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Brief

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Abstract: A crime caused by usury has resulted in hot debate over the legitimation of usury in China recently. Many claim it illegal and even criminal while some defend it with fine study of elites and furtherly claim legal standing for it. The institutional competition between modern money and banking system and ancient usury has lasted for centuries and seems far from ending. The phenomenon that usury had once died in the former 30 years before 1978, and revived after that in China is overviewed and attributed to institutional changes shaping people's desire and behavior in multiple aspects. And the fundamental cause is imbalanced and inadequate development. Usury, by its nature, is not any helpful debt but to drain out social productivity and splitting people into rival classes. As China entering the new era of building up a harmonized society and achieving common prosperity, usury must be prohibited strictly again.

Keywords: usury, modern banking system, institutional change

JEL Classification Codes: B52, N2, K42

This research is inspired by a widespread homicide case caused by usury in Shandong, China recently. Huan Yu, a young man killed one of the 11 debt collectors who sexually assaulted his mother. The mother, a car particle factory owner, had failed to repay fully a private loan at 10% monthly rate. In June, 2017, Yu was sentenced in the trial of second instance to 5 years in prison for intentional injury caused by excessive defense, instead of life imprisonment by the trial of first instance. In November, the usury gang was prosecuted for 8 crimes including illegal encroachment of residence, false imprisonment, participation in gangdom organization, forced transactions,

intentional destruction of property, and destruction of public telecommunications facilities, intentional injury, and rape. The first 3 crimes involve Yu's case (Tan 2017). The legitimization of usury was again under hot debate. Many claim it illegal or even criminal while some defend it with fine study by some elites and furtherly claim legal standing for usury.

People who believed usury has been dead since 1949 now come to realize that many so called private finance, developing fast after 1978, used to operate offline and locally , recently more online and universally, are in fact usuries, and often enforce their debts violently backed by gangdom. Why usury revive? What kind of finance do we really need? With more and more information disclosed in media, usury has raised serious concerns in the country.

Literature Review

Usury, a term usually refers to debit and credit activity featured with high interest rate. Literatures present several ways to define usury. Zhongyang Chen and Zhiyang Liu observed that usurious units would rather illegally enforce debts to reduce the loss ratio of default, instead of reduce the default ratio as normal banks emphasis. Thus the core feature of usury is to earn excessive huge profit, with a much higher profit ratio than formal credit do (Chen and Liu 2015). This means lending with abnormally high interest rate doesn't have to be termed usury. Another similar opinion is that high interest lending shall not be simply deemed as usury if it is used in production activity and the interest is part of the high profit. (Yan and Chen 1984). However, it would be complex to determine usury with ex post behavior or facts, especially that other than the lender.

Sonia Stefanizzi defines usury in a broad sense as that “the word usury cannot be intended merely as granting loans at rates above licit, but it must refer to any situation in which economic freedom is alienated to the advantage of one or more subjects able to impose their strength” (Stefanizzi 2014). It fits to explain those *nude loans* reported recently in China targeting young girls to prostitute themselves after default.

The third is, lending with interest rate higher than the legal interest rate cap set by the legal authority is usury. In practice, it is difficult to set the cap modestly and usurers can hide any excessive charges to escape the cap.

A more essential character to identify usury is drawn from Karl Marx's analysis on usury, which is, in the case of business credit, the interest or real cost ratio of the debt exceeds the profit ratio of the industrial and commercial capital (Marx [1894] 2009). It focuses on the relationship between financial capital and industrial capital and provides a basic criterion to credit phenomenon.

Capitalistic socialized production requires mass credit support, but usury always erode the industrial capital and thus hinder industrial capitalism from further development. In history, the Britain government had set the cap of annual interest rate at 10% in 1545, and dropped to 8% in 1624, 6% in 1651, and 5% in 1714 (Huang 2013, 84) . However, without significant competition from supply side, real borrowing cost cannot be lowered but be hidden in other forms, such as exaggerated principle on the IOUs, various fees beside interest and harsh terms.

Things have changed substantially since the Bank of England, the first modern shareholding bank, was established in 1694. Its discount rate was 4.5%~6%, much lower than usury at that time, and the dominant position of usury in credit has been shaken ever since. As Marx noted,

“The modern banking system, on the one hand set aside all the idle money reserve and put it in the money market, thus depriving the monopoly of usurious capital in the money market, on the other hand, establish credit currency, which restricts the monopoly of precious metals itself”(Marx [1894] 2009, 682).

