A Weberian Account of Social Norms and Trust in Financial Markets

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

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

Preface
Whether acceptance of the norms, which govern financial transactions in modern capitalism, implies a calculation of the costs and benefits that result from conformity to them or their violation, or their open or inner endorsement, has been debated. This article sets out to reconstruct Weber’s account of how norms are enforced, and trust maintained, in the London Stock Exchange of his time, which he considered exemplary for its organizational effectiveness and incorporation of the capitalist ethos. The essay will provide in its introduction a brief description of the sociological literature concerning financial markets, with reference to their structure and ability to control opportunistic behavior. The first part of the essay will consider how rational choice
theory and Parsonian functionalism have accounted for the existence of social norms and trust, and the extent to which these theoretical perspectives are compatible with Weber’s notions of rational action and social norms. The second part will investigate how, according to Weber, social norms and trust were upheld and preserved in the London Stock Exchange at the turn of the nineteenth century. Finally, Weber’s account will be discussed against the background provided by structural and cultural perspectives bearing on financial markets.

Introduction

A sociological description of financial markets

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

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

social relations in order to prevent and control ‘networks of malfeasance’ (Granovetter 1985: 490-93; see also Granovetter 1994: 466-68; Granovetter and Swedberg 1992: 9-13).

Financial markets have been the object of particular interest. Participants in financial markets may trade as brokers, who are members of the local stock exchange. Brokers conduct buying and selling on the behalf of investors, but never for their own accounts. In the London Stock Exchange, stock brokers are regulated by the Financial Services Authority. Alternatively, participants may trade as market makers, also known as ‘traders’ or, in the London Stock Exchange, ‘jobbers’, as they used to be called before the introduction of the Electronic Trading and Automated Quotation Systems in 1986. Market makers deal with brokers, provide for a commission up-to-date information on bids and offers to the public, and also trade as principals for their own accounts. In the United States, market makers dealing with stocks are called ‘specialists’. Finally, participants in financial markets may conduct transactions among themselves as agents of financial institutions, such as investment banks or brokerage firms. In this case, transactions — for instance, foreign exchange trading — are not located and organized in centralized exchanges, but may take place anywhere as traders avail themselves of electronic technology which makes stock brokers and market makers dispensable. This new technology has been instrumental in extending and intensifying international communication among traders and financial institutions (Swedberg 1990: 278-79).

Many sociologists would probably at least partly concur with George Soros, a leading operator in and expert on financial markets, that financial markets are inherently unstable, for participants act on the basis of their best interest as they perceive it, rather than as it actually is. This perception influences ‘not only [financial] market prices but also the so-called fundamentals that market prices are supposed to reflect… Boom and bust sequences that are characteristic of financial markets’ follow as a consequence (Soros 2003: 5). In these markets, however, prices obtain not only volatility but also stability, depending on the conditions on which theoretically guided research has shed light. Research on the structural (network) conditions conducive to steady, stable and smooth transactions has concerned transactions involving professional participants in financial markets in which securities, bonds and derivatives (such as futures or options contracts) are traded.
If financial markets are conceived as networks, network size (as measured by the total number of interactions among aggregates of buyers and sellers) and differentiation (as measured by the occurrence of two or more cliques in the network) are inversely correlated with the clique density and stability of stock prices. Clique density promotes coordination between participants in financial markets. As a consequence, there is less competition among them and less risky trading. Greater price stability follows from clique density, and therefore from the network’s small size and lack of differentiation (Baker 1984). A comparative investigation of different financial markets has supported this conclusion, but a cultural vision of these markets, which emphasizes the symbolic significance actors attribute to monetary exchanges, has supplemented it (Mizruchi and Brewster 1994: 270-71; Zelizer 1988: 623-28). The study of norms concerning proper market conduct may be pursued within this cultural framework. In fact, research on financial markets has included both a structural and a cultural approach.

Opportunistic conduct on the part of traders is encouraged in markets, such as bond trading in the 1980s, in which substantial financial gains are available in the relative absence of personal knowledge, stable relations, and informal, formal and institutional controls. In contrast, in the futures market a number of social mechanisms are instrumental to coordinate collective action, and thereby restrain opportunism. Informal norms of fair trade and organizational arrangements make reciprocal control effective, as their violations would involve exclusion from transactions. Such informal norms rest on ‘dense webs of trust, obligation, and reputation’ (Abolafia 1996: 37). Moreover, stock exchange committees in charge of surveillance on the members’ business conduct make ‘self-regulation’ possible by exerting formal control, while boards in charge of establishing and interpreting exchange rules are entrusted with institutional controls (Abolafia 1996: 38-63). In still another financial market, foreign exchange trading, control is exerted informally without such committees and boards. Traders abide by a code of honor that forbids opportunistic conducts in their mutual relationships. Violation of its norms would cause, at least in the long run, interruption of relations and loss of reputation (Knorr and Bruegger 2002: 936-39). In addition to trading, dealers exchange information. Personal knowledge between them strengthens ‘relationships of familiarity and trust’ in their business conducts. As a consequence, ‘rules of trust, exclusivity, and loyalty’
are formed and enforced (Knorr and Bruegger 2002: 942; see also MacKenzie, Milo 2003:139-41).

From an examination of the sociological literature on markets, with particular reference to financial markets, the following conclusions may be drawn. First, personal relations constitute an important but not sufficient condition for trustworthy behavior in economic relationships. The existence of small networks of dense, stable, and pervasive relations, such as those that obtain in cliques, is a further important condition, for these networks make the actors’ reciprocal informal control possible and easy to perform. Finally, in financial markets formal and institutional controls are necessary to curb and sanction malfeasance. Effective controls are a prerequisite to the steady, stable and smooth flow of transactions in these markets.

1. Rational action and social norms

1.1 Rational choice theory and the problem of trust
It has been remarked in this connection that ‘definitions of rational choice vary enormously in breath’ (Heckathorn 2001: 274). A set of postulates or axioms describe ‘thin’ rational action theory, as Boudon calls it. They are: methodological individualism; the possibility of understanding action; the existence of reasons in the mind of the actors as causes of their action; the actors’ consideration of the consequences to themselves of their own actions as producing their reasons for acting; finally, their selection of the course of action that has the most favorable balance of costs and benefits. Rational choice theory, so conceived, cannot however — according to Boudon, Elster, and other authors — account for phenomena involving non-commonplace beliefs, or for normative beliefs that cannot be explained in light of the consequences for the actors, or finally for behavior, the consequences of which do not affect them at all. A broader or ‘thick’ notion of rationality is therefore advocated (Boudon 2003). This conception of rationality, which may be related to Weber’s value or axiological rationality, keeps in consideration those reasons, which actors subjectively consider sufficiently strong for behaving as they in fact do.

