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## Is the Economic Crisis Driving Western Laws Closer to Islamic Laws on Interest Rate Prohibition?

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### ABSTRACT

This paper investigates historical, philosophical, and economic aspects of Western laws regarding the evolution of interest prohibition in a loan contract. The study is part of a global project that compares French and Islamic laws, with the aim to propose solutions to interest rate issues often raised in international finance. On one hand, oil-related sources of cash are found in the Islamic world; it is therefore relevant for the Western world to understand Islamic interest prohibition in order to sustain Western development. On the other hand, the financial crisis that originated in the US has fueled a growing debate on interest rates, and one may even wonder if stricter regulation makes sense. The original Christian interpretation of the term *usury* may in fact not be too distant from the Islamic term *Réba* in the Persian language, and *Riba* in Arabic. Having analyzed the prohibition of *usury* in Canon law, this paper highlights how practice has tried to hold this traditional position in check. Today Western laws prohibit only “rapacious” interest rates, and one observes a general move towards more fairness in interest treatment in Europe. Therefore, in this new context, and given the fact that money now in both the West and Islamic worlds no longer plays the same role it did in the time of The Old Testament or Koran, should both systems perhaps try to converge? The conclusion is that the distance between the two worlds may not be as remote as it seems.

JEL Classification: E4; K2.

Key Words: Interest Prohibition - Financial Crisis - Law & Economics - Code of Hammurabi - Genucia Law - Aristotle - Parable of the Talents - Canon Law - Saint Thomas Aquinas - “Contractus Tinus - “Contractus Mohatra” - Pothier - French Law - US Law - Payday Loans - Subprime Loan - Tax Treatment - Thin Capitalization.

### INTRODUCTION

Historically speaking, religions often prohibited interest on loan contracts.<sup>i</sup> Nowadays, this paper argues that Western laws are still willing to have a kind of “religion” on this interest issue - due to the financial crisis. Christian religion is on its way to be replaced by a “civil” religion.

In the Western world, law is no longer related in any way to religion.<sup>ii</sup> For instance, the French Republic is based on the principle of *laïcité* (or freedom of conscience). This principle, expressly mentioned in article 1 of the 1958 Constitution, is enforced by various laws: for instance the 1880s Jules Ferry<sup>iii</sup> law and the 1905 French law on the Separation of the Churches and the State. In the European context, everybody remembers the European Court of Human Rights’ decision, which upheld the ban of the Welfare Party to establish an Islamic Republic in Turkey.<sup>iv</sup> In Europe the distinction between law and religion is usually clear.

However, the interplay between law and religion is not totally absent in the West.<sup>v</sup> Interaction between the two - or even sometimes identification of law to religion - remains very strong in the Islamic world. And because it is in this world that oil-related sources of cash are predominant, sustainable development in the West depends now on a solid comprehension of the views it once historically shared with Islamic interest prohibition.

The financial crisis in the West has fueled a growing debate on interest *rates*. Many emphasize the role of loyalty and altruism in the business world;<sup>vi</sup> interest now carries with it the idea of fairness more than ever. One may therefore ask if stricter regulation in the West makes sense, where religion in a broader sense<sup>vii</sup> is popping up again (U.S. foreign policy, French domestic debate on the Islamic veil), and even where we least

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expect it: economics, banking, and finance!<sup>viii</sup> Business lawyers must therefore have a fundamental understanding of the evolution of interest prohibition, not merely to expand intellectual horizons, but as a business necessity.

Ancient civilizations were not always biased against interest. The Code of Hammurabi allowed interest whether the purpose of the loan was grain, or money.<sup>ix</sup> Aristotle understood that money is sterile: money does not beget more money the way cows beget more cows. Interest was therefore prohibited to protect agrarian interests against money interest. For Aristotle, “*money exists not by nature but by law*” (...): *of all modes of getting wealth, this is the most unnatural.*<sup>x</sup> Because this ground of natural law, Aristotle’s view was that “*The trade of the petty usurer is hated with most reason.*” Aristotle added, with respect to usurers: “*their common characteristic is obviously their sordid avarice.*” Why? It is because they make “*a profit from currency itself, instead of making it from the process which currency was meant to serve.*” There is another argument: the borrower, through his work, can certainly fructify borrowed funds. The lender, however, does not carry out any work. So if one allows such a lender to charge interest, one would authorize the lender to share the borrower’s profit and therefore despoil the borrower. So, early “moralists” did not allow to charge interest.

Despite this philosophical penchant, interest was applied at extremely variable rates all during the Hellenistic period, and Rome was no exception. The Genucia Law<sup>xi</sup> prohibited loans that carry interest, but it fell into disuse and interest rates were subject only to a maximum of 50%.<sup>xii</sup>

This short overview reveals not only that interest was used in ancient civilizations, but also that it had to be reasonable. It is therefore not surprising that in those days the term “*usury*” (from latin “*usura*”) meant “*the practice of lending money,*” and later “*excessive interest rate.*”<sup>xiii</sup> The modern meaning of usury, redefined by economists of the XVIIth and XVIIIth centuries, has only this second restricted sense: that usury is interest *greater than* the rate allowed by law.<sup>xiv</sup> But “*usury*” also has a third meaning, less known, that refers to any kind of disrespect to commutative justice.<sup>xv</sup>

