CLASSIC SOCIOLOGICAL THEORY AND THE SUBPRIME MORTGAGE INDUSTRY:
MARX, WEBER AND DURKHEIM IN A CONTEMPORARY CONTEXT

By
Connor J. Brooks

Submitted to the
Faculty of the College of Arts and Sciences
of American University
in Partial Fulfillment of
the Requirements for the Degree of
Master of Arts

In
Sociology

Chair: Natalia Ruiz-Junco

Dean of the College: John Drysdale

Date: July 24, 2010

2010
American University
Washington, D.C. 20016

AMERICAN UNIVERSITY LIBRARY 9597
This thesis has three goals. The first is to demonstrate the relevance of the classic sociological theories of Weber, Durkheim and Marx to contemporary socio-economic situations. The second is to examine the critical outlooks expressed by these three authors toward capitalism. The third is to examine the sociological content of the subprime lender-borrower relationship through the lenses of classic sociological theory. I examine Weber’s conception of the vocational attitude toward work as well as his multiple forms of rationalities in the context of lenders’ explanations for their actions. I explore Durkheim’s concepts of anomie at both the societal and individual level as well as his arguments regarding professional ethics in the economic sphere of society, applying the concepts specifically to subprime practices. From Marx’s work, I focus on his conception of exploitative relationships and the reification of interest-bearing capital in the context of the lender-borrower relationship and risk mechanisms.
ACKNOWLEDGMENTS

I wish to express my unending gratitude to Dr. Natalia Ruiz-Junco without whose guidance, patience and deadlines I would have not made it through this process. I would also like to thank Dr. John Drysdale for his encouragement and shared insights throughout my writing.
# TABLE OF CONTENTS

ABSTRACT ....................................................................................................................... ii

ACKNOWLEDGMENTS ................................................................................................. iii

LIST OF ILLUSTRATIONS .......................................................................................... viii

CHAPTER

1. INTRODUCTION ........................................................................................................ 1
   Problem Statement ...................................................................................................... 3
   Plan of Thesis .............................................................................................................. 4
   Differences Between Traditional and Subprime Mortgages ...................................... 9
      Subprime Mortgages ............................................................................................. 12
      Characteristics of Subprime Mortgages ............................................................... 14

2. WEBER .................................................................................................................... 18
   Introduction ............................................................................................................... 18
   The ‘Modern’ Rational Capitalist Ethos ................................................................... 19
      Vocation ................................................................................................................ 20
   The Spirit of Capitalism ............................................................................................ 23
   The Spirit of Capitalism and Greed .......................................................................... 25
   The Spirit of Capitalism Overcomes Traditionalist Attitudes ................................... 27
   Rationalities and Capitalist Practices ....................................................................... 30
   Types of Social Actions and Rationalities ............................................................... 30
Wirtschaftsbetrieb and Weber's Conception of Rational Capitalism ..........34
Social Relationships, Social Action and Wirtschaftsbetrieb .........................38
Vocation, the Spirit of Capitalism and Emotion ..................................................39
Institutions and Rationalities .................................................................................43
Conclusion ...............................................................................................................48

3. RATIONALITY AND VOCATION IN THE SUBPRIME MORTGAGE INDUSTRY .................................................................50
Weber's Rationalities in the Subprime Lender-Borrower Relationship ............51
  Formal Rationality of Subprime Lending ..........................................................51
  Substantive Rationality in Subprime Lending .....................................................55
  Conflicting Rationalities and Paradoxical Results .............................................57
Subprime Lending and Vocation ..........................................................................61
  Lending as Purposeful Activity ....................................................................62
  Innovation and the Spirit of Capitalism .........................................................64
  Charges of Greed Against the Lenders ............................................................67
  The Example of Countrywide ......................................................................71
Conclusion .............................................................................................................73

4. DURKHEIM .....................................................................................................75
Introduction ..........................................................................................................75
Durkheim's Concerns with Morality .................................................................77
Social Solidarity ....................................................................................................79
The Collective Consciousness .............................................................................80
Mechanical Solidarity ..........................................................................................82
Organic Solidarity ................................................................. 84

The Collective Consciousness in Societies of Organic Solidarity .......... 89

The Pathological Forms of the Division of Labor .................................... 91

The Anomic Division of Labor .............................................................. 92

Economic Anomie .................................................................................. 94

Professional Ethics ................................................................................ 96

The Aspirational Nature of Anomie .......................................................... 98

Conclusion ............................................................................................ 103

5. ANOMIE AND PROFESSIONAL ETHICS IN SUBPRIME LENDING ......... 105

An Anomie-Generative Relationship ....................................................... 105

Subprime Lending as Both the Solution to and Genesis of Anomie .......... 106

Lenders ................................................................................................. 110

Anomie and Regulation .......................................................................... 112

Professional Ethics ............................................................................... 116

Subprime Lending Institutions and Durkheim’s Views on Guilds .......... 117

Marketing Subprime and Durkheim’s Ethics ........................................... 122

Regulatory Arguments After the Fact .................................................... 125

Conclusion ........................................................................................... 128

6. MARX ......................................................................................... 131

Introduction .......................................................................................... 131

Capital Accumulation ............................................................................ 133

Surplus-Value ....................................................................................... 139
LIST OF ILLUSTRATIONS

Figure 1. Highly Structured Mortgage Finance.............................................................. 180
CHAPTER 1
INTRODUCTION

The collapse, mergers and federal takeover of numerous banks and lending houses over the past few years have brought financial and political-economic concerns to the forefront in public discourse. The effects of the collapse have been felt by more than just the business sector however. Many consumers have faced foreclosure and loss of homes, or have defaulted on loans and suffered severe damage to their credit ratings. The dollar amount lost in loans measures in the hundreds of billions, fueling an economic downturn that may cost trillions. More than the immediate effects however, confidence in markets, as well as the role of government regulation, has been brought into question. Indeed, these events lead us to more fundamental concerns about the capitalist mode of production in general as well as what constitutes the “American Dream.” While subprime mortgages are not the sole cause of the financial downturn faced by this country, the industry did play a significant role and in many ways embodies the concerns about capitalist practices that many have raised in light of the economic downturn.

We sometimes treat classic sociological theorists as representing disparate schools of thought within the tradition, citing incompatibilities and conflicts between the theorists’ bodies of work that prevent commonalities to be fully appreciated. Or, a common sentiment may be that classic sociological theory has little bearing to contemporary society having been written in some cases almost 150 years ago. Karl
Marx, Max Weber and Émile Durkheim are often viewed as central pillars in the establishment of the sociological tradition. At the same time, the corpuses of these theorists have lead to radically different schools of thought and paradigms for analyzing society. However, what I will demonstrate in this thesis is that although the way they approached topics differed, Marx, Weber and Durkheim do in fact have some common concerns for the societies which they analyzed. Despite their different methodologies and approaches to social phenomena, the theorists all exhibited worries about society which were rooted in similar origins, one of which is economics. I will also demonstrate that theoretical concepts from Marx, Weber and Durkheim are in fact germane to contemporary society and can be used to analyze the social impact of economic practices.

To this end, I examine the subprime mortgage industry in light of concepts from Weber, Durkheim and Marx. Each of these theorists treated the economic systems of their societies throughout their careers, and at some points, each posited critical claims toward Western capitalist practices, revealing their concerns about where excess capitalist rationalization might lead us, the ethical content of economic professional actions, or the general exploitative nature of the capitalist mode of production. Though these concerns are certainly different and result in different conclusions for each author, they are founded out of a shared concern for the social impacts of economic activities, and can be discussed in the context of the subprime mortgage industry.

There are three broad objectives I have in this thesis. The first is to demonstrate the relevance of classical theory to contemporary society. The second is to show that Marx, Weber and Durkheim shared some critical attitudes in their examinations of economy. The third objective, and the means by which I achieve the first two, is to
demonstrate how classic theory can be used to analyze the problematic nature of subprime lending.

**Problem Statement**

What about the subprime lending industry makes it worth studying, especially from a sociological, rather than economic, standpoint? First, the subprime industry was involved with hundreds of billions of dollars in home loans. When these mortgages started foreclosing at rates that doubled the previous year, billions of dollars were lost, affecting investors, banks, and borrowers through all echelons of society. It thus became a problem of national scope to be analyzed. However, the subprime lending industry would be worth studying even if it had not collapsed. Subprime mortgages represent innovations in capitalist practices, new modes of thinking and changes in the practice of risk assessment and management, cornerstones of investment and lending.

Second, the consequences of the subprime lending extend beyond the economical into the social. The original function of subprime loans was to reach out to a new consumer base to provide them with loans and opportunities that had normally not been available to them, as they would not qualify for prime rates on their loans. Lenders effectively sought to reach out to a new social stratum of customers previously untapped by other lenders and banks, an act which changed people’s status as homeowners, altering socioeconomic statuses and opportunities presented to new homeowners. The failure of so many loans also has social consequences. When a borrower becomes delinquent on a loan or enters foreclosure proceedings, credit scores are greatly affected. The effect is that borrowers whose loans fail or become delinquent are often in worse
socioeconomic situations than they were before they took the loan. On a societal level, the failure of subprime lending, accompanied by other deleterious financial collapses, leads to questioning of our regulatory system and our general capitalist mode of production.

This is exactly where classic sociological theory enters the fore. Weber, Durkheim and Marx all analyzed social and economic practices in their time. For Weber, a capitalist ethos developed uniquely to the West that influenced rationalities of practice as well as a vocational attitude. For Durkheim, the economic sphere of society was in constant crisis, due in part to a lack of economic professional ethics, leading to the generation of anomie both at the societal and individual level. For Marx, capitalism itself was exploitative, and above all he worried about the reification of capitalist practices that would further externalize the relations between the capitalists and the proletariat. While subprime lending, in its current form, was not in existence at the time that these theorists wrote, their works speak volumes to the social effects of the capitalist economy. Subprime mortgage lending, and the social relationships and actions that it entails, being a part of the capitalist economy, can thus be analyzed through the lens of the classic sociological theorists.

Plan of Thesis

To understand what subprime lending is and how it differs from traditional mortgage lending, it is necessary to discuss the characteristics of both types. In this introductory chapter, I outline some of the basic characteristics of mortgage borrowers in order to differentiate the essential components of subprime borrowers and loans from
those of the traditional structure. Though traditional mortgage lenders and subprime lenders often look at the same borrower characteristics, the standards are quite different for what is perceived as an acceptable risk. I will not go into the technical details about the mathematical equations behind the risk assessment activities. Rather, throughout the thesis, the focus is on the social content and consequences of risk assessment activities.

In Chapter 2 I rely on concepts from Max Weber. There are two main conceptual areas on which I focus. The first is Weber's conception of vocation and the development of the Western capitalist ethos. For this concept, I primarily rely on *The Protestant Ethic and Spirit of Capitalism* to elucidate Weber's characterization of Western capitalist attitudes. The second main conceptual area on which I focus is Weber's concepts of rationality. Here, I draw mainly from the volumes of *Economy and Society*. I explore the various types of rationality, including value rationality (wertrational), means-ends rationality (zweckrational), substantive rationality and formal rationality. At the end of the chapter, I address some of the current discussion surrounding the works of Weber. In *The Protestant Ethic and the Spirit of Capitalism*, Weber distanced emotions from the vocational outlook. However, recent discussion has focused on the role of passion in the works of Weber, particularly in the later vocation lectures. It is found that passion plays a significant role in the vocational outlook, making the concept more emotionally based than perhaps Weber acknowledged. Weber's concepts of rationality are also discussed in the context of how institutions set their goals, procedures and policies, and what the characteristics are of a rationalized institution.

In Chapter 3 I apply Weber's concepts to the study of the subprime mortgage industry. First, using the concepts of vocation and the capitalist ethos, I interpret lenders'
and regulators’ explanations of their actions. However, charges of greed leveled against the subprime industry as a whole would seem to contradict the vocational attitude that these lenders profess. Lenders seem to genuinely believe in what they do, but to an outside observer, their actions seem rather avaricious. Second, I point to the intersection of lenders’ rationalities as having severe economic consequences, namely the meltdown of the subprime mortgage industry, and the foreclosure of many homes.

In Chapter 4 I discuss concepts from Émile Durkheim. I focus on Durkheim’s notions of anomie and the arguments he made regarding professional ethics, particularly in the economic sector. I explore anomie in the context of both The Division of Labor in Society and Suicide. In the former, I characterize Durkheim’s discussion of anomie as much more structurally or societally focused compared to the latter. Durkheim focused his discussion of Anomie in The Division of Labor in Society on what he called the ‘pathological’ form of the division of labor. This is a form that would lead to a breakdown in social solidarity and moral cohesion. This differed from the discussion of anomie found in Suicide in which Durkheim’s focus was much more on the individual manifestation of anomie. In this context, economic anomie takes on a much more acute sense as individuals may be subject to economic anomie through unmet aspirations. I also discuss Professional Ethics and Civic Morals, later lectures of Durkheim in which he argued that regulation and self-regulation are lacking in the economic professions. Durkheim argued that effective standards, like those found in the era of guilds, were absent in the economic professions of his time. In discussing the secondary literature, I highlight how Durkheim’s conception of anomie, particularly as he wrote of it in Suicide, can be interpreted as springing from failed aspirations, making much more personal in
nature than one finds it to be in *The Division of Labor in Society*. At the same time, this discussion will also illuminate that there is a theme of anomie that connects *Professional Ethics and Civic Morals* to *The Division of Labor in Society* and *Suicide*. It is in fact largely due to the lack of professional ethics in economics and business that anomie, both at the societal and individual level is generated.

In Chapter 6 I apply these concepts from Durkheim to the subprime mortgage industry. First, I argue that the subprime lending industry at first was a method of preventing and ameliorating anomie. By granting access to loans to people who would normally have been excluded from them, the subprime industry opened up opportunities for economic advancement. However, as the industry grew and lending practices started becoming problematic by taking on excessive risks and creating complex loan products, borrowers were able to get loans that they could not afford resulting in a worse situation than they were in before taking the loan. Second, I contend that Durkheim’s arguments regarding professional ethics are parallel to the same criticisms that are leveled toward the economic and business professionals today. Their actions demonstrate a clear lack of standards by which the lending industry can abide.

In Chapter 7 I discuss concepts of Karl Marx, mainly from the volumes of *Capital*. First, the idea of exploitation in capitalist enterprise is part of the basis of Marx’s criticism of capitalism. Exploitation entails a relationship in which a party with access to capital and means of production extracts value from another party without this access to capital and the means of production. Second, I discuss Marx’s concerns with interest-bearing capital, as outlined in the third volume of *Capital*. Marx saw this capitalist exchange as the most reified and externalized form of capitalist relations. In the
discussion of current debate on the topic of exploitation, I look at some of the analytical Marxist arguments regarding exploitation. Some argue that it is an overstated concept that does not warrant so much attention, while others emphasize that Marx used it in a morally critical sense. In the end, I take the latter argument: that it is not an outmoded concept and that it is indeed central to classic Marxist criticism of capitalist practices. I also discuss the defense of Marxian theory against those who discredit the body of work based on the rejection of the mathematical and technical details of Marx's economic theory. I argue that even if one rejects the technical details regarding the calculation of surplus value, the exploitative relationship at the heart of Marxian theory is based on the inequality, in terms of power and access to capital, found in capitalist relationships. The theory bears social significance regardless of the mathematics of Marx.

Finally, in Chapter 7 I apply Marx's concepts to the subprime industry. First I demonstrate that although Marx put forth his theory of exploitation in the context of the capitalist-laborer relationship, exploitation can still be characterized as being part of the lender-borrower relationship following Marx's definitions. It is a relationship still founded by the unequal access to power and one in which the lender, as capitalist, benefits from the borrowers' lack of access to capital. Second, I argue that the securitization of subprime loans strongly recalls Marx's concerns about reified capitalist practices. I show that in fact, many of the criticisms aimed at the subprime mortgage industry regarding the complex securitization process closely resemble the same concerns that Marx voiced regarding interest-bearing capital.

Classic theory can thus bear relevance to contemporary society. Marx, Weber and Durkheim were each at times critical of capitalism, finding certain aspects of the
economic system to be very problematic. The subprime industry provides a contemporary case that illustrates the sociologically problematic nature of capitalism from the viewpoint of classic theory. Before turning to these points, I will first outline the characteristics of the subprime mortgage industry and what sets it apart from the traditional mortgage structure.

**Differences Between Traditional and Subprime Mortgages**

There are several different forms of mortgages that cater to different types of consumers as lenders structure mortgages in ways that minimize risk to them and ensure full, continuous payment of the loan. First, I will briefly outline some of the main characteristics of mortgages in general. I will then point out the major differences and features of subprime mortgages within the mortgage lending industry in general.

Mortgages can be either unsecuritized or securitized. Securitized loans may be agency sponsored or non-agency sponsored. Agency loans are guaranteed by the Government National Mortgage Association (Ginnie Mae), or another government sponsored enterprise such as the Federal Home Loan Mortgage Corporation (Freddie Mac) or the Federal National Mortgage Association (Fannie Mae). Non-agency mortgages are not guaranteed by any government agency, because they do not meet the agencies’ underwriting criteria. Non-agency mortgages (sometimes called nonconforming mortgages) may be ‘jumbo prime’, alternative-A (Alt-A), or subprime (Goodman, Li, Lucas, Zimmerman and Fabozzi 2008:3). Within these groupings, individual mortgage formulas can differ by lender, but these are the basic categories of home mortgages.
Important characteristics of the different loan types include FICO scores, loan-to-value ratios and combined loan-to-value ratios, documentation, the percentage of the loan that is adjustable rate mortgage and the debt-to-income ratio. All of these characteristics are used to determine and track performance of mortgage-backed securities. Some of these characteristics, such as the FICO score are determined using complex mathematical models of risk assessment, while others such as loan-to-value ratios are much less complex. However, the goal here is not to analyze the technicalities of those calculations behind the loans, but the social meaning and impact of those calculations.

The FICO score is a scale created by Fair Isaac Corporation and is the typical credit indicator most familiar to consumers. The scale is used essentially to calculate the likelihood that a borrower will repay a debt. The scale ranges from 350 to 900, where higher scores denoting lower borrower risk. FICO scores have been found to be indicative of prepayment and payment delinquency (late payment) patterns. A borrower’s FICO score is an important, but not the sole determining feature of the type of loan that the borrower will be able to receive. Average FICO scores for agency sponsored loans are around 730, while the scores for subprime (non-agency) borrowers are typically lower than 630 (Goodman et al. 2008:10-12; Immergluck 2009).

Loan-to-value (LTV) and combined loan-to-value (CLTV) are essential features of determining credit performance and the size of the loan to be given. The LTV is the ratio of the loan to the value of the home. A home valued at $200,000 with a $150,000 loan would have an LTV ratio of 75 percent. The CLTV takes into account subsequent loans. So the same $200,000 home with a first mortgage of $150,000 and a second of say $30,000 would have a CLTV ratio of 90 percent ($180,000/$200,000). The higher the
LTV and CLTV, the more the borrower had to borrow in order to pay for the home. Agency-sponsored loans with a LTV higher than 80 percent require private mortgage insurance; however, this is not the case with subprime loans. Goodman et al. (2008:11) showed that for 2006-2007, just above 30 percent of subprime loans issued had CLTV ratios of 100 percent, meaning the borrower could put nothing down towards the purchase of the home, and the entire amount was borrowed. Part of the problem with having such a CLTV is that if and when the home depreciates, it is possible that the borrower has mortgaged for more than the home is worth (Goodman et al. 2008:11). That same $200,000 home by devaluing by 15 percent is now worth only $170,000 while the borrower has mortgaged it for $180,000.

The debt-to-income (DTI) ratio is a measurement of borrower’s ability to repay debt. It differs from the FICO score which is a calculation of likelihood to repay debt based on past payment behavior, whereas the DTI indicates the ability of the borrower to repay debt. The DTI may differ according to the lender’s calculations but it is essentially the monthly expenditures of the borrower divided by the borrower’s income. Sometimes this ratio is limited only to housing payments in ‘front-end DTI’, or it can be broader to include additional things like credit card debt, auto debt or child support payments in ‘back-end DTI’ in relation to income. Like the LTV ratio, the higher the DTI, the more it seems that the borrower had to stretch more to purchase a home (Goodman et al. 2008:15).

Adjustable rate mortgages (ARMs) are mortgages that have interest rates fixed for a period of time, but after this initial period, the interest rate is adjusted periodically—typically every six months. For a 30-year mortgage, the most common subprime ARMs
are the 2/28 and 3/27; these are mortgages with a two or three year fixed rate and then for the remaining 28 or 27 years, the interest rate resets every six months. A danger for borrowers in ARM structures is that there is no way of knowing for sure what the interest rate will do. There is a cap set on how much the interest rate can increase, but within this range, the borrower does not know what the interest rate will be for the next six-month period. When ARMs reset they do so according to various indices such as the London Interbank Offered Rate (LIBOR) (Goodman et al. 2008:16).

The documentation required for traditional loans is quite stringent relative to non-agency loans. Agency loans require income statements verified by federal W-2 forms and a verified statement of assets from the bank. However, lenders of non-agency sponsored loans can waive these documentation requirements. It is possible for a borrower to secure a loan and for a lender to approve a loan based only on stated income with no verification of assets. The form of documentations that lenders choose can vary according to lender issuing the mortgage when it is not a government agency sponsored loan. This limited documentation has been correlated with higher LTV ratios, lower FICO scores and higher DTI ratios (Goodman et al. 2008:11).

Subprime Mortgages

Now that the essential features of all loans have been described, I will move on to what separates subprime mortgages form other types of loans. Before moving directly to this discussion however, it is worth addressing why the subprime industry merits its own analysis. Why not discuss subprime mortgages along with other types of mortgages? There are two apparent reasons why subprime can be discussed on its own. First, as its
own sector of the housing market, the subprime industry involves hundreds of billions of dollars per year. Second, the structure and characteristics of subprime loans will be shown to be uniquely problematic, to the point where their flaws stand out as singular amongst all forms of loans.

In 2006, at the highest point of non-agency loans in the last ten years, mortgages were distributed in the following proportions. Sixty-six percent of mortgage-backed securities were agency loans, the remaining 34 percent were non-agency loans; of this 34 percent, 13 percent were Alt-A loans, 8 percent were jumbo prime loans, and 13 percent were subprime loans (Goodman et al. 2008:4). Despite the fact that the majority of loans were agency loans, non-agency loans actually issued more money. Out of the gross issuance of about $2,070,089,000,000 agency loans represented 44.7 percent (or roughly $924,637,000,000) of the issuance, while non-agency loans represented the remaining 55.3 percent (roughly $1,145,452,000,000). Further, subprime mortgages made up 21.7 percent ($448,600,000,000) of the gross issuance for 2006 (Goodman et al. 2008:6).

Starting in 2006 the number of subprime mortgaxes entering foreclosure began to rise to 7.2 percent, up from 5.7 percent in 2005. However, this was still lower than the high point of 9.4 percent in 2001. But this number grew, almost doubling to 13.8 percent in 2007 and then 17 percent by the second quarter of 2008 (Immergluck 2009:136). When an industry is responsible for issuing almost half a trillion dollars in one year, yet the foreclosure rate the next year is almost 1 in 7, almost double the rate of the previous year, losses are going to be enormous. These numbers serve to emphasize the point of why one might single out subprime loans to analyze: they made up a significant part of the loans issued and they are a sector of the economy that moved hundreds of billions of
dollars each year. As has already been said however, the consequences extend beyond monetary loss. People have lost homes, ruined credit scores and ended up in worse positions than they were before they took out a subprime loan.

Characteristics of Subprime Mortgages

How do subprime mortgages differ from other loans? Given the characteristics described above—FICO, LTV, CLTV, DTI, ARMs, and documentation—how are these different for subprime mortgages? To begin, one observes lower FICO scores for borrowers of subprime mortgages. In 2006, the average FICO score for agency loans was 723, whereas the average FICO score for subprime loans was 626. This score was lower than both jumbo prime loans as well as Alt-A loans, which had average scores of 740 and 708 respectively (Goodman et al. 2008:10). It has already been noted above that higher FICO scores are correlated with lower rates of payment delinquency and foreclosure.

Loan-to-value ratio and combined loan-to-value ratios are typically much higher for subprime loans. In 2006, the average LTV for agency loans was 73 while subprime loans averaged at 81 and the CLTV was around 87, meaning that on average subprime borrowers borrowed 87 percent of the value of the home; they could put down only 13 percent (Goodman et al. 2008:10). It is worth noting too that Goodman et al (2008) show that more than 30 percent of subprime loans for 2006-2007 had CLTV ratios of 100; 30 percent of borrowers took out loans for 100 percent of the value of the home (p. 11).

Following the trend, the DTI ratio for subprime loans also tends to be higher. They have an average back-end DTI of 41 percent, higher than both jumbo prime (33 percent) and

---

1 Note that jumbo prime loans are typically associated with higher FICO scores than agency loans. This reflects the fact that jumbo prime loan amounts are greater than agency loans, so lenders look for higher FICO scores for these loans.
Alt-A (36 percent) loans (Goodman et al. 2008:15). This means that subprime borrowers, on average spent 41 percent of their monthly income toward housing, credit and auto debt. Like LTV ratios, DTI ratios serve as an indicator that a borrower had to stretch an income further to afford the home and the larger the DTI, the greater the risks are of defaulting on the loan. For subprime mortgages, the most popular type of ARM was the two year ARM in which the interest rate remained fixed for the first two years, but then could reset every six months after that within a certain cap for the remainder of the loan’s lifetime, typically 30 or 40 years. In total about 90 percent of subprime loans were some form of ARM when this form of mortgage had traditionally only been available to borrowers with good credit scores.

By contrast fixed rate mortgages have been a standard practice since the Great Depression and account for around 75 percent of current mortgage debt outstanding. One of the intents of ARMs is that they helped people secure loans in times of high fixed interest rates, when such loans would not be out of reach because of the high interest rates. This was generally less problematic, because they were still available only to people who posed minimal risks (Zandi 2009:548-572). However, by the Mortgage Bankers’ Association calculations even “in the best of times, the delinquency rate on ARM loans is 50 percent greater than on fixed-rate loans,” indicating that they are associated with higher risk lending (Zandi 2009:578).

‘Interest-only’ and ‘option’ ARMS are a further problematic loan structure that has been observed, particularly because so many subprime loans were forms of ARMs. Initially low monthly payments make these forms of ARMs very attractive. In interest-only ARMs, the borrower initially does not pay any principal, but rather only the interest.
With options ARMs, borrowers may pay only the interest, the principal plus interest, or just a minimum amount that does not even cover interest alone. The unpaid interest is tacked on to later payments. The result is negative amortization; instead of debt decreasing, it actually increases (Gramlich 2007b:3; Zandi 2009:591-597). ARMs mortgages seem to present a particularly problematic issue. In 2007, thirty-five states experienced 10 percent or greater ARMs loans entering foreclosure; this represented an increase from only three states in 2005 (Immergluck 2009:137). The overall rate for ARMs loans that ever went into foreclosure is about 25 percent higher than fixed-rate loans (Quercia, Stegman and Davis 2007).

Regarding documentation, it was not uncommon in subprime loans to rely only on borrowers’ unverified stated income and assets. In fact, on average only 60 percent of subprime loans are provided with full, verified documentation (Goodman et al. 2008:10). In 2001, 28.5 percent of subprime loans were low or no-documentation loans, but this number grew to 50.8 percent in 2006 (Immergluck 2009:86). This was a problematic practice because it has been found that there was ‘padding’ of such statements done by both borrowers and lenders in order to push loans through in what some have come to call ‘liar’s loans’ (Goodman et al. 2008; Zandi 2009).

Securitization is the process by which risk is layered and spread through different levels of investors (Goodman et al. 2008; Pavel 1989). Securitization is by no means limited to subprime loans, but what subprime lenders did was use a more complex structure called ‘excess spread/overcollateralization’ (Goodman et al. 2008:89). The process of securitization pools loans into different layers of risk, or tranches that receive ratings such as AAA, A, B and so on, with AAA being the lowest-risk, lowest-yield
layer. Investors may then buy these different securities based on how much risk they are willing to accept in their investments (Goodman et al. 2008; Immergluck 2009). In subprime lending loans are pooled and repooled into larger groups and go through several layers and several tranches in order to diffuse the level of risk to investors (Immergluck 2009). The process of securitization in subprime lending will be more thoroughly explained and a central part of Chapter 7.

In sum, the characteristics of subprime loans that set them apart from other forms of loans demonstrates that they are riskier loans in general. Though the loan size tends to be smaller—$185,000 on average versus the average $221,000 for agency loans—in aggregate, subprime loans were involved with enormous sums of money with higher risks than the other forms of mortgages (Goodman et al. 2008:10). Subprime mortgages clearly possess characteristics that set them apart from other forms of mortgages. They are constructions to be assessed and analyzed on their own. Having laid out some of the more prominent factors separating subprime from other types of loans, it is now possible to examine some of the components of the subprime mortgage industry, namely that of the lender-borrower relationship and the actions of the lenders. In the following chapters, I will discuss the concepts from the theorists that I wish to examine and then apply them to the context of the subprime mortgage industry.
CHAPTER 2

WEBER

Introduction

Throughout his career Max Weber (1864-1920) analyzed the origins and progression of modern, Western capitalism and characterized the social and attitudinal changes that accompanied it. Weber sought to find how modern, Western capitalism developed, what influenced its growth, and what made it unique, especially compared with other forms of capitalism that had existed before and concurrently. Through tracing economic history, Weber wanted to understand the viewpoints of actors and how these viewpoints shaped economic actions as well as patterned relationships. In understanding the viewpoints of actors, Weber looked to different conceptions of rationalities in order to make sense of why people acted the way they did.

Here, I first look at the capitalist ethos that Weber contended was unique to Western capitalism. One finds the development of this ethos to be brought about by the ascetic Protestant movements starting in the time of the Reformation. The concept of vocation was central to this economic evolution. The vocational attitude helped to place work and industry at the center of life, changing the nature of labor from simply ‘doing work’, to giving it purposeful meaning. This attitudinal development, in turn, gave Western economic activity characteristics particular to itself.

I turn next to the rational characteristics which Weber asserted made Western
capitalism distinctive. Rational capital accounting, the practice which Weber saw as the essential feature separating the development of Western capitalism from that of other modes of capitalism, is a central concept Weber saw as starting solely in the emergence of Western capital. This rational capital accounting entails a valuation of every need in calculable, monetary form, shaping social and economic actions and relationships.

There are two overarching goals of this chapter. The first is to elucidate Weber’s characterization of Western rational capitalism, its values, ethos and the ends at which actors involved in the economic system generally aim. The second goal is to examine where economic actions intersect with the various forms of rationality and social actions. In other words, what impact does rationally driven economic action have on social relationships, and how do these relationships shape social action?

The ‘Modern’ Rational Capitalist Ethos

In *The Protestant Ethic and the Spirit of Capitalism* Weber ([1904] 1958) examined the connection between the ‘modern’ and ‘rational’ capitalism of Western Europe and the United States and the social ethics of Protestant movements such as Calvinism and Methodism. Weber argued that as the ascetic forms of Protestantism spread, there was a simultaneous transformation of the place of work in a person’s life. Work was no longer just a means of survival but instead came to be seen as vocation, or a calling. This new role of work as a vocation is a defining feature of the new, rational model of capitalism and provides a contrast against the older, traditional capitalism, which the new mode replaced.

Much of *The Protestant Ethic and the Spirit of Capitalism* is devoted to the
examination of various Protestant movements and their stance regarding vocation. What is of more interest for the present purposes however, is the way in which Weber characterized the 'spirit of capitalism'. It is the 'modern', rational form that Weber saw as being the mode of capitalism of the United States and Western Europe, and it is this characterization that I am interested in applying presently. I will begin with Weber's conceptualization of vocation as this offers a good starting point for discerning the change from traditional capitalism to 'modern' capitalism.

Vocation

The way Weber characterized vocation, *Beruf*, is a fundamental part of his larger conceptualization of 'modern', rational capitalism. One can begin to discern the difference between 'modern,' rational capitalism and the traditional forms of capitalism through seeing how 'doing work' was transformed into 'having a vocation'. The significance of the change denotes an attitudinal shift in the view of the place that work occupies in one's life.

The idea of a vocation, or a calling, has religious origins. The vocation is a 'task set by God' to people in order that they can fulfill it and honor God (Weber [1904] 1958: 79-80). Weber rooted its origins in the various traditions found in the Protestant Reformation: "like the meaning of the word [vocation or calling] the idea is new, a product of the Reformation...at least one thing was unquestionably new: the valuation of the fulfilment [sic] of duty in worldly affairs as the highest form which the moral activity of the individual could assume"(Weber [1904] 1958:79-80). For those who followed the various movements within Protestantism, treating one's work as if it were a calling from
God, filling it with such value, was a way to honor God.  

The religious underpinning of the vocation was not permanent and eventually disappeared altogether. What Weber claimed started as a Calvinistic attitude would lose its religious tones and be adopted into secular attitudes. In fact, Weber noted, “The religious circles which today most enthusiastically celebrate that great achievement of the Reformation are by no means friendly to capitalism in any sense. And Luther himself would, without doubt, have sharply repudiated any connection with a point of view like that of [Benjamin] Franklin” (Weber [1904] 1958:82). Although the idea of vocation was religious in origins, the concept seeped into and maintained centrality in many people’s lives, even amongst the non-religious, and became an important social ethic:

And in truth this peculiar idea, so familiar to us today, but in reality so little a matter of course, of one’s duty in a calling, is what is most characteristic of the social ethic of capitalistic culture, and is in a sense the fundamental basis of it. It is an obligation which the individual is supposed to feel and does feel towards the content of his professional activity... (Weber [1904] 1958:54)

This transformation into a social ethic has stripped the vocation and the capitalist enterprise in general of the religious overtones which once defined it: “In fact, it [the modern capitalist system] no longer needs the support of any religious forces, and feels the attempts of religion to influence economic life, in so far as they can still be felt at all, to be as much an unjustified interference as its regulation by the State” (Weber [1904] 1958:72). Clearly, Weber thought that despite its religious origin and influences,

---

2 Weber differentiated between the various movements within the Protestant tradition. Lutherans and Calvinists for example did not share the same views on vocation. They were however, related in the sense all Protestant Reformation movements were characterized by Weber as contributing importance to worldly activities and elevating vocation and labor to a point above the mundane: “But it is unnecessary to go into detail. For, above all, the consequences of the conception of the calling in the religious sense for worldly conduct were susceptible to quite different interpretations. The effect of the Reformation as such was only that, as compared with the Catholic attitude, the moral emphasis on and the religious sanction of, organized worldly labour in a calling was mightily increased” (Weber [1904] 1958:82). The difference between the sects is important to note in the study of religion, but is tangential to the present interests.
vocation, and in general, 'modern', rational capitalism developed into a non-religious ethos, and perhaps even an attitude that many religious followers might find objectionable.

