Wall Street Journal, September 25, 2017

Should We Move to a Mostly Cashless Society?

Reducing the supply of cash in the U.S. could help lower crime and make the Fed's job easier, but some worry about the impact on legal activities

Some experts see public-policy benefits to reducing the supply of cash. PHOTO: ISTOCKPHOTO/GETTY IMAGES

Sept. 24, 2017 10:07 p.m. ET

The role of cash in the U.S. economy is shrinking, thanks to technology that allows for so many other ways to pay for things.

American consumers used cash in 32% of all retail transactions in 2015, down from 40% in 2012, according to the Federal Reserve's most recent survey of payment choices.

Cash accounted for just 9% of the value of payments by consumers in 2015, down from 14% in 2012.

But it's one thing for consumers to choose to use less cash. It's another for governments to dramatically reduce its supply. Supporters say that would crimp criminal activity, among other benefits, because criminals rely so heavily on cash transactions.

But others worry that the impact on people who depend on cash for legal activities would be too high a price.

Kenneth S. Rogoff, the Thomas D. Cabot professor of public policy at Harvard University and former chief economist at the International Monetary Fund, argues in favor of scaling back the cash supply. James J. McAndrews, an economist and fellow at the Wharton Financial Institutions Center and former director of research at the Federal Reserve Bank of New York, says that would be a mistake.

MORE IN FUTURE OF FINANCE

YES: It Would Mean Less Crime and Greater Fed Flexibility

By Kenneth S. Rogoff

It is high time for governments in the U.S. and other countries with advanced economies to accelerate the move that has long been under way toward a smaller role for cash.

The payoff: reductions in crime and tax evasion, and greater flexibility for the Federal Reserve to stimulate the economy when necessary.

Although there are a number of approaches the U.S. government could take, an obvious and relatively benign way to start would be to gradually phase out large-denomination notes, of say $50 and above, over a period of five to seven years, after a period of study and public comment.

Let's look at where we are now. Currency use continues its long decline, thanks mainly to ever-improving alternatives including contactless payments and person-to-person payment networks such as Venmo.

Yet there are three dozen $100 bills in circulation for every man, woman and child in the U.S. If you don't have three dozen, or any, you're not alone. Only a fraction of the known supply of paper currency can be accounted for in surveys of consumer and business holdings. So where is all that missing cash? Most of it is in the underground economy, where it fuels criminal activity and business that goes untaxed.

In the underground economy, cash plays a big, well-established role for which there is no remotely perfect substitute in terms of liquidity and universal acceptance. That's why reducing the supply of cash, particularly large bills, would reduce crime and tax evasion.

Without any $50 or $100 bills available, why wouldn't criminals and tax evaders simply switch to smaller bills? Consider this: $1 million in $100 bills weighs 22 pounds; the same amount in $20s would weigh 110 pounds, and take up a large suitcase instead of a small briefcase, making transport more difficult. Criminals and tax evaders also need to hide their cash. If you just have $100,000 to hide, the size of the bills hardly matters. But for wholesale crime and tax evasion—which are rampant—it is a big deal.

The concern that an absence of large bills would compel organized crime to involve legitimate businesses in the use of false invoices and bogus checks to pay for criminal transactions is overblown. This might happen on a very small scale, but not to an extent that would come close to outweighing the larger beneficial effect on crime.

Another advantage of eliminating large bills would be the effect on monetary policy. The Federal Reserve should be able to implement negative nominal interest rates vastly more effectively in the absence of large bills, which could prove quite important as a stimulative tool in the next financial crisis.

The biggest obstacle to deeply negative interest rates is the concern that they would cause big institutional investors like insurers and pension funds to bail out of negative-rate Treasury bills and bonds and move that money into physical cash, to preserve its value. That cash hoarding would blunt the stimulative impact of the negative rates.

Getting rid of $50s and $100s would discourage such hoarding, because transporting, storing and protecting cash is costly. In general, it will be easier for the Fed to take steps to stem a run into cash if it has already become marginalized in legal use.