This brief depiction also reveals the ambivalent position towards interest: sometimes prohibited, it was nonetheless often applied in practice. Did religious people radicalized the original interest prohibition? The position of Canon Law, which is Catholic Church Laws embodied in the *Corpus Juris Canonici*, provokes this question: medieval canon lawyers adapted Greek and Roman ideas about usury to Christian theology, creating a body of Church law designed to control the sin of usury. But similarly to Greece and Rome, prohibition was not fully respected. The form was maybe more important than the substance. Today however, Western laws usually prohibit *rapacious* interest rates. This paper also tries to understand the economic reasons of this evolution. The conclusion may well be that there is indeed a common approach between Western and Islamic laws. Despite the diversity of methods, and given the fact that the financial crisis originated in US subprime interest, one may wonder if the altruism extolled by Islamic law shouldn’t be generally restored at least to some extent in the West.<sup>xvi</sup> This paper calls it “civil religion.” The expression – civil religion – which usually refers to expressions of patriotism - does not include religion in the conventional sense, not God, but rather fundamental values.<sup>xvii</sup> In other words, this paper first shows that the traditional prohibition of usury in Canon law is surprisingly close to the Islamic prohibition (II), and then the paper investigates how Western laws are now moving closer to “civil religion.” (III)

## I CANON LAW SURPRISINGLY CLOSE TO ISLAMIC LAW

Canon law is surprisingly close to Islamic prohibition because of the ambivalent position towards the interest prohibition (A). On the one hand the principle of prohibition was proclaimed! On the other hand, many exceptions to the general rule were allowed! Canon law nonetheless remains distinct from Islamic law as it was unable to effectively prevail over civil law. This distinctive civil practice is probably the main factor that enabled the exceptions to override the principle (B).

### A Common Ambivalent Posture

The Bible expresses ambivalent prohibition of interest. Despite classical moralists and some Saints<sup>xviii</sup> aiming to harden the doctrine, Canon law mirrored the Bible’s ambivalent position. The reconciliation made by Saint Thomas Aquinas, who returned to biblical basics and the practice of Canon law, revealing contractual schemes that hide interest, is then mentioned.

1. In the book of Exodus in the Old Testament, one reads the following: “if you lend money to any of my people who are poor, you shall not require interest.”<sup>xix</sup> This is a clear rule prohibiting interest. There are other texts in the Old Testament however that do not contain absolute prohibition: they express more a saintly ideal or a charitable duty.<sup>xx</sup> The New Testament also voices an ambiguous position. In the Parable of the Talents, the Master explains to his servant that he should have put the money in the bank so he could have collected interest, rather than burying the money in the soil.<sup>xxi</sup> But the New Testament also says that “you should do good, and lend, hoping for nothing in return; and your reward shall be great.” Many interpret this as condemning usury, while others see it as a call for personal altruism, and not a general prohibition on usury. Therefore, the Bible does not appear to be in clear contrast with ancient civilizations. It is more the Saints, and later the moralists, who stiffened the accommodating Biblical attitude.

Saint Ambrose, in a series of sermons collected in the treatise *De Tobia*, denounced taking anything on a loan. He stated that “whatever is added to the principal is usury” and is a violation of the law of God, prohibited by the prescriptions of both “the Old and Divine law.”<sup>xxii</sup> Saint Jerome similarly prohibited usury, not only on the basis of the Law, but also on the basis of the Prophets’ words.<sup>xxiii</sup> In tune with Aristotle, the Fathers of the Church therefore saw in usury only “avarice and greed in the heart of the usurer [who is] heedless of the gospel precepts of charity, mercy, generosity and humanity towards one’s neighbor.”<sup>xxiv</sup> They also took the argument of commutative justice: the loan was a private exchange – a commutation – and thus was governed by the commutative justice that says one should never take more or receive less than their due. But contrary to the Bible, they always treat usury as a sin against justice, not charity. The Council of Elvira formally prohibited interest rates.<sup>xxv</sup>

2. In the Middle-Ages, Christian moralists softened this traditional position and admitted charging a modest interest if “extrinsic titles” were added to the loan contract. In other words, the Church allowed taking interest when one had a just title to it. This idea was developed by Saint Thomas Aquinas.<sup>xxvi</sup> He attempted to reconcile faith and reason in a comprehensive theology.<sup>xxvii</sup> Pope Benedict the XIVth adopted Saint Thomas Aquinas’s ideas in an Act, promulgated in 1745 Christian calendar. The title of this Act is “On usury and other dishonest profits.” In this Act, the Pope condemned the practice of charging interest on loans as usury. In doing so however, the Act did not deny that, at the time of the loan contract, certain other titles – which are not at all intrinsic to the contract – may run parallel to it. And “from these other titles,” the Pope added, “reasons may arise to demand something over and above the amount due on the contract.” This would be the case, for instance, when the lending of the money causes prejudice to the lender. Similarly, a pawnbroker<sup>xxviii</sup> can require interest to pay his or her employees. Other examples are when the lender, because of the loan, will deprive the lender from a profit he would have made if he had retained such money, or if there was a risk of never getting the loan money back. In fact, the canonist Cardinal Hostiensis composed, in Latin, a mnemonic that lists thirteen exceptions to the usury prohibition.<sup>xxix</sup> The 1917 Code of Canon law provided “that several penalties be imposed on those convicted of usury, which is listed with such crimes as murder, rape, and robbery.” But at the same time, Canon 1543 recognized that usury law allowed exceptions.<sup>xxx</sup> And the new Code of Canon Law in 1983 allows religious institutes to borrow money at interest!<sup>xxxi</sup> In addition to these exceptions, and very much alike Islamic law, the practice of Canon law has contractual schemes that hide interest.

