Legal Tender: Towards Government Backing of Electronic Currency

Jon Neuleib

INTRODUCTION

If it is true that money makes the world go around, does the world spin faster when money can circle the globe in a fraction of a second? “Money” itself comes in multiple such as coins or paper, negotiable bonds, and now bits of data residing on computer servers or pulses of light flowing through a fiber optic network. Changes in currency are causing ripple effects in everything from crime to the stability of governments.[1] One of the most significant challenges will come from the move to electronic currency. Electronic currency is the attempt to create an electronic and networked system “modeled after our paper money system.”[2] This note will explore the nature of electronic currency and the challenges it presents for lawmakers. Electronic currency has economic advantages, but it also has disadvantages including the risks of increased money laundering, fraud and more difficult enforcement actions for governments.

Electronic currency combines aspects of traditional tangible currency, like paper and coins, with the technological advancements of debit cards and electronic networks. From traditional currency come the aspects of anonymity and ease of use. From the more technologically advanced side come lightning fast transfers and limitless size. This note is not simply an examination of electronic currency, however. It argues for national backing of electronic currency by the United States government. To examine the plausibility and advantages of this approach it will be necessary to look at currency in the context of legal, technological and political changes. Part One is an overview of the changing nature of currency as new technologies interact with money. Part Two examines the current regulatory approaches that are being taken to control electronic currency transactions. Part Three is a comparison between private electronic currencies and a nationally backed “public” currency. Parts Four and Five apply the advantages of a nationally backed electronic currency to the areas of fraud and
money laundering, respectively. The final segment, Part Six, looks at the far-reaching implications of electronic currencies for nation-states themselves.

THE CHANGING NATURE OF CURRENCY

The history of currency is generally seen as a progression from barter to natural objects (such as shells or cattle), to coin, to paper, to electronic form. One of the critical junctures in the history of currency is when the notes or coins stop being a representation of some other, inherently valuable object such as gold. This form of currency is referred to as fiat money. A currency is virtual as soon as it stops being tied to a material object backing its worth. This step occurs well before the introduction of an electronic payment system. Currency has been a technology for representing absent value for decades in this country. Modern currencies have their values determined by an interaction of political and market forces. Using law to control currency has been beset with problems that can only be avoided with smart economic and legal choices. History shows that not all governments have been up to this task with almost all nations having had to abandon their currencies at some point in the 20th Century. The move to an electronic currency presents a new challenge that demands an understanding of law, technology and economics.

Electronic currency is an inexact term used to describe an electronic transaction that functions more like a cash exchange and less like a credit card charge. The term encompasses everything from stored value debit cards, online bill payment, e-coins, and virtual banking to the electronic brokerage systems of international currency traders. The difference between electronic currency and other forms of electronic payment is that the issuer backs currency. There is no need for a recipient of the funds to trust the person with whom they are transacting as long as they trust the issuer. With cash, people trust the government and there is no need for them to know the identity of the person paying them. Electronic currency is a technology that promises to bring this level of ease of use and anonymity to cashless transactions whether they happen on the internet or face-to-face. A transaction with electronic currency places real (if intangible) funds into a seller’s account whereas an electronic payment system
places only a promise to pay in that account.\[^9\] The technological leap of electronic currency is that it breaks the dependent relationship between the buyer and seller.

Currency has always been a technology, but it is a technology controlled and created by laws.\[^10\] It is a tool used to mark, move, and maintain value.\[^11\] Modern currencies, whether electronic or not, do not have inherent values, but rather represent a claim against the institution that issued the note.\[^12\] The move to electronic currency is not money becoming technology, but rather a moment at which money may reveal itself as technology. Currency stores value whether it is in the form of cash in a wallet or a microchip on a plastic card. What is remarkable about our current system is that people have very few qualms about the value of the pieces of paper that they carry with them. Currency is, in some ways, a technology of faith. People have faith in the government and that translates into faith in the value of currency. In a nation like the United States, that faith has not been tested. Electronic currency provides a technological innovation that may require people to have faith in companies and other private actors rather than the government.

In the contemporary structure of the nation-state, currency is a construct of the state.\[^13\] Money is not so much controlled by law, as created by it. At the simplest level, the actual ability to create physical currency is function of law.\[^14\] At the more theoretical level, a government’s ability to control fiscal and monetary policy is also a function of law.\[^15\] The role of nation-states in the creation of currency is currently taken for granted, but the history of the 19\(^{th}\) Century in this country shows that a nationally, centrally controlled currency is not inevitable, nor a teleological certainty.\[^16\] In the antebellum period, currency could be issued by almost anyone and there were 8,000 different state banks issuing currencies in 1860.\[^17\] Laws that change the status of currency have eventually led to changes in the political structures that created those laws themselves.\[^18\] Forms of electronic currency in the hands of private actors such as brokerage houses, credit card companies, banks or Paypal are all still traded in dollar denominations. The value assigned to the unit of currency has much more to do with the U.S. government’s policies than Citibank’s. Moving to a nationally backed electronic currency would
not take the money out of these private actors’ hands, but it would increase the certainty about the value and trustworthiness of funds traded electronically.

