SENATE JUDICIARY COMMITTEE

MINUTES OF MEETING

MARCH 29, 1977

The meeting was called to order at 8:10 a.m. Senator Close was in the Chair.

PRESENT: Senator Close
Senator Bryan
Senator Dodge
Senator Foote
Senator Sheerin
Senator Gojack
Senator Ashworth

ABSENT:

SB 184 Increases penalties and broadens reporting requirements for child abuse.

For further testimony on this matter, see minutes of meeting for February 16, 1977.

Mike Hoover, Director of Social Services, Washoe Medical Center informed the Committee that since the last hearing on this matte he had met with State Welfare on the subject of the creation of a 24-hour central registry and that he had been authorized by Washoe Medical Center to indicate their complete support of the proposal to be submitted by Dr. Penelope Pemberton. (see following testimony)

Dr. Penelope Pemberton, Pediatrician and Chairman of the Child Abuse and Neglect Committee at Washoe Medical Center. See attached Exhibit A for her statement.

Senator Bryan stated that under the present reporting requirements, various persons must report to the local office of the welfare division, county agency, the police department and the sheriff's department. He asked if under this proposed plan, would the reporting requirement be expanded so that the registry would be notified directly rather than receiving the information from another agency.
Dr. Pemberton replied that it would because many times the other agencies receive reports that are derived from community sources that they otherwise would not be aware of.

Sharon Gibbon, Washoe County Welfare Division testified in support of a 24-hour central registry. She did not feel there woul be any problem in requiring the person reporting to report to a different number of agencies. She stated that at the present

SB 184 time, Washoe welfare is the agency that receives the report; they process the information and then forward it to state welfare which currently maintains a registry. She did not see that there would be any problem in forwarding this same information to the Washoe Medical Center.

Mike Malloy, Washoe County Deputy District Attorney addressed some of the problems he felt were present regarding the penalty aspects of the bill. (see Mr. Hicks testimony for suggested amendments).
Senator Bryan informed him that there was a bill being introduced today that would take care of those problems.

Joe Braswell, Director of Inter-tribal Council, Social Services Program, testified in support of this measure. He expressed concern over the provision whereby the battery is committed upon a child by a person who is more than 2 years older.
Senator Close informed him that that had been taken care of during the previous hearing on this matter.

It was the feeling of the Committee that a central registry should be established and funded by the state rather than leavin it to the individual hospitals.
Senator Foote will contact the State Welfare Division on this.

No action was taken at this time.

SB 334 Establishes property rights of unmarried persons.

L. J. McGee, representing the Trust Committee of the Nevada Banker's Association, stated that they were in opposition to thi bill as there would be many problems in handling probate matters guardianship estates and trusts. He stated that there were enough difficulties in administering an estate where there is combined community property and separate property with married persons without getting involved in this situation.

Senator Clifton Young testified in support of this measure. He stated that this bill was addressed to a problem which will be confronting this legislature and society as a whole in that people are living together, increasingly, without the benefit of marriage. This issue was addressed in a recent court case wherein the judge decided that the woman was entitled to a certain portion of their accumulated properties.

Fran Breen, Nevada Banker's Association appeared in opposition to the bill and concurred with Mr. McGee's comments.

In discussion by the Committee, they felt that there were too many problems that would be involved with this type of legislation.

Senate Committee on Judiciary

SB 334 Senator Sheerin felt that they should continue on with joint-tenancy or with the presumption of tenants in common.

Senator Ashworth moved to indefinitely postpone.
The motion was seconded and carried unanimously. Senator Sheeri was absent from the vote.

SB 296 Increases maximum legal rate of interest.

Senator William H. Hernstadt testified in support of this measure. He stated that on line 4, which talks about 18% per annum, it was his intent that that should be annual percentage rate. He also requested that lines 13-17 be retained, which would mean that there aren't prepayment penalties, compensating balances or points. When he refers to 18%, he is referrinc to real interest and not 18% less 5 points or an annual percentage rate much higher that that.
The prime rate in the big money markets is 6¼%-6½% and in Las Vegas it is 9¼%. The reason being is that we are a growth state and where there is growth you have to attract capital and you dc that by making it more interesting for someone to invest. The present interest rate, in its effect, is slowing growth. It is curtailing new investments; it is slowing jobs; and it is hurtir the small business owners. If you can't get financing you are not going to go ahead with a project. By making money available through all spectrums, this will decrease loan sharking and will help protect people from themselves.

Thomas F. Cargill, Professor of Economics, University of Nevada, Reno testified on this matter. He informed the Committee that he had a PhD in Economics and that his area of expertise is in monetary economics. He is also consultant to the National Commission on Consumer Finance and has written numerous articles on interest rates and financial institutions. See attached Exhibit B for his remarks. He also submitted for the Committee' review, an article by Norman N. Bowsher entitled Usury Laws: Harmful when Effective. See attached Exhibit C.

Bill Kottinger testified in support of this measure. See attached Exhibit D for his testimony.

Perry Thomas, Chairman of the Board, Nevada State Bank testified in support of this measure. He stated that the present interes rates are counter-productive to Nevada's best interest. He informed the Committee that most of his time is spent looking for outside sources of money because it is so difficult to attract money from conventional institutions where gambling is involved. He felt that in the national money market, if the prime interest rate should ever get to 9%, it would be very adverse to maintaining the economic stature of Nevada.

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SB 296 Preston Tidvall, Nevada Superintendent of Banks informed the Committee that nationwide, within the banking system, there exists what is known as the federal funds market whereby banks loan to and borrow from each other to maintain statutory reserve requirements. In 1974, the banks of Nevada were in a very real dilemma. The maximum legal interest in Nevada was 12% per annum at that time and the rate on federal funds was much higher and fluctuating. If a Nevada bank had funds to sell, they could not get more than the legal usury rate of 12%. However, if they had to go into the federal market for needed funds for reserve purposes, they had to pay a much higher rate than they were allowed to charge, with the obvious result of a sizable loss of income. It was his opinion that the anticipated federal budget deficit of $60-$70 billion will dry up the money supply and result in increased interest rates. He therefore felt that banks must be allowed adequate flexibility in the usury rates in order to meet such a condition.