There are at least two types of contractual schemes that hide interest. The first is the “*contractus tinus*.” It means “triple contracts.”<sup>xxxii</sup> The *triple contract* became an established practice in the fifteenth century and was considered valid. And the French jurist Pothier, after discussing the triple contract in some detail, concluded: “it needs no great acuteness to perceive that such agreement is in truth nothing else than a loan.”<sup>xxxiii</sup> The second is the “*contractus mohatra*.” The *mohatra contract* is directly inspired from Islamic law. It is a complex and artificial construction of sale and repurchase clearly devised to evade the interest prohibition. *Mohatra* is a usury sale contract by which goods were purchased at a very high price, but on credit: the purchase price is not paid immediately. At the same time, the purchaser sells back the same goods to the merchant, but at a lower price, and in cash.<sup>xxxiv</sup> For instance, a merchant sells goods to a man in need of money, goods worth 500 Euros, but not immediately payable in cash, but payable within one year. These goods are worth 300 Euros. At the same time, the purchaser (who needs money) sells back to the same merchant for 200 Euros, but pays immediately. It is the same thing as if the merchant was lending a principal of 200 Euros, in order to get 500 Euros a year later.

As in Islamic law today, Canon law had somewhat the same structure: a general prohibition and contractual schemes, respecting prohibition, but not of the substance to the rule. But this common point should not prevent emphasizing the main difference between the two systems: Canon law existed alongside civil law, whereas

Islamic law is usually the rule of law itself. This key factor explains why the two different worlds followed separate routes: due to the new role money was playing, the West developed a distinctive civil law practice.

## B Distinctive Civil Practice

Civil law and practice in the West did not always respect the canonic interest prohibition, contrary to Islamic law which is rigorously followed where it applies. Although ancient French private law continuously supported the prohibition,<sup>xxxv</sup> it tried later on to hold this traditional principle in check by allowing exceptions.<sup>xxxvi</sup> In England, various Acts of the English Parliament authorized charging interest with respect to specific operations. The usury laws that still existed were definitively abrogated in 1854.<sup>xxxvii</sup> Very much like Islamic law, Christian theologians did not believe that civil law, as a common good, commends respect. For them, civil law simply cannot go against the Church.

In practice however, it was not the case: even the Pope allowed exceptions to the rule prohibiting interest when customary law or the civil law itself admitted interest. A recent PhD research conducted in the City of Lyon, France, shows that at the end of the XVIth century, interest was commonly charged at an average rate of 8% despite the civil and canon laws' prohibition. <sup>xxxviii</sup> Even case law ordered a Lyon merchant to pay interest to the nuns of the neighboring City of Crémieu.<sup>xxxix</sup> This practice of interest rates in the City of Lyon is not isolated from other practices elsewhere in France.<sup>xl</sup>

What were the justifications for such practices, sometimes explained as the “application of the Canon law exceptions?” These practices have been explained by different theories: first, the notion of renting, which is subjacent to the loan; second, the concept of association is another possible explanation. The concept of association authorized the lender to share, through a fixed interest, the profit made by the borrower. This explanation is not convincing though. Indeed, in a company, the moneylender is not a shareholder. Therefore, the real justifications for these practices appear to be linked to new economic considerations.

By the XVIth century indeed, times had changed. A substantially different economic life from the time of the Bible or the Qur'an, was developing. Money was becoming an essential element for profit.<sup>xli</sup> Contrary to the pre-capitalist society, production was no longer limited, barter vanished, and money was no longer scarce. Unlike the “natural” economy characterized by all the pastoral and tribal societies during Biblical times, capital existed. It needed to be productive, not fruitless or infertile.

A school of thought related to this change in the nature of money itself explains the new position towards interest.<sup>xlii</sup> Money was originally considered barren. It is now seen as productive, or a capital resource.<sup>xliii</sup> When the Biblical Scholars spoke of money, they had in mind real, tangible objects such as gold and silver coins. Money acquired the characteristics of capital, and “*since interest on capital is lawful, interest on loans must be also lawful.*”<sup>xliv</sup> If money has changed so that it is no longer barren, then one must therefore allow what was no longer unjust.<sup>xlvi</sup> Calvin criticized the use of certain passages of scripture invoked by people opposed to the charging of interest.<sup>xlvi</sup> In trying to reconcile this theory with the a general application of extrinsic title, today one could conclude that *extrinsic* titles can always exist - because in capitalism, the unlimited number of opportunities for investment have made money fruitful. Or said otherwise, the entitlement to interest was becoming *intrinsic* to the money itself.

And from this school of thought arose the theory of interest... In the end, interest came to be considered the norm, and usury the exception. And the scholastic analysis of usury came to center on the distinction between usury and interest.<sup>xlvi</sup>

The French revolution put an end to interest prohibition in civil law with an Act dated 1789. This voices a certain expression of Physiocracy<sup>xlvi</sup> and a clear triumph of freedom of contract.<sup>xlix</sup>

So there are a variety of influences explaining the more relaxed attitude towards interest: the changing nature of money, the Church's adaptation of its guidelines to the conditions and needs of the time, the rise of Protestantism. Civil law, which first appeared surprisingly close to Islamic law in its Canon law component, evolved. But the time when Western laws seem to have definitively cut their religious root, it is interesting to observe a return to values and humanism. The financial crisis is not foreign to this move towards “civil religion” which affects interest. Let's now examine Western laws moving closer to civil religion.



