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SOLVING THE USURY PROBLEM IN THE PHILIPPINES

By ERNESTO Y. SIBAL *

I

GENESIS OF THE PRESENT USURY LAW

Neither during the pre-Spanish era nor even during the more than three centuries of Spanish domination did the Philippines have any law fixing a maximum rate of interest legally chargeable on loans. The absence of such a law during the latter period is especially curious in view of the fact that Spain has always been a zealous exponent of the Roman Catholic faith, the faith which has always frowned upon money-lending for profit. One plausible explanation for this is the fact that as far back as 1856, Spain, realizing the futility and mischief of a statutory law fixing a maximum rate of interest, repealed her usury law.[1] Moreover, so far as the Filipinos were concerned, there could not have been any pressing necessity for such a law. Their country was mainly agricultural, and a rich one at that. Taught by their Spanish masters to frown upon a life of materialism, they did not pay much attention to their commerce and industry. Naturally, their physical wants were not many, and their need for credit, very small. Furthermore, they were intensely collectivistic. Such vicissitudes of life as marriage, or sickness, or death, or unemployment which, on individualistic people, would exact a heavy toll on the purse, they could easily tide over. In such cases, there were always the good relatives and friends who were ready to bestow dowries upon the newly-weds or to contribute voluntarily for the doctor's bill, or funeral expenses, or to support and take care of the unfortunate unemployed who, however, was a rare being.

The coming of the new regime, however, wrought a change on their lives. With the inauguration of a system of general

* A.A., Ph.B., LL.B. (U.P.), Member of the Philippine Bar, Graduate Student, Yale School of Law.

[1] Gallego, *A Critical Study of the Usury Law*, (1918) 5 Philippine Law Journal 2.

education, with the introduction of new forms of comforts and luxuries, with the growing need for a more intensive agriculture in order to meet these new necessities and luxuries, and with the great impetus given to commerce and industry, the demand for capital and credit became pressing. The landowner needed additional capital in order to install new improvements on his *hacienda*. Moreover, he needed a regular supply of credit to maintain his children in school or college; the seasonal harvest on his hacienda could not have assured them a regular allowance. Then there was the tenant on the farm. Whereas in the past he could always depend on his landlord for a regular advance during the period of planting and cultivation, presently he could only have such sums upon payment of interest; and if his landlord did not have them, he must procure them elsewhere. Again, industrialization introduced the wage-earner whose employment was often seasonal and who, therefore, must depend on credit for a part of the year. But above all, there was the progressive businessman whose need for credit became more pressing than ever.

Because of this increasing need for capital and credit, the collectivism of old gave way to the new spirit of individualism. The ordinary vicissitudes of life must now be met personally without outside voluntary assistance. Assistance or money could only be had upon payment of compensation. And as the demand for it became greater, the compensation paid for its use in the form of interest likewise became greater. As a result, people who had not been accustomed to seeing something paid for the use of money began to deprecate the idea of charging interest on loans. And it so happened that there were a good number of Filipino law students who in their studies of American law had come across the usury laws of several States of the Union. Moreover, the first legislative body for the Philippines, the Philippine Commission, was composed partly of Americans. Evangelism, therefore, had some ready apostles who soon prescribed a remedy which, as we shall later notice, had already been discarded in the principal countries of Europe and was being discarded or superseded in the United States.

But the most curious thing about these evangelists of legal and social reform was that the first anti-usury law which they passed in 1911 purported to be applicable only to the Moro Province, the Mountain Province and Nueva Vizcaya, the most thinly populated and most backward regions of the Islands!

The law [2] fixed a maximum rate of interest of 15% per annum, and this, regardless of the presence or absence of any security, the type and duration of the loan, risk, etc.

The Philippine Commission, thinking that it had already done its duty to the non-Christian inhabitants, then turned its attention to the progressive Christian population. So in 1916, at the time when the Russel Sage Foundation of America was finishing the draft of a Uniform Small Loan Law which allow a rate of interest as high as 42% per annum, the Philippine Commission passed a general usury law which fixed the maximum rate of interest at 14% per annum. Mr. Martin, the American Commissioner, sponsored the law. He modelled it after that of Minnesota. Mr. Justice Malcolm considered it as "following in many respects the most advanced American legislation." [3] A commentator [4] characterized it as "American in essence and in spirit." The law [5] prohibited the "taking or receiving" of interest at a higher rate than 12% per annum in case of loans secured by duly registered real estate titles,[6] and in case of loans not so secured, the maximum rate was fixed at 14%.[7] For building and loan associations, the maximum was set at 18%;[8] and for pawnshops, in the case of loans of less than ₱100.00, the maximum rate was fixed at 3% per month.[9] Any person collecting a higher rate than that fixed by law is not only civilly liable to return all the interest collected [10] but is also criminally liable to pay a "fine equivalent to the total interest stipulated, with subsidiary imprisonment in case of insolvency." [11]

Realizing that the usury law as passed could not effectively stem the tide of rising interest rates caused by the rapid industrialization of the Islands, the Philippine Legislature, in 1921, added the alternative of imprisonment from ten days to not more than six months.[12] Realizing further that the building and loan associations were growing in number and becom-

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[2] Act No. 2073.
[3] U. S. v. Constantino, 39 Phil. 552, 556 (1918).
[4] Gallego, *op. cit. supra* note 1, at 3.
[5] Act No. 2655.
[6] *Ibid.*, sec. 2.
[7] *Ibid.*, sec. 3.
[8] *Ibid.*, sec. 2.
[9] *Ibid.*, sec. 4.
[10] *Ibid.*, sec. 6.
[11] *Ibid.*, sec. 10.
[12] Act No. 2992.