George Aker, President, Nevada National Bank testified in support of this measure. He stated that there are presently 8 banks in Nevada that compete aggressively. He felt that if the usury rate were increased from 12% to 18% that there would not be a corresponding increase in the existing interest rate. The interest rate, which is the price for the product, is the shred point; the point of competition and there is aggressive competition not only among the 8 banks but with alternative lenders as well, on almost every range of credit.
He concurred with Mr. Tidvall's comments and stated that the time to approach usury questions is when there is not the intense pressure as there was in the 1974 money crunch.

Lou Schuman, President of Nevada Mortgage Broker's Association stated that they were not opposed to the bill, per se, but felt it should be amended to exempt loans of $50,000 and more or else permit federally insured agencies to be exempt from usury. He did not feel it was in the best interest of the people to have a complete increase in the usury ceiling to 18%.

No action was taken at this time.

There being no further business, the meeting was adjourned.

Respectfully submitted,

Cheri Kinsley, Secretary

APPROVED:

SENATOR MELVIN D. CLOSE, JR., CHAIRMAN

Senate Committee on Judiciary

CHILD ABUSE AND NEGLECT

24. hr. MEDICAL REGISTRY

Implementation of this proposal may require ammending NRS 432.100 as follows:

"There is hereby established a 24 hr. Medical Registry for Child Abuse and Neglect which shall be maintained by Washoe Medical Center, Reno, Nevada, in the Emergency Room at Washoe Medical Center, under the direct supervision of the Child Abuse and Neglect Committee of the Department of Pediatrics, and with the endorsement and support of the Washoe County Medical Society. This Medical Registry shall comply with all applicable federal and state statutes pertaining to confidentiality."

JUSTIFICATION

At the present time, there exists a central child abuse and neglect registry at the central welfare office in Carson City, which functions from 8 am. to 5 pm., Monday Through Friday, and is closed on holidays. Since the majority of serious child abuse and neglect cases are treated by private Physicians or emergency room Physicians on a 24 hr. basis (generally after 5pm, and frequently on weekends and holidays), the establishment of the above proposed 24 hr. Medical Registry would provide immediate, invaluable and critical information to the involved medical professionals at the time it is needed. The Child Abuse and Neglect Committee (under the Dept. of Pediatrics at Washoe Medical Center) has passed a resolution stating that the establishment of the Medical Registry is of top priority, and the committee is unable to function effectively without it. In addition, the Medical Registry will be a valuable supplement to all other social agencies involved in child abuse and neglect, and should enhance efficient recording and reporting of cases, and availability to Physicians.

ORGANIZATION

The Medical Registry shall be under the direct and active control of the Child Abuse and Neglect Committee, and shall comply with all existing state and federal laws governing proper reporting of cases, and confidentiality. Therefore, all records will be maintained in a locked cabinet in the Emergency Room at Washoe Medical Center, and the key to this cabinet will be kept in the narcotics locker (under the same strict standard hospital security system which has proved effective.) Direct access to these files will be restricted only to 1. Emergency Room Nurses, 2. the Social Service Dept. staff, 3. the Chairman of the Child Abuse Committee, 4. Physicians dealing with a specific case, and, 5. Law Enforcement officials and official representatives of other appropriate social agencies, under the supervision of the Social Service Dept. and the Child Abuse and Neglect Committee.

Upon receiving a call to the Medical Registry phone, the authorized person handling the call would establish the callers right to know, within the guidelines of NRS 432.120, and then search the files. Information would be released on a call-back basis only and not at the initial call, and only after establishing the legitimacy of the person seeking the informaiton. For example, if a Physician calls from Mt. Grant Hospital in Hawthorne, he is informed that the Registry will call him back, and then will be able to establish the authenticity of the original call. This is necessary to eliminate the possibility of unauthorized calls. The release of information from the Medical Registry would be legal within the definition of the new federal confidentiality statute, since the child in question would virtually always be in emergent circumstances, potentially affecting his life, health or safety, situations specifically referred to in the Federal Register section explaining the confidentiality statutes.

COST

The cost for establishing and maintaining the Medical Registry will be provided by Washoe Medical Center, with assistance from the Washoe County Medical Society, and community resources.

RESPECTFULLY SUBMITTED:

Penelope A. Pemberton, M.D., Chairman (on behalf of) Child Abuse and Neglect Committee

Donald E. Pickering, M.D.

Stephen Missall, M.D.

Joanna Frickie, M.D.

Jane Diedrichsen, M.D.

Anton Sohn, M.D.

Michael Hoover, M.S.W.

There are two arguments in favor of interest rate ceilings. First, ethical and religious arguments have often been relied on to a great extent to justify the limitation of interest on loans. Second, the public view of the small borrower as the underdog at the mercy of the large well-financed institutions such as commercial banks, and other lenders, has been a significant force behind interest rate ceilings.

The comparative market power of borrowers and lenders is probably the primary factor behind the reluctance of legislators to raise or eliminate interest rate ceilings.

There are a number of arguments against interest rate ceilings. These arguments are only meaninguful when the ceiling is effective, that is, when the market rate of interest on any particular loan exceeds the ceil ing rate. This has been frequently the case during the last decade since interest rates in general have reached historical highs in the U.S. Most economists would agree that interest rates will remain high and are likely to increase in the future. If this forecast turns out to be correct, the issues concerned with interest rate ceilings are going to become even more important, than they are today.

