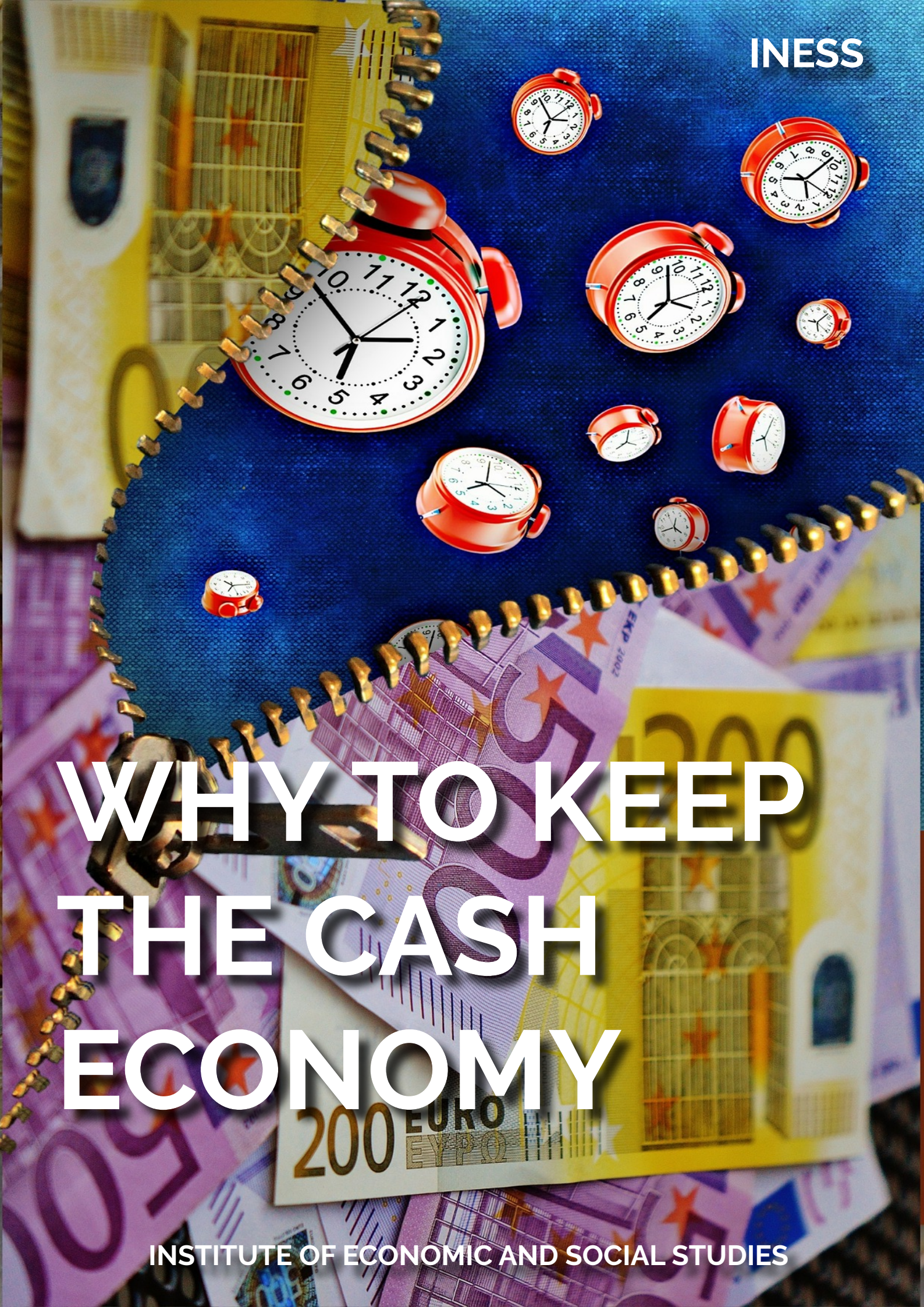




INESS

WHY TO KEEP THE CASH ECONOMY

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Cash has earned the label of obsolescence and high cost in the recent years. A modern economy is supposed to be a cashless economy. However, cash plays a number of important roles in the economy. Forcibly abandoning it can be a mistake.

Hard times are arising for cash all around the world. Several countries, especially in Europe, have introduced bans on the use of cash in transactions over a certain limit. The leader is Portugal, with a EUR 1,000 legal limit on all cash transactions. On the other hand, Germany, the biggest European economy, has not introduced any legal limits yet. But their politicians are musing about it.

A dozen countries out of the 28 EU members had legal limits on cash transactions in place at the end of 2015. Nevertheless, the discussion about introducing them is ongoing in almost all member states and recently, a new European Commission initiative seeking to introduce compulsory EU-wide limit appeared.

