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THE HOUSING CRASH AND THE END OF AMERICAN CITIZENSHIP

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> *No man who owns his own house and lot can be a Communist. He has too much to do.*[1]
>
> *William Levitt, architect of post-WW II suburbia*

> *We have a lot of kids graduating college, can't find jobs . . . . That's what happened in Cairo. That's what happened in Madrid. You don't want those kinds of riots here.*[2]
>
> *New York Mayor Michael Bloomberg, 2011*

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1. KENNETH T. JACKSON, CRABGRASS FRONTIER: THE SUBURBANIZATION OF THE UNITED STATES 231 (1985).

2. Erin Einhorn & Corky Siemaszko, *Mayor Bloomberg Predicts Riots in the Streets If Economy Doesn't Create More Jobs*, N.Y. DAILY NEWS (Sept. 16, 2011), http://articles.nydailynews.com/2011-09-16/local/30186558_1_mayor-bloomberg-jobs-plan-president-obama.

INTRODUCTION

To many Americans, it feels like the United States is a different country than it was just a few years ago. It is hard to explain to teenagers today that there was a time, even a short time ago, when political institutions did not seem riddled with corruption and when Americans were not split by stark economic and political lines. Such memories increasingly describe what sounds like a foreign land, not the American system we know today. The narrative is widely understood: economic gains go to the top while costs and risk are shifted onto everyone else.

The most obvious economic manifestation of this difference is the foreclosure crisis. Much as divorce became a culturally common activity in the 1960s, the rise of a foreclosure epidemic has made the loss of a home a searing but familiar experience for tens of millions of Americans.

Why is this happening? Why now? And why are American political and cultural leaders ratifying this shift by collectively asserting, as the U.S. Bank CEO framed it to frustrated business owners in November 2011, as essentially stop whining and "get over it"?[3] An exploration of the American housing system provides clarification on these questions; it is housing as a whole that has led the change, as both a foundational element of the American community and the key financial link between the elite sectors of the economy and the population.

The relationship between the shifting housing environment and the rest of American life is profound. In April 2011, President Barack Obama reversed a seventy-five-year government policy framework by encouraging renting over home buying.[4] Brian Moynihan, the CEO of Bank of America, echoed this shift a few days later, saying that Americans should no longer look at their homes as "asset[s]" but instead solely as "great place[s] to live."[5] This policy reversal points to a deceptively simple, yet unanswered, question about the current

3. Gregory Pratt, *U.S. Bank President Richard Davis to Disillusioned Business Owners: "Get over It,"* CITYPAGES PROTEST NEWS BLOG (Nov. 1, 2011, 3:33 PM), http://blogs.citypages.com/blotter/2011/11/us_bank_president_richard_davis_get_over_it.php.

4. Martin Fridson, *Obama Pushes Renting, Making it Easier to Whack Fannie and Freddie*, FORBES (Apr. 12, 2011), http://www.forbes.com/sites/investor/2011/04/12/obama-pushes-renting-making-it-easier-to-whack-fannie-and-freddie.

5. *BofA CEO: Owners Shouldn't Look at Home as an Asset*, MSNBC (Apr. 12, 2011), http://news.mobile.msn.com/en-us/article_biz.aspx?aid=42556230&afid=1.

American economic order: why has the political system been unable to arrest or mitigate the millions of foreclosures that have taken place since 2006?

There will be roughly six to twelve million foreclosures from 2006 to 2014.[6] This wave, which is highly deflationary in terms of its impact on the housing market, will reduce the most broadly held source of wealth for most Americans: home equity. The closer one gets to the problem, the more puzzling it becomes. Not acting to protect housing, the primary source of wealth for the middle class, is a radical policy choice. Why make it?

There are precedents in dealing with a debt overhang, the most obvious parallel being a write-down of debt in response to the United States' foreclosure epidemic of the 1930s. Yet policy-makers and business leaders have done virtually nothing; their lack of action has been coordinated and bipartisan. Debt is fundamentally a set of social relationships, and political leaders will not willingly alter those relationships to restore an equitable social contract unless forced to do so.

The thesis of this Article is that this wave of foreclosures signals the end of an older social contract and the beginning of a period of deep political and economic instability. The crash of the housing market radically altered the wealth and power distribution mechanisms for the American political order. For much of American history, housing operated as a proxy for wealth and stability.[7] From the 1930s onward, it offered a route to wealth for a majority of the population, while allowing the banking system to serve as a channel through which the Federal Reserve could manage the economy.

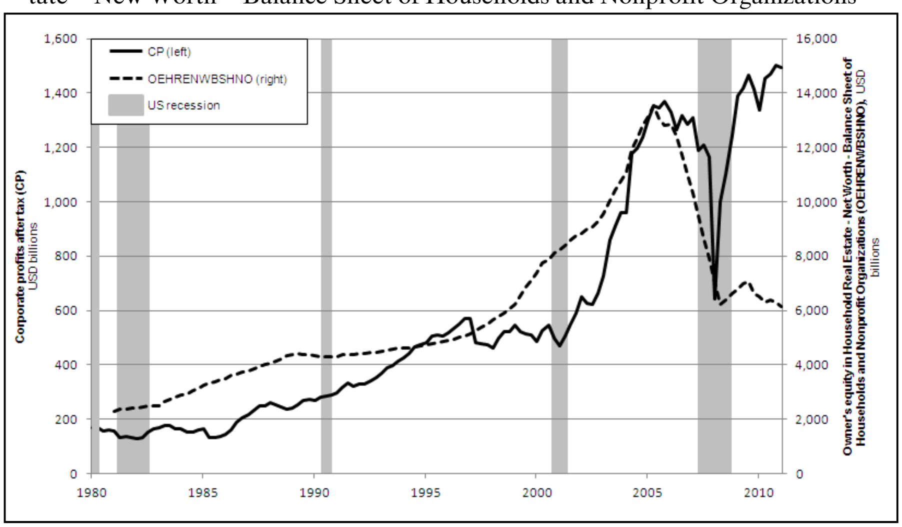
6. According to the Congressional Oversight Panel, there is no reliable federal source of foreclosure data. *See* Ryan Grim, *Foreclosure: In the Midst of Crisis, No Reliable Data*, HUFFINGTON POST (June 6, 2009), http://www.huffingtonpost.com/2009/05/06/foreclosure-in-the-midst_n_198207.html. I have compiled these estimates from a speech by Federal Reserve Governor Sarah Bloom Raskin given on November 12, 2010 called "Problems in the Mortgage Servicing Industry." *See* Sarah Bloom Raskin, Governor, Federal Reserve, Address at the Nat'l Consumer Law Center's Consumer Rights Litig. Conf.: Problems in the Mortgage Servicing Industry (Nov. 12, 2010), http://www.federalreserve.gov/newsevents/speech/raskin20101112a.htm. While there are not reliable numbers, it is quite obvious the foreclosure epidemic is vast and numbers in the millions. Laurie Goodman of Amherst Securities believes that there are as many as ten million more households who will default from 2012 onward on top of those who have been foreclosed from 2006 to 2011. *See* Jon Prior, *10 Million More Mortgages Set to Default, Expert Says*, HOUSINGWIRE (Sept. 20, 2011), http://www.housingwire.com/2011/09/20/amherst-to-senate-10-million-more-mortgages-set-to-default.

7. *See* JACKSON, *supra* note 1, at 50.

Over time, as financial asset growth replaced wage growth, housing became a leverage point masking the deterioration in America's financial status. The housing crash, far from a simple downturn in one sector of the economy, represents the collapse of this entire apparatus. The result is increasing political chaos, rising authoritarian structures, and social unrest.

In other words, the financial crisis snapped the spine of an implicit social contract, one that aligned the interests of the governing class and the citizenry. This fissure becomes evident in a change in the correlation of corporate profits with home equity—from 1950 onward, these moved in tandem. But in 2010 they split apart, throwing our traditional political model and distribution mechanism for wealth into uncharted waters.

Figure 1. Corporate Profits After Tax; Owners' Equity in Household Real Estate—New Worth—Balance Sheet of Households and Nonprofit Organizations[8]



This Article identifies two distinct eras in which the housing market played a pivotal role in regulating economic growth and social stability: the New Deal "High Trust" social contract era and the Reagan-era "Low Trust" social contract era. Over the course of seventy years, the housing finance system became the primary wealth distribution mechanism through which wealth was distributed. The

8. Data obtained with permission from Federal Reserve Bank of St. Louis. *Economic Research*, FED. RESERVE BANK ST. LOUIS, http://research.stlouisfed.org (last visited June 18, 2012).

national housing stock and finance system served different social aims during these eras, but the housing system remained unchanged throughout these periods, thereby acting as a national regulator.

Government policies like the home mortgage interest deduction and cheap Federal Housing Administration (FHA) loans encouraged broad-based wealth distribution, which took the form of home equity. While the New Deal and the Reagan-era housing systems differed in their basic social models and inequities, they were politically stable. The current financial crisis has eroded our housing system so much that we are entering a new era of fluctuating and unstable politics and finance, in an era in which earlier social guarantees are no longer valid.

Now many Americans are beginning to question the legitimacy of the democratic system in which they were raised. Pew and Gallup polls consistently show that public support for governing institutions —public schools, the Supreme Court, Congress, the media—are at historic lows.[9] With support for home purchases ebbing and political representation increasingly dominated by large, moneyed interests, it is unclear what sustains political stability in the face of a lack of public faith in political institutions and a lack of broadly distributed stakeholder society. Politicians like homeownership because it deters radicalism.[10] This Article considers the converse.

I. EVOLUTION OF THE HOUSING SYSTEM IN TWENTIETH CENTURY AMERICA

A. The Modern Conundrum

One mystery underlying modern politics is why neither political coalition has been able to stop the devastating wave of foreclosures that began in 2006, despite the politically problematic misery it caused. A foreclosure costs money to many parties, not just the homeowner.[11] Powerful, wealthy banks and investors, who own

9. *See Confidence in Institutions*, GALLUP, http://www.gallup.com/poll/1597/confidence-institutions.aspx (last visited Mar. 13, 2012); *Distrust, Discontent, Anger and Partisan Rancor: The People and Their Government*, PEW RESEARCH CENTER, 1–2, 4 (Apr. 18, 2010), http://www.people-press.org/files/legacy-pdf/606.pdf.

10. *See* Stephanie M. Stern, *Reassessing the Citizen Virtues of Homeownership*, 100 COLUM. L. REV. 890, 896–98 (2011).

11. *We All Pay a Price for the Foreclosure Crisis*, AMERICANS FOR FIN. REFORM (Feb. 28, 2011, 9:39 AM), http://ourfinancialsecurity.org/2011/02/we-all-pay-a-price-for-the-foreclosure-crisis. This is a good compilation of the literature on the costs of foreclosures.

mortgage debt, lose, homeowners lose, communities lose, and politicians lose.[12] A foreclosure epidemic magnifies the losses. It is odd, to say the least, that arresting the foreclosure epidemic is not on the political menu for 2012.[13]

Housing has been an important element of the American social contract for four generations, and this failure to grapple with—or even acknowledge in any serious way—the loss of the American home is beyond the experience of any American living today. American Presidents have consistently lauded the benefits of homeownership. Ronald Reagan said that homeownership "supplies stability and rootedness."[14] Lyndon Johnson went even further: "[O]wning a home can increase responsibility and stake out a man's place in his community . . . . The man who owns a home has something to be proud of and reason to protect and preserve it."[15] " And William Levitt, the architect of the modern suburb, gave what is probably the most illuminating rationale for homeownership when he said in 1948, "No man who owns his own house and lot can be a Communist. He has too much to do."[16]

This pro-home ownership rhetoric is backed by enormous financial and social incentives. In the United States, voting behavior and access to economic rights are highly correlated with homeownership.[17] Aside from its social benefits, housing has been an important channel for transmitting monetary policy, even if it is not explicitly recognized as such.[18] Every post-war recovery has been led by fixed residential

12. *See id.*; Thomas Ferguson & Jie Chen, 1, 2, 3, Many Tea Parties? A Closer Look at the 2010 Massachusetts Senate Race 10 (Apr. 13, 2012) (unpublished manuscript), *available at* http://www.rooseveltinstitute.org/sites/all/files/FergusonFinal_0.pdf.

