SHOULD INTEREST RATES BE REGULATED OR ABOLISHED?

THE CASE FOR THE ABOLUTION OF USURY

JOANNE LEE*

ABSTRACT:

This article makes the normative case against usury, defined in the article as any interest on a loan. It argues that usury legitimises bondage of the borrower to the lender through debt. Based on this radicalised understanding of usury, it is further argued that usury facilitates debt accumulation, as well as fosters irresponsible lending and borrowing. It considers the counter-arguments of moral hazard, adverse selection and efficiency, concluding that it remains that the better view is that usury should be prohibited altogether. The article proposes a law to criminalise usury, as well as critically examining this proposed law and its rationale.

I INTRODUCTION

Usury has historically been defined as any interest on a loan, not just excessive interest on a loan. Usury was absolutely prohibited in Medieval Europe, on the grounds that it was morally wrong.[1] However, as Europe transformed from an agrarian to a commercial economy, usury became increasingly seen as a necessity, and viewed as unacceptable only when in excess, rather than being

---

* BSc/LLB (Hons.), LLM candidate; University of Queensland.

The author would like to thank Professor Jonathan Crowe of Bond University, Australia for his excellent research guidance and directions. The author would also like to thank the anonymous referee for his helpful comments and review of her article.

[1] JM Ackerman, 'Interest Rates and the Law: A History of Usury' (1981) 27 *Arizona State Law Journal* 61, 72-77.

morally wrong *per se*.[2] As such, the role of usury law gradually evolved from one based on morality, to one which serves mainly economic purposes. Modern usury law in the West serves a regulatory and disclosure function,[3] reflecting the modern conception of usury as an economic rather than moral issue.

The debate on interest in the modern Western world is concerned with the best interest rate for all the parties, one which both borrowers and lenders are willing to accept, reflects a tension between the interests of consumer protection, and the profitability of lenders.[4] Therein lays the age-old tension between debtors and creditors. However, with loans being made a commodity to profit out of, this tension is heightened as debtors seek to borrow at the most affordable available rate, and creditors seek the rate which optimises their profits, all while diminishing the ability of debtors to repay loans.[5]

This article will be divided into two parts. The first part will make the normative case against usury, applicable to both personal and commercial lending. This is because the case made in this article will be against the essence of usury itself which is the same in both personal and commercial lending, rather than the ways in which the charging of usury is practiced, which are different in personal and commercial lending.

It will begin by examining the philosophical underpinnings and relationship between usury, credit and debt, and argue that debt confers bondage to the borrower. This bondage to debt facilitates long-term debt accumulation, leading to the ever-increasing credit spiral in the economy. As such, this encourages irresponsible lending and borrowing in which loans are taken out even when

---

[2] Ackerman, above n1, 77-79; John T Noonan, *The Scholastic Analysis of Usury* (Harvard University Press, 1957).

[3] Ackerman, above n1, 101.

[4] Iain Ramsay, ''To heap distress upon distress?' Comparative reflections on interest-rate ceilings' (2010) 60(2) *University of Toronto Law Journal* 707, 729.

[5] Banks et al., ''In a perfect world it would be great if they didn't exist': How Australians experience payday loans' (2015) 24 *International Journal of Social Welfare* 37.

they cannot be repaid in full owing to the profits from such indebtedness which usury provides.

The second part of the article will draw on this normative case against usury to propose a new law to effectively criminalise usury. It will critically examine the physical elements, mental elements and defences, and elaborate on how a usurious charge should be distinguished from a non-usurious charge relating to a loan.

This article uses the term 'usury' to mean any interest on a loan, as this definition more accurately captures the moral dimension of usury.

II ARGUMENTS AGAINST USURY

Borrowing is often thought to be an exercise of liberty. As such, it is assumed that loans are mere commodities, which can be bought and sold like ordinary goods.[6] Usury, it follows, is therefore a price on such a commodity, justified as a price of goods bought and sold.[7] However, this conceptualisation of a loan is problematic as it fails to distinguish between the risk and ownership of a loan and a good respectively.[8] This section will begin by examining this conceptualisation of a loan by drawing on philosophical underpinnings of credit, debt and usury. It will then critically examine how debt accumulation, leading to financial crises is facilitated by usury, and how usury encourages

[6] DB Furnish and WJ Boyes, 'Usury and the Efficiency of Market Control Mechanisms: A Comment on "Usury in English Law" Revisted' (2013-14) 30 *Arizona Journal of International and Comparative Law* 115, 119.

[7] Ibid.

[8] 'A Natural-Law Case Against Usury' in John T Noonan, *The Scholastic Analysis of Usury* (Harvard University Press, 1957) 38, 56-57; Jongchul Kim, 'Identity and the hybridity of modern finance: how a specifically modern concept of the self underlies the modern ownership of property, trusts and finance' (2014) 38 *Cambridge Journal of Economics* 425, 428-435; Joan Lockwood O'Donovan, 'The Theological Economics of Medieval Usury Theory', (2001) 14(1) *Studies in Christian Ethics* 48, 55-57.

irresponsible borrowing and lending, in that loans are taken out even when unrepayable.

A *History of Usury in the West*

Historically, the argument made against usury was that it oppresses the poor.[9] However, this argument held limited, if any weight at all, when money-lending was increasingly practiced among merchants.[10] The question then became whether usury was against charity or equity, not whether usury was inherently wrong.[11] This implied that usury was acceptable where it was not uncharitable or inequitable between the parties. With the increasing growth of trade and commerce in Europe during the 16th century, usury became gradually regarded as acceptable and even necessary for prosperity. The question then yet again became what the appropriate interest rate was.[12] By the mid 19th century, most countries in Europe repealed all acts against usury, defined as excessive interest, on that basis that is limiting or prohibiting usury was unnecessary.[13] This reflected the attitude towards usury of West in the mid 19th century and onwards until the 21st century.[14]

[9] 'The Philosophical Framework' in John T Noonan, *The Scholastic Analysis of Usury* (Harvard University Press, 1957) 21, 30-31.

[10] 'The Scholastic Theory of Usury' in John T Noonan, *The Scholastic Analysis of Usury* (Harvard University Press, 1957) 193, 194-195; 'A Countertheory of Usury' in John T Noonan, *The Scholastic Analysis of Usury* (Harvard University Press, 1957) 365, 365-367.

[11] 'A Countertheory of Usury' in John T Noonan, *The Scholastic Analysis of Usury* (Harvard University Press, 1957) 365, 365-367.

[12] Ackerman, above n1, 80.

[13] Ibid 84.

[14] Joseph Persky, 'Retrospectives: From Usury to Interest' (2007) 21(1) *Journal of Economic Perspectives* 227.

B *Usury Legitimises Bondage to Debt*

Where there is a loan between a borrower and lender, the borrower in entering a loan agreement with the lender implicitly promises to repay the loan in full.[15] The lender lends to the borrower an asset that he or she owns, and ownership of the loaned property remains with the lender. Thus, the loaned property is not owned by the borrower under the loan. It follows, therefore, that a failure to repay the loan in full would amount to a failure to return the property to the lender. This would be akin to theft, as it would amount to taking away the property of another without authorised transfer by the owner.[16] In addition to this, failure to return the whole of the loan money would also amount to breaking of an implicit promise to repay.[17] Thus, it follows that the lender has a just claim against the borrower for the value of the property loaned to the borrower since ownership remains with the lender. The borrower, on the other hand, is obliged to satisfy the just claim for repayment of the loan by the lender.[18]

It is clear then that debt gives rise to a relationship between the debtor and creditor. In having a justified demand for repayment of debt owed, irrespective of the borrower's ability to repay the debt, the lender has power over the borrower. Usurious loans are not analogous to the sale of goods at a price as the modern conceptualisation of credit implies, in which the parties are simply

[15] 'Games with Sex and Death' in David Graeber, *Debt: The First 5000 Years* (Melville House, 2011) 127, 144.

[16] Jordi Coral, 'Anxious householders: theft and anti-usury discourse in Shakespeare's Venetian plays' (2015) 30(3) *The Seventeenth Century* 285, 287-288.

[17] 'A Brief Treatise on the Moral Grounds of Economic Relations' in David Graeber, *Debt: The First 5000 Years* (Melville House, 2011) 89, 104-108; 'The Great Experiment' in Charles R Geisst, *Beggar Thy Neighbour* (University of Pennsylvania Press, 2013) 137, 139.

[18] 'On the Experience of Moral Confusion' in David Graeber, *Debt: The First 5000 Years* (Melville House, 2011) 1, 13.

engaged in a transaction involving only the buying and selling of goods.[19] Unlike the sales of goods, debt confers an obligation to the borrower to repay the debt to which the lender has a just claim.[20] Since the borrower has no claim against the lender for an obligation owed to him or her, the borrower is therefore subject to the lender. Thus, it can be said that the borrower in 'bondage' to the lender, the source of which is the debt.

