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Credit or Debit:
How Do Lower-Income Consumers Pay?

Over the last few decades, debit card use in the United States has expanded to rival credit cards as the preferred way that many people pay for everyday transactions. The percentage of Americans using a debit card has increased rapidly, from 9 percent in 1992 to 67 percent in 2007. During that time, according to *The Survey of Consumer Finances*, the percentage of consumers with a credit card remained flat at around 73 percent. Few studies have attempted to measure the extent to which different income groups use credit and debit cards, however. New data from the *The 2008 Survey of Consumer Payment Choice* can fill that gap and improve understanding of how lower-income consumers differ from the rest of the population.[1]

The main finding of the authors' analysis is that low- and moderate-income consumers tend to use debit cards much more often than they use credit cards.[2] LMI consumers are more likely to own a debit card than a credit card, they are nearly twice as likely to use one for a given transaction, and in general, they tend to rate them as being better payment instruments. This fact should be an important consideration for everyone who works with credit or debit cards.

Differences in Card Usage

According to *The 2008 Survey of Consumer Payment Choice* (SCPC), a nationwide survey conducted by the Federal Reserve Bank of Boston, debit cards are more commonly owned than credit cards among LMI consumers.[3] (See "Percentage of Consumers with Credit and Debit Cards.")

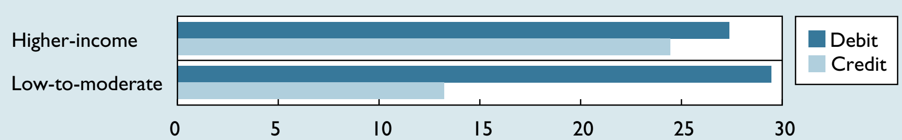
More than 75 percent of LMI consumers have a debit card, whereas only 62 percent have a credit card. Higher-income consumers are more likely to have a credit card. In fact, 90 percent of higher-income consumers have a credit card, and 84 percent have a debit card.

LMI consumers' preference for debit cards over credit cards is also reflected in how often they use their cards. A look at the volume of debit and credit card payments as a percentage of total monthly payments shows that LMI consumers use debit cards for 29 percent of their payments, whereas they use credit cards for only 13 percent. Higher-income consumers also use debit cards more frequently than credit cards, but the difference is much smaller (27 percent versus 24 percent). (See "Shares of All Payments Made with Credit and Debit Cards.") Interestingly, debit card payments make up a larger share of all payments for LMI consumers than for higher-income consumers.

Percentage of Consumers with Credit and Debit Cards

Source: 2008 Survey of Consumer Payment Choice

Shares of All Payments Made with Credit and Debit Cards



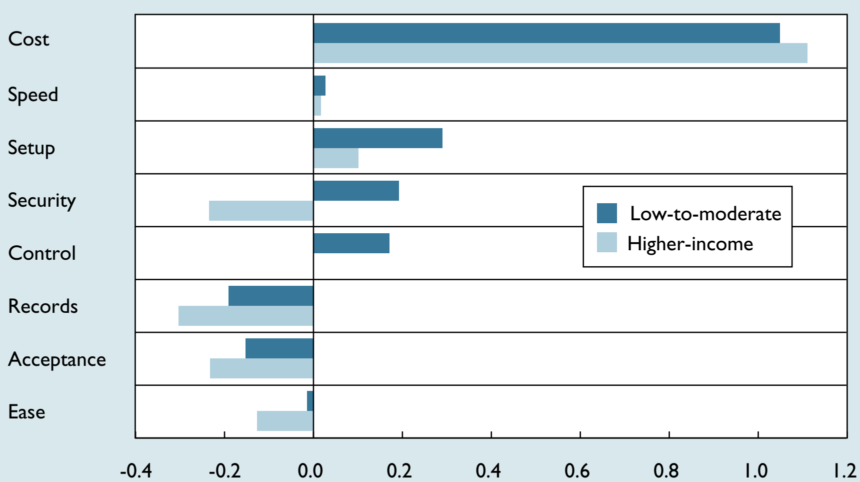
Source: 2008 Survey of Consumer Payment Choice

Perceptions

Why do lower-income consumers seem to prefer debit card payments? The 2008 SCPC asked respondents to rate certain characteristics of different payment instruments on a 1–5 scale (with 5 as the best). The eight characteristics included were cost, speed, setup, security, control (over payment timing), record keeping, acceptance as payment, and ease. (See "Differences in Consumers' Card Ratings.")