Even though they make little or no reference to Weber, both ‘thin’ and ‘thick’ formulations of rational choice theory — as formulated, respectively, by Coleman, or Boudon and Elster — are relevant for a Weberian theory of institutionalized trust in the modern stock exchanges. Coleman, a leading name among the representatives of rational choice theory, considers social norms as bearing, in particular,
on trust relations in financial transactions. As he writes, ‘A norm concerning a specific action exists when the socially defined right to control the action is held not by the actor but by others’. This control is exerted by ‘sanctions or threat of sanctions’, which affect the individuals’ utilities, and therefore actions (Coleman 1990a: 243-44). In trust relations, a potential trustor has decided to place trust in a potential trustee in the expectation to gain utility after the transaction has been completed. The trustor, therefore, expects the trustee to be trustworthy (Coleman 1990a: 96-104).

In financial transactions, as in other transactions, there are intermediaries in trust relations. Intermediaries, whether persons or organizations, may be described as advisors, guarantors, and entrepreneurs. All such intermediary activities may be found in merchant banking. The trustor lays trust in the advisors’ judgement or credibility, and the latter trusts the performance capability of the trustee, if they think doing so would benefit them, given the available alternatives. The performance capability of the trustees may be trusted, directly or indirectly, by a dense community of actors, each of whom trusts the other’s judgement. Trustees, in this case, are placed at the center of the communication structure. Unlike the advisor, the guarantor experiences losses in resources (not just credibility) if the trustee proves untrustworthy, and therefore needs accurate information on potential trustees. Entrepreneurs as intermediaries combine at their own risk their trustors’ resources, often placed in the hands of third parties, to obtain a benefit for themselves and their trustors as well (Coleman 1990a: 180-88).

Whenever there are intermediaries in trust relations, trust may be conferred and withdrawn at any time. The potential for social action on the part of the trustees is accordingly unstable (Coleman 1990a: 196). In their position of intermediaries, trustees must be connected with every one of their trustors in order to receive benefits or sanctions from them. As providing sanctions is costly (in monetary terms or otherwise), it raises the question of who will cover these costs for the common good of all those who have incurred in losses because of the trustee’s activities (Coleman 1990a: 270-78). The closure of the network, ‘the existence of relations between those who experience externalities [consequences] from another’s action’, supplies a solution to this second-order free-rider problem, ‘due to the benefits that each of those who experience externalities of the actor’s action receive from one another’ (Coleman 1990a: 278). Network closure, therefore,
stabilizes trust relations among trustors (Coleman 1990a: 275-76, 318-20; see also 1990b).

According to Coleman’s version of rational choice theory, cooperation among actors results from the cooperators’ rationally pursued personal interest. More in general, ‘people, by individually rational action, bring about an outcome that is good for all, or at least not bad for all’ (Elster 1983: 29). Opportunism would then provide the ‘cement of society’ (Elster 1989c). Elster disagrees. As he remarks, opportunism leaves conduct undetermined, for there can be a number of equally rational and therefore equally preferable choices (Elster 1986: 17-20). Also, actors may seek to restrict their own freedom of choice in a variety of possible ways (such as avoiding knowledge, imposing costs or delays to their decisions, eliminating options, and so on) with the purpose of protecting themselves against ‘passion, preference change, and…time-inconsistency’ (Elster 2000b: 1).

What is more, cooperation implies trust, and therefore the partners’ mutual credibility, which threats and promises may not suffice to maintain. Mutual credibility involves therefore the existence of social norms. True, norms are not always advantageous to all, or even most, actors involved. Further, at least some of the actors do not, in fact, even follow norms that would be actually beneficial to everyone (Elster 1986: 23-24). When this is the case, one assumption of individual rationality—of ‘consistency between beliefs and desires on the one hand and the action for which they are reason’ on the other (Elster 1983: 1; see also 1986: 12-16; 1989b: 3-4)—does not hold (Elster 1986: 20-22). Finally, the fact that norms are beneficial does not per se account for their existence, as Merton (1957) pointed out long ago and Elster (Elster 1984: 28-35) has reiterated. To ascertain why norms or other social events exist, the relevant causal connections must be specified (Elster 1989a: 3-10).

Yet—as evidenced by ‘the presence of norms of cooperation’, whose origin in individuals is apparently non-selfish—norms may ‘exercise an independent power, not reducible to adjustment costs’ (Elster 1986: 24, 132-33). Norms of cooperation ‘on the whole, are immensely beneficial’ in that they ‘have useful consequences for other people, at least under most circumstances’ (Elster 1989a: 117). Generally speaking, norms of social honesty, as embodied in codes of honor, promote credibility when accompanied by the absence of opportunism, in the sense of ruthless pursuit of personal interest. Codes of honor endorse norms which involve reciprocating the other
Credibility and trust may be sustained if the actors act cooperatively. Within the theoretical framework provided by game theory, which is entirely compatible with rational choice theory, a particular cooperative game called ‘assurance game’ is especially relevant here. (On assurance games, see Elster 1984: 20-22, 146; Heckathorn 1996: 259; see also 2001: 276-78.) ‘Games’, in the language of game theory, are sets of mutual rule-regulated strategic (reward-seeking) relations, in which participants have alternative choices of conduct and receive different rewards, or payoffs, according to which alternative they select. While many games are non-cooperative, as pursuing individual preferences do not lead to collectively rational outcomes, assurance games are cooperative, for no participant would benefit otherwise, and obtaining the public good is premised on the collaboration of everybody. Coordination of preferences and perfect information are necessary for collaboration to obtain. To this end, everyone must also cooperate with everyone else. Finally, everyone expects that everyone else is likewise fully informed, and willing to cooperate with all other participants. This set of requirements may be met if participants form ‘a small and stable group’ (Elster 1984: 146). Though Elster objects to ‘thin’ rational choice theory, he then concurs with Coleman that network closure stabilizes trust relations.

