



Interest Rates

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Background

In the world of banking and finance, interest is money that is paid by a borrower to a lender in exchange for the use of the credit. Money held in an account, such as a bank savings or checking account, may earn interest also because the bank has use of the money while it is held in the account and the interest constitutes payment to the account holder for the temporary use of the money.

Typically, interest is computed as a percentage of the amount borrowed, which is known as the principal. Interest may be computed on a yearly basis, which is known as simple interest. For example, if a borrower borrows \$1,000 at a simple interest rate of 12 percent, with the loan due to be repaid in one year, the total interest owed on the loan is \$120. Alternatively, interest may be compounded. With compounded interest, the calculation of interest occurs periodically and unpaid interest is added to the principal. For example, assuming a loan of \$1,000 with a 12 percent interest rate compounded monthly, the interest that accrues during the first month of the loan is \$10. That amount is added to the principal, making the total amount \$1,010. The interest accruing during the second month of the loan—12 percent of \$1,010—is \$121.20. With compounded interest, the interest rate stays the same but the amount of interest may increase periodically.

History

Interest on borrowed funds has existed since ancient times, but interest was not always an acceptable means of conducting business. Religious groups in the Middle Ages—Jewish, Christian, and Islamic— forbade the use of interest, considering it reprehensible. Romans in ancient times also outlawed the practice of charging interest, as did the English government until the thirteenth century. In time, and with increasing demands for credit to support the growth of commerce and trade, a distinction was made between moderate interest rates and excessive interest rates. Chinese and Hindu laws prohibited excessive interest rates, known as [USURY](#), and in 1545, England set a maximum rate of interest. Other countries followed England's practice. In the United States as of 2002, the payment of interest for loans is a widely accepted business practice, with illegal usury reserved for interest rates exceeding the maximums set by law.

Interest and Inflation

Interest rates fluctuate constantly. They are controlled by supply and demand and other economic indicators.

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Other factors that help determine an interest rate include the length of the loan and any [COLLATERAL](#) used to secure the loan in the event the borrower cannot repay the loan. Low interest rates can stimulate the economy; consumers are attracted to low interest rates on consumer goods, cars, and houses and may spend more when interest rates are low. High interest rates usually have the opposite effect. Consumers are reluctant or unable to spend money, or spend as much money, when interest rates climb.

The Federal Reserve Board of Governors, part of the Federal Reserve System, sets a benchmark interest rate known as the prime rate. The Federal Reserve, the central bank of the United States, was founded in 1913 to help regulate the country's money supply. The goals of the Federal Reserve Board are to control inflation, maintain stable prices, and promote maximum employment and output of products for a favorable economy. This is done, in part, by raising and lowering interest rates. Low interest rates spur the economy but may lead to inflation, which harms the economy in the long term. The Federal Reserve Board looks at a range of economic indicators to help it determine what its policies should be and whether to raise, lower, or maintain the prime interest rate.

Any national bank must be a member of the Federal Reserve System and is governed by its [FISCAL](#) policies. State banks may belong to the Federal Reserve System but are not required to; state agencies regulate state banks. Savings and loans, which are similar to banks in many ways, are regulated at the federal level by the Federal Home Loan Banks System. However, regardless of the Federal Reserve's [JURISDICTION](#) over any financial entity, the prime interest rate is often the [ARBITER](#) of interest rates.

Interest rates have a profound effect on the national and worldwide economies and are affected by economic changes as well. Economists like Adam Smith and David Ricardo theorized that interest rates are the key in balancing investments with savings. Marxist economists believe that interest benefits only capitalists, leaving other classes exploited, since no service is rendered to those who pay interest. Other economic theorists have deemed interest as a sort of reward for those who save, rather than spend, their money, since bank accounts and other investment vehicles typically pay interest to account holders.

State Usury Laws

ALABAMA: Legal rate of interest is 6 percent. Usury limit is 8 percent. Judgment rate is 12 percent.

