THE MOVE TO DIGITAL PAYMENT

When the Check is No Longer in the Mail

Hanns Kuttner

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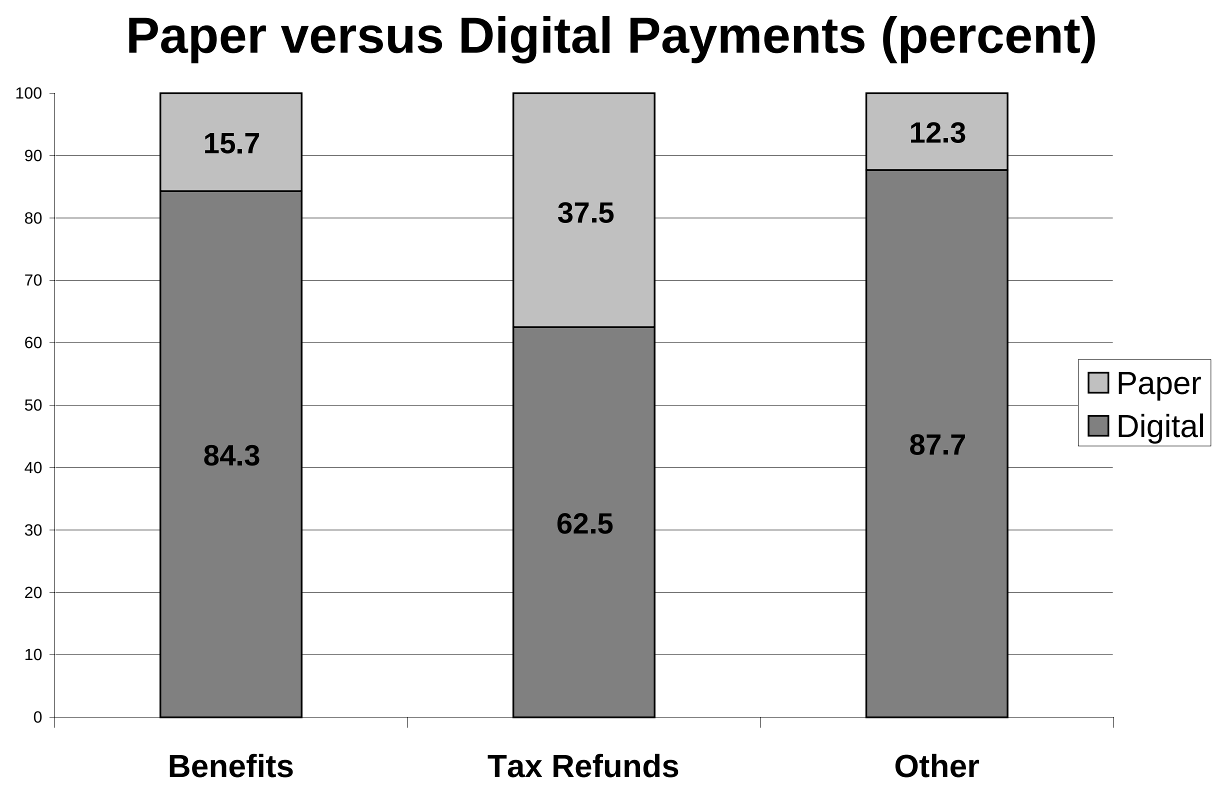

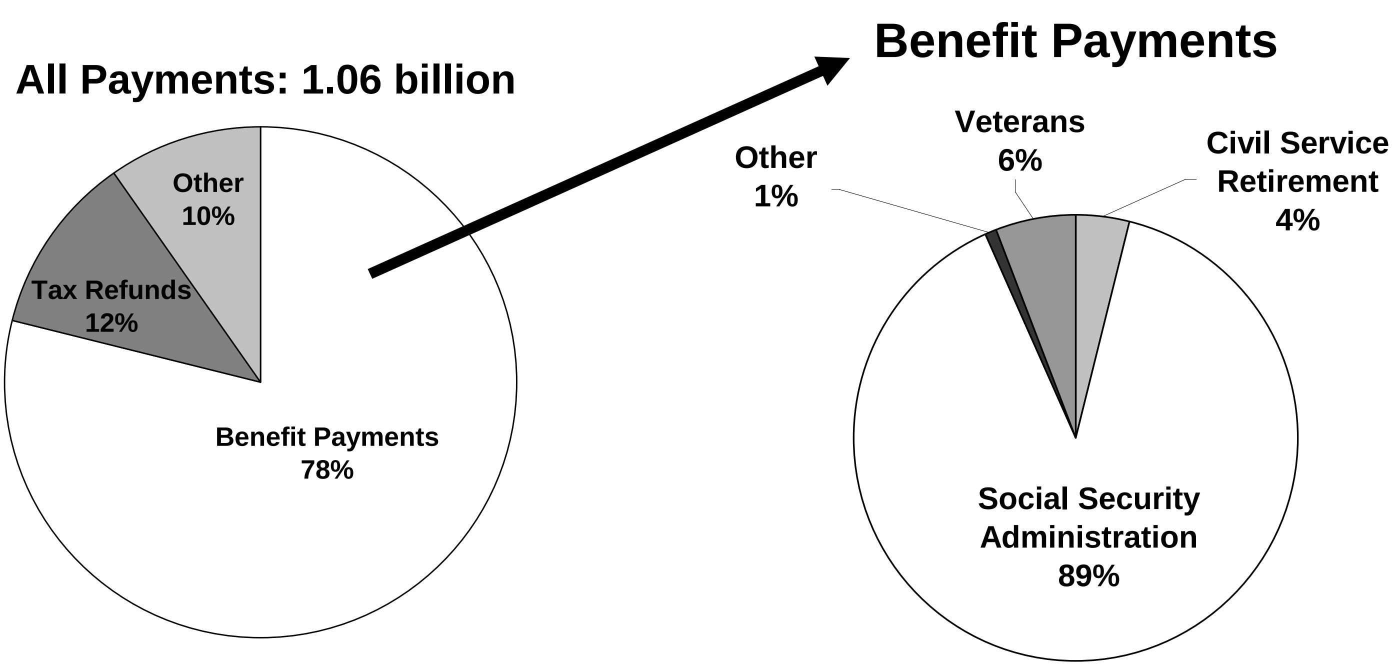

Source: Financial Management Service, "Governmentwide Treasury-Disbursed Payment Volume: EFT Payment Volume Chart for September 2010," http://fms.treas.gov/eft/reports/payment_volume_FY10.pdf. Accessed December 7, 2010.

Digital payment shows how productivity can grow in the public sector. Making a payment digitally costs less than a paper check. Those who receive a monthly benefit payment, most often from Social Security, make up the largest number of payments the federal government makes by paper check. Direct deposit has been an alternative to paper checks for 35 years. Not everyone has a bank account, limiting the potential for direct deposit. A newer form of digital payment, a prepaid debit card, will allow digital payment to replace the monthly paper check. Millions of recipients will now go digital in 2013, implementing a change Congress called for in 1996. Those who do not choose a digital payment type will be enrolled as prepaid card users.

An era is coming to an end. It began in January 1940, when the Treasury sent Ida May Fuller of Ludlow, Vermont, the Social Security program's first monthly check.[1] It wasn't the first time the federal government had sent a monthly benefit check to an American. Veterans had long received monthly payments. What made Fuller's check notable was what would follow. She was the leading edge of a group that today accounts for five out of six of the 60 million Americans who receive a monthly payment from the federal government.

Only about nine million still receive a dark yellow envelope containing a paper check every month. The others have gone digital. Most use direct deposit. More than a million have opted for a new option, a prepaid debit card. More will be digital in the future as more who retire opt for digital over paper.

The displacement of paper checks by digital forms of money shows how productivity grows. The same result, in this case getting payment from the government to a beneficiary, requires fewer resources.[2] Each digital payment costs 92.5 cents a month less than a paper check. Those savings include the cost of paper, envelopes, and postage, the machinery to print checks, salaries for government workers to print and mail the checks, and the larger number of civil servants who deal with checks that become lost, are forged or stolen, or cannot be delivered.

