BEGGAR THY NEIGHBOR

A History of Usury and Debt

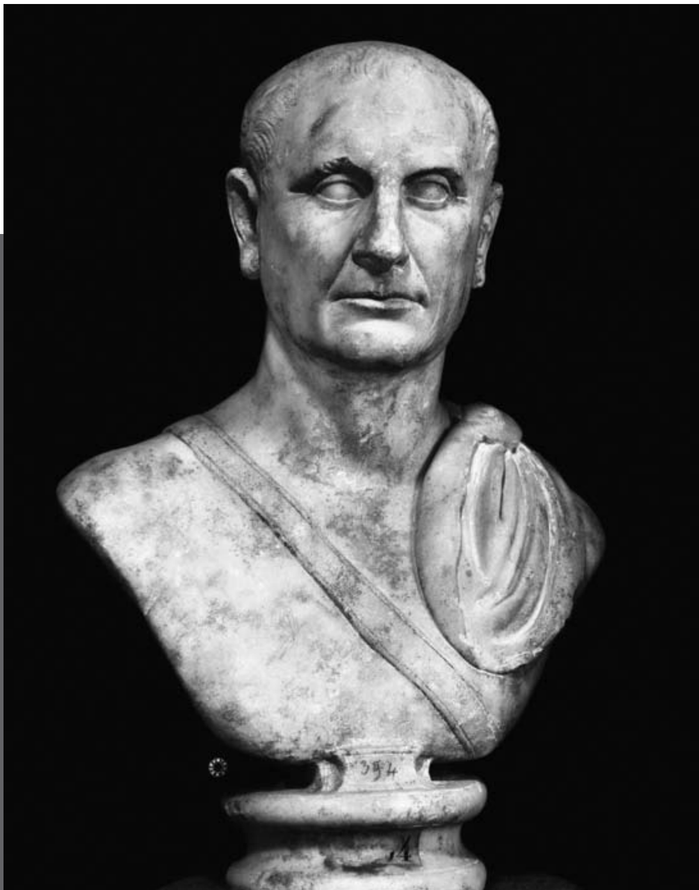
By Charles R. Geisst

Seven years before the assassination of Julius Caesar, an acrimonious dispute broke out between Marcus Tullius Cicero, at the time the provincial governor of Cilicia, and Marcus Junius Brutus, a young provincial Roman administrator. The elder statesman chided the younger man for using his administrative post in Cyprus to earn ill-gotten gains at the expense of the local people. Cicero received reports that Brutus had been lending money in Cyprus at four times the maximum rate stipulated by Roman law. To make matters even worse, he did it anonymously through an agent who did not mind using strong-arm tactics to collect the debts. When Cicero brought the matter to his attention, Brutus ignored him and continued to lend money. When he finally returned to Rome, he did so a wealthy man.

The problem caused Cicero to coin a name for the practice which became a cornerstone of Roman law. The story was told innumerable times over the next 1,800 years. The Roman historians dutifully recorded it, and Adam Smith alluded to it in the *Wealth of Nations*. According to Roman law, simple interest was permitted, but compound interest was anathema. Compounding had been used in many ancient civilizations, but the Romans eventually made it illegal. By doing so, they also established a tradition that would create much confusion in the centuries to follow. They did not make all interest illegal, only compound or "accumulating interest."

Prohibitions against excessive interest, or more properly usury, have been found in almost all societies since antiquity. Charging interest on loans is the oldest financial practice. It has also been decried almost from the beginning as predatory, with the lender seeking to take advantage of the borrower. Whether loans were made in cash or in kind, unscrupulous lenders were said to be practicing a beggar-thy-neighbor policy by ensuring that the borrowers were disadvantaged to the point of losing their collateral, or in extreme cases even losing their freedom or families. Charging simple interest was barely condoned, but charging compound interest was unscrupulous, immoral and rapacious. It was also practiced with near impunity.

The problem was clear in the ancient world but became obscured over time. Over the centuries, usury prohibitions



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Left: Bust of Marcus Tullius Cicero (106 – 43 BC), provincial governor of Cilicia, who accused Brutus of using his administrative post in Cyprus to earn ill-gotten gains at the expense of the local people through usury. *Right:* Statue bust of Marcus Junius Brutus (85 – 42 BC), who loaned money in Cyprus at four times the maximum rate stipulated by Roman law.

became part of civil law, and that unwritten law of nations generally referred to as the natural law. But it was still practiced widely and openly by the accursed moneylenders who quickly became part of legend and literature. This uneasy combination of theory and practice is partially responsible for the uneven patterns of economic development found in Europe from the decline of Rome to the Reformation. In the early Middle Ages especially, all interest was considered usury by the church. Compound interest became "Jewish interest," suggesting that it had dark, magical, non-Christian qualities that could be used for expropriation by the lender, considered a societal outsider.