ing more popular because of their higher rates, but not perhaps conscious of the beneficent social functions of such associations and the fact that such associations must meet overhead and other expenses and that whatever profits they may realize most ultimately go to the members, including the borrowers themselves, the Legislature cut the privileges of such associations to the collection of a premium of not more than 2% in addition to the ordinary maximum rate of 14%. The pawnshops suffered the same fate, their maximum rate being reduced to 2½% per month in the case of loans of less than ₱100.00.[13]

It is needless to say that as was the case with England, France, Germany and the United States,[14] these laws were ineffective in their attempt to reduce the rates of interest. The rates continued to rise. Bootlegged money-lending by loan-sharks became the order of the day. Diverse and various were the ways devised to circumvent the law. Sales with right of repurchase (*pacto de retro*), additions of interest to the loan, fictitious contracts, and the like were but a few of them.[15] In the field of consumer credit, especially, were the rates as high as 100 to 300%. But did the borrowers ever care to complain? The answer is found in this very express admission of a member of the Philippine Legislature: "The fact of the matter is that these transactions that would be denounced usurious are sometimes more benignant for these people in their peculiar circumstances than certain strictly legal contracts." [16]

Few indeed were the cases of usury that were litigated in the courts, and most of these were attempts of the debtors to evade their liability under their contracts. But it would be interesting to note how the Philippine Supreme Court has followed the liberal attitude of the American courts in these cases. In the United States, as far back as 1902, Prof. Beale made this observation: "The courts, whether from love of commerce or from hatred of usury laws, have upheld contracts wherever it was possible against the defense of usury." [17] Prof. Vance likewise observed that in the construction of contracts, if two reasonable constructions are possible, by one of which the contract will be legal and valid while by the other it will be usurious and

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[13] Act No. 3291 (1926).

[14] See *infra*, Parts II & III.

[15] Bocobo, *Strengthening the Usury Law* (1929) 9 Phil. Law Journal 38.

[16] Romero, *Should the Usury Law be Reformed?* (1929) 9 Phil. Law Journal 116, 118.

[17] Beale, *Conflict of Laws* (3 vol. ed., 1902) cited by Ryan, *Usury and Usury Laws* (1924) 16.

invalid, the court will always adopt the former.[18] The Philippine Supreme Court whose members are renowned for their breath of wisdom has happily followed this attitude. As Mr. Romero [19] very aptly observed: "The decisions of our Supreme Court have decidedly inclined toward meting justice in accordance with equity rather than with the technicalities of the case. * * * From the hundreds of cases before them these learned and level-headed magistrates have learned to see where justice for the debtor ends and injustice for the creditor begins." A few cases will suffice to illustrate this attitude of the Supreme Court. In *Go Chioco v. Martinez.*[20] the Supreme Court held that even if the loan may be legally usurious the creditor can still recover the principal, and this in spite of the positive provision of section 7 of the law declaring that all usurious contracts "shall be void."[21] Again, in *People v. Hodges,*[22] the Court in acquitting the accused-defendant held that usurious interest not actually paid but simply added to the capital from time to time and included in renewal notes cannot be regarded as "taken or received", by the lender within the meaning of section 2 of the Usury Act and cannot serve as a basis for criminal prosecution under section 10 of the Act.[23] No decision could have completely emasculated the "pet child" of the Philippine Commission. And in *Tolentino v. Gonzales* [24] where the debtor, although in fact paying a usurious rate of interest, was made to appear in the contract as merely paying "rent", the Court held that there was no usury inasmuch as "rent" is different from "interest".

But instead of taking the hint from these decisions of the Supreme Court, the Philippine Legislature, apparently displeased by the attitude of the Court, amended the law in 1932 in order that in addition to the "taking or receiving" of unlawful interest, the mere "demanding or agreeing" to charge an unlawful interest will also be a crime. And not satisfied with the previous term of imprisonment, it now increased it to not less than thirty days but not more than one year.[25]

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[18] Vance, in *Cyc. of Law and Proc.*, vol. 39, p. 917.

[19] Romero, *op. cit. supra* note 16, at 118.

[20] 45 Phil. 256 (1923).

[21] See dissenting opinion of three Justices. One of them, however, in spite of his reference to usury as a "virulent social cancer," subsequently changed his stand in *Sajo v. Gustilo,* 48 Phil. 45 (1925).

[22] 46 Phil. 503 (1924).

[23] This ruling was followed in *Garcia v. Matias,* 49 Phil. 257 (1926).

[24] 50 Phil. 558 (1927).

[25] Act No. 3998 (Dec. 1932).

But has the Legislature in this wise succeeded in its much vaunted mission to curb out usury? Far from it. The depression has made the supply of money and credit more scarce; as a result the money rates have been rising. Loan sharks are preying like vultures on their victims, particularly the consumer-borrowers. This turn of events, contrary to their expectations, certainly perplexed and confused the legislators. So, recently, they created an anti-usury board to investigate cases of usury and to prosecute the loan sharks. There are indeed a million and one cases of usury, but when it comes to asking the victims to assist in their prosecution, the board would hit a snag. Only the few victims who realize that ingratitude is the only escape from their financial embarrassment would dare to cooperate.