CURRENT REGULATORY SCHEMES

Current regulatory schemes are marked by a reluctance to interfere with the technological development of the private sector. There is a widely held belief that technology must mature in the private sector, first, before it is subjected to regulation. Current attempts to write laws controlling electronic currency seek to regulate its development in the private sector by using traditional banking and commercial paper approaches. The controls that have been implemented and those that are being discussed will not create a true electronic currency, but will merely provide electronic versions of secured transactions. Although this avoids stifling the private sector, it is unclear that it will provide the confidence that consumers need to trust the system and make it a robust market of users and providers. With companies such as Microsoft looking to privatize the means of exchange based on these regulations, it is unclear that consumers will be well-served by the wait-and-see approach to the regulation of electronic currency.

In Part Six, this note considers whether nation-states could lose the present level of control that they have over currencies. While that is not an inevitable result, the present course of regulation will lead to competing private currencies and not the adoption of a nationally backed electronic currency.

Implementing new laws governing electronic currency demands that lawmakers understand the nature of the challenge they are facing. An early look at the future of electronic currency in the infancy of the internet listed a long shopping list of electronic currency attributes: security, reliability, scalability, anonymity, acceptability, customer base, flexibility, convertibility, efficiency, ease of integration, and ease of use. This rather exhaustive list describes both the factors necessary for effective implementation and those required by consumers to adopt a new system. These factors describe an ideal system and the current use of credit cards over the internet suggests that consumers are willing to undertake transactions
without all of these factors in place.\textsuperscript{[27]} Additionally, the guidelines that policy makers are using are considerably less stringent than those advocated by academic writers.\textsuperscript{[28]}

There have been some very concrete efforts to regulate electronic currency, but their implementation has been neither uniform nor far-reaching.\textsuperscript{[29]} There have been essentially three areas of development in the regulation of electronic currency. First, there have been federal efforts of to control money laundering and illegal transfers such as those forwarded by the Treasury Department’s Financial Enforcement Network.\textsuperscript{[30]} Second, there have been efforts by states (and the uniform law committees who attempt to influence state legislatures).\textsuperscript{[31]} These efforts have been marked by a recognition that applying old laws to new currency forms is mistake, but also that state legislatures may not know enough about the new forms to craft appropriate laws.\textsuperscript{[32]} State efforts have largely been an attempt to adapt old concerns about secured transactions and commercial paper to the new realm of electronic commerce through initiatives such as digital signature acts.\textsuperscript{[33]} The final area of legal development has been at the transnational and global level. These have included both domestic attempts to shape the global debate and truly international attempts to confront the implications of electronic currency.\textsuperscript{[34]}

It is this third area, the transnational and global space, in which the most interesting changes in the nature of currency are going to take place.\textsuperscript{[35]} The critical question to be asked at this juncture is whether there is going to be a fundamental disassociation between the nation-state and currency.\textsuperscript{[36]} Will the medium of exchange that the citizens of a country use to buy goods and services be permanently unbound from the power of the state? At one level, this question seems absurd. As stated earlier, currencies themselves are the creation of the entities that produce them.\textsuperscript{[37]} The U.S. dollar is a product of the laws of the United States.\textsuperscript{[38]} Without those laws, without the backing of the government, the paper in our wallets or the photons describing our balances on an ATM screen, lose their meaning. When they lose their meaning, of course, they also lose their value. Recent catastrophic currency events such as the ongoing crisis in Argentina suggest that currencies, even in their present state, are perfectly capable of outrunning the laws meant to govern them.\textsuperscript{[39]} The movement to electronic currencies presents
new risks and possible rewards, however. One of the peculiarities of the present system is that private sector companies such as Microsoft are the patenting the exchanges through which electronic currencies flow. We have to ask ourselves whether the technology of currency is capable of outstripping the capacity of the technology of the law to control it.

**Technical Implementation**

This essay suggests a very particular form for electronic currency. A nationally backed electronic currency would function in the following way. Each unit of currency would have a unique identifier attached to it. This identifier would work just as the current serial numbers do on paper currency. In the present system of electronic transfers, there is an identifier, but it is a mark of the transaction itself or a digital signature. The nationally backed electronic currency would be exchanged freely for all debts public and private and the government would not have to be aware of any transactions until there was suspicion of fraud or money laundering. When there was a reasonable suspicion about the path that a particular unit of currency had taken, law enforcement would be able to track it through either an embedded audit trail or a series of nodes in the system such as a bank’s servers.

The units of currency could be fungible in this system with each combination of units being a virtual redemption. As an example, imagine a person making their mortgage payment. The person has received (say from salary, a rebate on a toaster, and the balance of their Las Vegas hotel account) currency units XJH64827364, KJG84936586, and JUR19573057. The sum total of these three units is $2000, the amount of the mortgage payment. The person would have the option of forwarding the three units themselves to the mortgage holder as satisfaction of the debt or creating a new unit which we can call ZZZ1111222. The choice would be up to the individual, but the if the person converted the other currency units into a $2000 unit called ZZZ11112222, the previous three would be “redeemed” by the government and unit ZZZ11112222 would be “issued.” This process would stop the proliferation of currency units and provide a means to keep track of the currency as it went through various hands. If privacy were the utmost concern, the person could pass on the three
units that had been issued to someone else, but if convenience was the concern, the person could acquire a freshly minted currency unit, ZZZ11112222.

