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EXPLAINING THE GLOBAL FINANCIAL CRISIS: NIETZSCHE GETS HIS MBA

ERIC BOOS

Abstract

There has never been a better time to study the philosophy and ethical theory of Friedrich Nietzsche. While the world adjusts to a global economic catastrophe, rooted in the American banking industry’s handling of subprime mortgages, we would do well to predicate our predictions of the global market’s trajectory on Nietzsche’s view of the human person and his view of ethics. The failure of economics to identify, predict, and address this crisis, particularly in light of the symptoms it shares with other financial catastrophes, such as Enron, WorldCom, and Qwest, is evidence that the traditional paradigms employed by economics are missing something fundamental. It is this author’s contention that what economics is missing can be found in Nietzsche’s work. The classic “master-slave” formulation of Nietzsche’s ethical perspective gives perfect expression of not only the sub-prime mortgage and subsequent foreclosure scandal, but it also provides a perfect cover for the legal and political fallout to date and, more than likely, a window to future economic and social events. Given the shocking magnitude of the problem and the recalcitrant attitude of the American banking industry and its executives, who collect bonuses while enforcing illegal foreclosure proceedings against hapless victims, Nietzsche’s usual reception as an extreme and hyperbolic harbinger of moral discourse might be supplanted with a collegial curiosity if not a heart-warming and hardy welcome. This article intends to highlight the aspects of Nietzsche’s ethical theory that are particularly evident in the current economic crisis and point to a likely set of outcomes with regard to the crisis. In so doing, this article will establish Nietzsche’s relevance as a

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practical course of study in MBA programs, law schools, business schools, and college curriculums.

WHEN A HOUSE IS NOT A HOME: UNDERSTANDING THE GLOBAL ECONOMIC CRISIS

Most people are aware by now that the global economic crisis was precipitated by the collapse of the housing market in the United States, though few comprehend the relationship of the housing market to the broader economy, and even fewer understand the nuances of the banking and credit system that facilitated this collapse. How can extending home loans to people with bad credit and who are likely to default on their mortgages lead to a global economic crisis, particularly when creditors built mechanisms into these risky loans to offset the anticipated losses?

By 2007, half of all mortgages in the United States (approximately 27 million) were subprime loans,\(^2\) with a combined value of $4.5 trillion.\(^3\) By comparison, all other US mortgage loans amounted to over $10 trillion.\(^4\) Yet, there is little doubt that subprime loans are the key to the 2008 financial collapse.\(^5\) The Financial Crisis Inquiry Commission (hereinafter FCIC) reiterated this in their final report: "[W]hile the vulnerabilities that created the potential for crisis were years in the making, it was the collapse of the housing bubble—fueled by low interest rates, easy and available credit, scant regulation, and toxic mortgages—that was the spark."\(^6\)

The collapse was not just of the American housing market and financial institutions, it was truly a global phenomenon. The relatively simple

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2. "Subprime loan" is the term used when a bank or credit agency lends money to a borrower who does not qualify for a traditional mortgage loan because of bad credit from previous payment delinquencies, lack of a down-payment or collateral, a poor debt-to-income ratio, or other financial problems. Such clients pose a risk of nonpayment and are usually denied a loan because if they default, the lender gets saddled with real property that often they must dispose of at a loss. The process of foreclosing on such properties is costly and time-consuming and affects a lender’s profit margin and its own credit rating among investors. Borrowers with strong credit histories and ample assets are “prime” and usually get loans based on the prime rate set by the Federal Reserve. To offset the greater risk of lending money to “sub-prime” borrowers, banks often charge them a higher rate of interest and often put them into adjustable-rate mortgages (ARMs) which typically increase the initial interest rate of the loan by a considerable margin. Thus, lenders built into the system a means of recuperating some of the anticipated losses from granting risky loans.


4. Id.

5. O. C. FERRELL, JOHN FRAEDRICH & LINDA FERRELL, BUSINESS ETHICS, (South-Western Cengage Learning, 7th ed. 2009) [hereinafter FERRELL, FRAEDRICH & FERRELL]; see also Peter J. Wallison’s dissent from the majority opinion in the FCIC REPORT, supra note 3 at 443-538.

6. FCIC REPORT, supra note 3, at xvi.
problem of subprime lending somehow escalated to "trillions of dollars in risky mortgages . . . embedded throughout the system as mortgage-related securities . . . packaged, re-packaged, and sold to investors around the world. The losses were magnified by derivatives such as synthetic securities . . . and the impact is likely to be felt for a generation."

The scope and complexity of the financial crisis led the FCIC to say, "[W]e have been at various times fascinated, surprised, and even shocked by what we saw, heard, and read."

In identifying the causes and conditions of the financial collapse, the FCIC pointed to: the explosion of subprime lending and securitization, predatory lending practices, unregulated derivatives, the Federal Reserve’s failure to stem the flow of the toxic mortgages, the financial institutions’ lack of due diligence in examining the mortgage securities they bought and sold, and credit agencies covering the inherent risks and dangers in the securities market by inflating credit ratings and ignoring the use of off-balance sheet entities, over-the-counter derivatives, and participation in the multi-trillion dollar repo lending market. In a bold proclamation, dissent and controversy notwithstanding, the FCIC stated quite emphatically: "There were warning signs. The tragedy was that they were ignored. We conclude this financial crisis was avoidable."

This particular view serves as an underlying theme of this paper. If

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7. FCIC REPORT, supra note 3, at xxiv (The Commission reiterated the global nature of the problem by adding, "While many of these mortgages were kept on the banks' books, the bigger money came from global investors who clamored to put their cash into newly created mortgage-related securities.").
8. Id.
9. Id. at xvii-xviii.
10. Peter J. Wallison, a member of the FCIC wrote his own dissent, which is published along with the FCIC REPORT, see id. at 431-538.
11. See FCIC REPORT, supra note 3, at xvii. On the other hand, if this crisis was not avoidable, we are left with a question that has plagued economics: why does economics fail to do what good science does, which is provide laws, predict with precision and predict the unexpected, unify diverse phenomena, and so on? For an excellent analysis of this, see HAROLD KINCAID, The Empirical Presuppositions of Metaphysical Explanations in Economics, 78 THE MONIST: AN INT'L QUARTERLY JOURNAL OF PHILOSOPHICAL INQUIRY 368-385 (1995). Kincaid examines the views of philosophers of economics such as Alexander Rosenberg, Alan Nelson, John Dupre, and Helen Ross, and argues that "metaphysical assumptions abound in economics, but they are intimately tied to specific economic issues and must be evaluated accordingly." Claims that modern economics fails because the essential predicates or kinds it identifies are not "natural kinds" are inherently weak, argues Kincaid, because such metaphysical diagnosis ignores diversity and wrongly treats economics as a homogenous whole. As Kincaid says, "lacking natural kinds is not the best explanation for the alleged failure of economics." Whether or not the "kinds" that modern economics identifies "cuts nature at the joints" is a fascinating discussion, and Kincaid makes a very compelling argument for expanding the scope of criticism of economic theory to include more of the empirical, local details, but it is beyond the scope of this paper. As useful as Kincaid's arguments would be in helping us understand the dissenting view of Peter Wallison from the majority opinion of the FCIC, this paper accepts the basic premise that the entire crisis was avoidable and that it was very much the result of human action and inaction.
Indeed the financial crisis was avoidable, then how is it possible that it was not avoided? Does not this position assume that at least some individuals involved in the financial meltdown understood the possible (negative) consequences and acted in spite of those consequences? The FCIC answered this directly when it said, "[W]e do place special responsibility with the public leaders charged with protecting our financial system, those entrusted to run our regulatory agencies, and the chief executives of companies whose failures drove us to crisis." More specifically, "[T]he captains of finance and the public stewards of our financial system ignored warnings and failed to question, understand, and manage evolving risks... Theirs was a big miss, not a stumble," concludes the FCIC.

In spite of the FCIC’s view that "the crisis was the result of human action and inaction, not Mother Nature or computer models gone haywire," it warns against pinning "the crisis on mortal flaws like greed and hubris," and encourages all concerned to view the crisis in the broader philosophical context of "human nature and individual and societal responsibility." The FCIC provides the scope of its philosophical consideration of the problem when it avers, "it was the failure to account for human weakness that is relevant to this crisis." This more general philosophical problem is precisely what we intend to examine in this paper. If the failure to account for this human weakness is at the core of the financial crisis, then we must examine what means we have of knowing the weakness and accounting for it in the future if we are to avert a similar disaster. To begin, we must look more closely at the financial crisis and ask: Why did this happen?

