MORE UNION CARDS AND FEWER CREDIT CARDS: DID HIGH INTEREST RATES DESTROY THE AMERICAN ECONOMY?

By Nick Gier

Voracious usury ... an evil condemned frequently by the Church,
but nevertheless still practiced in deceptive ways by avaricious men.

-- Pope Leo XIII, *Rerum Novarum* (1891)

Today the word "usury" means the charging of excessive interest, but ancient Jews, Christians, and Muslims believed that interest amounts to unearned income and is therefore is immoral and unjust.

The Hebrew word for interest *neshekh* means "a bite," and this describes the negative connotation very well. As the Book of Leviticus states: "Take no usury or interest from him; but fear your God, that your brother may live with you" (25:36). The complaint that usury exploits the poor still rings true with the 200 percent annual rate that is charged at pay day joints.

Some commentators believed that this prohibition applied only among Jews, and this reasoning was used as a justification for Jewish money lending to Gentiles in the Middle Ages. Many Christians condemned this practice and used it as a means to persecute and kill thousands of Jews.

The Qur'an prohibits usury under the concept of *riba* (meaning "excess" or "addition"), and hundreds of millions of Muslims have honored this prohibition even to this day. Some American banks and even Freddie Mac are now offering mortgages to Muslims that still allows the banks to make a profit without charging interest.

In response to the criticism that no financial system could survive without the charging of interest, one could point out the fact that the Roman Republic survived for 300 years with a strict law against usury. Under Julius Caesar the interest rate was capped at 12 percent and later emperors cut it by half.

Historians also can point to the sophisticated banking system of medieval Islam, which assumed the principle of private property and introduced for the first time bills of exchange, check writing, limited partnerships, and corporations. This system worked primarily because, although interest was forbidden, selling at a profit was not.

The Council of Nicea (325) made it illegal for priests to lend money for interest, and within a hundred years the prohibition was extended to all Catholics. Arthur Birnie explains the Christian position well: "To live without labor was denounced as unnatural, and so Dante put usurers in the same circle of hell as the inhabitants of Sodom and other practicers of unnatural vice."

Pope Sixtus V (1521-1590) declared that charging interest was "detestable to God and man, damned by the sacred canons and contrary to Christian charity." The pope may have been provoked by the fact the Henry VIII of England had signed a law entitled "In Restraint of Usury," which allowed the practice as long as the interest rate was not excessive.

Theologian Roger Ruston sums up the effects of the Protestant Reformation: "Usury passed from being an offence against public morality . . . to being a matter of private conscience, and a new generation of Christian moralists redefined usury as excessive interest."

Until the late 1970s the U.S. had anti-usury laws that usually capped interest at 9 percent. In 1978 Supreme Court ruled that nationally chartered banks were not bound by state anti-usury laws except the state in which they resided. Many banks relocated to states with no limits on interest and started sending credit cards out to everyone, and states changed their laws so that their own banks could compete.

As a graduate student I traveled in Europe on a TWA "Getaway" card even though I had less than $1,000 to my name. As long as banks could charge exorbitant interest and fees, they didn't care if I could pay off my balance. The moral basis for banking has collapsed: banks no longer cared about personal character or debt risk.

In the April issue of *Harper's Magazine* Thomas Geoghagen argues that usury, even more than deregulation, has been the basic cause of our current financial crisis: "We dismantled the most ancient of human laws, the law against usury, which had existed in some form in every civilization from the time of the Babylonian Empire to the end of Jimmy Carter’s term."

Geoghagen is not satisfied with a bill in Congress that would cap interest rates at 35 percent. Not surprisingly, that's exactly the rate lobbyists claim that credit card companies need to stay in business with their current customers. Geoghagen would like to see the rate come down to 17 percent. There of course should be flexibility to raise that rate if inflation becomes the problem that it did in the late 1970s.

Geoghagen points out that even Adam Smith, the father of free markets, believed in limiting interest rates. Smith believed that government regulation was necessary in this case to make sure that most investments went into the real economy rather than financial markets run by "prodigals and projectors." Today we would call them "speculators."

Smith's warnings have proved to be prescient. Over the last 30 years, capital, both financial and human, has flowed from manufacturing into financial companies. Top mathematicians, computer scientists, and physicists, who earlier would have been working in basic research and technology, were now inventing complex financial instruments that even the brokers themselves did not understand.

The result was a dramatic dislocation of the American economy in which the financial sector was reporting 40 percent of all corporate profits. Even companies such as GM and GE set up their own banks so as to recoup the losses they experienced selling their products.

The decline in manufacturing and aggressive corporate attacks on unions led to a precipitous drop in union membership and a thirty-year stagnation in real wages. This has led to levels of economic inequality far worst than the Gilded Age. In 1894 John D. Rockefeller made $1.25 million, 7,000 times the average American's salary, but hedge fund manager James Simons now makes 38,000 times more than the average worker.

From 1950-1980 families could support themselves with one wage earner, but now some parents work three to four jobs to pay the bills. In addition to running up huge credit card debt, far too many people also took out home equity loans to keep up the Jonses.

I was raised in family in which the basic values were hard work, thrift, pay as you go, and above all, and fulfilling basic needs rather than frivolous desires. My German Catholic father and Scotch-Irish mother had lived through the Depression and their Old World values served them and tens of millions of Americans very well.

My brother and I were always envious of the rich kids on the east side of Medford, Oregon, who didn't work in the summer (I picked pears and fought forest fires), but am I now grateful for being on the right side of Aesop's fable of the Ant and the Grasshopper.

Nick Gier taught religion and philosophy at the University of Idaho for 31 years. He obtained several references from Wayne Visser and Alastair McIntosh**,** "A Short Review of the Historical Critique of Usury,"*Accounting, Business & Financial History*, 8:2 (July 1998), pp. 175-189.