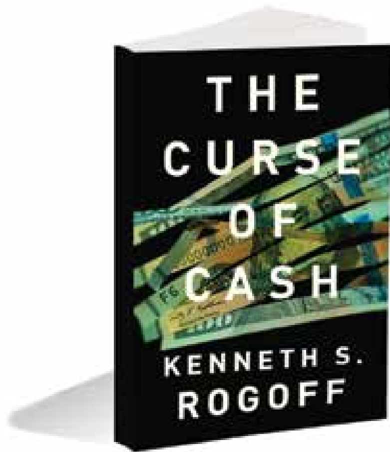
# A Barbaric Relic




*Kenneth S. Rogoff*

**The Curse of Cash**

Princeton University Press, Princeton, New Jersey, 2016, 248 pp., $29.95 (cloth).

The Johns—Law and Keynes—strove to defenestrate gold, and they rather liked fiat paper. But advances in payment technology have always driven both new payment media and monetary theory. Technology is such that physical media *can* now mostly be abandoned in wired societies. In *The Curse of Cash*, Kenneth Rogoff passionately presses the case that they *should* be eliminated because the social ravages of paper currency far outweigh the benefits.

If such a plan is ever fully implemented, this book will have been at least its initial, if not ultimate, blueprint. Meticulously written, it covers everything needed for such a monetary reform. But the book is not excessively polemical. Rogoff details almost all the arguments against tinkering with paper currency, then labors to refute or defuse them.

The plan allows for both macroeconomic reform and possibly massive confiscation of illicit cash. Its boldness in these dimensions reminds me most of the Colm-Dodge-Goldsmith Plan of 1946 for German monetary reform. But, to state my doubts up front, given that precursor, I am skeptical that it can ever be implemented without an occupying army or a totalitarian regime that forecloses the issuer's geopolitical aspirations.

Critiques against today's currency denominations have become a cause célèbre for senior academic economists. Foremost, high denominations are the lifeblood of the underground economy. At a minimum, Rogoff and others want to eliminate large denominations like $100, €500, and Sw F 1,000 notes.

Eliminating paper currency would have numerous desirable effects, including reduced tax evasion for high-volume cash and off-book businesses and unreported wages. Terrorists, human traffickers, drug dealers, gunrunners, corrupt politicians, and dictators would risk confiscation of their cash or at least disruption of their activity.

> Rogoff and others want to eliminate large denominations.

What of lost privacy in personal transactions? That ship has already sailed in a society with ubiquitous video surveillance, U.S. National Security Agency snooping, and massive data gathering by social media and other hackers. Will the illicit activities simply find alternative mechanisms? What of the socially positive uses of underground cash? People in egregiously run economies would lose an avenue to escape hyperinflation. A large unbanked population needs physical money, and people need cash when power outages disrupt electronic transactions.

To address these objections, Rogoff suggests workarounds. He compiles evidence that the social gain to currency elimination would outweigh the loss, but concedes that it is a judgment call. A relentless prosecutor, he loads the indictment with every conceivable crime: paper currency is a vector for disease!

But he neglects a crucial rationale for high denominations. Great-power currency and financial instruments play a dual role: they are tools of economic and financial policy and conduits of geopolitical power. There is tension between them. Maintained at great economic cost, the euro makes little sense outside the geopolitical sphere. Disadvantaging itself economically, the dollar system, including paper currency policies, has focused ever more on geopolitical goals. For example, to overthrow the Taliban, U.S. agents delivered blocks of $100 notes to mercenary tribal armies to get them to switch sides. Stanford University economist and former Treasury Under-Secretary John Taylor has recounted how the United States flew in bales of $100 notes to pay the Iraqi bureaucracy prior to currency reform. Sometimes dictators are paid to support the interests of high-denomination issuers. If the United States and Europe eliminated their currencies, they would have to buy even larger planeloads of 100 yuan notes for such national security operations. This is enough to convince me that paper denominations high in real value will endure.

Even the European Central Bank's plan to stop issuing €500 notes will do little to reduce the outstanding stock in the near future and seems geared to increase it. On a contrary tack, the United States ceased issuing denominations higher than $100 in 1969 to preclude their illicit use. Subsequent inflation has increased by sevenfold the weight of $100 notes needed to service a kilo of cocaine. Inflation is doing Rogoff's work without requiring explicit action!

