Interest-Free Lending

ONE OF THE GREATEST BENEFITS of Banking 2.0 is that it eliminates the need for interest. Interest has been banned many times throughout history. In fact, all five major world religions—Buddhism, Christianity, Hinduism, Islam, and Judaism—have banned interest at one time or another. Even Adam Smith, despite his *laissez-faire* approach to economics, had concerns about the use of interest.

> Today the use of interest is so commonplace that few consider it wrong, and we think of the historical bans on interest as being quaint, except in Islamic nations.

It is interesting that the only point in the Scriptures that C. S. Lewis backed off from defending in his book *Mere Christianity* was the scriptural prohibition on interest. He did note, however, that: "There is one bit of advice given us by the ancient heathen Greeks, and by the Jews in the Old Testament, and by the Christian teachers of the Middle Ages, which the modern economic system has completely disobeyed. All these people told us not to lend money at interest. That is a question I cannot decide on. I am not an economist and I simply do not know whether the investment system is responsible for the state we are in or not. But I should not have been honest if I had not told you that three great civilizations had agreed in condemning the very thing on which we have based our whole life." Lewis would most

likely have welcomed Banking 2.0 as having scriptural relevancy.

It is surprising to many that interest was not really banned for moral reasons.

Interest was banned because of a practical concern. Do you remember learning in school about how interest compounds over time? That lesson left many wondering whether an account could be left open for a long enough period of time to eventually contain all the money in the world. The reason this can't be done is because there are so many other accounts earning interest. It is because of the prevalence of the use of interest that our money supply grows, and it is because our money supply grows that the value of our money declines over time.

Interest damages the value of money over time.

Our ancestors understood this. They banned interest to stabilize the value of their money. Banning interest today would help stabilize the value of the dollar, making it less prone to monetary inflation. But could you run a banking system without interest?

If the Fed generated the reserves that banks needed for lending, and neither the Fed nor the bank were allowed to charge interest, banks could still earn an origination fee for writing a loan, as well as a servicing fee for managing the

loan. When I was a conduit lender in the 1990s, I earned an origination fee for the loans I wrote. The interest that the borrowers had to pay was just a nuisance to me. The lending industry would thrive without interest, as origination fees are sufficient for the work of underwriting loans. And if the Fed provided the capital, interest would no longer be necessary to attract deposits for lending.

Let's now look at what borrowing would be like in an interest-free world.

Borrowing would still entail origination and service fees, and you would still have to pay the principal amount of the loan back, of course, but if you were no longer charged interest, loans would cost much less. Let's look at how much eliminating interest would save on a typical mortgage and student loan:

- Eliminating interest would reduce the monthly payment on a $400,000 mortgage from $2,147 down to $1,111, which would save $372,960 over the life of the mortgage.[1]
- Eliminating interest would reduce the monthly payment on a $100,000 student loan from $763 to $417, which would save $83,040 over the life of the loan.[2]

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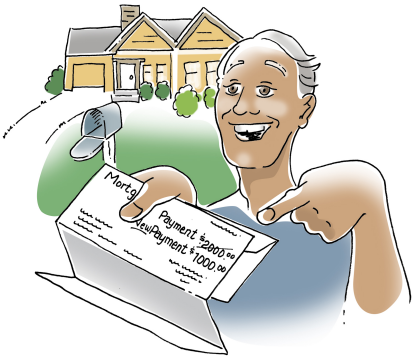
[1] The difference between 5% interest and 0% with a thirty-year amortization.
[2] The difference between 6.8% interest and 0% with a twenty-year amortization.

Slashing the cost of credit would not only reduce our cost of living it would also benefit the economy.

The money we would save by not paying interest would flow into the material economy.

Interest-free mortgages would cut the cost of mortgage payments nearly in half. When banks qualify a borrower for a mortgage today, they allow one third of the borrower's income to be spent on the mortgage. That rule would have to change under Banking 2.0 so home prices don't double. If we did not have to pay interest, it would shrink the cost of housing from a third of our income to just a sixth of our income. And that is exactly the type of improvement that progress is supposed to deliver. Interest-free Banking 2.0 would provide us with more living for less money.



When you stop and think about it, the 2008 financial crisis was really a lesson in how punishing the impact of interest can be. Not only did millions of people lose their homes, we spent billions of dollars of taxpayers' money bailing out the banks. We could have saved all that money and avoided the foreclosures if we had just been able to roll

interest rates back. The root cause of the crisis was the monetary economy. There was nothing wrong with our material economy. The financial sector was simply costing us too much.