A simple answer to this question is that we developed an economy around the exploitation of peoples’ desires to own homes, which required a loosening of the lending rules and led to a cultural shift in seeing homes as commodities. In 1968, Congress chartered Fannie Mae, a stockholder-
owned corporation with the sole purpose to purchase and securitize mortgages in order to ensure that funds would be available to institutions that lend money to home-buyers. By 1970, the idea grew to include the inauguration of Fannie Mae’s brother corporation, Freddie Mac, as a way to expand the secondary market for mortgages in the United States. Fannie Mae and Freddie Mac bought mortgages on the secondary market and then repackaged and sold them as mortgage-backed securities to investors on the open market. In short, banks were encouraged to lend more freely to borrowers for the purchase of homes with guarantees that Fannie Mae and Freddie Mac would buy the mortgages from the banks. In receiving immediate repayment of the original mortgage plus a profit by selling to Fannie Mae and Freddie Mac, banks had more money to lend to even more borrowers. For their part, Fannie Mae and Freddie Mac sold securities to investors that were backed by the money generated in home loan repayment.

The entire system was based on peoples’ desire to own homes of their own in the first instance, and the belief (and trust) that such a desire would impel borrowers to do whatever it took to stay in their homes due to the threat of foreclosure always hanging over their heads.\textsuperscript{18} Freddie Mac and

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\textsuperscript{18} The threat of foreclosure is a specific issue we intend to treat in this paper because it underscores the manipulation of moral standards and values and as such bolsters a position put forth by the philosopher Friedrich Nietzsche. As we shall see, the mortgage industry, the Government of the United States, and the media have aided in the perpetuation of a psychology of fear and moral reprobation regarding the repayment of debts. For a terrific treatment of this from the perspective of legal psychology see Brent T. White, \textit{Underwater and Not Walking Away: Shame, Fear and the Social Management of the Housing Crisis}, 45 \textit{WAKE FOREST L. REV.} 971,
Fannie Mae convinced investors that profits would continue to rise as the overall economy improved and more and more people would be able to take on a mortgage and buy a home.

Overconfidence in the system and desire to increase corporate profits resulted in a variety of corporate and accounting improprieties. In 2003, Freddie Mac revealed that it had misstated earnings by $5 billion, and by 2004, both companies were under investigation for illegal accounting practices and “phantom profits.”19 Both companies continued to donate large sums of money for various political candidates and lobby for more deregulation of the mortgage loan industry. Each step of the way, they continued to expand their share of the subprime loan market and hence their collateralized debt obligations. Prior to their trouble in 2008, Fannie Mae and Freddie Mac guaranteed about half of the $12 trillion mortgage market in the United States.

Fannie Mae and Freddie Mac were not the only subprime games in town.20 Angelo Mozilo co-founded another lending institution, Countrywide Financial, which specialized in subprime loans. At the same time, Mozilo diversified into the securities market—which helped expedite the flow of mortgage-backed securities, thus freeing up more money to loan to individual borrowers. Within a few decades, Countrywide had become the largest single provider of home loans in the United States. In 1992, Countrywide initiated a program called “House America” that enabled more consumers to qualify for home loans. Countrywide had the distinction of being the number one provider of home loans to minorities in the United States and prided itself in lowering the barriers of homeownership for low-income individuals. By 1993, its loan transactions reached the $1 trillion mark. From 2000 to 2006, Countrywide made an astounding $2 trillion in home loans.21 Countrywide was the darling child in the mortgage loan industry. Between 1982 and 2003, Countrywide delivered a 23,000% return to investors.22

Returns of this magnitude had every investor’s attention, and when Alan Greenspan, former chairman of the Federal Reserve, lowered the Federal Funds rate from 6.5% to 1.0% between 2000 and 2003, a multitude

971-1023 (2010) [hereinafter White].

19. See Mara Der Hovanesian, Lenders: Still Not Safe, BUSINESSWEEK, Mar. 24, 2008, at 28. The author writes that phantom profits are when mortgage lenders “sell risky adjustable-rate mortgages (ARMs) for which borrowers pay less than the total interest owed each month, yet the lenders report the full amount of the interest as income . . . . in essence, lenders were counting their chickens before they hatched.”

20. Ferrell, Fraedrich & Ferrell provide a good account of Countrywide’s involvement in the mortgage and housing crisis; see FERRELL, FRAEDRICH & FERRELL, supra note 5.


22. FERRELL, FRAEDRICH & FERRELL, supra note 5, at 391.
of investors looked to Wall Street for alternatives and many jumped into mortgage-backed securities. In 2000, there was a “global pool of money” of about $36 trillion in fixed-income securities. This money essentially represented “the world’s savings.” Insurance companies, pension fund managers, central banks from other countries, investment bankers, and others joined in the speculative venture of mortgaged-backed securities. Money that would normally have been invested conservatively in treasury bills or municipal bonds suddenly found its way into mortgage-backed securities so that by 2007, the global pool of money (the “world’s savings”) had doubled to over $70 trillion. This is how the problem led to a global economic crisis in 2008.

The huge returns on investments in mortgage-backed securities were enough to blind investors and government officials alike against the inherent risk of mortgage-backed securities and the many improprieties being committed by banks and investment firms. In spite of multiple investigations of Fannie Mae and Freddie Mac, Congress and Presidents Clinton and G.W. Bush set aggressive goals to increase home ownership and encouraged the purchase of more subprime loans from banks. During the same period, the government eased restrictions on commercial banking activity by signing the Gramm-Leach-Bliley Act, which repealed part of the Glass-Steagall Act of 1933. This repeal enabled commercial banks, like Citigroup, to expand into other financial activities previously reserved for investment banks, such as insurance and trading mortgage-backed securities.

Initially, these securities were relatively safe investments. They were built out of mortgages with big down payments from borrowers with steady incomes and savings in the bank. So many mortgages were sold in an attempt to satisfy investors’ appetites that there came a point in 2003 where just about every qualified mortgage-seeker had already obtained one. The demand for these securities remained, however, resulting in a loosening of the mortgage qualification guidelines in order to lend to less financially qualified people. Mortgage lenders came out with the “stated income, verified asset loan” (SIVA) approach, which meant a borrower did not have

25. Id.
26. Id.
27. FCIC REPORT, supra note 3, at xxvii.
to provide paycheck stubs and W-2 forms to obtain a mortgage. Borrowers could simply state their income and show that they had money in the bank. This was still not enough to satisfy the demand for mortgage-backed securities.

In order to produce more mortgages and securities, the qualification guidelines were progressively loosened until, eventually, borrowers could obtain a loan with virtually "no income and no assets" (NINA)—all that was required to obtain a mortgage was a credit score. Among mortgage lenders, Countrywide was notorious for processing these "liar loans." But some within the organization did have their doubts. According to the Financial Crisis Inquiry Commission Report, "as early as September 2004, Countrywide executives recognized that many of the loans they were originating could result in ‘catastrophic consequences.’" 29

Countrywide was certainly not alone in the use of liar loans, as they had certain obvious benefits. 30 The lenders raised the up-front costs of these extremely risky loans and pocketed commissions and bonuses, and then passed the risk by selling them to Wall Street firms, who in turn sold them to global investors. The total amount in losses just from liar loans could be over $100 billion. 31

The demand for mortgage-backed securities could not be easily satisfied, so mortgage lenders resorted to another tactic: appealing to the wanton desire of middle and upper-middle class Americans to have bigger and better homes with a variety of subprime loan alternatives. 32 A Wall Street Journal study revealed that from 2004-2006, the rate of middle- and upper-income subprime loan borrowers rose dramatically. During the early to mid-2000s, when real estate prices were booming and confidence levels were high, even clients who could have qualified for regular loans chose to take out subprime loans to finance their real estate speculations. 33 By the

29. FCIC REPORT, supra note 3, at xxii.
30. It has been estimated that 90% of liar loan applicants overstated their income, with three out of five overstating it by at least 50%. It is unlikely that such rampant dishonesty could have occurred without the mortgage companies’ awareness, if not their collaboration. See FERRELL, FRAEDRICH & FERRELL, supra note 5, at 389.
31. Id. Countrywide is still under investigation regarding the liar loans they generated before they were bought out by Bank of America in 2008. There is some question as to whether Countrywide assisted borrowers in falsifying information on its mortgage applications. Likewise, individual borrowers have accused Countrywide of predatory lending saying that the company misled them and induced them into taking on mortgages that the company knew they could not handle.
32. FCIC REPORT, supra note 3, at 6. The FCIC identifies a number of these new loan packages. "The securitization machine began to guzzle these once-rare mortgage products with their strange sounding names: Alt-A, IO (interest only), low-doc, no-doc, ninja (no income, no job, no assets) loans, 2-28s and 3-27s, liar loans, piggyback second mortgages, payment options or pick-a-pay adjustable rate mortgages, exploding ARMs."
33. FERRELL, FRAEDRICH & FERRELL, supra note 5, at 385.
first half of 2005, more than one out of every ten home sales was to an investor, speculator, or someone buying a second home. "Bigger-is-better" was the trend and even the structures themselves ballooned in size; the floor area of an average new home grew by 15% to 2,277 square feet in the decade from 1997 to 2007.34

Not only were middle and upper class borrowers buying bigger and better homes, flipping houses, and buying second homes as investments, they were taking advantage of the new lending practices to refinance in order to have cash to:

[S]end their kids to college, pay medical bills, install designer kitchens with granite counters, take vacations, or launch new businesses . . . and pay off credit cards. Survey evidence shows that about 5% of borrowers pulled out cash to buy a vehicle and about 40% spent the cash on a catch-all category including tax payments, clothing, gifts, and living expenses.35 Refinancing went from $460 billion in 2000 to $2.8 trillion in 2003.36

The rewards realized from mortgage-backed securities overwhelmed the risk. Options Group, which computes compensation figures for investment banks, examined mortgage-backed securities sales and trading desks at eleven commercial and investment banks from 2005 to 2007. It found that associates had average annual base salaries between $65,000 and $90,000, but received bonuses that often exceeded their base salaries. Vice presidents averaged base salaries and bonuses from $200,000 to $1.15 million. Directors averaged anywhere from $625,000 base salaries plus bonuses to $1.625 million total compensation. At the very top were people like Dow Kim, the head of Merrill Lynch's Global Markets and Investment Banking segment, who got a base salary of $350,000 a year plus a $35 million bonus.37 At the very same time, Merrill Lynch began losing billions—a reflection that the system was not sustainable.38

Sensing the instability of a system based on the housing market—with its relatively static number of people needing mortgages, or second mortgages for bigger homes and second homes, a surplus of new housing built by overly eager contractors that drowned home values, and a high

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34. FCIC REPORT, supra note 3, at 5.
35. Id.
36. Id.
37. FCIC REPORT, supra note 3, at 118.
38. Id. at 259. By October 24, 2008, Merrill Lynch was forced to make a $1 billion write-down on subprime mortgages and a $6.9 billion write-down on credit default options for a net loss of $2.3 billion in the third quarter of that year. This reflects the instability of the system and the magnification of subprime mortgages problem.
percentage of likely defaults in the offing—a team of math whizzes at J.P. Morgan pioneered a new financial instrument called a credit default swap (CDS). Like ordinary derivatives, the CDS is a form of insurance against sudden change in value due to underlying variables. The difference is that these are “swapped” or traded between financial institutions or sold to third-party investment firms. By 2007, there were $57 trillion worth of CDS contracts globally and their reach was pervasive—including public sector and non-profit organizations whose portfolio managers tried to ride the wave of high returns unbeknownst to the individual investors. As Ferrell, Fraedrich & Ferrell point out, “[T]he use of credit default swaps became so profitable that traders and managers lost sight of anything but their incentives for selling these instruments.”

Congress stymied oversight of these instruments when they passed the Commodity Futures Modernization Act of 2000, which allowed for the self-regulation of derivatives, including credit default swaps. In April 2004, the Securities and Exchange Commission decided to relax the net capital rule, which enabled investment banks to substantially increase their financial leverage and aggressively expand their issuance of mortgage-backed securities.

Knowing the risk, but not willing to forgo the chance for huge profits, bankers used the credit default swaps as a sort of insurance policy against bad loans. Third-party investors would assume the risk of the massive defaults on these loans in exchange for regular payments from the bank—similar to insurance premiums. A bank, such as J.P. Morgan, would then get to remove the risk from its books and free up reserves of capital—similar to the method employed by Enron years earlier which led to its total collapse.

Some investment bankers—Goldman Sachs in particular—bet against

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39. Id. at 216. Subprime mortgages remained below 10% of all mortgage originations until 2004, when they spiked to nearly 20% and remained there through the 2005-2006 U.S. housing bubble. By September 2008, average U.S. housing prices had declined by over 20% from their mid-2006 peak. This meant that borrowers with adjustable rate mortgages who could not make the higher payments once the initial grace period ended had a difficult time trying to refinance. Those who could not refinance began to default. By 2007, about 20% of subprime ARMs were delinquent or in foreclosure, and by 2009, that rose to 40%. See also Ferrell, Fraedrich & Ferrell, supra note 5, at 385ff.
40. Ferrell, Fraedrich & Ferrell, supra note 5, at ix.
41. Ferrell, Fraedrich & Ferrell, supra note 5, at viii.
43. Credit default swaps are very similar to the “off-the-balance-sheet” partnerships employed by Enron prior to its collapse. Tragically, the credit default swaps, in spite of the similarity to Enron’s activities, were not illegal as there was no specific regulatory oversight for them.
the very positions they were pushing on their customers. Credit default swaps ballooned into a $62 trillion market before AIG, "something of a last backstop in the CDS market," needed to be bailed out by American taxpayers after it defaulted on $14 billion worth of credit default swaps it had made to investment banks and many other entities. Warren Buffett, who in early 2003 had called these unregulated instruments "financial weapons of mass destruction," proved something of a prophet as the house of cards built on subprime mortgages, mortgage-backed securities, and credit default swaps began to crumble and threatened to take the world economy with it.

The debt taken on by financial institutions had increased dramatically during this time, from 63.8% of US gross domestic product in 1997 to 113.8% in 2007 when we hit the tipping point. In late 2007, foreclosure rates skyrocketed and both borrowers and investors began to feel the downside of subprime lending. Wary investors began to dump their mortgage-backed securities, and major banks and investment firms such as Morgan Stanley, Merrill Lynch, Citigroup, Bear Stearns, Lehman Brothers, Goldman Sachs, Bank of America, JPMorgan Chase, and Wells Fargo were hemorrhaging money. Adding to the potential financial impact was the $426 billion in second mortgages on the balance sheets of just four banks: Bank of America, JPMorgan Chase, Wells Fargo, and Citigroup.

Banks were clearly not the only losers in the subprime crisis, and, considering the "bailouts" of many banks, they may not end up being losers at all. Those with weak credit who did not really have the assets to afford mortgages ended up in default and foreclosure. Moody's estimated that 2.1 million families would be foreclosed on in 2011, and the Mortgage

46. Id.
47. See FCIC REPORT, supra note 3, at xvii ("From 1978 to 2007 the amount of debt held by the financial sector soared from $3 trillion to $36 trillion, more than doubling as a share of the gross domestic product.").
48. Prior to 2007, the foreclosure rate in the United States was historically less than 1%; by 2009 that had risen to 2.2%. FCIC REPORT, supra note 3, at 402. By 2009, 9.7% of all mortgages were seriously delinquent or in foreclosure. Id. at 215. By the fall of 2010, 1 in every 11 outstanding residential mortgages in the United States was at least one payment behind. Id. at 402.
50. The potential for the problem of predatory lending was recognized as early as June 1, 2000, when the U.S. Treasury and the U.S. Department of Housing and Urban Development issued a joint report on recommendations to curb predatory home mortgage lending. HUD TREASURY TASK FORCE, CURBING PREDATORY HOME MORTGAGE LENDING (June 1, 2000), available at http://www.huduser.org/portal/publications/hsgfin/curbing.html.
Bankers Association, the industry trade group, said that the total number threatened with losing their homes is four million. That would bring the total number who lost or will lose their homes over the five-year period, 2007-2011, under the combined impact of financial collapse and economic slump, to a staggering nine million families.  

Aside from the foreclosure problem, there are those who refinanced with adjustable rate mortgages who ended up with higher rates and those who bought bigger, more expensive homes during this period who ended up with “underwater mortgages” as housing prices and real estate values plummeted. As of January 5, 2011, nearly one-quarter of all US homeowners with mortgages (somewhere between eleven and fifteen million borrowers) were “underwater,” owing more than their homes were worth.

The problem of “underwater mortgages,” or mortgages in which the borrowers owe more on the mortgage than the house is worth, presents us with a specific challenge. As Peter Coy warned in his 2008 BusinessWeek article, Recession Time,

[I]t is extremely dangerous for there to be millions of homeowners who have a clear financial incentive to abandon their homes because they are worth less than the mortgages on them. Already there are signs that the stigma of abandoning a home is fading. The entire capital of the U.S. banking system would be wiped out many times over if everyone who was underwater on a mortgage turned the keys over to their lenders.

For now, the vast majority of borrowers whose mortgages are underwater continue to pay on those mortgages even when a strategic default is clearly in their best interest. According to Brent White, the

51. Id.
52. An “underwater mortgage” means that the homeowner/borrower owes more on his/her mortgage than the property is worth. See CONGRESSIONAL OVERSIGHT PANEL, OCTOBER OVERSIGHT REPORT: AN ASSESSMENT OF FORECLOSURE MITIGATION EFFORTS AFTER SIX MONTHS 24 (2009), available at http://cop.senate.gov/documents/cop-100909-report.pdf (reporting that between 15-18 million homeowners are underwater); see also FIRST AMERICAN CORELOGIC, SUMMARY OF SECOND QUARTER 2009 NEGATIVE EQUITY DATA FROM FIRST AMERICAN CORELOGIC (Aug. 13, 2009), available at http://www. facorelogic.com/uploadedFiles/Newsroom/RES_in_the_News/FAACL%20Negative%20Equity_final_081309.pdf (reporting that 15.2 million mortgages were underwater in the second quarter of 2009).
55. “Strategic default” is the term used to identify a mortgage borrower’s acquiescence to the foreclosure process by non-payment. The sharp decline in real property values has meant that
limited number of strategic defaults is the result of a desire on the part of homeowners to avoid the shame and guilt associated with foreclosure and a fear over the perceived consequences of foreclosure. However, the possibility that more borrowers might exercise the strategic default option has prompted something of a social backlash from politicians, the banking industry, the media, and others, who insist that borrowers honor their debts and pay their mortgages as a matter of moral propriety. As White contends,

[T]hese emotional constraints [shame and fear] are actively cultivated by the government, the financial industry, and other social control agents in order to induce individual homeowners to act in ways that are against their own self-interest . . . . Unlike lenders who seek to maximize profits irrespective of concerns about morality or social responsibility, individual homeowners are encouraged to behave in accordance with social and moral norms that require individuals to keep their promises and honor financial obligations.