We can briefly review the difficulties created by interest rate ceilings when they are effective:

First, interest rate ceilings interfere with the flow of funds from lender to borrower. Both theoretical and empirical evidence indicates that interest rate ceilings reduce the flow of credit. Those individual: that are eliminated from the market are generally the very groups the interest rate ceiling was designed to protect.
As an example, consider the attempt in 1968 by the state of Washington to impose an interest rate ceiling of 12 percent on credit card credit. The rate had bee 18% and consumer advocates felt that this was "too high At 12% the quantity of credit demanded exceed the quantity supplied and those that were eliminated were the very ones the interest rate ceiling was designed to protect -- welfare mothers, people with unstable employment records, students and the elderly. Gainers from the reduced rates were well-to-do individuals with high credit ratings.

Second, to the extent the ceiling is effective, lenders will have an incentive to develop methods to circumvent the ceiling and borrowers will be willing to incur the added trouble and expense. For example, in the case of retail credit, the price of the goods and services will often be used to make up the difference between the ceiling rate and the market rate of interest. Banks may often favor customers that maintain compensating balances and so-called "ceiling fees" can be imposed. These and other attempts to circumvent the ceiling interfere with the flow of funds between lender and borrower and increase the total cost of making loans.

Third, ceilings are often justified as a method of making up for the apparent unequal market power between lender and borrower; however, the issue here is very complex. There is first the question of how competitive is the financial system, and specifically, how competitive

is the consumer loan market? Available evidence indicates that the consumer loan market is not dominated by monopolistic firms that can charge any price they desire, at the same time, however, the loan market is not as competitive as would be desirable from society's point of view. Much can be done to increase the degree of competition but not by interest rate ceilings. Instead, attention should be devoted to increasing the ease of entry into financial markets and providing all financial institutions with greater flexibility in their uses and sources of funds. These are actions that should be taken -- not to legislate interest rates.

Fourth, many foret that financial institutions are part of a national money and capital market. Restrictions on interest rates for consumer credit or any other type of credit simply provides an incentive for these institutions to transfer funds to markets that have higher or no interest rate ceilings. There are many specific examples of this type of action and they all demonstrate that credit is very fluid and seeks it's highest return.

Until the early 1970's, there was little broad-based information on the effects of ceilings; however, the National Commission on Consumer Finance (1972, December) compiled extensive information on amounts, types, and costs of consumer credit on a state-by-state basis for 1971. The data base collected and analyzed by the Commission represents the most extensive effort to obtain information on many issues related to interest rate ceilings.

The implications of the Commission's study are difficult to summarize and not all investigators agree with the conclusions derived by the Commission; however, with regard to the issue of the interest rate ceiling in the consumer loan market, two general findings are worth mentioning.

1) Evidence does support the claim that increased interest rate ceilings will increase the availability of credit. (personal loan category)

2) The actual rate of interest is significantly influenced by the interest rate ceiling and especially, the number of lenders.

The Commission did not favor complete elimination of ceilings since basic elements of market power were found in all of the major suppliers of consumer credit. They stressed that states should give higher priority to promoting the competitiveness of consumer credit markets by reducing restrictions on entry and allowing greater freedom to financial institutions in managing the uses and sources of funds. Increasing interest rate ceilings to to be regarded as a complement to this effort.

In the case of Nevada, there is a problem with concentration in the consumer loan market and interest rates on consumer credit, for example, are generally higher than other states; however, the higher interest rates exist for all major lenders of consumer credit: banks, finance companies, and credit unions. In spite of the greater concentration on the suppliers side of the market in Nevada, I would still regard an interest rate ceiling of 12% as having the effect of reducing the availability of credit.

I think a serious study should have been done on the degree of competition in the loan market in Nevada before the present ceiling legislation was passed into law two years ago. However, the present question is how to deal with the existing legislation which ties the maximum rate allowed to the prime rate of interest. There are three possible courses of action:

1) Maintain the present system. I would advise against this since it is cumbersome; creates difficulties in determining at what poin in time the rate of a loan should be established; and in general, makes little economic sense. The prime rate is an administered rate of interest and reflects a type of credit fundamentally different from consumer loans.

2) Return to the 12% ceiling. I would not be in favor of this move for the reasons stated earlier.

3) I would be in favor of expanding the ceiling above 12%; however, Nevada is a unique state in the sense of being a highly concentrated loan market. Thus, to what level the rate should be raised I have no answer since it would require more information than I have available to me at this time.

Usury Laws: Harmful When Effective

NORMAN N. BOWSHER

MOST INTEREST rates have risen to historically high levels in recent months. This development, in view of present law, has caused serious problems to develop in the credit markets because in most jurisdictions usury restrictions on the payment of interest have generally remained at previously established lower levels. The consequence of this has been that borrowers who are willing to pay the competitive rate for funds often find that they are legally unable to obtain financing. As a result, they are faced with the choice of either circumventing the law to obtain the desired funds or losing out to other borrowers who may not be willing to bid as much, but who are legally able to contract because of the nonuniformity of usury laws.

Despite the credit market distortions caused by ceilings on interest rates, usury laws have been retained in most jurisdictions. It is the intent of this article to provide some insight and perspective on the value of such restrictions by reviewing briefly the history and justification of such laws, the role of interest rates, and some of the effects of interest rate restrictions.[1]

History of Usury Laws

Usury laws have been traced back to the dawn of recorded history. Both legal and religious restrictions on interest charges were imposed in ancient times.[2] The early Babylonians permitted credit but limited the rate of interest. One of the earliest writings of the Bible (Deuteronomy 23:19-20) stated, "Thou shalt not lend upon usury to thy brother, . . . Unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury . . . ." In the New Testament (Luke 6:35) the admonition was broadened ". . . lend freely, hoping nothing thereby."

In Greece, Aristotle considered money to be sterile, and that the breeding of money from money was unnatural and justly hated. During the period of the Roman Republic, interest charges were forbidden, but they were permitted during the time of the Roman Empire.

