

FRENCH LEGISLATION AND THE DEVELOPMENT OF CREDIT AVAILABILITY FOR MICROENTERPRISE

Laurence Attuel-Mendes, CEREN-Groupe ESC Dijon-Bourgogne
Arvind Ashta, CEREN-Groupe ESC Dijon-Bourgogne

ABSTRACT

The failures of the socialist model, evidenced by high unemployment, have led France to reorient itself towards more enterprise creation. These entrepreneurial ventures require financing. However, bankers do not want to assume the high risk of newly created enterprises. Moreover, small entrepreneurs who do manage to get financing may find themselves rationed at the margin if the rate of credit is capped by the legislature. Concurrently, the growth of microfinance in the world has shown that innovative techniques can increase credit availability, without unduly high risk. However, such increased credit availability may not materialize if credit rates are capped by usury laws, as it was in France. This paper traces out a number of legislative changes that took place in France in the last five years, focusing especially on usury laws and other barriers to credit. It places these legislative changes in a perspective of Western Europe's socialist model, comparing legislation on credit and usury in a number of developed countries. It also examines if these legislative changes have been accompanied by the desired impact. Finally, it examines alternative future legislative evolution possibilities.

JEL: D45, D53, E22, E4, G18, I38, K20, K29, N10, N20

INTRODUCTION

The Western European socialist model has led to certain failures, including notably the high unemployment rate in many countries. The high cost of unemployment benefits and associated inactivity traps has led to thinking that the EU should move from a model of "handouts" to that of "hand-ups". Although the average EU unemployment rate has gone down from 10% in 1995 to 7.7% in 2006, the rate in France hovers around 9.5% (Eurostat). This necessitates high transfer payments to unemployed workers. Partly, the higher than average unemployment in France is due to the fact that France has much less entrepreneurs than other Western European countries. For example, for a similar population level, France has 2.4 million enterprises compared to 3.4 million in the UK. Moreover, the number of new enterprises created in France had fallen from 200,000 per year in the 1980s to 175,000 per year in the 1990s. Since economic development and the need to reduce unemployment required more businesses to be created, France examined the obstacles to new enterprise creation. One of these obstacles was funding. It is impossible to use only self-financing to create new enterprises and the entrepreneur must therefore resort to credit. There is, however, an impediment to financing in that bankers do not want to assume the high risk of financing many newly created enterprises.

Nevertheless, the growth of microfinance institutions all over the world has alleviated this problem in many poor countries. However, microfinance cannot grow if there are interest rate caps on usury legislation. The next section conducts a brief literature review on microfinance and on usury legislation and explains how they are related.

LITERATURE REVIEW

A thorough review of microfinance theory has been made recently by Armendariz de Aghion & Morduch (2005), including review on topics such as comparison with other similar credit institutions, group lending, other incentives to repay, microsavings, microinsurance, sociological aspects such as gender,

difficulties in measuring social impacts, subsidies, sustainability and management issues in microfinance. Zeller and Meyer (2002) contains a compilation of papers focusing on what they termed the triangle of Microfinance: Outreach, Impact and Sustainability. Much theoretical research continues in these areas. For example, Egli (2004) researches progressive lending as an incentive to repay and shows that there is a strong tendency to split up projects into subprojects, and that it might be necessary to perform less productive projects first in order to keep pressure on the borrower to repay. Similarly, Sriram (2005) studies how social collateral contributes to trust in lending with asymmetric information. McIntosh et al (2005) confirm that increased competition between Microfinance Institutions (MFIs) lead to a drop in repayment rates. Chowdhury et al (2005) study the social impact of microlending in Bangladesh and distinguish between objective and subjective poverty (subjective poverty is if the respondent feels he is poor) and find that there is some improvement for six years and then there is a leveling off. Daru et al. (2005) show that Microfinance by itself is not a panacea, but needs to be combined with education, skills, hygiene, health, social awareness, collective bargaining and legal property framework to reduce the impact on poverty and debt-bondage. This is in line with Ledgerwood and White's (2006) recommendation that MFIs should provide full financial services to the poor (including not only microcredit, but also savings, insurance, remittances, etc.) and, more particularly, with Bedson's (2007) recommendation that industry should start forming partnerships with Microfinance Institutions to provide other non-financial services too. At the same time, with financial sustainability, more and more private investments are coming into the field (Matthäus-Maier and Von Pischke, 2006). Thus, Microfinance seems to be a very interesting subject in terms of poverty alleviation as well as a business model in its own right.

