

# LAW AND POPULAR CREDIT IN MEXICO

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## *Resumen*

*Poner de presente el "derecho vivo," el comportamiento real y las actitudes de los participantes en un determinado campo de actividad regulado por el derecho, es tan importante para el entendimiento de la ley en muchos países de raíz romana, como lo es el exhaustivo conocimiento y manejo de sus legislaciones. A manera de ejemplo del llamado "derecho vivo," la primera parte de este estudio describe la organización y el modo de funcionar del crédito popular, tal como existe en la Ciudad de México. Este tipo de crédito es definido como una fuente no institucional de préstamos de dinero, nunca superiores a cincuenta mil pesos mexicanos (U.S. \$4,000.00 aproximadamente). La investigación pone de presente las prácticas y actitudes, tanto de los prestamistas como de los solicitantes de préstamos involucrados en este tipo de actividad, tales como fueron percibidas por el autor, a través de entrevistas realizadas durante los meses de junio y julio de 1.976, con personas conocedoras de las transacciones. El presente trabajo no se refiere a las operaciones de préstamo de dinero formalizadas que se observan en aquellas instituciones financieras altamente sofisticadas y posiblemente con algún toque de influencia extranjera, como son los bancos. Los préstamos de dinero estudiados, sin embargo, incluyen tanto aquellos para fines comerciales, como los destinados al consumidor. Las fuentes del crédito popular en las cuales se hace énfasis, son las siguientes: (1) la tanda, la cual consiste en la integración de un fondo común a través de contribuciones personales y libres; (2) la caja de ahorros, esto es, una pequeña asociación crediticia de carácter informal; y (3) los prestamistas o sea personas particulares dedicadas a hacer préstamos. La segunda parte del estudio examina el concepto formal de la usura en las operaciones privadas de préstamo de dinero en donde están involucrados los prestamistas. Debido a que las leyes mexicanas sobre la usura no establecen topes máximos de interés que se pueden imponer sobre préstamos, sino que solamente manifiesta que aquellos*

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*no pueden ser “desproporcionados... a la contraprestación recibida...,” el concepto de usura revierte en el problema de saber cuál tipo de interés, en un préstamo dado, es considerado justo, tanto por los jueces, como por los abogados, los prestamistas y los solicitantes de dinero en préstamo. Mientras la mayoría de los jueces miran como justo un interés del 2% mensual y el cual es usualmente cobrado por los bancos, los prestamistas consideran que cualquier tipo de interés en el cual acuerden las partes, debe considerarse justo. En cambio, ni los que solicitan dinero en préstamo, ni los abogados, tienen una idea uniforme de lo que debe considerarse un interés justo. Este trabajo no pretende seguir las pautas estadísticas propias de la investigación de campo. El propósito del artículo y de otros estudios sobre el derecho vivo, es facilitar una información que se considera importante, y poner de presente las verdaderas conductas y actitudes en cierto campo específico de actividad, tanto a los jueces, abogados y legisladores, como a los investigadores, con el fin de que en el manejo de la llamada ley formal, logren decisiones y determinaciones de carácter más adecuado.*

#### *Abstract*

*An awareness of the “living law,” the actual behavior and attitudes of participants in a given activity that falls within the ambit of the formal law, is as critical to understanding the law of many civil law nations as is a comprehensive knowledge of the Code articles. As an example of the living law, the first part of this study describes the organization and operation of popular credit, defined as non-institutional sources of cash loans of up to 50,000 pesos (U.S. \$4,000.00), available in Mexico City, Mexico. The data reveals popular practices and attitudes of the lenders and borrowers involved in these credit transactions as discovered by the author through interviews, conducted during June and July, 1976, with persons having first-hand knowledge of popular credit transactions. This discussion does not deal with formalized loan transactions which one would find in sophisticated, foreign-influenced loan institutions such as banks. The cash loans studies include both loans for commercial and consumer purposes. The sources of popular credit described in detail are: (1) la tanda, a personal, informal “pooling” of funds; (2) la caja de ahorros, an informal, small credit union and (3) los prestamistas, private, individual moneylenders. The second part of this study examines the formal concept of usury in private moneylending transactions, involving prestamistas, in Mexico. Because Mexico’s usury law prescribes no ceiling on interest rates except that they not be “disproportionate... to the value of his or her [the lender’s] consider-*

ation . . .," the concept of usury becomes a question of what interest rate the members of the judiciary, lawyers, lenders and borrowers perceive as fair in a given situation. Most judges view the interest rates charged by banks in Mexico, e.g., 2% per month, as fair, while the prestamistas feel that whatever interest rate the parties agreed to should be deemed fair. Neither borrowers nor lawyers have uniform perceptions as to a fair rate. This field study does not purport to follow the statistical methodology of field research. The purpose of this article and other living law studies is to provide valuable information and an awareness of actual conduct and attitudes in a given activity to the judges, lawyers and legislators of Mexico, the international legal practitioner who represents clients in Mexico and comparative legal scholars, to enable them to make responsible legal determinations.

## INTRODUCTION

This article was written in the fall of 1976 while I was attending the University of Arizona College of Law. It was my opinion that the basis of a good legal education should include not only an understanding of the formal law, which includes the study of judicial opinions, legislation and administrative enactments, but also the study of the actual behavior and attitudes of people involved in activities that fall within the ambit of the formal law. This latter concern constitutes what is commonly referred to as the "living law" and is distinguished from the formal law in that it reflects "what is" and not "what ought to be" the conduct in any given activity.<sup>1</sup>

My interest in the living law was stimulated by a study completed by Professor Boris Kozolchik<sup>2</sup> concerning the legal aspects of consumer credit in San Jose, Costa Rica.<sup>3</sup> One of the primary purposes of the Costa Rican study was to discover and describe the principal sources of in San Jose with the ultimate purpose of reforming the country's commercial laws in a fashion consistent with the current commercial practices and public policy of the country.

Critical to the study was the need for data which would reveal the actual behavior and attitudes of people involved in credit transactions. It was clear that this data could only be obtained through field

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1. See Introduction by Professor Boris Kozolchik, "Living Law" section, 1 ARIZ. J. INT'L & COMP. L. 85 (1982).

2. Professor of Law, University of Arizona College of Law.

3. C.F. Knight, B. Kozolchik & R. Rausch, Law and Consumer Credit in Costa Rica: Preliminary Draft (1969) (unpublished manuscript) [hereinafter cited as Knight].

research. For example, the law of usury plays a central role in credit transactions because it provides the formal law's view as to what is a fair rate of interest. But what if the usury statute provides, as it does in Costa Rica,<sup>4</sup> no specific maximum limit on interest rates that can be charged in these transactions except to say that a court may find a rate of interest usurious if it is unconscionable?<sup>5</sup> Due to the lack of a prescribed maximum rate of interest in the statute, there should be an awareness by those applying the statute, e.g., judges ruling on a case, lawyers advising their clients or legal reformists, of the actual behavior and attitudes of the lenders and borrowers operating in the market place as to what rate of interest they perceive as unconscionable. It is only through this awareness that those applying the formal law can begin to make responsible legal determinations.

Due to the proximity and frequency of contact between Mexico and the United States, and my interest in the field of credit, I decided that a living law study conducted in Mexico, which paralleled certain aspects of the Costa Rican study, would be of interest. In light of this, I chose to examine popular, or non-institutional, sources of credit in Mexico.<sup>6</sup>

Accordingly, the first part of this study is devoted to the description of the organization and operation of popular credit, which for the purpose of this study is defined as non-institutional sources of cash loans of up to 50,000 pesos (U.S. \$4,000.00)<sup>7</sup> in Mexico City, Mexico. By considering only cash loans of 50,000 pesos or less, I hoped to discover customary lending practices peculiar to Mexico City and to avoid highly formalized loan transactions which one would find in sophisticated loan institutions such as banks. Also, it should be noted that the cash loans studied included both loans for commercial and consumer purposes. The sources of popular credit discovered and described herein are: (1) *la tanda*, a personal, informal "pooling" of funds; (2) *la caja de ahorros*, an informal, small credit union and (3) *los prestamistas*, private, individual moneylenders.

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4. CODIGO DE COMERCIO art. 497 (Costa Rica 1964), in Knight, *supra* note 3, at "Sources of Consumer Credit and Creditor Practices," pt. 2, p. 2.

5. CODIGO PENAL art. 289 (Costa Rica 1941), in Knight, *supra* note 3, at "Sources of Consumer Credit and Creditor Practices," pt. 2, p. 2.

6. Due to a lack of time, funding and staff, the scope of the present study was narrowed from that of the Costa Rican study, which covered both institutional, i.e., banks, government pawn shops and commercial finance companies, and non-institutional sources of credit.

7. At the time of this study the official exchange rate was 12.5 pesos (Mexican) = 1.00 dollar (U.S.).

The second part of this article deals with the question of what is a fair rate of interest. As discussed above,<sup>8</sup> the usury law plays an important role in the field of credit transactions. The usury law of Mexico,<sup>9</sup> like that of Costa Rica, is subjective in nature, i.e., no specific maximum rate of interest is prescribed except that interest shall not be "disproportionate...to the value of his or her [the lender's] consideration..."<sup>10</sup> Therefore, it is a law whose application depends on the members' of the judicial system, i.e., the formal law, perception of fairness in a given situation. Accordingly, by comparing and contrasting the attitudes and actions of judges, lawyers, creditors and debtors who are the actors in the credit field as to what constitutes a fair rate of interest in Mexico, the relationship or lack of one between the formal law and the living law may be discovered.