DIFFERENCES BETWEEN PUBLIC AND PRIVATE ELECTRONIC CURRENCIES

We are, realistically, at a crossroads that will determine the relationship between currency and the nation-state.\textsuperscript{43} The risk is that regulations governing banking, money laundering, monetary and fiscal policy, and commerce will not be up to the task of controlling electronic currency.\textsuperscript{44} It is not enough to suggest that the particular policies themselves are improper. It is the terms of the current debate itself that are inadequate. Legislatures are focusing on issues like digital signature initiatives that, while vital and novel, are somewhat beside the point.\textsuperscript{45} Working on digital signature initiatives is laudable, but unless there is a fundamental shift in our understanding of the way that electronic currency may escape the control of the nation-state, it is just rearranging deck chairs on the Titanic. The only solution is to have national backing for electronic currency. This proposal is not for a nationally backed electronic currency alongside private ones. A true nationally backed electronic currency would supplant the private forms just as Federal Reserve notes are the sole legal tender circulating as cash in the tangible world.

A nationally backed electronic currency differs from a private one because the government is the issuer of the currency.\textsuperscript{46} Private electronic transfers are currently common as credit card purchases, debit and stored value cards, and wire transfers.\textsuperscript{47} These are not properly speaking currencies.\textsuperscript{48} Currency differs from a draft or a note because the issuer does not have to redeem the “paper” for it to be turned into something of value.\textsuperscript{49} The currency holds its value and circulates without ever having to return to the issuer for redemption.\textsuperscript{50} For electronic transfers, this is a novel concept because currently, electronic payments have to be moved back and forth between different forms, such as credit card charges and Paypal transfers, to be used by the recipient.\textsuperscript{51} Electronic currency would be usable by the recipient and could be passed to a new recipient without any privity, liability or contact with the previous holder.\textsuperscript{52}
For private electronic currencies, the recipient has to trust both the issuer and the person from whom the payment is received. The first advantage of a nationally backed electronic currency is that the payment would ultimately be backed by the U.S. government. Having U.S. backing for an electronic currency would increase the confidence, security, convertibility, acceptance and widespread use of electronic currency. There are risks to being the first mover in a space like electronic currency and the size and stability of the government insures a more stable introduction than could be gained from the private sector. The advantages of having a nationally backed electronic currency go beyond the confidence that would be instilled in the currency. There are widespread concerns about fraud and money laundering through electronic currency and placing the government as the ultimate issuer would reduce these risks.

The disadvantages of a nationally backed electronic currency are: the stifling of innovation and competition in the private sector; and, the increased surveillance that the government would have over electronic currency. Having government control the issuance of the currency and leaving the type and structures of the transfer up to the private sector means that there could still be innovation from the private sector. The government essentially serves as the backstop for final redemption, but because it is currency, it could be freely traded without having to return to the government at each transfer. The risks that the government would intrude on the privacy of individuals is a real threat, but one that does not account for the law’s ability to constrain improper government action. The government would only have access to the path of the currency when it was redeemed.

Just because the information was electronic, there is no reason to think that there would be a decrease in the current protections stemming from probable cause and the illegality of warrantless searches. The choices for electronic currency are not between privacy and scrutiny. The choices are between the government and private actors. Government law enforcement agents would still be able to subpoena bank records from the private sector, but there is no guarantee of what the private actor could do with a person’s information. The likely solution would be a law mandating people’s financial privacy. Thus, the protection for financial
information linked to electronic currency will be a function of law in either scenario. The choices between allowing the government or Microsoft to have control of your financial information may not be palatable, but the one has constitutional guarantees attached while the other does not. There are certainly risks to privacy with electronic currency, but the comparison of the two systems show the advantages attached to government backing.

**THE DECREASED RISKS OF FRAUD WITH A NATIONALLY BACKED ELECTRONIC CURRENCY**

On the one hand, the impersonal and ephemeral nature of electronic commerce makes the area seem ripe for fraudulent activity.\(^{[57]}\) On the other hand, the mediated nature of electronic currency makes it eminently traceable. Whether this is an advantage or not, depends on a careful comparison between the present state of electronic commerce and what the landscape would be like with a nationally backed electronic currency.

Would you value an electronic transfer of $100 differently than you would the handing over of a piece of paper with a picture of Benjamin Franklin on it? There is something else at work besides the inherent trust we have in Franklin’s balding head and dubious expression. If there is some risk to the electronic transfer or some disutility in the form, then one might value it at a discount. It might take $102 in electronic currency to make us part with the same quantity of goods that we would for $100 in paper currency. There are two possibilities for this reluctance. One would be the heightened transaction cost associated with the electronic form and the other would be a concern about the security of the transaction.\(^{[58]}\)

There needs to be a distinction between electronic transfers at this point and electronic currency.\(^{[59]}\) Currently, the cost of credit card transactions (the most prevalent form of present electronic exchange) creates a certain friction in electronic exchanges.\(^{[60]}\) A person attempting to use the money that arises from an electronic exchange has to move the funds between a number of different accounts, or states of existence, to actually spend it.\(^{[61]}\) The advantage of electronic currency is that, in its truest form, it would not require these additional transactions.\(^{[62]}\) Ideally, the difference between an electronic transfer and electronic currency is that “currency” is
immediately useable while a currency denominated value in an electronic account, is not.\[63\] The difference between currency and a transfer is that currency can be used without returning to the issuer for redemption.\[64\] It can be used by the recipient without having to return to the original issuer.\[65\] As the ubiquity of an electronic currency spreads, the transaction problems would decrease and the costs would follow.\[66\]

