HM Treasury
Cash and Digital Payments in the New Economy
Call for Evidence

The response of ESTA to the UK public consultation

5 June 2018

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Executive summary

ESTA wishes to respond to this call for evidence as we think we can contribute constructively to the debate on cash and digital payments. Our response starts with addressing aspects not raised in the consultation document, which are critical to any debate on cash.

One such critical aspect not addressed is that cash continues to work when nothing else works anymore. Cash is so far the only contingency plan for disruptions of digital money. Any plan or any situation which would lead to a lasting reduction of cash in circulation would require putting in place a sustainable model for securing a reliable short term cash availability, as reduction of cash in circulation would likely increase the cost of cash as it is a volume driven business. Considering the level of risk related to cyber threats, either by terrorist groups or hostile countries, a contingency plan is a must.

Our submission also flags that cash is more than just a means for transactions and store of value. It reflects the trust of people in the State. Policies publicly calling for a reduction of cash bear the risk of undermining the confidence of the people in the State, particularly in a period of relative distrust in the financial system.

Cash is public money and generates public revenues. Digital money is commercial money. ESTA's views are that the very substantial growth of digital money, and its continued growth in the future, is driven by commercial purposes and do not need any public support. The role of the government is *not* to assist in the development of commercial initiatives, but to secure an environment where consumers can chose freely which payment means they want to use. It is also to protect consumers and merchants from the huge and increasing fraud on digital payments.

A large number of Britons rely entirely on cash. Other have chosen, particularly after the financial crisis, to use more cash for various reasons (budget control, lack of trust in the financial system etc.). Some however should use *more* cash: these are the 8.8 million Britons on the verge of over-indebtedness and those who are overspending because of the stimuli generated by digital money. ESTA wonders whether the support to digital money is not likely to make their situation worse.

Digitalisation also has serious consequences on civil liberties. When the government calls against the *anonymity* of cash allegedly protecting a minority of fraudsters, it is de facto making a call against the *privacy* of the vast majority of law-abiding citizens. What may be even worse is that the privacy lost to big data will primarily fuels the commercial interests of a handful of global businesses. What would make it possibly unacceptable is if the UK authorities get no benefit with regards to addressing *anonymity* concerns, if the owners of the data (all American) refuse to cooperate with UK public authorities, has they have refused to cooperate in the US authorities in their home country.

Is however cash still anonymous? This response looks at the "digitalisation of cash" that is allowed through banknotes serial numbers reading allowing to trace banknotes throughout their cycle. When connected to biometric technologies and notably facial recognition, it allows to identify anyone paying in cash.

Finally, our response also reviews the use of cash in tax evasion, hidden economy and money laundering. Whilst nobody argues that cash is not used for such purposes, our response shows that cash restrictions put in place in a number of countries have had very limited impact on tax evasion and the hidden economy, and that money laundering concerns primarily non cash processes, the magnitude and scale of which are far bigger than those involving cash.

ESTA hopes that this submission will contribute constructively to the debate and we remain available for more information as may be the case.

About ESTA

The **European Security Transport Association – ESTA** - is a not-for-profit association which was established in Brussels in 1975.

We represent the interests of the sector throughout Europe and count 90% of the European cash management industry as members.

Our main objective is to define and promote our members' joint positions on European policy, in order to improve the quality of the industry.

The Board of ESTA is chaired by **Loomis** and composed of representatives of **Batistolli Brink's, G4S, Nokas,** and **Prosegur.**

Our vision *is to be the recognised voice of the industry ensuring that cash is safe, reliable, available and an efficient means of payment.*

The key assets of cash are: Availability | Reliability | Efficiency | Safety

Joint efforts to innovate on these key elements will enable a cash-friendly society. Cash is efficient, cash is solid, cash is reliable, cash is less expensive. Cash means fiscal revenue to our governments, and in uncertain times, cash is a safe haven.

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I. Introduction

In March 2018, HM Treasury launched a public call for evidence in relation to "cash and digital payments in the new economy". The consultation document starts from the premise that the *share* of cash in payments has reduced both in volume and in value and is predicted to fall further, whilst the growth of digital payments has been rapid. The document states that in the UK as many as 2.7 million people are entirely reliant on cash.

The aim of the consultation is to assess "*how the government can support digital payments and ensure that the ability to pay by cash is available for those who **need** it, whilst cracking down on the **minority** who use cash to evade tax and launder money*." (our emphasis).

ESTA would respectfully submit that the question could be slightly different:

- The role of Government should not only be to ensure that cash is available to those who *need it*, but to all those who *want it*;
- Cash payment transactions number still increase in absolute numbers, but less rapidly than non-cash payments. The decrease of the share of payment is therefore only relative;
- Cash is made available to citizens and consumers through banks who have no incentive to offer cash as they have competing products to offer. The role of the government is to ensure that cash is made easily available to consumers, through banks or outside banks;
- Cash is public money whereas electronic money is private money. There is in our view no role for the government to "*support*" digital payments as arguably the role of the government is not to favour the privatisation of money;
- Electronic money is developing at a rapid pace and is driven by the commercial motives of its issuers. It does not need any government support as it is driven by the commercial interest of private global economic operators;
- However, the role of the Government is to ensure that anyone can freely use whatever payment instruments are convenient and that payment instruments available are safe and efficient. It is up to citizens and consumers to decide what payment instrument is best and their choice will depend on a number of circumstances.

The debate on electronic payments vs cash often hides a number of essential differences that means that these payment instruments are not fully substitutable:

- Cash, as the only public money, has legal tender and is underpinned by the State or the national central bank. The role of the government is to ensure that it is accepted universally

- Cash generates public revenue (seigniorage) whilst electronic payment instruments generate profits for their owners. Most of the owners and developers of payment instruments are non UK, let alone non EU, operators. The government needs to assess the consequences of promoting private payment instruments which can only be at the detriment of cash.

- A direct consequence of electronic money being private money is the risk of competition distortion. In the mid-2000s, EU competition authorities had to address the serious issue of price fixing in relation to the multilateral interchange fees (MIF) and legislated by way of Regulations to set rules.

- A second consequence of this situation is on privacy. By pushing citizens and consumers into "non-anonymous" payment instruments, additional and very comprehensive data will be generated which will add to the billions of data already collected through social networks and platforms. ESTA considers that this raises a number of serious issues which will be examined in this submission.

In addition, ESTA would like to stress an aspect regrettably not covered in HM Treasury consultation document, namely that of *contingency*. Cash is the only payment instrument that can be used on the spot without payment infrastructure, IT system or any specific device. In other words, cash continues to work when nothing else is working, be it the outcome of natural disasters, economic disruption or cyber-attacks.

This is particularly important to recall that private, non EU, payments operators have no responsibility or duty (other than commercial) to ensure the continuity of payment systems in the UK which is the sole responsibility of the UK government. The government should therefore ensure that payments are not left solely to foreign operators whose objectives are to pursue a commercial not a social/public interest.

ESTA's views are that digital money and cash are complimentary and respond to different needs in different circumstances. Almost everyone uses both, regardless of which one is their preference. However what matters is that the choice must be that of the consumer. It must not be imposed by anyone and no one should be forced to use one or the other.

This response from ESTA is structured in the following way:

1. The first part (sections II to VII) will respond to a number of statements raised in HM treasury's document and suggest a different view where appropriate. It will also provide comments on questions *not* raised in the call for evidence;

2. The second part (section VIII) will respond to specific questions in the call for evidence.

II. Three major issues on cash omitted in the consultation document

Three essential aspects of cash have not been considered in the consultation documents: i) cash is public money, not equal to other private payment instruments, ii) cash embodies the public trust in the financial system and iii) what to do when nothing works ?

1. Cash is public money; e-money is commercial money.

Cash and cards and other digital means of payment are not equal. Cash is public money and fulfils a public service.

It is important to distinguish cash from other payment instruments. Cash is State money. By opposition, digital money is commercial money issued by private operators.

Cash is the only payment instrument underpinned by the State which is legal tender. Therefore, cash is more than just a public payment instrument: it reflects the confidence of the public in the State. It derives from the fact that cash comes with the certainty that it will be universally accepted, that the State, the emitter, cannot go bankrupt and therefore the value of the note is guaranteed. There is one unique feature of cash that is unrivalled by any other means of payment:

> *"Cash embodies the value of unconditionality. Cash is basically not dependent on a third-person or a private contract. It is not contingent on the solvency of banks or the effectiveness of the financial system. Unlike bank money, cash transactions are immediately cleared and settled. There is one but significant reservation to the principle of unconditionality: Cash remains dependent on the solvency of its issuer, the government."*[1]

The reservation to the principle of unconditionality is the solvency of the issuer of cash, ie *in fine* that of the Government and of the Central Bank. However the strength of cash is precisely the strong belief in public opinion of the "continuity of the state" which implies that in any circumstances the Central Bank will act as a lender of last resort and the debt represented by the note will be honoured. In other words, one of the unique assets of cash is "*the expectation of future marketability, characterised by the unlikelihood of any issuer defaults*".[2]

[1] Fabio Andreotti "*The war against cash in Europe*" Oct 2016.
[2] dito

2. The trust factor: cash is more than just about payments and storage of value

The call for evidence seeks to assess what more could be done by the UK government to remove barriers to digital payments, after "*digital payments have been made simpler, quicker and cheaper*."

In addition to the certainty of the value underpinned by the State, cash also bears the promise that any "book money" such as money held in an account of a financial institution can be converted on demand and without delay into cash.

Cash is actually the *only* way of allowing deposits held by banks on behalf of non-bank operators to be withdrawn.

Trust of the public and economic operators is key to the functioning of any financial system. This trust lies to a large extent on the certainty of withdrawing deposits by converting them into cash at any time.

As history has shown, the bankruptcy of one small bank in 1929 and the resulting bank run had worldwide dramatic consequences when the public at large no longer had confidence in the financial system. Arguably, similar consequences were avoided in the aftermath of the Lehman Brother collapse on 15 September 2008 because Central Banks issued very substantial amounts of cash. The ECB alone issued more than €40 bn in October 2008 and made public statements that they would do "whatever it takes" to ensure the stability of the financial system. In the UK, stabilisation of the financial sector had recourse to nationalisation of major retail financial institutions after some experienced bank runs.

The 2007-2010 financial crisis was not a crisis of solvency, but one of liquidity, where banks refused to lend to each other. This was materialised by the fact that interbank short term interest rates were higher than long term interest rates. The massive issuing of cash by national central banks was the necessary immediate response to the crisis and as proved to be the right response as it delivered.