### METHOD

The field work for this article was done in Mexico City, Mexico, during June and July of 1976. A successful field study depends heavily on establishing contact with people whose status provides the field investigator with both direct access to the prospective subjects and a cloak of legitimacy which facilitates gaining the subjects confidence and, hopefully, increases the reliability of their information.<sup>11</sup>

The information concerning popular practices and attitudes was acquired by me through interviews with persons having first-hand knowledge of popular credit transactions. All information describing popular credit as presented herein is based on these personal interviews and contacts with the community during this field study. At the interviewees' requests, no "real" names are used in the study. When appropriate, the status of the source of the information will be noted.

The interviews were carried out at the subjects' convenience and usually at a place of their choice. For example, most of the

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8. See *supra* notes 4-5 and accompanying text.

9. CODIGO CIVIL PARA EL DISTRITO FEDERAL [CODIGO CIVIL] arts. 17, 2395 (México 1928); CODIGO PENAL PARA EL DISTRITO FEDERAL [CODIGO PENAL] art. 387, fr. VIII (México 1931).

10. CODIGO CIVIL, art. 17, *supra* note 9.

11. I would like to thank the following persons for the contacts they provided: the late Sr. Guillermo Berentsen, Professor Javier Esquivel, Sr. Salvador Jimenez, Professor Boris Kozolchyk, Lic. Guerrero Moreno, Professor Alberto Szekely, Mr. Robert Young and La Familia de los Zamora. Without their cooperation, this study would not have been possible.

information which was acquired in the central market of Mexico City, *La Merced*, was obtained in meetings with a debtor in a tiny office located over the back of his next-door neighbor's vegetable warehouse. Another lender with whom I spoke made it clear that he wanted to meet in a neutral, dark and busy place. At his suggestion we met in front of a hotel on the *Avenida Reforma* at 8:00 p.m. Upon meeting, I was guided on foot to a bar in another hotel where the lights were low and the music loud enough to drown out our conversation. Other interviews were conducted in the offices of lawyers, judges and businessmen as their schedules allowed.

Because of the nature of the interviews, which were make-shift and often interrupted, and the diversity of the people spoken to in terms of level of education and willingness to talk, the same questions could not always be asked of all those who were interviewed. However, in each case similar questions were asked touching on the practices involved and the subject's attitude as to what is a fair rate of interest. Generally, the only time limitation on the interviews was that imposed by the subject.

I have not been formally trained in the method of field research and am aware of the many technical shortcomings of this paper.<sup>12</sup> For instance, the size of the study sample, both geographically and demographically, is unwieldy. Indeed, Mexico City, with a population of twelve million, is too large a sample universe for an ideal study of the credit phenomenon. On the other hand, I remain confident of the trustworthiness of the data acquired because of its striking consistency. From the produce market to the factory, from the lawyer's office to the merchant's store, whether the loan was for commercial or consumer purposes, the basic data regarding popular credit in Mexico remained consistent.

It is my hope that this study, rudimentary as it may be, will be the first of a series of articles endeavoring to discover and analyze the role of the living law in the general study of law.<sup>13</sup>

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12. Hopefully, the presence of a "living law" section in this *Journal* will encourage formal training in living law research methodology at the University of Arizona and elsewhere.

13. This author, together with several University of Arizona law students, is presently involved in a living law study which is being funded in part by the American Bar Association and by private matching funds. The study will compare the commercial real estate loan processes of Mexico and the United States. The field work will take place in Hermosillo, Sonora, Mexico, and Tucson, Arizona, U.S.A. This study will appear in the 1983 volume of the *ARIZONA JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW*.

## POPULAR CREDIT IN MEXICO

*La Tanda*

The earnings of most Mexicans do not keep pace with their rising material needs and expectations. In order to fill this gap, they must either obtain additional employment or find a source of credit. Because of the great difficulty in acquiring loans from institutional sources such as banks,<sup>14</sup> most prospective borrowers must look for non-institutional sources of credit. One prominent source of credit to which the borrower often turns is known as *la tanda*. The Spanish term, *tanda*, literally means a turn or rotation which is an artful description of the feature which best depicts this Mexican institution. In essence, *la tanda* is an informal "pooling" of funds which is drawn from on a revolving basis by its contributing members.

The types of people who take part in *tandas* vary from individuals who make as little as 2,000 pesos a month (U.S. \$160.00), to those who make up to 20,000 pesos a month (U.S. \$1,600.00). As a rule, each *tanda* will be composed of individuals whose earning capacities are more or less comparable. For example, in one *tanda* observed by this author the membership consisted of housewives, teachers, social workers, young professionals (accountants and doctors), secretaries and small merchants,<sup>15</sup> while in another, the members were teacher's auxiliaries and janitorial employees.<sup>16</sup>

The uses to which the money is put by the members are myriad, the only limitation being the size of the particular *tanda's* fund. For instance, in the wealthier *tandas* the money is commonly used to remodel the home, take a trip, make a down-payment on a car, or for a child's Saint's Day or birthday party. In the less affluent *tandas*, the money is employed for necessities such as clothes for the children or an electric blender.<sup>17</sup>

*La tanda* serves two important functions: (1) It gives its members the opportunity to purchase goods and services that they could not ordinarily afford by forcing them to set aside, periodically, a determined quota and (2) it provides its members with a source of cash loans of amounts larger than the person could accumulate alone, when

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14. See *infra* p. 104.

15. The activities of this *tanda* were observed throughout the month of June, 1976, during which time the author rented a room from the Director of the *Tanda*.

16. Interview with Director of *Tanda* (July 21, 1976).

17. Curiously enough, the blender (*licuadora*) because of its multi-purpose use, in particular its use for preparing *jugos* (juices), was considered a "necessity" by those members of *tandas* whose earnings were only 2,000 pesos (U.S. \$160.00) per month, e.g., janitorial employees.

he wants it, without collateral and, most importantly, without interest. It is the second function which is most relevant to this study.

*La tanda* plays an important and extensive role in the Mexican economy. It has been estimated by several *tanda* members that at any given time, 20% of those who make 20,000 pesos or less participate in one or more *tandas*.<sup>18</sup> Yet, it is an institution which is not regulated by the formal law and therefore does not rely on legal sanctions for smooth functioning. It truly is an institution created by the “people” to fulfill their economic needs.

### Formation

*Tandas* are usually formed because someone needs money in a hurry, and the *tanda* offers the easiest and least expensive way of obtaining it. The first general rule of any *tanda* is that the person organizing the *tanda* has the right to receive the fund first. However, along with this right the organizer of the *tanda* assumes a very heavy responsibility. Although unstated, it is expected by the participants and accepted by the organizer that if someone does not make his or her payment to the fund or if a member absconds with the fund, the organizer will act as a guarantor of the participants’ funds. Consequently, since the organizer puts no cash down before receiving the first revolving fund, she must be a person of unquestionable honesty.<sup>19</sup>

Although there is no specific name given to the person who organizes the *tanda*, for the purposes of this paper this person will be referred to as the Director. In most instances, the Director will be a middle-aged *señora* (married woman). It is the Director’s responsibility to decide who may participate in, and to determine the terms of, *la tanda*. The Director will generally make invitations to prospective participants with the following priority in mind: (1) Director’s immediate family, often her married children; (2) relatives; (3) friends and (4) others recommended by her friends or family. In a city as large as Mexico City, it is also important that the prospective participant live relatively close to the Director, so that little time is wasted in the periodic collection of money.

In determining the fundamental terms of the *tanda*’s operation, the Director must first decide on the amount of the fund. Normally, it is equivalent to the costs of the Director’s immediate economic need, e.g., purchase of new clothes. An average *tanda* will have a revolving fund of up to 5,000 pesos (U.S. \$400.00). Secondly, the Director

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18. This figure is an average of those estimations given by different members and Directors of *tandas*.

19. Interview with Director of *Tanda*, *supra* note 16.

must decide the number and frequency of revolving funds. The number will equal the number of people participating. For instance, most *tandas* are composed of eleven people so that in any one period ten of them will contribute to the fund which will be received by the eleventh person. Since most *tanda* participants are on salaries which are paid on a bi-weekly basis, the most common practice is to have a "fund" every two weeks. In other words, if the fund was 5,000 pesos the Director would probably invite eleven people to participate. In each period ten people would contribute 500 pesos apiece for the benefit of the eleventh person and this would go on for eleven two-week periods, or five and one-half months, by which time each individual shall have received the fund once and also contributed an amount equal to the fund.<sup>20</sup>

The final operational term of the *tanda* is the order in which the participants will receive the fund. As mentioned earlier, it is automatic that the Director will receive the fund first. As to the other participants, there are two common ways in which their positions are fixed. The most common method is to allow the participant to choose the period in which he or she would like to receive the fund. Those in favor of this procedure will want the fund only when they actually need it for a specific purpose, e.g., a child's birthday party. In this situation the *tanda* functions as a non-profit cooperative venture. The second method of selection of positions for receiving the fund is by a *sorteo* (raffle). In this situation the *tanda* may become a financing tool for the persons falling into the first several positions because they have the opportunity to take the interest-free money and reinvest it for profit.

