The High Cost of Being Unbanked

Data from Mexico, Colombia and Brazil shows urban poor pay large portion of income for basic financial services

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Micro-economists and students of socio-economic data often refer to a “vicious circle” of poverty, reflecting the way the poor tend to pay more for basic services, (water, sanitation, etc.), for basic needs (shopping piecemeal in poor neighborhoods is more costly than buying in bulk supermarkets) and for transportation or in travel time (low-income neighborhoods tend to be located far from the work, schools and markets). New data is showing how the poor also pay more for financial services. These costs can cut significantly into already meager earnings, since the “unbanked” as a group overlap with low-income groups, adding to the difficulties of escaping from the vicious circle and moving towards upward mobility.

Data gathered during the past four years in Mexico, Colombia and Brazil suggests that in these countries somewhere between 65 and 85% of urban households do not hold any kind of deposit account in any formal financial institution.1

The macro-economic implications of the large number of unbanked have been analyzed in terms of overall financial sector development and its links to economic growth, to income distribution and to poverty alleviation.2 On a micro-economic level, however, less work has been done. The data from Mexico and Colombia begins to shed important light on the flip side of the macro-economic studies, showing how the underdeveloped financial sector – translated into a lack of financial services at the household level – can limit economic growth and poverty alleviation, by significantly increasing costs to families who already tend to be in the lower income brackets. The data show how the poor and unbanked pay more to get paid, to make payments, to save, and to borrow, than their compatriots who have bank accounts.

Costs of making payments. Officials at the Central Bank of Mexico report that cash transactions cost up to five times more than payments by check, which, in turn, cost up to fifteen times more than electronic payments. For urban families in Mexico City and Bogota who have no bank accounts, paying monthly bills by cash— for water, electricity, sanitation, telephone, and for schools— means a trip downtown with a wad of bills. It’s worrisome (pickpockets and muggers abound), costly in terms of transportation, and costly in terms of time too. In Mexico City 70% of those surveyed reported that there are no service payment offices within 20 blocks of their homes or places of work. Over half claimed travel time of over two hours to make payments for water, electricity, telephone, gas and urban services. That’s ten hours each month, not counting the fact, relayed by focus group participants, that the lines in each office are two to three hours long.

Focus group participants seem resigned. “If it’s not raining, I have a good time in line. I catch up with friends from other parts of the city. ” And it beats the alternative, since paying directly at a commercial bank costs US$3.50 for non-account holders. In Colombia the commercial banks will receive payments from non-account holders without charge, but they provide only one teller for a limited number of hours per week.

In the United States, check cashing outlets (“CCO’s”) and pawn shops usually offer bill payment services. For a fee, they write checks for families who have no bank accounts and cannot do so themselves. John Caskey, of Swarthmore College, estimates that unbanked families in the US pay an average of US$450 annually for bill payment services.3

Costs of getting paid. Even though fewer than 75% of those surveyed in Mexico City have deposit accounts, a full 85% of the unbanked report getting payments by check. Another 6.3% get paid through deposits to a third party’s account. Turning a paycheck or deposit into usable cash is costly for persons without bank accounts. Most of those interviewed reported that they make the trip to the bank which issued the check. (Financial institutions will not cash checks drawn on other banks for non-account holders.) The bi-weekly trip to the bank is costly again in terms of time and travel. Banking hours and locations are not convenient to low-income earners. (The trio of Bank studies also shows that banks tend to locate in better-off neighborhoods.) About a third of the unbanked reported changing checks in commercial stores (in return for purchases) or at money changers (cajas de cambio) for a fee. As in the United States, check cashing services charge between 5% and 10%, which amounts to a direct tax on the income of many poor.

