UNPROFITABLE LENDING: MODERN CREDIT REGULATION AND THE LOST THEORY OF USURY

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CONTENTS

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> "Can we suppose, that the principle of moral restraint of such uniform and universal adoption has no good sense in it? Is it altogether the result of monkish prejudice? Ought we not rather to conclude that the provision is adapted to the necessities and the wants of our species, and grows out of the natural infirmity of man and the temptation to abuse, inherent in pecuniary loans . . . It is an idle dream to suppose that we are wiser and better than the rest of mankind. Such doctrine may be taught by those who find it convenient to flatter popular prejudice; but the records of our courts are daily teaching us a lesson of more humility."[1]

With these words the Chancellor of the Supreme Court of New York[2] referred to that theory that held usury *per se* unjust, one that dominated Western law and ethics for over a millennium. This jurisprudential approach, which this article refers to as the "scholastic theory of usury," was rooted in ancient religious texts, Aristotelian philosophy, and Roman law contract theory. It argued that under natural law principles, the charging of a gain or profit on the lending of money (as opposed to the investment of capital) was a violation of commutative justice.[3] The scholastic theory also noted that the persistence of usury systemically leads to undesirable wealth transfers inconsistent with distributive justice.[4] Yet, despite such a universal

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1 Dunham v. Gould, 16 Johns. 367, 378-79 (N.Y. 1819).

2 The Supreme Court was at that time the highest court in the state of New York.

3 Two quotations from Aquinas can serve as a definition of commutative justice. "In the first place there is the order of one part to another, to which corresponds the order of one private individual to another. This order is directed by commutative justice, which is concerned about the mutual dealings between two persons." 2 ST. THOMAS AQUINAS, SUMMA THEOLOGICA, pt. II-II, q. 61, art. 1 (Fathers of the English Dominican Province trans., Benziger Bros. 1947). "[I]n commutations something is paid to an individual on account of something of his that has been received, as may be seen chiefly in selling and buying, where the notion of commutation is found primarily. Hence it is necessary to equalize thing with thing, so that the one person should pay back to the other just so much as he has become richer out of that which belonged to the other." *Id*. at pt II-II, q. 61, art. 2. *See* Jacques Melitz, *Some Further Reassessment of the Scholastic Doctrine of Usury*, *in* 24 KYKLOS: INTERNATIONAL REVIEW FOR SOCIAL SERVICES 476 n. 3 (1971) ("The usury doctrine, dating mainly from 1150 to 1350, appeals not to authority and charity, but to 'natural law', therefore to reason and commutative justice.").

4 Again Aquinas can provide a definition of distributive justice: "[T]here is the order of the whole towards the parts, to which corresponds the order of that which belongs to the community in relation to each single person. This order is directed by distributive justice, which distributes common goods proportionately." AQUINAS, *supra* note 3, at pt. II-II, q. 61, art. 1.

acceptance of the scholastic theory of usury, as noted by the Chancellor, modern credit regulation bears little resemblance to the highly developed arguments and applications of the scholastic usury theory.

Today, approximately five hundred years after a novel subjectivist understanding of usury began a process of distorting the original natural-law based scholastic theory of usury, there is a growing political-academic recognition that our current credit system needs reform. Currently acknowledged problems include record credit card debt, rising consumer bankruptcy, predatory payday loans, and the collapse of the subprime mortgage market.[5] On the legislative front, Congress has enacted laws to protect members of the military and their families from certain expensive loans.[6] Bills have been introduced in both the House and the Senate to authorize bankruptcy judges to restructure mortgage loans by reducing interest rates and payments.[7] Despite this awareness of problems, there has been wide disagreement as to the content and scope of possible solutions.

The recent legislative efforts mentioned above appear to contradict the federal trend towards eliminating by preemption interest rate regulation.[8] Some academics have advocated various solutions including complete deregulation, heightened disclosure law, higher usury rates, lower usury rates, and the use of an unconscionability standard.[9] Yet even in arguments purporting to be historical surveys,[10] the perspective the Chancellor referred to as being universally accepted

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[5] *See infra* note 21, Editorial, *Credit Card Buyer Beware*, N.Y. TIMES, July 31, 2007, at 18 (discussing the need for Congressional reform in an area where current regulations are designed to favor banks and credit card companies rather than to protect consumers); Robert H. Frank, *Payday Loans Are a Scourge, But Should Wrath Be Aimed at the Lenders?*, N.Y. TIMES, Jan. 18 , 2007, at C4; Rex Nutting, *Rate of Late Consumer Loans Reaches High Since '01*, WALL ST. J., July 5, 2007, at B8 (American Bankers Association's chief economist, James Chessen, cited "[s]low expansion in employment, falling home prices and weaker economic growth" as reasons for the poor financial condition of consumers.); Bloomberg News, *Regulator Favors Standards Against Predatory Lending*, N.Y. TIMES, Mar. 28, 2007, at C2; Michelle Singletary, *A Horror Movie for Our Times*, WASH. POST, Mar. 4, 2007, at F01.

[6] John Warner National Defense Authorization Act for Fiscal Year 2007 § 670, 10 U.S.C. § 987 (2006). The Secretary of Defense has promulgated implementing regulations at 32 C.F.R. § 232 (2007). Among other things these laws and related regulations limit interest rates that may be charged for certain consumer credit products offered to members of the military and their families.

[7] *See* H.R. 3609, 110th Cong. (2007), H.R. 3778, 110th Cong. (2007) and S. 2133, 110th Cong. (2007). After months of political wrangling and lobbying, this concept did not survive in the housing legislation passed by Congress. *See* Lori Montgomery, *Senate Approves Housing Package*, WASH. POST, Apr. 11, 2008, at D01. But, the idea of allowing bankruptcy modification of home mortgages is still being advocated by some consumer groups. *See* Pam Dawkins, *As Banking Chairman, Dodd Concentrates on Solutions to Subprime Woes*, ADVOCATE (Stamford, Conn.), Apr. 24, 2008, at 1.

[8] *See infra* Part VI.A.

[9] *See infra* note 21.

[10] *See, e.g.*, Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 FLA. L. REV. 807 (2003).

for so long a period of history has been noticeably absent from contemporary debates about usury. This nuanced theory of usury dominated the Western world for over a millennium and still influences the growing Islamic financial sector. This article will bring a historical perspective to the usury debate by analyzing the scholastic theory of usury.

Part I will briefly present statistical data illustrating the problems in our consumer credit market. The data demonstrates the rising levels and costs of consumer debt. Part II outlines the historical approaches to usury that predated the scholastic theory, noting how some of them survive in contemporary debates. These theories included limiting interest rates, banning the charging of interest altogether, and abandoning all credit regulation. Part III presents the essential aspects of the scholastic theory of usury as it developed from the fourth to the sixteenth century. Part IV discusses the scholastic theory's adaptation to the new commercial environment of the sixteenth century. It then considers the reasons for the replacement of the scholastic theory with a system of simple rate regulation. Part V evaluates the history of the scholastic theory and abstracts the essential principles of the theory. Part VI makes some general observations regarding the application of these principles to the modern credit system, while noting that the growth of Islamic finance in recent decades shows the feasibility of such a theory interacting with modern economic realities.

I. THE PROBLEM OF CONSUMER CREDIT

> With the passage of time, a new philosophy evolved regarding consumer credit. No longer was borrowing a stigma, a sign of poverty, or financial mismanagement. Rather borrowing became the American way to instantly raise one's standard of living. Indeed, it became desirable economic policy to facilitate consumer credit and thereby accelerate the movement of goods and services in the marketplace. Consumers accepted their duty to borrow with enthusiasm, and the availability of consumer credit exploded.[11]

The twentieth century has seen an explosion in the levels and costs of consumer credit. In 1976, total household debt outstanding was \$818.9 billion. By 2006, it had grown to \$12.816 trillion.[12] These outstanding total debt figures comprised \$517.0 billion of home mortgage debt and \$229.0 billion of consumer debt, respectively, in

[11] Jarret C. Oeltjen, *Pawnbroking on Parade*, 37 BUFF. L. REV. 751, 762 (1989).

[12] *See* Federal Reserve, *Flow of Funds Accounts of the United States: Flows and Outstandings Fourth Quarter 2006*, Mar. 8, 2007, at 8, *available at* http://www.federalreserve.gov/releases/z1/20070308/z1.pdf.

1976 and $9.676 trillion and $2.438 trillion, respectively, in 2006.[13] In 1976, U.S. households borrowed $83.1 billion whereas by 2006 households borrowed a staggering $1.012 trillion.[14] When business, government, financial sectors, and foreign debt are included, total borrowing rose from $244.7 billion in 1976 to $2.1 trillion in 2006. Over the same 30-year period, annual consumer credit borrowings rose from $22 billion to $111.1 billion and borrowings secured by home mortgages rose from $57.6 to $792.5 billion.[15] In 2006, debt growth outpaced growth in gross domestic product (GDP) (with GDP growing by only approximately 6.3 percent and total household outstanding borrowings growing by approximately 8.6 percent).[16] The growth of the credit market can also be seen in the proliferation of new lenders. Payday lending, for example, was non-existent 30 years ago, but by 2005 there were over 20,000 payday loan retail outlets nationwide, more than McDonalds, Burger King, Sears, J.C. Penny, and Target Stores combined.[17] Debt seems to be our most popular consumer product!

Along with the increasing debt levels, individual financial failure as measured by bankruptcy filings also increased from in excess of 200,000 filings in 1980 to over 1.4 million filings in 2006.[18] Studies have suggested a statistically significant positive correlation between increasing debt levels (and particular revolving, *i.e.* credit card debt and home mortgage debt) and consumer bankruptcy filings.[19] This growing mountain of debt and increase in consumer bankruptcy filings has been paralleled by two phenomena: (1) a growing laxity in usury laws[20] and

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13 *See id*.

14 *See id.* at 7.

15 *See id*.

16 *Id.* at 8,12. Percentages calculated based on the data. Total U.S. debt outstanding (household, business, government, financial and foreign) grew by 7.3 percent from 2005 to 2006. *Id.*

17 *See* Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: An Empirical Analysis of American Credit Pricing Limits*, BERKELEY ELECTRONIC PRESS, Aug. 8, 2007, at 2, http://works.bepress.com/christopher_peterson/1.

18 Charles J. Tabb, *Consumer Bankruptcy Filings: Trends and Indicators*, BERKELEY ELECTRONIC PRESS, Oct. 2006, at 2, http://law.bepress.com/uiuclwps/papers/art67.

19 *Id*. at 11-23. *See also* Robert M. Lawless, *The Paradox of Consumer Credit*, 2007 U. ILL. L. REV. 347, 363 (2007) ("In the long run, however, rising (or falling) consumer credit appears to be followed rather consistently by rising (or falling) bankruptcy rates several years later.").

20 *See* Peterson, *supra* note 17, at 21 ("In 1965 every state in the union had a usury limit on consumer loans. Today nine states have completely deregulated interest rates within their borders. In 1965 banks were bound to comply with all state usury laws. Today banks are free to charge whatever interest rate they choose within the loose and changing tolerances chosen by banking regulators for their safety and soundness guidelines. In 1965 no state had a law either explicitly or implicitly authorizing prices with an annual percentage rate of over 300 percent. Today, at least 36 states have law [sic] allowing lenders to charge over 300 percent. In 1965 usury laws were drafted with sufficient rigidity that 45 states held actual allowed annual percentage rates to 60 percent or under. In 2007 the number of states accomplishing this has fallen to only seven.")

(2) legal scholarship calling for new approaches to credit regulation.[21] Yet, among this scholarship the scholastic theory of usury, which framed the discussion of credit and investment for over a millennium, has been notably absent other than occasional over-generalized references to outlawing all loans at profit.[22] The scholastic theory has received too little attention and needs to be interjected into current legal and policy debates about credit.

II. THE PRE-SCHOLASTIC APPROACH TO USURY

Before explaining the scholastic theory of usury, this part summarizes the most influential theories of credit regulation of the ancient world which preceded it. The modern heirs of these theories are identified. The breadth of approach is great, ranging from no restraint to complete prohibition.

A. *The Ancient Version of Laissez-Faire*

The laissez-faire approach of the ancient world to usury allowed

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[21] *See, e.g.*, *infra* note 22; 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*, 31 HOUS. L. REV. 721 (1994); Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 PEPP. L. REV. 151 (1988); John A. E. Pottow, *Private Liability for Reckless Consumer Lending*, 2007 U. ILL. L. REV. 405 (2007); Vincent D. Rougeau, *Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates*, 67 U. COLO. L. REV. 1 (1996); Todd M. Finchler, Note, *Capping Credit Card Interest Rates: An Immodest Proposal*, 12 ANN. REV. BANKING L. 493 (1993); John D. Skees, Comment, *The Resurrection of Historic Usury Principles for Consumption Loans in a Federal Banking System*, 55 CATH. U. L. REV. 1131 (2006); Angela K. Littwin, *Beyond Usury: A Study Of Credit Card Use and Preference Among Low-Income Consumers* (2007), http://lsr.nellco.org/harvard/faculty/papers/8.

[22] *See, e.g.*, Steven M. Graves & Christopher L. Peterson, *Usury Law and the Christian Right: Faith Based Political Power and the Geography Of American Payday Loan Regulation* (2007), http://ssrn.com/abstract=1092006. This paper presents an extensive mapping of the proliferation of high-cost payday loans and the location of conservative Christian minorities and concludes there is a correlation between a high concentration of payday lenders and conservative Protestant and Mormon communities. In part of the paper the authors present biblical passages on usury and purport to present the Christian application of these passages. Yet the authors pass over in silence the millennium of scholastic treatment of usury. They present the Christian understanding of usury as the price-capping of excessive interest. This price-capping approach was a product of the subjectivist approach to usury theory that arose out of the debates of the sixteenth century as discussed in Part IV *infra*. Ignorance of the scholastic theory of usury among Christians may explain this apparent contradiction of conservative Christian states tolerating high-cost lending that exploits the poor. *See also* Peterson, *supra* note 10 (purporting to identify all of the approaches to loans taken throughout world history while utterly ignoring the scholastic theory other than a brief discussion of the *mons pietatis* of the sixteenth century; however even this discussion does not describe the theoretical framework that gave birth to the *mons pietatis*).

the market to rule transactions in money and allowed fees and profits without limit. The Athenians allowed transactions in credit to proceed unregulated.[23] Although Athens became known for its sophisticated commercial credit market, it was infamous for the highest consumer interest rates in the ancient world at 9,000 percent.[24] In modern times, the Athenian approach was advocated by Jeremy Bentham and adopted in England in the mid-nineteenth century.[25] Since usury in any amount was not prohibited, this approach did not develop a definition of usury. Advocates of this school argue that free market forces will eventually reach price equilibrium and be beneficial for borrowers and society and legitimate lenders will displace "illegal" credit suppliers.[26] Utah is a modern example of this approach.[27] A modern variation of this theory regulates information disclosure during the credit agreement process but does not restrain the substance of the agreement reached. The Truth in Lending Act is an example of this variation.[28]

B. *Rate Regulation*

Rate limitation defines usury as interest in excess of the legal rate allowed. The law thus regulates the price charged for the use of money with varying consequences, including forfeiture of the excess, loss of all interest, forfeiture of the principal and criminal penalties. The ancient Babylonians attempted to distinguish just from unjust loans on the basis of price.[29] Rome is probably the best ancient example of this approach. After experimenting with no limitation on lending and a brief prohibition of all lending at a profit, the ancient Romans settled into a system of allowing for-profit loans but at a regulated rate.[30] The

[23] *See* SIDNEY HOMER & RICHARD SYLLA, A HISTORY OF INTEREST RATES 21, 32-39 (4th ed. 2005).

[24] *See* Peterson, *supra* note 10, at 807, 832-33.

[25] Jarret C. Oeltjen, *Usury: Utilitarian or Useless?*, 3 FLA. ST. U. L. REV. 167, 174 (1975).

[26] Oeltjen, *supra* note 11, at 751, 778-79.

[27] UTAH CODE ANN. §§ 11-6-4, 70C-2-101 (2008); Christopher L. Peterson, *Failed Markets, Failing Government, or Both? Learning from the Unintended Consequences of Utah Consumer Credit Law on Vulnerable Debtors*, 2001 UTAH L. REV. 543, 555 (2001) (stating "Thus, the Utah Senate rejected the oldest commercial regulation in the history of humanity, eliminating all interest rate caps in the state of Utah after a total of ninety-seven seconds. The bill passed unanimously, but for the sole dissenting vote of Senator Overson, and the five senators who did not show up that morning.").

[28] 15 U.S.C. §§ 1601-1667f (2006). Although this Act regulates the process of offering and agreeing to credit transactions, it does not significantly restrict the economic terms agreed to by the parties.

[29] *See* Peterson, *supra* note 10, at 807, 821.

[30] *See* Dunham v. Gould, 16 Johns. 367, 376 (N.Y. 1819); HOMER & SYLLA, *supra* note 23, at 44-48; Benjamin S. Horack, *A Survey of the General Usury Laws*, 8 LAW & CONTEMP. PROBS. 36 (1941).

American states adopted this Roman approach (inherited through England before she abolished the legal rate in 1854).[31] Other than nine states[32] that have abandoned any price regulation of credit, the laws of the remainder of the U.S. states set a statutory maximum permissible rate.[33] Supporters of this type of rate regulation argue that it responds to credit market failures, namely: (1) asymmetrical information and (2) monopolistic power in segments of the credit market.[34]

A modern variation of this approach limits usury by the doctrine of unconscionability.[35] Limiting usury by the doctrine of unconscionability rests on the same premise as rate regulation. Both approaches consider charging for the use of money to be appropriate so long as the amount does not shock the conscience. Rather than the legislature setting a numeric rate, using the doctrine of unconscionability leaves the determination of an excessive rate to the courts on a case-by-case basis.[36]

The most compelling criticism of rate regulation is that limiting the amount of interest charged is arbitrary. How do we determine the correct limit? What makes 20 percent unacceptable (or even unconscionable) and 19 percent not so? The unprincipled nature of this approach is evident in the wide variation of usury limits emerging from the deregulation over the past 30 years.[37] If we conclude that certain transactions are contrary to justice (either commutative or distributive), then the transactions should be prohibited as long as the injustice is not above a certain amount. Thus, to accept rate regulation one has to either hold that usury is not unjust or that it is acceptable to allow but merely limit the effects of injustice.

C. *Prohibit Usury*

The definitional approach to prohibiting usury centers on distinguishing which transactions constitute the lending of money for a profit. The most well-known example in the ancient world of this approach is Israel, which outlawed usury among Israelites but permitted

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31 *See* Oeltjen, *supra* note 25, at 174; Peterson, *supra* note 10, at 843.

32 Delaware, Idaho, Nevada, New Hampshire, New Mexico, Oregon, South Dakota, Utah and Wisconsin. *See* Peterson, *supra* note 17, at 21 n.108.

33 Jack C. Merriman & James J. Hanks, Jr., *Revising State Usury Statutes in Light of a Tight Money Market*, 27 MD. L. REV. 1, 7-8 (1967).

34 Robert W. Johnson, *Regulation of Finance Charges on Consumer Installment Credit*, 66 MICH. L. REV. 81, 90 (1967); Oeltjen, *supra* note 11, at 772.

35 *See, e.g.*, Bender, *supra* note 21, at 725, 739-41, 803-11.

