Illustration by Peter K. McDonnell

Justice for All? How Inequality is Eroding the Rule of Law

by Joseph E. Stiglitz

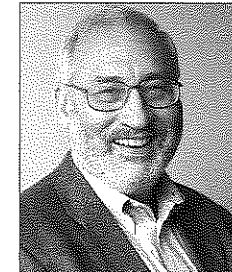


Photo by Dan Deitch

Editor's Note: In 2011, Professor Joseph Stiglitz, noted economist, wrote an article for Vanity Fair *magazine entitled, "Of the 1%, by the 1%, for the 1%." The term was picked up as a rallying cry in the Occupy Wall Street movement as the U.S. working class woke up to the fact that they had been robbed — fleeced clean by Wall Street financial institutions — of their houses, their credit rating, their ability to borrow money and finally their jobs. While the Occupy movement was quickly smashed by the various local and state governments working in tandem, the consciousness that something is definitely wrong in the state of the United States continues to resonate. Meanwhile, the 2008 financial disaster has resulted in the making of fortunes. In this excerpt from Professor Stiglitz' book* The Price of Inequality, *he details one aspect of the process that has led to the marginalization of the working class in the United States.*

Predatory Lending

Early on in the housing bubble, it became clear that the banks were engaged not only in reckless lending — so reckless that it would endanger the entire economic system — but also in predatory lending, taking advantage of the least educated and financially unsophisticated in our society by selling them costly mortgages and hiding details of the fees in fine print incomprehensible to most people. Some states tried to do something about it. For instance, in October 2002 the Georgia legislature, after observing that mortgage lending in the state was riddled with fraud and predation, tried to call a halt to it with a consumer protection law. The response from the financial markets was quick and furious.

The ratings agencies, today best known for their role in calling pools of F-rated mortgages A-rated securities, also had a hand in sustaining fraudulent lending practices. They should have welcomed the actions of states like Georgia: the law meant that the agencies would not need to assess whether mortgages in a given pool were fraudulent or inappropriate. Instead, Standard & Poor's, one of the leading rating agencies, threatened not to rate any of Georgia's mortgages. Without these ratings, the mortgages would have been hard to securitize and without securitization (in the business model of the day) mortgage lending in the state might dry up. Evidently, the rating agencies were worried that if the practice spread to other states, the flow of bad mortgages from which they made so much money "rating" would be greatly diminished. S&P's threat was effective: the state quickly reversed the law.[1]

In some other states, too, there were attempts to stop predatory lending,[2] and in each of these instances banks used all their political muscle to stop states from enacting laws aimed at curtailing predatory lending. The result, as we know now, was not only massive fraud but also bad lending: too much indebtedness, with financial products that could explode with a change in interest rates or in the broader economic conditions, and indeed many did explode.[3] In a simpler world, the adage ("let the buyer beware") might have been appropriate; but not in today's complex world. A regulatory agency for financial products is needed to prevent not just fraud but also abusive, deceptive, and inappropriate products.[4] Even many financial institutions recognized that some regulation was needed: without bank and insurance regulations ensuring the soundness of these institutions, individuals would be reluctant to turn over their money to banks and insurance companies, lest they never get it back. Individuals on their own would never be able to assess the financial conditions of these large and complex institutions; it has proven hard enough for experienced government regulators to do so.[5]

But the U.S. banking sector resisted the suggestion that regulation be extended to protect consumers, in spite of its terrible record of bad lending and poor credit practices before the crisis, which had led to widespread public support for an agency to do so. And when a provision creating such an agency was included in the Dodd-Frank bill, financial institutions campaigned to make sure that Elizabeth Warren, a Harvard law professor with all the credentials necessary to run such an agency, including the expertise and commitment to protect consumers, was not chosen to head it. The banks won. (She was, in fact, widely cited as the originator of the idea of such an agency, and a tireless campaigner for it, a sin for which the financial community could not forgive her. Even worse, she served as chair of the Congressional Oversight Panel, overseeing the government's bailout program. The panel revealed that the administration was

Joseph E. Stiglitz is a Nobel Prize-winning economist and is the best-selling author of The Price of Inequality, Freefall *and* Globbalization and Its Discontents. *He is a columnist for* The New York Times *and* Project Syndicate *and has written for* Vanity Fair, Politico, The Atlantic *and* Harper's. *He teaches at Columbia University and lives in New York City.*

giving the banks a great deal — getting back from the banks preferred shares worth about half of what the government was giving them.[6])

Bankruptcy Law

A host of other laws and regulations shape the market and thereby affect the distribution of income and well-being. Bankruptcy law (which specifies what happens when an individual or a corporation can't pay back what is owed) has particular relevance to two parts of our society — those at the top (the bankers) and those at the bottom, who struggle to make ends meet.