13. Huma Khan, *Little Talk of Housing Crisis on the Campaign Trail*, ABC NEWS NOTE BLOG (Oct. 20, 2011, 8:00 AM), http://abcnews.go.com/blogs/politics/2011/10/little-talk-of-housing-crisis-on-campaign-trail.

14. U.S. DEP'T HOUSING & URBAN DEV., HOMEOWNERSHIP AND ITS BENEFITS, URBAN POLICY BRIEF NO. 2 (1995) [hereinafter HOMEOWNERSHIP AND ITS BENEFITS], *available at* http://www.huduser.org/Publications/txt/hdbrf2.txt.

15. *Id.*

16. JACKSON, *supra* note 1.

17. *See* Matthew J. Holian, *Homeownership, Dissatisfaction and Voting*, 20 J. HOUSING ECON. 267, 275 (2011).

18. *See generally* Frederic S. Mishkin, *Housing and the Monetary Transmission Mechanism* 1 (Fed. Reserve Bd. Divs. of Research & Statistics & Monetary Affairs, Working Paper No. 2007-40, 2007), *available at* http://www.federalreserve.gov/pubs/feds/2007/200740/200740pap.pdf (finding the housing market to be of "central concern to monetary policy makers" as a "monetary transmission mechanism").

investment.[19] On a political level, the coalition backing homeownership—Wall Street and the construction and real estate sectors—meant that broad-based homeownership as a policy priority could deliver wealth throughout society.[20]

What happened to this system? Why did the Bush administration, and then the Obama administration, remain inert in the face of its collapse?[21] Why have all attempts from well-meaning Congressional and regulatory actors to remediate this situation failed?[22] To understand how deeply rooted the problem is, we need to understand the national consensus underlying our economic foundations, a consensus first established in the 1930s through a set of financial institutions that flowered in the 1940s and 1950s alongside the rise of suburbia.[23] From there we will see that this consensus, and the institutions it required, was altered, but not destroyed, by the Reaganite political realignment of the late 1970s and early 1980s.[24] Then we will travel through the housing boom and bust, tracing the political contours of the shift.[25] After this journey, it should become clear that the Obama administration's economic policy failures have come from the fracturing of the political coalition underlying broad prosperity for the middle class.[26] We will further see that rebuilding some sort of stable coalition is the order of the day.[27]

B. The New Deal Social Contract

The nation's housing system was set up during the Great Depression and World War II in the context of an effort to reconstruct social

19. *When the Roof Fell in*, ECONOMIST (Mar. 3, 2011), http://www.economist.com/node/18250439.

20. *See* Fridson, *supra* note 4.

21. Matt Stoller, *The Big Banks Win Again: Foreclosure Victims Get Little Help in a Mortgage-Settlement Plan that Only Benefits the Banks' Bottom Line*, SALON (Feb. 10, 2012), http://www.salon.com/2012/02/10/banks_get_off_easy_in_mortgage_settlement_deal.

22. David Dayen, *HAMP Is Hurting Liberalism*, FIREDOGLAKE (July 26, 2010), http://news.firedoglake.com/2010/07/26/hamp-is-hurting-liberalism; Tami Luhby, *Has Obama's Housing Policy Failed?*, CNN MONEY (Jan. 18, 2012), http://money.cnn.com/2012/01/18/news/economy/Obama_housing/index.htm.

23. JACKSON, *supra* note 1, at 190–218, 231–36.

24. THOMAS FERGUSON & JOEL ROGERS, RIGHT TURN: THE DECLINE OF THE DEMOCRATS AND THE FUTURE OF AMERICAN POLITICS 114–37 (1987).

25. *See* discussion *infra* Part I.B.

26. *See* discussion *infra* Parts I.C, I.D.

27. *See* discussion *infra* Part II.

stability by proposing a particular sort of social contract.[28] The basic premise of this contract was matching secure thirty-year jobs with thirty-year mortgages, allowing people to develop bonds with their homes and therefore committing themselves to social stability.[29] Both private and public actors matched their organizational models to promoting and sustaining this social contract.[30] The supporting financial system was built in the 1930s out of the ashes of a banking collapse: the post-World War II "Fair Deal" environment took advantage of these new financial institutional arrangements to shift resources from war production to the construction of the suburbs and a consumer economy.[31]

In the spring of 1933, the private housing finance system was groaning under the weight of collapsed demand and limited liquidity.[32] Foreclosures were running at over a thousand a day, and half of all mortgages were in default, threatening the viability of a semi-toppled banking system.[33] As part of a restructuring of the financial system, President Franklin Delano Roosevelt established a new set of institutions to support homeownership.[34] He pursued a series of radical innovations so that the government addressed market failures, building on the early work of the Hoover administration.[35] By shifting traditional constitutional boundaries, the Roosevelt administration created the institutional framework to support an explicit set of industrial and residential goals.[36]

Though opposed in his attempts to reorganize the financial system, Roosevelt had a favorable political environment. The nature of the downturns and the collapse of the existing social order were unlike

28. *See generally* BRUCE ACKERMAN, WE THE PEOPLE, VOLUME 1: FOUNDATIONS 47–56 (1991) (discussing how the New Deal, and particularly Supreme Court decisions during that era, changed the public's perception that states' autonomy was paramount and that the existing constitutional framework demanded a smaller, less-active federal government).

29. *Cf.* JACKSON, *supra* note 1, at 206 (discussing suburbanization in the New York City area during the early 1950s and how that trend became a stereotype of the American way of life).

30. Frank Levy & Peter Temin, *Inequality and Institutions in 20th Century America* 16 (Mass. Inst. of Tech. Dep't of Econ., Working Paper No. 07-17, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=984330.

31. *See* JACKSON, *supra* note 1, at 231–33.

32. *Id.* at 193.

33. *Id.*

34. *Id.* at 195, 203, 221, 224.

35. *See, e.g.*, JESSE H. JONES WITH EDWARD ANGLY, FIFTY BILLION DOLLARS: MY THIRTEEN YEARS WITH THE RFC (1932–1945) 165 (1951).

36. ACKERMAN, *supra* note 28, at 47, 53, 107.

anything anyone had ever experienced in America at the time. The Great Depression was a "balance sheet" downturn, with a deflationary spiral leading to foreclosures and home price depreciation.[37] The deflation was especially vicious due to the characteristics of the housing finance market of the 1920s. The typical mortgage prior had been a five-year loan with a large down payment and a balloon payment to handle the balance at the end of the loan term.[38] Homeowners would typically roll over their mortgages, expecting lenders to have credit at the ready.[39] The collapse of the banking system thus led to a substantial number of liquidity-driven foreclosures, as homeowners could not afford the lump sum to pay off their mortgage balances, nor could they find lenders to continue offering credit.[40]

The most significant policy response to this problem was the Homeowner Loan Corporation (HOLC), which was designed to alleviate the housing problem as well as relieve pressure on the banking system caused by the foreclosure crisis.[41] This corporation sold bonds to lenders in return for home mortgages, which it then held or refinanced.[42] The government seeded the HOLC with capital from the Reconstruction Finance Corporation (RFC), the industrial bank set up by Hoover to handle the banking collapse.[43]

The HOLC alone refinanced one tenth of all owner-occupied, nonfarm residences in the United States (ninety-nine percent of eligible occupants applied for loans in Mississippi).[44] It created the long-term amortizing fixed mortgage, which was established at twenty years but eventually lengthened to thirty.[45] The government created the FHA

37. *See* Atif Mian et al., *Resolving Debt Overhang: Political Constraints in the Aftermath of Financial Crises* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 17831, 2012).

38. Laura Bramble, *The Amortization of a Mortgage*, S.F. GATE HOME GUIDES http://homeguides.sfgate.com/amortization-mortgage-2809.html (last visited Apr. 11, 2012).

39. *See id.*

40. *See id.*

41. JACKSON, *supra* note 1, at 195–97.

42. Jonathan D. Rose, *The Incredible HOLC? Mortgage Relief During the Great Depression*, 43 J. MONEY, CREDIT, & BANKING 1073, 1079 (2010).

43. SEC'Y OF THE TREASURY, FINAL REPORT ON THE RECONSTRUCTION FINANCE CORPORATION 1, 16 (1957) [hereinafter TREASURY FINAL REPORT], *available at* http://fraser.stlouisfed.org/docs/publications/rcf/rfc_19590506_finalreport.pdf.

44. JACKSON, *supra* note 1, at 196.

45. *Id.* at 196–97, 204.

in 1934[46] and what would later become Fannie Mae, the RFC-financed Federal National Mortgage Association in 1938.[47] Additionally, the government established national building standards for homes, ratings systems for neighborhoods, a secondary market for mortgages, and a stable federally-insured and professionally-managed Savings and Loan industry.[48]

The HOLC established standards for the refinancing of home mortgages, transforming large lump fixed debts into small affordable monthly payments, and mapped neighborhoods to assess credit risks.[49] The anti-slum, anti-density model of development, pushed by cultural conservatives such as Edward Bok of *Ladies' Home Journal*, influenced how credit was allocated, and led to the spacious auto-dependent suburban tract house.[50] The FHA then took these community standards and used them in its decisions about how to insure mortgages.[51] The Savings and Loan industry adopted FHA standards for credit allocation.[52]

Although Roosevelt was able to restore some normalcy in the housing market after the collapse of 1933, the homeownership rate did not surpass its 1930 level until the next decade.[53] The nascent New Deal housing finance system did not meet its real test until the post-war housing shortages.[54] Millions of servicemen returned home to start families, even as the residential construction industry had been dormant for nearly sixteen years of depression and war.[55] These families had liquid assets from saved military pay and they had been

46. *The Federal Housing Administration* (*FHA*), HUD.GOV http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/fhahistory (last visited Apr. 11, 2012).

47. *See* Kate Pickert, *A Brief History of Fannie Mae and Freddie Mac*, TIME BUS. (July 14, 2008), *available at* http://www.time.com/time/business/article/0,8599,1822766,00.html.

48. *See id.* at 203, 216; *see also* TREASURY FINAL REPORT, *supra* note 43, at 12–13 (discussing the secondary market for mortgages).

49. *See* JACKSON, *supra* note 1, at 196–97.

50. *Id.* at 186.

51. *See id.* at 199–200; *see also* Manuel B. Aalbers, *The Financialization of Home and Mortgage Market Crisis*, 12 COMPETITIVE CHANGE 148, 153–54 (2008), *available at* http://home.staff.uva.nl/m.b.aalbers/bestanden/Aalbers_The%20Financialization%20of%20Home%20and%20the%20Mortgage%20Market%20Crisis.pdf.

52. *See* JACKSON, *supra* note 1, at 204.

53. *See Historical Census of Housing Tables*, U.S. CENSUS BUREAU, http://www.census.gov/hhes/www/housing/census/historic/owner.html (last visited Apr. 11, 2012).

54. *See* JACKSON, *supra* note 1, at 232.

