The Makings of a Crisis: An Inquiry into the Role of the State in the Sub Prime Mortgage Crisis

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Submitted to

Central European University

Department of Sociology and Social Anthropology

In partial fulfillment of the degree for Masters of Arts

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Budapest, Hungary

2011

Abstract

The thesis considers the role of state in the creation of the Sub-Prime Mortgage Bubble and its role in spawning the current financial crisis. It outlines a brief history of financial markets beginning with the Great Depression with emphasizing the role of the state in their functionality. It then recounts the Sub-Prime Mortgage market from its beginnings, giving an overview of its structure. Using an actor-network approach, the thesis constructs a narrative based on eighty industry and newspaper articles, detailing the implicit associations as key discursive features. These features are then compared with a policy brief published by the United States' Department of Housing and Urban Development, where a correlation is drawn between the goals of market and state practice. I argue that the Sub-Prime Mortgage market embodied a neo-liberal *governmentality*, where a market solution was created to meet a perceived social need: the need for increased homeownership among lower-class residents. The thesis implies that a closed network of social relations between state and market actors, working toward the same end with different justifications, created the housing bubble.

Acknowledgements

First and foremost, I would also like to thank my secondary supervisor, Balazs Vedres, who never failed to ask tough questions and whose critical insights are present throughout. Tom Rooney also deserves mention for his diligence and support. I also extend my thanks to my parents, who provided a never ending fountain of love and encouragement. Also, Tetiana Tsybulnyk, who endured this grueling process with me, deserves mention for the little breathes of fresh air in between sentences. I would also like to thank my partner, Amanda June, for her efforts and patience during this process. Without her support, this would certainly not be possible. This thesis would not be possible without the aid and guidance of my primary supervisor, Alexandra Kowalski. I am deeply thankful, and indebted to her efforts during the writing process

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Chapter One: Introduction

The Sub-Prime Mortgage Crisis has been one of the most widely discussed topics in recent memory. To many, the event can be described as a catastrophe, the effects of which rippled throughout the modern world. It seems that much of the discourse surrounding the financial crisis in popular literature is concerned precisely with effect alone, allowing critical questions about the inner-workings of the financial system to be left to the experts. That is not to say that the cause of the financial crisis has gone unexplained. Much of the discussion has centered on predatory lending practices on behalf of banks and sub-prime mortgage lenders, less-than-honest accounting practices, corrupt ratings agencies, lack of government oversight, or a veil of expertise hiding the practices of high-finance. This thesis will not attempt to weigh in on the debate on what caused the financial crisis, but instead will analyze the makings for a climate of catastrophe.

The Sub-Prime Mortgage Crisis is the fifth in a series of major financial downturns beginning with the Great Depression: three of which (Sub-Prime Mortgage Crisis, Savings and Loan Crisis, and the Great Depression) involve speculation on real estate. The end of World War II saw the erection of a global financial state regulatory framework, known as the Bretton Woods System, which sought to control speculation and prevent another Great Depression. The system seemed to work for the years following World War II until its dissolution in the early 1970s as there were no major financial downturns during this period. Since then, the global economy has been deregulated allowing the market to surge and recede according to its ‘natural’ order. As such, the market has seen a major recession roughly every ten years since the 1980s: the Savings and Loan Crisis from 1988-1991, the Dot.com Bubble of 1998-2001, and the current Sub-Prime Mortgage Crisis from 2007-present.

The academic literature has taken many perspectives in regards to the making of financial markets, and this thesis will seek to understand the makings of financial crises. Some have noted large-scale patterns which place the current financial crisis within a historical framework extending as far back as the 1600s. Others have undertaken more specific analyses, showing the evolution of specific national markets within a historical period. The most compelling literature attempts to trace markets from the ground up, attempting to understand the makings of financial interactions, the networks that are created, as well as the discourses and actions that constitute economic behaviors. It is from this perspective that this thesis will use as the foundation for its analysis, taking as a rule that behind all theoretical frameworks lie a network of human interactions.

The purpose of my thesis will be to better understand the effects of finance culture on the financial crisis. It will attempt to answer the following questions: 1) how was the climate for the financial crisis produced? 2) What kind of discourses surrounded sub-prime mortgages and sub-prime mortgage securities? 3) How did these discourses help to fuel the financial crisis? To answer these questions, I have looked at eighty industry articles and newspaper reports, which deal with sub-prime mortgages and mortgage backed securities, published between 1997 and 2006. These articles represent a window into the world of high finance before the market began to tip in 2007. Unhindered by hindsight, they express conceptions held by the actors regarding sub-prime mortgages prior to the financial crisis; the makings of the crisis lie within these discourses.