In assurance games, opportunistic conducts would then be irrational collectively and individually, as they would not be conducive to the public good, and would provide no benefit to any individual participant. Norms prescribing or encouraging participation may then be necessary to prevent ‘a downward spiral of participation’ (Heckathorn 1996: 259), for effective norms — whether self-imposed or imposed by some external authority — would make non-participation more costly to potential participants (Elster 2000b: 1). From the vantage point of ‘thick’ rational choice theory, norms regulating the stock exchanges, and financial markets in general, are necessary for their long-term functioning, as long as they are conducive to assurance games that would benefit the market as an institution, and all the individual participants. This was precisely Weber’s argument. In keeping with a ‘thick’ rational choice theory, which considers the Weberian notion of value-rational action as within its purview, and by way of recapitulation, the following statements may be made:
a. social norms exist if others receive a right to control a given actor’s actions;
b. positive and negative sanctions support social norms;
c. the pursuit of individual benefits may not provide a satisfactory account of norm-abiding conduct;
d. in particular, norms of cooperation may be followed for their own sake, disregarding personal interest;
e. credibility and trust presuppose allegiance to norms of cooperation;
f. if there is network closure, as in small and stable groups, coordination of preferences and full information make the enforcement of norms of cooperation possible and relatively easy;
g. hence, network closure promotes credibility and trust.

1.2 Rational Choice Theory and Weberian sociology

Whether Weber’s conception of rational action and sociology of norms may be interpreted with the framework of rational choice theory depends, accordingly, on which definition has been adopted. All the authors who have dwelt on the compatibility of Weberian sociology with rational choice theory have focused primarily on the concepts of rational and social action, while norms have often been considered in conjunction with the Weberian concept of value rationality.

In this connection, James Coleman has declared that focusing on the rational or purposive action has provided him with ‘the simplest...foundation’ of social theory ‘in the tradition of Max Weber and Talcott Parsons’ (Coleman 1996: 348). Coleman’s reception of Weber has been qualified by serious reservations, however. Coleman’s criticism of The Protestant Ethic and the Spirit of Capitalism evidence the ambivalence of his intellectual debt to Max Weber. According to this criticism, Weber has failed to solve the so-called micro-macro problem, for no indication has been made of how a macro phenomenon—Protestant religious doctrine—was affected, or had been affected by, a micro phenomenon such as the individual values or norms of Protestants. Moreover, no indication has been made of how these norms and values were causally related to individual economic behavior, or how the economic behavior of individuals combined to produce a macro phenomenon such as capitalism (Coleman 1990a: 6-10). What is more, ‘Weber did not include in his theory of rational authority any feedback mechanism to provide information that might affect action’ (Coleman 1990a: 613). The appropriateness of these criticisms is questionable, as will be shown later. Weber’s contribution to rational choice theory is then limited—according to Coleman—to the

epistemological position of methodological individualism, and the related conception of individual rational action. Coleman’s own rational choice theory of the origins and effectiveness of norms bears no relationship to Weber’s intellectual legacy (Coleman 1990a; 1990b).

Jon Elster, too, has shown an ambivalent appreciation of how Weber has contributed to rational choice theory. On the one hand, Elster declares that ‘Weber’s analyses of action and rationality display a stunning depth of insight’. Elster points to what are in his mind Weber’s ‘main accomplishments’: (a) his stress on emotions, whether reducing instrumental rationality as with spontaneous emotions, or strengthening instrumental rationality, as with the case of durable emotions when made subservient to some end; (b) his analysis of how human behavior may receive guidance by conforming to general principles such as unconditional adherence to a value, or anticipation of disapproval or practical inconvenience caused by deviating from social norms; (c) his consideration of the following items. First, the influence of emotions, such as guilt and shame, on norms. Further, the stimuli or values that have produced them. Finally, the course of action typically ensuing from them.

On the other hand, however, Elster points to a number of ‘serious omissions’ on Weber’s part: (a) there are several modes of behaving rationally, rather than only one, as Weber is alleged to have maintained. This is so for a number of reasons: because actors may find too costly investigating the truth of their beliefs, and have no way of assessing the probability of occurrence of relevant events; and because rational actors try to imagine, without a secure foundation, what other actors believe to be their best conduct; (b) since there are several modes of behaving rationally, if and how much a given behavior may have been rational cannot be established by comparing that behavior with a perfectly rational one; (c) what is irrational behavior from the viewpoint of others may be rational from the point of view of the actors themselves in the light of their own goals (Elster 2000a).

Coleman’s and Elster’s strictures are of a different sort, for Coleman considers only Weber’s methodological individualism compatible with rational action theory, while Elster finds ‘Weber’s analysis of irrational behavior (including value-rational behavior) more illuminating than his dissection of instrumental rationality’ (Elster 2000: 40). Other authors have advanced, however, the quite different thesis of full compatibility of Weber’s epistemological writings with the axioms of rational action theory. According to Kiser and Hechter, for instance, Weber articulated
a theoretical and methodological approach to comparative and historical sociology that uses abstract models and intentional action as its main causal mechanism… Weber was a methodological individualist who argued that it was preferable to begin analyses by assuming instrumental motivation and using abstract models of forms of social relations [such as] ideal types… The core of Weber’s approach to historical analysis corresponds to emerging developments in sociological versions of rational choice theory (Kiser and Hechter 1998: 797-98 n. 35).

Peter Abell, likewise, has argued that ‘rational choice or action theory may be understood as one possible interpretation of Weber’s program’ (Abell 2000: 223). In this connection, he has made reference to Weber’s well-known definition of social action as an action that takes into account the meaning actors confer on other actors’ behavior, and is thereby oriented in its course (Weber 1956: 1; 1968: 4). Rational choice models accounting for interdependent actions involve considerable simplification, and cannot therefore consider ‘locally detailed and complex’ social actions (Abell 2000: 223). Causal explanations of the course and effects of social action, as Abell observes in keeping with Coleman’s reference to The Protestant Ethic and the Spirit of Capitalism, are situated at the abstraction level of the social system, rather than at the individual level. Individual actions, however, provide the unit of analysis and observation (methodological individualism). Causal explanations that proceed from macro causes to the micro, or individual, level, and back to the level of macro outcomes, or vice versa, are seen by Abell as consistent with Weber’s epistemology as well as with rational choice theory, for ‘rational choice theory may be interpreted as one response to Weber’s injunction about causally understanding social action’ (Abell 2000: 228; see in general 223, 228-29, 236; see also Abell 1992).

