HORIZON KINETICS

Cryptocurrency Musings
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BITCOIN AND LEGAL TENDER
(AND FRAUD, HACKING AND GOVERNMENT SUPPRESSION)

What is Legal Tender, Exactly?

The most common refrain of those who insist that bitcoin is a bubble is that bitcoin is not even legal tender. What is meant by this statement is that the legal system does not recognize bitcoin as being a valid form of payment for the discharge of financial obligations. If one wished to repay a loan, the bank is not obligated to accept bitcoin.

According to the Coinage Act of 1965, Section 31 U.S.C §5103, "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." However, the United States Treasury clearly does not interpret this as it would be understood by a layman. The average person would think that the law requires that U.S. currency be accepted as a proper discharge of a financial obligation.

On the U.S. Treasury website[1], the following language can be found:

> "This statute means that all United States money as identified above are a valid and legal offer of payment for debts when tendered to a creditor. There is, however, no Federal statute mandating that a private business, a person or an organization must accept currency or coins for payment for goods and/or services. Private businesses are free to develop their own policies on whether or not to accept cash, unless there is a state law which says otherwise. For example, a bus line may prohibit payment of fares in pennies or dollar bills. In addition, movie theaters, convenience stores and gas stations may refuse to accept large denomination currency (usually notes above $20) as a matter of policy."

Thus, an automobile dealer is not required to accept U.S. currency as payment. A convenience store is certainly not required to accept a credit card, in light of the fact that the law, as written and enacted by Congress, and as interpreted at the current time by the U.S. Treasury, does not require anyone to accept or reject any mode of payment. It might be a good idea to reflect upon this question of legal tender.

In fact, the definition of "legal tender" does not conform to the prevailing belief that one must accept U.S. currency as payment. The practical realities of business transactions can be so diverse that it is impossible to devise any rigid standard that will be workable in all instances. Imagine if an ordinary vending machine were required to accept a $100 bill, even for a $1 purchase. The machine would need to store enough currency to make change in the event that several people decided to pay with a $100 bill.

[1] www.treasury.gov/resource-center/FAQs/currency/pages/legal-tender.aspx

A better example of the practical complexities of executing what might otherwise be thought of as a simple regulation is President Franklin Roosevelt's Executive Order 6102, issued on April 5, 1933. This required all persons to sell any gold they had to the Federal Reserve for $20.67 per ounce. This transaction needed to be completed no later than May 1, 1933. The logic of this order was that the Federal Reserve needed more gold to issue more currency, since the Federal Reserve Act of 1913 required that all currency issued be 40%-backed by gold reserves. There were exceptions made for rare gold coins, dental gold, gold for jewelry use, and other purposes. This was to enable ordinary human activity.

The primary interest in this connection is how the government actually paid for the gold. It could, of course, pay in cash. However, at the time, it was believed that the Depression was caused by a shortage of cash. The reason that the government needed the gold was to be able to issue more cash. Thus, if the government actually went to the banks to borrow the cash, the Depression might even worsen. After all, banks were constantly closing due to an insufficiency of cash to pay their depositors—one can imagine how extreme this situation felt at the time.

Naturally, the government could issue Treasury checks in payment for the gold submitted by the citizenry. However, in order to be cashed, these would have needed to be deposited in banks. Very few people trusted in banks' solvency. Even so, if the checks were deposited and cashed, the cash would leave the banking system, which would have been self-defeating from a policy perspective, since the government wanted *more* cash in the system.

Thus, the government issued the Series 1934 Gold Certificates (but not to the owner of the gold—continue reading). These were in denominations of $100, $1,000, $10,000, and $100,000. In practice, one sold gold to a bank in exchange for Gold Certificates, but the bank actually held the Certificates, as opposed to the actual owners, and the banks used these only for transactions with the Federal Reserve. These were actual money, legal tender. Yet, the public never had possession of the money. Thus, legal tender is not necessarily money in the functional sense of public possession and use. Moreover, as noted previously, legal tender that is in public possession and use is not required to be accepted for payment in most circumstances.

The reason for this historical exposition is to understand that modern fiat money viewed as legal tender is not a legal requirement. One can always quite legally reject fiat money in favor of other means of payment, from credit cards to cryptocurrency. Money was, and remains, a matter of consensus.

<u>Newer Forms of Tender</u>

Another form of tender, of course, is a check, which is a negotiable instrument that involves money. It is nothing other than an instruction to one financial institution to pay another financial institution on behalf of the payee. It is hardly new, though. During the Abbasid Caliphate of the 9th century, it was fairly common to use a saqq. This is the Arabic word from which the modern word "cheque" is derived.

In the modern era, though, checks can be electronic, since there are electronic checks, and it can be a credit form of money, since it can be part of a line of credit. However, they are not legal tender. Furthermore, no one is required to accept a check as a form of payment.

Even within the modern era, the idea of electronic money is nothing new. A credit card is electronic money. Yet, credit cards, which were never made legal tender by the U.S. government, did not require government permission or regulation in order to enter into common use.

