



The Rundown

A BLOG OF NEWS AND INSIGHT

Making Sen\$e -- November 24, 2010 at 12:57 PM EDT

What Does Justice in the Foreclosure Crisis Look Like?

BY: PAUL SOLMAN

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*Paul Solman answers questions from NewsHour viewers and web users on business and economic news most days on his **Making Sen\$e** page. Here's Wednesday's query:*

An amended answer today to a question answered imperfectly (or worse) last month.

The email, from Bruce Temple, **was in response to one of our stories on the foreclosure crisis** and read as follows:



In tonight's episode you asked one of the foreclosed homeowners whether she thought viewer's would sympathize with her position. I am struggling to understand the answer you accepted from her. She bought the house for \$80,000 and had several hundred thousand due on the mortgage. You assumed she took out home equity loans. Where is the economic justice when she benefits from loans on the property and then effectively defaults on the property only to be able to buy it back at a fraction of the amount that collateralized the home equity loans? Putting the emotional costs aside for a minute -- I can't figure out why this process (Boston Community Capital) deserves any support, let alone precious time on your otherwise very helpful reports.

My answer **back in October**:

This story addressed a question that [also] came up forcibly in a series of stories we did on foreclosure in and around Cape Coral, Florida back in April and one in particular, on **strategic default**.

The question: why can't homeowners buy back their own homes once they're foreclosed on? Buy back at the new market price, that is?

In market economics, "justice" is, very generally speaking, the greatest good(s) for the greatest number. According to that criterion, Boston Community Capital would deserve support because:

- 1) the investors who own the mortgage would be better off, since the foreclosure process costs extra money and an abandoned house is often vandalized, costing even more;
- 2) the neighborhood is better off, since vandalism drives home prices further down;
- 3) the homeowner is better off.

In economic terms, there are "negative externalities" (costly side effects) to proceeding with foreclosure, compared to the alternative of reselling to the homeowner, with a responsible third party overseeing the process and providing the discipline that the previous lenders and their agents never did.

The problem with my answer may be the assertion that, "in market economics, 'justice' is, very generally speaking, the greatest good(s) for the greatest number."

Let me give the floor to longtime Wellesley economics professor and master teacher Karl "Chip" Case, whose [biography can be found here](#). (His poem on the housing crisis [was featured on Making Sense](#) in February)

Intrigued by the question of "economic justice" and the charge that is was being badly served by loan modifications, I interviewed Case recently for a story on the issue slated to run on the NewsHour this week or next.

Here's what the good professor said, edited a bit for clarity, but in a fuller version that we could use on the show (emphasis added):

Paul Solman: The question concerns "economic justice": that somehow it isn't economic justice if somebody enters into a contract to borrow money at one rate, then gets a new deal at something like half price when there are all these people out there struggling to make their own mortgage payments at full price.

Chip Case: It's a really hard question. This gets to the real nub of what economics is about. You have to have a system that's efficient, that uses resources efficiently and produces what we want at least cost.

And that involves risk-taking, because we don't know what the future is. When you build capital, when you save, you put money aside and it's for the future. When you invest in plant equipment, it doesn't do you any good if that industry doesn't do well.

So part of the problem is that you have to have a system that imposes penalties on people who take risks and lose. Otherwise, the system doesn't work.

PS: Why am I wrong to have written as I did the other day in response to this very email I was telling you about, that it is economic justice, justice as market economics defines it, for somebody to buy back their home at the current market price. The investor will get more than he or she otherwise would; the homeowner doesn't have to move; and the neighborhood is better off. This is economic justice, isn't it?

CC: I don't think you have to go justice. It's efficient, it makes sense, it's common sense. If you have a non-zero sum game you can make literally everybody better off if you do the deal.

There are different definitions of justice which we can talk about, but in this case you don't have to go that far. If you can show that the total benefit when you carve it all up exceeds the benefit when you let it sit, you should do it. There's no question about that. Every economist in the world would agree. That's how Pareto made his name.

Vilfredo Pareto was an Italian economist who got us out of utilitarian thought. Utilitarianism is, if you take a platinum egg out of somebody's dining room and you divide it up amongst the poor, you improve wealth. To do that you have to make comparisons among people.

Pareto said that if you can take a situation and change it, move resources, change the mechanism, and make some people better off without making others worse off, even potentially, that's an efficient change. That brought the whole profession together because reasonable people would agree that if you can make some people better off and nobody else worse off that's a good thing to do.

A Pareto-optimal deal is a change which makes some people better off and nobody worse off. **So if you can show that by rearranging resources or changing the outcome, there's a surplus, there's something that people can benefit from in total, then you do it.**

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Helenk 11/25/2010 07:57 PM

For the first time I watched your segment and spent a lot of time finding myself saying 'what?'. Could not make out for certain that someone was really justifying these mortgage defaults getting substantially reduced. The house will just sit there and then some truck will pick up the copper.....' What? Are you kidding? This is a justification. I am surprised at you. Your segments are generally rational.

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Patricia Oneal 11/25/2010 07:37 PM

I will like to make a comment on your faulty reporting. You chastised the lady receiving the loan modification without noting that she is "on the hook" for 1.24 million dollars in mortgage payments over a forty year period at a modified monthly mortgage rate of 2600.00 a month. My point -- and this is the point that you should have made--the lady is paying as much with the loan modification as she would have paid without it. So in other words, people are being are being scammed with the loan modification and you failed to note this fact.

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gofight 11/24/2010 05:46 PM

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