The new conception of vocation as a central pillar of life differs from the traditional ways of viewing labor, where one did not labor for labor's sake, but simply to earn wages for survival. Weber ([1904] 1958) gave an example of the difference between the two when he discussed the tension between a laborer still in the traditional mindset and the employer who embraced the 'modern, rational' form:

A man, for instance, who at the rate of 1 mark per acre mowed 2 ½ acres per day and earned 2 ½ marks, when the rate was raised to 1.25 marks per acre mowed, not 3 acres, as he might have easily done, thus earning 3.75 marks, but only 2 acres so that he could still earn the 2 ½ marks to which he was accustomed...He did not ask: how much can I earn in a day if I do as much work as possible? but: how much must I work in order to earn the wage, 2 ½ marks, which I earned before and which takes care of my traditional needs? ...A man does not 'by nature' wish to earn more and more money, but simply to live as he is accustomed to live and to earn as much as is necessary for that purpose. (Pp. 59-60)

One sees here the difference between the traditional laborer and the employer who wishes to embrace the 'modern' mindset and expand operations. The traditional laborer has no desire to change things, but would rather continue with the traditional modes of laboring. He or she is content with simply performing a task to earn a living. They are not living to work, but working to live. Life, in the traditional mindset, was not consumed by or devoted to work, but work was only a part of life:

The number of business hours was very moderate, perhaps five to six a day, sometimes considerably less...Earnings were moderate; enough to lead a respectable life and in good times to put away a little...A long daily visit to the tavern, with often plenty to drink, and a congenial circle of friends, made life comfortable and leisurely (Weber [1904] 1958:67).

The transformation of work into vocation denotes a fundamental shift where
capitalistic enterprise and labor became an ethical duty. When the attitude toward work shifts toward the vocational outlook, one feels a sense of duty toward the work, not out of a sense of monitored obligation, but a sense of personal commitment. "It is an obligation which the individual is supposed to feel and does feel towards the content of his professional activity, no matter in what it consists..." (Weber [1904] 1958:54). This ethic supports the idea that one ought to devote one's life to a career, changing the way labor is viewed dramatically. Leisure time was gone or at least greatly diminished, the working day was longer and more intense, and the pursuit of getting meaning out of one's occupation became central to life (Weber [1904] 1958:67-68). This ethic encourages people to see their labor as a vocation and is a fundamental component of the spirit of capitalism.

The Spirit of Capitalism

It is important to point out that in Weber's conceptualization of the spirit of capitalism that capitalist economies do not depend on the spirit of capitalism: "To be sure the capitalistic form of an enterprise and the spirit in which it is run generally stand in some sort of adequate relationship to each other, but not in one of necessary interdependence" (Weber [1904] 1958:64). Capitalism has existed without this particular Western ethos, and in many different areas of the world, such as China, India, Babylon, the "classic world" and the Middle Ages, where Weber ([1904] 1958:52) found this social ethic to be lacking. However, the spirit of capitalism and the economic system are joined uniquely in the West as a result of historical developments both economic and religious. It is particularly in the West that the two have forged a relationship: "We
provisionally use the expression spirit of (modern) capitalism to describe that attitude which seeks profit rationally and systematically in the manner which we have illustrated by the example of Benjamin Franklin" (Weber [1904] 1958:64).

Weber began the description of the spirit of capitalism with a number of quotes from Benjamin Franklin including phrases that have become something of proverbs, such as “Time is money,” and “Credit is money” (Weber [1904] 1958:48). Weber attributed to Benjamin Franklin the title of the ‘modern’ capitalist par excellence. To Weber, Franklin’s writings were expressions of a real set of ethics. They sought to establish ethical codes for not just working and managing, but living and proper upbringing:

Remember this saying, *The good paymaster is lord of another man’s purse.* He that is known to pay punctually and exactly to the time he promises, may at any time, and on any occasion, raise all the money his friends can spare. This is sometimes of great use. After industry and frugality, nothing contributes more to the raising of a young man in the world than punctuality and justice in all his dealings; therefore never keep borrowed money an hour beyond the time you promised, lest a disappoint shut up your friend’s purse for ever. (Weber [1904] 1958:49)

Weber attributed to these writings the very embodiment of the spirit of capitalism. These writings denote a very serious emphasis on productive work, on not ‘wasting’ time, and in doing so, give working an ethical importance. That they were so popularly accepted and became something like tenets of folk wisdom was evidence to Weber that the spirit of capitalism held a strong place in the minds of Western capitalists. “The infraction of its rules is treated not as foolishness but as forgetfulness of duty [italics added]” (Weber [1904] 1958:51). To be unproductive has become something contemptible; idleness is unethical. This spirit of capitalism “takes on the character of an ethically coloured maxim for the conduct of life” (Weber [1904] 1958:52). It is a maxim that has shaped
societal attitudes toward business and occupation.

The Spirit of Capitalism and Greed


It should be taught in the kindergarten of cultural history that this naïve idea of capitalism must be given up once and for all. Unlimited greed for gain is not in the least identical with capitalism, and is still less its spirit. Capitalism *may* even be identical with the restraint, or at least a rational tempering of this irrational impulse. But capitalism is identical with the pursuit of profit, and forever *renewed* profit, by means of continuous, rational, capitalistic enterprise. (p. 17)

Capitalism is not predicated on greed. In fact, Weber thought that when rationally pursued, capitalism would actually restrain greed. So important was this clarification for Weber that he placed it in the text before he offered his own conceptualization of what capitalism is. Modern, rational capitalism is not an unrestrained quest for accumulation. Rather it is the quest for profits in a restrained, rational manner (Weber [1904] 1958:53-58).

Weber’s point that traditionalists viewed the spirit of capitalism as ‘avaricious’ and ‘lacking in self-respect’, that its focus on labor and profit were not proper virtues to instill in a person has already been discussed. Yet the spirit of capitalism that developed in the Western bourgeoisie was if anything a tempering or a reining in of avarice and unrestrained accumulation. That is to say, the spirit of capitalism presented a restraint against excess accumulation and greed: “The universal reign of absolute unscrupulousness in the pursuit of selfish interests by the making of money has been a specific characteristic of precisely those countries whose bourgeois-capitalistic development, measured according to Occidental standards, has remained backwards”
The Western bourgeois class, having adopted the view of vocation described above, scorned ostentatious accumulation, capitalist adventuring and wild speculation. Capitalist adventuring and speculating have been present not just in Western capitalism but also in the different forms of capitalism throughout the world. Weber cited the ‘greed of the Chinese Mandarin’ and ‘the old Roman aristocrat’ as examples of such ‘greedy’, capitalistic characters outside of Western, ‘modern’, rational capitalism (Weber [1904] 1958:56). The story of reckless capitalists is not unique to the Western mode of capitalism, nor is it a consequence of the spirit of capitalism. The greed expressed by such as group in fact stands quite in contrast to what the spirit of capitalism represents (Weber [1904] 1958:57-58).

There is an important distinction to be made between charges of greed and avarice and the beliefs of people like Franklin, argued Weber. However, it is not difficult to imagine Franklin’s writings being interpreted in the light of avarice or an unending desire for accumulation:

A state of mind such as that expressed in the passages we have quoted from Franklin, and which called forth the applause of a whole people, would both in ancient times and in the Middle Ages have been proscribed as the lowest form of avarice and as an attitude entirely lacking in self-respect (Weber [1904] 1958:56).

Weber pointed out that the utilitarian outlook that shaped Franklin’s views colored his writings. Those traits that Franklin called virtues were those traits that would bring the benefits of economic success: “Honesty is useful, because it assures credit; so are punctuality, industry, frugality... Those virtues, like all others are only in so far virtues as they are actually useful to the individual, and the surrogate of mere appearance is always sufficient when it accomplishes the end in view” (Weber [1904] 1958:52). The virtues of
Franklin, and those of the capitalist spirit, assure economic success. Because these virtues take on such utilitarian character, Weber contended that they would actually not be considered virtuous by many traditionalists (Weber [1904] 1958:55, 70-76).

However, for those who adopted it, there was nothing questionable or unvirtuous about this mindset. Rather, this ethos created a virtue out of dedication to working hard and to making a vocation out of one’s work. It was not meant to promote avarice or unrestrained accumulation. Weber ([1904] 1958) countered these views of the spirit of the capitalism when he wrote:

In fact, the *summum bonum* of this ethic [the ethos of the spirit of capitalism], the earning of more and more money, combined with the strict avoidance of all spontaneous enjoyment of life, is above all completely devoid of any eudemonistic, not to say hedonistic, admixture. It is thought of so purely as an end in itself, that from the point of view of the happiness of, or utility to, the single individual it appears entirely transcendental and absolutely irrational. Man is dominated by the making of money, by acquisition as the ultimate purpose of his life. Economic acquisition is no longer subordinated to man as the means of satisfaction of his material needs. (p. 53)

One can see here that Weber’s interpretation of the meaning behind the spirit of capitalism was not one of greed and exorbitance, but of a form of an ascetic way of life devoted to being productive and that spurns exorbitance. It is in this way that the concept of vocation as discussed above plays such a central part of the spirit of capitalism.

The Spirit of Capitalism Overcomes Traditionalist Attitudes

The unique spirit of capitalism found in Western countries stood in contrast, and had to contend with, traditional attitudes as has been touched upon already. Traditionalism stood in the way of the new capitalist spirit, because its emphasis on vocation and earning profit was alien to the traditionally held values which would view
such an ethos of work and profit as avaricious and lacking in self-respect and restraint (Weber [1904] 1958:56). This new capitalistic attitude was so new and strange to traditionalists that it met with heavy resistance (Weber [1904] 1958:59-62). These three examples Weber offered denote the difficulty the spirit of capitalism faced. Labor had been viewed only as a means to wages, and the change towards viewing work as a vocation, which is a central value of the spirit of capitalism, did not happen overnight. “Labour must...be performed as if it were an absolute end in itself. But such an attitude is by no means a product of nature. It cannot be evoked by low wages or high ones alone, but can only be the product of a long and arduous process of education” (Weber [1904] 1958:62). It was a slow process for the spirit of capitalism to become a mainstay of western, capitalist enterprise. It took innovation and the development of the capitalists’ desire to make work a vocation.

Weber characterized such a process with the example of the transformation of the 'putter-out,' a kind of linen distributor. The business of this capitalist was to buy linen from peasants in the area. Traveling merchants would then buy from the distributor’s warehouses and sell the linens to their own customers. The distributor’s workday was a moderate six hours a day, and the wages were enough for a respectable living. This was the form of the traditional capitalist. But the method of the distributor changed as he started seeing his work as vocation. Leisure time was gone as business required longer workdays (Weber [1904] 1958:66-67). The style with which the distributor conducted business changed as well:

Some young man from one of the putting-out families went out into the country, carefully chose weavers for his employ, greatly increased the rigour of his supervision of their work, and thus turned them from peasants into labourers. On
the other hand, he would begin to change his marketing methods by so far as possible going directly to the final consumer... At the same time he began to introduce the principle of low prices and large turnover. There was repeated what everywhere and always is the result of such a process of rationalization: those who would not follow suit had to go out of business. The idyllic state collapsed under the bitter pressure of a bitter competitive struggle... The old leisurely and comfortable attitude toward life gave way to a hard frugality, because they did not wish to consume to earn, while others who wished to keep on with the old ways were forced to curtail their consumption (Weber [1904] 1958:67-68).

This is an example of the way in which Weber characterized the transition to the 'modern', rational capitalism. Business became the center of life, the entrepreneurs lived to work and those they hired, the laborers, were forced to go along. As the rational model spread, the rules of competition changed. Those who were not able to keep up, or those who wished to keep to the traditional ways of doing things were eliminated from competition and relegated to lower social positions.

When one lives in the capitalist system that promotes competition and innovation, one must learn to either compete successfully with other capitalists or face economic failure. “The capitalistic economy of the present day is an immense cosmos... It forces the individual, in so far as he is involved in the system of market relationships, to conform to capitalistic rules of action” (Weber [1904] 1958:54). If one cannot adapt to these rules, then economic failure is almost certain. Weber even came to call this the ‘economic survival of the fittest’ (Weber [1904] 1958:55). In essence, as capitalists assumed more and more the identity of the modern, rational capitalist, as the spirit of capitalism came to dominate business and enterprise, its ubiquity forced even those not of entrepreneurial inclinations to abide the rules of capitalism, because their survival and well-being depended on it.

Yet, those who survived and thrived in the new rules of capitalism were generally
not daredevils, speculators or financial adventurers. Nor were they all genius economic financiers. They were rather capitalists who grew up calculating and entrepreneurial, who were socialized into the spirit of capitalism and completely devoted to their vocation (Weber [1904] 1958:69). At the same time, as discussed above, the religious underpinnings of the vocational outlook had generally disappeared from these capitalists who took to heart the new ethos of modern capitalism. In fact Weber ([1904] 1958) said, “The people filled with the spirit of capitalism today tend to be indifferent, if not hostile to the Church” (p. 70). Religion serves as a distraction to labor, as the appeal of paradise that once captivated the Reformers had subsided (Weber [1904] 1958:70).

People had come to exist “for the sake of [their] business, instead of the reverse,” an irrational reversal of the order of things, according to Weber ([1904] 1958:70). It appears irrational because business and enterprise, human-made social constructs, have become the reason for living, even though it is humans who created them in the first place. People could still exist without businesses, but not them without us. Yet many act as if the reverse were true, because the economic structure of a society in which one finds oneself can have a significant impact on one’s attitudes and beliefs. The spirit of capitalism combined with modern, rational capitalism has taken an essential place in the structuring of society, influencing social interactions and economic behavior.

Rationalities and Capitalist Practices

Types of Social Actions and Rationalities

Weber defined social relationships as “the behavior of a plurality of actors insofar as, in its meaningful content, the action of each takes account of that of the others and is
oriented in these terms” (Weber [1956] 1968:26). Social action “includes both failure to act and passive acquiescence, [and] may be oriented to the past, present or expected future behavior of others” (Weber [1956] 1968:22).

Weber outlined four types of social actions: (1) ‘affectual’, which is action determined by emotional states; (2) traditional, which is action determined by habit; (3) instrumentally rational (zweckrational), which is action determined by expectations of certain outcomes and behavior of other human beings; and (4) value-rational (wertrational), which is action determined by a conscious belief that the action should be taken for its own sake whether for reasons of ethics, aesthetics, religion and so on (Weber [1956] 1968:24-25). Of particular interest for this thesis are the zweckrational and wertrational forms of action, which as will be discussed shortly, Weber saw as the most dominant types of action in Western capitalism.

The wertrational form of action is one of ultimate values. There is a conscious decision to take certain actions, because those actions are viewed as having intrinsic value (Weber [1922] 1978:25). The vocational outlook most closely resembles this form of action: “Examples of pure value-rational orientation would be the actions of persons who, regardless of possible cost to themselves, act to put into practice their convictions of what seems to them to be required by duty, honor, the pursuit of beauty, a religious call [italics added]...” (Weber [1922] 1978:25). The vocational attitude, which had begun as a conception of a religious calling and evolved into a sense of duty toward one’s work is a clear demonstration of the wertrational in action.

The zweckrational form of action however, concerns itself with both the ends and the means of actions. This form of action may be more closely linked to Weber’s
discussion of utility: “The action of [economically acting] individuals is oriented to the estimated importance of such utilities as means for the ends of their economic action” (Weber [1956] 1968:68). Weber’s definition of utility regarding economic action was “the specific and concrete, real or imagined, advantages (chancen) of opportunities for present or future use as they are estimated and made an object of specific provision by one or more economically acting individuals” (Weber [1956] 1968:68). The 
zweckrational form of action is a crucial form for Weber’s social-economic theory, because it is through this concept that Weber arrived at the calculability of actions.

Weber defined economic action as “any peaceful exercise of an actor’s control over resources which is in its main impulse oriented towards economic ends” (Weber [1922] 1978:63). Economic actions, when rationally planned, are always oriented towards the greatest utility. These utilities can be in the form of inanimate objects—goods—or they can be in the form of human action—services, leistungen. There is a clear connection between the zweckrational form of action and economic actions as both are concerned with both means and ends, and involve calculations of alternative routes of action.

What this leads to is the connection of social actions with economic actions. So too, social relationships can be objects of utility: “Social relationships which are valued as a potential source of present or future disposal over utilities are, however, also objects of economic provision” (Weber [1922] 1978:68). This means that social relationships can become utilities in the sense that they can be forged solely for the potential economic

---

3 Economically oriented action differs in that it does not have to be a peaceful action. Violence, for example, can be economically oriented action, but is not an economic action by Weber’s definition (Weber [1922] 1978:64). The focus here is strictly on the first form—economic action.
advantages that such a relationship may have for one or all parties. To the extent that economic action takes into account the behavior of others, they are thus social actions. For example, the relationship of producer and consumer is both social and economic. It is economic in the sense that both parties establish the relationship out of a desire for some utility or end (either the use of the product or the profit gained from the selling). It is a social relationship because each party's actions are informed by the expected behaviors of others.

Finally, Weber also noted that economic actions can further be analyzed in terms of formal and substantial rationality. Formal rationality is the "extent of quantitative calculation or accounting which is technically possible and which is actually applied" (Weber [1956] 1968:85). Formally rational economic systems are those that have made all of the needs, and the methods of providing for the needs, expressible in calculable terms (Weber [1956] 1968:85). Formal rationality is concerned with the technical details of actions and the questions of how certain ends will be attained. Formal rationality and the zweckrational form of action bear distinct similarities. Both formal and the zweckrational form of action are concepts built around the means-ends duality. Not as concerned with the ultimate values or meanings of actions, formal rationality and the zweckrational form of action focus rather on if the action will achieve the desired result.

Substantive rationality on the other hand refers to the "degree to which the provisioning of given groups of persons (no matter how delimited) with goods is shaped by economically oriented social action under some criterion (past, present or potential) of ultimate values (wertende Postulate), regardless of the nature of these ends" (Weber [1956] 1968:85). The substantive rationality of economic actions is concerned with the
values, or ultimate ends, embedded in the actions, whether they be aimed at a system that is egalitarian, utilitarian, communist, socialist and so on. There is a clear value judgment in the substantive rationality of economic action (Weber [1956] 1968:85, 86). The substantive rationality of economic action can too be linked with a form of social action—wertrational. Both forms of action focus on the ultimate values at which the action aims. Formal and substantive rationality both can lead to the further consideration of economic actions as social actions.

*Wirtschaftsbetrieb* and Weber’s Conception of Rational Capitalism

Weber characterized modern capitalist enterprise as being rationally conducted enterprise. It involves calculations and decisions based on desired outcomes. Capitalism may further be described as a type of “organized system of continuous economic action” which Weber ([1956] 1968:63) referred to as an “economic establishment” or *Wirtschaftsbetrieb*.

Capitalism is present wherever the industrial provision for the needs of a human group is carried out by the method of enterprise, irrespective of what need is involved. More specifically, a rational capitalistic establishment is one with capital accounting, that is, an establishment which determines its income yielding by calculation according to the methods of modern bookkeeping and the striking of a balance (Weber [1927] 1950:275).

What further separates western capitalism from other modes of capitalism that have existed throughout history is the “provision of the everyday wants by capitalistic methods” (Weber [1927] 1950:276).

For Weber, a crucial, defining factor that separated modern, Western capitalism apart from the other modes of capitalism that had existed before and concurrently is the
development of rational capital accounting. Rational capital accounting, as explained in General Economic History (Weber [1927] 1950), is the “most general presupposition for the existence” of modern capitalism (p. 276). First, it requires the appropriation of all physical means of production, by ‘autonomous private industrial enterprises’. Second it requires a free market. The third feature is rational technology- or ‘calculation to the largest possible degree’. The fourth requirement is calculable law, by which Weber meant that the capitalist industrial organization must be able to reliably depend on administration and adjudication by the state and whatever regulatory agencies it sets up. The fifth requirement is free labor. This means that there is a presence of people who are able to voluntarily sell their labor on the free market, but they are also ‘economically compelled’ to do so by the basic necessities of sustenance. The sixth requirement is the ‘commercialization of economic life’, by which Weber meant the ‘general use of commercial instruments to represent share rights in enterprise, and also in property ownership’ (Weber [1927] 1950:276-278). These features comprise rational capital accounting, and together they are the defining activities of Western, rational capitalism.

The presence of formal rationality and the zweckrational form of action is apparent in rational capital accounting. All of the requirements laid out for rational capital accounting are means by which economic ends can be achieved. Technology, predictable and calculable law, rules of free market, formally free labor and commercialization are all products of formal rationalization. They serve to increase the calculability and the determine procedure for capitalist economic action.

Rational capital accounting, in its quest for profit, is also a product the wertrational form of action. Free trade and private, capitalist enterprise can be viewed as
ultimate values. Actors who defend the right of private corporations to conduct their business without overbearing governmental regulation turn to this form of rationality when they defend their practices. The capitalist who decries government interference in business sees free capitalist transactions as an ideal that he or she is pursuing. The substantive motivation of the capitalist defending his or her practice is exactly that free capitalism is an idea worth defending. Rational capital accounting, and capitalist practices in general are subject to substantial rationality. In turn, actors may act in the wertrational form of social action in pursuit of values like economic success through private enterprise.

Weber’s conceptualization of commercialization exemplifies the capitalist practices with which this present work is most concerned: “Commercialization involves, in the first place, the appearance of paper representing shares in enterprise, and, in the second place, paper representing rights to income, especially in the form of state bonds and mortgage indebtedness” (Weber [1927] 1950:279). Weber contended that this form of commercialization was unique to Western economic development. What commercialization represents is a development in capitalism where capital and exchange value are able to exist on paper, in the abstract, and in agreement between parties contracted to the finance agreement. It is a process whereby capitalists can invest their capital into stocks and financing ventures with the ‘rational’ intent of generating more capital and profit. It seems to be the ultimate Weberian notion of rationalization of capitalist enterprise, because in the end, it is capital directly generating more capital continuously through interest rates and refinancing.

Money and credit are clearly two examples of the expression of formal
rationality, and these too can be found outside Western capitalist systems. Rational monetary accounting is a development applicable to any economic system that is formally rational. However, what is unique to Western, ‘modern’, rational capitalism is the development of rational capital bookkeeping. There is an analogous relationship between zweckrational form of social actions and formally rational economic actions in that both are concerned with ends, but also the means of achieving those ends (Parsons 2003:64).

Monetary accounting is the quantified valuation of meeting the needs of the present or future, similar to what was discussed as the consequences of money and credit above. This includes calculating the costs of means of production, labor, transporting and exchanging. It represents the complete quantification of every need into calculable monetary form; “money is the most ‘perfect’ means of economic calculation” (Weber [1956] 1968:86). Monetary accounting is the quantification of needs into calculable monetary form, and it is not unique to Western capitalism. Any formally rational system will have some degree of monetary accounting.

Systems of credit also work toward the rationalization and calculability of action: “Where the action is rational, both parties expect an improvement in their position, regardless of what it consists in, over what it would be under the present distribution of resources without the exchange” (Weber [1956] 1968:81). One effect of the money system is the allowance for delayed obligations arising out of exchanges. With credit, the consumer or customer can still engage in an exchange for a utility with the promise that he or she will come up with the money at a later date. This in turn allows the seller, or perhaps financier, to create an accumulative account for the consumer whereby the credit
afforded the consumer builds up and the seller or financier as creditor can continuously collect on payments by the consumer (Weber [1956] 1968:80-81). One of the implications of a system of credit is that everything, from behaviors to desires and needs, becomes subject to calculation, and is evaluated in terms of monetary worth:

...Monetary calculation means that goods are not evaluated merely in terms of their immediate importance as utilities at the given time and place and for the given person only. Rather, goods are more or less systematically compared, whether for consumption or for production, with all potential future opportunities of utilization or of gaining a return, including their possible utility to an indefinite number of other persons who can be brought into the comparison insofar as they are potential buyers of the powers of control and disposal of the present owner (Weber [1956] 1968:81).

When credit is established, the flow of promised money is constant. A constant exchange and flow of capital, a system of regular trade is what Weber called _Wirtschaftsbetrieb._

**Social Relationships, Social Action and Wirtschaftsbetrieb**

Actors involved in capitalist transactions establish necessarily and by the definition of capitalism a social relationship within the economic transactions—each actor has taken into account the actions of others and determined his or her own actions by these considerations. In participating in capitalist enterprise, one makes adjustments for the expected behavior of others in order to realize profit. When these relationships are established and the transactions repeated continuously and patterned into relationships, the result is _Wirtschaftsbetrieb_—a continuous economic system (Weber [1922] 1978:63). So while Weber separated conceptually strictly economic actions from social actions, it can be said that social actions and relationships play a very large part in shaping the economic system.
The idea of *Wirtschaftsbetrieb* further supports the notion that social relationships become objects of utility, and subject to the *zweckrational* form of action that treats them as such: “Social relationships which are valued as a potential source of present or future disposal over utilities are, however, also objects of economic provision” (Weber [1956] 1968:68). Relationships can be valuated in monetary terms in the interest of profit. As has been demonstrated in this discussion, social relationships are an important facet of *Wirtschaftsbetrieb*, and when they become quantified, monetarily valued utilities, they are a means to an end—profit. Social interaction and social relationships are heavily affected by economic activity in these ways.

There is probably no economic or social action that is a pure form of one of these types of actions. As Weber ([1922] 1978) noted, “It would be very unusual to find concrete cases of action, especially of social action, which were oriented only in one or another of these ways” (p. 26). Capitalist enterprise then is one that rests on rationality of calculability and predictability as well as the substantive rationalities of actors who may imbue their actions with any number of ultimate values. As Weber noted, there are an infinite number of possible reasons an actor may give to explain his or her actions.

**Vocation, the Spirit of Capitalism and Emotion**

In *The Protestant Ethic and the Spirit of Capitalism*, Weber ([1904] 1958) argued that the concept of *Beruf*, as shaped by the spirit of capitalism, is not a concept that is driven by emotional force: “In fact, the *summum bonum* of this ethic, the earning of more money, combined with the strict avoidance of all spontaneous enjoyment of life, is above all completely devoid of any eudæmonistic not to say hedonistic, admixture” (p. 53). The
motivations that are informed by the spirit of capitalism are not pursuits of material enjoyment or hedonistic pleasures, but rather a rationalized pursuit—rational from the actor’s point of view—of work and achievement for the sake of work and achievement. Barbalet (2008) has argued that:

> Against such endeavors [as avoiding impulsive enjoyments], emotion is understood by Weber to be spontaneous, unruly and disorganizing. Rational action, therefore, in realizing motives that are long held and seriously regarded, must be against the emotions because, as Weber explains, the emotions are spontaneous and impulsive forces that distract a person from their purposes. (P. 57)

Thus, Barbalet pointed out, rationality and Beruf are coupled as far as The Protestant Ethic and Spirit of Capitalism goes. However, in Weber’s lectures, on “Politics as a Vocation” and “Science as a Vocation,” Barbalet (2008:58) argued that Beruf takes on a different characterization with regard to emotion. Though the idea of vocation still depends on self-limitation, in these lectures the concept is founded on emotion rather than opposed to it (Barbalet 2008:58). Passion is essential for the political vocation, being one of the ‘three pre-eminent qualities…decisive for the politician’, the three being passion, a feeling of responsibility and a sense of proportion (Weber 1919:115).

What might it mean for reason and rationality if in The Protestant Ethic and the Spirit of Capitalism the concept of Beruf is characterized as oppositional, or at the very least, devoid of passion, whereas in the vocation lectures passion is essential to Beruf? As Barbalet (2008) pointed out, “There is an alternative perspective which holds that reason and emotion are not necessarily opposed but clearly different faculties, and that their differences allow each to serve in a division of labour in which their distinct capacities contribute to a unified outcome” (p. 70). What Barbalet argued in this context
is that the rationalization of action does not necessarily have to be opposed to emotion, and though Weber’s stance on emotion in the vocational context changed through the progress of his life and career, the act of rationalizing does not necessarily differ because of the emotional input.

What the Western use of *Beruf* has done, according to Weber, is shape the Western personality in such a way to prepare it for capitalistic life (Goldman 1988; Marsh 2007).

For *modern* capitalism to have developed as it did, Weber argued, a *new kind* of person must have existed, a person with special qualities and capacities for work, with a natural inclination for the new kind of rationalized labor that capitalism as a system brought with it (Goldman 1988:19).

The spirit of capitalism and the increased emphasis on rationality that was embodied in the innovations of the emerging capitalist entrepreneurs helped to shape the Western capitalist personality in a way that was necessary for Western capitalism to be systematically rationalized. Marsh (2007) calls these character traits ‘spiritual capital’, and this category includes traits like positive outlook, strong motivation, and inspiration. To this characterization of the Western, capitalist personality, Goldman (1988) added: “In fact the ‘type’ of the first great entrepreneur is essentially the same as the ‘type’ of the figures who reappear as the politician, scientist, artist, and entrepreneur of Weber’s later essays” (p. 19). What these authors have argued is that the character traits that Weber saw as emerging from the Calvinistic and Lutheran doctrines, only to supercede these religious origins and become quite secular in nature, were crucial components to the development of modern, Western capitalism.

There has been much criticism aimed at Weber’s connection between particular
Protestant traditions and the development of western capitalistic attitudes. The criticisms range from calling Weber's historical evidence thin or incomplete to saying his connections between the development of Western capitalist attitudes and certain religious traditions were overstated (Hamilton 1996; Samuelsson [1957] 1961). However, the goal here is not to evaluate Weber's arguments about the historical accuracy of Beruf and capitalist attitudes, nor is it to engage with the critics of Weber who cite evidence as lacking. Rather, the present investigation is more interested in the characterization Weber ascribed to current Western capitalist practices. As Goldman (1988) stated the problem: "[I]t is not principally Calvinism but rather these first great entrepreneurs that are the real object of Weber's investigation—not the concrete and actual individuals but their type" (p. 18). Following this line of thought, I am not primarily concerned with Weber's arguments about Calvinism per se, but with how he characterized the *types of motivations of capitalist actors.*

Taking what Weber said about the power of passion in his later vocation lectures then, a new picture emerges of the vocational attitude that adds another dimension to vocation not particularly discussed in *The Protestant Ethic and Spirit of Capitalism.* The vocational attitude can incorporate passion. In fact, it would seem passion would be necessary to cultivate the feeling of duty toward one's work. The politician needs passion to stay the course and the scientist needs passion to devote toward grueling work that may not always be recognized and come to be discovered as completely erroneous. Other occupations can have similar requirements for passion if those involved are to remain dedicated to the work. It seems unlikely that Weber would have denied the place of passion in vocation even in *The Protestant Ethic and the Spirit of Capitalism.* Instead,
the emotions that are inappropriate to the vocational outlook are those that distract from vocation: the eudemonistic, carefree existence is the antithesis of the attitudes toward work cultivated by the vocational attitude. The emotions that lead to these consequences are the emotions that are distanced from the vocational outlook, not passion.

Institutions and Rationalities

The rationality of institutions defines how those institutions function, how they determine their procedures as well as the goals and reasoning behind those procedures. In his research on the distinction between Weber’s concepts of formal and substantial rationality, Arthur Stinchcombe (1990) constructed an ideal type description of ‘institutionalized reason’:

1. People are trained as practitioners in an area in schools in which both the role of teacher and the role of student are differentiated from the roles in the practical work of the institution...

2. The body of culture has at its core cultural principles that can be reduced to paradigms, structures of rules of rational calculations which produce a capacity of different experts to come to the same judgment in a large number of cases.

3. Judges of particular cases in the institutionalized area are required, at least in problematic ones, to give reasons which can be examined by other experts to justify their decisions...

4. There are structural provisions that have the purpose of keeping the personal interests of the judge in a given case separate from the process of judgment, a set of norms of ‘disinterestedness’ so that reason can prevail over both rationality and passion.

5. There are regular routines for information collection before judgment, in which information is protected from corruption and degradation, examined for veracity and relevance, and entered into a regular information storage system so that it will be available for the application of reason to it... (Pp. 300-301)

By ‘reason’ Stinchcombe (1990) referred to ‘norms governing a body of thought
recognized as authoritative in a culture...” (p. 289). This definition of reason juxtaposed with Stinchcombe’s definition of rationality—individual behavior that maximizes benefits or minimizes costs—gets at the heart of substantial and formal rationality (Stinchcombe 1990:289). Stinchcombe’s ‘reason’ seems akin to the substantial rationality, the meaning, behind action. What this idealized type of institutionalized reason argues for is that actors within the institution are placed, trained, and encouraged to act for the utility of the institution, and thus the reasons of the institution. The institution is set up in such a way to prevent individual actors from being exposed to conflicts of interest, to give them the most relevant information available to make those judgments. Stinchcombe (1990) applies this institutionalization of reason to Weber’s view on the importance of the predictability of law for capitalism: “Capitalism involves coordinated activity, and the mechanisms of coordination are political creations like money, sales and labor contracts, penal law for thefts, organizational charters for corporations, and so on” (p. 311). Following Stinchcombe’s argument, one can see that institutions, particularly capitalist institutions, require that there be formal rationality based on substantial reasoning, in order for the institution to be effective.

Weber ([1922] 1978) characterized the formal rationality of institutions as essentially the instructions for how individuals should act, while substantial rationality of an institution reveals why they should act a certain way. The famous “iron cage” of rationalization that concerned Weber can be seen as the negative impact of formal rationality in the form of over-routinization (Weber [1904] 1958:181). What is of major concern is that reason, to borrow Stinchcombe’s terminology, is trumped by rules. In fact, in the fourth criterion listed for institutionalized reason, Stinchcombe (1990) used
the phrase ‘so that reason can prevail over both rationality and passion [italics added]’ (p. 301). This demonstrates the conflict between reason and rule, between substantial rationality and the formal rationality of an institution. Some authors (Ritzer 1975) have argued that for Weber, professionalization is connected with rationalization and bureaucratization, in that Weber saw most professionals becoming part of the routinized and mechanized way of life: “The end, for Weber, is clear, unavoidable and horrible. It is a mechanized, routinized world in which professionals, bureaucrats, and bureaucratic-professionals are all neat little cogs in a perfectly functioning machine” (p. 633).

Caution should be used against identifying rationality solely with bureaucratization and increased efficiency, as Parsons (2003) noted:

It would thus appear that concentrating on the analysis of rationality either in economic theories or in the context of bureaucracies would lead to an identification of ‘rational’ with ‘efficient’. However, this is not how Weber understands rationality in the context of his sociological analysis of economic action. (p. 61).

To view rationalization as only pertaining to bureaucratization and efficiency misses the multidimensional aspect of the different forms of rationality and how they may intersect (Kalberg 1980:1145-1146). The over-emphasis on bureaucratization chiefly entails only one of the types of Weber’s rationalities: formal rationality, not leaving room for attention to the other forms of rationality (Kalberg 1980:1159). Parsons’ (2003:61) argument is that what this leads to is the identification of instrumental and formal rationality with only the election of means or technical decisions of procedure. The zweckrational form of action entails consideration of both means and ends. Formal rationality too, entails a consideration of ends in that it refers to the degree of quantifiable and calculable means are employed to achieve that end (Parsons 2003:62-67). No action
then in either formal rationality or the zweckrational form of action ought to be considered entirely means based.

At the same time, Weber's distinction between formal and substantive rationality has been criticized precisely for separating rationality among these different dimensions in such a way that some claim to 'obfuscate rather than clarify' the theoretical rigor of the concept (Eisen 1978:61). Eisen's (1978) main criticism is that to separate formal rationality from substantive only muddles the concept because "[a] thing of process can ultimately be judged efficient, purposive or systematic only relative to some end. The standard must come from outside. Considerations of substance are not extraneous to 'formal' ones but rather built in unavoidably" (Pp. 63-64). The separation of the two, Eisen claimed, is rather arbitrary and confuses more than helps.

