Means of Payment, the Unbanked, and EFT '99

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The Debt Collection Improvement Act of 1996 mandated that all federal payments except tax refunds were to be made by electronic transfer by January 2, 1999. Such payments consist mainly of government benefits such as Social Security or Supplemental Security Income but also include other payments, such as those to vendors.[1] The goal of the mandate was to save the government money by having payments switched from paper checks to less expensive electronic transfers.

The government's move toward electronic means of payment comes at a seemingly opportune time. Recent developments in telecommunication and computer technologies have greatly reduced the cost of electronic communication. A growing number of consumers regularly make purchases and pay bills electronically. Despite this trend, however, there is an important impediment to the government's move: Nearly 15 percent of U.S. households, most of which are low-income, do not own checking accounts.[2]

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[1] Requirements to make payments by electronic transfer are also found in the Welfare Reform Act of 1996. This Act required that welfare benefits, the costs of which are shared between the states and the federal government, be paid electronically by the year 2002.

[2] We will use the term *low-income* to refer to people who are generally less financially secure. Though this label is too broad for the population we study—for example, even students and wealthy people can have low incomes—we follow this convention because the label is commonly used in this manner.

This obstacle delayed the implementation of EFT ’99, the electronic funds transfer portion of the Act. In particular, the Department of the Treasury discarded early plans that required *all* government beneficiaries to receive their payments electronically because the requirement would have imposed a hardship on those without accounts. Instead, the Treasury instituted a strategy of encouraging government beneficiaries to receive payments voluntarily by electronic means. At the center of this strategy was the creation of an inexpensive type of bank account called the Electronic Transfer Account (ETA) through which beneficiaries could receive their payments electronically.

We have two specific objectives in this article. The first is to understand why low-income households choose certain means of payment. In particular, we want to understand why so many people in this group do not own checking accounts. The second objective is to use these findings to assess EFT ’99. Understanding why many people do not own checking accounts will provide insight into whether ETAs are likely to be adopted.

Throughout our article we refer both to quantitative and qualitative sources of information. In particular, we report on the results of two focus group interviews and use this information to elaborate on the quantitative findings. We believe that field research is an important method for gathering information about low-income households’ need for and use of financial services. Our hope is that, by example, this article illustrates the value of these research methods. (See the Appendix for detailed information about our field research and the two focus groups.)

We start by reporting information on the “unbanked,” that is, people without bank accounts.[3] We describe who they are and study their tradeoffs between owning and not owning a checking account. We find that many of the unbanked have inexpensive alternatives to account ownership for their payment services. The majority of the unbanked are cashing their checks for free, ironically, at banks and other institutions such as grocery stores. Few of the unbanked use the much-maligned check-cashing outlets as a regular source for cashing checks. We also argue that, for low-income individuals, owning a checking account can be more expensive than is commonly believed. In particular, we speculate that checking accounts are expensive in part because of the implicit credit extension they contain. Moreover, we find that a small fraction of people forgo bank accounts because their creditors can seize their bank account balances to satisfy debts. For these reasons, we conclude that forgoing the use of a checking account is a rational decision for many of the unbanked. Furthermore, our analysis suggests that ETAs will not be widely adopted by the unbanked.

[3] Throughout this article, *bank accounts* will refer to accounts held at banks, thrifts, and credit unions.

1. BACKGROUND INFORMATION ON THE UNBANKED

There is a surprisingly large percentage of the population that does not own an account at a depository institution. According to the Federal Reserve’s triennial Survey of Consumer Finances in 1995, 13 percent of households (roughly 13 million of them) had no bank accounts of any kind and 15 percent did not own checking accounts.[4] These numbers have fluctuated somewhat over time. In the 1977 survey, 9 percent of households did not own bank accounts while in the 1989 survey, the number rose to 15 percent (Kennickell, Starr-McCluer, and Sunden 1997).[5]

Likewise, many recipients of government benefits are unbanked. According to Hawke (1997), the number is at least 10 million. Many of these beneficiaries receive their benefits from the Social Security Administration (SSA) and the Supplemental Security Income (SSI) programs. We do not know the breakdown of the unbanked by each of these programs, but we do know the number of payments each agency makes by check; presumably these two numbers are positively related. For example, the SSA program distributes benefits to 44 million people: Over the six-month period from October 1, 1998, to March 31, 1999, it made 270 million payments, 25 percent of which were by check. The SSI program distributes benefits to 6 million people and, over the same period, it made 40 million payments, 54 percent of which were by check. It is worth noting that the SSI program mainly distributes benefits to low-income people, which, as we will see, is the demographic group most likely not to own an account.

Sources of Information

In general, little information has previously been published about the unbanked. The Fed’s Survey of Consumer Finances, which collects detailed information on financial asset holdings of U.S. families every three years, is useful for determining the characteristics of the unbanked because it collects demographic information and data about checking account ownership.[6] It does not collect information, however, about how the unbanked make and receive payments.