Costs of savings. Deposit accounts, even without interest, figured as the “most wanted” financial product among the unbanked in Colombia, Mexico and in Brazil. Although it may be that families realize that a deposit account would also allow
them to lower greatly the costs of service payments and check cashing, deposit accounts also help them to save, and about half of the unbanked report holding liquid savings. But saving outside of a formal system can represent opportunity costs, as well as insecurity. Savings options reported by the unbanked were, in order of popularity: cash under the proverbial mattress; informal savings clubs (“tandas” in Mexico, “cadenas de ahorro” in Colombia); savings clubs in commercial stores, like “lay-away plans” linked to specific items; and loans, interest bearing or interest-free, to relatives and friends. In Mexico and Colombia, where the nominal interest rate on passive deposits is on the order of 8% per annum, saving in any of these informal systems represents a loss of value relative to formal deposits, and a potential loss from robbery or non-payment.

Costs of sending and receiving money. About 5% of those surveyed in both Bogota and Mexico City reported receiving income from remittances.

Slightly more than half of the remittances were national, while the remainder were international. While the number and percentage of persons affected is low, costs of a remittance for an unbanked person are significant. Information from the focus groups in Mexico and tests by the authors of the Bank’s study found that sending US$100 by wire through a bank costs US$19 for the transfer if the recipient does not have a bank account. If the sender and recipient both have accounts in the same bank, however, the transfer may only cost as much as the recipient must pay in ATM fees to withdraw it.

Costs of borrowing. About a third of those surveyed in both countries reported taking out a loan of some kind in the past three years. But costs differ enormously depending on the source of the loan. Currently the interest rates on bank loans are capped at around 17% in Mexico and Colombia, but credit card charges can reach 36% and 40% per year. On the other hand, loans from commercial stores, money lenders and pawn shops, where the unbanked commonly borrow, start at 10% per month and reportedly reach up to 35% per month (150% to over 400% per year). It should not be surprising that respondents from both Mexico City and Bogota report their preferred source of loans to be friends and relatives, the actual source in about a third or attempting to develop liquid savings, reliance on financial services increases. But if unbanked, they must pay a higher cost for savings, credit and payments services. Thus costs of financial services can cut deeper into the incomes of families trying to get on the path to upward economic mobility.

Summing up, it’s expensive not to have a bank account. For those who are starting up or managing informal businesses, having to rely on informal financial systems can cost up to 15% of their income for families in Mexico City and up to 20% in Bogota, Colombia. Granted, this group represents only about a quarter of the unbanked population, but that’s close to 20% of the overall population. For the 95% of the unbanked who must make monthly service payments, not having a bank account can translate into a 1% reduction in income. Not much for the rich perhaps, but for families earning below median incomes, 1% means medicines for a family, or a day’s food.

Another group of the unbanked – over half – have to spend up to 10% of their income merely to cash in their paychecks. Ironically, for the families who take steps to break out of poverty by starting up a business, investing in education or in a home, or attempting to develop liquid savings, reliance on financial services increases. But if unbanked, they must pay a higher cost for savings, credit and payments services. Thus costs of financial services can cut deeper into the incomes of families trying to get on the path to upward economic mobility.

The difficulties of breaking out of the “poverty cycle” have been widely studied along with the high costs of being poor. With new data on the unbanked we can now begin to understand how financial services figure among those costs, and how the poor can benefit from access to formal financial institutions.

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1 Information from Colombia and Mexico is based on statistically representative surveys of the capital cities (Bogota and Mexico D.F.). Percentages of unbanked would probably increase if the survey included other cities, where the ratio of banks to population is markedly lower, and would increase still more if extended to rural areas. The results of these surveys are presented in: Brazil: Access to Financial Services, Report No. 27773-BR, The World Bank, Washington, 2004; and Caskey, Ruiz and Solo, “The Unbanked in Mexico and the United States”, World Bank Savings Institution, Brussels, 2004; and Broadening Access to Financial Services Among Mexico City’s Unbanked and Access to Financial Services in Colombia, forthcoming, The World Bank.


4 65% own their homes, revealing a capacity and habit of savings in non-liquid form.