ALASKA: Legal rate of interest is 10.5 percent. Usury limit is 5 percent above the Federal Reserve interest rate as of the date of the loan.

ARIZONA: Legal rate of interest is 10 percent.

ARKANSAS: Legal rate of interest is 6 percent. For consumers, the usury limit is 17 percent; for nonconsumers, the usury limit is 5 percent above the Federal Reserve interest rate. Judgment rate is 10 percent per annum or the lawful agreed upon rate, whichever is higher.

CALIFORNIA: Legal rate of interest is 10 percent for consumers. Usury limit is 5 percent above the Federal Reserve Bank of San Francisco rate.

COLORADO: Legal rate of interest is 8 percent. Usury limit is 45 percent. Maximum rates to consumers is 12 percent per annum.

CONNECTICUT: Legal rate of interest is 8 percent. Usury rate is 12 percent. Interest allowed in civil suits is 10 percent.

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DELAWARE: Legal rate of interest is 5 percent over the Federal Reserve Rate.

DISTRICT OF COLUMBIA: Legal rate of interest is 6 percent. General usury limit is 24 percent.

FLORIDA: Legal rate of interest is 12 percent. General usury limit is 18 percent. For loans exceeding \$500,000, the maximum rate is 25 percent.

GEORGIA: Legal rate of interest is 7 percent. Usury limit for loans less than \$3,000 is 16 percent; otherwise 5 percent. For loans below \$250,000, interest rate must be specified in writing and in simple interest.

HAWAII: Legal rate of interest is 10 percent. Usury limit for consumers is 12 percent.

IDAHO: Legal rate of interest is 12 percent. Judgment interest is 5 percent above U. S. Treasury SECURITIES rate.

ILLINOIS: Legal rate of interest is 5 percent. General usury limit is 9 percent. Judgment rate is 9 percent.

INDIANA: Legal rate of interest is 10 percent. Judgment rate is 10 percent.

IOWA: Legal rate of interest is 10 percent. Maximum rate for consumer transactions is 12 percent.

KANSAS: Legal rate of interest is 10 percent. Usury limit is 15 percent. Judgment rate is 4 percent above federal discount rate. For consumer transactions, maximum rate of interest for first \$1,000 is 18 percent; otherwise 14.45 percent.

KENTUCKY: Legal rate of interest is 8 percent. Usury limit is 4 percent above Federal Reserve rate or 19 percent, whichever is less. No limit for loans exceeding \$15,000. Judgment rate is 12 percent compounded annually or at a rate set by the court.

LOUISIANA: Legal rate of interest 1 percent above average prime rate, not exceeding 14 percent or less than 7 percent. Usury limit is 12 percent.

MAINE: Legal rate of interest is 6 percent. Judgment rate is 15 percent for judgments below \$30,000; otherwise the 52 week average discount rate for T-Bills plus 4 percent.

MARYLAND: Legal rate of interest is 6 percent. Usury limit is 24 percent. Judgment rate is 10 percent.

MASSACHUSETTS: Legal rate of interest is 6 percent. Usury limit is 20 percent. Judgment rate is 12 percent of 18 percent if the court finds a frivolous defense.

MICHIGAN: Legal rate of interest is 5 percent. Usury limit is 7 percent. Judgment rate is 1 percent above the five year T-note rate.

MINNESOTA: Legal rate of interest is 6 percent. Usury limit is 8 percent. Judgment rate is secondary market yield for one year T-Bills.

MISSISSIPPI: Legal rate of interest is 9 percent. Usury limit is 10 percent or 5 percent above the federal reserve rate. No usury limit on commercial loans exceeding \$5,000. Judgment rate is 9 percent or legally agreed upon rate.

MISSOURI: Legal rate of interest is 9 percent. Judgment rate is 9 percent.