For details on payment methods, we sought answers from three specialized surveys and from fieldwork. The first survey was one conducted by John Caskey, as reported in Caskey (1997). His telephone survey asked 900 people

[4] Other data sources give estimates of the unbanked that range from 8 percent to 20 percent. See Hogarth and O’Donnell (1999) for a summary of these sources.

[5] As this article went to press, the 1998 numbers were released. The survey found that the number of households without checking accounts had dropped to 13.2 percent (Kennickell, Starr-McCluer, and Surette 2000).

[6] For more information on the Survey of Consumer Finances and for findings from the 1995 survey see Kennickell, Starr-McCluer, and Sunden (1997).

with incomes less than $25,000 about their use of the “alternative financial sector,” e.g., check-cashing outlets, pawnshops, and consumer finance companies. The survey was conducted in only three locations (Atlanta, Oklahoma City, and a group of five smaller Pennsylvania cities), so it is not clear how representative its results are. Nonetheless, the results are valuable for our purposes because the survey was designed to answer questions similar to ours.

The second specialized survey was conducted by Booz, Allen & Hamilton and Shugoll Research (1997). The Treasury commissioned this group to obtain information about the banking patterns of government beneficiaries. Like the Caskey survey, it measures variables that are of interest to us, though some caution should be used in interpreting its statistics. The survey oversamples the smaller government programs, undersamples the larger SSA and SSI programs, and does not adjust the reported results for these sampling rates. Furthermore, this survey was administered in two parts, a telephone survey followed by a mail survey of people whose telephone numbers were unavailable. The mail survey is particularly significant for our purposes because low-income people, who comprise most of the unbanked, are less likely to own a phone. Because the results differed so often between the two types of surveys, we report the results from each separately.

The third survey, also prepared for the Treasury, is Dove (1999), which studied the banking patterns of government beneficiaries. This survey was administered by mail and received 385 responses from individuals without bank accounts.

Responses from two focus groups constitute our final source of information. Focus group participants, drawn from two Richmond area low-income housing developments, were asked questions about their use of financial services, including payment services.[7]

Although information from sources such as focus groups are qualitative and not easily quantified, it can be useful in several ways. First, good qualitative research is a foundation for more formal quantitative research. Evidence from focus groups and other qualitative sources provides an important guide for developing more formal instruments. As we will see, several findings from the two focus groups were quantitatively important factors in the specialized surveys. Second, qualitative research allows investigators to gather more detail and probe further into issues than does quantitative research. In this article, we use the focus group responses to provide additional insight into answers cited by the quantitative surveys. We view this evidence as illustrative, suggestive, and indicative of directions that future research should explore.

[7] More information on how the focus groups were conducted is contained in the Appendix.

Table 1 Demographic Characteristics of the Unbanked

Characteristic	Percent
Overall	12.6
Race/Ethnicity	
Hispanic	29.7
African American	36.9
White	7.4
Other	10.7
Gender	
Male	9.7
Female	19.9
Age	
• 24	28.1
25-34	16.1
35-44	12.3
45-59	10.8
60-64	12.5
, 65	8.1
Average Education	10.8
Income	
• $9,999	38.4
$10,000-$24,999	16.9
$25,000-$49,999	4.8
, $50,000	1.2
Marital Status	
Married	6.7
Unmarried	19.0
Employment Status	
Employed	9.4
Retired	7.9
Laid Off/Unemployed	42.5
Other Not Employed	30.3

Source: Hogarth and O’Donnell (1997).

Who Are the Unbanked?

Most of the unbanked are low-income individuals. Table 1, calculated by Hogarth and O’Donnell (1997), lists demographic characteristics of the unbanked from the 1995 Survey of Consumer Finances. Income stands out as an important indicator of whether or not someone owns a checking account. Among those with $9,999 or less in annual income, 38.4 percent do not own bank accounts. This percentage drops dramatically to 16.9 percent for those with incomes of $10,000 to $24,999, and to less than 5 percent for those with incomes of $25,000 to $49,999. Other demographic characteristics, such as whether one is a minority, unemployed, young, or single, or possesses a low level of education, are also highly correlated with not owning a checking account. Because these characteristics are negatively correlated with income, Hogarth and O'Donnell (1997) ran a multivariate logistic regression and determined that only three characteristics—having low income, being unemployed, and being of Hispanic descent—remained statistically significant. The implication is that the other demographic characteristics—age and minority, marital, and educational status—were only correlated with being unbanked because they were also correlated with these variables.

How Do the Unbanked Use the Payment System?

People need two types of payment services. One is a means for paying bills. The other is a means for converting a received payment into a usable form, such as a deposit or cash. For people who own a checking account, these services (along with savings services) are bundled together.

Making Payments

For people without checking accounts, the two primary means of making payments are with a money order or in person with cash. A money order is issued by an institution for payment of a specified sum of money collectible from itself. If someone wants to pay using a money order, that person can purchase the order (usually with cash), make it out to the recipient, and mail it. The recipient can then deposit the money order at the recipient's bank. Money orders are sold by banks, convenience stores, grocery stores, check-cashing outlets, and the U.S. Postal Service. At present, the Post Office charges 80 cents per money order.

