The Bank of England lends inadvertent support to my tax...

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I [mentioned yesterday how hard it would be for the Bank of England to get rid of cash](#), as Andy Haldane has suggested might be necessary for monetary policy to work.

It was odd he suggested this [in the same week that the Bank of England Quarterly Report](#)suggested a rising demand for cash (that is notes, especially). As they noted in a new article out last week the demand is up:

And as they say:

The growth in demand has been driven by three different markets.

The evidence available indicates that no more than half of Bank of England notes in circulation are likely to be held for use within the domestic economy for transactions and for 'hoarding'.

The remainder is likely to be held overseas or for use in the shadow economy. However, given the untraceable nature of cash, it is not possible to determine precisely how much is held in each market.

So the three markets are for legitimate transactions, illicit transactions and overseas hoarding.

The demand for cash for legitimate transactions is falling. As the BoE note:

This suggests that between 21% and 27% of total UK cash was held within the domestic transactional cycle at any one time in 2014. However, as a proportion of UK cash, transactional holdings have been in gradual decline, down from between 34% and 45% since 2000.

And they also note that the demand for domestic hoarding is relatively immaterial (£5 billion).

Despite this they say:

[G]rowth, which has been concentrated in the two highest denominations – £20 and £50 notes – has outpaced growth in aggregate spending in the economy.

And that makes no sense, given the declining demand in the domestic economy, unless the growth relates to an increase in the shadow economy, on which the BoE commentary is (to be polite) naive. They say:

The shadow economy is defined broadly as covering 'those economic activities and the income derived from them that circumvent or otherwise avoid government regulation, taxation, or observation'.

The source for that is Prof Friedrich Schneider, whose work I have also used. Then they add:

This comprises of two elements: (i) legitimate activities that are concealed from the authorities; and (ii) illegal activities and transactions.

And then they quote a Schneider report for the Institute of Economic Affairs report that estimated the size of concealed legitimate activities to be equivalent to 10.3% of GDP in 2012, with it having declined relative to GDP since the late 1990s. There are two things not mentioned here. The first is that the decline is small. The second is that this figure does not cover illegal activities and transactions. They instead note:

This estimate was one of the lowest of all OECD countries

And that

HM Revenue and Customs estimates that the value of uncollected tax, which includes estimates for hidden activity and tax evasion, has been broadly stable over the past decade

This makes the heroic assumption that HMRC, on a massively declining sample size which they use to make this estimate got it right, and that with a massively declining number of staff the data available from which to sample had not itself shrunk. I think neither an appropriate assumption.

They're also wilfully optimistic on illegal activity, saying:

In relation to illegal activities, data from the Home Office indicate that incidents of crime may have fallen in each year for the past decade, with significant reductions in robbery, theft and domestic burglary.

This is ridiculous data to use: it is fraud that matters here and they appear to be specifically ignoring it to conclude that:

Together, this evidence suggests that activity in the shadow economy has not seen significant growth, so transactional holdings of cash in the shadow economy are unlikely to have been the primary driver of the growth in banknote demand in recent years.

Which is a conclusion in stark contrast with a previous statement in the report that said:

No single source of demand is likely to have been behind the sustained growth. Indeed, the stock of notes held within each of the three markets for cash is likely to have grown.

This comment is hard to understand when they have already said domestic legitimate demand appears to be falling, as noted above, and when they also note that the use of money in the overseas shadow economies is restricted almost entirely to those largely domestically unseen £50 notes that it seems the Bank of England produce almost entirely to assist criminality but which constitute only about 20% of all cash.

In fact, given that the Bank of England specifically endorses the view that I share that at least 10% of the UK economy is in the shade, meaning that the recorded economy that is reflected in GDP is only about 90% of the total and that therefore £180 billion of shadow economy transactions take place a year (at a tax evasion cost of around £70 billion, whatever HMRC might like to say) the explanation for the rise in cash use and holding would actually seem to be obvious. The facts all point to there being a rise in illicit trading in cash, as I have long suggested. In that case it seems to me that the BoE is offering internally inconsistent explanations in its article to avoid reaching that same conclusion when it seems to be the only obvious one available.

So three obvious questions arise.

The first is why the BoE is offering such inconsistent explanations within its own work?

The second is why is it that the obvious conclusion that if domestic demand for legitimate cash is falling and overseas demand is not changing significantly the obvious conclusion that increased demand for cash for illicit transactions is growing cannot be stated, even if it contradicts HMRC?

And third, why is the BoE still producing £50 notes and what is more, why have they no plans to replace them and so withdraw this currency when it is used for largely illicit purposes?

I think some explanations are required.

In the meantime, all I can see is evidence that my tax gap estimates look very likely to be right.