

Magazine

# Should We Trash Cash?

On Money

By JOHN LANCHESTER    JAN. 10, 2017

Two months ago, the world's largest democracy embarked on one of the biggest monetary experiments the world has ever seen. On Nov. 8, without warning or preamble, without discussion papers or leaks, Narendra Modi's Indian government invalidated most of the country's cash. The 500- and 1,000-rupee notes — India's two highest-denomination bills, then worth around \$7.50 and \$15, respectively — were, as of that moment, no longer legal tender. Anyone in possession of these notes had until Dec. 30 to take them to a bank and either deposit them or exchange them for other notes. Anyone presenting more than 250,000 rupees in cash (\$3,700) had to provide an explanation for why he had so much, and proof that he had paid tax on it; the penalty for unpaid tax was to cough up 200 percent of the amount owed.

The two retired notes represented 86 percent, by value, of all the cash in circulation in India. To see what a big deal this is, you have to appreciate the nature of the Indian economy. Many Westerners have become so used to discussing China as the most populous country in the world, with 1.357 billion inhabitants, that they forget India is just behind it, with 1.252 billion. Of that total, only 12 million pay income tax. That's an astonishing number: 99 percent of Indians don't pay tax. The majority of Indians work in what economists call the "informal" or "unorganized" economy, which runs overwhelmingly on cash.

The short-term result of Modi's move has been, unsurprisingly, chaos: huge lines at A.T.M.s and banks, farmers unable to buy seeds to plant crops, weddings

and property transactions canceled, piles of illicit cash shredded or burned. Some workers have been forced to choose between earning a day's pay or spending the same day waiting to deposit money in a bank. Many of the poor don't have bank accounts at all. (This despite an admirable push for financial inclusion on the part of the Indian government, which led to 175 million new bank accounts between 2011 and 2014.) The government has brought out a new 500-rupee note and a new denomination, a 2,000-rupee note, but there isn't nearly enough of the new cash to replace the old, nor will there be anytime soon.

From the outside, you have to wonder what on earth would make it desirable to undertake an experiment of this scale and apparent recklessness. As it turns out, there are good reasons for having doubts about the way cash works in the contemporary economy. In a brilliant and lucid new book, "The Curse of Cash," the Harvard economist Kenneth Rogoff gives a fascinating and thorough account of the argument against cash. There are two main pillars to it. The first and more wonkish concerns something called the "zero lower bound." Because official interest rates can't be set below zero — if they were, people would just hold cash instead — the tool kit of monetary policy has a built-in limit. This might sound like a small point, but as Rogoff explains, "the zero bound has essentially crippled monetary policy across the advanced world for much of the past eight years." Governments want to get money moving in the economy, but in a world awash in paper currency, monetary policy can do nothing further to help. If central banks could go below the zero bound, as a cashless economy would allow, they could in effect force people to spend their money and thereby kick-start the economy.

The zero bound, however, is not the issue in India. There, the main focus is the second big argument against cash: that far too much of it is involved in crime. Think for a moment about how much actual physical cash you have. I'm willing to bet you're a long way below the per-capita amount of dollars in circulation in the United States: \$4,200 for every man, woman and child in the country. Eighty percent of that is in the form of \$100 bills, which many Americans hardly ever see. Where is all this money? The short and very disconcerting answer is that, in Rogoff's words, "treasuries and central banks simply do not know" where this money is.

Among students of the subject, the assumption is that this cash is overwhelmingly used for activities that evade tax but are otherwise legal (for instance, paying workers, from builders to babysitters, off the books) but also for outright crime. The “underreporting of business income by individuals who conduct a significant share of their transactions in cash” is, Rogoff reports, the single biggest contributor to the “tax gap,” the approximately \$500 billion annual difference between federal tax voluntarily paid and tax due. The numbers for untaxed criminal transactions are huge, too. One example: Business in the United States for the four main drugs — heroin, cocaine, marijuana and methamphetamine — is worth \$100 billion a year, almost all of it carried out in cash.

A million dollars in \$100 bills weighs 22 pounds and can fit in a shopping bag. Imagine that a proposal to phase out high-denomination notes was implemented in the United States. If the highest-denomination note were \$10, that million bucks would weigh 10 times more, take up 10 times as much space and be a lot harder to hide — and how many legal activities would be disadvantaged as a result? This is why Modi went after cash: The idea was to crack down on what he calls “black money,” a term encompassing tax evasion and all forms of crime up to and including the use of counterfeit currency to fund terrorism. By the end of 2016, Indians with serious “black money” (including counterfeit versions of the old bills) had no choice except to either trash it or take it to a bank and explain how they earned it.

This Indian experiment is far from over yet, and the initial chaos may well yield to an outcome that feels as if it was worth the trouble. As of late December, it was estimated that nearly 15 trillion rupees had been deposited in banks, out of a total 15.4 trillion rupees outstanding, meaning that 97 percent of the relevant cash was now legal and in the system, an outcome that no doubt exceeds the government’s expectation.

I wonder, though, about the wisdom of the anti-cash crusade. The problem with the argument is that it concedes too much power to the modern triple-headed monster of the economy — the state, the central bank and the banking system. If there is no cash, there is nowhere for the private citizen to hide any assets at all, not just for criminal reasons but simply for financial security. The year 2008 was a reminder of how fragile our banking system is and how all-encompassing financial

crisis can be. Merryn Somerset Webb, editor of the financial-advice magazine MoneyWeek, has argued that one of the best things an individual can do, with banks fragile and interest rates low, is buy a good safe and fill it with cash. I have no desire to do that myself, but it is reassuring to know that if I wanted to, I could.

The rich have many ways of hiding assets and making them safe from states and from the taxman. As we've recently been reminded, some very rich people don't pay any income tax at all. Cash is one of the few ways in which ordinary citizens can enjoy a tiny taste of the freedom, privacy and security that the rich take as their due. That, for me, is what's missing in the critique of cash. If there were to be a big, convincing, systemwide drive to tax the hidden assets of the rich, to drag them inside the same norms that constrain the rest of us, to make it clear that we are all playing by the same rules — well, then maybe we can start to talk about abolishing cash. Until then, we would do well to bear in mind a favorite line of the pro-cash lobby, Dostoyevsky's observation from a czarist prison: "Money," he wrote, "is coined liberty."

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A version of this article appears in print on January 15, 2017, on Page MM18 of the Sunday Magazine with the headline: Many economists would like to abolish cash, which enables tax avoidance and crime. But would a cashless world be a fairer one?.

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