55. *Id.*

promised suburban housing by the government and industry.[56] Household formation was high and remained high for the next two decades, but there were virtually no homes for sale at the war's end.[57] In Chicago, trolley cars were sold as homes; in Omaha there were ads for iceboxes that could be used as housing; in North Dakota, people lived in surplus grain bins.[58]

The Veterans Administration, which guaranteed loans to returning veterans from World War II, met the demand for housing by using FHA guidelines.[59] An enormous construction industry emerged.[60] Almost half of all housing could claim FHA or Veterans Affairs (VA) financing in the 1950s and 1960s.[61] Home purchases after World War II rose dramatically, along the lines laid out by the HOLC and adopted by the FHA and across the industry.[62] First-time homebuyers and veterans had access to government financing, and still do.[63]

FHA standards could well be considered a key part of the "social contract" established by the government on behalf of the home buying public. According to Kenneth Jackson:

> Eight criteria were established (the numbers in parentheses reflect the percentage weight given to each): Relative economic stability (40 percent) Protection from adverse influences (20 percent) Freedom from special hazards (5 percent) Adequacy of civic, social, and commercial centers (5 percent) Adequacy of transportation (10 percent) Sufficiency of utilities and conveniences (5 percent) Level of taxes and special assessments (5 percent) Appeal (10 percent).[64]

In addition, the FHA retained inherited racist biases, with one underwriting guide noting: "If a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same

56. *Id.* at 232–33.

57. *Id.* at 232.

58. *Id.*

59. *See id.* at 204.

60. *See id.* ("Builders went back to work, and housing starts and sales began to accelerate rapidly in 1936. They rose to 332,000 in 1937, to 399,000 in 1938, to 458,000 in 1939, to 530,000 in 1940, and to 619,000 in 1941. This was a startling lift from the 93,000 starts of 1933. After World War II, the numbers became even larger, and by the end of 1972, FHA helped nearly eleven million families to own houses and another twenty-two million families to improve their properties.").

61. *Id.* at 215.

62. *Id.* at 215–16.

63. *See The Federal Housing Administration (FHA)*, *supra* note 44; *Information on the Home Loan Program*, U.S. DEP'T VETERAN AFF., http://www.benefits.va.gov/homeloans/veteran.asp (last visited Apr. 12, 2012).

64. JACKSON, *supra* note 1, at 207.

social and racial classes."[65] Housing did not represent the totality of the New Deal social contract.[66] Efforts to rescue and reconstruct the housing system must be understood as a subset of an overall explicit national industrial policy pursued by the Roosevelt administration to combat the Depression and then fight World War II. For instance, the federal government's Reconstruction Finance Corporation would play a role in capitalizing most important initiatives of the New Deal and World War II, including what would become Fannie Mae, the FHA, housing finance for soldiers, and the business lending marketplace.[67] These efforts must also be understood as reliant on key decisions made in the 1930s to deal with the debt overhang, an abrogation of creditor contract rights. In 1933, Roosevelt broke the link between the dollar and gold, reflating the currency.[68] He also nullified gold-index clauses, which had allowed parties to demand payment in dollars or in gold equivalents of dollars.[69] By removing fixed sums of gold, he unmoored the economy from what Keynes called a "barbarous relic" that arbitrarily increased the burden of debt servicing.[70] Government intervention in the housing market was consistent with a new role for government intermediating between creditors and debtors (including on an international scale in the post-war Bretton Woods system).[71]

Other important elements of this new social contract included labor bargaining power through mass unionization, Social Security, free or low-cost college education for veterans, a national highway system, and eventually Medicare.[72] Americans saw their wages increase, the economy grew rapidly, corporate profits increased, and the financial sector strengthened.[73] Union density increased enormously, until

65. *Id.* at 208.

66. *See* Levy & Temin, *supra* note 30, at 17–18.

67. *See* JONES, *supra* note 35, at 146–52.

68. *See* Peter Temin & Barrie A. Wigmore, *The End of One Big Deflation*, 27 EXPLORATIONS IN ECON. HIST. 483, 488–89 (1990), *available at* http://economics.mit.edu/files/7257.

69. Randall S. Kroszner, Is it Better to Forgive than to Receive? Repudiation of the Gold Indexation Clause in Long-Term Debt During the Great Depression 1 (Oct. 1998) (unpublished manuscript), *available at* http://faculty.chicagobooth.edu/finance/papers/repudiation11.pdf.

70. JOHN MAYNARD KEYNES, MONETARY REFORM 187 (1924).

71. JEFF MADRICK, AGE OF GREED: THE TRIUMPH OF FINANCE AND THE DECLINE OF AMERICA, 1970 TO THE PRESENT 62 (2011).

72. *See* Levy & Temin, *supra* note 30, at 18.

73. *See generally* ALAN BRINKLEY, THE END OF REFORM: NEW DEAL LIBERALISM IN RECESSION AND WAR (1996) (examining the consolidation of this social con-

roughly a third of working Americans belonged to a union.[74] A disproportionately high number of AFL-CIO members owned a home, perhaps a testament to how American domestic unions helped temper radical impulses.[75]

This social contract relied on high and increasing wages and a tolerable amount of labor unrest.[76] From the end of the war to the early 1970s, a high density of unionization and full employment gave labor substantial power to demand its share in economic gains.[77] This was the era of the "Treaty of Detroit," an agreement between the United Auto Workers and automakers to increase wages and benefits steadily over time.[78] There were wage gains in all income brackets.[79]

During this period, American consumers used housing as a mechanism to accumulate wealth, escaping from the rent-extractive behavior of landlords and the predatory lenders that flourished in the 1920s.[80] Housing also served as an anchor for local community growth; public high schools carried legitimacy and educated citizens in a manner that broadly allowed most children to acquire the skills to move into the middle class and some degree of economic security.[81] Property was in many cases the tax basis for local and municipal services, and credit allocation was key to post-war suburban segregation.[82]

In this era, housing would last for a career and equity extraction occurred at retirement. Cheap oil allowed for the growth of car-dependent suburbs, which helped important national industries like automobiles and chemicals.[83] Housing was a proxy for wealth and

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tract in the late 1930s and the 1940s). Arthur M. Schlesinger, Jr.'s, Age of Roosevelt Series provides a reasonably comprehensive overview of the policy disputes and consequences of the political fights of the 1930s and 1940s. ARTHUR M. SCHLESINGER, JR., THE POLITICS OF UPHEAVAL: 1953–1936 (1960); ARTHUR M. SCHLESINGER, JR., THE COMING OF THE NEW DEAL: 1933–1935 (1958); ARTHUR M. SCHLESINGER, JR., THE CRISIS OF THE OLD ORDER: 1919–1933 (1957).

74. GERALD MAYER, CONG. RESEARCH SERV., UNION MEMBERSHIP TRENDS IN THE UNITED STATES 11 fig.1 (2004), *available at* http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1176&context=key_workplace.

75. JACKSON, *supra* note 1, at 7.

76. *See* Levy & Temin, *supra* note 30, at 18.

77. *See id.* at 31.

78. *See id.* at 8.

79. *See id.* at 17.

80. ROBERTO G. QUERCIA ET AL., REGAINING THE DREAM: HOW TO RENEW THE PROMISE OF HOMEOWNERSHIP FOR AMERICA'S WORKING FAMILIES 2–3 (2011).

81. *See* JACKSON, *supra* note 1, at 147.

82. *See id.* at 196–203, 285.

83. *See id.* at 172.

stability, typically located near factories and the value-generating institutions of American power.[84]

During the immediate post-war era, Americans put their savings into regulated savings institutions, which made mortgage and commercial loans.[85] This allowed the Federal Reserve to have a remarkable degree of control over lending and borrowing in the economy, or the "transmission belt" from finance to the real economy.[86] Housing in this era was connected to stable management of the economy by political elites through a highly regulated financial system.[87] The Federal Reserve exercised tight control over the regulated banking system, and thus, to the economy itself.

This was accomplished through a variety of institutional mechanisms. Savings and Loan thrifts were small and community-based, and local officers who knew the community in which they were lending did the credit analysis.[88] National banks were not allowed to branch, and consumer credit was relatively restricted.[89] FDIC insurance covered much of the savings pools, and reserve balances were substantial. In 1951, regulated depository institutions held 65% of financial sector assets and liabilities; the Federal Reserve held 11.3% of all deposits as reserve balances.[90] International capital controls ensured that public domestic institutions controlled the flow of money in the economy, and a dense set of rules prevented the ruinous bank competition over deposits that had fueled the credit creation of the 1920's stock market bubble.[91]

As a result of the narrow channels of money flow, the Federal Reserve's tools worked. Interest rate increases and reserve requirements had a direct impact on the institutions that were lending to real world commercial interests and consumers. When the Federal Re-

84. *See id.* at 50.

85. *See* Jane D'Arista, *Setting an Agenda for Monetary Reform* 11 (Univ. of Mass. Amherst Pol. Econ. Research Inst., Working Paper No. 190, 2009), *available at* http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_151-200/WP190.pdf.

86. *See id.* at 11, 13.

87. *See id.* at 11.

88. *See* OFFICE OF THRIFT SUPERVISION, HISTORICAL FRAMEWORK FOR REGULATION OF ACTIVITIES OF UNITARY SAVINGS AND LOAN, *available at* http://www.ots.treas.gov/_files/48035.html (last visited Mar. 27, 2012).

89. For a good overview of post-war finance, see MADRICK *supra* note 71, at 13–20.

90. D'Arista, *supra* note 85, at 11.

91. MADRICK, *supra* note 71, at 13.

serve wanted to cool the economy, it could scale back bank lending.[92] This would show up first as a slowdown in housing starts.[93] Similarly, when it wanted to boost the economy, it could ease funding costs for homeownership, and housing starts would lead the recovery.[94] The political consensus that homeownership was a useful place to put resources was part of this regulatory mechanism.[95]

In this era, an inflationary boom could be moderated by a tax increase or interest rate hike, and a recession would be followed by a recovery. Every recovery was led by the housing sector, and business investment followed.[96] Regardless of temporary economic conditions, the number of adults was always increasing, and so the number of households was always growing.[97] In recessions, "pent-up demand" for housing would accumulate.[98] When the Federal Reserve lowered interest rates or increased the amount of bank lending, housing starts would jump, followed by business investment.[99] There was consensus that resources could be put into homeownership as a vehicle for economic regulation.[100]

There simply were no significant debates about the wisdom of allocating capital into home-construction as a vehicle for economic regu-

92. *See* Eric S. Rosengren, President & C.E.O., Fed. Reserve Bank of Bos., Remarks at the Economic Outlook Seminar, Stockholm, Sweden: Housing and Economic Recovery 3 (Sept. 28, 2011), *available at* http://www.bostonfed.org/news/speeches/rosengren/2011/092811/092811.pdf (noting that the housing sector is very responsive to monetary policy).

93. *Id.*

94. *Id.*

95. HOMEOWNERSHIP AND ITS BENEFITS, *supra* note 14.

96. *See* Rosengren, *supra* note 92, at 3 ("Historically, an outsized proportion of U.S. economic growth in the first two years of a recovery from a recession is generated by residential investment.").

97. *See The Story of Household Formation Weakness is About Families*, SOBER LOOK (Jan. 16, 2012), http://soberlook.com/2012/01/story-of-household-formation-is-about.html.

98. This is a fairly standard economic narrative, put best by Warren Buffett in his 2012 shareholder letter on how "hormones" eventually lead the country out of a housing crisis by impacting household formation and thus demand for housing stock. Letter from Warren E. Buffet, Chairman of the Board, Berkshire Hathaway Inc., to the Shareholders of Berkshire Hathaway Inc. (Feb. 25, 2012), *available at* http://www.berkshirehathaway.com/letters/2011ltr.pdf.