Fear of an increase in strategic defaults prompted public admonition from Secretary of the Treasury Henry Paulson, who declared in a televised speech: “[A]ny homeowner who can afford his mortgage payment but chooses to walk away from an underwater property is simply a speculator—and one who is not honoring his obligations.” Though directed at those who might possibly be considering a strategic default at that time, Secretary Paulson acknowledged that subprime mortgages comprised only 13% of all outstanding mortgages and these accounted for only half of all foreclosure starts in the third quarter of 2007. More importantly, those whose mortgages were underwater were more than likely people who held subprime adjustable rate mortgages, which made up only 6.5% of all mortgages.

borrowers owe more on the home than it is actually worth and they would be much better off walking away from the home under the terms of the mortgage. The default is “strategic” in the sense that they would be much better off economically by purchasing a different home while property values are low, or renting a property while they re-establish themselves economically. A strategic default is very similar to the idea of an “efficient breach” sometimes used by businesses when the original terms of a contract create a disproportionate advantage for one party. However, unlike business contracts which can include liquidated damages clauses, mortgage contracts generally do not include any penalty for breach by the disadvantaged party. Hence, the interesting question is why more mortgage borrowers do not make use of the strategic default option. This is the precise question that Brent White examines in his article. See White, supra note 18.

56. Id. at 971-72.
57. Id.
Secretary Paulson was not the only public figure that joined the chorus promoting mortgage payments as “moral obligations.” While praising the virtue of homeowners who pay their mortgages each month, President Barack Obama lamented the erosion of our “common values” by those who irresponsibly borrowed beyond their means.\(^59\) The comments by the President and other political figures were mild compared to “the media invective toward those who strategically walk away from their mortgages. Such individuals are portrayed as unseemly, offensive, and unethical, and likened to deadbeat dads who walk out on their children or to those who would have given up and just handed Europe over to the Nazis.”\(^60\) White points out in his research that the media has worked to make people who consider strategic default feel like the “most despicable members of society.”\(^61\) The consistent message from both government and the media is that “walking away [from a mortgage] is not a responsible choice and should be avoided at all costs.”\(^62\)

This campaign, or “moral suasion,” as White calls it, has resulted in keeping sentiment opposed to helping individual homeowners.\(^63\) “It is not just the media and the government that act as norm enforcers, but also individuals.”\(^64\) A 2008 Harris Interactive survey reported 42% of people felt that the US government should not help individual homeowners who were in danger of losing their homes.\(^65\) As White says, “even sympathy for those who default because of predatory lending is frequently lacking.”\(^66\)

In spite of the possible social benefits of helping borrowers restructure their mortgages and state and federal government attempts to provide financial incentives to encourage banks to adjust interest rates, spread loan

\(^{59}\) Barack Obama, President of the United States, Remarks by the President on the Housing Mortgage Crisis at Dobson High School (Feb. 18, 2009), available at http://whitehouse.gov/the_press_office/Remarks-by-the-President-on-the-mortgage-crisis/.


\(^{61}\) White, supra note 18, at 999.

\(^{62}\) Id. at 1000-01. In spite of the fact that strategic default is legal and in most cases the most rational choice, White points out in his research that most people with underwater mortgages are not defaulting. White points out many of the psychological, social, political and philosophical factors, but none is as powerful as the “moral suasion” of the “major socializing agents in the United States.”

\(^{63}\) Id.

\(^{64}\) Id.

\(^{65}\) Coy, supra note 54.

\(^{66}\) White gives a very detailed account of how the government, the media, and even non-profit agencies like the National Consumer Law Center, use moral suasion, fear, and misinformation about the foreclosure process to deter people from defaulting on their mortgages. White, supra note 18, at 999-1004.
payments over longer terms, or simply write down mortgage debts, lenders have generally resisted calls to modify underwater mortgages. The Home Affordable Modification Program (HAMP) is falling well short of its goal to help three-to-four million families by 2012. As of December 2010, HAMP had resulted in the permanent modification of only 520,000 mortgages. Although banks report that they have independently approved 3.4 million loan alterations of various kinds, evidence shows that these loan alterations simply roll missed payments into a new mortgage and thus result in higher monthly payments.

This phenomenon is fundamentally incongruent with the facts of the financial crisis. Subprime mortgages are at the root of the financial crisis. More responsibility should be placed on the lenders who had superior knowledge of the financial implications of subprime mortgages and who had an obligation to exercise due diligence in making sure the borrower could handle the loan and that it would be sufficiently collateralized in the event of default. The loan-to-value ratio is a critical determinant of default risk, and lenders control the appraisal process, which sets that ratio as part of the underwriting procedure. But the fact is, “lenders relaxed the loan-to-value requirement as credit-default models showed that few borrowers were ‘ruthless,’ meaning that few borrowers would default as soon as the loan value exceeds the market value of the home.” This shows the basic intention to exploit the desire for owning a home as mentioned at the outset and points to a clear “moral double standard.”

Adding insult to injury, the stinginess towards families facing foreclosure and eviction is sharply contrasted by the hundreds of billions lavished on the banks and other financial institutions that benefited from the Wall Street bailout. “The same system that was so efficient at creating millions of mortgage loans over the past decade has been ineffective at resolving problems in the housing market, including the efforts of homeowners to modify their mortgages.” As John Taylor, president and CEO of the National Community Reinvestment Coalition, explained to the FCIC,

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67. *Id. at* 973.
68. FCIC REPORT, *supra* note 3, at 405.
69. *Id.*
71. *See FCIC REPORT, supra* note 3.
72. White, *supra* note 18, at 1009.
73. Martinez, *supra* note 49, at 1. *See also* FERRELL, FRAEDRICH & FERRELL, *supra* note 5, at xii. (“Executives at Merrill Lynch awarded $3.6 billion in bonuses to employees in 2008, with $121 million going to four top executives.”).
74. FCIC REPORT, *supra* note 3, at 405.
There was a fundamental change in our financial services sector that is the reason we are in this crisis. [A] few hundred thousand people, even a million people going into foreclosure you can kind of blame them and say ‘you should have known better.’ But 15 or 16 million American families can’t all be wrong. They can’t all be greedy and they can’t all be stupid.\(^{75}\)

This perspective invokes the admonition of the FCIC that blaming the crisis on mortal flaws such as greed and hubris is an oversimplification. The invitation to delve deeper into human nature in order to understand the crisis seems particularly appropriate in light of the banking industry’s recalcitrant attitude toward paying executive salaries and bonuses with bailout funds vis-à-vis their general resistance to offering loan modifications and proceeding with foreclosure even when the process has been shown to be flawed and illegal.\(^{76}\) Only when Bank of America, JPMorgan Chase, Ally Financial, and other big mortgage lenders admitted that they had falsified hundreds of thousands of foreclosure documents filed with state courts around the country did the Obama administration intervene and call for a moratorium on foreclosures. Congressional Democrats and state officials of both parties joined the call for a temporary halt to foreclosures, and the sheriff of Cook County, Illinois, which includes Chicago, suspended enforcement of eviction orders.\(^{77}\)

The flawed foreclosure process got so bad that in the fall of 2010, all 50 state attorneys general joined together to investigate the matter. Some of the main problems revolve around the so-called “robo-signers” who processed as many as 10,000 foreclosures a month. The FCIC Report also cites gaps in the chain of title, back-dating of documents, false affidavits, failure to establish legal standing to foreclose, and invalid notarizations as general flaws in the foreclosure process.\(^{78}\)

The flawed foreclosure process did not come as a surprise to some.

\(^{75}\) Id. at 404.

\(^{76}\) As Adam J. Levitin explained, foreclosure is either less costly or more profitable than modification. About 40% of mortgages are not being serviced by a third party, but instead are on banks’ books. The banks do not want to recognize the losses on these loans, which they would have to do immediately if they were to modify the loans. The $426 billion in second lien mortgages out there are almost all on Bank of America, JPMorgan Chase, Citigroup, and Wells Fargo. That amount is roughly equal to the market capitalization of those four banks and if they started writing off their second lien mortgages they would be insolvent. If the loans default, however, “the bank can stretch out the period of time before foreclosure,” thus “stretching out the time before it has to recognize the loss.” See Mortgage Services and Foreclosure Practices: Hearing Before the S. Comm. of Banking, Housing, and Urban Affairs, 111th Cong. (2010) (statement of Adam J. Levitin, Professor of Law, Georgetown Law), http://www.c-spanvideo.org/program/NominationHearing2.