Different income groups rate debit and credit cards differently. First of all, LMI consumers prefer debit cards over credit cards in five of the eight categories. The largest difference was cost, but higher-income consumers also rated debit cards much higher than credit cards with respect to cost. LMI consumers also seem to strongly prefer the setup, security, and control of debit cards.

Differences in Consumers' Card Ratings
(Debit card rating minus credit card rating)



Source: 2008 Survey of Consumer Payment Choice

Record keeping and acceptance received the lowest relative ranking from LMI consumers, meaning that these are features that LMI consumers think are not as good with debit cards as with credit cards.

If we compare the relative ratings for each income group (that is, if we look at the *differences in the differences* between debit and credit cards by comparing the lengths of the two bars in "Differences in Consumers' Card Ratings," we can see that LMI consumers generally prefer debit cards more than higher-income consumers do. This is true for every characteristic listed, with the exception of cost, where LMI consumers give slightly lower relative rankings to debit cards. Surprisingly, security is the most extreme case in which LMI consumers perceive that debit cards are better than credit cards. Since credit cards generally limit their owners' exposure to fraud more than debit cards, their view seems irrational. However, it could be that lower-income consumers perceive that entering their PIN at a debit card terminal is a more reliable safeguard than signing, as with a credit card.

Possible Explanations

This clear difference in the use of each instrument across income groups shows how debit cards may be appealing to consumers in ways that credit cards aren't. One possible explanation for this is that low-income consumers are using debit cards for convenience. Debit cards offer them a way of using a card for everyday purchases and having it deducted from their bank account. Credit cards, on the other hand, bundle unsecured loans at high interest rates with their products. Lower-income consumers may find themselves having to take these loans because of excess spending on their credit cards, which they have a harder time avoiding.

Another possibility is that consumers are shut out of the market for credit cards. However, this is not supported by the fact that more than 50 percent of LMI consumers in our sample currently have credit cards, and an even larger percentage report having had them at some point in the past. Over time, being shut out may become more of a factor limiting credit card use, but right now it appears to be less important than other considerations.

Implications

The 2008 SCPC shows that poorer consumers tend to prefer debit cards to credit cards, both in terms of having and using them and in terms of rating them on a number of characteristics. This is an important fact to keep in mind for anyone working with lower-income communities. It is especially important for policymakers who seek to regulate debit and credit cards.

As the regulatory and business environments surrounding cards change, preferences may change. Congress has passed a number of regulations for credit and debit cards that may alter lower-income consumers' calculus.[4] However, it would be well to take debit card use by lower-income consumers into consideration as new policies and regulations are formulated.

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Endnotes

1 See Kevin Foster, Erik Meijer, Scott Schuh, and Michael A. Zabek, *The 2008 Survey of Consumer Payment Choice*, Federal Reserve Bank of Boston public policy discussion paper no. 09-10, 2009, http://www.bos.frb.org/economic/ppdp/2009/ppdp0910.htm.

2 As with many government programs, we classify individuals as having a "low-to-moderate income" if their household falls within 300 percent of the poverty line defined by the Department of Health and Human Services over the past year. The analysis focuses on differences between households that are in this group and households with higher incomes. Obviously, there are differences within each group, so any result should not be interpreted as a statement about everyone in either group. Instead we are looking for trends within each group to compare how LMI consumers and other consumers pay for transactions.

3 *The 2008 Survey of Consumer Payment Choice* was produced by the Consumer Payments Research Center of the Federal Reserve Bank of Boston and the RAND Corporation.

4 The Credit Card Accountability, Responsibility, and Disclosure (CARD) Act, which President Obama signed on May 22, 2009, is intended to protect consumers. For debit cards, the Durbin amendment, part of the Restoring American Financial Stability Act of 2010, is meant to regulate the fees merchants pay to process debit card transactions.