Substantial rationality, or the rationality of value postulate, does entail a focus solely on the ends, thus making it more akin to the wertrational form of social action. The substantive rationality of action depends entirely on the values held by the actor. As such as many actors as there are, there are as many valid processes of substantive rationalization. That is to say,

Since the standpoints represented by value postulates can be, in principle, infinite, action may be ordered into patterns and, indeed, into entire ways of life in an endless number of ways... The infinity of possible value postulates points to a critical feature of Weber's notion of substantive rationality: its radical perspectivism (Kalberg 1980:1155).

The concepts of substantial rationality and wertrational social action make room for the notion that any actor, or group of actors, may hold certain beliefs as their ultimate ends or values. What this means is that actions taken by these actors in pursuit of their desired ends is entirely rational from the substantive and wertrational orientation.
Actions then are not necessarily determined by any one form of rationality. Rather, multiple processes of rationalization can be at work in determining how an actor will behave in a given situation. Vocational outlooks and behaviors can provide an example of multiple rationalities and forms of action at work. The vocational attitude requires a dedication to one’s work as a duty. This dedication serves as value toward which one strives and is the substantive rationality behind treating one’s work as a vocation. Being productive is a value held in the vocational outlook, thus working diligently is a *wertrational* form of action. At the same time, in the process of doing one’s work processes designed to achieve desired outcomes guide one through the work. These processes are ones of formal rationalization. It may be that the different forms of rationality do not align so neatly in all cases and become problematic for actors. Perhaps there are conflicting values that prompt incongruous action, or changes in the formal rationality of an organization with which one is involved are no longer sufficient to meet the ultimate values or result in unanticipated consequences. Human rationalization and the actions resulting from it can be flawed processes after all, as Weber ([1922] 1978) recognized:

> The calculations underlying trading activity will be called “speculative” to the extent to which they are oriented to possibilities, the realization of which is regarded as fortuitous and is in these sense uncalculable [sic]. In this sense the merchant assumes the burden of “uncertainty.” The transition from rational calculation to what is in this sense speculative calculation is entirely continuous, since no calculation which attempts to forecast future situations can be completely secured against unexpected “accidental” factors. (p. 159)

This uncertainty in the rationalization process as well as the possibility for conflicting processes of rationalization and social action will be examined in relationship to the subprime lending industry in the next chapter.
Conclusion

This chapter has explored Weber’s characterizations of vocation—*Beruf*—in relation to the spirit of capitalism. The ethic of work that emerged from the evolution of the vocational attitude had taken its place as a central defining feature of Western capitalism. Work has become a vocation, and as a vocation, it entails a sense of duty. Weber also argued that capitalist practices, including vocation, were rationalized in a way singular to the West, emphasizing economic ends while simultaneously stressing the value of the activity of work for its own sake. Because of this simultaneous emphasis, there exists tension between the *zweckrational* and the *wertrational* forms of action. The multiple rationalities that exist, the formal and substantive rationality, and the *zweckrational* and *wertrational*, can at times conflict with one another within a given economic institution.

I have also attempted to demonstrate here that at times Weber was very critical of this ethos of work for work’s sake. The place of work, and the rationalizations that come along with vocations, result, in Weber’s view, in the ‘iron cage’ (Weber [1904] 1958:181). Subject to being born into a pre-existing economic system of rationalization and the ethic of vocation, those born to this situation become subject to this ‘iron cage’, in which society encourages finding meaning in one’s work but also places value on achievement and material success. These conflicting results of differing rationalities can manifest in even more immediately harmful ways, such as will be demonstrated with in the following chapter on subprime mortgage.

The attitudes of the lenders will also be explored in the following chapter. The
vocational outlook for Weber was a key defining feature of capitalist institutions. As such, one might expect lenders to exhibit some of these vocational characteristics. But how do these attitudes hold up in the face of an industry meltdown as was experienced by the subprime mortgage industry? In the following chapter, I will explore how the competing rationalities were at play in the lending process of subprime lenders as well as how their outlooks shaped what they believed about their actions.
CHAPTER 3
RATIONALITY AND VOCATION IN THE SUBPRIME MORTGAGE INDUSTRY

In this chapter, I apply Weberian concepts discussed in Chapter 2 to the subprime mortgage industry. In particular, I examine how different forms of rationality and action intersect, specifically in regard to how the lenders act and how some have explained their actions. I show that the substantive rationality of lenders' actions, as they explain their actions, is the pursuit of capitalist enterprise, in other words a devotion to the work of lending. I argue that rules regarding risk assessment can be interpreted in the light of Weber's concept of formal rationality, and that in pursuit of the substantially rational end of capital enterprise, lenders' processes of formal rationalization underwent significant change that would prove fatal to the subprime industry.

The second half of this chapter examines the actions and explanations of lenders to determine how Weber's concept of vocation may explain the subprime mortgage industry. Charges of greed leveled against subprime lenders certainly would contradict the vocational attitude laid out in The Protestant Ethic and the Spirit of Capitalism, and from the way some lenders, and regulators, described their actions retrospectively, they indeed were acting in the characteristic fashions of the vocational attitude. What this demonstrates is that even the vocational attitude, the substantive rationality of which is a sense of duty to one's work, can lead to paradoxical results as processes and procedures change without robust change in the application of formal rationality.

50
Weber's Rationalities in the Subprime Lender-Borrower Relationship

Formal Rationality of Subprime Lending

Richard Bitner (2008), president and cofounder of Kellner Mortgage Investments, a subprime mortgage firm, would ask as a litmus test before approving a loan, “Can the borrower afford to make the monthly mortgage payment?” and “Will closing the loan put the borrower in a better position than he is in today?” (p. 5). Bitner would ask himself these questions as a way to frame his thinking about the potential borrower. These questions reflect the focus on measurable, desired outcomes of Bitner as the lender. Such a process of weighing outcomes is a clear reflection of Weber's concept of Wirtschaften: “any peaceful exercise of an actor’s control over resources which is in its main impulse oriented towards economic ends” (Weber [1956] 1968:63). The lender may ask such questions regarding what the outcomes of certain actions may be. Obviously, these are not the only questions lenders ask of potential borrowers. These questions only indicate the beginning of the probe by lenders and underwriters into potential borrowers’ credit risk. Lenders also analyze borrower characteristics such as the FICO score, income statements, LTV ratios, and DTI ratios.

Weber defined a rational capitalistic establishment as “one with capital accounting, that is, an establishment which determines its income yielding by calculation according to the methods of modern bookkeeping and the striking of a balance” (Weber [1927] 1950:275). Risk assessment involves these actions outlined by Weber. When lending agencies assess potential borrowers, they do so by looking at their risk ratings. It was noted above that lending agencies assess borrowers’ credit characteristics such as
FICO scores, Loan-to-Value or Combined Loan-to-Value ratios of the potential loan, and the debt-to-income ratio of the borrower. Lenders also look at borrower traits like employment history, and some may choose to look at verified statements of income as well as bank verified statements of assets (Goodman et al. 2008; Immergluck 2009; Stuart 2003). Lenders compile all of these data in order to assess the risk of taking on the borrower. The risks taken on by the lender are then spread around and managed through the process of securitization.

The construction and assessment of risk, when expressed in its most basic elements, is essentially the determination of income via repayment interest-rates through calculating what the lender can afford to, and will most likely, pay. It is a compilation of what some call the ‘four C’s of mortgage underwriting’: credit, collateral, capacity and character (Goodman et al. 2008:35; Stuart 2003). Credit refers to the assessment of the borrower’s credit history as noted by measurements like the FICO score, which assess probability of payment behavior. Collateral refers to the value of the home for which the loan is being taken, and informs the LTV and CLTV ratios (Goodman et al. 2008:39-44). Capacity refers to the income of the borrower and affects the DTI ratio. Character can refer to both the documentation provided by the borrower and that the lender chooses to require in order to secure the loan as well as the borrowers’ willingness to pay (Goodman et al. 2008:44-45; Stuart 2003:83-90). What the assessment of these various characteristics attempts to do is to somehow manage uncertainty (Stuart 2003:4). In order to manage uncertainty, lenders use measurable characteristics of borrowers, such as payment history, to predict future actions of the borrower as a social actor.

Risk assessment, and the decision to take on risk is also a Weberian form of social
action—zweckrational. This form of action is predicated on the “expectations as to the behavior of objects in the environment and of other human beings; these expectations are used as ‘conditions’ or ‘means’ for the attainment of the actor’s own rationally pursued and calculated ends” (Weber [1922] 1978:24). When lenders assess risk they are doing so on the basis that they will be able to analyze and predict the future behavior of the borrower. The lender-borrower relationship is itself one of utility for both parties. The borrowers get access to money with which to purchase a home and the lenders make profit off the lent money, giving both parties increased utility. In order to realize this end however, lenders must exercise formal rationality in risk assessment. Uncertainty is calculated and managed in pursuit of the end of profit.

One of the consequences of modern rational capitalism is that everything becomes subject to calculation:

Rather, goods are more or less systematically compared, whether for consumption or for production, with all potential future opportunities of utilization or of gaining a return, including their possible utility to an indefinite number of other persons who can be brought into the comparison insofar as they are potential buyers of the powers of control and disposal of the present owner. (Weber [1956] 1968:81)

The lender engages the borrower in a relationship precisely with this mindset. The risk, as measured by past credit performance, is calculated and if it is manageable, if it can be securitized and spread through mortgage-backed securities (MBS) to other investor pools, the lender will make the loan. The goods being compared here are the loans themselves. The loans are packaged products tailored for niche consumer bases. The structure of the loans, both in the form of payment by the borrower and the securitization the loan goes through at the lenders’ end, is subject to systematic and deliberately planned financial
engineering designed to help the lender and investors benefit from a steady revenue stream.

These rules for risk assessment, which have been treated only briefly, may be called the formal rationality of the lending process. However, as some have argued even this formal rationality is not always present, or at least is diminished in practice:

The language of financial risk is an economic language, imbued with the legitimacy of ‘formal rationality,’ but the risk criteria used to decide who gets a mortgage and who does not lose their ‘formal’ patina when one investigates their origins and the way they are implemented. Their origins show that the contemporary decision-making rules are a mix of rules of thumb, accepted norms, and theoretical assumptions imposed on reality... This does not mean that these rules and practices are irrational or ad hoc, but it does mean that they constitute a version of rationality that is not the only possible one. In other words, when lenders explain what they are doing when they make loan decisions, it mostly makes sense—they provide good reasons for how they make their decisions. But those reasons are grounded in a certain set of values or established ways of doing things, and they often make sense only because other lenders adhere to them as well. (Stuart 2003:2)

Stuart, a public policy expert, argued that lenders start viewing these rules as more of guidelines. In assessing the development and construction of risk, Stuart asserted that the rules are attempts by lenders to pursue actions that are based on ‘what makes sense’ (Stuart 2003:179). Stuart unpacks ‘what makes sense’ to show that acceptable borrower traits change according to policy and regulations. This ranges from borrower attributes like FICO scores and credit histories. In other words, the acceptable characteristics that are assessed change according to policy and changes in economic thinking. The ‘sense’ comes from ‘rules of thumb, accepted norms, theoretical assumptions imposed on reality, and self-fulfilling prophecies’ (Stuart 2003:179). In essence, Stuart’s argument is that the assessment of risk is a socially constructed activity whose formal rationality is more or less present, but still maintains a somewhat malleable form as the notions about what is
acceptable in risk assessment change over time as policies, advocate groups and regulations change. Although the rules may change, it is still a system that depends, at least to some extent, on formal rationality— the rules that govern behavior toward certain economic ends.

Substantive Rationality in Subprime Lending

What are the meanings behind lenders’ actions? What seems to be the motivation here? These questions attempt to understand the substantive rationality and the wertrational orientation of subprime lending. As for the substantive rationality of lenders, Michaelson (2009) pointed out about Countrywide Financial: “Countrywide was first and foremost a sales organization” (p. 93). The primary motivation is indeed a capitalistic one. It is the pursuit of profitable enterprise that motivates lenders to sell loans to borrowers. This is the essence of the lending business. If it were not profitable to do so, it seems unlikely that so many would be concerned with selling loans to put people into homes. Actions taken by representatives of lending companies, in the course of business, are all done with the intent of helping the lending company to either acquire new transactions or maintain current transactions to keep profit flowing. As Weber put it in The Protestant Ethic and the Spirit of Capitalism, the pursuit of economic success is paramount for these businesses. This is the wertrational of the lending enterprise.

Weber admitted the ambiguity of the concept of substantive rationality. He cited only one element common to all ‘substantive’ analyses: “…they do not restrict themselves to note the purely formal and (relatively) unambiguous fact that action is based on ‘goal-oriented’ rational calculation…but apply certain criteria of ultimate ends...
There are an infinite number of possible value scales for this type of rationality” (Weber [1956] 1968:85-86). In other words, an act may have any of an infinite number of values supporting it, because the aims of that act are valued through the viewpoint of actors. This leaves room for much ambiguity in assessing the rationality of actors, because Weber’s concept of substantive rationality does not purport to assess actions by objective standards.

In the case of lenders and regulators however, explanations for actions have been demanded of them and lenders have offered them. The explanations offered by lenders typically revolve around the theme of enabling people to better their economic standing, or achieving their goal of homeownership (Andrews 2009; Bitner 2008; Gramlich 2007; Michaelson 2009; Mozilo 2003). Homeownership is often viewed as being part of the “American Dream,” and from lenders’ explanations, it would seem they are simply trying to make that dream a reality. These explanations make it seem as if the lenders’ ultimate value is to put people into homes rather than make a profit.

The ultimate end for the lender, however, is not to put a borrower into a home. As Michaelson (2009) was quoted above, it is a sales business. The fact that people are put into homes is incidental as the means by which the lender does achieve the ultimate end of making profit. The subprime lender is after all, a capitalist. Despite any mission statement which claims devotion to helping ‘troubled borrowers’ find a home, which incidentally is a characteristic of subprime lending that will be discussed regarding vocation, at the end of the day, if putting people into homes is not profitable, the lender will stop doing it (Bitner 2008; Gramlich 2007; Michaelson 2009). So the lender-borrower relationship is built upon the substantive rationality of two ultimate ends: for
the borrower, a purchase of home; for the lender, making a loan that will generate revenue and allow them to carry on capitalist enterprise. These are complementary ends in capitalist enterprise and each party enters the relationship, an instrumentally rational, social relationship, which should provide benefits for each party.

To sum up what has been said so far, the actions of the lender and borrower are influenced by different motivations. On the one hand, borrowers may act out of a *wertrational* orientation (e.g. the “American Dream” of homeownership) or a *zweckrational* orientation (owning a home is a means to higher economic standing). The lenders act out of the quest for profit, which too may be interpreted as *wertrational* or *zweckrational*. However different the orientations of the actors may be, the social action they take in joining in the lender-borrower relationship, which is a social relationship itself, is an instrumentally rational action for both parties. The relationship itself is instrumentally rational for both the borrower and the lender. It is the lender’s rules that shape the relationship, and so it is the lender’s use of formal rationality that determines where the relationship will lead the parties involved.

Conflicting Rationalities and Paradoxical Results

In several places in his works, Weber discussed the paradoxical results of actions, *parodoxie der folgen*, or the unintended, unanticipated consequences of actions, particularly in regard to the role asceticism played in providing the means by which accumulation of capital became a standard practice of Western society, contradicting the original ideas of ascetic, religious movements (Swedberg 2005; Weber [1904] 1958; Weber [1956] 1968). Actions taken by lenders follow this paradoxical pattern in that
through trying to reach a broader consumer base and strengthen business, what subprime lenders did by changing the rules was undermine their own, and their borrowers', stability.

As one delves deeper into the behaviors of lenders and structures of loans, the formal rationality guiding lenders is brought into question. That is to say lenders started to ignore calculations of risk or they increased the amount of risk they were willing to accept (Bitner 2008; Immergluck 2009; Zandi 2009). In either case, processes of formal rationality were altered. To the outside observer, the actions of lenders would seem irrational. By irrational in this sense, I mean to say that the processes largely ignore, or seriously alter, established practices of risk assessment, which is the expression of formal rationality in subprime lending.

To the extent that loans were made with a disregard for the rules of risk assessment, as some argue, it would seem that the subprime lenders, as a group, effectively acted irrationally as far as the calculability afforded by formal rationality is concerned (Andrews 2009; Bitner 2008; Michaelson 2009; Stuart 2003). The fact that the subprime industry failed, may at the very least suggest that either (1) the established rules for risk assessment and underwriting were ignored to the detriment of the lending institutions, as well as many borrowers; or (2) the rules were not working properly or did not fit the new model of business, and they did not provide a safeguard against the risk lenders accepted. In either case, what this suggests is that there was a breakdown in the formal rationality of the lending establishments. If the calculated actions of taking on loans were not properly working to help lenders achieve desired ends, the rational action, from an economic point of view would to be to find rules that work better. To continue
to use rules based on faulty calculations and that demonstrate repeatedly that following them does not yield desired outcomes would seem irrational from any ends-oriented view. Of course, the complicated layers of risk spread and securitization ensured that money still flowed and investors may not have felt the disruption of cash flow as acutely, making it more difficult to convince people that the rules and calculated models did not work.

At the same time, from the lenders' point of view these actions could still be rational. Weber ([1922] 1978:85) noted that the substantive rationality of economic actions could be informed by any number of ultimate values and the means by which these values are pursued is unlimited. What this means for the analysis of subprime lenders’ actions then is that the substantive rationality of the value of free capitalist enterprise encourages innovation and new ways of thinking. Pursuing a greater consumer base and creating new products, like subprime loans and lines of credit, are simply acceptable means of working toward these values. Lenders start to tinker with rules of risk, taking greater chances with increasingly ‘exotic’ loan forms with riskier borrowers, and the borrowers take on loans that they either do not understand fully, or have conditions by which they cannot abide. The deliberately planned relationship between lender and borrower becomes subject to the desire for innovation in lending in the drive toward free capitalist enterprise.

The result is a paradox created out of these intersecting rationalities. The consequences of the massive increase in subprime lending were not what most lenders anticipated. Instead of the continued ability to sell loans and reach previously untapped consumer bases, lenders started going out of business as loans moved from delinquency
to foreclosure. The act of reaching out to a larger consumer base—an action motivated by the substantive rationality of capitalist enterprise—led to a change in the processes of formal rationality that had for the most part worked. The changes in the processes of formal rationality simply were not sustainable in the long run.\footnote{It should be noted here that lenders' actions are not being solely made responsible for the subprime market crash, as parties like appraisers and brokers were also involved in an entire set of changing practices such as property appraisal.}

Bitner (2008) demonstrated what he considers a serious disregard for the principles of underwriting in his description of a loan that was processed for a family that ended up having to vacate the home because they could not afford it. The combined monthly income of the borrowers was $2,800, which after the mortgage left them with $700 dollars to cover all other living expenses. They had $250 in their checking account after closing the purchase of their house. They showed very little credit history apart from a department store credit, a line of credit that showed delinquent patterns of repayment. Neither of the two signing the loan had held a job for more than nine months in the past three years. Yet this loan was approved despite these risky characteristics (Bitner 2008:10-11).

This story exemplifies what some have viewed as 'irrational' lending actions, or what others have seen as simply irresponsible (Andrews 2009; Zandi 2009; Bitner 2008). The risk posed by the loans was too great, and the loans became delinquent, perhaps even defaulted, and the home went into foreclosure. It is this lack of paying attention to risks that many are citing as one of the leading factors in the breakdown of the subprime mortgage industry (Andrews 2009; Immergluck 2009; Zandi 2009). However, all of these judgments are being made in retrospect, after the collapse of many lending
companies, when people’s opinions have been formed with the knowledge of past events. It is important to keep in mind that looking back on one’s actions necessarily means that the judgments one makes about one’s actions will be informed differently, because there is knowledge an actor will have currently that the actor did not have at the time of action.

In sum, it seems that changes in the exercise of formal rationality have made all the difference. While the ultimate values of homeownership and profitable enterprise have remained the same, the processes and levels of risk taken in the pursuit of those values have changed. There seems to be an incongruity of rationalities, because despite the shared substantive rationality of both prime and subprime lending, the formal rationality for subprime lending was not enough to maintain a lending institution that tried to change the rules of risk. The result of the lender-borrower relationship was ironic for both parties involved: many borrowers ended up in worse financial situations and credit than they had previous to pursuing a subprime loan as well as losing the home for which they took out the loan in the first place, and many of the lending institutions, instead of generating a steady stream of revenue, simply ceased to exist.

**Subprime Lending and Vocation**

The vocational attitude, which Weber saw as a preeminent development in Western capitalism may be briefly stated: “It is an obligation which the individual is supposed to feel and does feel towards the content of his professional activity, no matter in what it consists…(Weber [1904] 1958:54).” Those who do treat their work as a vocation see it as a meaningful part of their lives. The results of their work are worth pursuing, and it may give their life meaning to do so. At the same time, Weber ([1904]
1958) noted at the end of *The Protestant Ethic and the Spirit of Capitalism*:

But victorious capitalism, since it rests on mechanical foundations, needs its [the spirit of asceticism] support no longer. The rosy blush of its laughing heir, the Enlightenment, seems also to be irretrievably fading, and the idea of duty one’s calling prowls about in our lives like the ghost of dead religious beliefs. (Pp. 181-182)

This section will explore how the vocational attitude was ambiguously present, at least in some extent, to those involved with the lending and innovative strategies of the subprime market. That is, the ideal of vocation and duty to one’s occupation was used as an explanation, and in some cases a justification, of the lenders’ actions, as a defense against charges of greed and irresponsibility.

**Lending as Purposeful Activity**

Richard Bitner (2008), of Kellner Mortgage Investments, stated in his book *Confessions of a Subprime Lender*:

> When people used to ask me what I did for a living, the answer was never, ‘I’m a mortgage lender.’ Instead I would tell them, ‘I’m a subprime lender.’ I knew the system was less than perfect, but it really felt like we in the subprime business made a positive difference in people’s lives. (p. 181)

The appeal of the ‘American Dream’ of homeownership is powerful, and those who help others to realize their dreams may indeed view their work as meaningful and purposive. To dedicate one’s life-work to putting people into positions of homeownership, ideally bettering their financial situations and helping them to secure their own future is a strong motivation that encourages a devotion to a career in lending. A part of Weber’s concept of vocation was that it was not about only prospering economically, but it was finding meaning in the work one did. The attitude that lenders maintained indicates that they did not view their work simply as jobs, but as a meaningful part of their lives.
Adam Michaelson (2009) who worked in Countrywide Financial recalled a conversation with a man who recruited him into the company:

...He looked me straight in the eye with an earnestness I had not witnessed in all my years of advertising meetings with hundreds of clients and said, ‘I have never believed more in what I’m doing, Adam. What could be more wonderful than helping someone get a home, really?’ (p. 54-55)

Countrywide would even later launch a campaign called “Realize Your Dreams”, a compelling slogan that indicated the company was there to help people achieve a higher status through homeownership. To believe in what one does for a living is to draw meaning from the activity. The fact that one does find meaning in one’s work is what Weber used to characterize the vocational attitude

In a 2003 presentation entitled *The American Dream of Homeownership: from Cliché to Mission* delivered in Washington, DC, Angelo Mozilo, a founder and CEO of Countrywide Financial, stated:

We wanted to make the American Dream of Homeownership something tangible—something to which people could do much more than just aspire. We wanted to make it something they could access, afford and achieve. We wanted to prove that our company could and would succeed by offering home loans to hard-working families—of all races and of all ethnic backgrounds. In other words, it has always been our intention to be more than a corporation that makes mortgage loans; we wanted to be a force in making positive differences in people’s lives. (p. 4)

Not only was Countrywide’s mission to enable people to achieve homeownership, but also to help eradicate social inequalities by enabling minorities and other historically disenfranchised groups achieve the same dream. The vocation of lending has gone beyond something that is personally fulfilling. What this presentation implied is that subprime lending, and Countrywide in particular, perform a necessary social service.

This identification with purpose is a sentiment Weber characterized as being part
of the vocational outlook (Weber [1904] 1958:54). It is also a sentiment that the
corporate culture of Countrywide Financial embraced. The vocational attitude is one in
which one’s activity is part of a larger ‘calling’. When one views one’s work as a
vocation, the work done itself has meaning, and it is a source of both personal and ethical
fulfillment to do one’s job well. What Michaelson, Gramlich and others have expressed
here reads as a deep commitment to their occupations and the general purposes of the
lending industry, namely putting people into homes. Their viewpoints express the
embodiment of the vocational outlook described in *The Protestant Ethic and the Spirit of
Capitalism*.

### Innovation and The Spirit of Capitalism

The vocational outlook does not however preclude economic success and material
accumulation. The actions of lenders that put people into homes are not altruistic in
nature, because lenders do make profit from this arrangement. As Weber claimed in *The
Protestant Ethic and Spirit of Capitalism*, the spirit of capitalism, which takes a major
role in the western development of the idea of vocation, does emphasize productivity for
the sake of economic gain: “The earning of money within the modern economic order is,
so long as it is done legally, the result and the expression of virtue and proficiency in a
calling…” (Weber [1904] 1958:53-54). So too, with the subprime lending industries did
the bottom-line come down to the dollar.

As with the example of the ‘putter-out’, or textile distributor who innovated a new
business model by increased supervision, direct relations with the consumer, lower prices
and higher turnover, innovation in the lending industry rewarded lenders (Weber [1904]
1958:67-68). Through aggressive pricing models and willingness to take on more risk,
which are tactics taken by the innovative, those lenders get ahead of the competition.

Michaelson (2009) described throughout his book that during his tenure at Countrywide, innovation within the parameters of the Countrywide mission was the key to getting noticed and advancing:

    Whether talking about creative, culture, or people, it was generally known that Countrywide had its own way about it; a mythology directly derivative of its powerful brand and of Angelo. A candidate for a job at Countrywide who was wholesome, honest, hardworking, helpful, and friendly would be referred to as “very Countrywide.” A call center representative who went the extra mile; a branch manager who always had a smile—such were the stuff of Countrywide… And the concepts we reviewed that day all were inviting, warm and friendly, complete with white-picket-fenced images touting the beauty of the American Dream. (p. 121)

The corporate culture of such companies encourages its workers to view their jobs as vocations. It is bringing the vocational outlook to the institutional level by encouraging workers to innovate and see value in their jobs. Those who succeed at cultivating this vocational outlook are rewarded with advancement and recognition.

    In fact, the story of the founding of Countrywide runs fairly closely with the example of the textile distributor, who, motivated by the spirit of capitalism, transformed the industry into being competitive, with a high turnover and larger distribution area (Weber [1904] 1958:67-68). The transformation of industry away from the traditional attitudes toward labor did not happen because of a large stream of ‘new money invested in the industry’, but rather because the spirit of capitalism provided a strong motivational force for individuals to experiment with new ways of enterprising (Weber [1904] 1958:68). With Angelo Mozilo, the case was very similar: a son of Italian immigrants grew up in a working class family and started a business with a partner through borrowed money. Through innovative lending practices and reaching a larger clientele, Mozilo and
David Loeb, the cofounder of Countrywide Financial, were able to grow a company that would end up being worth billions (Michaelson 2009:140; Morgenson and Fabrikant 2007).

Industry leaders and even regulators were onboard with financial innovation in lending. On numerous occasions Edward Gramlich, a former governor of the Federal Reserve Bank, looked to new lending mechanisms as a way to reach new consumer bases while trying to correct economic inequalities, a sentiment shared with what Mozilo outlined in his presentation about Countrywide (Gramlich 2004, 2007a, 2007b; Mozilo 2003).

Even after the fact of the subprime meltdown, Gramlich (2007a) stated in his presentation to the Federal Reserve Bank,

> But again going back to the boom-and-bust story, that seems exactly the wrong message to take from the experience. The subprime mortgage market was a valid innovation, and it did enable 12 million households to become homeowners, a large majority of these who would have been denied mortgage credit in the early 1990s. (p. 107)

Further, in his book Gramlich (2007b:83) stated, “The subprime market came about through a series of changes, these changes are difficult to reverse, and it would not even make sense to reverse most of them. The subprime market is here to stay, and American homeownership rates are probably permanently higher by 5 percentage points.” To view these innovations, which others have cited as the cause of the economic downturn, as experiments with somewhat optimistic results seems to clearly demonstrate an approval of creative thinking and bold financial engineering. Gramlich (2007b) did qualify his support with policy changes such as greater transparency and oversight. The heart of the matter is that the innovations were deemed ‘valid’, despite the negative effects they did
present.

Former Chairman of the Federal Reserve Board, Alan Greenspan, famous for his free-market approach and hands-off approach to handling economic 'bubbles', also was in favor of lending and mortgage innovation (Zandi 2009:1029). In a 2004 speech to the Credit Union National Association, he argued:

Indeed, recent research within the Federal Reserve suggests that many homeowners might have saved tens of thousands had they held adjustable-rate mortgages rather than fixed-rate mortgages during the past decade, though this would not have been the case, of course, had interest rates trended sharply upward. American homeowners clearly like the certainty of fixed mortgage payments. This preference is in striking contrast to the situation in some other countries, where adjustable-rate mortgages are far more common and where efforts to introduce American-type fixed-rate mortgages generally have not been successful. Fixed-rate mortgages seem unduly expensive to households in other countries... American consumers might benefit if lenders provided greater mortgage product alternatives to the traditional fixed-rate mortgage. To the degree that households are driven by fears of payment shocks but are willing to manage their own interest rate risks, the traditional fixed-rate mortgage may be an expensive method of financing a home (Greenspan 2004).

The traditional loans, Greenspan argued are 'unduly expensive', meaning an unfair financial burden was being placed on borrowers in the traditional mortgage structure. Again, the innovative approach taken by private enterprises in the quest to serve a greater number of consumers was heralded not only as a good business practice, but also as an effective way to help homeowners.

Charges of Greed Against the Lenders

The essence of the spirit of capitalism and a dedication to one's work have been cited as strong motivating forces for lenders' actions. The spirit of capitalism does not entail an avaricious quest for wealth, but rather situates economic success as a meaningful part of life, even a duty. From the accounts given by subprime lenders, it was
a motivation towards success and an expansion of business that drove their innovations, not greed.

Of course, innovation can have its drawbacks. It was innovative financial models, structures and practices that would eventually enable the subprime crisis. ARMs, no and low documentation loans, high LTV and CLTV ratios were all results of financial innovations in the subprime lending field. Those who managed to brand their company’s own version of these financial inventions, such as the Countrywide’s “PayOption” loan, which was essentially a loan that let the borrower choose a payment option half of which were negative amortization options, were generally applauded by their companies for pushing beyond traditional thinking (Michaelson 2009:10-13). It was these same innovations and new trends in underwriting that became problematic (Bitner 2008; Goodman et al. 2008; Immergluck 2009; Zandi 2009).

There also seems to be a rather fine line between what some may consider innovation and what others may consider poor business practices. Techniques like credit repair, speculative appraising of both property and investments, leveraging income and automated underwriting were all designed to ‘help’ the borrower in securing the loan. However, as was the case in many instances, the borrower still was not able to make good on the loan’s terms, and the loan went into delinquency, default and perhaps the home was eventually foreclosed (Bitner 2008:80-91).

Criticism of the subprime mortgage lenders has also gone beyond the charges of simply ‘bad business practices’ to outright claims of greed, fraud, and unethical behavior. The title alone of Bitner’s (2008) book, Confessions of a Subprime Lender: an Insider’s Tale of Greed, Fraud and Ignorance, though obviously chosen to pique readers’ interests,
conjures up images of devious corporate businesspeople making backroom plans to swindle innocent consumers out of their money. Beyond titles to catch the reader’s eye, more substantial claims about the greed of lenders, and others involved with the loan process, are found in the book (Bitner 2008:15-38, 103-126). In his book that focuses on the subprime securitization process, Justin O’Brien (2009) characterized the proceedings in the U.S. House of Representatives: “From the start, it was apparent that a narrative based on greed would play a central role. Much was made, for example, of a $440,000 bill accrued by a subsidiary of American International Group at the luxurious St. Regis Hotel in Monarch Beach…” (p. 63). O’Brien (2009) went on to charge “There was a perverse rationality to the systematic inflation of the [housing] bubble. Integrity was compromised, willingly, at each stage” (p. 65). O’Brien (2009:65) then cites the already discussed ‘liar’s loans’- meaning loans with no income, jobs or assets statements (known by the acronym NINJA)—as evidence of this willingly compromised integrity.

Media outlets also took part in this narrative. Articles containing interviews of subprime lenders, or of former subprime lenders who left the industry, detailed the wealth or luxury that surrounded those involved with the lending (Creswell and Bajaj 2007), contrasting those companies that continued to make money during the crisis with ‘victims’ of the subprime crisis (Anderson 2007, Eckholm 2007, Morgenson 2010). Other articles cited the machinations used by lenders to make loans, furthering the narrative of a corporate machine let loose (Browning 2007). Stories of executive bonuses in a time of economic crisis abound in media outlets, print and television. In his book, American Nightmare: Predatory Lending and the Foreclosure of the American Dream, Richard Lord (2005), an economic reporter from Pittsburgh, creates a narrative of
victimization of corporate wrongdoing out of numerous stories and interviews with subprime borrowers. To charge the lending system as being dominated by greed seems to be a common choice and a compelling narrative.

In *The Protestant Ethic and the Spirit of Capitalism*, Weber ([1904] 1958) strongly argued that greed ought not to be conflated with the idea of vocation and capitalism in general: “It should be taught in the kindergarten of cultural history that this naïve idea of capitalism must be given up once and for all. Unlimited greed for gain is not in the least identical with capitalism, and is still less its spirit” (p. 17). At the same time, the asceticism of the Protestant ethic and the spirit of capitalism that came from this tradition did not always morally condemn material enjoyment. The accumulation of wealth is a logical consequence of the spirit of capitalism (Weber [1904] 1958:172).

Wealth is thus bad ethically in so far as it is a temptation to idleness and sinful enjoyment of life, and its acquisition is bad only when it is with the purpose of later living merrily and without care. But as a performance of duty in a calling it is not only morally permissible but actually enjoined. (Weber [1904] 1958:163)

One is thus confronted with differing views on the actions of lenders. From the point of view of the actual lenders, there is the claim that they were doing their jobs to the best of their abilities and at worst, perhaps became too carried away with innovative strategies in the attempt to fulfill their duties better. This does require giving the lenders the benefit of taking them at their word regarding their motivations. However, some of the journalists cited above and borrowers claim that there were abuses of economic power and trust committed by lenders (Michaelson 2009). Believing these charges leads one to believe that the subprime industry is one of avarice and deceit.
The Example of Countrywide

The story of the previously discussed Angelo Mozilo and the company he cofounded, Countrywide Financial, bears relevance to the tension between the descriptions of vocational attitudes and charges of greed leveled against lenders. Mozilo came from humble beginnings as the son of a butcher immigrant living in the Bronx. Through borrowing and saving his own money, he founded Countrywide Financial with his business partner, the late David Loeb. With the oversight of Mozilo and Loeb, Countrywide came to be worth $200 billion. By 2005, Countrywide had become heavily invested in subprime, ARMs, and interest-only loans, becoming one of the leading lenders of the time (Morgenson and Fabrikant 2007). This story truly matches the one Weber presented in *The Protestant Ethic and the Spirit of Capitalism* as being exemplar of the sort of evolutionary thinking that transformed capitalist enterprise into the modern form we know today.