99. *See Private Investment and the Business Cycle*, CALCULATEDRISK (Dec. 26, 2011, 3:41 PM), http://www.calculatedriskblog.com/2011/12/private-investment-and-business-cycle.html ("This is important to follow because residential investment tends to lead the economy, equipment and software is generally coincident, and nonresidential structure investment lags the business cycle.").

100. *See, e.g.*, HOMEOWNERSHIP AND ITS BENEFITS, *supra* note 14; Rosengren, *supra* note 92.

lation. Contrast this with the enormous political reaction against the Federal Reserve's "quantitative easing" measures, or the "stimulus."[101] There is currently no consensus about how to allocate national resources, but this was not true when housing flourished as the national wealth distributor. Having a non-controversial fulcrum for credit deployment was a key regulatory mechanism for political elites.[102]

Of all the New Deal institutional frameworks, the only one to continue expanding after 1968 was that of the housing finance complex.[103] The alignment of builders, homeowners, Wall Street, and politicians was far stronger than the consensus that underwrote other significant wealth-broadening programs such as Medicare or Social Security.[104]

C. The Reagan Era Social Contract

> The political reconfiguration that broke the back of labor unions provided all the backing the dollar needed as the increased threat of unemployment proved a much more convincing anchor than gold for wealth owners around the world.
>
> *Jane D'Arista and Korkut Erturk*[105]

The highly inflationary environment of the late 1960s and early 1970s profoundly challenged, and ultimately broke, the New Deal social contract. The chaos of the decade that followed eventually molded a new version of that national consensus, solidified during the early part of Ronald Reagan's presidency.

Then-Federal Reserve Governor Paul Volcker could be considered one of the key, if not the most influential, architects of this new con-

101. *See, e.g.*, David Dayen, *Politicizing the Fed: GOP Leaders Warn Bernanke Against Monetary Expansion*, FIREDOGLAKE (Sept. 21, 2011, 6:10 AM), http://news.firedoglake.com/2011/09/21/politicizing-the-fed-gop-leaders-warn-bernanke-against-monetary-expansion.

102. *See, e.g.*, William C. Dudley, Pres. and C.E.O., Fed. Reserve Bank of N.Y., Housing and the Economic Recovery: Remarks at the New Jersey Bankers Association Economic Forum, Iselin, N.J. (Jan. 6, 2012), *available at* http://www.newyorkfed.org/newsevents/speeches/2012/dud120106.html.

103. *See* Thomas Ferguson & Robert Johnson, *Too Big to Bail: The 'Paulson Put,' Presidential Politics, and the Global Financial Meltdown*, 38 INT'L J. POL. ECON. 3, 22 (2009), *available at* http://www.newdeal20.org/wp-content/uploads/2011/07/paulson-put.pdf.

104. *See id.* at 18.

105. *See* Jane D'Arista & Korkut Erturk, *The Monetary Explanation of the Crisis and the Ongoing Threat to the Global Economy*, 53 CHALLENGE 5, 18 (2010), *available at* http://www.challengemagazine.com/extra/005_029.pdf.

tract. No longer would wages, taxes, or regulations increase.[106] In a 1981 speech in Kansas, Volcker explained the changes he sought.[107] First, he derided the economists of the 1950s and 1960s as "social philosopher[s]."[108] That era, he explained, in which economists who sought a "little inflation" to avoid "[s]ocial conflict over the exact size of each group's slice of the national pie . . . . by giving everyone a little extra in nominal income," was over.[109] The Fair Deal era of high and increasing wages was premised, he thought, on a "game of mirrors," and it had crippled productivity growth.[110]

As he put it, "[t]axes are themselves an element in costs, and high tax rates impair incentives . . . . [F]rom the standpoint of economic policy, the best way—and the only realistic way—to reduce the deficit is to cut expenditures . . . ."[111] Moreover, he argued, "further large budget cuts will be required in future years to make room for the tax reductions that we need."[112] In terms of regulatory policies, he made it clear that the consumer and environmental movements had hit their limits: "We simply cannot afford regulatory or other policies that inhibit competition, add unnecessarily to costs or prices, or excessively shelter some groups from economic risks of their own making."[113]

Volcker diagnosed the problem of inflation as tied to increasing wages, using the high wage industry of automakers as his example. The difficulties of that industry were not quality of the product, but "related in a significant degree to wage and cost pressures building over a number of years."[114] And, "[i]f inflation is to be unwound, and our industry is to restore full competitiveness and provide high levels of employment, private behavior in wage bargaining . . . will need to reflect the new realities of the marketplace."[115] Volcker kept interest rates so high that he even angered Reagan White House officials.[116]

106. Paul A. Volcker, Chairman, Fed. Reserve Sys., Address at Kansas State University Alfred M. Landon Lecture Series on Public Issues: Dealing with Inflation: Obstacles and Opportunities (Apr. 15, 1981), *available at* http://fraser.stlouisfed.org/docs/historical/volcker/Volcker_19810415.pdf.

107. *See id.*

108. *Id.* at 3.

109. *Id.*

110. *Id.*

111. *Id.* at 7.

112. *Id.*

113. *Id.* at 8.

114. *Id.* at 10

115. *Id.* at 11.

116. WILLIAM GREIDER, SECRETS OF THE TEMPLE: HOW THE FEDERAL RESERVE RUNS THE COUNTRY 430 (1989).

As Bill Greider noted in *Secrets of the Temple*, Volcker would rebut their excessive optimism on inflation and pull "out his card on union wages" and note that inflation would not come down permanently until labor "got the message and surrendered."[117]

Globalization and labor arbitrage was also on the menu. Volcker said in one speech, "the case for 'free trade' depends not just on abstract propositions of comparative advantage and long-run increases in national income, but on the advantages, here and now, in reinforcing pressures toward price stability."[118] In fact, one 2001 study of Federal Open Market Committee minutes by Charles L. Weise posited that the Fed did not respond to any pressure group except the AFL-CIO, and in that case, the data implied that the "Fed purposely [took] a position opposite to that advocated by the AFL-CIO."[119]

Labor got the message and surrendered. Striking disappeared from the American economic scene after 1980. Volcker's plan for the Federal Reserve was to slam on the brakes, hard. From 1979 onward, interest rates jumped up to nineteen percent. A brutal recession followed in 1981, the longest and deepest in post-war history up to that point.[120] Unions were decimated and did not recover during the recovery period.[121] America fell into recession as a unionized nation and recovered into a non-unionized Wall Street boom. Wages, which had not increased in real terms since 1973, stayed stagnant.[122]

Consumption, however, did not decline.[123] Americans began shifting their financial posture from liquid savers with pensions, savings, and home equity into debtors with 401Ks, credit cards, and second mortgages.[124] Policy became far more creditor friendly, from the 1978

117. *Id.*

118. Volcker, *supra* note 106, at 12.

119. Charles L. Weise, *Private Sector Influences on Monetary Policy in the United States*, 40 J. MONEY, CREDIT, & BANKING 449 (2008), *available at* http://www.gettysburg.edu/academics/economics/char_weisehomepage/completepapertoJMCB11-01.pdf.

120. *See* FERGUSON & ROGERS, *supra* note 24, at 136–37.

121. *See id.* at 137.

122. *See* David Cay Johnston, *Is Our Tax System Helping Us Create Wealth?*, TAX ANALYSTS (Dec. 21, 2009), http://www2.ucsc.edu/whorulesamerica/power/is_our_tax_system_helping_us_create_wealth.pdf ("For most workers, [wages] fell. Wages peaked way back in 1972–1973, were on a mostly flat trajectory for more than two decades, rose briefly in the late 1990s, and then fell sharply in the new century.").

123. *See Personal Consumption Expenditures*, FED. RESERVE BANK OF ST. LOUIS, http://research.stlouisfed.org/fred2/series/PCE (last visited Mar. 30, 2012).

124. *See generally* Robin Stein, *The Ascendancy of the Credit Card Industry*, FRONTLINE (Nov. 23, 2004), http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/rise.html (documenting the drastic rise in credit card spending in the 1980s).

Marquette Supreme Court decision that lifted usury caps to tightened bankruptcy laws enhancing the rights of lenders to financial deregulation allowing the securitization of mortgages and subprime lending.[125]

Unlike the curtailed social programs of the New Deal, the housing finance complex continued to expand in the Reagan era. Fannie Mae, by now a private corporation with a government guarantee, became a political slush fund for the emerging right-wing "New Democrat" consensus.[126] Lower income groups, which had very little influence in an era of declining social spending, easily adopted this new credit-friendly consensus. As an example, the National Community Reinvestment Coalition had as its motto: "Access to credit and capital is a basic civil right."[127] Thus formed a new political machine, with Wall Street pouring money into politics, liberal Democrats and conservative Republicans both seeking the liberalization of lending standards, and funded community groups seeking to bring more credit to under-served communities. The most obvious signpost of housing's import was that in the 1986 Tax Reform Act, the mortgage interest tax deduction was preserved, while the tax deduction for all other kinds of consumer debt was eliminated.[128]

In the 1980s, household financial obligations gradually increased even as interest rates fell. The American consumer was levering up, even by the official statistics.

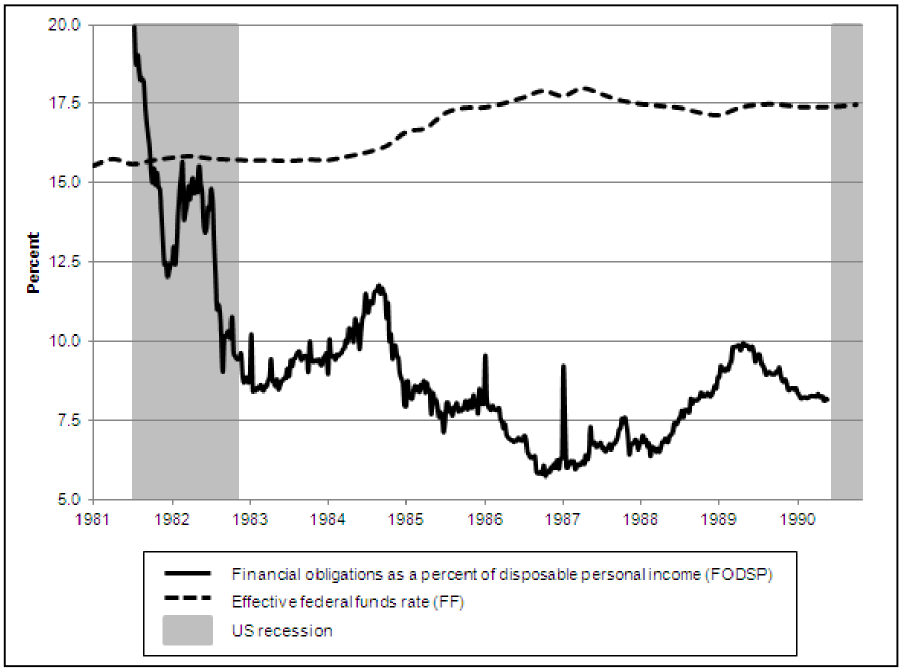
125. Marquette Nat'l Bank of Minneapolis v. First Omaha Serv. Corp., 439 U.S. 299 (1978); Diane Ellis, *The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate*, FDIC DIV. INS. BANK TRENDS (Mar. 1998), http://www.fdic.gov/bank/analytical/bank/bt_9805.html [hereinafter Ellis, *The Effect of Consumer Interest*].

126. *See* Ferguson & Johnson, *supra* note 103, at 4.

