

Money Does Not Grow on Trees: An Argument for Usury

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Abstract Usury, charging a higher interest rate than thought by some to be “fair,” has had and still has, a bad press. Historically, it was heavily punished. It was then, and all too often is now, thought to be exploitative. Yet, as even the most economically unsophisticated must realize, *both* sides of these transactions must necessarily gain at least in the *ex ante* sense, otherwise one or the other would refuse to enter into the deal in the first place. The present paper is an attempt to justify the practice of charging interest on loans, at *any* rate agreeable to both borrowers and lenders.

Keywords Usury · Free enterprise · Economic freedom · Borrowing · Lending

JEL classification E4 · E51

Introduction¹

My grade school years were filled with many memorable achievements—and one “felony” my mother will never stop teasing me about, even to this day. I always had my school supplies available and was willing to share them with the other children when they forgot theirs. However, in fourth grade, I began to realize that some of my peers did not always care for my school supplies as I did and would often lose them or simply never return them. I felt bad

asking my mother for more pencils and pens every week. So, I spoke with some of my very responsible friends and we decided to loan our school supplies for a fee. When the next student asked to borrow something we explained the new terms: “Most items cost a penny per day, except scissors which are a nickel a day, and your name will be kept in a book until payment and return of the school supplies borrowed.” Being young, innocent children, we did not even have specific consequences and actions of recourse established for what would happen if the terms were not met. And luckily, this system worked magnificently. My supplies were returned more quickly than ever before and my friends and I made a few extra cents. That is, until a teacher saw our actions and the exchange of money. We explained, and she immediately confiscated our earnings for the day before sending us to the Principal’s office. This was a day that would forever live in infamy in my little world. That was the day I was forced to miss “Good Behavior Day” and was forever branded a loan shark.

But, what exactly was so wrong with this practice? And how was the term loan shark even applicable, as we did not threaten acts of violence? I understand now that as children the act was illegal, but how can it be when one is a consenting adult? In any case, even as grade schoolers both parties to these exchanges gained, otherwise one or the other would have refused to engage in these deals.

In second section of this paper, we discuss the “[History of Usury](#)”. Third section is devoted to “[Payday Loans](#)”. The fourth section focuses on “[An objection](#)” to our thesis. Subject of the fifth section is “[Economics](#)”. Sixth section discusses the “[Conclusion](#)”.

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¹ This introduction was written, mainly, by the first mentioned co author of this article.

History of Usury

A brief look at the history of usury reveals that it is a subject involving religion, morality, conflict, and even claims that the act should be penalized by death. It is also an economic contract without clear definition, as some deem loaning money with low or no interest rates acceptable while others claim “when gain and fruit is sought, without labour, cost or risk, from the use of something which is not fruitful” the correct meaning of the condemnable practice—usury (Watt, p. 4).

The word usury derives its etymological meaning from *uses*, to use, and *aera*, a mark upon money to show its value (however, all transactions whether monetary or not are included).² It is interesting to note that the words “interest” and “usury” are said to have different meanings, however, it is more likely that they have different connotations. Interest is simply a charge for the use of credit and generally lacks a strong negative connotation. In many contexts, it is an accepted concept by most members of society. However, usury depicts a high or even exorbitant rate of interest, an amount that differs for each individual, and is negatively viewed by virtually all.³ This is a typical reaction: “When money is lent on a contract to receive not only the principal sum again, but also an increase by way of compensation for the use, the increase is called interest by those who think it lawful, and usury by those who do not” (Blackstone, p. 1336).

Usury has been controversial and upheld since Leviticus and Deuteronomy of the Old Testament. The biblical definition in these two books state: “Thou shalt not lend upon usury to thy brother. Thou shalt not give him thy money upon usury nor lend him thy victuals for increase” (Murray 2011). Because of these statements and many others, Jews lending to non-Jews became the common practice.⁴

Examining the risky and surreptitious act of moneylending can be found in records dating back to fourteenth century France. One specific instance noted in Shatzmiller (1989) involves a money lending Jew, Bondavid, and the borrower, Girardi. A typical loan would involve a mutual agreement between consenting adults followed by the notarization of a promissory note. As a lender in this time, Bondavid had about a 12% chance of receiving his money back from loans. When the money is returned in a punctual manner, the promissory note would be transferred from

lender to borrower. However, when the money was not returned within the specified time (which is what happened the majority of the time), the case would be taken to court. Upon presentation of the promissory note, the judge would request the borrower’s presence in court. If the judge found the documents were true, a *mandamentum* would be given to the debtor stating that he must pay off all debts in a given time. If the debt could not be paid by this time, it was legal for the moneylender to seize the property of the borrower.