A number of authors concur with Abell in arguing that Weberian sociology is compatible with a broad definition of rational action theory. Boudon (2003), Hechter and Kanazawa (1997: 194-95), are cases in point. Along these lines, Peter Hedstroem and Richard Swedberg have maintained that ‘the three key elements of rational choice theorizing’ may be found in Max Weber’s sociology. They are: methodological individualism, analytical primacy (i.e. the primacy of analytical abstractions, and hence of ideal types such as the rational social actor), and intentional explanation (namely, explanation of the actors’ motives, which involves the Weberian procedure of Verstehen). They also maintain that Weber’s expanded concept of rationality, with its distinction between instrumental and value rationality, is of par-
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ticular interest for rational choice theory. Not only did Weber anticipate rational choice theory by advancing the thesis that the ‘scope for rational action...has increased considerably’ with modern capitalism. Weber also sought, they argue, to include value rationality within his broad notion of rational action. Accordingly, ‘a value may be pursued just as rationally as any material interest’, but value rationality — in contrast to instrumental rationality — does not consider all the consequences of action (Hedstroem and Swedberg 1996a: 138-39. See also Swedberg 1998: 36-39).

Finally, Norkus’ attempt to consider the relationship between Weberian sociology and rational choice theory is worth noting (Norkus 2000). As Norkus maintains, Weber’s concept of rationality comprehends both parametric and instrumental rationality. Its principle is here expressed — in a way that is compatible with Abell — as follows: ‘All collective facts can and should be explained as consequences of individual action’ (Norkus 2000: 263). The interpretation of methodological individualism may be weak or strict, according to whether sociological institutional rules are included or not in the description. Weber’s methodological individualism was conducive to the study of the macrosociological conditions, such as institutional rules, that make social order possible, and therefore subscribed to the weak interpretation of this principle. A macro analysis of rational action would cast light on how they are embodied into and applied by economic, scientific, and legal institutions.

Weber’s concept of subjective instrumental rationality is relevant in this connection, as Norkus emphasizes, for instrumentally rational actors must take into consideration the institutional context constraining their actions. Weber has described action as instrumentally rational from the subject’s viewpoint if it is performed only after deliberation of which alternative means are more appropriate (in terms of effectiveness and importance) to reach the ends pursued, and of what are the expected consequences of pursuing alternative ends. Real actors do not usually carry out such an in-depth deliberation, except—at least to a considerable extent—when economic exchanges in competitive modern markets recommend it. Other types of action, such as value-rational, affective or traditional action, are accordingly relevant as descriptive of actions at the individual or micro level of analysis. This analysis might reveal the existence of mixed types, such as actions that are instrumentally rational only in the selection of means, while they are value rational in the choice of ends. Ultimately, an instrumentally rational actor must give due consideration to the high costs
(monetary or otherwise) involved in any purely instrumental rational action. Accordingly, this actor must decide after deliberation on which is the best way to act, namely, whether it is convenient to frame a given contingent decision as instrumentally rational, or rather value rational, traditional, or affective.

All these authors, then, concur in finding a common ground between the Weberian epistemology and the basic assumptions of rational choice theory. They have laid emphasis on: (a) methodological individualism; (b) the procedure of Verstehen, as applied to the reasons that may be attributed to the actors as causing their actions; (c) hence, the consideration of the actors’ beliefs and values, as relevant for an evaluation of their value rationality; (d) the distinction between value rationality and instrumental rationality. Instrumental rationality has been considered from the actor’s point of view, rather than from the vantage point of those who have other beliefs and/or information than the actor; (e) the different levels of analysis, macro and micro, that are involved in sociological explanations, according to Weberian epistemology and also to rational choice theory.

1.3 Parsons’ functionalism and Weberian sociology

Much as some rational choice theorists have done for their own theoretical perspective, Parsons’ functionalism has maintained the existence of a common ground between, on the one hand, his epistemological assumptions and theoretical categories, and Weber’s on the other hand. In Parsons’ interpretation of Weber, as advanced both in his first major work and toward the end of his life, Weber’s classification of modes of action orientation has evidenced ‘a focus of interest on the normative aspect of action systems’. Therein, a distinction is formulated between efficiency norms and legitimacy norms. While efficiency norms ‘denote standards of the “right” relation of ends and means in a given context’, legitimacy norms denote ‘the “right” modes of doing things with reference to binding values’. Norms of efficiency, otherwise stated, involve ‘the efficient adaptation of means to ends’ and refer to the actors’ interest, whereas norms of legitimacy by implying ‘moral obligation’ involve the actors’ normative orientation to a legitimate order (Parsons 1937: 649-53, 678-79). Both kinds of norms are learnt in the process, and by means, of the socialization process, which fulfills the function to train ‘individual personalities…to be motivated and technically adequate to the performance of adult roles’ (Parsons 1964: 130).
A focus on the normative aspect of action is instrumental, as Parsons argues, to formulate ‘the general concept of rationality of action’. ‘The atomistic character of utilitarian thought’ is thus avoided, with its untenable (as Parsons views it) postulate of the natural identity of interests, while the focus on an integrated ultimate value system, which Parsons finds in Weber, is considered by Parsons himself as incompatible with ‘the random ends of utilitarianism’ (Parsons 1937: 718-19, 773). As Parsons has added elsewhere by way of clarification, for an act to be judged as rational, the selection of means to the end must conform with certain standards which can be defined by observers and understood by actors. No random...relation of means to end can be called rational in this sense... Weber...argued that binding commitments to ‘maxims’ are crucial...for stable ‘legitimate orders’ or institutions, and also for ‘customs’ and ‘usages’ (Parsons 1976: 362).

This holds true, in particular, for ethics in the capitalist order:

The new economic order—as Richard Muench has written, with reference to Parsons’ interpretation of Weber—is both the result of expanding markets and expanding ethical and legal regulation (Muench 2005: 551).

In this connection, Parsons argued that ‘economic activity takes place within the “institutional” framework of a society’, and therefore ‘moral sentiments’ and in general ‘disinterested elements of motivation’ typically play a role in the determination of the course of such activities. These elements are in the usual case ‘intimately intertwined’ with self-interest (Parsons 1940: 190, 193).