36 Bender, *supra* note 21, at 743; Oeltjen, *supra* note 25, at 174.

37 Christopher L. Peterson's recent study showed a standard deviation of maximum annual percentage rates applicable to payday loans of 207.9 percent (attributing the highest state's limit to those states with no usury law at all). Peterson, *supra* note 17, at 25.

it if the borrowers were foreigners.[38] The Romans briefly experimented with a ban on all charges for a loan.[39] The scholastic theory, which dominated European thought on usury from the fourth century until the sixteenth century, was a more nuanced version of the ancient Israeli approach.[40] Contemporary to the scholastic theory, Islam developed a very similar theory of usury which survives into the modern age.[41] The Islamic approach begins with severe condemnations in religious texts of taking *riba* in connection with a loan.[42] Scholars debate the correct translation of *riba* as either usury or interest,[43] which may be due to the historical change in meaning of these terms in the West. Yet, the Islamic condemnations do not condemn business and commerce (or trading), which is distinguished from taking *riba*.[44] Over the centuries Islamic jurisprudence has developed forms of investment in businesses, such as joint ventures, limited partnerships, insurance arrangements, sale leaseback transactions, and higher purchase prices on credit sales, which comply with the prohibition of *riba*.[45] These transactions are often distinguished from *riba* by Islamic jurists on the basis of changes in risk sharing (compared to a loan), profit to the financier being based on the productivity of the business financed (rather than a fixed percentage of the amount of money provided), and fees for other services (such as purchasing the item sold on credit).[46] Many of these transaction forms, and the rationales supporting them, bear a similarity to the scholastic theory analyzed in Part III.

III. THE SCHOLASTIC THEORY OF USURY: THE FOURTH TO THE SIXTEENTH CENTURY

[38] *See* HOMER & SYLLA, *supra* note 23, at 21.

[39] *Id*. at 44-45.

[40] The exact dates are obviously not fixed. I am constructing a border around the period of the scholastic theory beginning with the condemnation of usury by the Council of Nicaea in 325 and ending with the passage of the Acte Against Usurye, 1545, 37 Henry VIII c. 9 (Eng.), which allowed loans charging up to 10 percent. *See* JOHN T. NOONAN, JR., THE SCHOLASTIC ANALYSIS OF USURY 15 (Harvard U. Press 1957); NORMAN JONES, GOD AND THE MONEYLENDERS 48 (1989). The scholastic theory is described in detail in Part III, *infra*.

[41] *See* Daniel Klein, *The Islamic and Jewish Laws of Usury: A Bridge to Commercial Growth and Peace in the Middle East*, 22 DENV. J. INT'L L. & POL'Y 535 (1995).

[42] There are a total of eight verses in the Qur'an which condemn taking *riba*. *See id.* at 536-37. Mohammed is reported as having compared taking *riba* to committing adultery 36 times and committing incest with one's mother, which demonstrates the intensity and seriousness of the issue in Islamic thought. *See id.* at 537.

[43] Dr. Theodore Karasik, Frederic Wehrey & Steven Strom, *Islamic Finance in a Global Context: Opportunities and Challenges*, 7 CHI. J. INT'L L. 379, 381 (2007).

[44] *See* Klein, *supra* note 41, at 536.

[45] Karasik et al., *supra* note 43, at 383-85.

[46] *See id.*

With the context of the varying alternatives to regulating credit proposed by the ancient world established, this Part traces the history of the scholastic theory of usury from its beginnings in ancient biblical texts through its developments in the Middle Ages. The scholastic thinkers translated the simple biblical prohibitions into the language of the Roman law and natural law philosophy. Part A summarizes the ancient foundation on which the scholastics worked. Part B analyzes the scholastics' philosophical, juridical and theological defenses of these foundations. Part C presents the scholastics' application of the scholastic theory to actual economic situations.

A. *Ancient Foundations: Jewish and Roman Law and Aristotelian Philosophy*

The scholastic theory established principles for identifying transactions that constituted usury. It then prohibited them on terms originating in the ancient Jewish approach. The Jewish scriptures contained several texts concerning usury that became the starting point of analysis for the scholastics:

> If thy brother be impoverished, and weak of hand, and thou receive him as a stranger and sojourner, and he live with thee, Take not usury of him nor more than thou gavest: . . . . Thou shalt not give him thy money upon usury . . . . If thy brother constrained by poverty, sell himself to thee, thou shalt not oppress him with the service of bondservants: But he shall be as a hireling, and a sojourner: he shall work with thee until the year of the jubilee . . . .[47]
>
> Thou shalt not lend to thy brother money to usury, nor corn, nor any other thing: But to the stranger. To thy brother thou shalt lend that which he wanteth, without usury: that the Lord thy God may bless thee in all thy works in the land, which thou shalt go in to possess.[48]
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> Lord, who shall dwell in thy tabernacle? or who shall rest in thy holy hill? He that walketh without blemish, and worketh justice: He that speaketh truth in his heart, who hath not used deceit in his tongue: Nor hath done evil to his neighbour: nor taken up a reproach against his neighbours. . . . He that sweareth to his neighbour, and deceiveth not; He that hath not put out his money to usury, nor taken bribes against the innocent: He that doth these things shall not be moved for ever.[49]
>
> Hath not lent upon usury, nor taken any increase: hath withdrawn his hand from iniquity, and hath executed true judgment between man and man: Hath walked in my commandments, and kept my

[47] *Leviticus* 25:35-40 (Douay-Rheims).
[48] *Deuteronomy* 23:19-20 (Douay-Rheims).
[49] *Psalm* 14:1-5 (Douay-Rheims).

> judgments, to do truth: he is just, he shall surely live, saith the Lord God. . . . That grieveth the needy and the poor, that taketh away by violence, that restoreth not the pledge, and that lifteth up his eyes to idols, that committeth abomination: That giveth upon usury, and that taketh an increase: shall such a one live? he shall not live.[50]

These biblical texts provided the underlying principles of usury analysis in the West for approximately 1,200 years. First is the principle of commutative justice. Usury is presented as a sin of individual injustice.[51] It is included among such other offenses as stealing, refusing to restore a pledge, and lying, all of which involve an injustice in dealings with another individual. Second is the principle of distributive justice. Usury is unjust in its redistribution of wealth. Usury injures the poor.

Despite the clear prohibition of usury, it is only defined in a very general sense as the taking of more than was lent. Yet, no definition of what constitutes lending is provided. Much of the scholastic analysis focused on developing what constituted "lending" and "more."

The passages also suggest that usury involves lending a consumable good (money is linked with corn)[52] to someone who needs it. The prohibition of Leviticus beginning, "if thy brother is impoverished" suggests usury involves lending to someone who needs the money to acquire necessary consumables. This passage may suggest usury involves procedural injustice, such as abuse of a weakened bargaining position or undue influence. Yet, the passage does distinguish between a loan and other types of transactions with those in a weakened position. The passage permits one to hire even someone in poverty as a wage laborer or indentured servant.[53] The passage sanctions transacting at a profit with the needy if the transaction is not a loan. This distinction suggests that the problem with usury is more than a procedural injustice; it is a matter of substantive injustice.

Finally, if the activity constitutes usury, it is prohibited absolutely. The text does not define usury as charging above a certain rate. If the transaction constitutes usury, it is unjust and condemned. This last point makes the definition of usury critical. If a transaction constitutes lending for a profit, it is usury and prohibited.

50 *Ezekiel* 18:8-9, 12-13 (Douay-Rheims).

51 *Id.*; *Psalm* 14:1-5. The exception for lending at usury to a stranger or enemy is consistent with this understanding. Although killing is unjust it is morally permissible in a just war against an enemy. *See* AMBROSE, DE TOBIA, lib. 1, cap. xv, para. 51, in SANCTA AMBROSII MEDIOLANENSIS EPISCOPI OPERA (Venice 1781) vol. i, 738-39. ("Ergo ubi jus belli, ibi etiam jus usare," which can be translated "Where there is the right to fight a war there is also a right to lend at usury."); BENJAMIN N. NELSON, THE IDEA OF USURY: FROM TRIBAL BROTHERHOOD TO UNIVERSAL OTHERHOOD (Princeton U. Press 1949) (arguing that much of the history of usury theory in the West can be understood in light of changing ideas of universal brotherhood).

52 *See Deuteronomy* 23:19 (Douay-Rheims).

53 *Leviticus* 25:39-40.

The scholastics developed a definition of usury in light of two other sources from the ancient world: Roman Law and Aristotelian philosophy. Among the categories of loan transactions, the Romans distinguished between *mutuum* and *commodatum*. The former referred to the transfer of ownership of consumable goods coupled with an obligation to later return goods of identical type and quantity. *Commodatum* was the lending, for use by the borrower, of a non-consumable good coupled with an obligation to return the identical good.[54] The Roman law provided a categorization distinguishing the lending of consumable as opposed to durable things. In a *mutuum* the consumable lent was to be returned in the exact same amount without any additions or deprivations.[55] Although a non-gratuitous alternative contract existed for a *commodatum*, such an alternative did not exist for a *mutuum,* which had to be gratuitous. A *locatio conductio rei* permitted the addition to the *commodatum* of a fee for use (or what modern law would call rent).[56] Despite positive Roman law permitting, by *stipulatio*, the charging of fees in connection with a *mutuum*[57] (or what we would call interest), Justinian suggested that money could not by its nature be the subject of a *locatio conductio rei* or *usufruct.*[58]

The Roman law preserved the gratuitous contractual form of the *mutuum*[59] but accommodated additional charges by allowing the parties to enter into a separate *stipulatio* in which the borrower promised to pay fees. The *mutuum* and *stipulatio* were two distinct types of legal obligations (one *obligatio re* the other *obligatio verbis*[60]) and could not be combined into one single contract.[61] The two distinguishing characteristics of a *mutuum* were (1) the thing involved became owned by the borrower (since in order to consume it one had to own it)[62] and (2) the only permissible promise was one to return equivalent value (not

54 REINHARD ZIMMERMANN, THE LAW OF OBLIGATIONS: ROMAN FOUNDATIONS OF THE CIVILIAN TRADITION 153-54, 188-89 (1990); James Gordley, *Enforcing Promises*, 83 CAL. L. REV. 547, 552 (1995).

55 *See* ZIMMERMANN, *supra* note 54, at 158.

56 *Id.* at 353; NOONAN, *supra* note 40, at 40.

57 *See* text accompanying notes 59-60.

58 DIG. § 7.5 (Gaius, Provincial Edict 7) (Although the senate tried to create a quasi-usufruct of money "natural reason cannot be altered by the authority of the Senate." The idea that it is against nature to treat the lending of money like a loan for use of durable goods is the basis of the natural law argument against usury of the scholastics). Usufruct (*usus fructus*) can be defined as the right to the use and enjoyment of the property of another for a time, without altering the substance of such property. *See id*. § 7.1.1 (Paul, Vitellius 3).

59 Roman law maintained that a promise to pay more than received in a *mutuum* contract was unenforceable. *See* ZIMMERMANN, *supra* note 54, at 155, 158 and 163.

60 An *obligatio re* was a contract that involved the transfer of a thing (*res*) whereas an *obligatio verbis* was created by the exchange of promises (words, *verbis*) usually by question and answer. *See* ZIMMERMANN, *supra* note 54, at 32, 546-47.

61 *Id.* at 158, 163.

62 Since a *commodatum* and *locatio conductio rei* required the return of the identical object, ownership, which involves the ability to dispose or consume, was not transferred to the borrower.

identical object).[63] Thus, the scholastics started from a legal basis where a form existed in *theory* that precluded the payment of more than the principal. All they needed to do was prohibit the making of a separate *stipulatio* promising to pay additional amounts. A separate legal form, *locatio conductio rei*, existed that permitted one to charge for the use of a non-consumable good.

In addition to the biblical texts and Roman law, the philosophy of Aristotle influenced the scholastics in their formulation of a rationale for the theory of usury. Aristotle held that commutative justice required equality in all exchange transactions between individuals in society.[64] Aristotle was not unconcerned with the distribution of wealth among people,[65] but the principle of equality in exchange held that particular transactions between individuals (voluntary or involuntary) were not the way to achieve redistribution. James Gordley has explained that equality in exchange is not meant to achieve a just distribution of wealth, the achievement of which involves principles of distributive rather than commutative justice, but is meant to "avoid random redistributions" of wealth through "the system of exchange."[66]

B. *Natural Law Theory and the Definition of Usury*

The philosophers and jurists of the period from 325 to 1550 elaborated a definition of, and justification for, prohibiting usury consistent with the biblical texts and incorporating the Roman distinction between consumptive (*mutuum*) and non-consumptive (*commodatum*) lending. The scholastic theory required the former to be without profit while the latter could be with profit. The scholastic theory drew its justification from the Aristotelian[67] notion that a party who exacts a gain out of an exchange transaction was unjust. The

63 BERNARD DEMPSEY, INTEREST AND USURY 143 (1948).

64 5 ARISTOTLE, NICOMACHEAN ETHICS 1131b32-1132a7, 1132a14-19, *reprinted in* THE BASIC WORKS OF ARISTOTLE (Richard McKeon ed., Random House 1941).

65 *Id.* at 1130b30-33, 1134a1-3 (stating that justice involves both equality in individual exchange and a proportionate (not necessarily equal) distribution of wealth among all in society).

66 James Gordley, *Equality in Exchange*, 69 CAL. L. REV. 1587, 1616 (1981). This equality in exchange does not mean that one party cannot use the thing received in exchange to make a profit but this is not a gain from the exchange itself.

67 I do not mean to imply that the text of Aristotle was consciously incorporated by all the writers on usury as Aristotle's *Ethics* was not generally available in Europe until the thirteenth century. *See* FERNAND VAN STEENBERGHEN, ARISTOTLE IN THE WEST 105 (Leonard Johnston trans., 2d ed. 1970). Yet, the principle of equality in exchange made its way into Roman law "in a pool of classical ideas to which he [Aristotle] had been a prime contributor." *See* Gordley, *supra* note 66, at 1590. Examples of passages in Roman law include: "By the law of nature it is fair that no one become richer by the loss and injury of another" and "For it is by nature fair that nobody should enrich himself at the expense of another." DIG. § 50.17.206 (Pomponius, Various Readings 9); *id* § 12.6.14 (Pomponius, Sabinus 21).

Revelation of God, principles of ancient philosophy, and the law of ancient Rome were harmonized in the process.

The natural law argument saw usury as unjust as a matter of commutative justice. As a subtext, a second argument rooted in distributive justice can be discerned. This second argument drew attention to the harmful effects of usury rather than its intrinsic injustice. Yet, the primary rationale rested on the principles of commutative justice. The effects of usury served a secondary role of confirming the conclusions of the first argument.[68] Both themes are evident in the biblical texts.

1. Commutative Justice: Development of a Definition of Usury

The argument resting upon principles of commutative justice is exemplified in two sources. The first dates from the earlier part of the period under consideration. The *palea Ejiciens*, a fifth-century Christian comment on usury, later incorporated in the twelfth-century canon law collection entitled the *Decretum*, reads:

> Of all merchants, the most cursed is the usurer, for he sells a good given by God, not acquired as a merchant acquires his goods from men; and after the usury he reseeks his own good, taking back his own good and the good of the other. A merchant, however, does not reseek the good he has sold. One will object: is not he who rents a field to receive the fruits or a house to get an income similar to him who lends his money at usury? Certainly not. First, because money is only meant to be used in purchasing. Secondly, because one having a field by farming receives fruit from it; one having a house has the use of inhabiting it. Therefore, he who rents a field or house is seen to give what is his own use and to receive money, and in a certain manner it seems as if he exchanged gain for gain. But from money which is stored up you take no use. Thirdly, a field or a house deteriorates in use. Money, however, which is lent [and returned], is neither diminished nor deteriorated.[69]

There are several points to be drawn out of this passage that reappear in the later natural law arguments against usury. The essence of the argument is that money bears no fruit in and of itself. Money is only good for buying other assets, which may or may not be productive.[70] The passage distinguishes two transactions that do not constitute usury, which are significant in developing a definition of

[68] *See* NOONAN, *supra* note 40, at 81 ("The social case against usury is not absent from scholastic thought. . . . But, on the whole, this kind of argument is subordinated to the juristic formulae.").

[69] *Id.* at 38-39 (citing *Decretum Gratiani*, D. 88, c. 11).

[70] An analogy exists in tax law's distinction between active and passive investments.

what constitutes usurious lending. The lending of productive assets to a business venture is not usury. This distinction is exemplified by permitting charging for the use of a field. The farmer uses the field to produce fruits and can return the field to the owner. The owner and the farmer each contributed an asset (the field and labor) to the production of new assets. They can therefore share in the fruits of that new asset. As the owner only contributed the field for a time to the venture, he is entitled to the return of his field at the end of the agreed venture.

The renting of a house presents a different distinction. A house is not consumed in use.[71] One can use a house (live in it) and then return the same house to the owner.[72] One cannot, however, use money and return the same money to the owner because money is consumed in use. Money's purpose is to purchase other things. Since the use of money necessarily results in its loss (in purchasing something), an owner cannot let the recipient use it for a time. He can only transfer ownership to the money since the use of money necessarily involves the power to alienate it. Due to the inability to separate use and ownership, when an owner lends $100 he is really selling the $100 dollars. This is evident in the fact that when someone borrows $100 we say it is his $100, not the one who lent it. If the lender (former owner) charges usury, he is charging $100 (the value of the $100 transferred) plus an amount for the right to use the $100. Based on these two examples, two aspects of the definition of usury emerge: usury does not involve the lending of a productive asset or the lending of a durable, non-consumable good.

As the scholastic period progressed, later thinkers built upon the foundation of the principles of the *palea Ejiciens*. Two passages from the writings of Aquinas can serve as representative of the development of the definition of and rationale for usury.

> All other things from themselves have some utility; not so, however, money. But it is the measure of utility of other things, as is clear according to the Philosopher in the *Ethics* V:9. And therefore the use of money does not have the measure of its utility from this money itself, but from the things which are measured by money according to the different persons who exchange money for goods. Whence to receive more money for less seems nothing other than to diversify the measure in giving and receiving, which manifestly contains iniquity.[73]
>
> To take usury for money lent is unjust in itself, because this is to sell what does not exist, and this evidently leads to inequality

[71] Although a house or a field may be affected by use (*i.e*. the house suffers wear and tear and the field may have its soil depleted), they are not completely consumed in use.

[72] Even if a house is destroyed during use by storm or flood, it is not the tenant's use which consumed it but the risk inherent in the ownership of any house.

[73] *See* NOONAN, *supra* note 40, at 52 (quoting St. THOMAS AQUINAS, IV LIB. SENT., III:37:1:6).

> which is contrary to justice.
>
> In order to make this evident, we must observe that there are certain things the use of which consists in their consumption: thus we consume wine when we use it for drink and we consume wheat when we use it for food. Wherefore in such like things the use of the thing must not be reckoned apart from the thing itself, and whoever is granted the use of the thing, is granted the thing itself; and for this reason, to lend things of this kind is to transfer the ownership. Accordingly if a man wanted to sell wine separately from the use of the wine, he would be selling the same thing twice, or he would be selling what does not exist, wherefore he would evidently commit a sin of injustice. In like manner he commits an injustice who lends wine or wheat, and asks for double payment, viz. one, the return of the thing in equal measure, the other, the price of the use, which is called usury.
>
> On the other hand, there are things the use of which does not consist in their consumption: thus to use a house is to dwell in it, not to destroy it. Wherefore in such things both may be granted: for instance, one man may hand over to another the ownership of his house while reserving to himself the use of it for a time, or vice versa, he may grant the use of the house, while retaining the ownership. For this reason a man may lawfully make a charge for the use of his house, and, besides this, revendicate the house from the person to whom he has granted its use, as happens in renting and letting a house.[74]

The first argument presented is that money as a medium of exchange has a fixed value established by the sovereign[75] and thus to transfer the ownership of money at a different price than its fixed value is to sell money for more than it is worth, which violates Aristotelian equality in exchange. The second, and more significant, argument holds that although it is possible to charge separately for the ownership and use of certain assets (one may sell a piece of real estate subject to a prior lease of its use), this is impossible with money since it is consumed in its use. If the ownership of a sum of money is transferred, the use will normally involve transferring the ownership thereof (*i.e.* by spending it). Unlike durable assets, use and ownership cannot be transferred separately and hence cannot be charged for separately.[76] To charge $100 for the ownership of $100 as well as $10 (or 10 percent) for the use of the $100 is therefore to charge twice for the same thing which is

[74] AQUINAS, *supra* note 3, at pt. II-II, q. 78, art. 1.

[75] This is essentially the same definition of money used today. *See* U.C.C. § 1-201(b)(24) (2007).