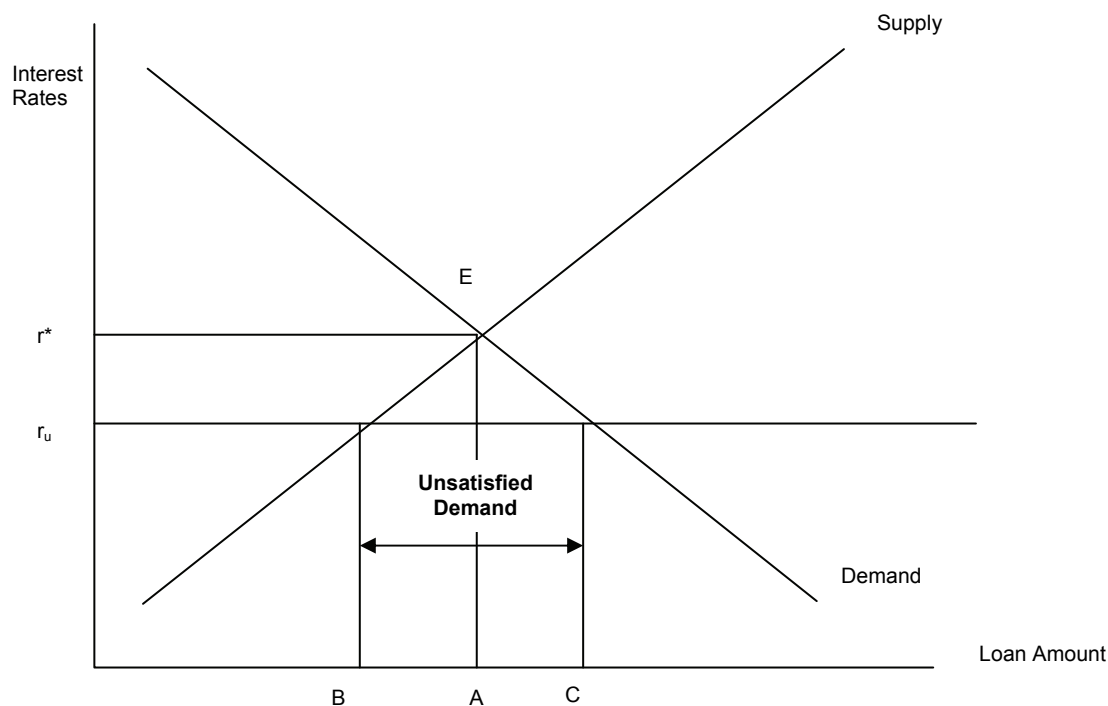
Micro lending is different from commercial banking (Armendariz de Aghion & Morduch, 2005; Evers & Jung, 2007) in terms of small loan sizes, quick and easy access, non-traditional credit worthiness evaluation, and alternative collateral requirements. Microfinance targets some non-profit maximizing goals such as social inclusion, job creation, micro enterprise development and development of regions. In most countries where microfinance has taken off, the institutions offering credit to the poor are charging interest rates varying from 40% to 100% on average (Honohan, 2004). These rates are higher than conventional banking rates because of high overheads for evaluation and recovery for the small size loans, high risk of lending to start ups, inflation fears, lack of court enforcement and lack of sufficient competition between financial intermediaries (Armendariz de Aghion & Morduch, 2005; Honohan, 2004). However, the rates charged by MFIs are lower than those charged by moneylenders owing to their access to cheaper sources of finance (Ashta, 2007).

Although MFIs are not profitable without scale, it still makes economic sense for welfare states to support such institutions as a means of paying less dole. Microfinance helps create microenterprises, which create jobs and self-employment. In France and other Western European countries, however, microfinance has not really taken off whether it is in terms of outreach, impact or sustainability (Evers & Jung, 2007). European MFIs have very low outreach: about 100 loans per year per institution on average, perhaps because most institutions are new (most were created after 2000), but also because family and friends pitch in, banks cream off the good risks, and credit card debt and consumer loans are available. Even the French Microfinance institution, ADIE, founded in 1989, has only about 6000 clients per year, compared to 6 million clients for each of the big three institutions in Bangladesh (Grameen, ASA and BRAC). European MFIs also have had very low impact: MFI financed entrepreneurs are doing only as well as other entrepreneurs. Finally, European MFIs do not have the pressure of aiming for institutional financial sustainability because a lot of social money is available on a regular basis, donor organizations are looking for social results and NGO MFIs have other objectives.

Thus, Europe needs to develop microenterprise, but owing to a lack of credit supply, this is not developing as fast as required. Evers and Jung (2007) estimate that 20% of West European SMEs are facing financing constraints. They need high interest spreads to cover risks of start-ups. However,

Western Europe legal and public morals do not allow high interest rates as evidenced by usury laws. Therefore, even the creators of SMEs and micro-enterprises who have access to credit may find themselves rationed at the margin, if the rate of credit is capped by usury laws. The rationing of credit by usury legislation is depicted in the accompanying graph. Without usury ceilings, the equilibrium between the downward sloping demand curve and the upward sloping supply curve of micro-loans would be at E, with total loans of amount A at an interest rate of r^* . However, a usury ceiling of r_u blocks this equilibrium from taking place. At this interest rate, the maximum supply for credit is limited to B while the demand rises to C. The difference between C and B is unsatisfied demand. The suppliers of credit can decide to ration their supply to potential borrowers either by excluding some borrowers, or by providing lower amounts to all borrowers, or some combination of the two.

Figure 1: The Market for Micro-loans



This figure shows the rationing of credit by usury legislation.

A more comprehensive graphical representation of the general economic analysis can be found in Goudzwaard (1968) who also presents the case for monopolistic suppliers of funds. Other specific problems which have been studied include the particular problems of small loans and their high transactions costs leading to high interest rates and even high usury ceilings to ensure that the market is not left void through extreme credit rationing (Fisher, 1929). Hodgman (1960) considers that credit rationing is a function of risk characteristics of the borrower and the lender's willingness to supply to him. The lower risk customer could eventually find money but at higher interest rates. Blitz and Long (1973) find that it is not possible to state who gains by usury legislation: the borrower or the lender and that it depends on the level of the rate, the elasticities of substitution between different credit products (regulated and non-regulated), and the dispersion of risk among borrowers. They also find that in any case, it is not possible to control the monopolistic lender through such ceilings, nor is it possible to reduce consumption expenditure.

The economic debate on usury legislation is not new. One stream of academic literature traces the history of religious prohibition of usury. Usury legislation dates back to the Old Testament (Moser, 1997; Lister 2006), where three ancient Jewish codes contain a prohibition on interest taking. The Code of Covenant, the Law of Holiness and the Deuteronomic Code differ in their interpretation with respect to whether the prohibition on interest taking was to all Jews and all poor or only to poor Jews. In any reading, it seems interest could be charged to rich non-Jews. Similar prohibitions are contained in Christianity (Frierson, 1969), and Islam (Gambling and Karim, 1986). A review is available in a paper by Visser and MacIntash (1998) for these three religions and for Hinduism and Buddhism.

This history may have had an influence on economics. A stream of academic literature relates to discussing why Adam Smith might have defended usury laws inspite of being in favor of free trade, including Bentham's criticism of Smith's position (Hollander, 1999; Paganelli, 2003). Undoubtedly, Smith must have been influenced by religious and historical precedents.