Meanwhile, the European Central Bank announced in the spring of 2016, that it will start phasing out the production of the 500 euro note. The reason? This note allegedly helps facilitate “illegal activities”. The note will remain valid and in circulation, but commercial banks will be replacing it with other notes.

US dollar 1,000 notes left the circulation in a similar fashion

half a century ago, remaining in the hands of collectors. Canada stopped producing the 1,000 dollar note some years ago. Singapore ceased printing the 10,000 dollar note (worth circa 7,000 US dollars!) two years ago. The last Mohicans are represented by Singaporean (and Brunei's, since the tiny country has its currency managed by Singapore) 1,000 note and of course the 1,000 Swiss franc note. Australia seriously started considering end of the 100 dollar note in November 2016. And many voices are heard from Sweden, that the country is getting ready to abandon cash altogether.

Respected financial portals are publishing cheering articles about the end of cash. Notable economists, like Kenneth Rogoff, Larry Summers or Bank of England's Andy Haldane, are supporting the idea. And of course, one or another of the payment processing companies is lurking behind the scenes, with some analysis about the tremendous economic savings potential of cashless economy ready at hand.

As the economist Bruce Yandle once noted, all bans seem to be promoted by a coalition of

two sides. One side he called “The Baptists” and the other “The Bootleggers”, quoting the historic Prohibition experience of unusual synergy between baptistic preachers and the liquor bootleggers. The first group pushes the ban, believing they are trying to make the world a better place. The second group uses the same language, but searches for a business advantage.

The stated reasons for abandoning cash are weak

In the public discussion, we can identify four basic reasons to ban cash. The order of importance of these four reasons is different in each country, depending on how deep are the targeted problems.

Crime fight. Cash transactions do not flow through financial institutions and are more difficult to follow. This makes life easier for terrorists, drug dealers, smugglers or illegal arms dealers. The dying 500 euro notes were sometimes even nicknamed “The Bin Ladens”. Common sense is strengthened by empirical research. A study conducted on data from 49 countries finds a strong correlation between bigger share of electronic payments and less crime in the country.

Kalle Kappner and Alexander Fink from IREF put these results in a different light. Less cash seems to reduce crime only in limited sectors of crime – pickpocketing, robbery, bank heists and similar. Impact on organized “high” crime seems to be limited. First, organized criminal networks are quite capable of utilizing the financial system. Second, criminals are good inventors and quickly find alternative means of payment. Starting with cigarettes (the cigarette economy was brilliantly described by economist and WW2 POW R.A.Radford), crude oil (remember ISIS?), gold or “blood” diamonds of African dictators and ending up with Amazon coupons, liquid detergents used by NY drug dealers or ramen noodles used in prisons. Booming cryptocurrencies make the transfer from cash economy yet easier for criminals. Does anyone consider Switzerland, with its 1000 Franc note, to be having a serious problem with crime?

The most dangerous crimes are often very cheap. For example, majority of the recent terrorist attacks in Europe costed less than EUR 10,000 each.

Suppressing shadow economy. The use of cash helps all plumbers, mechanists, taxi drivers and others to circumvent their tax and social security obligations, either using direct sale, or facilitating illegal employment.

Ban on cash can substantially reduce the shadow economy. Such a step would be clearly repressive. Shadow economy is the immune response to the restrictive economic policies and

can be targeted also preventively – by improving the economic conditions and lowering the motivation of taxpayers to operate in the shadow zone. In some cases, the shadow economy saves lives. Without it, the people in North Korea or Venezuela would be facing death by starvation. We had a saying during the socialistic era in (Czecho-) Slovakia: “If you are not stealing from the state, you are stealing from your family.” Without the shadow economy, it was almost impossible to buy digestible meat, furniture, decent clothing, and in some periods even toilet paper and sanitary napkins in the centrally planned economy.



There are marginalized groups in all countries, be it illegal migrants in the US, or the Roma minority in Slovakia. Many of their members are cut from the legal economy thanks to their missing skills, language, education, and cultural background. The shadow economy enables them to keep certain standard and build their lives. As noted also by

other authors, cashless economy sounds great to the ears of an Ivy League techno hipster, but can be a disaster for a slum-dweller.

The shadow economy facilitates the value creation in spaces, where the regulations do not keep pace, or where their costs are prohibitive. In Slovakia for example, there is no way for a young student to offer babysitting services for a few hours per week legally, and not to bear the substantial cost of operating a limited company or registered self-employed person. However, that does not mean that her (shadow) babysitting services do not create value for the society. Fighting the shadow economy with repressions like cash ban will lower the public administration motivation to target the primary causes which are catalyst for shadow economy – bureaucracy, high taxes and overregulation.