The fear of fraud would still be real, no matter how many people were using an electronic currency.\[67\] The intangibility of electronic currency creates a certain distrust that is unlikely to be dispelled without assurances from a third party. There are essentially two types of fraud: An exchange in which one party uses something other than legitimate currency and the improper removal of funds from an account. These can be analogized to someone using counterfeit paper currency and a pickpocket. The state of the law is currently capable of dealing with either of these occurrences.\[68\] The current drafts of the Uniform Money Services Act, the Uniform Commercial Code and the developments surrounding the Uniform Computer Information Transactions Act all account for the need to support a cause of action when a party has been defrauded in an electronic transaction.\[69\]

The state of the debate surrounding the various uniform codes and E-Sign is largely beside the point for electronic currency.\[70\] The real change comes from the altered status of electronic transactions when they are trading in a nationally backed electronic currency. Under the present system, although there may be jurisdictional issues, the ability to file suit against someone who has defrauded another party is not seriously in contention.\[71\] What has not been fully explored, however, are the advantages in tracing that come with an electronic currency. Electronic currency would have to reside on servers and hard drives and as with email, its trail would never truly disappear. The Basel Committee on international banking practices has urged that, “the existence of clear audit trails for all e-banking transactions should be ensured and all measures to preserve confidentiality of key e-banking information should be appropriate with the sensitivity of such information.”\[72\] Obviously, governments have an interest in making
sure that transactions do not escape the scrutiny of law enforcement altogether. The balancing factor is whether this becomes an intrusion on the privacy of the individual.

Commentators have debated the importance of anonymity to electronic currency. The argument is that anonymity is necessary for people to be able to trust the medium of exchange. Concerns about the anonymity of electronic currency result from misconstruing the relationship between law and currency. Currency is created as a function of law, but that does not mean that the government is a monolithic structure incapable of formulating objects and, at the same time, producing the means to limit itself. A nationally backed currency does not have to devolve into a “big brother” scenario with the government tracking every transaction. Law is flexible enough for an entity both to create currency and, at the same time, hold itself in check. To disbelieve this component is to suggest a disbelief in the ability of government to limit itself in general. That may be a persuasive argument for some aspects of the political spectrum, but it does not hold up in actual practice.

The government currently has both authority and proper restrictions on that authority in the area of banking. The banking industry is highly regulated at the federal level, but there are functional constraints on law enforcement’s use of the information gained through regulatory authority. In *Breakey v. Inspector General of U.S. Dept. of Agriculture*, the court held that there was no legitimate law enforcement purpose for a subpoena. The Office of the Inspector General sought bank records regarding the flow of funds to a housing project and the court determined that the initial explanation given for the subpoena was inadequate. The defendant in the case was claiming the defense available to it under the Right to Financial Privacy Act. Conversely, in *Donovan v. U.A. Local 38 Plumbers and Pipe Trades Pension Fund of San Francisco*, the court held that there was a legitimate law enforcement purpose. The courts function so that individuals are not harmed by the regulatory power of the state. It is the law itself that creates both the law enforcement mechanism and the protection from it. Just as the Uniform Commercial Code creates a cause of action for fraud when using a credit card or
writing a check, so laws could be formulated to protect from fraud with a nationally backed currency.

Finally, it may be important for the government to issue electronic currency because the choice is not truly one between government oppression and anonymity. The Federal Trade Commission has argued that anonymity is at risk in the present system because the companies that have the information are not adequately protecting it. The choice is not *whether* information is known about your financial transactions, but rather, who it is that is holding the information. The risks of anonymity are greater than the advantages to pseudo-anonymity. In the status quo, government has the ability to trace financial transactions, but it is an arduous process that wastes resources and creates exploitable gaps. We have to trust the law is also robust enough to curtail any abuses that the government might be tempted to undertake in the name of law enforcement.

### THE ADVANTAGES OF A NATIONALLY BACKED ELECTRONIC CURRENCY FOR THE CONTROL OF MONEY LAUNDERING

Traditional money laundering schemes move money into a legitimate transaction from an illegal one. The money enters the laundering scheme as cash from illegal activity. The risk with an electronic currency is that money laundering becomes quite easy and undetectable. The advantage of a nationally-backed electronic currency is that the enforcement of money laundering laws becomes slightly easier. The reason to be concerned about money laundering itself is that it is a nexus point for all organized criminal activities. Electronic currency has obvious advantages for cyberlaunderers. It is fast, efficient and much less likely to lead to official attention than carrying a suitcase full of twenty dollar bills through an airport. What needs to be found is a way to allow legitimate use of the electronic transfer of funds and at the same time, not create an ironclad resource for money launderers.

The US anti-money laundering schemes involve enforcement across numerous levels of government. The traditional path of laundered money is from an illegal activity to a set of off-
shore accounts that are difficult for U.S. authorities to trace. Money is then “layered” by splitting it up into smaller amounts to both hide the trail and escape laws governing notification. Merchants and banks have to notify the U.S. government when a transaction involves $10,000, or more, in cash. Breaking up a single transaction so that it is a series of layered transactions worth less than $10,000 each, is now illegal (even to aid and abet) under the Money Laundering Control Act of 1986.

The risk with electronic currency is that, beyond the advances in speed and security already available to money launderers, the ability to transfer funds without leaving a paper trail is getting easier and more accessible. Currently, direct transfers between stored value cards are possible and this transaction eliminates any paper trail. A stored value card is a credit card-sized piece of plastic with a computer chip in it that serves as an electronic ledger. These cards are already in widespread use for everything from paying for your copies at Kinko’s to vending machines. At this point, however, the cards are largely tied to a single merchant and cannot be used as a true electronic currency. Unless a drug trafficker has a lot of copies to make, stored value cards are not yet the weapon of choice. That may soon change. Banks are increasingly getting involved with the distribution of stored value cards and their acceptance is growing.