This process was not as straightforward, however, as it may appear. Even without the promissory note, the borrower may still be able to avoid payment in court. For when any amount of money was given to the moneylender, the borrower received the promissory note (Schatzmiller, p. 15). Adding to the risk of money lending is that no interest was to be charged! At least, the interest charged was not to be spoken of or written about. If the ecclesiastical court discovered “that a rate of interest had been charged, the creditor would be labeled *usurarius*. As an initial punishment, he would not be entitled to that part of the sum which constituted interest” (Schatzmiller, p. 23). After the initial punishment, repayment of previous gains of interest, heavy fines, and a poor reputation resulted. So, essentially, laws from the Old Testament and definitions of usury by Pope Innocent IV relinquished individual rights and made the part of the lender a risky and sometimes (a nonintended) charitable operation.

Religion aside, is it possible for usury to exist in America where separation of church and state is presumed? Unfortunately, no. Since the U.S. kept many of English laws that “detestable sin of usury” (Watt) began plaguing our colonies. With each State coming into existence, so did fixed or set interest rates. Throughout the 1800’s interest rates and laws for each State were set, usually at a rate of 6% (Murray 2011). This could be viewed as progress as moneylenders were now able to document the amount of interest, as long as it was at or below the State’s usury limit, in transactions without penalties. However, the government does not have to abide by its own decrees and can change the allowed rates arbitrarily.

Payday Loans

For example, “In 1980, because of inflation, Congress passed the Depository Institutions Deregulation and Monetary Control Act exempting federally chartered savings banks, installment plan sellers and chartered loan companies from state usury limits. This effectively overrode all state and local usury laws” (FDIC). This Act, though welcome from the point of view of greater economic freedom in its gradual elimination of all limitations on the

² The dictionary defines “usury” as “The practice of lending money and charging the borrower interest, especially at an exorbitant or illegally high rate.” <http://www.thefreedictionary.com/usury>

³ More strictly speaking, usury indicates a rate of interest that the speaker or writer finds offensive, for any reason.

⁴ In many historical epochs, Jews were forbidden to enter industries other than money lending. See on this: <http://answers.encyclopedia.com/question/role-jews-medieval-europe-91156.html>.

rates of interest, was not applicable to the commercial banks. Further, every state is able to decide what amount of interest is usurious, and not all banks are given the same treatment. For usury to be protected in some sectors and prohibited in others at different cut off points only adds another element of arbitrariness.

As the emergence and proliferation of payday loans mount, some are deeming the practice immoral and lobbying for yet more restrictions on usury. According to attorney Mike Skotnicki “Certainly, we all enjoy the constitutional protection of freedom of contract, but the state has decreed some contracts as unlawful or immoral, and payday loan agreements are immoral on their face” (Tenney 1977). Each state in the U.S. is allowed to limit the annual interest rate collected by the company or even outlaw this practice. How can this practice, which is based on a voluntary exchange, be considered economically exploitative? Surely, if two parties agree to a commercial interaction, it must be beneficial to *both*, or they would not agree to engage in it.

Grow and Epstein (2007), in their needlessly provocatively entitled article give numerous examples of individuals and families struggling with debt. They place the blame not only on payday loan companies but also other markets that “have made financing readily available to even the riskiest of borrowers.” If this is the definition of exploitation and all such acts should be prohibited then if logical consistency is the goal, our society should quickly make credit cards, college tuition, and many other purchases illegal. For in our equality-for-all society, everyone is entitled to the same services and products as everyone else.