If then the mere passing of severe measures with their *in terorrem* threats of imprisonment has not only aggravated the usury problem but has even hindered the progress of commerce and industry, what then should the solution or solutions be? A brief survey of the manner in which the principal countries of Europe and the States of the American Union have solved or are trying to solve this problem will certainly prove to be most illuminating and practical.

II

SOLUTION OF USURY PROBLEM IN EUROPE

In France

Until the middle of the 18th century, the French laws against interest were known as the most severe in Europe. But notwithstanding this severity, particularly that of the edict of 1766 by which the French King had attempted to reduce the legal rate of interest from five per cent (since 1665) to four per cent, money continued to be lent in France at rates above the maximum, the law being safely and easily evaded in several ways. At about this time, however, a monetary crisis occurred in Angouleme. After a series of suspensions of payment, failures, and bankruptcies, the bankrupt borrowers of Angouleme, unable to get further advances, combined to prosecute the creditors under the usury laws.[26] Turgot, an Intendant of the place, thereupon took up the defense of the money-lenders and accordingly submitted his memorandum "Sur Les Prets d' Argent"

[26] Ryan, *op. cit. supra* note 17, at 48, citing Adam Smith, *Wealth of Nations* (1784), bk. ii, ch. 10, p. 45.

in defense of interest. A writer [27] summarizes this work as follows:

"Dividing his subject into three parts, in the first he established the necessity of interest-bearing loans for the exigencies of trade and industry and proves that the rate is variable in proportion to the abundance or scarcity of capital and to the nature of the risk. In the second part he refutes the arguments of scholastic philosophers, of jurisconsults and of theologians. In the third part he seeks the historic causes of the hatefulness of usury and of the bad reputation of money-lenders.

"Finally in a strong based conclusion, he prays that interest-bearing loans be legalized and that the rate be left to the free agreement of borrower and lender, and that usurers who prey upon the passions and inexperience of youth be punished only by the laws relating to breach of confidence and other kinds of imposition."

Attacking the idea of statutory maximums, Turgot argues:[28]

"There is no reason for a law which fixes the rate of interest. The rate ought to be, as is the price of all commodities, fixed by the agreement between the two contracting parties and by the relation of supply and demand. * * *

"The rate of interest is, moreover, even more difficult to fix than is the price of any kind of merchandise because the rate of interest follows circumstances and considerations much more delicate and variable than does the price of a commodity, which are the time of making the loan, the time at which payment is stipulated, and especially the risk or the opinion of the risk which the capital must run. This opinion varies from one time to another; a momentary alarm, a series of bankruptcies, rumors of war, can cause a general uncertainty which suddenly tightens all negotiations for money. The opinion and the reality of the risk vary still more from one man to another and are augmented or diminished in all possible degrees. Consequently there must be just as many variations in the rate of interest."

Turgot's defense was so able and convincing that it not only caused the acquittal of the money-lenders but also influenced the National Assembly to repeal the usury laws. Since then, France has never committed the mistake of fixing a statutory maximum rate of interest.

In England

During the early period of her history, England had penal enactments prohibiting the lending of money at any rate

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[27] Leon Say Turgot (Anderson's Translation, 1883), p. 81, cited by Ryan, *ibid.*, at p. 49.

[28] Ryan, *op. cit. supra* note 17, at 50.

of interest whatever, under punishment more or less severe ranging from forfeiture of chattels, lands, and Christian burial, under Alfred, to a loss of all substance, whipping, exposure in the pillory, and perpetual banishment, under William the Conqueror. In 1545, recognizing the needs of business and commerce, England legalized the taking of interest by the Statute of Henry VIII, because, as the Act declared, "the statutes prohibiting interest altogether had so little force or no punishment ensued." This Statute was, however, repealed by 5, 6 Edward VI, c. 20, seven years later, but reenacted by 13 Elizabeth, c. 8, in 1571. The maximum rate was fixed at 8% by 21 James I, c. 17, in 1624, and later reduced to 7% by 12 Charles II, c. 13, in 1660, and finally to 5% by 12 Anne, c. 16, in 1713.[29]

But, as one writer observed:[30]

"Legal limitation of the rate of interest failed to stem the demand for credit. To be sure, the bankers were able to supply the needs of the large industrial and landed borrowers. And the pawnbrokers, favored in their rates, were able to supply the smaller needs of those who brought tangible security. But there was a large intermediate group whose demands for loans was persistent and whose security was not liquid or adequate enough to satisfy bankers and pawnbrokers. A rate of interest which would support the better loans would not support the loans which involved considerable risk. The economic demand, therefore, encountered legal limitation. The result was, inevitably, evasion."

As a matter of fact, the developing industrialism of England at this period created so great a demand for credit that the government itself was, in 1818, borrowing at more than the legal rate.[31] The same writer continues:[32]

"Spurred by industrial needs and Benthamite philosophy, the commercial and landed interests in 1818 roused Parliament to action, asking for releases from restrictions on the rate of interest which impeded the country's trade. The House of Commons appointed a select committee to consider the question of the effect of the laws regulating or restraining the rate of interest. The Committee came to the conclusion that usury laws had failed entirely to impose a maximum rate of interest but had actually raised the rates, and declared that the rate was ripe for their repeal."

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[29] Ryan, *op. cit. supra* note 17, at 45-46; Orchard, *Money-Lending in Great Britain* (1933), 13-27.

[30] Orchard, *ibid.*, 35.

[31] *Ibid.*, 39.

[32] *Ibid.*, 39-40.

Thereafter the laws were gradually relaxed until they were completely repealed in 1854.

