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Regulation of Usury: Justification, Consequences, and Some Lessons from Polish Experience*

Regulacja lichwy: uzasadnienie, konsekwencje i wybrane wnioski z polskich doświadczeń

Abstract

In this paper we analyse a recent debate on justification of usury regulations and their implications. To investigate the impact of liberal, competition-enhancing policy on usurious practices, we present a case study of the Polish payday loan market after 2008. We also examine the efficacy of usury regulations in Poland. Our study finds that consumer welfare, social welfare, and the risk of exploitation of borrowers are the main arguments for introducing interest caps. We demonstrate that, in pursuit of greater profits, loan companies use additional non-interest fees and commissions as well as bundling, and thereby reduce the transparency of loan agreements. We show that rising competition on the payday loan market is not sufficient to reduce the cost of loans, especially when the efficacy of regulatory control is deficient and unsatisfactory. Therefore, the efficacy of the judicial system can be seen as essential to combat usurious lending.

Keywords:
consumer protection, usury, payday loans, interest rate caps, credit market regulation

JEL classification codes:
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Streszczenie

W artykule zarysowano główne nurty współczesnej debaty naukowej poświęconej zasadności i konsekwencjom regulacji lichwy. Studium przypadku polskiego rynku pożyczek pozabankowych pozwoliło zbadać wpływ liberalnej polityki wspierającej jego konkurencyjność na kształtowanie się praktyk lichwiarskich po 2008 r. Przeanalizowano również skuteczność regulacji antylichwiarskich w Polsce. Ustalono, że wzgląd na dobrobyt indywidualny oraz społeczny, a także ryzyko wyzysku pożyczkobiorców, leżą u podstaw argumentacji za wprowadzaniem ograniczenia maksymalnego oprocentowania kredytów. Wskazano również, że firmy pożyczkowe – w pogoni za większymi zyskami – stosują różnego typu opłaty i prowizje, jak również techniki sprzedaży wiązanej, ograniczając tym samym transparentność umów. Rosnąca konkurencja na rynku pożyczek bankowych nie jest czynnikiem wystarczającym do obniżenia kosztów kredytu, zwłaszcza gdy regulacje są ułomne. W konsekwencji skuteczność i sprawność systemu prawnego mogą być postrzegane jako niezbędne w walce z praktykami lichwiarskimi.

Słowa kluczowe:
ochrona konsumenta, lichwa, pożyczki pozabankowe, ograniczenie maksymalnego oprocentowania, regulacja rynku kredytowego

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Introduction

The issue of usury regulation is problematic for both developing and highly developed countries [Faherty, McCarthy, Byrne, 2017; Gul, Podder, Shahriar, 2017; iff/ZEW, 2010; Madeira, 2019; Maimbo, Henriquez Gallegos, 2014; OECD, 2019; Takalo, 2019] and therefore presents a policy challenge, amplified by the financial crisis of 2008 [Ramsay, Williams, 2020].

In the article, we do not assess the "appropriate" level of interest rates that distinguishes a fair price for borrowing money from a usurious one. We do not discuss historical or religious motives for introducing usury regulations, either. Nor do we investigate the changes in the meaning of the term usury, which initially referred to lending at interest and only later changed into lending at excessive or legally prohibited interest (see e.g. Mews, Abraham [2007], Persky [2007], Calder [2016]). In our analysis, we adopt the most general contemporary definition of usury, i.e. lending money at excessively high interest rates. It may or may not be restricted by law, according to the principle that not everything that is unethical should or must be prohibited. This assumption leads to two complementary conclusions: first, that regulating usury is not only an ethical but also a political issue [Mayer, 2013], and, second, that limiting the understanding of usury to illegal activity is a gross simplification.

The aim of the article is to analyse the arguments in favour of the regulation of usury. We draw attention to the unintentional consequences of limiting excessive interest rates. We also provide an analysis and assessment of the Polish experience in combating usury. Our contribution to the subject literature is twofold. First, we link the ethical (philosophical) aspects of regulating usury with the economic ones, emphasising the duality of arguments used in debates on the regulation of excessive interest rates. Second, taking Poland as an example, we argue that the liberalisation of usury laws confronted with the state's institutional weakness leads to an increase in usury rather than to benefits for borrowers resulting from growing competition between loan companies. We believe that our conclusions can be considered universal, at least in relation to countries which underwent a political transformation similar to that witnessed by Poland, and, therefore have been subject to similar socio-economic conditions.

This paper is organised as follows. Section 1 offers an overview of the economic and ethical arguments for introducing interest rate caps and examines the consequences of introducing interest rate ceilings based on previous studies. Section 2 presents the results of our analysis of the situation in Poland after 2008. The overview of the changes in interest rate ceilings is combined with an analysis of their impact on the payday loan market, arrears, and the number of bankruptcies declared. The final section contains a summary and conclusions.

Literature review

Combating usury: the economic justification

The economic justification for the government's interference in the credit market by imposing caps on interest rates focuses on social welfare and consumer welfare. In the theoretical approach, usurious activities may refer to the most broadly defined notion of borrowing money (and its various forms). In practice, however, extortionate pricing or unfair credit is manifested primarily on the market of unsecured payday loans and pawnshop loans. Mainstream financial institutions rarely demand excessive interest rates, which is related to the characteristics of their customers – banking services are available to creditworthy persons (i.e. sufficiently collateralised borrowers), and the types of credit collateral are limited. For these reasons, short-term bank loans and those offered by payday lenders are their weak substitutes. Moreover, it can be assumed that their theoretically possible substitution in the case of very rich individuals excludes the use of usurious interest rates [Crosato, Dalla Pellegrina, 2019].