There are several problems with the alternative idea of raising the inflation target so that the resulting higher interest rates would give the Fed more room to lower rates in a crisis without going negative. Among the biggest: Ditching the Fed's longstanding commitment to low inflation would destabilize financial markets. Longer term, higher inflation would result in more frequent adjustment of prices and wages, lessening the impact of Fed policy throughout the cycle. Moreover, with the effects of cuts muted, the Fed would still quickly run out of ammunition in a crisis. And yes, inflated $100s would become more like smaller bills over time, but that would simply spark calls for printing larger denominations.

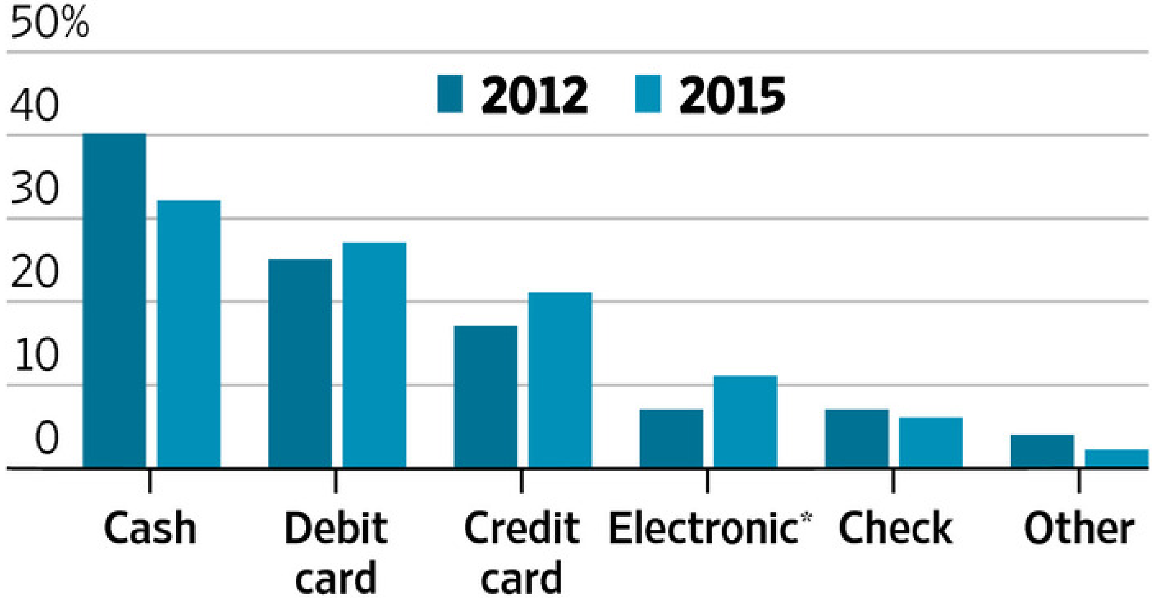
The phasing out of large bills should have relatively little impact on the vast bulk of the population, who make little use of $100s. For those who rely on cash because they don't have bank accounts, efforts to bring them into the banking system would help. If countries ranging from Sweden to India can efficiently provide free debit accounts to low-income individuals, so too can the U.S.

Abandoning cash entirely would be folly into the foreseeable future, for reasons of privacy, the need for cash in the wake of disasters like hurricanes, and the convenience of cash for small payments. But a society that uses far less cash is inevitable and desirable.

Dr. Rogoff is the Thomas D. Cabot professor of public policy at Harvard University, former chief economist at the International Monetary Fund and co-author of "The Curse of Cash: How Large-Denomination Notes Aid Crime and Tax Evasion and Constrain Monetary Policy." He can be reached at reports@wsj.com.