## II WESTERN LAWS MOVING CLOSER TO CIVIL RELIGION

Western laws offer two expressions of civil religion towards interest. Although none of these laws prohibit interest, they most of the time do prohibit *excessive* interest. Therefore, the discussion is no longer over the possibility to charge an interest, but rather on the *rate*. The prohibition of excessive interest has to be discussed first (A). In a similar vein, due to the financial crisis, all regulators try to infuse more loyalty in business and tax issues relating to interest. The second civil religion appearance is the promotion of business and tax loyalty (B).

### A Prohibition of Excessive Interest

Excessive interest rates are only sometimes prohibited. This results from a comparative survey of a few legal systems. In the EU, usury is regulated comprehensively in certain Member States (Spain, France, Italy, Portugal), but not in all. In fact, an academic report explored the laws of the various EU Member States and concluded that there is considerable variation in the attitude of EU Member States towards the regulation of consumer credit prices.<sup>1</sup> 14 Member States only had either some form of an absolute ceiling (Greece, Ireland, Malta) or a relative ceiling based on a reference rate (Belgium, Estonia, France, Germany, Italy, the Netherlands, Poland, Portugal, Slovakia, Spain, Slovenia). England, for instance, is more relaxed towards interest limitation. Outside Europe, and despite the financial crisis, the US has no federal usury law. Therefore, the prohibition of excessive interest is not (yet) as widespread as one may think.

1. Right after the French Revolution, contractual interest rates were not limited. The 1804 French civil code, which allowed interest, provided that interest could only be limited by a civil law. Such law was enacted three years later, in 1807. Interest rate could not be over 5% in civil matters, and 6% in commercial. Later on, the law tried to impose rigorous formalism for interest rates,<sup>li</sup> or organized the advertising of banks' general conditions.<sup>lii</sup> Nowadays, the criminal sanction imposed on the limitation of interest only applies to consumers, not to corporate borrowers. Indeed, the French usury statute, codified in Article 313-3 of the French consumer code, as modified by law on July 1st, 2010 and reads as follows: "*a conventional loan constitutes a usurious loan when it is granted at a rate that exceeds, at the time it is granted, at least one-third of the average effective rate applied during the prior quarter of the year by credit institutions for loans of the same nature with similar risks.*"<sup>liii</sup> The validity of usurious rates now depends solely on the nature of the loan. In 2010, maximum rates varied from approximately 3% for long term loan, to 19% for overdraft.<sup>liv</sup> And violation of the French usury statute constitutes a criminal offense, subject to imprisonment and monetary fines. Therefore, French usury law does not provide only one limitation, but rather various limitations depending on the nature of the loan.<sup>lv</sup> For corporate borrowers and individuals acting in the course of their business (not consumers), criminal sanctions are no longer applicable: the only civil sanction provides that, the excessive portion of interest is automatically applied to the normal interest and additionally to the principal of the loan. If the loan is paid back in regard to both principal and interest, the sums wrongfully received must be returned, together with the interest at the legal rate calculated from the day of their settlement.<sup>lvi</sup> Finally, let it be known that interest rate restriction is very effective in France!

2. In contrast to French law, New York or English law are less effective with respect to interest limitation.<sup>lvii</sup> They even clearly provide an exemption from usury rules for corporate loans. Due to the proliferation of loan sharking, English usury laws were reintroduced by the Money-Lenders Act of 1900, which set the usury threshold at 48%.<sup>lviii</sup> But the Consumer Credit Act of 1974<sup>lix</sup> superseded it by which allows a court to reopen terms of a credit agreement that it finds "*extortionate*" so as "*to do justice between the parties.*" The "Credit Act" refrains from setting a crystal clear usury threshold.<sup>lx</sup> Most importantly, it only restricts interest on loans to individual borrowers, not to corporate borrowers.

The system in the US is even looser, where following the National Bank Act of 1863, usury is a matter of State law. New York law, for instance, does not permit usury prohibition in corporate lending following the 1850 case *Dry Dock Bank v. American Life* (thereafter "*Dry Dock Bank*"). In *Dry Dock Bank*, a New York Bank had succeeded in having its corporate obligations of 250 thousands USD declared void on the ground that they had been given in payment for usurious loans made by the bank. In response to this unanticipated use of the usury statute as a shield by a bank borrower, the New York legislature enacted a statute providing that "*no corporation shall hereafter interpose the defense of usury in any action.*" For consumers however, State usury laws limit interest rates.<sup>lxi</sup> This has resulted in competition between State laws. Due to high inflation, a 1980 federal legislation freed State institutions from state usury limitations. As a consequence, States responded by amending

their usury laws in order to compete with out-of-state national and State banks, increasing the percentage of rates allowed or eradicating interest rates limits. Payday loans are symptomatic of this tendency. They are based on high interest rate loans with short repayment term. Therefore, a consumer can obtain a small sum of money by writing a personal check to the lender, post-dated by one or two weeks. For instance, a two-week loan of 300 USD requires 45 USD in interest. The average annual percentage rate for these types of loans is 391%! But can the US government still stay out of the regulation of interest rates on the grounds that it considers them as purely private transactions? Or, is the Islamic approach to interest more meaningful in the context of the financial crisis? The answer may be found in the promotion of business and tax loyalty in interest treatment.