\(^{77}\) Martinez, supra note 49, at 1.

\(^{78}\) FCIC REPORT, supra note 3, at 407-08.
Michael Orey points out that, "As the mortgage market crumbled, a number of major law firms formed subprime litigation SWAT teams ready to tackle an expected deluge of lawsuits from both individuals and institutions." The FCIC acknowledged the severity of this problem when it said,

Across the market, some mortgage securities holders have sued the issuers of those securities demanding that the issuers rescind their purchases. If the legal challenges succeed, investors that own mortgage-backed securities could force the issuers to buy them back at the original price—possibly with interest. . . . The Congressional Oversight Panel [said] . . . the consequences could be severe.  

On that account, pushing for a moratorium on foreclosures based on a flawed process might produce legal evidence of fraud on the part of banks, which would in turn provide evidence for investors to sue for recovery of their original investments plus interest, a severe consequence. According to Shaun Donovan, the Secretary of Housing and Urban Development, a moratorium on foreclosures and evictions would "do more harm than good." Several officials warned that the result would be Wall Street and international investors losing confidence in the US mortgage market. "The major banks resumed foreclosure proceedings after a brief halt and are on course to accelerate their efforts" in 2011. Likewise, politicians, banks, and the media continued their assault on homeowners considering strategic default.

Discouraging homeowners from strategic default and refusing to modify underwater mortgages when banks themselves defaulted on their credit default options seems duplicitous. However, continuing to process foreclosures in spite of calls for a moratorium for known illegalities (which investors can use as grounds for rescinding the deals) seems unconscionable. As Brent White says, "the asymmetry of moral norms for borrowers and market norms for lenders gives lenders an unfair advantage in negotiations related to the enforcement of contractual rights and obligations, including the borrower's right to exercise strategic default," which the lenders have exploited.

What White refers to as an "asymmetry of moral norms for borrowers

80. See FCIC REPORT, supra note 3, at 408.
82. Id.
83. Id.
84. White, supra note 18, at 1011.
85. Id. at 1011-12.
and market norms for lenders” might more accurately be described as two disparate ethical paradigms operating at the same time. Chairman of the House Committee on Oversight and Government, Henry Waxman, reiterated this notion when he said, “there seem to be two economic realities operating in our country today. Most Americans live in a world where economic security is precarious and there are real economic consequences for failure. But our nation’s top executives seem to live by a different set of rules.”86 In short, there is one system of ethics for the rich and powerful and another system of ethics for the poor and powerless.

NIETZSCHE GETS HIS MBA

There is at least one philosopher, Friedrich Nietzsche, who espouses a dualistic system of ethics, which would account for the incongruent behaviors in this global financial crisis. He also affords us an answer to the question asked by the FCIC, what “human weakness” did we fail to account for that allowed this crisis to happen?87 Again, the FCIC invites a deeper philosophical inquiry into the matter when it concludes that the problem cannot simply be reduced to human greed or hubris, but remains a matter of our basic human nature.88 This position points to the limitations of language where the metaphysics of human nature are concerned, as well as the tendency for humans to vacillate in their application of moral labels depending upon their circumstances and perspectives. Nietzsche’s philosophy begins with this exact premise.

As the FCIC indicated, explaining the financial crisis in terms of greed and hubris does nothing to help us understand the real “human weakness” that lies at the root of the problem. Worse still, our tendency to reduce human problems to a war of words, or metaphysical assertions expressed inadequately and inconsistently in moral labels, reduces the real situation to a non-sensical “chicken-and-egg” type argument. In the present situation, the borrowers and lenders are cast opposite one another and the debate fails to transcend the “chicken-and-egg” argument. Borrowers borrowed because lenders lent; lenders lent because borrowers borrowed.

There is no better evidence of this than the fact that there are two separate dissents from the majority opinion in the FCIC Report. While the majority was clear in laying blame at the feet of the lenders (executives, industry leaders, and public officials), the dissents, especially that of Peter Wallison, laid more blame at the feet of borrowers. The “blame game” surrounding the financial crisis has resulted in the vitriol exchange of moral

86. Ferrell, Fraedrich & Ferrell, supra note 5, at 390.
87. See FCIC Report, supra note 3, at xxiii.
88. See Id.
labels with little progress or improvement of the real situation.\(^{89}\)

In Nietzsche, we find an account of human nature that goes beyond moral labels, and in fact, destroys such labels. Nietzsche concludes that we create our own values insofar as we assign words to actions in the naïve belief that there are free and independent “subjects” behind each action. But for Nietzsche, “the acting man’s delusion about himself [is] his assumption that free will exists.”\(^{90}\) Therefore, the language used to describe human actions is not just biased; it is backwards in many cases. Our most immediate project, then, is to transcend the moral language used to describe events and avoid the tendency to look for “subjects” behind the actions. Nietzsche’s ethics is appropriately suited to the task.

Nietzsche’s metaphysics of human nature reflect a profound philosophical materialism resulting in an ethical paradigm that allows us to calculate human action, but only when we remove the idea of “subjects” from the equation. As Nietzsche says, “there is no being behind the doing, acting, becoming; the ‘doer’ has simply been added to the deed by the imagination—the doing is everything.”\(^{91}\) A perfect illustration of this is the status accorded corporations as “persons” under the Fourteenth Amendment to the Constitution of the United States.\(^{92}\) There is no “being” behind the “doing, acting, and becoming” of a corporation, though its rights as a being are protected by the courts. At the same time, even a cursory glance at our legal history will show that the responsibilities of a corporation remain vague, elusive, and hard to compel. This is especially true in the context of the current financial crisis. Lending institutions have argued vehemently for the protection of their rights to carry out their contractual obligations to pay executive salaries and bonuses with federal bailout money while at the same time defaulting on their payments to investors and avoiding legal sanction even when fraud is evident.\(^{93}\)

\(^{89}\) High-ranking officials such as Secretary Paulson and President Obama have joined in the exchange as we mentioned previously—and it has done precious little to change the reality of the situation. Paulson, supra note 58; Obama, supra note 59.


\(^{92}\) In 1886, the United States Supreme Court decision in Santa Clara County v. Southern Pacific Railroad led to the perception of corporations as “persons,” and hence the Fourteenth Amendment became applicable even though it was designed specifically to protect the rights of free Negroes. The most common use of the Fourteenth Amendment has been to protect the rights of corporations as “persons,” and countless courts since 1886 have struck down laws that sought to protect individuals and communities from corporate harms as contrary to the corporation’s primary [fiduciary] duty to enrich its shareholders. This is a far cry from the original idea of a chartered corporation in our country’s first 100 years; nevertheless, it has held sway for the past 125 years as the right approach for the fruition of capitalism. 111 U.S. 394; 6 S.Ct. 1132 (1886).

\(^{93}\) One interesting consideration in the current financial crisis is that some of the banks used the same irregular/illegal accounting techniques that sent some Enron executives to prison years
Clinging to the notion that "subjects" stand behind the social phenomenon we investigate forces a circular reasoning. As Nietzsche says, "the common man doubles the doing . . . he states the same event once as cause and then again as effect."\(^9\) The role of subprime mortgages in the financial crisis is a poignant example. As Wallison argues in his dissent from the majority view in the FCIC Report, but for the high rate of default on the 27 million subprime mortgages, we would not have a crisis;\(^9\) but the financial crisis exacerbated the economic conditions that forced so many defaults. Nietzsche provides an analogy for our circular cause-and-effect reasoning on most matters. He says, "the natural scientists are no better when they say that 'energy moves,' 'energy causes.' For all its detachment and freedom from emotion, our science is still the dupe of linguistic habits; it has never yet got rid of those changelings called 'subjects.'"\(^9\)

This seems especially true in the field of economics and is the precise reason that economics fails to predict problems and avert disasters.\(^9\)

The FCIC shows an acute awareness of the dangers of looking for individual "subjects" to blame, while itself placing great responsibility on public figures and captains of the industry.\(^9\) It hints at the need to transcend the limited perspective of our current values but lacks the specific direction. In practical terms, the government of the United States has to find a way to resolve the tension between a public which is losing confidence in a banking system that has squandered the public trust by engaging in shoddy and sometimes illegal practices, which the public now pays for with a federal bailout, and those politicians that approved the bailouts. At the same time, the government must demonstrate to investors (especially foreign investors) that they can restore confidence in the system. As the FCIC stated, "[t]hese are serious matters that must be addressed and resolved to restore faith in our financial markets to avoid the next crisis . . . ."\(^9\) In short, the government has to explain its "too big to fail" approach in bailing out the Wall Street banks—or at the very least, it must distract the public’s attention from the particular events of the crisis which appeared to reward the moral double-standard behavior of the banks.\(^10\)

Nietzsche gives context earlier. This time around, however, no one is likely to get any prison time. In a sense, the system has evolved even further to shield individuals from personal responsibility. For Nietzsche, this is completely comprehensible given his understanding of ethics as a two-tiered system of values.