### Operation

There is no written record of the operating rules of the *tanda*. If the Director is an organized person, the only written record of the exchange of money will be kept in a small black *libreta* (book) where the receipts and disbursements of the money are noted by the Director; otherwise, the only record will be a folded sheet of paper with some scratches. The participant keeps no written record of his or her contributions and is given no written evidence of it (such as a receipt) by the Director. Yet, the *tanda* works smoothly. From discussions with Directors and participants of different *tandas*, it was found that there had been only one total failure in which the Director of the *tanda* absconded with the funds and left the city.<sup>21</sup> Otherwise,

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20. Example based on *tanda* cited *supra* note 15.

21. See *supra* note 15.

the only complaint stated by the Directors was that occasionally participants are one or two days late in making their payment to the fund, thus delaying the receipt of the “fund” by the designated beneficiary.

In the author’s opinion, the success of the *tanda* is based on several key factors. The first, and most important, is that it is based on a consensual agreement by people of equal bargaining power who are usually not motivated by profit. Secondly, the participants tend to know each other directly or know that the integrity of a participant has been vouched for by another member of *la tanda*, making it a highly personalized economic institution of minimized risk. Thirdly, the role of the Director is always filled by a *señora*, a person of strong moral authority within the Mexican social structure who guarantees the participants’ funds. Because of her social role, the *señora* is better able to select the participants as she usually knows the person’s economic solvency as well as his or her moral solvency, i.e., honesty or responsibility. Furthermore the participants are more likely to comply with the terms of the *tanda* because of this strong moral obligation. This final factor is mirrored in a saying popular with *tanda* participants, “*La tanda antes que nada*,” which literally translated means, “*La tanda* before anything else.” When the author asked one participant to interpret this saying, he was told that if a person had to choose between making an installment payment on a bank loan or contributing his quota to *la tanda*, she would pay her quota first.<sup>22</sup> One possible explanation given by several *tanda* participants for this attitude is the strength of social censure in Mexico.<sup>23</sup> Since the debtor has much closer social ties to the people involved in *la tanda* than he does to a banking institution, the moral pressure which is subtly exerted upon him by the former is strong enough to outweigh the purely economic obligation to the latter.

### *Caja De Ahorros (Credit Union)*

*Caja de ahorros (caja)* (credit union) is a major economic institution which is used both formally and informally in Mexico. The formal *caja* closely follows the regulations of formation and operation provided by Mexican law.<sup>24</sup> In essence, it is a highly formalized credit union and, for the purpose of this paper, is regarded as an institutional source of lending which falls outside the present inquiry. This section

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22. Interview with Director of *Tanda* (June 9, 1976).

23. Interview with members of *tanda* cited *supra* note 15.

24. LEY GENERAL DE INSTITUCIONES DE CREDITO Y ORGANIZACIONES AUXILIARIES cap. II (México, D.F. 1941, amended 1970).

of the study will deal with the more prevalent "informal" *caja*,<sup>25</sup> a non-institutional source of credit with a structure more formal than *la tanda* but less formal than a credit union.

The *caja* offers three principal economic benefits to its members: (1) a source for cash loans with reasonable interest rates; (2) a mechanism for forced savings and (3) a source of income for its members through a distribution of profits at the end of the year derived from interest earned on loans.

Many *cajas* are found in each ministry, agency and branch of the government of Mexico as well as in the offices of large private businesses. For example, there are three *cajas* alone in the Faculty of Law at the National Autonomous University of Mexico (U.N.A.M.). On the average there are from twenty to fifty members in a *caja*, though it can be as few as 10 or as high as 300.

The *caja* is a popular institution for several reasons. First, the salaries earned by office workers in Mexico, both government and private, are extremely low in relation to the cost of living in Mexico City.<sup>26</sup> Consequently, in order to make ends meet, he or she must either moonlight or rely on loans. Secondly, without a *caja* the average worker has no alternative source for cash loans except the oppressive *prestamista* (moneylender)<sup>27</sup> or the remote possibility of obtaining an early position in his or her *tanda*. He or she does not have sufficient collateral to qualify for a bank loan and has probably, in most instances, already exhausted low-interest loan opportunities offered by the government. Thirdly, as a savings institution the *caja* is better than the bank. It is more convenient because it is located at the member's place of work, and the member earns more interest than he or she would at the bank. Higher interest rates are charged on the *caja's* loans, and, because the government does not closely regulate the *caja*, the member does not declare the profits as income for tax purposes. Finally, most employees enjoy being members because they feel they are satisfying their social obligation to help their fellow man.

The cash loans received by the members of the *caja* are generally used for consumer goods such as electric blenders and clothes. However, sometimes the money is used to buy presents for the family or to give large fiestas on a child's Saint's Day.

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25. All information described herein is based on personal interviews with Directors and members of seven different *cajas*.

26. The average monthly salary of an office worker is between 2,500–55,000 pesos (U.S. \$200.00–\$400.00). Averages are based on information obtained from office workers and managers of both private business and government agencies in personal interviews conducted throughout the summer of 1976.

27. See *infra* p. 102.

### Formation

The initiator of an informal *caja* is usually an office worker who has participated previously in another successful *caja*. The idea is discussed informally by the workers, and, if there is general agreement that a *caja* should be organized, they will then decide who should be its director. The two bases for selecting a director are honesty and duration of employment in the office. As a consequence, most directorships are usually filled by women secretaries who have worked for at least several years not only in the same department but in the same office. As a rule, the director receives no pay for the job. When asked why they were willing to devote hundreds of hours a year and accept the large responsibility, directors answered that it was done as a *labor social* (community service).

Upon her selection, the Director and the initiator meet and discuss the important terms of the *caja*. Then the other office workers are presented the terms and, in a rubber stamp fashion, give their consent orally. Because the *caja* is an informal institution, there are no written legal documents evidencing its rules and regulations.

There are four basic terms of a *caja* which must be agreed upon. The first is the eligibility requirement for membership. In most *cajas*, any employee who works within the same government department or private business will be allowed to participate. If a person's moral solvency is questionable, then the Director has the power to deny the applicant admittance. Secondly, the minimum quota that each member must contribute periodically to the *caja* as part of his or her savings account must be determined. The amount of the member's savings will depend on the average salary made in the department as well as the individual's own salary. As a rule, the minimum savings required is 25 pesos (U.S. \$2.00) every two weeks, although any member is allowed to save more. However, once a member chooses a specific saving quota, e.g., 100 pesos (U.S. \$8.00), he or she is not allowed to reduce it at a later date, since the calculations as to amounts available for prospective loans are based on the promised savings. Thirdly, the interest rate to be charged for the loans must be set. The percentage is determined in a very arbitrary fashion. The two major factors taken into account are: (1) the percentage of interest charged by private money lenders and (2) the percentage of interest charged by other *cajas*. Consequently, the interest rates adopted are usually smaller than those charged by the *prestamistas* and generally approximate the amount that one of the members has heard another *caja* charges. In the *cajas* studied by this writer, with one exception,<sup>28</sup> the rates varied from as low as 3% per month or 36% a year to as high

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28. See discussion of *Caja Libertad* *infra* p. 102.

as 5% a month or 60% a year. Although these rates may seem exorbitant to an American,<sup>29</sup> in Mexico they are common and shock no one. Finally, the dates on which the funds of the *caja* will be liquidated must be determined. In Mexico, most *cajas* operate only eleven months of the year. This means that all debts, principal and interest, must be paid on or before December 1 of that year so that by December 15 the members' savings and proportional share of the profits, derived from the interest, may be distributed to them. Of course, the selection of December 1 as a closing date is far from an arbitrary choice; rather it is a logical, security-oriented choice which benefits the *caja* as well as the individual members. The *caja* is benefited because it is at this time that all government employees and most private business employees receive their gratification from the *patrón* (government or business employer). At times, the gratification equals the employee's monthly salary, thereby providing the member with the money needed to pay off the loan owed to the *caja*. By these payments, the *caja* is made whole and is then able to distribute to the individual members their savings and profits enabling them to meet the expenses of *las posadas* (pre-Christmas fiestas), Christmas gifts and the New Year celebration.

### Operation

At the end of January, the Director receives the members' first "savings" quota. Notations of the amounts received are made next to each member's name on a sheet in the front of a black *libreta*. Usually, the Director issues no receipts evidencing the transactions to the members.

Prior to the deposit of the first quota the members desiring a loan will have signed a list kept by the Director. Generally the loans are granted on a first come, first served basis, rather than on the individual's need or the amount requested, although the Director tries to spread the money equally so that as many members as possible may receive loans. The demand of the members is so great that on the day the prospective quotas are deposited the monies are distributed to the waiting members/debtors, leaving no funds in the till of the *caja*.

Upon receipt of the money, most members/debtors need only sign a *vale* or *pagaré* (promissory note).<sup>30</sup> The *vale* includes an unconditional promise to pay the capital amount, the date, and the debtor's

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29. See *infra* p. 107.