## B Promotion of Business and Tax Loyalty

Loyalty has the flavor of chivalry. It is linked with the concept of fairness. The Draft Common Frame of Reference could include therefore such a principle in future EU-contract law as “*principles recognized as fundamental in the law of the Member States.*”<sup>lxii</sup> The subprime loan crisis rejuvenates the concept of loyalty. Loyalty is now popping up all over the place. To understand its vitality, one must expose the booster, which lies in subprime loans. They are loans given to “risky” borrowers, those who are less likely to make their loan payments because of their poor credit history. They are also termed “*second-chance lending.*” To offset this risk, subprime loans charge higher interest rates than ordinary loans. Risk and interest (return) are two sides of the same coin. But in the subprime situation, the interest rates were too high, which was fine when the housing market was up. When it went down, the whole system collapsed. Before the crisis, France always offered greater protection: the French Supreme Court requires banks to inform the consumer / borrower of risks associated to the loan.<sup>lxiii</sup>

Now the US is also turning to business loyalty: some members of Congress have tried to create a *federal* usury statute that would limit the maximum allowable interest rate, but the measures have not progressed.<sup>lxiv</sup> In July 2010, the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#) was signed into law by President Obama. The act provides for a Consumer Financial Protection Agency to regulate credit practices, but does not have an interest rate limit. The Washington, D.C. bureau was installed, but the new website launched a few weeks ago provides limited information.<sup>lxv</sup>

The banks’ stress test also has to do with business loyalty. Bank stress tests are supposed to determine how well a bank would be able to withstand any further financial downturns or economic difficulties. This means that capitalization is key, as the banks may have to absorb losses later on, while still carrying out their day-to-day business. There is particularly strong criticism of the modern practice of banks that make loans for which they do not have deposits. When creating credit the bank does not suffer any loss. And yet, it makes a profit from the credit, which should be considered usury. Said otherwise, if a bank issues money and then loans it out to the lender at interest, isn’t such interest usurious? Isn’t this credit creation “institutional usury?”

It is true that more information, stress tests, or any other obligation imposed by law increase what economists call “transaction cost.” It is also true that, conceptually, Islamic finance costs more, as it involves more transactions. However, in today’s age of low-cost financial engineering and easier information, the actual cost of Islamic finance or additional burden imposed by law is tiny and can be lost in the wash. Especially as compared to the total estimated cost of the financial crisis, tabbed in trillions of USD. Contracts as a ruse for lending with interest create more economic benefit than harm.<sup>lxvi</sup> Similarly, more obligation or interest limitation should limit credit access of high-risk consumers / borrowers, but may benefit the credit market as a whole.<sup>lxvii</sup>

For corporate loans, the tax tool is an interesting one. Interest is generally tax deductible. However, interest is deductible only below the maximal legal rate.<sup>lxviii</sup> In groups of companies, where there is an equity relationship between the company granting the loan and the one receiving it, the interest deductibility is regulated by “thin capitalization” rules. In France for instance, a company is considered as under-capitalized when the interest it pays to a related company exceeds the highest of the following thresholds: (1) the interest expense on debt equal to 1.5 times the equity; (2) 25% of the borrower’s adjusted EBITDA; and (3) the amount of interest income received from related parties. This rule certainly promotes more tax loyalty in interest allocation. Indeed, the aim of the “thin capitalization” rules is to offset abusive schemes aiming to localize interest of a group of companies in entities located in France (which are highly taxed). And France recently extended these rules to loans granted by a third party, but guaranteed by a related company.<sup>lxix</sup>

#### IV CONCLUSION

To conclude, a bridge between the attitude of the Western and Islamic worlds may be possible: as a token, the French tax authorities recently agreed to treat the profit or remuneration by investors in *Murabahalxx* or *Sukuklxxi* transactions as interest for French tax purposes.lxxii More generally, the working group on treatment of Islamic financial instruments proposed to add a new commentary to the OECD Model tax convention. It aims to assimilate to debt relations “*non-traditional financial arrangements (...) although their legal form is not a loan.*”lxxiii And if a sign of convergence arises outside taxation, it is perhaps due to the very recent proposal from the European Council and Social Committee of the EU.lxxiv The first step may indeed be to establish a European range of clearly defined usury rates.