At the same time, the reported behaviors of Mozilo clash with the ascetic principles of modesty and restraint. Morgenson and Fabrikant (2007), in their profile of Mozilo reported how he maintained an ‘outsider status’ within the banking and lending industry:

However much the banking business rolled headlong into risky mortgage practices, on the surface the industry has historically been marked by a preference for low-key behavior and conservative dress. In both regards, Mr. Mozilo was an outsider. He favored speaking his mind in public and was blunt about his corporate aspirations. To complement his ever-present tan, he wore flashy clothes and drove expensive cars like Rolls Royces, and often in a shade of gold. (p. 3)

Such an ostentatious display of wealth clearly contradicts the whole attitude of vocation and the general spirit of capitalism, which Weber insisted promoted restraint.
Michaelson (2009:81) also reported that in working for Countrywide, Mozilo was viewed within the company with a reverence that seemed to border idolization. In the headquarters of Countrywide was a museum documenting the history of the company complete with images of Mozilo together with the new homeowners who were able to reach their goal of homeownership with Countrywide and Mozilo’s help (Michaelson 2009:81). Again, the deliberate attention placed on the self and what seems like a quest for recognition simply do not correspond to the spirit of capitalism as described by Weber.

The most recent part of the story of Mozilo is that in June 2009, the Securities and Exchange Commission indicted Mozilo with securities fraud and insider trading. The charges indicate that Mozilo misled investors by understating the risk involved with Countrywide products, while at the same time privately referring to them as ‘toxic’ and ‘poison’ according to emails that were cited as evidence in the SEC’s case (Morgenson 2009:1). In the meantime, Mozilo sold stock in Countrywide generating a personal profit of $140 million. In a later email, he described the ‘PayOption’ loan—a Countrywide brand of adjustable rate loans—by saying:

We have no way, with any reasonable certainty, to assess the real risk of holding these loans on our balance sheet... The bottom line is that we are flying blind on how these loans will perform in a stressed environment of higher unemployment, reduced values and slowing home sales. (Morgenson 2009:2)

Such actions do not suggest that Mozilo acted in the tradition of modern, rational capitalism, but rather as one of the adventurous, unscrupulous pre-capitalist attitude
It would be baseless to assert that we should take Mozilo’s actions to be representative of every lender. However, what his story does represent is a nuanced capitalistic attitude. Founding a company through determination and much labor, then to display ostentatiously the wealth garnered from that business, only to later be accused of defrauding others who believed in your company shows the extreme of capitalistic actions. On the one hand, the beginning of Mozilo’s story is akin to the ascetic capitalists, about whom Weber wrote, who worked diligently but who did not flaunt their success. However, the later behaviors and accusations cannot be sustained within the ascetic tradition Weber ascribed to modern, Western capitalism, but rather fly in the face of the restraint that the spirit of capitalism is said to entail. The story of Mozilo is without doubt an exceptional case in subprime lending, but illustrates the ambiguity associated with the modern vocational outlook.

Conclusion

In this chapter, I have attempted to examine the way that the various forms of rationalization suggested by Weber may intersect and create contradictory and problematic economic and social behaviors. I have argued that changes in the process of risk assessment as formal rationality ignored the realities of risk posed by borrowers and that new rules lenders used to assess risk were not robust enough. Lenders are rational, economic actors. As such their actions can be rationalized in several dimensions. The

---

5 Although no sentence or conviction has yet been forwarded, in June 2010, the Federal Trade Commission excised a $108 million fine from Bank of America—the company that bought Countrywide—in order to distribute to some 200,000 former Countrywide customers who were made to pay exorbitant foreclosure fees, one of which included charging the borrower $300 for a lawn-mowing (Morgenson 2010).
wertrational form of their actions is the goal of successful capitalist enterprise. Putting people into homes is a means of achieving this, thus establishing a social-economic relationship of lender-borrower is a zweckrational action.

At the same time, lenders did not view their actions as ones of greed, or at least they have not admitted to acting out of such motives. Rather, their claims indicate that they were acting out of an attitude akin to Weber’s concept of Beruf—a vocational attitude toward their work, which prompted new, rapid innovations without regard for the new levels of risk they were taking on. However, charges of greed from journalists and borrowers present an irreconcilable narrative with this vocational outlook. If the critics of subprime lending are correct, then the vocational attitude ‘defense’ from lenders cannot stand.
CHAPTER 4
DURKHEIM

Introduction

A central focus of Émile Durkheim's (1858-1917) career was the study of morality. More broadly, Durkheim wanted to examine how societies function, maintain and perpetuate themselves through the analysis of the moral life of social interactions and structures. *The Division of Labor in Society* ([1893] 1984) is an early attempt by Durkheim to analyze how societies maintain cohesion and how the various sectors of society interact with one another, establishing normative patterns of behavior and functions for each part. In a later work, *Suicide*, Durkheim attempted to find the social causes of suicide rates using sociological principles and applying some of the same concepts, particularly anomie, found in *The Division of Labor in Society*. *Professional Ethics and Civic Morals* ([1950] 1958), on the other hand, is a later work of Durkheim's, unpublished in his lifetime, which is a collection of lectures—the first half of which discusses the role of ethical standards established in the professions. I focus on these works by Durkheim because in them the reader finds how Durkheim viewed the intersection of socially recurring patterns of economic activities and moral behavior. Durkheim sought to find to what extent certain economic activities or relationships are subject to moral standards, or even perhaps how the activities actually may shape them.

The goal of this chapter is to elucidate the various claims Durkheim made
regarding the concept of anomie, how it changed from *The Division of Labor in Society* to *Suicide* and through *Professional Ethics and Civic Morals*. One finds quite different conceptions of anomie between these works. In the former, anomie takes on a more structural nature; anomie is found to be a pathological manifestation of the division of labor. In the latter, Durkheim narrowed the focus of anomie to a more individualistic level of a concept akin to dashed personal aspirations, while still attributing the genesis of this form of anomie to the economic sector of societies. The point of examining the different characterizations of anomie is to find how the concept as a whole might be applied to the topic of subprime mortgages.

The second major work I focus on is *Professional Ethics and Civic Morals*. In this work, Durkheim critically outlined what he saw as the ethical failings of the economic profession. In this series of lectures, Durkheim emphasized the need for economic professionals to establish a set of standards and ethics by which they would abide. An underlying concern of Durkheim in *Professional Ethics and Civic Morals* is that this lack of ethics is a principal point of origin of anomie. The three works are thus connected by the recurring theme of anomie.

Having discussed Durkheim’s conceptions of anomie, as well as a point of origin he found in the failure of the economic profession to set up ethical standards by which they can abide, I will then be in a position to apply these conceptions to a modern social phenomenon, the subprime mortgage lending industry in the next chapter. To begin, I discuss Durkheim’s concerns with the morality of society. Of particular importance in *The Division of Labor in Society* are the concepts of social solidarity, organic solidarity, and the anomie division of labor. However, in order to put these in context, a more basic
discussion of the collective consciousness, mechanical solidarity and the pathological forms of the division of labor is necessary.

**Durkheim’s Concerns with Morality**

Early in *The Division of Labor in Society*, Durkheim ([1893] 1984:3) posited the moral character of the division of labor. The division of labor, which Durkheim saw to be growing greater in his time and his society, affects all spheres of social and economic life. It transcends any one segment of society and affects all others; a change in the division of labor entails a change in the way we function and even in the methods with which we regulate how we function. The division of labor implies not only the specialization of labor processes to increase productivity and advance industry, but it entails consequences for social solidarity of the society as a whole. Solidarity and social cohesion are issues of moral import, a claim of Durkheim’s that will be discussed below. If we accept that social solidarity is an issue with moral impact and that the division of labor itself has some impact on social solidarity (for better or worse), the division of labor itself must have moral import. Thus Durkheim was interested in moral consequences of the division of functions of segments of society.

At the same time, Durkheim ([1893] 1984) took care to separate himself from those moralists who deduce their doctrine not from an *a priori* principle, but from a few propositions borrowed from one or more of the positive sciences, such as biology, psychology or sociology, [and who] term their morality ‘scientific’. We do not wish deduce morality from science, but to constitute the science of morality, which is very different. (p. xxv)

Durkheim’s project was not to moralize from scientific proofs but rather to study the moral structuring of societies, to understand how societies function, what holds them
together and what may tear them apart.

This is not to say that Durkheim was disinterested in changing society or reforming certain societal practices. On the contrary, one finds a great deal of concern for active change in societal practices in Durkheim. Only a short while after distancing himself from the moralists, Durkheim states in the preface to *The Division of Labor in Society*, “Yet because what we propose to study is above all reality, it does not follow that we should give up the idea of improving it. We would esteem our research not worth the labour of a single hour if its interest were merely speculative” ([1893] 1984:xxvi).

Later in the book he stated, “Instead of letting causes produce their effects at random according to the forces impelling them, reflective thinking intervenes to direct their path, this can spare us many a painful ordeal” (Durkheim [1893] 1984:278). In *Professional Ethics and Civic Morals*, the concern Durkheim ([1950] 1958) had for reform was even more pronounced:

> And it is precisely due to this fact [the lack of a standard of professional ethics] that the crisis has arisen from which the European societies are now suffering. For two centuries economic life has taken on an expansion of it never knew before...A form of activity that promises to occupy such a place in society taken as a whole cannot be exempt from all precise moral regulation, without a state of anarchy ensuing...If we put forward this anarchic competition as an ideal we should adhere to—one that should even be put into practice more readily than it is today—then we should be confusing sickness with a condition of good health...It is therefore extremely important that economic life should be regulated, should have its moral standards raised, so that the conflicts that disturb it have an end, and further that individuals should cease to live thus within a moral vacuum. (Pp. 11-12)

The distinction between Durkheim and the moralists he wished to distance himself from does not seem be as great as he proposed in the preface to *The Division of Labor*. That is, he may have wished to avoid engaging in philosophical or metaphysical debate, but he...
certainly supported specific moral-minded reforms for society in his vision of what constitutes ‘healthy’ society, reforms which could be planned with the science of sociology ([1893] 1984:xxv). Durkheim thought the science of sociology could lead the way in working toward a functional, cohesive society.

Social Solidarity

A primary moral concern Durkheim had in *The Division of Labor in Society* was social solidarity. Durkheim based his definition of social solidarity on Comte’s, but the term ‘solidarity’ itself is not precisely defined, although organic and mechanical solidarity are both explored in detail. In sum, by solidarity Durkheim meant the extent to which a society is cohesive and functions as a whole while being composed of individuals and smaller groups. Durkheim often used biological metaphors in *The Division of Labor*, so by using the term ‘function’, he likened the different sectors of society to different parts of the body: “But we also say that the digestion fulfills the function of controlling the absorption into the organism of fluid or solid substances indented to make good its losses” (Durkheim [1893] 1984:11). Solidarity then refers to the effective functioning of the various parts of society in whatever capacity they exist: economic, law, political and so on. The aim of *The Division of Labor in Society* was to find if and how ‘modern’ divisions of labor were in fact a source of social solidity:

Thus we are led to ask whether the division of labor might not play the same role in more extensive groupings—whether, in contemporary societies where it has developed in the way that we know, it might not fulfill the function of integrating the body social and of ensuring its unity. It is perfectly legitimate to suppose...that these great political societies also cannot sustain their equilibrium save by the specialization of tasks; and that the division of labor is the source—if not the sole, at least the main one—of social solidarity (Durkheim [1893] 1984:23).
Durkheim classified social solidarity and the division of labor as phenomena of moral import: “We are therefore led to consider the division of labour in a new light. In this case, indeed, the economic services that it can render are insignificant compared with the moral effect that it produces, and its true function is to create between two or more people a feeling of solidarity” (Durkheim [1893] 1984:17). The division of labor is examined to find if and how it could create greater social solidarity in those societies with a greater division.

Drawing on Comte, Durkheim ([1893] 1984) noted the moral character of social solidarity:

It is through the division of labor, or at least mainly through it, that the cohesion of societies would be ensured...By this very fact...we can nevertheless vaguely perceive that, if this is the real function of the division of labour it must possess a moral character, since needs for order, harmony and social solidarity are generally reckoned to be moral ones. (Pp. 23-24)

Thus the examination of social solidarity, and the division of labor that may generate it, or destroy it, entails an examination of the “normal” versus the “pathological” structures of society. Because Durkheim argued that these studies concerned what is “good” for society, they necessarily engage with morality.

The Collective Consciousness

Before discussing the two types of solidarity, it is important to distinguish the concept of the collective consciousness. The collective consciousness is the “totality of beliefs and sentiments common to the average members of a society [forming] a
determinate system with a life of its own" (Durkheim [1893] 1984:39). It entails customs, norms and traditions of the society, permeating individuals' own consciousness; it passes on generationally, outlasting the consciousnesses of individuals. The individual consciousness and the collective consciousness are by no means identical but it is only in individuals that the collective consciousness is actually realized in action. The collective consciousness is not the sole source of social solidarity, but rather a source of one particular form of solidarity—mechanical solidarity. The collective consciousness is expressed much more weakly in societies of organic solidarity. The way in which the collective consciousness is expressed in a society can be used as an indication as to the mode of solidarity of that society. That is, if one found a society to express a strong collective consciousness, it would indicate one type of social solidarity; expressions of a weak collective conscience indicate another type of social solidarity.

The method Durkheim used to examine the solidarity of society was to analyze the laws and sanctions found in society. To his mind, these form the clearest expressions of the consciousness of society. Through understanding the sanctions imposed legally in a society, Durkheim believed one would be able to inductively characterize how that society is held together and functions as a whole (Durkheim [1893] 1984:24-25). He classified two general types of sanctions: repressive (or punitive) and restitutive. Each of the two different classes of sanctions corresponds to one type of social solidarity (Durkheim [1893] 1984:28-29).

---

6 In the translation that I use here, Durkheim used the terms “collective” and “common” interchangeably; I am going to use the term “collective” throughout. Durkheim also noted that the collective consciousness is not synonymous with social consciousness. This is particularly the case in "higher societies," where the collective consciousness makes up only a part of the total social consciousness; the latter includes “judicial, governmental, scientific and industrial” functions that are outside the domain of the collective consciousness (Durkheim [1893] 1984:39).
Mechanical Solidarity

Simply put, a society that is characterized as having greater similarities in beliefs, practices, customs and so on, between its members, and that has a lesser division of labor and a stronger collective consciousness (rather than a greater number of varied individual consciousnesses) can be characterized as maintaining cohesion through mechanical solidarity. Mechanical solidarity is in essence solidarity based on similarity. The collective consciousness in societies of mechanical solidarity is more prominently felt in individuals within that society (Durkheim [1893] 1984:40-44).

Durkheim’s ([1893] 1984) definition of crime and punishment indicates how he characterized societies of mechanical solidarity: “[P]unishment constitutes essentially a reaction of passionate feeling, graduated in intensity, which society exerts through the mediation of an organized body over those of its members who have violated certain rules of conduct” (p. 52). Further, “an act is criminal when it offends the strong well-defined states of the collective consciousness” (Durkheim [1893] 1984:39). It is the rules of conduct that express the collective consciousness of that society. In societies with a strong collective consciousness, acts that run counter to beliefs held by the collective consciousness are met with swift and stern punishment. An act does not offend “the common consciousness because it is criminal, but…it is criminal because it offends the common consciousness” (Durkheim [1893] 1984:40).

Thus in Durkheim’s discussion of mechanical solidarity, one finds a heavy emphasis on the repressive and punitive laws of societies of mechanical solidarity. Crimes committed against a strong collective consciousness arouse such moral indignation towards the transgressors that society takes vengeance. Although
punishments have changed in form, punishment overall “has remained for us what it was for our predecessors. It is still an act of vengeance, since it is expiation. What we are avenging, and what the criminal is expiating, is the outrage to morality” (Durkheim [1893] 1984:47). Punishment as directed vengeance finds its clearest expression in societies held together by mechanical solidarity, because a well-defined collective consciousness demands a stronger reaction against transgressors.

Mechanical solidarity, or ‘solidarity by similarities,’ is predicated on this strong collective consciousness, because it is the collective consciousness which holds the society together. It is then essential for “mechanical” societies to be able to enforce the beliefs of the collective consciousness. Thus, in “mechanical” societies, one finds repressive laws to generally be much more harsh, greater in number as well as much more specific in how they forbid undesired behavior (Durkheim [1893] 1984:55-60). In a society that is built on and bound by similarities, crime “disturbs those feelings that in any one type of society are to be found in every healthy consciousness” (Durkheim [1893] 1984:34). In societies of mechanical solidarity the collective consciousness and the individual consciousness resemble each other to greater extent, and the “healthy” individual’s beliefs will match those of the society in which he or she is located.

In sum, societies of mechanical solidarity exhibit strong collective consciousnesses. The consciousnesses of the individuals in the society do not differ to a large degree from that of the collective; it is a society whose cohesion is dependent upon the similarities between its members. The laws that characterize such societies are punitive in nature, demanding expiation from the criminal for the transgression committed against the collective consciousness.
Organic Solidarity

If mechanical solidarity is founded on the similarities of individuals within a society, organic solidarity may be its conceptual opposite. Rather than basing cooperation on the fact of the similarity between individuals, organic solidarity depends on the difference between individuals to foster interdependence. It is precisely this type of solidarity that Durkheim believed the division of labor engenders. It is the type of solidarity one finds when individuals specialize and therefore must depend on, and cooperate with, others who have specialized differently. Where mechanical solidarity was generated via a strong collective consciousness, organic solidarity corresponds with a weakening of it. Where mechanical societies demanded punitive reactions against crimes, organic solidarity entails restitutive reactions.

Restitutive sanctions, in contrast to repressive ones, are not emotionally driven, do not seek vengeance, and generally do not seek to inflict suffering on the transgressor as a form of penance. Rather, restitutive sanctions are meant to restore the order of things to the way they were before the transgression occurred; they focus on restoring order in the present and for the future instead of demanding retribution for transgressions of the past. Durkheim ([1893] 1984) offered the reader a clear example of the difference between the reactions that the deviant behaviors provoke:

The ideas that murder can be tolerated sets us up in arms, but we very readily accept that the law of inheritance might be modified, and many even conceive that it could be abolished. At least it is a question that we are not unwilling to ask… Since these prescriptions [Durkheim also referred here to changing the rules regarding easements, the buyer-vendor and administrative functions] do not correspond to any feeling within us, and as generally we do not know their scientific justification, since this science does not yet exist, they have no deep roots in most of us. (p. 69)
Why is it the case that these types of transgressions do not evoke such a strong reaction in us that moves us to punish strongly the transgressors as it does with other transgressions? It is because transgressions of this nature do not act against the collective consciousness. It is true that they are viewed as wrong, maybe even criminal, and a debtor may be looked upon as being in the wrong for accruing too much debt, but, as Durkheim pointed out, we generally do not feel moral outrage in cases like these (Durkheim [1893] 1984:68-69).

Repressive and restitutive sanctions form a continuum along the collective consciousness (Durkheim [1893] 1984:69). At one end, repressive sanctions are more severe in terms of the type and amount of punishment doled out because they directly correspond to the collective consciousness. At the other end, restitutive laws do not represent the collective consciousness, except perhaps in a very diffuse amount: “Repressive law corresponds to what is the heart and centre of the common consciousness. Purely moral rules are already a less central part of it. Lastly, restitutory law springs from the farthest zones of consciousness and extends well beyond them. The more it becomes truly itself, the more it takes its distance” (Durkheim [1894] 1984:69).

In other words, restitutive laws are generated from a completely different source than repressive laws, which have their genesis in the strong collective consciousness. It follows then that restitutive laws, if not expressive of the collective consciousness, they are also not expressions of mechanical solidarity as Durkheim defined it; they therefore originate elsewhere. Restitutory laws, taken as an expression (perhaps the expression par excellence for Durkheim) of organic solidarity have the division of labor as their place of origin.
Durkheim reached this conclusion, again through inductive reasoning, through classifying the various modes of expression for restitutive laws. He also saw the very nature of restitutive laws as being sufficient to show that they originate from a different source than repressive laws. That is, these laws, unlike repressive laws are expressed through highly specialized structures. "...[R]estitutory law sets up for itself ever more specialized bodies: consular courts, and industrial and administrative tribunals of every kind. Even in its most general sector, that of civil law, it is brought into use only by special officials—magistrates, lawyers, etc., who have been equipped for their role by a very special kind of training" (Durkheim [1893] 1984:70). It seems the most striking feature of this form of solidarity for Durkheim ([1893] 1984) was the fact of its specialized nature:

Since the rules where sanctions are restitutory do not involve the common consciousness, the relationships that they determine are not of the sort that affect everyone indiscriminately. This means that they are instituted directly, not between the individual and society, but between limited and particular elements in society, which they link together. (p. 71)

Restitutory laws correspond to different sectors of society. Each sector is bound by a specialized set of rules. Even in the case of civil law, specialized training and processes are used in dealing with situations arising in this arena.

The division of labor actually entails two forms of solidarity: positive and negative. Only the first creates cohesion, the second presupposes it and maintains it (Durkheim [1893] 1984:75). Negative solidarity can be exemplified in two forms of rights: 'real' and personal (Durkheim [1893] 1984:72-74). Essentially, real rights are those rights that relate to property, that bind things to people. Durkheim classified 'real' rights as 'negative' because their effect is to bind property to a person and to ensure no
others interfere with that person’s use of the property. Similarly, personal rights (among which Durkheim classified the right to credit) ‘negatively’ bind people to one another in that one party agrees to pay damages that may occur to the other party. Instead of being a positive agreement for rendering services, negative rights focus on preventing misdeeds from happening and restoring the balance when they do. Durkheim classified these as negative rights, noting the ambiguity in that term.\(^7\) It seems the distinction between the two is less clear than one might suppose at first, because negative solidarity presupposes positive solidarity, and it seems positive solidarity normally entails some form of negative solidarity. So while they are at first ‘negative’ in their preventative nature, they take the form of restitution when need be (Durkheim [1893] 1984:77).

More at the heart of organic solidarity is positive solidarity. Where negative solidarity only served to maintain already existent social cohesion, positive solidarity creates it. Positive solidarity is expressed in domestic, contractual, commercial, procedural, administrative and constitutional law (Durkheim [1893] 1984:77). Positive solidarity entails active obligations of one party to another; positive agreements mean two parties are in a relationship of reciprocal obligation.\(^8\) The agreements signify cooperation between parties that are necessarily different from one another. That is, in domestic law one has the question of who is the guardian and who receives guardianship; in contractual law one has the question of who is responsible for what service; in procedural law, the question of who acts as a defense lawyer, a juror, etc.; and, most notably for the present

\(7\) "The very expression ‘negative solidarity’ that we have employed is not absolutely exact. It is not a true solidarity, having its own life and being of a special nature, but rather the negative aspects of every type of solidarity” (Durkheim [1893] 1984:75).

\(8\) It is true, Durkheim noted, that there are positive relationships that are not unilateral, but that are gratuitous or ‘benevolent’. However, these contracts are few in number compared to the number of contracts that specify reciprocal obligations (Durkheim [1893] 1984:79).
topic, in commercial law, the question of who is the lender and who is the borrower. In addition to defining the roles the parties are to play, the questions arising in laws expressing positive solidarity also regulate the functions of each party. In short, these laws which express positive solidarity set down the roles and functions for each party entering into a cooperative relationship under the auspices of the division of labor—each party has a different, specialized function and role to play (Durkheim [1893] 1984:77-83).

In a society with greater divisions of labor, one expects to find more relationships of this latter type, where parties differ from each other in the specialized function each serves. Specialized rules are developed for each area of society, and they serve to demarcate exactly where each person's obligation lays in relation to another's. This is the function of laws of positive solidarity. On the other hand, negative solidarity serves to maintain these demarcated boundaries by through essentially obligations of abstention from interfering with another's functions. In the end, Durkheim suggested that both positive and negative solidarity are needed to maintain cohesion in societies with a high division of labor and that the former generates the latter. Both positive and negative solidarity are components of organic solidarity found in societies of higher divisions of labor. However, as discussed above, Durkheim contended that restitutive laws, as symbolic expressions of organic solidarity, do not have their origin in the collective consciousness. What then is the condition of the collective consciousness in societies of organic solidarity?
The Collective Consciousness in Societies of Organic Solidarity

As discussed above, the collective consciousness is the totality of beliefs and sentiments common to all members of society. The strength of the collective consciousness can be seen in how strongly individuals have adopted societal beliefs. That is to say the more similarly will attitudes be shared between members of that society. In effect, this indicates greater similarities between members of a society, with lower divisions of labor. However, when people start to specialize, they start develop differing rules, personalities and even societal functions, all increasing the division of labor. This leads to a weakening of the collective consciousness and an increase in the individual personality.

The situation is entirely different in the case of [organic] solidarity that brings about the division of labour. Whereas the other [mechanical] solidarity implies that individuals resemble one another, [organic solidarity] assumes that they are different from one another. The former type is only possible in so far as the individual personality is absorbed into the collective personality; the latter is only possible if each one of us has a sphere of action that is peculiarly our own, and consequently a personality (Durkheim [1893] 1984:85).

Further, “division of labour progressed the more individuals there are who are sufficiently in contract with one another to be able to mutually act and react upon one another” (Durkheim [1893] 1984:201). This is what Durkheim calls the ‘moral density’. With the increase of population, population shifts and population density, interactions among individuals become more numerous. At the same time they become more numerous they also become more specified. As evidence of this, Durkheim looked to Darwinian lines of thought.

Darwin observed that like organisms compete more strongly the more alike they
are. Living in a limited area, like organisms will compete with other like organisms more strongly than they will with unalike organisms. Durkheim applied this law to humans as well. Where humans are alike in their aims and needs, they compete with others for those same aims and needs. However, as individuals specialize in their functions, their aims change and they can meet their needs in ways that are not competitive with others in the society. Durkheim offered the examples that the "shoemaker does not compete with the hatter, the mason with the cabinet-maker, the physician with the chemist, etc" (Durkheim [1893] 1984:210). In instances where there are individuals who perform similar functions, competition emerges and the stronger will outlast the weaker, and the weaker simply ceases its competition or is absorbed into the stronger (such as when a larger company absorbs a smaller company that performs similar services). When these forms of relationships are set up, whether they are cooperative or competitive, there are normative, moral rules established to accompany the structure of the relationship. The effect of all this competition and cooperation is an increased division of labor. The collective consciousness in turn is made weaker by the specialization of individuals, because by necessity, they must differentiate themselves into spheres of specialization, the act of which requires them to adopt specialized rules that are different from the rules of the collective consciousness in general.

The consequence of the division of labor may be a weakening of the collective consciousness, but this does not mean that there is a decrease of social solidarity on the whole. Rather, the division of labor creates organic solidarity, a social cohesion that is reached and maintained through cooperative relationships of interdependence. The relationships take on regular forms and through these regular forms develop moral rules
of conduct. Each party is obligated to fulfill certain functions, and these rules take on a life of their own and find their ultimate expression in the above-mentioned restitutive laws, both in positive and negative forms.

The Pathological Forms of the Division of Labor

There are, however, abnormal forms to which the division of labor can lead. Durkheim discussed three such 'pathological' forms: anomie forms, forced division of labor, and a third division that is essentially incoordination between parts of society. By the forced division of labor, Durkheim meant societies with caste or class system whose structure is enforced without regard for people's aptitudes and abilities (Durkheim [1893] 1984:311-312). This forced division of labor produces constraint on those within the society, forcing them into social positions not in their interests or desires:

Constraint begins only when regulation, no longer corresponding to the true state of affairs and consequently without any moral foundation, is only maintained by force. Conversely, we may therefore state that the division of labour only produces solidarity if it is spontaneous, and to the degree that it is spontaneous (Durkheim [1893] 1984:312).

This constraint described by Durkheim is the factor that leads to the breakdown of solidarity, because it stands in the way of the spontaneous division of labor, and it is this spontaneity that is required for social solidarity.

The third abnormal form Durkheim discussed is never given a succinct name and its discussion is comparatively brief. It is essentially the development in the division of labor where certain functions are no longer consistently vital to the integrity of the structure as a whole. Continuing the use of biological analogies, Durkheim compared the necessity for humans to eat to that of a snake. Humans must eat fairly regularly in order
to survive, because the function of food is that it is a source of energy needed for other life functions. The snake however is able to sustain these other life functions for long periods of time, because they do not depend so heavily on constant food intake. Thus the function of eating and other life functions for the snake are less solidly linked than those of the human (Durkheim [1893] 1984:324). This is seen in the division of labor when the functional activity of a certain group or sector decreases because it is not needed. When a company pays wages to workers who are inactive because of a lack of work, this is a waste of wages and maintenance of extraneous labor force. Durkheim argued that this too is a form of a breakdown in solidarity. However, the pathological form that is of most interest here is the anomie division of labor.

The Anomic Division of Labor

The anomic division of labor can be characterized as the unintended consequence of overspecialization. The result is a society in which sectors no longer function in tandem with each other. Communication between the sectors diminishes, and there is a general loss of focus on societal beliefs and consequences due to the increased attention paid to the specialized function of the sector. That is to say anomic division is the destruction of solidarity. This leads to a loss of the regular, moral ties one sector has with another. “The division of labour, by its very nature, may therefore exert a dissolving influence, which above all may be appreciable where its functions are very specialized” (Durkheim [1893] 1984:295). What Durkheim tried to grapple with was the seemingly inevitable process of dissolving social cohesion that stems from the division of labor. Durkheim ([1893] 1984) did note however,
What resolves this contradiction is the fact that, contrary to what has been said, the division of labour does not produce these consequences through some imperative of its own nature, but only in exceptional and abnormal circumstance... For normally the operation of each special function demands that the individual should not be too closely shut up in it, but should keep in constant contact with neighbouring functions... (Pp. 307-308)

If the various sectors or branches of industry, commerce, and so on, keep in communication with the others, then the anomie division of labor would be avoided. “If the division of labor does not produce solidarity it is because the relationships between the organs are not regulated; it is because they are in a state of anomie” (Durkheim [1893] 1984:304). If the regulatory sector of society cannot effectively regulate, and if a sector cannot self-regulate its growth or activities, it is possible for the sector to grow too big or to take on too much activity for it to maintain control. This is exactly what Durkheim ([1893] 1984) saw as happening, and this language will appear again later:

...As the organised type of society develops, the fusion of the various segments entails the fusion of the markets into one single market, which embraces almost all of society. It even extends beyond and tends to become universal... The result is that each industry produces for consumers who are dispersed over the length and breadth of the country, or even the world. The contact is therefore no longer sufficient. The producer can no longer keep the whole market within his purview, not even mentally. He can no longer figure out to himself its limits, since it is so to speak unlimited. Consequently production lacks any check or regulation (italics added). (p. 305)

Durkheim wished to avoid in The Division of Labor in Society making any determinate conclusions about what the government ought to be doing in its regulatory functions. In this work, the government played a somewhat ambiguous role. It is simultaneously the voice of the collective consciousness, yet does not always have the capacity for regulation. Its multifaceted nature can be seen when Durkheim described the situation: “A fortiori the government cannot effect an adjustment between these functions
and make them work harmoniously together if they themselves are not in harmony...

Thus it is not the brain that creates the unity of the organism, but it expresses it, setting its seal upon it" (Durkheim [1893] 1984:297). He went so far as to point out, "What is certain is that this lack of regulation does not allow the functions to perform regularly and harmoniously" (Durkheim [1893] 1984:303). But here Durkheim stopped in this particular work in his outline of what regulations ought to be. Durkheim returned to this theme in *Professional Ethics and Civic Morals*, which will be discussed below. Before turning to the discussion however, it is important to note that Durkheim treated anomie from a different angle in his later work *Suicide*. The discussion of anomie presented in *Suicide* will add to the conception of anomie being used here.

**Economic Anomie**

In *Suicide*, Durkheim ([1897] 1951) grounded his conception of anomie in economic crises as being a contributing factor to higher rates of suicide. However, by ‘crises’ Durkheim did not only mean economic downturn, but also periods of strong economic growth. It is rather the “disturbance of the equilibrium” that increases the “impulse to voluntary death” (Durkheim [1897] 1951:246). This form of anomie is found when people’s desires outstrip the means available to them that enable them to attain those desires: “[O]ne does not advance when one walks toward no goal, or—which is the same thing—when [one’s] goal is infinity” (Durkheim [1897] 1951:248). This lack of advancement is the point of origin of anomie in Durkheim’s argument.

This conception of anomie is connected with the division of labor in that anomie can spring from one’s situation in society:
...At every moment in history there is a dim perception, in the moral consciousness of societies, of the respective value of different social services, the relative reward due to each, and the consequent degree of comfort appropriate on the average to workers in each occupation. The different functions are graded in public opinion and a certain coefficient of well-being assigned to each, according to its place in the hierarchy (Durkheim [1897] 1951:249).

Regulation, not by the state but through public opinion and perception, puts pressure on people to accept this hierarchy, and it is this regulation, when it is accepted, that functions to maintain equilibrium of distribution. However, in times of crises, social positions change. In disasters “something like a declassification occurs which suddenly casts certain individuals into a lower state than their previous one...and its very prospect is intolerable” (Durkheim [1897] 1951:252). So too in times of ‘abrupt growth’, “the scale is upset; but a new scale cannot be immediately improvised...So long as the social forces thus freed have not regained equilibrium, their respective values are unknown and so all regulation is lacking for a time” (Durkheim [1897] 1951:252-253). Further Durkheim ([1897] 1951:253) argued, “With increased prosperity desires increase. At the very moment when traditional rules have lost their authority, the richer prize offered these appetites stimulates them and makes them more exigent and impatient of control”.

Economic growth and expansion, despite whatever material benefits it may bring, is a cause for concern and disequilibrium within society.

The sector of society in which Durkheim saw this type of anomie as ‘chronic’ was trade and industry (Durkheim [1897] 1951:254).

On both sides nations are declared to have the single or chief purpose of achieving industrial prosperity; such is the implication of the dogma of economic materialism, the basis of both apparently opposed systems. And as these theories merely express the state of opinion, industry, instead of being still regarded as a means to an end transcending itself, has become the supreme end of individuals and societies alike (Durkheim [1897] 1951:255).
Durkheim argued that this societal desire for industrial growth and increased material well-being have prevented societies from even moderately regulating their trade and economic functions. As will be discussed in the next section on professional ethics, Durkheim argued here as well that this excitement for growth has prevented stronger standards by professional economic groups from ever taking hold (Durkheim [1897] 1951:255). What this leads to is a chronic disequilibrium in which our desires know no bounds and we are thus never satisfied with our lot, but left wondering “How can I better my position?”

As with the anomie division of labor, Durkheim ([1897] 1951) noted that the growth of industry beyond the scope of what was maintainable by producers was problematic:

So long as the producer could gain his profits only in his immediate neighborhood, the restricted amount of possible gain could not much overexcite ambition. Now that he may assume to have almost the entire world as his customer, how could passions accept their former confinement in the face of such limitless prospects? (p. 256)

With unrestrained economic growth, people’s aims continue to grow as well. They start to believe that there is no limit to what can be achieved. When this sets into the entire economic sector, as Durkheim argued is the case, anomie becomes widely felt and manifests as the pathological case of the division of labor. The prevention of this anomie can be found in regulation through professional ethics.