A loan, however, is distinguishable from an employment contract. In an employment contract, there is a reciprocal relationship of obligations between the employee and employer. While the employee is obliged to do work for the employer, the employer is also obliged to give the employee remuneration for the work done. A loan, however, does not confer any remuneration or its equivalent to the debtor. Rather, it imposes an obligation on a borrower to the lender, while no reciprocal obligation is imposed on the lender to the borrower.[21] Although it could be argued that the borrower benefits by obtaining capital which could not otherwise be obtained, and the lender incurs a risk of loss,[22] the lender nevertheless has a right to demand repayment of the debt, regardless of the borrower's circumstances or ability to repay.[23] It is this right which gives power to the lender over the borrower through debt.

However, the question that remains is what makes usury wrong or illegitimate in the moral sense such that it should be prohibited. It may be argued that usury

[19] Alyssa Labat and Walter E Block, 'Money Does Not Grow on Trees: An Argument for Usury' (2012) 106 *Journal of Business Ethics* 383, 386.

[20] Graeber, above n17, 121.

[21] Ibid 109.

[22] Sally J Scholz, 'Rousseau on Poverty' in Helen M Stacy and Win-Chiat Lee (eds), *Economic Justice: Philosophical and Legal Perspectives* (Springer, 2013) 13, 19; Campbell et al., 'The Regulation of Consumer Financial Products: An Introductory Essay with a Case Study on Payday Lending' in Nicolas P Retsinas and Eric S Belsky (eds), *Moving Forward: The Future of Consumer Credit and Mortgage Finance* (Brookings Institution Press, 2011) 206, 225-226.

[23] 'Saints and Sinners' in in Charles R Geisst, *Beggar Thy Neighbour* (University of Pennsylvania Press, 2013) 13, 32-33.

is wrong on the grounds that it increases the chances a borrower will end up being trapped in a cycle of debt. Usury, as such, is exploitative of the debtor, and therefore wrong.[24] This argument, however, runs the risk of being defeated by the contention that where it is not exploitative to the borrower, such as a business, usury would not be illegitimate,[25] just as the traditional argument that usury is morally wrong because it exploits the poor, which eventually held no weight as money-lending among merchants became normal.[26]

While trapping a person in a debt cycle is exploitative, this argument fails to capture the real essence of usury. A stronger argument would be that usury is inherently unjust as it seeks to charge the borrower for obtaining a loan, to which he or she is made bondage by the obligation to repay the debt.[27] Usury, it follows, is profit made off the indebtedness of others through which they are in bondage to the lender. Rather than being a charge for the sale of goods, it is a charge for borrowing the lender's property whereby risk of loss is transferred to the party obliged to make payments, but where ownership remains with the party to whom payments are due.[28] It is that the lender has a claim to profit from the loan which itself confers bondage to the borrower, while the lender incurs no risks of being unable to repay by remaining the owner of the loaned property, that makes usury inherently unjust.

[24] R Mayer, 'When and Why Usury Should be Prohibited' (2013) 116 *Journal of Business Ethics* 513, 520.

[25] Kenman Wong and Donovan Richards 'Commercialization and Microfinance Interest Rates: Usury or Just Prices?' (2014) 17(2) *Journal of Markets & Morality* 381, 387-389.

[26] 'The Scholastic Theory of Usury' in John T Noonan, *The Scholastic Analysis of Usury* (Harvard University Press, 1957) 193, 194-195; 'A Countertheory of Usury' in John T Noonan, *The Scholastic Analysis of Usury* (Harvard University Press, 1957) 365, 365-367.

[27] Steven W Bender, 'Rate Regulation at the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive Commercial and Consumer Interest Rates under the Unconscionability Standard' (1994) 31(3) *Houston Law Review* 721, 728-730.

[28] Simone Westerfeld and Frithjof Weber, 'Selecting credit portfolios for collateralized loan obligation transactions: a heuristic alogorithm' (2009) 5(4) *Journal of Credit Risk* 65, 66.

Yet, it may be asked is whether usury is justifiable on the grounds of the need to compensate for inflation, as lenders lose money on the principal, owing to decrease in the value of money.[29] Where inflation occurs, the value of money is decreased.[30] As a result, the value of debt based on the initial monetary value would be lower than that based on the final monetary value. It would follow that repayment based on the initial value would amount to not a full repayment of the debt owed. The inflation-adjusted value of debt would need to be paid to fully repay the debt.[31] Usury, however, is a charge on a loan, for the use of the loan, rather than an adjustment tool.[32] Although it may be argued that it may in practice serve as an adjustment tool, the inflation-adjustment value of debt is the value of only the principle which accounts for the decrease in value due to inflation to ensure that the lender does not lose debt repayments owed due to inflation.[33]

This analysis of debt and credit radicalises the current understanding of loans and usury, laying the foundation for understanding how usury perpetuates debt accumulation by providing an incentive for irresponsible lending and borrowing. In the backdrop of the recent global financial crisis perpetuated by irresponsible lending and borrowing, leading to debt accumulation, a renewed understanding of the fundamental concepts of debt and credit is needed to understand how

[29] Joseph A Burke, 'The Scholastic Analysis of ZIRP: Justice, Usury, and the Zero Interest Rate Policy' (2014) 17(1) *Journal of Markets & Morality* 105, 107-113.

[30] 'Why Study Money, Banking and Financial Markets?' in Frederic S Mishkin, *The Economics of Money, Banking and Financial Markets* (Pearson, 10th ed, 2013) 44, 50.

[31] 'Why Do Interest Rates Change?' in Frederic S Mishkin and Stanley G Eakins, *Financial Markets and Institutions* (Pearson, 7th ed, 2012) 104, 128.

[32] There is no single factor which drives interest rates, such adjustment for inflation, but rather many factors which drive interest rates: Maureen Were and Joseph Wambua, 'What factors drive interest rate spread of commercial banks? Empirical evidence from Kenya' (2014) 4 *Review of Development Finance* 73, 79-81; Dorfleitner et al., 'What determines microcredit interest rates?' (2013) 23(20) *Applied Financial Economics* 1579, 1595-1596.

[33] Miskhin and Eakins, above n31.

usury has been responsible for the debt crises of the modern globalised economy.

C *Usury Facilitates and Perpetuates Debt Accumulation*

Usury reduces the ability of the borrower to repay debts, by increasing debt owed to the lender. As a result, it increases the chances that a borrower will become trapped in the cycle of debt.[34] This is particularly obvious in the case of a bank loan which incurs compound interest. However, the effects of usury need not be as extreme. By holding people in debt bondage, it facilitates and perpetuates debt accumulation in the economy.[35] As more individuals become trapped in the cycle of debt, lending institutions will themselves become indebted. [36]As a result, an ever-increasing credit spiral occurs, in which the debt continues to accumulate, rather than be written off.[37] This cycle is problematic in itself because debts are increasing, rather than being written off, while credit continues to expand, leading to the collapse of the economy.[38]

There have been many solutions proposed for dealing with the spiral of debt and ever-increasing credit expansion. They range from quantitative easing,[39] to

---

[34] Edward L Glaeser and Jose Scheinkman, 'Neither A Borrower Nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Laws' (1998) 41(1) *The Journal of Law and Economics* 1, 19.

[35] Juan Vega Vega, 'The International Crime of Usury: The Third World's Usurious Foreign Debt' [1987] 29 *Crime and Social Justice* 45, 54-55.

[36] Anna Gelpern, 'Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt' (2012) 121(4) *Yale Law Journal* 888.

[37] 'Financial Crises in Advanced Economies' in Frederic S Mishkin, *The Economics of Money, Banking and Financial Markets* (Pearson, 10th ed, 2013) 227, 231; S Keen, 'Household Debt: The Final Stage in an Artificially Extended Ponzi Bubble' (2009) 42(3) *The Australian Economic Review* 347, 353; Graeber, above n18, 3.

[38] Michael Hudson 'US "Quantitative Easing" Is Fracturing the Global Economy' (Working Paper No. 639, Levy Economics Institute of Bard College, November 2010) 5.

[39] David Cobham and Yue Kang, 'Financial Crisis and Quantitative Easing: Can Broad Money Tell Us Anything?' (2012) 80(1) *The Manchester School* 54, 68; Bowman et al. 'Quantitative easing and bank lending: Evidence from Japan' (2015) 57 *Journal of International Money and Finance* 15, 25-27; Eric Girardin and Zakaria Moussa, 'Quantitative easing works: Lessons from the unique experience in Japan 2001-2006' (2011) 21 *Journal of International Financial Markets, Institutions & Money* 461, 479; Thomas I Palley, 'Monetary Policy at the Zero Lower Bound and After: A Reassessment of Quantitative Easing and Critique of the Federal Reserve's Proposed Exit Strategy' (2015) 66(1) *Metroeconomica* 1, 16-17.

credit easing,[40] and to bailouts.[41] Yet, some propose the more radical solution of debt forgiveness.[42] However, the question that remains is what facilitates and perpetuates debt accumulation over the long-term.