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- <sup>iii</sup> Jules Ferry (1832 –1893) was a [French](#) statesman and republican, promoter of [laicism](#).
- <sup>iv</sup> ECHR, *Refah partisi v. Turkey*, Feb. 13, 2003.
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- <sup>vi</sup> J. Mestre, *Qualités humaines et droit des affaires*, *Privatrecht in Europa – Vielfalt, Kollision, Kooperation*, Festschrift für Hans Jürgen Sonnenberger zum 70. Geburtstag, Verlag C.H. Beck, Munich, 2004, p. 53; P. Diener, « Éthique et droit des affaires », *D.* 1993, chron. p. 17 ; et surtout Ph. Le Tourneau (dans l'ordre chronologique), notamment *La Vision chrétienne de l'entreprise*, in *Exigences chrétiennes et droit de l'entreprise*, Téqui, 1987, p. 61 et s. ; *Le Chrétien et l'entreprise*, in *Un Avenir chrétien pour l'Europe*, Fayard, 1991, p. 75 et s. ; *La Rencontre du management et du discours chrétien sur l'entreprise*, in *Histoire, gestion et management*, Université de Toulouse 1, 1993, p. 101 et s. ; *Existe-t-il une morale des affaires ?*, in *Centre de droit des affaires*, *La Morale et le droit des affaires*, Montchrestien, 1996, p. 7 et s. ; *L'Éthique des contrats internationaux*, in *Centre de recherches en éthique économique*, *Éthique des affaires : de l'éthique de l'entrepreneur au droit des affaires*, Librairie de l'Univ. d'Aix-en-Provence, 1997, p. 223 et s.
- <sup>vii</sup> In Europe, religion is an *individual* belief. But if one is thinking of “religious ideas,” (differing from ideology) that shape convictions and national identity, then religion has certainly still a strong impact on law. See for instance President Sarkozy and the Christian identity of France.
- <sup>viii</sup> See for instance, Ahmoud A. El-Gamal, *Islamic Finance, Law, Economics, and Practice*, Cambridge University Press, 2006; Centre français de droit comparé, *La finance islamique : l'autre finance*, Société de législation comparée, Paris, 2009; Geneviève Causse-Broquet, *La finance islamique*, Revue Banque edition, 2009; M. Ariff, M. Isbal, *The Foundations of Islamic Banking – Theory, Practice and Education*, 2011.
- <sup>ix</sup> Rule 100 reads as follow: “*he shall write down the interest on the money (...) and he shall make returns to his merchant.*” E. Cuq, *Les nouveaux Fragments du Code de Hammourabi sur le prêt à intérêt et les sociétés*, Paris, C. Klincksieck, Librairie, 1918.
- <sup>x</sup> Aristotle, 1258b, *Politics*. Aristotle also added that “*the most hated sort (of wealth getting) and with the greatest reason, is usury, which makes a gain out of money itself and not from the natural object of it. For money was intended to be used in exchange but not to increase at interest. And this term interest, which means the birth of money from money is applied to the breeding of money because the offspring resembles the parent.*”
- <sup>xi</sup> Enacted 342 B.C. by plebeian consul L. Genucius, the Genucia Law prohibited loans which carry interest. It also declared that same office should not be held twice within ten years nor two offices at once, also that both consuls might be plebeians.
- <sup>xii</sup> See E. Cuq, *supra*, p. 14.
- <sup>xiii</sup> Félix Gaffiot, *Dictionnaire latin français*, Hachette, 1934. *Réba* is the corresponding Persian term, *Riba* being the Arabic term, and *Ribbit* the Hebrew one.
- <sup>xiv</sup> Thomas F. Divine, S. J., *Interest: An Historical and Analytical Study in Economics and Modern Ethics*, Milwaukee: The Marquette University Press, 1959, p. 96.
- <sup>xv</sup> One can find this third meaning of “usury” in the “Social Code” which is a social synthesis of the Catholic Church doctrine, drafted in 1920. Therefore, an excessive purchase price in a sale contract, or an exaggerated



remuneration in a service contract, would be considered as “*usury*” because there is a breach in “*commutative justice*.” Commutative justice calls for fundamental fairness in all agreements and exchanges between individuals or private social groups. It is distinguished from other forms of justice, such as distributive justice, which refers to what society owes to its individual members, that is the just allocation of resources. This paper will no longer refer to this third meaning of “*usury*.”

<sup>xvi</sup> See lately, J. Ercanbrack, *The Regulation of Islamic Finance in the United Kingdom*, Eccl. L. J. 2011, p. 69.

<sup>xvii</sup> See e.g. Ruth A. Wallace, Emile Durheim and the civil religion concept, *Review of Religious Research*, vol. 18, no. 3, Spring, 1977, p. 287

<sup>xviii</sup> A *Saint* is a person of exceptional holiness. It is the Christian equivalent of an *Imam* in Islam.

<sup>xix</sup> See Exodus 22:25.

<sup>xx</sup> See Leviticus 25:36.

<sup>xxi</sup> Matthew 25 : 14-30; see also Luke 19 : 12-28, and Luke 6:35 “lend, expecting nothing in return....”

<sup>xxii</sup> Lois Miles Zucker, S. Ambrosii: De Tobia: A Commentary, with an Introduction and Translation, The Catholic University of America Patristic Studies, vol. 35, Washington D.C., The Catholic University of America, 1933, p. 65.

<sup>xxiii</sup> Quoted in Jacques Le Goff, *Your Money or Your Life: Economy and Religion in the Middle Ages*, trans. Patricia Ranum, New York, Zone Books, 1988, p. 26.

<sup>xxiv</sup> Divine, supra, Interest, p. 32.

<sup>xxv</sup> 305-306 AD.

<sup>xxvi</sup> Italian theologian and Doctor of the Catholic Church. The Christian thinkers following scholasticism, i.e. the philosophical systems, working against a background of fixed religious dogma, sought to solve anew general philosophical problems (as of [faith](#) and [reason, will](#) and intellect, [realism](#) and [nominalism](#), and the provability of the [existence of God](#)).