[76] The one exception proving the rule that the scholastics could find was renting money *ad pompam*, which is when someone transferred possession of money to a bailee for purposes of displaying it. *See* NOONAN, *supra* note 40, at 41.

unjust.[77] Put in Roman law terms one cannot enter into both a transfer of ownership (such as a *mutuum*) and a contract for use (such as a *locatio conductio rei*) for money. By entering into a *mutuum*, the attribute of use has vested in the recipient with the *mutuum*. Although this theory rejects the *stipulatio*'s evasion of the required gratuitous nature of the *mutuum*, it does not explicitly reject the charging for something other than the use of money in a contemporaneous transaction to the *mutuum*. For example, the scholastics distinguished usury from interest (as the Roman law used that term to mean a measure of damages[78]) with only the former being prohibited.[79] The absence of a prohibition of interest (again in the Roman law sense of damages) will be significant in the sixteenth-century development of usury theory since new economic circumstance created more damages and hence more legitimate interest.

From the time of the *palea Ejiciens* to Aquinas, three basic arguments in favor of outlawing usury were offered: (1) money is not a productive asset, (2) money is a fixed medium of exchange and can only be sold for its fixed price and (3) the ownership of money means nothing more than the right to use the money to buy things so one cannot charge separately for the use and ownership of money. All of these arguments sound in commutative justice. It is unjust for the lender to charge the borrower usury as the very nature of money makes usury an unjust exchange.

One might object to the first argument in that money in the hands of a merchant can fructify. He can use the money to generate more wealth. In a more modern context, an investor can buy a corporate bond and the corporation can use the money to build a factory to increase production and generate more wealth. Yet, the scholastics drew an important distinction. It was not the money that produced the new wealth but the asset purchased with the money (or the use to which the

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77 Although St. Thomas Aquinas and other pre-sixteenth-century scholastics add other minor arguments, they are essentially a variation or elaboration of these two main points. For example, it is sometimes argued that the usurer sells time (the time between the making and repayment of the loan). Since nobody can own time, the usurer sells something not his own. But this argument is essentially another way of expressing the second argument. Since the borrower owns the money during the loan, the lender cannot charge for the time one owns his own property. See *id*. at 38-81 for a more detailed discussion of these finer points of the argument.

78 Recovery of expectation damages is the most equivalent legal concept to the term interest as used in Roman law and scholastic theory. See the text accompanying notes 100-03, *infra*, for a more complete discussion of the term interest.

79 *See* HOMER & SYLLA, *supra* note 23, at 71.

> "The prohibition was against usury, 'where more is asked than is given.' The Latin noun *usura* means the 'use' of anything, in this case the use of borrowed capital; hence, usury was the price paid for the use of money. The Latin verb *intereo* means 'to be lost'; a substantive form *interisse* [sic] developed into the modern term 'interest.' Interest was not profit but loss."

Id.

money is put) and the labor of the merchant. Thus, money, as a medium of exchange, in and of itself bears no fruit. Certain assets purchased with the money can bear fruit. Aquinas describes the relation of money to production:

> The money of the usuries is not related as a root to the profit which is made from it, but only as matter. For a root has to some degree the power of an active cause, in as much as it ministers food to the whole plant; whence in human acts the will and intention are compared to a root, so that if it is perverse, the work will be perverse; this, however, is not necessarily in that which is matter; for someone can sometimes use evil well.[80]

This distinction between a productive and non-productive use of money (as distinguished from money being productive in and of itself) is important to the scholastics' application of the usury theory to business investments.

In order to understand the second and third arguments, a modern example may be helpful. The Attorney General of Pennsylvania testified to a Congressional Committee regarding the findings of an investigation conducted by the Pennsylvania Bureau of Consumer Protection.[81] Agents entered into a consumer credit transaction to acquire a 20 inch color television which provided for total payments of $1,709. The Attorney General testified that the television had a suggested retail value of $297 and could be bought at a discount store for $250. Since money is a medium of exchange whose value is measured by its consumption, the financier provided a value of between $250 and $297 (the loan money was consumed at this exchanged value) and required the return of $1,700. Put another way he sold a value of $250-$297 for $1,700, or sold the television eight times.

2. Distributive Justice: Confirmation of the Conclusion

A less prominent but significant argument sounding in distributive justice is present throughout the 1,200-year period under consideration. Usury works injustice in its harmful effects on the redistribution of wealth from the needy to the wealthy. Pope Innocent IV, in his *Commentaria Apparatus in Quinque Libros Decretalium*, focuses on the observable effects of usury. Usury results in individual and societal decline of wealth. The borrower at usury transfers a portion of his future wealth to the usurer. The society suffers as usury diverts

[80] *See* NOONAN, *supra* note 40, at 111 (quoting St. THOMAS AQUINAS, QUAESTIONES QUODLIBETALES III, q. 3, art. 19).

[81] *See* Susan Lorde Martin & Nancy White Huckins, *Consumer Advocates vs. the Rent-to-Own Industry: Reaching a Reasonable Accommodation*, 34 AM. BUS. L.J. 385, 401 (1997).

investment away from productive activities, such as farming, since the wealthy invest their money in usurious loans where the money is put to non-productive uses.[82] Defenders of the usurers suggested that the really needy poor and those who need money for a short time due to a temporary emergency (such as illness or crop failure) benefit from usury. St. Bernardino of Siena explained how no person needs usury since it only makes the needy worse off.[83] The first group needed social charity, or in modern language public assistance.[84] If they are really needy they cannot afford to pay the cost of the goods and services they need plus the usury.[85] The payment of usury only exacerbates their poverty. The second group is similar.[86] They are gradually impoverished as the usurer, taking advantage of their temporary need, transfers wealth from the needy to the wealthy.[87] This group would be better off liquidating assets, forgoing consumption, or having recourse to public assistance.[88] These arguments focus on the distributive implications of usury. Those who borrow at usury for needed consumption (*i.e.* food and shelter) are transferring what little wealth they have to those wealthier than themselves. This is an unjust redistribution as it takes from those in need and enriches those with excess wealth. This is inherent in usury since one who is not in need of the money lent would not pay usuries to acquire it but would use his existing wealth.

An interesting perspective on this argument emerged in the debate over the English usury statute of 1571.[89] In addition to the debilitating effects on the poor, many of those in favor of the traditional English (that is prior to Henry VIII) usury laws prohibiting all usury pointed to a broader macroeconomic effect, the lowering of those in a higher socio-economic sphere to a lower sphere by usury.[90] Borrowing at usury to maintain consumption needs not only makes the poor worse off, but reduces the middle class to a lower state or even poverty.[91] Since usury involves paying more than the value of money received, it always involves a wealth transfer to the usurer. In this vein, Ben Johnson quipped that usurers were "base rogues that undo young gentlemen."[92] This is a perspective not noted even by modern supporters of strict

[82] INNOCENT IV, COMMENTARIA: APPARATUS IN QUINQUE LIBROS DECRETALIUM, V, *De Usura,* ante *c.1*. (Minerva GmbH 1570, reprinted 1968).
[83] *See* NOONAN, *supra* note 40, at 71, 73-74.
[84] *See id.* at 74.
[85] *See id.*
[86] *See id.*
[87] *See id.*
[88] *See id.*
[89] *Acte Against Usurye*, 1545, 13 Eliz., c.8 (Eng.), made perpetual by 39 Eliz., c.18 (Eng.).
[90] *See* JONES, *supra* note 40, at 43-45.
[91] *See id*.
[92] *Id.* at 45.

usury laws. Not only are the poor made poorer, but the number of the poor is enlarged over time by the declining numbers of the wealthy.

Nearly 900 years after the arguments of Innocent IV and St. Bernardino, their truth is demonstrated by the results of the current practically unbridled consumer credit industry in the modern economy. The example of Pam Sanson who needed $300 for current consumption is illustrative.[93] She borrowed the $300 from a payday lender, a lender who borrows against anticipated future wage income. In six months she had accrued $900 in finance charges.[94] She transferred $900 of wealth for the consumption of $300 of value. Although hers may be an extreme case as to amount, the principle is the same regardless of the amount. This transaction involved a wealth transfer to the financing company regardless of whether the amount is $9, $90, or $900. The only difference is the extent of the wealth transfer. If the consumption was necessary for her and her family's survival, she should then be a case for public provision of assistance for this consumption and not a target of wealth transfers. Rather than providing the necessary assistance, a law permitting this usurious loan is requiring her to transfer future wealth for survival.

In addition to the observations of St. Bernardino and Pope Innocent IV, modern commentators have identified other social costs of permitting overextension of for-profit credit:

> (1) public subsidization of the credit regulatory system [a restatement of the scholastic argument that usury causes re-distribution]; (2) lost productivity due to 'court appearances, meetings with creditors, and general psychological stress'; (3) loss of respect for government [which requires an unjust wealth redistribution to obtain the necessities of life]; and (4) extreme hardship for the debtor and his family.[95]

The effects of default in the consumer context are more than economic. They include increased risk of anxiety, sleeplessness, aggression, divorce, and suicide.[96] Some debtors have even sold their

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93 *See* Pearl Chin, Note, *Payday Loans: The Case for Federal Legislation*, 2004 U. ILL. L. REV. 723, 724 (2004).

94 *See id.*

95 Oeltjen, *supra* note 25, at 213 (quoting George J. Wallace, *The Logic of Consumer Credit Reform*, 82 YALE L.J. 461, 470-471 (1973)).

96 *See* BRUCE BONGAR, THE SUICIDAL PATIENT: CLINICAL AND LEGAL STANDARDS OF CARE 86-92 (1991); DAVID CAPLOVITZ, CONSUMERS IN TROUBLE: A STUDY OF DEBTORS IN DEFAULT 280-83 (1974) (arguing that debt causes health problems); JANET FORD, THE INDEBTED SOCIETY, CREDIT AND DEFAULT IN THE 1980S 122 (1988); MARTIN RYAN, THE LAST RESORT: A STUDY OF CONSUMER BANKRUPTS 50, 114-17 (1995) (noting difficulty in objectively correlating health problems with debt trouble but still concluding debt trouble probably causes emotional and health problems); Peterson, *supra* note 27, at 566-67 (citing W.C.A.M. Dessant & A.A.A. Kuylen, *The Nature, Extent and Causes and Consequences of Problematic Debt Situations,* 9 J. CONSUMER POL'Y 311, 328 (1986)); T. Puckett, *Consumer Credit: A Neglected Area in Social Work Education*, 2 CONTEMP. SOC. WORK EDUC. 121, 121-23 (1978).

vital organs to meet debt obligations.[97]

In summary, usury offends against commutative justice in that it charges more than the value of money lent, which is unjustified since money is barren and can produce nothing in and of itself. Usury effects wealth transfers from the poor to the rich and is harmful to individuals and society in many ways. In addition to these general arguments, the scholastics elucidated their arguments by applying them to specific transactions and situations. The next Section will examine some of these areas of application. In discussing these matters, the scholastics refined the definition of usury by identifying fact patterns which did not fall within the definition of usury.

C. *Distinguishing between Usury and Other Licit Transactions and Investments*

There were two major categories of transactions where one party provided money to another and justly could require the return of an additional amount beyond the principal. Examining these categories will illuminate what scholastics considered to be usury and hence what was actually prohibited by the scholastic theory.

The first category can be identified as loans of money pursuant to which damages are due.[98] Damages were licitly payable when the provider of the funds was harmed in some way beyond the loss for a time of the amount loaned. This occurred for example when a borrower failed to honor his promise to repay the funds provided and this delay caused damages to the lender.[99] Scholastic legal theory preserved the Roman law concept of *quod interest*, or the difference, which is essentially the modern concept of expectation damages (including lost profits).[100] The term referred to the difference between the position of the promisee now and what it would have been if the promise had been performed. In the case of contracts for the repayment of money (*mutuum*), if the borrower failed to pay the stated amount and if this caused damage to the lender (including if the lender were going to use that money to acquire wealth producing assets, lost profits), the

97 Christian Williams, Note, *Combating the Problems of Human Rights Abuses and Inadequate Organ Supply Through Presumed Donative Consent,* 26 CASE W. RES. J. INT'L L. 315, 323 n. 36 (1994).

98 *See* AQUINAS, *supra* note 3, at pt. II-II, q. 78, art. 2, reply obj. 1 ("A lender may without sin enter an agreement with the borrower for compensation for the loss he incurs of something he ought to have, for this is not to sell the use of money but to avoid a loss.").

99 In England this form of interest was generally known as *poena conventionalis* and was seen as compensation for the loss the lender incurred by forbearing collection of the funds lent. *See* ERIC KERRIDGE, USURY, INTEREST AND THE REFORMATION 7-9 (2002).

100 *See* NOONAN, *supra* note 40, at 105-06.

borrower was required to pay these damages to the lender.

> Interest is never thought of as payment on a loan; it is the 'difference' to be made up to a party injured by the failure of another to execute his obligations. The common distinction is between *usura* and *interesse*, *id est non lucrum sed vitatio damni* [which means "it is not profit but avoidance of loss"]. Interest is purely compensatory. It is accidentally and extrinsically associated with a loan. . . . The early recognition of interest is thus strictly limited to individual cases where the writers have seen that the lender has actually suffered damage.[101]

Two expressions of this right to damages (or interest) were *damnum emergens* (damage emerging) and *lucrum cessans* (profit ceasing). These titles arose not as a right to payment on account of making a loan due from the outset, but were compensatory expectation damages assessed due to the actual fault of the debtor.[102] For the scholastics, the term "interest" had a very different meaning than it does for jurists today. A sixteenth-century English Chancery document is illustrative of the scholastic understanding of the difference between usury and interest: "Usury and trewe interest be things as contrary as falshod is to truth."[103] Interest is compensation comporting with commutative justice; usury is a violation of commutative justice.

The second category involves various transactions which to a modern jurist may appear similar to a loan in effect but which according to the scholastic theory did not constitute a loan. These can be divided into four general transaction forms: partnership investments (*societas, foenus nauticum*, and *depositum*), annuities (*census*), government bonds (*mons*), and future sales (including credit sales of goods and foreign currency exchange transactions). An examination of the reasons for each of these forms falling outside the definition of usury further refines the scholastic definition of usury.

The partnership, or *societas*, existed in Roman law. It was a "pooling of resources (money, property, expertise or labour or a combination of them) for a *common purpose*."[104] Roman law recognized various forms of partnership, ranging from a pooling of all assets to the pooling of specific assets for a single transaction.[105]

101 *Id*. at 106-07 (quoting St. Raymond of Pennaforte, *Summa casuum conscientiae*, 2:7:2).

102 Public Record Office, State Papers Domestic, Elizabeth, 75/54. Although prior to the sixteenth century there were a few theologians who attempted to argue that *damnum emergens* or *lucrum cessans* could be estimated and charged from the beginning of a loan, the majority opinion was opposed to this approach as this would break the connection between these rights and the compensation of actual damages. *See* NOONAN, *supra* note 40, at 120-21.

103 Constant J. Mews & Ibrahim Abraham, *Usury and Just Compensation: Religious and Financial Ethics in Historical Perspective*, 72 J. BUS. ETHICS 1, 2 (2007).

104 ZIMMERMANN, *supra* note 54, at 451. *See also* Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333, 1356 (2006).

105 *See* ZIMMERMANN, *supra* note 54, at 453-54.

Roman law allowed the partners to allocate the partnership profit and loss among themselves, but a partner could not be allocated all of the loss and none of the gain.[106]

Significantly, the partnership provided virtually no asset shielding as each partner was liable pro rata for the liabilities of the partnership, and the law made no distinction between the obligations and assets of the partnership and that of the partners.[107] Although the law did not recognize a distinction between the assets of the partner and the business venture, the claims to profit of a partner contributing money were contingent upon the business venture succeeding. If the partnership's assets were lost, a partner could not recover his investment and hoped-for gain from the personal assets of the other partner.[108]

This restriction on recovery was used to distinguish a partnership from a loan. A partner was seen as retaining an ownership interest in his contribution to the partnership since he bore the risk of its loss in the venture. The inability of the other partner to use the invested money in any way other than in accordance with the common venture, demonstrated an attribute of retained ownership in the investment. Although the nature of the partners' ownership of contributed assets changed (the two partners are now joint owners of the money[109]) and they have contractually agreed to limit the use of their joint property in accordance with their specific common purpose, they still retained an ownership interest in the joint assets. This ownership distinguished the *societas* from a *mutuum* since in a *mutuum,* the lender lost any ownership interest in the money provided as the borrower was free to consume it in use.[110] Further, a partner was not charging for the loan of his money (since he remains an owner). Rather, he shared in a pre-agreed allocation of the profit of the partnership. It was not the money invested that bore fruit; it was the business of the partnership conducted with the assets purchased with this money. Aquinas succinctly summarizes this distinction:

> He who lends money transfers the ownership of the money to the borrower. Hence the borrower holds the money at his own risk and is bound to pay it all back: wherefore the lender must not exact more. On the other hand he that entrusts his money to a merchant or craftsman so as to form a kind of society, does not transfer the ownership of his money to them, for it remains his, so that at his risk the merchant speculates with it, or the craftsman uses it for his craft,

[106] *See id.* at 458-59 (A purported agreement where one partner bore only loss and no gain was referred to as a *societas leonina*.).

[107] *See id.*

[108] *See* NOONAN, *supra* note 40, at 134.

[109] *See* ZIMMERMANN, *supra* note 54, at 465 ("each partner having 'totius corporis pro indiviso pro parte dominium.'").

[110] *See* NOONAN, *supra* note 40, at 135.

> and consequently he may lawfully demand as something belonging to him, part of the profits derived from his money.[111]

In other words, it was lawful for a person to take money and use it in commerce (by purchasing goods for sale for example) and make a profit. An investor could contract with another to supply the human effort and activity in lieu of himself. Since the investor did not expend the effort himself, it was just that not all of the gain accrued to him but was shared with the one supplying the effort. The amount received beyond the invested money was not usury but a portion of the lawful profit the investor would have been entitled to if he had worked alone and not in the *societas* with his partner.

The justice of receiving profits from a *societas* is implied in St. Thomas' argument: "[T]he use of money does not have the measure of its utility from this money itself, *but from the things which are measured by money* according to the different persons who exchange money for goods."[112] What is the purpose of forming a partnership with a partner providing money? The merchant has a plan for conducting some business that requires the purchase of goods or services (which may include his own services) expected to make a profit. These things need to be paid for in money (exchanged for money). A partner's contribution of money could be re-characterized as the partner purchasing the goods or services needed to make the profit and then contributing those to the *societas*. Rather than purchasing them himself, the partner provides the money to the other partner who completes the purchase. A partnership is not a loan of money but a contribution of assets (goods or services) needed for the common purpose of a business venture. The measure of the investment is not the money but what the money is exchanged for (the profit-producing assets).[113] In this way, a *societas* differs from usury not merely in form but in substance. A *societas* involves the retention of ownership of the money and its contribution to the venture for the purpose of acquiring or sustaining productive assets.

It is possible to view the *foenus nauticum* and the *depositum* as variations of a *societas*. Based on Roman law,[114] a *foenus nauticum* (or what is sometimes called *pecunia trajectia*) involved an investor

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111 AQUINAS, *supra* note 3, at pt. II-II, q. 78, art. 2, reply obj. 5.

112 *See* NOONAN, *supra* note 40, at 52 (quoting ST. THOMAS AQUINAS, IV LIB. SENT., III:37:1:6) (emphasis added).

113 St. Thomas's argument that the measure of the use of money deriving from what the money is exchanged for is very similar to part of Knut Wicksell's theory of natural interest. Wicksell describes the credit economy as evolving from a system in which goods are lent directly into one in which money to acquire goods is lent instead. The measure of the value of the loaned money is the goods that would have been contributed directly in the prior order. *See* DEMPSEY, *supra* note 63, at 7-8 (summarizing Wicksell's theory).

114 *See* DIG. § 22.2.1 (Modestinus, Encyclopedia 10).

loaning goods or money to a seafaring merchant.[115] If the ship were lost at sea, the merchant need not repay the amount invested.[116] If the voyage were successful, the merchant must return the thing loaned and provide an agreed percentage of the expected profits from future sale of the goods transported.[117] During the actual, on-land trading, the merchant acts for his own account as the investor's return accrues upon completion of the voyage.[118] Following the Roman law example, the scholastics saw this as a loan (during the on-land period) and a partnership (when at sea).[119] During the sea voyage, the investor, as the risk-bearing owner of the goods in partnership with the transporting merchant, was entitled to an agreed allocation of profits. Once the goods reached port, the investor was entitled to a portion of the profit earned by completing this portion of the ultimate sale transaction.