Perhaps, the man greatly responsible in opening the eyes of his countrymen to the folly of their predecessors, was Jeremy Bentham, the great economist and jurist. His "Letters in Defense of Usury" is an unanswerable polemic against attempting to control interest rates by statute. It suffices here to point out the manner in which, according to him, usury laws accomplish harm to the commonwealth:[33]

"(1) Fixing a rate of interest also fixes a minimum security. Persons who cannot furnish this security cannot borrow. (2) The effect is to raise the rate higher than it would naturally have been, because the lender, in addition to requiring insurance against ordinary risks of lending, must now charge more in order to make up for the extra risk of being prosecuted for usury. He has to be indemnified against the law. Law-abiding lenders withdraw from the field, and those who remain, because of the scarcity of loanable funds for this type of loan, can charge higher rates. (3) The law being continually broken creates in the popular mind a disregard for law. (4) Such laws corrupt the morals of the people, by encouraging borrowers to enter into usurious contracts in order to take advantage of lenders. (5) Such laws declare something to be a crime which is no crime at all. (6) There are a great many ways of evading the law, such as commissions, fees, selling accepted bills at an undervalue, etc."

With the repeal of the usury laws, relief in cases of true or moral usury, i. e., where the money-lender is guilty of unfair dealing or of taking undue advantage of the necessity or inexperience of the borrower, was administered by the courts. In such cases, the courts had power to reopen the transactions and modify the agreement of the parties in accordance with the equities of the case. The exercise of this power by the courts is now defined by the Money-Lenders' Act of 1900, as amended by the Money-Lenders' Act of 1927.[34] Under the latter Act, the Court, unless the contrary is proved, should presume the interest excessive and the transaction harsh and unconscionable if the rate charged exceeds 48 per cent a year. But this level of 48 per cent a year is not an absolute maximum; rather, it is a turning point for the burden of proof; in other words, even if the rate charged be 100%, yet if it can be shown by the circumstances of the case, such as the type of the loan, duration, security, and risk, that the rate is justified, the Court will up-

[33] Ryan *op. cit. supra* note 17, at 56.

[34] 17-18 Geo. V, c. 21.

hold the contract. In accordance with this legal provision, the Court of Appeal has held that 80% interest a year is not necessarily excessive,[35] and the King's Bench Division has held that 160% interest a year is not excessive under certain circumstances.[36] Lord Justice Slesser, in pointing out in the first case the circumstances which justified the higher rate of interest, remarked: [37]

"It is not a case of a man who is in difficulties who cannot escape and advantage is taken of him, and that, therefore, is harsh and unconscionable. The terms were very stiff and his business was extraordinarily speculative, but he was making large profits. * * * This was a true matter of business embarked upon by a gentleman who struck me as being * * * a man of great intelligence * * * carrying on a high class of business, simply finding that his business is so speculative that he cannot get finance from the bankers, but so profitable in his skilful hands that he can make profits which can pay 60 or 80 per cent interest. * * * The policy of the Act was to enable the Court to prevent oppression, leaving it in the discretion of the Court to weigh each case upon its own merits."

In Germany and other European Countries

In Denmark, the usury laws were repealed in 1855; in Spain, in 1856; in Sardinia, Holland, and Norway, in 1857; in Saxony and Sweden, in 1864; in Belgium in 1865; and in Prussia and the North German Confederation in 1867.[38]

III

SOLUTION OF USURY PROBLEM IN THE UNITED STATES

In 1661, Massachusetts adopted a usury law fixing a legal maximum rate of 8% per annum, and providing for the avoidance of the contract in case of its violation. Several States followed suit, modelling their statutes after that of 12 Anne, c. 16. These laws were quite severe, most of them providing for either the forfeiture of the contract or even three times of the principal.

But, as in Europe, the writings of Turgot and Bentham had a powerful influence in opening the eyes of the American legislators to the futility and mischief of general usury laws. Efforts were started in different States to lessen the severity

[35] Reading Trust, Ltd. vs. Spero (1930) 1 K. B. 492, 99 L. J. K. B. 186, 142 L. T. 361, 74 Sol. Jour. 12, 46 T. L. 117.

[36] Parkfield Trust, Ltd. vs. Dent (1931) 2 K. B. 579.

[37] Reading Trust, Ltd. vs. Spero, *supra* note 35.

[38] Ryan, *op. cit. supra* note 17, at 57.

of the usury laws or to modify or repeal them. So, just as Massachusetts was the first state to adopt a usury law, it was also the first to admit its folly, and in 1867 repealed it. New York relaxed its usury law even earlier, for in 1850 the legislature enacted an amendment prohibiting corporations from interposing the defense of usury in any action. This was followed by the exemption of call or demand loans, by the reduction of the penalty in the case of banks so that they forfeit only the interest in case of usury, and later by the enactment of a small loan law taking out consumptive loans from its control.[39] But even then, this did not prevent Mr. Chief Justice Parker of the New York Court of Appeals from characterizing the New York usury law as "an Act to prevent the man without means from borrowing money." [40]

So deep, however, has been the faith of the public in the usury laws as a panacea for high rates of interest that, in spite of the writings of such brilliant economists as Fischer, Marshall, Carver, Taussig and a host of others, only Massachusetts, Maine, Nevada, New Hampshire and Colorado have so far succeeded in abolishing their usury laws.

