ENDING POVERTY: A STEP IN THE RIGHT DIRECTION

By Phil Lord

This paper summarily lays out one potential legislative solution to poverty and homelessness in developed countries. This solution would be a government program offering loans to noncreditworthy individuals, repaid through additional, progressive taxation. The program helps to solve the fundamental problem of access to credit for noncreditworthy individuals and to alleviate structural mismatches between labour supply and labour demand.

The Problem

Current approaches to alleviating poverty have not been as effective as expected. There has, indeed, been very little fluctuation in the poverty rate over the past several decades.[i] It is, in that context, imperative to consider new and innovative approaches to alleviating poverty, which are outside the range of solutions traditionally implemented by the state.

While poverty has remained omnipresent in Canada, the very poor seem to have remained systematically shut out from the corridors of power. It would be unsurprising to find that the very poor have little voice in the public debate. The very poor do not write or apply our laws. Their issues seem to be hard to fathom for the majority of the population. While the majority of people are most likely familiar with the challenges faced by those in the middle-class, it seems one (even as a member of the middle-class) can go through life without being exposed to the challenges of the very poor. Most would likely be surprised to find that there is still a significant portion of the population which does not have access to the banking system.[ii] Most people, while familiar with the high rates charged by credit card companies, are likely unaware that a significant portion of the population can only borrow at much higher interest rates—rates which make those offered by credit card companies seem very appealing.[iii] The lack of access to credit creates insecurity for those already living on precariously low incomes, forcing them to rely on "payday lenders, check cashers, or other fringe banking institutions" for credit.[iv] In accessing credit, they pay high fees and interest and dedicate a significant portion of their income to services that those with a bank account get for free—which also contributes to higher bankruptcy rates.[v] While social mobility has defined Canadian society, those in the bottom quintile of the population remain extremely unlikely to see their income grow.[vi]

A Potential Solution

A potential legislative solution to poverty and homelessness in developed countries would be a government program offering loans to noncreditworthy individuals, repaid through additional, progressive taxation for a set period of time. Individuals whose income does not reach a certain level would not need to repay the loans, whereas individuals with a high income would effectively repay a multiple of the loan principal amount. (Repayment would depend on income, and loans would not be dischargeable in bankruptcy, but only for a limited period of time—similar to that of a traditional loan.)

The minimum level and progressive rates would be fixed and adjusted to ensure that the program proceeds cover the program costs, including the bad debts expense.[vii] This feature would make the program somewhat apolitical and likely to survive future financial and political pressures. It would also provide funding for the expansion of the program.[viii]

The program would need to be government-sponsored to respect the usury provisions under criminal statutes and to potentially make the loans non-dischargeable.[ix] If the private sector were to offer such loans to noncreditworthy individuals, the interest rate would likely need to exceed the legal limit under usury provisions. Investors in corporations have the option to make an equity investment instead of providing debt where the risk of default is too high.[x] This option is not available when credit is extended to an individual.

The program helps solve the fundamental problem of access to credit for noncreditworthy individuals. These individuals, homeless or extremely poor (and, quite importantly, often racialised and otherwise marginalised), are often at a structural disadvantage: their low income and lack of assets prevent them from saving the money they need to make investments in their future or to collateralise a loan that would fund such investments. While usury provisions help ensure that individuals with low or no financial literacy are not abused by sophisticated lenders, they also substantially restrict access to credit for the individuals who arguably need it most.[xi]

The "progressive, additional taxation" aspect of the program helps address the main concern with high-yield debt: the debt spiral.[xii] High-interest loans are often easily accessible. Individuals with low financial literacy obtain them without paying attention to the interest rate. When the loan becomes due and the borrower's financial situation has not improved, they can often only repay the loan by obtaining a new loan. Individuals progressively fall into a debt spiral. The proposed program prevents this problem. Only individuals who have the resources to repay the loan amount need to do so—and only *when* they have these resources.