The *foenus nauticum* can be understood as a limited (in time) special purpose-partnership for the purpose of investing in a portion of commercial trading on the dangerous seas. As with a general partnership, it involved the contribution of assets or money to a profit-producing venture and involved indices of ownership. Even though of a more limited scope, it was reconcilable to the same principles underlying the exclusion of investment in a *societas* from usury.

The *depositum*, inherited and adapted from Roman law, was similar in form to a modern deposit account. The depositor would place goods (and in later times, money) with a merchant (or in later times, merchant banks).[120] Under Roman law, the merchant would return the exact amount of the deposit, but by the thirteenth century, a merchant was permitted to use the deposited assets in his business during the deposit period and would pay the depositors a portion of the profits of the business conducted during the deposit.[121]

This transaction can be viewed as a form of a partnership, although one where the investing partner's role is extremely passive. The *depositum* involved the investment in productive ventures directly (in the case of deposits with merchants) or indirectly (in the case of investments with merchant banks which used deposits to invest in various *societas* and made payments on the deposit as a share in the collective profitability of these partnerships). The investor also bore the

115 *See* NOONAN, *supra* note 40, at 134-35.

116 *See id*; David M. Collins, *Comments on the American Rule of in Rem Liability*, 10 MAR. LAW. 71, 72-73 (1985).

117 *See* NOONAN, *supra* note 40, at 134-35.

118 *See id.*

119 *See id.*

120 *See id.* at 171-72.

121 *See id*; Charles D. Salley, *Origins of the Regulatory Separation of Banking and Commerce*, 93 BANKING L.J. 196, 199 (1976). (Originally the amount paid was at the merchant's discretion but later it was fixed at agreed percentages.).

risk of the venture's producing no profit, in which case the payments of profit on the deposits would cease.[122] These features made the deposit a form of partnership, although a simpler contractual form than the *societas*, and distinguished it from a loan with predetermined usury payments unrelated to the use of the loaned funds.

The second transaction form was similar to the modern annuity contract. A *census* was the purchase of a stream of future payments (like an annuity) that were derived from some fruitful property, called the *census* base.[123] Although in form it could resemble a loan (A pays $100 for a stream of payments that together will equal $100 plus an additional amount), in substance the scholastics found a distinction in the requirement of a fruitful base. The *census* holder was buying a partial property interest in the *census* base. The extent of the *census* return was limited to the agreed periodic *census* payment and was subject to the base actually producing a minimum return to pay the *census*.[124] Unlike a loan for usury, a *census* buyer bore the risk of sterility of the *census* base, which constituted indices of ownership.[125]

Although some scholastics disagreed whether certain permutations of the *census* went so far as to become a loan, there was a consensus that a true *census* involved the sale of an interest in a productive asset, not time or money since the buyer's return was contingent in some way on the productivity of the base.[126] In a sense, the *census* was another variation of a partnership. Instead of contributing assets or the money used to buy assets to an income producing venture, the *census* seller already owned the asset and sold partial ownership in it to the *census* buyer, who contributed the asset back to the partnership. In so contributing a productive asset, the *census* buyer was entitled to a share of the gain made by the *census* seller out of the contributed asset. The difference between a *census* and a *societas* is analogous to the modern distinction between a purchase money loan for acquisition of an income-producing asset and a securitization of an existing income-producing asset. In the first case, the investor provides the capital to purchase the asset. In the second, the current owner sells the future

[122] *See* NOONAN, *supra* note 40, at 173.

[123] *See id*. at 155.

[124] This is most obvious in the early form of the *census*, in which payment was made in the fruit itself (a portion of the crop of a field for example). Later the transactions were simplified so that the *census* seller could substitute an equivalent in money rather than delivering the fruit itself much like the cash settlement of a modern futures contract. *See id*.

[125] *See id*. at 157-58 (citing Alexander Lombard, TRACTATUS DE USURIS, c.7 f.162v:a, f.164v:b; Joannes Andreae, Gloss ON SPECULUM OF WILLIAM DURAND IV:4, de Usuris and Panormitanus, COMMENTARIA IN LIBROS DECRETALIAM, V:19:6).

[126] For example, many scholastics considered a personal *census* (one whose base was all the assets of the seller including his future income from wage labor) which was required to be redeemed by the seller on a certain date to be a usurious loan disguised under the mere name of *census*. *See id*. at 158-62.

income to be produced by the securitized asset. The economic substance is nearly identical although the chronology and form differ. The *census,* like the *societas*, involved the retention of a partial ownership interest in a productive asset evidenced by a risk of uncertain future profit.

The third transaction form was the city *mons*, or government bond. Several Italian city-states enacted compulsory conscriptions of capital from their citizens to fund government operations.[127] The government had the right to redeem the *mons* (*i.e.* return the conscripted capital) and reserved the right, often exercised, to pay an annual gratuity.[128] Although some in the fifteenth century argued that the *mons* constituted usury, most distinguished them on the basis of the power of the sovereign to tax.[129] Since the contributions were compulsory under the power of the state to tax and conscript needed assets for the public good, the state could set the terms of this conscription. The state could choose to lessen the loss to its citizens occasioned by the exercise of this power by agreeing to pay the gratuity. Unlike a voluntary loan, a city *mons* was an involuntary transfer of money brought into being by the positive power of the state to legislate with respect to its own tax revenue. The holder of the *mons* also bore the risk that the state would exercise its power of conscription and simply cancel the gratuity or the repayment of the capital. The scholastics thus distinguished public finance of the government from voluntary usury.

The fourth type of transaction, future sales, can be subdivided into credit sales of goods (*venditio sub dubio*) and foreign currency exchange transactions (bills of exchange). As do commentators on modern usury laws,[130] the scholastics recognized in credit sales (purchase of goods allowing future payment therefore) a potential for disguised usury. Hostiensis, a 13th-century Italian canonist, feared that acceptance of credit sales opened the way to the exploitation and fraud of usury.[131] Despite the recognized risk of evasion of the usury prohibition inherent in credit sales, the scholastics advanced two

[127] *See id.* at 122.
[128] *See id.*
[129] *See id.* at 122-25.
[130] 47 C.J.S. *Interest & Usury* § 192 (2008); William Smith et al., *Practice Under Florida Usury Law: Transactions Subject to Usury*, *in* FLA. BAR. § 3.12 (2006). ("The series of transactions consisting of a credit sale and a subsequent assignment by the seller of the conditional sale contract or other credit instrument has frequently been attacked by purchasers as involving a usurious loan."); Fadra L. Day, Comment, *Application of the Time-Price Doctrine in Credit Sales of Real Property*, 40 BAYLOR L. REV. 573, 578 (1988); Ann L. Iijima, *The Jurisprudence of Justice Esther Tomljanovich: Balancing the Scales of Justice*, 32 WM. MITCHELL L. REV. 435, 449 (2005); William D. Warren, *Regulation of Finance Charges in Retail Installment Sales*, 68 YALE L.J. 839, 843-44 (1959). *See also* Ralph J. Rohner, *Leasing Consumer Goods: The Spotlight Shifts to the Uniform Consumer Leases Act*, 35 CONN. L. REV. 647, 681 (2003); James J. White, *The Usury Trompe L'Oeil*, 51 S.C. L. REV. 445, 472 (2000).
[131] *See* NOONAN, *supra* note 40, at 92.

arguments justifying some difference in credit and cash pricing of goods.

To understand these arguments, it is necessary to understand something of the scholastic theory of the just price.[132] Based on Aristotelian theories of justice as the mean,[133] the just price theory teaches that voluntary exchange transactions need to be proportional in value. No person should profit from another's loss.[134] In an exchange, justice is found in an equal exchange of value but injustice is found in an unequal one as the mean is not maintained.[135] Under this theory, the just price of goods and services is considered to be equal to the general estimation of the utility to satisfying human needs of the thing exchanged, as opposed to the particular need of a transaction participant.[136] Despite this rejection of a subjective estimation based on the varying needs of each individual, jurists and scholastics recognized that, absent the setting of a legal price by the sovereign,[137] the just price was not objectively fixed for all goods for all time since the common estimation of the utility of a thing could change over time.[138] Thus, the scholastic theory of the just price allowed for a range of prices over time as the common estimation changed.

Therefore, not all credit sales (a sale where payment is made at a later date than transfer of the object of sale) involved the payment of an

132 The just price doctrine is a complex topic in and of itself, separate from usury theory. Usury was unjust not because the amount charged exceeded a just price for the loan; it was unjust because the lender charged extra without conferring any added benefit (that is, he charged for the use of money separate from ownership). As Aquinas says, "Wherefore if he exacts more for the usufruct of a thing which has no other use but the consumption of its substance, he exacts a price of something non-existent: *and so his exaction is unjust*." AQUINAS, *supra* note 3, at pt. II-II, q. 78, art. 1, reply obj. 5 (emphasis added).

133 For a discussion of the origin of the just price theory in Roman law and Aristotelian equality of exchange theory and its continued influence on modern contract law, *see* Gordley, *supra* note 66..

134 Dig. § 50.17.206 (Pomponius, Various Readings 9) ("Iure naturae aequum est neminem cum alterius detrimento et iniuira fieri locupletiorem.").

135 ARISTOTLE, *supra* note 64, at 1131b32-1132a7.

136 *See* Aquinas, *supra* note 3, at pt. II-II, q. 77, art. 1 ("Yet if the one man derive a great advantage by becoming possessed of the other man's property, and the seller be not at a loss through being without that thing, the latter ought not to raise the price, because the advantage accruing to the buyer, is not due to the seller, but to a circumstance affecting the buyer."); *See also* DIG. § 35.2.63.

137 *See* John W. Baldwin, *The Medieval Theories of the Just Price: Romanists, Canonists, and Theologians in the Twelfth and Thirteenth Centuries*, TRANSACTIONS AM. PHIL. SOC., July 1959, at 33, 49 (the just price was to be determined either by reference to the legal price or the determination of the common estimation by a good man (*ad arbitrium boni viri*)).

138 *See* Dig. § 35.2.63.2 (Paul, Lex Julia et Papia 2) ("Sometimes place or time brings a variation [uarietatem] in value; oil will not be equally valued at Rome and in Spain nor given the same assessment [*aestimabitur*] in periods of lasting scarcity as when there are crops. . . ."); Aquinas, supra note 3, at pt. II-II, q. 77, art. 3., reply obj. 4 (discussing whether a merchant with knowledge that merchants with a greater supply of the goods sold are about to arrive in a location needs to disclose the likely downward price effect); see also NOONAN, supra note 40, at 85.

additional amount on account of the extension of credit; the credit price might actually be the just price and the cash price a discount thereto.[139] Given the scope of prices permitted by the just price theory over time, as long as the credit price did not clearly exceed the just price, the profit could be seen as just profit on the sale and not a charge for credit.[140] The second argument arose from the recognition that the value (and thus price) of goods could change over time.[141] Wheat, for example, can justly cost more before the autumn harvest since it is scarcer. A seller who made delivery prior to the time of payment could charge the just price he expected the good to command at the time of payment (constrained by the just price doctrine) since he could have decided to withhold delivery until the time of payment.[142]

The legislation governing credit sales placed two conditions on permitting a difference in cash and credit pricing to attempt to prevent evasion (inadvertent or intentional) of the usury prohibition. As the Latin title (*venditio sub dubio* "sale under doubt") implies, there had to be a real "doubt" as to the price of the thing sold on credit at the time of payment.[143] If the good was one as to which there was no real doubt that it would cost more at the time of payment, a higher credit price could constitute usury. The other constraint developed to prevent widespread use of licit credit sales to evade usury was that a combination of a sale with a pre-agreed resale at a different price (or the same price but which allowed the "lender' to keep the fruits of the good sold and resold) was usury, despite its form.[144] The scholastics recognized in theory that certain credit sales were clearly distinguishable from usurious loans but acknowledged that in practice it was difficult to distinguish the licit sales from disguised usurious loans. This is likely why Pope Alexander III, while permitting *venditio sub dubio*, counseled against higher priced credit sales as the risk of usury existed.[145] Most theologians through the fifteenth century remained suspicious of contracts with higher prices for credit sales than for cash

139 *See* NOONAN, *supra* note 40, at 90.

140 *See id*.

141 *See supra* note 138.

142 Gregory IX, *Naviganti* (1234), *reprinted in* 4 READINGS IN WESTERN CIVILIZATION: MEDIEVAL EUROPE 316 (Julius Kirshner and Karl F. Morrison, eds., Julius Kirshner, trans., 1986).

143 *Decretales*, V:19:6, Gregory IX, *Naviganti*, *supra* note 142, at 317.("[S]omeone who pays ten shillings in order that the equivalent measures of grain, wine, or oil will be handed over to him at some other time shall not be considered a usurer, even if they then turn out to be worth more, so long as there is a reasonable doubt whether they were going to be worth more or less at the time of settlement. By reason of the same doubt even someone is excused who sells cloth, wine, oil, or other goods so that after a certain amount of time he gets back more for them than they are worth at the time of the sale. . . ."); Innocent IV, *supra* note 82, at *titulus* XIX, *caput* V *In Civitate*.

144 *See* NOONAN, *supra* note 40, at 95-99.

145 *See id*. at 91.

sales, as contracts *in fraudem usurarum* (that defraud the usury prohibition) .[146]

Unlike the *societas*, *census*, and *depositum* and their variations, credit sales were not limited to the purchase of productive assets or commercial transactions. Although a merchant could transact with another merchant *venditio sub dubio*, so could a person buying consumption goods. The other forms necessarily involved commercial transactions and the financing of profit-producing ventures. This difference may have made it easier to distinguish these transactions from usury than to distinguish licit credit sales from usurious loans.

As to foreign currency exchange, the scholastics achieved much less of a consensus as to how to categorize these transactions. After some early hesitation, what modern economists would call "spot" foreign exchange (the contemporary exchange of one coinage for another at a premium) and forward foreign exchange where the bank was the party required to make future delivery (and hence most akin to a debtor) were recognized as licit and distinct from a loan for profit.[147] Scholastic thinkers disagreed whether a bank customer who received currency in one city and agreed to repay a different currency in another city at a later date was involved in a usurious loan.[148] Some scholastics saw usury when the amount repaid in the future exceeded the amount originally received. These concerns were heightened when this transaction was enhanced to produce a "dry" exchange (when a customer settled the future delivery obligation by directing payment back in the original city in the equivalent amount of the original currency provided).[149] Most of the rejections of foreign currency exchange prior to the fourteenth century were more conclusory condemnations of usurious credit in various sectors of society rather than detailed considerations of the aspects of the exchange transaction or were general condemnations of usury that lacked a discussion distinguishing these exchanges from the general discussion.[150] Those scholastics who defended the exchanges saw an analogy with the credit sale of goods (*i.e.* the price set at contracting was an estimation of the future spot exchange rate at the time of settlement) or payment for services such as transportation of documents and maintenance of the foreign branches used to settle the transactions.[151] Although the

146 RAYMOND DE ROOVER, SAN BERNARDINO OF SIENA AND SANT'ANTONINO OF FLORENCE: THE TWO GREAT THINKERS OF THE MIDDLE AGES 29-30 (1967).

147 *See* NOONAN, *supra* note 40, at 190. The early hesitation by the theorists may have arisen due to the lack of a Roman-law precedent for this type of transaction and general silence on the subject in the early usury legislation. *See id*. at 180.

148 *See id.* at 180-90.

149 *See id.* at 177.

150 *See id.* at 181.

151 *See id.* at 180-90.

exchange banker might profit due to movements in exchange rates, he might also, and in fact often did, lose.[152] The theoretical discussion remained unresolved, but by at least the fourteenth-century, currency exchange transactions were treated as licit. In fact, the most significant international moral and legal authority at the time, the Papacy, was an extensive participant in these transactions and in fact authorized specific banks as exchange bankers to the Holy See.[153]

Despite some scholastics' concerns that some forms of exchange involved disguised usury, no legal or moral consensus against a true foreign currency exchange transaction emerged.[154] One explanation for this lack of agreement with respect to exchange could be that these transactions were limited to three distinct spheres: (1) the financing of the great trade fairs by the operation of a payment system very similar to the modern checking system (where merchants would receive local currency to finance their venture to the fairs and repay this amount in the currency of the fair after their commercial venture there), (2) the balancing of currency flows for the international financial operations of the Papacy (which generally received revenue in foreign coins and needed to transmit them back to Rome for centralized expenses),[155] and (3) public finance of government action such as wars (particularly during the campaigns of the Crusades). These applications involved either investment in a business venture (the fairs) or government finance, both of which were considered substantively different from the simple *mutuum* at a profit.[156]

By the sixteenth century, the definition of usury and its rejection as unjust were well established. Although the scholastics still debated some points of difference with respect to practical applications, the theory contained definitional distinctions which allowed for investment in the limited amount of commercial activity of the time as well as the financing of government. The expansion of commercial activity in the sixteenth century precipitated a new confrontation with the usury theory. In the theological, philosophical, and legal debates that would

[152] *See* EDWIN S. HUNT & JAMES M. MURRAY, A HISTORY OF BUSINESS IN MEDIEVAL EUROPE 1200-1550, at 72 (1999).

[153] *See* NOONAN, *supra* note 40, at 178. These bankers were referred to as "*compsores Apostolicae Sedis*." *Id.*

[154] Indeed some of the objection may be attributable to the popular distrust of commerce (and foreign (Italian) bankers in particular) in areas of less commercial development such as England and, to a lesser extent, France. *See id.* at 190.

[155] An example of this would be the use of a bill of exchange to pay in Rome the substantial tax due there by one appointed to a bishopric or benefice. The exchange would be closed out in the home territory out of the revenues collected on account of the benefice or bishopric as taxes in local currency. Often the Holy See would recommend specific bankers to perform this exchange for new appointees. *See id.* at 179.

[156] See the foregoing discussion of the *societas* and the city *mons* in the text accompanying notes 104-13 and 127-28.

arise as a result of this new context, further refinement of the theory would occur. New approaches would enter into the debate, which would cause usury theory to take a new road ending in the mess of contemporary usury laws. The next Part considers these new approaches.

IV. THE SIXTEENTH-CENTURY DEBATES AND ADAPTATIONS

How did Western law alter from the nuanced scholastic theory of usury developed prior to the sixteenth century to the modern approaches of either *laissez-faire* non-interference or price control? This Part will prove that the usury laws of the twenty-first century have their origin in the introduction of new ideas into the application of the scholastic theory of usury to the new economic realities of the sixteenth century. This part uses the mid-sixteenth century as the line of demarcation between the scholastic theory and these new developments. In 1545, England adopted a novel but short-lived usury act which marked a change from the transaction classification and prescription of the scholastic theory, and in 1571 England readopted a variation of the 1545 statute. [157] This part will show that with acceptance of several rationales for effectively legalizing new forms of profit seeking loans, the course ending in our existing usury law and theory had been charted. After examining this history of ideas, this Part will also examine a significant social welfare initiative of the sixteenth century born of the scholastic theory of usury.

A. *New Economic Realities–New Theory or Application?*

What occasioned the debates of this century? A dramatic change in economic circumstances created a need to apply the existing usury theory to radically new facts. The economic environment to which scholastic usury theory was being applied was changing dramatically in the sixteenth century.[158] Prior to this century, the demand for and uses

[157] *The Acte Againste Usurye*, 1545, 37 Hen. VIII, c.9 (Eng.), effectively permitted usury (called compensation for loss) at a rate limited to 10 percent. In 1552, *A Byll Against Usurie*, 5 & 6 Edw. VI, c.20, repealed this statute. In 1571, a new *Acte Against Usurie,* 13 Eliz. I, c.8, made perpetual by 39 Eliz. I, c.18, made a loan with charges above 10 percent void and prescribed damages of triple the principal. Loans charging less than 10 percent were technically also prohibited but the lesser penalties and methods of enforcement effectively permitted them. *See* JONES, *supra* note 40; ALFRED W. B. SIMPSON, A HISTORY OF THE COMMON LAW OF CONTRACT: THE RISE OF THE ACTION OF ASSUMPSIT 513-14 (1975).