Someone who signs up for Social Security at age 65 and opts for a paper check instead of direct deposit or prepaid debit makes a decision that means $205 in higher costs over the time benefits get paid.[3] Over the last quarter century, the

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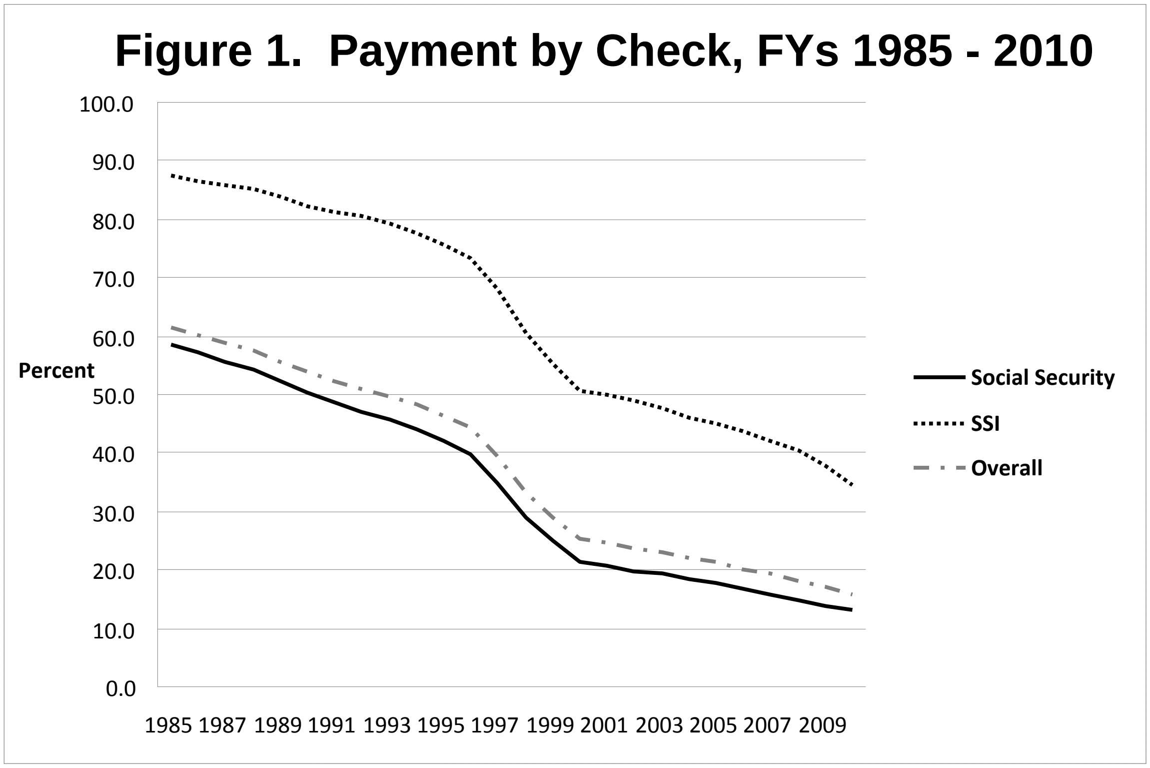
[1] http://www.ssa.gov/history/imf.html. Accessed October 19, 2010.

[2] One estimate is that a nation's economy would be one percent larger with all payment made electronically compared to one with all payment made by paper (cash and check). David Humphrey, Magnus Willesson, Ted Lindblom, and Goran Bergendahl, "What does it Cost to Make a Payment?" *Review of Network Economics* 2, no. 2 (2003).

[3] Savings based on Treasury's estimate of the difference in monthly cost in its proposed rule, "Management of Federal Agency Disbursements," 75 *Federal Register* 34394 (June 17, 2010), referenced subsequently as "Proposed Rule." Life expectancy in the United States at age 65 was

cumulative effect of digital payment displacing paper checks has made the balance in the Social Security trust funds $12 billion higher than they would have been had paper checks remained the only way to get payment.[4]

The share of Social Security benefit payments made by paper check has steadily declined (Figure 1). Even if the government made no additional effort to get recipients to go digital, the share that gets payment through paper checks would likely decline, even if it never reached zero. The slow process of generational turnover almost assures it, as more and more payments go to the generations of Americans who experienced the introduction of ATMs, the rise of personal computing, and the emergence of the Internet.



Source: "Social Security Administration. Beneficiary Trend in Direct Deposit Participation. Percent Direct Deposit. 12/1/10" http://www.ssa.gov/deposit/trendenv.shtml. Accessed October 27, 2010.

Rather than fade away, checks will end according to a schedule set by the Department of the Treasury's Financial Management Service. Beginning May 1, 2011, all who start to receive benefits from federal programs such as Social Security, veterans' benefits, and civil service retirement must choose between two

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18.5 years (or 222 months) in 2006 (Elizabeth Arin, "United States Life Tables, 2006," *National Vital Statistics Report* 58, no. 21 (June 8, 2010). The savings number is in nominal terms, neither discounting the stream of future costs or anticipating future growth in the differential between making payment by check and making payment electronically.

[4] Savings based on 2009 cost differential and rate of return earned by the Social Security trust funds.

digital forms of payment, direct deposit and prepaid debit.[5] New beneficiaries for ongoing government payments such as Social Security would have to choose between direct deposit or a debit card. Less than two years later, the era that began with the check sent to Ida May Fuller will end. Beginning March 1, 2013, all monthly payments will be made either by direct deposit or prepaid debit cards.[6] Exceptions will be for those over age 92 and those who believe not getting a paper check would pose an undue hardship because of mental impairment or remote location. The end of the check will be a landmark on the path to an era when interaction between government and citizens takes place primarily in digital formats.

To the government, going all digital will save money, $125 million a year, Treasury estimates.[7] To those who get monthly payments, the change may mean some change in the details of how they use the financial system. For those who already have accounts like checking accounts, it may mean minimal change. For those who do not, who use some combination of banks, check cashers, and retailers to turn a government check into cash and money orders to pay their bills, the change will be larger.

The federal government has made digital alternatives to paper checks available for more than a generation. Convenience and familiarity have drawn a growing share of those who get regular government payments to opt for direct deposit and the more recently introduced prepaid debit card.

Many of those who have stuck to paper and who will find themselves "going digital" are on the other side of the digital divide. They don't have internet access in their homes, a Facebook account, or own an iPhone or Blackberry. Broadband may not be available in their communities. However, the emergence of technology that does not require having a checking account has made location on the digital divide irrelevant. The electronic payments network reaches many people and places that other technologies do not.

Payment technology is bridging another gap, that between the "banked," who have an account with a financial institution, and those who do not. When a mainstream middle-class American signs up for Social Security and hears about the

[5] The final rule was published December 2010. See "Management of Federal Agency Disbursements," 75 *Federal Register* 80315 (December 22, 2010), referenced subsequently as "Final Rule." The rule applies to anyone who received recurring payments, that is, anyone to whom an agency expected to make more than one payment a year (31 CFR 208.4(f)). Benefit payments accounted for 89.1 percent of the 936.7 million non-tax refund payments Treasury disbursed in FY 2010.

[6] The rule applies to all recurring payments. The large majority of these are monthly benefit payments. The category also includes, as the comments on the proposed rule show, a variety of other payments that includes attorneys who represent Social Security disability applicants and people who are members of federal advisory committees.

[7] Regulatory Impact Analysis, Proposed Rule, 34399.

payment options, direct deposit seems a natural. It is how she has received payroll payment for years. She provides information about her bank and account number, and Social Security becomes one more automatic transaction that occurs in her checking account each month. But what about people who do not have checking accounts? Just as cellular phones demonstrated that copper wire and land lines are not the only way to have telephone service, prepaid debit cards are showing how people can pay for something without cash, a check, or a credit card.