This section proposes that usury facilitates long-term indebtedness by increasing debt incurred. Where usury is not charged, borrowers will be able to more easily repay their debt in full.[43] This is not to suggest that borrowers will not possibly be trapped in a debt cycle by not having to pay usury, but rather that there will be a lower chance that this will occur. Neither is it to suggest that borrowers against whom usury is charged will necessarily be trapped in a debt cycle. Rather, it is to explain using empirical evidence, the effect of usury on debt, and how it has lead to the problematic expansion of credit, in which the demand for credit continues to increase, in spite of the accumulation of debt.[44]

Conventional neo-liberal macroeconomics has neglected the role of private debt in the economy.[45] It is often assumed that debt is merely a redistribution of spending power between borrower and lender.[46] This is in stark contrast to post-Keynesian economics which purports that debt has a significant macroeconomic

[40] Carlson et al., 'Credit Easing: A Policy for a Time of Financial Crisis' [2009] *Economic Trends* 7, 10-13.

[41] Randall D Guynn, 'Are Bailouts Inevitable?' (2012) 29(1) *Yale Journal on Regulation* 121; Emiliano Grossman and Cornelia Woll, 'Saving the Banks: The Political Economy of Bailouts' (2014) 47(4) *Comparative Political Studies* 574.

[42] Professor Michael Hudson, *The Lost Tradition of Biblical Debt Cancellations* (1992) <http://michael-hudson.com/wp-content/uploads/2010/03/HudsonLostTradition.pdf>; Bob English, Interview with Professor Steve Keen, Professor of Economics (Media Interview, 18 July 2013).

[43] S Keen, 'Bailing out the Titanic with a Thimble' (2009) 39(1) *Economic Analysis & Policy* 3, 3-5.

[44] I Fisher, 'The debt-deflation theory of great depressions', (1933) 1(4) *Econometrica* 337, 344, quoted by S Keen, 'Bailing out the Titanic with a Thimble' (2009) 39(1) *Economic Analysis & Policy* 3, 5.

[45] S Keen, 'Household Debt: The Final Stage in an Artificially Extended Ponzi Bubble' (2009) 42(3) *Australian Economic Review* 347, 347; S Keen, 'Post Keynesian Theories of Crisis' (2015) 74(2) *American Journal of Economics and Sociology* 298, 299.

[46] S Keen, 'Post Keynesian Theories of Crisis' (2015) 74(2) *American Journal of Economics and Sociology* 298, 308.

effect.[47] Its analysis is based on the underlying premise that debt which has not been written off is still of effect, and cannot be eliminated simply by reversing the direction of the economy.[48] It recognises that debt creates more debt,[49] and also that the financial crises continue to occur on a cyclic basis, owing to accumulated debt preceding the boom being the cause of both the boom and the bust in a debt-based economy.[50] As such, private debt has been shown to be pivotal to the financial crises, and therefore, neglecting the role of private debt in the economy will result in a somewhat incomplete and even faulty analysis of the credit-based modern economy.[51]

Arguably, one of the key assumptions of mainstream economics is that the accumulated private debt can be diminished simply by reversing the effect of debt. Monetary policies based on this assumption, such as quantitative easing in response to deflation have been shown to have only a short-term, rather than a long-term overall benefit.[52] Evidence has shown that the impact of deleveraging, the reduction of debt relative to equity, is the cause of the increase in proportion of debt of the aggregate demand,[53] and unemployment.[54] This indicates that wealth is financed by debt, such that where debt is attempted to be paid off, it

[47] Keen, above n 45, 347-348.

[48] Domenica Tropeano, 'Quantitative Easing in the United States after the crisis: conflicting views' in Louis-Philippe Rochon and Salewa 'Yinka Olawoye, *Monetary policy and central banking: new directions in post-Keynesian theory* (Edward Elgar Publishing, 2012) 227, 231-235.

[49] S Keen, 'Bailing out the Titanic with a Thimble' (2009) 39(1) *Economic Analysis & Policy* 3, 9-10.

[50] Keen, above n 49, 9; Keen, above n 45, 351-352.

[51] Aldo Barba and Massimo Pivetti, 'Rising household debt: Its causes and macroeconomic implications – a long-period analysis' (2009) 33(1) *Cambridge Journal of Economics* 113, 130-131.

[52] Gern et al. 'Quantitative Easing in the Euro Area: Transmission Channels and Risks' (2015) 50(4) *Intereconomics* 206, 210; Robert Jarrow and Hao Li, 'The impact of quantitative easing on the US term structure of interest rates' (2014) 17(3) *Review of Derivatives Research* 287, 315.

[53] Thomas I Palley, 'Debt, aggregate demand, and the business cycle: An analysis' (1994) 16(3) *Journal of Post Keynesian Economics* 371, 384; Keen, above n 49, 12-13.

[54] Keen, above n 49, 12-13.

leads to increased debt,[55] thereby facilitating the continual accumulation of debt.[56]

However, the question that remains is the precise role which usury plays in the modern debt-based economy. It is clear that usury imposes additional costs of lending to the borrower, increasing indebtedness of the borrower to the lender. Where the controversy lies, however, is the particular form of usury, in terms of whether it is fixed or compounding interest, and the amount of usury. As such, this may lead some to conclude that a moral distinction needs to be made between fixed and compounding interest, as well as what is a reasonable interest rate.[57] Indeed, much of modern usury law is concerned with what is the optimum rate which provides for the greatest economic efficiency for businesses, and is not excessive, but fair to the borrower.[58] The question which still remains is why usury should be absolutely prohibited. This question concerns principles of morality. The general effects of usury can be argued to be manifestations of what usury is, in the moral sense.

The effect of usury can be more clearly seen in the 'euphoric economy' phase where both lenders and borrowers are assured that most investments will succeed, such that neither party incurs an unacceptable risk of loss.[59] Owing to

---

[55] I Fisher, 'The debt-deflation theory of great depressions', (1933) 1(4) *Econometrica* 337, 344, quoted by S Keen, 'Bailing out the Titanic with a Thimble' (2009) 39(1) *Economic Analysis & Policy* 3, 5 (same as above I Fisher)

[56] Serkan Arslanalp and Takahiro Tsuda, 'Tracking Global Demand for Advanced Economy Sovereign Debt' (2014) 62(3) *IMF Economic Review* 430; 457-458; Silvia Federici, 'From Commoning to Debt: Financialization, Microcredit, and the Changing Architecture of Capital Accumulation' (2014) 113(2) *The South Atlantic Quarterly* 231, 233.

[57] Constant J Mews and Ibrahim Abraham, 'Usury and Just Compensation: Religious and Financial Ethics in Historical Perspective' (2007) 72 *Journal of Business Ethics* 1, 9.

[58] S Mercatante, 'The Deregulation of Usury Ceilings, Rise of Easy Credit, and Increasing Consumer Debt' (2008) 53 *South Dakota Law Review* 37; Paige Marta Skiba, 'Regulation of Payday Loans: Misguided?' (2012) 69(2) *Washington and Lee Law Review* 1023; Stephanie Ben-Ishai, 'Regulating Payday Lenders in Canada: Drawing on American Lessons' (Research Paper No. 16, Comparative Research in Law & Political Economy, 2008).

[59] Keen, above n 45, 352.

asset price inflation, the only way to profit is by trading assets on the rising market, which is called 'Ponzi financing' which makes its gains through interest on credit.[60] Ponzi financing during this period is willing to incur debt, despite servicing costs being higher than the profits from assets because it is confident that assets can be sold for profit.[61] However, the rising interest-servicing costs incurred eventually force all investors to sell capital assets so as to be able to repay all debts. Additional sellers enter into the asset market, which sharply reduces the exponential rise in prices on which the Ponzi financiers depend.[62] As a result, the Ponzi financiers become bankrupt, bringing the euphoric phase to an end, and causing another debt-induced systemic crisis.[63]

The economic system both with and without Ponzi financing can be modelled. The model of the system without Ponzi financing shows that a debt crisis can occur at extreme conditions, but near equilibrium, the model is stable.[64] This is in contrast to Ponzi financing, which model shows a series of boom and bust cycles, with debt levels ratcheting up over time, until the debt incurred in the final cycle overwhelms the debt-servicing capacity, followed by a depression.[65] Therefore, these models provide evidence for the claim that usury traps debtors into a cycle of debt, leading to the bust which occurs as a result of continual debt accumulation until the point where lenders no longer have credit to provide.[66]

---

[60] A Profile of The Con Artists and Their Victims' in Tamar Frankel, *Ponzi Scheme Puzzle: A History and Analysis of con Artists and Victims* (Oxford University Press, 2012) 110, 130-149.

[61] Keen, above n 45, 352.

[62] Ibid.