Glaeser and Scheinkman [1998] consider interest rate regulations as a tool which can potentially lead to increasing social welfare. They play the role of primitive social insurance, and, as such, enable persons affected by a negative, temporary, idiosyncratic income shock to obtain loans at a lower price and to smooth individual consumption. Benefits measured in terms of aggregate welfare stemming from the administrative determination of interest rates below the free-market level are conditioned by the difference between the marginal utility of lenders' and borrowers' income (in their model – between "the rich" and "the poor"). Their scale depends on loan supply inelasticity. The degree of this inelasticity, and, for example, the size and durability of income inequalities, together with the income growth rates, determine the restrictiveness of usury regulations. Moreover, **Coco and de Meza** [**2009**] argue that, when the market equilibrium is characterised by credit rationing, adding moral hazard to the model makes administrative intervention in interest rates beneficial to social welfare, even if borrowers and lenders have equal marginal utility of income.

While the findings of Glaeser and Scheinkman should be treated as particularly relevant with reference to poorly developed capital markets, as the authors point out, **Posner** [**1995**] considers administrative restrictions of the permissible level of interest rates desirable in an advanced welfare state. By providing a social safety net, it encourages individuals to take excessive risks and accept high interest rates on loan funds. Possible failures of risky investments ultimately increase the cost of the functioning of the welfare state (which *de facto* burdens the whole community) and limit the effectiveness of efforts aimed at reducing poverty. Legal regulations governing interest rates put a limit on socially costly decisions of individuals.

Although social welfare is important, it does not seem crucial to regulatory initiatives. Individual (consumer) welfare usually serves as the basis for government activity. The main argument in this case is to treat these restrictions as a tool in consumer protection. In their empirical study, **Skiba and Tobacman** [**2011**] argue that access to high-interest unsecured payday loans increases the probability of individual bankruptcy [see also **Morgan, Strain, Seblani, 2012**]. However, if access to formal bankruptcy protection mitigates the scope of "informal" bankruptcy (i.e. a situation in which financially troubled borrowers simply choose to stop making payments), the impact of loan caps on consumers' welfare will be an open question. From a borrower's point of view, the requirement of mandatory balloon payments can be a significant burden on the household budget. This often results in costly rollovers, which may further lead to a debt spiral and, ultimately, to a debt trap [**Desai, Elliehausen, 2017**; **Vandone, 2009**]. Significantly, the very use of payday loans may become an impulse to apply for other forms of credit, which – in the medium term – leads to an increase in the share of the consumer's total debt in default, including non-payday loans [**Gathergood, Guttman-Kenney, Hunt, 2019**]. From such a perspective, payday loans become a triggering factor for consumers' even greater financial problems. Unrestricted rollovers seem to exacerbate this risk for the poorest as they increase the likelihood of their use together with pawnshops [**Carter, 2015**]. In this context, **Melzer's** [**2011**] finding that access to payday loans resulting in a high debt service burden adversely affects the households' ability to meet their financial obligations, including mortgage, rent, utility bills, and even healthcare expenditure, is hardly controversial. This access also increases the number of involuntary bank account closures – to a greater extent than poverty, for example, as **Campbell, Martínez-Jerez, and Tufano** [**2012**] argue. Its negative impact is also evident in the area of productive job performance [**Carrell, Zinman, 2014**].

References to individual welfare found in regulatory initiatives are evidently linked with individual preferences. Within ethical individualism, to which economists are strongly attached, an individual is the best "judge in his own case". He knows best what he prefers and thus what is good for him. Even if one assumes that the choices made by individuals reflect their preferences – which is not necessarily as obvious as it might seem; see more on the topic in, e.g., **Hausman** [**2012**] – it may still be premature to infer from them about the individual's welfare. First, these preferences may be based on false beliefs resulting from imperfect information about credit products. In such cases, as **Bertrand and Morse** [**2011**] argue, providing information conductive to reducing cognitive biases – which supports thinking in terms of real costs in the long term and allows for comparing alternative sources of credit – may limit the level of irrationality in individuals' borrowing decisions. **Sunstein** [**2006**: 260–261] also emphasises the importance of clearly expressed and targeted information. He indicates that a simple "provide more information" strategy may at best be a remedy for a lack of information, and not an effective tool for eliminating cognitive biases. It remains unclear how effective a forced information policy can be (compared to a simple regulation of the maximum interest rate) in a situation when most borrowers demonstrate low levels of debt literacy [**Lusardi, Tufano, 2015**; **Martin, 2010**]. Then, as **Zinman** [**2014**: S219] points out, it is not a lack of knowledge itself (including mathematical ignorance) that seems to be crucial to over-indebtedness, but its coexistence with cognitive biases.

Second, most customers of lending institutions which offer high-interest loan products are poor individuals who suffer from a scarcity of various resources (e.g. money, time, food). These shortages direct their attention to ways of finding solutions to the most pressing problems of everyday life and, at the same time, they lose sight of the long-term consequences of their decisions. Therefore, it can be assumed that decisions made by these individuals are influenced by their reduced cognitive capacity and are not a matter of their adaptive preferences or specific pathological behaviours originating in the "culture of poverty". They are the result of the psychology of poverty, in which resource scarcity acts as a specific type of fuel [**Mani et al., 2013**; **Mullainathan, Shafir, 2013**; **Shah, Mullainathan, Shafir, 2012**].

Third, decisions may be influenced by over-optimism about the level of self-control and be harmful for borrowers [**Heidhues, Kőszegi, 2010**]. As **Hyytinen and Putkuri** [**2018**] empirically prove, households' over-optimistic predictions about their financial situation are positively correlated with a higher debt-to-income ratio and with the borrowers' perception of themselves as being over-indebted and having problems with coping with debt and other payments.

Fourth, it can be argued, at least theoretically, that the time inconsistency of preferences resulting from hyperbolic discounting leads to individuals succumbing to the temptation of a quick "reward" in the form of easily accessible high-interest loans, thus affecting the size of debt to the detriment of their long-term welfare [**Heidhues, Kőszegi, 2010**; **Laibson, 1997**]. **Meier and Sprenger** [**2010**] report an empirical relationship between a present bias and an increased debt, but, as they themselves emphasise, it is correlative in nature. Thus, the results of their study do not confirm the theoretical findings which assume the causal character of this relationship.