**Professional Ethics**

*Professional Ethics and Civic Morals* consisted of a series of unpublished lectures written by Durkheim, yet they show very strongly his concern for economic regulation.
This leaves little ambiguity for the reader as to Durkheim's ([1950] 1958) thought on the matter of regulation:

The individual can take in no more than a small stretch of the social horizon; thus, if the rules do not prescribe what he should do to make his actions conform to collective aims, it is inevitable that these aims will become anti-social. For this reason, no professional activity can be without its own ethics... It is the functions of the economic order alone that form an exception. Even here, some rudiments of professional ethics are not lacking, but they are so little developed and have so little weight that they might as well not exist. This moral anarchy has been claimed, it is true, as a right of economic life. It is said that for normal usage there is not need of regulation. But from what source could it derive such a privilege? How, should this particular social function be exempt from a condition which is the most fundamental to any social structure? Clearly, if there has been self-delusion to this degree amongst the classical economists it is because the economic functions were studied as if they were and end in themselves, without considering what further reaction they might have on the whole social order. (p. 15)

Durkheim looked back to the guild system as an example of the way individuals involved in similar trade formed a group to set up standards of practice (Durkheim [1950] 1958:17-23). However, guilds no longer maintain power over trade and have been looked on disfavorably with the modern economic thought falling along the lines of free market and self-regulation. The argument and language used here strongly resemble the argument Durkheim made regarding unrestrained economic growth in Suicide: the societal ambition for economic growth is so great that we do not see the need to regulate or restrain activity. Yet, Durkheim asked, people are bound by regulation (laws) and taxes to the state in which they live, so why should they not be bound to regulation of their profession similarly? It is also here he made the assertion that the “whole framework” of regulation ought to be attached to the state (Durkheim [1950] 1958:39). Durkheim seems much clearer in his ideas of the position of the state here than in The Division of Labor in Society.
The fact of the matter is that Durkheim clearly thought regulatory reform necessary if we wish to avoid the 'state of anarchy' which "comes about not from this machinery [of labor] being in these hands and not in those, but because the activity deriving from it is not regulated" (Durkheim [1950] 1958:31). Because labor becomes so highly divided and the functions of the different parts of society are so specialized, methods, goals and standards become specialized to the sectors as well as they are made routine within each sector of society. If these specialized groups are out of contact with other spheres of society, and if there is no regulation, the group morality that develops may be very different from society at large, perhaps even harmful to the social cohesion of society. This is the generation of societal anomie. This breakdown in solidarity is what Durkheim referred to in The Division of Labor in Society as a 'pathological form' of the division. Both regulation by the state and self-regulation through professional ethics are desirable to avoid just that. Without regulation, the division of labor becomes too great, and specialized sectors of society lose touch with what happens in other sectors, making cooperation impossible. Without a standard of ethical practices in the economic sector, there is not an effective guard against unethical actions that harm society, and the potential for anomie to manifest. This tendency of economic professions to be anomie generative is what Durkheim feared he was seeing at the time of his writing, and this is precisely what I question here.

The Aspirational Nature of Anomie

Economic anomie, the form of anomie Durkheim primarily wrote about in Suicide, has also been interpreted as a form of failed aspirations. Economic anomie, as
already discussed, can emerge when desires outstrip the means available toward meeting those desires. At the same time, this economic anomie goes beyond individual aspirations. As Durkheim put it in *The Division of Labor in Society*, the anomic form is a pathological manifestation of the division of labor, affecting whole sectors of society structurally as well as the individuals in those sectors. Economic anomie then seems to have a dual-nature:

Durkheim’s use of the notion of anomie tends to assimilate two discrete senses in which human aims or aspirations may be ‘unrealizable’. One is the sense in which needs have no intrinsic limits of ‘ceiling’. The other is that in which aspirations cannot be realized in a definite social setting or form of society, because that society creates potentialities which are incapable of actualization within the existing social framework (Giddens 1986:107-108).

As Giddens points out, there are consequences in taking either approach. The latter sense of economic anomie stresses the ‘pathological’—in Durkheim’s terms—development of society, whereas the former sense of anomie seems to isolate the individual within a society where the individual’s desires are constrained by societally imposed moral standards (Giddens 1986:107-108).

The contention that economic anomie follows the first form, that of unlimited human desires constrained by societal morals, has been compared to strain theory (Agnew 1997). “The absence of society is important...not because it increases freedom but because it increases the frustration/anger that drives individuals to deviance. So the absence of society leads to strain at the individual level in Durkheim, and it is this strain that causes deviance” (Agnew 1997:31). This view of anomie stresses the absence of societal influence over the individual and the failure of norms to take root in the mentalities of individuals in order to restrain behavior and desire. In this sense of
anomie, individual desires are without limit, because society has not been absent in fostering restraint in individuals.

The view of anomie as the 'absence of society' contrasts with the idea of anomie as dérèglement. The difference between the two is an absence of societal influence (normlessness) and the failure of society to positively regulate (déreglement- or the rule that is lack of a rule) (Mestrovic 1988:64). In the former sense, societal influence seems to be completely absent. In the latter sense, it is not that societal influence is absent, but that it simultaneously fosters certain desires while constraining actors through the division of society. With this argument, the focus is not on the aspirations of individuals, but rather a breakdown in the societal ability to offer moral restraints on desires or behaviors due to social pressure that contradicts restraint.

This failure of regulation does not depend on the 'absence of society'. Cultural influence can be quite strong, but still lack the ability to effectively regulate the desires and passions of its people. Passas (1997) added to this conception of anomie by putting it with the concepts of reference groups and relative deprivation:

Anomie theory points to deviance caused by a cultural overemphasis on success combined with structurally limited opportunities. Reference-group theory and relative deprivation can help in further specifying how the American Dream (which promotes such cultural overemphasis) and, more generally, egalitarian discourses affect people differently situated in the social structure (p. 68).

This view of anomie seems to take into account both the structural origins of anomie as well as the individual effects it can have. In this view of anomie, one does not see the absence of society. It almost seems that rather society has too large an influence on people's desires, but is lacking the regulatory capacity to check those desires once unleashed.
The 'American Dream,' a theme that emerges throughout this thesis, often contains the ideal of homeownership. The idea of the American Dream is then one, at least partly, of property and owning things. What effect might such a strong compulsion have regarding anomie?

The spectacular growth of credit systems of payment in contemporary societies can be cited as a symptom of situations where everyone is called upon to spend and buy beyond affordable levels. Loan advertisements and 'buy now, pay later' signs are omnipresent. ‘Winning a car’ can be an incentive for getting a housing loan. Borrowing constitutes for many people an appealing short-term solution (Passas 1997:75).

The author continues on to argue that one borrowing more than one can handle, the taking on of excess and ultimately harmful risks are anomie tendencies (Passas 1997:75-80). The borrower is led into believing that taking on more loans—and thus debt—is a way for he or she to rise to a higher social position. However, what remains unspoken is the risk that the borrower also takes on when facing uncertain interest rates, prepayment penalties and hidden fees. As was briefly touched upon in the introduction, and as will be seen in later chapters, this aggressive promotion of spending and acquisition is not uncommon in the world of mortgage lending.

This viewpoint of anomie stresses both the structural-societal origination of economic anomie, through the strong cultural emphasis on spending and accumulation, as well as the individualistic consequences of anomie that are expressed through actors acting on their desires in ways that may ultimately be harmful to the self. What are the results however, when anomie sets in for a professional group? Durkheim ([1897] 1951, [1950] 1958) claimed that in the economic professions, anomie is found to be in a chronic state.
The view of anomie as dérèglement, rather than normlessness, has particular significance for Durkheim’s contentions regarding professional ethics. *Professional Ethics and Civic Morals* is really a study in anomie in the sense of dérèglement (Mestrovic 1988:67). Durkheim took this lack of ethics in the economic professions to be indicative of the manifestation of anomie within this sphere of society. The lack of self-regulation is akin to the interpretation of anomie as dérèglement (Mestrovic 1988).

The desire for innovation and growth may be strong enough to foster a deregulation of activities by a company. “The condition of anomie so essential to precipitating innovation appears to be perpetual for organizations” (Vaughan 1997:99-100). In a study of NASA following the Challenger Space Shuttle explosion, Vaughan (1997) examined the functioning and risk assessment practices carried out by NASA employees before and after the explosion. Vaughan found that what people saw as unacceptable behavior after the explosion, such as launching despite the knowledge that some parts may be damaged or worn, was acceptable behavior before the accident, or at least assessed as an acceptable risk level. The conclusion of her study was that the lack or resources, plus the normalized culture of competition fostered by NASA effectively paved the way for such behaviors to take root (Vaughan 1997:116-117). The desire to expand influence and best the competition is a strong impetus to start being more accepting of innovation and risk. For the sake of growth, or perhaps in the dogged pursuit of any goal, one may start to push rules and restraint to the side, even if the results are unattainable. This is the idea of economic anomie found in *Suicide* (Durkheim [1897] 1951).

Why is the economic sphere of society burdened with this ‘chronic’ state of
anomie? Anomie is to be found particularly in times of change and flux (Durkheim [1897] 1951:246-254). The economic sphere of life also seems to be constantly in flux. Businesses are either dealing with crises or finding new ventures to pursue. To stagnate means to perish in competitive capitalist economies. It would make logical sense then to expect to find anomie’s constant presence in this sphere of society, precisely because those involved in economic ventures are always seeking to expand or acquire new business. They are pressured to grow out of competition with others, thus there is a social pressure to grow, while at the same time, Durkheim argued, there is an absence of social regulation that would offer restraint and guidance on this growth.

**Conclusion**

How societies function and maintain solidarity was of the highest interest for Durkheim. Anomie can manifest as a ‘pathological’ form in society and is a major threat to the normal functioning of society. Anomie takes root in structural causes such as the inability of sectors of society to self-regulate and to communicate with one another. This lack of regulation is detrimental to the social solidarity of that society.

Durkheim also argued that the economic sphere of society is in a chronic state of anomie, both on the professional level and on the consumer level. As consumers, we may experience the effects of anomie when we desire objects, or perhaps even lifestyles, that are out of our capacity to ever realize. As for professions, Durkheim argued that it is because of the lack of professional ethics in economics that economic crises are so socially devastating and economic growth becomes the ultimate goal at the cost of societal well-being.
In the next chapter, I examine how these arguments from Durkheim may be applied to a modern context of subprime lending. Is this industry one that instigates anomie? If so, what practices might be indicative of the Durkheimian notion of anomie? How do lenders or borrowers experience this sense of anomie? What is the status of professional ethics in this industry, and are they, as Durkheim claimed, absent in the prospect of economic growth and expansion of business? In exploring the ability of Durkheim's concepts to explain the social effects of the subprime lending industry, I do not focus on only what went wrong with the subprime industry, but also what may result when the subprime industry 'functions normally.' Durkheim had a definite idea of how a healthy society ought to function. In particular, *Professional Ethics and Civic Morals* and parts of *Suicide* seem at times to be almost prescriptive in the way Durkheim treated economic professions and actions. His concern for societal well-being is paramount through all of these works. It is following Durkheim's concerns for the well-being of society that I seek to explore social consequences of the subprime industry in the next chapter.
I have outlined in Chapter 4 several dimensions of analyzing anomie. Here, I look at Durkheim’s conception of anomie in relation to economic relationships. In "The Division of Labor in Society," one finds Durkheim’s writing about anomie to be from a structural standpoint. That is to say that the ‘pathological’, anomie form of the division of labor emerged as a breakdown in communication and regulations between the different ‘organs’, or sectors, of society. Durkheim highlighted the economic functions of society to be revealing of anomic functioning, “The producer can no longer keep the whole market within his purview, not even mentally. He can no longer figure out to himself its limits, since it is so to speak unlimited. Consequently production lacks any check or regulation” (Durkheim [1893] 1984:305). However, the anomic form of the division of labor is a pathological form, not an inevitable conclusion of specialization, argued Durkheim (Durkheim [1893] 1984:307-308). The individual’s fate is determined by the ever-increasing preponderance of new innovations in the economic sphere of a highly specialized society that caters to the capitalist and consumer desires. To that end, this section will examine how the relationship of the subprime lender-borrower may be examined through the various levels of Durkheim’s conceptions of anomie.
Subprime Lending as Both the Solution to and Genesis of Anomie

In *Suicide* one finds that anomie can still spring from economic dysfunction, yet Durkheim applied it to a much more individual basis in this work. Durkheim ([1897] 1951) argued anomie stems from individuals striving for goals in life, both material and ideal, but which remain outside the means of the individual striving to attain them: “No living being can be happy or even exist unless his needs are sufficiently proportioned to his means. In other words, if his needs require more than can be granted, or even merely something of a different sort, they will be under continual friction and can only function painfully” (Durkheim [1897] 1951:246). A particularly problematic source of anomie is trade and industry, for it is these sectors in which anomie appears in a ‘chronic state’ (Durkheim [1897] 1951:254). Here, anomie still finds its roots in structural causes, in the deregulation and unrestrained growth of enterprise. Durkheim went so far as to call it ‘normal’: “There [in the industry and trade] the state of crisis and anomie is constant, and so to speak, normal. From top to bottom of the ladder, greed is aroused without knowing where to find ultimate foothold. Nothing can calm it, since its goal is far beyond all it can attain” (Durkheim [1897] 1951:256). Yet this attitude in capitalist business manifests in the individual.

But the man who has always pinned all his hopes on the future and lived with his eyes fixed upon it, has nothing in the past as a comfort against the present’s afflictions, for the past was nothing to him but a series of hastily experienced stages. What blinded him to himself was his expectation always to find further on the happiness he had so far missed. Now he is stopped in his tracks; from now on nothing remains behind or ahead of him to fix his gaze upon. Weariness alone, moreover, is enough to bring disillusionment, for he cannot in the end escape the futility of an endless pursuit. (Durkheim [1897] 1951:256)

The individual, argued Durkheim, is caught up in the frenzied innovation and expanding
of enterprise and adopts the attitudes of the economic sector of society so that when these businesses suffer, the individual suffers with them.

If anomie, particularly economic anomie, is generated through individuals’ desires exceeding their needs, it would seem the subprime industry is actually a remedy. The desire for homeownership is a strong one. The idea of the “American Dream” almost always involves homeownership. However, there are those who do not have access to homeownership under the traditional rules of mortgage lending. One of the functions of the subprime mortgage companies was to create this access. Those who take out subprime loans are typically those who cannot qualify for prime rate loans because of their credit histories and perceived risks. Yet the allure of homeownership does not affect only those whose credit histories enable them to purchase homes. Those who cannot afford to buy a house may still feel this desire. This is precisely what the lenders realized when the ventured into the subprime lending industry. This pool of potential borrowers represents a previously untapped source of new profitable loans for those willing to make riskier business ventures.

As one author and subprime borrower quoted his lender, “‘I am here to enable dreams,’ he explained to me...‘If you came to me and said you’d been unemployed for seven years...who am I to tell you that you shouldn’t do what you want to do? I am here to sell money, and to help you do what you want to do’” (Andrews 2009:11). Others, like Edward Gramlich, a former governor on the Federal Reserve Board, viewed subprime mortgages as a way of opening markets to potential homeowners who would previously not have had access. This includes ethnic minority groups who had a long history of facing discrimination in the housing market with practices such as ‘redlining’ and
'predatory lending' (Gramlich 2007:13-35; Immergluck 2009; Stuart 2003). In fact, in neighborhoods where 75 percent or more of residents were black, subprime lenders represented 51 percent of refinance loans compared to 9 percent in white neighborhoods (Immergluck 2009:80). It would seem that anomie would be averted, or at least appetites for homeownership sated by measures designed to enable a greater number of people to participate in purchasing a home, particularly for those populations who have had a history of facing discrimination in the housing market. For these groups, the relationship established with a lender presented a means to avoid anomie, to rise above the means historically available to them to achieve the desires shared by so many that comes from capitalist attitudes of ownership.

However, this was not always the case in subprime lending. Almost as a perversion of the goal of trying to help historically discriminated and vulnerable populations scale the economic ladder in order to achieve economic security, there is evidence that these loans were targeted at those vulnerable populations, not out of a sense of trying to correct historic social injustices, but as a further symptom of predatory practices targeting vulnerable populations in order to realize higher interest rates. What Stuart (2003) studied in Chicago was the creation of segregated neighborhoods brought about through the risk assessment practices. His argument mainly focused on the practice of discrimination within the general lending industry. He examined practices such as redlining and racial steering—practices which had long preceded the venture of subprime lending. Stuart's argument does extend to subprime lending however. Writing before the collapse of subprime lenders, Stuart (2003) argued:

...[T]he absence of a viable prime mortgage market opens the door for
unscrupulous lending practices. The advent of subprime lending, which is often associated with unscrupulous, “predatory” practices, in the black housing markets is a manifestation of a chronic problem that these markets have faced over the years, namely, segregated black markets present themselves as a target for unscrupulous practices. (p. 174)

What Stuart’s argument leads to is that populations with already troubled economic standing are steered into markets where new loan products are advertised to them, selling them the idea of homeownership, but at a higher cost. One of the issues with this is the fact that the costs in interest rates may simply be too high for these consumer bases to afford.

This practice would seem to be symptomatic of Durkheim’s economic anomie in a number of ways, and this anomie can manifest in several dimensions. First, as Stuart (2003:175) pointed out living in segregated, low-income neighborhoods can present further economic difficulties. “Cognitive maps”, which are signals to employers based on information about where an applicant may live, can have a significant effect on the employer’s conception of the applicant as employers will make a judgment on the quality of the applicant based on where he or she lives (Tilly, Moss, Kirschenman and Kennelly 2000; Bluestone and Stevenson 2000). These arguments were made regarding discrimination in general lending practices. However, the potential for anomie would be even greater if or when borrowers default on their mortgage, because subprime mortgages disproportionately targeted these groups that had already faced economic difficulty.

Second, when borrowers do default on their subprime mortgages, their credit is much worse off. Faulty loan payments, foreclosures and delinquencies all show up on individuals’ credit history. These marks on payment histories have “growing
implications in terms of diminished social and economic opportunities because credit histories and scores are increasingly evaluated in applications for employment, rental housing, and auto insurance, as well as other credit markets” (Immergluck 2009:143).

What is a problematic pattern for both borrowers and lenders is that the subprime loans go into delinquency and have defaulted at a much higher rate than conventional mortgages. The result for these borrowers is an even worse credit history than what he or she previously had. In these cases where the loan defaults, the consequence of establishing a subprime lender-borrower relationship is almost antithetical to the reason that the borrower entered into the relationship in the first place (Michaelson 2009: 25-32, 133-138). Whereas previously the borrower had hopes of being able to elevate him or herself into a new economic bracket via homeownership, the borrower’s aspirations are dashed and he or she is put into an even more precarious economic position than before the loan was made.

Lenders

From the lender’s point of view, lenders were enabling people to achieve greater economic success. In fact some authors, who worked for subprime lending companies, even report getting caught up in their own ideals. Describing a brainstorming marketing session, Adam Michaelson (2009), a former employee of Countrywide Financial, one of the largest subprime lenders wrote:

With a precision and a professionalism I had not seen since the Air Force, the mechanisms of Countrywide processes, procedures, checking and rechecking, and attention to perfect, verifiable detail had to be on a par with or exceeding that of NASA... I was constantly proud of the culture of perfection that surrounded me, for what we were doing was important large and meaningful (italics added). (p. 111)
Such fervor by the marketers could easily be interpreted cynically as exaggerated claims made to disguise the greed of lenders, especially after the fact of the subprime mortgage implosion. However, at the time, it seems that many lenders actually believed it. Michaelson (2009:121) and Bitner (2008:6) both described how they believed the work they did in lending was meaningful and had positive impacts on people’s lives.

Countrywide later launched a marketing campaign called “Realize Your Dreams” (Michaelson 2009:125). Such an attitude indicates at the very least the realization by the lenders that they had the capacity to entice people to enter into loans to purchase houses and thus enter an economic standing that may have been previously closed off to them. However, for many borrowers the consequences were not what they intended—they lost their homes, filed for bankruptcy, or suffered even more deterioration of their credit score. In short, for many their situation was even worse off than it was before the loan.

It would seem that lenders wanted to promote such an image for themselves. To be seen as an enabler of dreams would presumably be great publicity for the lenders and help them to attract more customers. In reality however, it seems that the subprime lenders were more akin to pushers, steering people in the direction of expensive and risky loans. Researchers at the Boston Federal Reserve Bank found that about 70 percent of subprime borrowers had credit scores above 620, but most of these were low or no-documentation loans where borrowers had high debt-to-income and loan-to-value ratios (Immergluck 2009:142). A credit score of around 620 to 630 usually served as one indicator that borrowers would need to go to the subprime market. However, the fact that many borrowers did have scores higher than 620 may indicate that the lenders pushed
them toward the more expensive subprime loans when in fact the borrowers may have been better off, and have been able to pay, a conventional prime loan. Being at the threshold of a cutoff seems to have been enough for lenders to steer borrowers toward subprime loans. What is problematic here is that these loans often led to higher DTI and LTV (or CLTV) ratios for the borrowers, which put them into further economic trouble. It would seem then that the subprime lender-borrower relationship is rife with the opportunity to generate economic anomie.

Anomie and Regulation

Durkheim wrote of anomie in *The Division of Labor in Society* at a structural or societal level. *The Division of Labor in Society* focuses on the ‘macro’ aspect of societal division stemming from anomie, whereas *Suicide* discusses economic anomie as stemming from personal ambitions or desires. The anomie division of society concerns the different ‘organs’ of society not being able to coordinate and communicate with one another. As has been discussed above, Durkheim would later assert in *Suicide* that it is in industry and commerce where anomie division is felt most acutely. In fact, Durkheim began his discussion of the anomie form of the division of labor by stating “a first case of this [pathological] nature is provided for us by industrial commercial crises, and by the bankruptcies that are so many partial breaks in organic solidarity” (Durkheim [1893] 1984:292). Now, it would be an exaggeration to blame the collapse of the subprime industry for the recent economic downturn; however, it did play a large part. It has already been stated that hundreds of billions of dollars were lost because of defaulted loans and many companies ceased to exist because of their bankruptcies. So clearly, the
effects of the subprime mortgage industry are not limited to the lender and borrower relationship only, but have implications for the economy of society at large.

What Durkheim sought for regulation between the divided functioning sectors of society was the government. He did not propose that the government be able to create and enforce any rules it pleased, nor did he see the government as an enormous all-encompassing body. Rather, he saw it only a regulatory necessity, a mechanism by which laws can be enforced and checks on harmful practices for society could be maintained. The government would not have the power to regulate what cannot be put in 'harmony' (Durkheim [1893] 1984:297).

We do not maintain that restrictive legislation is necessary. We have not to weigh here the advantages and disadvantages. What is certain is that this lack of regulation does not allow the functions to perform regularly and harmoniously. The economists show, it is true, that harmony is re-established by itself when necessary, thanks to the increase or decrease in prices, which according to the need stimulates or slows production. But in any case it is not reestablished in this way until after breaks in equilibrium and more or less prolonged disturbances have occurred (Durkheim [1893] 1984:303).

What Durkheim has described are the attitudes of the economists who rail against regulations, who believe that economies are self-correcting, that equilibrium will always be re-established, and cycles of booms and busts are natural and unavoidable.

Such was the thinking of former Federal Reserve Chairman, Alan Greenspan, whose famous view on economic 'bubbles' was to not pop them lest one disturb natural economic progress. Rather the correct way of approaching economic disturbances is to let them run their course, let the bubbles 'pop' on their own and use the power of government regulation to clean up the mess left and try to limit the damage (Andrews 2009; Zandi 2009). Greenspan (1999) argued "[B]ubbles generally are perceptible only
after the fact. To spot a bubble in advance requires a judgment that hundreds of thousands of informed investors have it all wrong. Betting against markets is usually precarious at best.” Four years later, Greenspan (2003) maintained:

It is, of course, possible for home prices to fall as they did in a couple of quarters in 1990. But any analogy to stock market pricing behavior and bubbles is a rather large stretch. First, to sell a home, one almost invariably must move out and in the process confront substantial transaction costs in the form of brokerage fees and taxes. These transaction costs greatly discourage the type of buying and selling frenzy that often characterizes bubbles in financial markets. Second, there is no national housing market in the United States. Local conditions dominate, even though mortgage interest rates are similar throughout the country. Home prices in Portland, Maine, do not arbitrage those in Portland, Oregon. Thus, any bubbles that might emerge would tend to be local, not national, in scope.

The view was clearly that any crises in housing would be limited to smaller localities and thus be somewhat easy to clean up the mess and limit damage. Hindsight shows a different picture; the collapse of subprime lending was not limited to any specific locality but felt nationwide.

Not only was the potential damage of the failure of the housing market underestimated in terms of geographic spread and monetary extent, but many economists and regulators maintained throughout that a hands-off approach was the best that the government could do in order to ameliorate any negative impacts of the increase in foreclosures and defaults. In other words, the crisis, while underway, was still viewed by many, including Greenspan, as simply a natural part of a cyclical economy. These are viewed as simply growing pains of expanding markets and new economic innovation.

However, what these economists view as the natural order of economics, Durkheim ([1893] 1984) saw as a manifestation of the anomic form of the division of labor:
...[A]s the organized type of society develops, the fusion of the various segments entails the fusion of the markets into one single market, which embraces almost all of society. It even extends beyond and tends to become universal, for the barriers between peoples are lowered at the same time as those that separate the segments within each one of them. The result is that each industry produces for consumers who are dispersed over the length and breadth of the country, or even the whole world... The producer can no longer keep the whole market within his purview, not even mentally. He can no longer figure out to himself its limits, since it is, so to speak, unlimited. Consequently production lacks any check or regulation. It can only proceed at random... Hence the crises that periodically disturb economic functions (p. 305).

This quote almost perfectly describes what has happened in the subprime market. Lenders sought new markets in those consumers to whom loans were previously unavailable. Tapping into this new market revealed enormous potential for the lenders. Innovation and creative risk assessment and management outpaced regulatory concerns. Riskier and riskier loans were made along with new developments in securitizing mechanisms so the risks to investors were so abstract that the risks were not immediately felt. As more and more loans started to default, the system came tumbling down, because no one actually had the capital to back up the loans. As a result, the sector of the economy suffered from an acute and protracted crisis in which the numbers of delinquencies, defaults and foreclosures shot up dramatically, causing not only lending companies to go out of business, but many borrowers to lose their homes. It is indicated in several accounts that lenders, as a group, did not take into account the limits of their growth (Andrews 2009; Bitner 2008; Immergluck 2009; Michaelson 2009; Zandi 2009).

As we are starting to move past the crises, it remains to be seen the extent of any new regulatory legislation that will be passed, and whether this legislation will have lasting effects. Whether or not such bubbles will continue to be allowed to emerge or if the Federal Reserve will try adjusting rates to avoid allowing the bubbles to expand will
depend on whether the current view of free-market, self-correcting economies remains
the mindset of regulators. What some authors have called for is not necessarily more
regulation, but better regulation (Andrews 2009; Bitner 2008; Michaelson 2009; Zandi
2009). That is, they argue that there needs to be more documentation, more transparency
regarding risk and better explanation by the lenders to the borrowers about the rules of
the loan. These measures will not be taken on the volition of lenders alone, but will
require government regulatory actions to spur the lenders into following these guidelines
more stringently. Looking at the subprime mortgage market in the context of Durkheim’s
concepts, what one sees is the failure of any form of regulatory organ of society to curb
the practices of specific sectors of the economy. This results in anomie, both in the
structural division of societal functions, and in the personal economic anomie.

Professional Ethics

It is not a coincidence that the sector of society in which Durkheim thought
anomie was in a ‘chronic’ state was also the one that he viewed as lacking a real system
of professional ethics. Durkheim ([1950] 1958) placed much of the blame for the
economic woes of his time on this lack of professional ethics within the economic
professions:

It is not possible for a social function to exist without moral discipline.
Otherwise, nothing remains but individual appetites, and since they are by nature
boundless and insatiable, if there is nothing to control them they will not be able
to control themselves. And it is precisely due to this fact that the crisis has arisen
from which the European societies are now suffering. For two centuries
economic life has taken on an expansion it never knew before. From being a
secondary function, despised and left to inferior classes, it passed on to one of
first rank. We see the military, governmental and religious functions falling back
more and more in face of it (p. 11).
The anomie that originates in the economic activities of society does so, claimed Durkheim, because the growth is not checked by professional standards and ethical considerations. Unlike the other professions, such as in law and science, there were no codified rules for activity for economic professionals. The role of regulation, as far as Durkheim was concerned, would have to fall to the state if the professions could not be trusted to take it upon themselves (Durkheim [1893] 1984).

In the years since the publication of *Professional Ethics and Civic Morals*, the debate about regulation continues: should it fall to the state, or does the market self-regulate? It would also seem that upon examining the actions and accounts of those lenders involved in the subprime lending, ethical considerations were not among their primary concerns. In these sections, I will examine some of the accounts from those inside the regulatory agencies and lending industries to ascertain how they viewed professional ethics and what role they played, or did not play, in the actions of the lenders.

**Subprime Lending Institutions and Durkheim’s Views on Guilds**

Richard Bitner, who had cofounded and acted as President of Kellner Mortgage Investments, a subprime mortgage company that at its peak had $225 million in annual loans wrote,

I wanted to believe that writing a mortgage for borrowers till meant the odds of them making their mortgage payment were greater than the likelihood of default. Violating this basic tenet was never supposed to be part of the equation. It wasn’t until we wrote a loan for Johnny Cutter that I realized our business, the whole industry really, had lost sight of its purpose. The subprime industry, which once upon a time helped credit-challenged borrowers, was no longer contributing to the greater good (Bitner 2008:6).
Bitner describes how he had gotten into the business of mortgage lending, because he believed it was a truly socially beneficial and fulfilling activity. Upon reviewing why the loan soured, Bitner found that the borrowers had a total, combined monthly income of $2,800 and after mortgage payments were left with only $700 for the whole month for all other expenses. After the purchase of the house they had only $250 left in their checking account. Their credit rating was very poor, with no proof of making any housing payments within the last year, and neither of the Cutters had held a job for more than nine months within three years of signing the loan (Bitner 2008:10-11). For all of this risk, Bitner contended, this couple was not an exceptional example of their clients; rather they fell along the typical characteristics of the borrowers with whom Kellner Mortgages worked. Bitner found that no one had missed these details in the underwriting and that the borrowers had fit the model of lending used by the company. In other words, guidelines were followed correctly. However, what Bitner (2008) claimed is that the guidelines themselves are not correct:

This loan didn’t provide value to anyone—not to them, my company, or the investor... For all its complexity, subprime lending still comes back to our two fundamental questions. Somewhere along the way we have to believe a borrower can make the payment. The decision to lend money should require us to find something to hang our hat on, some aspect of the borrower’s profile to justify the loan. It doesn’t take much—income, credit, cash reserves—but something has to confirm the decision. In the end, the Cutters had nothing. This loan was indicative of an industry that had lost its way. (p. 11-12)

What Bitner argued is that although the lenders were following underwriting and risk assessment guidelines, it was the guidelines themselves that were faulty. The guidelines did not take into account the important questions about the loans or the characteristics of the borrowers. The industry leaders, as far as Bitner was concerned,
ignored, or tried to ignore, these important considerations regarding their potential borrowers and changed their business practices in attempts to achieve greater economic ends.

From a Durkheimian perspective, the high rates of defaulting on loans might be interpreted as a pathological consequence of the subprime lending industry. To find out what causes this pathology, one would have to look at the guidelines that direct lenders’ actions. As Bitner pointed out however, even correctly following guidelines does not guarantee that the loan will be successful. The guidelines themselves may be incorrectly formulated, as Bitner seems argued. Those in the subprime lending industry sought to evolve their guidelines in order to capture a wider consumer base; this included changing the requirements for credit scores, assets and income reporting standards, loan-to-value ratios, debt-to-income ratios as well as the structure of the loans (Goodman et al. 2008). These guidelines are written for material interests of the lending companies, not moral considerations.

Durkheim discussed guilds in his lectures in *Professional Ethics and Civic Morals*. In fact, the majority of the first part of the book—the part entitled *Professional Ethics*—is concerned specifically with guilds. Although he saw there is a ‘historical prejudice’ against the guilds, he still viewed them as a potentially beneficial, if not necessary, component of the economic life of a society (Durkheim [1950] 1958:17-29). The guilds, at their highest function, served as a moral center for the group, and Durkheim ([1958] 1950:29) argued that they were still essential in his time, even more so for moral rather than economic reasons.

Having said that, when Durkheim ([1950] 1958) discussed the guilds in
Professional Ethics and Civic Morals, he also recognized that guilds could be formed with such material emphasis:

Now the records left to us of the former guilds and the very impression we get of the remnants that still survive, do not lead us to believe them equal to such a role [the focus of moral life for a group]. It seems as if they could fulfil [sic] only utilitarian functions, as if they could only serve the material interests of the profession... We form an idea of the guilds (as they were in the final years of their most recent period) as taken up entirely with holding on jealously to their privileges and exclusive rights or even with increasing them. Now, it is not likely that absorption in affairs so narrowly professional could have any very favourable reaction on the morality of the corporate body or its members. (p. 19-20)

What Durkheim recognized here is that guilds might only be concerned with the material well-being of the professional group rather than with the general moral well-being of society at large. However, he went on to argue that such a view of guilds is not universally applicable. Citing the works of Waltzing and Boissier, Durkheim ([1950] 1958:21-22) wrote of the Roman guilds that served as moral centers of the group with statutes that directed the activities of the individuals of the group with a focus not only on the group’s well-being but on the moral principles laid out by the society in which they were located. Following Levasseur’s work on Christian guilds, Durkheim ([1950] 1958:22-23) posited, “All kinds of precautions were taken to prevent the merchant or craftsman from deceiving the customer or from giving the merchandise an appearance unwarranted by its true quality.” Durkheim’s argument concerning guilds was that they provide a historical example of morally, and materially, oriented regulation imposed by a group upon itself.

While guilds had provided a means by which standards of professional behavior were codified, “there came a time (eighteenth century) when these regulations became more vexatious than useful and were exploited to safeguard the masters’ privileges rather
than to protect the good name of the profession and the straight dealing of its members” (Durkheim [1950] 1958:23). Durkheim ([1950] 1958:23) cited this breakdown in the guild system as being due to the deterioration that every institution eventually experiences. What Durkheim feared the most about the economic professions was that they had no ethical standards by which to conduct their behavior. The criticisms he offered of the guild system came when he characterized the guilds as being utilitarian and overly materialistic at the expense of their moral obligation to the general society in which they operate (Durkheim [1950] 1958:19-20). This experience of the guild system, in which the guilds focused only on the well-being of those involved in the profession at the expense of the consideration for the general good of society—what Durkheim would call the moral considerations—seems to be analogous to the collective behaviors of the subprime lenders.