\(^9\) NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 179.
\(^9\) See FCIC Report, supra note 3, at 456.
\(^9\) NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 178-79.
\(^9\) See FCIC Report, supra note 3.
\(^9\) Id. at 4.
\(^9\) FCIC Report, supra note 3, at xxviii.
\(^10\) The Obama Administration does exactly this in its Reforming America's Housing Finance Market: A Report to Congress, which was released February 10, 2011, and is discussed at the end of this section. See infra note 137, at 31-35.
and insight regarding this challenge.

Nietzsche explains the complexities of human relationships in terms of “the oldest and most primitive relationship between human beings, that of buyer and seller; creditor and debtor.”¹⁰¹ This relationship is not a consequence of society: it is ontologically prior. Nietzsche concludes, “purchase and sale, together with their psychological trappings, antedate even the rudiments of social organization and covenants. From its rudimentary manifestation in interpersonal law, the incipient sense of barter, contract, guilt, right, obligation, compensation, was projected into the crudest communal complexes together with the habit of measuring power against power.”¹⁰² The fundamental drive underlying human nature is, therefore, a “will to power.”¹⁰³

First and foremost a philologist, Nietzsche arrives at his conclusions about human nature by diving into the value system of civilized man and redressing the basic concepts of “good” and “evil.” That system shows at every turn the influence of the anthropologists, sociologists, and, most importantly, psychologists who have mistakenly premised the human value system on the ideas of “utility, forgetfulness, habit, and finally, error.”¹⁰⁴ Nietzsche says of the psychologists’ theory: “[O]riginally, altruistic actions were praised and approved by their recipients, that is, by those to whom they were useful. Later on, the origin of that praise having been forgotten, such actions were felt to be good simply because it was the habit to commend them.”¹⁰⁵ But this cannot be the case, concludes Nietzsche, for the judgment “good” does not originate with those to whom the good has been done. Rather, it was the “good” (the nobility) who decreed themselves and their actions to be “good.”¹⁰⁶ The real origin of the human value system, with its basic concepts of good and bad, “is to be found in the pathos of nobility and distance, representing the dominant temper of a higher, ruling class in relation to a lower dependent one.”¹⁰⁷

The existence of two classes of people, the nobility and a lesser, dependent class of people, is not a social construct, but a brute fact of nature. As Nietzsche says, “everything is necessity.”¹⁰⁸ Suffice to say, all men are not created equal—at least not in terms of their attributes and abilities. Clearly, some have a higher intellectual capacity than others, and,

¹⁰². Id. (concluding, “[N]o phase of civilization, no matter how primitive, has been discovered in which that relation did not to some extent exist.”).
¹⁰³. Id.
¹⁰⁴. Id. at 159.
¹⁰⁵. Id. at 160 ([O]ne would almost be justified in seeing the origin of language itself as an expression of the rulers’ power.”).
¹⁰⁶. Id.
¹⁰⁷. Id.
¹⁰⁸. NIETZSCHE, HUMAN, ALL TOO HUMAN, supra note 90, at 274.
historically, they have been the arbiters of language and hence morality. As Nietzsche says:

It was the ‘good’ themselves, that is to say the noble, mighty, highly placed, and high-minded who decreed themselves and their actions to be good; i.e., belonging to the highest rank, in contradistinction to all that was base, low-minded and plebian. It was this pathos of distance that authorized them to create values and name them.\textsuperscript{109}

For the “master class,” “all truly noble morality grows out of a triumphant self-affirmation . . . such values grow and act spontaneously, seeking out their contraries only in order to affirm themselves.”\textsuperscript{110} Practically speaking, “the noble lives before his own conscience with confidence and frankness,”\textsuperscript{111} and as Nietzsche sees it, this person acts with power in the pursuit of power; he is “the original founder of the state and he subjects to himself those who are weaker.”\textsuperscript{112} The noble regards himself as a determiner of values—a creator of values—and he does not require the approval of others.\textsuperscript{113}

The noble’s valuations “may go amiss and do violence to reality, but this happens only with regard to spheres which they do not know well,”\textsuperscript{114} offers Nietzsche. This is precisely what happened when lenders relaxed the loan-to-value-ratio because their research showed that “few borrowers were ‘ruthless enough’ to default as soon as the loan value exceeded the market value of the home.”\textsuperscript{115}

According to Nietzsche, the moral psychologists have mistakenly associated the word “good” with altruistic deeds. Contrary to this commonly accepted view, continues Nietzsche, “there is no \textit{a priori} necessity for associating ‘good’ with altruistic deeds.”\textsuperscript{116} In fact, Nietzsche points out that “the very etymology of the term ‘good’ leads us back to the basic concept of ‘noble’ in the hierarchical, class sense, and from this has developed by historical necessity, the concept ‘good’ embracing nobility of mind, spiritual distinction.”\textsuperscript{117} The psychologists’ association between

\begin{itemize}
\item \textsuperscript{109} NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 160.
\item \textsuperscript{110} \textit{Id.} at 170.
\item \textsuperscript{111} \textit{Id.} at 172.
\item \textsuperscript{112} NIETZSCHE, HUMAN, ALL TOO HUMAN, supra note 90, at 269.
\item \textsuperscript{113} FREIDRICH NIETZSCHE, GREAT TRADITIONS IN ETHICS: BEYOND GOOD AND EVIL 214 (Theodore Denise, Nicholas White & Sheldon Peterfreund, eds., Wadsworth, No. 260, 2008).
\item \textsuperscript{114} NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 171.
\item \textsuperscript{115} Vandell, supra note 70.
\item \textsuperscript{116} NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 160.
\item \textsuperscript{117} According to Nietzsche, “the development of ‘good’ runs parallel to that other concept which eventually converted the notions of ‘common,’ ‘plebian,’ ‘base,’ into the notion of ‘bad’.”
\end{itemize}
"good" and altruistic deeds is "unhistorical, and amateurish, and...in intrinsically unsound," says Nietzsche. More importantly, this mistaken assumption leads to a "herd instinct" which reduces all moral valuations to an "egoism-altruism dichotomy" which is wholly unproductive and fundamentally unnatural. To expect that strength will not manifest itself as strength, as the desire to overcome, to appropriate, to have enemies, obstacles, and triumphs, is every bit as absurd as to expect that weakness will manifest itself as strength.

The "herd instinct" is the ethical foundation of the "slave class," and it "begins by saying no to an 'other.' It requires for its inception a sphere different from and hostile to its own... it requires an outside stimulus in order to act at all; all its action is reaction." It does not create values and it does not determine values; rather, it reacts to the values posed by the master class and searches for 'subjects' to assign responsibility:

Small wonder, then, that the repressed and smoldering emotions of vengeance and hatred have taken advantage of this superstition and in fact espouse no belief more ardently than that it is within the discretion of the strong to be weak, of a bird of prey to be a lamb. Thus they assume the right of calling the bird of prey to account for being a bird of prey.

From this follows the habit of the slave class to use moral labels such as bad, evil, exploitative, and immoral. For Nietzsche, this is unproductive. First, it ignores the reality of human nature. Second, it won't have any impact because "it is a sign of strong, rich temperaments that they cannot for long take seriously their enemies, their misfortunes, their misdeeds; for such characters have in them an excess of plastic curative power, and also a power of oblivion." Thus, members of the master class appear aloof, indifferent, impenitent, and unconcerned for the plight of those in the slave class. But the simple fact is, "the inherited feeling of being a higher being, with higher pretensions, makes one rather cold, and leaves the conscience at peace." This, more than anything else, infuriates the slave class and results in the slave class hurling epithets at the members of the master class.

We see plenty of evidence of this in the current crisis, as when Angelo

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The German words schlecht (bad) and schlacht (simple) provide a poignant proof. Id. at 162.

118. Id. at 162.
119. Id. at 160-61.
120. Id. at 178.
121. Id. at 171.
122. Id. at 179.
123. NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 173.
124. NIETZSCHE, HUMAN, ALL TOO HUMAN, supra note 90, at 264.
Mozilo boldly reminded the nation in a 2007 *Business Week* interview how he had created $25 billion in value for shareholders. He was incredulous toward the public’s outrage at his $400 million profit from the sale of stock options while Countrywide was collapsing and his subsequent $100 million severance package when Countrywide was bought by Bank of America.

