Cash ban and the black economy myth

According to the government's Black Economy Taskforce, a restriction on cash is needed to curb the black economy. Such a conclusion is farcical in view of the evidence: A 2018 report, "Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?", by Leandro Medina and Friedrich Schneider, clearly shows there is no correlation between cash use and the black economy. Switzerland, the United States, Austria, and Japan rank among the smallest black economies worldwide, yet these nations have no cash restrictions. European countries with the most severe cash restrictions, including Italy, Spain, and France, have larger black economies than does Australia. (See chart, based on Medina and Schneider's 2017 data.)

Medina and Schneider used the Multiple Indicators Multiple Causes (MIMIC) method of statistical analysis to identify black economies in 158 countries, which explicitly considers several causes, as well as the multiple effects, of the informal economy. They define the shadow economy (a.k.a. black, grey, or hidden economy) as the economy which includes all activities hidden from official authorities for various reasons: "This varies from being monetary, to regulatory, to institutional reasons. Monetary reasons include avoiding paying taxes and all social security contributions, regulatory reasons include avoiding governmental bureaucracy or the burden of [the] regulatory framework, while institutional reasons include corruption law, quality of political institutions and weak rule of law."

Given the nature of the black economy, Medina and Schneider used a night lights intensity approach which best measures changes in economic activity in a given economy that otherwise go unreported. The night lights approach (also used in 2012 by Henderson, Storeygard, and Weil in "Measuring Economic Growth from Outer Space") makes use of light intensity from outer space as a proxy for the "true" economic growth. Several US Air Force weather satellites circle the earth, recording the intensity of Earth-based lights. These satellites observe every location on the planet every night at some instant between 8:30 and 10:00 PM local time. The consumption of nearly all goods in the evening requires lights and in general there's a strong relationship to an increase in light intensity at night and GDP growth.

Medina and Schneider concluded an overall "declining size and development of the shadow economy from 1991 to 2015. The continuous decline is only interrupted in the year 2008 due to the world economic crisis." Notably, Australia's black economy significantly declined too. In 1991 it measured 15.69 per cent of GDP; in 2015 it had nearly halved, to 8.10 per cent! So why the rush to ban cash?

Switzerland

Medina and Schneider ranked Switzerland as number one, i.e. having the smallest black economy. From 1991 to 2015 the black economy amounted to 7.24 per cent of GDP. Interestingly the Swiss National Bank reports "banknote circulation has risen drastically in terms of value since the SNB started business in 1907". From the end of 1907 to the end of 2018, nominal banknote circulation of the Swiss franc increased by 88,761 per cent. "Since 2008, cash has regained its significance as a store of value", reports the SNB on its website. "The persistently low level of interest rates is a major factor in the rise in demand for banknotes. In addition, the financial market and sovereign debt crises have helped to render cash holdings more attractive."

United States

Ranking at number two, the USA also has a big cash economy. There is now over $1.7 trillion of US currency in circulation, up from around $900 billion a decade ago. Data from the Federal Reserve's Diary of Consumer Payment Choice shows that cash remains the most frequently used payment instrument accounting for 31 per cent of all consumer transactions.

Austria

Ranking at number three, Austria has a massive cash economy as the Oesterreichische Nationalbank (OeNB), the central bank of Austria, makes clear on its website: "While card ownership has steadily augmented since 1996, most Austrians still clearly prefer cash: Cash payments accounted for 82 per cent of all transactions and 65 per cent of the total transaction value according to the 2011 survey. … Remarkably, the 2011 survey indicates that cash was still used for about one-half of all payments exceeding €100." ATMs in Austria rarely charge on-site withdrawal fees as is common in many other countries.

Japan

Ranking at number four, Japan is well-known for its extensive use of cash, having the highest cash to GDP ratio among all major economies of the world. Four out of five purchases are still made with cash.

Italy, Spain, France et al.

By contrast, several nations with punitive laws restricting cash transactions have notably larger black economies. Medina and Schneider report Italy’s black economy at 24.95 per cent of GDP; Spain at 24.52 per cent; and France at 14.08 per cent. In Italy, cash payments are restricted to a maximum of €3,000. In Spain, cash payments are restricted to a maximum of €2,500 where one of the parties of the transaction is a business or a sole trader. In France residents are not allowed to make cash payments for goods of over €1,000. Cash payments for certain services cannot exceed €450.

Cash provides privacy in transactions, and protection from cyber threats and financial institution failures. In the event of an extended power outage or significant cyberattack, cash could continue to serve the functions of money while electronic payment systems could not. The war on cash has no justification and certainly the myth of stamping out the black economy is exposed by the empirical evidence of Medina and Schneider.

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