All this explains why most countries had usury legislation at some time or other. The academic literature discusses the usury legislation in specific periods in history, mostly in the US, but with rather few forays into other countries (e.g. Harrison, 1980 studies Spain). Many studies focus on the effects of usury legislation on markets. Strangways and Yandle (1971) find that the effect of usury legislation on housing was insignificant. However, other studies (Robins 1974; Austin and Lindsley, 1976; Ostar, 1976) conclude that usury legislation restricts homebuilding.

Owing to these distortions created by usury legislation, different escape mechanisms were used by business in the wake of usury legislation. For example, departmental stores selling goods on credit use a service charge for deferred payments (Cole, 1958). Similarly, Peterson (1983) finds that people easily switch from cash credit to consumer credit to escape usury legislation. When the U.S. government clamped down on consumer credit in the 1960s, Hudson (1993) indicates that the rent-to-own industry was born. In addition, if usury legislation only aims at individuals, people use corporations to borrow money (Jensen, 1983; Boyes & Furnish, 1984).

In the wake of academic studies on the adverse impact of usury legislation, today, many countries either do not have usury legislation or have slowly dismantled their usury legislation. In the United States and Canada, there is no usury rate. The American federal laws on usury were abolished from 1978, although from time to time, there are specific regulations in some American states. Americans and Canadians are used to high interest rates, especially for consumer credit. The UK examined the possible introduction of a framework on usury interest rates in an effort to curb abusive lending to the poor, but finally concluded that it should not introduce such a framework after a study on the effect of capping of interest rates in countries where there was such regulation. In Austria, there is no ceiling on interest rates, but there is only a ban on the exploitation of the situation by one of the contract parties or abuse of a dominant position.

In other countries, there is some usury legislation or court-made law. For example, in German, usury is left for the appreciation of the courts: the pressure is generally considered excessive when the interest rate applied is twice the average rate prevailing on the market for that type of credit or where the rate exceeds the rate usually practiced on the market by 12 points. In Spain, the Act of July 23, 1908 provides for the annulment of any contract whose interest rate is significantly higher than the normal rate and patently disproportionate. For the latter, the judge decides the excessive nature. Further, an Act of 1984 on consumers and protection of the user provides a maximum interest rate for advances on current account, equal to 2.5 times the legal interest rate. Italy distinguishes half a dozen different credit types, with special provisions, in each of them, for the case of small loans. In general, everything is considered usurious at rates 50% higher than average interest rates. However, an even lower rate applied to a borrower in serious financial difficulty can be considered usurious. Nevertheless, in many of these

countries, discussions are underway to ease regulations on usury for business. Therefore, the general liberalization of the price mechanism and the globalization of financial markets have led to reforming or abolishing the usury regulation in most major developed countries over the past thirty years.

In France, the history of usury legislation shows that it has evolved with economic circumstances and reigning philosophical ideologies. After a period of complete freedom in credit practices during the Revolution, a law passed in 1807 restored legislation in this area by instituting a rate of usury, that is a ceiling for interest rates beyond which a criminal offense is constituted, compared to the statutory rate (5% in civil matters, 6% in commercial matters). A law of 1886 removed this interest rate ceiling for commercial loans in order to liberalize trade. After the First World War, in 1918, another law aligned the civil regime on the commercial one to promote reconstruction. However, ceilings were restored in 1935. The regime, until 2003, was the result of the Acts of December 28, 1966 and December 31, 1989. It was based on protecting borrowers against abusive rent levied by lenders.

The analysis of the French law, which has governed the financing of business enterprise until the early-2000s, viewed in a perspective of quasi-absolute freedom existing in many parts of the world led to major reforms in 2003 and later in 2005. The question for our study is whether the recent change in French usury legislation has had an impact of the development of microenterprise through the development of microfinance, and whether more changes are required. We will therefore outline the recent changes to the French usury legislation (Part I), study the impact (Part II) and look at recommendations in this and related areas for the future development of business and finance (Part III).

PART I: REFORM OF FRENCH USURY LEGISLATION

We will describe briefly the French usury legislation, as it existed before the reform as a background to the discussion on the reform.

The Law Before The Reform

Usury is a criminal offense governed by articles L 313-1 to L 313-6 of the French Code of Consumption. Article L 313-3 of this Consumer Code states that "any conventional loan is usurious if it is contracted at an gross effective rate that exceeds, at the time it was made, by more than a third, the average gross effective rate charged during the previous quarter by credit institutions for transactions of a similar nature involving similar risks."

According to Article L 313-1 of this Code, the gross effective rate is the rate determined by the interest, to which are added "fees, commissions or payments of any kind, whether direct or indirect, including those that are paid or payable to intermediaries who may intervene in any manner whatsoever in granting the loan, even though these fees, commissions or payments correspond to actual expenses."

Punishments are listed in art. L 313-5 of the Code of consumption. They may extend to two years' imprisonment and 45,000 € fine. One can already make two points: first, the reference to the criminal element is an exception in Europe. France's main European neighbors are unaware of this concept. This means that it is more penalizing for French banks to violate usury laws than for banks in other neighboring countries. Thus, it is more difficult for microfinance institutions, wanting to charge higher interest rates for the higher risk, to develop in France.

Secondly, the inclusion of these provisions in the code of consumption, designed to regulate the relationship between professionals and consumers (B to C) raises the question whether the usury legislation hindered the development of credit for micro-businesses, which would be a B to B transaction.

However, through a reference to these provisions in the Monetary and Financial Code, which has a broader vocation, we see that all transactions are covered.