Cash Is King...for Now

Cash was the most frequently used form of payment for retail transactions in the Fed's latest report, but its share declined. Transactions by payment type:



*Such as ACH transfers and online bill pay

Where It Goes

Share of cash transactions by category

Food and personal-care supplies	52%
Auto and vehicle related	16
Gifts and transfers to people	11
General merchandise	9
Entertainment and transportation	4
Medical, education, personal services	3
Government and nonprofit	3

NO: It Would Hurt All Those Without Bank Accounts

By James J. McAndrews

The U.S. won't become mostly cashless anytime soon, and that is a good thing, because millions of Americans depend on cash to keep themselves afloat financially.

As alternatives ranging from debit and credit cards to E-ZPass and others continue to grow in popularity, many consumers can lead a mostly cashless life if they so wish without facing too many inconveniences.

Others aren't so lucky. According to the 2013 U.S. Survey of Consumer Finance, about 7.5% of American households don't have bank accounts. Cash is an important way for them to participate in the economy—to receive wages and to buy goods from a variety of sellers. Until the U.S. has a financial system that serves these people, cash is vital.

But what if we just phased out \$50 and \$100 bills? Would that harm these people? It would at least make life more difficult for them, and others. And, while it might help reduce certain types of crime and tax evasion because of the reliance of much criminal underground activity on large-denomination bills, It would fuel a different kind of crime: It would draw many legitimate businesses into criminal activity, because organized crime would forcibly involve them in noncash criminal transactions to get around the absence of large bills.

Surveys that reveal most people hold very little cash don't reflect the urgent demands for high-denomination bills that many people have on occasion. For example, people seeking medical procedures that they want to keep secret; the immigrant day laborer who sends cash to family in his home country; the wealthy suburban homeowner in Houston after Hurricane Harvey who seeks to assist neighbors and restore her property.

These uses of high-denomination currency are extremely high-value to the individual and society. We would lose a lot if we eliminated the bills that can meet these urgent, and sometimes desperate, needs. Then there are the everyday uses of large bills. Day laborers, for instance, are paid in cash and pay their rent the same way.

Legitimate businesses, meanwhile, would be put at risk. Here's how: Imagine a thief has stolen a valuable collection of art and has arranged to sell it to the mafia. Today, the mob could pay the thief in $100 bills and there would be no record of the transaction. But in the absence of large bills, the mob needs another payment option that still obscures its involvement, and one way to do that is to draw in a third party through the use of fraudulent invoices.

The mob would force a legitimate business to write a check to the thief, disguised as a payment for an invoice from a nonexistent company for services that were never actually rendered. The legitimate business wouldn't lose that money—the mob would deposit that amount in the business's account, disguised as a payment for goods or services. But the business would be guilty of criminal activity that could ultimately destroy it.

The mob can force companies to do this by threatening violence, or by threatening to expose a company's noncompliance with zoning laws or employment of undocumented workers. There are other ways for the mafia to deal with an absence of large bills, but I believe this scenario would be common.

There is a way to achieve the results promised by phasing out large bills—disrupting criminal activity and giving the Fed more leeway in its interest-rate policy—without also abruptly disrupting legitimate economic activity and creating unwilling new criminals: Raise the inflation target.

A higher inflation target would be followed, over time, by a higher inflation rate, which would be accompanied by higher nominal interest rates. That would give the Fed more room to cut interest rates without having to resort to negative nominal rates, removing the danger of negative rates causing a widespread run to cash.

A higher inflation rate also would mean the real values of $50 and $100 bills would decline more quickly—meaning criminal activity would be disrupted by the need to transport, store and exchange many more bills. Of course, this also would impose that same inconvenience on the legitimate uses of large bills. But while a higher inflation rate would accelerate the need for more bills to complete transactions, that would still happen over a much longer time frame than the phaseout of large bills envisioned in this discussion, giving people much more time to adjust.

Whether we achieve a mostly cashless society sooner or later should be left to technological advancement. As all the uses of cash can be met in better ways, people will adopt those alternatives over time; to rush adoption of inferior alternatives would be a mistake.

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Appeared in the September 25, 2017, print edition.