30. DEL PAGARE. IN LEY GENERAL DE TITULOS Y OPERACIONES DE CREDITO cap. III (1932) regulates the use and collection of the *pagaré* (promissory note) as a credit instrument.

signature, as well as other terms that vary from *caja* to *caja*. For example, some *vales* include the rate of interest and/or the term of the loan, and others only the capital amount. However, in most instances the specific terms of the *vale* are unimportant since they are never adhered to and are never legally enforced by the members. Although many debtors will pay the interest on a monthly basis, it is rare that the capital is paid before the end of the *caja's* fiscal year. The major reason for using the *vale* is to show receipt of the money by the member on a certain date, so that at liquidation time the interest owed can be accurately calculated.

Other members/debtors, if they are known to be poor payors or are new to the *caja*, may also be required to have another member sign as an *aval* (guarantor) in order to receive the loan. If the member later proves his or her credit worthiness, no *aval* will be required to obtain a subsequent loan. In the *cajas* studied by this writer, resort to the *aval* for payment of the debt occurred only once. Since the *aval* is usually a close friend of the member/debtor, the *aval's* real value is that he or she morally obligates the member/debtor to repay the loan rather than providing the *caja* someone to proceed against “legally” in case there is nonpayment by the member.<sup>31</sup>

The signed *vale* or *pagaré* is then attached to individual sheets in the Director's *libreta* where the member's name, the amount of the loan and the monthly interest owed is recorded. As the interest is paid by the debtor, the Director writes “paid” next to the interest figure, and when the entire capital is repaid a large “Paid” is marked on the sheet. The member receives no receipt from the *caja* showing the payment of the interest or capital.<sup>32</sup>

During November, the collection process begins for the December 1 closing date. No new loans are granted since it is probable that a member could not repay the loan by December 1. The Director devotes a great deal of her time reminding the members that the loans are due shortly. At interviews with the director it was learned that the collection problems are minimal and, in fact, in one *caja* which operated fifteen years there was only one case of non-payment.<sup>33</sup>

The total amounts received by the closing date are usually substantial. Depending on the *caja's* membership, it is not uncommon for the *caja* to wind up with 15,000–60,000 pesos (U.S. \$1200.00–\$4800.00) capital and 3,000–12,000 pesos (U.S. \$240.00–\$960.00) interest. Therefore, in many instances the funds are deposited in a

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31. *Id.* arts. 109–116 (1932) defines the obligations of an *aval* (guarantor).

32. Interview with Director of *Caja* (June 8, 1976).

33. Interview with Director of *Caja* (July 21, 1976).

bank account until they are distributed either by check or by cash to the individual members.

At times the economic goals<sup>34</sup> of the *caja* clash, resulting in the members' confusion and uncertainty as to the priority of each goal. *Caja Libertad* (Liberty), observed by this author, consisted of 10 members and operated similarly to the *cajas* described above, with one exception. It charged 12% interest per month or 144% per year on its loans. The reason given by the members for this seemingly exorbitant rate was that the *caja* would earn more at the end of the year because of the high "interest" profits. Apparently each member could only see the fellow member as a debtor, and yet when the *libreta* was reviewed it was discovered that each member had borrowed from the *caja*. Clearly, this *caja's* goal to serve as a source of income all but abolished its goal to serve as a source of cash loans with low interest rates.

The *caja's* "hybrid" nature, to provide both profit and community service, distinguishes it from *la tanda*<sup>35</sup> and the *prestamistas*.<sup>36</sup> When the concept of profit does not totally dominate that of community service, the *caja* serves as a prominent source of cash loans for the Mexican individual.

#### *Prestamistas (Moneylenders)*<sup>37</sup>

The *prestamista* (private moneylender) in Mexico City is a person who swims beneath the visible stream of commerce. Although pervasive and dominant in most small commercial and consumer activities, the moneylender is recognizable only to, and protected by, his family of debtors. It is the role and method of operation of the *prestamista* which is the subject of this section of the study.

One general explanation for the secrecy surrounding the *prestamista's* identity and mode of operation is that he acts outside the formal law. In fact, there are some jurists and lawyers who believe that the activity of private money lending is illegal in Mexico, and that only the banks have the authority to loan money.<sup>38</sup> Whether this is

34. See *supra* p. 98.

35. In the section of this study describing *la tandas*, *supra* p. 94, it was seen that *tandas* are not a profit institution, i.e., interest is not charged for the loans.

36. In the following section of this study describing *prestamistas* the institution is described as one purely motivated by profit and consequently is the most expensive source of credit.

37. The format of this section closely follows that used in the Costa Rican study, Knight, *supra* note 3, at "Moneylenders or *Prestamistas*," sec. 2, pt. B, in order to facilitate comparisons between the two and because of the quality of the Costa Rican study's presentation.

38. Interview with attorney (July 23, 1976).

true theoretically is unimportant, since the reality of the situation is that without private money lending, the private economy would not operate successfully. But what is certain is that most *prestamistas* violate the law by not paying income tax<sup>39</sup> on the profits derived from interest earned, and by charging interest rates that in most instances would be deemed usurious or illegal by the courts.<sup>40</sup> Consequently, the *prestamista* carries out his activity in relative secrecy, and the small merchant or consumer, both in need of a sure and steady source for cash loans and in the belief that they, too, are participating in an illegal activity, protect the *prestamista's* secrecy by not revealing his or her identity.

*Prestamistas* are not a homogeneous group in Mexico. They include friends, relatives and fellow employees, as well as professionals who lend money for profit. However, as stated in *Law and Consumer Credit in Costa Rica*, it is not always easy to distinguish between the professional and the "friend, relative or co-worker."<sup>41</sup> This study of Costa Rica attempts to distinguish between different kinds of moneylenders on the basis of their lending practices, in particular the use of security devices. For the purposes of this paper, the Costa Rican study's definition of the term *prestamista* as any of a "large number of irregular lenders (friends, relatives, co-workers) and the hard core of professional lenders, all of whom use security devices other than simple trust"<sup>42</sup> will be adopted. More particularly, this study will be limited to the practices of those *prestamistas* whose average loan to any one individual is 50,000 pesos (U.S. \$4,000) or less.

The pervasiveness and dominance of the *prestamista* are due to several social and economic factors. First, the rapid population growth and urbanization of Mexico have combined to make Mexico a "capital-short" country.<sup>43</sup> Under these economic conditions, the sources of credit for small loans are severely limited, creating a flourishing market for the *prestamistas*. Second, the average salary earned by an employee of the government or private business is very low in relation to the employee's cost of living in Mexico City. For example, an *educadora* (nursery school teacher) for the *Ministerio de Gobernacion* (Ministry of the Interior) earns 2,500 pesos (U.S.

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39. LEY DEL IMPUESTO SOBRE LA RENTA art. 1 (México, D.F. 1964).

40. See discussion of "Usury – A Perception of Fairness" *infra* p. 110.

41. Knight, *supra* note 3, at "Moneylenders or *Prestamistas*," sec. 2, pt. B, p. 44.

42. *Id.*

43. Interviews with a major industrialist (July 14, 1976) and a large corporate lender (July 9, 1976). This aspect of the study should be further explored by economists familiar with Mexico.

\$200.00) a month for fulltime work.<sup>44</sup> At the same time, the cost of renting a room on an *azotea* (roof-top) for living quarters is 2,000 pesos (U.S. \$160.00) per month. After adding the cost of food, clothing and transportation, the employee's salary is clearly insufficient, thus necessitating resort to outside money sources.

A third important factor is the conservative attitude of the Mexican banking industry.<sup>45</sup> In order for a person to qualify for a bank loan, the bank requires security from the prospective client in the form of assets, personal or real. A person's earning capacity is not considered valuable security for a loan by Mexican bankers. Consequently, a great majority of lower and middle class Mexicans who own no assets must look elsewhere for the loan, usually to the *prestamista*.

A fourth factor contributing to the *prestamista's* prominence is the peculiar attitude taken by Mexican society towards the *prestamista*. Many people see in the *prestamista* a friend who is doing a "favor" for the borrower. In one man's words, the *prestamista* "*es un salvador*"—"is a savior."<sup>46</sup> This attitude is also reflected by many debtors' perceptions of interest as a "tip" paid to the lender for lending the money, rather than as a mechanism of profit. The *prestamista's* image as a "friend" is reinforced by the absence of violent enforcement techniques; to the contrary, the lender is usually friendly and courteous to the debtor.

The fifth factor which helps explain the omnipresence of the *prestamista* is the consumer's high demand for quick cash loans. As pointed out in *Law and Consumer Credit in Costa Rica*,<sup>47</sup> there are several basic reasons the members of the lower and middle class resort to *prestamistas* for cash loans. First, the Mexican, like the Costa Rican, prefers personalized treatment over the cold, impersonal treatment of the institutional lending sources, such as banks. It is not purely a subjective reason, however, because the borrower does receive the objective advantage of being able to make late payments to the *prestamista* without fear of immediate repercussions. In fact, the *prestamista* prefers that the debtor not re-pay the capital so that he continues earning a high rate of interest over a long period of time. Whereas the bank tends to rely much more on the threat of an actual repossession or foreclosure of the debtor's security in order to

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44. Interview with the nursery school teacher (July 5, 1976).