Some companies allow customers to pay bills in person with cash. For example, utility companies frequently have in-person bill payment offices. Often, bills can be paid in this manner at a third-party location, such as a bank or grocery store. The bank or store accepts cash and in turn transfers funds to the biller's account. The store that collects the payment usually offers these services free of charge and receives payment for the service from the billing institutions.

Dove (1999) reports that 55 percent of the unbanked paid some of their monthly bills with cash, and 50 percent paid some by money order. Caskey (1997) also found that money orders were an important means for bill payment. In Caskey (1997), 84 percent of respondents without deposit accounts reported using a money order at least once a year, while 39 percent reported using money orders more than 30 times in a year. In Dove (1999), for those who do write money orders, the mean number written per month by the unbanked was 3.3. (The unbanked who do not write money orders were excluded when calculating this average.) At a rate of 80 cents per money order, this payment method would cost on average, $31.68 a year.[8]

Finally, Dove (1999) reports that 20 percent of unbanked respondents sometimes paid some bills via someone else. The other quantitative surveys do not consider this option, and in the qualitative research this bill payment option was not mentioned. Consequently, we do not know much about it. We did find one individual in the focus groups, however, who cashed checks through a relative. Presumably, networks of family and friends are also being used to pay bills.

Receiving Payments

As mentioned previously, banks, thrifts, and credit unions are the most important check-cashing sources for the unbanked. In Caskey’s survey, 48.5 percent of the unbanked report that they regularly cashed checks at depository institutions. The percentages for government beneficiaries were 62 percent in the Treasury’s telephone survey, 42 percent in the Treasury’s mail survey, and 51 percent in Dove’s survey. Table 2 reports Caskey’s findings on sources of check-cashing services. Table 3 reports the results from the Treasury and Dove surveys.

After depository institutions, the next most important source of check-cashing services is grocery stores. Two of the surveys report that 25 percent of the unbanked regularly use the stores for this purpose, another reports 30 percent, and the final survey reports 36 percent.

The third most important source is check-cashing outlets. Caskey finds that 17.2 percent of unbanked respondents regularly use outlets; the other surveys report that approximately 10 percent use them. According to Caskey, other sources of check-cashing services that charge fees, such as convenience and liquor stores, are regularly used by 4.5 percent of respondents.[9] The remaining sources are used less frequently than check-cashing outlets. For example, friends and relatives are used by 12 percent of the respondents in the Treasury’s mail survey and by 7 percent in the Dove survey.

Considering how much attention check-cashing outlets have received regarding their fees, it is interesting that these outlets are only a minor source of check-cashing services. For government and payroll checks, outlets will

[8] Focus group participants indicated substantial variation in the price of money orders. According to respondents, banks were the most expensive while convenience stores were relatively inexpensive, even as low as 39 cents. Presumably, these prices are set so low in order to draw customers with cash into the store.

[9] In the Richmond focus groups none of the respondents reported regularly using a check-cashing outlet or convenience store to cash checks, though they knew fellow community members who did.

Table 2 Check-Cashing Sources (Caskey Survey)

	Percent
Bank, savings & loan, or credit union	48.5
Grocery Store	23.2
Convenience or liquor store	4.5
Check-cashing outlet	17.2
Employer	1.5
Elsewhere	1.5
Did not cash any checks	3.5

Table 3 Check-Cashing Sources

	Treasury's telephone survey (Percent)	**Treasury's mail survey** (Percent)	**Dove's survey** (Percent)
Bank or Credit Union	62	42	51
Grocery Store	30	24	36
Friend or Relative	1	12	7
Check-Cashing Service	10	12	12
Other Retail	3	10	11
Other			10

often charge a fee of 1 to 3 percent of the face value of the check.[10] If a personal check is cashed, the fee to cash it is higher still. Whether these fees are excessive is an open question, but because outlets bear the risk of a bad, forged, or stolen check, and because they often operate in high-crime locations for long hours, there is good reason to think that the fees are not excessive (Caskey 1994). Regardless, the finding that check-cashing outlets are used infrequently is important because it bears directly on our analysis of the decision to own a checking account, as we will see in the next subsection.

We offer a note of caution about this finding on check-cashing outlets. Outlets tend to be more prevalent in larger cities, particularly Chicago and

[10] In addition, check-cashing outlets frequently provide services and products such as bill and tax payment, money orders, and money wires. Where not forbidden by state law, many check-cashing outlets also offer payday loans. To obtain one of these loans, a borrower writes a personal check to the cashier, who agrees not to cash it until the borrower's payday. Such loans tend to be made only to people with stable employment histories. All reported information on check-cashing outlets is taken from Caskey (1994).

New York City (Caskey 1994).[11] The Dove survey reports that 27 percent of the unbanked in urban areas use check-cashing outlets, while only 8 percent of the unbanked in small towns and the same percentage in rural areas use them. Apparently, there are differences between urban and non-urban markets.