Combating usury as an ethical issue

The classical line of defending the decision not to introduce any interest rate regulations, known as an efficiency argument in, e.g., the area of contract law [**Posner, 1995**: 284], refers to the assumption that both parties to a voluntary contract benefit from it. It can be assumed that, if both parties sign a contract agreement voluntarily, without any coercion, they must consider it profitable. In such circumstances, the intervention of the government or any other entity in the form of introducing a maximum price is nothing more than a restriction on the freedom of capital owners to dispose of and benefit from their capital [**Bentham, 2014**]. Such government activity has distributive consequences: it makes some individuals (borrowers) better off at the cost of making others (lenders) worse off. However, at least three issues seem crucial if such reasoning is to be considered convincing and, consequently, treated as a strong argument for rejecting usury regulation. These issues are: a lack of coercion, the ability to correctly assess the benefits of one's own decisions, and the impact on third parties, i.e. externalities which accompany credit agreements.

An individual's economic situation is determined primarily by his income from work, social transfers and public services. The late 1970 s and early 1980s marked the beginning of a rapid increase in income inequalities and a decrease in the generosity of the welfare state. Stagnant real wages, combined with the process of deregulation of economies, including the financial sector, was conductive to a dramatic increase in the debt of low and middle-income households, which made efforts to maintain their relative standards of consumption [**Barba, Pivetti, 2009**]. However, the statement that the popularity of the neoliberal concept and the economic changes which it triggered were a source of structural coercion in the context of household indebtedness, seems to be too far-reaching. These changes, resulting in an increase in economic and social inequalities, still raise the question about the roots of the extraordinary growth of the unsecured, short-term loan industry. High interest rate loans, addressed primarily to non-wealthy households, with unstable incomes and frequently facing a desperate situation, can be regarded as an example of mutually beneficial exploitation [Wertheimer, 1996]. If we consider such lending transactions unfair, even though they are beneficial for both parties, an ethical argument can be raised in the discussion on the interest rate control or on rollover restrictions [Mayer, 2003].

The existence of cognitive errors mentioned in the previous section means that the individuals' decisions are made in conditions of bounded rationality, which results in their inability to comprehensively assess the benefits of their decisions. The government, which cares about the welfare of individuals, may be pushed into paternalistic initiatives aimed at protecting borrowers from harmful consequences of their bad decisions. In their most extreme form, these initiatives can include prohibiting certain market practices, introducing limits on liabilities, interest rates, etc., and thus constitute an example of strong paternalism. However, two remarks should be made here with reference to this type of paternalism. First, it restricts the freedom of choice, and, second, it is potentially harmful, particularly to those whose choices are not influenced by limited rationality. Libertarian paternalism [Thaler, Sunstein, 2003], by contrast, guarantees the preservation of freedom of choice but does not seem to be relevant to the protection of individuals with limited rationality on the credit market, particularly those at risk of over-indebtedness. By setting default rules, it aims at neutralising cognitive errors by steering individuals in directions that will promote their welfare. As an illustration of this kind of soft paternalistic policy, Sunstein [2006] gives an example of credit cards, which could be replaced by debit cards (treated as a default option). By using them, people would avoid high interest rates and late charges caused by their procrastination. Of course, although this psychological mechanism results in additional unnecessary costs for consumers, the reduction of over-indebtedness risk obtained thanks to this card switch is still likely to be negligible. This is simply because this risk usually applies to those individuals for whom debit and credit cards are not substitutes and who appreciate the possibility to borrow money for their expenses. Besides, high-interest credit card debt can be explained by consumers' perception of future credit access risk [Druedahl, Jørgensen, 2018; Fulford, 2015; Gorbachev, Luengo-Prado, 2019].

Asymmetrical paternalism, which is based on regulatory tools that offer significant benefits to individuals suffering from cognitive errors and incur little or no costs to others, seems to be slightly more useful [Camerer et al., 2003]. All bureaucratic procedures (including information disclosure) enforced by regulations which accompany loan agreements are burdensome for all borrowers. But these inconveniences cannot be compared with the potential benefits to be gained by individuals with limited rationality, who are informed, for example, of the true costs of a loan and the risks associated with late payment or default. Such regulatory intervention, however, implies that both parties to the transaction have to follow a specific procedure, which, undoubtedly, restricts freedom of contract. Therefore, maybe even weak paternalism – in order to be effective – must, after all, interfere with individual freedom.

Even if doubts about the paternalistic justification for controlling interest rates or other parameters of the credit transaction were to be considered legitimate, this would not necessarily imply an automatic acceptance of non-interference. The argument that the individual's welfare should be at the core of public policy and that the "better informed" government should take care of consumer interests can be replaced by the argument referring to the effects of the individual's actions on third parties of a transaction. It rests on an obvious observation that the individual's freedom cannot be unlimited. It may be argued that lenders and less solvent borrowers operating on a free market (in terms of interest rate limits) are the ones who benefit; however, the vast majority of customers who are more solvent borrowers are the ones who lose. The latter pay more than they would pay because of the need to cover the losses caused by those who do not pay off their debts and are, therefore, compelled to cross-subsidise the least solvent debtors. A lack of usury regulations can thus be viewed as a practical exemplification of the maximin principle. According to this principle, only solutions that improve the situation of the least advantaged group are taken into consideration, regardless of the scale of unfair burdens on those who may constitute a decisive, yet only slightly better off, majority [Mayer, 2013].

Economic consequences of combating usury

Introducing usury caps should directly lead to a decrease in the average interest rate, which is of great significance especially for low-risk debtors. The strength of this impact depends, however, on the disparity between market interest rates and the ceiling. It should be remembered that many types of loans with different maturities are offered on the credit market, and limiting the maximum interest rate affects neither mortgage loans nor most popular consumer loans, including car loans, instalments, and overdrafts.