[158] NOONAN, *supra* note 40, at 199 ("Europe was undergoing a commercial revolution in many ways no less far-reaching in economic consequences than the Industrial Revolution of the

of capital were so limited that it was reasonable to assume that one acquiring the use of money needed it for consumption, not production.[159] The increased demand in the sixteenth century for investment in business ventures was due in part to the geographic rediscoveries of America and the Far East and the resulting high-risk trading and colonization ventures.[160] As the demand for, and supply of (owing to the discoveries of gold in the New World), resources to invest in commercial activity increased, requests for different forms of investing rose. Importantly for usury theory, requests for tailoring the sharing of profits and risks of the underlying business ventures arose.[161]

New economic demands can create the need for new forms of transacting or the adaptation of existing ones. The two major focal points of the sixteenth-century debate were over the acceptance of the alteration of the *societas* into a "five percent" or "triple" contract and the expansion of the *census* into the personal redeemable *census*.[162] Sixteenth-century thinkers faced a greater demand to penetrate the details of these commercial transactions than their predecessors, since, prior to the sixteenth century, most loans (or similar transactions) were made for consumptive, not business purposes.[163] For our purposes what is important about these debates is not the result (eventually a widespread consensus emerged permitting most forms of these transactions) but the arguments for acceptance. This Part will show how some of the ideas used to justify these new forms eventually shifted usury theory to price regulation or no transaction regulation. The debate over these two forms of transactions encompassed many approaches but can be generalized into two categories, which Norman Jones summarizes thus:

> [T]he objectivist, Aquinian position enshrined in the law [*i.e.* existing prior to the debates], continued to define usury as the lending of anything with a guaranteed return of more than the value of the loan. Although the members of this school admitted certain exceptions [*e.g. damnum emergens*], they viewed usury as an act committed under a distinct set of external conditions. . . . [T]he subjectivistic nominalist position[] accepted the definition of usury propounded by the Aquinians but refused to accept any external, objective measurements of the crime. Insisting that it was evil intent that made lending at interest a sin, they recognized that there were innocent and legitimate occasions for lending at interest. Condemning "biting" loans, they were willing to tolerate loans at

late eighteenth and nineteenth centuries.").

159 *See Usury and the Canon Law*, 22:43 DUBLIN REV., 69, 72-73 (Jan. 1874).

160 *See* Horack, *supra* note 30, at 37; HOMER & SYLLA, *supra* note 23, at 109-10.

161 *See* NOONAN, *supra* note 40, at 199; HOMER & SYLLA, *supra* note 23, at 109-10.

162 *See* JONES, *supra* note 40, at 11-13; NOONAN, *supra* note 40, at 202-48.

163 *See* HUNT & MURRAY, *supra* note 152, at 71.

interest for legitimate business purposes."[164]

For ease of reference, this Part will refer to these two positions as the "objectivist" and "subjectivist" approaches. These categories refer to types of argument, not individuals advancing them. Individual jurists, legislators, or philosophers do not necessarily fall into one or the other category. It is often, perhaps even more, common to find a combination of objectivist and subjectivist arguments being employed by the same person or school.[165] An analysis of the subjectivist arguments will show a fundamental change in understanding the nature and essence of usury that resulted in modern legal and philosophical theories of usury.

The difficult debate over the new form of *census* also occasioned a re-examination of the Roman law concept of interest. This part will show how this re-examination eventually led to recognition that the new and riskier economic activity gave rise to more legitimately compensable losses under the titles of *damnum emergens* and *lucrum cessans*.

B. *Objectivist and Subjectivist Arguments over the Triple Contract*

The triple contract (*contractus trinitas*) or as it was more commonly known in Germany, the "five-percent contract," involved the addition of two significant features to the accepted *societas*.[166] The triple contract contained two agreements beyond the original partnership contract. In the first, a partner agreed to exchange the percentage share of uncertain future profits of the partnership for a fixed amount of guaranteed profit. In the second contract, one partner would insure the return of the other partner's capital in exchange for a further reduction of the agreed guaranteed profit.[167] Those employing the objectivist approach and the subjectivist approach eventually accepted the triple contract but for very different reasons.

164 JONES, *supra* note 40, at 19.

165 Likewise, sixteenth-century debates of the scholastic theory and application do not easily bifurcate along Catholic Protestant lines. *See* NELSON, *supra* note 51, at 29-73 (documenting the wide variety of understandings of usury among the Protestant leaders); NOONAN, *supra* note 40, at 199-248 (surveying the various Catholic analyses of the triple contract and mutually redeemable *census*); WILLIAM JAMES ASHLEY, AN INTRODUCTION TO ENGLISH ECONOMIC HISTORY AND THEORY 456-57 (Longmans Green & Co. 1906) (describing Martin Luther's vacillations in opinion on usury which at times was more conservative than Catholic theologians).

166 *See* HUNT & MURRAY, *supra* note 152, at 243.

167 *See id.*; NOONAN, *supra* note 40, at 209.

1. The Objectivist Approach

The objectivist approach grappled with the question of whether these features changed the societas so much as to transform it from an acceptable form of economic activity into usurious lending. Those who accepted the triple contract from an objectivist approach concluded that each part of the triple contract was individually legitimately distinguishable from usury (the simple *societas*, the exchange of the unlimited share of profits for a fixed return, and the insurance of this fixed return and the initial capital by the other partner in exchange for a reduction in return).[168] This contractual alteration of the classical *societas* is accomplished using the accepted principle of *societas*: the partners are free to allocate future profits from the *societas* as they choose so long as they do not create a *societas leonina*, a partnership where one partner receives all losses and no profits. Even though one partner agreed to assume the loss of his partner's investment and granted his partner a preferred payment of future profit, this partner is not left with only loss and no possibility of gain; in fact his percentage of gain has increased by the amount accepted in exchange for the fixed return. The required business purpose of all *societas* assisted in distinguishing the transaction from consumption credit.[169] Finally, even though one partner "guaranteed" a return to the other partner, the risk of ownership still existed, as *socii* are liable for the acts of the *societas* (although there was some debate as to whether they were jointly and severally or only pro rata liable).[170]

Angelus Carletus de Clavasio presents a typical example of the defense of the triple contract from this objectivist approach. A partner who "commonly for profit of the partnership would have received 6 per cent or 8 per cent and sometimes more, so agrees with his partner that his partner give him only 3 per cent or 4 per cent as profit and insure him on the capital."[171] Since a *societas* was distinguishable from a usurious loan and since insurance (the sale of the risk of an uncertain result for a fixed price) was universally accepted as an otherwise

[168] *See* JONES, *supra* note 40, at 11.

[169] *See supra* text accompanying notes 104-13; ASHLEY, *supra* note 165, at 447 (noting that merely calling a loan a partnership did not save the transaction from the usury prohibition if the purpose was for consumption and not business).

[170] *See* ZIMMERMANN, *supra* note 54, at 467-69; GURY, COMPENDIUM THEOLOGIAE MORALIS, pars i. n. 917 (7th ed. 1858) (teaching that the condition "ut quivis socius subeat onus damnorum et expensarum, quae intuitu societatis adveniunt" [whoever undertakes a burden of losses and expenses is considered part of the partnership] was necessary for a triple contract to be accepted as a true partnership).

[171] ANGELUS CARLETUS DE CLAVASIO, SUMMA ANGELICA, *Societas* n. 7 (1476).

acceptable sale subject only to the just price constraint,[172] their combination, it was argued, was permissible. The risk inherent in speculative business ventures was sufficient evidence, as had previously been concluded, of retention of ownership of the capital invested and retention of ownership (at least joint) distinguished the *societas* from the *mutuum*.[173] The purchase of insurance against this risk does not defeat the indices of ownership since the desire to purchase insurance indicates rather than disproves the presence of risk.[174] Further, the entitlement to profit from a partnership arises from the use of capital in a business with a prospect of making a profit.[175]

Although those following the subjectivist approach, especially those influenced by nominalism,[176] criticized the objectivist approach (and even those who concluded the triple contract was licit) as paying excessive attention to the form of the transaction,[177] the debate[178] was not a discussion of form for form's sake. Rather, those advancing an objectivist approach were attempting to discern if the change in form of the *societas* altered the substance of the transaction enough to change it from an actual partnership into a disguised loan. Those on the ultimately prevailing side still found within the form evidence of ownership (although the risk giving rise to this was insured against) and the fructifying of productive assets giving rise to the right to profits. Thus, the fundamental theoretical framework of the usury theory was essentially intact and merely applied to a new, more complicated factual context.

Those employing an objectivist approach placed a significant limit on their acceptance of the triple contract. As the name "five-percent contract" implies, many of the advocates of its licitness discussed the amount of the fixed guaranteed partnership return. Five percent was not a fixed legislated maximum. The requirement was that the exchange of risk for a fixed return involved a sale, not a loan, and was thus governed by the just price doctrine, not the usury doctrine (*i.e.* that the exchange

172 *See* NOONAN, *supra* note 40, at 203 ("Thus, without any important opposition whatsoever, the insurance of property was accepted by the theologians.").

173 *See id*. at 205.

174 *See id.*

175 *See id.* at 205-06; BENEDICT XIV, DE SYNODO DIOECESANA., lib. x. c. 7, 2 (1755) (noting in a description of a licit triple contract, that the investing partner must have credible hope ("*probabiliter sperat*") of making more profit than the agreed fixed return, otherwise he would not be trading anything for the guarantee of the fixed return).

176 Nominalism is a movement in metaphysics which, in the context used here, rejects the existence of universals. *See* Nominalism in Metaphysics, The Stanford Encyclopedia of Philosophy, http://plato.stanford.edu/entries/nominalism-metaphysics/#Uni.

177 *See* JONES, *supra* note 40, at 14.

178 Although those holding the triple contract not a usurious loan in substance prevailed in establishing a consensus, there were those who argued even into the eighteenth century that the form of a *societas* was so altered that in substance the triple contract was a loan and thus profit usurious. *See* NOONAN, *supra* note 40, at 225-28.

of the fluctuating future return of a partnership interest and return of original investment for a fixed profit must be a just exchange).[179] Five percent was discussed as an amount under the circumstances then existing that appeared within the range of the just price.[180] Although many spoke of the triple contract as the five-percent contract and in many areas this became the customary price, the theory of the objectivist approach was not tied to the acceptance of a legal limit to justify the contract. The investment of the capital in a business venture was sufficient to distinguish the transaction from usury without reference to the amount of return agreed. Any concern about the amount of the return on an investment in a partnership was not an issue of usurious rate regulation as understood in the twenty-first century but a question of compliance with the just price theory. As usury was per se unnatural, no price at a profit above the amount lent was just. The investor in a partnership is evaluated under the same legal approach as the seller of wheat or furniture. A legally acceptable price is dependent upon the common estimation of the value of possible future profit, which in turn is dependent upon economic circumstances of the time and place of transaction. The law need not fix an exact maximum price.

Eventually, once the three components of the triple contract are individually and then collectively accepted, the end result, which can be summarized as the contribution of capital to a business, is accepted even if the separate components were no longer specifically documented. The components were seen as implicit contracts within the investment of capital with a merchant in any business venture even if not explicitly stated as partnership and insurance contracts.[181]

2. The Subjectivist Approach

The subjectivist approach attempted to justify the direct lending of money for a profit in varying circumstances rather than distinguishing certain transactions from loans. In practice many of those utilizing this approach advocated no more than the same transactions (the triple contract or five-percent contract) as those of the objectivist approach; however, they advanced reasons for permitting it which would shape the future development of usury law.

The first difference in approach lies in the emphasis on intention. The so-called Tübingen school advocated that intention distinguished usury from licit investment.[182] Instead of focusing on the substance of

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179 *See id*. at 18.
180 *See id*.
181 *See id*. at 269-71.
182 *See* JONES, *supra* note 40, at 11.

what was occurring (explicitly or implicitly), the subjectivist approach argued that what constituted usury was the lending of money with a bad intention.[183] Although different thinkers described the bad intent differently (as the intent to do the borrower harm, the lack of charity, the intent to profit illicitly, covetousness),[184] they agreed that the test of usury was subjective, internalized, and a matter of conscience and not an objective discernment of attributes of different transactions.

This shift has significant implications for usury law: if usury is a matter purely of subjective intention based on the particular circumstances of each borrower and lender, this appears an area less appropriate to legal prohibition and left more to the realm of personal judgment (deregulation) or one only regulated at the extreme of bad intention (price capping). Since even those of the subjectivist approach had not yet reached the conclusion of the Utah legislature that all usury law should be abolished,[185] they needed to find a way to justify some limitation of usury. This was difficult to do once determination of the presence of usury depended on subjective intention. They preserved the regulation of transactions such as the five-percent contract by claiming that the law could (or should) prohibit only excessive or "biting" usury.[186]

Proponents of this proposition argued that only excessive charges, not moderate charges, should be prohibited.[187] A high rate of return signified the presence of a bad intention and thus logically, the limitation of a rate would capture the wrongly intended transactions. Five percent (or in the English usury statute of 1571, 10 percent[188]) became a fixed point of demarcation in usury analysis; a higher rate indicated bad intention and constituted usury. The rate of five percent therefore had a very different purpose than in the objectivist approach. Ironically, the subjectivists ended up advocating a rigid objectivist standard of a fixed maximum rate of return. In their approach is the birth (or rebirth) of usury as price limitation. With its rebirth we can easily anticipate the argument of arbitrariness which persists today. Why does six percent and not five percent evidence an intention to harm or of covetousness? Unlike the objectivist approach, which placed this

183 *See id.* ("The only way to derail the Aquinian definition of usury was to change it by making it a crime of intent, rather than a factual contractual matter.").

184 *See id.* at 11, 14, 19, 32.

185 *See supra* note 27.

186 *See* JONES, *supra* note 40, at 21-22.

187 *See* Oeltjen, *supra* note 25, at 174.

188 In fact, those advocating the complete licitness of lending at a rate of less than 10 percent were unable to attain a complete victory at this stage, and the statute actually outlawed a charge at any rate but crafted remedies which would effectively allow the charging of under 10 percent to go unpunished. *See* JONES, *supra* note 40, at 62-63. By the reign of James I this compromise legislation had created a *de facto* "safe" rate for loans for any purpose (business or consumption). *See id.* at 78.

issue in the realm of just price regulation, this subjectivist approach ultimately had no way to answer the question of what rate was too much.

C. *Objectivist and Subjectivist Arguments over New Forms of the Census*

The second major focal point of debate was new forms of the *census*. Essentially, this was a debate over how many changes to the classic real estate-based *census* transformed it into a loan. The two principal aspects of the discussion were how much property could form the *census* base and whether the *census* buyer could demand repurchase of the *census* right and return of the original price paid for the *census* (called "mutually redeemable").[189]

In the sixteenth century a debate arose over what type of property could serve as a *census* base. Was a *census* base limited to definite income-producing realty (a *census realis*) or could moveable and more indefinite personal property serve as a base (a *census personalis*) of the seller.[190] A modern analogy would be the distinction between asset and whole business securitization. The debate essentially reduces to one about the extent to which the *census* needed to be tied to a clearly fruitful base. On one side, some objectivist approach arguments insisted that every *census* needed to be paid out of a definite fruitful immobile good and the return could not be guaranteed.[191] Others allowed for a much broader base (including the future labor of the *census* seller) and a guaranty of the fruitfulness.[192] The difference between these positions is a matter of degree. The latter allowed a more vague connection between the base and the payments and even, as in the triple contract, a second agreement substituting the uncertainty of the fruitful base for a lower return but with greater certainty.[193] Thus, although those utilizing an objectivist approach might draw the line between *census* and usury at slightly different points on a spectrum, they agreed that a *census*, as a sale of future income, needed some nexus to a fruitful asset in order to be distinguished from usury. At a bare minimum, even the most accepting of authors require the one selling a *census* to have enough work to produce enough to support his basic

189 *See* NOONAN, *supra* note 40, at 230-31.

190 *See* ASHLEY, *supra* note 165, at 452.

191 The two best examples of this approach are *Cum onus* of Pius V and the writing of Navarrus who interpreted *Cum onus* to require the fruitful immobile base as a matter of natural justice. *See* NOONAN, *supra* note 40, at 237-39.

192 This approach is exemplified by the Jesuit General Congregation of 1573, Lugo and Alphonsus Liguri. *See* NOONAN, *supra* note 40, at 239-47.

193 *See id*. at 242-47.

necessities and thus precluded buying a *census* from a non-working person.[194] St. Alphonsus Liguri can be taken as a good example of the minimal objectivist approach position on the need for some fruitful base. He concludes "the only naturally illicit *census* is one founded on an unfruitful thing or person, for there no real good or usufruct is purchased."[195]

Some of the difficulty in analyzing how much of a connection to a fruitful base is necessary to distinguish a *census* from a loan arises from the interplay of this issue with a second concern. Could a *census* be redeemable by the buyer? Many employing an objectivist approach saw a mutually redeemable *census* as indistinguishable from a loan.[196] There appears a generally accepted recognition that if one both removes the fruitful base and allows the buyer to demand return of the original price, there is no objective way to distinguish the transaction from a loan.

This recognition led some to adopt a subjectivist approach with respect to a mutually redeemable *census,* an appeal to intention. Summerhart is a good example. Having reduced the *census* to the sale of a future right to the return of money, his response to the objection that all usury would be thus licit is a vague appeal to intention.[197] Given the clear similarity of his understanding of *census* to a loan, it is unclear what "intention" is required. Again, the only limit the subjectivist approach is left with is an arbitrary price limit.

By the end of the seventeenth century, despite the divergence of conclusion and analysis among those employing an objectivist approach, they appear to agree that a *census* and a loan are distinct transactions. Yet, even more than with the partnership, the scholastic writers recognize that a *census* can be nuanced to a point where it becomes a *de facto* loan at usury. Some attempt to fix the line of demarcation in the nature of the base and others focus on the redeemability attribute. With analysis in such a state of uncertainty, it is understandable why some accepted the subjectivist approach solution of limiting return to a low rate indicating a licit intention.[198] Due to the

194 *See id.* at 240, 246.

195 *See id.* at 247.

196 *Cf.* Soto's conclusion that this right to require return of the original purchase price for a *census* is indistinguishable from a lender's demand for return of principle and thus converts a legitimate *census* into a loan. *See id*. at 236.

197 *See id*. at 233-34.

198 Events in Bavaria in the late sixteenth century are illustrative of this tension between the need for a clear resolution of the issue and the complexity of the analysis. In 1553, Albert V promulgated a law allowing a *census anuus pro pecuniis mutuatis* which allowed an annual payment as long as not excessive (the subjectivists' simpler solution). The conscience of his successor, William V, was troubled by this law so he wrote to Pope Gregory XIII to inquire as to whether the following transaction is usurious. One person ("T") provides money to another ("S"), not necessarily a merchant, for a time, without regard to the purpose of providing the

difficulty in distinguishing these situations and the risk of evasion, one can understand the appeal of resorting to the intention-based subjectivist approach.[199] The simplicity of the subjectivist emphasis of intention exalts the significance of the rate as opposed to the attributes and purpose (productive or consumptive) of the transaction. Perhaps those employing an objectivist approach never reached a consensus on the minimum nature of the fruitful base and the effect of the ability to redeem because events moved faster than their analysis. Since the scholastic theorists found other forms of investment transactions, such as a triple contract, licit, the *census* transaction fell into disuse before the debates were resolved.[200]

D. *A Re-evaluation of Interest*

For those who were not willing to abandon completely the scholastic theory in favor of intention, the recognition that some purported *census* transactions were in fact loans led some attached to the objectivist approach to attempt in these cases to determine if there was a separate justification for the receipt of an additional amount above the *census* price. This trend led to a reconsideration of when interest (in the Roman sense) was licit.

