One Law for the Rich, One Law for the Poor

The new foreclosure crisis reveals the shocking unfairness in how the law treats struggling homeowners.

By Joseph E. Stiglitz

Posted Sunday, Nov. 7, 2010, at 8:24 AM ET

FROM
PROJECT SYNDICATE

The foreclosure crisis has revealed flaws in mortgage law.

The mortgage debacle in the United States has raised deep questions about "the rule of law," the universally accepted hallmark of an advanced, civilized society. The rule of law is supposed to protect the weak against the strong, and ensure that everyone is treated fairly. In America in the wake of the subprime mortgage crisis, it has done neither.

Like 653
PRINT
DISCUSS
E-MAIL
RSS
RECOMMEND...
REPRINTS
SINGLE PAGE

Part of the rule of law is security of property rights: If you owe money on your house, for example, the bank can't simply take it away without following the prescribed legal process. But in recent weeks and months, Americans have seen several instances in which individuals have been dispossessed of their houses *even when they have no debts*.

To some banks, this is just collateral damage: Millions of Americans—in addition to the estimated 4 million in 2008 and 2009—still have to be thrown out of their homes. Indeed, the pace of foreclosures would be set to increase—were it not for government intervention. The procedural shortcuts, incomplete documentation, and rampant fraud that accompanied banks' rush to generate millions of bad loans during the housing bubble has, however, complicated the process of cleaning up the ensuing mess. To many bankers, these are just details to be overlooked. Most people evicted from their homes have not been paying their mortgages, and, in most cases, those who are throwing them out have rightful claims. But Americans are not supposed to believe in justice *on average*. We don't say that most people imprisoned for life committed a crime worthy of that sentence. The U.S. justice system demands more, and we have imposed procedural safeguards to meet these demands.

But banks want to short-circuit these procedural safeguards. They should not be allowed to do so.

To some, all of this is reminiscent of what happened in Russia, where the rule of law—bankruptcy legislation in particular—was used as a legal mechanism to replace one group of owners with another. Courts were bought, documents forged, and the process went smoothly. In America, the venality is at a higher level. It is not particular judges who are bought, but the laws themselves, through campaign contributions and

ALSO IN SLATE

How One of the Last Soldiers in Iraq Spent New Year's Eve

Weigel: The Political Predictions I Got Wildly Wrong in 2010—and a Few I Got Right

Lady Antebellum: The World's Dullest Band Is Also One of Its Most Popular

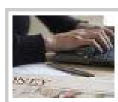
What Happens to the People Whose 99 Weeks of Unemployment Benefits Run Out?

RECOMMENDED FOR YOU

TheStreet
10 Things Your Grandparents Know About Money (That You Don't)
TheStreet.com

REUTERS
MBIA wins key ruling in Bank of America case
Reuters

COUPON SHOEBOX
What Can You Live Without in Order to Increase Your Frugality?
Coupon Shoebox


Good Customer or Credit Risk?
Inside Edge

[What's This?]

Slate
Slate.com on Facebook
Like 120,861

lobbying, in what has come to be called "corruption, American-style."

It was widely known that banks and mortgage companies were engaged in predatory lending practices, taking advantage of the least educated and most financially uninformed to make loans that maximized fees and imposed enormous risks on the borrowers. (To be fair, the banks tried to take advantage of the more financially sophisticated as well, as with securities created by Goldman Sachs that were designed to fail.) But banks used all their political muscle to stop states from enacting laws to curtail predatory lending.

When it became clear that people could not pay back what was owed, the rules of the game changed. Bankruptcy laws were amended in 2005 to introduce a system of "partial indentured servitude." An individual with, say, debts equal to 100 percent of his income could be forced to hand over to the bank 25 percent of his gross, pre-tax income for the rest of his life, because the bank could add on, say, 30 percent interest each year to what a person owed. In the end, a mortgage holder would owe far more than the bank ever received, even though the debtor had worked, in effect, one-quarter time for the bank.

When this new bankruptcy law was passed, no one complained that it interfered with the sanctity of contracts: At the time borrowers incurred their debt, a more humane—and economically rational—bankruptcy law gave them a chance for a fresh start if the burden of debt repayment became too onerous.

That knowledge should have given lenders incentives to make loans only to those who could repay them. But lenders perhaps knew that, with the Republicans in control of government, they could make bad loans and then change the law to ensure that they could squeeze the poor.