127. *Building Healthy Communities: Community Reinvestment Act and the Financial Modernization Movement*, LEADERSHIP CONFERENCE ON CIVIL RIGHTS & LEADERSHIP CONFERENCE EDUCATION FUND 27, http://www.protectcivilrights.org/pdf/reports/healthy_communities/cra_report_chapters.pdf (last visited Apr. 1, 2012).

128. Eric Toder et al., *Reforming the Mortgage Interest Deduction*, TAX POLICY CTR. (Apr. 2010), http://www.taxpolicycenter.org/UploadedPDF/412099-mortgage-deduction-reform.pdf.

Figure 2. Household Financial Obligations as a Percent of Disposable Personal Income; Effective Federal Funds Rate[129]



The transformation of the American polity away from a high trust culture with high savings, productivity sharing between corporations and workers, social and educational programs based on a well-funded tax base, and a housing system supporting this structure was complete by the early 2000s.[130] Financial asset growth replaced wage growth, and falling interest rates allowed for stock market holdings, and then housing, to become a leverage point masking the deterioration in the financial status of the American citizenry.[131]

129. Data obtained with permission from Federal Reserve Bank of St. Louis. *Economic Research*, FED. RESERVE BANK ST. LOUIS, http://research.stlouisfed.org (last visited June 18, 2012).

130. *See generally* Tim Noah, *The United States of Inequality*, SLATE (Sept. 3, 2010, 3:06 PM) http://www.slate.com/articles/news_and_politics/the_great_divergence/features/2010/the_united_states_of_inequality/introducing_the_great_divergence.html; ELIZABETH WARREN & AMELIA WARREN TYAGI, THE TWO-INCOME TRAP 22–32 (2003) (discussing the transformation of the housing market into the playing field for a bidding war for the smaller and smaller pool of homes near good educational systems).

131. *See* Josh Rosner, *Housing in the New Millennium: A Home Without Equity Is Just a Rental with Debt*, GRAHAM FISHER (June 29, 2001), http://www.institutmontaigne.org/medias/documents/06-29-01%20Home%20Without%20Equity%20is%20a

By the 2000s, a primary driver of consumer spending growth was mortgage equity withdrawals, which supplied up to nine percent of disposable income.[132] American women went to work.[133] Then Americans drew down their savings and took out credit cards.[134] Finally, they liquidated their financial assets, including their home equity.[135]

In this system, a homeowner still received a home in which to live, which was also a savings vehicle.[136] But there was a significant difference in terms of what a family received. Unlike the home equity model of the high trust era, the equity in the home was liquid.[137] A homeowner could withdraw his equity not after a thirty-year career, but at any point.[138] He could also withdraw equity based on excessive housing appreciation inconsistent with economic fundamentals, transforming wealth accumulation from a steady progressive widening of the fruits of the economy into a lottery ticket. Schooling costs were still linked to property tax values, but the growth of private schools in the 1970s began to undercut the perceived value of a public school system.[139] Homeowners had more options for schooling their children with less of a common obligation to ensure that common infrastructure fulfilled its goal.

In the arena of political representation, the social contract also shifted. A homeowner could vote, but with far more money in politics, politicians were increasingly responsive to the needs of upper in-

%20Rental%20.pdf (discussing structural changes in the housing market to mask poor underwriting standards); *see also* Johnston, *supra* note 122 (discussing financial weakness in the form of stagnating and then declining wages).

132. Alan Greenspan & James Kennedy, *Sources and Uses of Equity Extracted from Homes* 45 (Fed. Reserve Bd. Div. of Research & Statistics & Monetary Affairs, Fin. & Econ. Discussion Series, Working Paper No. 2007-20, 2007), *available at* http://www.federalreserve.gov/pubs/feds/2007/200720/200720pap.pdf.

133. *See, e.g.*, Robert Reich, *The Truth About the American Economy*, ROBERT REICH (May 30, 2011), http://robertreich.org/post/5993482080.

134. *See, e.g.*, Daryl G. Jones, *Personal Savings Rate: Worse than We Thought*, CNN MONEY (June 30, 2010), http://money.cnn.com/2010/06/30/news/economy/personal_savings_decline.fortune/index.htm; Stein, *supra* note 122.

135. Robert Reich, *The Most Important Speech of His Presidency*, ROBERT REICH (Dec. 6, 2011), http://robertreich.org/post/13852130536.

136. GRETCHEN MORGENSON & JOSH ROSNER, RECKLESS ENDANGERMENT: HOW OUTSIZED AMBITION, GREED, AND CORRUPTION LED TO ECONOMIC ARMAGEDDON 222 (2011).

137. *Id.*

138. *Id.* at 223.

139. WARREN & TYAGI, *supra* note 130, at 22–28.

come donors.[140] The collapse of unions as a political force accelerated the lack of political representation in the economy for most middle-income homeowners.[141] Pensions declined in importance, and military service waned in the face of a volunteer armed service.[142] Homeowners no longer banked with a reliable institution, but they did receive far more credit in the form of home equity lines, student loans, and credit cards.[143] In return for all of this, a homeowner paid taxes and obeyed the law. Cultural bonds frayed, and society became more litigious.[144] Societal norms were enforced through a coercive frame. Bankruptcy laws tightened, the prison system expanded dramatically, and employment became tied to metrics such as credit reporting scores.[145]

The banking system changed as well. The Savings and Loan industry crafted by the New Deal era fell apart under high interest rates, money market funds, and deregulation.[146] Mortgage financing moved to securitization, the shadow banking sector, and nonbank originators of home mortgages.[147] The fundamental change in the banking system was that control of credit creation passed from public to private entities. As Jane D'Arista notes: "By year-end 2001 . . . reserve balances had shrunk to 0.2 percent of deposits and banks' share of total

140. LARRY BARTELS, UNEQUAL DEMOCRACY: THE POLITICAL ECONOMY OF THE NEW GILDED AGE 252–65 (2010).

141. *See* FERGUSON & ROGERS, *supra* note 24 (discussing the political consequence of the early 1980s collapse of organized labor density in the workforce and its impact on the 1984 Presidential election).

142. U.S. CENSUS BUREAU, CENSUS ATLAS OF THE UNITED STATES: MILITARY SERVICE 198 (2007), *available at* http://www.census.gov/population/www/cen2000/censusatlas/pdf/12_Military-Service.pdf.

143. Revolving credit jumped 18-fold between 1980 and 2006, from roughly $50 billion in 1980 to roughly $900 billion in 2006. *Historical Data: Consumer Credit Outstanding*, BD. GOVERNORS FED. RESERVE, http://www.federalreserve.gov/releases/g19/HIST/cc_hist_r.html (last visited Mar. 7, 2012).

144. *See generally* ROBERT PUTNAM, BOWLING ALONE: THE COLLAPSE AND REVIVAL OF AMERICAN COMMUNITY 146–47 (2001) (attributing the sudden reliance on lawyers and formal institutions at the end of the twentieth century, in part, to growth in the number of legal professionals and "preventive lawyering").

145. For information on bankruptcy law changes and their impacts, see Ellis, *The Effect of Consumer Interest*, *supra* note 125. For prison statistics, see MICHELLE ALEXANDER, THE NEW JIM CROW: MASS INCARCERATION IN THE AGE OF COLORBLINDNESS 218–19 (2010).

146. Timothy Curry & Lynn Shibut, *The Cost of the Savings & Loans Crisis: Truth and Consequences*, 13 FDIC BANKING REV. 26, 26 (2000), *available at* http://fcx.fdic.gov/bank/analytical/banking/2000dec/brv13n2_2.pdf ("From January 1, 1986, through year-end 1995, the number of federally insured thrift institutions in the United States declined from 3,234 to 1,645, or by approximately 50 percent.").

147. MADRICK, *supra* note 71, at 351–70.

financial assets and liabilities had fallen to less than half that of the 1950s."[148] This meant that interest rate moves became ineffective, allowing private banks to innovate around the sclerotic central bank.

Longer, slower recoveries were the result of a breakdown in monetary tools. The political consensus underlying this economic order is a support of a shadow banking system controlled by large banks.[149]

D. The Twenty-First Century Housing Collapse

The Reagan paradigm of credit growth substituted for wage growth eventually ran out of space. Economist Thomas Palley noted that debt-fueled growth presented policy-makers with a paradox:

> America's economic contradictions are part of a new business cycle that has emerged since 1980. The business cycles of Presidents Ronald Reagan, George H.W. Bush, Bill Clinton, and George W. Bush share strong similarities and are different from pre-1980 cycles. The similarities are large trade deficits, manufacturing job loss, asset price inflation, rising debt-to-income ratios, and detachment of wages from productivity growth. The new cycle rests on financial booms and cheap imports. Financial booms provide collateral that supports debt-financed spending. Borrowing is also supported by an easing of credit standards and new financial products that increase leverage and widen the range of assets that can be borrowed against. Cheap imports ameliorate the effects of wage stagnation.[150]

While the housing boom led to growth in construction, much of the financing activity by the late 2000s financed second homes, investment properties, and mortgage equity withdrawals.[151] By 2006, financial services industry participants had created a product, the synthetic collateralized debt obligation (CDO), that allowed the trading of housing finance paper without the housing.[152] Traders could effec-

148. D'Arista, *supra* note 85, at 11.

149. Simon Johnson, *The Quiet Coup*, ATLANTIC (May 2009), http://www.theatlantic.com/magazine/archive/2009/05/the-quiet-coup/7364.

150. Thomas I. Palley, *The Debt Delusion*, PROJECT SYNDICATE (Feb. 8, 2008), http://www.project-syndicate.org/commentary/the-debt-delusion.

151. Andrew Haughwout et al., Real Estate Investors, the Leverage Cycle, and the Housing Market Crisis 32 (Federal Reserve Bank of N.Y. Staff Report No. 514, Sept. 2011), *available at* http://www.newyorkfed.org/research/staff_reports/sr514.pdf; *Q3 2011: Mortgage Equity Withdrawal Strongly Negative*, CALCULATEDRISK (Dec. 19, 2011, 12:59 PM), http://www.calculatedriskblog.com/2011/12/q3-2011-mortgage-equity-withdrawal.html. For a discussion of increasing leverage due to second mortgages, see MORGENSON & ROSNER, *supra*, note 136, at 219–37.

152. *See* BETHANY MCLEAN & JOE NOCERA, ALL THE DEVILS ARE HERE: THE HIDDEN HISTORY OF THE FINANCIAL CRISIS 78–79 (2010).

tively bet on the same house an infinite number of times. The securitization chain was driven by the logic of speed, routinely violating local property record-keeping requirements and pooling and servicing agreements that secured collateral.[153] Wall Street banks were misrepresenting the quality of loans, lending to people who could not pay it back, and propping up industries whose model was regulatory arbitrage: credit default swaps, private mortgage insurance, and credit ratings agencies.[154]

The system collapsed, and roughly six trillion dollars left homeowners' balance sheets.[155] The Obama administration implemented a strategy of rescuing the financial sector while also pursuing policies to help the homeowner that would not conflict with the interests of the financial sector. These included extending the first time homebuyer tax credit, nationalizing Fannie and Freddie and engaging in unprecedented Federal Reserve intervention in the secondary mortgage market,[156] backstopping nearly one-hundred percent of the mortgage market,[157] extending credit from the Federal Home Loan bank system,[158] and promising seventy-five billion dollars in assistance through the Home Affordable Modification Program (HAMP).[159]

Corporate profits responded, but homeowner equity did not. The Wall Street-builder-homeowner coalition was broken.

153. FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 6–10 (2010), *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

154. *Id.* at xxii, xxiv–xxv, 212, 225.

155. *Flow of Funds Accounts of the United States: Flows and Outstandings, Fourth Quarter 2011*, BD. GOVERNORS FED. RESERVE SYSTEM 106 (Mar. 8, 2012), *available at* http://www.federalreserve.gov/releases/z1/current/z1.pdf.

