United States: No country for poor men

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In the United States, banking products are designed less for those who need them, more for those who can afford them.

Seven million Americans have their names on a black list ("Check System") due to problems with bounced checks or overdrafts on their accounts. And up to eight million families are not even eligible for that dubious honor, since they can't even access the most basic financial services: current accounts, forms of payment and loans.

Researcher Francesc Prior and professor Javier Santomá explain the situation in "La estructura de los sistemas de pagos al por menor y la bancarización en Estados Unidos" ("Structure of Retail Payment Systems and Banking in the United States"). It would appear that the financial system in the world's wealthiest country is designed only for those who can afford it. The options are expensive; cash machines in marginalized areas are scarce; and the alternative operators who fill the gap do so in exchange for abusive fees.

"Right of admission reserved"

Traditional banking is out of reach for anyone earning less than $25,000 a year. A simple current account requires the holder to keep too high a minimum balance in order to avoid high maintenance fees.

Wages are paid with checks that take a day or two to clear once they are cashed. Just enough time for anyone whose funds do not make it to the end of the month to have to resort to a mini-loan for an advance on their paycheck. In these cases, fees are so exorbitant that getting a two-week advance on 300 dollars could cost 54 dollars. Measured against the annual percentage rate (APR), we're talking about an interest rate of 470 percent!

The checking system is one of the roots of the problem. It is the most frequently used form of payment in the United States, accounting for 45 percent of such transactions. Next are credit cards (23 percent) and debit cards without real-time authorization (13 percent).

The conclusion is obvious: the financial system is about authorizing most of its transactions on the basis of credit parameters. In other words, most payments are not verified instantly (in real time) if the consumer can cover them. This creates operative risks (which is why minimum balance requirements exist) and the need for an auxiliary sector to facilitate payment of checks beyond traditional banking hours. Banking is inefficient and the consumer pays for the damages in the form of fees.

Prior and Santomá feel that the development of electronic payment systems would be the beginning of a solution. The European experience shows that implementation is costly but ultimately worth it: between 1992 and 2000, the increased use of electronic payments (41 percent) led to a 20 percent reduction in banks' operating costs.

Some studies estimate that checks are up to three times more expensive for a banking entity than electronic payments. And cost savings are necessary in order to design a more affordable option for people who have problems at the end of the month.

Furthermore, a third of all checks, often paychecks, are cashed at the same bank where they were drawn. Wouldn't it make more sense to deposit the money directly into an account?

The meager implementation of electronic payments is also evident with bills. Many people who do not have current accounts still send checks in the mail to pay their bills: electricity, telephone, and the like. An electronic form of payment would eliminate the risk of payments getting lost, arriving late or being forgotten about, not to mention the postage costs. Further, it would allow people to start building a credit history.

But formulas such as direct debit still have to win people's trust, including those already in the banking system. It is estimated that American consumers would save a billion dollars annually with direct-debit systems, but they often prefer to keep paying by check because it gives them a feeling of control. Yes, the process is tedious and totally manual - but it never goes on behind their backs.

Cash machines no help either

Global statistics say that the United States has a good network of automated teller machines (ATMs). The density is higher than the average for developed countries. Prior and Santomá believe that ATMs could help get Americans into the banking system. But they are too expensive and offer limited functions.

In Europe, the expansion of the network was based on lowering costs for financial institutions, which was more evident as the number of bank ATMs per branch increased. On the other side of the Atlantic, the preference was a model of non-banking terminals that charge high fees. They are preferably installed in affluent areas where people don't have difficulty making it to the end of the month. Aside from being pricey, they do not offer sufficient functionality. In a country where checks rule, most ATMs do not offer an effective way to cash them or make an immediate account deposit, for example.

One solution could be to develop a network of correspondent ATMs along the lines of those used in certain Latin American countries such as Brazil, Peru and Colombia. There they use point-of-sale terminals with real-time authorization for financial transactions, deposits and even credit.

The advantages in terms of cost, density and functionality would mean a big step forward for the United States: the lower operating costs even allow for the waiving of fees for cash withdrawals, something unthinkable for the country's ATMs. Moreover, nearly all businesses have a point of sale. The entire population would have access to the system.

Forms of electronic payment in real time are more practical, faster and more secure than checks. Everyone would come out a winner: a company would gain in efficiency if it paid employee wages via bank deposits; the people would avoid the slow process and risks associated with checks, which could lead to overdrafts. The list of examples is endless.

But right now, there are fewer forms of electronic payment because mass implementation would be costly. It comes down to an inertia problem: businesses will not invest in the necessary infrastructure unless a good many consumers are going to use it. And the consumers will not choose electronic payments in real time if many businesses are not going to accept them.

The issuing institutions - the suppliers of the system - are also somewhat reluctant to implement such systems. The investment would be profitable, though not so much for them, but rather for the general public - what the authors refer to as positive social externalities. Further, the current system has already been costly for them. The authors see only one solution: government intervention.

The Federal Reserve has backed the development of the current checking-based system since the early 20th century. Now it is up to the U.S. government to subsidize the mass implementation of electronic payment in real time. That would open the door to developing an attractive offer for Americans with more modest incomes, and the entry into the banking system of an entire segment of the population.

From there might follow a series of positive social externalities, which would be extremely worthwhile. Higher quality of life would mean more consuming as well as more savings. Given the way things stand, with the country in a financial crisis, neither the banking sector nor the U.S. economy in general can afford the luxury of rejecting that prospect.