Monetary experiments. Some economists consider the opportunity to run monetary experiments in a cashless society to be an advantage. Some monetary tools, like negative nominal interest rates for non-institutional depositors, are infeasible with the cash option existing. However, I consider this option to have wider options in monetary manipulations not an advantage, but a disadvantage and will focus on it few paragraphs later in this text.

Lower transactions cost in the economy. Processing cash payments requires a certain cost. Starting from the cost of paper and printing machines, and ending up with safes, money transports and never-ending re-counting of amounts paid and received.

Yet, a simple look at the skyscrapers in financial districts and tens of thousands of bank employees suggests that the electronic payments generate some costs as well. I do not have to tell this to any vendor accepting card payments. An older study from 2012 compared the retail costs of both cash and electronic payments in six European countries. Electronic payments were cheaper than cash in only two of the six countries. European Commission regulation introduced official limits on card payment fees since then (pushing them from circa 0.8% to 0.2-0.3% of the transaction value), but the costs (and profit margins of card companies) did not disappear overnight. There are small shops, which do not accept card payments unless over a certain threshold, and others are trying to persuade customers to pay in cash by offering various bonuses (a practice often prohibited in their contracts with the payment processing companies). They do it because cash is cheaper for them.

Consumers do dozens of economic decisions every day, confronting value and cost of various products. Why should a central authority decide for them about the option they should use? Should you be forced to use diesel passenger cars, because they are more fuel-efficient and more cost-effective? Such a decision depends on how the consumer values multitude of variables like cost per mile, reliability, power, or image. Value and cost are not derived from some physical measurements, but are highly subjective. If electronic payments become less costly than cash in all life situations, so be it. Cash

will slowly disappear from our lives, like horse carts and top hats did.

But a simple look into our wallets suggests this is not happening yet – and it is not because consumers are too stupid to consider the cost of cash. It is because a complete abandonment of cash and transfer to electronic payments not only carries significant cost, but also significant risks.

Cashless society risks

The zealots of cashless society ridicule cash. I noticed a slogan in a Swedish source, going: “Cash is only for your grandma – and bank robbers”. An impression of a “race” is created. Being cashless is presented as being modern and progressive. You need an empty wallet to go with your Tesla, iPhone and neon handmade socks! But looking closer, the reasons to hold on to cash have nothing to do with backwardness.

Control. Transferring your whole financial life into a bank means parting with your own control over this aspect of life. A simple bureaucratic mistake, a typo or a confusion of identification numbers by a bank, or a judge, or a debt collector (not so unusual in Slovakia due to chaotic debt collection rules) can send you into deep financial problems overnight. It doesn't matter how rich you are or how big financial cushion you created. Locking your account takes seconds.

Middleman risks. Cash transfer is an immediate transfer of value between two parties. Electronic payments (with the exception of some cryptocurrencies) always involve a middleman and create a new layer of risk. The middleman

has the power to override the payment in some cases and you cannot be sure, if the transaction just conducted will really materialize. One of the examples is the PayPal fraud, when the buyer fraudulently triggers buyer protection despite receiving the goods. Both parties have to believe the middleman will not side with any of the parties.

Cushion against financial crisis and credit risk. In a cashless society, your money is hostage to the financial system. You never deposit money to your bank – you lend it. You are a creditor to your bank. Without cash, you do not have the option to exit the financial system and its risk at least with some part of your financial assets. Rows of desperate people in front of ATMs in Bulgaria, Greece and Cyprus during the recent years proved that a collapse of a single bank, or a whole banking system, is still an option even in developed countries. In Greece, having a stack of cash in company's safe often decided about the survival of business. Just a reminder, two years later, the “short term” capital controls are still in place (albeit relaxed) in Greece and depositors are forbidden to handle their financial assets freely. A complete banking collapse is not the only danger to consider. Even a collapse of a single bank can inhibit a value transfer between two solvent business partners.

Privacy. You entrust your privacy to the hands of others. Dubious government handling of private data on a large scale is a serious topic even in Western democracies. In countries from behind the Iron Curtain, the history of spying on its own

citizens is long and rich. Even today, it is not that unusual for the ruling politicians to pull any kind of private data collected by state agencies to discredit their political rival. Of course, privacy issues do not include the government exclusively. Private subjects have troubles handling data from time to time as well. Let's just name the Ashley Madison data breach, to make this text cheesier. Paying with card is like showing your ID. Your bank account statement is like your diary – it shows how and when do you commute, what hobbies your kids have and what cosmetics your wife uses. In a cashless society you have the right not to purchase, or all purchases can be used against you!

Monetary experiments.