For a money launderer to use the stored value card exchange, all that would be necessary is a merchant who was willing to move the funds from one card to another. Additionally, a stored value card could be a repository for numerous cash deposits and then that card be taken physically off-shore quite easily. The movement of funds between stored value cards could be achieved anonymously because the funds do not have to be linked to a specific person; it just like getting your change at a store when you use cash. If the cards become widely used, then there would be literally millions of people making billions of deposits and redemptions from their cards and the audit trail would become largely unmanageable. What is needed is a system that decreases the anonymity of these exchanges without reducing the utility they would have for legitimate users. A nationally backed electronic currency would have the advantage
of making the government the final redeemer of the stored value currency. While this would not eliminate the possibility of money laundering, it would mean that for funds to re-enter the legitimate economy, they would have to become visible to law enforcement authorities.\footnote{111} A criminal who had placed funds onto a stored value card would, when attempting to deposit the money into a bank or brokerage account, re-enter the visible economy.\footnote{112}

There are no technological reasons why stored value cards and other instruments used to move funds electronically could not also contain an audit trail with them.\footnote{113} Just as the chips on the cards, or the stored information on a bank’s hard drive, could retain information about the amount, it could also record the transactions that led to that amount. It is essentially a question of storage capacity that would create an audit trail capable of being reproduced when the funds re-enter the legitimate economy.\footnote{114} A nationally backed electronic currency would mandate that the re-entry point be accessible to law enforcement authorities.\footnote{115} If the electronic currency is the creation of law, then it becomes easier to mandate that the audit trail be maintained and available to the proper authorities.\footnote{116} Because the government is always the issuer and final guarantor of the currency, it is more legitimate for the law to say how and when information about the source of the funds must be maintained.

This regulation would not go much farther than the current controls on money laundering that banks are subject to, but it would change the development of electronic currency by giving the government an earlier say in how they are developed.\footnote{117} If the government leads the development of electronic currency, then it is not a case of having to retrofit and control practices that have developed in the private sector. If regulation is a feature of the landscape from the outset the burden becomes less onerous. Instead of trying to determine whether there is enough capacity in the electronic network to add audit trails to the information already contained therein, the growth of the system would only take place with the knowledge that the capacity to record the trail was a necessary part of the process. Rather than having banks and other institutions squawk because it would be burdensome to add identifying features into an already
existing system, national currency law should lead the change and thus avoid a possibly difficult retrofit.

Avoiding the hard choices that will be necessary to ensure tracing and enforcement runs the risk of creating a money system that exists in parallel with the legitimate system.\footnote{118} If anonymous access to the payment system is allowed, an entire system could be created that escapes government’s ability to regulate.\footnote{119} It would not be an underground economy escaping notice, but rather an entire parallel economy that would displace the present one.\footnote{120} This is primary reason that a nationally backed electronic currency must supplant rather than coexist with private currencies. The risk is legitimizing a form of exchange, that once present, would be nearly impossible to wrest away from those conducting illegal activities in that financial space.\footnote{121} Attempting to regulate these transfers after they have grown in the private sector will create enormous difficulties for law enforcement.\footnote{122} The choices here are not between regulation and freedom, but rather, it is a question of how best to implement the necessary regulations. The choices are between having the law lead the way into cyberspace so that the government has a hand in controlling the next stage of electronic currency growth and attempting to close the barn doors after the animals have already left.

One example of such barn-door-closing attempts is the Uniting and Strengthening America Act by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act).\footnote{123} The USA PATRIOT Act extends current anti-money laundering measures to nearly all entities that are capable of conducting large transactions in electronic form.\footnote{124} The Act will apply bank-style regulations to entities from car dealers and jewelers to real estate firms.\footnote{125} This Act is an example of what happens when the government is forced to play catch-up. The Act extends current regulations that are not necessarily capable of stopping money laundering to new entities that have not been subject to this level of regulation.\footnote{126} It is difficult to say that the problems with money can be solved by extending the reach of the current measures. What is needed is a different approach that reconfigures the object at the core of all this concern: the currency itself.
Creating a nationally backed electronic currency changes the landscape for money launderers from the inside-out. The USA PATRIOT Act is, essentially, an attempt to change it from the outside-in. The Act says that if a jeweler gets a customer who wants to buy four $80,000 loose diamonds and have them shipped to Karachi, she should be suspicious. Should she be just as suspicious if 33 men with similar accents come in on sequential days and each want to purchase one diamond worth $9,967 and sent to Karachi? What if eleven men come in wanting to use credit cards, another eleven want to use checks and the last eleven want to use smart cards? Are the transactions still similar enough to warrant suspicion? The problem with the Act is that it places the burden (and the liability) on the person facilitating the transaction without giving her the tools she needs to control, compile and understand the transactions.

A nationally backed electronic currency with an embedded audit trail would allow the government to do the work of compiling the data that would reveal criminal wrongdoing. Rather than mandating Soviet-style, neighbor-spying suspicion into other people’s transactions, the jeweler could sell the diamonds knowing that the transaction itself, if illegitimate, was creating the audit trail that would undo the criminal conspiracy. The advantage of a nationally backed electronic currency is that it creates retrievable data each time that it is transferred between one person and another. The only way for a terrorist to keep their funds invisible would be for them to hold their smart cards close to their hearts deep within their caves. As long as they did not use the funds, they would be untraceable. But, that result, in effect, takes care of itself. A nationally backed electronic currency becomes visible when it is used and it is traceable when authorities believe that it has been used improperly.