The trust factor of cash is also illustrated by the situation in some countries where the people has lost all trust in the national currency. In those countries, the distrust in the national currency is compensated by high level of circulation of foreign currencies as parallel currency (known as "*dollarization*"[3] or "*elminting*") which are typical of emerging economies and post financial/economic crises: people will still want cash, even if it's not the state currency and it does not matter if the parallel currency has no legal tender in the country: everyone knows it will be accepted as it is underpinned by strong economies.

[3] In the "narrow sense" of massive currency substitution, not the broader meaning of US hegemony; cf Fields, David, and Matías Vernengo. "Dollarization." The Wiley-Blackwell Encyclopedia of Globalization (2013)

3. Cash works when nothing else works

Another critical aspect of cash is that it works without the need for infrastructure of network, without the need for connection or power supplies: it only needs the trust of the users in its emitters to work.

There are many possible causes for any payment infrastructure to stop operating: this goes from power failure and social conflicts to climate events. More recently, threats of cyber-attacks are being considered as a major risk, whether it is conducted by terrorist organisations or by hostile countries. In an economy dominated by electronic money, any disruption would have major consequences for businesses, consumers and citizens and for public authorities.

The hard learned lessons of the past should be retained. In the aftermath of the two major earthquakes in Christchurch, New Zealand, in 2010 and 2011, the NZ Reserve had to organise the distribution of 350 NZ$ to each citizen to cope with immediate necessities as the banking system was completely disrupted, no electronic payment was possible anymore and cash could not even be obtained from non-working ATMs. With this experience in mind, Mr Alan Boaden, director of cash in the NZ reserve responsible for the distribution of cash to the people, came to the conclusion that ***"high use of electronic payment methods may be a vulnerability, not a strength."***[4]

There is a number of examples of disruptions of digital payment systems where cards or other e-payment systems stop operating for a couple of hours or more.[5] There are also a number of examples of total disruption of e-payments systems which made any electronic payment impossible.[6] The question therefore is what is the back up for digital payments in case of such outage ? There is only one: cash

This probably explains why countries which have gone through very serious financial crises, such as for example Iceland and Japan, have seen a substantial increase in the demand for cash of their population after the crisis (see below section III.3)

ESTA regrets that these three aspects of high relevance to cash and payments have been completely omitted from HM treasury's document. They are of essence to the debate on the promotion of digital money as the awareness of respondents to these issues may influence their opinion on digital money.

[4] A. Boaden, former Head of Currency, NZ Reserve bank "Demand for cash after a natural disaster"; presentation at the Singapore International Currency Conference, October 2011..
[5] Cf the outage of Visa on a substantial part of Europe on 1st June 2018
[6] Cf the total disruption in Belgium on 24 December 2013 where no e-payment could be made for a few hours.

III. Evolution of the use of cash

1. The volume and value of cash payments continue to increase in the UK

It is often stated, as does HM treasury's consultation document, that the share of cash payments is decreasing.

According to the British Retail Consortium (BRC), the value of payment in cash continues to increase in the UK. In their last payment report (2016), released in 2017, the value of all cash payment in the UK has increased from £79bn in 1015 to £81.5bn in 2016; i.e. a 3.2% increase. From the 2015 payment survey, it can be seen that 47.15% of all transactions were in cash, out of a total of 8.9bn transactions, i.e. 4.2bn transactions in cash. This compares with 8.1 bn cash transaction in 2016

Therefore, whilst the *share* of cash payments is said to have decreased by 5% in volume between 2015 and 2016, the reality is that the total *number* of cash payments has substantially increased during the period.

The alleged 'decrease' in the number of cash payments in the UK therefore needs to be put into perspective as it is only relative: it simply reflects that the growth of cash payments in volume is only slower than the growth of non-cash payments, but the reality is that cash is going up again in volume and in value.

2. Cash in circulation increases in many countries, including in the UK

This submission has developed in the previous section that the essential virtue of cash is not just in how it is used for transactions and storage of value but in the confidence it generates for the entire financial system of a country. The virtue of cash is therefore not only what it represents in terms of payment instruments for transactions, but first and foremost what it means for society with regards to the smooth operation of the financial system and its supervision by the State authorities. The main impact of reducing cash in circulation is therefore not so much to be seen on which payments instruments are used, but on how the perception by the public may undermine its confidence in the financial system, and public calls by country's monetary authorities that this might be a State policy would only exacerbate the possible mistrust of the public in the financial system.

The consequence of this is to be found in the paradox that cash in circulation in relation to GDP has grown significantly in many countries, including in the UK, whilst at the same time cash used for transactions has decreased (in *relative terms* as seen above) compared to transactions performed by alternative means of payment.

The cash to GDP ratio is often used as a proxy for the demand for cash. Cash in circulation has increased to 7 to 9% of GDP in a large number of countries between 2000 and 2016.[7]

In the Eurozone, the value of bank notes in circulation has grown by an annual average rate of 4.5% since 2007. The number of banknotes in circulation has grown by 6.1% annually during the same period. Interestingly, this also includes growth in low denominations such as 10, 20 and 50 euros notes which are typically transaction notes in the Eurozone[8] (though the 50 euros note serves both as store of value and transaction purposes). The growth of cash in circulation in Germany emitted by the Bundesbank in 2017 has been +7.2%.[9]

The rate of growth is substantially higher than the growth rate of the Eurozone, so demand for cash is not just led by the economic recovery after the financial crisis. There are intrinsic reasons for the growth of cash.

3. The financial crisis has promoted the use of cash

The virtue of cash as "safe haven" can be seen in the peculiar evolution of the demand for cash in countries where demand for cash differ widely although the countries are similar in terms of economic and social characteristics.

> "*One such example is the Nordic region. At the start of the 2000s, Iceland's cash-to-GDP ratio was as low as 1.2%, while Denmark, Norway and Sweden were clustered at around 3– 4%. Since then, cash demand has shown a secular decline in Sweden and Norway, while in Denmark it has remained stable at around 3.5%. However, in Iceland, cash demand has more than doubled since its banking crisis, and now exceeds that of Norway and Sweden*."[10]

Hence countries whose population have experienced the dire impact of the 2007 financial crisis have seen a very significant increase in the demand of cash after the crisis. This explains the situation in Iceland, where cash in circulation to GDP has doubled after the financial crisis compared to prior to the second semester of 2007. This is also the case in Japan, where the ratio of cash in circulation to GDP is among the highest (20%) after their two-decade long financial crisis.

In the UK also, there was an increase in the use of cash in the immediate aftermath of the financial crisis where use of cash increased in 2012 compared to 2011. According to the UK Payment Council, 20.8 billion payments in cash were made in the UK in 2012 compared to 20.6 billion in 2011.

4. Financial crisis of 2008: cash saved the world - literally

In the context of this consultation of stakeholders by HM treasury, this outcome is of major importance. It shows that whatever will drive the promotion of digital payments, the government needs to remain prepared for the worst, as a substantial part of the demand for cash is driven by precautionary reasons. This is particularly true for those who have been hit

[7] Morten Linnemann Bech, Umar Faruqui, Frederik Ougaard and Cristina Picillo: "Payments are a-changin' but cash still rules" Bank of International Settlements (BIS Quarterly Review), March 2018.
[8] European Central Bank, '*ECB Update'* Presentation at the ESTA 2017 conference in Budapest, 14 May 2018.
[9] Bundesbank figures (https://www.bundesbank.de/Redaktion/DE/Reden/2018/2018_02_28_thiele.html#doc424966bodyText1)
[10] Bech et all "Payments are a-changin' but cash still rules" cited above

hard by the crisis. Recent experience by customers of some large retail banks in the UK having to queue hours to withdraw their deposits, as well as the millions, not customers of the concerned banks but having witnessed these scenes day after day in their newspaper or on TV, are likely to react very promptly should they perceive any sign of instability of the UK financial system in the future. Because the risk is essentially systemic, the UK government may not be in full control of it if the crisis is imported from banking failures in third countries.

Not only is "*cash what works when nothing else works*", but in the context of the last major crisis of 2007, cash is what '*saved the world'* – literally - when big emission of cash by central banks were one of the tools used in western economies to restore the required liquidity.

IV. Reduction of cash in circulation will lead to a reduction of public revenue

1. Seigniorage

The profit generated by public authorities/emitters of money is usually referred to as "seigniorage' and can be succinctly defined as the difference between the face value of a note and its production cost. More precisely, it is the zero interest loan that the holders of a banknote gives to the emitter of cash between the time a note is emitted and the time it returns to the emitter. It constitutes the rent for the monopoly of issuing paper money.

In times of low interest rate, seigniorage is lower than in times of high interest rates, but the amount remains very substantial: in 2015, seigniorage on all US dollars bills in circulation was annually of 0.40% of the US GDP (US$ 70 bn). For the ECB, the annual income from seigniorage was estimated at 0.55% or around €60 bn. In the UK it is estimated that seigniorage amounts annually to 0.18% of GDP in 2015[11]

Central banks are often discreet about the cost of production of specific bank notes[12] but at worst, a £50 note would cost a few pennies. In the UK, even if the new polymer notes are rumoured to be more expensive by 40-50% compared to the cotton based paper notes, additional seigniorage revenue is expected from the longer life duration of these notes.

Also of note is that the government earns seigniorage on ***all*** cash in circulation, whether its use is legitimate, illegal or criminal, used domestically or exported because cash is cash, irrespective of its effective use and where it is used.

The reduction of the cash in circulation will reduce seigniorage revenue. The question is how this will be compensated.

2. Inflation tax

Seigniorage is however not the only revenue that the government draws from cash. Another revenue is the "inflation tax", when more money is issued than needed that fuels inflation (the government spend the notes at their full value when it is emitted and bearers bear the cost of the inflation tax through the reduced purchasing power of the note resulting from inflation when it returns to the central bank).

[11] Kenneth S.Rogoff: "the curse of cash"; Princeton University press 2016; at pages 81 and 84.

[12] With the notable exception of the US Federal Reserve which lists the cost of production of each notes, where it can be seen than a $1 note costs 5.6 cents and a $100 note no more than 13.2 cents (cf https://www.federalreserve.gov/faqs/currency_12771.htm)

Reducing cash in circulation would lead emitters to forgo seigniorage as less notes would be printed and reduce the ability to generate inflation tax which, as some government knows well, can be convenient to reduce debts. Inflation tax is the perfect 'stealth tax'.