Through its long history, interest and usury have gone from being anathema to being big business in the contemporary world, but they remain at least partially illegal in many jurisdictions. Many American states still retain laws against criminal interest, or loan-sharking. At the same time, it frequently is ignored in the same places with impunity and only becomes the center of attention in poor economic climates or in times of capital shortage or high inflation. Perhaps that is why it has remained part of the universal canon of proscribed practices.

Usury prohibitions firmly are part of the natural law tradition, in that natural law specifies what cannot be done. Since the fall of Rome, there have been more centuries characterized by what is known as capital shortage than there have been of periods of sustained growth and general prosperity. It is not a coincidence that the outcry against usury has been most shrill during those difficult times.

Today, usury is considered excessive interest, but that definition is relatively new in historical terms. Originally, *usura* was interest and its actual rate differed from place to place. The debate over it was intense. Excessive interest in many ancient societies was interest on interest, or *usurae usararum,* which added to the principal of an unpaid loan. In the ancient world and Middle Ages especially, this was anathema. The tribal tradition of the Hebrews prohibiting Jews from lending to each other at interest was cited by medieval churchmen as the major Old Testament source for proscribing all interest, not just simple interest. The great irony was that Jews were exempt from lending to gentiles and accepted as moneylenders by the church in the Middle Ages. That loophole allowed them to compete with

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the Lombards and Cahors who were allowed to lend at interest.

In medieval Europe, these groups were the main moneylenders before the arrival of the Jews. Curiously, none was condemned for it, and the Lombards were responsible for the development of the money markets in the 14th century. The Italian bankers in particular became financiers to monarchs and princes as far north as England. Their experiences with Edward III in particular were unpleasant, but their skills were highly sought after in countries where the treasuries were either low on cash or management skills. Despite the general ban on interest, the moneylenders were tolerated and even occasionally put the feet of monarchs to the fire when the interest bill was overdue. Jewish lenders usually were less fortunate. This apparent contradiction can be explained by a combination of tradition, religion and law. The Lombards were the barbarian tribe that conquered Rome in the sixth century; the Cahors were the descendants of the Visigoths who settled in France. Neither group had any provisions against interest or usury in their laws because both came from societies that originally used barter or payment in kind rather than money. Natural law in the late Roman Empire assumed a commonality among civilized societies, but that did not include barbarians. Neither group had a tradition against usury; each continued to pursue its newly-acquired money lending skills without interruption. No loud objection was heard until the Lombards were conquered by Charlemagne in 800, but by that time their tradition was established.

The barbarian invasions also relegated much of Roman law to the shadows of history until the general revival of learning in the 17th century. When many books that had been missing for centuries reappeared, those of Aristotle became the main reference for many churchmen, including Thomas Aquinas. This complicated matters for money lending because the Scholastics accepted Aristotle's dictum that money was sterile, having no intrinsic qualities other than being used as a medium of exchange. It could not beget itself, and therefore usury was not useful. Unknown (or ignored) was the discovery of Justinian's Code in 1130. In it, the prohibition against *anatocismus* (Cicero's term) and *alterum tantum* compound interest. Normal rates of interest were tolerated, but adding interest to outstanding principal was banned. But medieval church law would not even admit to ordinary interest despite the distinction between the two in Roman law.

Compound interest would not become a math exercise until the Middle Ages, when the Italian mathematician Fibonacci discussed compound interest questions and puzzles. Because of the usury prohibition, he carefully avoided discussions about loan values and instead focused on future value problems, an issue medieval philosophers were not acquainted with and did not discuss. He posed questions about the future value of a unit of currency and, most famously, how many rabbits would be the result of an original pair, assuming continuous rabbit compounding. But he avoided the usury issue, as did his equally-famous countryman Luca Pacioli two centuries later when he discussed double entry bookkeeping. Fibonacci did, however, tackle the problem of debasing a currency, a politically correct topic in the 13th century for kings and princes.

There is a great temptation to criticize various usury and interest ceilings as being inconsistent over the centuries. The medieval church adopted a ban on usury, similar to the one in the Muslim world, only to see it circumvented with great frequency between the 12th and 19th centuries. Different commentators had sundry opinions on the subject, but all agreed that interest needed to be controlled. Even Adam Smith, considered the father of free market economic theory, favored a ceiling on interest. But as usury and interest approached the 19th century, it became more clear that there was a great deal of consistency in the way they were treated, given the differences in cultures and political motives of those opposed to them. The tendency to abuse one's position as a lender was recognized by most commentators regardless of their political or moral position.

The term "beggar thy neighbor" today is used to describe an international trade practice where one nation attempts to establish advantage over its trading partners through restrictive trade practices or policies. This derives from a mercantilist idea that owed its origins to an era when colonial powers exploited their far-flung colonies and ensured that they exported more than they imported. Before the mercantilist period, however, the term was associated more simply with borrowing and lending. The Shylocks of the world exploited the Antonios, seeking to extract their pound of flesh, when Christian principles demanded fairness and lenient lending policies. Equity and Christian charity suggested that lenders should treat borrowers as brothers, members of the same community. The idea was practiced only rarely.