THE REDUCED RISKS OF SPECULATION BASED CURRENCY INSTABILITY WITH A NATIONALLY BACKED ELECTRONIC CURRENCY

Thus far, this note has focused on changes that are largely incremental. The difference between money laundering with and without an electronic currency is largely one of ease and practicality of enforcement. The regulations that would go into an electronic currency, whether it is national or not, would be roughly equivalent. The difference comes in whether
the burdens and assurances are born by the government or the private sector. Current laws have a mechanism for dealing with disputes that arise over electronic currency whether it is nationally backed or not. The future of electronic currency is going to radically change, however. As the previous discussions of fraud and money laundering have suggested, even old threats are going to take on new form in a wired world. The focus of Part Six is a different set of concerns, but still one that can be guided and shaped by proper legal implementation. This risk-reward pair concerns the effect of speculation and the impact on democratic forms themselves if electronic currency is not backed by the national government.

Changes in currency can have a very real impact on the political forms that have created them. The development and adoption of the euro in the European Union is both a product of, and a critical element in influencing, the political course of that entity’s future. There is a difficult causal question to be analyzed about the fate of political systems and their connection to their currency systems. The founder of Paypal has explicitly (if somewhat hyperbolically, at this point) declared that electronic currencies will allow individuals to defund governments with whom they do not agree. The mechanics of this system involve the speed of the internet, the security of stable currencies, but not necessarily the backing of any government. Governments have to at least tolerate the spread of electronic currencies, however, and this seems to be the approach of the status quo. This note seeks to show that governments who ignore the link between currency and the nation-state do so at their own peril. When a currency, electronic or not, escapes the reins of the government that created it, it can lead to the swift downfall of that government. While the U.S. government may be large enough to weather these kinds of storms, loss of control over the currency can still have a debilitating effect on the nation and the world at large.

The ability to move funds across the internet allows a person in Moscow, for example to process nearly all of their transactions in dollar denominations, as long as there are enough people (also using a combination of electronic currency technologies) with whom he can trade. The money itself could be logically located on a server in San Francisco, Antigua, or
One of the effects of electronic commerce is to reduce and eliminate the transaction costs associated with time and distance. The physical location of the transaction need not even be a nexus point for the transfer of funds. In other words, if two people agree to settle a debt while they are in Latvia, the first party could contact her bank in Brussels, which would then contact the second party’s bank in Dubuque. The second party’s connection to Latvia is tenuous and the funds do not have to go Brussels-Latvia, Latvia-Dubuque. For purposes of this essay, the question is not whether Latvia would have jurisdiction over the transaction, but rather what currency the two parties are using.

What are the effects if this transaction is carried out in dollars or yen? The argument that there should be a free flow of currencies through transnational transactions is that each party would have the highest level of confidence and that the transaction would have the lowest possible cost if there is competition among currencies for this particular piece of business. The argument is that there should be a market for the currency choice in this transaction. To allow this to happen would create efficiencies for consumers and instill discipline in the monetary policy of the issuers. The risk is that nation-states will lose the amount of control that they currently have over monetary policy if they are exposed to the twin risks of competition and speculation.

The threat from competition comes in two forms. First, there is the present competition between currencies for the business of any given transaction. This competition exists now, but it would be accelerated and more pervasive if more people have access to electronic currencies through the internet. The second form of competition comes from the possibility that people will be able to vote with their wallets. This is the scenario envisioned by the CEO of Paypal, Peter Thiel. Electronic currency allows people to expatriate funds without the knowledge or approval of their governments. While such nations could impose export controls on currency, it becomes infeasible when it would mean cutting their citizens off from electronic commerce in general. This form of “competition” means that issuers are able to compete for people to use their currency because it creates a virtuous circle in which more
widespread use creates more acceptance and more confidence. Arguably, issuers will better manage their currencies so that they will be attractive to consumers and this will create the greatest amount of choice and the lowest cost. The argument against creating a nationally backed electronic currency is that it would stifle competition. Having a competitor like the U.S. government would mean that other, private electronic currencies would not be able to thrive.

The argument that competing with the government will harm consumer choice is spurious. If the ideal that competition supporters claim is achievable, then the large number of countries issuing electronic currencies should be sufficient to spur competition. Additionally, having a nationally backed electronic currency would not mean that entities like Paypal would no longer exist. Electronic transfer companies are not truly issuing their own currencies at this point. They are dealing in dollar denominations that are still controlled by the federal government. If a Paypal credit is sent out for $100 and it is not spent until ten days later, any change in the value of that $100 (the fluctuation in the amount of goods and services it can purchase) is not in the control of Paypal. Yet, Paypal is flourishing. It faces stiff competition from Citibank and Well Fargo in the transfer business and that discipline its practices. Issuing its own currency would make Paypal more like a bank and subject it to regulation that could severely reduce its profitability and harm consumers. There is a middle ground between a state monopoly in the creation and control of electronic currency and still allowing private firms to offer services in the transfer of those funds.

