

The Great Paradox of Cash and Why Its Reign is Far From Over

Marc Schwartz, Yannis Messaoui

January 2021

The media often report that cash will soon be a memory of the past, even though the circulation of fiat money (coins and bills) is at a historic high. Despite increased competition from digital means of payment, cash is here to stay.

1) The volume of cash in circulation is on an ever-increasing trend

The demand for cash can be measured by looking at the value of coins and bills in circulation or at the ratio of the value of cash in circulation to GDP. These two indicators clearly show that the demand for cash is experiencing continuous growth globally, with some notable exceptions (China, Sweden...). Cash in circulation for both the euro and dollar has been steadily increasing by about 6% to 8% annually over the past twenty years. Since the introduction of the euro as a fiat money in 2002, the value of euros in circulation has been multiplied by a six-fold factor. The ratio of cash in circulation in the Eurozone has doubled between 2006 and 2019, increasing from 5.1% to 11.1%.

Fears that cash could act as a transmission vector at the onset of the COVID-19 pandemic were debunked. Cash in circulation experienced tremendous growth in 2020: +11% for the euro and +15% for the USD. This can most likely be attributed to a hoarding phenomenon. Contrary to popular belief, the global health crisis sparked a real scramble for cash.

From a macroeconomic standpoint, the demand for cash is positively correlated to economic growth and negatively correlated to interest rates. In times of crisis, uncertainty affirms the role of cash as a compelling store of value.

Fiat money is still in high demand and widely used for all its intended purposes. The increasing trend of cash in circulation can mostly be attributed to the macroeconomic conjuncture (sustained economic growth, low interest rates), the systemic uncertainty due to economic crises, and the appealing nature of cash as a means of payment.

2) Cash still plays an important role as a means of payment

Alternatives to cash are becoming more ubiquitous, resulting in a decline in the use of cash as a means of payment. Consumers own more and more payment cards and the value of card payments has doubled since 2000 globally. Contactless payment is now a direct competitor for cash, bolstered by a decrease in the legal minimum transaction amounts for such payments.

Even though the transactional use of cash is decreasing, ECB data shows that cash remains the primary means of payment in the Eurozone. In 2019, cash accounted for 73% of all payments in the Eurozone (vs 24% for card payments) and 59% of payments in France (vs 35% for card payments). Cash is generally preferred for lower value transactions.

The global health crisis contributed to accelerating the decline in the use of cash as a means of payment. 40% of the people surveyed by the ECB in a 2020 study stated that their use for cash for groceries and other everyday transactions has decreased. Studies conducted in the US and Canada show similar results.



Two contrasting trends emerge: the use of cash as a means of payment is declining whereas its use as a store of value is skyrocketing. The COVID-19 pandemic undeniably accelerated the transition towards digital payments, but it did not turn cash into an obsolete means of payment.

3) A shifting paradigm: from the death of cash to its defense

Sweden was the first nation to claim the advent of a cashless society. In 2018, the country reversed course and began advocating for cash. The ECB and the European Commission welcomed the policy change and took the opportunity to reaffirm their commitment to ensuring that cash remain “widely available and accessible”. This paradigm shift marks the status of cash as a public good.

There are several reasons to argue in favor of cash:

Cash is a *means of payment* that is *universal, free and easy to use*. Coins and bills are the only money that is acceptable as legal tender and they instantly settle transactions.

Cash is an *inclusive means of payment*, particularly for those who do not have a bank account (30 million people in Europe) or those who do not feel comfortable using digital technology (20% of the French population).

Cash is *the most resilient means of payment*. Cash does not require any specific infrastructure, unlike digital payments which are vulnerable to power outages and natural disasters.

Cash preserves freedom of choice between means of payment, which in turns guarantees confidence in the currency.

Cash protects personal payment data, unlike digital payment companies that use the data for advertising. Even though cash is often criticized for enabling criminal activity, coins and bills are far from being the only means of payment that can be used to fraudulent ends.

Cash holds a special place in people’s hearts, for rational reasons as well as psychological and symbolic reasons. Money is not just a means of payment. It is an economic institution that creates a sense of belonging to a community.

4) Towards a Central Bank Digital Currency?

Central Banks could issue a digital currency (CBDC), which would be similar in use to the commercial digital money that we interact with on a daily basis. However, the existence of this digital cash is conditional on it featuring the same advantages as cash, a not so easy task. A Central Bank digital currency also creates the risk of a disintermediation of the banking system.

Central banks are conducting experiments and research regarding CBDC. It seems unlikely that a Central Bank digital currency will become widely available in the short term.

*

The global health crisis undeniably accelerated society’s transition towards digital payments. However, the coronavirus pandemic did not mark the death of cash. Quite the opposite in fact, the pandemic triggered an acceleration in the demand for cash. This is the great paradox of cash: the crisis is both alienating some from paying with cash and making cash more appealing. The reign of cash is far from over: getting rid of a public good is not so easy!