It is usually true that people with low income are charged a higher rate of interest than those with more wealth, but this is due to the differential rates of repayment. The poor are less likely to repay their loans than the rich. The profits on both types of loans, however, are typically close to one another. Yes, the poor pay high rates of interest, but more often default on their loans, which cost the lenders in revenues that go uncollected.⁵

Rothbard’s (2010) reiteration of the Dutch Calvinist Claude Saumaise’s stance on usury is simple. “Money-lending [is] a business like any other, and like other businesses [is] entitled to charge a market price...If the number of usurers multiplies, the price of money or interest will be driven down by the competition”.

⁵ This is true for many other products as well, when there are risk differentials. For example poor people who live in inner cities typically pay more for groceries than those who live in the richer suburbs. This is because there is more crime in the latter places than in the former. However, the profits earned are about the same. They have to be. For, if they were markedly different, there would be a reallocation of investment from the places with lower to higher profits.

Another claim in favor of market price rather than government set rates of interest, is that a just price is inconceivable. How can state institutions assign a nonarbitrary price to an item? Markets determine prices and these prices fluctuate in times of surplus, shortage, when income rises, when income falls, and from numerous other factors. When the government sets price controls, such as minimum wage and rent control, and establishes laws such as the Federal Price Gouging Prevention Act,⁶ it is the market i.e., the people, who suffer from a lowered supply and increased demand and a lack of rationing. Setting an arbitrary interest rate and claiming that rate is the just price does not allow consumers and producers to communicate. Therefore, the just price must be, and can only be, the mutually agreed upon price, or interest rate.

An Objection

Let us consider an objection to our thesis: a claim that “usury compels growth [and] growth is no longer desirable—it’s actually a bad thing” that interest rates should be set at the rate of growth⁷ so as to avoid a situation where more money is needed in the economy than there is currently.

Here is the argument in a nutshell:

Imagine an economy of ten people, all standing in a circle. Each of them has one gold coin to begin with, then each of them takes that one gold coin and lends it to the person to the left, at 10% yearly interest. There are now ten coins in circulation, but eleven are owed back at the end of the year. Either “the economy” will grow by 0.1 new coin per person, or ten percent of loans will default (or all loans will fall short by 10%—indebting and indenturing the entire economy.) The problem was that in ancient times, economies did not/could not grow exponentially... So that’s the problem with usury without growth. If the economy stays at one gold coin per person, but 1.1 gold coins per person are due at the end of the year, all usury accomplishes is indebting/indenturing the poor and dull while enriching the rich and clever—in other words, concentrating wealth.

But this is easily refuted, and on its own terms. Imagine not ten people, but merely two. Not sitting in a circle, but facing each other over a table. A lends B \$100; whereupon B returns the favor, and lends this same amount of money to A. Null and void, since each cancels out the other? True. But irrelevant. That applies in the 10 person economy, too. The question is, is that any untoward debt generated? Of

⁶ <http://www.govtrack.us/congress/bill.xpd?bill=h111-2129>.

⁷ <http://mises.org/Community/forums/t/20601.aspx>.

course not. At the end of the year, all debts are wiped out, as much in the 10 person case as in the two person scenario. And, if there are 1.1 coins at the end of the year or an additional 10% of money⁸ with the large sample, does this mean that there are now 1.5 coins in existence, or an additional 50% of the money?

The argument appears to be that usury creates more wealth than what is available or that debt only works in a growing economy, this is refuted over and over again throughout history. Surely, there has been borrowing and lending in static or even retrogressing economies? No, mutual lending of this exotic sort is wiped out when all debts are paid. The charge of interest is equivalent to money payments for any other service or product. If usury is bad because it retards economic growth which it most certainly does not do, should we prohibit sleeping, resting, recreation, because it also reduces economic gain below the level that would otherwise obtain?

Muslim law⁹ prohibits acts of usury, and banks, such as the JAK members Bank in Sweden, have been established which meet these customers' needs (Carrie, n.d.).¹⁰ The bank simply replaces interest rates with membership fees and a point accrual system where the amount of points a member earns is equal to the amount he is able to take out in a loan. Although Sweden repealed her usury laws in 1864, some people still lend without charging interest. Will abolishing laws against usury drive up interest rates? According to studies in Germany undertaken in the century before last, the answer is no. In Germany Usury Laws were repealed three years after Sweden. Recently, however, "an inquiry was officially made of all the branch offices of the German bank, as to whether, in consequence of the abolition of the usury laws, an increase of usury and a rise of the rate of interest had been observed. The question was answered in the negative by all" (Dana and Wells 1881). With the repeal of usury laws, rates of interest will likely fall. They will do so since the high interest rate black markets will disappear. Government control ultimately leads to more risk for the moneylender. This only drives up the costs that borrowers must expend, which raises the interest rate for those who borrow.