Why Are the Unbanked Unbanked?

Many discussions on why the unbanked do not own checking accounts compare the cost of owning a checking account (exclusive of fees for bounced checks) with the cost of using a check-cashing outlet. For example, Doyle, Lopez, and Saidenberg (1998) assume that the cost of owning a checking account with no bounced checks is $44 per year. They compare this cost with that of using check-cashing outlets to cash paychecks at a rate of 1.1 percent of face value. Under their assumptions, the cost of not owning an account is $110 plus the cost of money orders for a family with an income of $10,000, while it is $172 plus the cost of money orders for a family with an income of $15,600 (the 1997 poverty level for a family of four). Since this sum is substantially higher than the $44 estimate, why would anyone choose to live without a checking account?

We argue that for many people, forgoing a checking account is a rational choice. First, we contend that being unbanked is not as expensive as the numbers above indicate. More specifically, we demonstrate that check-cashing outlet fees incorrectly measure the costs of not owning an account. Second, we argue that owning a checking account can be more expensive than $44, because maintaining a very low balance, as many low-income people do, can often result in overdraft fees.

What Are the Costs of Being Unbanked?

As we saw earlier, expensive sources of check-cashing services, like check-cashing outlets and convenience stores, are only used regularly by approximately 20 percent of the unbanked population. The critical issue then is to determine how much the unbanked are paying to cash checks through banks and grocery stores. Unfortunately, none of the surveys explicitly asked respondents how much they paid for check-cashing services but the Caskey and Dove surveys asked respondents if they usually paid fees to cash their checks. Caskey (1997) reports that 59 percent of the unbanked in his survey did *not* usually pay a fee to cash their checks. For its sample, Dove (1999) reports a similar number of 61 percent.

[11] There are fewer check-cashing outlets in midsize cities such as Richmond, Virginia, a metropolitan area with fewer than one million residents. The 1999 Greater Richmond Yellow Pages lists only seven locations that provide check-cashing services. However, many sources of check cashing, such as convenience stores, are not included in this list.

We do not know how much people pay in fees or precisely how these fees are broken down by the check-cashing source. Dove (1999), however, reports that 81 percent of the unbanked who cash their checks at banks do not pay fees. The focus group interviews provide insight as to why some banks do not charge fees. In one case, a non-account holder was able to cash checks for free at a particular bank because her employer held an account there. Presumably, others are finding banks that will cash checks for free—particularly those that are government or payroll checks of locally known companies. Indeed, an employer with many unbanked employees might choose a bank that would cash its employee paychecks without charging fees.

One can further speculate that a bank in a small community, where fraud is difficult, would be more willing to cash a check than a bank in a large city. One of the Dove (1999) findings is consistent with this speculation. In its sample, 53 percent of urban unbanked recipients paid check-cashing fees, while only 29 percent of small-town unbanked recipients paid these fees.

The evidence also indicates that it is inexpensive to cash checks at grocery stores. Most of our information on their practices comes from the focus groups and other qualitative sources. Respondents in the Richmond focus groups reported that the grocery stores they frequented did not charge fees to cash their checks, but that the stores sometimes required a minimum purchase to cash a check. In addition, they reported that using a grocery store for check-cashing services was not always convenient for those without a car. We followed up on these findings by contacting two grocery stores in Richmond to ask them about their check-cashing policies. Both cashed payroll and government checks for free. In addition, we discovered that grocery stores sold money orders and collected bill payments for some companies. Companies would contract with them to collect bill payments. The grocery stores would not charge the consumers but would instead charge the company on a per-bill basis. They did not consider this service costly to provide, since an employee assigned to this duty could usually perform other duties as well. Furthermore, offering these services attracted customers with cash into their stores.

Finally, friends and relatives are cited as a minor source for cashing checks. In the Treasury's mail survey, 12 percent of the respondents mentioned this source and at least one focus group respondent used a relative to cash checks. We can probably assume that these sources provide their service for free.

In summary, \$172 (from Doyle et al.) overestimates the cost of cashing checks for a substantial portion of the unbanked population. As the Caskey survey, the Dove survey, and the focus group interviews indicate, many of the unbanked are cashing their checks at banks, grocery stores, and even with friends and relatives at no cost. Furthermore, many payments are being made free of charge. For about two-thirds of the unbanked, particularly those not located in urban markets, the evidence suggests that the costs of not owning a checking account are very small and probably best approximated by the cost of writing money orders, around $30 by our earlier estimate.

What Are the Costs of Owning a Checking Account?

Both the Caskey and Treasury surveys asked people why they did not own checking accounts. The results are reported in Tables 4, 5a, and 5b.[12] The most common reply was that respondents did not have enough money or enough savings for an account to be worthwhile. It is difficult to evaluate this response or similar responses such as “[I] don’t have a need for any.” These responses suggest judgment about the relative costs and benefits of owning versus not owning a checking account; they are not informative about the actual costs of owning an account or the relative importance of different costs.

