Book Review: A maldição do dinheiro (The Curse of Cash)

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By Kenneth Rogoff
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The purpose of this book is clear: to convince the reader that the circulation of paper money should be drastically reduced – if not completely eliminated. Rogoff divides the book into three parts, each with a certain type of argumentation in defence of his thesis.

In Part I, Rogoff argues that if paper money, or at least large-denomination currency, is banished, this will significantly increase tax revenues and criminals will find it harder to pursue their activities

In Part II, the author elaborates on negative interest rates, starting by analysing the historical experience with the zero limit, and how central banks have attempted to mitigate the problem. Following this, he presents proposals to deal with the zero limit which are, naturally, not tested empirically. Finally, he explores how to achieve negative interest rates without the need to phase out money and discusses how to mitigate the risks and concerns associated with this solution.

In the less-developed Part III, the author explores the international dimensions of the progressive elimination of paper money and discusses digital coins.

After the introduction, where the author once again places all the cards on the table, Rogoff devotes the second chapter to the history of coins and paper money. He relates to the reader the history of the commodity currencies used in different regions and talks about the first metallic coins in Lydia (modern Turkey). He stresses the leading role of China in the introduction of paper money, which it has used for centuries, before being abandoned by 1,500 and goes on to explain how paper money started to be used in Europe and in the USA and how the western world went from the Gold Standard to pure fiat money. All along the chapter, the author points out that money has a dynamic history – which should make us

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accept that paper currency is not its definite form – and that two things have repeatedly been responsible for giving rise to credibility issues which are related with the use of money, namely, counterfeiting and excessive issuance.

The next two chapters provide some impressing statistical information about the amounts of paper money in circulation. Despite the proliferation of new alternative payment mechanisms, the global values of cash in circulation as a share of GDP and also per capita keep on increasing. Furthermore, the proportion of this currency that corresponds to large notes is amazingly large in many countries For example, more than 90% of euros in circulation were issued in notes of 50 euros or larger, and about 80% of dollars in circulation are in notes of $100. Additionally, surveys indicate that consumers hold only a small proportion of cash in circulation. In the USA, about 40% of all transactions use cash, although this represents only about 14% of the value of transactions, which shows the predominance of small transactions. Therefore, if it is not the average consumer that holds all this cash and all these large notes, who does? Estimates for the USA in the 90's indicate that firms held about 2% of the outstanding cash in their cash registers, with banks holding about 5% of the currency in circulation – most of it in required reserves. Rogoff thus concludes that the large notes must be mostly in the hands of the underground economy.

In Chapter 5, the list of illicit uses of cash is detailed, such as: tax evasion, corruption, human trafficking, exploitation of immigrants and illegal immigration, terrorism and counterfeiting. Some numbers are presented to provide an idea of the scale of cash supposedly used in each type of illegal activity. Although it is acknowledged that the elimination of cash will not put an end to crime, and that criminal organisations will find a way to circumvent this obstacle, the author argues that the loss of the ability to trade anonymously, in real-time, with low transaction costs, through cash, will at least cause some reduction in crime – which will certainly benefit society. The emphasis is placed on the benefits of reducing tax evasion, largely on account of its large magnitude. The benefits arise from the increase in fiscal revenues and from the improvement in horizontal equity and in efficiency. Tax evasion is responsible for inefficient distortions when it increases the profitability of sectors which do not compare favourably with other sectors in terms of pre-tax returns.

After defending that there are significant benefits from eliminating cash, or at least from eliminating large notes, the author recognises that this would implicate costs. Nevertheless, the costs are minimal when compared to the benefits. Chapter 6 is devoted to what seems to be the strongest reason for opposing the elimination of cash: seigniorage. The cost of printing a $100 bill is 12.3 cents, which means that the Federal Reserve can buy assets worth $100, while spending just 12.3 cents. Letting go of this source of revenue could even endanger central banks' independence. However, the elimination of cash does not necessarily mean the end of seignorage revenue. For seignorage also arises from the creation of electronic bank reserves – and these would become more important in an economy with less cash. These profits amount to the difference between the interest the central bank earns on its assets and the interest paid to banks.

During the phasing out of paper currency, the central bank has had to purchase it back by issuing interest-bearing debt. This interest corresponds to a cost, although these costs are negligible, at the current low level of real interest rates.

The last chapter of Part I suggests a plan for phasing out paper money by replacing small notes with coins, as a measure to discourage the transportation of large quantities. We would not say that we consider this to be a detailed plan, which is ready for implementation, as, after all, it has to be adapted to the actual context. It should thus be seen more as a series

of principles that should guide the process. The author also uses this chapter to examine the other costs of his proposed measure.