The speculative side of the argument is represented by contradictory figures like George Soros. He has made billions by betting against over-valued currencies and the question should be whether speculation is discipline for improperly valued currencies or a threat to the individual citizens on the ground who have to deal with the effects of a rapidly and radically devalued currency like the Thai baht. He is contradictory because he now writes and speaks against the sort of structures that allowed him his prominence in the first place. The question for Open Society supporters seems to be whether we can protect individuals, particularly those in
developing countries, from the ravages of speculative global capitalism. The argument that PayPal CEO Theil is making is that more open and free electronic transfers will allow people to defund countries that are behaving monetarily inappropriately.

There is a disconnect between these positions. Soros and Theil are talking about radically different conceptions of who it is that pulls the strings of global currency developments. In a sense, they are not truly disagreeing, but they are imagining different degrees of global currency transfer. Soros is saying that we should act to protect people who are at the mercy of their governments when it comes to the effects of monetary policy. Theil is saying that we should give people the means to address this problem through their own choices. The difference between the two opinions is largely one of timeframe. Soros is talking about the immediate effects of global capitalism. Theil is describing a response that would be effective, but which would require a long lead time and a great deal of concerted action to bring about. Neither of these positions is logically threatened by a nationally backed electronic currency. While it is a position that would not be popular in either the libertarian or the Open Society camps, an electronic currency supported by the U.S. government could lead to greater stability and confidence even though it would likely lead to the electronic version of the dollar becoming the mechanism for that stability. From a purely selfish perspective, the U.S. should take a leadership position on creating a nationally backed electronic currency because the widespread acceptance and use of it would allow the U.S. increased leverage. From an altruistic standpoint, a nationally backed electronic currency would create an electronic safe haven for funds that could shield people from the improvident decisions of their governments.

The argument against the problems of speculation is that competition would solve the problems inherent in privately backed currencies. Because consumers would be drawn to a stable currency, the issuers of private electronic currencies would have an incentive to stabilize the values of those currencies. There are two problems with this argument. First, why would a private backer have a greater ability to stabilize a currency than a government? Second, why would a private backer have greater discipline? If the problem with government backed
currencies is that political decisions are sometimes swept away by world events, it does not logically follow that company will be better able to weather the storm than a government. If the problem is instead, that governments make selfish currency decisions, then their two responses. First, the competition among governments would create the sort of forces that instill discipline. Second, a stable and efficient safe haven currency would allow people to avoid the choices of their own governments or hedge in several currencies from the comfort of their laptops. Either problem is solved by the existence of multiple currencies that trade against each other, but the multiplicity does not have to be vast for the mechanism to work.

It can be argued that regulations will stifle the market for currencies, but it does not logically follow that therefore a nationally backed electronic currency will create a greater burden on electronic funds transfer services. The greater risk actually seems to be that the government will stifle competition among electronic services by applying banking regulations. The creation of a nationally backed electronic currency does not increase or decrease the likelihood that there will be regulation of the electronic transfer industry as a banking entity. If anything, legislation like the USA PATRIOT Act makes it appear that without the increased tracing and anti-money laundering features of a national currency, truly onerous regulations get passed. A nationally backed electronic currency would allow the government to track illicit payments when necessary, but would not require that the private sector increase the transaction costs of every single transfer. Creating a nationally backed electronic currency may quash private currencies, but that may actually decrease the net amount of regulation that companies in this space may face. There will still be ample room for companies to compete over the types and quality of services that they provide in the transfer business.

The idea that competition will solve the temptation to manipulate monetary policy cannot be supported as more likely when the government is competing against the private sector than when it is competing against other governments. If competition is what instills discipline in a market, then it seems absurd to remove it from the realm of a democratically elected body of lawmakers. It is the law that creates currency and it is a function of government to control
The argument for competition assumes that governments make unassailable choices in monetary policy and that individuals are left at their mercy. Is there really greater control over the companies in the private sector? To argue against a nationally backed electronic currency is to forget that the law is an effective technology to control the actions of government. Democracy itself is a technology that allows the people a measure of control over their government. Although shareholders have some say in the conduct of the companies they own, it is a far cry from true control unless one owns a controlling stake in the company.

If the problem is government manipulation of the currency, the law itself could be used by dissatisfied citizens. Alternatively, democratic change could allow anti-market forces to prevail at times of great national crisis. Imagine what would have happened to the value of a private currency issued by a brokerage firm resident in the World Trade Center on September 11. Even though the company would have redundant stores of information the perception could still be enough to cause a destabilizing panic. With government control over an electronic currency, the voters themselves could approve measures that lead the market in times of crisis rather than responding to fear. This sort of “manipulation” may be anathema to true free marketers, but there are times when an anti-market strategy could reduce the negative impact on a large number of individual citizens. The government would be able to absorb the impact through deficit spending or simply the greater confidence that comes from an institution like the federal government. Either one of these would allow the currency to tack against prevailing market forces. This maneuver would be possible, however, only where the technology of law is present to allow the government to act. It would not be present in the private sector.

Private companies will issues electronic currency with the goal of making a profit[^176] In the private sector, competition would be the only tool available and it would push companies towards profit-seeking actions. No private company would be small enough to be disciplined by competition and yet be large enough to take anti-market action when necessary. The law is a technology that we can use to make sure that government can do this and there is never a need to make a profit.[^177] In these days of Enron-scale distrust why should we be more willing to
assume that a private company “disciplined” by competition will not be tempted to manipulate the value of the currency that it issues? Commentators are distrustful of governments’ willingness to make politically unpopular decisions, but they do not discuss the pressure that meeting Wall Street’s quarterly expectations would have on a private company. The potential for abuse and the lack of control that consumers would have over the process seem to be a distinct disadvantage of allowing the private sector to develop electronic currency. If there is to be competition, there can be functional competition as well as democratic controls with a nationally backed electronic currency.