Despite these reservations, it is evident that such regulations directly benefit those consumers who manage to borrow money at a lower price when reduced interest rates are legally enforced. However, the assessment of other consequences and, therefore of usury laws in general, is inconclusive in the literature. It focuses on three aspects of regulatory initiatives: their purpose, efficacy and unexpected costs (unintended consequences).

Zinman [**2010**] argues that the restriction of access to payday loans may have a negative impact on job retention and the financial well-being of borrowers. **Morse** [**2011**] emphasises that access to payday loans can be treated as a welfare-enhancing proposition in a situation when individuals are affected by an unexpected financial shock inducing distress. The results of a laboratory experiment conducted by **Wilson et al.** [**2010**] lead to similar conclusions.

From this perspective, introducing interest rate caps and, consequently, limiting access to loans, seem pointless, at least for those individuals who experience incidental financial shocks – in contrast to those who treat loans as a way of financing their temptation consumption. **Maimbo and Henriquez Gallegos** [**2014**] point out that competition policy seems to be more efficacious in reducing interest rates than interest rate caps, particularly with regard to microloans [**Fernando, 2006**; see also **Helms, Reille, 2004**]. However, it should be remembered that the absence of interest rate ceilings is not sufficient to lead to greater competition in the loan industry, because historical developments, the role of state-owned banks, and other financial regulations also play an important role [**iff/ZEW, 2010**].

Referring to the US payday loan market, **Desai and Elliehausen** [**2017**], and **Bhutta** [**2014**] point to insufficient evidence supporting the claim that payday loans significantly affect consumer financial health. According to their findings, the regulation of the market of payday loans, even if it does improve the situation of some borrowers, certainly does not protect them from falling into a debt trap. In contrast, as **Li, Mumford, and Tobias** [**2012**] argue, lowering the maximum interest rate and the maximum loan amount reduce the probability of default.

The impact of usury regulations on the risk of bankruptcy, which could be treated as one of the measures of their efficacy, is difficult to assess for several reasons. First, the established level of the interest rate cap is crucial. It is usually set much above the market rate, therefore the supply of mainstream credit products is rather unaffected. Second, there is a difference between interest rates in various types of credit, which means that the interest rate ceiling can only be applied to a given market segment. In addition, although interest rate caps reduce costs for borrowers characterised by inelastic demand for short-term loans [**Elliehausen, Lawrence, 2001**; **Lawrence, Elliehausen, 2008**], they may also direct the most high-risk customers towards more unfavourable, more expensive substitutes [**Morgan, Strain, Seblani, 2012**; **Zinman, 2010**], including those offered by loan sharks [**Labat, Block, 2012**; **Mann, Hawkins, 2007**].

Although, from a theoretical point of view, the increase in illegal lending as a consequence of usury laws may seem a reasonable prediction, practice does not provide convincing evidence for it. This results primarily from the unavailability of the relevant data [**Faherty, McCarthy, Byrne, 2017**; **Howell, 2017**; **iff/ZEW, 2010**; **Mayer, 2012**]. Finally, technological innovations on consumer credit markets leading to a decline in the cost of information, transaction costs of lending, and the cost of bankruptcy [**Livshits, MacGee, Tertilt, 2010**; **Sánchez, 2018**] may play a much greater role in personal bankruptcies than usury laws.

Establishing interest rate caps may encourage lenders to compensate for their negative effects by increasing non-interest fees and imposing costly additional services (e.g. insurance products). Introducing extra charges or product bundling reduces transparency and the borrowers' ability to compare various offers [**Ferrari, Masetti,** Ren, 2018; iff/ZEW, 2010]. Moreover, as argued by DeYoung and Phillips [2013], while the introduction of interest rate ceilings limits extremely high interest rates, it may also result in gravitating average payday loan price upwards toward these ceilings. It also diminishes the variation in finance charges across payday loans and replaces competitive pricing pressure with strategic pricing behaviours.

The consequences of introducing interest rate caps can be analysed not only with regard to consumers (borrowers) and lenders, but also from the perspective of regulators and – in a broader perspective – financial market efficiency.

Howell, Wilson, and Davidson [2008] point out that, in order to comply with the established interest rate caps, regulatory control and adequate enforcement of sanctions for non-compliance are necessary. However, such interest rate control is a difficult and, if tighter restrictions are implemented, costly task.

The introduction of interest rate caps reduces the profitability of financial intermediaries, which may not only limit the range of products offered, but also lead to their withdrawal from certain segments of the loan market (e.g. rural areas or loans for women) [Campion, Ekka, Wenner, 2010; Ellison, Forster, 2008; Ferrari, Masetti, Ren, 2018; Miller, 2013]. Recent experience with interest rates caps in Kenya [Alper et al., 2019] and Bolivia [Heng, 2015] confirms their negative impact on the scale of financial intermediation. After the introduction of interest ceilings, financial institutions offer less credit to small farmers and small and medium-sized enterprises.

Regulation of usury in Poland: a short case study

First attempt to regulate usury: faith in the market mechanism

The history of contemporary interest rate regulations in Poland is marked by the low quality of legislation and a specific, unjustified (or even dogmatic) belief in the market mechanism. Paradoxically, it is also an example of how, with time, an unwillingness to introduce stricter regulations and tolerance for socially destructive market practices fuel highly restrictive initiatives through their consequences. Such initiatives can seriously threaten the profitability of loan companies and their ability to operate on the market legally.

Interest rate caps were introduced in Poland in 2006. The borrower protection rules are regulated in the Civil Code and in the Consumer Credit Act. Under these rules, the annual interest rate for all types of loans could not exceed four times the Lombard rate of the National Bank of Poland. Initially, the ceiling was set on the interest rate, and it was decided that additional fees and commissions charged by lenders in accordance with a loan agreement could not exceed 5% of the loan amount. Since 2016 the interest rate cap has been determined according to a different formula based on the Polish central bank's reference rate.