3. Reducing cash in circulation will increase recurrent costs for the government

The story unfortunately would not end here: to buy back cash in circulation, the central bank would have to issue interest bearing debt, which would further increase the debt to GDP ratio. The loss in public revenue would therefore be the amount of seigniorage lost when buying back the cash plus the interest charge of the debt to buy it back. There are reasons to think that this process would further increase pressure on financial markets, leading interest rates to rise.

Finally, the lost public revenue from seigniorage foregone in the process of reducing cash in circulation would need to be compensated by other public revenues (new taxes or increase in existing taxes) or by a reduction of public expenditures. Tax payers would ultimately bear the cost, either by increased taxes or lower public services in return for their taxes.

4. Cash is not just good for "those who need it", but also for the State

For these reasons, ESTA thinks that cash should not only be preserved for "*those who need it*" as it is stated in the consultation document, but primarily so because it is in the best interest of the UK government; and *in fine* of the UK taxpayer, to keep it. This is particularly so as, as will be shown in this response, restriction in the use of cash will deliver very little with regards to the fight against social plagues such as tax evasion, money laundering, crime and terrorism.

Cash restrictions will essentially affect law-abiding citizens.

V. A major privacy concern with digital payments

1. The UK should beware of policies pushing citizens towards non-anonymous payment instruments.

The European Council adopted an action plan on 2 February 2016 to fight the financing of terrorism[13] where it suggested, without substantiating this affirmation, that "*payments in cash are widely used in the financing of terrorism*" and invited the Commission to explore the possibility for EU wide harmonisation of cash payment limitations. In January 2017, the Commission issued an "Inception Impact Assessment" on a possible EU harmonisation of cash payment limitations in the context of the fight against terrorism and opened a public consultation of stakeholders which ended on 31st May 2017. According to information released after the consultation by the Commission, 95% of the 30,317 responses received opposed cash payment limitations.

Very telling about the concerns of respondents is the response to the question "*In your opinion, what would be the main arguments against the introduction or restrictions in payments in cash at EU level ?*": The response, as per the table reproduced below, shows that for 87% (26,340) of respondents the issue of *privacy* is the main concern. Another 73% considered that restriction in the use of cash would be ineffective in addressing issues of crime, tax evasion or terrorism. [14]

Further, when looking at the detail of responses and more specifically at the responses given by "*representatives of public authorities*",[15] no less than 83% disapproved of cash payment limitations, 59% considered they would be ineffective in addressing the purported objectives and, reassuringly, 78% of responding public authorities considered that "*paying anonymously in cash is an essential freedom*".

		Answers	Ratio
Paying anonymously in cash is an essential personal freedom.		26340	86.88%
Paying in cash is convenient.		20175	66.55%
Alternatives to payments in cash are either unavailable or more expensive.		9836	32.44%
Restrictions on payments in cash hamper business.		16058	52.97%
Restrictions on payments in cash are ineffective in achieving the potential objectives (fight against criminal activities, terrorism, tax evasion).		22290	73.52%
None of the above.		579	1.91%
No Answer		128	0.42%

Source: European Commission DG ECFIN (ESTA emphasis)

[13] COM(2016) 50 Final
[14] See the statistical overview published by the EU Commission at: https://ec.europa.eu/info/consultations/eu-initiative-restrictions-payments-cash_en
[15] 41 responses were received from public authorities representatives during the consultation

Aside from the online survey, a number of organisations and researchers, including ESTA, submitted substantial contributions to explain in detail their views in relation to the proposed initiative. All the contributions gathered by ESTA show that respondents oppose the initiative as it will be ineffective against terrorism. A number of them also flag the risk of potential adverse consequences.[16]

Nearly a year later, the European Commission's DG ECFIN informed ESTA by email of 23 February 2018 that "*the findings* [of the study in relation to the impact assessment] *are that restrictions in payments in cash do not have any significant impact on terrorism financing or directly on tax evasion*".

The Commission adds that restrictions in cash however might "*help in fighting money laundering and that divergence of cash payment limitations between EU member states create distortions in the internal market*". The issue of money laundering is dealt with separately in this submission and ESTA's views are that cash raises no specific issues in relation to money laundering. With regards to the argument of the internal market, ESTA responded to the Commission that cash payment limitations are not "obstacles" to the internal market in the sense of the Treaty on the Functioning of the EU.[17]

It is public knowledge that the Commission launched the cash payment limitations initiative on the request of Germany. The German government requested the Commission to take this initiative at EU level after the domestic debate in Germany proved the measure to be very unpopular with Germans, the people in Europe with the highest rate of use of cash along with the Austrians.

2. Anonymity and privacy are the two sides of the same coin

The real agenda of the Commission may have been elsewhere than cash payment limitations just in relation to the fight against the financing of terrorism. The Inception Impact Assessment makes two worrying statements in the section on "options for a legislative initiative":

- *"Forcing payments through means which are not anonymous"; and*
- *"Preventing the anonymity linked to cash payments is the driver".*

It seems therefore like a confession that regardless of the reasons (which are changing over time), the rationale is to push a cash payment limitation initiative with the main objective of restricting the ability of all EU citizens to pay in cash to force them into "*non-anonymous means of payment*". Privacy seems to be the target, despite the fact that it guaranteed in Article 7 of the European Charter of Fundamental Rights of the Citizen as well as in Article 7 of the European Convention on Human Rights.[18]

[16] Unfortunately a year after the end of the stakeholders consultation, the Commission has not yet published the contributions received from stakeholders, despite the requirement to do so in the Commission Better Regulation guidelines (see page 70 of the BR tool box, https://ec.europa.eu/info/sites/info/files/better-regulation-guidelines-stakeholder-consultation.pdf)

[17] CF ESTA's response to the EU public consultations (www.esta-cash.eu/publications/) and particularly section 3 on Better Regulation principles

[18] We don't infer that this would make any restriction on privacy impossible, however ESTA claims that the evidence base and the proportionality of any measure encroaching fundamental rights would need to be much more robust.

HM treasury call for evidence does not say anything different when it suggests that, although "*the vast majority of traders and business accepting payments in cash do so honestly*" anonymity of cash facilitates tax evasion hidden economy or money laundering (see § 4.2) for a "minority" (§1.7).

Anonymity and privacy are two words of the exact same reality, except that the former has a negative connotation related to tax evasion and crime and the other has a positive connotation related to a fundamental rights of law-abiding citizens. Therefore, if the idea is to put an end to the '*anonymity'* of cash, it is also to put an end to the *privacy* allowed by cash.

No government in a democracy would dare to publicly call for putting an end to the privacy of the vast majority of honest citizens. Fighting against the "*anonymity of a minority*" via the limitation of the use of cash is nothing short than reducing the *privacy* of the *vast majority of honest cash users*.

The role of the State is not just to chase fraudsters, but also to ensure the wellbeing of its population and privacy is major concern for the population. Beyond the inevitable proportionality issue, there are undoubtedly better ways to address the misconduct of the *minority* the UK government wants to address.

3. *"Follow the money"*

The serious issue raised by the collection of big data by global internet platforms and social networks has recently been exposed with the Cambridge Analytica affair which showed how millions of persons were targeted, on the basis of their own personal data, for political purposes. A documentary by the BBC[19] has also shown how social network data were misused to influence the campaign in favour of Brexit by targeting very specifically individual persons who were considered as receptive to their arguments. Clearly, it is very unlikely that any of the persons targeted had given their explicit consent for their data to be used this way.

Adding payment information gathered through 'non-anonymous' digital payments to existing big data already providing behavioural information, people's networks and private and social life data collected by social networks and global internet platforms will leave very little unknown about everyone.

It is therefore hardly a surprise that a number of GAFAs are venturing into payment instruments, such as Google Wallet, Google Pay, Apple Pay, Amazon Pay etc.

The value of such information is obvious: credit card companies have been selling their credit card transactions data to digital advertisers and marketing companies, although they have been very discreet in communicating this for fear of adverse reaction from card holders – it seems however unlikely that those card holders have been told about this and have given consent to it. The objective is to tailor advertising to specific and individual customers of the

[19] BBC Panorama "What Facebook Knows About You" (https://www.bbc.co.uk/programmes/b08qgbc3/ (unavailable at the date of submission) the documentary also shows how Facebook's big data was used in the US presidential campaign where a campaign's spokesperson confirms having paid as much as US$70 M to access data for targeting voters.

card companies. The cooperation between global credit cards and digital marketing companies is already well documented.[20]

More recently, MasterCard organised online sales pitches to market their transactions data for targeting consumers specifically. When launched, MasterCard said it would only target US card holders; however once the data is available and the process established, it is only a question of time until it is extended to all their cardholders irrespective of their locations. Visa sells retailers the ability to send text messages to consumers based on their past credit card transactions.[21] Companies are able to amass vast profiles about the activities or people spending more and more time in front of their computers and mobile phone about their activities both online and away from the screen while Facebook is working with a data company, Datalogix, to track whether people buy products after viewing ads on their social network site.[22] Connection with people's loyalty cards and other sources of information are also easily made and allow the accumulation of very comprehensive information on anyone.

This is precisely why everyone, at times, prefers paying with cash.

Keeping in mind that a number of these organisations are developing face recognition software (eg "*Rekognition*" developed by Amazon; Facebook privacy policy requesting authorisation for face recognition etc.), the reconciliation of individual data and facial recognition allows for a tracking of individuals virtually every time they pass by a CCTV camera, whether in a shop, in a street near a shop, in an airport, or anywhere else.

4. The use of non-anonymous payment instruments does not mean data will be available to UK authorities

So pushing people into "non-anonymous payments" raises a serious issue of privacy. Whilst the UK government may consider that non-anonymous payment instruments may have an advantage for specific purposes, such as security or the fight against crime and tax evasion, the reality may be that the government would ***not*** have the data at hand: it would have to request it from those who "own" it prior to conducting the appropriate investigations. However, even before such a need is identified by public authorities, this data is already used by the organisations, which have processed it for purely marketing and commercial purposes.

None of these companies are European. They are all American. The ability for the UK or other European law enforcement authorities would be based on the willingness of these non-European organisations to share these data.

