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Editorial

Cash, Crime and Tax

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Digital payments have become normal. We have grown accustomed to our 'virtual wallet' filled with plastic smart cards giving access to 'virtual money' and no doubt we will grow accustomed to paying by our smart phone. Yet, according to the European Central Bank, by the end of 2013 an amount of Euro (EUR) 934 billion (some 10% of the GDP in the Eurozone) circulated in physical currency. And mid-2015 the amount has even increased to more than EUR 1,000 billion.[1] Where interest on bank accounts comes nearer to nil, and fear exists that even negative interest may be charged, people tend to keeping more money in cash. But governments do not like cash: virtual money is traceable, notes and coins are anonymous.

Notes of EUR 50 and lower are widely accepted and they take about 45% of total cash value in circulation (peaking each year in December). In the UK the British Pound (GBP) 50 note is the highest denomination. In the Eurozone, however, there are three higher denominations. About 20% of the cash value is in EUR 100 notes, about 4% is in EUR 200 notes and about 30% is in notes of EUR 500. A regular customer would not put these high denominations in his physical wallet when he goes shopping, the more so as it would hardly be possible to find a shop that accepts these notes. For the criminal sector of the economy, however, they are an excellent anonymous means of payment.

The anonymous character of cash, says American economist Rogoff,[2] makes it a vehicle for facilitating tax evasion and illegal activities. He estimates that in most countries more than half of cash transactions by value are driven by the desire to hide something from the authorities' accounts, so abolishing physical currency would help governments to reduce the tax gap, fight crime and improve monetary policy. Chakravorti and Mazotta[3] refer to a report by the Internal Revenue Service of the USA (2006) in which is stated that:

> even assuming a small fraction, say 25%, of the current [US] tax gap was possible due to cash transactions, the value lost to public coffers from cash-related improper reporting would have been more than $100 billion.

Totally abolishing physical currency is a daring plan, the more so as it (still) plays an important, though not always decent role. On its journey though the economy, it behaves like a chameleon, permanently changing colours between white and black through various shades of grey. The handyman seldom carries a paying device to put your credit card into, most taxi drivers, cleaning ladies, babysitters and newsvendors accept cash only, and collectors for charity, organ grinders and beggars would be nowhere without cash, in particular coins. Small shops, bars and cafes more and more indicate their preference for electronic payment for safety reasons (less cash in the tilt), but they do not want to lose customers by rejecting notes or coins.

More serious and harmful is the role of cash as vehicle for facilitating hard criminal activities in the 'underground economy'. Drugs, stolen cars, and 'criminal services' are bought with anonymous cash. The same goes for weapons (from a simple hand gun to a Kalashnikov) other than those bought by private individuals with a license by the government. In the criminal scene, denomination notes higher than EUR 50 are favourite, and it might help the government in their fight against crime if these denominations are scrapped. Although it would not help to reduce 'business-to-consumer' supplies of (soft and hard) drugs that are paid in lower denomination notes.

Money is an abstraction based on trust. That goes for both virtual and physical money. In times of severe financial crises and staggering banks, people lose trust in virtual money and run to the cash points of the banks, as we have seen recently in Greece where the maximum amount that could be pulled out of 'the hole in the wall'

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1 *Source*: http://www.ecb.europa.eu/stats/euro/circulation/html/index.en.html.

2 Kenneth S. Rogoff, *Costs and Benefits to Phasing out Paper Currency*, NBER Working Paper 20126 (http://www.nber.org/papers/w20126). See also: *Leaving Dead Presidents in Peace,* The Economist, 20 Sep. 2014, http://www.economist.com/news/finance-and-economics/21618886-abolishing-notes-and-coins-would-bring-huge-economic-benefits-leaving-dead.

3 Bhaskar Chakravorti & Benjamin D. Mazzotta, *The Cost of Cash in the United States*, in *The Institute for Business in the Global Context (IBGC)*, 32 (Fletcher School at Tufts U. 2013).

had to be reduced to EUR 60. One may wonder what happens if a government would announce that cash (notes and coins, domestic and foreign) will no longer be a legal means of payment. Tax revenues might increase, but at what cost? Will it be possible to create a society that can exist without any sort of cash? Will the hard core of the criminal sector be converted to decent citizens with virtual wallets?

Further reducing the use of physical currency, step by step starting with scrapping the denominations of the Euro notes higher than EUR 50, together with a monetary policy of increasing interest rates on bank accounts may be a better scenario than bluntly trying to abolish cash as the root of all evil.