[63] Ibid .

[64] Keen, above n45, 353.

[65] 'Background and Tools for Understanding and Dealing with Recurrent Financial Crises' in Lester D Taylor, *Capital, Accumulation*: *An Integration of Capital, Growth and Monetary Theory* 181, 188-189; Keen, above n45, 353.

[66] Keen, above n45, 355.

It may be argued that debt accumulation in a debt-based economy will still occur even without Ponzi financing,[67] and therefore that it is not debt accumulation in the long-term *per se* that is relevant, but rather *excessive* debt accumulation in relation to the debt-servicing capacity.[68] Since it is excessive debt accumulation in the long-term which is the cause of the financial crisis leading to the collapse, the question is what maximum private debt level should be permitted, rather than how to prevent long-term debt accumulation itself.[69] This question, however, is based on the assumption that debt itself is a necessity for economic growth. Thus, the question as to whether debt should be the basis of economic growth arises. As such, it can be argued that because Ponzi financing worsens, by means of usury, rather than creates debt accumulation, the case against usury is strengthened.[70] It is the debt itself from which wealth is generated which leads to market crashes when debt levels reach a certain point. Usury facilitates such debt accumulation over the long-term.

The apparently simple reality of usury has profound implications. Usury has significant impacts on the economy, from the macroeconomic to the individual level. The debt crises in the 20th and 21st centuries are fruits of long-term debt accumulation which is the driving force of the modern Western economy. Such effects are exacerbated by Ponzi financing, rather than caused by Ponzi financing. Therefore, eradicating Ponzi financing would not prevent the cyclic debt crises. Rather it is long-term debt itself, facilitated by usury which needs to be eradicated to do so.

---

[67] Anastasia Nesvetailova and Ronen Palan, ' Minsky in the Shadows: Securitization, Ponzi Finance, and the Crisis of Northern Rock' (2013) 45(3) *Review of Radical Political Economics* 349, 352-353; Javier Bianchi, 'Credit Externalities: Macroeconomic Effects and Policy Implications' (2010) 100(2) *American Economic Review* 398, 400-401.

[68] Keen, above n45, 353.

[69] Francisco Covas and Wouter J Den Hann, 'The Role of Debt and Equity Finance Over the Business Cycle' (2012) 122 *Economic Journal* 1262, 1283; Federici, above n 56, 234-240.

[70] 'Capital Values, Wealth, and Related Topics' in Lester D Taylor, *Capital, Accumulation*: *An Integration of Capital, Growth and Monetary Theory* 79, 87-88.

D *Usury Encourages Irresponsible Lending and Borrowing*

Usury, being a charge on a loan, can provide huge profits for lending businesses.[71] This is indeed the case with payday lending businesses, which provide credit to individuals for consumption.[72] Payday lending has not been without controversy. Some criticise payday lending as exploitative and predatory.[73] On the other hand, some argue that payday lending is necessary for low- or average- income individuals or families, without which their welfare would be worse.[74] Yet others are more ambivalent on the issue of payday lending, arguing that that while payday lending can be exploitative and predatory, it need not necessarily be exploitative and predatory, but rather that its merits depend on how each individual customer is affected.[75] This section will consider the competing arguments for and against payday lending by drawing on empirical evidence of the impact of payday lending. On the other hand, the question as to whether loans taken out for basic sustenance are owing in part to poor management of personal or household finance arises, and will also be examined in the context of payday lending.

---

[71] Osman Uluyol and Samiye Ekim, 'A Study of the Relationship Between Banking Sector's Profitability and Interest Rates on Deposits Using Johansen Cointegration and Granger Causality Test' (2015) 2(1) *Pressacademia* 58; S Samuel Ogunbiyi and Peters O Ihejirika, 'Interest Rates and Deposit Money Banks' Profitability Nexus: The Nigerian Experience' (2014) 3(11) *Arabian Journal of Business and Management Review* 133, 145.

[72] Diane Standaert and Brandon Coleman, 'Ending the Cycle of Evasion: Effective State and Federal Payday Lending Enforcement' (Policy Brief, Centre for Responsible Lending, November 2015) 1; Susanna Montezemolo and Sarah Wolff, 'Payday Mayday: Visible and Invisible Payday Lending Defaults' (Report, Centre for Responsible Lending, March 2015) 2; Leslie Parrish and Uriah King, 'Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume' (Report, Centre for Responsible Lending, 9 July 2009) 27.

[73] Michael A. Stegman and Robert Faris, 'Payday Lending: A Business Model that Encourages Chronic Borrowing' (2003) 17(1) *Economic Development Quarterly* 8; Uriah King and Leslie Parrish, 'Payday Loans, Inc: Short on Credit, Long on Debt' (Report, Centre for Responsible Lending, 31 March 2011) 11-12.

[74] Skiba, above n 58, 1045; William M Webster, 'Payday Loan Prohibitions: Protecting Financially Challenged Consumers or Pushing Them over the Edge?' (2012) 69(2) *Washington and Lee Law Review* 1051, 1080-1090.

[75] Noreen Byrne, Olive McCarthy and Michael Ward, 'Money-Lending and Financial Exclusion' (2007) 27(1) *Public Money & Management* 45, 50; Banks et al., above n 5, 41-42.

Since this article focuses on individual and household debt, rather than corporate or national debt, the dynamics of payday lending will be analysed to provide insight into how usury encourages irresponsible lending, by encouraging individuals to consume credit on a regular long-term basis, and also irresponsible borrowing, by borrowing irrespective of the ability to repay all debts owed. This section will provide an analysis of the dynamics of borrowing and lending, to examine the relationship between debt, credit and usury in the context of personal and household debt.

The literature on the impact of payday lending on consumers is often ambiguous and riddled with apparent conflicts.[76] However, these ambiguities and apparent conflicts could be explained by the different methodologies employed by various studies to measure financial distress or well-being, leading to different conclusions on the impact of payday loans.[77] In addition to this, these studies generally tend to have a focus on the short-term impact of obtaining a loan, rather than the long-term impact on the customer's ability to repay loans.[78] Since the purpose of this section is to examine the impact of usury in terms of indebtedness, it will draw on data concerning the impact of payday lending in terms of long-term indebtedness, rather than the ability to receive a loan in the future, or short-term purchasing power. The rationale of this approach is to highlight the impact of usury on indebtedness, which is more marked in the long-term.

[76] Richard Hynes, 'Payday Lending, Bankruptcy, and Insolvency' (2012) 69(2) *Washington and Lee Law Review* 607, 614-618.

[77] See Brian T Melzer, 'The Real Costs of Credit Access: Evidence from the Payday Lending Market' (2011) 126 *The Quarterly Journal of Economics* 517, 547-550; Jim Hawkins, 'Regulating on the Fringe: Reexamining the Link Between Fringe Banking and Financial Distress' (2011) 86 *Indiana Law Journal* 1361, 1399-1402; Neil Bhutta, Paige Marta Skiba and Jeremy Tobacman, 'Payday Loan Choices and Consequences' (Working Paper No. 12-30, Vanderbilt University Law School, 25 January 2013) 20-22; Montezemolo and Wolff, above n 72, 11-12.

[78] For example Adair Morse, 'Payday lenders: Heroes or Villains?' (2011) 102 *Journal of Financial Economics* 28, 42.

Evidence has shown that payday lending can either reduce[79] or increase financial distress.[80] Where credit structures are designed so that borrowers will be able to repay, it may be argued that overall long-term indebtedness is reduced.[81] Unlike credit cards, payday loans are short-term, non-revolving and have tight constraints,[82] where the maximum credit that can be taken out is the customer's weekly income.[83] As such, it can be argued that because of these credit restraints posed to customers, and that indebtedness is inevitable when borrowing money, there is no reason to claim that such loans necessarily increase indebtedness over the long-term or are intended to trap customers into a debt cycle.[84] Thus, it may be argued that payday lending, and more generally loans, can either reduce economic constraint by providing a temporary source of credit, despite the charging of usury, or increase debt burdens in the long-term.[85] Although payday lending does not necessarily cause long-term indebtedness, however, it has been shown that access to payday loans increases the difficulty of paying bills and the delay of required health care.[86] These findings taken together may indicate that the indebtedness of individual resulting from such loans depends on the extent to which an individual manages to live within one's means.[87]

[79] Melzer, above n 77.

[80] Hawkins, n 77, 1394-1399; Skiba, n 58, 1038-1041.

[81] Hawkins, n 77, 1399.

[82] Ibid.

[83] Hawkins, n 77, 1374.

[84] Annie Schafter, Shee Wong and Stephen B Castleberry, 'Payday Lending: Perfunctory Or Predatory?' (2009) 5(6) *Journal of Business Studies* 98-99.

[85] Ibid 99.

[86] Melzer, above n 77.