With one out of four mortgages in the United States under water, there is a growing consensus that the only way to deal with the mess is to write down the value of the principal (what is owed). America has a special procedure for corporate bankruptcy, called Chapter 11, which allows a speedy restructuring by writing down debt, and converting some of it to equity.

It is important to keep enterprises alive as going concerns, in order to preserve jobs and growth. But it is also important to keep families and communities intact. So America needs a "Homeowners' Chapter 11."

Lenders complain that such a law would violate their property rights. But almost all changes in laws and regulations benefit some at the expense of others. When the 2005 bankruptcy law was passed, lenders were the beneficiaries—they didn't worry about how the law affected the rights of debtors.

Growing inequality, combined with a flawed system of campaign finance, risks turning America's legal system into a travesty of justice. Some may still call it the "rule of law," but it would not be a rule of law that protects the weak against the powerful. Rather, it would enable the powerful to exploit the weak.

In today's America, the proud claim of "justice for all" is being replaced by the more modest claim of "justice for those who can afford it." And the number of people who can afford it is rapidly diminishing.

This article comes from Project Syndicate.

*Like **Slate** on Facebook. Follow us on Twitter.*

Like 653 people like this. Be the first of your friends.

MORE FROM SLATE

- **Breaking up with Hotmail: Why I'm ending my longest online relationship.** *(from Slate)*
- **Why won't the GOP's financial-crisis report follow the money?** *(from Slate)*
- **How "mortgage assistance relief" companies prey on homeowners facing foreclosure.** *(from Slate)*
- **The Best Music of 2010** *(from Slate - Brow Beat)*

MORE FROM THE WEB

- **Cash Is King, Again** *(from Inside Edge)*
- **Gainful Employment: Flawed and Unfair** *(from My education. My job. My choice.)*
- **UPDATE 1-Obama's New Year's resolution? Fix the economy** *(from Reuters)*
- **Switching Banks: Should You Stay or Should You Go?** *(from Inside Edge)*

[what's this]

Bankruptcy

VIDEOS	WEB	IMAGES

CBS News
Bankruptcy Claims On The Rise

MSN Video
Bankruptcy Legislation and Energy Policy

ABC News
Bankruptcy Secrets

Joseph E. Stiglitz, a Nobel laureate in economics, is University Professor at Columbia University. The paperback version of his latest book, Freefall: Free Markets and the Sinking of the Global Economy, *with a new afterword, was published in October.*

Photograph by Istockphoto/Thinkstock.

Login Login required, click here to begin

Share This Page

Follow Cancel Post

Dave G
Whether property is foreclosed on or written down to market, a bank has the same value from its investment. If it forecloses, the property does not magically gain value back to the amount owed. If anything, a foreclosed property has LESS value than an occupied property with an owner paying a mortgage based on the current market value. Only if a bank is able both to foreclose AND pursue the owner for the difference would it come out ahead by foreclosing. Most foreclosures do not require the

Federal Deficit Disorder
Why the tax-cut deal won't solve America's fiscal or economic crises.
Simon Johnson | Dec. 16, 2010

Search for more Project Syndicate articles

Subscribe to the Project Syndicate RSS feed

View our complete Project Syndicate archive

Classic EXPLAINER! Is it possible to have the first newborn of the year on purpose? http://slate.me/eLpAjH

Happy New Year! http://slate.me/dEcg36

The year's best editorial cartoons! What was the best political moment of 2010? http://slate.me/dU5vTD

- **MTV's Abortion-Themed Special Starred Black Teen Mom**
- **NOLA Residents to Be Kicked Out of FEMA Trailers**
- **Carol Moseley Braun, Danny Davis Will Not Drop Out of Chicago Race**

- **New Year's Resolutions for World Leaders**
- **Our Favorite Headlines of 2010**
- **The Secret History of Iran's 50-Year Quest for the Bomb**

- **China takes a short-cut to power**
- **Bond plan could end the euro crisis**
- **How west can reverse a decade of decline**

borrower to pay the difference. In this case, given that most banks were complicit in a fraud perpetrated upon the borrowers at the time the loans were extended, it would be particularly egregious to allow the bank to acquire the property back to be resold AND sue the borrower for the difference. That would be perfect proof that crime DOES pay if you are a financial institution.

Marking loans down with a provision that the bank would participate in any future appreciation in the value of the home is a more logical resolution that preserves rights for both the banks and the borrowers.