According to Nietzsche, the animosity of the slave class ignores the reality of human nature and obscures the root of the problem, thereby setting the stage for it to happen again. "We don’t accuse nature of immorality when it sends a thunderstorm and makes us wet; why do we consider the injurious man immoral? Because in the first case, we assume necessity, and in the second case, a voluntarily governing free will. But this distinction is in error." So complete is Nietzsche’s commitment to philosophical materialism that he suggests, “it should be stressed that all tables of values, all moral injunctions, with which history and anthropology concern themselves, require first and foremost a physiological investigation and interpretation and next critique on the part of medical science.” The plain fact is we are left with a master morality and a slave morality, and the natural condition is that, “the welfare of the many and the welfare of the few are radically opposite ends. To consider the former *a priori* the higher value may be left to the naïveté of English biologists.”

What the slave class considers exploitation is part and parcel of human nature according to Nietzsche:

**Exploitation does not belong to a depraved, or imperfect and primitive society: it belongs to the nature of living being as a primary organic function; it is a consequence of the intrinsic Will to Power, which is precisely the Will to Life. Granting that as a theory this is a novelty—as a reality it is the fundamental fact of all history let us be so far honest towards ourselves.**

Moral systems inform the “will to power” in each person and differ according to the class a person is born into. The moral system of the noble class, or “aristocracy” as Nietzsche sometimes calls it, grows out of triumphant self-affirmation. Their actions are “good” because they emanate from the noble. The moral system of the slave class is always a reaction to something outside themselves; essentially, it is a reaction to the actions of...
the nobility. This means that each class fails to understand the other class. Nietzsche leaves us with this perspective:

When a rich man takes a possession from a poor man...the poor man misunderstands. He thinks that the rich man must be a villain to take from him the little he has. The rich man does not feel the value of a particular possession so deeply because he has many...so he cannot put himself in the place of the poor man, and he is by no means doing as great an injustice as the poor man believes. Each has a false idea of the other.131

This seems a particularly accurate description of the financial crisis and foreclosure scandal.

With this level of misunderstanding, it is very unlikely that any resolution can be achieved; that is, no justice will be found—at least not that both classes would agree upon. According to Nietzsche, “[t]he initial character of justice is barter,” but in its complete realization, “justice is requital and exchange on the assumption of approximately equal positions of strength.”132 We see this level of justice achieved between members of the same class: banks and the government of the United States setting the terms of the bailout. “Justice, at this level, is good will operating among men of roughly equal power, their readiness to come to terms with one another, to strike compromise.”133

However, between members of different classes, the lenders and the borrowers in this case, who are not approximately equal, it is very likely that borrowers will have to accept the terms offered by the lenders.134 As Nietzsche says, “in the case of others less powerful, [the lenders will] force them to accept such a compromise.”135 For borrowers with underwater mortgages who might consider using strategic default as a bargaining chip to renegotiate the terms of their mortgages, Nietzsche offers this analogy:

If one party, a city under siege, for example, submits under certain conditions to a greater power, its reciprocal condition is that the first party can destroy itself, burn the city, and thus make the power suffer a great loss. Thus, there is a kind of equalization on the basis of which rights can be established. Preservation is to the enemy’s advantage. Rights exist between slaves and masters to the same

131. NIETZSCHE, HUMAN, ALL TOO HUMAN, supra note 90, at 264.
132. Id. at 266.
133. NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 203.
134. See White, supra note 18. Brent White makes exactly this point in his article.
135. NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 203.
extent, exactly insofar as the possession of his slave is profitable and important to the master. The right originally extends as far as the one appears to the other to be valuable, essential, permanent, invincible, and the like. In this regard, even the weaker of the two has rights, though they are modest.136

Based on this analysis, we can assume that the larger the (underwater) mortgage, the more likely the bank is to be willing to work with the borrower on a loan modification. Meanwhile, those mortgages that are small and pertain to less valuable properties are more likely to be foreclosed upon. This is precisely what is happening in the United States, and Nietzsche’s view is prophetic.

True to Nietzsche’s form, the Obama administration announced on February 10, 2011, a new strategy for Reforming America’s Housing Finance Market.137 This strategy includes provisions to “improve the treatment of lien property” so the modification process will be easier for those middle and upper class Americans who took out second mortgages to buy bigger and better properties, second properties, or personal property, and now are underwater.138

Meanwhile, the Obama administration’s strategy includes several elements that will make it considerably more difficult for low-income individuals to buy a home. For example, the strategy calls for a decrease in the maximum loan size that qualifies for Federal Housing Assistance insurance—making it more difficult for low-income families to buy a home.139 This is a clear pronouncement of Nietzsche’s master-slave dichotomy and a manifestation of master ethics and the pathos of distance.140

The overall goal of the Housing Finance Market Reform Report to Congress (Reform Report) is to reduce the federal government’s role in the mortgage industry, by “unwinding” Fannie Mae and Freddie Mac, thereby shifting the bulk of the entire mortgage industry over to the private sector—the same private sector that created the mortgage-backed securities and credit default swaps that crashed the global market and then paid exorbitant salaries and bonuses to their executives as the market crashed. All of these facts are conspicuously missing from this latest congressional report. Few

136. NIETZSCHE, HUMAN, ALL TOO HUMAN, supra note 90, at 266-67.
138. Id. at 18.
139. Id. at 14.
140. See NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 160.
philosophers or economists can make sense of this, save for Nietzsche. This is like putting the "birds of prey" (as Nietzsche calls the master class) in charge of the "sheep" (the slave class). The master class, of course, blames the indiscretion of the slaves for the financial crisis, as reflected in the dissent from the FCIC Report and in the Obama administration’s plan for reform, yet they harbor no animosity toward them. “We have nothing against these good lambs,” say the birds of prey, “nothing tastes better than a tender lamb.”

The language adopted in the aftermath of the financial crisis is perhaps the clearest indication that Nietzsche’s master-slave dichotomy is real and in play, and that the birds of prey will forever remain birds of prey. The Reform Report is strikingly similar to Peter Wallison’s dissenting view in the FCIC Report insofar as it puts the blame on the risky mortgages made to people with poor credit and on Fannie Mae and Freddie Mac for issuing those loans. This emphasis is counter-factual even by the Reform Report’s own presentation of the facts. The Reform Report acknowledges that “initially, Fannie Mae and Freddie Mac were largely on the sidelines while private markets generated increasingly risky mortgages. Between 2001 and 2005, private-label securitizations of Alt-A and subprime mortgages grew five-fold, yet Fannie Mae and Freddie Mac continued to primarily guarantee fully documented, high-quality mortgages.” Yet, the Reform Report focuses on the $130 billion it took to bail out Fannie Mae and Freddie Mac, a mere pittance compared to the bailout costs of the private equity firms, so that it can “pave the way for a robust private mortgage market . . . by winding down Fannie Mae and Freddie Mac.”

The Reform Report also decries the “preferential tax treatment and the lower capital requirements” that gave Fannie Mae and Freddie Mac advantages which helped them “dominate the market,” things which they successfully lobbied for in Washington, and this was unfair to the private sector. But this doesn’t really square with the Reform Report’s analysis that shows Fannie Mae’s and Freddie Mac’s combined market share in the mortgage industry dropped from 70% of new loan originations in 2003, down to 40% in 2006.

In essence, the government is setting up Fannie Mae and Freddie Mac as the scapegoats for the industry while paving the way for the master class bankers to take a larger role in the very industry they corrupted and collapsed. This position reverses the government’s position from 1968 when it concluded that we (as a nation) should work to facilitate home

141. NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 178.
142. REFORM REPORT, supra note 137, at 7 (emphasis added).
143. Id. at 11.
144. Id. at 8-9.
ownership for more people—a view that every administration from Johnson to George W. Bush embraced—and follow a new idea that “not everyone should own a home.”

The Obama administration poses this recommendation without pretense or apology, as though it were common sense that some people are not worthy of owning a home, and it spends two and half pages in the Reform Report touting its “renewed commitment to affordable rental housing.”

This, again, appears counter-factual given the Reform Report’s statement that,

In the past, broader government efforts to support affordability through Fannie Mae and Freddie Mac’s affordable housing goals proved inefficient and ineffective. Their affordability goals were inadequately responsive to the unique needs of underserved families and communities. They were misaligned with lending in the primary market. And most egregiously, they did not exclude high-cost, predatory loans.

Not only were many low-income borrowers not accommodated by the affordable housing goals, but many of those who did qualify were victimized by predatory lenders. A more obvious inconsistency in the Reform Report is that while the blame is laid at the feet of Fannie Mae and Freddie Mac, the fact is that their defaults were not nearly as high as those in the private sector. According to the Reform Report, “Delinquency rates on many private-label securities and other loans held by banks and other private market institutions were far higher than on the loans held by Fannie Mae and Freddie Mac, including loans qualifying for the affordability goals.”

Yet, the goal of the mortgage market reform is to “pave the way for a robust private mortgage market.”

