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Response to Kenneth Zimmerman

By Neil Fligstein

I appreciate Professor Zimmerman’s thoughtful response to my comments about the current financial crisis in *economic sociology, the European electronic newsletter*. I find myself in agreement with much of what he says about model building and forecasting. But I take issue with a couple of his arguments and our differences of opinion are worth unpacking. Sociologists are not really model builders in the sense that economists are. Most of us work discursively and look at firms, industries, and markets. We use lots of different kinds of evidence and there are almost no economic sociologists I know of who have an economist’s view of model building. So, while this discussion certainly explains what is wrong with economics in terms of understanding the financial crisis, it has little to do with what is wrong with what economic sociologists do.

My critique of economic sociology was quite different than that to which he eluded. None of the economic sociologists who were studying financial markets and financial instruments saw how dominant the securitization business became and how it penetrated into many other aspects of capitalism. Zimmerman makes the same point repeatedly, but the way out of this problem for him is for scholars to follow a Latourian path. But, the problem with this is that there were a great many scholars using the “social studies of finance” who were following this path and they failed to understand how the system was transforming itself.

I am skeptical that someone studying financial transactions by studying trading rooms in Latour’s sociology of science style would ever have grasped that the financial system had in fact evolved in a new and suddenly different direction. Sociologists studying financial markets mainly were being descriptive because their principal method was ethnography or interviews. If they did have a more theoretical argument, it was an abstract kind of neo-marxism arguing that financial flows were large and increasing and thus might potentially undermine the actions of states. I agree with Zimmerman’s main point here that the real problem was a lack of paying attention to how the financial system had actually changed and how that mattered. But I disagree that an actor-network approach or a more macro sociological approach would have seen this coming.

This brings me to the critique Professor Zimmerman proposes of my approach to this problem. He asserts two things: that I underestimate how virulent modern financial capitalism is and that we need to study “actors” not firms and markets. I believe he misunderstands my perspective which seeks to understand that the processes of market emergence, stabilization, and decline are understood by looking at the construction of a market as a field. A market coming into existence is different from a market that has matured. In the case of the mortgage market and the markets more generally for securitization products, these markets exploded from the mid 1980s. Indeed, capitalism is at its most virulent at these early stages. Witness the past 150 years of capitalism and these crises are endemic. In this period, the government in the U.S. played a number of important roles in the founding of the market, a role that undermines the view that American regulators were only interested in deregulation.

Professor Zimmerman wants to argue that we need to study “actors” but he seems to dismiss the idea that actors include firms and governments. My response is that what happened in these markets was exactly a co-evolution of regulation and firms. There is good evidence that the largest banks in this period grew in size and market share. Henry Kaufman (an economist whose pessimism has earned him the nickname “Dr. Doom”) shows that the top 10 banks in the US went from holding about 10% of financial assets in 1990 to about 50% of such assets in 2003 (2009: 100). Even more intriguing, in the U.S., it is clear that banks began to vertically integrate their participation in these markets and became mortgage loan originators, packagers of such loans into bonds, bond sellers, servicers of those bonds, and holders of those bonds (Fligstein and Goldstein, 2009). How would we even know the structure of the banking industry had changed if we rejected my approach of studying firms, their strategies and structures and how these changed over time?

The most interesting fact to explain about what happened is why did the largest banks hold onto mortgage...
backed securities based on subprime mortgages which meant that when the market turned down, they faced liquidity crises? This question can only be answered by studying what the firms thought they were doing. This takes us to an analysis of the players in the market. This is exactly the kind of work that my view of markets suggests needs to be done.

Regulators played a complex role, one that is not easily reducible to the idea that they believed in neoliberalism or market fundamentalism. That Alan Greenspan generally thought such markets were efficient and better off left to their devices shows his own disregard for the history of those markets and what actors in those markets were doing. He believed that they would never take on risks that would undermine their firms and he certainly lacked a systemic view of the financial markets. But once those markets started to fall apart, the banker led Bush Treasury Department act quickly put a large cushion under failing banks. In the end, the American government is now the largest holder of mortgages in the U.S. and currently providing backing for 95% of the new mortgages.

The U.S. government was deeply involved in the creation of the mortgage market through its ownership of the government sponsored enterprises that provided somewhere between 60-70% of the mortgages. It was also involved in trying to increase rates of home ownership. We do not totally understand how regulators shared decision premises with bankers, how they came to be captured by bank interests, and how they chose to ignore what were obvious warning signs of problems. For me, the reconstruction of what happened will need some “structural” or “systemic” analysis. How else will we be able to make sense of the complex back and forth between market players (i.e. firms) and between those players and government? The actor network approach with its extreme micro focus will not carry us to analyze the real relationships between the state and the banks which were at the core of the crisis.

References