156. *See* Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).

157. Nick Timiraos, *U.S. Role in Mortgage Market Grows Even Larger*, WALL ST. J. (Apr. 30, 2010, 7:46 PM), http://online.wsj.com/article/SB10001424052748704093204575216530213580458.html ("Government-related entities backed 96.5% of all home loans during the first quarter, up from 90% in 2009, according to Inside Mortgage Finance. The increase was driven by a jump in the share of loans backed by Fannie Mae and Freddie Mac, the government-owned housing-finance giants.").

158. *See generally* Ferguson & Johnson, *supra* note 103.

159. *See* Stoller, *supra* note 21.

II. REASSESSING THE HOUSING MARKET: THE COMING OF A NEW SOCIAL CONTRACT

A. The Failed Policy Response

It is far easier to understand the roots of the current policy morass in this context. The neoliberal policy framework has deep political strength, as its political funding and power is supplied and organized by large sell-side banks. As long as there was alignment between these banks and the voting home-owning public—alignment supplied by increasing leverage in both spheres—there was equilibrium. Whatever else is true about the beliefs of elite actors in both parties, they *believe* in this alignment.[160]

The obvious precedent of the 1933 FDR-style break with the creditor relationships of the previous decade was considered and discarded. In a little-noticed interview in 2010, Obama criticized Roosevelt's sharp discontinuity with Hoover's policy framework, calling the political architect of the New Deal "irresponsible" for handling the bank runs of the 1930s with a restructuring over a bank holiday (which Obama did *not* do when faced with a similar bank run in the money markets).[161] Obama then reflected on the failure of his administration's HAMP program, noting sadly, "this is a multitrillion-dollar problem . . . . [W]e've got only so much gravel and we've got a really big pothole."[162] Senior Obama advisor Jared Bernstein noted that even at the height of the recession there was no appetite for public works-style programs to create jobs in the administration.[163] Finally, Obama retained a key contingent of the Bush economic team—Bernanke and Geithner were both key architects of the bailouts.[164]

160. *See* Theresa Tedesco, *The Great Solvent North*, N.Y. TIMES, Feb. 27, 2009, at A23. This is inferred from recent adulation of political and economic elites lavish on the Canadian banking system, which is composed of a small number of extremely large banks.

161. *Roundtable Interview of the President with Bloggers*, ESCHATON BLOG (Oct. 27, 2010), http://www.eschatonblog.com/2010/10/my-day.html.

162. *Id.*

163. Jared Bernstein, *Shoulds Versus Coulds*, ON THE ECONOMY: FACTS, THOUGHTS, & COMMENTARY BY JARED BERNSTEIN (May 30, 2011), http://jaredbernsteinblog.com/shoulds-versus-coulds.

164. *See* Ferguson & Johnson, *supra* note 103, at 4.

Even Neil Kashkari,[165] Troubled Assets Relief Program (TARP) Chief under Bush, continued under Obama.[166]

President Obama has also spoken fondly of the status quo of existing megabanks, praising the leaders of both JP Morgan and Goldman Sachs, justifying the reach of these institutions by appealing to the example of the Canadian system of concentrated financial systems.[167] Larry Summers, Obama's Chief Economic advisor in 2010, claimed that smaller institutions are far more destabilizing than large institutions.[168] Throughout the Reagan, Bush, Clinton, Bush, and Obama administrations, there developed a consensus towards universal megabanking and private credit control. This consensus is embedded in the large regulatory banking agencies, Congress, implicitly in the economics profession, and indeed, in the Obama White House.

Various administration officials, such as Larry Summers and Jared Bernstein, have argued that the Obama administration's policy response to the foreclosure situation would be far better but for political constraints.[169] Bernstein noted that a "serious program of mortgage modifications" would provoke a fierce political reaction.[170] But forcing mortgage modifications would not have provoked such a political reaction in late 2008 when the financial system was on its deathbed. Congressional Democrats proposed including bankruptcy modification provisions in the $700 billion TARP to allow those in bankruptcy to renegotiate their mortgages.[171] Then-Senator Obama whipped his own party in 2008 to support the TARP bill without such a provision (though the bill did include liquid coal and solar subsi-

165. *See* Heidi N. Moore, *Meet Ned Kashkari: The Man with the $700 Billion Wallet*, WALL ST. J. (Oct. 6, 2008, 11:45 AM), http://blogs.wsj.com/deals/2008/10/06/meet-neel-kashkari-the-man-with-the-700-billion-wallet.

166. Heidi N. Moore, *Will Obama Pick a New $700 Billion Man? Not Yet*, WALL ST. J. (Feb. 25, 2009, 11:41 AM), http://blogs.wsj.com/deals/2009/02/25/neel-kashkari-treasurys-700-billion-man-still-employed.

167. *See* David Leonhardt, *After the Great Recession*, N.Y. TIMES MAGAZINE (Apr. 28, 2009), http://www.nytimes.com/2009/05/03/magazine/03Obama-t.html?partner=rss&emc=rss&pagewanted=all.

168. Shahien Nasiripour, *Larry Summers Defends Megabanks, Says Too Many Small Banks Make U.S. 'Less Stable'*, HUFFINGTON POST (June 23, 2010, 6:12 AM), http://www.huffingtonpost.com/2010/04/23/larry-summers-defends-meg_n_549574.html.

169. *See* Bernstein, *supra* note 163; E. Scott Reckard & Peter Hong, *Banks Slow to Modify Mortgages, Treasury Reports*, L.A. TIMES (Aug. 5, 2009), http://articles.latimes.com/2009/aug/05/business/fi-loans5.

170. Bernstein, *supra* note 163.

171. Edmund L. Andrews, *Housing Experts Say Ballot Proposal May Do Little for Homeowners*, N.Y. TIMES, Sept. 22, 2008, at A22.

dies).[172] In fact, he committed to passing a "cramdown" provision in order to secure the vote of Congresswoman Donna Edwards, but reneged on the deal.[173] Obama then later refused to put the cramdown provision in the stimulus and watched passively as the Democratic Senate caucus decided that the bill could not pass.[174]

During the first era of homeownership—from the New Deal to roughly the 1970s—housing was correlated with income growth. In the Reagan era, neoliberals in both parties substituted debt and asset inflation of housing for wage growth; as long as asset prices remained high, the housing coalition could be sustained. The housing crisis has ended the political unity behind the homeownership coalition, separating the interests of Wall Street from the construction industry and the public at large.

The Obama administration is operating as if there is still a political alignment between homeowners and finance. Thus, Obama's strategy, while supporting the banking system, seems weak and unable to deliver tangible benefits for homeowners. But rescuing the banking system and inflating asset values, while it delivered financial benefits to a broad base in earlier periods, no longer works to deliver anything to the public at large. The Reagan-era model of piling debt on consumers has reached its endpoint.

The foreclosure crisis is the area where this strategy is most obviously falling short and creating a legacy of wealth destruction. The economics of a foreclosure are well known, so from an efficiency standpoint, the policies of the Obama administration make no sense. Every foreclosure is costly to the homeowner, the community, and the lender. A locality loses roughly $30,000 in lost tax revenue and vacant property costs, the homeowner loses his or her home, the value of the home drops substantially, and houses in the community decline in value.[175] Foreclosures reduce fixed residential investment, which is already at a post-World War II record low percentage of

172. *See* Michael Cooper & Jeff Zeleny, *Both Obama and McCain Make Push for Bailout*, N.Y. TIMES, Sept. 30, 2008, at A24.

173. *See* David Dayen, *Pro Publica Advances Narrative on How Obama Killed Cramdown,* FDL NEWS DESK (Feb. 4, 2011), http://news.firedoglake.com/2011/02/04/pro-publica-advances-narrative-on-how-obama-killed-cramdown; Matt Stoller, *Donna Edwards and Her Concession from Obama on Bankruptcy*, OPEN LEFT (Oct. 3, 2008, 5:26 PM), http://openleft.com/diary/8815.

174. *See* Cyra Master, *Dems Agree 'Cram Down' Bill Will Not Be in Stimulus*, ATLANTIC (Jan. 26, 2009), http://www.theatlantic.com/business/archive/2009/01/dems-agree-cram-down-bill-will-not-be-in-stimulus/132.

175. Mike Konczal, *The Cost of a Foreclosure*, RORTYBOMB (Feb. 1, 2010), http://rortybomb.wordpress.com/2010/02/01/the-cost-of-a-foreclosure.

GDP, and they reduce auto sales.[176] This increases unemployment, accelerated deflationary housing trends, and causes political problems for an administration whose electoral weakness is clearly the economy. Moreover, the housing crisis is confiscating the largest store of broad-based wealth held by American families. Home equity has dropped to 38.6% of the value of homeowner held real estate, the lowest percentage since the 1920s.[177] Seven trillion dollars is gone from household balance sheets.[178]

This path of negligence is happening despite options to intervene. There are clear examples of how to handle too much debt so as to restore healthy credit relationships. There are also legal tools. The conservatorship of Fannie Mae and Freddie Mac offer enormous latitude for action for loans backed by government sponsored enterprises.[179] Even in the private mortgage-backed security market, significant legal problems with foreclosure paperwork done through securitization and the resulting widespread fraud suggest that the range of action is not constrained by Congressional pressure.[180] The administration and both houses of Congress have made consistent sets of choices to create an atmosphere conducive to foreclosures.[181]

Moral hazard is also a poor explanation for elite policy choices. Clearly, both the Bush and Obama administrations have been willing to offer financing and subsidies to large financial institutions.[182] Un-

176. Atif Mian et al., *Foreclosures, House Prices, and the Real Economy* 35 tbl.1, 36 tbl.2 (Nat'l Bureau of Econ. Research, Working Paper No. 16685, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1722195.

177. *Q2 Flow of Funds: Household Real Estate Assets Off $6.6 Trillion from Peak*, CALCULATEDRISK, (Sept. 16, 2011, 2:00 PM), http://www.calculatedriskblog.com/2011/09/q2-flow-of-funds-household-real-estate.html.

178. Carrie Bay, *Foreclosure Woes to Plague Industry for at Least Five Years: Survey*, DSNEWS.COM (Oct. 3, 2011), http://www.dsnews.com/articles/foreclosure-woes-to-plague-industry-for-at-least-five-years-survey-2011-10-03 ("Data from the Federal Reserve shows that between 2005 and mid-2011, Americans lost $7 trillion in home equity.").

179. David Dayen, *Warren: FHFA Must Help with Principal Write-Downs*, FDL NEWS DESK (Feb. 9, 2012, 8:55 AM), http://news.firedoglake.com/2012/02/08/warren-fhfa-must-help-with-principal-write-downs.

180. *See* Complaint, United States v. Bank of America, (D.D.C. Mar. 14, 2012) 1:12-cv-00361-RMC, *available at* https://d9klfgibkcquc.cloudfront.net/Complaint_Corrected_2012-03-14.pdf.

181. Stoller, *supra* note 173.

182. *See* DEAN BAKER & TRAVIS MCARTHUR, CENTER FOR ECONOMIC AND POLICY RESEARCH, THE VALUE OF THE "TOO BIG TO FAIL" BIG BANK SUBSIDY (Sept. 2009), *available at* http://www.cepr.net/documents/publications/too-big-to-fail-2009-09.pdf; *see also* Cooper & Zeleny, *supra* note 172; Ferguson & Johnson, *supra* note 103.

popularity does not work as an explanation either. At first, subsidies to the financial sector took the form of "shadow bailouts," but increasingly the bailouts became explicit through the Federal Reserve and finally through the Congressional appropriations procedure.[183] These were extremely unpopular measures, and remain so.[184] Yet neither administration attempted to address problematic political blowback from these measures, such as clawing back outrageous AIG bonuses[185] or purchasing equity from the banks at levels equivalent to private investors such as Warren Buffett.[186]

A better explanation is that the Bush administration, and then the Obama administration, relied on a functional New Deal era housing system around which to orient both their economic and political strategies. This system no longer exists, and there is as of yet no replacement.