In the meantime, the usury laws of the different states continued to be evaded. Not only in the field of consumers' loans, but also in the field of investment and commercial loans were unlawful rates of interest charged. And this, in spite of the wealth and credit facilities of the country. As late as Nov. 26, 1915, Mr. John Williams, Comptroller of the Currency made the following announcement:[41]

"Twelve hundred and forty-seven national banks in thirty-six states, covering thirty-six per cent of the area of continental United States outside of Alaska, in their statement of Sept. 2, 1915, admitted under oath that they were charging on some of their loans rates in excess of the maximum rates permitted by laws of their own states or of the United States.

"Ten hundred and twenty-two national banks in twenty-five states were by their sworn statements charging an average of not less than ten per cent and in some cases eighteen per cent on all their loans."

In 1921, Samuel Untermyer, as a member of the Lockwood Committee, learned by sworn statements that savings banks,

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[39] Ryan, *op. cit. supra* note 17, at 59-60.

[40] People v. Warden, 176 N. Y. 177.

[41] Ryan, *op. cit. supra* note 17, 113, quoting the *New York Sun*, Nov. 27, 1915.

life insurance companies, trust companies, estates, loan companies, mortgage brokers, and money-lending institutions were, in the guise of bonuses, commissions and discounts, receiving interests at rates as high as 50% per annum. Mr. Untermyer was so convinced of the futility and mischievousness of the usury law that he strongly advocated its repeal, and pointed out that it was not to be expected that money could be borrowed at six per cent when investors could buy tax-exempt securities that would yield almost that amount, and could buy the highest class of railroad and industrial bonds on an eight per cent basis or better.[42]

But greater still was the evasion of the law in the field of consumers' loans. Such loans are usually procured to satisfy the ordinary necessities of life and tide over such emergencies as sickness, death, unemployment and the like. They are usually small, and because of their size, duration, and the greater risk involved, they are not accommodated by the ordinary commercial banks. As a result, people in need of them have to resort to private unlicensed money-lenders, many of whom are unscrupulous and have come to be popularly known as "loan sharks."

Gallert [43] reports that at about the beginning of the present century the best procurable evidence showed that in the American cities of over 25,000 inhabitants about one family in five was a victim of loan sharks who charged interest at rates as high as 1,300 per cent a year. Such indeed were the evil consequences arising from the practices of the loan sharks that one judge was forced to remark that these said practices had "brought on conditions which were yearly reducing hundreds of laborers and other small wage-earners to a condition of serfdom in all but name." [44]

It soon began to dawn to the public that there was a difference between the so-called investment or commercial loans and the consumers' loans; that the type of security given for the latter, their duration, and the greater risk involved justified for them a different treatment; and since, at the prevailing legal rates, no person can profitably conduct the business of lending to small borrowers, a higher legal maximum rate for small loans was absolutely necessary. So, at the end of the last century, some public-spirited citizens started the idea of establishing semi-philantrophic remedial loan societies, and accord-

[42] *Ibid.*, at 119.
[43] Gallert, *Small Loan Legislation* (1932), 54.
[44] In re Home Discount Co., 147 Fed. 538, 546 (1906).

ingly petitioned the legislatures for proper authority. Ohio, Rhode Islands and New York were the first states to recognize the beneficent purposes of these societies. Under the laws thus passed, these societies were allowed to charge rates of interest as high as 3% a month; but there was a statutory limit set on the payment of dividends.[45]

These societies, however, grew so slowly as to practically leave the problem of the loan shark unsolved. Moreover, there were not enough philantrophists to risk their money on the operations of such societies. But something must certainly be done. So, the Russell Sage Foundation, a charitable institution of New York directed its efforts to the solution of the problem. It formed the National Federation of Remedial Loan Associations and encouraged the further establishment of such societies. It then began the study of the adoption of a uniform law which will, by allowing a higher rate of interest, attract private capital to enter the small loan business under government supervision. The results of the studies of the Foundation by 1916 are summarized by Gallert: [46]

"The investigations of the Russell Sage Foundation and the experience of the semiphilantrophic societies had shown the lending of small sums to be a social necessity. And as a logical consequence, the death of the theory of prohibition gave added vitality to the theory of regulation and supervision of commercial lenders. This development is made clear by a series of principles which, by 1916, had thoroughly established themselves.

"1. The business was recognized as a public necessity.

"2. To obtain sufficient capital to supply this necessity the law had to allow the business to be conducted on a commercial basis, and to authorize a return which would attract into the field enough capital to supply the needs of borrowers.

"3. This return had necessarily to be above the usual legal contract rate and the conventional banking rate of the state.

"4. In consideration of this higher return on loans, the business had to submit to public supervision and regulation.

"5. Such supervision and regulation were necessary to prevent lenders from abusing their privileges and to protect the section of the public most needing protection.

"6. The law had to contain certain regulations for the conduct of the business, which experience had shown to be necessary.

"7. The law had to govern all loans below a certain amount, except such as were otherwise specially regulated by law.

"8. The penalties of the law had to be such that the law would be effective."

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[45] Gallert, *op. cit. supra* note 42, 22-25.

[46] *Ibid.*, at 113.

In accordance with these principles, the Uniform Small Loan Law was drafted late in 1916. Briefly, the Act required all lenders charging more than the banking rate of interest to submit to license, execution of a bond, and frequent examination by the state banking department. It set up numerous safeguards regarding the keeping of books, method of making loans, for the protection of the borrowers; and provided adequate penalties for violation (fine or imprisonment in the discretion of the court), with power of enforcement in the hands of the supervising authority. The Act was, however, limited to loans of not more than $300. On such loans licensed lenders were authorized to charge an interest rate of not more than 3½% per month, to be computed on unpaid balances, without fees or other charges. Pawnbrokers and building and loan associations were exempted from the limitations of the law.