Ultimately, the problem is that these questions ask about motives, and the answers are less reliable than those to questions that require factual responses. For this reason, we will only mention the survey responses when we feel they are useful.

Some Speculation

We speculate that overdrafts are an important reason that checking accounts are unappealing to the unbanked. The possibility of an overdraft is a key difference between payments made by cash and personal checks: No credit is extended with cash payments, but credit is extended, albeit short term, when payments are made by personal check.[13] Overdrafts, because they do not include check-writing services, are not possible with ETAs. If our speculation is correct, removing check writing from the standard checking account has value.

From a customer’s perspective, overdraft fees could be a significant deterrent to owning an account. While overdraft fees are avoidable, overdrawing an account is easier to control in theory than in practice, particularly for an account that is frequently near a zero balance. One miscalculation that results

[12] The two Treasury surveys are not directly comparable. Unlike the mail survey, the telephone survey did not give respondents a list of answers from which to choose. However, in the telephone survey respondents were also asked if they agreed whether the following reasons were important for not owning a checking account. Included were “bank fees are too high,” “I have no need for bank services,” “I don’t want anyone else to have records of how much money I have,” “I don’t trust banks with my money,” “bank hours don’t match my schedule,” and “there are no banks conveniently located near me.” At least 20 percent of respondents strongly agreed that each reason was important while the highest number, 40 percent, reported “bank fees are too high.” The differences between the aided and unaided responses are a bit troubling. We do not have a theory for this discrepancy and feel that more focused investigation through qualitative methods is warranted.

[13] Technically, the retailer is extending the credit since a bank may return a check for insufficient funds. However, the bank could still accept the check, and in that case it would bear the risk.

Table 4 Reasons for Not Owning a Deposit Account (Caskey survey)

Survey Responses	Percent
Bank account fees are too high	23.1
Fees considered to be the biggest problem	
Monthly account maintenance fees	40.0
Check-writing fees	10.0
ATM fees	11.1
Bounced-check fees	28.9
Banks require too much money just to open an account	22.1
Don't need account because we have no savings	53.3
Not comfortable dealing with banks	17.6
No banks have convenient hours or location	8.5
Banks won't let us open an account	9.5
We want to keep our financial records private	21.6

in two overdrawn check charges can produce a memorably expensive financial experience. For example, a bank's overdraft fees can range from $20 to $35 per check, while merchants will often charge an additional fee.

There is some support in the surveys that overdraft fees deter the unbanked from choosing to own an account. In the Treasury's mail survey, 13 percent of the respondents cited problems managing their money as a reason for not owning a bank account.[14] (In the Treasury's mail survey, respondents could explicitly choose this option; in the telephone survey, respondents could only give unsolicited reports of this response.) Also, 28 percent of respondents in the Caskey survey who complained about fees said that overdraft fees were their main concern.

In the focus groups and other qualitative information sources, money management problems were frequently considered important. Our discussions with bank staff underscored the greater likelihood of significant overdrafts on low-balance accounts, as compared to those with a higher balance. Often with overdrafts, the low-balance account holder tends to close the account, while a high-balance account holder simply pays the service charges. In the Richmond focus groups, several unbanked participants reported that they previously owned bank accounts and suffered losses from overdrawn accounts. Overdraft problems may help explain Caskey's notable finding that 70.7 percent of the unbanked previously had checking accounts.[15] Admittedly, our analysis at this point is merely speculation. However, we feel the connection between

[14] Innumeracy could be one reason for money management problems.

[15] Another argument is that increases in fees explain why account ownership rates decline. Stegman (1999) argues that banks began to charge fees to low-balance customers because of changes in the regulatory environment.

Table 5a Reasons for Not Owning a Deposit Account (Treasury’s telephone survey)

Survey Responses	Percent
Don’t have enough money to justify/make worthwhile	47
Don’t have need for any	21
Fees/costs are too high	6
Problems with managing an account	3
Don’t know	20

Table 5b Reasons for Not Owning a Deposit Account (Treasury’s mail survey)

Survey Responses	Percent
Don’t have enough money to justify/make worthwhile	67
Don’t have need for any	27
Fees/costs are too high	24
Problems with managing an account	13
Use another person’s account	11
Poor credit history/turned down for one	10
Banks inconveniently located	4
Difficult to get to a bank	4
Keep records private from government	4
Don’t want money frozen in event of divorce/lawsuit/judgment	4

overdrafts, bank fees, and the decision to own a checking account is worth further investigation.[16]

In some cases, we can identify specific reasons that respondents do not own a checking account. For some people, the fact that creditors could access a debtor’s bank account is reason enough not to own such an account. For example, if someone defaults on a debt, creditors may attach the defaulter’s bank account. This concern, primarily raised in the focus groups, is only mildly apparent in the Treasury’s surveys. In Caskey’s survey, however, 21.6 percent mentioned privacy as a reason for not owning a checking account. Presumably, this reason includes fear of attachment, though it could also include motives such as evading taxes, avoiding the savings limitations on welfare beneficiaries (Edin and Lein 1997), or hiding income from other household members.