45. Interview with a branch manager of Banco de Londres y México, S.A. (August 5, 1976).

46. Interview with a borrower (July 22, 1976).

47. Knight, *supra* note 3, at "Moneylenders or *Prestamistas*," Section 2, Part B, p. 46.

recover the value of the loan. Second, the *prestamista* in most cases is the borrower's last or only known source of credit. In Mexico, it is common that the borrower will have exhausted all other sources of credit such as the *caja* (credit union) or a government agency loan (e.g., I.S.S.T.E.)<sup>48</sup> and has no capital with which to join a *tanda*, thereby leaving the *prestamista* as the only remaining credit source. The final reason these Mexican borrowers resort to *prestamistas* is because the borrowers are, as a rule, unsophisticated and disorganized financial planners. As a result, they generally do not plan for their known financial needs, thus when a crisis arises the only source of fast money is the *prestamista*. In most instances, a borrower may request and receive the loan within hours from the *prestamista*; whereas other lending institutions, such as banks, take days to process a loan application.<sup>49</sup>

The final factor which explains the proliferation of *prestamistas* is the nature of the moneylending business and its indirect encouragement by the government. When asked why they had chosen to be *prestamistas*, the lenders answered that it is convenient; it involved small overhead expense; it was more remunerative than other businesses, especially because no taxes were paid; legal proof of the loans was easy because of the favorable negotiable instruments law and finally, if the *prestamista* was also a merchant, it usually benefitted some phase of his or her business.<sup>50</sup>

However, the principal advantage of being involved in the moneylending field is the relative absence of any regulation by the government limiting the amount of interest that may be charged for personal loans. Theoretically, the parties are free to contract to any rate of interest.<sup>51</sup> Since the debtors generally have no bargaining power, due to the reasons enumerated above, the result is that the interest rates are high and in favor of the lender.

### Operation

The *prestamista* in Mexico is one of the largest identifiable sources of cash loans. Although his operations are wide-spread and cut across

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48. Interviews with twenty borrowers (Summer, 1976). I.S.S.T.E. are the initials for the Mexican government's social security agency which offers loans with low interest rates to eligible federal employees. LEY DEL INSTITUTO DE SEGURIDAD Y SERVICIOS SOCIALES DE LOS TRABAJADORES DE ESTADO (México, D.F. 1960).

49. Interview with branch manager, *supra* note 42.

50. Interviews with six *prestamistas* (Summer, 1976).

51. CODIGO CIVIL art. 2395, *supra* note 9; CODIGO DE COMERCIO art. 362 (México, D.F. 1887).

all economic levels of society, perhaps the best showcase of the *prestamista's* role and practices is *La Merced*, the largest "produce" market in Mexico City and the distribution center for all other produce markets in the various districts of the city. Millions of pesos are moved daily, creating a demand for quick cash by the merchant/purchaser and a market for the *prestamista's* services. In this section of the study the common loan procedure is described by following a typical small merchant, Don Pablo of *La Merced*, in search of a cash loan.<sup>52</sup>

Don Pablo is a middle-aged, hard-working vendor and warehouseman of tomatoes. His whole business operates on the basis of cash loans. Don Pablo's demands for cash loans are two types. First, he needs loans for a term of three months or longer (long-term) in order to buy the *huertas* (fields of tomatoes) at the time they are first planted. By guaranteeing the farmer a certain price for his product, Don Pablo receives a good price on the field. When the tomatoes are ripe they will be delivered to his market stall and will hopefully be sold for a handsome profit from which he will be able to re-pay the *prestamista*. Secondly, during the tomato season if either his own fields have failed because of bad weather or he sees that it is a vendor's market, he will try to buy truckloads of tomatoes from other farmers or warehousemen in order to sell them quickly for a profit. For this he needs a quick source for cash loans, in return for which the *prestamista* demands quick re-payment, usually from one week to one month. In many instances, the same *prestamista* will provide both short and long-term loans to the borrower. The principal distinction between the two types of loans is the different interest rates charged.

Because the *prestamista* operates outside the effect of the law he has neither an office nor written advertisements promoting his services. Usually, the Mexican *prestamista* does not lend on a full-time basis; rather, it is an activity supplementary to his or her main occupation or business. The *prestamista* may be a widow, a gruff owner of a fleet of trucks or a mild mannered administrative clerk of a business; however, they all tend to be middle-aged and unstriking in appearance. It should also be noted that the sophistication of each as a lender varies greatly depending on his or her level of education.<sup>53</sup>

Assuming Don Pablo is looking for a new source of cash loans, he will find the *prestamista* only by word of mouth. Since Don Pablo's colleagues probably depend on cash loans, it will not be difficult for him to find a *prestamista*, but whether the *prestamista* will loan to

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52. Interviews with merchant/borrower (July 18 and August 2, 1976).

53. Interviews with *prestamistas*, *supra* note 50.

Don Pablo is not as easy to determine. Most *prestamistas* prefer to lend to a closed circle of known people, often friends, and usually are not interested in acquiring new clients. However, if Don Pablo knows a friend of the *prestamista* and the friend is willing to serve as an *aval*<sup>54</sup> (guarantor) of the loan, then the *prestamista* will probably make the loan to Don Pablo if money is available.

The trusted mutual friend who will serve as an *aval* will take Don Pablo either to the *prestamista's* place of business or to a previously arranged *cafeteria* where the parties discuss the transaction over coffee. In this situation it is clear from the outset that the mutual friend will serve as *aval* for the loan; therefore, the lender, although interested in the debtor's business and its solvency, does not typically take a look at the debtor's business record. The terms, including the size and the interest rate of the loan, are then discussed and agreed upon. In addition to the *aval*, the *prestamista* almost always requires security which usually consists of a *letra de cambio*<sup>55</sup> (bill of exchange) signed by the debtor and the *aval*. In most cases, if the parties agree to the terms of the loan within a few hours, the document will be signed and the money received by the debtor, Don Pablo.

In over twenty loans that were studied by this author, the amounts of the loans varied from 500–50,000 pesos (U.S. \$40.00–\$4,000.00). The average loan was about 12,000 pesos (U.S. \$960.00), and the average length of the loan was 3 months. Loans like those in which Don Pablo participated were generally 50,000 pesos (U.S. \$4,000.00) each for long-term *letras* and 15,000–20,000 pesos (U.S. \$1,200.00–\$1,600.00) for short-term *letras*.<sup>56</sup>

Due to the factors described in the introduction to this section,<sup>57</sup> the interest rates charged by the *prestamista* are high, especially when compared with the average rates charged in the United States. There does not seem to be a going "street" rate. This is probably due to the debtors' urgent need and lack of competition among *prestamistas* in the market place. The long-term loans (3 months or more in length) sought by Don Pablo on the average ran about 3–4% per month or 48 percent per year; while the short-term loans (1 month in length) ran as high as 15% per month or 180 percent per year with the average being about 10% per month or 120 percent annually.<sup>58</sup>

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54. The legal obligations of the *aval* are stated in the LEY GENERAL DE TITULOS arts. 109–116, *supra* note 30.

55. See *id.* at chapter 2 for legal definition and regulations.

56. Interviews with merchant/borrower, *supra* note 52.

57. See *supra* pp. 103–105.

58. Interviews with borrowers and lenders (Summer, 1976).

In places like *La Merced* there are *prestamistas* who loan on a daily basis. The retailer who comes from the district market to buy at *La Merced* often needs to borrow before he or she can buy the produce for the day. In early morning at the main building of *La Merced* one will find lenders waiting in the doorways for these small retailers. The size of the loans granted are small, i.e., 500–1,000 pesos (U.S. \$40.00–\$80.00), but they must be repaid that same afternoon at the retailer's stall with 10% interest. The only written evidence of the transaction is a notation in the *prestamista's libreta*; repayment is assured by the debtor's fear of losing his only source of credit.<sup>59</sup>

In most instances, upon maturity of the loan, the borrower can only pay the interest owed and none of the capital amount. However, the *prestamista* really prefers that the borrower not repay the capital so that he is assured of a high periodic income based on the borrower's interest payments. If the capital is paid, the *prestamistas* would incur more work by having to go out into the market again to find a new home for the capital.<sup>60</sup>

### Loan Security

In sixteen of the twenty loans studied, the *prestamistas* used the *letra de cambio* (bill of exchange) signed by the borrower to secure the cash loans. Although the *letra* was designed as a three-party instrument, in Mexico it substitutes for the *pagaré* (promissory note), the security device used generally in two-party credit transactions in other countries such as Costa Rica.<sup>61</sup> The borrower signs both as drawer and as acceptor of the instrument.

The *prestamista* may additionally secure the loan by requiring the signature of an *aval* (guarantor) on the back of the *letra*. This gives the lender an independent right against the *aval* for payment of the *letra* without first going against the borrower for the payment.<sup>62</sup> However, once a *prestamista* has dealt successfully with the borrower, the *aval's* signature is seldom required in subsequent loans.

The *letra* is used by *prestamistas* in several ways but always with the same intent of disguising the "true" rate of interest. By law, *letras* cannot stipulate interest.<sup>63</sup> Therefore, in the instrument's most informal usage, only the capital amounts of the loan are inscribed on the *letra*, while the parties make an oral agreement on the side as to the rates and payments of the monthly interest. A more common

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59. Interview with borrower (August 16, 1976), and this author's personal observation.