The regulation of usury in France was (and is) not constituted by a single rate above which all loans would be considered usurious. Appendix 1 gives a snapshot of usury rates at one point in time before the reform. It shows that France uses a rather flexible arrangement that demonstrates the willingness of legislators to maintain flexibility in the "price of money", within limits depending on the economic forecasts. The method of calculation used is endogenous, because it is derived from the behavior of lenders. While maintaining a practical view of heterogeneity of the credit market, the French system demonstrated extraordinarily complex rules: the proof of this is the complexity of usury regulation, even today.

This extraordinary complexity led to a multiplication of adverse effects of the usury legislation. Firstly, usurious lending could easily be bypassed as the transaction could be undertaken by other mechanisms such as leasing and factoring. Note the similarity with Cole (1958), Peterson (1983) and Hudson (1993). Secondly, it even leads to a diversion of consumer credit, for which the ceiling rate is above 18%, to business uses, where the average interest rate on a bank loan for the creation of an enterprise is 6.79 % two percentage points below the level of the usury rate ceiling (Hurel, 2003). Thus, if a banker gives a B to B loan at 10%, it is considered usurious, but if the same banker gives the same loan to the entrepreneur as a personal loan, it is considered OK. Since money is fungible, it is not possible for the banker to monitor what is done with the proceeds of his loan and the borrower can use it as he wishes, unless the expense has been incurred for the given purpose before the credit is deblocked. Faced with increasing criticism of this legislation, considered too burdensome for business and constituting a brake on economic initiative, the legislature began a comprehensive reform of credit.

The Reform

At this time, there was an increased awareness that the difficulty of finding funding is the main obstacle to new projects. It was observed that the creators and buyers of small businesses have little access to financial markets. Despite the devices of public guarantees (frowned upon by the EU) and the intermediation of mutual guaranteeing organizations, lending to small business was often rationed. It was felt that the main reasons were the combined effects of the costs of examining the viability of a microenterprise and the international capital standards imposed on credit institutions (Basel 2) in respect to SME lending, and the low interest rate ceilings because of French legislation on "usury" (Senate Report, 2003). Although, as we have seen, usury legislation could easily be circumvented, it still constituted a brake on economic initiative, since the micro-entrepreneur is neither always financially aware nor capable of understanding the ramifications of sophisticated financial products.

Therefore, we can see that several reasons have motivated the development of the French legislation in this field to overcome the problem of bank credit rationing to the detriment of SMEs by allowing them to charge higher interest rates for micro-credit to finance the more risky activities such as the creation of business. It was considered that a high interest rate is not necessarily a social evil when the loan is contracted for a short maturity, and because in some cases, it is vital for business creators to get a minimum long-term capital.

Although, other credit reforms also took place to develop Microenterprise, such as the creation of the government loan scheme called a Loan for the Creation of Enterprise (PCE), we will limit our paper to the evolution of usury legislation. The right wing government came to power in 2002 and decided that freeing initiative was required. In the initial version of the bill for economic initiative and the parliamentary debate, which ensued, we find some alternative proposals to modify the usury legislation.

First, it was proposed to increase the usury rate for corporations to 15 points above the average effective rate. This, it was supposed, would cover the highest possible risk posed by a number of small businesses. This proposal was supported by many structures such as the French Microfinance Institution ADIE (Association for the Development of Economic Initiative), MEDEF (French Enterprise Movement) as helping to increase availability of credit. The Caisse des Depots et Consignations supported the proposal because it included the degree of risk in the price. The French Banking Federation supported it because it permitted to index the remuneration of loans on company performance. On the other hand, the proposal instilled a fear in the minds of businesspersons that higher rates could lead to inflation.

A second proposal was suggested by the president of the CGPME (General Confederation of Employers of Small and Medium Enterprises). Since the processing of small loan applications leads to high management costs and the reluctance of banks, a solution would be to extract from the calculation of Gross Effective rate, the costs for processing applications. However, this proposal was not even discussed and therefore could not be passed by Parliament.

A final proposal from the Commission of the Senate, supported by the ADIE (the French MFI), was to prevent the brakes on the development of microcredit. In this proposal, the idea was to extend the removal of usury ceilings to individual entrepreneurs (and not just corporations). The argument was that they are probably the ones who have the most to gain because, on one hand, they are those whose access to credit is the most rationed, and many of them could benefit from obtaining loans with higher interest rates in exchange for lower guarantees (Senate Report, 2003).

On August 1, 2003, the law on economic initiative was adopted. It provides for the deletion of the provisions relating to usury for corporate entrepreneurs, except for overdrafts. Thus, it was more liberal than the first proposal which was to raise the ceilings, and not as liberal as the third which required extending this to individuals too. However, this lacuna was made up two years later and a law on Small and Medium Enterprises (2005) took off the usury ceilings on individual entrepreneurs too. This meant that it was no longer a crime to lend to individual entrepreneurs at high interest rates.

Civil sanctions still exist for overdrafts accounts (charging excessive interest rates or other fees on the principal of the debt) pursuant to Art. L 313-5-1 of the Monetary and Financial Code. The usury law currently in force in France is now based on the following reading of Article L 313-3, Code of consumption:

"A loan is usurious if granted at an interest rate that exceeds, at the time it was made, by more than a third, the average effective rate charged during the previous quarter by credit institutions for transactions of a similar nature involving similar risks, as defined by the administrative authority after consultation with the Advisory Committee on the financial sector. (...) The provisions of this article and articles L. 313-4 to L. 313-6 shall not apply to loans granted to a person acting on his professional needs or a corporation engaged in industrial, commercial, craft, agricultural or non-commercial professional activities."

Effectively, these laws now concern mainly consumer loans and overdrafts to business. Appendix 2 gives an example of usury rates and effective average rates in 2007.

PART II: THE IMPACT OF THE REFORM

Overall Positive Effect

Although the impact of the removable of usury ceilings has been positive, it seems to be rather limited. A first positive effect is seen in the fairness or equity between different business structures. The new usury

legislation now provides the same treatment for all borrowers, whether corporate or individuals, as long as they are borrowing for business purposes.

