

Credit Poverty Premium: The cost of money

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Access to affordable credit is essential for individuals living with low incomes to fully participate in society. However, due to their limited credit history and volatile incomes, many of these individuals are unable to access mainstream sources of credit, such as credit cards and personal loans. As a result, they often rely on expensive forms of credit, like payday loans or rent-to-own (RTO) agreements, which not only leads to a cycle of financial disadvantage making it challenging for them to meet their basic needs, but also has been shown to result in negative outcomes such as reduced well-being, lower credit scores, and increased indebtedness. Despite numerous studies exploring the usage of high-cost credit, there has been little attempt to estimate the actual cost difference between high-cost and mainstream credit due to a lack of representative data on borrowing costs. To fill this gap, we analyze data from the Financial Lives Survey (FLS) to calculate the poverty premium associated with the use of high-cost credit and identify the factors driving it. The findings from this research will provide insight into the factors that influence the experience of poverty premium and help policymakers target interventions to support poor households in need.