[20] See for example: http://adage.com/article/dataworks/mastercard-amex-feed-data-marketers/240800/ on MasterCard and Amex strategies to sell their transaction data.
[21] Emily Steel, "MasterCard mines Data for marketers", Financial Times updated May 2018 available at https://www.theglobeandmail.com/report-on-business/industry-news/marketing/mastercard-mines-data-for-marketers/article4619510/
[22] Emily Steel, Financial times article already cited

Experience however shows that public authorities/law enforcement authorities requesting data from those organisations may not always be able to obtain it. A notorious case concerns the 2015 shooting in the US city of San Bernadino when Apple refused to assist the FBI in unlocking the iPhone of the perpetrator on grounds that it might undermine the confidence in the privacy of their products vis à vis other customers.[23] In this case, company policy and commercial interests prevented law enforcement authorities to get assistance in relation to a criminal/terrorist investigation. Subsequently, the company clarified its rules however continuing to claim that it will have sole discretion to decide upon which requests are justified or not:[24] Apple, not the authorities, will decide when an overarching important reason justifies the sharing of data with authorities.

Considering that Apple, as a US company, was able to resist pressing calls from the US government leaves little doubt as to how they may respond to non-American authorities' requests. If Apple was thought to be strong enough to oppose the FBI, who can believe they would be more cooperative with non US law enforcement authorities? Who can believe that other digital payments companies will be more cooperative at the risk of losing business to Apple, now that Apple has passed the message to the world that they will resist requests even from the FBI?

Therefore the main conundrum, not to say limitations, in the UK government desire to oppose the anonymity of cash by promoting digital payments will therefore be that the data will be held by non UK, non-European organisations which may not necessarily be cooperative, particularly when this contradicts their commercial interests or company policies.

ESTA wonders whether it is proportionate to compromise the *privacy* of millions of UK citizens for opposing *anonymity* provided by cash in a context where the ability for the UK law enforcement authorities to obtain critical data for their criminal or fiscal investigations will in essence depend on the good will and commercial interests of US based companies which own the data.

5. The anonymity of cash: the beginning of a myth?

Indeed, cash payments may be anonymous.

In the UK, 42% of all transactions are in cash[25], i.e. the lowest after Sweden (20%) and before the Netherlands (45%).[26] In the Eurozone, 79% of all POS transactions are in cash, representing 54% of the total value of transactions.[27] The average cash payment in the

[23] See for example "*Apple vows to resist FBI demand to crack iPhone linked to San Bernadino February attacks". Washington Post 17 February 2016* www.washingtonpost.com/world/national-security/us-wants-apple-to-help-unlock-iphone-used-by-san-bernardino-shooter/2016/02/16/69b903ee-d4d9-11e5-9823-02b905009f99_story.html?utm_term=.cafebaddf52a

[24] Cf https://www.apple.com/privacy/government-information-requests/

[25] BRC payment survey 2016 – the report show that for the first time the share of debit car payments overtook that of cash payments

[26] G4S World cash report 2018, available at www.g4scashreport.com

[27] Henk Esselink, Lola Hernandez "The use of cash by household in the Euro area"; ECB occasional paper 201; November 2017

Eurozone is €18, and 65% of all cash payments were below €15. According to the ECB survey, only 2% of payment at POS where above €100, and only a third of these payments were made in cash, ie 0.67%

So cash is anonymous. But who needs to trace average payments of €18?

Yet, the anonymity of cash is something that perhaps needs to be put into perspective. Small cash payments are anonymous but they are by and large of no interest to the authorities. Large payments in cash are rapidly conspicuous. For example in France, paying at retail with a high denomination banknote may take you to prison for 20 hours, as happened to a customer paying a €210 bill in a supermarket with a €500 note in October 2014.[28]

Banknote processing machines now allow for their serial number reading. The technology allows for automatic reading and recording of each bank note serial number and is now available for wholesale and retail cash management, for CIT and for banks. With this technology each banknote can be precisely traced throughout its life cycle. As one manufacturer of such machine advertises, banknote serial number reading technology "*connects banknotes to the digital world by providing its individual lifecycle data by serial number reading*". In other words, the process of the 'digitalisation' of cash has now started.

In addition to the tracking and tracing of the banknote through its serial number reading, facial recognition devices can easily reconcile a payment with a person. CCTV systems have been installed in shops for some time now for security reasons. They are being deployed in streets for public security purposes and the UK is the country with reportedly the largest CCTV network in Europe.[29] Once the cameras are in place, it is easy to install new software to allow for facial recognition of persons entering the premises or walking nearby. Many shops are now using facial recognition software.

For anyone paying in cash, reconciling facial recognition data with serial number reading will make the anonymity of cash a thing of the past. For anyone paying in cash, facial recognition devices will allow to identify the person based on previous card payments or from other sources where the face is tagged with an identity or a 'profile', if not a name.

Therefore relying on cash for illegal activities is somewhat riskier than it may have been. There are many other ways to remain anonymous when conducting illegal transactions, including by digital payments. Prof Nikos Passas, from the Northeastern University School of Criminology and Criminal Justice in Boston, in his response to the EU consultation on cash payments limitation on 2017 identified a number of ways frequently used to remain anonymous:

> "*Cash offers anonymity, but there are other methods to hide from authorities. Fake IDs are one such option, as we saw with the cell behind the Paris and Brussels attacks16 as well as in the UK. Smuggling, trade diversion, mis-invoicing and barter deals are also possible (services, goods provided freely or under threats; commodities, such as drugs, tobacco, alcohol or*

[28] http://www.lavoixdunord.fr/archive/recup/region/arretee-a-leclerc-pour-avoir-paye-avec-un-vrai-billet-ia16b0n2421162
[29] With 6 million CCTV cameras already deployed in 2015; see for example: https://www.theguardian.com/world/2015/jan/06/tony-porter-surveillance-commissioner-risk-cctv-public-transparent

diamonds). The use of third parties to avoid detection can be forced, if other options are restricted, so conceivably more people could be blackmailed or forced to allow some amounts to go through their accounts on behalf of terror and organized crime groups'"[30]

There are therefore many ways to remain anonymous without using cash.

[30] Nikos Passas; "*Report on the debate on EU cash payment limitations*" Submission to the EU public consultation; Journal of Financial Crime, Volume 25; issue 1; 2018 (https://www.emeraldinsight.com/doi/full/10.1108/JFC-06-2017-0058)

VI. The social role of cash

1. Cash is a counter power in the hands of the people against 'unreasonable' policies

The consultation document refers to the fact that cash should remain available "*to those who need it*". ESTA considers that this is not the right approach as it suggests that cash should only be kept for those who can't operate otherwise. This is true for a large number of people who are unbanked (or de-banked). However far many more people want to use cash and not only the "*minority who use the anonymity of cash to evade tax and launder money*".[31]

As has been shown above, many more people rely on cash today compared to prior to the financial crisis, and this is based on the fact that there has been a long lasting loss of confidence in the financial system. Countries which have been very strongly hit by the crisis, such as Iceland and Japan, have seen a radical change of attitude of their population towards cash, leading to a doubling of cash in circulation post crisis compared to pre-crisis in Iceland and to the highest ratio of CIC/GDP of all countries for Japan. The recourse to cash to control one's budget after the crisis is not only visible in low income households, but also in high income households.

The opportunity cost of holding cash in a time of low inflation and low interest rate is negligible. This explains, in part only, the fact that cash in circulation to GDP has increased.

Cash has a number of "micro-economic" properties which are well known and documented such as the ease of use, immediate settlement of debts, immediate acceptance and real time transaction etc. There are also three main "macro" factors that are essential:

- The first, as already developed earlier, is the confidence in the system and the risk of undermining trust if economic operators perceive that their assets and deposits in the financial sector are at risk and available cash may not allow for timely withdrawal;

- The second is that cash acts as a limit to excessive budgetary policies: if the fiscal pressure reaches a point where adhesion of citizens to tax is compromised, economic operators will change behaviour and resist. Conversion of assets into cash is one way of doing it, whether legally or illegally, but it is not the only one. This is best summarised in the Laffer Curve, where public revenue increases with the increase of the tax rate up to a point where an additional increase in the tax rate will lead to a reduction of public revenue. This prevents the implementation of excessive budgetary policies (which in any case would prove disastrous for the economy in the medium to long run);

- The third is that cash acts as a limit to excessive monetary policies. At time when "unorthodox" monetary policies are being implemented, notably through negative interest rates policies (NIRPs), cash provides a limit to what can be imposed on

[31] Call for evidence document, §1.2 at page 2.

citizens and businesses. Arguably, NIRPs implemented so far have not led to runs on cash, however negative rates imposed have remained reasonable (the lowest rate was -0.75% in Switzerland) and have not been applied to households accounts. However, some economists advocate for much stronger NIRPs of -6 to -10% which would no longer be 'reasonable' and might well create a run on cash. Without cash, economic operators would be captive and hostage to such policies and society would be at a loss.[32]

Therefore the mere existence of cash allows citizens and economic operators to have some control of public policies implemented by their government.

2. Who's going to be impacted with the reduction of cash in society

There have been a number of analyses of who would suffer most from the reduction of cash in society. The consultation document refers to "*2.7 millions Britons who are entirely reliant on cash.*"

In general, the least well-off in society will suffer most from the reduction in cash. It does not mean they will be the only ones impacted, but the impact will be stronger as the most vulnerable in society have limited choices but to use cash for their daily needs. A succinct and accurate summary can be found in Nikos Passas' report on cash payment limitations under the section entitled "*victimisation of the vulnerable*":

> *The Cash payment limitations will be inevitably discriminatory regarding digital access and capacity and the financial control for many categories of the population, with a massive impact on the most vulnerable:*
>
> - *Elderly: older people are more adversely affected, as they have trouble with understanding new technologies, have to cope with outdated hardware and in the context of increasingly sophisticated cybercrime, of lack of updated cyber protection.*
> - *Mentally ill: these may need extra control-options to limit potential financial harm in an e-economy*
> - *Financially excluded/unbanked: substantial numbers of people have no bank accounts or access to financial services (exclusion)*
> - *Poor: worst affected will be lower socio-economic strata 73 - furthering destabilizing injustice and inequalities*
> - *Rural communities or other areas without reliable internet service*
> - *Digitally illiterate*
> - *Migrants (language, culture and technology barriers) and fragile communities"*[33]

Please refer to the original article for more details and relevant references. Please also refer to our response to Question 16 (see section VIII.8 below) on the social an economic

[32] For an analysis of the social costs of NIRPs, see Aleksander Berentsen's "*Amazing Pumkin Investment Opportunity*" (www.libinst.ch/presentationen/LI-Berentsen-Bargeld.pdf)

[33] Nikos Passas; "*Report on the debate on EU cash payment limitations*" report already quoted available at: https://www.emeraldinsight.com/doi/full/10.1108/JFC-06-2017-0058

consequences of demonetisation in India as an illustration of the consequences of the reduction of cash in the economy.