B. Why Housing Cannot "Recover"

The financial, housing, and foreclosure crises have snapped the spine of an implicit American national strategy, one that tightly linked homeownership, political citizenship, and elite management of the economy. The implication of this thesis is that the policy goal of "a recovery" of the housing market, or a simple mitigation of foreclosure problems, overlooks the deeper structural problems implicit in our national industrial policy. Indeed, the reason the massive monetary and fiscal government interventions in the economy have failed to generate a robust recovery is because of a lack of consensus of what that recovery is supposed to do and how to restructure the credit creation system.

Attempts to recreate prior solutions to our current policy dilemmas run up against a fundamental structural problem—the lack of an institutional apparatus to build a sustainable credit model based on shared prosperity. We see this most obviously in the transfer of banking power from public institutions to private globe-spanning banks, but it is not what exists that is most problematic, it is what does not. The Obama administration and its allies in the Federal Reserve and

183. Ferguson & Johnson, *supra* note 103, at 24.

184. *See id.* at 7.

185. *See AIG Bonuses in 2010 Total $100 Million*, HUFFINGTON POST (Feb. 10, 2010, 11:20 PM), http://www.huffingtonpost.com/2010/02/03/aig-bonuses-in-2010-total_n_447025.html.

186. Barry Ritholtz, *Bungling the Bank Bailout*, BIG PICTURE (Jan. 10, 2009, 11:30 AM), http://www.ritholtz.com/blog/2009/01/bungling-the-bank-bailout.

various regulatory agencies have pursued an aggressive strategy to restore the prior credit creation system, but the housing crash has caused such a strategy to deliver significant benefits to the economic elites and no one else, as there is no mechanism to deliver broadly shared gains.[187] Political instability is the result.

The current intellectual and policy consensus is to attempt to reconstruct a particular social order: the Reagan-era social contract in which the democratization of credit and the widening of financial asset ownership across the broad base of the population offset male wage stagnation.[188] This strategy avoided labor conflict by breaking unions while substituting debt for wage gains. Housing was one significant leverage point of the system. Innovations in housing finance drove much Wall Street activity and profits from 1980 onward, and gains in housing values represented the primary source of economic gain for most Americans during this time.[189] During the recession of the early 2000s, residential fixed investment prevented a deep recession.[190] By 2001, housing, though it had always led economic recoveries, had become the national regulator of economic activity, aligning elites who wanted to avoid a recession, homeowners, builders, and financial market players.[191] Mortgage equity withdrawals actually drove some part of consumer spending.[192]

Throughout this time period, the interests of elites and the public, through housing, had a degree of unity. While this system concentrated financial gains among elites, gains were real enough in the population at large to sustain political legitimacy. Implicit in this strategy is that private actors play a dominant role in the management of the credit creation process, and that the state's power to serve as a check on these interests recedes. New Deal era restrictions on finance were deregulated both domestically and internationally, but housing was broadly available and wealth creation happened among

187. *See generally* Dudley, *supra* note 102.

188. *See* discussion *infra* Part II.C.

189. *See* Jonathan McCarthy & Charles Steindel, Housing Activity and Consumer Spending 2 (Apr. 2007) (unpublished manuscript), *available at* http://nyfedeconomists.org/mccarthy/Housing_Activity_and_Consumer_Spending.pdf.

190. *See id.* ("Although the recent growth rate of residential investment has not been unusual, the level of housing market activity has been extraordinary. This reflects the fact that the recent expansion of residential investment has occurred without a significant bust preceding it.")

191. *See* Paul Krugman, *Dubya's Double Dip?*, N.Y. TIMES (Aug. 2, 2002), http://www.nytimes.com/2002/08/02/opinion/dubya-s-double-dip.html.

192. Brian Blackstone, *Greenspan Sees Spending Link to Home Equity*, WALL ST. J. (Apr. 24, 2007), http://online.wsj.com/article/SB117734315504079111.html.

the voting public at large, as well as among financial elites. This is the coalition that Bush, and then Obama, sought to rebuild. It is the coalition that President Bill Clinton used to sustain economic growth during his presidency. There is too much debt piled on the American consumer, however, to allow debt-fueled aggregate demand expansion, and re-mediating the foreclosure situation would require a radical shift in philosophy. It would require acknowledging that the state can and should serve as a check on private financial interests. Instead of stopping foreclosures, the Obama administration has acceded to the wishes of a financial system that no longer offers anything to ordinary Americans. It has even gone as far as subordinating the system of laws governing credit relationships to preserve the existing privately mediated credit system.[193]

The problem is thus twofold. It is critical to build a political and intellectual apparatus with the capacity to break with existing creditor relationships, as the Roosevelt administration did (and as has been done before, during the Latin American debt crisis using "Brady bonds" to deal with a debtor cartel, and during the Swedish banking crisis of the early 1990s).[194] It is also necessary to figure out how the twenty-first century American polity will distribute wealth. How does one construct new institutions based on modern technical and cultural capabilities and as well as pressing resource constraints? The suburban model of regimented schooling, television as the key information distributor, and cheap oil as the main energy source must be replaced with something else.

C. The Coming Breakdown

> [W]here conformity to a society's institutions is secured primarily through governmental coercion or privately deployed sanctions, the resource costs may be substantial. Examples include some authoritarian political systems, colonial regimes, and as we will see, highly unequal capitalist economies.
>
> *Samuel Bowles and Arjun Jayadev, 2005, "Guard Labor"*[195]

193. *See* YVES SMITH, ECONNED: HOW UNENLIGHTENED SELF INTEREST UNDERMINED DEMOCRACY AND CORRUPTED CAPITALISM 270–305 (2010).

194. *See* Michael Gavin & Ricardo Hausmann, *The Roots of Banking Crises: The Macroeconomic Context* 9–10 (Inter-Am. Dev. Bank, Office of the Chief Economist, Working Paper No. 318, 1998), *available at* http://www.hks.harvard.edu/fs/rhausma/WP/pubWP-318.pdf.

195. Samuel Bowles & Arjun Jayadev, *Guard Labor: An Essay in Honor of Pranab Bardhan* 7 (Univ. Mass. Amherst Political Econ. Research Inst., Working Paper No.

Fundamentally, the mortgage crisis has revealed that housing is no longer a proxy for wealth. Debt is not increasing, and neither are wages. Housing is no longer a savings vehicle, since assets are dropping and not increasing in value. And the thirty-year fixed mortgage may no longer make sense as a product. Careers are unstable,[196] and oil is no longer cheap.[197] States and localities will need to find sources of financing other than property values.

The Reagan era social contract—stagnant wages with higher credit availability—is on the verge of ending. Rather than wage stagnation, Americans face wage cuts. The average American was forty-five percent poorer in 2009 than in 2007, with median income having fallen roughly ten percent over that time.[198] Debt loads have come down slightly but are still quite high.[199] And housing is frozen, no longer a driver of growth, social stability, and monetary control.[200] Housing was first de-linked from wealth during the Reagan era, but it was still associated with global willingness to supply credit (and oil) to American consumers. Now there is no way to measure American wealth, no monetary proxy. Instead, creditors are rationally attempting to liquidate anything of value, whether that be housing, public infrastructure, or mineral wealth.[201]

90, 2004), *available at* http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_51-100/WP90.pdf.

196. *See* Phyllis Korkki, *The Shifting Definition of Worker Loyalty*, N.Y. TIMES, Apr. 23, 2011, at B08.

197. *See Oil Price History and Analysis*, WTRG ECONOMICS, http://www.wtrg.com/prices.htm (last visited Apr. 12, 2012).

198. Jesse Bricker et al., *Surveying the Aftermath of the Storm: Changes in Family Finances from 2007 to 2009* 25 (Fed. Reserve Bd. Fin. and Econ. Discussion Series, Working Paper No. 2011-17, 2011), *available at* http://www.federalreserve.gov/pubs/feds/2011/201117/201117pap.pdf.

199. *See generally* Charles Roxburgh et. al., *Debt and Deleveraging: Uneven Progress on the Path to Growth*, MCKINSEY GLOBAL INST. (Jan. 2012), *available at* http://www.mckinsey.com/Insights/MGI/Research/Financial_Markets/Uneven_progress_on_the_path_to_growth ("Debt in the financial sector relative to GDP has fallen back to levels last seen in 2000, before the credit bubble. US households have reduced their debt relative to disposable income by 15 percentage points, more than in any other country.").

200. *See, e.g.*, Dudley, *supra* note 102.

201. *See* Jeff McMahon, *Fracking Gas Is Writing America's Energy Policy*, FORBES (Mar. 29, 2012), http://www.forbes.com/sites/jeffmcmahon/2012/03/29/fracking-gas-is-writing-americas-energy-policy; Dylan Ratigan, *America for Sale: Is Goldman Sachs Buying Your City?*, HUFFINGTON POST (June 15, 2011), http://www.huffingtonpost.com/dylan-ratigan/america-for-sale-is-goldm_b_877285.html.

This lack of consensus among elites is often taken for an increase in divisiveness. Elites are currently panicking and bemoaning a "lack of bipartisanship" in making political decisions.[202] Yet the bipartisanship for which they nostalgically yearn is actually a reflection of the underlying economic logic and profitability of the New Deal era and the later securitization financial models. Higher wages kept an egalitarian social contract in place, then higher debts with stagnant wages kept a more unequal social contract in place.[203] But there is no model social contract for deflation in the main asset class held by the broadest number of Americans combined with stagnant or even declining real wages.

Reconstructing a stable social contract in a period of chaos is an ugly process and often comes only after a war or some sort of systemic collapse.[204] Ideally, successful political and intellectual organizing can align enough elite economic actors with the public interest so as to preclude catastrophic damage. So far, this does not appear to be happening.

Alongside policy paralysis is an increasingly bitter series of conflicts within and outside the formal political system. The state is substituting authoritarian technologies, techniques, and legal tools for traditional mechanisms for mediating conflict, namely social spending through the private or public sectors.[205] And the public is increasingly embittered. Labor protests in Wisconsin (matched in several other Midwestern states) were historically large and paralleled the *Citizens United* Supreme Court decision formalizing corporate control over the political system.[206] Occupy Wall Street protests have expanded

202. Consider the formation of groups such as Unity 08, No Labels and Americans Elect, multi-million dollar entities dedicated to ending partisan rancor.

203. The most obvious indication of Reagan's creation of a social contract was Barack Obama's laudatory comments towards Reagan for generating a new kind of transformative politics. *See* Jonathan Weiler, *President Obama, Ronald Regan, and Our Fraying Social Contract*, HUFFINGTON POST (June 22, 2010), http://www.huffingtonpost.com/jonathan-weiler/president-obama-ronald-re_b_620061.html.

204. Both the Treaty of Versailles and the Bretton Woods Conference reorganized the global monetary order and emerged after World Wars. FDR implemented much of the New Deal legislation in the first hundred days during a banking crisis. *See* ROBERT CARO, MASTER OF THE SENATE: THE YEARS OF LYNDON JOHNSON (2002). The strategy to implement the Great Society was crafted immediately after JFK's assassination. *See generally* NAOMI KLEIN, THE SHOCK DOCTRINE: RISE OF DISASTER CAPITALISM (2007).