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MONTANA: Legal rate of interest is 10 percent. General usury limit is 6 percent above New York City bank's prime rate. Judgment rate is 10 percent.

NEBRASKA: Legal rate of interest is 6 percent. Usury limit is 16 percent. Judgment rate is 1 percent above bond yield equivalent to T-Bill auction price.

NEVADA: Legal rate of interest is 12 percent. No usury limit.

NEW HAMPSHIRE: Legal rate of interest is 10 percent. No general usury limit.

NEW JERSEY: Legal rate of interest is 6 percent. Usury limit generally is 30 percent for individuals and 50 percent for [CORPORATIONS](#).

NEW MEXICO: Legal rate of interest is 15 percent. Judgment rate is determined by the court.

NEW YORK: Legal rate of interest is 9 percent. General usury limit is 16 percent.

NORTH CAROLINA: Legal rate of interest is 8 percent. General usury limit is 8 percent.

NORTH DAKOTA: Legal rate of interest is 6 percent. General usury limit is 5.5 percent above six-month treasury bill interest rate. Judgment rate is 12 percent.

OKLAHOMA: Legal rate of interest is 6 percent. Consumer loans may not exceed 10 percent unless lender is licensed; usury limit on non-consumer loans is 45 percent. Judgment rate is 4 percent above T-Bill rate.

OREGON: Legal rate of interest is 9 percent. Judgment rate is 9 percent or agreed upon rate, whichever is higher. Usury limit is 12 percent for loans less than \$50,000.

PENNSYLVANIA: Legal rate of interest is 6 percent. General usury limit is 6 percent for loans less than \$50,000. Criminal usury limit is 25 percent. Judgment rate is 6 percent.

PUERTO RICO: Legal rate of interest is 6 percent.

RHODE ISLAND: Legal rate of interest is 12 percent. Judgment rate is 12 percent. Usury limit is 21 percent or 9 percent above the interest rate charged for TBills.

SOUTH CAROLINA: Legal rate of interest is 8.75 percent. Judgment rate is 14 percent.

SOUTH DAKOTA: Legal rate of interest is 15 percent. Judgment rate is 12 percent.

TENNESSEE: Legal rate of interest is 10 percent. Judgment rate is 10 percent. General usury limit is 24 percent, or 4 percent above average prime rate, whichever is less.

TEXAS: Legal rate of interest is 6 percent. Judgment rate is 18 percent or contracted rate, whichever is less.

UTAH: Legal rate of interest is 10 percent. Judgment rate is 12 percent or contracted rate.

VERMONT: Legal rate of interest is 12 percent. Judgment rate is 12 percent. General usury limit is 12 percent.

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VIRGINIA: Legal rate of interest is 8 percent. Judgment rate is 8 percent or contracted rate. No usury limit for corporation or business loans.

WASHINGTON: Legal rate of interest is 12 percent. General usury limit is 12 percent or 4 percent above average T-Bill rate, whichever is greater. Judgment rate is 12 percent or contracted rate, whichever is higher.

WEST VIRGINIA: Legal rate of interest is 6 percent.

WISCONSIN: Legal rate of interest is 5 percent. Judgment rate is 12 percent.

WYOMING: Legal rate of interest is 10 percent. Judgment rate is 10 percent or contracted rate, whichever is less.

Additional Resources

Lectric Law Library. Lectric Law Library, 2002. Available at www.lectlaw.com.

West's Encyclopedia of American Law. West Group, 1998.

Organizations

American Bankers Association

1120 Connecticut Avenue, NW
Washington, DC 20036 USA
Phone: (800) 226-5377
URL: www.aba.com

bankrate.com

11811 U.S. Highway 1
North Palm Beach, FL 33408 USA
Phone: (561) 630-2400
URL: www.bankrate.com

United States Federal Reserve

20th Street and Constitution Avenue, NW
Washington, DC 20551 USA
Phone: (202) 452-3819
URL: www.federalreserve.gov

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