Modern banking system featured with cheap lending has spread over Europe and other countries all over the world mainly since 18th century. As an institutional device, it has fundamentally changed the relationship between lender and borrower from reckless and usurious pattern into caring and sharing within industrial and commercial profit pattern at large and positively contributed to modern capitalist industrialization.

Now that usury has somehow return to the spotlight while the modern banking system has been attacked for credit rationing, rent seeking and poor service with expensive fees. Those usurious units, “once relegated to the fringe or the underground, have moved nearer to the center of economic life” (Brown 2008, 77). Usury, taking on a new look, equipped with internet information techniques, and innovative financial engineering, such as ABS, target peasants, small business and low-income consumers and students. Many agree that the recourse to usury is in fact directly

proportional to the difficulty in accessing legal credit—where the difficulty is greater, resorting to the loan shark is more frequent (Stefanizzi S. 2014). Some attribute it to the financial liberalization especially interest rate marketization and financial deregulation.

These explanations are reasonable yet stay on the surface. The fundamental cause of the revival of usury lies in the imbalanced and inadequate development of society, economy and culture. The experience and lessons of China in this regard provide much to learn.

Overview of Usury in China

Usury had a long history reaching thousands of years in China. Before 1949 usury prevailed in rural countries and urban cities as well. A significant portion of peasants carried debts with high usurious interest. Workers and small peddlers were often the debtors of usury in cities. The usurers were typically the landlords and merchants many of whom connected with gangdom. Just like *Merchant of Venice*, one of Shakespeare's master pieces, *White-Haired Girl*, a famous opera which was first on show in 1945 in Yan'an, tells a dreadful story of usury of that era.

After 1949, a highly centralized planned economy had been gradually established, and usury had for a long time disappeared from the scene. After 1978, China has carried out reform and open policy to establish a socialist market economy. Private lending has grown fast in those coastal advanced provinces such as Zhejiang, Shandong, and Guangdong. According Dewen Zhou, one of the closest to private capitals of Wenzhou, a city of Zhejiang Province famous of private economy, the private lending amounted to 350 billion yuan and 87.5% of the Wenzhou credit market flow of 2011 alone, most at monthly rate over 6%, i.e., the debt will double after 12 months (Zhou Dewen 2014, 4). Many people including government officers participate in usury to make a quick rich. In Huichang, a small county in Jiangxi Province, private loans are usually at monthly rate above 3%, some 10% or more; principle amount ranges from tens of thousands to millions; practice in a hidden way that covers interest charge by issuing new IOU adding unpaid interest to the principle. And usury lawsuits amount to 70% of total lending cases in court (Li 2014).

After 2013, internet has been a new stage for usury. P2P lending

platforms, internet microfinance, asset management companies etc., spring up like mushrooms. About 2693 internet platforms extend *cash loan*, a consumer loan of short term usually within 6 months, without collateral requirement. And most cash loans are usurious with interest rate annualized over 100% (NCEIFST 2017). Several internet microfinance corporations engage in cash loans have been publicly listed in stock exchanges in the United States in late 2017. One of the listed major providers of cash loans, Qudian Inc., has been questioned in Chinese media about its usurious business model and has been filed a class action lawsuit recently in the United States (ACCESSWIRE 2017). Thus the stock price has dropped significantly below its IPO.

Usury, though provide urgent cash to people, have caused a lot of tragedies. Small entrepreneurs either escaped or jumped to their death from buildings after borrowed usury. Over 30 were killed in usury caused conflicts in Zouping of Shangdong Province, where outstanding private loans had reached 100 billion yuan in 2012, and many are usurious (Zhou Junsheng 2017). And college students were reported to be harassed and threatened after default their usurious instalments or cash loans borrowed from internet platforms after 2015. A lot of internet P2P lending platforms were closed since 2014 with hundreds of thousands investors' money gone in millions. More and more people call for government actions against usury.

An Institutional Analysis

Usury had once died in China after 1949 and the institutional reasons are of multiple aspects. In the political aspect, as a bloody exploitation device over proletarians and labor mass, usury was hated and abolished since 1949. In the economic aspect, most properties in the country, though poor after long wars, were public. Those rich sold their business to government and lived on their own labor equally with common people. A highly centralized planned economy had been gradually established. Almost every labor had a job and all citizens were covered with social security. Free education, low rent public housing and free healthcare were established countrywide.

In the financial aspect, a centralized banking system was established featured with cheap lending against usury. Lending between nonfinancial units was illegal (and even now so). Credit cooperatives had been developed

comprehensively in rural countries, which provided cheap funding to secure agricultural production and supported peasants to join in various cooperatives to develop local economy collectively.