During the early Middle Ages religious leaders treated the subject more thoroughly, and reached the same conclusion – that interest on loans was unjust. The exploitation of the poverty-stricken by rich and powerful creditors who lent money at interest was considered sinful to the Christians of that period, who stressed humility and charity as among the greatest virtues and played down the value of earthly goods. Secular legislation responded to the Church's influence and, in general, interest charges and usury were regarded as synonymous.[3]

The increase in economic activity and expansion of personal freedom that came with the Renaissance forced modifications in the prevailing views concerning interest rates. Recognizing that man was imperfect, Martin Luther and other 15th century reformers began to concede that creditors could not be prevented from charging interest. In the 16th century John Calvin rejected the scriptural basis for interest prohibition on grounds of conflicting interpretations and changed circumstances, but still advocated some

[1]Previous discussions of interest rate controls were given by Clifton B. Luttrell, "Interest Rate Controls — Perspective, Purpose, and Problems," this *Review* (September 1968), pp. 6-14, and Charlotte E. Ruebling, "The Administration of Regulation Q," this *Review* (February 1970), pp. 29-40.

[2]See Sidney Homer, *A History of Interest Rates* (New Brunswick, New Jersey: Rutgers University Press, 1963).

[3]Eugene von Böhm-Bawerk, *Capital and Interest*, trans. George Huncke and Hans Sennholz (South Holland, Illinois: Libertarian Press, 1959), pp. 13-24.

control. Turgot, an 18th century French economist, claimed that money was the equivalent of land, and hence the owner should not be inclined to loan his money unless he could expect a return as great as he would obtain through the purchase of land.[4]

Legal restrictions on the payment of interest were generally relaxed in the 18th century, but the belief continued that the people who needed to borrow funds should be protected against overly high charges. Consequently, most nations maintained legal maximum usury rates at "reasonable" levels.

Usury laws in the United States were inherited, in large part, from the British in colonial days. While these laws generally remain in force in the United States, Great Britain, after intense pressure in the early 19th century, repealed these and other restrictions on commerce and trade in 1854.[5]

One factor complicating attempts to maintain interest rate ceilings arose from the fact that risks and administrative expenses in making very small loans were often so great that legitimate dealers could not handle such advances with prevailing rate ceilings. This situation fostered illegitimate loan "sharks" with exorbitant interest charges. As a result, it was eventually recognized that higher rates should be permitted on small loans, and the small loan laws emerged.

Arguments for Usury Laws

As noted, ethical and religious arguments have been relied on to a great extent to justify either the prohibition or limitation of interest payments. Another factor which has been instrumental in sustaining support for usury laws has been public opinion which generally viewed the small borrower as an underdog at the mercy of large well-financed institutions. As a consequence of this public attitude, legislators have been reluctant to raise or eliminate interest rate ceilings.

Several economic arguments also have been advanced to justify usury laws, and these considerations tend to bolster the moral and political reluctance to raise rate ceilings. The first of these arguments asserts that whereas most lenders are knowledgeable about conditions in the particular credit market in which they operate, it is readily observable that a sizable number of borrowers are unsophisticated and naive. It is contended that these borrowers are concerned only with obtaining credit and do not even know what rate of interest they are paying. Furthermore, relatively few make a serious effort to study conditions or to shop around for better terms or better timing. Finally it is argued that contracts made with such unknowing borrowers at rates above those existing in the market for similar types of loans represent a distortion of competitive forces and provide a windfall to lenders.

A similar argument for the regulation of interest rates is related to the comparative market power of borrowers and lenders. Since lenders are usually fewer in number and larger in resources than borrowers, it is contended that they have market power which can be used to command artificially high rates. Hence, usury laws provide competitive balance between the two groups.

Another argument for interest rate regulation is concerned with the impact of lower interest rates on the economy. It has been contended that low interest rates are desirable to encourage more investment and consumption and promote faster economic growth.

Arguments Against Usury Laws

Those who oppose interest rate restrictions view credit markets as relatively efficient when left alone to operate freely. According to this position free competitive markets lead to an optimum allocation of resources and maximum individual satisfaction. Consequently, interferences with normal credit flows, by use of imposed ceilings on lending or deposit rates, can only create inefficiencies in financial markets which hamper production and exert an adverse influence on the distribution of goods and services.

It has been charged that maximum loan rates are necessary because credit applicants are gullible and would enter into oppressive contracts without such protection. But, are not individuals just as likely to be gullible in their dealings in other markets? Why then is the credit market singled out as an area to promulgate legal restrictions against such oppressive contracts? More importantly, has this special attention had its intended effects? That is, can and do these laws protect the uninformed from exploitation, and can the benefits of this protection be justified in view of the attendant social costs? Existing imperfections in credit markets could probably be reduced to a greater extent and with less cost by fostering greater competition among lenders. Also, education and counseling of borrowers may be a more efficient method to improve their performance than imposing rigid ceilings.

[4]Ibid, pp. 25-60.

[5]Homer, *A History of Interest Rates*, p. 187.

In most credit markets competiton is very keen. Major lenders include commercial banks, savings and loan associations, insurance companies, mutual savings banks, mortgage companies, sales finance companies, personal finance companies, credit unions, real estate investment trusts, farm credit agencies, retailers, and individuals. It is relatively easy to establish a business for lending funds, except for restrictions imposed by the Government. In most cases where competition is lacking in a given market, it has resulted from legal limitations on entry or activities. In practice, competitive forces have kept most market interest rates below usury ceilings for most of the past forty years.

For a brief period, artificially holding interest rates down probably does stimulate investment and contribute to economic expansion. However, maintaining arbitrarily low rates by imposing ceilings discourages saving at the same time that it stimulates investment demand, placing upward pressure on interest rates. As a result, rates can only be maintained at the lower level by some form of nonprice rationing (which tends to reduce efficiency and offset, in the longer run, the sought-after investment increases) or by the creation of money and credit at progressively faster rates (which contributes to accelerating inflation).

