeyer (R-MO) asked, "As digital assets become more common in the global marketplace . . . how do we ensure the dollar remains the [world's] reserve currency?" "Digital Assets and the Future of Finance: Understanding the Challenges and Benefits of Financial Innovation in the United States," U.S. House Committee on Financial Services, December 8, 2021. Furthermore, Sens. Jim Risch (R-ID), Bob Menendez (D-NJ), and Bill Cassidy (R-LA) introduced the Accountability for Cryptocurrency in El Salvador. During a press release, Cassidy said, "If the United States wishes to combat money laundering and preserve the role of the dollar as a reserve currency of the world, we must tackle this issue head on." United States Senate Committee on Foreign Relations, "Risch, Menendez, Cassidy Introduce Legislation to Mitigate Risks of El Salvador's Adoption of Bitcoin," press release, February 16, 2022.

2. F. A. Hayek, *Denationalization of Money—The Argument Refined* (London: Institute of Economic Affairs, 1990), p. 23.

3. As noted by F. A. Hayek, "As soon as one succeeds in freeing oneself of the universally but tacitly accepted creed that a country must be supplied by its government with its own distinctive and exclusive currency, all sorts of interesting questions arise which have never been examined." Hayek, *Denationalization of Money*, p. 13.

4. Lawrence H. White, "What You Should Know about Free Banking History," *Cato at Liberty* (blog), Cato Institute, April 28, 2015.

5. While dollarization has become the dominant term to describe currency substitution in developing nations, it is important to note that the process is not unique to the dollar. Any currency is able to take the lead so long as it is preferable to the domestic currency. For example, "euroization" has been used to describe countries that have adopted the euro despite not being a member in the European Union.

6. Thinking Crypto, "Congressman Byron Donalds Interview—The SEC Crypto Reporting Requirements & US Crypto Regulations," March 22, 2022, YouTube video.

7. Federal Deposit Insurance Corporation, "How America Banks: Household Use of Banking and Financial Services," 2019 FDIC Survey, October 2020.

8. Isabelle Morales, "Poll: Voters Oppose Bank Snooping Plan, Believe It Will Increase Audits on Taxpayers Making Less Than $400k," Americans for Tax Reform, October 28, 2021; and Nicholas Anthony, "Why Don't Americans Have Stronger Financial Privacy Rights?," *Cato at Liberty* (blog), Cato Institute, October 28, 2021.

9. Anthony, "Why Don't Americans Have Stronger Financial Privacy Rights?"

10. Canadian Prime Minister Justin Trudeau's decision to invoke the Emergencies Act and freeze bank accounts was another eye-opener for Americans. Norbert Michel and Nicholas Anthony, "Keep Your Coins, Canada," *Cato at Liberty* (blog), Cato Institute, February 15, 2022.

11. 12 U.S.C. §§ 3401–3422.

12. 12 U.S.C. § 3413.

13. 12 U.S. Code §§ 3413 (c) and (g).

14. George Selgin and Aaron Klein, "We Shouldn't Have to Wait for FedNow to Have Faster Payments," *American Banker*, February 28, 2020.

15. In addition to calling for an expansion of the operating hours of FedWire, George Selgin explained that the private sector had already developed an initial alternative: Real Time Payments (usually referred to as the RTP network). See George Selgin, "Facilitating Faster Payments in the U.S.," Cato Institute, September 25, 2019.

16. Selgin, "Facilitating Faster Payments in the U.S."

17. For a full discussion of the issues with FedNow, see Selgin, "Facilitating Faster Payments in the U.S."; and Norbert Michel, "The Federal Reserve Should Not Compete with Private Firms," *Forbes*, December 16, 2018.

18. Board of Governors of the Federal Reserve System, "Chairman Bernanke Will Hold Press Briefings Four Times per Year to Present the FOMC's Current Economic Projections and to Provide Additional Context for Policy Decisions," press release, March 24, 2011.

19. Tyler Powell and David Wessel, "Survey of Academic and Market Observers Gives High Markets to Fed Communications," Brookings Institution, January 14, 2021.

20. Norbert Michel and Gerald Dwyer, "Bits and Pieces: The Digital World of Bitcoin Currency," Heritage Foundation, September 16, 2015.

21. George Selgin, "Monetary Policy," *Cato Handbook for Policymakers*, 8th ed. (Washington: Cato Institute, 2017).

22. Nicholas Anthony, "From This Week's Stablecoin Hearing: Concentration and Completion," *Cato at Liberty* (blog), Cato Institute, February 10, 2022; and Randal K. Quarles, "Parachute Pants and Central Bank Money," June 28, 2021.

23. Quarles, "Parachute Pants."

24. Anthony, "From This Week's Stablecoin Hearing."

25. Board of Governors of the Federal Reserve System, "Is It Legal for a Business in the United States to Refuse Cash as a Form of Payment?," FAQs, July 31, 2020.

26. 31 U.S. Code § 5103.

27. United States Senate Committee on Banking, Housing, and Urban Affairs, "Stablecoins: How Do They Work, How Are They Used, and What Are Their Risks?," Full Committee Hearing, December 14, 2021.

28. United States Mint, "Liberty Dollars Not Legal Tender, United States Mint Warns Consumers," press release, September 14, 2006.

29. Internal Revenue Service, "Schedule D, Form 1040."

30. Neeraj Agrawal, "Congress Takes a Step Toward a De Minimis Exemption for Everyday Cryptocurrency Transactions," Coin Center, February 3, 2022; and Suzan DelBene, "DelBene, Schweikert Introduce Bipartisan Legislation to Expand Use of Virtual Currency," press release, February 3, 2022.

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