In Roman law, "interest, as "the difference," was a compensatory concept for a loss suffered.[201] If applied to usury theory, when it could be shown that in lending 100 and receiving 105, the five which at first

money, and S pays T 5 percent of the sum provided annually and later returns the whole sum. The Pope's answer exemplifies the difficulty of analyzing *census* transactions from the more complex objectivist approach. The Pope responds that this general description of a transaction is a loan. Yet, he goes on to say that he does not mean that all transactions in money where one party pays 5 percent would be. If the transaction fulfilled all the conditions of a *contractus trinus* or *census* or if the lender had a legitimate claim for interest, in its Roman law sense, it did not violate the usury prohibition. Since there is no definition of *census* in this response the reply does not provide clear tests for when a *census* is really a *census* and not a loan. On the basis of the response, William repealed the exception to the usury prohibition of his predecessor but at the same time promulgated several forms of contracts which could be used licitly. *See* ASHLEY, *supra* note 165, at 455-56. William recognized that there was a difference between "authorizing *every kind of loan under all circumstances* [so long as only 5 percent is charged] and authorizing *a certain number of ways of investing money*, each of which remained subject to conditions. " *Id.* at 456 (emphasis in original). One can accept William's conclusion while recognizing that identification of the certain types of permissible transactions and their conditions are still a matter of difficult debate.

199 This is exemplified by the decision of the Jesuit Congregation of 1581, which essentially concluded that whenever the ownership of money is transferred for any purpose to anyone (other than aged or infirmed persons without property), the transaction, regardless if resolvable to a triple contract or *census*, is licit with a licit intention evidenced by not charging more than obtainable in a triple contract or *census* in another context. *See id*. at 276.

200 *See id.* at 453.

201 *See supra* text accompanying notes 100-03.

appeared more than was lent was actually compensation for loss caused by lending the 100, no excess is being demanded in repayment. The loss compensated could take two forms: the loss of profit (*lucrum cessans*) that could have been made with the money lent that is foregone and the incurrence of costs in making the loan itself (*damnum emergens*). All just entitlements to true interest must have the sole purpose of avoiding loss to the lender.[202] Applying an objectivist approach, the amount of interest must be dependent upon the determination of actual or likely loss. Applying a subjectivist approach would require inquiry into the intention in charging the interest.

As to expenses, the pre-sixteenth-century scholastics accepted that interest could be charged for costs incurred (other than merely the loss of use of the money lent itself), and it had to be capable of proof and subject to impartial assessment.[203] They recognized the justice in requiring compensation in the form of lost profit when the borrower defaulted on a loan.[204] Thus, it was not usury if one lent $100 and, after a borrower failed to repay, the lender could demonstrate he had an opportunity to use that $100 at the time of repayment. This specific missed opportunity may have cost the lender something for which he could be compensated. The earlier scholastic writers, however, were skeptical of a general claim for compensation for potential lost profits from the beginning of a loan as this was seen as too speculative.[205]

As the sixteenth century unfolded, several thinkers began to consider whether, in light of new opportunities for investing capital, more lenders could charge for *lucrum cessans* from the inception of a loan rather than merely demonstrating specific foregone profits after the fact.[206] One stumbling block to admitting this claim to *lucrum cessans* was the understanding of money as a good of a fixed, non-fruitful, value. Cajetan is able to reconcile this theory of money with the ability to use money to make a profit implicit in the acceptance of an investment in a *societas*. Money itself is not inherently fruitful and is consumed in use, but it can be consumed to further either a fruitful or a consumptive purpose. Cajetan exemplifies this point by comparison with a grain of wheat, which is something consumable in use like

202 *See, e.g.*, ST. BERNARDINO, QUADRAGESIMALE EVANGELIO AETERNO, CARITARIS ET . . . DE USURA, sermo XLII, ad init., art. I, ad init., *in* OPERA, vol. ii, 248-49 (Venice 1745).

203 *See id.* at sermo XLI, art. I, ad init., cap. ii, iii; sermo XLII, art. I, ad init., cap. i, ii, iii, ad. init., *in* vol. ii, 237-39, 249-51; DEMPSEY, *supra* note 59, at 171, 173.

204 *See* DEMPSEY, *supra* note 63, at 171, 173.

205 *See, e.g.*, AQUINAS, *supra* note 3, at pt. II-II, q. 78, art. 2, reply obj. 1 ("But the lender cannot enter an agreement for compensation, through the fact that he makes no profit out of his money: because he must not sell that which he has not yet and may be prevented in many ways from having.")

206 *See* Edgar Salin, *Usury*, *in* ENCYCLOPEDIA OF THE SOCIAL SCIENCES 195 (The McMillan Co. 1934) (noting that proof of actual *lucrum cessans* became easier with the increase of investment opportunities and in fact was presumed to exist for merchants and manufacturers).

money. A grain of wheat can be eaten and completely destroyed or it can be used as seed to produce more wheat.[207] This understanding of the lending of money expands the use of *lucrum cessans* to an *ex ante* assessment of loss from a pure *ex post facto* application if the lender can demonstrate the ability to use the funds in a productive way.

The next question is, to whom is this argument available? Did the lender have to be someone actually engaged in another profitable business from which the money lent was directly diverted, or were economically productive uses of money available to all—enabling all lenders to claim a loss profit?[208] A plausible explanation for the hesitancy in expanding the acceptance of *lucrum cessans* to almost all loans is that it is occurring contemporaneously with the expansion of commercial investment opportunities. In a time when very few people could invest money in anything more than their own labor, the test of *lucrum cessans* had to focus on the profit potential of the labor of the individual lender. As the need, and thus opportunity, for investment in the businesses managed by others becomes more obviously available to almost anyone with surplus money, so does the acceptance of *lucrum cessans* for all lenders since everyone, even non-merchants, could invest the money in a *societas* or triple contract with a merchant. St. Alphonsus Liguri summarizes this new economic reality thus: "Although he has an inefficacious will of doing business, yet he wills efficaciously to gain justly; and because he can gain, he can now gain justly from the loan, since the loan is the true and efficacious cause that gain from businesses ceases for him."[209]

With this recognition that more widespread commercial investment opportunities created for most or even all lenders a lost opportunity comes a need to determine the amount of this lost opportunity. If one were to charge more than the forgone profit this would transform *lucrum cessans* from compensatory to a profit on the loan itself. When *lucrum cessans* remained an *ex post facto* evaluation of lost profit it still involved some speculation but less so than an *ex ante* prediction of lost future profit. Several approaches were discussed to prevent *lucrum cessans* from becoming profit on lending itself. Some suggested that the lender have to point to a specific use of the money from which the loaned funds were diverted, while others required the loan to be involuntary, and yet others (the subjectivists) required that the motive for lending had to be charitable.[210]

207 *See* NOONAN, *supra* note 40, at 253.
208 *See id.* at 259-64.
209 *Id*. at 267.
210 Cajetan is an example of retaining the Thomistic requirement that *lucrum cessans* may not be claimed if one voluntarily lends for a non business purpose. *See id*. at 254. Summerhart took the nature of the intention to its most stringent form requiring the lender to prefer not lending the principal to lending and receiving *lucrum cessans*. *See id*. at 251-52. Navarrus recognized the

Despite the expansion of the availability of *lucrum cessans*, these thinkers still realize that some standard must be developed for limiting it to compensation. Even Lugo, who would liberally allow *lucrum cessans*, admits that "[t]he lender preferring lending to other work is probably asking more for his loan than he actually has a title to by "*lucrum cessans*."[211] One answer could be the common estimation of the fixed returns available through triple contracts and *census*. Yet for an objectivist approach these are important merely as evidence of the actual profit foregone by making a loan, whereas for the subjectivist they become substitutes for discerning the bad intention. The subjectivist approach permitted rates that were even more detached form the theoretical reasons for their usefulness.

Although payment of interest (as compensation) including *lucrum cessans,* was permitted by the pre-sixteenth-century scholastic theory, it is only when the opportunities to invest capital productively become widespread that the charging of *lucrum cessans* becomes more widespread. It does not mark a change in theory but an application of the prior theory to new economic realities.

E. *The Mons Pietas and Usury Theory*

Perhaps the best way to understand the acceptance of *lucrum cessans* charged from the inception of a loan is to look at the context for the first official approval of it from the highest legal and moral authority of the time, the Church. In the first half of the sixteenth century, papal and counciliar authority approved the payment of *lucrum cessans* to depositors in a *mons pietatis*.[212] These institutions (initially funded by charitable donations) were established to lend funds to the poor to fund necessary consumption.[213] In the sixteenth century the *mons* proposed that in order to expand their charitable work they take deposits of cash and pay *lucrum cessans* of between four and six percent.[214]

In authorizing this approach, Pope Paul III recognized that those who could use money to make a profit, but who diverted these funds to assist the poor, were not acting unjustly in asking for some

difficulty in requiring a charitable intention and thus grasped at a more objective standard: the lender had to have a business purpose from which the money lent is withdrawn, thus requiring the lender to be in a business which could make use of the lent funds for a profit-seeking venture. *See id*. at 260-61.

211 *Id*. at 266.

212 See Petersen, *supra* note 10, at 835. *Mons pietatis* can be translated "mountain of piety." CASSELL'S NEW LATIN DICTIONARY 379, 449 (1959).

213 *See* CAROL BRESNAHAN MENNING, CHARITY AND STATE IN LATE RENAISSANCE ITALY, THE MONTE DI PIETÀ OF FLORENCE (1993).

214 *See* NOONAN, *supra* note 40, at 258.

compensation for their loss.[215] The permission restricted the payments to depositors to an amount which is less than the depositors would have made if the money were employed in business.[216] Although this decision introduced the concept of price control into the usury analysis, it is not based on limiting the price to protect the borrower (in this case the *mons pietatis*) but to limit the return to the lender to something less than expected from business investment at the time. Put in other words, the lending of money to fund necessary consumption can create a loss for the lender equal to the guaranteed (or safe) investment in businesses available at the time. To charge more than this estimation of *lucrum cessans* would mean charging a profit on the loan, but to charge less would be compensatory. All of this analysis assumed the actual availability of such business investment opportunities.

The *montes* present another important aspect of recognizing the right to compensation for loss in lending: the right to charge the reimbursement of the cost of making the loan (both variable and fixed costs).[217] The *montes* were what modern law would call not-for-profit public associations usually having ecclesiastical authorities on their boards of directors.[218] The directors in many *montes*, such as that in the Florentine *mons*, received no salary for serving (although there were members of staff who ran day-to-day operations who drew a salary).[219] The institutions developed in Italy, but spread throughout Europe in the sixteenth century[220] to address the needs of the group of borrowers who have a short-term need for funds due to a temporary necessity.[221] They were not meant for the poorest of the poor, who could never repay the funds provided (as the borrower from a *mons* had to leave assets exceeding the value of the loan).[222] The acceptance of the *mons* assumed a parallel system of charity which provided outright gifts to the most needy of the poor without assets to pawn.[223] The *montes*, being required to ask applicants about the use of funds, were not permitted to lend for unnecessary consumption and for a time required borrowers to make an oath that the funds were required to pay for necessities.[224] This

215 *See id.* Pope Paul III's decision was affirmed by two of his successors as well as the Council of Trent. *See id.*

216 *See id.*

217 *See* Peterson, *supra* note 10, at 835.

218 *See* NOONAN, *supra* note 40, at 295.

219 *See* MENNING, *supra* note 213, at 55, 59.

220 *See* PETERSON, *supra* note 10, at 836.

221 *See supra* text accompanying notes 83-88.

222 *See* MENNING, *supra* note 213, at 58 (The Florentine *mons* required the funds advanced to equal no more than 2/3 of the value of the item pawned.); Maria Lucia Pilla, *The Monti di Pieta and Role of the Catholic Church in Fifteenth- and Sixteenth-Century Italy*, at 5, *available at* http://www.misp.it/italiano/images/stories/documenti/Pilla-_Marchetti.pdf. (last visited Aug. 11, 2008).

223 *See* Pilla, *supra* note 222, at 11.

224 *See id.* at 9.

section of the moderately poor served by the *montes* was otherwise forced to pay illegal usury to black market moneylenders at rates of approximately 37 percent.[225]

As the *montes* began operating it soon became apparent that they would eventually exhaust their ability to serve the poor; if they merely received back the amount lent, their capital would be depleted in paying their costs of operation, including salaries to employees and *lucrum cessans* to depositors.[226] It was thus proposed that those benefiting from their operation share the costs of operation in proportion to the benefit received, *i.e.* the amount of the loan borrowed and repaid.[227] Said another way, those who actually benefited were bound in justice to contribute back to the *mons* to compensate for the loss occasioned by their benefit. Often the charges payable upon repayment of a loan were not described as "interest" but "payment of salaries and rents."[228] In practice these charges amounted to 5 percent per annum, on average.[229]

Acceptance of the *mons pietatis* was evidence that forbidding gain on a loan did not require a lender to suffer a loss on a loan. This had always been true with respect to *damnum emergens*. The recovery of costs when the purpose of lending was not profit seeking was consistent with the scholastic understanding of usury as gain on a loan. The not-for-profit attribute of the *montes* was demonstrable in two ways. First, when the borrower could not repay the loan, the property securing the loan was sold and any surplus was returned to the debtor,[230] not the *mons* and the *mons* could not pursue what modern law would call a deficiency judgment against the debtor.[231] Thus, the *mons* bore all of the risk on the value of the property pawned declining,[232] but the

225 *See* NOONAN, *supra* note 40, at 295.

226 *See id*.

227 *See* Oeltjen, *supra* note 11, at 759; Peterson, *supra* note 10, at 835; PILLA, *supra* note 222, at 6.

228 MENNING, *supra* note 213, at 60.

229 *Id.* at 60-61.

230 *Id*. at 68 (noting that the surviving accounts of the Florentine *mons* show several customers shown as creditors owed the repayment of surpluses obtained from the sale of pawned items).

231 Surprisingly, I have not found a source that states directly that the *mons* could not obtain a deficiency judgment. It appears to be what happened. The medieval notion of pledge was more like a conditional sales agreement than a security interest, and the concept of deficiency judgment does not make an appearance until the fourteenth century, and that is in Germanic law. *See* Edward A. Tomlinson, *Security for a Commercial Loan: Historical & International Perspectives*, 23 MD. J. INT'L L. & TRADE 77, 86-87 (1999). In the case of the Florentine *mons,* the officials who assessed values of items to be pawned were liable to the *mons* if the sale of the pawn realized less than the debt. These officials were required to obtain guarantors (*mallevador*) to guaranty any obligation they might incur in this respect. *See* MENNING, *supra* note 213, at 61. In a private e-mail correspondence with Carol Bresnahan Menning, I confirmed that in her review of the records of the Florentine *mons* she could not recall any records showing debtors being pursued for deficiency judgments. E-mail from Carol Bresnahan Menning to Brian McCall (July 20, 2007, 11:02 EST) (on file with author).

232 In some cases, it was officials of the institution who bore the risk. The records of the

borrower retained any reward on the value increasing. Secondly, if in a particular year, a *mons pietatis* overestimated its costs and actually made a profit it was required to donate this money to another charity.[233] As a further measure to keep the costs passed on to borrowers to a minimum, the constitution of some *mons* capped permissible annual costs to a fixed amount.[234] Once these restraints on profit from lending were coupled with a limitation on the use of lent funds, the *mons* could justly charge for the covering of their costs of capital and operating expenses.

One important pre-requisite for the success of the *montes* appears to be the parallel restriction of for-profit consumptive lending. As lending for a profit (as opposed to mere compensation for loss) became legal throughout Europe, the *montes* also began to disappear despite sporadic re-emergence.[235] A charitable lending institution cannot compete with an unregulated profit-driven private lending market which seeks to encourage credit rather than relieve existing consumption needs.[236] Since the *mons pietatis* was designed to help only those in need, it assumes a background that does not permit private lenders to promote and fund consumption beyond fulfilling basic needs. This was the legal and cultural background of the time in which the *montes* arose and flourished.

Thus by the seventeenth century, the scholastic theory did have a methodology for responding to the increased financial complexity that had been developing. The theory could be applied (albeit with complexity) to permit investments in businesses and income-producing assets and limited non-profit (but not-loss-making) lending for necessary consumption. Pope Benedict XIV summarized the new applications of the usury theory to permissible activity in the mid-18th century:

> The nature of the sin called usury has its proper place and origin in a loan contract [*mutuum*]. This financial contract between consenting parties demands, by its very nature, that one return to another only as

Florentine *mons* indicate that when the ledgers were balanced a deficiency in sums repaid as opposed to sums lent was balanced by listing the *massaro* of the *mons* a debtor for such amount. *See id*. at 88. The *massaro* was the official appointed by the directors to oversee the acceptance of and care for each pawned item. *See id.* at 58.

233 *See* Pilla, *supra* note 222, at 10.

234 *See* MENNING, *supra* note 213, at 62.

235 *See* Peterson, *supra* note 10, at 837-39. The Mexican Bank of Pity is another example of a survival of the original *mons*. It operates on very similar business practices to the Florentine original. The Mexican bank is a private assistance institution under Mexican federal law that was originally founded in the eighteenth century by Don Pedro Romero de Terreros to "lend money on redeemable objects to all people in need; to save the poor from being broken by usurers; to aid poor students with scholarships; to help small businessmen; and to protect widows and orphans by assuming executorship of their debts and businesses." Richard Condon, *The Bank of Pity*, 33 HOLIDAY 58 (Mar. 1963).

236 *See* Peterson, *supra* note 10, at 838-39.

> much as he has received. The sin rests on the fact that sometimes the creditor desires more than he has given. Therefore he contends some gain is owed him beyond that which he loaned, but any gain which exceeds the amount he gave is illicit and usurious . . . . We do not deny that at times together with the loan contract certain other titles–which are not at all intrinsic to the contract–may run parallel with it [*e.g. lucrum cessans* and *damnum emergens*]. From these other titles, entirely just and legitimate reasons arise to demand something over and above the amount due on the contract. Nor is it denied that it is very often possible for someone, by means of contracts differing entirely from loans [*e.g.* true *societas* and *census*], to spend and invest money legitimately . . . to engage in legitimate trade and business. From these types of contracts honest gain may be made.[237]

The Pope's statement expresses an objectivist approach to the usury theory. An alternative, theoretically simpler, approach was advocated by subjectivists to justify many of the same results. Yet it detached itself from the theory of money and lending that held sway for the past millennium. With an appeal to subjective intention, it resolved usury into charging more than a legally specified rate above which was excessive or biting and below which a presumed good intention existed. It is from this second approach that the existing rate regulation evolved. Would a refocusing of the usury debate on the objectivist approach benefit modern usury debate? This question is addressed in the next Part.

V. EVALUATION OF THE SCHOLASTIC THEORY AS IT DEVELOPED BY THE END OF THE SEVENTEENTH CENTURY

The scholastic theory of usury and its further elaboration in the sixteenth and seventeenth centuries through the objectivist approach is often dismissed on a superficial level.[238] The scholastic usury theory as it developed was certainly complex and involved many points of more or less fine distinction, but the complexity and distinctions were developed to preserve several fundamental principles at the core of the theory. Of prime importance among these was the position that usury was a matter of objective commutative justice; certain types of transactions were unjust regardless of motive or intent.

The difficulty we face in retrospect is that the theory developed

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[237] BENEDICT XIV, VIX PERVENIT, II and III (1745) *available at* http://www.ewtn.com/library/ENCYC/ B14VIXPE.HTM (last visited Dec. 30, 2007).

[238] KEVIN W. BROWN & KATHLEEN E. KEEST, USURY AND CONSUMER CREDIT REGULATION § 2.2.1 (1987) (describing the scholastic theory as "mainly twisted logical explanations, convenient doctrines and clever legal fictions"). *See also* MARK H. LEYMASTER, CONSUMER USURY AND CREDIT OVERCHARGES § 3.3 (1982).

over a long period of time and was similar to the development of common law in that it developed in reaction to specific factual questions. This process was complicated by the introduction of the novel, intention-based rationales and the lack of clear lines of demarcation between these two approaches (particularly as to the end result). The subjectivist approach eventually leads to either the abandonment of all usury regulation or a compromise rate regulation without any logical rationale for the rate selected. The principles used to analyze specific situations are not always enunciated but underlie examination of specific variations and circumstances. Although it is possible that some thinkers who contributed to the process were merely attempting to rationalize the legitimacy of existing or evolving business practices (we certainly cannot see or let alone judge the secret motives of people writing hundreds of years ago), it is also possible to explain the history in terms of a struggle to prevent the wholesale abandonment of principles essential to natural justice in search of practical simplicity. It would have been simpler to either condemn all transactions remotely resembling a loan for profit or, on the other extreme, approve of any and all transactions. Yet, a more complex answer would preserve the existence of the underlying principles in the context of more complicated economic realities.