Unfortunately, the protection provided by these regulations was largely illusory because of the vagueness and imprecision of Article 7a of the Consumer Credit Act, and due to problems connected with its interpretation. In the interpretation most favourable for lenders, the ceiling was limited only to fees related to the conclusion of a consumer credit agreement. The dysfunctional scope of the application of this article, combined with certain vague and inconsistent concepts embodied in the law, made it possible for lenders to easily circumvent its provisions [UOKiK, 2009]. The introduction of high fees, especially in the form of credit repayment insurance and home service charges, allowed personal loan companies to receive additional revenues, up to 100% of the loan amount.

Surprisingly, it turned out that the best remedy for these weaknesses was not making the regulations more precise but abolishing them. In 2011, a new Consumer Credit Act was adopted, which removed restrictions on credit fees and commissions and introduced a more detailed obligation to provide information to borrowers, especially in reference to the annual percentage rate and total cost of credit. The justification for such a solution, presented by the UOKiK [2009] and shared by the legislator [Sejm Rzeczypospolitej Polskiej, 2012], was based on several premises. First, it was assumed that the price of a loan should be determined by the free play of market forces. Second, although it was admitted that improving the quality of law making and undertaking institutional efforts in its enforcement make it possible to reduce the borrowing costs, the market mechanism could obtain this aim at a much lower cost. In other words, it was assumed that usurious behaviours would be eliminated through free competition of credit market players. Third, it was recognised that these results could be achieved with the assumption that borrowers were provided with complete and reliable information on the terms and conditions of their loan agreements, including their total costs. The risk of an increase in non-interest fees after the removal of a ceiling was considered small.

However, the argumentation in favour of abolishing the regulation of non-interest costs of credit does not seem convincing in any way. This is caused by the specific nature of the short-term loan market. Apart from the fact that this market is characterised by a deep asymmetry of information, it is also characterised by high probability of mutually beneficial exploitation, which results from the profile of payday borrowers [**Jakubowska-Branicka, 2018**; **NBP, 2015**]. Moreover, individuals make sub-optimal decisions not only because they lack sufficient information, but also, or perhaps above all, because of their limited rationality.

The unwavering belief in the power of the unregulated market mechanism had its practical consequences. It shaped legal regulations without considering the specific features of a particular market. According to data by the Association of Financial Companies in Poland, the country's oldest association of financial services institutions (formerly known as the Conference of Financial Companies in Poland), the amount of loans granted by its members increased by almost 50% from 2011 to 2014, compared with just over 6% in the 2008–2011 period [**Herman, 2018**: 104]. In 2013, the total amount of loans granted by all entities representing the non-bank lending sector was estimated at anywhere from PLN 3 billion to PLN 4 billion [**PwC, 2013**; **ZPP, 2015**]. However, these data (as well as all other data concerning the non-bank lending market in Poland) should be treated with caution as they do not provide a complete view of the analysed market. The situation changed – at least in terms of records – in 2017, when an obligatory register was introduced by the Polish Financial Supervision Authority. By October 2021, a total of 530 institutions had been listed in the register.

This increase, in terms of both the amount of loans granted and the number of companies lending from their own funds, is also reflected in data reported by Statistics Poland (Table 1). The number and amount of loans apply to all the surveyed entities (i.e. credit intermediaries and loan companies), so it can be used only indirectly to assess the size of the non-bank lending market in Poland. More detailed information is available for the 2008–2009 and 2014–2017 periods. It shows that the amount of loans granted by entities from their own funds (i.e. loan companies) in the 2014–2017 period represented 26%–30% of the total amount of loans granted, up from 9%–10% in the 2008–2009 period [**GUS, 2010**; **2016**; **2017**; **2018**].

Table 1. Credit intermediation and loan companies in Poland: key growth statistics, 2008–2018

Year	Number of entities	Number of entities granting loans from own funds	Number of loans granted	Amount of loans granted (PLN mln)	Share (%)*
2008	56	13	2 645 021	19445.4	5.3
2009	59	15	1 940 726	12527.1	3.1
2010	64	16	1 996 655	16965.8	3.6
2011	69	22	1 784 599	20295.2	3.9
2012	118	50	2 353 152	26336.7	5.0
2013	140	71	4 325 720	24995.9	4.6
2014	168	95	6 266 925	28636.3	5.0
2015	168	95	6 064 311	33091.8	5.4
2016	257	126	5 323 579	39973.3	6.2
2017	283	146	5 488 305	42420.2	6.4
2018	283	146	5 438 837	50841.2	7.2

* Loans granted by surveyed entities as % of the amount of loans to households provided by the banking sector.

Source: Own calculations based on Statistics Poland and National Bank of Poland data.

The expansion of lending companies was undoubtedly supported by both the banks' self-regulatory initiatives to supply loans in response to the global economic crisis and the tightening of credit standards in accordance with Recommendation T issued by the Polish Financial Supervision Authority in 2010. The recommendation, addressed exclusively to the banking sector, contributed to a reduction in the supply of bank loans, and at the same time led to the migration of customers, especially those experiencing financial difficulties, to the non-bank lending sector [**Gemzik-Salwach, 2017**; **PwC, 2013**: 12].

All these changes in the business regulatory environment, combined with the expansion of financial technology companies, significantly increased the number of entities, including large foreign loan companies, on the Polish loan market. This led to the development of two market segments: one covering traditional loan service providers and the other including entities offering loans via the internet [**Herman, 2018**].