Parsons’ stress on Weber’s alleged focus on norms has been questioned as textually unfounded. Conformity to norms may occur, as Weber pointed out, for reasons different than inner adherence to values the norm represent, for habit and self-interest may be also relevant. In particular, as a careful perusal of the relevant texts shows, Weber did not establish any necessary connection between instrumentally rational action and the actors’ adherence to norms. Nor did he state that reference to norms or values is always involved in the selection of ends. Nor did he attribute to values any greater influence on behavior than habit and self-interest, though the pursuit of ultimate values may be incompatible with that of self-interest (Cohen, Hazelrigg and Pope 1975: 233-36. See in this connection Weber 1956: 12-13; 1968: 24-26). These criticisms of Parsons’ interpretation do not of course imply that Weber adopted ‘the framework of an individualistic positivism’, as they have been construed (Muench 1982: 820 n. 23). It has
been pointed out, furthermore, that for Parsons ‘the patterns of behavior motivated by economic rationality and political rationality’, though ‘basically cooperative,’ may in fact ‘represent competing subcultures’. By the same token, a conflict may actually occur ‘between ethical rationality and instrumental political expediency’, which ‘Weber so profoundly articulated as the tension between the ethic of responsibility and the ethics of expediency and faith’ (Alexander 1988: 156-57).

Parsons’ position may be recapitulated thus, taking into consideration the criticisms to which it has been subject: (a) as ends are non-randomly related to means, they may be guided by norms and values; (b) though economic rationality may not be aligned with political rationality, the ethics of the market rests on the legal regulation of market transactions.

1.4 The Weberian notion of rationality

A number of Weberian interpreters have expatiated on this notion (See Brubaker 1984; Eisen 1978; Kalberg 1980; Levine 1981; Lindner 1986: 156-58). They have considered not merely those passages in Economy and Society that directly bear on it (see especially Weber 1956: 12-13; 1968: 24-26), but rather Weber’s oeuvre as a whole with particular reference to texts concerning religion, economy, and law. They have often pointed to the frequent occurrence of the term of rationality in Weber’s writings, and the plurality of its apparent meanings (see in particular Brubaker 1984: 1-2; Eisen 1978: 58-61). Accordingly, they have endeavored to clarify them through conceptual analyses and typologies. The result of their efforts has not been entirely consistent or cumulative, but attention will be paid to interpretative statements on which there seems to be agreement, or at least absence of disagreement. The distinctions between the different meanings, and the corresponding ideal types, of rationality has yielded the following typology:

1. Conceptual rationality, which stresses the coherence and consistency of concepts and conceptual frameworks.
2. Instrumental rationality, which stresses the adequacy of the relationship between means and ends.
3. Substantive rationality, which stresses the adequacy of the relationship between values and norms on the one hand, and conduct on the other.
4. Formal rationality, which stresses the extent to which conduct and norms are predictable and calculable.
Cutting through all these ideal types is the distinction between subjective and objective rationality, the former considering the actor’s subjective point of view, the latter having regard for the correct relation between means and ends according to available scientific knowledge. As Brubaker remarks, furthermore, the unifying themes of knowledge, impersonality and effective control provide ‘the thematic strands’, which ‘run throughout Weber’s discussion of the rationality of the modern social order’ (Brubaker 1984: 30; see in general 30-35). Rational choice theory—as a general theoretical framework, and also insofar as its compatibility with Weber’s conception of rational action and sociology of norms is concerned—has not dwelt on conceptual rationality, and has conflated instrumental and formal rationality. Its reception of Weber has therefore been selective. Moreover, while Parsons’ critique of utilitarianism may be extended to the ‘thin’ version of rational choice theory, his stress on norm-allegiance leaves conduct motivated by self-interest unaccounted for. These two points should be considered in some detail.

1. Rational choice theory and the Weberian conception of rationality share the epistemological position of methodological individualism, and intend to explain conducts by imputing plausible motives to social actors. What is more, the distinction between ‘thin’ and ‘thick’ rationality is similar to that between instrumental and substantive rationality. Both instrumental (‘thin’) rationality and substantive (‘thick’) rationality may account for cooperative (that is, correct, loyal, and honest) conduct, and therefore for credibility and trust among participants in stable interactions. To the extent that reality approximates the ideal-typical, abstract condition of network closure, cooperative conduct is rational from a subjective as well as an objective viewpoint, for it is predictable, hence calculable (knowledge), abiding to social norms (impersonality), and amenable to discipline and regulation (control). Rational choice theory and Weber have accordingly considered both micro (subjective) and macro (objective) levels of sociological analysis.

2. The analytical inclusion of value rationality in the conceptual apparatus of rational choice theory may account for normative conduct in a variety of social contexts, including the institutional context of market transactions. In this context, Weberian sociology, rational choice theory (in its broad definition), and Parsonian functionalism lay emphasis on norms and values as a source of conduct regulation. In contrast to Parsonian functionalism, however, only Weber’s notion of rationality and ‘thick’ rational choice theory may explain market
conduits that are presumably accounted for by self-interest as well as norms and values. Parsons’ selective focus on norms, and rational-choice theorists’ emphasis on self-interest, do not accordingly sufficiently illuminate Weber’s epistemological and theoretical position. Norms, for Weber, may exert guidance on behavior for a variety of reasons, of which the actor may be more or less aware. In particular, norms—or rules (Regel)—are followed: (a) without any awareness on the part of the actor, who takes for granted and repeats what other people do, until the behavior becomes an unconscious habit; or (b) as a deliberate application of principles drawn from the actor’s own lived experience; or (c) as a consequence of the actor’s upbringing or imitation. Thereby, the actor follows the norm as something worth conforming to for its own sake, and subsequently—thanks to the actor’s own life experience, which has been subject to careful consideration—further elaborates it until the norm guides his or her actions (Weber 1973: 330-31).

2. A Weberian sociology of social norms in financial markets

2.1 A brief survey of the literature
Weber considered habit, self-interest, norms and values relevant to the formation and upholding of trust and social norms. In this regard, he referred to the social, economic, and financial exchanges characteristic of modern capitalism. In particular, insofar as financial exchanges in stock exchanges are concerned, Weber made them the subject of detailed investigations in the 1890s (Weber 1999; 2000). Their content and conclusions, which bear on the crucial relevance of social and legal norms in financial markets, will be epitomized in the following section. A preliminary survey of the literature on these investigations, and on the related topic of how stock exchanges were organized and regulated during Weber’s times, may help illustrate Weber’s account. Besides summarizing Weber’s relevant publications in these research areas, the literature has dwelt on their context. Attention has been paid, in particular, to the fierce debate that occurred in Imperial Germany on the ethical justification and economic consequences of futures trading. This debate was conducted in legal, political and academic milieux.¹

Some of these points will be here touched upon. First, the legal regulation of the stock exchanges in Germany, England, and elsewhere toward the turn of the nineteenth century. The literature has dwelt on the variety of formal and informal norms existing in the Austrian and German nineteenth-century stock exchanges, and in particular in the Berlin Stock Exchange. It has also hinted at the debate within the Government-appointed Commission of Inquiry into the German stock exchanges between those in favor of centralized control, and those who instead favored the administrative autonomy of each German stock exchange. The literature has furthermore criticized the innovations brought by the 1895 reform Law of the German stock exchanges as an ineffective compromise between the opposed organizational principles of free market on the one hand, and Reich controls that would have proven unable to check speculative abuses. In keeping with Weber, the German normative framework has been contrasted with that prevailing in Paris, New York, and especially London.

