The Enforceability of Interest Under a Title-Transfer Theory of Contract

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To many libertarians the idea that there might be limits to the legitimate enforcement of interest on loans will seem unattractive, a "mediæval" relic of the prejudice against usury. But such limits may be implicit in what I take to be the most promising libertarian theory of contracts, the *title-transfer* theory defended, in various ways, by Murray Rothbard, Williamson Evers, and Randy Barnett[1] (though I certainly don't mean to suggest that those authors would agree with the implications I draw here).

The central insight of the title-transfer theory is that the enforceability of contracts is not a basic moral principle, and so must be grounded in something else enforceable (as, for example, promises and expectations are not). That foundation is property rights. And assuming the self is inalienable,[2] the enforceability of contracts, even service contracts, must be grounded on the enforceability of rights to *external* property.

The bridge between property and contract is the idea of *conditional transfer*. Suppose you transfer to me title to some bit of external property *on condition* that I deliver some good or perform some service; then if I don't do it, the condition for transfer isn't met, and the title reverts to you. I am now in the same position as anyone else in wrongful possession of someone else's property.

What are my enforceable obligations when I am in wrongful possession of someone else's property? First, I have to give the property back (or the nearest equivalent, if I've lost or destroyed it); and second, I have to pay damages. Why damages? Because I need to restore not just the present property but the past property, for the period when it was away from your control. And since, barring access to a time machine, I can't literally restore the past property, damages are the nearest equivalent. (And here, by the way, I don't think it matters whether my being in wrongful possession is culpable or not. If I mistakenly walk off

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[1] See Murray N. Rothbard, "Property Rights and the Theory of Contracts" (**mises.org/rothbard/ethics/nineteen.asp**); Williamson M. Evers, "Toward a Reformulaiton of the Law of Contracts" (**mises.org/journals/jls/1_1/1_1_2.pdf**); Randy E. Barnett, "A Consent Theory of Contract" (**www.randybarnett.com/pdf/consenttheory.pdf**) and "Contract Remedies and Inalienable Rights" (**www.randybarnett.com/4socphilpol179.html**).

[2] See my "Slavery Contracts and Inalienable Rights: A Formulation" (**web.archive.org/web/20090608002240/http://libertariannation.org/a/f22l1.html**).

with your umbrella, my innocence doesn't entitle me to keep it. Being forced to restore property and pay damages is not a "punishment" for wicked conduct.)[3]

In the case of damages, how is the "nearest equivalent" to be determined – either for the temporary or for the irretrievable loss of some property? This is a notoriously tricky question. Going by prevailing market value may be unfair, if what was lost had special sentimental value, or if the owner had been relying to his detriment on the unexpectedly absent item. On the other hand, placing too much emphasis on sentimental value runs the risk of placing the restitutor at the mercy of the owner's testimony as to subjective valuations difficult to verify; and placing too much emphasis on reliance ignores the difficulty of determining what counterfactual opportunities really were forgone as the result of the item's absence. These are issues at least as much for wise particular judgment as for abstract theory, and so may belong in part to the province of the arbitrator rather than to that of the philosopher; in a competitive judicial system, arbitrators with a reputation for wisdom and fairness will have a chance to outcompete their rivals.

So, then, if you transfer property to me on condition that I do something that I then *don't* do, the ownership reverts to you, and thus I have an enforceable obligation to return the property (or, when that's impossible, the nearest equivalent) as well as to pay damages for the period of deprivation. What I do *not* have is an enforceable obligation to do the thing I originally agreed to do; since the self is inalienable, I cannot transfer title to my future services.

What if what I agreed to do was to hand over a good rather than perform a service? Here it depends whether what I was agreeing to was a) to transfer title in the future, or b) to transfer title now, to some good to be delivered in the future. Rothbard seldom quotes Hobbes favourably, but he does so on this point:

> Words alone, if they be of the time to come, and contain a bare promise ... are an insufficient sign of a free gift and therefore not obligatory. For if they be of the time to come, as *tomorrow I will give*, they are a sign I have not yet given, and consequently that my right is not transferred, but remaineth till I transfer it by some other act. But if the words be of the time present, or past, as, *I have given*, or *do give to be delivered tomorrow*, then this is my tomorrow's right

[3] For the injustice of punishment, see my "Punishment vs. Restitution: A Formulation" (**praxeology.net/libertariannation/a/f12l2.html**) and "The Irrelevance of Responsibility" (**praxeology.net/long-irrelevance-responsibility.pdf**).