3. Cards and overspending: why make it worse with the promotion of digital payments?

This submission has referred earlier to cash as a tool for households' budget control, particularly since the crisis.

A contrario, the psychological stimuli for spending have been analysed since the mid-1980s by Richard Feinberg[34] and followed by many other researchers since. The research suggests that consumers have been conditioned to associate credit card logos with consumption and that exposure to credit card logos may therefore stimulate craving.

The stimuli generated by credit cards is not just that people are going to spend more than they should with cards, but also that they are ready to pay more with a credit card than with cash for the same product. One of the reasons is that consumers paying by card tend to benchmark the price against their credit limit – which can be high – rather than by the value of the banknote they would use which is much lower: this way, a £5 price may seem high if paid with a £10 note, but small if paid with a card with a limit of £1,000. Another factor is that people paying by card tend to forget earlier purchases and fail to have a good perception of the total amount spent.[35] Another strong stimuli for spending are the card reward schemes.

Cards, and by extension the dematerialisation of payments allowed by digital payments (which makes it less painful to type a pin code than to hand over banknotes for paying), stimulate overspending. The concrete manifestation of this reality is that the first step of a bank when confronted with a customer recurrently overspending is to take their cards back.

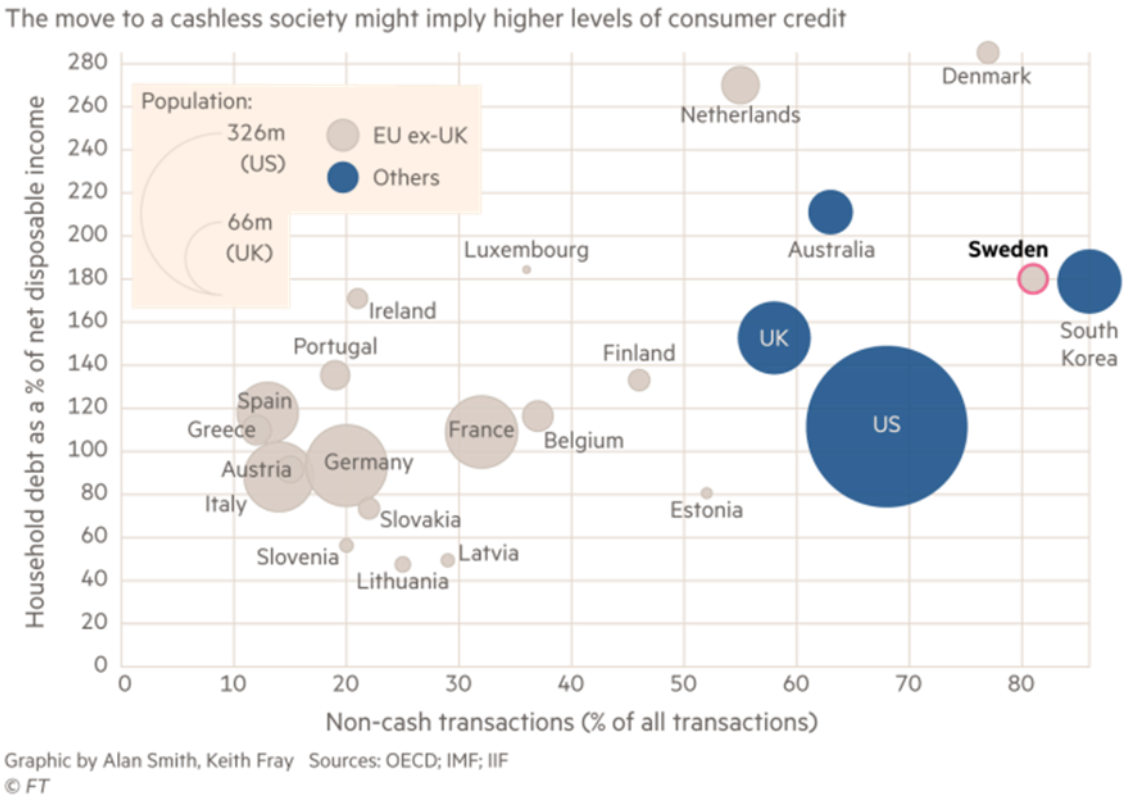
The British Retail Consortium announced in 2017 that for the first time card payment had overtaken cash payments in the UK, and that the momentum was unlikely to change.

Shortly after that (without suggesting there might be a correlation), by early 2018, the charity National Debtline announced that 16% Britons (around 7.9 million people) say they are likely to fall behind with their finances in January 2018 after spending too much at Christmas.[36] The reason lies in overspending on Christmas due to putting end of year expenses on credit for 37% of Britons, compared to 33% the previous year. The growing reliance by consumers on credit has led to the highest personal debt levels in recent history, with the average person owing over £8,000 – not including mortgage repayments.

A recent article in the Financial Times makes an interesting analysis of indebtedness and the prevalence of non-cash transaction by countries: "*take a look at the countries with the*

[34] Richard A Feinberg: "*Credit cards as spending faciliting stimuli: a conditioning interpretation*" Journal of Consumer research; Volume 13 N°3; December 1986.
[35] See for example: Drazen Prelec and Duncan Simester "*Always leave home without it: A Further Investigation of the Credit-Card Effect on Willingness to Pay*"; Marketing Letters 12:1, 5-12 2001; Kluwer academic publishers.
[36] Stephen Little; "*Millions of Britons start 2018 with huge Christmas debt*"; The Independent, 2 January 2018

biggest proportion of electronic payments and compare it with those that have high levels of consumer debt, and you'll spot a worrying correlation."[37]



Source: Financial Times, 10 May 2018

An average personal debt in excess of £8,000 excluding mortgage in the UK is a rather high amount though it may be manageable in period of very low interest rates. However, interest rates are now starting to rise and a debt of that level could soon prove to be a time bomb for a large number of households.

The challenge for the government is whether it is a good policy to push people into dematerialised, digital payments and their spending stimuli at a time when the level of personal debt has never been so high and economic perspectives in the light of Brexit are at best uncertain.

8.8 million Britons are on the verge of over-indebtedness.[38] Cash would definitely help them to better control their budget and avoid being further exposed to the rapid increase of credit charges if, as can be expected, interest rates start to rise.

[37] Patrick Jenkins; "*We don't take cash': is this the future of money?"* Financial Times; 10 May 2018

[38] http://www.financialinclusioncommission.org.uk/report; last accessed on 4.06.2018

VII. Do digital payments really need a push from public authorities ?

1. Strong development of digital payments driven by commercial purposes

"*Global non-cash transactions broke a decade-long record for growth in 2014-2015 with volumes exceeding 11% growth to reach more than 433 billion".* This is the first line of the introduction to the World Payment Report of 2017.[39] The growth "*exceeded expectations*" made in 2016 by nearly 7 billion transactions. The report also expects a continued growth by 10% p.a. until 2020, driven by emerging countries but also in mature markets (+6.8%). In Europe, the growth was mainly driven by non-Eurozone countries (+10.2%).

When looking at the future evolution, the report suggests that in Europe, the growth of digital payments will be fuelled by innovation, entry of new players and increase of competition deriving from the implementation of the EU PSD2 directive. "*However, this growth rate may stabilise or reduce in case of a new banking crisis and declining customer satisfaction because of increased cybercrime and fraud rates*".[40]

This reflects the findings of the Bank of International Settlements (BIS) which states that "*the value of card payments for CPMI member countries increased from 13% of GDP in 2000 to 25% in 2016*".[41]

The UK has the largest share of digital payment to GDP already. Whilst the value of card payments to GDP varies greatly between countries, the BIS reports that it is of more than 40% in the UK, i.e. one of the highest levels observed. The growth is driven by a number of factors such as the increase in the number of cards held by each individual, the subsequent more frequent use of the cards and the lower value of transaction conducted with a card. The reason is the more widespread infrastructure of terminal attached to POS, but also the development of mobile terminals.

The future of digital payments, as anticipated by the World Payments Report, will be characterized by a "*proliferation of alternate channels such as contactless, wearables, augmented reality coupled with modern authentication and authorization technologies* [which] *is expected to further catalyse the growth of mobile payments*".

This demonstrates that there is no need for public support in assisting in the development of digital payments: they take care of themselves very efficiently already and this is due to the fact that their development is commercially driven. In addition, a number of these payments are launched by global platforms which have the necessary resources to develop and

[39] World Payment report 2017 (WPR 2017); https://www.worldpaymentsreport.com/#non-cash-payments-content
[40] WPR 2017 ; page 12
[41] BIS quarterly review March 2018, at page 69. "CPMI countries" are: AU, BE, BR, CA, CN, EA, FR, DE, HK, IN, IT, JP, KR, MX, NL, RU, SA, SG, ZA, SE, CH, TR, GB and US

support these new instruments until they reach a critical mass. The size of these platforms is such that any failure in the launch of a new payment product will hardly affect their P&L. The rationale of why taxpayers' resources should be engaged in the promotion of their products is not obvious.

Further, and as predicted by the World Payments Report 2017, if it is not clear where new digital payments means find their market share in the payment market. New e-payments tend to substitute first to older e-payments which are rapidly becoming obsolete. With the possible exception of contactless, the first decision of a consumer is to choose whether to pay in cash or digitally, and only once it is decided to pay digitally, then the next choice is which electronic payment should be used (e.g. card – debit or credit - or mobile).

2. Where to invest, what to support ?

Digital payments require certain conditions before they can become operational and change the payment markets. The first three conditions are that:

- They require a consortium of banks or industry-wide participation before they can take off. Failing to have this, acceptance will be minimal and new digital payments instruments will not develop;

- Second, even in the case they have strong support from the banks and sponsoring organisations, they also need a critical mass of consumers and merchants to develop;

- Users – consumers and merchants - need to see the benefit of the new instrument offered to decide whether to use it or not.

In addition, payment preferences are proving hard to change and new payments instruments are slow to penetrate markets.[42] Because of these prerequisites, only major/global players are able to develop new digital payments and most of these players are not British, let alone European.

A number of new products, which were supposed to substitute for cash, such as electronic purses launched in the 2000s, no longer exist today. With the development of new payment systems which no longer require the backing of any card system, the new prophecy is now that of the demise of cards - which cash may well witness. Biometric technologies may well soon allow paying '*with a blink of the eye'*.[43]

The difficult question regulatory authorities have to face is then what new instruments to support and where to push for investments. Ideally, public authorities' support should be technology neutral as any bias of public policies toward one specific technology might then hamper the development of alternative, competing technologies. It is up to the market to decide.