A second positive effect is that the usury ceiling rate no longer rations credit. As mentioned above, earlier, to mitigate the effect of the low interest ceiling, banks sought risk-reduction by demanding guarantees or collateral. It is difficult for poor people to provide these. The modification of the usury legislation allows banks to charge higher interest rates and, so, it can dispense with some of the guarantees and securities. This means that the economy will grow, since poor people are dotted with an enterprise spirit and often have repayment rates better than those of the rich (Yunus, 2005). A survey confirms this trend: 21% of banks surveyed by the Bank of France said they have restricted their lending due to the constraint of usury legislation (Report Banque de France, 2006).

A third positive effect is that the above benefit is already vindicated by empirical evidence (Report Banque de France, 2006): shortening the time it takes to access credit for new companies less than 3 years old, the increase in the number of risky enterprises funded (over 20%), increasing the amount of funding distributed to the most risky (over 20%). Fourthly, the fear of a very strong inflation in interest rates for small firms has not materialized. The fear was based on American evidence where the deregulation of usury rates on consumer credit has led to an easing of conditions for the granting of credit and an increase in margins (Rougeau, 1996; Ausubel, 1997).

However, no increase in the rate of credit has been witnessed since the change in legislation. This may be because of the increased competition between credit institutions, increased information with borrowers as well as due to the transparency of the conditions for loans. In fact, microcredit loans have never been contracted at rates higher than the earlier usury limits. (Report National Assembly, 2005; Obolensky, 2003).

However, a new fear has emerged, that of over-indebtedness of small entrepreneurs, owing to a proliferation of loans. The fear is based on the American experience. Ellis (1998) has seen a very sharp rise in personal bankruptcies from 1978, the year of entry into force of the deregulation of usury, to 1996. Part of this could be explained by the higher interest rates charged by banks as indebtedness increases, corroborating Rougeau (1996) and Ausubel (1997), mentioned above. However, there is no evidence of this yet in France. There is no increase in the rate of default of the most risky SMEs. Nor has it resulted in a significant impact on financial stability since the high profitability of these credits is sufficient to cover the higher risk taken by banks. Ultimately, the reform has led lenders to better discriminate the risks of borrowers and link the price of credit to the marginal risk borne, without necessarily lead to a rise in general rates for all debtors.

A Rather Limited Impact

This reform, innovative and liberal as it is, has gone relatively unnoticed by firms (Report Banque de France, 2006). In fact, it has been observed that firms were largely ignorant on the existence of usury regulation regime in effect before 2003, as well as of the reforms in 2003 and 2005. The ignorance is a function of the size of the company, it is more pronounced for small businesses.

Secondly, most firms consider that the reform has not had any major impact on their relationship with banks (Report Banque de France, 2006). Ultimately, the regulation of usury and the lifting of ceilings applied to businesses have only affected the attitudes of lenders rather than those of SME borrowers.

PART III: FUTURE EVOLUTION POSSIBLE

The further development of usury legislation is not the only way to develop microfinance and microenterprise. This section reviews suggestions to develop usury legislation further as well as other possible innovations in related fields.

Future of Usury Legislation

Would the usury legislation move forward in the same direction and be scrapped entirely, as in the USA, for consumer loans as well? At first glance, it would not because France, and much of Europe, is very catholic and is attached to the principles leading to the usury legislation argued by Thomas Aquinas in the thirteenth century. This prohibition is also found in the Koran, the second most prevalent religion in France.

It could also be possible to delink the subsidized scheme of loans to create enterprises from traditional banking loans. The latter are subject to usury legislation and therefore are often rationed. This rationing then adversely affects the giving of loans to create enterprises, because these subsidized loans are subject to a precondition that they are accompanied by traditional banking loans. However, Hurel (2003) considers that economic development necessitates increasing the linkages between the entrepreneurs and the banking networks, and thus avoiding the creation of a parallel banking network specializing in the financing of entrepreneurship.

Evolution in Related Fields

Other solutions for the development of microenterprise might lie in the development of loan guarantee schemes at the regional level, development of local investment funds, and development of specialized State banks to finance entrepreneurs. In the latter vein, in 2005 France has merged existing institutions and created OSEO, an organization to encourage and finance small and micro enterprises.

France has also launched a special scheme to help creation and transfers of businesses: assistance for the unemployed creators or buyers of enterprise (ACCRE). This device is designed to facilitate the structuring and development of both projects to create or resume business activities. It consists of an exemption from social security contributions and maintaining, for a fixed period, some minimum social doles.

France has also created a financial assistance under the arrangement EDEN (encouraging the development of new businesses). In this, the entrepreneur is given vouchers allowing him to access a panel of experts. For such consultancy, two-thirds of the cost is borne by the State. More important, in 2005, the law for social cohesion created social cohesion funds whose mission is primarily to guarantee loans to the unemployed who wish to start their own business. The law has set aside 247 million Euros for the year 2009, for example.

With the high interest rates charged by Microfinance institutions, some question how it is different from predatory lending, loan sharks, debt bondage, debt farming, etc. In these situations the lender is exploiting information asymmetries and his superior knowledge of market and laws allowing him to charge high interest rates and non-interest fees, flipping of loans and charging fees each time and lending against collateral without seeing ability to pay, just to get their houses or other collateral cheap (Honohan, 2004). The current subprime loan crisis, founded in over indebtedness resulting from aggressive selling of credit by American banks, may be a manifestation of this. This crisis has also alerted France to the evils of too much consumer credit. Thus, a brake on this credit, operated by usury ceilings, seems likely to be maintained in the near future, although Honohan (2004) maintains that the solution is not usury

ceilings but better education of the public, truth in lending requirements, legal protection and increased competition. However, whether MFIs or money lending can survive increased competition is debated by academics (Armendariz de Aghion & Morduch, 2005; McIntosh et al, 2005) because increased competition at the village level permits borrowers to bypass prudential borrowing limits by borrowing from multiple lenders. In fact, the subprime crisis may be a reflection of the inability of credit information to circulate perfectly between lenders.