Functions of Interest Rates

Interest rates play a strategic role in the economy. Interest rates are prices, and, as is true of all prices, they serve a rationing function. They are the prices that allocate available funds, and hence command over resources, among competing uses. Normally, the term "interest rate" is used in reference to the return on marketable securities or a loan of funds. However, the concept of "interest rate" can be applied to all goods. The rate of interest reflects the price of the convenience of earlier availability, the preference for more certain rather than less certain consumption rights, and the economy's ability to use resources to increase output.

To the borrower, interest rates represent a cost, and as such, influence investment and consumption decisions. To the saver, they represent a return and affect decisions regarding the amount to be saved. To wealth holders and managers of funds, interest rates or yields are a common denominator for evaluating alternative forms of holding wealth and alternative avenues for placing funds.

At any time, some individuals or businesses find that with their incomes, tastes, and investment prospects it is not desirable to pay the going rate for funds. They are "priced out of the market," just as there are those who find that at current prices it is not expedient to hire a servant, eat steak, or purchase a luxury automobile. Any movement in interest rates (as with other prices) will cause a reevaluation of projects which require the borrowing of funds.

General Impact of Usury Laws

Throughout most of the period since the 1920s, usury laws have been ineffective because the interest ceilings were at levels above prevailing market rates. However, with the rise in inflation, and consequently interest rates, since the mid-1960s, usury laws have had a significant impact on many credit markets. Their effects have been quite arbitrary and have weighed heaviest on those credit seekers generally considered most risky.

Professor Roger Miller contends that usury legislation often adversely affects the ones it is designed to protect.[6] He illustrates this conclusion by citing the Washington state experience, where consumer loans from credit card companies were generally at an annual rate of 18 percent. Consumer advocates felt that this rate was much too high, and that poor people would be aided by a lower charge. In 1968, the maximum rate was lowered by referendum to 12 percent. However, at the lower rate the amount of credit demanded exceeded the amount supplied, and the people with the weakest credit worthiness were the ones denied credit at 12 percent. Welfare mothers, people with records of unstable employment, students, and the elderly fell into this category. Gainers from the reduced rates were the ones who had the most wealth, best jobs, and the highest probability of being able to repay the loan.

Sometimes those higher risk borrowers, who are refused credit from legitimate lenders because of usury laws, seek funds from loan sharks who ignore the legislated ceilings. Costs of operating outside the law are relatively high, and competition among such unscrupulous lenders is severely limited; hence, some interest rates may be several times the level that would have existed in the absence of ceilings.[7]

As market rates approach usury ceilings, venture or developmental credit, which of course contains a higher than average degree of risk, becomes limited.

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[6] Roger L. Miller, *Economics Today* (San Francisco: Canfield Press, 1973), pp. 244-250.

[7] John M. Seidl, "Let's Compete with Loan Sharks," *Harvard Business Review* (May-June 1970), pp. 69-77.

Since such credit can only be extended by lenders at a higher rate of interest to compensate for the additional risk involved, these loans are among the first to be affected as market rates rise relative to usury ceilings. Without such venture capital, the entrepreneur is frustrated, and economic progress and growth is hampered.[8]

By contrast, the volume of credit flowing to wealthy individuals and sound established businesses may be as great or greater under severe usury restrictions as under free market conditions.[9] Since low usury maximums prevent other individuals and firms from effectively competing for funds, a greater share of the available funds tends to flow to lower risk applicants. The anticompetitive effects of these laws are thus spread from credit to product markets.

Usury Laws in the Eighth District

In general, usury laws tend to be more restrictive in the central section of the country than in states on or near either coast. In several Eighth District states usury laws have been a major obstacle in credit markets. In Illinois and Missouri the current general usury ceiling is a very low 8 percent, and in Kentucky the ceiling is 8.5 percent. In each of these states, however, exemptions from the ceiling exist, such as for corporations. Despite the exemptions, many credit flows have been interrupted because of the ceilings, particularly away from potential individual borrowers.

Arkansas, Mississippi, and Tennessee have somewhat higher usury ceilings — 10 percent in each case. However, because of the lack of legal exemptions from the maximums in Arkansas and Tennessee, the ceilings have been causing substantial disruptions to borrowers, lenders, and the general economy of these states. This has been particularly noticeable since April when the prime rate on business loans nationally climbed above 10 percent. During May and June of this year, commercial and industrial loans declined 9.3 percent at weekly reporting banks in Memphis and Little Rock, while they were rising 2.8 percent at all weekly reporting banks in the nation. In the corresponding period last year, when market rates were below the ceilings, these loans changed little in Memphis and Little Rock and rose 2.9 percent nationally.

In an effort to alleviate hardship, the ceiling in Mississippi was raised to 10 percent from the extremely restrictive 8 percent level, effective July 1, 1974. In Illinois, the ceiling for residential loans was raised on July 12, 1974 from 8 percent to 9.5 percent for the period until July 1, 1975. Among Eighth District states, only Indiana has had credit markets relatively free from usury restrictions.

Quantitative measures of the volume of potential loans affected by the rate restrictions are not available, but comments from market participants indicate that it is sizable. The following sketchy, indirect evidence also indicates that the impact has been great.

In the first four months of this year, the average interest rate on FHA 30-year mortgages was 8.78 percent nationally; in the corresponding period last year the rate was 7.62 percent. Two District states had usury laws applicable to home mortgages that were between these rates — Mississippi and Missouri at 8 percent. In these two states residential construction contracts fell 34 percent from the first four months last year to the comparable period this year, according to F. W. Dodge data. In Arkansas, Indiana, and Tennessee, which had 10 percent or higher usury ceilings, and Kentucky and Illinois, which exempted certain residences from the ceilings, residential contracts declined 16 percent. The average decrease for the nation was 21 percent over the same period.