To begin, the mode of risk assessment used by companies is somewhat standardized through the use of FICO scores and other various equations that determine a borrowers’ credit risk. This is a far cry away from the stricter guidelines seen in the guild system however. The amount of risk that a company is willing to take on is entirely up to that company, and in no way was codified between the lenders. So unlike the guild system, in which professionals were at least in theory held to much stricter standards, the lenders could decide what course of action to take given the standardized assessment tools available to them. In the case of the subprime lenders, as has already been described numerous times, the risk taken on by the lending companies was typically much greater. During the rise and boom of subprime lending, efforts to regulate the market were not successful, and there was no standard set of acceptable risks, as it was
left up to individual lending companies (Goodman et al. 2008; Immergluck 2009; Zandi 2009). As evidenced by the collapse of many lending institutions, these risks were too great.

Durkheim’s account of the deterioration of the guild system is analogous to the demise of the subprime industry as told by lenders. It was a demise that came about due, at least in part, to a lack of moral concern for the well-being of the general society because efforts were focused on the material well-being and security of those involved in the actual lending. A set of guidelines was established, but they were established without regard to those outside the direct involvement with the lending industry. The changing guidelines served the select few it was designed for, which would ironically lead the lenders and borrowers down a path of excess risk, delinquency, foreclosure and bankruptcy.

Marketing Subprime and Durkheim’s Ethics

Among the actions Durkheim viewed as ethically egregious for professionals to take was to mislead consumers into believing statements about a product that were not true, and the guild held the function of holding merchants to standards of advertising (Durkheim [1950] 1958: 23). Marketing and advertising played a large role in the growth of subprime lending. Marketing is a process of making products attractive to consumers in order to attract business. By its very nature of trying to appeal to consumers, marketing runs the risk of exaggeration and distortion of the truth. However, to call unethical any act of marketing which tries to make a product appeal to consumers’ desires perhaps through some exaggeration would seem hyperbolical and distracting from...
the practices that are truly grievous. To be sure, the subprime marketing strategy
involved both.

In his book, Adam Michaelson (2009) who worked for Countrywide Financial in
new customer acquisition marketing chronicled some of the practices marketers would
take in trying to sell loans for homes. Some of the projects Michaelson was in charge of,
such as the redesigning of the Countrywide website to make it easier for consumers to
find loan projects as well as to seem simply more aesthetically pleasing, were seemingly
innocuous (Michaelson 2009:103-105). Of course the layout of the website was designed
in order to attract customers and keep them interested in hopes that they would eventually
purchase a loan from Countrywide. As far as Durkheim was concerned in Professional
Ethics, there seems to be little to object to ethically regarding these marketing practices
upon which consumer capitalism is predicated.

There were other products Michaelson saw coming out of Countrywide over
which he expressed some level of discomfort, at least after the fact and in his book. The
product to which Michaelson singled out time and again as particularly problematic was
the “PayOption” loan that spanned the entire line of Countrywide’s loan services. This
loan was essentially Countrywide’s branded version of the Adjustable Rate Mortgage.
The PayOption model allowed the borrower four choices when paying off the loan. Two
of the options constituted traditional payments of principal plus interest; one of these
options allowed borrowers to pay higher principal as if the loan was a 15 year loan. The
other two options were a minimum monthly payment, which could potentially be lower
than principal plus interest payment depending on the rates the borrower was able to get,
and the second was interest only payments (Michaelson 2009:11). These forms of ARMs
have been discussed in the introductory chapter, but to recall why so many viewed these loans as troubling was the fact that they could lead borrowers into negative amortization, which increases the amount that the borrower owes to the lending company. The consequence is that while the borrower chips away at the debt little by little, the total amount of debt is still growing.

In his book, Michaelson (2009) claimed to be concerned not only with the viability of the model, he claimed at the time that he was worried that the PayOption product was predicated on the false belief that property values would continue to climb, but on how aggressively Countrywide pushed the product:

Lenders, including Countrywide, created more and more exotic loan products and lent money to anyone with a heartbeat so that everyone would Refi [refinance]. For example, Countrywide alone offered almost two hundred different loan products. This enabled homeowners to get into larger homes and to use their increasing home value as a personal ATM. (p. 152)

Although Michaelson thought that this was a product that was pushed aggressively, he maintained that Countrywide kept to a strict set of ethics: “Every advertisement, every direct mailer, every letter, every web banner, every TV ad, print ad, and windshield wiper flyer had to go through a rigorous meat grinder of both legal and regulatory approval” (Michaelson 2009:193). His claims are that Countrywide did not deliberately misrepresent or lie, but instead worked off assumptions based on ‘projections’ (Michaelson 2009:186-188). Michaelson’s argument is that Countrywide worked with optimistic projections both about the continual rise of housing prices as well as the continued ability of borrowers to pay their loans. His claim is that it is not that the Countrywide lied, but that they were simply overly optimistic about their products.

To be overly optimistic about the viability of a product would not seem to violate
Durkheim’s notions of professional ethics, although one might argue actively self-deluding would be professionally unethical. To make a product attractive and appealing would also not be unethical from Durkheim’s point of view. However, the act of pushing a product such as the PayOption, which could potentially confuse consumers not versed in understanding the structure of loans, would violate Durkheim’s ideal of professional ethics. That the loan structure was arguably known to cost customers more, yet marketed as a cheaper alternative to traditional loans is truly dishonest. This tactic of confusing customers or omitting to tell them everything about the loan is a common tactic that others have found in predatory lending (Bitner 2008; Lord 2005; Stuart 2003).

Regulatory Arguments After the Fact

Perhaps the most powerful, straightforward argument that Durkheim’s concerns about professional ethics have yet to be solved and are still directly applicable is the fact that after the subprime collapse both governmental policy makers and those involved directly with the lending industry have argued that there needs to be a stronger establishment of professional ethics. These arguments for greater, and better, regulation come after the fact. Although they are tinted with this hindsight bias, the arguments still indicate that the economic downturns make us look for causes of the failure, and actors, to blame. Like Durkheim did in his time, many concerned with subprime lending look to the lack of professional self-regulation as a key component.

For his part, Michaelson claims that we have entered a state of malaise, which he has called our “Great National Worry”, the likes of which have not been felt since the 1970s (Michaelson 2009:293). He stated the problem interestingly by saying,
"Sometimes, who is a 'victim' and who is a 'perpetrator' depends greatly on one's point of view, particularly in the naturally occurring and free-flowing dynamics of the capitalist marketplace" (Michaelson 2009:305). Michaelson discussed self-interest, corporate culture, consumer drive, as being the causes of the subprime collapse, with his main point being that it is not worth the time to vilify certain parties, as this distracts from the more important task of repairing confidence in the mortgage industry. Having said that, he pointed out specific measures he thinks should be taken. Among them is (1) creating a "foreclosure fault index" in order to determine which borrowers receive state support after foreclosure based on whether the 'triggering events' that caused their foreclosure were in their control (Michaelson 2009:315-321). Michaelson (2009:321-323) argued that (2) buying a home and securing a loan should remain harder. Other measures include: (3) doing away with ARMs loans; (4) complete separation of the property appraisal process from the lenders; (5) ending sales commissions for mortgage salespeople based on loan generation; (6) end no-documentation loans; (7) mandated pre-loan closing counseling sessions; (8) a lenders' and borrowers' "Bill of Rights and Responsibilities"; (9) a more comprehensive and extensive version of mortgage insurance; and (10) institute a 'financial responsibility' curriculum in grade schools (Michaelson 2009:323-328). Among these proposals, numbers 4 through 8 strongly resemble exactly what Durkheim argued for in Professional Ethics and Civic Morals. These measures focus on the profession of lending and the responsibilities that professionals ought to take.

Other authors have posited similar changes. Bitner (2008:155-174) argues for increased liability for the investment banks who securitize mortgages in order that they
cannot bet against them; overhauling credit and investment rating industries for greater transparency and liability; raising the standards put in place by the Mortgage Bankers Association, which has nothing in place to certify the expertise of a loan officer; changing the structure of the property appraisal process to prevent inflationary assessments; and changes to lending including modified prepayment penalties if not complete abolition, mandated escrow accounts for borrowers and mandatory counseling. These measures bear strong similarity to those offered by Michaelson. The focus seems to shift between responsibilities of the borrower to those of the lender, but the idea remains that greater self-regulation is needed. When Bitner calls for a raising of standards by the Mortgage Bankers Association, nothing could be closer to what Durkheim envisioned as the responsibility of the professional group. It is significant to note that missing was the expansion of government regulation. Rather, both Michaelson and Bitner, who were directly involved with selling subprime loans, advocate self-regulation on the part of the lending industry, not government regulation, indicating that they believe that professional ethics are achievable for whatever will become of the subprime industry and in the lending industry as a whole.

Others from outside the industry have also made suggestions for change. Edward Gramlich, a former Governor on the Federal Reserve Board, in contrast to the suggestions above advocates revising government standards and policies such as HOEPA with the idea that greater accountability to government regulation would clean up these practices (Gramlich 2007:86-92). Immergluck also follows this point of view in stressing the role of federal and state regulation. Among his proposed changes are: a broadening and strengthening of the Community Reinvestment Act to apply to all firms providing
capital or credit for residential or small business purposes; improving the “Home Mortgage Disclosure Act to provide more comprehensive data on mortgage lending products and practices”; reducing the complexity and increasing the transparency of loan structures; and greater and more routine supervision of credit rating agencies (Immergluck 2009:206-212). Immergluck also seems to show little confidence in the ability to self-regulate on the part of the lending industry.

There seems to be two sides to this debate: government regulation and self-regulating markets. However, what all of the authors reviewed here seem to agree to is that there needs to be stronger sets of standards. To vilify the lenders would serve to cloud the issue further, because there were many more actors such as appraisers, investors, rating agencies, brokers and even some borrowers who had a hand in the subprime market downturn. Further, they were only operating in a capitalist demand and supply driven market. Yet, the lenders as a group still failed to anticipate, or at least to react successfully, to declining property values. A significant part of this was a mix of optimism and the desire for ever-increasing value that obscured the responsibilities of the lenders.

**Conclusion**

The debate is an old one: should markets self-regulate, or should the government play an active part in regulating economic activity? Durkheim did not offer a clear, precise answer on this. In *Professional Ethics and Civic Morals*, one finds Durkheim to be saying that professional ethics can be, and have been historically, established in order to guide the conduct of the group. At the same time, he saw these as perpetually lacking
in the economic sphere of society. At other points in his works, such as in *Division of Labor in Society*, Durkheim outlined a quite significant role for the government to regulate. Here too though, the power of the government was limited.

It is not the government that can at every moment regulate the conditions of the different economic markets, fix the prices of goods and services, regulate production to the needs of consumption, etc. All these practical problems throw up a mass of details, depend upon the thousands of special circumstances that they alone are aware of who know them intimately. *A fortiori* the government cannot effect an adjustment between these functions and make them work harmoniously together if they themselves are not in harmony (Durkheim [1893] 1984:297).

Thus we have the need for professional ethics for self-regulation. If the government is unable to ensure the harmony of parts of society, it is up to those parts to reach harmony. Although the *Division of Labor in Society* was written years before *Professional Ethics and Civic Morals*, one can still see Durkheim’s ([1893] 1984) concern with the professional group:

But such a representation [that each individual feel that he is not sufficient unto himself, but forms part of a whole upon which he depends] abstract, vague and, moreover, sporadic like all complex representations, is of now avail against the vivid, concrete impressions that are aroused at every moment in each one of us by his professional activity. Thus if this activity has the effect attributed to it, if the occupations that fill our daily lives tend to detach us from the social group to which we belong, such a conception, which only is awakened at a distance and never occupies more than a small part of our field of consciousness, will never be sufficient to hold us (p. 298).

If Durkheim did feel that government is incapable of curbing the influence of the anomie division of labor, then the only way that anomie could be prevented is through sets of professional standards that are codified keeping in mind society at large, or in Durkheim’s terms, the collective consciousness which ideally is embodied in the form of government. What the government can do, like the brain, to follow Durkheim’s biological analogies, is to regulate communication between the sectors of society. The
government can make sure that the legal system knows what the commercial system needs and that the commercial system understands the laws in which it operates. The sectors of society can rely on the government to make sure that they are performing in harmony, however within each sector the government alone cannot be solely relied upon to make sure everything is functioning properly. There must be some autonomy and self-regulation with each sector that keeps in mind society as a whole, or else there is a breakdown in the form of anomie. This is a function of professional ethics- the prevention of anomie.
CHAPTER 6
MARX

Introduction

Karl Marx (1818-1883) usually stands out amongst the three classic social theorists discussed in this work as being exceptionally outspoken and critical toward economic and philosophical thinking of his time. From his work with the Young Hegelians to The Communist Manifesto, co-written with Engels, to his time in The First National, Marx was politically active and vocal (Raddatz 1978). Frederick Engels, in the preface to the English edition of Capital, wrote:

“Das Kapital” is often called, on the Continent, “the Bible of the working-class.” That the conclusions arrived at in this work are daily more and more becoming the fundamental principles of the great working-class movement, not only in Germany and Switzerland, but in France, in Holland and Belgium, in America, and even in Italy and Spain, that everywhere the working-class more and more recognises, in these conclusions, the most adequate expression of its condition and aspirations, nobody acquainted with that movement will deny. And in England, too, the theories of Marx, even at this moment, exercise a powerful influence upon the socialist movement which is spreading in the ranks of “cultured” people no less than in those of the working-class (Marx [1887] 1967:5-6).

Further, Marx and Engel’s Communist Manifesto, written earlier than Capital, was a call to arms for the proletariat by the two political radicals in response to the conditions of the working class. Marx’s work came in the context of transformation towards massive industrialization. Large-scale production was on the rise in Europe, and Marx and Engels observed the conditions in which the laboring class toiled (Marx and Engels 1848). In
Marx's work, he aimed to critically examine capitalist modes of activity. Though his ideas evolved and were refined through the course of his career, one finds throughout a strong desire to change society to rid it of the effects of the emerging forms of industrialization, which Marx saw as an obstacle to the full realization of human potential. To support his critical stance on economic activities, Marx grounded his assertions in careful analysis of economic relationships—between those who control the means of production and those who are simply hired to produce, and between the buyers and sellers of commodities.

The main concepts from Marx that I wish to explore are exploitation and interest-bearing capital. These concepts bear relevance on the larger topic of interest here—the subprime mortgage—in that through analyzing how Marx characterized the exploitative nature of the relationship between the labor force and the capitalist, one can see an analogous situation between the borrowers and lenders within the subprime market. As exploitation appears throughout Marx's career its meanings underwent changes as Marx's thinking evolved and he refined his conceptualizations. Here, however, I will draw more heavily on the volumes of *Capital*.

These volumes were written towards the end of Marx's life, and he did not live to see them all published. Into these volumes, Marx poured much of his former thinking and refined his concepts. At times, the volumes read very technically and at other points very polemically. However, being a culminating collection of his work, *Capital* offers valuable insights into the ways that capitalist activity may involve exploitation. Marx often wrote in mathematical terms, using equations and ratios to support his assertions. However, I will not be analyzing these sorts of details in his work, but rather the
meanings and social impact of the larger concepts. Specifically, I discuss Marx’s concept of capital accumulation, the generation of surplus value, the following transformation of surplus value into capital and profit, and the relationships of buyer-seller and lender-borrower. Following this are discussions on exploitation generated through these processes. Finally, I will look at a particular form of capitalist production that Marx saw as standing apart from industrial capitalism. This is the concept of interest-bearing capital, which itself is a subset of the larger concept of merchant’s capital.

**Capital Accumulation**

The aim of a capitalist undertaking is to make profit through the selling of services or commodities. It is the goal of the capitalist to make profit and accumulate through providing what consumers need and want: “The restless never-ending process of profit making alone is what he aims at” (Marx [1887] 1967:152-153). Capital serves the function of starting the process of generation of value for the person who possesses it—the capitalist. Capital first appears as money to begin the circulation of money in commodities in order that the capitalist can realize profit (Marx [1887] 1967:146).

Capital is generated through what Marx had come to call the M-C-M’ cycle. This cycle denotes the use of money (M) to buy a commodity (C) only to sell it for a greater amount of money (M’). This is what Marx called the ‘general formula for capital’ (Marx [1887] 1967:146-155). This is contrasted with the cycle C-M-C, essentially the circulation of commodities, in which a commodity is sold for money, and the seller uses that money to buy a commodity he or she wants. There are two phases to each cycle. The C-M-C cycle begins with a seller selling his or her commodity for money (C-M).
The seller then takes the money earned from the transaction and becomes a buyer of a different commodity he or she wants (M-C).

The general formula for capital (M-C-M') is the antithesis of this, yet there is still a transformation, except this time the buyer becomes the seller. The cycle begins with a buyer purchasing a commodity, though not for his or her own use (M-C). The buyer then becomes a seller with the goal of selling the commodity for more money than he or she paid for it (C-M'). The different ends of these two circuits are apparent. In the circulation of commodities, the seller gets rid of a commodity for which he or she has no need in order to obtain money to purchase a commodity he or she does want or need. In the general formula for capital however, the end is to obtain more money than was invested at the beginning of the cycle. The money going through this circuit represents "value in process"; it signifies the desire to increase value and profit (Marx [1887] 1967:154). Money used in this sense is capital. Derivatives of this formula for capital include M-M', the formula for interest-bearing and 'merchant’s capital’ (Marx [1887] 1967:155).

The essential difference between the commodity and money-capital circuits is the type of value resulting from the exchange. In the circulation of commodities, one tries to obtain the materials or objects that one needs or wants. In the capital circuit, one’s goal is to come away with greater value. In the first circuit, the total value remains the same, that is the value of the commodities did not change, but simply changed hands to a person who had more use for them. In the second circuit, the value for the person buying and then selling the commodity has increased. It is this money that is used to increase value that is capital.
The reader will notice early in the first volume of *Capital* the power that Marx attributed to the basic circuit of capital. The exchange of commodities is relatively unproblematic; it is simply exchanging one object which has no use value for the seller for another that does have a use-value. The basic capital circuit however, seems to indicate greater consequences for those involved:

The circulation of money as capital is, on the contrary, an end in itself, for the expansion of value takes place only within this constantly renewed movement. The circulation of capital has therefore no limits. As the conscious representative of this movement, the possessor of money becomes a capitalist...The expansion of value, which is the objective basis or main-spring of the circulation M-C-M, becomes his subjective aim and it is only in so far as the appropriation of ever more and more wealth in the abstract becomes the sole motive of his operations, that he functions as a capitalist, that is, as capital personified and endowed with consciousness and a will (Marx [1887] 1967:151-152).

Merely through engaging in the enterprise of making profit, a person becomes something other than simply human- the person becomes capital personified. Capital is imbued with a will of its own and it is a self-generative process that always seeks to expand; “it has acquired the occult quality of being able to add value to itself” (Marx [1887] 1967:154).

Here one finds the formation of capital—how it comes into existence and its derivation from the simple exchange of commodities into a circuit of its own. One also begins to see the power that Marx saw in capitalist interactions. Capitalism, for Marx, implies the tendency to accumulate. By its own formulation (M-C-M’) capital must always try to increase value. If the circuit were to fall into M-C-M, where the money at the start is the same amount of money as the end, it would be a quite pointless exercise in simply exchanging currency with commodities. This is essentially simple reproduction and is not the aim of capitalist undertaking.

Simple reproduction is a vital part of capitalist accumulation. Reproduction
entails the capitalist ensuring the means of production, i.e. the objects with which commodities are made, are kept in renewed working order as well as ensuring that the sources of labor, the laborers, from which the capitalist extracts value, are also maintained enough to the point where they remain productive. Simple reproduction is essentially the maintenance and the continuance of the processes of production. In simple reproduction, nothing is gained and nothing is lost; the value and capital advanced at the beginning of the process is equal to the value and capital consumed at the end of the process (Marx [1887] 1967:566-570). The true capitalist tries to ascend beyond simple reproduction into production, because it is only beyond the stage of simple reproduction that the capitalist manages to extract surplus labor and the surplus-value resulting from that surplus labor.

It is at the point of capitalist accumulation where Marx spoke of the ‘industrial reserve army’ and it becomes very clear how the relationship between the capitalists and laborers comes to exist as necessary condition for capitalist production.

Since the process of production is also the process by which the capitalist consumes labor-power, the product of the laborer is incessantly converted, not only into commodities, but into capital, into value that sucks up the value-creating power, into means of subsistence that buy the person of the laborer, into means of production that command the producers. The laborer therefore constantly produces material, objective wealth, but in the form of capital, of an alien power that dominates and exploits him; and the capitals as constantly produces labor-power, but in the form of a subjective source of wealth, separated from the objects in and by which it can alone be realized in short he produces the laborer, but as a wage-laborer. This incessant reproduction, this perpetuation of the laborer, is the sine qua non of capitalist production (Marx [1887] 1967:571).

The capitalist, because of the very nature of production and the requirements entailed in seeking increased value and profit must maintain the supply of labor and means of production. The capitalist must be able to at least reproduce the same quantity and value
from year to year without a loss; it will not do to lose productive labor, produce less commodities than before (assuming the demand does not change), or to let go the maintenance of the means of production. At the same time, it is not enough that the capitalist only be able to maintain simple reproduction, the capitalist must sell more of the product to obtain the extra value that is the goal of enterprise in the first place. If the capitalist does not expand production and generate increased value and capital, he or she will find that the competition will more than happily take his or her place, because the competition will seek greater value and profit.

In this process of expansion and growth the relationship between the capitalist and the laborer is solidified into recurring patterns of behavior:

Capitalist production, therefore, under its aspect of a continuous connected process, of a process of reproduction, produces not only commodities, not only surplus-value, but it also produces and reproduces the capitalist relations; on the one side the capitalist, on the other wage-laborer (Marx [1887] 1967:578).

As production expands, the demand for productive labor also expands, yet the relationship between the capitalist and the laborer is not changed. True, the price of labor, the wages, may increase, but only to a point. Marx was determined to correct what he saw as a misconception by the political economists. For him, “the rise of wages…is confined within limits that not only leave intact the foundations of the capitalistic system, but also secure its reproduction on a progressive scale” (Marx [1887] 1967:620). Further, “The law of capitalistic accumulation…in reality merely states that the very nature of accumulation excludes every diminution in the degree of exploitation of labor, and every rise in the price of labor, which could seriously imperil the continual reproduction…of the capitalist relation” (Marx [1887] 1967:621). What Marx asserted was that when
accumulation of capital is great, the demand for labor is less intense, so the price of labor goes down; conversely, when the rate of accumulation is lower, the demand for labor increases, driving the price of labor up. However, wages are confined to limits so that the demand (or lack thereof) will never be the causal factor in capital accumulation. In all of this, it is the accumulation that affects everything else.

As mentioned above, simple reproduction and the effects of capital accumulation, whether they are increased or decreased wages, serve to further solidify the relationship between the capitalist and the laborer. Accumulation of capital may even increase the number of relationships. Capital accumulation may temporarily work in favor of the laborers, when they feel their wages go up. However, the capitalistic mode of production is designed to benefit those who control the means of production. So as much as laborers may see their wages rise, they are still left in the same position as laborers under the capitalist.

As simple reproduction constantly reproduces the capital-relation itself, i.e., the relation of capitalists on the one hand, and wage-workers on the other, so reproduction on a progressive scale, i.e., accumulation, reproduces the capital-relation on a progressive scale more capitalists or larger capitalists at this pole, more wage-workers at that. The reproduction of a mass of labor-power, which must incessantly re-incorporate itself with capital for that capital’s self-expansion; which cannot get free from capital, and whose enslavement to capital is only concealed by the variety of individual capitalists to whom it sells itself, this reproduction of labor power forms, in fact, and essential of the reproduction of capital itself. Accumulation of capital is, therefore, increase of the proletariat (Marx [1887] 1967:613, 614).

The relations of the proletarian laborers and the bourgeois capitalists are solidified through capitalist production. Marx did believe that this was a truly harmful relationship, for both capitalists and laborers, and that the processes of capitalism, which serve to bolster this relationship, enable this social harm.
This accumulation is actually an ending to the cycle of capitalist mode of production. That is to say, accumulation is not where capitalist production begins, but the end toward which it aims. We have seen the start of capital accumulation in the M-C-M' circuit and the effects the accumulation has on the relationship between the capitalist and the laborer. Accumulation and production rely on the ability of the capitalist to simply reproduce, and this in turn relies on the relationship between the capitalist and the laborer. It is here that surplus-value is first generated. Through examining surplus-value, one gets a better idea of exactly how capital comes into existence and of the relationship between the capitalist and the laborer.

**Surplus-Value**

It is the quest for surplus-value that drives capitalist production. This is the sine qua non of all capitalist enterprises in that it is because of surplus-value that profit, capital, and capital accumulation are possible. It is through the generation of surplus-value that one sees Marx’s basis for exploitation. It is also in the discussion of surplus-value that we may observe how the capitalist turns money into capital.

The prices of the commodities, Marx contended, are ultimately determined by the socially recognized value of the labor put into them. That is, the value of the commodity produced is dependent on the labor time that goes into producing that commodity. “The labour-time socially necessary is that required to produce an article under the normal conditions of production and with the average degree of skill and intensity prevalent at the time” (Marx [1887] 1967:39). Further “...that which determines the magnitude of the value of any article is the amount of labour socially necessary, or the labour-time socially
necessary for its production” (Marx [1887] 1967:39). We have already discussed above that it is the nature of capitalism to gain from production. In order for this to be possible, the capitalist must somewhere in the process get out greater value than what he or she has advanced for production in the first place.

The matter comes down to the amount of labor that the capitalist can extract from a laborer. Marx’s claim was that a laborer really only needed to work half a day to be able to afford to sustain him or herself. However, the capitalist recognizes that the laborer will work more than half a day and thus the labor-power of the laborer actually provides a greater value for the capitalist than what the capitalist paid. Since the capitalists control the means of production, and the only bargaining power the laborer has is labor-power, it is within the capitalists’ power to set the length of the working day, and the laborers have no choice but to acquiesce to the capitalists’ demands. Thus the arrangement between the laborer and the capitalist is structured to favor the capitalist:

The fact that half a day’s labor is necessary to keep the laborer alive during 24 hours, does not in any way prevent him from working a whole day. Therefore, the value of labour-power, and the value which that labour-power creates in the labour-process, are two entirely different magnitudes; and this difference of the two values was what the capitalist had in view, when he was purchasing the labour-power...What really influenced him was the specific use-value which this commodity possesses of being a source not only of value, but of more value than it has itself. This is the special service that the capitalist expects from labour-power, and in this transaction he acts in accordance with the “eternal laws” of the exchange of commodities. The seller of labor-power, like the seller of any other commodity, realises its exchange-value, and parts with its use value...The circumstance, that on the one hand the daily sustenance of labour-power costs only half a day’s labour, while on the other hand the very same labour-power can work during a whole day, that consequently the value which its use during one day creates, is double what he [the capitalist] pays for that use... (Marx [1887] 1967:193-194).

We see that the capitalist has extracted more value from the laborer than for what has
been paid.\footnote{Marx also characterized these capitalists to be quite cunning: "Our capitalist foresaw this state of things, and that was the cause of his laughter" (Marx [1887] 1967:194).} Through extracting additional labor out of the laborer, the capitalist has secured the use of more labor power than for what the laborer was compensated.

On the other hand, the seller of labor-power, the laborer, has no choice but to give up the use-value of his labor when the exchange-value is already agreed upon. In accepting the exchange-value offered by the capitalist, the laborer also sells the use-value, or the labor-power. The use-value of labor is what the capitalist is after, and once the laborer accepts the exchange-value of the labor, he or she also parts with the use value (Marx [1887] 1967:175-185). Should the laborer start working only half a day in recognition that half a day is all that is needed for subsistence, the laborer will probably find himself or herself unemployed. That is, because the control over the means of production rests totally in the hands of the capitalist, the laborer is unable to determine the length of his or her own working day; this decision is in the hands of the capitalist.

After having extracted the unpaid surplus labor which the capitalist has put to use producing commodities, the capitalist returns to the market with the commodities to sell them. The capitalist, through selling the commodities, gets back the capital he advanced in securing the production of the commodities—which includes the costs of obtaining and maintaining labor as well as securing and maintaining the means of production—in addition to the surplus-value that consumers pay for the surplus-labor that has gone into the commodity, for which the capitalist did not have to pay anything.

The capitalist, formerly a buyer, now returns to market as a seller, [sic] of commodities. He sells his yarn at eighteenpence a pound, which is its exact value. Yet for all that he withdraws 3 shillings more from circulation than he originally threw into it. This metamorphosis, this conversion of money into
capital, takes place both within the sphere of circulation and also outside it... (Marx [1887] 1967:194).

In selling a commodity for all the value embodied in it, including the unpaid surplus-labor, without having paid for all of the labor in the first place, the capitalist has succeeded in obtaining surplus-value. It is this surplus value that can enter back into the production process as capital or serve as profit for the capitalist.

The conversion of surplus-value back into capital is what Marx termed the ‘accumulation of capital’ (Marx [1887] 1967:579). For something to be termed ‘capital’ it must be employed in production. “To accumulate it is necessary to convert a portion of the surplus-product into capital. But we cannot, except by a miracle, convert into capital anything but such articles as can be employed in the labour-process” (Marx [1887] 1967:580). If the capitalist does wish to accumulate, attention must always be paid to the future, and part of the surplus generated in production must be directed towards future production.

Consequently, a part of the annual surplus-labour must have been applied to the production of additional means of production and subsistence, over and above the quantity of these things required to replace the capital advanced. In one word, surplus-value is convertible to capital solely because the surplus-product, whose value it is, already comprises the material elements of new capital (Marx [1887] 1967:580, 581).

The capitalist, always mindful of the need to accumulate is compelled by the laws of capital accumulation to reserve some of the surplus to reconver it into capital, which includes renewing the means of production and ensuring further labor as needed. The

---

10 If the capitalist only breaks even, that is, when the value of the capital advanced is the same as the value reached at the end of the production process, then he or she has only spent all their capital transforming one object into another. In fact, in this case the capital may not even be considered capital, because it was only used as an exchange and did not produce any additional value—the purpose of capital in the first place (Marx [1887] 1967:190)
value imbued into the products through the labor-power of the laborers determines how exactly the capitalist will manage to do this.

Volume III of *Capital* begins with a much more detailed and technical account of how the profits of commodities are reached. Included in the discussion are variables such as maintenance of the means of production, materials for production, and differing values for labor-power. The commodity-value (the price for which the capitalist aims to sell the commodity ideally) is equal to the cost producing that commodity plus the surplus value ($C=k+s$). What this means is that the capitalist can sell the commodity for anywhere in the range of $s$ (surplus-value) and still make a profit; the commodity could be sold for below its value ($C$) yet still make a profit as long as the selling price is above the costs of production (Marx [1894] 1967:26-37).

What this very brief discussion of the details behind valuation of commodities shows is the importance of surplus-value. It is this component of the commodity value that determines the capitalist's behavior—how much to sell for, where to sell and how to market the commodity—because it is surplus value which determines his profit. If profit, which leads to accumulation, is the aim of capitalist enterprise as discussed above, and if surplus-value, which depends on the ability of the capitalist to extract surplus labor, is the key to profit, then it follows that the relations between capitalist and laborer, buyer and seller are of the utmost importance to capitalist enterprise.

**Relationships within the Capitalist Mode of Production**

Surplus-value has its origins in the transactions between the capitalist and the laborer as the buyer and seller of labor, respectively. The parties' interaction, as far as
Marx was concerned, is a defining feature of the whole of capitalist enterprise. On the one hand, there is the capitalist, who in the quest for profit and surplus value acts as a buyer. On the other hand is the laborer who sells his or her labor power in order to earn a living. The capitalist has access to the means of production, the materials necessary for production, access to the capital to start a business, and, it seems, the skill to manage laborers. The laborer sells his or her labor power to the capitalist for the exchange value, but in the process also gives away his or her use-value in the labor, because this is what interests the capitalist in the first place. It is in the excess labor power that the capitalist extracts from the laborer where the capitalist attains surplus-value.

The capitalist is in control of the means of production. Because the capitalist purchased the use of the labor-power from the laborer, the capitalist is free to dispose of it in any way desired (Marx [1887] 1967:185). What actually transpires in these transactions is that the capitalist has purchased something personal from the laborers, their labor-power. Labor-power appears personal in the Marxian sense in that the labor-power that an individual puts into a product means that the product is imbued with some of the qualities of the laborer. It almost seems as if there is transference of part of the person’s being into the product: “The [labor] process disappears in the product; the latter is a use-value, Nature’s material adapted by a change of form to the wants of man. Labour has incorporated itself with its subject” (Marx [1887] 1967:180). The laborer has toiled and exhausted his or her efforts to produce this product. For Marx, the product ‘absorbs’ labor-power, and this is what imbues products of labor with personal attachment, because labor-power is an intensely personal force: “Labour-power exists only as a capacity, or power of the living individual. Its production consequently pre-
supposes his existence. Given the individual, the production of labour-power consists in
his reproduction of himself or his maintenance” (Marx [1887] 1967:171). In the selling
of labor-power, the laborer is actually selling his or her capacity to labor, thus realizing
personal potential to labor to produce in service to the capitalist.

Now, in buying the labor-power and treating it as a use-value in effect turns the
labor-power into a commodity. The very definition of a commodity is an object that
satisfies wants; they are things that have a use-value (Marx [1887] 1967:35). A use-value
is inseparable from the object; it is an integral property of that object (Marx [1887]
1967:35-36). In the pursuit of profit, the capitalist must find the thing whose use-value
will in the end yield profit. The commodity to achieve this goal is labor, specifically the
unpaid or surplus-labor that the capitalist extracts. Marx clarified his concept of the
commodification of labor with two qualifications. First, the person selling the labor
power must be free and willing to do so; there cannot be coercive measures in obtaining
another’s labor-power. If this condition is not met, Marx likened the situation to slavery.
Second, the laborer is obliged to sell as a commodity his or her labor-power rather than
commodities that are products of it. This second qualification speaks to the fact that it is
the capitalists who have access to the means of production, and it is they who are able to
sell commodities not of their own labor (Marx [1887] 1967:167-169). If one accepts that
the buying and selling of labor-power is actually the same thing as the buying and selling
of commodities, given the personal nature of labor-power discussed above, it stands to
reason that the thing that is being commodified is something very personal and very dear,
because labor-power after all only exists as an individual’s potential to work and
maintain his or her self. This is true of both the labor that is paid for and the surplus
labor extracted by the capitalist. In the case of the latter, it would be even fair to say that
the situation is worse, because this labor-power, no less personal, is taken without
compensation.

When the laborer sells labor-power as a commodity, it no longer belongs to the
laborer, but the capitalist:

Suppose that a capitalist pays for a day’s labour-power at its value; then the right
to use that power for a day belongs to him, just as much as the right to use any
other commodity, such as a horse that he has hired for the day. To the purchaser
of a commodity belongs its use, and the seller of the labour-power, by giving his
labour, does no more in reality, than part with the use-value that he has sold

The laborer has released the rights of the products of his or her labor to the buyer of that
labor: “The former receives the value of his commodity, whose use-value—labour—is
thereby alienated to the buyer” (Marx [1887] 1967:584). The selling and buying of labor
power creates a circulation of the commodity of labor. “The ever repeated purchase and
sale of labour-power is now the mere form; what really takes place is this—the capitalist
again and again appropriates, without equivalent, a portion of the previously materialised
labour of others, and exchanges it for a greater quantity of living labour” (Marx [1887]
1967:583). By all accounts, the labor, once purchased, rightfully belongs to the capitalist.
But, always seeking to grow, the capitalist seeks more sources of labor.