Economics

Suppose that the ordinary interest rate for a blue chip company, one judged very likely to repay its debt based on

past experience, or, boasting a large and secure collateral, was 5%. Along comes a person, let us call him Mr. A, who has none of these qualities. Indeed, the very opposite. Either no credit record, or a poor one. Little or no collateral. As a result no bank is willing to lend him money at the aforementioned 5% interest. However, the bank, B, will allow A to borrow at 20% interest. This deal takes place, to their mutual benefit. Along comes G, government, and determines that an interest rate of 20% is unconscionable¹¹ and outlaws all such commercial agreements. A can no longer borrow from B, as a result. Whereupon A approaches a loan shark, LS¹² and they together agree upon a loan at an entirely different black market rate of interest: 500% annually.¹³

Moreover, if A does not repay B, the latter will haul him into court, and most likely, the worst case for the former will be a garnishee of his salary. If A declares bankruptcy, that may sometimes be the end of the matter.¹⁴

Matters are quite different when dealing with the LS. If A fails to repay the LS, fully, and in a timely, he will not be sued in a court of law. No, the LS has other methods, much harsher ones. They include being beaten, knee capped, or even killed.¹⁵

So, at the end of the day, did G really help A by driving him away from B and into the arms of LS? It is difficult to see that this would be the case. Very much to the contrary, it is clear that G *worsened* A's position with this supposedly humane and generous "protection."

Who is it, primarily, who loses out from anti usury laws? The rich? The poor? Obviously, the latter. The wealthy will not likely be charged, in the first place, interest rates that are typically declared usurious. It is, rather, those of lesser means who will be ensnared in usury legislation. Is it ethical to in this manner attack the impoverished? Hardly. There are no ethical theories according to which it is virtuous to single out the poor for disproportionate punishment.¹⁶

¹¹ On what basis does G make this determination? Fill in the blank here. Interest rates do not come down to us from heaven, written in stone tablets. There is no nonarbitrary way that 5% can be considered a proper rate of interest, and 20% an improper one.

¹² Or LS approaches A, it does not much matter.

¹³ This source (http://news.bbc.co.uk/2/hi/uk_news/8460730.stm) mentions an interest rate of 1500%. This source (<http://www.guardian.co.uk/money/2010/jan/15/loan-sharks-poorest-households>) 825%.

¹⁴ This is why B needs to charge 20% in the first place: to protect itself from such eventualities.

¹⁵ We abstract here from threats to family members, etc.

¹⁶ The preferential option for the poor, a mainstay of Catholic ethical theory, leads in the very opposite direction. Here, we are asked to be particularly conscious of how any legislation will impact the least well off in society. See on this http://www.osjspm.org/option_for_the_poor.aspx; and http://www.midwestaugustinians.org/justpaxprefopt_aug.html. Also, Block (1988), Jezreel (1997), Twomey (2005).

⁸ It is more than difficult to see how this can be true, absent fractional reserve banking.

⁹ The Jewish law of *ona'ah* prohibits usury within this community. See on this Block (2002).

¹⁰ See also <http://www.17-s.info/node/1099>; actually, in these cases, interest is implicit, not explicit.

Conclusion

In conclusion, a society that wishes to obtain more liberty should also seek more economic freedom. Personal liberties are not the only liberties. Economic liberties count too, and, count equally. Rights of individuals to hold occupations, though deemed immoral by the religions or values of other individuals, which do not coerce others with force and are voluntary between consenting adults, should be upheld. Loan agreements, at *any* interest rate are part and parcel of freedom. The market, namely individuals, should be allowed to decide appropriate interest rates and assume all risks of their acts. If others do not wish to participate in these acts, they are not forced to, but should not be allowed to prevent others from utilizing their right to free trade, certainly including the exchange for money now in return for money later.

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