On the other hand, banks in search of new markets, especially with the subprime crisis in the US, would like to develop European consumer credit and probably have the political clout to orient legislation. In the beginning, the development may be for specific priority sectors such as housing and education. However, instead of raising usury ceilings for these sectors, the banks are first pushing for government guarantees of loans in these sectors. After all, if the risk is removed, interest rates can be accommodatively low, even zero. Although banks may want to lend directly to micro-borrowers, they may also want to limit competition from Microfinance Institutions. For example, in France MFIs are restricted to loan amounts of 6000 Euros; for first 5 years of newly created enterprises; recipients have to be welfare recipients or unemployed; and before applying to MFIs, the borrower has to prove that banks have refused credit (Evers & Jung, 2007). Thus, the game gets complicated.

It is also possible that European markets may emulate the U.S. Community Reinvestment Act of 1977 calling on banks to lend equally to all communities. This kind of quota system makes the banking sector public oriented and would undoubtedly add to the costs and reduce the international competitiveness of European banks. Thus, although the system would fit in well with the European socialist model, it would further burden Europe, which is trying to liberalize and turn towards growth-oriented scheme. A detailed evaluation of whether the growth effect of lending to the poor would offset the costs of inefficiencies is beyond the scope of this paper and is left to future research.

CONCLUSION

The failures of the socialist model, evidenced by high unemployment, have led France to reorient itself towards more enterprise creation. These entrepreneurial ventures require financing. However, bankers do not want to assume the high risk of newly created enterprises. Moreover, small entrepreneurs who do manage to get financing may find themselves rationed at the margin if the rate of credit is capped by the legislature. Concurrently, the growth of microfinance in the world has shown that innovative techniques can increase credit availability, without unduly high risk. However, such increased credit availability may not materialize if credit rates are capped by usury laws, as it was in France.

This paper traced out a number of legislative changes, which took place in France in the last five years, focusing especially on usury laws and other barriers to credit. It placed these legislative changes in a perspective of Western Europe's socialist model, comparing legislation on credit and usury in a number of developed countries. It also examined if these legislative changes have been accompanied by the desired impact. Finally, it examined alternative future legislative evolution possibilities.

One area of future research was outlined at the end of the last section: a detailed evaluation of whether the growth effect of lending to the poor would offset the costs of inefficiencies. Another possible field of research is related to other unemployment reduction policies. Indeed, the paper started with the failure of the Western European socialist model and the need of reducing unemployment. Besides making financing available, there is also a need to reduce unemployment benefits progressively as business takes off, as in Germany and Ireland (Evers & Jung, 2007).

A final interrogation leading to another avenue of research would be to question why the entrepreneurial density in Italy is higher than in France, even though the usury legislation is similar in the two countries.

This comparison leads us to expect that abolishing usury limits is not the only means to economic development, but that other policies have to be used conjointly.

APPENDIXES

Appendix 1: French Threshold of Usury Rate (TU) and Average Effective Rate (TEM) Used by Credit Institutions (%) In 2003

Housing Loans to Individuals								
CATEGORIES	1 st Trimester 2003 J.O. 22.03.03		2 nd Trimester 2003 J.O. 25.06.03		3 rd Trimester 2003 J.O. 20.09.03		4 th Trimester.2003 J.O. 20.12.03	
	TEM	TU on 1.04.03	TEM	TU on 1.07.03	TEM	TU on 1.10.03	TEM	TU on 1.01.04
Fixed rate loans	5.69	7.59	5.53	7.37	5.16	6.88	5.08	6.77
Variable rate loans	5.28	7.04	5.17	6.89	4.80	6.40	4.58	6.11
Bridge loans	5.82	7.76	5.72	7.63	5.34	7.12	5.28	7.04
Other Loans to Individuals								
CATEGORIES	1 st Trimester 2003 J.O. du 22.03.03		2 nd Trimester 2003 J.O. du 25.06.03		3 rd Trimester 2003 J.O. du 20.09.03		4 th Trimester 2003 J.O. du 20.12.03	
	TEM	TU au 1.04.03	TEM	TU au 1.07.03	TEM	TU au 1.10.03	TEM	TU au 1.01.04
loans of an amount less than or equal to 1524 € (1) (2)	16.34	21.79	16.22	21.63	15.94	21.25	15.64	20.85
Overdrafts account, permanent loans and financing of hire purchase or sales	13.14	17.52	12.95	17.27	12.63	16.84	12.39	16.52
Amounts greater than 1524 € and hypothecated life annuity (1) (2)								
Personal loans and other loans in excess of 1524 €	7.97	10.63	7.77	10.36	7.47	9.96	7.20	9.60
Loans to Enterprises								
CATEGORIES	1 st Trimester 2003 J.O. du 22.03.03		2 nd Trimester 2003 J.O. du 25.06.03		3 rd Trimester 2003 J.O. du 20.09.03		4 th Trimester 2003 J.O. du 20.12.03	
	TEM	TU au 1.04.03	TEM	TU au 1.07.03	TEM	TU au 1.10.03	TEM	TU au 1.01.04
Loans for staggered purchases or sales	6.97	9.29	6.86	9.15	6.54	8.72	6.25	8.33
Loans for a period of more than 2 years at a variable rate	5.40	7.20	5.19	6.92	4.87	6.49	4.75	6.33
Loans for a period more than 2 years, fixed-rate	5.76	7.68	5.54	7.39	5.09	6.79	4.86	6.48
Overdraft account (3)	8.66	11.55	8.60	11.47	8.39	11.19	8.14	10.85
Other loans for a period less than or equal to 2 years	7.02	9.36	6.91	9.21	6.55	8.73	6.50	8.67

(1) For consumer credit, the thresholds of usury are expressed on equivalence method, in accordance with Article 1 of Decree No. 2002-927 of June 10, 2002 concerning the calculation of the rate applicable to the overall credit for consumption and modifying code of consumption (art. R313-1). (2) To assess the usurious nature of the overall effective rate (TEG) of an overdraft account or a permanent loan, the amount to be taken into account is that the credit actually used. (3) These rates do not include any commissions charged on the highest overdraft of the month. The average rate of such commissions on the highest overdraft during the month of January 2003 was 0.06% and 0.05% during the months of April and July 2003.