A recurring relationship is established through this buying by the capitalist and
selling by the laborer of labor-power and is strengthened as the capitalist accumulates
capital and wealth. As the demand for the commodity increases, the capitalist returns to
the labor-market seeking more laborers to meet this demand. Conversely, laborers, who
make only enough to keep them subsisting are never given access to the means of
production. They must always sell their labor as their only commodity. Each side of the transaction becomes further entrenched in their situation. The capitalist is forced to grow and seek greater surplus value because of the very nature of capitalism and the danger of falling into simple reproduction. The laborer is forced to sell his or her labor, because that is the only thing to which he or she has access to sell and needs a means of survival. This distribution of access is not a natural condition; it is a man-made, social condition that has no basis in the natural order of things:

One thing, however, is clear—Nature does not produce on the one side owners of money or commodities, and other men possessing nothing but their own labour-power. This relation has no natural basis, neither is its social basis one that is common to all historical periods. It is clearly the result of a past historical development, the product of many economic revolutions, of the extinction of a whole series of older forms of social production (Marx [1887] 1967).

The rejection of the point of view that accepted this distribution as naturally occurring and beneficial is one of the major ideological differences between the works of Marx and the accepted political-economic thought propounded by those following in Adam Smith’s (1776) tradition. It was this arrangement between those who have access to the means of production and those who do not that Marx saw as leading to systematic exploitation and alienation.

**Exploitation**

One of the negative consequences of capitalism Marx highlighted was the rampant exploitation of the laborers that occurs. The exploitation Marx discussed went beyond simply using others’ labors as use-values. The way in which surplus-value is generated has already been discussed. It is clear from this discussion that it is through extracting unpaid surplus-labor from the laborer that the capitalist generates surplus-value
to be reconverted into capital and set the stage for profit-making. The capitalist who
wishes to continue being a capitalist must always be making sure that the surplus-value
generated is adequate enough to both invest as capital in further production as well as
enough to ensure profits can be made from the commodity. In effect, this means the
capitalist looks for ways to accumulate capital, the consequence of this being either
greater extraction of surplus-labor from laborers currently employed, which Marx called
the method of increasing the ‘absolute surplus-value’ or finding additional sources of

Now in order to allow of these elements [referring to surplus-labor and means of
production] actually functioning as capital, the capitalist class requires additional
labour. If the exploitation of the labourers already employed do [sic] not increase,
either extensively or intensively, the additional labour-power must be found. For
this the mechanism of capitalist production provides beforehand, by converting
the working-class into a class dependent on wages, a class whose ordinary wages
suffice, not only for its maintenance, but for its increase (Marx [1887] 1967:581).

One sees here the solidifying of class boundaries according to the access to the means of
production. The laborers, having no access to the means of production are merely
exploitable labor-power in the eyes of the capitalists. There is apparently no love lost
between the two groups in Marx's view: “The capitalist may even convert the additional
capital into a machine that throws the producers of that capital out of work, and that
replaces them by a few children” (Marx [1887] 1967:582). The workers could possibly
be working towards their own termination with the capitalist.

It is clear that Marx saw the relationship between the capitalist and the laborer as
problematic. Marx did grant that the laborers as sellers are capable of deciding where
they want to work and as sellers, should be free of any coercion into selling their labor-
power to any particular capitalist. However, there seems to be little beneficence on the
part of the capitalist, for the wages they provide are meant only to ensure the continuance
of labor supply:

Hence both the capitalist and his ideological representative, the political
economist, consider that part alone [paying the laborer enough for sustenance] to
be productive, which is requisite for the perpetuation of the class, and which
therefore must take place in order that the capitalist may have labour-power to
consume... In reality, the individual consumption of the labourer is unproductive
as regards himself, for it reproduces nothing but the needy individual; it is
productive to the capitalist and to the State, since it is the production of the power
that creates their wealth (Marx [1887] 1967:573).

The act of laboring does not benefit the laborer, but conversely makes him or her even
more dependent on the capitalist class for wages. Further, “...the sum of the means of
subsistence necessary for the production of labour-power must include the means
necessary for the labourer’s substitutes, i.e., his children, in order that this race of
peculiar commodity-owners may perpetuate its appearance in the market” (Marx [1887]
1967:172). The laborers exist only for the purposes of continual labor-power supply. It
seems as if Marx has characterized the situation as one where the capitalist does not
recognize the workers as humans but rather only sees the workers as repositories of
potential labor-power. In this, one finds Marx’s deepest concerns about capitalism: that it
tramples on human potentiality. Labor-power, as a human capacity, is commodified in its

Returning to Volume III, Marx ([1894] 1967) discussed the relationship between
profit, surplus value and exploitation:

The degree of exploitation of labour determines the rate of surplus-value, and
therefore the mass of surplus-value for a given total mass of variable capital, and
consequently the magnitude of the profit. The individual capitalist, as distinct
from his sphere as a whole, has the same special interest in exploiting the
labourers he personally employs as the capital of a particular sphere, as distinct
from the total social capital, has in exploiting the labourers directly employed in
that sphere. (p. 197)

In seeking workers to generate surplus-value through unpaid, surplus-labor, the capitalist has turned the laborers into commodities. They are viewed only as use-values, strictly considered on the basis of their utility as if they were mere tools. What exploitation seems to entail is the extraction to the furthest extent possible of surplus-value from the laborer and the creation of dependency of the laborer on the capitalist. The arrangement is such that the capitalist is the one who benefits from the exploitation, because the laborer is compelled by necessity to enter into a relationship with the capitalist in order to sell labor-power.

**Interest-Bearing Capital**

The discussions in the previous sections have highlighted where it is in general capitalist enterprise that alienation and exploitation can be found. However, these discussions were limited in the sense that the capitalist mode to which they referred was that of industrial capitalism, or commodity capital. There is another general form of capitalism—merchant’s capitalism—that is conceptually different from commodity capitalism. Under this general form, Marx further separated commercial capital and interest-bearing capital. It is interest-bearing capital that is most pertinent for the present discussion.

It is important to note the difference between merchant’s capital and commodity capital. The two modes, while connected in practice, ought not to be conflated conceptually: “…Nothing could be more absurd than to regard merchant’s capital, whether in the shape of commercial or of money-dealing capital, as a particular variety of
industrial capital” (Marx [1894] 1967:323). Such was the mistake Marx ([1894] 1967) attributed to economists like Smith and Ricardo:

The great economists, such as Smith, Ricardo, etc., are perplexed over mercantile capital being a special variety, since they consider the basic form of capital, capital as industrial capital, and circulation capital... The rules concerning the formation of value, profit, etc., immediately deduced by them from their study of industrial capital, do not extend directly to merchant’s capital. (p. 324)

Although the two general modes are related and are mutually beneficial, they are conceptually distinct. If one were to generalize the functions of the two modes, one might call industrial capital the capital concerned with producing and merchant’s capital the capital concerned with exchanging, As Marx characterized the two: “...Merchant’s capital is penned in the sphere of circulation, and since its function consists exclusively of promoting the exchange of commodities it requires no other conditions for its existence...outside those necessary for the simple circulation of commodities and money” (Marx [1894] 1967:325). Commodity-capital is thus necessary for merchant’s capital, and it seems merchant’s capital helps to keep the exchange of commodities in its cycle, helping the industrial capitalists.

Marx’s discussion of interest-bearing capital focused on the relationship between two capitalists, one of whom wanted to borrow money as capital from the other in order to carry on his or her own enterprise. Marx uses the example of person ‘A’ who has access to a machine that yields a profit of 20 percent. A, with £100 of capital, is able to gain a profit of £20 from this machine. A then lends ‘B’ this £100 so that B can generate his or her own surplus-value using this profit-generating machine. However, part of the agreement is that B pays A part of the £20 surplus-value generated, perhaps £5 on top of the £100 borrowed. In this case, A acts as a capitalist because A has put forward capital
(£100) with the intent to make a surplus-value—the £5 paid to him by B. B also acts as a capitalist, but only with the consent of A, because it is A’s money after all that is loaned to B (Marx [1894] 1967:339, 340). “A gives away his money not as money, but as capital. No transformation occurs in the capital. It merely changes hands” (Marx [1894] 1967:348). The point here being that in this case both the lender (A) and borrower (B) act as capitalists. Both have invested capital, because both are interested in generating surplus-value. However, it is only A who is the true capitalist, because the capital really belonged to A in the first place. The cycle is nearly identical in form to the general formula for capital (M-C-M'), except that for A, the cycle is really abbreviated to M-M' (Marx [1894] 1967:342).

Marx argued that the capitalist aim of extracting surplus-value was attained by means of buying labor as the commodification of labor. Here, when the goal of generating surplus-value is done through the means of lending capital, we have the commodification of capital. “The owner of money who desires to enhance his money as interest-bearing capital, turns it over to a third person, throws it into circulation, turns it into a commodity as capital; not just capital for himself, but also for others” (Marx [1894] 1967:343). The money, being lent for an interest charge, is a commodity at the same time as it is capital for the lender. The lender has access to be able to exchange money as capital the same way the industrial capitalists are able to move around labor forces. The money as capital and commodity, has effectively taken the place of labor in this model. “The lender periodically receives interest and a portion of the consumed value of the fixed capital itself, this being an equivalent for the periodic wear and tear” (Marx [1894] 1967:344). In industrial capital, the capitalist made profit through
extracting surplus-value from unpaid surplus-labor; in interest-bearing capital, the
capitalist makes profit through generating surplus-value simply by putting capital into the
lending circulation where its use by borrowers comes at a price. It seems the process has
been shortened and there is no need for production. Instead of value deriving from
commodities and the labor imbued in them that had to first be produced and purchased
with advanced capital, value derives straight from the advanced capital. The lender by
accepting the borrower's terms has guaranteed the generation of surplus-value for the
lender-capitalist.

If the fact that the system of industrial capitalism takes on a life of its own was
worrisome to Marx ([1894] 1967), interest-bearing capital is positively alarming:

The relations of capital assume their most externalized and most fetish-like form
in interest-bearing capital. We have here M-M', money creating more money,
self-expanding value, without the process that effectuates these two extremes. In
merchant's capital, M-C-M' there is at least the general form of the capitalistic
movement, although it confines itself solely to the sphere of circulation, so that
profit appears merely as profit derived from alienation; but it is at least seen to be
the product of a social relation, not the product of a mere thing... The thing
(money, commodity, value) is now capital even as a mere thing, and capital
appears as a mere thing. The result of the entire process of reproduction appears
as a property inherent in the thing itself... In interest-bearing capital, therefore,
this automatic fetish, self-expanding value, money generating money, are brought
out in their pure state and in this form it no longer bears the birthmarks of origin.
The social relation is consummated in the relation of a thing, of money, to itself
(p. 391-392).

Interest-bearing capital is seen in a light of almost pure value-generation. It distorts
social relationships further than industrial capital, because by lending money with interest
to others, the lender-capitalist has in fact turned the borrower into the thing into which
capital is invested to produce further value. The distance between the capitalist and his
or her goal of surplus-value is diminished, because now the lender-capitalist does not
need to purchase labor or even secure means of production, but simply give the borrower capital with the requirement that the full value, plus interest, be returned.

**Debates of Exploitation and Marx’s Economics**

It is an understatement to say that Marx’s economic theories have received substantial criticism. This is the case even within Marxian strains of thought. The labor-theory of value in particular has been cited by analytical Marxists to be flawed in its construction (Cohen 1988; Elster 1985; Holmstrom 1997; Roemer 1981, 1985; Schweickart 1997). What does this mean for the concept of exploitation? Is the notion of exploitation dependent upon the labor-theory of value? If the underlying notions of the labor-theory of value are incorrect, does this invalidate the Marxian concern for exploitation? Further, if Marx’s economic mechanisms do not stand to scrutiny, what does this mean for his concerns about a reified movement of capital?

The rejection of Marx’s labor-theory of value need not necessitate the rejection of his concept of exploitation. Some, like G.A. Cohen (1988), view the two as completely unrelated:

The relationship between the labor theory of value and the concept of exploitation is one of mutual irrelevance. The labor theory of value is not a suitable basis for the charge of exploitation directed by Marxists against capitalism, and the real foundation is something much simpler which, for reasons to be stated, is widely confused with the labor theory of value (P. 209).

Here, Cohen defended the idea that exploitation is a valid criticism of capitalism for Marxists to make, but that exploitation does not derive from the labor theory of value.

Instead Cohen’s argument follows:

(17) The laborer is the person who creates the product, the thing which has value.
(11) The capitalist appropriates some of the value of the product.
The laborer receives less than the value of what he [or she] creates. The capitalist appropriates some of the value of what the laborer creates. The laborer is exploited by the capitalist (Cohen 1988:228).

In this formulation, Cohen attempts to separate the moral claims of Marxist exploitation from the labor theory of value, and thus Marx's theory of surplus value, which he regards as invalid.

The labor theory of surplus value is...unnecessary to the moral claim Marxists make when they say that capitalism exploitative. It does not matter what explains difference between the value the worker produces and the value he [or she] receives. What matters is just that there is a difference (Cohen 1988:214).

For Cohen, exploitation is in fact a moral concern, and the moral weight of exploitation lays in its unequal distribution of capital. “The capitalist’s ‘contribution’ does not establish absence of exploitation, since capitalist property in means of production is theft, and the capitalist is therefore ‘providing’ what morally ought not to be his to provide...The capitalist does not really give, because what he appears to give was unjustly taken in the first place” (Cohen 1988:234). It is the initial class differences then that give weight to the argument that exploitation is a negative harm resulting from capitalist economics.

John E. Roemer (1985) on the other hand has called exploitation theory an “unnecessary detour” (p. 62). He frames exploitation in a way he calls the “Property Relations” concept of exploitation, which focuses on the positions of the parties in society: “Exploitation... refers to the relationship between a person a society as a whole as measured by the transfer of the person’s labor to the society, and the reverse transfer of society’s labor to the person, as embodied in goods the person claims” (Roemer 1985:31). He contended that the motivations of understanding exploitation are really to
arrive at other Marxian theoretical concepts such as the accumulation theory:

"Exploitation of workers explains profits and accumulation under capitalism; it is the secret of capitalist expansion"; domination theory: "Exploitation is intimately linked to the domination of workers by capitalists, especially at the point of production, and domination is an evil"; alienation theory: "Exploitation is a measure of the degree to which people are alienated under capitalism. The root of alienation is the separation of one’s labor from oneself"; and inequality theory: "Exploitation is a measure and consequence of the underlying inequality in the ownership of the means of production, an inequality which is unjustified" (Roemer 1985:31-32). However, the attempt to connect these different strands of thought through the means of exploitation theory is not a valid route to take according to Roemer (1985:32). Instead, if one is to focus on the means of exploitation, the "focus must be on the ‘initial’ distribution of capital, what caused the class relations to emerge, and what opportunities exist for new generations and latecomers to the scene" (Roemer 1989:97).

Reiman (1997) takes the more traditional approach in his definition of exploitation: "A society is exploitative when its social structure is organized so that unpaid labor is systematically forced out of one class and put at the disposal of another" (p. 154). This definition of exploitation focuses on the relations of classes and the interactions that form patterned relationships between them, namely the unpaid labor that is extracted from the workers. Reiman critiques Roemer’s approach with the claim that what Roemer actually ends up showing is how Marxists “should not be interested in exploitation defined as the unequal transfer of labor without reference to the fact that the transfer is forced” (Reiman 1997:168). Reiman’s critique of Roemer centers on the
contention that what Roemer’s distributive definition of exploitation is lacking, at least in part, is the idea of force (Reiman 1997:173-174). What seems to be of major concern for Reiman is that Roemer’s treatment of Marx’s concepts takes away the moral impact that many believe Marx wanted to have, especially as Marx and Engels had argued passionately in *The Communist Manifesto* (Reiman 1997:174).

Nancy Holmstrom (1997) takes a view more akin to the view of Reiman in that she emphasized the need to remember why it was that Marx considered exploitation an ‘evil’ (p. 85). In the most negative definition of the term Holmstrom said,

> When X exploits Y, Y is forced to do unnecessary, unpaid labor and does not control the product of that labor. Force, domination, unequal power, and control are involved in exploitation both as preconditions and as consequences. This is why Marx thinks exploitation an evil (Holmstrom 1997:85).

What this view of exploitation allows the reader to see is that laborers are compelled by their social standing to sell their labor power in order to earn the means of living. The means of production are controlled by one group, thus there is an imbalance of power between the groups that works in favor of the one controlling the means of production. Holmstrom (1997:85) points out the connections with alienation: “Being congealed labor, the product is a function of the labor that went into it. When it is taken away from them, they are thereby diminished, impoverished denuded.”

Jon Elster (1985:216) carries this argument further to claim that although Marx “was apt to dismiss talk about justice and fairness as ‘bourgeois ideology’, there actually is a sense of injustice in the concept of exploitation. “Exploitation is the generation of economic injustice through free market transactions” (Elster 1997:27). Elster (1985) cites from *Grundrisse* to support his claim that Marx did indeed have some concerns for
justice:

The recognition by labour of the products as its own, and the judgment that its separation from the conditions of its realization is improper (ungehörig)—forcibly imposed—is an enormous awareness (enormes Bewusstein), itself the product of the mode of production resting on capital, and as much the knell do its doom, as with the slave’s awareness that he cannot be the property of another, with his consciousness of himself as a person, the existence of slavery becomes a merely artificial vegetative existence and ceases to be able to prevail as the basis of production (p. 106).

The term ungehörig, Elster noted, can be translated as unjust as well as improper. For Elster (1985:219), the use of the term ‘recognition’ in this passage demonstrates that Marx believed the injustice to be a fact about capitalism.

What these differing conceptions about Marxist exploitation have in common is that none of them place exploitation as being predicated on the labor theories of value and surplus-value. Instead, what most of these authors have argued, with the exception of Roemer (1985), who has claimed it is a distraction from the concepts of domination, power and alienation, is that exploitation is a serious Marxian concern, because it has concrete social implications. As has already been argued by Cohen, exploitation need not depend on the mathematics behind Marx’s economics. It rather depends on the fact that there is an unequal social relationship. Even if one rejects Marx’s economic mechanics, one does not need to also reject his claims about the social consequences of capitalism.

What I attempt to do here is not to vindicate Marx’s labor theory of value and surplus-value, but to try to find out how exploitation might work in different contexts. If we can find that exploitation theory is a useful framework for examining various situations, such as the subprime mortgage industry, then perhaps the attention paid to exploitation will be vindicated against claims of its being outmoded and useless or
distracting (Roemer 1985). Even if the technical details of Marx's theory of value were incorrect, one can still question the social and moral impact of exploitation as suggested by Holmstrom (1997), Elster (1985) and Cohen (1997). As a concept concerned with the social impact of relationships, exploitation is as much a social theory as it is an economic one.

Conclusion

This chapter has highlighted Marx's conception of exploitation, its origins in unpaid labor, and the nature of the exploitative relationship. The exploitation posited by Marx has traditionally been viewed as involving, in part, the extraction of unpaid labor from the worker by the capitalist. Exploitation also involves the unequal balance of power and knowledge in a relationship structured to favor the capitalist (Cohen 1997; Elster 1985). This nature of an exploitative relationship favoring the capitalist will emerge in the following chapter.

This chapter has also discussed the concerns Marx posited regarding interest-bearing capital, as the most externalized, fetishized form of capital relations. Although the economic claims of Marx have been strongly criticized, and according to some reputedly disproved, including by those from within the analytical strand of Marxism, the concerns about exploitation remain legitimate social concerns. The term exploitation itself may be used in a value-neutral way, as exploit can also mean 'to use'. However, it has been shown here that the way Marx used the term was not in this value neutral sense, at least not consistently.

In the following chapter, I examine how the subprime lending industry might be
characterized in the light of Marxian exploitation theory. Borrowers cannot be said to be working for the lender, nor are they producing objects that have value. Rather the opposite is true—the lender is in a way working for the borrower in writing and securing a loan for the borrower. Yet in the end, the lender ends up with profit. Is this an exploitative relationship in the Marxian sense? Is the structure of the relationship balanced in favor of the lender as capitalist?

I will also examine how Marx’s concerns with the reified interest-bearing capital cycle may bear relevance to the lending industry through the process of securitization. Marx worried that the flow of capital could take on ‘a life of its own’, that it moves beyond the control of individuals and spawns into a system that is too massive to reign in. In what ways might his concerns be seen in the modern context of interest-bearing capital? Does the flow of cash here resemble what Marx cited as the cycle of M-M’?

Many claim the structure of securitization to be complex to the point of incomprehensibility and many risk assessment practices to be at best nebulous. Of what relevance are these claims to the Marxian concern for a reified capitalist structure?

Throughout his career, Marx showed a deep concern for realizing human potential. Exploitation and capitalist relations were immediate obstacles to this realization and would eventually be removed through the overthrow of capitalism, an expectation which Marx held. I am not going to make anywhere near such claims in this thesis. Rather I want to examine a set of economic transactions between groups of people, namely the subprime lenders and borrowers. But in doing so, I wish to examine the applicability of classic Marxian theory to contemporary contexts, in the process discussing, and defending, the relevance of the concept of exploitation to modern society.
compelled to sell its labor power on the market to the capitalists in order to earn a means of subsistence. An important qualification for this is that the laborers are formally free, that is they are not slaves. Yet they are still compelled by the necessity of their social position to sell their labor power to whomever they want. It is not forced or slave labor—this is not capitalism, but slavery, an entirely different mode of production. This juxtaposition of classes of people is the factor that enables the capitalists to exploit the proletariat for surplus labor.

The Lender-Borrower Relationship and Marx's Exploitation

From the very definition of the lender-borrower relationship, in which the lenders make profit, and in turn, increased capital, from loaning money to the borrowers who use the loan to purchase a house, one wonders where in Marx’s schema would this relationship fit. In the third volume of *Capital*, Marx ([1894] 1967) addressed interest-bearing capital and money-dealing capital. However, those who borrowed the money in this case wished to use the money as capital. Marx was describing those borrowers who turned the borrowed money into capital to start up their own businesses to make a profit. By contrast, the case being considered here is one in which the borrower is not seeking to make an additional profit by borrowing money from the lender. In fact, the opposite argument might be made that the money borrowed never acts as capital technically because it is not used generate additional value in the strictest capitalist sense. Instead, as the money is used to buy a home, the borrower is actually purchasing a commodity for use.

There are exceptions one finds in people called 'flippers' who purchase the home
with borrowed money and try to sell it again as quickly as possible for a higher price in order to turn a profit, but these are the exception (Michaelson 2009; Zandi 2009). One might also object that purchasing a home in fact is an action that seeks to increase value, because it increases the purchaser's net worth and assets. There are others who buy homes in order to rent them out to others. In these cases, the homeowners act as capitalists, but these cases are outside the present interest. So while it is true that owning a home increases one's net worth and assets, it would be erroneous to equate this act with that of the capitalist who seeks to make a profit from actions and whose enterprise is to generate surplus value. For the majority of borrowers who want to be homeowners, the interest is in using the house as a home rather than only deriving value from it by selling it later.

Following Marx's characterization of exploitation as the unequal access to the means of production and capital, it would seem that the practice of lending for interest to potential homebuyers is by definition exploitative. In this case the lender is analogous to the Marxian capitalist, in that the lender is the one with access to money, while the borrower must apply to the lender for access to money. The borrower, like the laborer, is in a socioeconomic position in which he or she does not have access to the means to be able to afford the purchase of a house without borrowing the money to do so. Like the laborer, the borrower must apply to the party who does have access to capital and the necessary means of purchasing a home, and it is only through this party that the borrower is able to purchase a home. Looking at the other side of the relationship, the lender acts much like the employer or capitalist. The lender, as a representative of the lending institution, controls the access to the capital. Like the capitalist, the lender turns this
situation for his or her interest. Through the fact that access to the money being sought by the borrower is totally within the lender’s control, the lender has the borrower in a vulnerable position in which they remain at the will of the lender. The lender decides whether or not the borrower will be granted the loan, and thus access to the necessary capital to purchase a home.

The whole enterprise of lending is predicated on the pursuit of making money. It is in the lenders’ interests to make successful loans which the borrower can pay back with interest, and it is the interest that gives the lender the surplus-value. It was discussed in the earlier chapter on Marx how he characterized the relationship between the laborer and capitalist. It is through the extraction of surplus-labor that the capitalist is able to realize surplus-value and then profit. In the case of the lender-borrower relationship however, what the capitalist extracts is not surplus-labor, but surplus-value itself. The capitalist as a lender, is not interested in obtaining surplus labor but only the value. Having access to capital to lend, the capitalist can leverage this position in order to extract value from a borrower for the use of the borrowed capital. A loan arrangement in which the borrower pays a 10 percent interest rate yields 10 percent of the monthly payment as pure surplus-value for the lender. If the borrower must pay back $1000 per month on a mortgage with an additional 10 percent interest rate, then an extra $100 every month goes to the lender. Assuming that the interest rate stays at 10 percent (which we have already seen to be an unrealistic expectation of subprime loans whose interests rates fluctuate enormously) for a 30 year mortgage, then when the mortgage is finally paid off, the borrower will have paid back the original loan of $360,000 ($1000 per month x 360 months) plus an additional $36,000 in interest. It is this interest which allows the lender to stay in
business and make further loans.

The two relationships certainly have different characteristics in that the series of actions starts from different points: The capitalist producer seeks labor power to generate profit, whereas the capitalist lender seeks borrowers who wish to borrow money. The laborer is compelled by necessity to sell labor power in order to earn a living, whereas the borrower desires to own a home. Yet even from these different starting points, the result is the same for the lender, who is indeed a capitalist. From the laborers’ point of view, the process begins with a selling of labor for money, C-M, in which C is the commodity of labor power. The laborer uses this money to purchase necessities for sustenance, M-C. The cycle for the laborer is C-M-C. For the borrower, on the other hand, the cycle seems to be opposite, as it really starts with a purchase. The act of taking a loan is really a purchase of the use of someone else’s capital M-C. In this case, the capital is commodity from the borrower’s point of view. This is a special type of capital-commodity however, because it is used to purchase another commodity—a house. So from the borrower’s perspective, the cycle put together looks like M-C-C in which the capital-commodity is used to purchase a house, the final commodity. For both the laborer and the borrower then, the relationship is geared toward a purchase of a commodity.

From the capitalist’s point of view, the cycle of producing value is M-C-M, in which the capitalist purchases the labor power of the worker, M-C, which gives the capitalist the commodities to later sell for more money, C-M’ (Marx [1887] 1967: 151-152). From the lender’s point of view, the process ends the same way; however, the lenders are not really producing commodities as such, but rather turning money into a commodity through packaging into different forms of loan structures and selling these to
consumers, as well as to investors. They produce commodities only in an abstract sense. The lenders in fact engage in a process of pure packaging and selling, so that the process from their point of view is rather M-M'. Although capital as commodity is involved in this lender-borrower relationship, to term the cycle as M-C-M would conflate it with Marx’s conception of commodity capital, an error he saw as happening too much amongst the economists he studied (Marx [1894] 1967:324). In sum, the lender makes profit in the same way the capitalist does minus the step of physically producing a commodity to sell. The cycle of M-M' is at the heart of Marx’s model of interest-bearing capital.

The lender-borrower relationship, in the end, seems to follow an analogous path to the capitalist-laborer relationship. The transaction of the loan brings to the lender a profit just as the use of the laborer’s labor-power brings profit to the capitalist. The goals of the parties are the same, only the means of achieving them are slightly different. Both entail the extraction of surplus-value that is in some way derived from the activity of either the laborer or the borrower. Subprime lending serves as an interesting case study of the general lender-borrower relationship, because the subprime market was targeted to a previously untapped consumer pool—those who did not or could not qualify for traditional mortgages.

The Subprime Lender-Borrower Relationship

If the lender-borrower relationship in general is already shown to be exploitative, what might this mean for the subprime loan structure? It emerged out of the long-standing practice of home mortgages with some significant changes in its formal rules of
risk assessment as well as its targeted consumer base (Goodman et al. 2008). If the actions of lenders within the subprime industry follow the general pattern of capitalist lenders, then they too would be involved in the exploitative extraction of value from the borrower. However, as will be discussed, the changes lenders made to their own rules and standards in order to make subprime loans warrant closer inspection to see how the mechanisms of exploitation differ, and in many ways, would appear more egregious from the standpoint of Marx’s conception of exploitation.

The subprime borrower, as it has been stated throughout, is typically a person with a lower credit score or a troubled credit history. Subprime borrowers do not have the necessary assets and income to qualify for a traditional loan. Like all borrowers, subprime borrowers desire to purchase a home, but to do so they must borrow money with more conditions, prepayment penalties and higher interest rates than other borrowers. In exchange for this service, which the borrower enters into freely much as the laborer enters into an agreement with the capitalist freely, the borrowers must pay an interest rate on the loan, again in the case of subprime borrowers, adjustable higher rates that can cost double or more than traditional loans.

The defense of subprime mortgages offered from both regulators and those involved in the industry frames them as a method for correcting the past historic injustices of redlining, racial and class discrimination in the housing market (Bitner 2008; Gramlich 2007). The evolution of the subprime lending industry followed decades of housing reform and government-shaped regulation that passed with the intention of bringing an end to years and years of discrimination. Acts such as the Fair Housing Act of 1968, the Equal Credit Opportunity Act of 1974, the Home Mortgage Disclosure Act
of 1975, and the Community Reinvestment Act of 1977 all were drafted with the intention of bringing greater transparency and equality of opportunity to the lending process with regard to race, gender and socioeconomic status (Gramlich 2007b:23-29).

What those lenders in the subprime market sought to do was to market toward those groups who, despite these acts, were still facing the inability to secure loans in order to finance a purchase of a home.

At first, the subprime industry seems to be quite a noble experiment. Surely it makes sense to correct the social injustices that groups suffered by opening markets and hopefully reducing the unwarranted historical disparity between groups. However, the subprime industry seemed to change in its intentions. Immergluck (2009), a professor of the City and Regional Planning argues:

...[T]he growth of securitization and vertical disintegration did not appear out of thin air. They were enabled by a set of national and international economic and demographic conditions and, especially, by a series of deregulatory public policy moves in the financial services arena dating back to at least the early 1980s. What is also critical to understand about the initial subprime boom is its reliance upon and exploitation of the geographies of social disadvantage and isolation and the private efficiencies that were enabled by such geographies for the benefit of mortgage brokers, lenders and investors. (p. 74)

What Immergluck is describing here is the decreasing control by any single lender of the loan package from start to finish—vertical integration—and the preponderance of the practice of complex securitization in which risk is pooled and spread for investors who contribute toward funding the loan pools. Lenders, particularly in the subprime field, started packaging more and more complex securities out of their loans and marketed these towards all levels of investors: from those interested in low-risk, low-yield to high-risk, high-yield investments (Goodman et al. 2008; Immergluck 2009). What these
packages allowed lenders to do was to approve riskier and riskier loans, thus increasing their potential consumer pool greatly as more and more previously disenfranchised groups could be brought into the lending process. While subprime loans may have been started with the intention of opening up the housing market to disenfranchised groups, what happened as Immergluck and others have argued is that these groups soon became subjected to another form of what some would see as predatory lending or what others might call unscrupulous lending (Andrews 2009; Bitner 2008; Immergluck 2009; Lord 2005; Michaelson 2009; Stuart 2003). This group of consumers that has historically faced financial difficulties now find the housing market opened up to them, but the price for their admission is much higher than that of ‘prime’ borrowers.

Marx ([1887] 1967:194) pointed out the ‘cunning’ nature of the capitalist as an actor who is privy to information about the economic process of which the laborer, or borrower in this case, is not aware. For the capitalist, this situation of disenfranchisement for groups who were excluded from obtaining home loans presented an opportunity by which they could reap enormous profit. Gramlich (2004), a former Governor of the Federal Reserve Board said in an address to industry executives at a roundtable conference:

The increased availability of subprime mortgage credit has created new opportunities for homeownership and has allowed previously credit-constrained homeowners to borrow against the equity in their homes to meet a variety of needs. At the same time, increased subprime lending has been associated with higher levels of delinquency, foreclosure, and, in some cases, abusive lending practices.

Gramlich (2004) later stated in the same speech however, “These differential subprime shares do not necessarily suggest exploitation of these borrowers because borrowers with
the relevant characteristics may also be worse credit risks, but they bear watching.”

Taken from the same speech, these quotes seem to indicate that Gramlich demonstrated ambivalent feelings toward the subprime industry. Gramlich had tried to convince Alan Greenspan, then Chairman of the Federal Reserve Board, that the Fed ought to maintain a closer watch on the subprime lenders, but was told by Greenspan that this could not be the job of the Fed (Andrews 2007, 2009:79). Shortly before his death in 2007, Gramlich prepared a speech in which he stated:

Why are the most risky loan products sold to the least sophisticated borrowers? The question answers itself—the least sophisticated borrowers are probably duped into taking these products. Should we ban all exotic loan products? The thought is tempting, but the Fed’s normal approach is to make it more difficult to sell exotic products in the subprime market (Andrews 2007).

This expansion of the consumer base coupled with the fact that lenders could now put together complex securities for their loans enabled the rapid expansion of the subprime market to the point where it came to represent a significant portion of the total mortgage market, at its high point over 13 percent of the total mortgages issued in 2000 (Gramlich 2004). Members of a major financial institution like Gramlich clearly worried about the effects of the subprime market, even though they were not necessarily about to pass restrictive legislation on the economic activity. Gramlich (2007a, 2007b:57) did see enormous benefit in the subprime loan exactly because it did open the door to homeownership, which he viewed as being part of the ‘American Dream’. The position and existence of the subprime lender was at best a mixed blessing from such a viewpoint. Others argued instead that it simply opened another door for predatory lending (Stuart 2003). This latter view seems to fall in line with Marx’s conception of exploitation and its ever-increasing presence in a progressively more capitalist society. If predatory
lending does work based on the imbalance of power and knowledge in favor of the lenders, who are capitalists, then it fits the Marxian premise of exploitation.

Mechanisms within the Subprime Mortgage Relating to Marx's Exploitation

There are several mechanisms found commonly in subprime loans that are designed to keep the borrower paying at a steady rate in order for the lender to realize as much profit as possible from the interest rate put on the loan. Like the mechanization of labor, or the increased working day that can increase the amount of surplus-value the manufacturer obtains from the laborer, these loan rules are designed such that the lender is able ensure steady flows of profit from the loan.

A common feature of subprime loans is the inclusion of prepayment penalties. These penalties are put in place to make it prohibitively expensive for the borrower to pay off a loan too quickly or to pay back more than a certain amount in one month's payment. The Federal National Mortgage Association (Fannie Mae) reports estimated that 80 percent of subprime mortgages contain prepayment penalties compared to only 2 percent of prime mortgages (Zigas, Parry and Weech 2002). Prepayment penalties make it costly for borrowers to either refinance the loan or to pay it off early; it is a measure that is designed to keep the borrower paying the interest rate of the loan, because it is by carrying out the mortgage to its full term and paying the interest all along that makes the most profit for the lender (Gramlich 2007b; Immergluck 2009; Zandi 2009). Some estimates show that subprime refinance loans with prepayment penalties were 20 percent more likely to go into foreclosure than similar loans without the prepayment penalty attached (Quercia, Stegman and Davis 2007). Ironically, this same practice, which aims
to increase the amount of interest payments to the lenders, actually can result in lenders incurring additional costs. Quercia et. al (2007) estimated that there was an increase in foreclosure expenditures related to prepayment penalties amounting to about $450 million in 1999, still a few years before the major collapse. The prepayment penalties will work ideally in the interest of the lender by making it costly for the borrower to refinance, especially in ARMs loans in which the interest rate can shoot up quite dramatically. The structure of these payments is the next mechanism that will be considered.