60. Interviews with *prestamistas*, *supra* note 50.

61. Knight, *supra* note 3, at "Moneylenders or *Prestamistas*," sec. 2, pt. B, p. 50.

62. LEY GENERAL DE TÍTULOS art 114, *supra* note 30.

63. *Id.* art. 78.

approach is to combine the value of the interest for the term of the loan with the capital amount and write it as one sum on the face of the *letra*. There are also *prestamistas* who write in the capital amount of the loan on the face of the *letra* but deduct the value of the interest for the period of the loan in advance, leaving the borrower in many cases with only two-thirds of the stated capital. Another common technique is to have the borrower sign a blank *letra* or a *letra* showing only the date. The *prestamista* and the borrower orally agree on the interest rate and maturity of the loan. If the debtor should later default, the *prestamista* has complete power as to the terms of that *letra* (e.g., the due date or amount). As a result of these techniques, the *prestamistas* receive true rates of interest that vary from 48% to 200–300% a year.<sup>64</sup>

Other devices which *prestamistas* in Mexico use to secure loans are checks without funds, the pledge and bills of sale endorsed in blank and given to the *prestamistas*. The only distinctive feature which will be pointed out here pertains to the check without funds method of securing a loan. Briefly, the *prestamista* has the borrower sign a check for the amount of the loan, drawn on his own or a simulated bank account. When the loan matures, if the borrower does not pay, the *prestamista* will try and cash the check. Its non-payment for lack of funds gives rise to the criminal action of fraud against the drawer/borrower punishable by imprisonment.<sup>65</sup>

### Collection Practices

Although violent enforcement techniques in Mexico were discussed by one author,<sup>66</sup> after talking to many borrowers, this writer found no evidence of such techniques. In fact, when asked if organized crime or the Mafia was involved in these small loans, several merchant/borrowers replied laughingly that the only “Mafia” affecting them was the government officials who frequently expected *mordidas* (small bribes).

Similarly, it appears that the *prestamista* generally does not depend on the courts to enforce the collection of the loans. In discussions with Civil Judges of First Instance, equivalent to Arizona Superior Court Judges, all reported that cases in which *prestamistas* sought court enforcement of loans secured only by *letras* were rare.<sup>67</sup> Therefore, it is this author’s opinion, based on discussions with both

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64. Interviews with *prestamistas* and borrowers (Summer, 1976).

65. LEY GENERAL DE TITULOS art. 193, *supra* note 30; CODIGO PENAL art. 387, fr. X, *supra* note 9.

66. Kozolchik, *Law and the Credit Structure in Latin America*, 7 VA. J. INT’L L. 1, 17–18 (1967).

67. Interviews with Civil Judges of First Instance (Summer, 1976).

lenders and debtors, that for the most part, *prestamistas* depend on extra-legal pressures to enforce the repayment of the loan.

As a rule, Mexican borrowers repay their loans, albeit late. Neither violent enforcement techniques nor enforcement by the courts were found to play a major role in the collection of the loans. Therefore, it is my opinion that the lender's "real" security for the loan is provided by: the grant of first time loans to only those borrowers who can provide an *aval* (guarantor) and the debtor's knowledge that the *prestamista* is his or her only and last source of credit.

### USURY – A PERCEPTION OF FAIRNESS

One of the essential terms of a cash-loan transaction is the rate of interest agreed to by the lender and borrower. In the first part of this study, the actual rates of interest charged in three non-institutional sources of cash loans were discussed.

This second part of the study will examine the concept of usury in private moneylending transactions in Mexico.<sup>68</sup> The examination is based on interviews with members of the judiciary, lawyers, lenders and borrowers. Hopefully, the perceptions of these people as to what constitutes a fair rate of interest<sup>69</sup> will lead to a better understanding of the relationship between the formal law and the living law.

#### *The Law*

Mexican statutory law does not expressly establish a maximum rate of interest for private moneylending; in principle, the private parties are free to contract or stipulate to any rate of interest.<sup>70</sup> If the parties do not stipulate to a specific interest rate and litigation results therefrom, the Commercial and Civil Codes of Mexico stipulate "legal" rates of interest of 6% and 9%, respectively, which will be

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68. As seen in the preceding discussion of popular credit, the activities of the *tanda* and *caja de ahorros* are fundamentally based on trust among the members. These two sources of popular credit are not regulated by the formal law (other than the general principles of contract law). Accordingly, the second part of this study will deal with the *prestamista* (private moneylending) source of credit which, by the use of security instruments and guarantors, rises above mere trust between the parties and may result in the parties looking toward the formal law for enforcement of the agreement.

69. This branch of the law has dealt since ancient times with the determination of what is the "fair" price, if any, for money lent. See Kozolchyk, *Fairness in Anglo and Latin American Commercial Adjudication*, 2 B.C. INT'L & COMP. L. REV. 219 (1979).

70. CODIGO CIVIL, art. 2395, *supra* note 9; CODIGO DE COMERCIO, art. 362, *supra* note 51.

presumed by the law to be the interest rates intended by the parties.<sup>71</sup>

Due to some ambiguous language, the Civil Code is unclear as to whether article 17 and/or article 2395 apply to cash loan transactions evidenced and secured only by negotiable instruments, e.g., the *letra* (bill of exchange).<sup>72</sup> These articles provide:

Article 17 – When one, exploiting the extreme ignorance, obvious inexperience or extreme economic want of another, receives a profit which is plainly *disproportionate* to the value of his or her own consideration, the injured party has the right to seek rescission of the contract, and if this not be possible, a reasonable reduction of the injured's obligation.

Article 2395 – The legal rate of interest is 9% per annum. The conventional rate of interest is that which the parties agree on and it may be higher or lower than the legal rate of interest; but when the rate of interest is so *disproportionate* that it makes one believe with good reason that the creditor has unduly benefited from the economic need, inexperience or ignorance of the debtor, by petition of the debtor, the judge, mindful of the special circumstances of the case, may equitably reduce the interest to as low as the legal rate.<sup>73</sup>

The Commercial Code of Mexico provides the lender-creditor whose security is a negotiable instrument, e.g., *letra* (bill of exchange), a quick summary procedure for enforcing the collection of the loan known as the *acción ejecutiva* (executive proceeding).<sup>74</sup> Due to the prima facie nature of the negotiable instrument, only certain enumerated *excepciones* (defenses) may be raised by the borrower in the *acción*. Since usury is not a specifically enumerated *excepción*, several complex substantive and procedural problems arise as to whether and how the borrower may raise the claim. Depending on how the Civil Judge resolves these legal problems, article 17 and/or article 2395 of the Civil Code will be applied in evaluating the borrower's claim of usury.<sup>75</sup>

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71. *Id.*

72. This uncertainty was expressed by the Civil Judges in interviews, *supra* note 67. The basis for the confusion is whether the defense of usury may be raised by a borrower under article 8 of the LEY GENERAL DE TITULOS, *supra* note 30.

73. CODIGO CIVIL arts. 17, 2395, *supra* note 9, (emphasis added) (translation by author).

74. CODIGO DE COMERCIO art. 1391, *supra* note 51.

75. Interviews with Civil Judges, *supra* note 67.

Mexican law attempts indirectly to limit the interest rates that may be charged by individual moneylenders by prescribing certain general conditions which will make the transaction usurious or illegal. Usury is both a civil wrong<sup>76</sup> and a crime<sup>77</sup> in Mexico; consequently, the sanctions which may be imposed upon the transaction or against the *prestamista* (moneylender) depend upon the nature of the legal procedure involved. If it is civil, the judge may annul the usurious rate and equitably reduce the rate of interest to a sum as low as the "legal" interest;<sup>78</sup> if it is penal, the judge may impose both a fine and imprisonment on the *prestamista* but it is uncertain under the statute whether he may annul the transaction.<sup>79</sup>

The content of both the civil and penal "usury" articles is subjective in nature. In other words, neither the penal nor the civil provisions establish a specific maximum rate of interest or objective criteria by which the particular transaction may be found to be usurious. Instead, through the use of the term, "disproportionate," in both articles 17 and 2395 and the phrase, "interests or profits superior to those customary in the market," in article 387, fraction VIII of the Penal Code, the law leaves the determination of usury to the judges on a case by case basis. Therefore, a clearer understanding of the law's attitudes as to what is a fair rate of interest can be distilled from judicial interpretation of these words in the "usury" provisions of the Code.