Second, the presumable reasons that prodded Weber to conduct his research on the stock exchanges. Leaving biographical circumstances aside, specific historical factors have been indicated as plausible motives of his interest in the organization and regulation of stock exchanges. They are, namely, Weber’s desire to dispose of ‘all sorts of ignorant prejudice’ (Tribe 2002: 244) concerning the way futures trading operates, and his related preoccupation lest this prejudice should inspire ill-conceived reforms that would prevent Germany from holding her own against her economic competitors. Third, the conclusions of his research, and his reform proposals. Weber formulated these proposals in a number of publications, some of which were written as a member of the Commission of Inquiry. In this capacity, he took an active part in the debate among economists, jurists and other experts, on the legal reform of the German stock exchanges. Finally, the impact of his conclusions on the Law that reformed the German stock exchanges. The literature has reported Weber’s publicly expressed displeasure with the new Law (1896), which prohibited futures trading in grain and curtailed the stock exchanges’ self-regulation prerogatives.

2.2 A Weberian account of trust and social norms in economic exchanges
Economic theory, which is based on the principle of marginal utility, formulates an ideal-typical concept of economic exchange as an action conducted by fictitious perfectly rational actors, and makes use of this concept for theoretical purposes such as the description and
explanation of given economic events. Norms, insofar as applying to such an abstract, ideal exchange, are relevant for indicating the extent to which an actual exchange conforms to this ideal type. The individuals carrying out the exchange may be aware of, and feel bound by, moral norms that prescribe how a fair exchange ought to be. However, they may also follow the norm of fair exchange because doing so has proved, according to their experience, to be instrumental in conducting a successful exchange. The expectation of material and psychological benefits for those who follow this norm, and of costs—including psychological costs (Unfreundlichkeiten, Unlust)—for those who do not, determine in this case the exchange partners’ behavior. Finally, they may follow this norm without any awareness of the benefits yielded by conformity (Weber 1973: 200-203, 330-36).

Actions that follow the norm of fair exchange may therefore ensue from different subjective motives, which may be reconstructed in ideal-typical terms. Weber’s well-known typology of social action may be reconsidered here for the particular case of economic action. An exchange of economic goods may be, respectively, considered as the following. (a) Determined by affects or emotions, as for instance a panic on the stock exchange (Weber 1956: 2, 4; 1968: 6, 9). (b) Traditional, namely, ‘determined by ingrained habituation’ to the observance of the norm of fairness in business conduct, which—as a ‘practice…based on long standing’—has become a custom (Weber 1956: 12-13, 15; 1968: 6, 9, 24-25, 29). (c) Value-rational, to the extent that it is ‘determined by a conscious belief in the value for its own sake of some ethical…form of behavior, independently of its prospects of success’. A value-rational conduct may, for example, rule out bargaining between status peers. When the value of honesty provides exclusive guidance in business transactions, however, the prospects of successful exchanges are greatly increased. (d) Instrumentally rational, insofar as they are determined by ‘rational consideration of alternative means to the end, of the relation of the end to the secondary consequences, and finally of the relative importance of different possible ends’. This is the case when two or more participants in a market exchange compete among themselves to obtain the best exchange conditions (Weber 1956: 12-13, 15, 382-83; 1968: 24-26, 29, 635-37; 2002: 224 n. 221).

Instrumental rationality is in a sense subjective, for those who have different beliefs or assumptions from the actor are in a position to assess differently the adequacy of the means, which the actor has chosen, to the ends pursued and the consequences that are likely to
follow therefrom (Zweckrationalität). Weber would therefore concur with Elster in maintaining that there are several modes of behaving rationally in keeping with the actors’ beliefs or assumptions. In a different sense, however, instrumental rationality is objective (Richtigkeitsrationalität), since those actors who have more information than others are able to assess more objectively this adequacy, and the ensuing consequences (Weber 1973: 432-38). Normatively regulated consensual actions are necessary for any exchange—economic or otherwise—to take place. The consensus (Einverständnis) concerns the validity of this order. In order for this consensus to exist, every actor must assume to a sufficient degree that all other actors, who have part in the exchange, share with him or her the expectation that the set of guiding principles, or order (Ordnung), regulating transactions be complied with. In other words, every actor expects that the other actors comply with the agreed-upon terms of exchange. A macro phenomenon—such as a religious doctrine, or a set of social norms, or a political or language community—rests on the consensual action of the individuals who are concerned with it. Whether or not they agree on the doctrine, practices, norms, and whatever else constitutes this phenomenon, their factual conformity to its guiding principles, and their empirically correct expectation that the other concerned actors do likewise, are sufficient to create and preserve it. Failure to conform would cause exclusion from the collectivity of those involved in consensual action, in addition to legal sanctions when the state with its coercive apparatus of rational norms backs these guiding principles. In the case of monetary exchanges, participants each extend their expectations of compliance beyond their direct business partners, for monetary exchanges presuppose that the actual and potential members of the market community accept money as a means of exchange. Only money-based transactions make it possible to calculate gains or losses, which have occurred as a consequence, and are rational provided that these calculations make use of the reliable accounting procedures that prevail in, and define, modern capitalism. A capitalist market community presupposes, therefore, normatively regulated consensual actions, backed by the protection the law grants to contracts (Weber 1956: 36-37, 44-45, 58-59, 382-83; 1973: 452-64).

Accordingly, monetary and psychological costs and benefits ensue from compliance with the social and legal norms ruling market transactions, and therefore with the expectations prevailing among participants in the market community. An evaluation of these costs and benefits provides the social mechanism accounting for the transition
from micro phenomena, such as individual economic actions, to macro phenomena, such as the capitalist economic, social and legal order, and conversely. A social mechanism is a causal explanation which is ‘specifically tailored for a limited range of phenomena’, and ‘refers directly to causes and consequences of individual action oriented to the behavior of others’ (Hedstroem, Swedberg 1996b: 298-99). A ‘feedback mechanism to provide information that might affect action’ on the part of the rational authority (Coleman 1990a: 613) originates, as Weber maintained, from influential representatives of capitalistic interests.