But if a logistical headache for money launderers is Rogoff's true goal, why not simply increase the physical dimensions of high-denomination notes without jumping through the flaming hoop of elimination? Before 1929, U.S. currency was 40 percent physically larger than it is now. Restoring that size or making it even larger would instantly work the wonders of decades of inflation. The iron law for subverting illicit economies: a percentage increase in physical note size is equivalent to the same percentage increase in the price level.

***Peter Garber***
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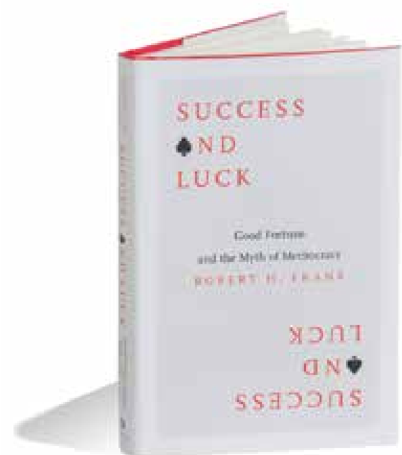
# When Winners Don't Take All




*Robert H. Frank*

## Success and Luck

### Good Fortune and the Myth of Meritocracy

Princeton University Press, Princeton, New Jersey, 2016, 187 pp., $26.95 (cloth).

In their 1995 book, *The Winner-Take-All Society*, Philip Cook and Robert Frank looked at the competition for fewer and larger rewards in winner-take-all markets. They postulate that these markets—in which the best performers capture the most rewards, leaving remaining competitors with very little—have led to spiraling income inequality, higher consumption spending, and perhaps, with their emphasis on winners only, a dilution of culture itself. Since that book's publication, Frank has been a strong proponent of the idea that a progressive consumption tax might end the income inequality spiral and divert funds from consumption spending to saving and investment.

His latest book, *Success and Luck,* follows naturally from his earlier work. It is a compelling discussion of how winner-take-all markets work, the rising income inequality and "expenditure cascades" in these markets, the economic need for winners to acknowledge the role of luck in such markets and thereby be willing to share their winnings for the common good, and how a change in tax policy might ameliorate some of these problems.

Frank, a professor of management and economics at Cornell University, argues that talent and hard work alone do not necessarily lead to proportional success in the market. Chance events such as being born into the right family (the influence of genes and early family advantage) or the right country (the influence of the physical, financial, cultural, and educational environment) also contribute greatly to success.

The effect of these chance events, or luck, is magnified in winner-take-all markets, he says. The winner, who may be only slightly better than the second best, takes all, thanks to open markets, most people's inability to choose among competing options because of a lack of time and energy, and the network effects of social media. Thus, rewards depend more on relative than absolute performance (think of the incentives for athletes to dope!), and rewards are highly concentrated in the hands of a few. Winners then lobby government to lower top tax rates and reduce regulations, which leads to spiraling income and wealth inequality.

One interesting implication is that as the wealthy spend more, those in lower income tiers also spend more—what Frank terms the positional arms race. The idea of what is "adequate" keeps changing with rising income inequality (reminiscent of Amartya Sen's influential essay *Poor, Relatively Speaking*). For those with lower incomes, this creates inordinate financial distress.

Frank then introduces the role of luck in winner-take-all markets. Using simulations, he illustrates why the biggest winners are almost always lucky—when all competitors are extremely talented and hardworking, winning requires almost everything to go right. Drawing on behavioral economics and experiments in psychology, Frank shows that winners themselves tend to downplay the role of luck. The notion that they worked hard is cognitively more "available" than the notion that they were lucky. And downplaying the role of luck encourages more hard work and effort.

Frank claims that there is an economic cost to underestimating the importance of luck. Winners who believe they have a legitimate claim to their winnings become reluctant taxpayers, making it more difficult to raise revenue for economic investment. Those who acknowledge luck's role in their lives are more likely to feel grateful for their success—and to share their winnings to support the common good.

> There is an economic cost to underestimating the importance of luck.

Finally, Frank argues that a change in tax policy—replacing the current progressive income tax with a much more steeply progressive consumption tax—could increase saving and investment and reduce spending. He shows evidence of both conservative and liberal interest in such a tax and provides examples of how it could be implemented.

Given the rising concern with income inequality during this U.S. election season, the tenuousness of the U.S. federal government's budget as baby boomers retire, and the urgent need for infrastructure investment, this book could not be more timely. It is not just another tax proposal; the author has deftly constructed a coherent framework for understanding some of society's most pressing issues. It is a quick and thought-provoking read—and provides far more economic insight than its title suggests.