There won't be any safe haven to hide in from monetary experiments. Millions in Venezuela use US dollar cash to protect themselves against the plight of hyperinflation. But we do not need to rely on the notorious examples of Venezuela, or Zimbabwe. The majority of central banks around the world engaged in unconventional monetary tools since the crisis – negative nominal interest rates for example. In cash society, (non-institutional) depositors have ultimate backstop against this policy: withdrawing their money from bank accounts and hiding them in their mattress. In a cashless society there is no escape. Do you want to spend, or save? That won't be up to you anymore but according to your central banker. The large internal disputes in ECB about the right policies do not offer much reassurance that the central

bankers actually really know what they are doing.

Taxes. We all pay them today. In a democracy, imposing a new tax, or a tax hike is always a painful step and costs political capital. Every politician has to think twice before doing so, in order not to compromise his or her career. With the shift towards cashless society, every value transaction can be turned into a subject of a tax. Tobin tax is just a light version. We are talking about taxing any movement – paying in store, sending money to your grandchildren, or to a savings account. It is not a hypothetical

to 0.971% - even when the fiscal impact may be the same. The Tobin tax, which slowly but surely spreads its wings in EU member state will be an ideal foundation stone.

Social, cultural and psychological impacts. Money in form of cash has been an integral part of human society for several millennia, in a fashion comparable to religion or art. One cannot expect to erase one part of the social puzzle and get easily predictable results. For example, a study by Cash Essentials states number of psychological and social effects of cash. Cash

helps some people to plan their financial life better and is a debt inhibitor. Handling small sums of coins and notes develops initial mathematical skills in children. Money is an important social bridge and one of the key steps in social inclusion. Imagine the millions of Syrian and Iraqi refugees, often without any formal identity, not to mention a bank account, coming to a cashless Europe. Hidden rolls of euros and dollars are often their only source

of power and influence over their own fate. Without cash, their ability to do any economic decisions would be reduced to zero. They would be completely reliable on outside help. Help, which we have seen to fail multitude of time during the recent years of migrant crisis.

Conclusion

We do not encourage you to hold all your assets in cash. Any form of value bears certain amount of risks, cash including. "Don't put



situation. Some years ago, one of the parliamentary parties in Slovakia (not a fringe one, but once a leader of two ruling coalitions for almost eight years) suggested to abandon all taxes and introduce only such an all-encompassing transaction tax. Transaction tax hikes are easier to disguise than income tax hikes, or VAT hikes, due to extremely low nominal rates. It is easy to make a lot of fuss about rising VAT rate from 15% to 20%, but who cares if the transaction tax rate will jump from 0.962%

all your eggs in one basket” is the best investment advice one can get in life. In many, or even majority of everyday situations, electronic money is safer, more comfortable and faster solution than cash. It is a vibrant world with revolutionary innovations unfolding in front of our eyes (take cryptocurrencies as an example). However, cash is one of the ways how to manage your privacy, economic strategy, and the risks in your financial life. Using cash is cumbersome and carries an irrefutable cost. But these costs should be compared to the benefits of cash and we should look also on the “tails” of the risk curve. Financial collapse, dictatorship, war – that’s when the benefits of cash become obvious. A forced expulsion of cash from our society means a transfer of a whole dimension of life to the third party – financial system and political authorities. Such a decision requires a large amount of trust and should not be accepted with ovations, but with a thorough criticism and public discussion.

LEGAL CASH TRANSFER LIMITS IN EUROPE (VALID OCTOBER 2015)		
COUNTRY	LIMIT	NOTE
Iceland	No limit	-
Norway	No limit	Co-responsibility for VAT when over ca EUR 1000 payment
Sweden	No limit	Business is not legally required to accept cash
Finland	No limit	Business can set cash limit
Denmark	No limit	Co-responsibility for VAT when over ca EUR 1,300 payment
United Kingdom	No limit	Business has to do one-time registration when accepting > EUR 15,000
Ireland	No limit	-
Germany	No limit	-
Netherlands	No limit	-
Cyprus	No limit	-
Luxembourg	No limit	-
Malta	No limit	-
Austria	No limit	-
Slovenia	No limit	-
Lithuania	No limit	-
Latvia	No limit	-
Estonia	No limit	-
Poland	EUR 15,000	
Croatia	EUR 15,000	-
Czech Republic	EUR 14,000	CZK 350,000 per day
Bulgaria	EUR 7,700	BGN 14,999
Slovakia	EUR 5,000	B2B or B2C transactions. Limit EUR 15,000 for transaction between two individuals
Hungary	EUR 5,000	HUF 15 million monthly
France	EUR 3,000	EUR 15,000 for non-residents
Belgium	EUR 3,000	Complete cash ban when transferring realties
Italy	EUR 2,999.99	Since 1.1.2016. Limit EUR 999.99 applied before this date.
Spain	EUR 2,500	EUR 15,000 for non-residents
Romania	EUR 2,260	RON 10,000 a day
Greece	EUR 1,500	-
Portugal	EUR 1,000	-

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