They demand that the legislative and judiciary institutions take into due consideration their expectations, which concern protection of contracts without excessive legal formalism, so that ‘legal practice’ would meet ‘the need to guarantee or secure...trustworthy conduct’ (Weber 1954: 306, and in general 304-308; 1956: 506, and in general 504-506). Coleman’s criticism, that Weber failed to explain how micro and macro phenomena are interrelated, is therefore textually unsupported.

Transaction partners pursue different and opposed interests, as manifested in the bargaining process. Still, they share the fundamental interest that the norms enjoining commercial fairness and respect for all contract stipulations be abided by for their own sake. If this is the case, legal sanctions imposed by formal courts are neither necessary, nor customary. To the extent that participants in market transactions have built a reputation of honesty and trustworthiness, they form a business community. Reputation flows from this community, and is accordingly impersonal (Weber 1956: 382-83; 1968: 636-38; 1973: 451, 453, 459-60, 462; 1999: 171-72; 2002: 224 n. 221). To the extent that norms prescribing fairness in business transactions shape economically oriented social actions, they provide the market with material rationality. Unlike other forms of material rationality, these norms—far from being an impediment to the accurate calculation of monetary gains or losses—promote the formal rationality of the capitalist economic order (Weber 1956: 44-45, 58-59; 1968: 85-86, 107-109; see also Brubaker 1984: 35-45; Segre 1983: 53-86; Swedberg 1998: 36-39).

A rational orientation to the expectation that the other partners will abide by the agreement, and an evaluation of the costs and benefits flowing from the market social and legal norms, may obtain along with the value of loyalty and a subjective commitment to these norms. Rational choice theory with its focus on rational purposive action does not then provide a satisfactory account of the behavior of the market.
participants, if this behavior is consistently oriented to the pursuit of the value of honesty in business transactions even to the detriment of monetary gains. A broader notion of rationality, such as that put forward by Boudon, should be accordingly preferred in this particular instance, in which actors apparently combine instrumental and value rationality (Weber 1956: 14; 1968: 28). Moreover, by giving exclusive emphasis on norm commitment, a functionalist account of the behavior characteristic of the ideal-typical capitalist market would leave all rational pursuit of monetary gains unaccounted for. Finally, to the extent that ‘ingrained habituation’ (Weber 1956: 12; 1968: 25) determines this economic behavior, in the sense that conformity to norms of fair business is taken for granted, both rational choice perspectives and Parsonian functionalism fail to supply a sufficient explanation.

2.3 A Weberian account of trust and social norms in financial markets

According to Weber, the legal and social norm of honesty consistently guided the behavior of brokers in the London Stock Exchange at the turn of the nineteenth century. Self-interest, disinterested endorsement, custom, or any combination of these factors may have dictated compliance with this norm. As Weber remarked, ‘that which the religiously lived epoch of the seventeenth century bequeathed to its utilitarian heirs was above all a startlingly good conscience (we can say without hesitation, pharisaically good) as concerns the acquisition of money’ (Weber 2002: 120; see also Weber 1981: 367). Self-interest, as considered by the ‘thin’ rational choice perspective, and disinterested endorsement of norms, as emphasized by Parsons’ functionalism, may both be relevant in this connection, but neither perspective nor even their combination provide an adequate account of the brokers’ conduct, to the extent that norm conformity was customary and taken for granted. Informal control, as Weber contended, is of relevance to well-functioning markets, but even more so to financial markets.

In all markets undetected malfeasance, and unethical behavior in general, can diminish impersonal trust and thereby negatively affect business exchanges. In financial markets, however, damage would be particularly serious if transactions are concentrated in a few leading stock exchanges, such as the London Stock Exchange during Weber’s lifetime, in the light of ‘the fully indispensable function, which the Stock Exchange must exert in economic life’ (Weber 1924: 285; 1999: 169). Formal social control on the exchange partners was exerted by a court constituted by stock exchange members (brokers and traders), rather than by regular courts of justice (Weber 1924: 285; 1999: 170.
Informal control rested on the business community as a whole, for it provided ‘the means by which cooperators can locate and interact with each other’ (Heckathorn 2001: 277) by establishing the reputation, hence the trustworthiness, of all participants. The English financial community benefited from an additional source of informal control. By exerting social closure—defined as ‘the process of mobilizing power in order to enhance or defend a group’s share of rewards or resources’ (Murphy 1984: 548)—well-knit and powerful small groups of brokers and traders who mediated all financial transactions were able to exclude from the exchange would-be participants, who were considered not qualified in terms of their financial property, and to effectively control with the sanction of expulsion the conduct of single brokers and traders. This control was exerted not only upon the stock exchange members, but also indirectly on the business community as a whole. The relations, which obtained within this small group of brokers as Weber described them, are of interest from the viewpoint of sociological theory. Their great financial weight granted brokers and traders superior power over non-brokers, who were in most cases lesser members of the financial community. Also, the brokers’ and traders’ belonging to a highly privileged status group (Stand) and propertied class made them members of a unitary corporate group, and promoted dense and frequent ties among them. Their privileged status, furthermore, was instrumental in enforcing and preserving an ethic of commercial honor based on strong capitalist traditions (Weber 1924: 284; 1999: 167-68).