The story of how the last checks will go digital shows that the path for new technology becoming part of how government delivers services is often not smooth. The idea that government benefit programs could get by without paper checks is not new. Congress passed a law in 1996 saying it would be government policy to make all ongoing payments like monthly benefit checks without paper. Treasury's Financial Management Service implemented the law with a rule saying that the policy would take effect on January 2, 1999. However, that rule came with a waiver provision that made the policy irrelevant for anyone who did not sign up.[8] All those who continued to receive paper checks likely did not realize that they did so under a regulatory waiver.

It will take at least fifteen years for the legislative vision to become reality. In December 2010, Treasury's Financial Management Service promulgated a final rule that will revise the waiver policy, ending routine waivers for new benefit recipients on May 1, 2111, and then for all who still get checks on March 1, 2013. The long path from Congress saying it wanted an end to checks shows what obstacles have to be overcome to make a good idea a good idea that can work for everyone. Additional technological possibilities that were not foreseen in 1996 had to come along before going digital could be not just a good idea but an idea that could work for everyone.

■ Why So Many Checks?

When Ida May Fuller died in 1975 at age 100, she was one of 32 million Americans who received a monthly payment from Social Security. About the only change in the payment system since Fuller received her first check was the addition of the zip code to the address line on checks in 1967. However, in the year before Fuller died, the Social Security Administration and the Treasury announced a new option. Rather than get a paper check, beneficiaries could have their payment directly deposited to a bank account. Within five years, one quarter of check recipients had signed up.[9]

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[8] 31 CFR 208.3.

[9] General Accounting Office, "Government Check-Cashing Issues," GGD-89-12, Washington: 1988.

By this point people could get Social Security monthly checks for more reasons than when Fuller first received hers. Fuller qualified for her benefits as a retired worker. By the time she died, Social Security payments also went to those who survived deceased workers, including their children, and workers who had become disabled. The Social Security Administration was also administering a new program, called Supplemental Security Income. It was the most substantial legislative fruit of the push for a guaranteed minimum income in the United States. People could get SSI payments if they had low income and assets, regardless of work history. It assured a minimum income, \$130 a month for individuals and \$195 for couples (which grew to \$674 and \$1,011 for individuals and couples, respectively, in 2010). The elderly qualified by virtue of their age; younger people qualified if disabled.

Over the years that Fuller received her monthly payment, Americans' use of checks as a means of payment had grown immensely. Pay packets filled with cash had given way to pay checks. Post-World War II prosperity led more and more people to open checking accounts. In Fuller's last years, the payments system was becoming clogged by the growing number of paper checks. The result was a physical and information challenge. The banking system had to move each check from the bank where the payee had presented it to the bank on which it was drawn. Keeping track of all this information made banks one of the largest customers for mainframe computers, a symbol of 1960s technological advance.

If the information on a check—bank, account, and amount—wound up in digital format, couldn't the information move from bank to bank without ever being written on a paper check? In the early 1970s, a group of bankers in California formed a committee to evaluate "paperless entries," and in 1972 they created the first automated clearing house (ACH) to set up the rules for and operate a system that would use magnetic tapes and disks to exchange transaction information between banks as a substitute for moving individual paper checks between banks.

Recurring payments such as government benefit payments were a perfect fit for the ACH. The government could prepare a data file with the information that showed which account at which bank should be credited with how much money. The bank receiving the information could credit the amount to the account without a paper check or a trip to the bank by the recipient to deposit the check.

The implementation of "direct deposit" created a win-win result. The federal government saved the cost of printing and mailing checks, following up on claims from people who did not receive the expected check, and reconciling checks in an accounting system that functions as the government's checkbook. Financial institutions saved the cost of processing paper checks. Beneficiaries could get access to their funds without making a trip to a bank.

Things that happened to paper checks could not happen to directly deposited payments. While only a small share of checks are lost, stolen or forged, that low rate applied to millions of payments made for thousands of transactions that would require laborious follow up each month. Treasury reports that it receives about half a million calls a year, about two thousand calls per work day, from people who have had a problem with a government check. There were 670,000 reports of lost or stolen Social Security checks in FY 2007. Some 70,000 Social Security checks for $64 million in benefit payments were reported to be altered or fraudulently endorsed.[10] Each lost, stolen, or fraudulently endorsed check means a beneficiary waiting for a new check to be issued.

■ New Technologies: The Search for Something that Works for Everyone

While the share of monthly benefit recipients who received payment from direct deposit was going up, passing the 50 percent level in 1993, Treasury seemed destined to remain in the check-writing business for a long time. Each percentage point increase saved the government $8 million a year in check-writing costs.[11] At best the cost of checks would melt over time or grow less slowly as the population of monthly check recipients slowly turned over, as a larger share of new recipients opted for digital payment than did those who, largely due to death, stopped receiving a monthly payment. Both the current year and future stream of costs could go away if payment was made electronically.

The logic of going digital and getting rid of paper checks for monthly payments was so compelling that Congress mandated it. A provision in the Debt Collection Improvement Act of 1996 said it would be the policy of the federal government to make all non-tax payments electronically.[12]

[10] Proposed Rule, 75 *Federal Register* 34396 (June 17, 2010).
[11] Based on Treasury's 2010 estimate that the 2010 level of 15 percent of payments made by paper check cost $125 million more to make than digital payment ($125 million/15 percentage points).
[12] 31 U.S. Code Section 3332: "Notwithstanding any other provision of law, all Federal wage, salary, and retirement payments shall be paid to recipients of such payments by electronic funds transfer, unless another method has been determined by the Secretary of the Treasury to be appropriate."

■ What about People Who Don't Have Bank Accounts?

It would be feasible to stop sending checks and make all payments through direct deposit if everyone had a bank account. Not every American does. The share who did not, the "unbanked," was about 13 percent of families at the time of the 1996 law.[13] How do you make electronic payment to people who do not have bank accounts? Ending paper checks would require every beneficiary have some sort of financial account where the payment could go. This necessity created synergy between getting government out of the check business and the cause of increasing access to financial services among lower-income Americans.[14]

Accomplishing the law's goal seemed to require inventing "bank accounts for people who don't have bank accounts." Treasury's Financial Management Service responded to the 1996 mandate by setting out terms for what it called an "Electronic Transfer Account" (ETA). These accounts offered limited features at a limited price. The financial institution that offered an ETA could charge account holders up to $3 a month. The fee covered at least four transactions and four balance inquiries per month along with a monthly statement. The transactions could be through use of the financial institution's ATMs or over the counter at a bank branch. Financial institutions could offer additional services at market rates, except that overdraft fees could not exceed $10 in any 24-hour period. Financial institutions received $12.60 for each account established.[15]

The ETA has a place on a list of unsuccessful new product introductions that includes Ford Motor Company's Edsel and the 1985 reformulation called New Coke. Consumer interest was underwhelming. The network of banks offering ETAs never reached the entire country. Offered the opportunity to move to the ETA from whatever financial arrangements they had already, check recipients stuck with what they had. From the time the ETA was introduced through 2010, only 245,000 people had opened accounts, and in March, 2010, the number of active accounts was fewer than 118,000.[16]

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[13] The population without a transaction account (checking, savings, or money market account or a call account with a brokerage) was 15 percent of families in 1989, 13 percent in 1992, and 13 percent in 1995 (Arthur B. Kennickell, Martha Starr-McCluer, and Annika E. Sunden, "Family Finances in the United States: Recent Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin* 83 (1997): 1-24). More recently, the "unbanked" are a smaller share of the population, with 7.9 percent not having a transaction account in 2007 (Brian K. Bucks, Arthur D. Kenickell, Traci L. Mack, and Kevin B. Moore, "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin* 95 (2009): A1-A56). Not having a transaction account has consistently been higher among lower-income families.

[14] An example of this comes from Michael S. Barr, until recently the Treasury's Assistant Secretary for Financial Institutions, "Banking the Poor," *Yale Journal on Regulation* 21 (2004): 121-237.

[15] Financial Management Service, "Common Questions: For Financial Institutions," http://www.fms.treas.gov/eta/questions/fi.html#fees. Accessed November 10, 2010.

