CBO TESTIMONY

Statement of
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on
Creating a New One-Dollar Coin

before the
Subcommittee on Domestic and
International Monetary Policy
Committee on Banking and Financial Services
U.S. House of Representatives

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NOTICE

This statement is not available for public release until it is delivered at 9:30 a.m. (EDT), on Wednesday, May 3, 1995.

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Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to discuss the cost savings associated with the proposal to eliminate the one-dollar bill and replace it with a new one-dollar coin. In my statement, I will make three points:

- Savings to the government in production and processing costs from substituting the more durable dollar coin for the Federal Reserve dollar note would be on the order of $150 million per year when the change is completed.

- Conversion would also have a favorable effect on the budget deficit. The Congressional Budget Office (CBO) estimates that over the 1996-2000 period, budgetary savings would total $100 million as a direct result of reduced production and processing costs. In subsequent years, as the switch to coin nears completion, budgetary savings could exceed $200 million per year, even more than the government's saving on production and processing costs.

- Switching from one-dollar bills to one-dollar coins could also have secondary effects that could produce additional budgetary savings. Those effects are reflected in the interest costs on the government's debt and are not scorable under the Budget Enforcement Act (BEA). They would result only if the public was willing to hold a higher value

of coins than notes; for example, if the public was willing to hold two one-dollar coins for each one-dollar note formerly held.

COST SAVINGS TO THE GOVERNMENT

The total cost of producing and processing coins and currency could be reduced by substituting dollar coins for dollar notes because the long-run annual cost of a coin is lower than the corresponding cost of a note. A dollar coin would cost about 8 cents to produce, which is more than twice the 3.8 cents that it costs to produce a dollar note. The higher initial cost of the coin is more than offset, however, by its significantly longer useful life (30 years versus 1.5 years). In addition, the costs to the government of maintaining the quality and integrity of coins are lower than they are for notes, which must be inspected individually for fitness and counterfeits. By contrast, coins can be checked by weight.

One way of expressing the savings is to compare the average annual cost to the government of meeting the public's need for a dollar of coin or currency over the expected 30-year life of a coin. If the government meets that need by furnishing a note rather than a coin, it will have to produce 20 one-dollar notes over the 30-year period to replace continuously those that wear out in order to keep a single one-dollar note in circulation. Thus, the average annual production cost for notes is about 2.5

cents per dollar in circulation. If, by contrast, the government meets the public's need for one-dollar currency through coins, the average annual production cost is only 0.27 cents for each dollar in circulation. In addition, the higher processing cost of notes adds to the cost of keeping a dollar note in circulation. Thus, the government saves between 2 cents and 3 cents for each dollar coin that replaces a dollar note. That would add up to a savings of $120 million to $180 million a year if $6 billion in notes are replaced by an equal number of coins.

However, other factors could affect the total cost savings of replacing the one-dollar note. If the assessments of the General Accounting Office and Federal Reserve are correct that the transitional experience of other countries that have substituted coins for their equivalents of one-dollar notes is a bellwether for the United States, two coins may be needed to replace each dollar note. In addition, a more precise calculation of the savings to the government in production and processing costs in any particular future year requires a large number of assumptions and projections. Those include the projected year-by-year growth in the demand for dollar notes under current policy; the 30-year outlook for the cost of producing and handling notes and coins; the extent to which the costs of production and processing are variable over the long run; the speed at which the Mint's capacity for coin production can be increased; the rate at which the public will be willing to accept coins for notes; the increase in demand for other denominations of notes that will result from withdrawing the one-

dollar note; the effect of that change on the demand for other denominations of coin; and the appropriate discount rate for converting future costs to present values.

Both the Federal Reserve and the General Accounting Office have developed spreadsheet models of those cost processes. The Federal Reserve, for example, estimates that the steady-state savings to the government in production and processing costs from converting to a one-dollar coin would be $164 million per year (in constant 1994 dollars).

THE EFFECTS ON DEFICIT REDUCTION OF CONVERTING TO COINS

The reduction in the budget deficit that is scorable for BEA purposes is larger than the total savings to the government in production and processing costs for the 1996-2000 period. That difference arises because the reduction in the cost of producing and handling Federal Reserve Bank notes is reflected in the budget deficit, but the increase in the cost of producing coins is not.

The disparate treatment of the cost of notes and coins arises from a series of decisions by the 1967 President's Commission on Budget Concepts. The commission decided to exclude the Federal Reserve Banks from the budget and to count the payment to the government of Federal Reserve earnings as a governmental receipt--

that is, a federal revenue. Consequently, a reduction in the cost of producing and processing Federal Reserve notes is reflected in higher budget receipts. The cost of producing coins is reflected in the budget--as an outlay--but it is offset, dollar-for-dollar, by counting a portion of the value of the coinage produced as offsetting receipts on the budget.