[42] Zilvinas Bareisis; Innovation in Payments: Key Factors for Success; EFMA retail payment weeks; Sept 2014

[43] Cardless ATMs are being developed to operate with biometric technologies

In this context, the role of public authorities is, *inter alia*:

- Supervising new payment systems and payment services providers, maintaining trust in the system;
- Ensuring consumers and merchant protection; notably against all sorts of fraud;
- Monitoring new and existing financial activities and providing guidelines for new payments operators,
- Supervision in relation to anti-money laundering processes and anti-fraud,
- In the contest of PSD2 and the new open banking initiative, it is essential that consumers and bank account holders are fully aware of when a consent to access account data is given and, as per the newly enforced GDPR, ensure that this consent is well informed and unambiguous.

The role of public authorities is ***not*** to take direct steps in the promotion of specific payments instruments against other payments instruments, nor to assist in the development of any. As HM treasury consultation document suggests, the role of the government is to ensure fair competition with all payments instruments, including cash, and to provide a safe environment for the use of payment instruments, ensuring a high level of protection against fraud. With regards to taking steps to support the creation of alternative digital payments (section 2.9 of the consultation document) ESTA suggests that this should be strictly limited to providing a favourable environment for any new products, not to engage specifically in the creation or development of any specific product.

In this context, ESTA suggests that the role of the government should also be to ensure a level playing field between all payments instruments and that includes cash, as cash is the only payment means that requires no infrastructure and no specific terminal/equipment making payment convenient to the 2.7 million British people who heavily rely on cash, as stated in HM Treasury paper.

3. Digitalisation of payments: a move towards 'cashless' or 'less cash' society?

The major paradox of cash is that it is made available to consumers principally through banks, which have no interest in cash and even have an economic interest in the reduction of cash payments. Cash may cost banks while it often brings no "direct" revenue to them (but does earn *indirect* revenue as explained above). On the contrary, other payment instruments such as cards or bank transfers generate revenue for banks.[44] The incentive for banks to reduce the availability of cash and push their customers towards alternative means of payments is therefore obvious. It is perfectly legitimate, but is in no way in the "public" interest. [45] However cash needs to remain available to consumers and it does not have to be so exclusively through banks.

[44] Of note, the fees that can be charged for such payments has been the subject of EU legislation, be it the MIF regulation for cards or the 2012 SEPA regulation for credit transfer and direct debit transactions in Euros

[45] Cf the European Payment Council (EPC) statement in their News SECA framework of 2016 that bank infrastructure should be rationalised "in conformity with public needs (accessibility in accordance with *less* cash usage…)" (ESTA underlines)

The concerns of ESTA, shared by a number of central banks in Europe, is that banks are disengaging too quickly from cash, which they perceive as a cost they can't recharge to their customers, before alternative circuits of distribution of cash are put in place. To some extent, the reduction in the use of cash in countries such as the Netherlands and Nordic countries may be linked to the reduction of ATMs and the disengagement of banks from cash. A good sign of the desire of consumer to keep using cash is the recourse to alternative way of accessing cash, such as cashback, in countries like Norway after banks started to reduce the number of ATMs.

Such concerns have been expressed by Norges Bank in April 2016 where it said that "*banks promote the changeover from cash to other solutions, argue publicly against cash and promote their own solutions on which they can charge fees*".[46] Of note is that Norway and Denmark have passed legislation to force banks to a minimum cash service and Sweden is also considering the need to legislate. The changeover to cashless is driven by the desire of essentially one economic operator to phase out cash in order to be able to promote its own products on which, contrary to cash, it can charge fees. Cashless, or as it stand today less cash, society is therefore imposed on consumers and citizens for purely commercial reasons.

However, the inertia that banks impose on society with regards to payment is not limited to the desire to phase out cash, but also in a resistance to new, real-time digital payment. The reason for that is well described by Harry Leinonen when he says:

.

- *"Banks have delayed moving to real-time transfer due to legacy of float benefits",* and
- *"Banks have been able to delay the speeding up of interbank real-time payments by refusing to improve the delivery speed of interbank payment systems."*[47]

This just sounds like a reminder that for the banking sector, time is money. Real-time payments are detrimental to their business.

In response to the call for evidence, ESTA submits that commercial incentives to push consumers towards digital payments are good enough for the promotion of those payments services: the government should rather secure the plurality of payment instruments and notably the availability of cash to the vast majority of those who enjoy it.

A practical way of doing that would be to clarify what "legal tender" of cash means. On the website of the Bank of England, it can be read that "*legal tender has a very narrow and technical meaning, which relates to settling debts. It means that if you are in debt to someone then you can't be sued for non-payment if you offer full payment of your debts in legal tender*."[48] For this reason, legal tender should also imply that cash many not normally be refused as a payment,for example when the cash is commensurate with the price,

[46] Leif Veggum, Norges Bank; "The Impact Of The Reduction Of Commercial Banks' Footprint On The Norwegian Cash Cycle"; The Future of cash conference, Paris, 11 April 2016

[47] Harry Leinonen, Financial counsellor, Ministry of Finance, Finland ; *Developing future payment instruments ?"* SUERF Conference; Zürich 2016

[48] https://www.bankofengland.co.uk/banknotes

contrary to what may be inferred in some places where it is stated that "*shops are not obliged to accept legal tender*".[49]

The conclusion of this section belongs to Yves Mersh, Executive director at the European Central bank:

"there is one problem with the argument of a cash less society: most people don't want it!"[50]

[49] http://edu.bankofengland.co.uk/knowledgebank/what-is-legal-tender/. See also the FT article of 10 may 2018 referred to earlier - see section VI.3.

[50] Yves Mersch, Executive Director of the ECB, 28th April 2017

VIII. Responses to specific questions of the call for evidence

1. Question 1:

How do you expect digital payment methods, and the adoption of these by merchants and consumers, to change over the next 10 years? What are the drivers of this?

Digital payments have increased continuously over the last years and are expected to continue doing so according to the last World Payment Report (see section VII.1 of this submission). According to the Bank of International Settlements, the UK has one of the highest ratios of digital payment to GDP already.

ESTA does not think that the process of development of digital payment instruments will change radically in the next 10 years. The conditions for a successful launch will not differ; they are those described in section VII.2 above: large industry base to back new instruments (e.g. a consortium of banks); requirement for a critical mass of merchants and consumers and a real need/benefit for consumers to adopt new payments instruments, which also includes the issue of the cost of payments. The third condition is a 'chicken and egg' dilemma and explains why new payment methods have been almost exclusively proposed within the GAFAs, as a critical mass of users is required to take off. In essence, these conditions mean that only global players who already have a direct access to a huge number of "accounts" can expect to successfully launch a new payment method.

The development of new digital methods will continue to be driven commercially and competition between relevant operators will play a key role. As discussed above, banks have been resisting card-less payments as this means the end of the benefit they get from the float – though at the same time real time payments will be a key driver for consumers and merchants.

A critical dimension is obviously the risk of fraud and cost associated to fraud for merchants and consumers. The development of e-commerce could only be possible once a sufficient level of confidence from consumers in the security of on-line payment was achieved – or at least perceived as safe. Increasing awareness of the vulnerability of mobile payment systems is an issue.

Another critical dimension is the trust of users in the stability of the financial system. As stated in the last World Payment Report, "*the growth rate of digital payments may reduce in case of a new banking crisis*". Some advocates that the next financial crisis is "*not a if, but a when*". The government's plans in relation to the future of digital payments need to include that dimension, just in case those dark prophecies come true and the financial system is affected to a point where digital payments are compromised.

2. Question 2

What further action could the government take to support greater adoption of digital payments by merchants and consumers (including civil society groups)?

As developed throughout this contribution, the development of digital payments is driven by commercial initiatives and profit making. We think that there is *no role* for public authorities for assisting in the developments of commercial initiatives apart for ensuring a level playing field to all payment instruments, and this includes cash which is in competition with digital payments. The role of public authorities is also to ensure that privacy is respected. Please see section VII.2 for more details.

3. Question 3

Are there international examples of countries supporting the adoption of digital payments that the government should look to?

ESTA is not aware of any examples of countries actively supporting digital payments; however ESTA is aware of a number of European Countries increasingly concerned by the demise of cash fuelled by the behaviour of the banking sector (see our response to question 16, in section VIII.8 below). Cash is essentially made available to the public by banks which have alternative, more profitable, products to offer. This has led to legislation being passed in Norway and Denmark and considered in Sweden.

4. Question 4

Why does the cost of processing payments differ between cash and digital payments? How is it changing? And do you expect the change to continue?

According to the British Retail Consortium, cash remains the cheapest payment means in their last report (2016). The reason is that cash requires no infrastructure, terminal or network. For digital payments, the assessment of the cost of digital payments needs to integrate the increasing fraud that exists. This confirms a study of the European Central Bank of 2012 where it compared the social cost of all types of payments and concluded that cash has the lowest unit social cost of all.[51]

The cost of usage of digital payments is subject to a fee, or a series of fees affecting the different stakeholders in the digital payment cycle. The cost of digital payments should also include the cost related to possible disruptions and necessary contingency plans.

Cash-paying consumers do subsidise card-paying consumers:

> "*By "subsidize" we mean that merchant fees are passed on to all buyers in the form of higher retail price regardless of the means of payments buyers use to pay for the goods and services they buy. Thus, buyers who do not pay with cards, end up paying higher retail prices to cover merchants' costs associated with merchant card fees.*

[51] "*The Social and Private Cost of Retail Payment Instruments: A European Perspective*", ECB Occasional paper 137, September 2012.

> *Because merchant fees eventually subsidize the rewards given to card users, and since cash users are not rewarded, non-card payers end up financing part of the rewards given to card users."*

However, this is not the end of the transfers between cash and card payers as it also involves a transfer from low to high income consumers:

> *"Consequently, the cross subsidy of credit card payers by cash payers also involves a regressive transfer of income from low income to high income consumers. This regressive transfer is then further amplified substantially by the practice of paying rewards to credit card users because rewards also are strongly positively correlated with income."*[52]

With regard to the cost of cash, it must be recalled that cash however is a volume driven business and the more cash in circulation diminishes in society, the more its cost might increase. The government should keep this in mind if cash is to be seen as the contingency plan for digital payments in case of major disruption affecting all or a substantial part of electronic payments.

