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Statement by

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before the

Subcommittee on Historic Preservation and Coinage

Committee on Banking, Finance and Urban Affairs

House of Representatives

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I am pleased to present the views of the Board of Governors of the Federal Reserve System on H.R. 12444, a bill to change the size, weight and design of the one dollar coin, and for other purposes. The Federal Reserve believes that a new dollar coin should be issued, if it will result in a reduced demand for the one dollar note. As I will discuss in greater detail, a circulating dollar coin would result in significant cost savings to the Federal Reserve, potentially exceeding \$30 million each year. And, because Federal Reserve earnings in excess of costs are almost all returned to the Treasury, these Federal Reserve savings would be passed on to the Government. However, I also wish to stress the importance of taking whatever steps are necessary to ensure that the proposed new coin circulates freely, and reduces the demand for one dollar notes.

Since 1920, the Federal Reserve has borne a major responsibility for the exchange of currency and coin. In accordance with the Treasury operating circular 55, the Federal Reserve Banks supply commercial banks with currency and coin upon request, and also absorb excess currency and coin from commercial banks.

Circulated currency and coin flows from commercial banks to Federal Reserve Banks where it is verified and sorted. Reusable currency and coin are returned to ordering banks while mutilated or worn out currency is destroyed. Demand in excess of the fit money returned is met by shipment of new currency and new coin obtained from the Bureau of Engraving and Printing and the Bureau of the Mint. While the costs of

minting and shipping new coin to the Reserve Banks are paid by the Bureau of the Mint, the costs of printing and shipping new currency are paid by the Federal Reserve System.

The Federal Reserve spent \$48 million for the printing of new currency in Fiscal Year 1977. This cost represents roughly 7 percent of the total operating costs of the Federal Reserve System. Of that \$48 million, \$28 million were spent to print nearly 2 billion one dollar notes. Thus, if all these dollar notes were replaced by coins, the Federal Reserve would realize savings of \$28 million in printing costs.

Of course, one must consider the cost of producing the coins in determining the true savings to the Government. The costs of producing the new coin will be slightly higher than the costs of printing a note--roughly 3 cents for the coin, 1.8 cents for the note. Even so, because the new coin is expected to last so much longer than the one dollar note, we would still anticipate significant savings to the Government.

Most new one dollar notes are used to replace worn out notes. On the average, a new dollar note only lasts for 18 months before it is worn out and destroyed. On the other hand, the new dollar coin is expected to last for 15 years or more, a greater life expectancy by a factor of ten. Thus, while it costs \$28 million annually to maintain a circulation pool of 2.4 billion one dollar notes, replacing each note every 18 months, it would only cost \$5 million annually to maintain the same size pool of dollar coins--a savings to the Government of \$23 million each year. If coins only

replaced half the dollar notes, the savings in production costs would still amount to \$11 million.

In addition to the savings in printing costs, the Federal Reserve would also realize savings in lower handling costs for the coin, compared to the costs of handling notes. Currency is difficult to sort and verify, and the process for destroying unfit currency is particularly cumbersome and costly. Unfit notes are cut longitudinally, then the upper and lower halves are destroyed under separate controls. Our staff estimates the cost for processing 1,000 new coins at \$.51 compared to \$2.19 for processing 1,000 notes, including destruction costs. It is estimated that each dollar note is processed by the Federal Reserve an average of 1.13 times per year. Thus, if dollar coins replaced half the dollar notes, and if each coin were processed one time per year, the Federal Reserve would save an additional \$2 million, annually, in currency processing costs. Like the savings in production costs, those savings would grow as currency and coin volume increase.

The introduction of the proposed new coin might also impact the Federal Reserve in ways which we cannot quantify at this time. For example, the impact on shipping costs is unclear. Coin weighs more than currency but should not circulate through the Reserve Banks as often, due to its longer life. And, the as yet unknown circulation patterns for the new coin could affect Reserve Bank requirements for vault space, with a corresponding impact on our building programs. While we have no precise

estimates, we doubt that these effects would materially increase or decrease the estimated potential savings from a new, circulating coin.

However, all these projected savings are contingent upon the new dollar coin circulating and replacing dollar notes. If the proposed new coin is produced but fails to circulate, or circulates without reducing the pool of dollar notes, additional costs rather than savings will be incurred by the Federal Reserve, with a consequent reduction in payments to the Treasury. And, our recent experience with the reintroduction of the \$2 note indicates that circulation of the proposed new coin is not automatically ensured.

Several steps could be taken to aid the circulation of the new coin and thus replace dollar notes. These include a marketing program, a coordinated retail industry utilization effort, and a financial institution program to encourage use of the new coin. We hope that the public will accept and utilize the dollar coin and that the financial institutions and coin vending industry will effectively encourage this usage. However, if the voluntary programs do not achieve acceptable circulation increases within a year of introduction, then the program must be reconsidered.

Our experience with the \$2 bill would indicate that the retailing community will be the key to whether the new coin can circulate freely, without controlling production of one dollar notes. If retailers use the coin in making change, the coin will circulate. Moreover, our \$2 bill

experience suggests that retailers can be persuaded to use the new coin, particularly if the coin is advantageous to their operations and if that advantage is properly communicated.

Compared to the dollar note, the new coin would appear to offer several advantages to retailers. Coins do not stick together nor do they fold. Consequently, the new dollar coin should facilitate change-making. Perhaps more important, the new coin should be employable in the cashier machines that automatically dispense the coin portion of a customer's change. These machines are now effectively limited to dispensing amounts of less than one dollar. With a useable dollar coin, this limit would be raised, and the effectiveness of the machines should be increased significantly.

We believe it is vitally important that these potential advantages be investigated and fully communicated to the retailing community, if the proposed new coin is to succeed. If the proposed legislation is enacted, we would strongly urge the Treasury Department to undertake such a program, and will offer the cooperation and assistance of the Federal Reserve System in carrying out the effort.