Preliminary figures from the Mint indicate that $72 million over the 1996-2000 period would be required to make the change. That amount includes $21 million in new equipment, approximately $20 million for the Mint to carry out its one-time public awareness campaign, and $3.8 million for melting down the remaining Susan B. Anthony dollars. By established budget convention, those costs would be financed from the "profits," or seigniorage, that accrues to the government from the difference between the cost of producing coins and their exchange value. Thus, the added costs of producing coins would not affect net budget outlays or the reported deficit.

The scorable budgetary savings from substituting one-dollar coins for one-dollar notes is simply the Federal Reserve's lower cost from producing and processing a smaller volume of notes. The savings would be reflected in the increase in the Federal Reserve's net income that is paid to the federal government each year. Those reductions in Federal Reserve costs and the increased federal receipts are projected to total $100 million during the next five years. That estimate assumes a phaseout of dollar notes over a five year period (see Table 1).

TABLE 1. ESTIMATED BUDGETARY IMPACT FROM THE ONE-DOLLAR COIN
(By fiscal year, in millions of dollars)

	1996	1997	1998	1999	2000	Five-Year Total
Increased Federal Reserve Earnings (Revenues)	0	0	20	30	50	100
Increased U.S. Mint Costs (Outlays)	23	3	10	22	14	72
Increased Offsetting Receipts (Outlays)	-23	-3	-10	-22	-14	-72
Net Savings	0	0	20	30	50	100

SOURCE: Congressional Budget Office.

It is also worth noting that greater budgetary savings could be achieved over the five-year period if the Congress decided to shorten the phaseout period of one-dollar notes and prohibit their production from the date the new dollar coins are introduced.[1] However, given the lead time needed for the Mint to produce one-dollar coins and the fact that the Mint's annual production capacity is limited to 2 billion new coins, a rapid phaseout of dollar notes would almost certainly lead to shortages of

1. For example, the One Dollar Coin Act of 1995 (H.R. 534) would prohibit the Federal Reserve from ordering or placing into circulation any new one-dollar notes from the date that the new one-dollar coins are placed into circulation.

currency in one-dollar denominations, particularly if the assumption is accurate that two coins will be needed to replace each note.

OTHER POSSIBLE BUDGETARY EFFECTS

Some agencies, notably the General Accounting Office and the Federal Reserve, are projecting much larger budgetary savings to the government from substituting the one-dollar coin for the one-dollar note than is CBO. The source of those additional savings is an assumption that the public will choose to hold more than a single one-dollar coin for each one-dollar note that is withdrawn from circulation. Specifically, the Federal Reserve and the General Accounting Office assume that the public will choose to hold $9 billion in one-dollar coins and $1.5 billion in additional two-dollar notes instead of the $6 billion in one-dollar notes currently held. As a result, the public's total holding of coins and notes is assumed to increase by $4.5 billion.

That increase will permit the government to finance $4.5 billion of federal debt by issuing non-interest-bearing coins, rather than interest-bearing debt. At a 6 percent rate of interest, the federal government would save $270 million in interest a year by substituting $4.5 billion in Treasury coins for Treasury securities. With reduced interest costs in the first year, borrowing from the public would be lower in all subsequent years and the interest savings would snowball into an ever larger sum.

That assumption about cumulative interest savings explicitly presumes that lower debt-service costs would be reflected in lower deficits. CBO does not score those potential indirect effects because of the scoring convention of not counting debt-service costs or savings for specific legislative proposals. In addition, we regard those effects as far from assured.

The General Accounting Office and the Federal Reserve cite the experience of other countries that have converted a currency note to a coin to support their assumption that the replacement rate will be much higher than one-to-one. In the cases studied, a replacement rate of 1.6 to 4 coins for each note withdrawn was reported. Whether those estimates and the experience of other countries would be directly applicable to the experience of the United States in a transition to a one-dollar coin is uncertain. Further, an increase in demand for one denomination of coin may have an offsetting effect on the demand for other denominations of coin. At the same time, we do not deny that an increase in demand for coins could happen here. Explanations for high replacement rates of coins for notes include:

- The apparent cross-cultural practice of setting aside one's pockets full of coins, but retaining notes, when dressing and undressing;

- The tendency of coins, to a much greater extent than notes, to remain for long periods of time in vending machines awaiting collection where they are unavailable to meet public demand for coinage;

- A shortage of notes before the coins are introduced; and

- The weight of coins that raises their explicit and implicit transportation costs. Their heaviness tends to delay their movement--whether by commercial shipper or personal portage--relative to notes from places where they are in surplus to places where they are in demand. Delayed shipment translates into an increased demand for coins compared with the notes they replace.

Thus, it may be that the replacement rate of coins for notes will be greater than one-for-one. If so, it will increase the portion of federal obligations held by the public in non-interest-bearing form, thereby reducing net interest outlays and leading to further budgetary savings.

CONCLUSION

Although replacing the one-dollar note with a new-one dollar coin would clearly reduce the costs of producing and processing currency for the federal government, resulting in budgetary savings, other factors are worth taking into consideration before enacting any proposal. The importance of a convenient currency, an efficient payments system, and a coin that is well accepted by the public needs to be considered in an informed and reasoned decision to change our national system of currency.