This implies that the government should also consider, as part of the digitalisation of payments, a sustainable model for cash processing in a context of lesser efficiencies resulting from lesser cash in circulation to allow for contingency purposes. Increasing the "*vulnerabilities in the economy*" resulting from higher share of digital payments comes at a cost.

5. Question 5

Who uses cash as their main form of payment and why?

ESTA has indirectly responded to the question in section VI.2 "who is going to be impacted with the reduction of cash in society", referring to work conducted by Prof Nikos Passas. Those who are the primary users are the "*2.7 million people who entirely depend on cash*" mentioned in the consultation documents. But as argued throughout this submission, they are not the only ones.

Also, "cash users" are not only limited to those who use cash to pay at a POS but include all those who use cash as a store of value, whether for precautionary purposes or because of relative distrust in the banking sector. This category of cash users ranges though the entire social category of the population and particularly among those categories that have incomes that enable them to have cash reserves. Looking at the ECB households survey of November 2017 referred to earlier, 24% of the respondents to the survey said they were holding cash reserves outside a bank. 19% declared reserved their reserve between €250 and €500, 9% above €1,000 and 2% above €5,000.

There is, in addition, another category or cash users which needs to be considered and this is those who should use *more* cash. They are the millions of Britons on the verge of over-

[52] Scott Schuh, Oz Shy, Joanna Stavins; "*Who Gains and Who Loses from Credit Card Payments? Theory and Calibrations" ; 26 March 2010n available at : https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1652260*

indebtedness or recurrently overspending because of the stimuli of digital payments. Paying in cash has numerous virtues, and primarily to make the reality and the magnitude of payments very visible to anyone.

According to the World Bank, some 139 million people in Europe (not just EU) are unbanked and use cash as the main/only means of payments. If usually the low level of income is the main explanation for people to be unbanked, it is not the only one: in Europe, 30% of people say that they have no bank account because they lack trust in the banking sector.[53]

In Britain, 2 million people were still unbanked in 2015 according to the UK financial inclusion commission and 8.8 million are over-indebted. [54] Cash is be key to them.

6. Question 6

How does cash usage and need vary by demographics, geography, and socio-economic status ?

ESTA does not have the specific data for the UK but would refer to the ECB recent households survey in the Eurozone[55] (excluding Germany) already quoted in this submission for the use of cash and the information provided by demographics by country.

7. Question 13

In what circumstances is a £50 note used in routine transactions and why (rather than multiple lower denomination notes)?

The notes distributed in ATMs are the notes which are used for transactions. If no £50 notes are distributed in ATMs, the note will not be used for transactions. A number of ATMs provide the choice of the denominations to be delivered in the cash withdrawal and consumers withdrawing cash should have the choice of the denominations they want to receive.

8. Question 16

Are there other international examples of countries managing a decline in demand for cash that the government should look to? Should the UK follow a similar pathway as other countries in modernising the currency?

ESTA is not aware of any country having "*managed a decline*" in cash, however ESTA would point to two countries which experienced sharp decline in cash use: India and Sweden.

India has probably gone through the worst experience with regard to the dire social and economic consequences of a policy to withdraw cash in circulation (also referred to as "*demonetisation*"). On 8 November 2016, Prime Minister Modi announced the withdrawal of two denominations (1,000 and 500 rupees) representing 86% of the cash in circulation. There were numerous adverse consequences flagged by the Takshashila Institution:[56]

[53] pubdocs.worldbank.org/en/113791483565360488/N2UnbankedV5.pdf

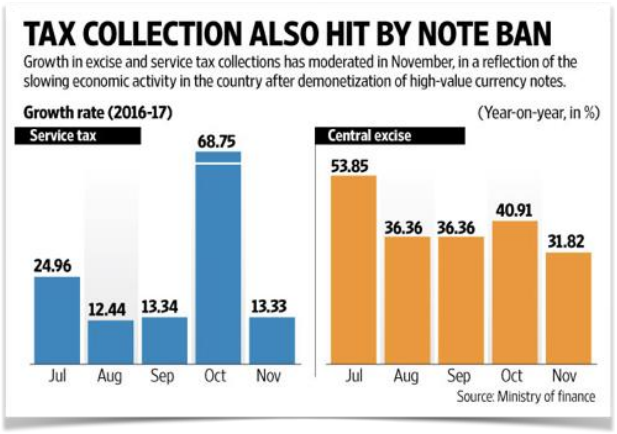
[54] http://www.financialinclusioncommission.org.uk/report ; last accessed on 4.06.2018

[55] Henk Esselink, Lola Hernandez "The use of cash by household in the Euro area"; ECB occasional paper 201; November 2017

[56] For more details, Please refer to A. Manur's presentation "the consequences of demonetisation in India", the Takshashila Institution; 2018 ESTA conference; available on request at contact@esta.biz

- Immediate shock to the economy, notably by a steep decline in GDP, a sharp reduction of private consumption and a drop in investments. This was rapidly followed by a sharp increase in unemployment (+1.5 million unemployed between January and April 2017);

- There was also a contraction of tax collection, due to the contraction of the economy (see graph).



- Concerning digitalisation of payments, an increase in debit cards payments was noted after the withdrawal, however the Indian economy still relies heavily on cash today. This was therefore both a very expensive, but also a very inefficient process.

- In the 50 days that followed the decision to demonetise, the cost was estimated to have culminated at the equivalent of £14bn, essentially borne by banks and businesses.

Sweden is the European country with the lowest level of cash in circulation, which continues to decline. The reality however seems to be that people are forced out of cash by bank branches refusing to accept cash deposits at their desk: without the possibility to deposit cash, shops and other businesses do not accept cash anymore. There is also a growing dissatisfaction in the country against this policy:

> *"Data from the Riksbank, Sweden's central bank, also suggests that anger toward the decline in cash has increased. In 2016, 31 percent of survey respondents expressed negativity toward the decline, compared to 24 percent in 2014. The increase in negativity does not mean that respondents lack access to alternative means of payment; 97 percent of respondents in 2016 said that they had access to a bank card*."[57]

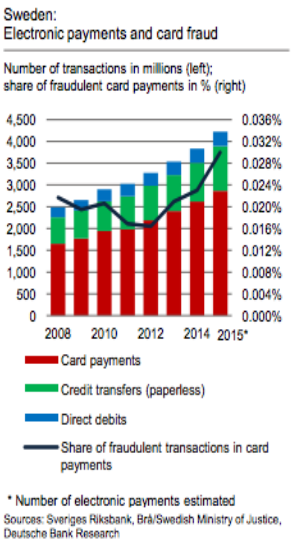
The reduction of cash in Sweden also leads to a severe increase in card fraud as can be seen from the graphs below.

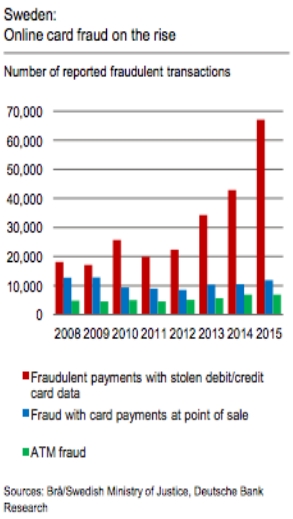
The facts that come to light are:

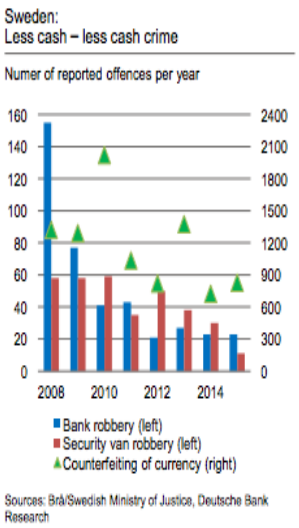
- Less cash logically leads to less cash related crimes, but inversely, more digital payments leads to more fraud. The difference however is that the risk with cash is limited to the amount in cash at stake, whilst the risk in card fraud and other non-cash fraud can extend to much more than what one has on his/her account.

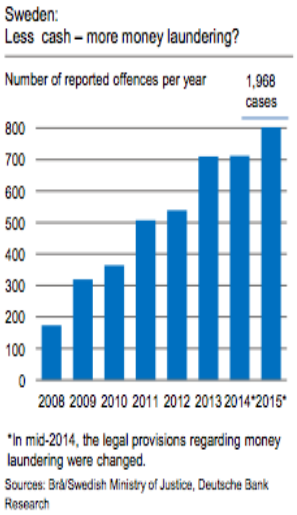
- Less cash in circulation has had no improvement on money laundering as the number of reported cases has continued to increase significantly. Cash is obviously not the culprit, and reduction of cash obviously not the panacea.

[57] See for example : http://pulitzercenter.org/reporting/swedish-opposition-cash-free-economy-gains-momentum









Quoted by N. Passas: "No cash, less Crime?", presentation at ESTA 2018 conference [58]

9. The issue of cash and fraud, money laundering and crime: questions 17 to 23

These questions raise the issue of the link between cash and a number of serious plagues in society. Before getting into the detail of our analysis on these issues, two quotes might help in putting the issue into perspective:

1. On 23rd February 2018, the Commission DG ECFIN wrote to ESTA in relation to the public consultation on cash payment limitations and the report conducted by ECORYS/CEPS on behalf of the Commission as a preparatory work for the Commission impacts assessment. The Commission wrote *"The ECORYS/CEPS report has indeed been finalised. In summary, its findings are that restrictions on payments in cash do not have any significant impact on terrorism financing, or directly on tax evasion"*[59]

2. Prof Friedrich Schneider, a world renowned expert in the analysis of crime and shadow economy, presented a research at the Bundesbank conference in Konstanz on 20-23 April 2017 which concluded: "*that cash has a minor influence on the shadow economy, crime and terrorism, but potentially a major influence on civil liberties.*"

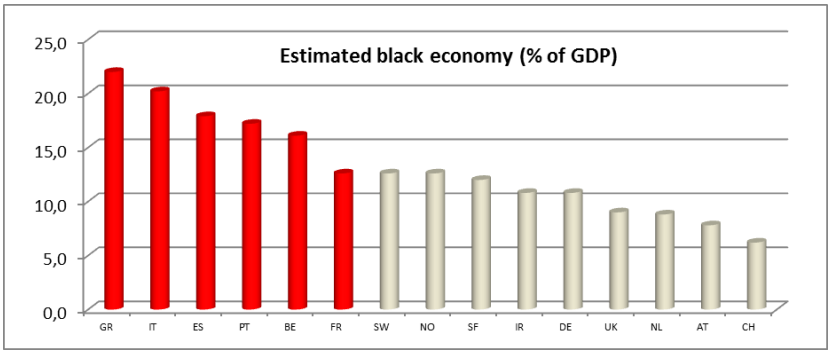
The works of F. Schneider are particularly interesting: he shows that when GDP drops by 10%, the shadow economy increases by 18%. When the share of cash payment decreases by 10%, the shadow economy only decreases by 2%. So the shadow economy is only marginally related to cash. [60] The reason is that cash is only a tool, not an end in itself. The objective is profit – it does not matter if it is in cash or non-cash.