The Obama administration’s position focuses on the deficiencies of the slave class in a very matter-of-fact manner. “The losses that the federal government has covered at Fannie Mae and Freddie Mac under HERA authority are virtually all attributable to bad loans that those firms took on during the height of the housing bubble.” This statement ignores other facts from the Reform Report, like Fannie and Freddie’s declining role in the mortgage industry after 2003, the predatory lending in the private sector, and the fact that Fannie and Freddie were “on the sidelines” when

145. Id. at 18-19.
146. Id. at 20-23.
147. Id. at 19.
148. REFORM REPORT, supra note 137, at 8.
149. Id. at 11.
150. Id. at 23.
the private sector went crazy with mortgaged backed securities and funky derivatives.

Again, the Reform Report looks very much like Peter Wallison’s dissent in the FCIC Report and nothing like the majority view. Here, Nietzsche would say, “did you expect the master class to take responsibility and perform a public mea culpa?” It is not in their nature, says Nietzsche, and anyone who expects that betrays his status as a member of the slave class.

So, the long and short of it is that the government allowed the sheep to get eaten by the birds of prey. When the birds of prey got sick from over-eating, the government blamed the sheep for being too fat. This reversal is again something Nietzsche predicts of human nature. “The aristocrat will, on occasion, misjudge a sphere which he holds in contempt, the sphere of the common man, the people.” Yet, the master class will not demonize the slave class (though the inverse is not true): “there is in all contempt too much casualness and nonchalance... to make of its object a downright caricature and monster.” In fact, the master class will simply restructure things in order to find new ways to exercise the will to power over the slave class.

Nietzsche offers insight into what our politicians will probably do. “The rulers,” says Nietzsche:

[D]eflect the attention of their subjects from the particular injury and, in the long run, achieve the opposite end from that sought by vengeance, which tries to make the viewpoint of the injured person prevail exclusively. Henceforth, the eye is trained to view the deed ever more impersonally—even the eye of the offended person.

This process is controlled by the manipulation of normative language by the master class as we have seen in Brent White’s research. Similarly, we can see the shift in tone from the FCIC Report to the Obama Administration’s Reforming America’s Housing Finance Market Report to Congress. Moving forward, we can expect less blame on the banking industry and lenders, and more emphasis on the responsibility of individual borrowers.

This follows Nietzsche’s perspective on the trajectory of society perfectly. “The higher must not be made an instrument of the lower; the pathos of distance must to all eternity keep separate tasks separate.

151. NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 171.
152. Id. at 171.
153. Id. at 208.
154. See White, supra note 18.
[nobility] must guard against . . . unrelieved loathing of man and unrelieved pity of him."\textsuperscript{155} Therefore, the masters must regroup and redirect the will to power to the recovery of the economic order and that requires being indifferent toward the suffering of those negatively impacted by the crisis. This follows Nietzsche's fundamental claim that pity is "the most sinister symptom of our sinister civilization" and "whoever sticks with it" will be invaded by "suspicion, distrust, and fear."\textsuperscript{156} Thus, the recovery is not so much an economic task as it is a job for the master class (American politicians and members of the banking industry) to convince other members of the master class (global investors) that they have control over their slave class. This directly involves the metaphysics of economics insofar as the goal is to regain "trust" and inspire "confidence" in the economic system—something that the Obama administration has stressed repeatedly—and, in short, to restore a sense of balance.

"Balance," as such, "is the precondition of all covenants and hence all law,"\textsuperscript{157} according to Nietzsche. And, as we have seen, this is a matter of "justice," which "is goodwill operating among men of equal power."\textsuperscript{158} Law, in the sphere of global economics, is paramount because it provides a mechanism of recovery should the balance of interests become unequal. "It follows that only after a corpus of laws has been established can there be any talk of ‘right’ and ‘wrong.’"\textsuperscript{159} That corpus of laws has already taken shape under the Dodd-Frank Wall Street Reform and Consumer Protection Act.\textsuperscript{160} According to the Obama administration, under the Dodd-Frank Act, [T]he Administration will mobilize all tools available to address the nation's broken system of mortgage servicing and foreclosure processing. Taken together, these steps [winding down Fannie Mae and Freddie Mac and the Dodd-Frank Act] will help restore trust in the underlying foundation of the mortgage market so borrowers, lenders, and investors have the confidence to purchase a home, issue a loan, or make an investment.\textsuperscript{161}

CONCLUSION

The global financial crisis has its roots in the idea that homeownership has considerable ontological significance and we would be better off as a society if more people had an opportunity to own a home. Wide-spread

\begin{itemize}
\item \textsuperscript{155} NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 261.
\item \textsuperscript{156} Id. at 154.
\item \textsuperscript{157} Id. at 153.
\item \textsuperscript{158} NIETZSCHE, GENEALOGY OF MORALS, supra note 91, at 203.
\item \textsuperscript{159} Id. at 208.
\item \textsuperscript{160} Pub. L. No. 111-203 (2010).
\item \textsuperscript{161} REFORM REPORT, supra note 137, at 2.
\end{itemize}
Homeownership was facilitated by the creation of Fannie Mae and Freddie Mac for the express purpose of making housing affordable to more people. Fannie Mae and Freddie Mac's success led members of the private sector, like Countrywide, to demand an opportunity to participate in the mortgage market more freely.

In the hands of the private sector, affordable housing standards were subsequently exploited and many new forms of mortgages were invented as well as new derivatives such as the credit default swaps which proved immensely popular with global investors. Pressure from the banking industry led to a loosening of mortgage rules and the Gramm-Leach-Bliley Act allowed commercial banks to expand into these diverse and speculative activities. The financial incentives overwhelmed reason and many people ignored the warning signs of an imminent collapse.

Somewhere along the line, the mortgage industry lost its focus. It was no longer about affordable housing for people in order to make a stronger society, but about using houses as commodities. By 2005, one out of every ten home loans was to an investor, speculator, or someone buying a second home. Re-financing homes and spending the cash equity on personal property and other things became prolific: from $460 billion in 2000 to $2.8 trillion in 2003. In pursuit of higher profits, lenders ignored the requirements of due diligence by servicing liar loans and engaging in predatory practices like relaxing the loan-to-value ratio. They did so based on their research, which showed that few borrowers were "ruthless" enough to default as soon as the loan value exceeded the home value. At the same time, lenders shirked their fiduciary duties by masking the risk behind the mortgage-backed securities they were selling to investors.

As the financial market began its meltdown, economists were at a loss to explain what went wrong or where we were headed. Mounting foreclosures on one end and banking bailouts on the other end pointed to the asymmetry of moral norms for borrowers and market norms for lenders with a general public trapped in between. The actions of the banking industry and the government at times appeared duplicitous. With 10-15 million mortgages still underwater, we are not out of the woods yet, and no single theory, economic or otherwise, seems capable of encompassing the totality of the situation—save for one, Friedrich Nietzsche.

Nietzsche offers us a view of two opposite moral paradigms that helps us make sense of the apparent inconsistencies in the behavior of the individuals and the institutions involved in the financial crisis. His view helps us understand how banks can default on their obligations, demand a bailout from the federal government and then foreclose (illegally, in many cases) on individual homeowners who they induced into adjustable rate

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162. White, supra note 18, at 1008.
mortgages by appealing to their selfish material interests. His view helps us understand how the important political actors, members of the media, mortgage bankers, and other members of the master class can preach the virtues of honoring contracts and paying one's debts while structuring bailouts for those who abandoned these virtues. His view can explain how a "strategic default" for an individual homeowner is "wrong," while an "efficient breach of contract" for a corporation is "right." His view can help us understand how we can lay blame at the feet of the private banks and yet turn around and offer them more control of the mortgage market in the future as part of our recovery plan.

Economists fail to identify and explain these phenomena because the metaphysical underpinnings of their theories don't seem to "cut nature at the joints" as some have argued. Nietzsche's philosophy avoids the debate over "natural kinds" insofar as he states very clearly that the origin of all human behavior resides in the creditor-debtor relationship. The creditors will always come out on top because they control the debtors—who are indebted to them for the very language they must use to describe their relationship. It is in this relationship that the human, "for the first time, measured himself against another individual," and so it is part-and-parcel of being human and will never end.

Thus, the problem is much more complex than just human greed or hubris—as the FCIC Report encourages us to consider. It is the age old measuring of power against power. Now the game is to see if we can repair the damage and move forward—and that requires transcending the normative language of the financial crisis, which holds us back. The human "weakness" identified by the FCIC is precisely the slave-like tendency to mire social problems in incessant normative debates, which is precisely what Nietzsche seeks to avoid. Rather, we must transcend these debates and unleash the will to power with courage. Already, the Obama administration and the banking industry are moving beyond the simplistic discussions of right and wrong and greed and ignorance. And if we understand Nietzsche's dual system of ethics, then the economic trajectory of the U.S. economy and the global economy is fairly clear. Birds of prey live nobly and eat . . . sheep live in fear and bleat.

163. KINCAID, supra note 11, at 368.
164. See NIETZSCHE, GENEALOGY OF MORALS, supra note 91.
165. NIETZSCHE, HUMAN, ALL TOO HUMAN, supra note 90, at 160.