Another difficulty in examining the history of these ideas is the difference that existed in the manner in which business was conducted. One of the principles that underlies the original scholastic theory of usury as well as the objectivist approach to its application is a distinction between the substance of investment in a business and a loan for consumption. The sixteenth-century writers do not clearly annunciate this substantial difference in these terms and often focus attention on the form of transaction (*societas, census, mutuum*) rather than the purpose of the transaction or use of funds. This may be due to the fact that the modern ability to distinguish business activity from personal consumption was not as explicit at such times. In modern times we more easily draw the lines between business and personal consumptive finance. This distinction was less apparent at the time the usury theory was being applied to the new commercial environment of the sixteenth and seventeenth centuries.[239]

Throughout the Middle Ages, commerce was conducted in two predominant forms, individual proprietorships and partnerships.[240] Even when the *compagnia* (from which our modern word "company" is derived) developed, the owners, like partners in a *societas*,[241] were still

[239] *See* HUNT & MURRAY, *supra* note 152, at 33, 60.
[240] *See* JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, THE COMPANY 7-10 (The Modern Library 2003).
[241] *See* ZIMMERMANN, *supra* note 54, at 467-68.

fully personally liable for the debts of the venture.[242] The Middle Ages did recognize a business entity with legal personality distinct from the personal affairs of the individuals involved.[243] These corporations were not business ventures; they were towns, universities, and religious societies.[244] Even when this legal form began to take on a characteristic of business affairs in the seventeenth and eighteenth centuries, it was more like a quasi-governmental entity than a private business venture.[245] The corporations of the Age of Discovery, the East India Company, the Virginia Company, etc., had armies, collected taxes, and performed other administrative functions in the colonies.[246] Although there were individuals attempting to prosper financially, these state monopolies appear more like governments than businesses. They were also not the common form used for business affairs until well into the nineteenth century.[247]

It is critical to keep this historical perspective in mind when evaluating the difficult debates about applying usury theory to practical situations for the four centuries following the year 1500. Whereas the ability to distinguish consumptive borrowing from productive investment is more obvious today, when a merchant was acquiring funds to finance a business venture it was the merchant personally who was the one borrowing or collecting the investment. The distinction between a merchant and his personal consumption and the business venture was less distinct than even that of a general partner in a partnership today, and thus an analysis of the form of the transaction may have appeared more necessary to distinguish usury from investment. In light of these historical difficulties, what then are the principles that underlie the original scholastic theory of money and loans and the objectivist approach that attempted to apply these principles to new economic realities? This Part will answer this question.

Usury is a matter of commutative justice based upon the nature of money. It is therefore not primarily a policy matter of economic utility for society nor certain socio-economic sections of society. Although people were aware of the harmful effects of usury on the poor or the community at large, these observations do not comprise the dominant rationale for usury theory but merely appear to confirm, by the injustice brought about in the larger community, the injustice wrought by usury in individual transactions. Requiring a borrower to place the lender into

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242 *See* MICKLETHWAIT & WOOLDRIDGE, *supra* note 240, at 8.

243 *Id.* at 12.

244 *Id*; WESLEY B. TRUITT, THE CORPORATION 2 (2006).

245 MICKLETHWAIT & WOOLDRIDGE, *supra* note 240, at 17-36.

246 *Id.*

247 *Id.* at 40 ("It was not until a combination of legal and economic changes from the 1820s onward that the modern company began to take shape.").

a better position than the lender was in before the loan is unjust to the borrower. Acceptance of this principle was based not only on religious textual prescriptions but also on a rational consideration of money and its function. Money as a medium of exchanging goods and services can only be valued by the use to which it is put since it is consumed in use. Unlike the exchange of money for goods or services, the simple exchange of money for money (in the same currency at least) involves an equal exchange. To charge more than this parity is unjust.

A distinction was recognized at least implicitly from the earliest discussions that the use of money to acquire goods or services to commence or expand a business was fundamentally different from the use of money to buy consumable goods. One providing the medium of exchange needed to acquire capital goods (regardless of whether it is provided directly to a business, as in a *societas*, or by purchasing an interest in a productive asset or pools thereof, as in a *census*), was justified in requiring a share in the fruits of that venture or asset. The amount of that return was not completely a matter of ambivalence, as it is subject to the just price theory, but is within such bounds a matter of private agreement based on the common estimation of the value of capital at that time and place. Such agreement may include an agreement as to the insurance of the investment. John Maynard Keynes, in re-evaluating the scholastic theory, restated this principle in modern economic terminology:

> I was brought up to believe that the attitude of the Medieval Church to the rate of interest was inherently absurd, and that the subtle discussions aimed at distinguishing the return on money-loans from the return to active investment were merely jesuitical attempts to find a practical escape from a foolish theory. But I now read these discussions as an honest intellectual effort to keep separate what the classical theory has inextricably confused together, namely, the rate of interest and the marginal efficiency of capital.[248]

In the scholastic's language, the distinction between a rate of interest and marginal efficiency of capital was the difference between usury from a *mutuum* and profit derived from a true *societas* or *census*. Implicit in Keynes's observation is recognition of a fundamental difference between capital and mere money. As Henry Somerville observes:

> Now The Canonists [his term for the scholastics] never quarreled with payments for the use of capital, they raised no objection to true profit, the reward of risk, ability and enterprise, but they disputed the identification of the lending of money with the investment of capital and denied the justice of interest as a reward

248 JOHN MAYNARD KEYNES, GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 351-52 (Harcourt 1964).

> for saving without investment . . . . The canonists' principle was that sharing in trade risks made an investor a partner, a co-owner of capital, not simply a money lender, and gave a title to profit. [249]

Sixteenth-century authors did allow the partner to insure against some or all of this business risk (as opposed to the mere risk of payment default present in every executory contract). The presence of the risk (which could only be insured against at a price, the foregoing of larger profits) distinguished capital from mere money.

Once this foundational distinction between money and capital is accepted, the law of usury must first and foremost distinguish between transactions where money or capital is provided. A loan can be defined for purposes of identifying transactions subject to usury law as the provision of funds for the purpose of acquiring goods or services which will be withdrawn from the market and consumed.[250] A transaction not involving a loan and thus not subject to usury law can be defined as the provision of funds for the purpose of acquiring unfinished goods or services which will be incorporated into new goods or services for future resale at an anticipated gain.[251] These definitions require the law to investigate the purpose of the transaction and the use of proceeds. Modern law routinely requires distinguishing between business and consumer purposes in a variety of contexts.[252] The distinction may not always be easy given various factual scenarios. The scholastics recognized a *census* or *societas* adapted too far could evade the required income-producing purpose. They chose not to abandon the effort and ban or permit everything but to persevere in attempting to better articulate the distinctions and continuously refine it in light of new economic realities.

Once the realm of business investment is distinguished from loans (even if the line of separation is difficult to mark in individual cases), that question of actual loans for consumption remains. The lending of money used to buy goods such as food, shelter, or clothing is a different matter as these goods do not produce further wealth. To receive back the money used to buy them with a profit is unjust according to the scholastic theory. The amount of the profit demanded only affects the extent of injustice worked in the situation. As an increasing precision in distinguishing business investments from loans emerged, so too a more precise definition of profit appeared in the distinguishing of *lucrum cessans* from true profit. Just as it was unjust to require the borrower to pay more than he received, it was recognized that to require the lender to end the transaction with less (although technically receiving the exact

249 Henry Somerville, *Interest and Usury in a New Light*, 41 ECON. J. 164, 646 (1931).
250 DEMPSEY, *supra* note 63, at 3.
251 *Id.*
252 *See* examples listed *infra* in the text accompanying notes 280-82.

amount loaned) was also inequitable. Thus, although the concept of indemnification for loss suffered in making the loan existed in the scholastic theory for centuries, its use was expanded from precise *ex post facto* calculations to *ex ante* estimations. This more nuanced understanding is important as the occasion of lost profit opportunities became relevant to more of the population as economic opportunities for investment expanded. The original meaning of interest as the difference was maintained as a compensatory, not profit-seeking concept. Implicit in this principle was recognition that although the types of losses and their occasion may vary as individual and general economic circumstances changed, the principle remained. Interest is a payment for compensation, not gain. Expanding the recognition of situations where compensation for lending existed was bounded by the stringent control upon charges for lending for consumption and the assumption that the truly poor should not have to borrow to survive.

A practical application of the usury theory to lending for consumption existed in the history of the *mons pietatis*. The recovery of actual operational costs as well as a reasonable estimation of certain lost profits (in the small return paid on deposits with the *mons* which were effectively passed through to the borrowers) is one of the clearest examples of the theory applied to consumer lending. The amount of this cost recovery was limited by the non-profit nature of the *mons* and the procedures designed to prevent the promotion of unnecessary borrowing (the limitation of credit to the acquisition of necessities and the exclusion of loans to the abject poor). A consumption lender barred from realizing a profit has no incentive to encourage unnecessary borrowing and thus contributes to the encouragement of investment of saved funds in wealth-producing activities, not consumption. In addition, the controlled consumer lending of the *mons* was situated within the broader context of social responsibility for the poor. Those without assets to pledge or incapable of acquiring the income to eventually repay the loan (such as the elderly) were provided for with direct transfers of goods, not loans.

These fundamental distinctions between employing capital and funding consumption lie at the heart of the scholastic theory. Of what relevance are these ideas to the task of re-assessing modern usury law? The next Part will address this question.

VI. APPLICATION OF THE SCHOLASTIC THEORY TO MODERN USURY LAW

> Upon first exposure to the subject of [contemporary] credit regulation, the impression of the average attorney might be that the

field is a maze, if not a mess, and probably both.[253]

Can the history of the scholastic theory of usury as adapted by the objectivist approach assist in resolving the maze and mess of modern credit regulation? This Part will apply the principles described in Part V to revise and revitalize modern credit regulation. This Part will first examine the requirement for complexity and consistency in formulating usury law. The scholastic theory will be applied to both commercial and consumer transactions. Finally, this Part will argue that although difficult, this application of an old theory is possible even in a complex modern economy.

A. *Complexity and Consistency*

The scholastic theory is flexible enough to regulate the multiplicity of privately ordered transactions and evolving economic conditions found in a modern market economy. As such, the scholastic theory cannot be stated in a single sentence or a single numeric rate. Instead, core principles should be allowed to adapt as economic conditions change. In order to do this, transactions need to be categorized into money lending and investment-related activities. Charges for transactions falling within the former category must be further categorized as compensatory or profit. These categorizations may be difficult in individual cases but doing justice has long been seen as a difficult undertaking.[254] A usury law based on these distinctions would require a degree of complexity, but as it would be guided by coordinated principles, the complexity would not appear to be a random maze. In this respect, a critique of modern usury law using scholastic principles would agree with many of the criticisms of usury price caps as being ineffective to adapt to the variety of transactions in a modern economy.[255]

253 KATHLEEN E. KEEST, THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES § 2.1 (1995).

254 *See* ST. THOMAS AQUINAS, COMMENTARY ON ARISTOTLE'S NICOMACHEAN ETHICS 338 (C.I. Litzinger trans., Dumb Ox Books 1993) (quoting 5 ARISTOTLE, NICOMACHEAN ETHICS at 1137a9-17 ("Similarly, some people think that no wisdom is needed to know what things are just and unjust because it is not difficult to understand what the law says. However, these things are only incidentally just but become truly just when done and distributed in a particular way. Now to know this way is a more difficult task than to know the things that are healthful . . . .")); *Id.* at 341 ("But proper adaptation to affairs and people is more laborious and difficult than knowing remedies in which the whole art of medicine consists. There is a greater diversity among voluntary acts about which justice is concerned than among the humors about which health is concerned."). What Aristotle and Aquinas say about justice in general is clearly true of different forms of economic activity and usury as seen from the brief history sketched in *supra* Parts III and IV.

255 *See, e.g.*, Marion Benfield, *Money, Mortgages and Migraine – The Usury Headache*, 19 CASE W. RES. L. REV. 819 (1967-68); Christopher C. DeMuth, *The Case Against Credit Card*

Since usury is a matter of commutative justice, the principles should not vary depending on the geographic location (or choice of law) of the transaction. Federal law could serve as a vehicle for attaining consistency in treatment. Yet, federal law has been developing towards uniformity of usury laws through the adoption of the lowest common denominator rather than as a principled jurisprudential approach. A national bank is now permitted to charge the legal rate of interest either of the state where it is located or where it is doing business.[256] In 1980, Congress extended the right to apply the usury law of the state where an FDIC-insured state bank is chartered to transactions in another state.[257] By making this freedom available to FDIC-insured banks only, Congress gave the impression of not pre-empting state usury law.[258] Yet, given that approximately 90 percent of all banks chose to become FDIC-insured,[259] this change effected a near total pre-emption of state usury law resulting in the export of lenient usury laws to out-of-state transactions. This federal intervention also persuaded many states to amend their own laws to allow their state-chartered banks to charge the same rates as federal- and state-chartered banks conducting business in

Interest Rate Regulation, 3 YALE J. REG. 201 (1986); Maxine Master Long, *Trends in Usury Legislation – Current Interest Overdue,* 34 U. MIAMI L. REV. 325 (1979-80). Those who demonstrate the distorting effects of interest rate limits on the supply of credit may be correct in their analysis based on the assumption that the supply of consumer credit by for-profit entities is justified. Once that assumption is challenged then their criticism of the denial of credit to some sections of the market is less relevant.

256 12 U.S.C. § 85 (2006); Marquette Nat'l Bank of Minneapolis v. First of Omaha Service Corp., 439 U.S. 299, 310, 313 (1978) (holding that a national bank could charge borrowers the rate of interest authorized in the state where it was located even if higher than the state where the loan was made and determining that a bank is located in the state specified in its organizational certificate and not in another state just because it extends loans there); Tiffany v. Nat'l Bank of Mo., 85 U.S. 409, 413 (1874) (holding that national banks could charge at least the same rate as in-state chartered banks); Cades v. H&R Block, Inc., 43 F.3d 869 (4th Cir. 1994) (holding that a loan secured by an income tax refund organized by H&R Block offices in South Carolina for a South Carolina client but technically advanced by a Delaware located bank could apply Delaware usury law); Basile v. H&R Block, Inc., 897 F. Supp. 194 (E.D. Pa. 1995) (holding that a Pennsylvania-headquartered bank could lend to a Pennsylvania resident and apply the law of Delaware since it chose to make the loan through its Delaware subsidiary); Wiseman v. State Bank & Trust, 854 S.W.2d 725, 726 (Ark. 1993). (holding an Oklahoma subsidiary of an Arkansas bank holding company could make a secured purchase money car loan to an Arkansas resident which the parties conceded violated Arkansas' usury law and could apply Oklahoma usury law); White, *supra* note 130, at 447 ("That this statute [12 U.S.C. § 85] would allow a bank in New York to lend from its South Dakota subsidiary to a resident of New York under South Dakota law, and so escape the New York usury law, would have seemed preposterous to a Civil War congressman.").

257 12 U.S.C. § 1831d(a) (2006) ("Interest rates. In order to prevent discrimination against State-chartered insured depository institutions, including insured savings banks, or insured branches of foreign banks with respect to interest rates . . . such State bank or such insured branch of a foreign bank may [charge interest on a loan] . . . at the rate allowed by the laws of the State, territory, or district where the bank is located . . . .").

258 White, *supra* note 130, at 454.

259 *Id*. at 451.

their state.[260] With the passage of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, national banks were allowed to extend loans in multiple states through branches rather than creating individual bank subsidiaries.[261] This change further facilitated the process of national banks importing the laws of states with limited or no usury laws into states with more restrictive laws. The national bank need only locate in a state with limited or no usury laws and establish branches in more restrictive states to remain subject only to the usury law of its home state. The Gramm-Leach-Bliley Act contained a provision (targeted at the major state usury holdout, Arkansas) pre-empting state constitutions with restrictive usury provisions.[262] This provision was intended to provide that a state or federally chartered bank located in any state could charge the same rate as any interstate bank branching into that state.[263] Congress has also pre-empted state usury laws with respect to certain home mortgages,[264] certain student loans,[265] loans to certain members of the armed forces and their dependents,[266] and agricultural loans.[267] This leaves only non-bank local credit providers such as pawn shops, rent-to-own dealers, and some payday lenders subject to state usury law and even these may be able to escape state usury law by partnering with an out-of-state bank.[268] Following the federal lead of preferentially protecting banks from usury laws, some states remove banks from the application of state usury law altogether.[269] The effect of this process of creeping pre-emption has

260 *Id*. at 454.

261 Pub. L. No. 103-328, 108 Stat. 2338 (1994) (codified as amended in sections throughout 12 U.S.C.).

262 Gramm-Leach-Bliley Act § 731, 12 U.S.C. § 1831u(f) (2006).

263 Johnson v. Bank of Bentonville, 122 F. Supp. 2d 994, 998 (W.D. Ark. 2000), *aff'd*, 269 F.3d 894 (8th Cir. 2001).

264 12 U.S.C. § 1735f-7 (2006); 38 U.S.C. § 3728 (2006).

265 20 U.S.C. § 1078 (2006).

266 10 U.S.C. § 987 (2006) (This section pre-empts, for covered loans, otherwise applicable state usury limitations with a maximum rate of 36 percent.).

267 12 U.S.C. § 2279aa-12 (2006).

268 Chin, *supra* note 93, at 734-40 (describing the "rent-a-bank" approach, and some legal challenges to it, used by some larger scale payday lenders which allows importation of lenient usury laws from the state of the payday lender's partner bank); White, *supra* note 130, at 458 (arguing that small local lenders are not escaping state usury law due to the economic inefficiency of partnering with out of state banks rather than as a function of prohibitive law). In fact a recent federal district court case may reconfirm the ability of partnering with national banks who initiate credit transactions and subsequently transfer the loans to a non-bank entity. *See* Munoz v. Pipestone Financial L.L.C., 2007 WL 2509755 (D. Minn. 2007) (holding that credit card debt exempted from state usury law retains its federal pre-emption status after transfer to a non-bank debt collector). Although the case dealt with a debt collector transferee, it confirms the general principle that once a debt is created in a pre-empted context, the pre-emption status is transferred to future holders of the debt. *See also* Phipps v. FDIC, 417 F.3d 1006 (8th Cir. 2005) (holding that courts must look at the originating entity and not the assignee to determine whether preemption controls interest rates).

269 *See, e.g.*, N.Y. BANKING LAW § 108 (McKinney 2001).

been to render "stern statutory restrictions on rates . . . an illusion whose only current function is to give the appearance that the state is protecting consumers from high rates."[270]

If usury is an unjust transaction, its prohibition needs to be enacted uniformly across jurisdictions and among all credit providers. According to scholastic principles, a usurious loan is one in which the lender exacts more than is just whether or not a bank is the lender. Federal pre-emption may not be the only solution to uniformity. A truly uniform state-law approach would work as well. What is problematic is an approach of incognito pre-emption which merely enables the evasion of any state's attempt to regulate or control usury.

B. *Investment and the Corporate Exception*

In response to *Dry Dock Bank v. American Life Insurance & Trust Co*,[271] the legislature in New York adopted a statute that banned corporations from presenting usury defenses against their debts.[272] This corporate exception was soon copied by many states.[273] The statute does not exclude loans to corporations from usury but merely prohibits corporations from using the defense of usury in actions by their creditors. The exception was further complicated by a later provision repealing the corporate exception for criminal usury,[274] which constitutes knowing lending at more than 25 percent when not authorized to do so by law.[275] The confusing nature of the corporate exception is further exemplified by the exclusion of bank lenders from criminal usury altogether.[276] The corporate exception may appear to be a survival of the scholastic distinction between investment in businesses or productive assets and loans. That this conclusion is untrue is evident from the rationale (if such contortions can be considered rational) cited for the corporate exception. Those justifying the theory do not argue that investing in businesses is fundamentally a different type of activity from lending for consumption. Rather they argue that as corporations are more sophisticated, they are better able to understand loan

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270 White, *supra* note 130, at 447.