[16] Proposed Rule, 75 *Federal Register* 34399 (June 17, 2010). Not all banks offered the accounts, and they never became available across the country. Interest was greatest in Puerto Rico. Four of

Many factors could be included on a list of reasons why check recipients did not take to the ETA. They can be summed up as this: check recipients thought they were better off sticking with a paper check. Those who got paper checks had figured out how to use banks, grocery stores, check cashing companies, and retail establishments to turn their government checks into a way to pay their bills. The ETA did not offer them something better. To those who had a way to cash a check that did not require a fee or required lower fees than the ETA, the ETA cost more. To those who had had checking accounts in the past and decided to drop the account, the ETA was a route to something they didn't want. To those who went to a grocery store or nearby provider of check cashing services, an ETA was a loss of convenience. Each of these factors played a role in particular recipients' preferring a paper check. For many, the question of which they preferred was moot because the network of banks offering the ETA never reached nationwide coverage.

The ETA would have been a bigger flop had the government tried to require check recipients to adopt them. While the 1996 law created the legal authority for the government to tell check recipients that they had no choice but to get an account, the Executive Branch held back from forcing recipients to adopt an alternative to paper checks. On the one hand, the rule promulgated to implement the 1996 law said there would be no more checks effective January 2, 1999; on the other hand, it granted a waiver to anyone who decided complying with the rule imposed a hardship. Check recipients had no reason to know that there was a mandate or that, as a matter of regulation, they had a waiver from the presumed means of payment.

Requiring citizens to adopt a technology in a democratic country is not easy. Treasury's past experience shows three factors that determine the requirement's political feasibility. First, how large is the group? Is it a substantial minority or a remnant few? In 1999, it was 15.7 million, 27 percent of monthly check recipients.[17] Second, what are the aggregate costs and benefits to citizens? More than half of check recipients had bank accounts. Some might need a deadline to go to direct deposit as a prompt to do something they did not mind. However, those who would have been required to open an ETA solely to keep getting their monthly benefit payment may have viewed the changes in how they carried out their financial lives as a substantial burden. The last factor is the weight given to people who might be perceived as worse off under the mandate.[18] An anecdote

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the ten largest providers of ETAs were banks that primarily do business in Puerto Rico: see http://www.fms.treas.gov/eta/reports.html. Accessed November 10, 2010.

[17] Calculations based on "Governmentwide Treasury-Disbursed Payment Volumes: FY 1996 – FY 1999," http://www.fms.treas.gov/eft/reports/payment_volume-FY96-99Rev.pdf. Accessed November 17, 2010.

[18] Put in terms of a formal model, feasibility depends on the number of people involved, the sum of benefits and costs overall involved, and the nature of the distribution of the costs and benefits. Even

involving an elderly person befuddled by the prospect of using an ATM for the first time in her ninety some years of life could outweigh hundreds of thousands of individuals lowering their financial transaction costs by moving to the ETA.[19]

To get rid of checks, Treasury needed a payment mechanism that consumers liked and the financial services industry actively embraced. Treasury had to have a politically saleable story for what it would do with people who had not voluntarily gone to direct deposit, the one alternative then available. The ETA was not it.

As the ETA sputtered, the world of payment changed. Consumers were moving away from checks and toward plastic. Between 2000 and 2008, the share of consumers who reported they had used either a credit or debit card in the past month rose from 78 to 91 percent and those writing a check fell from 84 to 69 percent.[20] Consumers showed more and more appetite for debit cards, substituting use of debit cards for both checks and credit cards. This financial innovation was catalyzed by the development of a network of a million merchants who would accept a debit card. More merchants accepting debit increased the value of debit cards to consumers.

Just as the payment patterns of middle- and upper-income Americans showed them choosing debit more frequently, millions of low-income Americans got an introduction to payment cards through the Food Stamp program (now the Supplemental Nutrition Assistance Program, or SNAP). Electronic benefits transfer (EBT) replaced paper coupons as the technology for issuing benefits. With EBT, benefit recipients received a plastic card and personal identification number instead of paper coupons. Coupons required extensive handling, both by merchants and the banking system. Further, they were more easily misused. EBT had a user experience that was just like using a debit card. Maryland became the first state to roll out a statewide electronic benefit transfer (EBT) model in 1993.

Over the decade from 1993 to 2003, the share of Food Stamp benefits issued by electronic benefit transfer (EBT) rather than paper coupons rose from 3 percent to

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if the sum was positive, a sufficiently long or thick tail of the distribution into negative values (costs) could make a net-beneficial innovation infeasible.

[19] The AARP emphasized the tail of the distribution in its comments on Treasury's proposed regulation, saying that losing the check option "may in some cases impose a significant increase in cost and inconvenience" on the oldest and most disabled check recipients. Letter of David Certner, Legislative Counsel and Legislative Policy Director, AARP, http://www.regulations.gov/search/Regs/home.html#docketDetail?R=FISCAL-FMS-2009-0003. Accessed September 20, 2010. Treasury's final rule responded to this concern by exempting beneficiaries born before May 1, 1921, from the requirement as well as providing an opt out for those who file a request for a waiver citing mental impairment or geographic remoteness.

[20] Susan Herbst-Murphy, "Trends and Preferences in Consumer Payments: Lessons from the Visa Payment Panel Study," Federal Reserve Bank of Philadelphia Payment Cards Center Discussion Paper, May 2010.

95 percent. By the end of 2004, every state had taken EBT statewide.[21] The Food Stamp program had demonstrated that it was possible to go the last mile and move all recipients who benefit from a public program to electronic forms of payment. Whatever the dislocations, whatever the problems with making a payment card work for a low-income population, states worked through them to make Food Stamp benefits something that could be had only by using a payment card and a PIN.

Against this background of changing and changed payment options, Treasury introduced a debit card option for Social Security and Supplemental Security Income recipients in June 2008. By April 2010, one million people had signed up to receive their monthly payments through the debit card.[22] The cards, dubbed "DirectExpress," are issued by Comerica and branded as a Mastercard.

The card can be used to make payments at retail locations, obtain cash back as part of a purchase, and obtain cash from a bank teller. Users pay a fee for some services. After one free withdrawal per federal payment per month at an Automated Teller Machine (ATM), the user must pay 90 cents per ATM transaction.[23] Paper statements cost 75 cents per month; calls to inquire about balances are free. Users can sign up for alerts by text message, email, or phone to let them know when their remaining funds are low. Treasury's contract with Comerica allows cardholders 90 days to report lost or stolen cards. Cardholders can have one free replacement card per year; thereafter, they must pay a $4 fee for a replacement card. For recipients who want a check to pay rent, for example, the lowest cost source is a U.S. Postal Service money order, available for a $1.10 fee for money orders up to $500 and a $1.50 fee for money orders for $500.01 up to $1,000, where the debit card can be used to buy the money order.[24]

DirectExpress has achieved something the ETA did not: consumer acceptance. There are many reasons check recipients might like the card over the account. The card has no fee for the user, compared to a fee of up to $3 a month for the ETA. Those who may have sketchy or negative experiences with checking accounts are more likely to have past experiences with debit and debit-like cards through using EBT cards to access Food Stamp/SNAP benefits. The card makes the nationwide network of merchants who accept debit available. The ETA provided access only

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[21] U.S. Department of Agriculture, "Food Stamp Electronic Benefit Transfer Systems. A Report to Congress," October 2003. http://www.fns.usda.gov/snap/ebt/pdfs/III_Current_Environment.pdf. Accessed November 15, 2010.

[22] Proposed Rule, 75 *Federal Register* 34397 (June 17, 2010). The universe of recipients who can opt for DirectExpress expanded to include veterans compensation and pension payments in May 2010.

[23] The user must also pay any fee required by the owner of the ATM. A network of banks offering 52,000 ATMs does not impose any fee.

[24] Rent is the single largest payment made each month by the typical low-income household. Unless a landlord becomes a "merchant" who has the capability to accept debit cards for making rental payments, a recipient must obtain cash or a money order to make the rent payment. Treasury is working with public housing authorities to set up the infrastructure to accept prepaid debit.

to ATMs and, on a fee-free basis, to the network maintained by the bank that provided the account to the beneficiary.