To further avoid the debt spiral problem and to control default rates, the loan amount could only be applied to expenses which are likely to increase the borrower's income, with a specific focus on vocational education for positions in industries experiencing a long-term labour shortage. This labour shortage increases wages for these high-demand positions (which reduces default rates). The program thereby also helps alleviate structural mismatches between labour supply and labour demand. It provides the capital needed for individuals to transition from disrupted industries to growing ones.

While the indirect costs of poverty and homelessness would not be factored into the calculation of the program's profitability, the program would result in significant savings related to the fixed costs of providing government services to non-taxpaying individuals.[xiii]

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The opinions expressed in this text belong to the author and do not reflect those of their position nor of their affiliated institutions.

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[i] There are many ways to measure poverty, and none is most widely accepted. The Canadian government tracks and reports several indicators which relate to poverty, but it has no official method of measuring poverty. For the purposes of my argument, purely relative indicators of poverty are the least helpful, as they define poverty solely as a level of income relative to the median or average income. These indicators are least helpful in understanding the *prevalence* of poverty. It is more helpful to use other indicators, such as Low Income Cut-Offs (LICO) rates. LICO rates have been reported by Statistics Canada since 1959. Statistics Canada defines the LICO rate as:

[The] income threshol[d] below which a family will likely devote a larger share of its income on the necessities of food, shelter and clothing than the average family. The approach is essentially to estimate an income threshold at which families are expected to spend 20 percentage points more than the average family on food, shelter and clothing. "Low Income Cut-Offs" (last modified 27 November 2015), online: *Statistics Canada* <https://www150.statcan.gc.ca/n1/pub/75f0002m/2012002/lico-sfr-eng.htm>.

LICO rates have not fluctuated significantly over the past several decades. For instance, the LICO rate in the early 2000s hovered around 12%, which is approximately the same rate as that in 1985. See "Persons in Low Income after Tax, by Prevalence in Percent, 1986-2005" (17 December 2015), online: *Statistics Canada* <http://www40.statcan.ca/l01/cst01/famil19g.htm>. For the past decade, the LICO rate has been stable at approximately 9.7%. See e.g. "Percentage of Persons in Low Income Based on Low Income Cut-Off (LICO)" (February 2016), online: *Canadian Index of Wellbeing* <https://uwaterloo.ca/canadian-index-wellbeing/what-we-do/domains-and-indicators/percentage-persons-low-income-based-low-income-cut-lico> (a more thorough analysis of these points is beyond the scope of this paper).

[ii] A recent report on access to banking services in Canada finds that 6% of Canadians are unbanked, i.e., have neither a savings or checking account. See "The Underbanked Canada: February 2016", online: *Mintel* <https://store.mintel.com/the-underbanked-canada-february-2016?_ga=2.150848245.2126905070.1570466499-1705706870.1570466499>.

[iii] Payday loans are the most notable example of high-interest financial products. In Canada, section 347.1 of the *Criminal* Code, RSC 1985, c C-46, allows provinces to regulate payday loans. This provision effectively allows provinces to let payday lenders charge borrowers an effective annual interest rate that is significantly higher than the 60% rate permitted under the usury provision (*Criminal Code*, *ibid*, s 347). As an example, Ontario caps the fees payday lenders can charge at $15 per $100 borrowed (see *Payday Loans Act*, 2008, SO 2008, c 9, s 32, which prohibits cost of borrowing which exceeds the "prescribed limit" and O Reg 98/09, s 23 and O Reg 358/16, s 4, which define the "prescribed limit"). With a borrowing cost of $15 per

two-week period, the annualised interest rate is 390% ($15 multiplied by 26 borrowing periods per year). With compounding at each period, the effective interest rate is 3,786%. It is worth mentioning that default charges are not included in the calculation of the maximum cost of borrowing (*Payday Loans Act*, *ibid*, s 1). As an example of how the barriers faced by the very poor are interrelated, I note that the report cited in the previous note found that those without a bank account are more likely to resort to alternative financial services providers such as payday lenders (The Underbanked Canada: February 2016, *supra* note ii).