In the cultural aspect, strong collectivism prevailed at the time and greatly strengthened the people's unity. Voluntary work for public affairs, giving material and spirit support to each other for no reward were popular good behavior among people. Savings society was established within most units to help those colleagues who live on a shoestring without interest and the maturity was very flexible.

As Da Huang, who won in 2011 the first Chinese Financial Discipline Lifetime Achievement Award from Liu Hongru Financial Education Foundation, which is the top prize in financial science in China, concluded for this period of time that "When issues such as job and labor protection have been well secured, though not have to mean the elimination of the soil of usury, the basis of active usury behavior no longer exists" (Huang 2013, 85)

These unprecedented institutional changes proved to have such effects: most people have no motivation to engage in usury; and if there was some, many dare not to do so as the loss would be tremendous in political sense. Although someone dare, he could not raise much money to do business as people consumed almost all income and saved very little. On the other hand, little space was left for an individual to pursue his own success especially in material fortune in such circumstance.

After 1978, great institutional changes have taken place and shaped people's desire and behavior dramatically. China has carried out reform and open policy, letting some part of the people to get rich first. And the revised constitution of 1982 precisely protects citizen's legal private property from infringement. To be rich fast has become a significant motivation for some people to engage in usury business though it is unethical and risky.

China has experienced about 30 years' rapid growth to have become the second largest economy in the world in 2010. The majority of the people, those used proletarians in former 30 years, have acquired and/or accumulated certain private property such as home and deposit. This has provided the requisition for usury to revive.

Meanwhile the gap between supply and demand of formal financial service is widened and substantial productive credit market vacant of rural

peasants, small business and industrial and commercial individuals is left to usury. On the other hand, as the social security system has been left behind, some people on a shoestring have to turn to usurers as “the lenders of last resort”. Such is Keynesian’s “absolute demand”. And modern marketing has its entire means to create the “relative demand” (Keynes 1930, 365), especially in college students, to purchase “culturally sufficient market basket of goods and services” financed with usurious cash loans or instalments.

The last institutional requisition is the loose regulation guided by the theory of financial liberalization since 1990s that allows private finance grow barbarously, many of which are usurious in nature, and some are funded with credit money from cooperatives and banks.

In theory, the long anti-usury policy in former 30 year is under question as some elites provided fine studies to legitimate usury. Mao Yushi , who won the Milton Friedman Prize in 2012 from Cato Institute, was one of the strongest proponents for usury. He argued that usury was good for economic development as to best locate financial resources and meet the demand that formal finance neglects (Mao, 2006, 2013). Chen Zhiwu, a professor of Yale university , leads empirical studies to legitimate the “high yield covering high risk” business model of usury (Chen, Lin and Peng ,2013). These have changed many people’s attitude toward usury, and reduced moral critics to it.

In practice, there is no specific law or regulation on usury in China. And usury, lending at high rate over given standard, is neither illegal nor criminal by itself. The Supreme People’s Court set in 1991 the legal cap of interest rate within 4 times of the contemporary bank’s similar loan rate, and interest rate above which will not be protected by law. Starting from 1996, however, China gradually liberalized interest rate to allow it float within limit. On July 20, 2013, the floating limit for loan interest rate has been taken off. Awkwardly, judges lost a clear standard to determine the legal cap for almost 2 years till the new cap of 36% annual rate is valid from Sept.1, 2015.

In summary, the great institutional changes after 1978 have provided motivation of getting rich fast by usury, moral relief theory, and requisitions for usury to revive such as private owned property, shortage in formal financial supply, loose and conflict regulation. And the fundamental reason is imbalanced and inadequate development.

Conclusion

The revival of usury in China is at large guided by a misunderstanding of socialist market economy. In fact, usury is no good for building up a harmonized society and achieving common prosperity as it functions to drain up social productivity and speed up the social splitting into rival classes. As the inequality of income and wealth increase to some point, usury must be prohibited strictly again.

The revival of usury is fundamentally an accumulated result of imbalanced and inadequate development. China needs to strengthen the advancement of modern banking system and build up a more inclusive financial system in order to provide adequate financial service supply to real economy. In this purpose, ethical financial innovations shall be encouraged to expand formal financial market to cover those productive small business and individuals, valuable high-tech emerging industries and modest sustainable consumers.

Learning from the experience of the former 30 years when usury died in China, comprehensive work need to be done to consolidate the unity of most majority of people, to eliminate poverty and backward phenomenon in the country, to advocate Chinese traditional virtue for modest consumption against wasteful and conspicuous consumption, to facilitate charity and enhance social security, and to promote good debt against ugly debt. Thus the new financial system will leave no ethical or economic standing for usury.

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