The Law was hailed as one of the most effective means of driving the "loan shark" out of business. Year after year, it gradually found its way into the statute books of the different states and by 1932, 36 states of the Union have passed laws patterned after it.[47] Speaking of the effects of the Law in Illinois, the Assistant Director of the Department of Trade and Commerce of Illinois said:[48]

"After two and one half years' experience in Illinois, I believe it has driven the old-time loan shark out of the business here. It is estimated that there are loans aggregating $15,000,000 under this Act in my state.

"The minimum old rate obtaining in Illinois prior to the enactment of this law was ten per cent per month. The Uniform Act provides for a rate of not to exceed three and one-half percent per month. This alone has saved borrowers in Illinois upward of $4,000,000 per year."

Summing the beneficial results of this type of law, Dr. Robinson remarked:[49]

"There is no question but that these laws have brought very beneficial results to both borrower and lender. Borrowers may now obtain their loans at less than one-third of the former cost, and have in addition the security of dealing with state-supervised concerns. On the other hand, the legalization of the small loan business has meant that responsible men could engage in it without disgrace and without fear of prosecution.

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[47] *Ibid.*, at 88.

[48] See Ryan, *op. cit. supra* note 17, at 139.

[49] Robinson, *Ten Thousand Small Loans* (1930), p. 14.

As a consequence, new men have come into the field, bringing with them higher standards and additional capital. Legalization has greatly improved the reputation of the business."

Besides drafting the Uniform Small Loan Law, the Russell Sage Foundation also drafted a Uniform Pawnbroking Bill. This Bill seeks to regulate the business of pawnbroking, and provides for a rate of interest of 3% per month. Many states are adopting laws patterned after it.[50]

In Minnesota

Inasmuch as the Philippine Law of usury was to a large extent modelled after that of Minnesota, and inasmuch as Mr. Justice Malcolm referred to this Minnesota law as "the most advanced American legislation," this survey of American attempts to solve the usury problem must necessarily be climaxed by an inquiry into the present status of the usury problem in that state and the trend of the movement to solve the said problem. For this purpose, no evidence could be better than the report of the findings and recommendations of the Interim Committee of the House of Representatives of Minnesota submitted in 1929. The most salient of these are:

"That the general usury laws of this state and of other states are such as to render it impossible for the average consumptive borrower to obtain money at a rate of interest within the limit fixed by law. * * *

"That to meet the needs of this large class of borrowers who cannot obtain money at legal rates of interest, the loan shark has appeared, supplying the need, but at unreasonable and extortionate rates of interest. * * *

"That in the large industrial centers of Minnesota, as in smaller centers of population in other states where effective legislation has not been enacted, loan sharks do a thriving business based upon rates of interest which range from 120 to 400 per cent per annum and higher. * * *

"That laws such as the general law of this state are ineffective in curbing the loan shark evil, because they are arbitrary and unsound in principle in that they do not make proper allowance for the various types of loans, the difference in credit and security possessed by borrowers and the elements of expense involved in the making of loans. * * *

"That in theory there are four possible methods of dealing with the loan shark evil: * * *

"The second method above suggested, i. e., that of attaching a criminal penalty to our general usury law, is inexpedient * * * because if effectively enforced, it would deprive nec-

[50] Raby, *The Regulation of Pawnbroking* (1924).

essitous borrowers of a source of funds to tide them over periods of emergency and throw them on charity for relief. * * *

"That the fourth method suggested, i. e., to legalize the lending of small sums of money at prescribed rates in excess of the general maximum interest rate, fair both to lender and borrower, with provision for state licensing, inspection and supervision of the lender, offers the only practical method of exterminating the loan shark. * * *

"That the enactment of legislation allowing a charge of three and one-half per cent per month, with proper safeguards to borrowers has brought legitimate capital to the small loan business and has elevated this business to a plane of decency and respectability where it properly belongs.

"Recommendations

"1. That the extension of credit unions as authorized by Chapter 206, Laws of 1925 should be encouraged.

"2. That the bill hereinafter set forth, being the Uniform Small Loan Law with slight modifications, be enacted by the legislature of the State of Minnesota."

IV.

WHICH WAY, PHILIPPINES?

The foregoing survey cannot but lead to the conclusion that the present Philippine law of usury is an anachronism in our legal and economic system. It is arbitrary and unscientific. It is nothing but "an antiquated skeleton from which all semblance of animate life has long since departed." It is an obstruction to commerce and trade, and instead of affording a relief to the poor needy borrower, it has placed such borrower at the mercy of the unscrupulous loan shark. France realized this bitter fact long ago. So with England, Germany, Spain, Holland, the United States; in fact, nearly every modern and progressive country of the world.

Therefore, at this time when the Philippines enters into a most crucial era of economic readjustment and development which necessitates a free flow of capital and credit, our lawmakers must examine our usury law in the light of the experiences of other countries. This is an age of realism, and the facts must be faced as they are. Mistakes must be admitted and then corrected. The eyes of the rest of the world are focused upon us. And nothing can amuse them more than to see us clinging tenaciously to measures which their jurists and economists have long found to be outmoded and antiquated.