[16] Interestingly, roughly 10 percent of respondents in the Caskey and Dove surveys reported that banks would not accept them as customers.

Furthermore, it is worth noting that even though federal benefits are protected from attachment by law, in practice the depositor is responsible for proving that the particular funds may not be attached. When benefits are commingled with other funds, determining which funds are protected and which are not can be complicated, effectively making it too costly for a low-income individual to stop the attachment.

Finally, some have argued that there are people who do not have accounts because (1) banks are inconveniently located and have poor service hours or (2) the unbanked are unaware of check-cashing fees. The surveys report minimal support for the first argument. Four percent cite location and service hours in the Treasury's mail survey and 8.5 percent cite them in Caskey's survey. In one of the Richmond focus groups, location was mentioned as an issue for people who did not own cars. As for the second argument, undoubtedly it is possible that some of the unbanked are naive about price differences, but we are skeptical that this is an important reason for not owning an account. The respondents in the Richmond focus groups were well aware of the costs of using check-cashing outlets or convenience stores but still used them occasionally.

In summary, we find that payment services are relatively inexpensive for many of the unbanked and that check-cashing outlet fees are not representative of the true costs of cashing a check. Furthermore, we speculate that because of bounced check fees, a checking account might be more expensive than the $40 to $50 often estimated. We think that together these factors explain why many of the unbanked do not own a checking account. Our analysis also finds that the cost of being unbanked varies across different groups of people. For example, someone who lives close to a grocery store may be able to obtain payment services at no cost. Someone in a neighborhood with neither a grocery store nor a bank willing to cash the checks for free would probably pay substantial check-cashing fees.

2. EFT '99

In this section, we use our findings on the unbanked to analyze the implementation of EFT '99—the Treasury's plan to encourage government beneficiaries to use direct deposit. Earlier strategies to implement the plan were altered to respond to concerns that the law would unfairly burden the unbanked. We believe our previous analysis explains why that opposition was so strong. Early proposals would have shifted costs to the unbanked.

The driving force behind EFT '99 was the pressure on Congress to reduce federal expenditure as part of the balanced budget compromise. The budget-scoring rules adopted by Congress required that new expenditures be matched by corresponding decreases in spending. Switching government payments from paper to electronic means was scored as savings. The Treasury's Financial Management Service estimates that a fully implemented EFT system would save the government $100 million per year in printing, processing, and postage costs (U.S. Treasury 2000).[17]

Early Strategies for Implementation[18]

The Debt Collection Improvement Act of 1996 mandated that all government beneficiaries receive their payments electronically, but it gave the Treasury the authority to grant waivers on the basis of four categories: financial hardship, impossibility, cost-benefit, and law enforcement and national security interests.[19] Early proposals to implement this mandate did not make liberal use of the waivers. The first proposal would have required that all government beneficiaries open a bank account in order to receive their payments. Another proposal would have given unbanked beneficiaries a year to open an account. A third proposal would have required that only those beneficiaries who already owned an account had to switch to electronic receipt. Community groups reacted negatively to these proposals, arguing that mandated accounts would adversely affect some low-income people.

The Adopted Strategy

In response to the criticisms of the earlier proposals, the Treasury adopted a strategy of making participation voluntary. The earlier proposals were modified so that anyone who did not sign up for direct deposit would automatically be granted a waiver to receive a check instead. The Treasury also developed the electronic transfer account, specifically designed to appeal to the unbanked. The goal was to encourage banks to offer ETAs and the unbanked to sign up for them.

ETAs

ETAs are low-cost accounts that are designed to receive government payments by electronic direct deposit. These accounts would be available only at federally insured financial institutions that offer them *voluntarily*. When an institution chooses to offer ETAs, the Treasury will reimburse it $12.60 for the one-time cost of setting up each account. The financial institutions offering ETAs would enter into contractual agreements with the Treasury that stipulate the account's specifications. These specifications require that ETAs:

† be an individually owned account at a federally insured financial institution;

[17] Roughly 30 percent of Treasury payments are made by check. From October 1998 to March 1999, approximately 130 million payments were made in this manner.

[18] Stegman (1999) describes the implementation process up until early 1999.

[19] The latter category includes law enforcement payments to informers, who for obvious reasons would prefer not to have an electronic record of a payment from the federal government.

- be available to any individual who receives a federal benefit, wage, salary, or retirement payment and other such deposits as a financial institution agrees to permit;
- charge no more than $3 per month;
- allow at least four free cash withdrawals and balance inquiries per month through any combination of proprietary ATM and/or over-the-counter transactions;
- provide the same consumer protections that are available to other account holders at financial institutions;
- allow access to point-of-sale networks, if this service is available to non-ETA holders;
- require no minimum balance, except as required by federal or state law; and
- send each account holder a monthly statement.