Monday, November 22, 2010, 14:18:21 – Flag – Reply

Jim Brousseau

on being asked about the American justice system, newly appointed Bobby Kennedy replied that a person gets the kind of justice that a person can afford. According to Stiglitz, nothing has changed. one gets the kind of justice one can afford.

Tuesday, November 16, 2010, 14:09:14 – Flag – Reply

Foreclosure Mess

I have represented quite a few borrowers in foreclosure proceedings. It is fairly common for a lender to foreclose on a property when a borrower is in a temporary modification (and is paying his/her mortgage under the modified terms). In some cases a modification actually forces solvent borrowers into foreclosure. I've attempted to explain how/why this happens in my blog http://touchlaw.blogspot.com/2010/11/can-bank-foreclose-if-you-are-paying.html

However, I am yet to see a case when a bank filed to foreclose on a borrower who is making full, timely payments. When "individuals have been dispossessed of their houses even when they have no debts," there are usually complex, "unsexy" reasons that have nothing to do with the current mortgage crisis.

Monday, November 15, 2010, 00:31:14 – Flag – Reply

G

Who are these horrid lying individuals in there 20s who bought houses they couldn't afford? I call BS on that - I bought my house in 2003 - put 20% down and got a 30 year low interest fixed rate mortgage - did I overbuy? No. Did I lie? No. My house is now worth less than half of what I owe on it - 7 years later - 3 kids, no job, no equity, no luck - and I know - my fault right? I know lots of folks in the same boat as I am - so the banks get a bailout and big bonuses but what do we get? Screwed. Mea culpa though, right? Lets give the rich another tax break - that'll solve everything.

Thursday, November 11, 2010, 18:56:18 – Flag – Reply

Liked by editcat

Ken Harvey

I call BS on your story. The only way your house is worth half of what you owe on it is if you are a HELOC abuser. You claim that you put 20% down in 2003. In 7 years of mortgage paying you would have paid down about another 10% of the mortgage. That means you owe 70% of the FMV of the house in 2003. House prices in some areas did increase a lot - but after 2003. Your story suggests that your house in now worth 35% of what the price was in 2003. I am sorry, but that is BS. You obviously took out a HELOC worth something like 100% of the value in say, 2006, which might be 140% of the value of the house now. I am sorry, and I don't mean to be insulting, but unless you live in some bizarro world location where prices are only 35% of their 2003 prices, you are simply another HELOC abuser peddling a sob story. QED.

Thursday, November 11, 2010, 23:43:05 – Flag – Reply

editcat

@Ken Harvey My home is worth about 35% of what it was worth in 2003. Fortunately, I bought it earlier than that, and I considered the gain to be illusory. My house, purchased in 1999, is appraised at about the same as it was when I bought it, so my downpayment and principle payments have gone to equity. But that was the luck of timing, not a special virtue on my part. Nor is my continued employment due to any special virtue; I have friends who were laid off through no fault of their own.

Saturday, November 13, 2010, 17:44:47 – Flag – Reply

Saber Iceage

First, many of these homeowners LIED to get their morgages. They often lied about their incomes. That is fraud, they should not be bailed out. Principle amounts should NOT be lowered, that would just mean responceable taxpayer will have to pay for their willfull fraud, that is for those who lied on their applications.

The only way for things to get back to normal is to forclosure on the properties and for the goverment to allow home prices to fall to where they belong. Then those who have waited all their lives to buy a home, will be able to afford on.

Thursday, November 11, 2010, 16:41:51 – Flag – Reply

Liked by Ken Harvey

Dave G

Borrowers were ENCOURAGED to lie by lenders offering no documentation loans. Borrowers were told that appreciation would work in their favor and make home acquisition a positive investment. There was NO REASON for no-documentation loans other than to allow borrowers to falsify their applications. When those loans went bad, the lenders were "shocked, shocked to find that lying was going on". Yes, it was

truly shocking when it was revealed that borrowers didn't tell the truth on the no-documentation loans. Unless, of course, you were a human being of even modest intelligence who understood that no-doc loans were designed to allow lying so that under-qualified candidates could buy property that they couldn't afford using traditional lending rules. Banks believed that they were protected against bad investments on these fraudulent loans by the value of the collateral ... failing to realize that their collateral might lose value. Oops!!
Monday, November 22, 2010, 14:27:42 – Flag – Reply