DirectExpress also got the interest of financial institutions. At least five responded to the federal government's request for proposals. The economics of debit made it more interesting to financial institutions than opening ETAs. Prepaid debit offered a revenue stream in the form of interchange fees paid by merchants, something that would allow offering the card at no cost to the benefit recipient. These payments provided a way for the government and those who get government payments to shift the incidence of the cost of the payment system. Government could get out of the cost of paper checks by making available a payment method payees prefer to paper checks. Payment recipients could get a way to make payments without taking on the potential cost and risks of a checking account. The interchange fee allowed the merchant to get the customer's business.

Whether a benefit recipient opts for direct deposit or a prepaid card, the cost to the government is the same. The government follows the same steps no matter which option the recipient chooses. Treasury's Financial Management Service prepares an electronic file that contains institutions, accounts, and amounts; some of those accounts are checking accounts, some are electronic cards. The government's contract with the bank that issues the cards, Comerica, includes no payment by the government to the bank for the services it provides. The bank's costs are offset by merchants who pay interchange fees and benefit recipients who go beyond the services offered at no cost (e.g., those who want paper statements, use an ATM more than once a month, etc.)

■ Getting to 100%

In the decade since the 1996 law said it would be the policy of the U.S. government to get rid of paper checks, millions who get monthly payments have gone digital. For some kinds of regular payments, electronic payment is already close to 100 percent. The share ranges from 98.7 percent among payroll payments for federal civilians to 62.9 percent of those who get payments from the Department of Labor's black lung program (Figure 2).[25] The two largest programs, Social Security and SSI, have a 20 percentage point gap in the share of beneficiaries who have gone digital (67.9 percent of SSI beneficiaries; 87.7 percent of Social Security beneficiaries.)[26]

The group that has not yet adopted digital payment for monthly benefits is not evenly distributed across the United States (Table 1). The payment recipients who have not gone digital are disproportionately in states where residents lag in adopting other technologies. Of the six states in the bottom five for either Social Security or SSI payments, four are in the bottom five when states are ranked by the percentage of households that have broadband Internet at home.[27]

Some beneficiaries who had already been receiving paper checks moved to electronic payment in response to enrollment campaigns sponsored by the Department of the Treasury and the Federal Reserve. These campaigns, aided by advertising and awareness campaigns run by private contractors, have emphasized the convenience and safety of direct deposit.[28]

But the share of recipients who get electronic payment has not reached 100%. The Treasury continues to make more payments on behalf of the Social Security Administration than any other government agency. In October, 2010, 53.4 million

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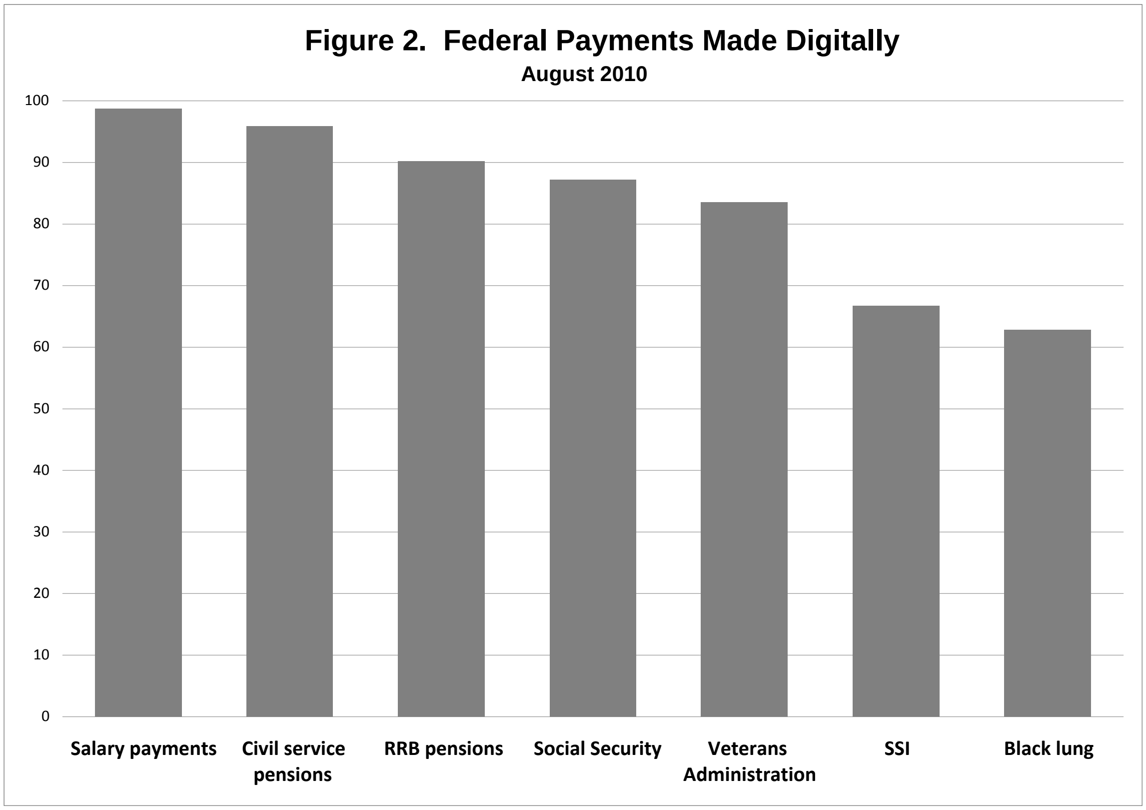
[25] Financial Management Service, "Governmentwide Treasury-Disbursed Payment Volume: EFT Payment Volume Chart for August 2010," http://fms.treas.gov/eft/reports/payment_volume_FY10.pdf. Accessed November 7, 2010. The lowest rate of electronic payment is in the smallest benefit program tracked by FMS, the Department of Labor's black lung program, in which 62.9 percent of the 53,780 August 2010 payments were made electronically. The one other monthly benefit payment with more than one million payments per month was veterans' benefits, where 83.5 percent of 4.2 million payments were made electronically.

[26] As of November 2010. The most recent monthly data for Social Security beneficiaries is available at http://www.ssa.gov/deposit/GIS/data/Reports/T2StateSum.htm. Data for SSI beneficiaries is available at http://www.ssa.gov/deposit/GIS/data/Reports/T16StateSum.htm.

[27] Department of Commerce, *Exploring the Digital Nation: Home Broadband Internet Adoption in the United States*. Washington, November 2010.

[28] While the federal government has been willing to make payments to advertising agencies to encourage check recipients to go digital, it has not tried paying people to go digital. The experience of the payments industry suggests consumers are strongly influenced by small amounts. Per transaction fees on one form of payment have a strong influence on payment choice. If the government faces $205 additional costs for an individual who always receives a paper check for Social Security, then offering a small payment to those who have not responded to appeals to convenience and safety and continue to get a paper check may be cost-effective.

people got a payment from the largest program, what most people have in mind when they think of "Social Security," payments based on earnings histories to retired workers, disabled workers, their widows and widowers, and dependent children. The means-tested SSI program made payments to 7.9 million low-income elderly and disabled people, sometimes as part of a single payment with SSI "topping up" the Social Security benefit.



Source: Financial Management Service, "Governmentwide Treasury-Disbursed Payment Volume: EFT Payment Volume Chart for August 2010," http://fms.treas.gov/eft/reports/payment_volume_FY10.pdf. Accessed November 7, 2010.

Of those 53.4 million payments, 46.8 million, or 87.6 percent, were digital, either direct deposit or a DirectExpress prepaid card.[29] The remaining 6.6 million went out as paper checks.