[87] Michael D Carr and Arjun Jayadev, 'Relative Income and Indebtedness: Evidence from Panel Data' (2015) 61(4) *Review of Income and Wealth* 759, 770-771; John Gathergood, 'Self-control, financial literacy and consumer over-indebtedness' (2012) 33 *Journal of Economic Psychology* 590, 600; Cristina Ottaviani and Daniela Vandone, 'Impulsivity and household indebtedness: Evidence from real life' (2011) 32 *Journal of Economic Psychology* 754, 759-760.

There has been evidence that indebtedness of individuals or households is in some part caused by a lack of sound financial management.[88] Amadi (2012) documents the research of various studies, several of which found that materialism was a significant factor in predicting the chances of a consumer incurring debt.[89] A typology of consumers identified two types of consumers, classified as either rational or hyperbolic discounters. Hyperbolic discounters were characterised as preferring current consumption over future consumption, more likely to use credit cards for borrowing rather than transacting, consume too much on a monthly basis, thereby accumulating high levels of credit card debt, and less likely to commit to constraining future choices.[90] In addition to this, White (2007) reports that in a study conducted by Panel Study of Income Dynamics, one-third of respondents said that high debt/misuse of credit was their primary reason for filing for bankruptcy. Two-thirds of respondents before filing for bankruptcy in a survey conducted by the National Foundation for Credit Counselling regarded 'poor money management/excessive spending' as their reasons for experiencing financial difficulty.[91]

While it may seem that all responsibility for indebtedness may lie on borrower, it appears that lenders may also be partially responsible for such indebtedness, by providing loans in such a way as to keep individuals in debt, to generate

[88] CW Amadi, 'An Examination of the Adverse Effects of Consumer Loan' (2012) 7(3) *International Journal of Business and Management* 22.

[89] G Jacobs and EVDM Smit, 'Materialism and indebtedness of low income consumers: Evidence from

South Africa's largest credit granting catalogue retailer'(2010) 41(4) *South African Journal of Business Management*, 11 cited in CW Amadi, 'An Examination of the Adverse Effects of Consumer Loan' (2012) 7(3) *International Journal of Business and Management* 22, 26.

[90] MJ White, 'Bankruptcy reform and credit cards' (2007) *21*(4) *Journal of Economic Perspectives'* 175 cited in CW Amadi, 'An Examination of the Adverse Effects of Consumer Loan' (2012) 7(3) *International Journal of Business and Management* 22, 27.

[91] MJ White, 'Bankruptcy reform and credit cards' (2007) *21*(4) *Journal of Economic Perspectives'* 175 cited in CW Amadi, 'An Examination of the Adverse Effects of Consumer Loan' (2012) 7(3) *International Journal of Business and Management* 22, 26.

profit. Long-term studies such as that conducted by the Centre for Responsible Lending from 2009-2015 confirm that consumers of payday loans fall into the debt cycle, creating a 'loan churn', in which the borrower has to continually repay the principal from the previous loan, owing to the failure to completely repay the debt from the previous term.[92] This is indeed one factor which increases the chance that an individual files for bankruptcy.[93] In 2009, the Centre for Responsible Lending reported that 76% of payday loan value was caused by loan churning.[94] A more recent report by the Consumer Financial Protection Bureau (2014) found that 80% of loan value is due to loan churn.[95] In a 2015 report, the Centre for Responsible Lending also found that the majority of payday lending revenue is generated by loaning churning.[96] That payday lenders make majority of profit from loan churning perhaps provides strong evidence that payday lenders have an incentive to design their business so as to keep customers in long-term debt.[97]

The assumption that there is no cause of concern for borrowers in regularly seeking loans, whether it be for financing necessities or non-necessities, appears to underlie many studies examining the impact of payday lending on consumers'

[92] Montezemolo and Wolff, above n72, 2.

[93] A Mechele Dickerson, 'Consumer Over-Indebtedness: A U.S. Perspective' (2008) 43(2) *Texas International Law Journal* 135, 152.

[94] Montezemolo and Wolff, above n72, 2; Parrish and King, above n72.

[95] CFPB Office of Research, 'CFPB Data Point: Payday Lending' (Report, Consumer Financial Protection Bureau, March 2014) 16 cited in Susanna Montezemolo and Sarah Wolff, 'Payday Mayday: Visible and Invisible Payday Lending Defaults' (Report, Centre for Responsible Lending, March 2015) 2.

[96] Consumer Financial Protection Bureau, 'Payday Loans and Deposit Advance Products' (Whitepaper, Consumer Financial Protection Bureau, 24 April 2013) cited in Diane Standaert and Brandon Coleman, 'Ending the Cycle of Evasion: Effective State and Federal Payday Lending Enforcement' (Policy Brief, Centre for Responsible Lending, November 2015) 1.

[97] Paul Sergius Koku and Sharan Jagpal, 'Do payday loans help the working poor?' (2015) 33(5) *International Journal of Bank Marketing* 592, 600; Rob Aitken, 'Finding the Edges of Payday Lending' (2013) 12 *Perspectives on global development and technology* 377, 400-401.

welfare.[98] This focus on only the effect of the loan itself, rather than also considering the motivations of the borrower themselves for taking out such loans appears to be unable to capture the full extent of the problem of consumer debt. There is also much focus on responsible lending, rather than both responsible lending and borrowing.[99] Debt and credit, however, involve both borrower and lenders as actors. Thus, it follows that the impact of lending and borrowing may be more properly assessed by also examining consumer behaviour which may in large part provide an explanation for long-term consumer debt.

There is strong evidence that payday lending can and does lead borrowers into a debt trap. Despite credit constraints that may be imposed by payday lenders on loans made to the consumer, it appears that such constraints are not made to protect the consumer from long-term indebtedness, but rather to reduce its risk of loss owing to non-repayment.[100] As such, consumers face a conundrum as to whether to borrow in the short-term, and risk remaining indebted over the long-term, or to live off credit to maintain sustenance.[101] This demonstrates the nature of debt which confers a continuing obligation to repay to the borrower, which

---

[98] Banks et al., above n 5; Stegman and Faris, above n 73; King and Parrish, above n 73; Skiba, above n 58; Noreen Byrne, Olive McCarthy and Michael Ward, 'Money-Lending and Financial Exclusion' (2007) 27(1) *Public Money & Management* 4; Melzer, above n 77; Montezemolo and Wolff, above n 72; Parrish and King, above n 72 cf. CW Amadi, 'An Examination of the Adverse Effects of Consumer Loan' (2012) 7(3) *International Journal of Business and Management* 22

[99] Standaert and Coleman, above n 72; Montezemolo and Wolff, above n 72; Parrish and King, above n72.

[100] Been-Lon Chen and Shian-Yu Liao, 'Capital, credit constraints and the comovement between consumer durables and nondurables' (2014) 39 *Journal of Economic Dynamics & Control* 127, 132; Orlando Costa Gomes, 'Constraints on Credit, Consumer Behaviour and the Dynamics of Wealth' (2009) 54(182) *Economic Annals* 119, 130.

[101] See Shawn Cole, John Thompson and Peter Tufano, 'Where Does It Go? Spending by the Financially Constrained' in Nicolas P Retsinas and Eric S Belsky, *Borrowing to Live: Consumer and Mortgage Credit Revisited* (Brookings Institution Press, 2009) 65; Edna R Sawady and Jennifer Tescher, 'Financial Decisionmaking Processes of Low-Income Individuals' in Nicolas P Retsinas and Eric S Belsky, *Borrowing to Live: Consumer and Mortgage Credit Revisited* (Brookings Institution Press, 2009) 92.

only ends when it is all repaid in full. It is one that does not appear to be of liberty, but of bondage. Usury not only adds to this bondage. It provides an incentive to profit of the indebtedness of others. This in turn encourages irresponsible lending, which provides an incentive for lenders to encourage borrowers to borrow irresponsibly, that is, irrespective of the ability to pay off the debts incurred.

E *Conclusion*

The dominant understanding of debt and credit in the modern Western world is that charging interest in a loan is simply akin to the sales of goods or services. However, unlike the sale of goods, a loan confers an obligation on the borrower to repay the lender. Usury, by charging a person for a loan which holds the borrower in bondage to the debt, amounts to profiting of the indebtedness of another. This is unlike the sales of goods where the buyer is charged for the goods to which he or she becomes the owner. Therefore, treating loans as akin to a sale of goods leads to a problematic understanding of debt, credit and usury. Usury facilitates the accumulation of debt, as it reduces the ability to repay debt by charging a price on it. Such debt accumulation leads to credit spirals, leading to creditors not being able repay their debts themselves. This was demonstrated by the Global Financial Crisis in 2008-2009 in which the economy crashed owing to a lack of credit supply created by ever-increasing debt. In addition to this, usury provides an incentive for lenders to profit of the indebtedness of borrowers, leading to loans being taken out regardless of ability to repay.