The Philippine law of usury must, therefore, undergo a major revision in order to be able to meet the demands of trade

and commerce, and particularly those of the small necessitous borrower who could hardly offer a security for the smallest loan. Before, however, laying down the general outline of a revised usury law, it will be appropriate to make some general suggestions which are conducive to the easing of credit facilities, namely:

1. The Philippine National Bank, should open branches in all the first class towns of the Islands. These branches must receive time savings and demand deposits, and make agricultural, commercial and consumers' loans. It is surprising that while the United States with its 124 million population has about 30,000 banks, and Canada with its 11 million population has about 4,000 main and branch banks, the Philippines, with its 14 million population, does not have more than 30 banks; and yet it has the most severe law on usury. What the effect of such law on the trade and commerce of the Islands can be easily imagined.

2. The requirement that no loans by banks on the security of real estate shall be made unless the title to such real estate shall have first been registered under the Torrens system must be abolished or at least suspended. The purpose of such requirement was to induce people to register their lands under the Torrens system. But this purpose could just as well have been accomplished by prescribing a lower rate of interest for lands so registered. But inasmuch as it takes time and money to register a piece of real property under the Torrens system and most people do not think of such registration except when they decide to borrow, the result has been that the present requirement has retarded the growth of banks as well as of trade and industry. If even the States of the Union, with their vast wealth and credit facilities, do not require Torrens titles as the only form of real estate security, for the Philippines to make such absolute requirement when it is evident that there are other land titles which are just as safe is sheer folly.

3. The Philippine Government should establish pawnshops in every town or municipality, or at least authorize and encourage them to do so. This is the practice of France, Belgium, Holland and other European countries. True cases of usury exist only in the field of consumers' loans. It is here where we find the necessitous and/or inexperienced borrower who falls easily a prey to the avarice of the loan shark. Municipal pawnshops will certainly be most effective in minimizing these cases.

4. Postal Savings Banks *should* be established in every town, and their existence and purpose must be brought home to the people by an aggressive campaign. At present, even when such banks are established in many municipalities, they are as mysterious and less understood as Einstein's theory of relativity.

5. The Bureau of Agriculture should make an aggressive campaign to encourage the establishment of agricultural credit associations in all towns and municipalities. So far, the Bureau has been very inactive. It is now time for it to wake up and sell the idea to the people. The abuses pointed out by Representative Romero [51] in connection with the administration of some societies should be avoided by limitation as to amount and duration of loans. A law should be passed allowing the establishment of credit unions in urban centers. In the United States, these unions do not only thrive among farmers but even among the urban population.[52]

With the foregoing general suggestions, we can now proceed to set forth the general outline of a revised usury law:

1. As we have already seen, the Interim Committee of the House of Representatives of Minnesota characterized the Minnesota usury law as "arbitrary and unsound in principle" in that it does" not make proper allowance for the various types of loans, the difference in credit and security possessed by borrowers and the elements of expense involved in the making of loans." A truly "advanced" usury law, therefore, should make a distinction between productive or commercial loans and the ordinary consumers' loans. True usury or moral usury which Ryan [53] defines as "taking advantage of the ignorance or necessitous condition of the needy borrower so as to get him into a hard bargain and exact from him unduly high charges" and which it is the social purpose of so-called usury laws to prevent, can only exist in the field of consumers' loans. The reason is that the need for such loans is often so pressing that borrowers will submit to any terms, however, harsh and unconscionable. In other words, in such loans, there is no room for the full play of the economic law of supply and demand. This is not the case, however, with investment or commercial loans. Here the need is not for the vital necessities of life, but for agriculture, commerce or industry. The borrower is, therefore, in a position to

[51] Romero, *op. cit. supra* note 16, at 119.
[52] See Bergrenghen, *Credit Unions* (1930).
[53] Ryan, *op. cit. supra* note 17, at xii.

bargain. Knowing that it is unwise of him to pay a rate which will not give him a margin of profit, he will only offer to pay such a rate as will yield him such profit; otherwise, he will either refrain from borrowing or go to another lender. In contrast, then, with consumers' loans, in this kind of loans, there is room for the full play of the economic law of supply and demand which for statutory law to prescribe will prove detrimental to trade and commerce. This is Turgot's and Bentham's most effective argument against a statutory maximum rate. The European countries have recognized this fact and have abolished statutory maximum rates. The states of the Union, too, have recognized it and have either abolished the general usury laws or have directed their efforts toward the regulation of the small or consumers' loans.

A revised usury law for the Philippines should make a different provision for productive or commercial loans and for consumers' loans. A presumption should be made, as in America, that small loans of a certain amount, say ₱300 or less, are consumers' loans. This is the theory of the Uniform Small Loan Law. Now, for the productive or commercial loans, I recommend the adoption of the English system under which the Court, unless the contrary is proven, should presume the interest excessive and the transaction harsh and unconscionable if the rate charged exceeds 48% a year. This flexible rate of 48% may still appall some of our legislators, but when we consider that our credit facilities are nil compared with those of England, it is certainly time for us to ponder and consider the effects of a very low statutory rate upon our economic development. But whatever the rate is, it should be flexible, leaving it to the court to determine from the circumstances of the case—the place of the making of the loan (in Manila or in the provinces), the time of the making of the loan, the time set for payment, the nature of the security given, the general credit of the borrower, the expenses involved, the nature of the industry or line of business for which the loan is intended, and the like—whether the rate stipulated is excessive and the transaction is harsh and unconscionable. In other words, as Representative Romero intimated,[54] the judges must be given full discretion to determine "where justice for the debtor ends and injustice for the creditor begins."