The transition should be gradual, to give people and institutions time to adapt. Ten to fifteen years are suggested. Furthermore, foreign central banks would need to cooperate, to assist those who needed to repatriate cash, but were abroad at the time. The elimination of cash is not recommended for less-advanced economies with undeveloped financial systems. Accordingly, in the more advanced economies, special attention needs to be given to poor people, who could possibly not possess bank accounts or smartphones, and who thus could otherwise become excluded from society. These individuals should be given free access to banking accounts and possibly to basic smartphones.

The loss of privacy, which is potentially the main argument of those that oppose the ideas of this book, is discussed in this chapter. As every operation is registered, in the absence of cash, anonymous transactions would not be possible anymore. Rogoff admits that this is a sensitive issue but argues that nowadays, people do not really have privacy anymore – with the use of GPS, cell phones and with the creation of huge databases. He gives the impression that privacy is an outdated concept. Let us not be naïve and expect that regulation will be sufficient to entirely protect citizen's privacy, for it is not to be expected that authorities will create a system that allows privacy without keeping the privilege of accessing it. Accordingly, information about transactions would be treated the same way that information about taxes is already treated nowadays. Even so, small denomination currency in circulation would enable privacy in modest person-to-person transactions.

Other serious concerns about relying on electronic money is the possibility of a system breakdown, or of being prey to a cyberattack. On the one hand, the author reminds us that already nowadays, people in advanced economies tend to hold only small values of cash and that physical money can also be stolen. On the other hand, cyber security technology is always evolving. Thus the existence of problems that are not yet anticipated is, in effect, just a reason to go slow.

To understand Part II, it is necessary to examine the background. In the 1970s and 1980s, high inflation rates, especially in the USA and Japan – but also everywhere, led to the adoption of restrictive policies that had a negative impact on the economy. We are currently faced with extremely low inflation rates, and the main challenge for central banks is to maintain expectations that inflation will not rise, but in parallel, to also convince the market that they are not fundamentalist supporters of low inflation. Low inflation rates equate to equally low nominal interest rates, and when these are very near to zero, a liquidity trap occurs and the margin for central banks to lower interest rates becomes extremely low. This means that the effectiveness of the monetary policy is compromised. Another reason why the zero limit is a problem, is that real interest rates have fallen so much that they have assumed zero, or even negative values in the short term. This is as a result of the following:

- an excess of global savings;
- the increase of risk aversion resulting from the 2008 crisis; and
- slower economic growth.

The zero limit makes conventional monetary policy ineffective in the fight against the occurrence of recessions. To deal with this scenario, traditionally central banks used unconventional monetary policy measures, namely, future guidance and quantitative easing. In the case of future guidance, the basic idea is that by not being able to reduce the nominal interest rate to the zero limit, the central bank can try to reduce the real interest rate

by managing inflation expectations. Central banks should inform the markets that, in the short term, they are unable to reduce interest rates below zero, thus making it impossible for firms to benefit from lower financing costs. However, central banks can then undertake to increase them in the future, but not so much as projections for output and inflation may imply. When it works, this tool manages to lower the real interest rate, even when the nominal interest rate is locked at zero. For this to occur, it is essential that central banks have credibility. Quantitative easing involves the use of short-term central bank debt to buy long-term assets, such as government bonds, which thus lowers long-term rates, in the hope that the other rates will follow the same path. The author argues that although these measures have some effectiveness, they are less effective than the alternative of falling below the zero limit. In this sense, the author proposes two ideas to mitigate the problem of the zero limit. The first is that central banks increase inflation rate targets, that the interest rate is maintained at a higher level, thus creating room for setting lower interest rates during recessions and the implementation of institutional and legal reforms alongside the elimination of paper money.

Chapter 9 presents solutions to alleviate the zero limit, namely,

- increase the inflation target from 2% to 4%, which would give central banks more leeway, before reaching the zero limit;
- increase nominal GDP targets, for if GDP is below the long-term trend, then monetary policy can promote inflation to compensate for lower real growth;
- soften rigidity in setting inflation targets. If temporary targets had been allowed at the beginning of the financial crisis, together with the initial fiscal impulse, then the liquidity trap could have been avoided. Higher inflation would stimulate demand, via lower real rates;
- the possibility of distributing money directly to people, particularly those with low income, who are more likely to consume; and
- use taxes to raise prices.

In particular, it is recommended to increase VAT and reduce IRS, thus guaranteeing fiscal neutrality. However, this solution would have the problem that these taxes affect different groups differently, and the redistributive power of fiscal policy may be called into question. The first three proposals are not new, and the last two are in the sphere of fiscal policy and not so much in the scope of monetary policy.