By contrast, contracts for nonresidential construction, which are frequently exempted from usury ceilings, rose 8 percent in Mississippi and Missouri from the first four months last year to the first four months this year. This was about the same as the 9 percent gain in Arkansas, Illinois, Indiana, Tennessee and Kentucky and greater than the 2 percent nationally in the same period.

Insured savings and loan associations in Missouri had a 74 percent smaller increase in savings "deposits" in April and May this year than they did in the corresponding months last year. Nevertheless, these associations purchased 10 percent more mortgages in the two months this year when the national market rate on mortgages was above the state's usury ceiling than in the like period last year when the market rate was below the ceiling. This seemingly contradictory development can be explained by noting that the bulk of these purchases were from states where the

[8]Studies show that in those states permitting higher rates, lenders tend to expand credit opportunities. Lenders appear more willing to accept higher risk of losses if the rate is sufficient to compensate for bad debt, investigation, and collection expenses. Maurice B. Goudzwaard, "Price Ceilings and Credit Rationing," *Journal of Finance* (March 1968), pp. 183-184.

[9]This may not always be the case, because the total volume of loanable funds is likely to be smaller under severe interest rate ceilings. Saving is discouraged relative to consumption and funds tend to flow out of the jurisdiction or directly from savers into venture capital.

STATE USURY LAWS[1]

State	Basic Rate	Some Major Exceptions
Alabama	8%	For individuals, firms, partnerships, associations, and non-profit organizations the rate is 8% on loans to $100,000 and 15% on loans above that. These same groups may agree to pay more than 15% on loans greater than $100,000. For corporations the maximum rate is 8% on loans to $10,000, 15% on loans between $10,000 to $100,000 and no ceiling on loans above $100,000.
Alaska	12%[2]	Twelve-and-one-half percent is the rate on real estate contracts.
Arizona	10%	Eighteen percent is the ceiling for loans over $5000 to corporations.
Arkansas	10%	
California	10%	Savings and loan associations, industrial loan companies, banks, credit unions, and agricultural associations are exempt from the usury law.
Colorado	12%	The maximum charge on non-supervised consumer loans is 12%. On supervised loans, except for revolving loans, the maximum rate is the greater of 18% on all unpaid balances; or a total of 36% on unpaid balances of $300 or less, 21% on unpaid balances over $300 and not over $1000; and 15% on unpaid balances over $1000. The maximum rate on consumer related loans is 18%, on revolving loans 12%, and all other loans 45%.
Connecticut	12%	The ceiling rate on loans to corporations in excess of $10,000 is 18%. The 12% ceiling does not apply to any loan made by any national or state bank or savings & loan, to any mortgage on real property in excess of $5,000, or made pursuant to a revolving loan agreement on which the total principal amount owing is more than $10,000.
Delaware	9%	There is no limit on collateral loans larger than $5000. Also the ceiling rate may be exceeded on loans secured by real estate only through written agreement.
District of Columbia	8%	Loans guaranteed under the National Housing Act or by the VA are exempt.
Florida	10%	The ceiling is 15% for corporate loans and all other loans above $500,000.
Georgia	8%	No ceiling applies on loans above $2500 to corporations and on loans above $100,000 to individuals. Loans secured by realty may carry a rate of up to 9%.
Hawaii	12%	
Idaho	10%	The maximum rate on non-supervised consumer loans is 18% and on revolving loans 15%. Supervised loans carry a maximum rate of 18% on all unpaid balances, or a total of 36% on unpaid balances of $390 or less, 21% on unpaid balances between $390 and $1300, and 15% on unpaid balances over $1300. A ceiling of 12% applies to loans of over $10,000 to corporations. Firms engaged in agriculture may be required to pay a maximum of only 10% on loans.
Illinois	8%	All corporate loans and business loans to non-profit organizations; as well as mortgage loans insured by the FHA or guaranteed by the VA may be contracted for at any rate. Also secured loans greater than $5000 may be at any rate. Effective July 12, 1974 the maximum interest rate that may be charged on loans secured by residential real estate and entered into before July 1, 1975 was raised to 9½%.
Indiana	18%	A maximum rate of 18% applies to non-supervised consumer loans, consumer related loans and revolving loans. Supervised loans carry a maximum rate of the greater of 18% on all unpaid balances, or a total of 36% on unpaid balances of $300 or less, 21% on unpaid balances over $300 but under $1000, and 15% on unpaid balances over $1000. There is no maximum charge on other loans.
Iowa	9%	There is no ceiling rate on either corporate loans or real estate investment trusts.
Kansas	10%	Consumer loans other than supervised loans carry a maximum rate of 12%. The maximum charge on supervised loans is 18% on the first $1000 and 14.45% on any additional. There is no ceiling on any other type of loan.
Kentucky	8½%	There is no ceiling on loans over $25,000 which are not on a single unit family residence. No special rate applies on loans to corporations.
Louisiana	8%	Loans secured by real estate carry a maximum rate of 10%. However, loans guaranteed by Federal agencies are exempt from the usury laws. Corporate loans may be any rate.
Maine	16%	No maximum rate applies if the loan is for non-personal or business purposes and the contract is in writing and involves more than $2000.
Maryland	8%	No ceiling applies to business loans in excess of $5000. Residential mortgage loans may be at 10%.
Massachusetts	None	
Michigan	7%	No ceiling rate applies to corporate loans, realty secured loans, or federally or state approved loans.
Minnesota	8%	No ceiling rate is applied to loans in excess of $100,000.
Mississippi	10%	Corporations organized for profit may pay to 15% on loans in excess of $2500.
Missouri	8%	Corporate loans may be at any rate.
Montana	10%	
Nebraska	9%	Corporate loans may be at any rate. The maximum rate is waived on certain loans by building and loan associations, installment loans, industrial loans, and personal loans by bank and trust companies or credit unions.

STATE USURY LAWS[1] (Cont.)