How Does EFT ’99 Affect Market Participants?

There are four parties that have been affected by the various possible implementations of EFT ’99: the government; the unbanked, who are represented at the policy level by low-income advocacy groups; the banks; and the alternative institutions to banks, such as check-cashing outlets. As noted earlier, the driving force behind EFT ’99 is the belief that switching to electronic payments would save the federal government a substantial amount of money. The question for the other affected parties is whether it is worth adopting this means of payment.

The Government

The government’s interest in costs and benefits is relatively clear. The more people who switch to electronic payment, the more money it saves. Presumably, there will be cost savings from ETAs, even with the $12.60 payment per account.

The Unbanked

As previously discussed, the decision to forgo owning a checking account is entirely rational. Early EFT ’99 proposals that would have mandated beneficiaries to own checking accounts in order to receive payments would not have saved resources for the economy but instead would have shifted costs from the government to the unbanked.

However, even with voluntary participation in the ETA program where there is no danger that EFT ’99 merely shifts costs, it is still uncertain whether ETAs will be widely adopted by the unbanked. The critical issue is the elasticity of demand with respect to price and ETA characteristics.[20] Our assessment is that these elasticities are small.

For the majority of the unbanked who are already cashing checks for free, the pecuniary benefits of adopting an ETA seem small or even negative. An ETA holder will pay $36 a year mainly for check-cashing services already obtained for free. It follows that ETAs may stand their best chance of success in urban areas where the prevalence of costly check-cashing outlets indicates a lack of costless alternatives.

Additional considerations enter the cost-benefit calculations of a potential ETA holder. For example, while the ETA removes the credit extension inherent in a traditional checking account, it does so at a cost in bill payment services.[21,22] An ETA holder will still have to withdraw cash from the account in order to pay bills in person or to purchase a money order. There seems to be little advantage to this method over going to a grocery store to cash checks and to pay bills all at once. For this reason, Caskey (1998) argues that the unbanked need accounts with access to something like a low-cost ATM that would not only supply cash but also money orders. Still, an earlier attempt to encourage the unbanked to own these or similar accounts is discouraging. In the 1980s several states mandated that banks offer "life-line accounts," low-cost checking accounts designed to appeal to the unbanked, but they were not widely adopted (Doyle, Lopez, and Saidenberg 1998).

The Banking Industry

Banks, like the community groups, disliked the early proposals. Many banks feared that political pressures would require them to offer low-cost checking

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[20] The price elasticity of a good is the percentage change in demand for it divided by the percentage change in price. It is a measure of how much demand will increase in response to a price change.

[21] Parallels exist with an interesting banking experiment that sought to simplify making small payments by mail in Britain during the late 19th century. Although the British wrote checks during this period, the lower and middle classes did not use them as extensively. Jevons (1897) argues that check use had not extended to these segments of society because the extension of credit involved in a check invited fraud. He was a strong advocate of the Cheque Bank, an institution that avoided this problem by issuing checks with limits on the amount for which they could be written. For example, a depositor who deposits £100 would receive any desired combination of checks as long as the maximum amounts did not sum to more than £100. The depositor would be able to write a check for any amount up to the maximum listed on it. This device greatly facilitated making payments through the postal services since there was no need for change. The Cheque Bank would maintain two balances for each account, the amount in the account, and the amount of credit extended by the checks. When a check was paid, both balances would be adjusted. Ultimately, the Cheque Bank failed in 1900 for reasons that included increased handling of small accounts by the rest of the banking sector and forgeries of its checks, which were apparently easy to cash (Banker's Magazine 1901).

[22] Point-of-sale purchases can still cause an overdraft if the purchases are off-line, that is, there is a delay between purchase and communication with the bank.

accounts to the unbanked. They claimed that regardless of the technological advances of electronic banking, they would lose money by carrying transaction accounts for those who were currently unbanked. In any event, the banks believed a large portion of the $100 million in government savings would be a transfer of cost rather than a savings to society.

Of course these concerns about cost shifting are not an issue with ETAs. Furthermore, in recognition that low service fees may not cover the costs of one of these accounts, the current ETA proposal requires the Treasury to provide the banks a one-time reimbursement of $12.60 to open each ETA. We do not know whether this is enough money to induce banks to offer the accounts. We suspect that this fee plus the service charges will be the only reliable sources of revenue for banks from these accounts. The experience that states have had with a similar type of account—electronic benefit transfer (EBT) account—is that it quickly draws down to a low balance. One study of an EBT pilot estimated interest income from balances to be 19 cents (U.S. Treasury 1997).

Banks do have a noneconomic incentive for offering these accounts. They may receive Community Reinvestment Act credit during the examination process if they offer ETAs. The Federal Financial Institutions Examination Council, an umbrella organization of all bank supervisory agencies, released a notice that financial institutions offering ETAs will be given positive consideration under the service test in the examination process (Federal Register, May 3, 1999).