Appendix 2: French Threshold of Usury Rate (TU) and Average Effective Rate (TEM) Used by Credit Institutions (%) in 2007

CATEGORIES	1 st Trimester 2007 J.O. 01.04.07		2 nd Trimester 2007 J.O. 05.07.07		3 rd Trimester 2007 J.O. 05.10.07		4 th Trimester 2007	
	TEM	TU on 1.04.07	TEM	TU on 1.07.07	TEM	TU on 1.10.07	TEM	TU on 01.01.08
Loans to Individuals Falling within the Scope of Articles L. 312-1 To L. 312-36 of The Code of Consumption (Housing Loans)								
Fixed rate loans	4.70	6.27	4.81	6.41	4.97	6.63	5.34	7.12
Variable rate loans	4.68	6.24	4.90	6.53	5.04	6.72	5.29	7.05
Bridge loans	4.76	6.35	4.86	6.48	4.90	6.53	5.25	7.00
Loans to Individuals Outside the Scope of Articles L. 312-1 to L. 312-36 of The Code of Consumption (Cash Credits)								
loans of an amount less than or equal to 1524 € (1) (2)	15.25	20.33	15.29	20.39	15.37	20.49	15.66	20.88
Overdrafts account, permanent loans and financing of hire purchase or sales Amounts greater than 1524 € and hypothecated life annuity (1) (2)	14.44	19.25	14.89	19.85	14.85	19.80	15.12	20.16
Personal loans and other loans in excess of 1524 €	6.54	8.72	6.70	8.93	6.78	9.04	7.04	9.39
Loans to Legal Persons Not Gainfully Employed in Industrial, Commercial, Craft, Agricultural Or Non-Commercial Profession								
Loans for staggered purchases or sales	8.07	10.76	8.19	10.92	8.62	11.49	8.65	11.53
Loans for a period of more than 2 years at a variable rate (4)	5.05	6.73	5.21	6.95	5.63	7.51	5.73	7.64
Loans for a period more than 2 years, fixed-rate	5.13	6.84	5.32	7.09	5.50	7.33	5.73	7.64
Overdraft account (3)	10.83	14.44	10.86	14.48	10.96	14.61	11.03	14.71
Other loans for a period less than or equal to 2 years	6.84	9.12	7.12	9.49	7.29	9.72	7.25	9.67
Loans to Individuals Acting on Their Professional Needs and Legal Persons Engaged in Industrial, Commercial, Craft, Agricultural Or Non-Commercial Profession								
Overdraft account (3)	10.83	14.44	10.86	14.48	10.96	14.61	11.03	14.71

(1) For consumer credit, the thresholds of usury are expressed on equivalence method, in accordance with Article 1 of Decree No. 2002-927 of June 10, 2002 concerning the calculation of the rate applicable to the overall credit for consumption and modifying code of consumption (art. R313-1). (2) To assess the usurious nature of the overall effective rate (TEG) of an overdraft account or a permanent loan, the amount to be taken into account is that the credit actually used. (3) These rates do not include any commissions charged on the highest overdraft of the month. The average rate of such commissions on the highest overdraft during the month of January 2007 was 0.07% and 0.08% during the months of April and July 2007. (4) Average rate practiced (TMP): The average rate practiced (TMP) is the effective rate of loans to businesses for an initial period of two years, at a variable rate, for an amount less than or equal to 152449 Euros. This rate is used by the tax authorities for the calculation of the maximum deductible interest on current accounts of associates. The average effective rate charged by credit institutions in the third quarter 2007 for this category of loans is 5.63%. Source: website of the Bank of France

REFERENCES

Armendariz de Aghion, Beatriz and Morduch, Jonathan (2005) *The Economics of Microfinance*, MIT Press

Ashta, Arvind (2007) "An Introduction to Microcredit: Why Money is Flowing from the Rich to the Poor", *Cahiers du CEREN Working Papers 21(2007)*, p. 77-87; Available at SSRN: <http://ssrn.com/abstract=1090195>

Austin, Douglas V. & Lindsley, David A. (1976) "Ohio Usury Ceilings And Residential Real Estate Development", *American Real Estate & Urban Economics Association Journal*, vol. 4 (1), p. 83-95