To use game-theory language, as in assurance games the participants (the brokers) could reach an optimum—a most satisfactory arrangement—not individually, but collectively, taking advantage of the fact that their community was ‘sufficiently small and stable so that everyone...[could] really come to know everyone else’ (Elster 1984: 21-22). The brokers’ coordination and absence of competition were required for the joint task of supplying the market with trust as a public good available to all participants in market transactions. The brokers’ own public good was their monopolistic control over brokerage commissions. ‘The mere assurance that the other will do the same’ (Heckathorn 2001: 277) rested on the brokers’ and jobbers’ opportunity to maintain social closure, and thereby secure the economic and social benefits of brokerage. The opportunity to secure these benefits motivated traders and brokers to cooperate with each other, over and above allegiance to norms prescribing this conduct.
Mutual control made it virtually impossible for brokers and for traders to compete with each other, and provided all of them with reliable knowledge that uncooperative behavior would have been punished certainly and severely. In this connection, Weber remarked that violations of agreements reached, most informally, ‘by mere signs, entirely unrecorded, and devoid of evidence’ were ‘almost unheard of in the annals of the stock exchange’ (Weber 1956: 383; 1968: 636-37). This ethic—whether based on custom, self-interest, allegiance to the status norms or to the brokers’ own code of honor, or any combination of these factors—legitimated discrimination toward those considered less honorable and worthy, for social closure was based on status and class criteria. As a consequence (whether intended or not), the privileges of the propertied class and status group, to which the English stock exchange brokers and traders belonged, were preserved along with the economic and social power of the financial elite (Weber 1924: 276 n. 1, 279, 285-87, 320-21; 1999: 161, 169-71; 2000: 653-55). On the other hand, Weber imputed to the absence of a futures market the occurrence of speculative crises (Weber 1958: 247-53; 1981: 286-94). Accordingly, he laid stress on the importance of futures trading—if entrusted to professional and competent brokers and dealers only—for the regular functioning of large financial markets, and for the price stability of the products and currency therein traded (Weber 1924: 301, 310-22; 2000: 631, 643-55).

Conclusion

Weber’s reputation as an expert on stock exchanges was already established in the 1890s, and has remained so thereafter (Borchardt and Meyer-Stoll 1999: 2-3). Historical research on the Chicago Board of Trade at the turn of the nineteenth century has also borne out some of Weber’s theses concerning the conditions for the regular functioning of futures markets. These markets were then possible—as they are nowadays—only if ‘social rules of self-restraint and institutional means for enforcing the rules’ exist, so that malfeasance and therefore uncertainty in transacting are effectively reduced. Cooperation between competitors and de facto barriers to entry were necessary to enforce these rules (Abolafia and Biggart 1991: 221-22). Weber not only proved to be a competent student of futures market, whose investigations on the futures markets of his times are still relevant today. He also anticipated contemporary research on financial markets, and added some interesting theoretical statements of his own. The brokers’ cliquish
character of relations among themselves was instrumental in achieving control of transactions in the London Stock Exchange, whether this was their intent or not. Control—in the dual sense that brokers mediated all transactions in the exchange, and that they collectively took care that no misconduct would take place on the part of themselves or their customers—was exerted informally most of the time, though formal control by means of local courts was available.

In keeping with Weber’s account of the London Stock Exchange’s formal and informal organization, the great effectiveness of brokers’ control on transactions was a consequence not only of their small number, and stable, mutual, and accordingly often personal relations in their daily business practice. It was also the consequence of their sharing the same propertied class and social status with traders in the exchange. This fact was conducive to social cohesion, having a similar world-view and corresponding moral standards of honesty in business conduct, which were accordingly respected and enforced. This was so for a variety of plausible reasons, which were possibly intertwined. Abiding by these standards was in fact necessary to trade in the exchange (‘thin rationality’), but they also conformed to the brokers’ and traders’ normative beliefs (‘thick rationality’). In addition, economic activity in general is institutionalized, and therefore normatively regulated (as Parsonian functionalism has emphasized).

From both a structural and cultural perspective, endorsement of moral standard and, therefore, trust in colleagues and business partners resulted from the peculiar network configuration of the relations that obtained in the London Stock Exchange at the turn of the nineteenth century. A clique of brokers traded with a cohesive group of jobbers. Representatives of both groups adjudicated cases in the exchange court. Brokers and jobbers, moreover, shared a class and social status background, so that they could easily and frequently intermingle among themselves, and also with others having the same or a relatively similar background. Cohesion, solidarity, and reciprocal social control had, accordingly, a dual source. They originated, on the one hand, from interactions in the course of their professional activities and, on the other hand, from association with persons they met in the course of their social life.

In addition to these elements conducive to social union and coordination, these groups of financial operators were members of the business community at large, whose value of fairness in transactions was possibly the central value in the exchange. To be considered honest and trustworthy is, moreover, a desired condition, and the
corresponding values are upheld in general. The London Stock Exchange brokers and dealers formed, accordingly, two sub-networks connected by a number of links, so that they jointly constituted a dense network. This network was nested in the much larger network of the British and the international business community, which in turn represented and gave voice to widely accepted values. The London Stock Exchange was thereby in a position to exert its functions as a leading financial center, in which trustworthy operators performed transactions smoothly and efficiently on behalf of all participants in business exchanges, and ultimately, on behalf of British society and the capitalist order as a whole.

This essay has sought to shed light on Weber’s account of trust and social norms in their relation to modern capitalism. It has been shown that norms, both formal and informal, are necessary for the formation and preservation of impersonal trust in the commercial fairness of business partners. In this connection, a Weberian theory of social norms has been reconstructed as follows. First, a dual prerequisite of formal rationality, which is characteristic of modern capitalism, is that there be a legal framework providing market operators with reciprocal trust by making contractual agreements enforceable; and that such a legal framework be sufficiently flexible to accommodate to their contingent needs. Second, informal social norms prescribing a fair business conduct are a necessary complement to legal or formal norms. Third, the empirical validity of these informal norms depends both on established business traditions sanctioning them and on controls jointly and reciprocally exerted by the members of the business community. Fourth, as shown by norms and patterns of conduct prevailing in the London Stock Exchange at the turn of the nineteenth century, the crucial importance for the capitalistic order of securing trust in financial exchanges may require establishing social closure in order to exert informal control on the brokers’ honesty and trustworthiness.

Social closure was obtained by means of: (a) a cohesive network of brokers and traders who monopolized transactions in the exchange, selected new members, provided self-regulation, and saw to it that cohesion and moral standards be preserved; (b) selection criteria based on economic class and social status, which maintained social homogeneity within the network (whether this result was intended or not).

‘Thin’ rational choice theory and Parsonian functionalism have contributed to explaining why turn-of-the-nineteenth century London Stock Exchange operators conformed to social and legal norms, despite the considerable short-run payoff of non-conformity, but neither per-
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Perspective has supplied a fully adequate explanation. Conducts aiming at long-run benefits, and the subjective endorsement of the norm of honesty in transactions, might have been relevant, possibly in addition to unconscious following of a time-honored tradition. It seems advisable, accordingly, to follow Weber, who did not rule out—in his account of the norms and organization of the London Stock Exchange—either an evaluation of costs and benefits on the part of the operators, or their commitment to general norms of honesty and fairness. But he laid emphasis on characteristics of the transactions between operators, and of their network, that were conducive to the effectiveness and pervasiveness of the local norms.

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