Illustration by Peter K McDonnell

Bankruptcy law is designed to give individuals a fresh start. The notion that under certain conditions debts should be forgiven has a long tradition that goes back at least as far as the Book of Leviticus, where debts were forgiven in the Jubilee year. Virtually every modern economy has a bankruptcy law. These laws can be either more debtor or more creditor friendly, making it easier or more difficult to discharge debts. How they are shaped obviously has strong distributional consequences, but the incentive effects can be equally powerful. If debts can't be discharged, or can't be discharged easily, lenders have less of an incentive to be careful in lending — and more of an incentive to engage in predatory lending.

In 2005, just as subprime mortgages were starting to boom, Congress passed a new creditor-friendly bankruptcy law that gave the banks even more of an upper hand, making it more difficult for distressed borrowers to discharge their debts. The change in the law introduced a system of "partial indentured servitude." An individual with, say, debts equal to 100 percent of his income could be forced to hand over to the bank 25 percent of his gross, pretax income for the rest of his life. This is because the bank could add on, say, 30 percent interest each year to what a person owed. In the end, a mortgage holder would owe far more than the bank ever lent. The debtor would end up working, in effect, one-quarter time for the bank.[7]

Every loan has a willing lender and a willing borrower; the banks are supposed to be financially sophisticated, to know how much debt individuals can manage. But a distorted financial system put more emphasis on the up-front fees that showed up quickly in the banks' bottom line than on the losses that might be incurred further down the line. Emboldened by the new bankruptcy law, they felt they could somehow squeeze money out of their hapless borrowers, whatever happened to the housing market and unemployment. This reckless lending, combined with deceptive practices and sometimes usurious interest rates, has put many households on the brink of financial ruin. In spite of so-called reforms, banks still sometimes charge rates nearing 30 percent a year (which means that a $100 debt can grow to $1,000 in a short span of nine years). On top of this, they can impose crippling fees. While some of the worst abuses have been curbed, such as those associated with overdrafts (which generated literally billions of dollars a year in profits[8] — money taken out of the pockets of ordinary citizens), many continue.

When the new bankruptcy law was passed, property rights were changed, but in a way that favored the banks. At the time the borrowers had incurred their debt, a more humane bankruptcy law gave them a chance for a fresh start if the burden of debt repayment became too onerous. The banks didn't complain about this change in property rights; after all, they had pushed for it vociferously. When things go the other way, of course, the owners of property complain that the rules of the game are being changed midcourse and demand compensation.[9]

Thank you Theatrical Stage Employees Local 16 IATSE for your support in NCCLP's fight for meaningful legal recourse for low-income workers

B.H. Chaifetz
Attorney at Law

SALUTES THE EFFORTS OF NATIONAL COALITION OF CONCERNED LEGAL PROFESSIONALS

1. For a discussion, see G. Morgenson and Joshua Rosner, Reckless Endangerment: How Outsized Ambition, Greed, and Corruption Led to Economic Armageddon (New York Times Books, 2011). More specifically, the ratings agencies claimed that they could not rate RMBS based on mortgages originated in New Jersey and Georgia, on the grounds that the RMBS holder would be liable under state Consumer Protection or Predatory Lending Law. Under the Georgia law, unlimited punitive damages for predatory lending under the Georgia Fair Lending Act would extend to RMBS holders in due course. This led to the amendment of the Georgia predatory lending statute in 2003. A similar chain of events happened in New Jersey, leading to the amendment of the New Jersey Homeownership Security Act of 2002 to appease lenders in June 2004.

2. One of the most important additional aspects was the preemption by federal bank regulators, notably the Office of the Controller of the Currency (OCC), which is the agency in the Treasury charged with overseeing banks, and OTS (the Office of Thrift Supervision, originally set up to oversee the savings and loans institutions), of stricter state regulation by claiming jurisdiction over national banks. This meant that if a state tried to regulate banks in its state more strictly, the tighter standards would extend only to state-chartered banks, which would then be less competitive than the nationally chartered institutions. Making matters worse, "some states, such as Georgia, have parity or wild card laws that exempt state-chartered banks and thrifts and their subsidiaries from state anti-predatory lending laws to the same extent as national banks and federal thrifts. . . ." P. McCoy and E. Reunart, "The Legal Infrastructure of Subprime and Nontraditional Home Mortgages," Joint Center for Housing Studies Harvard University, UCC08-5. The head of the OCC tried to allay worries about this preemption: "Our approach . . . protects consumers where abusive practices are found."