<sup>xxvii</sup> Saint Thomas Aquinas, *secunda secundae*, question 78. See also, Spick, *Somme théologique*, La Justice, t. III, p. 440 seq.; Noldin, *Summa Theologiae Moralis, De Praeceptis*, vol. II, no 585 seq.; J. B. Vittrant, *Théologie morale*, p. 177.

<sup>xxviii</sup> A *pawnbroker* is a person or an institution who lends money on the security of personal property pledged in his keeping. Pawnshops serve the credit needs of low-income individuals.

<sup>xxix</sup> Divine, supra, Interest, p. 56.

<sup>xxx</sup> It reads: *If a fungible thing is given to someone in such a way that it becomes his own and is to be returned later on in kind only, no profit may be made by reason of the contract itself; but in lending a fungible thing it is not in itself illicit to contract for legal interest, unless this be manifestly excessive, or even for a higher profit if a just and adequate title be present.*

<sup>xxxi</sup> See <http://www.vatican.va>.

<sup>xxxii</sup> It is a legal arrangement in which three simultaneous contracts were made with one merchant: the investor will enter into a *partnership agreement* with the merchant. Under this partnership agreement, the investor will bring money, and the merchant will contribute with his commercial activity. The investor then enters with the merchant into an *insurance contract* insuring the investor against any loss of wealth. Finally, in a third contract, the investor would sell back to the merchant the rights to any profit above a fixed sum. J. Ph. Lévy, *Dictionnaire de droit canonique*; J. Ph. Lévy, *Revue historique de droit français et étranger*, 1939, p. 422 seq.; Prümmer, *Manuale Theologiae Moralis*, t. II.

<sup>xxxiii</sup> Pothier, *Contrat de société*, no 22.

<sup>xxxiv</sup> C. Cardahi, *Le prêt à intérêt et l'usure au regard des législations antiques, de la morale catholique, du droit moderne et de la loi islamique (Analyse et synthèses comparatives)*, RIDC 1955, p. 499.

<sup>xxxv</sup> St Louis ordinance 1254; Charles IX ordinance 1560; Henri III ordinance, 1579.

<sup>xxxvi</sup> Charles IX Edit dated 1572; Henri IV declaration dated May 1609.

<sup>xxxvii</sup> A. Corbin, *On contracts*, § 1498 (1962).

<sup>xxxviii</sup> A. Mages, *Jalons historiques pour une théorie juridique du crédit (XVI<sup>ème</sup>-XIX<sup>ème</sup> siècles)*, Ph.D Thesis, University of Lyon, 2008, p. 219 et seq.

<sup>xxxix</sup> Judgment of Sept. 6, 1696. See A.-F. PROST de ROYER, *Lettre à Monseigneur l'Archevêque de Lyon*, Avignon, 1763, p. 87.

<sup>xl</sup> See Mages, supra, p. 230 et seq. (for Toulouse, Pau, Marseille, Grenoble ...).

<sup>xli</sup> And if the Code of Hammurabi authorized interest, it is because trade and agriculture was then flourishing.

<sup>xlii</sup> There is a second school of thought explaining the new position of the Church: the first seeks to make a general application of the extrinsic titles. Extrinsic titles are assumed to exist without proof. For instance, the

title for lost profit (*lucrum cessans*) became a general fact of life in the early modern world (see Rupert J. Ederer, *Is usury still a problem?*, *Homiletic and Pastoral Review* 84 (Aug.-Sept. 1984), pp. 12-20). Modern economists would say there is an “opportunity cost” of loaning out one’s money, for which one deserves just remuneration.

<sup>xliii</sup> Contra (minority view): Jacques Maritain, *Review of Social Economy* 43 (Apr. 1985).

<sup>xliiv</sup> Patrick Cleary, *The Church and Usury: An Essay on Some Historical and Theological Aspects of Money-Lending*, Dublin: M.H. Gill & Son, Ltd, 1914.

<sup>xlv</sup> John A. Hardon S.J., *Pocket Catholic Dictionary*, New York, Doubleday, 1985, “usury,” p. 445.

<sup>xlvi</sup> Letter to a friend, Claude de Sachin, 1545. However, Luther was much more rigorous than the Catholics.

<sup>xlvii</sup> Father Gary L. Coulter, *The Church and Usury: Error, Change or Development*, 1999.

<sup>xlviii</sup> Physiocracy (from the Greek for “Government of Nature”) is an economic theory developed by the Physiocrats, a group of economists (headed by Quesnay) who believed that the wealth of nations was derived solely from the value of “land agriculture” or “land development.” Their theories originated in France and were most popular during the second half of the 18<sup>th</sup> century. Physiocracy is perhaps the first well-developed theory of economics. Mercier de La Rivière and Turgot were indeed more relaxed towards interest, whereas Quesnay was not favorable to finance.

<sup>xlix</sup> See also law dated July 23, 1795.

<sup>i</sup> See iff/ZEW (2010): Study on interest rate restrictions in the EU, Final Report for the EU Commission DG Internal Market and Services, Project No. ETD/2009/IM/H3/87, Brussels/Hamburg/Mannheim.

<sup>ii</sup> Law no 66-1010, Dec. 28, 1966 as modified by law no 89-1010, dated Dec. 31, 1989; law no 78-22, Jan. 10, 1978; law no 79-596 dated Jul. 13, 1979.