III. COUNTER-ARGUMENTS AGAINST THE TOTAL PROHIBITION OF USURY

The case against usury itself raises many questions. Although the negative effects of usury may be acknowledged, such as a decrease in economic growth, the question that remains is why usury should be absolutely prohibited, rather than simply restricted or limited. Legitimate charges relating to the loan may be confounded with charges on the loan itself. Business efficiency could also become significantly compromised. As such, this section will examine the moral hazard, adverse selection and efficiency counter-arguments, by evaluating each of their rationales respectively.

A *Moral Hazard*

Moral hazard is the risk posed to a party in a transaction after the transaction occurs.[102] In the context of a loan, it is the risk of loss owing to non-repayment which lies on the lender once the loan has been taken out.[103] As such, it is often argued that usury is necessary to protect against such loss, and therefore, lenders should be at liberty to do so.[104] Owing to this increased risk of loss, lending will be significantly discouraged, resulting in a decrease in business activity.[105] Indeed, Arkansas' strictly enforced 10% cap on usury lead to a decrease in business activity during the 1970s.[106] Therefore, it follows that although usury is undesirable to consumers, it is necessary for lenders to compensate for actual or potential loss.

[102] 'An Overview of the Financial System' in Frederic S Mishkin, *The Economics of Money, Banking and Financial Markets* (Pearson, 10th ed, 2013) 67, 82.
[103] Will Dobbie and Paige Skiba, 'Information Asymmetries in Consumer Credit Markets: Evidence from Payday Lending' (2013) 5(4) *American Economic Journal: Applied Economics* 1, 23.
[104] Donato Masciandaro, 'In Offence of Usury Laws: Microfoundations of Illegal Credit Contracts' (2001) 12 *European Journal of Law and Economics* 193, 210-212.
[105] Stegman and Faris, above n 73, 27-28; Paul Ali, Cosima McRae and Ian Ramsey, 'The Politics of Payday Lending Regulation in Australia' (2013) 39(2) *Monash University Law Review* 411, 449.
[106] Ackerman, above n1, 104.

However, moral hazard is inherent in all transactions.[107] This inherent risk arises from the reality that in any transaction, each party gains at the loss of the other.[108] Owing to the difference in amount of information about the deal, the party with better information is in a position to ensure either that the loss it incurs is reduced, or that the gain it incurs is maximised.[109] This is inevitably at the expense of the other party because the gain of one party necessarily requires the loss of another.[110] For example, when an insurance company gives a car insurance premium to a buyer, the buyer may engage in more risky driving behaviours, thereby incurring more risk of loss to the insurance company.[111]

Although the concern of risk of loss is a legitimate one, it need not necessarily follow that usury must be charged to protect against risk of loss. Alternatives such as collateral could be used as a means of security against such risks, such as in the case of pawn-broking.[112] Collateral would replace the interest the borrowers pay. Nonetheless, that such alternatives to usury exist does not mean that lenders should be prohibited from charging usury. However, that alternatives exist provides lenders a weaker reason to charge usury. It may also indicate that the charging of usury serves a means of making profit,[113] rather than a means of security against risk of loss.

---

[107] Joseph E Stiglitz and Andrew Weiss, 'Credit Rationing in Markets with Imperfect Information' (1981) 71(3) *American Economic Review* 393, 407-408; Karl S Okamoto, 'After the Bailout: Regulating Systemic Moral Hazard' (2009) 57 *UCLA Law Review* 183, 204.

[108] Kevin Dowd, 'Moral Hazard and the Financial Crisis' (2009) 29(1) *Cato Journal* 141, 142-143.

[109] Stiglitz and Weiss above n 105, 393-394.

[110] Eva I Hoppe and David J Kusterer, 'Conflicting tasks and Moral Hazard: Theory and Experimental Evidence' (2011) 55 *European Economic Review* 1094, 1105-1106.

[111] Mahito Okura, 'The relationship between moral hazard and insurance fraud' (2013) 14(2) *Journal of Risk Finance* 120; Giovanni Millo and Giacomo Pasini, 'Does Social Capital Reduce Moral Hazard? A Network Model for Non-Life Insurance Demand' (2010) 31(3) *Fiscal Studies* 341.

[112] Hawkins, n 77, 1388-1393.

[113] Alejandro Valle Baeza and Ivan Mendieta Munoz, 'What is the Relationship Between the Rates of Interest and Profit? An Empirical Note for the US Economy, 1869-2009' (2012) 71(280) *Investigación Económica* 163, 168-177; Peter W Roberts, 'The Profit

Owing to the reduced choice of security, the absolute prohibition on usury may discourage business activity.[114] However, alternatives such as profit-loss sharing,[115] and shareholding contributions[116] could be employed. Profit-loss sharing requires that the loan being made is used for business activity, and the profit is generated from that business, and not for the loan itself.[117] Shareholding contributions involve contributions of capital by individuals to the business, which then use it to conduct business. The company lends money to other parties for use, without charging interest on a loan.[118]

B *Adverse Selection*

Adverse selection is the risk posed to a party in a transaction before the transaction occurs.[119] In the context of a loan, it is the risk of non-repayment by less creditworthy customers, resulting in an increase in loan purchase price,

---

Orientation of Microfinance Institutions and Effective Interest Rates' (2013) 41 *World Development* 120, 127.

[114] Ali, McRae and Ramsey, above n 105, 449; Ackerman, above n1, 104; Edward L Glaeser and Jose Schienkman, 'Neither A Borrower Nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Laws' (1998) 41(1) *The Journal of Law and Economics* 1, 19-26.

[115] Yeo Hwee Ying, 'Of Profit Sharing and Partnerships' [1995] *Singapore Journal of Legal Studies* 404; Rasem N Kayed, 'The entrepreneurial role of profit-and-loss sharing modes of finance: theory and practice' (2012) 5(3) *International Journal of Islamic and Middle Eastern Finance and Management* 203.

[116] Emilio Barucci and Fabrizio Mattesini, 'Bank shareholding and lending: Complementarity or substitution? Some evidence from a panel of large Italian firms' (2008) 32 *Journal of Banking & Finance* 2237; David Bholat, Alison Dunn and Joanna Gray, 'Share and Share Alike? Hedge Funds, Human Rights, and Owing Enterprise in Britain' (2012) 39(2) *Journal of Law and Society* 185.

[117] Nico P Swartz, 'Risk Management in Islamic Banking' (2013) 7(37) *African Journal of Business Management* 3799, 3807.

[118] Jannie Rossouw and Adele Breytenbach, 'Identifying Central Banks with Shareholding: A Review of Available Literature' (2011) 26(S1) *Economic History of Developing Regions* S123, S127-S129.

[119] An Overview of the Financial System' in Frederic S Mishkin, *The Economics of Money, Banking and Financial Markets* (Pearson, 10th ed, 2013) 67, 81.

which is undesirable to the lender.[120] It is argued that usury will protect lenders from this risk of loss, by serving as a form of guarantee, and therefore prevent costs from being passed to consumers.[121] It has been shown that lending to borrowers for a mortgage who have little or no chance of repaying the debt in full facilitates the debt accumulation which leads to the credit spiral of the economy.[122] Although the impact of debt accumulation for mortgages are larger than that of small loans such as payday loans, it could likewise be argued that permitting the mass lending of such loans may facilitate a debt crisis that will have a significant impact on the economy.[123] This raises the question of lending only to consumers who have a reasonable chance of repay all debts in full.

Lending to borrowers only when they can repay all debts due has been criticised as unfair.[124] Since those who are denied loans tend to rely on it for their welfare, it is argued that denying such individuals' access to loans is unfair.[125] However, it could be argued that although this may seem discriminatory, this practice of exclusion is not against the person him or herself, but rather on the basis of his or her borrowing behaviour.[126] Since discouraging irresponsible lending and borrowing is of paramount importance owing to the impact it has on the

---

[120] Will Dobbie and Paige Skiba, 'Information Asymmetries in Consumer Credit Markets: Evidence from Payday Lending' (2013) 5(4) *American Economic Journal: Applied Economics* 1, 19-20.

[121] R Mayer, 'When and Why Usury Should be Prohibited' (2013) 116 *Journal of Business Ethics* 513, 518-520.

[122] S Keen, 'Bailing out the Titanic with a Thimble' (2009) 39(1) *Economic Analysis & Policy* 3.

[123] Stephen Morris and Hyon Song Shin, 'Contagious Adverse Selection' (2012) 4(1) *American Economic Journal: Macroeconomics* 1, 18-19.

[124] Above n 4, 710.

[125] Family Welfare Association, 'The Poverty Premium: How poor households pay more for essential goods and services' (Briefing, 2007) 1, cited in Greg Marston and Lynda Shevellar, 'In the Shadow of the Welfare State: The Role of Payday Lending in Poverty Survival in Australia' (2014) 43(1) *Journal of Social Policy* 155, 169.