3. See my "Freefall" (New York: Norton, 2010) for a fuller discussion of the whole variety of bad financial products and the consequences.

4. Just as the Food and Drug Administration protects consumers against deceptive, dangerous, and ineffective drugs.

5. Evidenced by the fact that just shortly after European regulators subjected one of Europe's larger banks to a stress test—to see how well it would do in adverse conditions—and it passed brilliantly, the bank collapsed. Private rating agencies, too, have demonstrated that they are not up to the task.

6. In the first set of deals, taxpayers got back about 65 cents on the dollar, but in later deals, especially with AIG and Citbank, they got back about 41 cents on the dollar. See Congressional Oversight Panel, "Valuing Treasury's Acquisitions," February Oversight Report, February 6, 2009. While the legal system is stacked against ordinary citizens, the magnitude of the banks' bad behavior was so large that there was some accountability — though not enough to offset the huge profits they had made in their predatory lending, which was often targeted at poor African Americans and Hispanics. See chapter 3 for a more extensive discussion.

7. While many mortgages were nonrecourse (that is, creditors could claim only the house — they couldn't go after the borrower's other assets), and thus might not be affected by this provision, most of the subprime lending involved second mortgages, which were recourse. The change in the bankruptcy law applied to such loans.

8. Overdraft fees average between $30 and $35 a transaction and have risen by almost a fifth over the past five years. In 2011 they were estimated to increase bank earnings by $30 billion. Ninety percent of the fees are paid by 10 percent of the customers, mostly low income. The attempt to curb the fees in 2010 failed, partly because customers were misled by the banks. The director of the new consumer agency, Richard Cordray, criticized bank practices designed to ensure that customers did not understand the fees they faced. A New York Times editorial described bank practices that "deliberately buried information, requiring consumers to visit three Web pages and scroll through 50 pages of text to find fee information." "A Further Look at Overdraft Fees," New York Times, February 27, 2012, p. A16, citing in part data from Moebs Services, a research company that has conducted studies for both government and some banks. See also FDIC Study of Bank Overdraft Programs, November 2008.

9. They call it a regulatory taking. But any change in law that affects contracts or property has redistributive consequences.

Excerpted from The Price of Inequality: How Today's Divided Society Endangers Our Future *by Joseph E. Stiglitz Copyright © 2013 by Joseph E. Stiglitz. With permission of the Publisher, W.W. Norton & Company, Inc. All rights reserved.*

Editor's Afterword: On September 18, 2015, United Nations delegates from 193 nations, including the United States, adopted a resolution outlining the Sustainable Development Goals for the coming fifteen years. Their focus was to: "eradicate poverty in all its forms and dimensions, including extreme poverty… the greatest global challenge and an indispensable requirement for sustainable development."

To achieve that goal one of the specific Sustainable Development Goals calls on member states to:

> *… provide access to justice for all and build effective, accountable and inclusive institutions at all levels.*

Continued on page 18

•LICENSED PRIVATE INVESTIGATORS• •PROCESS SERVERS • BONDED•

Irving Botwinick
President

Woolworth Building
233 Broadway
New York, NY 10279

(212) 233-3346
FAX (212) 349-0338

Mark A. Gloade, Esq.

supports
Coalition of Concerned Legal Professionals' Know Your Law sessions.

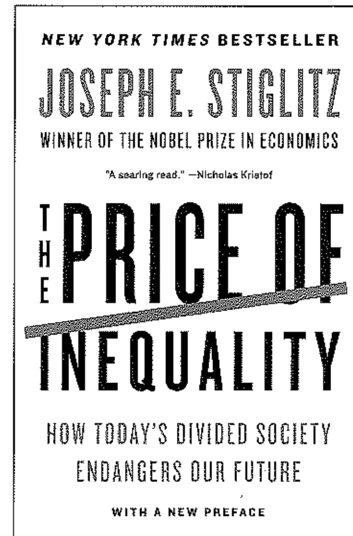
Continued from page 15

The goal includes as one of its targets to:

> Promote the rule of law at national and international levels and ensure equal access to justice for all.

The U.S. media has virtually blacked out any reporting on this monumental decision by the world leaders or the fact that each country agreed to take the Sustainable Development Goals to their legislative bodies to develop plans of implementation. Hence, there has been no discussion of how the United States is going to meet these goals or to involve the population in determining a way forward.