<sup>iii</sup> Law no 84-46, dated Jan. 24, 1984; decree no 84-708, dated Jul. 24, 1984. This advertising is now organized at the European level for consumers. See EU Directive dated April 23, 2008 on credit agreement for consumers (art. 4) provides for the indication of the total cost of credit for the consumer.

<sup>iiii</sup> See regulation (*arrêté*) dated March 22, 2011. This new rule is applicable since Apr. 1<sup>st</sup> 2011. See X. Lagarde, *Taux d’usure et crédit revolving: de quelques difficultés pratiques...* Rev. dr. banc. fi. 2011, n° 46.

<sup>lv</sup> Rates are available on the Bank of France Internet site: <http://www.banque-france.fr>.

<sup>lv</sup> For corporate borrowers, see Monetary and Financial Code, subsection 2 entitle “Interest Rates”, and specifically art. 313-5-1 providing: “*In the case of overdrafts, any contractual loan granted to a legal entity engaged in an industrial, commercial, craft-trade, agricultural or non-commercial business activity at an annual percentage rate which, at the time of its granting, is more than one third higher than the average effective rate applied by credit institutions during the previous quarter for loans of the same type presenting a similar risk factor, as specified by the administrative authority after consultation with the Conseil national du crédit et du titre, is a usurious loan.*”

<sup>lvi</sup> Monetary and Financial Code, art. 313-5-2.

<sup>lvii</sup> iff/ZEW (2010): Study on interest rate restrictions in the EU, Final Report for the EU Commission DG Internal Market and Services, Project No. ETD/2009/IM/H3/87, Brussels/Hamburg/Mannheim.

<sup>lviii</sup> Benj. S. Horack, *A Survey of the General Usury Laws*, *Virginia Law Review* 1967, vol. 53: 2, p. 327.

<sup>lix</sup> Sections 137 through 140.

<sup>lx</sup> It defines instead an extortionate credit agreement as one that “*requires the debtor ... to make payments ... which are grossly exorbitant, or ... otherwise grossly contravenes ordinary principles of fair dealing.*”

<sup>lxi</sup> This resulted in competition between state laws: see generally A. Borroni, *A Comparative Survey on Finance: the Need to Bridge the Western and Islamic Legal Systems*, JCLS, vol. 4 no 3 (2011), discussing extensively the US Supreme Court Marquette decision (1978), and more recent payday loans.

<sup>lxii</sup> Art. II-7:301.

<sup>lxiii</sup> French Supreme Court, Mixed Chamber June 29, 2007, RLDC 2007/43 no 2726; RLDA 2007/19 no 1176; decision confirmed by French Supreme Court, 1<sup>st</sup> Chamber, Sept. 18, 2008, RLDC 2008/54 no 3171 [VERIFIER QUE CELA NE S’APPLIQUE PAS AUX CONSOMMATEURS]

<sup>lxiv</sup> Comp. Fr. W. Ryan, *Why Usury Laws Have Failed – How Statutory Limits Have Been Evaded – Uniform Loan Law Recommended*, *The New York Times*, Apr. 9, 1922.

<sup>lxv</sup> See <http://www.consumerfinance.gov>.

<sup>lxvi</sup> See Mahmoud A. El-Gamal, *Incoherence of Contract-Based Islamic Financial Jurisprudence in the Age of Financial Engineering*, 2007.

<sup>lxvii</sup> An increase in interest limitation has also an effect on crime. This is the conclusions of a law & economic research project used usury laws as instrumental variables to identify the causal effect of pawnshops on crime.

Indeed, pawnshops are often suspected of being outlets for stolen property, and they may stimulate criminal activity. One could have predicted that States that cap interest and fees that pawnbrokers can charge should have fewer pawnshops because these limits restrict the profitability of pawnbroking. States with more generous limits on the interest and fees that pawnbrokers may charge have a greater incidence of pawnshops. Increases in the number of pawnshops are shown to raise the rate of those crimes in which pawnable property is stolen and to have no impact on the rates of those crimes in which such property is not taken (see T. J. Miles, *Markets for Stolen Property: Pawnshops and Crime*, Chicago, 2008).

<sup>lxxviii</sup> In France provided by article 39-1-3° of the French tax code.

<sup>lxxix</sup> 2011 Finance Law, art. 12, rev. Dr. fisc. 2011 no 1, com. no 35.

<sup>lxxx</sup> *Murabaha* is defined as a sales contract under which a seller sells goods to a financial institution that resells them to an end user at a deferred price that includes a profit margin. This arrangement allows the financial institution to avoid charging interest, which is prohibited under Islamic law.

<sup>lxxxi</sup> *Sukuk* are certificates that represent for the investor a proportionate ownership in an underlying asset or pool of assets. The investor is entitled to a share of the revenues and proceeds.

<sup>lxxxii</sup> See lately French tax ruling dated July 23, 2010, Rev. dr. fisc. 2010, no 35, comm.. no 14335 and 14336.

<sup>lxxxiii</sup> See UN, Economic & Social Council, Committee of Experts on International Tax Matters, Geneva, Oct. 20-24, 2008, EC 2008/18-5, available at <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/N08/451/96/PDF/N0845196.pdf?OpenElement>.

<sup>lxxxiv</sup> Opinion of the European Economic and Social Committee on 'Accessing consumer and household credit: abusive practices' (own-initiative opinion), (2011/C 18/05), OJEU Jan. 19, 2011.