Those who receive SSI payments are some of the least well-off people in America. With lower income people less likely to have checking accounts, it is not surprising that a smaller share of SSI than Social Security beneficiaries have gone digital. The gap, however, has narrowed. Over the five years from 2005 to 2010, there has been a 10 percentage point gain in SSI beneficiaries with digital payment, twice the

[29] http://www.ssa.gov/deposit/T2StateSum_a.htm. Accessed October 21, 2010.

five percentage point gain among Social Security beneficiaries. Still, 2.6 million receive payment by paper checks.[30]

These 9.2 million paper checks make $6.9 billion in payments each month to Social Security and SSI recipients, an annual total of $82.8 billion.[31]

Table 1. States with Highest and Lowest Share Receiving Digital Payment

		Percent with digital payment		Percent with digital payment
Social Security				
	Highest		Lowest	
	Arizona	93.0	West Virginia	76.2
	Washington	93.0	Kentucky	78.7
	Oregon	92.8	Mississippi	80.8
	Florida	92.7	Louisiana	81.7
	Utah	92.2	Alabama	82.2
Supplemental Security Income				
	Highest		Lowest	
	California	78.2	West Virginia	48.7
	Pennsylvania	73.4	Kentucky	50.0
	New York	73.0	South Carolina	54.6
	Florida	72.0	Alabama	55.0
	Oregon	71.9	Mississippi	56.6

Source: "Social Security Direct Deposit and Check Statistics." http://www.ssa.gov/deposit/T2StateSum_a.htm and "Social Security Administration Beneficiaries. Supplemental Security Income Direct Deposit and Check Statistics." http://www.ssa.gov/deposit/T16StateSum_a.htm. Accessed October 27, 2010.

The number who receive checks will likely decline even if the government made no effort to promote or require digital payment. New recipients are younger and more likely to have experience with either direct deposit or using a debit card. Even waiting for the population to turn over would still leave a group that would be

[30] http://www.ssa.gov/deposit/T16StateSum_a.htm. Accessed October 21, 2010.
[31] Based on $849 average monthly payment by check for Social Security (Social Security Administration. Annual Statistical Supplement, 2009, Table 5.K.1) and $498.75 per month for SSI (Social Security Administration, SSI Annual Statistical Report, 2009, Table 5).

small in share but large in number receiving checks. Why do some seem to prefer checks?

First, it is not clear that many who receive checks have a strong preference for checks. After receiving a paper check for several months, a recipient becomes very unlikely to switch. Inertia plays a role.

What may be most surprising about those who receive checks is how many have checking accounts or use banks. Among Social Security recipients, 73 percent have bank accounts, and among those who receive paper checks, 81 percent cash their checks at a bank.[32]

■ How Payments Fit in the Lives of Government Benefit Recipients

Those who receive paper checks are a diverse group. At one end of the spectrum are those who have checking accounts, regularly use them, and would not be much bothered by a prod to move to direct deposit. Paper check recipients also include individuals who have no bank account, who turn to alternative financial providers to do the mechanics of the financial transactions they must accomplish, and who would benefit both in convenience and cost from going digital, most likely to prepaid debit. It also includes people who have an emotional connection to a paper check. While examples can be drawn from points along the spectrum, there is no source of data that both has detail about what people do and allows making conclusions about what share of check recipients each example represents.

The impact on individuals from going to digital payment will depend on how they accomplish financial transactions now, how they do it once digital, and how many transactions they have.

Consider those who currently pay a convenience fee to cash a check and switch to receiving their monthly payments through DirectExpress cards. The "thrifty consumer" would likely reduce his or her total cost for financial services. Such a consumer sticks to the free services that come with the DirectExpress wherever possible. These people make balance inquiries by phone and obtain cash by using the "cash back" option when making purchases. For financial transactions that require a check, this debit user would turn to the U.S. Postal Service as the lowest cost source of money orders.

Prepaid debit works for transactions that are common among government benefit recipients. Many purchases that government check recipients make are from

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[32] Federal Reserve Bank of St. Louis, "Understanding the Dependence on Paper Checks: A Study of Federal Benefit Check Recipients and the Barriers to Boosting Direct Deposit," (OMB Control #1510-0074), http://www.fms.treas.gov/eft/reports/EFTResearch7.27.04FINAL.pdf. Accessed November 16, 2010.

individuals or corporations that have become equipped with point of sale terminals that allow access to the payments system. Thanks to the Food Stamp/SNAP program, almost all food sellers offer this payment mode. Food, whether purchased at a grocery store or restaurant, accounts for 14 percent of expenditures by the aged. Each food purchase provides an opportunity to obtain cash back that can be used for other purchases. Transportation is 15.8 percent of expenditures by the aged.[33] While the most frequent purchase is gasoline or diesel fuel, again a transaction involving sellers that mostly accept debit, the largest share of transportation expenditures goes to buying cars and trucks.[34] A debit card can be a way to accumulate funds for a vehicle purchase. However, accumulating funds in an amount that the government could know about is one reason SSI recipients have offered for not wanting a card. If financial assets, such as a card balance, exceed $2,000 for an individual and $3,500 for a couple, the recipient can lose SSI eligibility.

While "convenience" is often described as one advantage of debit, that term does not capture the importance of immediate availability to some who receive government benefits. Bill Simon, president and CEO of Walmart US, described what is seen in his company's stores just before midnight at the end of each month:

> About 11 p.m. customers start to come in and shop, fill their grocery basket with basic items, baby formula, milk, bread, eggs, and continue to shop and mill about the store until midnight, when ... government electronic benefits cards get activated and the checkout starts and occurs. And our sales for those first few hours on the first of the month are substantially and significantly higher.[35]

Debit allows otherwise unbanked consumers to accomplish financial transactions more easily. Debit users surveyed in two large cities said they used their debit cards to make 2.4 transactions per month. One common transaction was paying utility bills, a type of payment that would likely otherwise have required buying a money order. The greatest source of satisfaction to these debit users is being able to do

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[33] Social Security Administration. "Expenditures of the Aged Chartbook," SSA Publication 13-11832, November 2007, http://www.ssa.gov/policy/docs/chartbooks/expenditures_aged/exp_aged.pdf. Accessed November 21, 2010.

[34] Bureau of Labor Statistics, "Average annual expenditures of all consumer units and percent changes, Consumer Expenditure Survey, 2005 – 07," http://www.bls.gov/cex/twoyear/200607/csxtable1.pdf. Accessed November 30, 2010.

[35] "WMT - Wal-Mart Stores, Inc. at Goldman Sachs Retail Conference," September 15, 2010, http://media.corporate-ir.net/media_files/irol/11/112761/WMT-Transcript-2010-09-15T15_55.pdf. Accessed December 7, 2010. It is this demand for immediacy by consumers that concerns some groups that want restrictions on the ability of benefit recipients to borrow against future payments. See Leah Plunkett and Margot Freeman Saunders, "Runaway Bandwagon: How the Government's Push for Direct Deposit of Social Security Exposes Seniors to Predatory Bank Loans," National Consumer Law Center, 2010, http://www.nclc.org/images/pdf/pr-reports/runaway-bandwagon.pdf. Accessed November 19, 2010.

something that their credit rating might otherwise preclude: "I can buy online. I can do anything that a person with good credit can do."[36]

The largest expenditure category for aged, indeed all, households is housing. Among households of all ages, housing averages 32.6 percent of expenditures, and more (38.0 percent) among lower income households. Housing is a larger share for renters, accounting for 37.2 percent of spending among those 65 to 74 who rent and 45.3 percent among those age 75 and older.[37] Turning a benefit payment into a rent payment is the single largest ongoing financial transaction for most households that rent. There does not appear to be any evidence on what share of landlords accept what type of payment. While buying a money order solves the payment problem for those with mortgages or landlords who accept checks, some landlords do not accept checks. ATMs may have daily limits that do not allow getting the entire rent amount in one withdrawal.

Cost, convenience and efficiency may be important to outsiders, but what do check recipients prefer? Some who get checks have strong ties to receiving a piece of paper in the mail. A survey of check recipients found 44 percent of them described themselves as extremely unlikely to sign up for direct deposit. Those who are most wedded to checks are older, and more likely to be male, Caucasian, and live outside metropolitan areas than those who said they were open to alternatives to checks.[38]

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[36] Sarah Gordon, Jennifer Romich, and Eric Waithaka, "A Tool for Getting by or Getting Ahead? Consumers' Views of Prepaid Cards," Center for Financial Services Innovation, 2009, http://cfsinnovation.com/system/files/imported/managed_documents/voc-prepaidfinal.pdf. Accessed December 1, 2010. The sample interviewed included some people who said they got some of their income from government programs. They were not a majority of those interviewed.