- In 1928, the Charga-Plate system was introduced. One presented a card by which an impression was made by pressing an inked ribbon with paper against the card. This became the invoice for payment at a later date.
- In 1934, American Airlines and the Air Transport Association introduced the Air Travel Card.
- In 1950, the Diner's Club Card was introduced. One of the inventors was Alfred Bloomingdale, whose grandfather founded the Bloomingdale's department store.
- In 1958, American Express introduced "Carte Blanche." Also in 1958, Bank of America created the BankAmericard, which eventually became Visa.

<u>A Question of Fraud</u>

Those intrigued by bitcoin might be interested to learn that the first 60,000 Visa cards, or BankAmericards, as they were then called, were "air-dropped," unsolicited, in 1958, to Bank of America customers via the mail, in a manner similar to the air-drop of bitcoin gold to bitcoin holders on October 25, 2017.

By June 1959, there were 2 million BankAmericards issued, with a 22% default rate.[2] Credit card fraud became commonplace in much the same manner as there were serious hacking problems with bitcoin and Ethereum. None of this stopped development and progress. Master Charge, now known as MasterCard, was created in 1966. The so-called "drops" of unsolicited cards were not even regulated until 1970, by which time there were 100 million cards in the U.S.

Credit cards, although arguably a form of money, never evoked the generalized hostility evoked by cryptocurrency. It did evoke derision, in the sense that it was once the consensus view that credit cards, as a concept, would either never work or would remain confined to a small, eccentric group of customers. However, credit cards did not dis-intermediate the banking system. On the contrary, they created a great deal of profit for the banking system. Cryptocurrency will probably remove much of that profit. It should therefore not be surprising that it generates such opposition.

[2] Joseph Nocera, *A Piece of the Action: How the Middle Class Joined the Money Class* (New York: Simon & Schuster, 1995).

<u>Consensus, or What Makes Money Money</u>

Yet another form of money is the stored value card, which actually represents money, but not in an account maintained at a financial institution. Examples are gift cards, telephone calling cards, transit fare cards, and electronic toll collection devices such as E-Z Pass, which function with RFID transponders. The E-Z Pass functions like money at a toll barrier. It is obviously electronic, yet it is not legal tender. One could, in principle, assert that E-Z Pass is backed by a state government. However, no government backs an Amazon gift card. Nevertheless, the Amazon gift card is accepted as money as if it were legal tender, which it clearly is not, simply because it is generally believed that Amazon is sufficiently creditworthy to pay. Simply stated, this and all the other devices cited are forms of consensus money.

It should be clear at this point that there has been a vast array of instruments, and even devices, that function as money that are not legal tender and probably never will be legal tender. Gift cards were introduced in the United States without a National Gift Card Act being passed by the Congress. These various payment modalities happened by consensus, not legal action. Bitcoin, or cryptocurrency more generally, expands via such a consensus.

If money only requires consensus, and not legal tender status, to be accepted, is it the case that legal tender will not be accepted in the absence of consensus? Indeed, this is very clearly the case. One need only consider the case of the Venezuelan bolivar. From its inception in 1879 to February 1983, the Venezuelan bolivar was a reasonably stable currency. February 18, 1983 is known in Venezuela as *Viernes Negro* (Black Friday). This marked the beginning of a series of devaluations that have plagued Venezuela and which introduced very high inflation.

In January 2008, the bolivar was revalued on the ratio of one to 1,000, and renamed the *bolivar fuerte* (strong bolivar). As late as January 2011, the official government exchange rate for the bolivar was 4.3 to the U.S. dollar. The official exchange rate of the bolivar to the U.S. dollar as of this writing is 10.458 to one USD. The black market rate, which is referenced daily in Latin American Spanish-language newspapers, is about 44,348 to one USD.

The Venezuelan government itself does not even recognize the official rate. It operates something known as the Dicom exchange, which will pay about 2,640 bolivars for one USD. There have been, in Venezuela, other exchanges, known as SITME, SICAD, SICAD II, and SIMADI, in addition to those already referenced. All have been declared legal tender. None have been accepted by the population. Even a veritable dictatorship that has possession of copious oil riches cannot stop consensus money from developing and displacing the legal standard.

In fact, no matter how tyrannical a government might be, it cannot stop, and never has been able to stop, the development of consensus money. Most people would probably agree that the government of North Korea is the most tyrannical regime on the planet. The North Korean government will exchange North Korean won for United States dollars at the official rate of 900 won to one USD. The daily black market rate is published on a South Korean website called DailyNK.com. According to this source, the black market will pay 8,005 North Korean won for one USD.

There is a parallel black market for North Korean won in terms of rice, which would be one kilogram of rice. Expressed in won, this is 5,810 North Korean won for one kilogram of rice, according to the DailyNK.

One can look at trends on this website and see that the price of rice is rising relative to the black market NK won/USD rate.

In February 2017, the black market would pay 8,070 NK won for one USD. Now, the rate is 8,005 NK won for one USD. On February 17, 2017, one kilogram of high-quality rice was 5,000 NK won. Now the price of one kilogram of high-quality rice is 5,810 NK won. One can use this data to calculate a cross rate and see that the U.S. dollar is actually falling, in terms of North Korean denominate rice as well, oddly enough. This is consensus money in action.

If the North Korean government cannot stop the development of consensus money with threats of torture and executions, more liberal regimes certainly cannot stop the development of consensus money. Bitcoin and other cryptocurrencies are not legal tender. These are consensus money. History records that legal tender is a very poor substitute for consensus.

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