These two loan distribution channels are targeted at different customers. Online borrowing has become a means of financing unexpected expenses and consumption needs by young people with a relatively good financial standing but experiencing a temporary cash shortage. A universal trend can be observed in Poland whereby the social life of young adults is heavily affected by internet connections, and their online shopping habits are supported by instant loans [**Langley et al., 2019**; **Majamaa, Lehtinen, Rantala, 2019**]. This process undoubtedly increases the risk of accumulating expensive consumer debt in this group. On the other hand, the services of brick-and-mortar lenders are used mainly by the elderly and poor people who need money for unforeseen expenses or repayment of their liabilities [**NBP, 2015**: 144].

As a consequence of market environment changes, two groups of loan companies appeared on the market: large companies grouped together in various business associations and many small unaffiliated entities. According to estimates, before 2016 there were about 100 loan companies operating as joint-stock companies or limited-liability companies in total, and about 1,000 small local lenders, most of them operating as sole traders [**Herman, 2018**]. Loan companies aimed to emphasise the advantages of self-regulation in the context of business ethics. The largest of them viewed small lenders as a source of unethical (though de facto not illegal) business practices, and thus accused them of being responsible for the negative public perception of the entire loan industry.

Regulatory initiatives mandated by consumer protection laws introduced in 2010 and 2011 seemed to be symptomatic. It can be claimed that these tightened regulations "pushed" at least some consumers out of the banking sector into the substantially unregulated and liberalised non-bank lending industry.

The new regulations encouraged loan companies to resort to unfair practices, such as burdening their customers with additional high fees, which enormously increased the non-interest costs of credit [**UOKiK, 2013**]. In the case of short-term loans (for a period of around one year), the costs sometimes reached the net amount of the loan [**PwC, 2013**: 25]. Some companies openly adopted a business model based on offering loans totally beyond customers' financial capacities, which allowed them to benefit from rollovers. Their strategy was to deliberately "help" borrowers fall into a debt trap [**Herman, 2018**]. This practice was not new as **Stegman and Faris** [**2003**] discovered similar practices in the payday loan industry in the US state of North Carolina. Moreover, lenders often provided incorrect information about the annual percentage rate (APR), and the borrowers' ability to interpret the APR was most often a task that exceeded their capabilities, not to mention their ability to verify information provided by loan companies [**PwC, 2013**; **UOKiK, 2013**]. This is in line with evidence on the financial literacy of Polish households [**Cwynar et al., 2017**; **Cwynar, Cwynar, Wais, 2019**]. As **Reifner** (**2018**: 442) aptly put it, information rights defined in EU regulations (Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on Credit Agreements for Consumers), which were subsequently incorporated into the Polish Consumer Credit Act, turned out to be an offer of "stones instead of bread."

Usury regulation reconsidered: weak regulation in retreat

Negative experience stemming from specifically defined freedom in setting the terms of loan agreements led to the introduction of an amendment to Poland's Consumer Credit Act (also known as "Anti-Usury Act 2.0") in 2016. It limited maximum non-interest costs to 25% of the loan amount and 30% of the variable amount, depending on the period for which the loan was granted. Additionally, the legislators stipulated that all non-interest fees may not exceed the total loan amount. Furthermore, the amendment protected borrowers from falling into a debt trap. In case of rolling over the loan (the lender's granting subsequent loans within 120 days from the disbursement of the first one if it has not been fully repaid), the limit of non-interest costs is calculated from the first loan granted and includes the costs of granting subsequent ones.

The regulator's commitment to market competition resulted in setting the amount of the share capital of loan companies in Poland at a relatively low level of PLN 200,000. Although this allowed for some rearrangements on the payday loan market, such a low level raised doubts whether entities with low share capital would be able to meet all the required standards, in particular those related to debt recovery policy [**Herman, 2018**]. Moreover, it seems that once again the belief in the benefits of competition in the form of lower costs of credit, without taking into consideration the specific features of the regulated market, clashed with reality. It turned out that it was statutory limits, not competition, that served as the reference point for loan companies while setting non-interest fees [**Rzecznik Finansowy, 2018**]. Thus, the Polish experience in this area is consistent with the American experience [**DeYoung, Phillips, 2013**; **Mann, Hawkins, 2007**: 882].

Although the new Consumer Credit Act seemed to impose a strict limit on the total cost of credit, after two years of its implementation the Polish financial ombudsman acknowledged that loan companies had found ways to circumvent the statutory limits. They introduced the practice of refinancing personal loans within groups of interlinked companies, which only formally meant borrowing from a lender other than the original one [**Rzecznik Finansowy, 2018**]. Such a pseudo-change of lender allowed for charging full fees and omitting the statutory limits on non-interest credit costs.

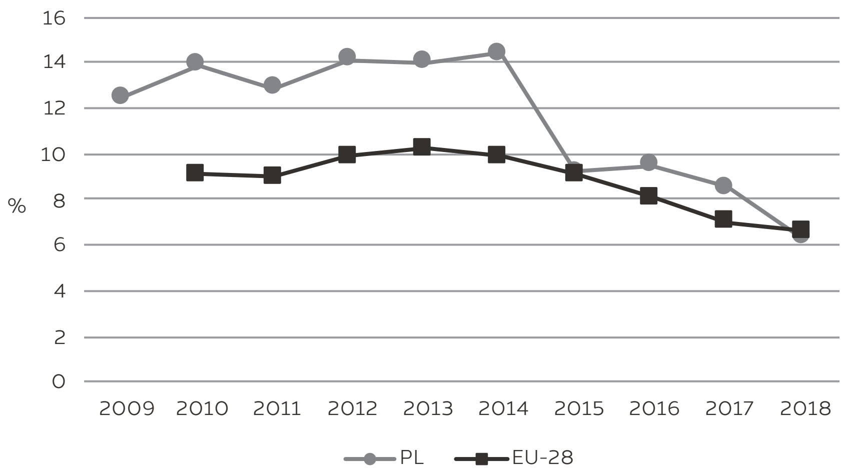
In 2019, a new anti-usury draft bill was announced. It was aimed to further cut the non-interest costs of loans. Loan companies perceived this strong tightening of regulations as an attempt to lead the legal payday loan market to collapse [**Union of Entrepreneurs and Employers, 2019**]. However, due to the end of the parliament's term and the parliamentary principle of discontinuation, the debate on new regulations was halted.