[37] Social Security Administration, "Expenditures of the Aged."

[38] Federal Reserve Bank of St. Louis (referenced above).

■ Income Tax Refunds: The Final Frontier?

When the last regular benefit check goes out in paper form, income tax refunds will be the most numerous federal payments made by check. A growing share of taxpayers who receive refunds opts for electronic funds transfer. The share rose from 45.0 percent in fiscal year 2004 to 60.4 percent in fiscal year 2009, when the government made 122.3 million refund payments.[39]

Will these, too, one day be made only electronically? Prepaid debit is already available as an option through some income tax return preparers.[40] Going digital only with refund payments is technically feasible, although doing so would require a change in the law. Those who did not supply a bank routing number and account number could be sent a prepaid debit card in lieu of a check.

One step away from checks is a pilot project Treasury has announced for the 2011 tax filing season. Direct mail and inserts to paychecks and paystubs will be used to contact taxpayers who have not previously used direct deposit. They will be offered the opportunity to open a bank account that can be accessed through a debit card and initially funded by an income tax refund. Treasury plans to use the results of the demonstration to inform future decisions about how tax refunds can improve access to financial institutions and tools to pay bills and save.[41]

The cost implications of debit displacing checks are different for income tax refund payments than monthly benefit payments. Each person who switches from check to digital allows the government to avoid one check per year rather than twelve. However, getting a tax refund recipient as a customer may be attractive to a financial institution. At a minimum, use of debit generates interchange fees. A reloadable debit card could lead to use beyond the income tax refund. However, the Federal Reserve Board's proposed rules for implementing limits on interchange fees that take effect in July 2011 make it unlikely that the card could serve as a type of bank account. Competition could emerge among financial institutions that want consumers to choose their prepaid debit card for income tax refunds. Financial institutions could share some of the interchange fee with consumers in

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[39] FY 2009 data from Financial Management Service, "Governmentwide Treasury-Disbursed Payment Volumes: EFT Payment Volume Count for September 2009," http://fms.treas.gov/eft/reports/payment_volume_FY09.pdf. Accessed November 6, 2010. FY 2004 data from Financial Management Service, "Governmentwide Treasury-Disbursed Payment Volumes: EFT Payment Volume Chart for September 2004" http://www.fms.treas.gov/eft/reports/payment_volume_fy04.pdf. Accessed November 6, 2010.

[40] Comptroller of the Currency, "Consumer Alternatives for Receiving Income Tax Refunds," Consumer Advisory 2010 – , February 28, 2010, http://www.occ.treas.gov/news-issuances/consumer-advisories/2010/consumer-advisory-2010-1.html. Accessed November 17, 2010.

[41] "Treasury Department Announces New Pilot to Help Deliver Safe, Low-Cost Financial Accounts to the Unbanked and Underbanked During Tax Season," September 2, 2010, http://www.ustreas.gov/press/releases/tg843.htm. Accessed November 17, 2010.

the form of rewards for card use to induce consumers to pick their card over a rival's.

The requirement that benefit recipients go digital suggests there is some level at which it becomes politically feasible to end the paper check option for income tax refunds. Treasury's policy for benefit checks shows that when use of a technology is at 15 percent, requiring remaining users to switch can be framed as "mainstreaming" rather than "denying choice." For tax refunds, the share who receive paper checks remains far above 15 percent.

As an intermediate step to dropping the paper check, Treasury could make the prepaid debit card the default option for receiving an income tax refund (rather than the paper check, the default option today) or make the paper check subject to a $1 service charge. This would allow users to sort themselves into the payment mode they value most while the government could realize the same savings as it would by requiring digital payment.

■ Room for More Innovation

While current technology makes going digital a choice between direct deposit and a prepaid card, Treasury's 2010 rules are technology neutral. It requires that payment go to an account that has a defined set of consumer protections. Where payment goes from there is up to the payment recipient and the financial institution.[42] The government completes its obligation once payment arrives in an account.

The openness allows other prepaid debit cards to compete for use by benefit recipients. For example, AARP, which has marketing agreements with many providers of services, could enter into an agreement with a financial institution to offer an AARP prepaid debit card to manage government payments. Veterans' service organizations could launch prepaid debit cards targeted to recipients of veterans benefits.

Competition could lead to innovation. The DirectExpress card does not allow additional funds to be added to the card. Those who want to consolidate all their financial transactions on a single card could find cards that allow deposits to be something they want. Individuals who already have a prepaid debit relationship may wish to remain with that provider when they become eligible for a government payment. Local financial institutions that do not want to lose local

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[42] Treasury's Financial Management Service has promulgated an interim final rule requiring that any prepaid debit card used to receive federal payments have certain features. These include deposit insurance and not having an attached line of credit that triggers repayment from the card account See "Federal Government Participation in the Automated Clearing House," 75 *Federal Register* 80335-80340 (December 22, 2010).

customers to national institutions might view prepaid debit as a way to gain customers who are not interested in checking accounts. The largest transaction many benefit recipients must accomplish each month is paying the rent. Larger landlords could partner with financial institutions to offer a prepaid debit card to tenants.

Prepaid cards are not the only physical means of payment through which payment happens. For example, a bank could enter into a joint venture with a cellular provider to make funds available through mobile phones. A consumer could use his or her cellular phone to use federal benefit payments to make payment by placing the cell phone in front of a payment terminal.[43]

When the contract for DirectExpress comes up for renewal, the contracting process will provide an opportunity for the realm of alternatives to direct deposit to expand. Multiple vendors could offer consumers additional possibilities. If mobile payment matures, a bank could partner with a cellular provider to bundle financial services and telephony. Competition could lead prepaid debit providers to offer loyalty reward programs to encourage payment recipients to switch to them, an option non-government payment recipients are likely to lose as a result of new limits on interchange fees except for government payments.

■ Lessons Learned

The interval between Ida May Fuller's first check and the availability of direct deposit was 34 years. More than that length of time later, the check is still alive. Whatever its shortcomings for government, it is still a technology that works for millions of payment recipients.

This long history offers several lessons for how government can become more productive through information technology:

Users adopt technology that works for them. ETAs worked for the government's purposes. They did not work for people who received paper checks from the government. Thus monthly payment recipients did not adopt the technology. The consumer decision to adopt a technology is a form of referendum. What consumers do not prefer, they do not adopt.

Network externalities are powerful. The ETA had to roll out bank by bank. ETA account holders could get access to their funds only through ATMs and bank branches. Beneficiaries could avoid ATM fees only at ATMs owned by their bank. Prepaid debit could launch nationally and offer access to a nationwide network with millions of merchants because it used a network that already existed.

[43] Marianne Crowe, Marc Rysman, and Joanna Stavins, "Mobile Payments at the Retail Point of Service in the United States: Prospects for Adoption," *Review of Network Economics* 9 (2010).

Financial institutions had created the debit network for reasons other than solving the government's paper check problem. A growing share of sellers of goods and services became "merchants" attached to the network. As with open networks like the Internet, the value of the debit network to merchants grows when additional users, like government payment recipients, join as users.[44]

However, the future development of the debit network is uncertain. As part of the financial market reform legislation, the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Federal Reserve Board will bring a public utility approach to network pricing. Card issuers will be limited to fees "reasonable and proportional to the cost incurred." The limitation does not apply to financial institutions with less than $10 billion in assets or to two types of cards, those issued to administer government programs and reloadable prepaid debit cards.