In Chapter 10, the author discusses three ideas of how to obtain negative interest rates, without eliminating paper money:

- Firstly, he argues that central banks should only enter slightly into negative rates, so as not to trigger a run on deposits and their subsequent conversion into cash. Such a run would limit the effectiveness of monetary policy as a result of raising money out of the system, and would not allow borrowers to enjoy low interest rates. However, this risk is limited by the fact that it is expensive to store money, as economic agents would accept negative rates up to a certain limit.
- A second idea is to charge small periodic taxes on the money that individuals possess. This would create stamp money, which would periodically obliged holders of paper currency to buy stamps and stick them on the back of the paper/currency to maintain their face value. This is equivalent to having negative interest on paper money.

- The third idea has to do with the creation of a double currency model, money and bank reserves – imposing a conversion rate between them, which could differ from one if monetary policy was to enter into negative rates.

The central bank would then manage this conversion rate. As the author points out, these are not new ideas, and the first option has already been carried out by Sweden, Switzerland, Japan and some European Union countries. These countries countered weak product growth by allowing interest rates to take negative values (+/–0.75%). However, in the context of negative reserve remuneration rates, the banks then pass them on to customers, for example, through increases in the cost of banking services.

In Chapter 11, the author explores some of the disadvantages of negative interest rates, including:

- The fact that the negative rate is a recent policy measure, may conceal less positive effects which are yet unidentifiable.
- It may have an impact on financial stability, particularly in the case of a continuous increase in the price of assets – which could lead to the creation of bubbles in the financial markets, with inherent risks for the whole system and an increase in private debt which negative interest rates can propitiate.
- It may bring about technical problems related to the fact that IT systems are not prepared to operate at negative interest rates.

However, the author does not see these arguments as being sufficient to block the adoption of a monetary policy which takes interest rates into negative ground.

The author ends this part of his book by discussing the issue that negative interest rates represent a departure from rule-based monetary policy. The author argues, with common sense, that the ideal monetary system must balance flexibility and compromise and that there is no incompatibility with the existence of rules. If we want to assess the extent to which this paradigm change in monetary policy implies the author's perspective, it is sufficient to observe the way his reflections end, arguing that the change of the world to negative rates would be comparable to the abandoning of the gold standard in the 1930s, or the fixed exchange rates of the 1970s, or even the advent of independent central banks in the 1980s and 1990s.

Finally, Part III addresses the international dimension of the disposal of paper money and the implications of digital coins. The most relevant aspect of his analysis is the author's conviction that none of these questions invalidates the main argument of Part II of his book.

Chapter 13 focuses on the discussion of various aspects related to the elimination of paper money. The author begins by stating that if national currency were eliminated, then the foreign notes would not replace the national ones, as it would be very difficult to use other currencies in the formal national economy. Nevertheless, countries should lift barriers to the movement of foreign currency between countries, for knowing that high-value bills are often used in illicit activities, withdrawing them from circulation would reduce the practice of these activities. In addition, banks are now obliged to report to the treasury large withdrawals and large deposits of money, which also contributes to limiting criminal activities. Withdrawing banknotes from circulation would potentially bring higher tax revenues, as it would reduce the parallel economy, particularly in emerging markets. However, on the other hand, if the elimination of paper money in developed economies does not seem to bring great constraints, this is no longer the case for emerging markets, as the level of banking is very low in these countries, and the existence of the informal economy is very associated with the fact

that a significant part of the population does not have the skills to work in the formal economy. Nevertheless, the author recommends the elimination of larger notes. The author ends up defending the need for international coordination of monetary policy when the zero limit is exceeded, for there are asymmetric consequences if some central banks break the zero limit, and if others fail to do so. The existence of negative rates, together with the elimination of money would lead to an increase in demand although the subsequent devaluation of the currency would bias the increase in global demand for the benefit of the country that adopted this policy, against those who did not adopt it.

Finally, Chapter 14 focusses on the concern regarding the effectiveness of monetary policy, as digital currency can operate outside the system. In any case, the author notes that governments have the power to create rules that limit the effects of these currencies and that some countries have already begun to regulate them. The author concludes that the advent of the digital currency does not change his conclusion. Digital currencies will have implications for financial technology in the future, raising regulatory issues, but they are not central to the argument for reducing the amount of paper money in circulation.

In conclusion, the author affirms that combating tax evasion and crime is a serious enough motive for eliminating cash, and that although there are many questions and objections, the argument for negative interest rate policies is also strong. If central banks can adopt this policy, they will then have more leeway to withdraw the economy from the deflationary spiral and counter the effects of credit contraction after a financial crisis.

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