The growing stringency of usury laws in Poland after 2015 undoubtedly resulted from numerous irregularities caused by a specific combination of prior aversion to stronger interference in the payday loan market with institutional indolence, especially in creating and enforcing the law. However, the question arises whether such a changing approach to consumer protection observed in the last decade has been reflected in statistics on the over-indebtedness of households. It can be argued that a poorly regulated payday loan market and virtually unlimited access to high-cost loans increase the risk of falling into an over-indebtedness trap. Unfortunately, highly aggregated and incomplete data do not allow for making unambiguous conclusions.

From the empirical perspective, the share of households with payments in arrears [**Angel, Heitzmann, 2015**; **Duygan-Bump, Grant, 2009**] is considered to be a crude proxy for over-indebtedness. The impact of payday loans, according to **Melzer's** [**2011**] findings, should be visible in the households' ability to pay utility bills on time.

From 2009 to 2018, the share of households in Poland that experienced difficulties in paying their utility bills decreased significantly (Figure 1). Therefore, these data cannot be used to draw conclusions about the growing problem of excessive debt, and, in particular, the extent to which the development of the payday loan market could have contributed to it. On the one hand, this impact may be unnoticeable due to the relatively small size of this market. On the other, it may be significantly weakened by other factors. For example, the demand for payday loans among the poorest households with many children decreased after 2015 [**Herman, 2018**], which can be attributed to the introduction of the "Family 500 plus" child benefit programme. Moreover, in 2015, the portfolio of lending institutions started to change, and a shift towards high-value loans with longer maturity was observed. These changes should be interpreted as anticipatory adjustments in view of the tightening of usury regulations introduced at the end of 2015 [NBP, 2016: 145–146].

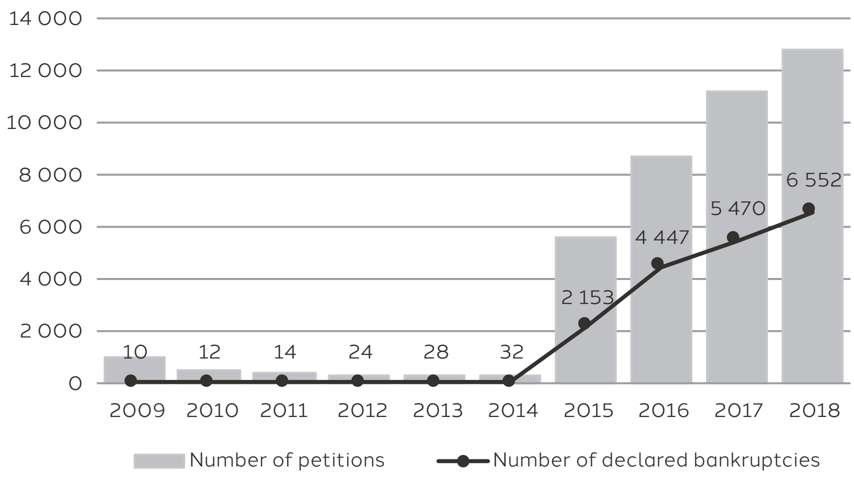
Figure 1. The share of households with arrears on utility bills, 2009–2018



Source: EU-SILC survey data, Eurostat, accessed September 15, 2021.

The effects of the tightening of interest rate regulations can be analysed not only using the scale of over-indebtedness but also through their impact on consumer bankruptcy. The increase in the number of personal bankruptcies could potentially indicate the malfunctioning of regulations and an increase in the financial strain caused by payday loans.

Figure 2. Personal bankruptcy in Poland: the number of petitions and declared bankruptcies; 2009–2018



Source: Informator Statystyczny Wymiaru Sprawiedliwości [2020].

However, the upward trend in the number of personal bankruptcies (Figure 2) is misleading due to a significant change in bankruptcy regulations. Initially, they were very restrictive and – as was the case with regulations on consumer credit – unclear and open to various interpretations. For example, the scope of application and the significance of circumstances leading to insolvency were disputable. In 2015, much more lenient regulations were introduced, which allowed for achieving debt collection and debt relief objectives. This reduced the probability of the debtor's financial and social exclusion. As a result, a huge increase in the number of bankruptcies was recorded in subsequent years. In 2019, consumer bankruptcy regulations were further relaxed, mainly by simplifying procedures.

Summary and conclusions

Most economists approach the idea of controlling the maximum interest rates charged by lenders with great caution. Theoretically, such regulations are supposed to eliminate usury from the economy. A standard, textbook approach to usury caps is a perspective in which the price (i.e. interest rate) determined by the interaction between supply and demand is replaced by a maximum price, which leads to market disequilibrium. When the quantity of loan funds demanded is larger than the quantity supplied, credit rationing is introduced and certain potential borrowers are refused a loan. It is also a perspective in which the government's interference can lead to negative consequences in terms of limiting market competition. This might result in reducing both the profitability of loan companies and the range of financial instruments available on the market.

However, this textbook approach has a number of evident weak points. These weaknesses explain long-standing efforts directed at eliminating usury from social and economic life. This approach presupposes the existence of equally well-informed credit market participants, including perfectly rational borrowers who maximise utility and are characterised by time-consistent preferences. On the other hand, information asymmetry on this market considerably weakens the argument against introducing administrative interest rate regulations based on rationing. Such rationing takes place even without any government intervention [**Gale, Hellwig, 1985**; **Jaffee, Russell, 1976**; **Stiglitz, Weiss, 1981**; **Williamson, 1986**, **1987**]. In addition, as behavioural economists indicate, individuals do not resemble utility maximisers described in textbooks.