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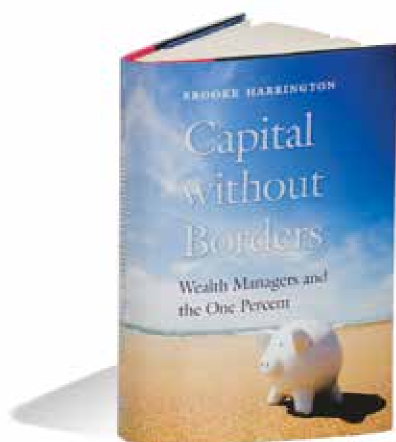
## Control the Manager




*Brooke Harrington*

**Capital without Borders**

**Wealth Managers and the One Percent**

Harvard University Press, Cambridge, Massachusetts, 2016, 358 pp., $22.95 (cloth).

Best-selling author John Grisham is famous for his detailed research before he even sits down to write a novel. Sociologist Brooke Harrington, the author of *Capital without Borders*, took the even more immersive approach of ethnography to try to understand wealth managers, who, she argues, helped create today's enormous wealth inequality. Eight years of research, including earning wealth management credentials and conducting 65 interviews with wealth managers in 18 countries, have allowed her to lift the veil of the wealth management profession.

The history of wealth management goes back to the medieval era, when a landowner away on military service would transfer the title of his assets to a trust. The process of recognizing trustees as professionals started later, in the 19th century. In the past 20 to 25 years, protection of wealth from taxes and other regulatory authorities has become a worldwide business, requiring coordination among banks, law firms, and accounting firms. Harrington argues that this change demands a new kind of professional expertise serving transnational and hypermobile capital and clients. Established in 1991, the Society of Trust and Estate Practitioners, known as STEP, counts 20,000 such experts.

Harrington finds that wealth managers have been innovative in developing tactics and techniques that help their clients benefit from legal loopholes and conflicting rules in cross-border transactions (so-called regulatory arbitrage) to minimize tax payments, protect assets from creditors or divorced spouses, and transfer wealth to future generations. The use of offshore financial centers—which shelter trillions of dollars in private and corporate wealth—has become an essential component of wealth management plans for corporations and individuals. Wealth managers place each asset in the jurisdiction most favorable to the client's interests and disperse these assets as widely as possible. Some even draft laws on behalf of foreign governments to enable them to attract more investment from abroad and have mocked Bill Gates's failure to set up Microsoft overseas.

While the profession tends to regard tax avoidance as a form of self-defense against the excessive exercise of government authority, the vast majority of wealth management practitioners avoid criminal acts at all cost, says Harrington. But that does not stop them from adopting strategies that, albeit legal, are socially destructive. It is "a game of playing cat and mouse with tax authorities around the world," says one wealth manager.

Harrington identifies two ways the work of wealth managers exacerbates inequality: by keeping wealth in families for generations and facilitating tax and debt avoidance. Dynastic wealth endures through the intervention of these professionals, contributing to 0.7 percent of the global population holding 41 percent of the world's wealth. Wealth managers' skillful use of trusts and other structures also reduced public awareness of this extreme concentration of economic power.

However, dark clouds are rapidly gathering in the world of the ultrarich and wealth managers, Harrington tells us. In April 2009, Group of 20 (G20) top industrial economy leaders took action to end the era of bank secrecy. This initiative improved countries' capacity to tackle tax evasion through offshore financial centers and banking secrecy. All financial centers committed to comply with the international standards on tax transparency or risk being labeled as noncooperative jurisdictions. Automatic exchange of information is to start by 2018 at the latest. Countries must also provide information on beneficial owners.

> "It is a game of playing cat and mouse with tax authorities around the world."

But financial secrecy and opacity are far from dead, writes Harrington. New constraints will engender new financial-legal innovation, or "creative compliance," as wealth managers reorient their services to conform to the law. Harrington concludes by suggesting a shift in attention from the wealthy who want to hide their assets to the professionals who make it happen. "The goal should be to encourage wealth managers to apply their formidable legal, organizational, and financial skills in ways that are less harmful—or even beneficial—to states and societies," she says.

A useful volume for tax policymakers and tax inspectors, the book is also timely: the leak of documents from Panama-based law firm and corporate service provider Mossack Fonseca—known as the Panama papers—led the G20 to improve transparency and exchange of information to stop tax evasion and avoidance by offshore financial centers.

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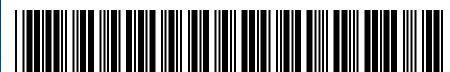


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