In discussing judicial perceptions of "fair" interest rates in small loan transactions, one important consideration must be kept in mind. As pointed out in the first part of this study, neither lenders nor borrowers in cash loan transactions rely on the courts for enforcement of their rights.<sup>80</sup> Consequently, the action or defense of usury, a cash loan problem, has rarely been considered by the Mexican judiciary.<sup>81</sup>

76. CODIGO CIVIL arts. 17, 2395, *supra* note 9.

77. CODIGO PENAL art. 387, fr. VIII, *supra* note 9.

78. CODIGO CIVIL arts. 17, 2395, *supra* note 9.

79. CODIGO PENAL art. 386, *supra* note 9.

80. See discussion on "Prestamistas (Moneylenders)," *supra* p. 102.

81. The author, with the help of the Foreign Law Librarian of the University of Arizona Law Library, Sr. Eugenio Revilla, found only four civil cases reported from 1917 to 1970 in the Mexican Supreme Court Reporter, JURISPRUDENCIA Y TESIS SOBRE SALIENTES SUSTENADAS POR LA SALA CIVIL: (1) Amparo en revision 1017/1959. Inmobiliaria de Lourdes, S.A., Octubre 27, 1969. Five votes; (2) Directo 1961/1959. Juan Maya Vargas. Resuelto el 5 de Abril de 1962. Five votes; (3) Amparo Directo 9525/1966. Maria Luisa Mondragon Uda. de Ayala, Noviembre 9 de 1967. Five votes; and (4) Amparo Directo 3196/1967. Cristobaz Guerrero Galicia. Marzo 17 de 1969. Mayoria 3 votos.

There were no penal cases reported from 1917 to 1970. JURISPRUDENCIA Y TESIS SOBRE SALIENTES ACTUALIZACION PENAL I & II, 1917-1970, Edicion Mayo.

In the present study, only one out of the six judges interviewed had heard a claim of usury and it happened so many years ago that the judge could not remember how the issue was resolved.<sup>82</sup> Therefore, the judges' attitudes reported in this study are not based on experience acquired from the resolution of cases, but are rather their opinions as to what they would do in a given case.

### Civil Judges

Although the texts of article 17 and article 2395 of the Civil Code are slightly different, each of the judges interviewed interpreted them as consisting of two principal elements which the borrower must prove in order to invoke the sanctions of these statutes: (1) the borrower's extreme necessity and (2) a disproportionate rate of interest. As a rule, the judges tended to read and interpret the terms of the statutes literally; since article 2395 states specifically that the parties are free to contract to any rate of interest, the judges stated that the borrower would have to show "extreme" necessity in order to fall within the terms of the statute. When asked to define the term, however, most judges vacillated and conceded it was so broad that it could only be defined on a case by case basis.<sup>83</sup>

The only "actual" example given as to what constituted extreme necessity involved a loan granted by a *prestamista* to a borrower whose business was in deep financial trouble. Accordingly, the *prestamista* charged the borrower 8% interest per month (96% per annum) and took security whose value exceeded the loan value by several times. Upon non-payment the *prestamista* brought an action to collect the debt. The borrower raised the defense of usury under article 2395. The judge lowered the interest rate to the "legal" rate of interest, holding that the *prestamista* had taken undue advantage of the borrower's extreme necessity to obtain cash.<sup>84</sup>

The second element, "a disproportionate rate of interest," is the real touchstone of the usury statutes. Again, due to the vagueness of the term, the judges had difficulty in defining its meaning specifically, but each of them stated that in order to determine whether the rate was disproportionate they would look to the market place to see what rate others were charging in similar transactions. Upon being pressed by the author to define the market more specifically, it became apparent that the "others" referred to by the judges were the private banks of Mexico. In other words, they did not look to similar cash loan

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82. Interview (July 29, 1976).

83. Interviews with Civil Judges, *supra* note 67.

84. Interview, *supra* note 82.

transactions to determine whether a rate of interest was disproportionate; rather they accepted an institutional lending source's rate of interest as being the standard to which all loans should be compared. In Mexico, the average rate of interest charged in a bank loan to an individual is approximately 2% per month or 24% per year.<sup>85</sup> To the question of why the bank rate was used as the standard, the judges responded that it was the largest and most experienced source of cash loans in the country and therefore its rates should best represent the "going" or market value of money.<sup>86</sup> Consequently, according to the judges interviewed, if a borrower could show that he or she was paying more than 2% per month interest on a cash loan and show that at the time of contracting this loan with the *prestamista* the borrower was in a state of extreme necessity, the judges would certainly reduce the rate of interest to that of the bank's and possibly as low as the "legal" interest, i.e., 6% or 9% annually.

#### Penal Judges<sup>87</sup>

Article 387, Fraction VIII of the Penal Code states:

The same sanctions enumerated in the previous article will be imposed upon: VIII. One, who by availing himself of the ignorance or bad economic condition of an individual, receives usurious gains from the same, by means of contracts or agreements which stipulate interests or profits superior to those customary in the market.<sup>88</sup>

As in the articles dealing with civil usury, there are two important elements which must be demonstrated in order for the State to convict a *prestamista* (moneylender) of usury. First, the borrower's ignorance or bad economic condition must be proved. As defined by the judge, a borrower is ignorant only if he or she is illiterate or lacks comprehension of the Spanish language; a borrower is under bad economic conditions if his or her business is bankrupt or the loan is required for basic necessities such as food or housing.<sup>89</sup> Secondly, the State must show that the interest rate charged the borrower is, "superior to those customary in the market." It is on this point that the attitude of the Penal Judge differed notably from that of the Civil Judges. Instead of

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85. Interview with branch manager, *supra* note 45.

86. Interviews with Civil Judges, *supra* note 67.

87. Unfortunately, the author was only able to interview one Penal Judge while in Mexico. However, a brief view of usury under the penal law was obtained. Interview, *supra* note 82.

88. CODIGO PENAL art. 387, fr. VIII, *supra* note 9. (translation by author).

89. Interview, *supra* note 82.

relying on the bank rates as do the Civil Judges, the Penal Judge said he would attempt to establish the market rates of interest by looking at rates charged in similar kinds of loans. Accordingly, “legal” usury under the penal statute would be much more difficult to prove since the market rate reflected by similar loans would probably be as high as that being paid by the present borrower.

However, it appears that this attitude probably would not be uniformly shared by other Mexican Penal Judges, especially the Justices of the Supreme Court of Mexico. Although no Supreme Court cases were found directly interpreting article 387, fraction VIII, the Article has been interpreted by Raúl Carranca y Trujillo, a highly regarded commentator and past Justice of the Supreme Court of Mexico, in his treatise, *Codigo Penal Anotado*.<sup>90</sup> He states that in determining the “market” rate of interest the judge should take into account any information acquired from the *Banco de Mexico* (the Federal Reserve Bank of Mexico) regarding present rates of interest. Obviously, the purpose and role of the *Banco de Mexico* and the market it represents are quite distinct and remote from those of the lenders and borrowers of small cash loans. Thus it appears that the attitudes of the Civil and Penal Judges might not be so diverse after all; rather, both would consider the banking industry as the best representative of the “market” and employ its rates of interest as the “legal” or non-usurious rates of interest.

### *The Market*

#### *Prestamistas (Moneylenders)*

In response to the question, “what is a fair rate of interest?” most *prestamistas* stated that a “fair” interest is one that is determined, fundamentally, by the laws of economics. Specifically, the principle of supply and demand should govern what the “fair” price or interest charged for money should be at any given time. It is their perception that the lender and borrower should be free to agree on a rate of interest and that rate should be deemed “fair.”<sup>91</sup>

In Mexico, however, when the *prestamistas* speak of a fair rate of interest being the creature of supply and demand, one must keep in mind that they are not using this concept in its traditional sense. As stated earlier, Mexico is a “capital-short” country, so much so that in the author’s opinion there presently exists a demand for money which far exceeds the supply. Thus, the present market cannot be considered

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90. R. CARRANCA Y TRUJILLO CODIGO PENAL ANOTADO (1966).

91. Interviews with *prestamistas*, *supra* note 50.

a *prestamista's* (vendor's) market but must be viewed as a monopoly by the *prestamista*.<sup>92</sup> As a result, the interest rate on which the lender and borrower agree does not reflect that of a market rate based on supply and demand; rather this interest rate is based solely on the *prestamista's* evaluation of the borrower's ability to repay to loan.<sup>93</sup> For example, one *prestamista* who worked in a large Mexican aviation company charged the pilots 10% per month while charging the mechanics and maintenance personnel only 5% per month or 60% per year, because he felt that since the pilots earned more, they could afford to pay higher interest than the other employees. This principle is applied by many of the *prestamistas* who grant loans to merchants for commercial purposes.<sup>94</sup> Consequently, when a lender and borrower agree on the rate of interest, the agreement reflects the particular borrower's ability to repay and not the "market" rate of interest paid by other, similar borrowers.

However, there does exist a small, peculiar group of *prestamistas*, composed of widows and devout Catholics, who look to the Catholic church for guidance as to what constitutes a "fair" rate of interest. In most instances, these widows have inherited a sum of cash upon the death of their husbands. Because they are unskilled and advanced in years, their possibility of employment is slim. Consequently, these widows' only alternative is to invest the money in some fashion. Lacking business expertise, they decide that lending money to known people is the easiest and safest manner of establishing an income. However, because of their deep Catholic convictions, they feel that those who lend with interest must have the rate approved by the Church. They go to the priest of the church to explain their financial circumstances and their consequent desire to make cash loans. According to one such *prestamista*, the priests are presently allowing her to charge 1½% per month or 18% per year, far below the actual rates being charged by most *prestamistas*.<sup>95</sup>

### Borrowers

At the outset it must be pointed out that, due to the general lack of sophistication of most borrowers interviewed, the meaning of the question, "What is a fair rate of interest?" was not well understood.

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92. This author has received no formal economic training nor have I interviewed economists involved with this issue. Hopefully, further work in this area would include an economist's insight.