The paper presents economic and ethical arguments supporting the introduction of usury regulations. Our findings suggest that social welfare and consumer welfare, on the one hand, and the risk of mutually beneficial exploitation strengthened by bounded rationality of consumers, on the other, provide strong grounds for concluding that administrative regulation of excessive interest rates is necessary and desirable. Thus, unintentional effects of usury regulations analysed in our study should be treated as barriers to excessively restrictive regulatory measures, and not as a confirmation of the superiority of strong market-oriented policies. However, some prudence in establishing usury caps is advisable, bearing in mind that, for example, unsecured short-term high interest loans may be the only source of credit for those individuals affected by incidental financial shocks who do not have access to mainstream financial institutions.

Our analysis has several limitations. First, we focused on the regulation of the interest rate without discussing other measures that can be used to limit usury. Second, although the problem of usury is universal, the efficacy of various tools, including interest rate caps, seems to be conditioned by historical, institutional and cultural contexts (for these tools and interest rate cap regimes, see: **Faherty, McCarthy, Byrne** [**2017**], **Ferrari, Masetti, Ren** [**2018**], **iff/ZEW** [**2010**], **Maimbo, Henriquez Gallegos** [**2014**], **OECD** [**2019**]). Therefore, one should be cautious in formulating universal guidelines for an effective regulatory policy in isolation from these contexts. Third, a lack of comprehensive and reliable data is a serious obstacle to analysing the effects of interest rate caps, which also applies to our study of the Polish payday loan market. Undoubtedly, the incompleteness of data on Poland to a large extent results from the regulator's specific approach to loan companies, which were virtually unsupervised, and were not even listed in any public register until 2017.

Referring to economic theory and the introduction of interest caps in Poland, it is possible to indicate several general findings. In order to be efficacious, protection against usury should consist of more than just legal limitations on the maximum interest rate. Legal regulations forcing lenders to provide detailed information on the terms and conditions of a loan should be treated as a fundamental component of a policy aimed at protecting consumers from actual or potential threats to their welfare. Thus, a borrower should obtain reliable information about all the costs of a loan and be able to compare what various financial institutions have to offer. Additionally, in the case of payday loans, the range of available measures should include limits on the number of possible rollovers and the obligation to convert mandatory lump sum repayment (a single instalment loan repayment) into payment plans. Finally, thanks to properly formulated consumer bankruptcy regulations, regulators can mitigate the consequences of usury and reduce the propensity to lend money to individuals with extremely poor creditworthiness.

The Polish experience seems to confirm the main drawbacks of usury regulations, especially those linked with reducing transparency [Ferrari, Masetti, Ren, 2018; iff/ZEW, 2010]. Lenders, impaired by a relative low interest rate ceiling, often circumvented these ceilings by increasing non-interest credit costs (fees and commission), as well as by bundling and complicating credit agreements. These practices undercut the efficacy of interest caps and contributed to their little impact on the payday loan market in Poland.

Furthermore, despite the relatively high APR for payday loans, it is difficult to identify it as the cause of arrears and defaults. The growing number of personal bankruptcies after 2015 is associated primarily with the relaxed usury regulations and growing awareness of consumer bankruptcy law. It must be admitted, however, that making unambiguous conclusions about the impact of such loans on households' over-indebtedness is almost impossible due to the weakness of empirical data.

However, our analysis does not indicate any other negative consequences of the introduction of usury regulations in Poland. The payday market is steadily developing, in terms of both the number of entities and the number and amount of loans granted. These conclusions are not in line with the results of the survey on interest rate restrictions conducted among the EU member states [iff/ZEW, 2010]. Moreover, predatory practices by some mainstream lenders seem to have been transferred to bank-related credit intermediation companies, which allowed for maintaining the high profitability of monetary financial institutions while weakening accusations of unethical market behaviours.

Although growing competition on the payday lending market may be seen as a factor reducing the cost of loans borne by borrowers [Lawrence, Elliehausen, 2008; Morgan, 2007], in Poland this impact is not confirmed. The Polish experience also demonstrates that the existence of interest rate caps does not weaken technological progress. The loan market is heavily penetrated by fintech companies. Therefore, encouraging competition among payday lenders does not seem to be an effective tool that could ultimately lead to limiting the negative consequences of usury for borrowers. This confirms the claim that the availability of a loan itself (convenience for customers) is a much stronger competition instrument than its price [Martin, 2010; Ramsay, 2010].

It seems that in Poland the limited efficacy of interest rate ceilings does not result from their being set at inappropriate levels, but is primarily driven by inadequate supervision and vague and imprecise usury regulations allowing for their arbitrary interpretation. Moreover, although the negative consequences of usurious practices imposed by loan companies gradually led to changing the regulation philosophy, tighter rules subsequently implemented are still accompanied by weak institutional and legal supervision over payday lenders.

This state of affairs allows for two interpretations that are not mutually exclusive. They may become the subject of further research, especially because of their potentially universal character, at least in relation to countries which, like Poland, have undergone a transition from a centrally planned to a market economy. Thus, if one accepts Ramsey's [2010] argumentation that the key factor shaping the regulation philosophy is the dynamics of the influence of political interest groups and their institutional setting, the reluctance to regulate becomes explainable as a result of the free-market, neoliberal attitude of a significant proportion of the Polish political and economic elites.

However, assuming the hypothesis that the efficacy of usury regulations is conditioned by the effectiveness of the judicial system [Crosato, Dalla Pellegrina, 2019], their growing restrictiveness could be interpreted as an obvious manifestation of the government's impotence in increasing the efficacy of courts, enforcing sanctions, and improving the quality of the institutional framework. The severe tightening of regulations of the kind that also took place in Slovakia [Bouyon, Oliinyk, 2019] is likely to lead to an expansion rather than curtailing of illegal lending. It can thus be treated as a substitute for other initiatives, less spectacular but undoubtedly much more useful in combating usury.

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