Professor Stiglitz' excerpt from his book The Price of Inequality *points to the reasons why not only has there been no effort by the government to hold that discussion in the legislature and without on those crucial goals, but that the system as it functions does precisely the opposite: reinforcing and deepening the division in society between the "One percent" and the rest of population.*



Between lowering wages, loss of benefits on the jobs, loss of jobs and student loans, the gap between the haves and have nots has grown exponentially. For example, according to a recent Oxfam study:

- In 2015, just 62 individuals had the same wealth as 3.6 billion people: the bottom half of humanity. This figure is down from 388 individuals as recently as 2010.
- The wealth of the richest 62 people has risen by 44% in the five years since 2010 — that's an increase of more than half a trillion dollars ($542 billion), to $1.76 trillion.
- Meanwhile, the wealth of the bottom half fell by just over a trillion dollars in the same period – a drop of 41%.

As the Oxfam report pointed out, our economic system is heavily skewed in favor of the wealthy. Income and wealth are not trickling down, but are instead being sucked upwards. Once in the hands of the wealthy, an ever more elaborate system of tax havens and an industry of wealth managers ensure that it stays there, far from the reach of ordinary citizens and their governments.

One of the key trends is the increasing return to capital versus labor. In the U.S., while many workers have seen their wages stagnate, there has been a huge increase in salaries for those at the top. CEOs at the top U.S. firms have seen their salaries increase by more than half (by 54.3%) since 2009.

The widening gap accelerated with the 2008 world-wide financial crisis, brought to us by a combination of actions by the United States government and the overreaching of the financial institutions. In November, 1999 Congress repealed the Glass-Steagall Act under pressure from the lobbyists in the financial industries. Glass-Steagall, passed in the wake of the 1929 stock market crash, prohibited the combination of commercial banks (which lend money) and investment banks (which organize the sale of bonds and equities), along with insurance companies. The rationale of Glass-Steagall was that the combination of commercial banking and investment banking led to a demand for the kind of high returns for commercial banks, which investment banks are known for — results that could be obtained only through high leverage and taking big risks. The repeal was rapidly followed by combinations that led to the behemoths dubbed "Too big to fail."

In April 2004 the Securities and Exchange Commission changed the rules, allowing big investment banks to increase their debt-to-capital ratio (from 12:1 to 30:1, or higher) so that they could buy more mortgage-backed securities. When the head of the Commodity Futures Trading Commission called for regulation of derivatives, they were stopped cold by Clinton's Secretary of the Treasury and the head of the Federal Reserve Bank. These unregulated swaps were at the heart of the subprime meltdown.

Illustration by Peter K. McDonnell

When all the tax cuts President George W. Bush orchestrated did not stimulate the economy but only enriched the already wealthy, the Federal Reserve then offered the banks use of money virtually free. The flood of liquidity made money readily available in mortgage markets, even to those who would normally not be able to borrow. Playing with other people's money made risk taking even easier.

Following the bailout of the banks by the Federal Government, Congress passed the Dodd-Frank bill, which was supposed to address these problems, ensuring they would not happen again. However, Wall Street has been successfully pressuring Congress into gutting the bill and the regulatory agencies into dragging their feet in implementing any regulation. The result is the continuing concentration of money into fewer and fewer hands.

This inequality is locked in through a legal system that is less and less available to working people. Between court budget cuts, the introduction of mandatory arbitration, severely limiting the use of class actions for collective remedy, and the use of the First Amendment to simultaneously elevate the right of corporations to spend money without check on elections and other forums to sway public opinion while citing freedom of speech to further break down solidarity in unions, there is little working people can do to gain recourse through the legal system.

These are but a few of the problems NCCLP has been writing and speaking about and addressing for decades through our fight for meaningful legal recourse and the building of a new legal system that serves all of us, not just the "one percent." There is a chasm in our country between the Rule of Law so necessary and now demanded by all the nations of the world; and the reality of legal practice in the United States. That's where the work begins for legal professionals and others committed to a rule of law embodying justice for all.

Keep up the good work, CCLP!

from

Michael Chambers, Esq.

San Francisco

Freight Systems Int'l, Inc.
1200 Fuller Road
Linden, NJ 07036
1-888-774-4FSI

Local Deliveries, Warehousing, Long Haul and Specialized Trucking, International Forwarding and Pier Work.

Family owned and operated.

David Michael Bigeleisen

Criminal Defense Attorney

1155 Pine Street
San Francisco, CA 94109

(415) 957-1717

FILE KEEPERS

It's What We Do.

File Storage

Secure Shredding

Scanning

Tape Rotation

Information Management Solutions

800.332.file

www.filekeepers.com