[iv] Mehrsa Baradaran, "It's Time for Postal Banking" (2014) 127:4 Harv L Rev F 166 at 166–67 [Baradaran, "Postal Banking"].

[v] *Ibid.* See also Guiseppe Coco & David De Meza, "In Defense of Usury Laws" (2009) 41:8 Journal of Money, Credit and Banking 1691; Regina Austin, "Of Predatory Lending and the Democratization of Credit: Preserving the Social Safety Net of Informality in Small-Loan Transactions" (2004) 53 Am U L Rev 1217; Mehrsa Baradaran, "How the Poor Got Cut Out of Banking" (2013) 62:3 Emory LJ 483 [Baradaran, "Cut Out of Banking"]; Mehrsa Baradaran, "Banking and the Social Contract" (2014) 89:3 Notre Dame L Rev 1283.

[vi] See Miles Corak, "Divided Landscapes of Economic Opportunity: The Canadian Geography of Intergenerational Income Mobility" (2017) University of Chicago Human Capital and Economic Opportunity Working Paper No 2017–043.

[vii] In accounting, the bad debts expense is the expense arising from defaulting payors. See e.g. *A Dictionary of Accounting*, 4th ed (Oxford: Oxford University Press, 2010), sub verbo "bad debt".

[viii] On legitimating state intervention in the provision of services traditionally provided by the private sector, especially in light of a failure by the private sector to do so adequately, see generally Baradaran, "Postal Banking", *supra* note iv; Phil Lord & Lydia Saad, "Tackling the COVID-19 Pandemic" (2020) 43:2 Manitoba Law Journal 1; Baradaran, "Cut Out of Banking", *supra* note v; Baradaran, "Banking and the Social Contract", *supra* note v; Mehrsa Baradaran, "Credit, Morality, and the Small-Dollar Loan" (2020) 55:1 Harv CR-CLL Rev 63 [Baradaran, "Small-Dollar Loan"]. I do not necessarily envision public-private partnerships in the administration of this program.

[ix] See e.g. *Criminal Code*, *supra* note iii, s 347, which criminalises the use of interest rates that exceed sixty per cent per year. Regarding the government's ability to make certain debts non-dischargeable, see e.g. *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, s 178(1)(g), which makes certain federal and provincial student loans non-dischargeable in bankruptcy.

[x] See generally Sung C Bae, Daniel P Klein & Raj Padmaraj, "Event Risk Bond Covenants, Agency Costs of Debt and Equity, and Stockholder Wealth" (1994) 23:4 Financial Management 28.

[xi] See generally Oren Rigbi, "The Effects of Usury Laws: Evidence from the Online Loan Market" (2013) 95:4 The Review of Economics and Statistics 1238; see generally Oren Bar-Gill,

Seduction by Contract: Law, Economics and Psychology in Consumer Markets (Oxford: Oxford University Press, 2012); Baradaran, "Postal Banking", *supra* note iv; Coco & De Meza, *supra* note v; Austin, *supra* note v; Baradaran, "Cut Out of Banking", *supra* note v; Baradaran, "Small-Dollar Loan", *supra* note viii.

[xii] See generally Torie Atkinson, "A Fine Scheme: How Municipal Fines Become Crushing Debt in the Shadow of the New Debtors' Prisons" (2016) 51:1 Harv CR-CLL Rev 189; Baradaran, "Postal Banking", *supra* note iv; Coco & De Meza, *supra* note v; Austin, *supra* note v; Baradaran, "Cut Out of Banking", *supra* note v; Baradaran, "Small-Dollar Loan", *supra* note viii.

[xiii] See e.g. Eric A Latimer et al, "Costs of Services for Homeless People with Mental Illness in 5 Canadian Cities: A Large Prospective Follow-Up Study" (2017) 5:3 CMAJ Open E576 (which finds that it costs $56,406 on average to provide social services to a homeless person with mental illness in Montreal).