

A Weberian Account of Social Norms and Trust in Financial Markets

Sandro Segre

Abstract

This study focuses on how Weber's writings, especially those concerning the organization and functioning of stock exchanges, imply a theory of social norms and trust in financial markets. Consideration is given to the extent to which accounts of social norms and trust, which have been proposed by rational choice theory and Parsons, are compatible with Weber's concept of social action. According to Weber, in a market community trust is based not only on the legal protection provided by the law to contractual agreements, but also on the reputation of the exchange partners. As they may not know each other, this reputation is impersonal. In a particular milieu such as the stock exchange, however, density of relations may promote ethical, as well as unethical, consensual action. As Weber contended, the leading position of the London Stock Exchange at the turn of the nineteenth century resulted from effective social control practiced by a close community of brokers and traders on its own members, and indirectly on all members of the financial community at large. General compliance with norms prescribing fair business practices, which were taken for granted in the London Stock Exchange, may be interpreted as a result of a rational calculation of costs and benefits involved in norm abidance, or of their endorsement on the part of participants in transactions, or of custom, or finally any combination of these factors.

Keywords: Business practices, Max Weber, Parsons, rational choice theory, social norms, stock exchange.

Preface

Whether acceptance of the norms, which govern financial transactions in modern capitalism, implies a calculation of the costs and benefits that result from conformity to them or their violation, or their open or inner endorsement, has been debated. This article sets out to reconstruct Weber's account of how norms are enforced, and trust maintained, in the London Stock Exchange of his time, which he considered exemplary for its organizational effectiveness and incorporation of the capitalist ethos. The essay will provide in its introduction a brief description of the sociological literature concerning financial markets, with reference to their structure and ability to control opportunistic behavior. The first part of the essay will consider how rational choice

theory and Parsonian functionalism have accounted for the existence of social norms and trust, and the extent to which these theoretical perspectives are compatible with Weber's notions of rational action and social norms. The second part will investigate how, according to Weber, social norms and trust were upheld and preserved in the London Stock Exchange at the turn of the nineteenth century. Finally, Weber's account will be discussed against the background provided by structural and cultural perspectives bearing on financial markets.

Introduction

A sociological description of financial markets

Markets may be viewed as 'a public feedback mechanism for trading off divergences among firms and between them and buyers'. As the market determines for every product the proper combination of volume and quality, the relevant tradeoffs concern the ratios between contribution and cost (volume), and between desirability and expense (quality). In particular circumstances, free entrance, that is, pure competition would provide no viable market. Some barriers to entry – such as legal and/or capital barriers – are then necessary for this end (White 1981: 526 and 529 n. 7; see also White 1992: 41-46). As will be shown, barriers are considered necessary in financial markets, for in these markets free entrance would prevent establishing and maintaining trust, and ultimately destroy them. In this connection, some notions should be provided concerning the conditions for establishing trust among market participants, with particular reference to participants in financial markets.

Contemporary sociological descriptions of markets have often followed Granovetter in maintaining that market behavior, like behavior in general, is embedded in 'concrete personal relations and structures (or "networks") of such relations', and that embeddedness plays a relevant role in 'generating trust and discouraging malfeasance'. Networks are an important but not sufficient condition for trust and trustworthy behavior, because they may not be sufficiently dense and pervasive, and also because networks and trust may be used for immoral purposes as well. Dense and pervasive networks, in other words, are instrumental in achieving reciprocal social control and trustworthy behavior, irrespective of whether the prevalence of moral standards in business conduct (the so-called 'moral economy') results from economic interest, moral principles, or both. But the networks themselves must be in turn embedded in larger webs of