2. Going now to the consumers' loans which are set at ₱300 or less. These loans, as their name implies, are those bor-

[54]. Romero, *op. cit. supra* note 16.

rowed for the purchase of the daily necessities of life or for tiding over such emergencies as sickness, death or unemployment. It is obvious that loans for such purposes will not ordinarily exceed ₱300. For the regulation of such type of loans, the adoption of the Uniform Small Loan Law with some modifications to suit Philippine conditions is strongly recommended. The passage of such a law will lead to the rise of the small loan or personal finance business.[55] Inasmuch, however, as such business cannot be profitably handled in all the towns of the Philippines, the operation of the Small Loan Law should be limited to cities and first class municipalities. It is evident that if a man's capital is only ₱10,000 and assuming that the maximum rate is 3½% per month and that the whole capital is actually utilized, his net income, after deducting salaries for bookkeepers, credit investigators, collectors, other miscellaneous expenses, and bad debts, from the gross income of ₱4,200, will be such as could scarcely yield a return of 10% on the investment. To assure a safe yield, therefore, the capitalization must be at least ₱15,000 or ₱20,000. Now, in many of the municipalities there are not enough people who can afford to make such investment. Moreover, even if there are, there will not be enough borrowers to make full use of the services of the small loan business. The operation of the Small Loan Law should, therefore, be limited to cities and first class municipalities.

The next question is on the maximum rate of interest. The Uniform Small Loan Law in American prescribes a flat rate of 3½% per month on unpaid balances. But inasmuch as the Philippines is many times behind the United States in comparative wealth or credit facilities, a higher rate in the Philippines in order to attract private capital is certainly justified. Moreover, one criticism against the flat rate of the Uniform Small Loan Law is that, inasmuch as the cost of making a $25 loan is the same as that of a $300 loan, thus causing the latter loan to be much more profitable, it often happens that a small loan company will refuse to make loans of ₱50 or less. As a result, the loan shark must still have to take care of small loans at exceedingly high rates of interest, To cover this loophole and to alleviate the effects of the lack of capital and credit in the Philippines, an ideal small loan law must prescribe the following rates:

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[55] For a descriptive study of this new type of business, see Neifield, *The Personal Finance Business* (1933).

For balances of ₱25 or less, 5% a month; of ₱25.01 to ₱75.000, 4½%; of ₱75.01 to ₱150.00, 4%; of ₱150.01 to ₱200.00, 3½%.

a. As for municipalities other than those in the first class, a uniform small loan law requiring the licensing and strict regulation of the small loan business cannot be made mandatory, inasmuch as in such small municipalities there is not enough capital nor are there enough borrowers to justify an investment in a regular small loan business. However, the rates of interest must still be regulated, inasmuch as it is in this type of loans where true or moral usury abounds. But, at the same time, the rates must be such as to permit people to assume the risk of making occasional small loans to those who may not even have anything to offer as security. For, if the rates are too low, either the poor needy borrowers without any kind of property to offer as security will be prevented from borrowing or even if they can, they can only do so from loan sharks. An ideal system of maximum rates for consumers' loans and small municipalities would be the following:

For unpaid balances of ₱25.00 or less, 3½% per month; of ₱25.01 to ₱75.00, 3% per month; of ₱75.01 to ₱150.00, 2½% of ₱150.01 to ₱300.01, 2%.

3. Pawnshops.—The present rates of interest for pawnshops are too low to attract capital to the business. As a matter of fact, the usury law has driven many pawnbrokers from the business, and those who remain often depend more on the foreclosure and sale of the pledged chattels than on the interest accrued or earned. The present rates are 2½% for loans below ₱100; 2% for loans between ₱100 and ₱500, and 14% per annum for loans over ₱500. In the United States, the rate provided for by the Uniform Pawnbroking Bill is 3% per annum for loans of $300 or less. It is very clear, therefore, that the Philippine rates are too low compared with those of the richest country in the world. A system of rates, then, which is more consistent with our economic condition and which is high enough to attract private capital should be the following:

For unpaid balances of ₱25.00 or less, 4½% per month; of ₱25.01 to ₱75.00, 4%; of ₱75.01 to ₱150.00, 3½%; of ₱150.01 to ₱300.00, 3%.

4. Building and loan associations.—In view of the beneficent functions of such institutions in marshalling the savings of the poor and encouraging the construction of homes, their promotion and establishment should be encouraged rather than retarded.

And inasmuch as the borrowing is limited to members and inasmuch as all earnings after deducting the overhead and other expenses ultimately go to the members, including the borrowers themselves, there seems to be no logic in limiting the rate of interest chargeable by such institutions. In the past, whatever abuses might have been responsible for the legislative antipathy towards these institutions have been due to the frauds of their officers. Legislation should, therefore, be directed towards their administration rather than on the rate of interest chargeable. The rate of interest should be left to the play of the law of supply and demand, and ultimately on the determination of the court as to the excessiveness or unconscionableness of the rate charged under the circumstances of the case.

The foregoing suggestions and recommendations, do not pretend to solve the problem of usury, more particularly moral usury, once and for all. But it is submitted that they are more realistic and scientific than the ancient and medieval types of usury legislation, the features of which characterize our present usury law. It is expected that instead of being an obstruction in our economic system, they will not only drive the loan sharks but will also assist immeasurably in the adjustment and development of our national economy which, at present, as everyone must admit, is under the stress of uncertainty if not immediate paralyzation. Practical realism and sane rationalization, instead of blind guesswork and asinine adherence to outworn concepts, are the need of the hour.