[58] Available on request at contact@esta.biz
[59] Email from DG ECFIN to ESTA, 23.02.2018. The ECORYS/CEPS report is expected to be published in June 2018 after it presentation to the ECOFIN council.
[60] Friedrich Schneider; "Restricting or Abolishing Cash: An Effective Instrument for Fighting the Shadow Economy, Crime and Terrorism?" Bundesbank Conference in Konstanz, April 2017

In relation to **question 22** of the call for evidence, ESTA has reviewed the experience of a number of countries which have implemented restrictions on cash to tackle their shadow economy. The evidence available suggests that this has failed.[61]

Cash restrictions and shadow/black economy.

Countries with cash payment limits[62]



Estimated black economy as a percentage of GDP[63]

The map on the left shows countries with strict cash payment limitations (CPLs), which are represented in red. The histogram on the right side shows the estimated level of black economy in 15 countries, where countries with CPLs are represented with red bars. Among the countries with limits, in some cases, the limit only applies to residents, whilst non-residents enjoy a much higher limit, around €15.000 (e.g. FR and SP). Also, in some cases (e.g. FR) CPLs do not apply for transactions between private parties but only when a business is a party to a transaction.

As can be seen from the histogram above, the first six countries with the highest estimated shares of black economy are all countries which have strict CPLs in place.[64] Considering that cash payment limits were primarily introduced to address this issue and related tax evasion, the obvious conclusion is that they did not deliver as expected. If CPLs were effective tools, these countries should be on the lower end of the graph. The two countries with the highest levels, France and Portugal, have suffered an increase of their estimated black economy since the limits have been put in place.[65]

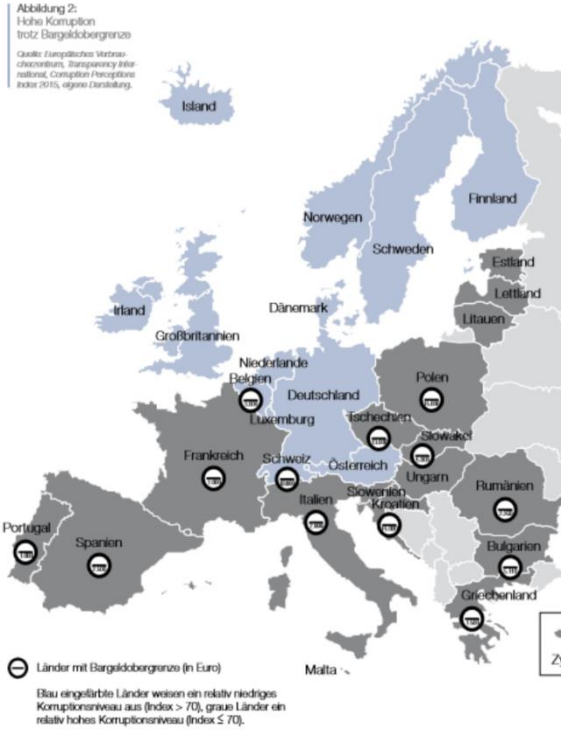
Incidentally, it can also be noted that the country with the highest bank note denomination, Switzerland (CHF1,000), has the lowest estimated share of black economy.

[61] This is based on ESTA's response to the 2017 Commission consultation on cash payment restriction, available at www esta-cash.eu.
[62] Source : centre européen des consommateurs
[63] Source : Schneider/Boockman, quoted in "*Bares Bleibt Wahres Bargeld Als Garant Für Freiheit Und Eigentum*", Stiftung Markt Wirtschaft, November 2016
[64] We don't have the data of estimated black economy for the other countries applying strict cash limits
[65] Cf. "*Bares Bleibt Wahres Bargeld Als Garant Für Freiheit Und Eigentum*", Stiftung Markt Wirtschaft, November 2016, page 5

Cash restrictions and corruption

The same applies to corruption, where the countries with CPLs are also those which have the highest level of corruption. The map below combines the maximum level of payment in cash and the corruption index based on Transparency International standards for a number of European countries.[66]

The dark grey countries have the worst corruption index, and lighter grey a better corruption index. The map overlaps with that of CPLs, where countries with higher corruption are also the countries with strict CPLs in place.



According to the authors of this research, corruption index in France and Spain have worsened since the introduction of their CPL whilst those in Germany and other countries without CPL have improved.

There is arguably no 'correlation' between CPLs and corruption; however the unavoidable conclusion is that CPLs have done little, if anything, to fight corruption.

Source: Stiftung Marktwirtschaft 2016

In response to **question 23**, the above shows that cash restrictions have delivered very little with regards to shadow economy and corruption. This experience suggests public authorities should more efficiently devote efforts and resources differently to track illegal activities, crime and money laundering than targeting cash. This does not mean that cash is never used for such purposes, but the scale of cash involved in illegal activities is much lower than the sums involved in non-cash laundering. One of the reasons is that cash needs to be physically transported which makes is very cumbersome and conspicuous when big sums are concerned.

Question 17 on *"which sectors or circumstances would cash usage likely increase tax evasion; hidden economy and money laundering*" raises reveals a clear suspicion against cash. As will be explained below, cash plays no specific role than non-cash and most tax fraud is not cash related. Looking at chart 4A of the consultation document (page 15), a number of sources explaining the tax gap are not cash related:

- *Failure to take reasonable steps*
- *Legal interpretation*
- *Error*

[66] *Ibid.*

- *Non payment*
- *Tax avoidance*

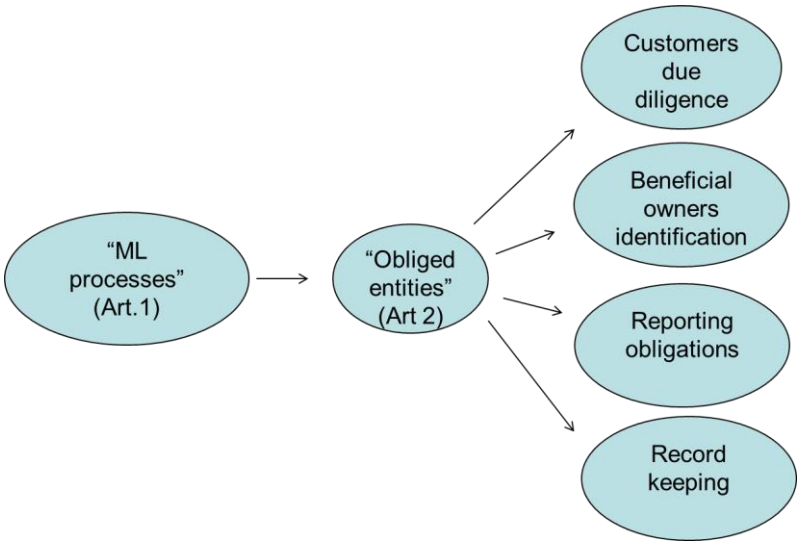
The three remaining grounds (evasion, criminal attacks and hidden economy) may be related to cash, but the non-cash element is real and substantial. As we argued in this submission, the issue of hidden economy is mainly non cash driven, and cash only plays a role for lower amounts than non-cash.

Question 20 looks at how to address cash related tax evasion hidden economy and money laundering. We have just referred to the work of F. Schneider to show that hidden economy was not fuelled by cash, or dependant on cash, to flourish. Concerning tax evasion, tax avoidance and money laundering, however, cases with big sums of cash are rare. The cases which have been on the headline of newspapers recently were all non-cash cases of money laundering: please refer to the Laundromat case where US$ 21bn was laundered without cash involved[67], or the panama and paradise papers on 40 years of laundering involving no cash.

The structure of EU anti-money laundering policies

With reference to money laundering, it is striking that all five anti-money laundering directives (AMLDs) adopted since 1991 by the EU do not address cash specifically, other than providing for mandatory due diligence on persons trading in goods over 10,000 euros. The reason is that money laundering processes are the same irrespective of the forms of the sums to launder. Arguably, if one has a few millions pounds to launder, the process is likely to be much easier if not in cash, through adequate financial engineering and a few shell companies. The volume and weight of several millions in £50 notes, the highest denomination, would be a problem in itself.

The structure of anti-money laundering is described in the chart below:



Source: ESTA

[67] https://www.occrp.org/en/laundromat/

It works the following way:

- It defines money laundering processes very comprehensively (i.e. acquisition, transfer, use, concealment etc. of property derived from or related to crime);
- It identifies who can be instrumental to launder (the '*obliged parties'*: initially financial and credit institutions, then lawyers, accountants, casinos, estate agents, trust and company service providers, high value dealers etc.);
- It provides for a number of general principles and obligations recalled in the chart above, and in particular the obligation to report any suspicious transactions;
- In addition, it defines "*property*" very widely *("assets of any kind, whether corporeal or incorporeal, movable or immovable, tangible or intangible, and legal documents or instruments in any form including electronic or digital, evidencing title to or an interest in such assets").*

Therefore it does not need to cover cash specifically; however as can be seen from the recitals of the directives as well as from the list of 'obliged entities', each new iteration of the directive gradually targeted essentially non cash operations.[68]

International transfer of illegal money: only fools would use cash.

A last example to be cited in our response to this call for evidence concerns international transfers of illegal sums. The general belief of the layman may be that these sums are converted into cash, put in containers and transported worldwide to where they need to be: this however takes time, has a high cost and involves the risk of being spotted somewhere by the customs of any destination or transit countries.

The reality is very different and involves no cash at all: sums in the origin country are converted anonymously with a computer into any crypto-currency. As crypto-currency, they are then transferred with another click and within a few seconds to any place in the world where they are converted with a third click into any other currency. The cost is virtually nil, the time spent is only a few second, the risk is zero and the risk of losing (or gaining) with the volatility of crypto-currency is nil since the transaction will use the crypto currency for just a few seconds – no time for significant change in value.

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[68] Even AMLD 5, adopted further to the February 2016 action plan against the funding of terrorism does not include any new provision on cash, despite the fact that the action plan states that "cash is widely used" by terrorists.