93. Author's opinion based on interviews with *prestamistas*, *supra* note 50.

94. Interview with *prestamista* (July 28, 1976).

95. Interview (June 15, 1976). As pointed out in the first part of this study, the average interest rates are 4-5% per month.

Consequently, most borrowers were only able to enumerate a specific rate of interest as being “fair” but they were not able to explain why the stated rate was so considered.

In the main, the borrowers can be divided into two principal camps by their attitudes. The first camp consists of those borrowers who believe that a “fair” rate of interest is that to which the borrower consents in a given transaction. The attitudes expressed by these borrowers can be characterized as those of “rugged individualism.” The basis for their belief is that the *prestamista* has the right to put his or her money to work however he or she sees fit. If the borrower does not like the terms offered by the *prestamista*, he or she does not have to accept the terms of the loan. Hence, no matter how exorbitant, the rate of interest is secondary to the consent of the parties.<sup>96</sup> The second camp consists of those borrowers who view the rate of interest charged by the *prestamista* as both oppressive and abusive. Generally, those that fall into this camp are small businessmen or the more sophisticated consumers who are familiar with other sources of credit such as the banks. As a rule, these borrowers believe that a “fair” rate of interest would be that charged by the private banks to their customers for a similar small cash loan, e.g., 2% per month. The principal reason given by the borrowers for selecting the bank rate as being “fair” was expressed by one borrower as follows: “[I]t (the bank) moves so much money, it ought to know what it is doing.”<sup>97</sup>

Only two borrowers believed that the nature of a borrower’s business or the concept of security should be considered in determining a fair rate of interest. They stated that if a bank was charging 2% per month (24% per year) on a secured loan, then *prestamista* should be allowed to charge 3% per month (36% per year) on an unsecured loan. These borrowers believed that the *prestamista’s* risk of non-payment was illusory in most instances and consequently the existence of security was not critical in determining a “fair” rate of interest.<sup>98</sup>

### *The Lawyers*

It is rare for a lawyer to participate in the planning or drafting stage of a small cash loan. The lawyer’s role, if any, is usually as an advisor to the *prestamista* who has been unable to collect the unpaid loan from the borrower. Therefore, the lawyer seldom counsels the *prestamista* as to the rates of interest he or she may legally charge.<sup>99</sup>

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96. Interviews with borrowers (July 21, 1976).

97. Interview with borrower (August 16, 1976).

98. Interviews with borrowers (June 13 and July 18, 1976).

99. Interviews with lawyers (Summer, 1976).

The lawyer's responses to the question of what is a fair rate of interest in small cash loans may be divided into three categories: (1) rate of interest charged by private banks; (2) rate of interest based on supply and demand and (3) rate of interest derived from (1) and (2) above.

The lawyers who believed that the fair rates of interest in a small cash loan transaction should be that charged by the private banks of Mexico generally approach the usury statutes, articles 17 and 2395 of the Civil Code, from an extremely philosophical point of view, i.e., the intrinsic value of money is determinative. In practical terms, however, they feel that the government should control the rates of interest charged for the use of money. Since the rates charged by private banks are regulated by the government, the lawyers look to these as the best measurement of what constitutes a fair rate of interest and interpret the word, "disproportionate," in article 17 and article 2395 accordingly. It might be noted here that these lawyers had not participated in a small cash loan transaction of the nature described in the section on *prestamistas*.<sup>100</sup>

The second category of lawyers who believed that the fair rates of interest should depend on supply and demand based their attitudes on the literal interpretation of the first part of article 2395 of the Civil Code which states, "The conventional rate of interest is that which the parties agree on and it may be higher or lower than the legal rate of interest...." Accordingly, as long as the borrower understands the terms and there is consent between the parties, the lawyer will draft the instrument enumerating the agreed rate of interest. However, one lawyer who represented this point of view thought that although there is no "legal" upper limit, there is an economic one since the wise *prestamista* would never attempt to charge the borrower a rate that the latter could not actually repay. As a result, the highest rate of interest that this lawyer had stipulated in a contract was 3% per month (36% per year), far from the actual rates charged by the *prestamistas* interviewed in this study.<sup>101</sup>

The attitudes of the majority of lawyers interviewed fell within the third category. When interpreting article 17 and article 2395 of the Civil Code in an attempt to answer what constitutes a "fair" rate of interest, they considered both objective and subjective factors. One attorney stated that before he could determine if the rate of interest proposed by the parties was "legal" he would need to know the use of the requested loan and, if a commercial loan, the borrower's potential profit as a result of the loan. If there was a high risk involved and the

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100. Interviews (July 6 and 23, 1976).

101. Interview (July 19, 1976).

borrower stood to make a large profit, then the *prestamista* could charge a higher rate of interest as a reflection of the borrower's potential gain. consequently, under the right circumstances, it is possible that any rate could be perceived as "legal."<sup>102</sup>

Another lawyer, in analyzing whether a proposed rate of interest is "legal," looked first to the present bank rate of interest and second to the actual market rate of interest for similar loans and derived a compromise figure. However, if the actual rate would be exorbitantly high in the lawyer's estimation, e.g., 5-10% per month, then he would choose a figure which more closely approximates the bank rate, i.e., 2% per month, and shut his eyes to the fact that the *prestamista* will increase his yield by deducting the amount of the interest owed from the principal amount of the loan at its inception.<sup>103</sup>

The lawyers' perceptions examined serve as a good review of the perceptions of fairness encountered by this author, because they reflect the views of the judges (formal law) as well as views of the *prestamistas* and borrowers (living law). However, it is clear that in terms of interest rates the perception of fairness which predominates in Mexico is that rate consented to by the *prestamista* and borrower, which is based on the *prestamista's* evaluation of the borrower's ability to repay the loan.

## CONCLUSION

The first part of this article described in detail the operation of three sources of popular credit in Mexico: *la tanda* (informal pooling of funds), *la caja* (informal credit union) and *prestamistas* (private, individual moneylenders). It was discovered that in *la tanda* no interest is charged nor written documents signed for the funds loaned to its members. Fundamentally, *la tanda* is a source of credit that relies on the trust and honesty of its members for its success. The *caja* is a lending source characterized as a cross between *la tanda* and the *prestamista*. Interest is charged for the loans but, as viewed in *Caja Libertad*, the members are never quite clear as to whether the *caja's* purpose is to help its members by providing low-interest loans or to function as a profit-making source of credit by collecting interest rates similar to those charged by *prestamistas*.<sup>104</sup> Although *cajas* charge interest on their loans and there is some written documentation involved, e.g., the signing of notes for the purpose of showing receipt

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102. Interview (July 7, 1976).

103. Interview (July 6, 1976).

104. See *supra* text accompanying note 28.

of the money, the *caja's* success, like *la tandas*, is based on trust and honesty since legal enforcement is never seriously considered. Accordingly, *la tanda* and *la caja* fall, for all practical purposes, outside the purview of the formal law.

The *prestamista* provides the most expensive source of credit, charging up to 10% per day. In fact, in this author's opinion, the only limit on the interest charged is the amount that the *prestamista* perceives the borrower could pay. There seemed to be no "market" price, i.e., what other *prestamistas* and borrowers may agree to in similar circumstances. In addition, *prestamistas* rely on written legal devices such as bills of exchange and guarantors to secure the debt.

The second part of this study examined the concept of usury in private moneylending transactions, involving *prestamistas*, in Mexico. The intent of this examination was to develop a better understanding of the relationship of the formal law to the living law. Since Mexico's usury law prescribes no ceiling on interest rates except that they not be "disproportionate...to the value of his or her [the lender's] consideration..."<sup>105</sup> the concept of usury becomes a question of what interest rate the members of the judiciary, lawyers, lenders and borrowers perceive as fair.

The author found that most judges viewed the interest rates charged by banks in Mexico, e.g., 2% per month, as being fair. On the other end of the spectrum, the *prestamistas* felt that whatever interest rate the parties agreed to should be deemed fair. As discussed above, however, Mexico's lack of capital basically grants the *prestamista* a monopoly in this area resulting in the borrower paying interest rates that average 5% to 10% per month. Curiously, most borrowers concurred with the *prestamistas'* perception as to what constituted a fair rate of interest; while a few of them expressed opinions closer to those of the members of the judiciary. Finally, the perceptions of the lawyers on this issue range from viewing the interest rates charged by banks to those agreed to by the parties as being fair.

The primary purpose of this article is to demonstrate that an awareness of the living law, the actual behavior and attitudes of people in a given activity, is as critical to understanding the law of Mexico as is a comprehensive knowledge of the Code articles. It is apparent that not only does there exist a wide gulf between the formal law and the living law of consumer credit, as shown in their divergent perceptions of fair interest rates, but most judges and lawyers are

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105. CODIGO CIVIL art. 17, *supra* note 9.

unaware of the operation of private moneylending through the *prestamista*, as evidenced by the absence of this issue in litigation.

It is hoped that this article and subsequent living law studies will provide valuable information for the judges, lawyers and legislators of Mexico, as well as for the international legal practitioner and comparative legal scholar. Finally, although humble in its goals, this author hopes to illustrate the benefits of using a field study method as a vehicle for comparative legal research.