[126] Jonathan Cook and John Banasik, 'Forecasting and explaining aggregate consumer credit delinquency behaviour' (2012) 28 *International Journal of Forecasting* 145, 154; Stephen Meier and Charles Sprenger, 'Present-Biased Preferences and Credit Card Borrowing' (2010) 2(1) *American Economic Journal: Applied Economics* 193, 208.

economy,[127] it can be argued that lending only when the borrower can repay all debts is justifiable.

In the broader context, the concern as to how to ensure the welfare of those who are excluded from credit remains. It could be argued that this could be resolved by implementing policies to encourage individuals and households to get off debt.[128] Alternatively, non-government organisations or charities may have a role in helping such individuals and households break the debt cycle and assist in providing for their basic means of sustenance.[129] Individuals and households could also be educated on how to live within their means so as to reduce the amount of debt incurred by an individual or household. [130]

Despite the apparent harshness or unfairness of credit exclusion, it has been found that being denied credit access may be beneficial for such individuals. By forcing individuals to reduce their spending, it may enable them to gradually repay their debts.[131] As a result of not continuing to accumulate debt, but reducing it, all the debt will eventually be paid off.[132]

C *Efficiency*

[127] Frederic S Mishkin, 'Over the Cliff: From the Subprime to the Global Financial Crisis' (2011) 25(1) *Journal of Economic Perspectives* 49, 65-68.

[128] CW Amadi, 'An Examination of the Adverse Effects of Consumer Loan' (2012) 7(3) *International Journal of Business and Management* 22, 29-30. See also debt counselling organisations such as StepChange at <http://www.stepchange.org/> and Christians Against Poverty at <https://capuk.org/>.

[129] CW Amadi, 'An Examination of the Adverse Effects of Consumer Loan' (2012) 7(3) *International Journal of Business and Management* 22, 29-30.

[130] Banks et. al, 'Caught Short' (Final Report, August 2012, Social Policy Unit, University of Queensland) 68, quoted in Paul Ali, Cosima McRae and Ian Ramsey, 'The Politics of Payday Lending Regulation in Australia' (2013) 39(2) *Monash University Law Review* 411, 421.

[131] CW Amadi, 'An Examination of the Adverse Effects of Consumer Loan' (2012) 7(3) *International Journal of Business and Management* 22, 28; R Mayer, 'When and Why Usury Should be Prohibited' (2013) 116 *Journal of Business Ethics* 513, 523.

[132] CW Amadi, 'An Examination of the Adverse Effects of Consumer Loan' (2012) 7(3) *International Journal of Business and Management* 22, 28.

Given that usury can protect against risk of loss,[133] its prohibition may reduce business efficiency.[134] Since risk of loss leads to the increase in loan purchase price, it is argued that usury which reduces this risk of loss will reduce the overall loan purchase prices.[135] As such, usury is a price control measure, the value of which is determined by the market supply and demand.[136]

However, the question which arises is whether something should be permitted because it is efficient. For example, businesses reduce working hours for individuals to enable them to fulfil family commitments, or permit holiday leave for individuals as a reward for their service to the company, which can reduce the efficiency of a business.[137] Likewise, it can be argued that although prohibiting usury may reduce efficiency, the moral consideration of prohibiting usury outweighs the interests of efficiency.

In addition to this, efficiency can be increased by alternative means, such as by maximising the efficiency of allocation of credit to each individual consumer.[138] For example, a business could improve its knowledge about its customer to more accurately determine the chances of repayment and the extent of repayment in determining which individuals to provide credit to.[139] This would enable the decrease in risk of loss owing to non-repayment, and therefore may help to increase overall efficiency.

D *Conclusion*

[133] Giuseppe Coco and David de Meza, 'In Defence of Usury Laws' (2009) 41(8) *Journal of Money, Credit and Banking* 1691, 1701.

[134] Ibid 1694.

[135] Bender, n 27, 748-749.

[136] Furnish and Boyes, above n 6 119-121.

[137] Lisa Giddings, Donna Anderson and Kathryn Birkeland, 'Is it profitable to offer paid leave? A case study of the legal profession' (2013) 16(1) *Journal of Legal, Ethical and Regulatory Issues* 73, 85-86.

[138] Emil Slazak, 'Credit market imperfections in the theory of credit rationing' (2011) 7(4) *eFinanse* 76.

[139] David Canning, Clifford W Jefferson and John E Spencer, 'Optimal Credit Rationing in Non-for-profit Financial Institutions' (2003) 44(1) *International Economic Review* 243, 246-247.

That moral hazard, adverse selection and reduction in efficiency occur does not necessarily demand that usury should be permitted. Moral hazard can be addressed by non-usurious means, such as collateral. Similarly, adverse selection also can be addressed by non-usurious means, such as profit-loss sharing. The reduction in efficiency owing to prohibition of usury can be compensated for by alternative ways of allocating credit so as to reduce risk of loss and minimise credit exclusion. The gravity of usury greatly outweighs these competing arguments, and therefore, the better view remains that usury should be prohibited.

IV PROPOSAL FOR A NEW LAW

History has shown that where an absolute prohibition on usury was imposed, varied financial devices were employed to disguise usury.[140] As such, any law attempting to criminalise usury will need to anticipate the ways in which usury can be disguised, to ensure these forms of covert usury are covered by the prohibition.[141]

A *Methodology*

Since usury can function as a means of protection against risk of loss,[142] which is a legitimate concern, legitimate steps to minimise risk of loss will be demarcated from usury to ensure that lenders can still protect themselves from loss, but also protect borrowers from being charged usury.[143] One of the main

[140] Ackerman, above n 1, ES Tan 'An Empty Shell? Rethinking the Usury Laws in Medieval Europe' (2002) 23(3) *Legal History* 177, 183-185; G Seabourne 'Controlling Commercial Morality in Late Medieval London: The Usury Trials of 1421' (1998) 19(2) *Legal History* 116.

[141] Tan above, n 140; Seabourne, above n 40, 118-122.

[142] Masciandaro, above n 104, 210-213; Joakim Sandberg, 'Mega-Interest on Microcredit: Are Lenders Exploiting the Poor?' (2012) 29(3) *Journal of Applied Philosophy* 169, 180.

[143] See Section II.B above

forms of protection is security.[144] As such, the proposed law will propose a definition of usury and security respectively, to distinguish between them. However, since facts do not always fall within the boundaries of legal definitions, criteria to distinguish between security and usury will be proposed to ensure that the two can be distinguished from each other when facts do not fall within the boundaries of the definition of usury and security respectively. The other main concern is the decrease in value of debt due owing to inflation.[145] While it is a legitimate concern that the full value of debt is repaid, an allowance for it could be circumvented to disguise usury.[146] Therefore, a definition of inflation will be proposed, and its application will be set out to ensure that the prohibition of usury is not circumvented by inflation-adjustment.

B *Definitions of the Proposed New Law*

The definitions of usury, security and inflation will be proposed in this section. Each definition will be interpreted and explained.

1 *Usury*

***Usury** is any interest charged on a loan.*

This adopts the classical dictionary definition of usury, as the proposed law seeks to draw on the economic and moral dimensions of usury with the aim of addressing the root problem of debt.[147] The significant word is 'any' preceding the phrase 'interest charged on a loan', indicates that all interest would be prohibited, and therefore, that the interest does not exceed a certain amount is

[144] Wim Voordeckers and Tensie Steijvers, 'Business collateral and personal commitments in SME lending' (2006) 30 *Journal of Banking & Finance* 3067, 3068; Aivazian et al., 'Loan collateral, corporate investment, and business cycle' (2015) 55 *Journal of Banking & Finance* 380; 'Security Rights' in Robyn Smith, *Personal Property: Selected Issues* (3rd ed. Thompson Reuters, 2015); 'Personal Property Security' Robyn Smith, *Personal Property: Selected Issues* (3rd ed. Thompson Reuters, 2015).

[145] Burke, above n 29, 108-111.

[146] Burke, above n29, 114-115.

[147] See Section II.C above.

irrelevant. The word 'interest' refers to a price paid for a loan.[148] Therefore, this definition of usury refers to any price paid for a loan, distinguished from a charge relating to a loan, but not on a loan itself. This shall be discussed below in Section IV.D of this article.

2 *Security*

Security *is any item or asset of value, which is provided to the lender by the borrower, for the purposes of guaranteeing repayment of the loan to which the security relates.*

The above definition of security can be broken down into three elements. The elements shall be explained as below:

(a) Item or asset of value

This refers to any tangible or intangible thing which people would ordinarily be willing to pay for, thereby giving it its economic value.[149]

b) Provided to lender by borrower

The security must be provided by the borrower or an agent of the borrower to the lender, and not by the lender to the borrower. This is to reflect that it is the borrower who is responsible for repaying all debts to the lender in any lending relationship.[150] It is anticipated that this will prevent lenders from being driven to charge usury as security, and also provide little to no excuse for lenders to charge usury owing to risk of non-repayment.[151] The possession, but not the ownership of the collateral is transferred to the lender upon giving the collateral. Possession reverts to the borrower upon repaying all debts due to the lender.