**CONCLUSION**

People who distrust the government are really distrusting the law’s ability to constrain the government. The rule of law is capable of stopping abuses and ensuring that the government serves the people rather than controlling them. The job of government is to handle affairs that are impractical, inefficient, or impossible for individuals and the private sector to control. The issuance of an electronic currency would be a huge undertaking that could best be undertaken by the entity that has the most experience with issuing it in the first place and the reach to insure that the currency is accepted. Government involvement would not stifle innovation, but provide a level playing field for individuals to control their financial lives. The law is a technology that can lead change. In the area of electronic currency, that change could be sweeping and beneficial if we are intrepid enough to take advantage of this opportunity.

---

[4] Id.
[5] Id.
[8] Id.
[12] Id.
[15] Of course, when we enter the realm of monetary policy, we often move from the legislative side to the executive. That the policies are not explicit, and in the case of the Federal Reserve, are actually secret, does not remove them from the realm of the law.
[17] Id.
[20] Id.
[26] Id.
[27] See, Macintosh, at 217.
[33] Id, at 418.
[37] See, Taylor, supra.
[38] Coinage Act, supra.
[39] See, e.g., A Decline Without Parallel, The Economist, March 2, 2002. One of the points made by this article is that the while the crater that Argentina has created is novel for its depth, the situation is not new and the continuing concerns of countries like Thailand and even Japan are similar.
[41] Neuman and Medvisnky, supra.
[42] See, Law, et al., supra. There mathematical limitations on the number of times that a currency unit could be split if the electronic infrastructure is to remain manageable.
Macintosh, The Case for Private Currencies, at 758.


See, Macintosh, The Case for Private Currencies, at 750.

Id.

Neuman and Medvinsky, supra.

Cf. Miller, at 341.

Id.

Macintosh, The Case for Private Currencies, at 748.

Neuman and Medvinsky, supra.

Macintosh, The Case for Private Currencies, at 748.

Thus answering the components that Neuman and Medvinsky cite, supra.

This is currently the case with electronic transfers, Boss at 418.

See, Macintosh, The Case for Private Currencies, at 748.

Dessent, at 945; see also Boss, at 418.

Neuman and Medvinsky, supra.


Cova-Burns, supra.

Neuman and Medvinsky, supra.


Sommer, at 95.

Id.

Id.

Id.

Macintosh, The Case for Private Currencies, at 750.

Boss, at 418.

Macintosh, The Case for Private Currencies, at 758.

Uniform Money Services Act


Neuman and Medvinsky

Oedel, at 85.

Macintosh, The Case for Private Currencies, at 750.


836 F.Supp 422, (E.D. Mich) 1993,

Id.

Id.


Id.


Id.


[89] Id.
[91] Id.
[92] Id.
[93] Id.
[95] Id.
[96] Zagaris, at 1030.
[97] Id.
[100] Id.
[102] Id.
[103] Id.
[104] Id.
[105] Id.
[106] Id.
[107] Id.
[108] Id.
[109] Id.
[110] Id.
[111] Id.
[112] Id.
[113] Id.
[114] Id.
[115] Id.
[116] Id.
[117] Id.
[118] Id.
[119] Id.
[120] Id.
[121] Id.
[122] Id.
[123] Id.
[124] Id.
[125] Id.
[126] Id.
[127] Id.
[128] Id.
[129] Id.
[130] Id.
[131] Id.
[132] Id.
[133] Id.

The term “speculation” should be given an overly negative connotation. It should be understood as the individual’s answer to arbitrage.
Bolton, supra.


Tavakol, at 1199.

Badow, at 97.

Id.

Id.

Id.

Tavakol, at 1199.

Id.

Watson, at 821.

Badow, at 98.

Id.

Id.

Id.

Id.

Macintosh, The Case for Private Currencies, at 787.

Taylorsupra, see also, discussion of Argentina, supra.

See, discussion of purpose at http://www.federalreserve.gov/fomc

Badow, at 99.

Id.

Sommer, at 14.

Id.

Id.

The literature on jurisdiction is copious to say the least. A great compendium to start with is Achieving Legal and Business Order in Cyberspace: A Report on Global Jurisdiction Issues Created by the Internet, 55 Business Lawyer, August 2000, 1801. It includes the opinions of some guy named Perritt.

Macintosh, The Case for Private Currencies, at 756.

Id.

Id.

Id.

Tavakol, at 1199.

Id.

Id.

Watson, at 821.

Badow, at 98.

Id.

Id.

Id.

Id.

Macintosh, The Case for Private Currencies, at 750.

Id.

Macintosh, The Case for Private Currencies, at 770.

Id.


Id.


Id.

Badow, at 99.

The question of access is still an important and would limit the scope and effect to those with the means to access the internet or some other form of electronic commerce in the first place.

Macintosh, The Case for Private Currencies, at 743-744.

Id.

See, discussion of Argentina, supra.

Tavakol, at 1222.

Macintosh, The Case for Private Currencies, at 750.

Reuda, at 14.

One might consider the case of ATM fees and their increase as competition decreased between the services.

Reuda, at 14.


But see, Macintosh, Electronic Cash, at 216 where she discusses the concept of seinorage. The government does make a healthy profit on the issuance of currency.

Id.