Shylock stood apart from that community; his religion and tradition were different; he was allowed to lend to non-Jews, a well-known, widely-circulated biblical fact. Coincidentally Portia, who successfully defended Antonio against Shylock in Shakespeare's court, was also the name of Brutus's second wife, which was probably not a coincidence since Shakespeare was well acquainted with Roman history.

The lending tradition became a nasty circle of recrimination and counter-recrimination that lasted for centuries. Lenders and early bankers, whether they were Jews, Lombards, Cahors or the Templars, realized that their financial expertise and alien status in many European societies made them subjects of envy, derision and ultimately retaliation from many hard-pressed sovereigns. As a result, many of them charged compound interest to compensate for their business risk or disguised interest charges as hidden, discounted fees. The risks they faced were more than simple counter-party risk because they could be expelled from their homes, sent to the Inquisition or expropriated. The fact that many well-known bankers in northern Europe prior to the Renaissance came from distant locales attests to the fact that foreigners were often sought as lenders precisely because borrowers could default on loans to them without much fear of reprisal.

The history of usury usually has been divided into a general discussion surrounding borrowing and lending on the one hand and the legal treatment of usury by various societies on the other. Since the early years of the Roman monarchy, through the republic and ending with the empire, Rome always had what is known as statutory usury. Laws governing interest were embodied in the law, at first in the *Twelve Tables* and then later in Justinian's *Code and Digest*. The latter incorporated the writings of many prominent rhetoricians and philosophers, so together they were an excellent compilation of the major ideas on usury in Rome for the previous centuries. These laws, different in scope and sophistication, actually specified the maximum rate of interest that lenders could charge borrowers. They did not ban lending rates but only sought a level of interest that was considered practical and viable.

To borrow an idea from Adam Smith, the more prosperous and wealthy a society, the lower its rate of interest. It has been suggested that the history of usury is nothing more than an exercise in intellectual history. Accordingly, usury is an idea with a long history, riddled with enigmas and inconsistencies, that exists mostly in the minds of economic historians. That is true, but it ignores the subtext, which has proved to be one of the most powerful notions in all societies for 3,000 years. As part of general natural law, it reflects societal notions of fairness and equity that have transcended ancient, medieval and modern societies. The power of interest, and especially compound interest, cannot be understated.

Usury and interest have been condemned together for centuries, although it is not always clear whether critics distinguished, or even understood, the differences between the two. Compound interest has commanded little discussion by itself until recently. John Maynard Keynes recognized the problems compound interest would cause for Germany in paying World War I reparations. Albert Einstein reputedly called it the eighth wonder of the world for its ability to produce future values far in excess of present value. The English clergyman Richard Price tried to use compound interest to retire the sizable British national debt in the 18th century. American lenders are now required to state the annual percentage rate they charge customers on unpaid balances, but the rates themselves have been left untouched by federal regulators. In the early 1980s, several large American banks went to great lengths and expense to establish credit card facilities in states with no functional usury laws in order to avoid potential prosecution for charging high interest rates, ratcheted even higher by daily or monthly compounding.

There has been a clear distinction between misgivings about usury and the law of usury. The misgivings certainly have been more colorful. Dante relegated usurers to the inferno while numerous writers cited scripture to illustrate the pitfalls of lending money. In early 19th-century Ireland, the Reverend Jeremiah O'Callaghan refused the sacraments to a dying man until he recanted his alleged usury, an incident that eventually got the priest banished to the wilds of northern Vermont. When the Catholic Church finally reconsidered its ban on usury, it did so quietly through a letter by the pope to the Italian bishops in the 18th century, not through a papal encyclical as would have been expected. One hundred years later, the ban would politely be ignored. After centuries of condemnation, the lure of fixed income investment returns finally became too great to resist.

Despite the colorful vignettes, it has always been easier to denounce the practice than actually pass a useful usury law. When the British government finally abolished its usury laws in the early 19th century, many of the arguments in the debate later surfaced in the United States. Banning usury was bad for business and, therefore, the usury laws should be abolished. No one could forcibly argue against the point, but no one could totally agree either, given the abuses to which lenders often subjected borrowers. Advocates of maintaining a ban often cited the Old Testament, and it became a major source of speech material for legislators in the 19th century.

While much of it sounded like hell, fire and brimstone, the laws that subsequently followed sounded very tame in comparison. Usury laws lived on in the United States for another 100 years. The fact that a major credit crisis followed within a few decades did not seem to faze proponents of leverage and free market interest rates who apparently were not aware that the South Sea Bubble, the Crash of 1929 and most of the American panics of the 19th and 20th centuries all were caused by excessive borrowing and high leverage that spilled over into the equities markets. **$**

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