271 3 N.Y. 344 (1850) (holding that loan to a corporation in excess of the legal rate was void).

272 The statute stated "No corporation shall hereafter interpose the defense of usury in any action." Paul Golden, *Evolution of Corporate Usury Laws Has Left Vestigial Statutes That Hinder Business Transactions*, N.Y. ST. BAR ASSOC. J., Nov-Dec 2001, at 20. This corporate exception is codified at N.Y. GEN. OBLIG. LAW § 5-521(1) (McKinney 2001).

273 *See* Golden, *supra* note 272, at 20.

274 N.Y. GEN. OBLIG. LAW § 5-521(3) (McKinney 2001).

275 N.Y. PENAL LAW § 190.40 (McKinney 1998).

276 *See* Flushing Nat'l Bank v. Pinetop Building Corp., 369 N.E. 2d. 766 (N.Y. 1977) *aff'g* on the Memorandum at 54 A.D. 2d 555 (App. Div. 1976).

transactions and protect themselves.[277] An addition to the New York corporate exception attempting to prevent loans to individuals from being artificially structured as loans to newly created or acquired corporations demonstrates the flaw in this assumption about the ability of corporations to protect themselves.[278]

The confusing nature of the operation of the corporate exemption arises from a flawed rationale. The exception should not be designed to exclude knowledgeable borrowers (for which the corporate form is a proxy) but like the distinction between a *societas* and a loan to distinguish an investment of capital in a business from a loan of money for non-productive consumption. The scholastic definition of usury would exclude the investment of capital from its prohibition, regardless of the business's form of organization. Despite modern legal parlance referring to investment in business a loan or debt, if it is really an investment by a capital provider in a bona fide business it cannot be a usurious loan. The terms of the instrument described as a loan merely document the terms of that investment with respect to priority of, limitation on and insurance of profit derived from the business. For various tax and accounting reasons investors and businesses may separate these investments into two categories, debt and equity but they both involve investment of capital in a business. Would any lender extend a business loan without any inquiry into what the business does?

Marking business loans off as outside the scope of usury[279] does not mean that the terms of and process for agreement to such investments would be free from all legal rules. It merely means that usury analysis and theory is not the appropriate heuristic devise for formulating that law. What principles should regulate the procedural and substantive terms of business investment is outside the scope of this article. Usury law need only mark this activity as outside its scope. Thus, a reformulated usury law should define usury as the transfer of money with a requirement of its repayment when the money is to be used prior to repayment for any purpose other than a business or

[277] Jack C. Merriman & James J. Hanks, Jr., *Revising State Usury Statutes in Light of a Tight Money Market*, 27 MD. L. REV. 1, 9 (1967) ("Such cases as these [upholding the corporate exception when corporations formed specifically for the purpose of borrowing] are correctly decided only if it can be shown from the record *that the borrower was familiar with commercial and lending transactions*.") (emphasis added); Oeltjen, *supra* note 25, at 185.

[278] N.Y. GEN. OBLIG. LAW § 5-521(2) (McKinney 2001). *See* Schneider v. Phelps, 359 N.E.2d 1361, 1365 (N.Y. 1977) ("It soon became apparent that, in making loans to individuals, the usury laws could be easily avoided by the simple expedient of establishing a corporation and making the loan directly to it instead of to the ultimate individual user of the proceeds. . . . Through this practice, the lenders could demand usurious rates of interest from desperate and unsophisticated borrowers cloaked with a corporate veil.").

[279] I prefer the terminology "outside the scope of usury" or "not constituting usury" to the term "exception" which implies that business loans constitute usury but are granted an exception from the otherwise applicable law.

productive use regardless of the legal form of the borrower or the transaction. This would require the law (and therefore the provider of money) to determine the use of funds to decide whether usury law applied. This is something the law already requires in many contexts. Article 9 of the Uniform Commercial Code establishes several different legal rules for loans used for consumer, personal, or household purposes.[280] The Truth in Lending Act distinguishes between consumer and commercial loans.[281] The Internal Revenue Code distinguishes between interest paid on investment loans and personal loans.[282] Business financiers can draw on existing practices to monitor the use of funds such as obtaining representations and continuing covenants with respect to use of funds (similar to stating the purpose of a *societas*) and monitoring the identity of recipients of disbursed funds.

C. *Credit to Fund Consumption*

Having removed the provision of capital for business uses from the scope of usury analysis, this leaves the issue of true loans, money lent to buy consumable goods or services. The scholastic analysis of usury provides principles for evaluating the modern monetary system and these loans. First, this topic intersects with a broad area of public policy. How does society assist those truly in need of the basic necessities of life? Second, are loans to fund present consumption inherently good or something to be avoided? The scholastic theory of usury demonstrates an underlying assumption that requiring people to borrow from profit-seeking businesses is not an appropriate solution to fund necessary consumption, as it violates commutative justice and can lead to effects not in harmony with distributive justice. Permitting such lending not only works individual injustice against the borrowers but makes their overall situation worse by redistributing what little wealth they have and their potential future wealth to those with more wealth. Thus, any revitalization of usury laws to prohibit profit-seeking lending for consumption must be coupled with programs that provide the poor not with opportunities to profit the wealthy but with real assistance. Put simply, the scholastic theory would not permit the response to the needs of the poor be "Let them borrow!"

As demonstrated by the *mons pietatis*, scholastic theory does not

[280] § 9-309(1) (2007) (providing for perfection upon attachment for a purchase money security interest in consumer goods); § 9-320(b) (containing a different priority rule for buyers of consumer goods); § 9-620(e) (containing separate rules limiting strict foreclosure on consumer goods).

[281] 15 U.S.C. § 1603(1) (2006).

[282] I.R.C. § 163(d), (h) (2006).

forbid all lending for consumption but rather consumption lending which seeks a profit. Those who wish to lend to those who have a prospect of obtaining the money to repay for consumption purposes may charge "interest" in the sense of compensation for loss. Applying this principle to the existing economy would be challenging. This section will identify possible methodologies for beginning this application. Specifically, the concepts of *damnum emergens* and *lucrum cessans* to modern economic realities will require more detailed economic and legal analysis.

The concept of compensatory interest is connected to the requirement of a *mutuum* that the borrower needed to return something of equal value to that loaned. Money during the time the scholastic theory of usury developed contained a fixed amount of precious metal (or an intrinsic worth). Today, money does not have a fixed value but rather one which fluctuates over time. The transition of money from a specified amount of a precious or semi-precious metal to a note representing the right to a specific amount of such *specie* to its current form, a promise by a government to print more of the same paper,[283] presents a new factual scenario for consideration by the scholastic theory. A loan of a quantity of gold, or a government note representing the right to that quantity of gold, has a fixed quantitative value. What that gold may purchase may vary over time (but this variation is attributable to the value of goods and services relative to gold and is thus extrinsic to the money itself). When the currency is detached from this fixed ratio and only represents the right to receive another of the same piece of paper, is borrowing a $100 and repaying the same $100 really an equivalent exchange?

This fluctuating nature of the value of monetary units is exacerbated by a second feature of modern money that is different from prior centuries–its quantity in circulation is constantly fluctuating and subject to manipulation by government and a banking system operating on a fractional reserve basis.[284] Put another way, if $100 lent is equivalent to only $90 at the point of repayment due to an increase of money (not wealth) in the economy, it is just to require repayment of the prior value now expressed as $110. This is analogous to the application of the usury theory to true bills of exchange discussed *supra* in Part III.C. If the value of money in and of itself (as distinct from the prices of goods and services to be bought with money) is subject to

[283] *See* 12 U.S.C. § 411 (2006) (mandating that Federal Reserve Notes "shall be redeemed in lawful money on demand") and 31 U.S.C. § 5103 (2006) (making Federal Reserve Notes lawful money). Thus a dollar bill represents the right to demand the payment of another dollar bill. *See also* CHARLES PROCTOR, MANN ON THE LEGAL ASPECT OF MONEY § 2.16 (6th ed. 2005).

[284] DEMPSEY, *supra* note 63, at 106 ("the volume of money . . . may depend upon the proximity of the next election"), 210 ("the supply of money is conditioned in large measure by arbitrary decisions.").

variations, it may not be seeking a profit to require repayment of money in a different quantity estimated to account for this variation. At least one medieval canonist suggested the principle of *venditio sub dubio* might apply to the lending of money.[285] For example, if a lender lends $100 today for repayment in one year and if it is uncertain how much $100 will be worth next year, the lender may require the return of $110 if $110 is a reasonable estimate of the value of $100 in a year's time. I have been unable to find any other scholastic writer who developed this thought. I suspect this is because, due to the nature of the money at that time, people assumed money would retain a relatively stable value and thus its future value was not subject to real doubt.[286] Under the modern monetary system, there is likely real doubt that the value of money remains constant. The realm of economics would have to be consulted to devise a method for measuring such change in the intrinsic value of money (as separated from the changes in prices of goods and services). If distinguishing between these two factors were to prove impossible or impracticable, one could conclude that the rate of inflation or deflation (which also captures the changes in the price of goods and services) would be an acceptable approximation of this loss. Such detail is beyond this article's scope. The general principle remains that the return of equivalent value may necessitate a more complex calculation in light of current monetary systems than at the time the scholastic theory was formulated.[287]

Beyond a compensatory payment that may be necessitated by the nature of modern monetary form, the example of the *mons pietatis* demonstrates that the scholastic theory would allow a lender that incurs demonstrable costs in making the loan (a specific cost related to the loan plus a charge to cover a portion of general costs if the lender were an institution charged with making such loans generally) to recover these costs. The scholastic theory would allow a lender to add an amount representing a minimal safe lost profit (*lucrum cessans*) which could have been received upon investment which could, for example, be the amount banks are generally paying on deposits.[288] Usury law based

[285] *See* John W. Baldwin, *supra* note 137, at 81 (citing WILLIAM OF RENNES, GLOSSA TO VERSIMILITER DUBITATUR SUMMA RAYMUNDI II, 7, par. 3, p. 228-29 (1603)).

[286] *See id.*

[287] Such considerations led Dempsey to speculate about the presence of institutional usury within a monetary system allowing fractional reserve banking (even before the abandonment of the gold standard). In summary he speculates that when lenders (government or bankers) can create (by printing more or lending more than deposited) the money they lend, there is no cost incurred or lost opportunity of investment (since the money did not exist before the request arises to lend, the money is not being diverted from another profitable enterprise). S*ee* DEMPSEY, *supra* note 63, at 216-28. Dempsey's critique suggests a broader debate about the justice or injustice of modern monetary policy and reserve banking outside the scope of this article.

[288] In the absence of specific facts proving a particular lender withdrew the loaned funds from a use from which a proven amount of foregone profits can be proved with reasonable certainty, a

on scholastic principles would prohibit charging more than the aggregate of these components. Usury law would not limit compensation to any particular numeric amount but rather a rate that would vary as these components changed. Although this approach reduces to a rate limitation (or variable rate based on a formula), it is based on a principle. The rate is set so as to merely compensate the lender rather than allowing gain. This principle contrasts with a rate limit meant to limit the illusive idea of "excessive" interest.

Clearly such a legislative change would dramatically reduce the incentive for lending money for consumption. In a society dependent upon consumption credit, such a shift must be coupled with the provision of necessary consumption. Unnecessary consumption would have to be funded from current income or the sale of other assets valued less than the thing to be consumed or those willing to lend with expectation of receiving only an equivalent value in return. Although this will obviously have the effect of discouraging lending to fund present consumption, it will redirect those funds to productive activities. The macroeconomic implications of such a shift in understanding credit needs to be evaluated, and the consequent discouragement of current consumption and encouragement of investment of savings in capital explored.

Detailed analysis of the application of a compensation-based approach to consumer lending may necessitate particular applications for home mortgages, credit sales of goods, and credit cards.[289] Such detailed analysis is beyond this article's scope. However, given the public and political attention on the housing credit market recently, we should see what the scholastic theory has to offer in this context. A complete discussion of the current problems necessitates a detailed study of the home loan mortgage market to fully apply the scholastic theory, but a few observations can be made at a level of generality.

First, the scholastic theory would consider that lending funds to individuals for the acquisition of a residential dwelling does not involve the investment in a productive asset or business. Despite the fact that houses can appreciate in value, the use of the house does not generate any new real wealth.[290] I have the impression that some of the build-up

general amount of *lucrum cessans* must be based on a generally available certain profit. As St. Thomas Aquinas explained, a lender cannot charge for a profit which he "may be prevented in many ways from having." AQUINAS, *supra* note 3, at pt. II-II, q. 78, art. 2, reply obj. 1. This principle would serve as a limitation of a general (as opposed to situation specific) rate of *lucrum cessans* which could be charged.

[289] Any discussion of credit cards needs to distinguish the dual nature of them, payment devices and means of accessing credit. Usury analysis need not affect the payment system function of cards as the charging of a fee for such services is a different issue from charging for making credit available.

[290] The purchase of any consumer good can result in a fortuitous increase in value. I might purchase a supply of grain for this winter to eat and due to a crop failure discover that my stored

of the mortgage bubble related to people confusing this issue and considering the purchase of a house as a business investment.

A home mortgage is the lending of money for consumption. Once categorized this way, the scholastic theory requires that the loan be structured to compensate the lender for loss, not provide a profit. Although discussed *supra,* distinguishing compensation from profit is much more difficult in the modern context. Yet, at least at some level of the mortgage market (the subprime level), rates are clearly above the level of compensation for loss. From 1995 to 1998 the subprime origination interest rates were between 9 and 10 percent.[291] Between 1999 and 2000, the interest rates rose to around 11 percent.[292] After the peak in 2000, the interest rates started to decline, leveling off at around 7.5 percent in 2004.[293] Many popular types of subprime mortgages give the borrower a low interest rate at origination that continues for the first two or three years, and then the rate resets to an adjustable rate, consisting of an index rate plus a margin percentage.[294] The reset rate can increase the borrower's interest rate by as much as five percentage points.[295] These rates are in addition to an origination fee designed to cover the cost of making the loan.[296]

A defender of free-market credit would likely assert that the only way such consumers can buy a house is to pay such rates. The scholastic theory challenges this basic assumption. Should enabling those with wealth to profit be the only way for people to purchase shelter for their family? Should the basic need of shelter be an opportunity for an upward wealth redistribution? Just by way of a simple example, on a $100,000 mortgage at 10 percent per annum over 30 years, the total payments to the lender are $315,925. In other words, the borrower must pay 3x the value of the property being financed so as to own it. Although my analysis at this point has not produced a detailed alternative paradigm to such a system, the scholastic theory offers a criticism of the theoretical underpinnings of such a system of home acquisition–that people should have to return three times the amount borrowed in order to acquire a non-productive asset. Although there is a need for much detailed scholarship exploring the precise causes of the current financial housing crisis, such an undertaking

grain is worth 20 percent more than I paid for it. This does not make my original purchase a business investment.

291 Souphala Chomsisengphet & Anthony Pennington-Cross, *The Evolution of the Subprime Mortgage Market*, 88 FED. RES. BANK ST. LOUIS REV., Jan.-Feb. 2006, at 31-56, *available at* http://research.stlouisfed.org/publications/review/06/01/ChomPennCross.pdf.

292 *Id.*

293 *Id.*

294 Sheila C. Bair, *Fix Rates to Save Loans*, N.Y. TIMES, Oct. 19, 2007, at A25.

295 *Id.*

296 Chokmsisengphet & Pennington-Cross, *supra* note 291.

would benefit from the more general critique of the system as a whole offered by the scholastic theory. This theory challenges the basic assumption that for-profit lending, with its commutative and distributive justice concerns, is not necessarily the only or most just method to finance the acquisition of necessities.

D. *Islamic Finance–Proof This is Possible*

Skeptics may argue that principles developed in a different economic environment are irreconcilable with the modern economy. Scholastic usury principles just cannot function today. The rise of Islamic finance in recent decades, however, may prove this objection incorrect. The Islamic approach to usury, which prohibits the charging of *riba* or profit on loans but permits profit-sharing on investment in productive activities,[297] bears striking similarities to the scholastic theory.[298] While in the West the scholastic theory has not yet been applied to modern banking and finance, Islamic theory has been able to adapt modern banking products to its usury proscriptions.[299] Islamic finance has grown over the past three decades in both Muslim countries and international financial markets and was estimated to include over US $200 billion in managed assets in 2003.[300] Growth rates are estimated to be in excess of 15 percent a year.[301] As Constant Mews and Ibrahim Abraham note, "the increasing trend for large conventional banks (Citibank, HSBC, UBS, Deutsch Bank, etc.) to offer *shari'a*-compliant [non-usurious] banking and investment products or even establishing Islamic institutions of their own is only going to continue, with the ethical discussions on usury and just compensation at the fore."[302] The example of Wall Street banks adapting products to Islamic usury principles demonstrates the possibility of applying the scholastic theory to a contemporary economy. Ironically, such a paradigm shift

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[297] Karasik et al., *supra* note 43, at 383-85.

[298] *Id*. at 381.

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> "What appears apparent, however, is that Christian financial corporations and ethicists have yet to provide a systematic approach to financial relationships and ethics for the modern economy that re-imagines and rearticulates core religious teachings on finance. Islamic financial institutions have spent over three decades developing financial products modelled [sic] for the modern economy that, never the less, incorporate and reference long-established religious ethics and prohibitions."

Mews & Abraham, *supra* note 103, at 11.

[300] Umar F. Moghul & Arshad A. Ahmed, *Contractual Forms in Islamic Finance Law and* Islamic Inv. Co. of the Gulf (Bahamas) Ltd. v. Symphony Gems N.V. & Ors.: *A First Impression of Islamic Finance*, 27 FORDHAM INT'L L.J. 150, 151 (2003). *See also* Karasik et al., *supra* note 43, at 379.

[301] *See* Moghul & Ahmed, *supra* note 300, at 151.

[302] Mews & Abraham, *supra* note 103, at 10.

(or return) in the West could function as a bridge of reconciliation with the Muslim East.

CONCLUSION

Modern usury law is a chaotic mess of state and federal regulation. As concerns about the state of our nation's credit market grow daily, the debate over how best to regulate the extension of credit remains inconclusive. One surveying the literature over the past few decades is unlikely to find one article expressing complete satisfaction with the approach of existing usury legislation and policy. This article has argued that the scholastic theory, which framed the discussion of credit for over a millennium, should be re-admitted to the debates over usury. The challenges of applying this theory to novel forms of commercial investment in the sixteenth century gave birth to a flawed application of the original theory in the subjectivist approach. The simple rate capping of the subjectivist approach, based on the principle of using "excessive" or "biting" usury as a proxy for a bad intention, has dominated usury law for too long. A return to the original approach of the scholastic theory of usury would benefit the modern debates over credit regulation.

The scholastic theory of usury, as maintained through the objectivist approach of the sixteenth century, challenges existing assumptions about the nature of credit, consumption, and commutative and distributive justice. Application of the scholastic theory would produce a uniform, consistent legal regime which distinguishes between (1) the investment of capital in business ventures and (2) the lending of money for consumption. The former category would not be subject to usury law but would be governed by general contract and corporate law. Redesigned usury laws would regulate the second category to permit lenders to recover their costs (including operational costs and loss occasioned by inflation of the money supply). Beyond this cost recovery, usury law would prohibit the charging of a profit (except perhaps as compensation for the lost opportunity of investing the loaned money as capital at a safe rate of return). Rather than addressing the needs of those without the resources to obtain the necessities of life by turning them over to profit-seeking usurers, we would need to address their needs directly. Formulating the details of a usury regime which precluded profit on a loan for consumption but permitted charging compensatory fees in a world of a volatile fiat monetary system would certainly be complex and challenging, but it would offer the prospect of working towards a more principled, consistent, and just system of credit in our society.