205. Bowles & Jayadev, *supra* note 195, at 7.

206. Citizens United v. Fed. Election Comm'n, 130 S. Ct. 376 (2010); *see, e.g.*, Robert Barnes, *Two Justices Suggest* Citizens United *Ruling Should Be Reconsidered in Montana Case*, WASH. POST (Feb. 17, 2012), http://www.washingtonpost.com/

this unrest nationally.[207] Higher labor unrest matches higher levels of government and private corporate surveillance by local officials.[208] New laws criminalizing the videotaping of police officers in public places (subsequently ruled unconstitutional),[209] the increasing scope of the national security state,[210] a reconstitution of debtor's prisons, aggressive and innovative debt collection techniques,[211] tax farming by private actors,[212] and the use of credit reporting for employment and national security clearance purposes[213] are constructing the scaffolding for a creditor-dominated state.

Attempts to restructure credit relationships through the political process are being met with explicit restrictions on voting rights. The second iteration of the Tea Party movement was sparked by a speech from financial commentator Rick Santelli on CNBC complaining

politics/two-justices-suggest-citizens-united-ruling-should-be-reconsidered-in-montana-case/2012/02/17/gIQAJ07kKR_story.html (discussing corruption and corporate control over the democratic process since the *Citizens United* decision); James Kelleher & David Bailey, *Largest Crowds Since Vietnam War March in Wisconsin*, REUTERS (Feb. 16, 2011), *available at* http://www.reuters.com/article/2011/02/26/us-wisconsin-protests-idUSTRE71O4F420110226.

207. *See, e.g.*, Justin Elliott, *Occupy Wall Street: A Historical Perspective*, SALON (Oct. 8, 2011), http://www.salon.com/2011/10/08/occupy_wall_street_a_historical_perspective.

208. *See* Bernard Harcourt, *Outlawing Dissent: Rahm Emanuel's New Regime*, GUARDIAN (Jan. 19, 2012), http://www.guardian.co.uk/commentisfree/cifamerica/2012/jan/19/outlawing-dissent-rahm-emanuel-new-regime.

209. *Judge Rules Against State's Ban on Recording Police Officers*, CBS CHICAGO (Mar. 2, 2012) http://chicago.cbslocal.com/2012/03/02/judge-rules-against-states-ban-on-recording-police-officers.

210. *See generally Top Secret America*, WASH. POST, http://projects.washingtonpost.com/top-secret-america (last visited Apr. 16, 2012) (consisting of a series of articles that deal with the secrecy of the government's national security and intelligence system).

211. *See, e.g.*, Mike Bevel, *The Good, the Bad, and the Opinions*, FORBES (Aug. 25, 2011), http://www.forbes.com/sites/insidearm/2011/08/25/new-debt-collection-practices-the-good-the-bad-and-the-opinions; Jessica Silver-Greenberg, *Welcome to Debtor's Prison, 2011 Edition*, WALL ST. J. (Mar. 16, 2011), http://online.wsj.com/article/SB10001424052748704396504576204553811636610.html.

212. *See* Fred Schulte, *Wall Street Sees New Points in Homeowner Distress*, HUFFINGTON POST (Dec. 9, 2010), http://www.huffingtonpost.com/2010/12/09/wall-street-sees-new-prof_n_794245.html.

213. *See* Mike Konczal, *Demos on Credit Reporting and Employment, Surveillance, Inequalities, and the Labor Market*, RORTYBOMB (June 23, 2011), http://rortybomb.wordpress.com/2011/06/23/demos-on-credit-reporting-and-employment-surveillance-inequalities-and-the-labor-market; *Foreclosure May Affect More than Your Credit Score*, ARMY TIMES (Mar. 31, 2008), http://www.armytimes.com/money/financial_advice/military_sgtshopper_033108w/.

about moral hazard and bailouts of homeowners.[214] There are currently Republican politicians passing laws that disenfranchise the poor, minorities, and the young, in a replay of Jim Crow restrictions.[215] There are conservative politicians arguing that voting rights should again be restricted to those who own property.[216]

Creditors are also beginning to govern outright. The Obama administration and leaders of both parties are encouraging foreign sovereign wealth funds to invest in public infrastructure, such as roads, medical services, schools, turnpikes, airports, prisons, bridges, ports, hospitals, parking garages, water and sewer plants, and energy assets.[217] The House Transportation Committee is considering the privatization of Amtrak.[218] Goldman Sachs, in a recent 10-K filing, expressed interest in public "distressed assets" but warned that there were reputational risks associated with managing them.[219] Chicago, for instance, has sold its parking meters to a consortium led by Morgan Stanley; now the city cannot hold street fairs or design bus or bike lanes without permission and compensation.[220]

Political actors are also assaulting overtime pay, the forty-hour workweek, and even child labor restrictions.[221] Drug testing for unemployment benefits is being introduced as a proposal across the

214. *See Rick Santelli Sounds Off . . . Again* (CNBC television broadcast Feb. 20, 2009), *available at* http://video.cnbc.com/gallery/?video=1040944991.

215. *See* Ari Berman, *The GOP War on Voting*, ROLLING STONE (Aug. 30, 2011), http://www.rollingstone.com/politics/blogs/national-affairs/gop-war-on-voting-targets-swing-states-20120309.

216. Zaid Jilani, *Tea Party Nation President Says it "Makes a Lot of Sense" to Restrict Voting Only to Property Owners*, THINK PROGRESS (Nov. 30, 2010), http://thinkprogress.org/politics/2010/11/30/132532/tea-party-voting-property.

217. Rebecca Blumenstein & Laura Meckler, *Chinese Firms Set Sights on U.S. Investments: Computer Maker Lenovo Underlines Broader Interests; White House Encourages Sovereign-Wealth Fund to Take Stakes*, WALL ST. J. (Jan. 27, 2011), http://online.wsj.com/article/SB10001424052748704062604576105952027426880.html; Ratigan, *supra* note 201.

218. Ashley Halsey III, *House GOP Proposal Would Privatize High-Speed Rail Along Amtrak's Northeast Corridor*, WASH. POST (May 26, 2011), http://www.washingtonpost.com/local/house-gop-proposal-would-privatize-high-speed-rail-along-amtraks-northeast-corridor/2011/05/26/AGBEZKCH_story.html.

219. Goldman Sachs Grp., Annual Report, Form 10-K, at 227 (Feb. 28, 2011), *available at* http://www.goldmansachs.com/investor-relations/financials/current/10k/2010-10-k.pdf.

220. Aaron Renn, *Parking Meters and the Perils of Privatization*, URBANOPHILE (Aug. 22, 2010), http://www.urbanophile.com/2010/08/22/parking-meters-and-the-perils-of-privatization.

221. Holly Rosenkrantz, *Newt Gingrich Leads Push to Ease Child-Labor Laws*, S.F. CHRON. (Dec. 20, 2011), http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2011/12/19/BUGP1MEC7O.DTL.

country[222] and class action lawsuits have been curtailed by the 2010–2011 Supreme Court term.[223] The fundamental ability of the state to constrain the actions of private, powerful interests is gone, so those interests are now governing with an extremist bias towards creditors.

This is not a sustainable model of governance. As the social safety net frays, and as the major source of wealth and prosperity declines, the willingness of the public to tolerate elite misbehavior also declines. This response can be offset through increasing militarization and intimidation, as is happening through an increased police presence[224] and higher internal security spending.[225] But it is unclear what happens when food price volatility, which has so far been confined to poorer countries, combines with budget cuts to food stamp programs.

A new social contract is coming. The outlines of said contract could be a far more authoritarian model, where a small protected elite lives over what is essentially an occupied colonial body. Or it could be the restoration of an egalitarian model of shared prosperity, with sustainability at the core of our social, political, and financial relationships. In the meantime, until this new social contract emerges, it is likely that increasing unrest and discord will be the norm.

CONCLUSION

The basis for the New Deal housing consensus was not housing per se, it was a macro-economic framework that led to shared nationwide prosperity and some level of acceptable fairness. Investment in infrastructure, exploitation of cheap oil, unionization, safe banking, and transparent capital markets were critical components of this prosperity. Housing served as a fulcrum for that system. Discussing housing as a fulcrum for a stagnating economy and a chaotic political envi-

222. *See* Andrew Rosenthal, *Want Unemployment Benefits? We'll Need a Urine Sample*, N.Y. TIMES LOYAL OPPOSITION BLOG (Dec. 12, 2011, 1:07 PM), http://loyalopposition.blogs.nytimes.com/2011/12/12/want-unemployment-benefits-well-need-a-urine-sample/.

223. *See* J. Russell Jackson, *An Analysis of the Supreme Court's Class Action Decisions from the 2010–2011 Term*, SCOTUSBLOG (Sept. 6, 2011), http://www.scotusblog.com/2011/09/an-analysis-of-the-supreme-court's-class-action-decisions-from-the-2010-2011-term/.

224. *See, e.g.*, Bowles & Jayadev, *supra* note 195; Amy Gahran, *ACLU: Most Police Track Phones' Locations Without Warrants,* CNN (Apr. 3, 2012), http://articles.cnn.com/2012-04-03/tech/tech_mobile_police-phone-tracking-gahran_1_cell-aclu-track?_s=PM:TECH.

225. *See generally* D. ANDREW AUSTIN & MINDY R. LEVIT, CONG. RESEARCH SERVICES, TRENDS IN DISCRETIONARY SPENDING (Sept. 10, 2010), *available at* http://www.fas.org/sgp/crs/misc/RL34424.pdf (tracking higher defense spending since 9/11).

ronment makes little sense, so this paper attempts to suggest a solution for moderating the current crisis until a new economic framework emerges.

Even as this new social contract emerges, it will be necessary to address the basic problems in the current multi-trillion dollar housing market. The basics of any approach will require a restoration of transparency and integrity to the market.

Whatever economic strategy emerges, housing values must be correlated with wage increases or decreases. Additionally, housing finance should require more equity; people need to have a stake in their homes. The following suggestions would help stop some bleeding in the current housing market and possibly prevent a wholesale collapse.

The key to restructuring the current housing morass is building a trusted intermediary institution, such as the Home Owners' Loan Corporation, that can write down debts to manageable levels. Such an institution would allow currently defaulted homeowners to remain as renters in their homes, write down principal to a manageable level, or foreclose. Changes to bankruptcy laws, in particular the right for judges to write down first mortgages on primary residences, would help provide a second layer of defense for rationality in the financial markets.

Aggressive law enforcement to prosecute mortgage and foreclosure fraud would help restore confidence in the mortgage market, as well as prevent the transformation of existing housing stock into massive blighted sets of suburban ghost towns. Secondary liability needs to be reintroduced in criminal law—if you help perpetrate a fraud, you should be charged as an accessory. This would eliminate the legions of lawyers and accountants who can aid criminal behavior without consequence. Extending the statute of limitations on securities abuses would help.

The mortgage servicing industry is thinly capitalized, excessively automated, and inadequately staffed.[226] It needs to be restructured and tightly regulated. Loan-level data needs to be disclosed to investors on a regular basis to prevent securitization abuses. A mortgage should be held for a year before it can be securitized, and there should be no resecuritizations of slices of baskets of mortgages (i.e.

226. *See generally The Foreclosure Crisis: Hearing Before the H. Comm. on Oversight & Gov't Reform*, 112th Cong. 44 (2011) (statement of Mark A. Kaufman, Comm'r of Financial Regulation, Maryland Department of Labor, Licensing and Regulation).

no "CDO-squared"). And finally, structures to enable consumer protection, either through national and state-based homeowner associations initially capitalized by government, or effective non-captured government regulatory agencies, are critical to arresting rampant fraud in the mortgage servicing industry.