- Ausubel, Lawrence M. (1997) "Credit Card Defaults, Credit Cards Profits, and Bankruptcy", *American Economic Review*, n° 1
- Bedson, Jamie (2007) *Capacity Building for Partnerships in Microfinance Trainer's Manual*, The Foundation for Development Cooperation
- Blitz, Rudolph C. & Long, Millard F. (1965) "The Economics Of Usury Regulation", *Journal Of Political Economy*, vol. 73 (6), p. 608-619
- Boyes, W. J. & Furnish, Dale Beck (1984) "A Note on the Use of Incorporation as an Escape from Usury Ceilings", *Journal of Industrial Economics*, vol. 32 (3), p. 367-372
- Chowdhury, M. Jahangir Alam, Ghosh, Dipak and Wright, Robert E. (2005), "The Impact of Micro-Credit on Poverty: Evidence from Bangladesh", *Progress in Development Studies*, vol. 5 (4), p. 298-309
- Cole, Robert H. (1958) "Service Charge Or Interest Charge?" *Journal Of Marketing*, vol. 23 (2), p. 179-182
- Daru, Patrick; Churchill, Craig & Beemsterboer, Erik (2005) "The Prevention of Debt Bondage with Microfinance-led Services", *The European Journal of Developmental Research*, vol.17 (1), p. 132-154
- Egli, Dominik (2004) "Progressive Lending as an Enforcement Mechanism in Microfinance Programs", *Review of Development Economics*, vol. 8(4), p. 505-520
- Ellis, Diane (1998) "The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-offs, and the Personal Bankruptcy Rate", *Bank Trends*, n° 98-05, FDIC
- Eurostat : available at
http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=STRIND_EMPLOI&root=STRIND_EMPLOI/emploi/em071
- Evers, Jan & Jung, Martin (2007) "Status of Microfinance in Western Europe – an Academic Review", *European Microfinance Network Issue Paper*
- Fisher, Clyde Olin (1929) "The Small Loans Problem: Connecticut Experience", *American Economic Review*, vol. 19 (2), p. 181-197
- Frierson, James G. (1969) "Changing Concepts On Usury: Ancient Times Through The Time of John Calvin", *American Business Law Journal*, vol. 7 (2), p. 115-125
- Gambling, T. E. & Karim, R. A. (1986) "Islam And Social Accounting", *Journal of Business Finance & Accounting*, vol. 13 (1), p. 39-50, 1
- Goudzwaard, Maurice B. (1968) "Price Ceilings And Credit Rationing", *Journal of Finance*, vol. 23 (1), p. 177-185
- Harrison, Joseph (1980) "Spanish Economic History: From the Restoration to the Franco Regime", *Economic History Review*, vol. 33 (2), p. 259-275
- Hodgman, Donald R. (1960) "Credit Risk and Credit Rationing", *Quarterly Journal of Economics*, vol. 74 (2), p. 258-278

Hollander, Samuel (1999) "Jeremy Bentham and Adam Smith on the Usury Laws: A 'Smithian' Reply to Bentham and a New Problem", *European Journal of The History of Economic Thought*, vol. 6 (4), p. 523-551

Honohan, Patrick (2004) "Financial Sector Policy and the Poor: Selected Findings and Issues", *World Bank Working Paper No. 43*

Hudson, Michael (1993) "How the Poor Pay More: Big Premiums on Big Ticket Items", *Business & Society Review*, vol. 85, p. 43-46

Hurel, François (2003) délégué général de l'Agence pour la création d'entreprise (APCE), *Audition devant la Commission Spéciale de l'Assemblée Nationale sur le Projet de Loi pour l'Initiative Economique*

Jensen, Charles F. (1983) "The Use of Corporations In Real Estate Transactions: Judicial Acceptance of The Agency Theory", *Journal of Corporation Law*, vol. 8 (2), p. 361-387

Ledgerwood, Joanna & White, Victoria (2006), *Transforming Microfinance Institutions: Providing Full Financial Services to the Poor*, The World Bank

Lister, R. J. (2006) "The Composition of Interest: The Judaic Prohibition", *Accounting, Business & Financial History*, vol. 16 (1), p. 121-127

Matthäus-Maier, Ingrid and Von Pischke, J.D. (2006), *Microfinance Investment Funds : Leveraging Private Capital for Economic Growth and Poverty Reduction*, Springer

McIntosh, Craig, de Janvry, Alain & Sadoulet, Elisabeth (2005) "How Rising Competition Among Microfinance Institutions Affects Incumbent Lenders" *The Economic Journal*, vol. 115, October, p. 987-1004

Moser, Thomas (1997) "The Old Testament Anti-Usury Laws Reconsidered: The Myth of Tribal Brotherhood"; available at SSRN: <http://ssrn.com/abstract=41844>

Obolensky, Ariane (2003) « La Suppression du Taux de l'Usure est une Bonne Mesure », *BANQUEmagazine*, May, p. 16-18

Ostas, James R. (1976) "Effects of Usury Ceilings in the Mortgage Market" *Journal of Finance*, vol. 31 (3), p. 821-834

Paganelli, Maria Pia (2003) "In Medio Stat Virtus :An Alternative View of Usury in Adam Smith's Thinking", *History of Political Economy*, vol. 35 (1), p. 21-48

Peterson, Richard L. (1983) "Usury Laws and Consumer Credit: A Note", *Journal of Finance*, vol. 38 (4), p. 1299-1304

Rapport de la Banque de France au Parlement (2006), *Les Incidences de la Réforme de l'Usure sur les Modalités de Financement des Petites et Moyennes Entreprises*, December, graph 7

Rapport n° 2429 de l'Assemblée Nationale sur le projet de loi en faveur des petites et moyennes entreprises (2005)

Rapport n° 217 de la commission spéciale au Sénat sur le projet de loi sur l'initiative économique (2003)

Robins, Philip K. (1974) "The Effects of State Usury Ceilings on Single Family Homebuilding", *Journal of Finance*, vol. 29 (1), p. 227-235

Rougeau, Vincent D. (1996) "Rediscovering Usury: an Argument for Legal Controls on Credit Card Interest Rates", *University of Colorado Law Review*, vol. 67, n° 1

Sriram, M.S. (2005) " Information Asymmetry and Trust: A Framework for Studying Microfinance in India", *Vikalpa*, vol. 30(4)

Strangways, Raymond & Yandle Jr., Bruce (1971) "Effect of State Usury Laws on Housing Starts in 1966", *Journal of Financial & Quantitative Analysis*, vol. 6 (1), p. 665-669

Visser, Wayne A. M. & Macintosh, Alastair (1998) "A Short Review of the Historical Critique of Usury", *Accounting, Business & Financial History*, vol. 8 (2), p. 175-189

Yunus, Muhammad (2003) *Banker to the Poor: Micro-Lending and the Battle Against World Poverty*, Public Affairs

Zeller, Manfred & Meyer, Richard L. ed. (2002) *The Triangle of Microfinance: Financial sustainability, Outreach and Impact*, John Hopkins University Press