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The World is Flat...and Crooked
By Rep. Brad Miller

The punditocracy is gravely concerned about business ethics in America.

Bernard Madoff's "alleged Ponzi scheme was only slightly less outrageous than the 'legal' scheme that Wall Street was running, fueled by cheap credit, low standards and high greed," Thomas Friedman wrote Tuesday in the New York Times. "The Madoff affair is the cherry on top of a national breakdown in financial propriety, regulations and common sense. Which is why we don't just need a financial bailout; we need an ethical bailout."

"In all that's been said in recent days about the latest proposals to rescue the financial system, two words have been conspicuously absent," Steve Pearstein, a business columnist for the Washington Post, wrote in September. The words were "We're sorry." "What responsible, honorable people do is apologize for their mistakes, promise that it won't happen again and vow that they'll make it up to us once the crisis has passed," Pearlstein said. "But in the past year, we've not heard any of that from the titans of Wall Street."

And Pearlstein was in high dudgeon last week over Wall Street executives' continued lack of contrition. On Tuesday, Pearlstein wrote that instead of acknowledging mistakes, Wall Street executives insist that they are innocent victims of freakish, unforeseeable events "to explain why their company or their industry is suddenly in the soup," an argument that the economics blog Calculated Risk calls "Hoocoodanode."

"What capsized the economy was not a perfect storm," Pearlstein wrote, "but a widespread failure of business leadership--a failure that is only compounded when executives refuse to take responsibility for their misjudgments and apologize." Pearlstein wrote on Thursday that Wall Street executives' "leadership failure was a big part of how we got into this mess, and it continues with their stubborn refusal to take responsibility, apologize and ask for a chance to make things right."

I suggested a little repentance was in order more than a year ago, before all of Wall Street landed "in the soup," when the subprime meltdown was just causing millions of middle-class families to lose their homes to foreclosure. I thought that was reason enough:

The financial industry was engaged in a fierce public relations battle then to present the borrowers as unsympathetic, as speculators, or people who bought far more house than they could afford. Friedman repeated, uncritically, the story of a lender giving "a worker who makes only $14,000 a year a nothing-down and nothing-to-pay-for-two-years mortgage to buy a $750,000 home." Michael Lewis, in an otherwise useful and engaging article about Wall Street's securitization of subprime mortgages, repeated the same story with added details that the borrower was "a Mexican strawberry picker...with no English."

Like Reagan's "welfare queen," the story of the Mexican strawberry picker has a political point: subprime borrowers are not victims worthy of our sympathy, and subprime lenders and the Wall Street firms that bought the mortgages were therefore not villains. Even if true (the story of the welfare queen was wildly hyperbolic at best), the story of the Mexican strawberry picker presents no more accurate a picture of subprime mortgage lending than the story of the welfare queen presented of poverty in America.

I've written in the blogosphere before about the causes of the subprime mess. Almost three quarters of subprime mortgages were refinances, not mortgages to purchase a home. And well more than half of subprime mortgages during the frenzy from 2004 to 2006 were to borrowers who qualified for prime mortgages. Most of the subprime borrowers were middle class families that had a rainy day--illness, unemployment, divorce--and needed to borrow money against their home. The problem was the mortgages, not the borrowers: the mortgages stripped borrowers of the equity in their homes with unconscionable upfront costs, and trapped homeowners in a cycle of repeated borrowing.

Lenders often boasted in their offering documents that the subprime mortgages they were selling had subprime terms, but many of the borrowers qualified for better. Purchasers of the mortgages apparently never asked whether that meant that the borrowers had been cheated.

And they never asked the next obvious question: if you cheated the borrowers, how do I know you won't cheat me? Instead, purchasers saw tidy profitability in prime borrowers in subprime mortgages.

Wall Street firms relied to their grief on rating agencies to tell them what they were buying. Middle class homeowners relied on mortgage brokers to tell them what they were signing, also to their grief.

So Steve Pearlstein is still waiting to hear "we're sorry" for the devastation that the securitization of subprime mortgages caused to Wall Street companies and hedge fund investors. And I'm still waiting to hear "we're sorry" for the devastation that subprime mortgages caused middle class homeowners.