The Check-Cashing Industry

Blessed with an extensive distribution network but threatened with the likely loss of business from ETAs, the check-cashing industry is trying to ally with financial institutions. For example, Citigroup has signed a deal with the National Check Cashiers Association to issue a debit card to government beneficiaries. A beneficiary would open an account with Citigroup and could use the debit card at ATMs, point-of-sale terminals, and check-cashing outlets that are members of this association. Charges on the account would range from $3 to $6 per month, with $1 to $2 fees for withdrawals and point-of-sale purchases (Keenan 1999).

Any attempt to distribute government benefits through check-cashing outlets has been controversial, mainly because low-income advocacy groups view the check-cashing outlet fees to be exploitative. These concerns have led to recent rules banning financial institutions from providing ETAs in partnership with institutions like check-cashing outlets and liquor stores. Furthermore, the Treasury recently requested public comments asking whether to regulate partnerships between check-cashing outlets and financial institutions that offer non-ETAs (*Federal Register,* January 8, 1999). Some fear that a regulated financial institution may encourage its customers to have their government checks electronically deposited into a standard deposit account and arrange for a nondepository institution to dispense those funds. Under such an arrangement the nondepository institution could then charge fees, and there would be no regulatory control over that arrangement.

3. CONCLUSION AND AN ALTERNATIVE IMPLEMENTATION

There are good reasons to think that the elasticities of demand for ETAs are small. The most important reason is our finding that many of the unbanked presently obtain their payment services at no or low cost. Still, the unbanked are a heterogenous group and ETAs may well appeal to a portion of them. Since this group has varying needs, one could imagine an alternative implementation that allows for some government cost savings while still letting individuals decide what is best for themselves: Let beneficiaries face the marginal tradeoff between different means of payment. Beneficiaries could be paid to receive electronic payments, could themselves pay to receive a check, or could realize some combination of the two. The point is to have beneficiaries bear the costs of the means of payment, which in the absence of externalities or some sort of market failure align individual tradeoffs with those of society.[23] Those who find it worthwhile to continue receiving a check will do so and those who do not will switch. Ultimately, the beneficiary is best positioned to determine the tradeoff.

APPENDIX

Here we provide background information on field research with focus groups, discuss in more detail their advantages and limitations, and describe how those discussed in the article were conducted. Focus groups are just one type of field research for gathering qualitative information. Other related methods for gathering information include interviews with key informants, community interviews, structured direct observation, and small-scale surveys. Kumar (1993) contains a wealth of information on these methods, including a description of an investigator's experience in using each method. Townsend (1995) contains a good example of qualitative field research followed by a small-scale survey.

[23] One complication with this suggestion is that most government payments (73 percent) are already made electronically. In view of the government's budget constraint, it does not make sense to pay beneficiaries who already have switched. Instead of offering the program to everyone, the government could target subsets of existing check users and offer them cash to switch. The results of these targeting efforts could be used to estimate elasticities of demand, much like the credit card companies do now with their offers.

There can be enormous advantages to using qualitative field research. This type of research can be conducted quickly and inexpensively. Also, the format allows the researcher to learn from the process itself. The give-and-take of open-ended interviewing allows topics to be explored in detail. Further, respondents may raise issues that the researcher may not have been aware of before the interview. Another advantage of field research is that results can be used to develop large-scale formal survey instruments. A survey that does not ask the right questions is of no use.

The idea behind focus groups is that the group interaction generates data and so can itself be used as a source of data. Focus groups historically have been used heavily in marketing, but also have been used in sociology, nursing, and the health sciences. This method can be effective in gathering information from multiple individuals at the same time. A classic source on focus groups is Merton, Fiske, and Kendall (1956).

Like any source of qualitative information, data from focus groups require cautious interpretation. Among other things, participant samples are often non-random. Furthermore, interviewers must be careful that they do not ask leading questions of respondents, and investigators must make sure that they are not just seeing what they want to see when interpreting the interviews. Not surprisingly, there is a large literature in the fields mentioned above that discusses these problems and presents strategies for avoiding them.

The Richmond Focus Groups

Each group of participants was drawn from a Richmond area housing development that is run by a nonprofit housing organization. The first group consisted of 11 individuals, and the second group consisted of five. Participants were recruited by individuals from the nonprofit organization and were not randomly chosen. Their incomes were low; some worked and others received government aid. Interviews lasted two hours and were conducted on site. The moderator was given an outline of questions to guide the discussion, though occasionally the investigators would interject more specific questions. Generally, participants were asked about their uses of and need for financial services, including how they and other members of their community made and received payments. For example, did they own checking accounts? How did they pay their bills? If they did not have accounts, why not?

We have chosen to report these interviews as supplementary sources of information. Though the usual caveats apply to any interpretation of this evidence, several findings were substantiated by the quantitative surveys. For this reason, we are confident that any additional details reported are important. We believe qualitative data-gathering methods of the sort described here will prove to be particularly valuable for studying the low-income household's use of and need for all financial services, not just those involving payment services.

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