Adjustable rate mortgages, ARMs, present an interesting gamble for the borrower. With the 3/27 or the 2/28 structured ARMs loans, the interest rate paid by the borrower remains locked in for either the three or two-year period. After this period, the rate can adjust to within whatever cap is specified in the loan. What is not uncommon for borrowers to experience however, is a sort of payment shock when the rates suddenly rocket upwards after the fixed period. There is no real way for the borrower to know exactly how much the interest rate will increase from month to month. As was mentioned with the prepayment penalties, it is also difficult and costly for borrowers to refinance their loan into a different structure or even to pay greater principal to lessen the duration of the mortgage’s life (Immergluck 2009; Zandi 2009). This seems to fit into Marx’s conception of exploitation quite well, in that again, the loan is structured to extract surplus value from the borrower. Through adjusting the interest rate, without the borrower ever being sure of how much the rate will change, the lender has all of the power in the relationship. The prepayment penalties provide an obstacle for the borrower to get out of the ARM loan, so he or she remains subject to the varying interest rates and
uncertainty that accompanies them. This imbalance of power fits into Marx’s conceptions of class exploitation and the sustaining of class boundaries through the perpetuation of dependency of the laborer upon the capitalist for means of subsistence (Marx [1887] 1967:581). In this case however, the borrower is made to depend upon the lender, and is penalized for trying to get out of the current loan and into a better one.

There are other lender actions which at first seems to be in the interest of the borrower, but in the end, actually have hurt both borrowers and lenders overall, and have been widely cited to be a major cause of the collapse of the subprime industry. I outlined in the introductory chapter that subprime loans were be undocumented, or at least underdocumented, when compared to prime loans. This means that borrowers would not have to report their incomes or assets in order to obtain the loan. This was supposedly one of the ‘advantages’ that attracted potential borrowers to the subprime market. The lenders too, seemed happy to embrace this freedom from the restriction of reporting (Andrews 2009; Bitner 2008; Michaelson 2009; Zandi 2009). Pleading ignorance of potential risks seemed to allow lenders to make loans that would normally be viewed as too risky. Not only would borrowers not require documentation, but there have been reports of substantial ‘massaging of credit’—making the borrowers’ credit scores appear to be higher than they are (Bitner 2008:80-86).

This may at first seem quite benevolent on the part of the lenders. It would seem to exemplify an act of generosity by taking on potential borrowers deemed as too risky to qualify for prime-rate loans. However, what this viewpoint would fail to take into account is that lenders were often steered toward very expensive loans that would prove very difficult to pay off or to refinance. Such loans could include forms of the
aforementioned ARMs loans, which have already been shown to be problematic in terms of their exploitative nature. Admittedly, it is difficult to know the exact motivations of lenders; some would claim a genuine desire to put people in homes while at the same time claiming that other lenders are essentially unscrupulous conmen (Bitner 2008; Gramlich 2007; Michaelson 2009). From a Marxian perspective, the system itself is problematic, so both the ‘genuine’ lenders and the conmen are guilty of exploiting the other group, regardless of their intentions. Their participation in the lending system is enough to level this claim for their actions. The resulting relationship, despite the original intentions of the lender, is still one of exploitation. The power dynamics are such that the borrower is steered in certain directions through the maneuverings of lenders, who know the rules of the lending trade because it is their job to know and to make profit for the lending company. This imbalance of knowledge leaves the borrower dependent on the good will of the lender whose job it is to extract value from the borrower. In terms of both knowledge of loan processes and structures as well as control of the flow of capital, the relationship is stacked in favor of the lender. Marx argued that the relationship between capitalist-laborer was in the economic interest of the capitalist in terms of access to capital and means of production. The two relationships are structured similarly in terms of access to capital, but in the case of the lender, knowledge of the loan process and an understanding of the terms of the loan is what gives the lender the even greater advantage.

The subprime lending relationship between lender and borrower is one of general exploitation in the Marxian sense. Further, upon closer inspection of certain activities that stand out in subprime loans, it appears that certain mechanisms only serve to
perpetuate the exploitative nature of the relationship, rendering the exploitation of the borrower even more pronounced than what one may find in a prime lender-borrower relationship. As long as the lenders as a group control access to capital, it would seem that the Marxian conception of exploitation would be unavoidable. By the very definition of the term, what occurs is the dependency of one group of people without access to capital or the means of production upon those with the access. Within the realm of the subprime industry, the situation is exacerbated because those borrowers typically already experience more economic difficulty than the prime-rate borrower.

How is such a system of exploitation established and maintained? In the following sections, I examine how Marx analyzed interest-bearing capital, and how his analysis bears very clear similarities to the criticisms and worries one finds arising today, albeit ex post facto, against subprime lending.

Marx’s Interest-Bearing Capital and Subprime Mechanisms

Marx treats other forms of capitalist enterprise in the third volume of *Capital*, moving away from the focus on the industrial capitalist. Interest-bearing capital, unlike commodity-capital, does not depend directly on production, but instead surplus-value is generated for the ‘money-capitalist’ simply through his or her loaning the money to a borrower. This circuit of capital in interest-bearing capital is not M-C-M’ but M-M’, or M-M+ΔM (Marx [1894] 1967:338-349).

Before continuing, there is a necessary distinction to point out here regarding interest-bearing capital and the lender-borrower relationship about which Marx wrote. The relationship between the lender and borrower that Marx characterized was that

However, what is of present interest is a relationship not between the a lender and borrower, both of which act as capitalists, but rather a borrower who is a capitalist and a lender, who acts as a consumer in the process of borrowing in order to purchase a home. The significance of this fact makes only a small immediate difference, but may be a starting point for an analysis of the way lenders may conduct themselves differently depending on who the borrower is: capitalist or consumer. Such an analysis may get at the balance of powers within the lending-borrowing relationship, but is beyond the present scope.

What immediate difference this distinction does make is that one may object that the borrower may not technically be borrowing money as capital, because he or she is not applying the money as such, i.e. towards obtaining surplus-value. However, the successful purchase, or maintenance, of a home yields to the buyer a greater credit score and increased net-worth, thus an increase in value. The point here being that the borrowed money does act as capital by being used to increase the assets of the borrower-homebuyer. Further, the fact that the borrower is not an industrial capitalist does not change the outcome of the circuit. The money still flows back to the lender in order to increase his or her profit. The difference in the borrowers then, is relatively insignificant for the present purpose.

The language Marx used to describe interest-bearing capital reveals why he considered it so problematic. "The relations of capital assume their most externalized and most fetish-like form in interest bearing capital" (Marx [1894] 1967:391). Further:

In the form of interest-bearing capital this [the form M-M'] appears directly,
unassisted by the process of production and circulation. Capital appears as a mysterious and self-creating source of interest—the source of its own increase. The *thing* (money, commodity, value) is now capital as a mere thing, and capital appears as a mere thing. The result of the entire process of reproduction appears as a property inherent in the thing itself... The social relation is consummated in the relation of a thing, of money, to itself. Instead of the actual transformation of money into capital, we see here only form without content (Marx [1894] 1967:392).

As terrible as Marx thought the conditions of commodity capital were, the circuit of interest-bearing capital seems to be even more worrisome. Capital becomes a fetish, like other commodities, taking on a life of its own. It is constantly in motion, creating new value for the lenders, those who were already in possession of some capital, and who, after the circuit of interest-bearing capital is complete, will have even more. The missing steps of production and selling of products means that capital accumulates even more readily and quickly. The social relations, meaning the relation between those who have capital and access to means of production and those who do not are even more solidified with the circuit of interest-bearing capital.

In his worries about the fetishism of capital, the automatic and self-fulfilling expansion of value, with the interwoven relationships between banks and lenders, Marx seemed almost prescient to some of the same concerns that are being voiced today (Marx [1894] 1967:400-413). As will be discussed in the following sections, the aftermath of the subprime collapse has elicited strong opinions against certain mechanisms of securitization and lending. These mechanisms are often cited as complex, nebulous machinations of the financial industry designed to keep money flowing, profits increasing, and often, impenetrable to all but the most trained financial eyes.
Complex Subprime Securitization and Loan Structures

One of the criticisms widely directed toward subprime securitization is that the derivative rules it used and the way securitization was structured was simply too complex for a real understanding of how the security functioned or to predict effectively how well it work:

As time went on the market for these new securities became increasingly esoteric. Derivatives such as collateralized debt obligations, or CDOs, were particularly attractive... Evaluating the risk of such instruments was difficult if not impossible; yet investors took comfort in the high ratings given by analysts at the ratings agencies, who presumably were in the know. To further allay any worries, investors could even buy insurance on these securities (Zandi 2009:251).

The complex structures of securities made it difficult to effectively assess the totality of the risk taken on by lenders, and investors would often only be able to rely on the rating agencies for their opinion of how well the stock would perform. Now, it is true that the lenders were not completely responsible for the securitization of loans; much of this process falls to the responsibility of investment bankers and fund managers. That said, they are still on the lending side of the relationship, and those who actually do the lending—the lenders—are the ones who provide the initial loans that begin the cycle of securitization.

Criticism of the derivative market and the securitization of high-risk loans did not come only after the collapse of the subprime market. There were those, like the famous investor and often-sought investing ‘guru’ Warren Buffet, who were skeptical of the new structure even before the major collapse took place. In the 2003 Berkshire Hathaway Annual Report Letter to Investors, Buffet warned: “The derivatives genie is now well out of the bottle, and these instruments will almost certainly multiply in variety and number
until some event makes their toxicity clear… [D]erivatives are financial weapons of mass
destruction, carrying dangers that, while now latent, are potentially lethal” (Berkshire
Hathaway 2002:16). Six years later in the 2008 annual report, after the collapse of the
market, Buffet wrote:

Lenders happily made loans that borrowers couldn’t repay out of their incomes,
and borrowers just as happily signed up to meet those payments. Both parties
counted on “house-price appreciation” to make this otherwise impossible
arrangement work. It was Scarlett O’Hara all over again: “I’ll think about it
tomorrow.” The consequences of this behavior are now reverberating through
every corner of our economy (Berkshire Hathaway 2008:11).

The mistrust Buffet had toward these new investing mechanisms turned out to be well
founded as the collapse proved.

How were these securities and loans structured so that the stream of money kept
constantly flowing? In the introductory chapter, it was discussed that securitization is
essentially the process in which the money that funds loans is separated from the
originator of the loan or the lender. The loans are ‘pooled’ with other loans into the form
of bonds, or trusts that are bought by other groups of investors (Immergluck 2009). This
process is also called ‘vertical disintegration’, and essentially means that the lender is no
longer tied to the loan, except by origination (Jacobides 2005). These loans are pooled
into what are called residential mortgage-backed securities (RMBS) in which different
levels of investors, from those seeking high-risk, high-yield to low-risk, low-yield can
invest in the security. To further separate risk to investors, securities could be organized
into “Collateralized Mortgage Obligations” (CMO), which is essentially a more complex
form of RMBS that further divides up the loans into ‘tranches’—or risk layers—for
different types of investors and which are given ratings from AAA to B by rating
CHAPTER 7
INTEREST-BEARING CAPITAL AND EXPLOITATION IN THE SUBPRIME INDUSTRY

The Subprime Lender and Borrower Relationship from the Marxist Exploitative Viewpoint

The purpose of this section is to examine the dimensions in which the subprime lender-borrower relationship might or might not fit Marx’s conception of exploitation. To begin, I will briefly discuss the general lender-borrower relationship outside of the particular characteristics of subprime lending. After having established how the lender-borrower relationship may parallel the exploitative relationship of the capitalist-laborer, I argue that from a Marxist point of view, the subprime lender-borrower relationship is more egregiously exploitative than traditional mortgage lender-borrower relationships.

While the subprime lender-borrower relationship differs from the capitalist-laborer relationship in Capital, in a number of ways the subprime relationship speaks to Marx’s concerns about capitalism.

Marx charged capitalism as inherently exploitative. Its very nature necessitates the exploitation of the workers by the bourgeois capitalist classes in order to extract surplus value and hence profit, some of which is to be turned into additional capital that is spent to keep this process in motion. By Marx’s definition, exploitation occurs whenever one group, controlling the means of production, benefitted from another group’s lack of access. This group lacking access to the means of production is
agencies based on risk involved. Freddie Mac introduced this form of security in 1983 (Goodman et al. 2008:89; Immergluck 2009:36).

More recent innovations in security structure include the ‘Collateralized Debt Obligation’ (CDO). The CDO essentially added another layer of investors, and thus security, between the lowest tranches—highest risk—of RMBS. What the CDO accomplished is making room for those investors who are willing to take on greater risk in the interest of making even more money off of the investment into the security, because the CDO pools a greater number of higher risk loans in order to increase the chances that they will yield higher return (Immergluck 2009:95-96). Figure 1, taken from Immergluck (2009:97), demonstrates a simplified version of the CDO structure.

Figure 1. Highly Structured Mortgage Finance (Immergluck 2009:96)
This figure serves to demonstrate the complex structure that securitization mechanisms can take. At the beginning of the loan process, borrowers take out loans from lenders. These loans, numbering in the thousands, are pooled into ‘special purpose vehicles’ by investment banks with which the lender works. The loans are then divided into bonds organized into tranches with AAA, AA, BBB, B or Residual ratings. Those with bonds with high enough ratings, meaning generally lower risk, are sold right to the investors. However, those bonds with lower ratings are pooled with other loans into CDO trusts and bonds, the goal being that with a large enough number of mortgages, even the lower rated ones will yield profits for investors (Immergluck 2009:95-96). The result of the structure is a steady flow of capital from borrowers to investors through such a complex and multifaceted pool that the origins of the money, and the risk associated with the investment, are difficult to trace.

All of these innovations were fueled by what some call the ‘virtuous cycle’ (Goodman et al. 2008:299-300; Immergluck 2009:92). The belief that home prices would continuously rise is widely cited as being a fundamental flaw in the mentality of lenders that is attributable for the subprime crisis (Andrews 2009; Bitner 2008; Immergluck 2009; Michaelson 2009; Zandi 2009). This belief spurred the continued innovation by lenders to come up with products that could make buying a home more affordable despite the continued increasing in home prices. As this purchasing power increases, it drives home prices up, thus decreasing affordability, in turn increasing the desire for lenders to innovate new products, starting the cycle once again. This cycle of increased prices, lower affordability and greater lender innovation is what is referred to as the ‘virtuous cycle’ (Immergluck 2009:92-93).
‘The externalizations of the relations of capital’ that concerned Marx are thus realized in this process of securitization (Marx [1894] 1967:391). The borrowers are on one end of the cycle. By taking out a loan, they fill the wallets of investors who are on the other end of cycle, separated by layers and layers of investment mechanisms of bonds, trusts and pools. The flow of capital between them is designed to be constant. As Immergluck (2009:122) points out, with these complex structures, servicing the loan is no longer a matter concerning only the borrower and the lender. Because the loans are divided into tranches, and the exact cash flow of each loan becomes more difficult to follow, there are more rules and regulations that need to be followed in order to ensure that no one tranche benefits at the cost of another. To do otherwise could instigate ‘interparty litigation’ amongst the various investors (Immergluck 2009:122).

To apply the Marxian cycle to this model, the money loaned to the borrowers is M, and at the end of the model, the profits realized by investors is M', the interest paid back to the lenders by the borrowers. Capital becomes the ‘self-creating source of interest’ through the process of securitization. The creation of a diffuse route through which capital flows makes it more difficult to trace and more difficult to assess the risk involved with the lent money. Through pooling thousands of loans, what lenders are able to, or try to do, is maximize the M' with the lowest possible risk.

The complex structure of subprime mortgage-backed securities allowed the risk to be spread widely enough so that no one investor was subject to too much risk, thus the incentive for caution was decreased. This engineered decrease in risk is what allowed these models to function for a time. The risk of a defaulted loan was made much less
hazardous because loans were grouped in such a large pools that a single default was like a drop in a pond.

Subprime Risk

The risk of a loan entails the likelihood that the loan will be able to be paid off; the lower the risk, the more likely the loan will be repaid. There are several characteristics of subprime loans, mentioned in the first chapter, that bear relevance to the increased risk inherent in this market. These factors include collateral, capacity, character and credit (Bitner 2008:76). Collateral is the property that is used as security against the loan, capacity is the borrower’s ability to pay the mortgage, character is based on whether the lender actually believes that the borrower will pay the money back and credit is the statistical history of the borrower’s payments (Bitner 2008:76-77). With loans of higher risk one will more typically see: low or no documentation of assets or income, higher debt-to-income ratios, higher loan-to-value and combined loan-to-value ratios and lower credit scores for borrowers (Goodman et al. 2008:9-18; Immergluck 2009). These higher risk borrowers represented an untapped consumer base as well as an impetus for more innovative financial engineering.

The growth of high-risk lending yielded more adjustable-rate mortgages (ARMs), loans with increasing prepayment penalties, negative amortization loans, and very low to zero down payment loans (Immergluck 2009:84-92). However, as evidence emerges after the fact, we are finding that the risk assessment models used were not up to par. For example, the FDIC reviewed a set of 24 CDOs and found that for nine of them, none of the credit rating agencies provided a public presale report on their risk level, and for only three of the twenty-four did agencies provide ‘robust’ performance data (Immergluck
2009:112). This lack of information is indicative of the underassessment of the risk involved in the subprime market and of the fact that the actual risk was not clear to investors.

Immergluck (2009) makes a compelling case out of the story of New Century Financial, a lending company that continued to take on high-risk loans despite the increasing foreclosure rate. From January 2004 to January 2007, the early payment default rate climbed from just over six percent to almost seventeen percent at the same time as the number of stated-income (no documentation) loans grew from about 43 percent to forty-seven percent and 80/20 loans (an eighty percent down first mortgage with a twenty percent down second mortgage) increased from under ten percent to over thirty-five percent in 2006 (Immergluck 2009: 128-132). So compelling was the short-term profit garnered from these larger risks that New Century maintained their high risk lending practices until 2006, when the rates of loan defaults and foreclosures overwhelmed and destroyed even short-term profitability.11

Through dividing risk into different pools, securitization provides a way to allay the fears of investors and encourage them to buy into bonds and trusts of what would normally be considered high-risk loans, but that through risk layering, promise only solid, constant returns. From the Marxian concern with interest-bearing capital, this creates a problem of a reified capital flow structure. No one has to worry about from where capital flows, because the system is built on aggregates so that it can handle a large number of failures, and still not be affected too severely.

11 Interestingly, from 2002-2005, the principals at New Century began to exercise their stock options and the three founders made more than $40 million in profits from doing so (Creswell and Bajaj 2007).
Goodman et al. (2008) presented a nuanced view about the blame being placed on risk securitization. Their argument is that the claims leveled against securitization that criticize the practice for separating too much the borrower and the lender, thus taking away direct risk for the lender, are overstated and somewhat exaggerated. In reality, the lender still faced 'institutional risk' because if their loans continued to fail and cost investors money, no one would want to buy from that lender (Goodman et al. 2008:314).

At the same time however, securitization allowed for complex structures like CDOs to exist and loans would not have been priced so aggressively low. Securitization let the industry expand further than it probably could have in its absence (Goodman et al. 2008:315).

The criticisms leveled against securitization argue that the system created through the process is too convoluted and complex to maintain and monitor. The ‘excess spread/overcollaterization’ model that spreads the risk throughout tranches and layers, makes it difficult to follow the flow of cash as well as forecast potential losses a mortgage-backed security might endure (Goodman et al. 2008:316). These concerns regarding the underestimation of risk, and the overextension of enterprise are not only found in contemporary cases. The following passage clearly demonstrates how concerns today with what the subprime mortgage fiasco has wrought are eerily similar to the criticisms Marx made:

And in most cases these basic enterprises were already overburdened. The enticingly high profits had led to far more extensive operations than justified by the available liquid resources. Yet there was credit—easy to obtain and cheap. The bank discount rate stood low... The Bank of England had an unheard-of supply of gold in its vaults. All inland quotations were higher than ever before. Why then allow this splendid opportunity to escape? Why not go in for all one was worth? Why not send all one could manufacture to foreign markets which
pined for English goods? And why should not the manufacturer himself pocket the double gain arising from selling yarn and fabrics in the Far East, and the return cargo in England? ...[This] soon developed into a system of consignments purely for the sake of getting advances...which led inevitably to overflooding the markets and a crash (Marx [1894] 1967:407).

The question of “why not?” seems to be the guiding philosophy behind the system of financial innovations that brought the subprime market system to life. Here too, one finds that Marx saw this question as motivation for innovation and extension of economic ambition. Just as enterprising financiers of the mid nineteenth century speculated on building railroads and opening new avenues for trade and commerce, innovative financial engineers of today seek to create new loan structures that will allow them to reach a previously untapped consumer base.

In the passage quoted above, Marx pointed out the overextension of projects without the liquid resources available to back this up—the overextension of credit and the underestimation of risk involved. The parallels to the modern situation are uncanny. Just as companies like New Century Financial continued to partake in high-risk loans despite the increasing rates of default, Marx saw the speculation involved with the building of railways in the 1840s as a problematic practice economically and socially (Marx [1894] 1967:407).

Conclusion

This chapter has demonstrated that Marxian concerns are not absent in modern economic activity. However, this is not to state that those who make criticisms of the subprime mortgage industry or subprime lenders embrace any sort of Marxian thought. Many of the authors would probably balk at such an idea. Rather what this demonstrates
is that there is a good deal in common between criticism aimed at the subprime industry and the classic concepts of Marxian thought as far as the concerns for the social impact of economic activities are concerned.

The concerns Marx demonstrated in his time were aimed more towards the industrial capitalist, especially concerning exploitation. However, in the third volume of *Capital* we saw how Marx critically characterized systems of banking and interest-bearing capital. Although his concerns about exploitation were focused on the relationship between the industrial capitalist and the laborer, the characteristics of the relationship can be found between the borrower and lender in the subprime market. The imbalance of access to capital as well as knowledge of the loan structure and market rules have constructed a relationship that is arranged for one party to benefit much more than the other. It is a situation of exploitation because the borrower, having no other means to afford a home, and with a particular credit history, is forced into a niche market system in which the characteristics of their loan are considerably costlier, and riskier, in relation to the traditional loan structure.

The structure of securitization, whether or not it is actually viable, is designed so the flow of profits runs smoothly and fairly constantly. The risk is spread through layers of trusts, bonds and investors in order that disturbances such as defaults and foreclosures do not put the system into disequilibrium. Through this complex securitization and layering process an economic system is set up to run automatically—capital begets capital. It is the ultimate externalization of capitalist relations—the lending capitalist’s activity is minimized in relation to the industrial capitalist. All the lending must do is get someone to sign a loan for something he or she already wants, a home. The Marxian
concepts of capitalist exploitation and reified financial trade did not die in the post-industrial age, they are alive and well, and are exemplified in practices such as subprime lending.
CHAPTER 8

CONCLUSION

Rereading the classic works of Weber, Durkheim and Marx in a contemporary context elucidates the relevance of these theorists to issues today, demonstrates that the theorists' concerns for society were not radically dissimilar, as well as reveals the sociologically problematic nature of the socio-economic activity of subprime mortgage lending. These are the three broad arguments I wished to put forth in this thesis and have defended throughout. In returning to the classics, one develops an appreciation for the truly remarkable insights these theorists were able to put forth in their time. Even after finding flaws in Marx's mathematics in his economic theory, the seeming lack of historical evidence in Weber's *Protestant Ethic and the Spirit of Capitalism*, or the nature of Durkheim's moralistic and political claims on how society ought to function, it cannot be denied that each of these theorists have offered invaluable paradigms for analyzing the social world. The theories of Marx, Weber and Durkheim can be put to effective use in analyzing contemporary contexts and are worth revisiting.

Relevance to Contemporary Society

That economic practices have changed due to innovation from the time of Marx and forward is obvious. The U.S. economy has moved beyond the industrial age about which Marx opined. Yet, the problematic nature of capitalism for Marx was not that it was industrial, but that it was exploitative. The industrial nature was incidental and
provided an example of the exploitative relationship between the capitalist and the laborer, but by no means was the only embodiment of exploitation. Following Marx’s critical view of capitalism as an exploitative economic system in general, we would expect to see such a problematic relationship in the capitalist practices of today. I have argued that the subprime mortgage industry provides such an example of classic Marxian exploitation.

Marx can perhaps be described as even prescient in his analysis of interest-bearing capital. His worry was that interest-bearing capital represents the most reified form of capitalist enterprise. It takes on a life of its own and is beyond the control of human actors. This anxiety bears remarkable similarity to the question asked by many in politics and the news media today, “Can we allow institutions to become ‘too big to fail’?” The phrase ‘too big to fail’ entails this same notion of a reified system that stands over and against its creators. It would probably not be well received to call anyone who asks this a Marxist, yet similar capitalistic practices and characteristics that deeply troubled Marx in the nineteenth century are troubling today.

Durkheim too offered strong criticism of capitalist economic actors that is still found in the public mind. Durkheim argued that ethics in the economic and business professions were absent. We find this argument to be commonplace today. The most extreme examples of the lack of professional ethics can be found in cases of Enron, Tyco, Arthur Andersen, Bernie Madoff, and Countrywide’s Angelo Mozilo (whose case, it should be noted, is still pending). These actors and institutions provide modern day examples of the same lacuna of ethics in business and economics that Durkheim saw in his time. They have been branded as case studies in greed and unscrupulous business
activity. Their actions resemble what Durkheim described as indicative the anomie-generative nature of the economic sphere of society. Each sought continual expansion of their business beyond the scope of what was attainable and sustainable. As a result, their businesses imploded, taking with it consumer confidence in the market as well as citizen confidence in the regulatory agencies' abilities to function effectively. The concerns voiced today about business ethics are essentially the same that Durkheim voiced near the beginning of the twentieth century.

So too, are the concepts from Weber relatable to this contemporary case. Weber's conceptions of rationality have had significant impact on the study of bureaucracy and institutions. I have demonstrated here that his conception of capitalist attitudes is in fact present in lenders' and regulators' accounts. Indeed, lenders have used the vocational reasoning as a form of rationalization—and justification—for their actions. Citing their thinking as being due to a commitment to the ideal of helping people with homeownership, and making a business and career out of doing so, is indicative of the vocational outlook as described by Weber. At the same time, such appeals made by lenders strike a somewhat emotional and passionate chord as they explain that their actions were intended to help potential homeowners achieve their dream. It is this devotion to the capitalist ethos that informs lenders to take actions along the wertrational form of action and that causes them to disregard or change significantly the formal rules that had been established for lending out of what Weber would call the formal rationality of lending. The consequences are unforeseen for all parties: borrowers lose their homes and lenders are put out of business. The paradoxe der folgen thus results from competing rationalities in contemporary society just as Weber argued. Regardless of the
era, social actors will rationalize their actions in some form, whether it be based on ultimate values, utility of the action, or even an emotional drive, and in many cases will rationalize in more than one way, sometimes inconsistently and with significant consequences.

**Similar Critical Outlooks**

The second major objective I started with is to demonstrate that the theorists did in fact share some critical outlooks regarding Western capitalist society. What motivated each theorist to be critical may have differed, but each had deep concerns about the direction in which his society was headed. Although it would probably not be widely accepted to call all three of these authors “critical theorists”, each at times wrote quite critically.

The famous “Iron Cage” from Weber provides such an example of the critical commentary in his work about the rationalization and the predominant place of work in people’s lives. Indeed, Weber was worried that the emphasis placed on work and the role it plays in people’s lives would overshadow other places from which people could draw meaning for themselves. Although humans had created their occupations and jobs, Weber saw that people influenced by the capitalist ethos started existing only to work. It was their prime directive. What seemed to worry Weber most in *The Protestant Ethic and the Spirit of Capitalism* was that the high valuation of work would lead to a devaluation of everyday life. Weber was concerned, and critical, of this tendency he saw as progressing through the development of Western capitalism.

Durkheim, in parts of *Suicide*, but especially in *Professional Ethics and Civic*
Morals, is markedly critical of the economic professions. He viewed the economic sphere as absolutely lacking in self-regulation through a set of professional standards, but Durkheim also argued that the governmental sphere allows the economic to function without effective regulation. Durkheim saw grave consequences of such tendencies. Anomie, both at the individual and societal level, can be traced in Durkheim's work to the breakdown of regulation in the economic sector of society. Anomie is a concept that may have undergone conceptual changes throughout the works of Durkheim, but in places Durkheim applied it critically in his examination of society.

Marx, out of the three theorists here, is probably best known for being critical. His critiques hardly need to be restated. Marx saw capitalism as an economic system to be abolished, a view that goes much further than either Weber or Durkheim. Marx saw capitalism as inherently exploitative and alienating. The harmful effects of capitalism were not solely applicable to the exploited classes however. For the capitalists too, Marx argued capitalism was detrimental. For both capitalists and the proletariat, the system of capitalism prevents human potential from being realized. Both being trapped by in capitalist relations, neither the capitalists nor the proletariat can realize their own potential until the shackles of capitalism are shed permanently. Declaring capitalism an economic and social system that must be, and will eventually be, overthrown, Marx maintained a critical attitude toward capitalist practices.

Though the reasoning and approaches of Marx, Weber and Durkheim differed in regard to why and how they were critical, each presented some critical conceptions in their work that they saw as being problematic consequences of capitalism. The subprime mortgage industry is, or was, a facet of capitalism in the United States. It stands to
reason then that the criticisms put forth by Marx, Weber and Durkheim will also be applicable to the subprime mortgages.

The Subprime Mortgage Industry as Socially Problematic

The third objective of this thesis was to demonstrate that the subprime mortgage industry was sociologically problematic using the concepts from classic theory. For Marx it was not the failure or potential failure of capitalist practices, like the subprime mortgage failure, which make them harmful. Workers and the proletariat are subject to exploitative relationships even when capitalist enterprise carries on 'as it should'. Successful capitalist enterprise, even more than failed enterprises like subprime lending firms, are subject to even greater reification because successful business practices encourage entrepreneurs and executives to keep using the same tactics and practices. Investors will bolster and expand as much as possible a system that effectively guarantees its investors’ capital and profit. Business practices are encouraged that increase investors’ revenue, and successful business practices are those that can attract and keep new clientele. In the case of subprime lending, it was the lenders, as representatives of investors, who innovated and changed the nature of the business to attract a new type of customer, one who would not qualify for traditional prime loans. The relations of capital become even more externalized in the case of the subprime loans when subprime lenders effectively apply their complex business model to an increasing number of consumers.

What prompts this desire for innovation and expansion that leads to reification and further externalization of relations? Following Weber, it would be the very spirit of capitalism and the vocational outlook upon which it is built. As I have argued in Chapter
3, innovation can be seen as a product of the substantial rationalization of capitalist business practices. If an actor views free capitalist enterprise as an ultimate value, then that actor’s actions will be in that spirit of capitalist enterprise. In working toward this value, actors may innovate, taking any means available to them in order that their actions embody this value. Such is the *wertrational* form of action. I have argued lenders’ actions in innovating new risk models and loan structures seemed to act out of such a rationality of ultimate value. The consequence of acting out of ultimate values, as Weber pointed out, is that the actions themselves become secondary considerations as merely steppingstones toward fulfilling *wertrational* action. As a result, forms of rationality may intersect and conflict, leading to unexpected results as we saw in the subprime industry.

In acting out of an action of ultimate values, is it possible that lenders lost sight of other possible consequences of their actions? Was self-regulation lacking? Following Durkheim’s concerns with the business and economic professionals of his time, it would seem that his concerns are very much relevant to business practices of today. In some cases, lenders deliberately misled borrowers or at other times ‘massaged’ the borrower’s credit ratings in order to qualify the borrower for the loan. These practices demonstrate a clear lack of professional ethics, the kind of which prompted Durkheim in his lectures in *Professional Ethics and Civic Morals*. Acting while solely considering the ends one tries to attain without regard for what the consequences of actions might be can lead down this path about which Durkheim was worried, with unexpected results.

One of the unexpected consequences of lenders trying to take action embodying the ultimate value of free capitalist enterprise was the default and foreclosure of an inordinate amount of subprime loans and the subsequent bankruptcy or failure of many
lending businesses. What social effects might this have? As Durkheim pointed out, structural and economic anomie were central problems for societies with high divisions of labor and in which the economy expands at a rapid pace and is prone to crises of growth and decay. Wanting to live beyond one’s means is the origin of economic anomie. Durkheim expanded this to the whole economic sector of society, in which businesspeople want to continue to expand their revenue and consumer base beyond what is actually sustainable. There is a connection that emerges between all three theorists. The reification of capitalist systems encourages further innovation bolstered by the spirit of capitalism, and this innovation changes processes of formal rationalization with possible unintended and unexpected consequences such as anomie.

**Conclusion**

I have not set out to catalog the mistakes made in subprime lending, nor do I claim to be able to point out to any one cause of the economic crises. In fact, the subprime industry was only a part of recent American economic woes, albeit a significant part. However, when the industry suffers a meltdown like the one subprime mortgage lenders did, discussion of errors in lending practices is unavoidable. There are in fact, more parties involved that merit further research that might reveal different aspects of the subprime industry. Some of these types of actors include brokers, investment bankers and real-estate appraisers. These actors all also had a hand in subprime transactions in different capacities than lenders with much different interaction, if any, with the borrowers.

The role of government regulation is another major aspect of lending that
warrants its own study, outside the scope of this thesis. The actions, or inactions, of
regulators raise many questions about governmental tolerance for what seems like
economic recklessness and the effectiveness of federal regulatory agencies, some of
which had not raised any concerns about the sustainability of subprime mortgages prior
to the collapse of the industry.

Instead, I have attempted to shed light on the social phenomenon of subprime
lending using classic sociological theory. I have explored in several instances the idea of
homeownership as being part of the "American Dream." Subprime lending was intended
as a means to enable a larger number of people to realize this ideal. Yet the practice
proved to be unsustainable over a longer period of time at the rate of expansion sought by
lenders. However, I have argued, it is not just the collapse that was problematic. Even
when subprime lending showed no signs of failure, there were problems such as
deceptive or deliberately confusing loan terms, increasingly complex and abstract
securitization structures and cash flows, and little to no regulation of lender actions.

When the cost of failure amounts in the hundreds of billions of dollars and adds to
a chain reaction of collapses and federal takeovers that cost citizens further, the need for
cautions is paramount. In the pursuit of free capitalist enterprise, it seems all too easy to
lose caution and self-restraint. Innovations, such as subprime lending, must be checked
to see if they are both economically viable and socially beneficial. The cost of failed
industries is increasing as the effects of one failed industry spill over into others, as we
are now seeing in banking and automotive industries. The social content of economic
activities and relationships cannot be ignored. Any major occurrence in the economic life
of a society will undoubtedly entail social consequences for its members.
REFERENCES