This new regulatory environment will change the incentives faced by the financial institutions that created the debit mode of payment. It will not be clear until after the Federal Reserve Board concludes its rulemaking and market participants respond whether the loss is in foregone innovations (like consumer rewards for each card use) or some features and reach of the network that already exist.[45]

Firms in the financial services sector may decide debit cannot earn a sufficient return and not actively pursue new opportunities like government benefit recipients. The Federal Reserve suggested in its proposed rule that debit card issuers could respond by shifting the incidence of the payment system to consumers; for example, issuers could charge consumers an annual fee. Debit could become a two-track product: annual fees for consumers and cost-based regulation of transaction costs in the private market and cards free to users and merchants paying transaction costs for government payment.

Only experience will show whether a two-track market is sustainable. Government payment via debit will be at risk if it is not. Apart from the risk of the disappearance of a "no annual fee" track, government payments are a small share of the overall payment market. This small segment of the overall payment market would be unlikely to serve as a platform for introducing innovations. The two markets will have different incentives. In the worst case scenario, a debit card like DirectExpress that comes with no cost to the consumer would no longer be viable.

When technology has implications for citizens, government does better by following than leading. A custom technology, the ETA, did not work for

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[44] Robert M. Hunt, "An Introduction to the Economics of Payment Card Networks," *Review of Network Economics,* 2 (2003): 80-96.

[45] The Federal Reserve Board proposed a rule, "Debit Card Interchange Fees and Routing," at its meeting on December 16, 2010 that would take effect on the statutorily-set date of July 21, 2011 (http://www.federalreserve.gov/boarddocs/meetings/2010/20101216/20101216_InterchangeFeeProposedRuleFRNotice.pdf). Accessed December 20, 2010.

Treasury. Requiring payment recipients to use an ETA if they did not have or want to use direct deposit for another account was not politically feasible.

The technology that has proved to be a "bank account for people who don't have bank accounts," prepaid debit, is conceptually very similar to the ETA. On the government side, they are identical: a place to which an electronic funds transfer can be sent. They differ in small ways that make a big difference to users. The firms that created prepaid debit engaged in trial and error to find out what those differences are. By offering a product that incorporated those features, prepaid debit succeeded where the ETA has not. That, combined with the share of the market that direct deposit has gained from paper checks, has positioned the government to make a stronger case that it is time to require those who had not voluntarily switched to accept an alternative to paper checks.

Government managers can't pick up $20 bills on the street. Each person who can be motivated to move from paper to digital saves the government money. A private sector business that could save $205 per customer, as is possible when a Social Security beneficiary opts for digital over paper check, would be willing to spend money to get the customer to change his or her behavior.

Treasury's Financial Management Service has funded a public outreach campaign which is said to have moved 4.5 million beneficiaries from paper to digital. The cost? Less than $4 million per year. The savings? Eventually as much as $800 million. A quick calculation says the government has already gotten at least a three-time return on its marketing investment and could eventually get a twenty-time return. A private firm would be eager to put more resources in this kind of investment.[46]

What financial institutions have done to market products like DirectExpress provides some examples of what private managers would do if they faced the government's problem but did not have access to the government's ability to require a change in payment technology:

- *More marketing.* While beneficiaries going digital will deprive the U.S. Postal Service of future volume, the Postal Service will deliver mailings to check recipients encouraging them to go digital. The financial services industry extensively uses direct mail to gain customers; the government could use direct mail to sign up check recipients for digital payment.

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[46] Savings depend on how long a beneficiary can be expected to receive a payment. Savings are larger from changing over those who have begun to receive a check fairly recently. The $800 million number assumes that switches occurred shortly into the time period receiving benefits. A private firm would also be very attentive to what share of newly-digital beneficiaries are people who would have gone digital anyway and who went digital because of the campaign.

- ***Incentives.*** Financial institutions offer cash to encourage potential customers to move their accounts. How many would go digital if offered a $25 gift card?[47]

Many financial choices reflect inertia. People stick with what they have because it is what they have. What they have is most often what they chose when they first signed up for the benefit program. How many more beneficiaries would adopt digital if claims representatives who take applications for government programs got incentive payments for every percentage point increase in digital payment they or their group accomplished?[48]

Agencies and groups that work with beneficiaries have been partners in the digital payment outreach effort. Could those partnerships be deepened? For example, a group that served older Americans in an area with low adoption of digital payment could be more committed to the cause if offered incentive payments for bringing the area they serve up to the national average.

Change the default. The private firm could make digital the default option, available at no cost. Some customers may value getting a paper check and be willing to pay to get one. The difference between cost to the firm and value to the consumer creates a market opportunity. The firm could make digital an option that is available for free and paper check an option that comes with a service charge. Those who valued a paper check at less than the service charge would choose digital. Those who valued a paper check at more than the service charge would gladly pay, and both the customer and firm would be better off.

Whether it is habit or deriving enjoyment from handling a paper check, some benefit check recipients really like getting a paper check. Recall that 44 percent of check recipients in one sample described themselves as extremely unlikely to sign up for direct deposit. A user fee would ask people who say they prefer a paper check whether they value a check at more than the cost of producing it.

The way government does business stands in the way of many of these approaches. Incentives to frontline workers to enroll more applicants in direct deposit might save money, but they make no sense to government managers who must work within a budgeting process that creates walls that can not be surmounted between program dollars and administrative dollars.

For example, the Social Security program has the most to gain from moving away from checks. More payment made digitally than by paper check means paying less

[47] When surveyed in 2003, a large share of check recipients (25 percent of Social Security and 40 percent of SSI beneficiaries) expressed interest in converting if offered a small incentive (up to $10).
[48] One third of check recipients could not recall direct deposit being presented as an option when they signed up for Social Security or SSI. Also, Social Security offices were viewed as the preferred source of information about check alternatives (St. Louis Federal Reserve Bank, referenced above).

to the Treasury Department to send out monthly payments. However, the budget process destroys incentives to realize those savings. It does this by putting money in two categories and erecting a fiscal wall between the two. One category is the Social Security trust fund; the other is the money made available from the trust fund each year by the annual appropriations law to pay Social Security's administrative costs. Money for incentives to pay workers would come out of the funds available to administer the program. Every dollar put into incentives is a dollar not available to pay for the additional workers who might review the backlog of disability applications or make it more likely that a phone call gets answered. The impermeable membrane between trust fund dollars and the administrative dollars precludes doing what is most efficient overall.

Financial institutions and their marketing partners will not face the limitations that keep government managers from putting more resources into pursuing government check recipients. Treasury's requirements that check recipients go digital may lead to private sector investments that realize returns the government did not.

■ Getting to a World without Checks

Many technologies have disappeared. While check use has declined, checks are still in wide use. Can the government get out of making routine payments by check while checks remain in broad use?

The federal government has placed a technological bet. It has direct deposit. It is a technology that works, but not for everyone. Those who opt for prepaid debit show that it works for many, particularly those who do not have an account to accept direct deposit. If it does not or can not, other payment technologies may emerge. These technologies would have to offer something current payment technologies do not to gain consumer acceptance. For some, bundling of telephony and payment may be attractive. A very different appeal will be required to capture those who get paper checks because they like the tangibility of a check.

Absent a set of innovations that provide enough alternatives that there is something that works for everyone, the era that began with Ida May Fuller receiving her monthly benefit check will last far longer than expected.

Elements of Scenarios for the Future of Federal Payments

- <u>Collapse</u>: Federal Reserve Board regulation leads to financial institutions deciding there is not a sufficient rate of return for prepaid debit and do not pursue the federal payment market. Only alternative to paper checks is direct deposit. More than a million revert from prepaid debit to paper checks. Paper checks continue indefinitely.

- <u>Long farewell for checks</u>: Resistance to Treasury's proposal to pull the plug on paper check. Sympathy for those who prefer things the way they were leads to backlash. Share who receive digital payment continues to grow slowly. Still some with paper check at centennial (2040) of Ida May Fuller's first Social Security check.

- <u>Push</u>: Treasury's plans to require paper check recipients to go digital move forward without successful challenge.

- <u>New entrants</u>: Other firms decide to compete for the federal payment recipient market. Some may turn to partners to gain access to payment recipients. Others may try loyalty rewards and other tools to gain market share.

- <u>New technology</u>: One possibility: cellular devices, with new entrants offering free cell phones or cell phone minutes/texts to gain market share.

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