State	Basic Rate	Some Major Exceptions
Nevada	12%	
New Hampshire	None	
New Jersey	8%	The basic rate applies to loans under $50,000. Loans secured by realty carry a maximum of 8¾%. The rates are not applicable to loan contracts made by savings and loan companies, banks, or any department of Housing and Urban Affairs or FHA approved loans purchased by Federal government.
New Mexico	10%	A 12% ceiling applies to unsecured loans.
New York	8½%	Demand notes of $5000 or over with collateral security may carry a rate of up to 25%.
North Carolina	8%	Ceiling rates on loans are graduated according to the size and purpose of the loans reaching 12% on loans of $100,000 and unlimited on loans of $300,000 and larger. First mortgages on single family dwellings may be contracted for in writing at any rate agreed upon by the parties. Corporations may pay any rate.
North Dakota	9%[3]	Business loans in excess of $25,000 may carry any rate. Corporate loans regardless of size may carry any rate.
Ohio	8%	Loans in excess of $100,000 may be at any rate.
Oklahoma	10%	Oklahoma's Uniform Consumer Credit Code allows 18% to supervised lenders and 10% to others lending to consumers. There is no ceiling rate on other types of loans.
Oregon	10%	Loans in excess of $50,000 may be made at any rate. The maximum rate on loans smaller than $50,000 is 12% for corporations and 10% for individuals and non-profit organizations.
Pennsylvania	6%	The maximum rate does not apply to loans of more than $50,000; loans of $50,000 or less secured by a lien upon real property; loans to business corporations; unsecured, non-collateralized loans in excess of $35,000; and business loans in excess of $10,000. The interest rate on residential mortgages of an original principal of $50,000 or less is a fluctuating administered rate. For July 1974 this rate was set at 9.5%.
Rhode Island	21%	
South Carolina	8%	The maximum rate on loans of from $50,000 to $100,000 is 10% and on loans between $100,000 and $500,000, 12%. Loans larger than $500,000 may be at any rate. First mortgage real estate loans made by savings and loan companies, the Department of Housing & Urban Affairs or FHA approved mortgages are exempt.
South Dakota	10%	Corporate loans may carry any rate. However, the maximum rate on all loans on real estate regardless of borrower is 10%.
Tennessee	10%	The contract rate does not apply to loans extended under the Industrial Loan and Thrift Company Act or to installment loans of banks and trust companies and building and loan associations on which interest is deducted in advance and added to the principal.
Texas	10%	Corporate loans above $5000 have an 18% ceiling.
Utah	18%	Revolving loans and non-supervised consumer loans carry a maximum rate of 18%. Supervised loans carry a maximum rate of 18% on all unpaid balances, or a total of 36% on unpaid balances of $390 or less; 21% on unpaid balances over $390 and not over $1300. All other loans may be made at any rate.
Vermont	8½%	No ceiling rate applies to loans for income producing business or activity. Loans to finance real estate which is to be used as a primary residence or for agriculture is subject to the contract rate. However, loans to finance real estate improvements or a second residence may be at any rate.
Virginia	8%	Any rate may apply to non-agricultural loans secured by a first mortgage or realty.
Washington	12%	
West Virginia	8%	
Wisconsin	12%	Corporate loans may be at any rate.
Wyoming	10%	Revolving loans and consumer loans other than supervised loans may carry a maximum rate of 10%. Supervised loans may be at a rate of the greater of 18% on all unpaid balances of $300 or less, 21% on unpaid balances over $300 and not over $1000, and 15% on unpaid balances over $1000. All other loans may be at any rate.

[1]This table presents a synopsis of the maze of laws concerning usury in effect in the various states and the District of Columbia as of mid-July 1974. Due to the complex nature of this area of the law, the table may not be completely accurate with respect to certain specific technical provisions. It should, however, allow the reader at least an opportunity to gain some conception of the wide range of opinion concerning interest rate regulation by virtue of the great discrepancy it reveals between the states as to both their basic interest rate ceilings and the nature of the exceptions to those rates.

It might also be noted that national banks are permitted to charge 1 percentage point more than their Federal Reserve Bank's discount rate. At present national banks may charge at least 9 percent on loans even in states with lower usury ceilings since the discount rate is 8 percent.

[2]The basic contract rate for loans in this state not involving real estate is 4 percentage points above the Federal Reserve discount rate at the 12th district Reserve Bank prevailing on the first day of the month preceding the commencement of the calendar quarter. The rate for real estate contracts or commitments is 4½% above the Federal Reserve rate. At the time of this writing that rate stands at 8%, consequently the basic ceiling rates are 12% and 12½% respectively.

[3]Where the parties agree in writing, interest may be charged and collected at a rate of up to 3% above the maximum bank deposit interest rate authorized by the state banking board. However, the sum of the 3% add-on charge and bank board established limit can never fall below 7%. The current bank deposit interest rate limit set by the board is 6%, thus the present 9% ceiling rate on written contracts.

ceiling was sufficiently high so as not to impinge on market rates. As a result, the amount of new mortgage loans made on *local* properties declined markedly.

A number of District commercial banks and savings and loan associations have found that it has been more expedient to lend a greater share of their available funds in the unrestricted Federal funds market than to lend locally under oppressive ceilings. For example, on the April 24, 1974 call report, member banks in the Eighth District (outside eight large money market institutions) lent a net of $368 million in Federal funds, at a time when the effective Federal funds rate was 10.3 percent. A year earlier, on the March 28, 1973 call date, when the Federal funds rate was 7.3 percent, these same banks advanced $283 million in this market.

Available data also indicate that those who are not covered by usury restrictions are able to attract a larger share of available funds when market interest rates rise relative to effective rate ceilings for others. Eight large banks in the District advance credit to a great extent in national money markets where lending rates are virtually unregulated. Also, during the second quarter of this year, total deposits of the eight large District banks, bolstered by large CD purchases, rose at a 36 percent annual rate, while deposits at other member banks in the District increased at a 11.4 percent rate.