Guest
I refuse to believe Joseph Stiglitz wrote this article! Perhaps an intern on his staff? The quality of the writing is so poor that sections of it are nearly unreadable.
Thursday, November 11, 2010, 11:08:20 – Flag – Reply
Liked by Ken Harvey

Tbone900
@Ranting Loons
If you can get your bank to agree to a write-down on your loan, then good for you. If you can't, then you are just a loser at capitalism, so quit moaning.
Thursday, November 11, 2010, 00:08:15 – Flag – Reply

Ranting Loons
Writing down the principle is also not fair for those of us that did not over-buy and put money down. Can I have my mortgage lowered "just because" too?

It is sad for the people affected, but they are partially to blame. Giving them a pass is not fair to those of us that were more responsible and did not have to have the biggest and latest.
Wednesday, November 10, 2010, 15:06:07 – Flag – Reply

Guest
Might as well be as many laws as there are manners by which individuals end up with their name momentarily on a title. Just varying degrees of culpability for being in debt; either 100% your own intent or shared with Barney Frank and the A-house-for-everybody ilk who facilitated you to reach the closing table.

Home ownership is a state of stewardship that occurs before their financial qualification is determined. It is a commitment to opt to be at home, not driving around in your big new SUV if the opportunity presents. This is why neighbors expect you to take in your trash cans once emptied, rake your leaves, shovel your walk and not be a short term flop house to an extended census of "family".

The mortgage banker in my family (a real one, not the sham outfits using F-Mac and F-Mae to "qualify dopes", says once a week he has to tell an applicant they do not able to decide they "deserve" a house because they want to if they have a record of never having a debt they paid off. That includes many vocations as well as those lacking a consistent vocation.
Wednesday, November 10, 2010, 05:23:09 – Flag – Reply

dr vicki
Spend one day watching HGTV, and you will laugh at the premise of this article. The housing crisis was largely caused by GREED. By 20 somethings on up buying McMansion houses that they could not afford. The average home size has exploded. Not to mention everyone thinks they should have granite counter tops, stainless steelappliances, and a bathroom for every bedroom, and a three car garage full of brand new SUVs.
Tuesday, November 09, 2010, 15:16:18 – Flag – Reply
Liked by David Farinacci Ranting Loons

David Farinacci
Major fuel to the raging fire.
Tuesday, November 09, 2010, 15:18:36 – Flag – Reply

Arjuna1969
Amen. The Granite Countertop Recession.
Tuesday, November 09, 2010, 15:24:28 – Flag – Reply

2 more (expand)

Ken Harvey
My comment above was to Ian.
Tuesday, November 09, 2010, 21:12:19 – Flag – Reply

Steve Wheeler
Dr. Vicki, you could not be more wrong in your assessment of the situation.

Sure, everything that you listed is true, but it's your perception that is off. That and the fact that your argument is a canned talking point for the banks and the Politicians who bailed them out. Blame the greedy little guy.

Considering, that the greedy little guy actually was investing in real estate, which the banks "used" to do. The problem is that they (The Banks and Lenders) stopped "investing" in actual real estate (the land or home was just a vessel for the loan) and began "originating" loans that were packaged as securitized assets, leveraged for (sometimes) 20 times their value and sold for 80 cents on the dollar.

I think that weighs a bit more toward the reality of this economic horror than your Granite counter top and more than 2 car "SUV" explanation.

The Banks only got back into real estate when it came to kicking people out of the houses (that didn't matter to them in the first place) that the banks themselves devalued by betting it all at the track.

Tuesday, November 09, 2010, 23:08:51 – Flag – Reply

Liked by Dustin Arand

More

Social Networking by Echo

How One of the Last Soldiers in Iraq Spent New Year's Eve

Weigel: The Political Predictions I Got Wildly Wrong in 2010—and a Few I Got Right

Lady Antebellum: The World's Dullest Band Is Also One of Its Most Popular

A Book That Pinpoints When Civilization Started Caring About Human Rights

What Happens to the People Whose 99 Weeks of Unemployment Benefits Run Out?

The Places in America Where It's Almost Impossible To Buy Healthy Food

site map | build your own Slate | the fray | about us | contact us | *Slate* on Facebook | search
feedback | help | advertise | newsletters | mobile | make *Slate* your homepage

Share Page | Recommended | Like | Twitter | Slate's Most Popular Reads Right Now