> given away today. ... There is a great difference in the signification of [the] words ... between *I will that this be thine tomorrow*, and *I will give it thee tomorrow*: for the word *I will*, in the former manner of speech signifies a promise of an act of the will present; but in the latter, it signifies a promise of an act of the will to come: and therefore the former words, being of the present, transfer a future right; the latter, that be of the future, transfer nothing.

One would have to look at the wording and the circumstances of the contract to determine whether it is best interpreted as a present transfer of title or as a promise to transfer title in the future. If it is the former, then I may legitimately be compelled to deliver the good up to you, since it is now yours; if it is the latter, then I may keep the good, paying you instead the original consideration plus damages.

There is one circumstance in which a contract *must* be interpreted as a promise to transfer title in the future rather than as a present transfer of title, and that is when the contractor does not currently possess title to the good in question. You cannot transfer what you do not have. And this is where the enforceability of interest can become problematic.

Suppose you lend me $1000 today, on condition that I pay you back the same amount plus an additional $100 a year from now. If I don't meet the condition, the ownership of the $1000 reverts to you, and I must pay it back. If I've spent it all, I still owe it to you, just as if I stroll off with your umbrella (whether intentionally or by mistake) I owe you back the umbrella (or the value equivalent) even if I've since destroyed or lost it. You may not be able to collect the $1000 from me right now, but once I am able to pay, you may forcibly collect (though there may be issues of proportionality as to how much of my total possessions you may seize at one time).[4]

But what about the additional $100 of interest? Can you collect that as well? It depends.

I don't think I can be interpreted as having transferred title to $100 to you. First, I may not have (title to) an extra $100 at the time of contract, and what I do not have I cannot transfer. (If I had title to it without having possession of it, as for example if someone else has stolen it, I could transfer title, whereupon you would be entitled to recover from the wrongful possessor.) Second, even if I do have (title to) an extra $100, I don't think I could

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[4] For the issue of proportionality, as well as an earlier version of the argument given here, see my "Note on Credit Institutions in a Free Nation" (**web.archive.org/web/20080724012231/http://www.libertariannation.org/a/f73l2.html**).

be interpreted as having transferred title over it to you, conditionally or otherwise, because (barring contractual stipulation to the contrary, as in the case of bonds or collateral-secured loans) I haven't wronged you if I spend that money in the meantime.

Does that mean that interest payments are unenforceable in the case of unsecured loans? No, because in addition to returning the principal I also owe you damages. And while we've seen that the determination of damages can be tricky, it's surely easier when both parties have committed themselves on paper to what they take the nearest equivalent to be; thus if contractors stipulate that $1000 now is being exchanged against $1100 a year from now, it is not unreasonable to set the damages at $100.

So the interest agreed on is a rough or provisional guide to damages, but it cannot, I think, be decisive. Suppose that, in desperation, you agree to pay me $10,000 a year from now in exchange for $100 now – but when the time comes you are unable to do so. To keep things simple, let's also stipulate that I don't rely to my detriment on the promised $10,000. So you owe me $100 plus damages – but is it really plausible to place the value of the damages at $9900? After all, keeping in mind the Austrian principle of the double inequality of value, the valuation evinced in the contract was not, strictly speaking, that $100 at time 1 and $10,000 at time 2 were of equal value; if that had been the case, neither contractor would have bothered to make the exchange. All it showed is that you valued $100 at time 1 *more* than $10,000 at time 2, and that I valued $100 at time 1 *less* than $10,000 at time 2. That indicates only that paying me $10,000 at time 2 would be *sufficient* to make me whole, not that it would be *necessary*. And it is my valuations, not yours, that count, since the point of restitution is to make me whole, rather than, as it were, to make you unwhole. As I've described the case, it is unlikely that making me whole requires paying me the entire contracted amount – though figuring out what it actually does require will again be, at least in part, the province of arbitratorial judgment rather than philosophical argument. And this suggests that in a just libertarian society there will indeed be limits to the enforceability of "usury" (and presumably from arbitratorial competition a set of norms and expectations would emerge to render such limits predictable).

This does not mean, however, that highly usurious contracts will never be in the interest of contractors. For there are ways of securing compliance with agreements other than by force – such as by reputational effects, credit reports, and the like. Such effects may well give lenders sufficient expectation of repayment to make it in their interest to enter into such

contracts, despite their unenforceability, when borrowers need them. But if libertarian economic and social theory is correct in its predictions of the effect of freed markets on poverty, it is likely that borrowers will stand in need of highly usurious loan contracts far less often than they do at present.