[148] Definition from Free Dictionary by Farlex, proposed by Professor Campbell R Harvey of Duke University, North Carolina, US.

[149] 'Income and Output' in Thomas Piketty, *Capital in the 21st Century* (Cambridge, 2014) 26, 31.

[150] See Section II.B above.

[151] See Section III.A above.

Where the borrower declares that he or she cannot repay all debts, or is regarded by the law as not being able to do so, the ownership of the collateral is transferred to the lender.[152]

c) Purpose of guaranteeing repayment of the loan to which the security relates

Securities have been employed since ancient times to guarantee repayment of loans. The item is given to the lender only for the purpose of guaranteeing repayment of loan. Once the repayment has been fully made, the collateral shall be returned to the borrower. This definition does not apply to a loan to which the security does not relate since the purpose of security is to guarantee repayment of the loan to which it relates.[153]

3 *Inflation*

Inflation *is the decrease in value of items or assets owing to decrease in monetary value.*

The economic definition for inflation[154] is adopted to recognise the effect of inflation on the value of debt, which is critical in determining whether a charge relating to a loan amounts to usury.[155] However, it also recognises that inflation could be exploited by lenders to charge covert usury by manipulating figures.[156] Therefore, it is proposed that inflation adjustment can be applied only to the principal, and that the value of the principal can only be adjusted to the final date of repayment to be agreed upon by the lender and borrower before entering

[152] See Section II.B above.
[153] See Section III.A above.
[154] 'Introduction' in Frederic S Mishkin, *The Economics of Money, Banking and Financial Markets* (Pearson, 10th ed, 2013) 44, 50.
[155] Section II.B above.
[156] Ackerman, above n1, 96-99.

the loan transaction. This is to ensure that the value of the inflation-adjusted principal accounts only for inflation of the principle.[157]

C *Elements of Usury*

Like all criminal offences, the proposed usury offence will be broken down into physical elements, mental elements and defences.[158] Defences are available where the law regards a person who satisfies all physical and mental elements as one who should not be found guilty.[159] This section will propose a provision which criminalises usury as defined in Section IV.B.1 above. It will set out the physical and mental elements, as well as the defences, and critically examine each element.

The proposed usury offence provision is that:

A person who charges any interest on a loan or receives any interest shall be guilty of an offence;

But shall not be guilty of this offence for:

a) Making a charge in relation to a loan which does not amount to interest; or

b) Adjusting for inflation for only the principal and for only the period of the loan from when it is taken out to the final payment date.

1 *Physical Elements*

a) Person who charges or receives interest is the lender, an agent of the lender or an independent third party

---

[157] Burke, above n 29, 114-115.

[158] 'Elements of Criminal Responsibility' in Andreas Schloenhardt, *Queensland Criminal Law* (3rd ed., Oxford University Press, 2013), 54, 55.

[159] Schloenhardt, above n 158, 61-62.

To ensure that the proposed law targets all usury, it covers lenders, persons who charge, collect, or facilitate the charging or collecting of usury, or its proceeds on behalf of the lender (agent), or a third party. The phrase 'on behalf of the lender' is intended to be construed so as to effectively ensure that this provision covers usury or its proceeds which the lender channels to another party for the lender's benefit. This includes the channelling of usury or its proceeds to the businesses' customers where such customers profit, for the company's benefit, or to an anonymous shell company.[160] The provision also covers the charging of usury where the proceeds are to be given to a third party to ensure that no usury charged can be legally channelled off to a third party, such as a beneficiary of a trust.[161] This is to prohibit the charging or receiving of usury itself, by making it irrelevant as to whether the charger or receiver is a lender, an agent of the lender, or a third party.

A charge arising from business activity which utilises the loan does not amount to usury because it is a price paid for services which utilise the loan, not the price paid for the loan itself.[162]

b) The loan is provided, or will be provided by a lender to a borrower

The charge must be on the loan, not merely relating to the loan. Any price the lender charges to the borrower in exchange for the loan amounts to interest, whether it is called a fee, surcharge, or any other name given to the charge on the loan. It is irrelevant for the purposes of establishing this element as to whether the charging of usury is actualised. As long as the lender holds out that

[160] JC Sharman, 'Shopping for Anonymous Shell Companies: An Audit Study of Anonymity and Crime in the International Financial System' (2010) 24(4) *Journal of Economic Perspectives* 127, 137.

[161] Similar to phoenix activity, or perhaps a type of phoenix activity as described in Australian Crime Commission, 'Organised Crime in Australia' (Public Report, 2015), 25.

[162] Abdul-Rahman et al., 'Failure and potential of profit-loss sharing contracts: A perspective of New Institutional Economic Theory' (2014) 28 *Pacific-Basin Finance Journal* 136, 137-140.

a charge applies to lending, this element is satisfied since the provision covers interest charged on loans which are to be provided, but not yet provided to a borrower. The rationale is that it is the charging of usury itself which is to be criminalised, which includes potential usury not yet actualised.

2 *Mental Elements*

a) Knowledge of charging interest on the loan

'Knowledge' refers to knowledge of the facts.[163] It is appropriate that knowledge is an element of the usury offence because it is possible that a person may charge or receive interest on a loan without knowing that this is so. This is because it is contrary to the principles of criminal law to criminalise a person who was unaware of what his or her actions were at the time it was done.[164]

b) Intention to charge or receive usury

'Intention' is the will of the person in carrying out the act.[165] Objective intention is determined according to the standard of the reasonable person imposed by the law.[166] This is in contrast to the subjective intention, which is intention of the individual person.[167] Where objective intention applies, the law determines whether a person intended to charge or receive usury according to the standard of a reasonable person. The subjective intention, on the other hand, is determined according to whether the individual intended to charge or receive usury. As the nature of usury is an objective one in that a person either charges or receives usury, or does not, it is more fitting that objective, rather than subjective intention applies.

[163] Schloenhardt, above n 158, 85-86.
[164] Douglas Husak, 'Mistake of Law and Culpability' (2010) 4(2) *Criminal Law and Philosophy* 135, 140-142.
[165] Schloenhardt, above n 158, 82-83.
[166] Schloenhardt, above n 158, 89.
[167] Schloenhardt, above n 158, 81.

3 *Defences*

a) Mistake of fact

It is possible that it is not actually or constructively known to the person receiving or charging usurious money that it amounts to usury in the factual sense. Since the underlying rationale of the mistake of fact defence is that a person who did not know, or has no reason to know that his or her actions amounts to the acts satisfying an offence, should not be guilt, the mistake of fact defence would be appropriate.[168]

D *Distinguishing between Usury and Non-usurious Charges Relating to a Loan*

Usury is the price paid to obtain the loan itself. Therefore, it follows that a charge relating to a loan which is not for obtaining the loan itself, would not amount to usury. Such an example would be late penalty fees which are imposed to penalise late repayments, and not for obtaining the loan.[169] However, distinguishing between late penalty fees and usury is problematic in practice, as late penalty fees are often used as a substitute for usury.[170]

However, the line between charging for the loan itself and not charging for the loan itself is a thin one. This is because a charge relating to a loan may be imposed by a lender for multiple reasons, some of which may be legitimate, but also for the purpose of charging usury. Therefore, determining whether a charge is for a loan itself requires not only determining the reason or reasons for the charge, but also whether legitimate reasons are justifiable in light of a possible motive to charge usury.

---

[168] Kenneth W Simons, 'Ignorance and Mistake of Criminal Law, Noncriminal Law, and Fact' (2012) 9(2) *Ohio State Journal of Criminal Law* 487, 516; Kenneth W Simons, 'Mistake of Fact or Mistake of Criminal Law? Explaining and Defending the Distinction' (2009) 3(3) *Criminal Law and Philosophy* 213, 216-222.

[169] See Section II.B above.

[170] Nadia Massoud, Anthony Saunders and Barry Scholnick, 'The cost of being late? The case of credit card penalty fees' (2011) 7 *Journal of Financial Stability* 49, 57-58.

This difficulty highlights the need for usury law to be broad in scope, so as to recognise any attempt to disguise usury, based on its essence. It also indicates the importance of permitting a charge relating to a loan, only when it can be demonstrated that a lender could not reasonably have had a motive for charging usury, in light of the circumstances.

V FUTURE RESEARCH

The questions of how the proposed usury law can be circumvented and enforced arise. Since empirical evidence is needed to examine such questions, it is beyond the scope of this article to do so.

VI CONCLUSION

Since usury is inherently extortionate, as a profit made of the indebtedness of others, so as to subject them to debt bondage, there is reason to treat usury as a criminal act. Although circumstances may justify changes as to how to interpret the law, the act of usury itself is fundamentally exploitative, and thus changes in circumstances are not enough to justify its decriminalisation.