Avoidance of Usury Law

The impact of usury laws on credit markets has been made somewhat more tolerable by legal exceptions and other methods devised to soften the impact of the legislation. Without such exceptions it is conceivable that credit flows could virtually come to a halt in states like Missouri when the national rate on business loans with prime credit risk exceeds the 8 percent ceiling which prevails in this state.

In a number of jurisdictions small loan laws have been enacted which permit higher rates on certain small extensions of credit where operating costs are high and risk is frequently large. Many other legal exceptions have been granted for a variety of reasons. Retail credit charges, time-sales contracts, and loans to out-of-town residents are subject to higher ceilings in some states.

In Missouri, as in a number of other states, corporate businesses that are supposedly capable of protecting their interests in dealing with lenders are free to pay any rate that they desire. As might be expected, these corporations find that they have a tremendous advantage in attracting funds over unincorporated firms and individuals that are "protected" by the state.

In addition, many credit market arrangements have been devised for circumventing usury laws and permitting credit flows which otherwise would be halted. Some of these activities may be an outright violation of the law, such as simply ignoring the ceiling, or by calling the payment something other than interest. However, violation of usury laws frequently carries high financial penalties, such as loss of all interest or even principal; hence, lenders are generally reluctant to knowingly violate the statutes.

Other arrangements, which may or may not be technically legal, but which certainly conflict with the spirit of the law, have been adopted in order to effectively adjust a loan made at the legal rate to the market rate. One method is to lend to those who in some other way help you. Examples include the practice by lenders of favoring customers who maintain compensating deposit balances or whose firm does.

The effective rate on mortgages has traditionally been adjusted upward through the use of "points" charged either to the buyer, the seller, or both. At times, loans have been granted by third parties at the legal rate, after which the real lender then purchases the loan at a discount. Other loans have been "closed" in a more liberal location, such as across a state line. Such techniques, although permitting credit to flow, run risks of illegality, are inefficient, and probably cause effective rates to be slightly higher to the borrower and lower to the saver than they would be in a free market setting.

Lenders in states with low usury ceilings also have an option of moving funds into a state with more liberal laws. Comments from managers of funds indicate that the interstate movement of funds because of usury laws is sizable. Investment funds leave the state to finance mortgages in other states and to buy notes and bonds. Also, banks and savings and loan associations "sell" net sizable amounts of day-to-day Federal funds in the national money markets. This alternative of lending in another state protects large lenders to some extent and makes funds more readily available in states with liberal usury ceilings. However, such movements tend to be inefficient since credit is extended to less urgent projects and the cost of administering the loan is increased. Also, in the low ceiling state borrowers find credit still more difficult to obtain, lenders with small amounts are forced to accept lower yields, and economic activity suffers.

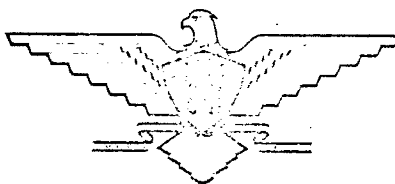
Conclusions

Ceilings on interest rates are relics of ancient and medieval thought, and have survived to the present largely because of a lack of confidence in market forces or because of a presumed benefit to higher credit risks. Actually, supply and demand for funds, rather than rate controls, have been the chief forces holding interest rates at existing levels.

Ceilings on rates may, at times, be of some benefit to borrowers easily deceived by unscrupulous lenders. However, usury laws cause a loss of individual freedom, and in modern economies they are disruptive, especially during periods of inflation when interest rates, like other prices, rise. Usury laws are based on false premises, operate perversely, and are economically inefficient. The cheap money which cannot be obtained is of little usefulness.

Effective usury ceilings, which alter the flow of funds, retard economic growth. The low maximums tend to prevent credit from flowing to higher risk individuals and businesses. Funds available are channelled into well-established, low- risk functions. As a result, innovation is discouraged, economic progress is slowed, and competition is reduced. The recognition that usury laws are burdensome, inequitable, and cause funds to leave the jurisdiction has led some states to relax the law.

Controls also adversely affect the saver, since they deny him the right to a competitive return on his funds. This is especially true of smaller savers. Those with large amounts of savings can more easily by-pass the controlled market by investing in uncontrolled central money and capital markets. Not only is the saver of moderate means injured, but the economy also loses as he becomes discouraged and saves less.



Mr. Chairman, my name is Bill Kottinger. I am a Vice-President of Paine, Webber, Jackson & Curtis, members of the New York Stock Exchange. Obviously, we are not commercial bankers. As a matter of fact, we compete with the commercial banks in a number of financial activities and services. However, as members of the state's financial community, we are well aware of the need for our banks to be viable and competitive under any economic circumstances.

SB 296, by raising the maximum legal rate of interest, increases the ability of our Nevada banks to provide funds to their customers during unpredictable, but nevertheless recurring adverse money market conditions. Nevada, because of its population size and unique economic base, has traditionally been an importer of capital. In other words, our state banks total deposits have not been adequate to internally generate the capital demands of our rapidly growing state. Because of this, during periods of tight credit and high interest rates, our banks ability to accomodate their customers is severely restricted in comparison to the money center banks.

We believe that SB 296 goes a long way in assuring Nevada citizens availability of bank loans, during stormy economic periods in the future.

Because the money markets of our country are intensely competitive, the change in the ceiling does little to increase borrowing costs and greatly reduces the complications of the bill as it is currently written.

It should be pointed out that in todays environment of energy shortages and accompanying extraordinary dollar flows to the Middle East oil producers, combined with what appears to be

an adverse weather cycle and continuing high Federal deficits, it is prudent to use the calm, less emotion-charged periods such as we are currently experiencing, to buttress our basic institutions. Nothing is more basic and fundamental to our economy than a strong banking system. The bulk of this countrys money supply is held in the form of savings deposits. It follows that the banking system is the residual lender to the government and corporate sectors of the economy. I urge your support