

## Building a New Paradigm

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Project New Initiative is a program intended to foster the building of a new paradigm for real estate and capital markets. This is discussed in *Reading Recommended to Improve Forecast of Outcomes* and other items

The process relies on *Strategy Matters; Maury's Blog* as a start to provide a facility for discussions built upon the two essays central to the Subprime Crisis Research Council's work in fostering research that would provide better forecasts of outcomes. It goes beyond the initial work and background reported on the website in an attempt to blend other disciplines into enhancing the existing paradigms typically in use, and potentially building a new paradigm.

Such a new paradigm might be viewed as *bio-economics* in that by the use of the concept of consilience it takes an organic view of economics which requires an interdisciplinary approach. The approach may be viewed and being taken through a seminar as envisioned in the *Preface to Readings Recommended to Improve the Forecast of Outcomes: The Subprime Crisis as a case in Point*.

Part I of the discussion focuses on the discipline components discussed in *Readings Recommended to Improve the Forecast of Outcomes: The Subprime Crisis as a case in Point*. Part II of the discussion focuses on biological principles engendered in the holistic view of the health of the human body.

A key concept in the biological principles engendered in the holistic view of the health of the human body is that of viewing forces as bio-forces. In that concept, the force operating within an organ of the human body is part of the larger system of organs, and is more effectively viewed holistically.

This concept, as applied to economics or what may be called bio-economics, is the subject of Part II of the discussion along with the concept that the system's operation is dependent on energy and communication. As a start on building the new paradigm, the discussion focuses on foreclosure and the market for toxic derivatives.

Foreclosure at law is the legal process taken by the mortgagee to recover on debt secured by the pledge of property. The process differs by state law. In economics it is the process to recover on debt; it relies on law. That process is part of a larger system of

providing credit for investment in real estate; housing for the purposes of present discussion.

This larger system includes the political economy which in the United States has a federal policy of favoring home ownership. Thus, just as the stomach, the heart, or the brain is but one of fourteen organs in a system of biological function, so is foreclosure just one part of mortgage lending in the capital market structure used to finance home ownership. Viewed in isolation, it is unacceptable for government to interfere in the legal contractual rights between the borrower and lender. But, viewed holistically, the health of the system may, in some cases, justify overriding private contract.

The critical issue is the determination of when, if ever, such overriding private contract is justified. In the biological analogy, a cancerous organ may be removed in some cases. However, for some people with religious beliefs such intervention is unacceptable. And, so it is in the case with some ultraconservative citizens who view the sanctity of contract protected from interference by the very governments relied upon to enforce it.

The socio-economic system relies on a political process to administer some community affairs. That administration is restricted by constitutional protections which view governmental authority as arising from the rights of individuals. Other nation-states may take different views with the authority emanating from the body politic, be it monarchy, church, or state. The paradigm used in viewing foreclosure needs to be viewed in this context, especially since in strict Muslim observance mortgage loans at interest are forbidden.

The new paradigm, taking a holistic view, may permit intervention in the foreclosure process when the side effects of foreclosure provide substantial detrimental impacts on innocent third parties. Such may be the case when a cascading of foreclosures destroys the values of neighboring properties to an extent that the wealth destruction reverberates to the local economy in the loss of employment sufficient to engender a severe recession.

If that is the case, then the holistic view needs a paradigm structure that enables policy to deal with regulation that could identify such economic disaster areas before the intervention such as is provided for natural disaster areas. That new paradigm has a variety of issues to deal with focused on other organs in the system.

For example, in the subprime crisis that turned into a debacle, the Federal Government was encouraging Fannie Mae and Freddie Mac, two government sponsored entities, to finance subprime loans that by any

reasonable standard should never have been made. That was akin to contaminating the liver by excessive alcohol consumption.

Excessive regulation of the mortgage finance sector of the economy is akin to excessive regulation of human activity. Overly strict diets, exercise regimes, or any activity impinge on the freedom of the individual and the would-be health benefits are overridden by the psychological damage. The extent of tolerance for regulation varies substantially by culture as for example with the émigrés from the former Soviet Union left America to return to Russia because the decisions on where to live and where to work were too much for them.

In a free society, there is great reliance on markets to influence the production and distribution of economic goods, including housing. In some cases markets are overridden by regulation or subsidized to enhance participation. But markets are simply another organ in the system of societal organs.

In the case of the current housing debacle, the markets went wild because of excessive credit. Then came the wealth destruction when the price boom reversed itself. Obviously some fluctuation in markets is essential in order for markets to perform the intended function. The New Paradigm needs to consider what conditions are necessary for markets to effectively perform the intended functions.

This example needs to be vetted and the example of toxic derivatives needs to be developed. That process would lead to Part III, a statement of principles in a New Paradigm.