Following a pattern outlined in the second chapter, this thesis will show that markets reflect state processes, where both institutions, if they are to be seen as separate, mutually affect one another. As such, it is important to view the market and the state as a closed system of social relations. The analysis will show that the state was a key factor in creating the cultural climate for the Sub-Prime Mortgage Crisis beyond its regulatory policies. Rather, the narratives shown in the sample of articles will be compared with a policy brief issued in 1995 from the United States Department of Housing and Urban Development. The discursive features of both the sample and the policy brief come together to show a motivation for increasing homeownership, and as such, describe a neo-liberal *governmentality* held by lenders and policy makers alike. To best understand the effect of the state on financial markets, it is important to understand the history of their interaction.

Chapter Two: Historical Considerations – From the Great Depression to the Sub Prime Mortgage Crisis

2.1 The Great Depression and the Bretton Woods System

Trying to recount the history of modern finance can be tricky as the scope of the system extends beyond borders into different nation-states and economies. This section will attempt to highlight the role of the state in the evolution of financial markets, with an emphasis being on their interconnected nature; it will show how the evolution of the economy is guided by the state, and vice-versa. This section will highlight important events in the development of two countries, the United States and the United Kingdom which were chosen because of their respective statures in the global financial system. The results of the history will be to highlight the *effects* of state practice on the direction of the economy. It can be said that modern finance has its roots in the Bretton Woods system: a regulatory framework established after World War II which promoted exports, and focused capital nationally. After Bretton Woods, the ideology behind capital accumulation shifted, and speculative practices swept the financial world. This section will begin with the roots of the Bretton Woods system and conclude with the beginnings of the Sub-Prime Mortgage Crisis.

The idea that the state should exert some control over the flow of capital was a prominent opinion among economists during the Great Depression. The structure of finance in the twentieth century United States has its foundation in the passage of the Glass-Steagall Act, a section of the Banking Act of 1933. The Glass-Steagall Act sought to fortify commercial banks and investment banks as separate institutions. This made it a federal offense for any banker to be involved in commercial banking activities, like taking deposits, and investment banking activities, such as bond trading, simultaneously (Jackson 1987). The law created two spheres of investment activity, which remained in place until its repeal in 1999 and was a defining feature of US financial policy in the twentieth century. It is possible to see other, albeit less significant, examples of state intervention practices, such as the pegging of the British Pound to the US Dollar, prior to World War II, which helped create a stable platform for international trade (Foreman-Peck 1983:252-253).

More significantly, the planning stages of the post World War II economic order, showed a common mentality toward the role of the state in economic affairs. The United States and the United Kingdom had separate plans for a post-war economy, but their similarities "lay in their opposition to floating exchange rates and to competitive trade restrictions, and favouring the national right to control short-term capital movements" (266). It was under these auspices that an agreement was met, and the Bretton Woods system was established as a means of governing international trade. The two institutions that arose out of this system were the International Monetary Fund and the International Bank for Reconstruction and Development[1]: the former as an authority over international exchange rates and balance payments, which required any currency to be pegged either to gold or the US dollar; the latter, governed international investment in the long-term (267-268). The effects of these two institutions allowed trade to move swiftly from country to country, but the movement of capital remained nationalized (Ferguson 2009:305). With these two supra-national institutions, a system of tight regulation of international trade was established, reflecting the sentiments of the time that the state played a crucial role in promoting a stable economy. This sentiment would last through much of the 1950s and 1960s.

[1] This institution became the World Bank (268).

During this period, the financial world was not particularly volatile. A tightly regulated market, subject to both national and international legislation, such as the Glass-Steagall Act in the US, or the Bretton Woods System over the world economy, was limited in the amount of capital it could accrue, as well as the types of investments it could make. After the Great Depression, the United States had about forty years of economic growth, with few incidents, which some have attributed to the tightly regulated market. What would be become the multi-billion dollar investment firms in the latter half of the United States, began as small partnerships of investors who allocated their own funds for the firm, and thus managed their money conservatively. Paul Volcker, who would later become the head of the Federal Reserve at the end of the1970s, worked at Chase Manhattan Bank as a financial economist earning $45,000 a year throughout the 1960s (Ferguson 2011: 11:00-13:10). This was directly related to state laws over the movement of capital.

Alternatively, Britain, which did not have a tightly regulated market, but rather a social welfare system erected in the post World War II era, enjoyed substantial post-World War II growth until about 1973 (Feinstein 1994:104). This has been attributed to demand side factors, stemming from an expectation of full employment for British workers (Foreman-Peck 1987: 267). The role of capital was to supply labor opportunities for these workers, and thus meet this demand. In this market climate, economic growth in post-war Britain was nationally focused, where trade was mostly export-based, spurred by favorable conditions outlined in the General Agreement on Tariffs and Trade (GATT). It can then be inferred that the financial climate was similarly conservative and less speculative. Whereas in the United States, national government regulation had contributed to a stable economy, the Bretton Woods System, as well as GATT, had created the market conditions for safe investment practices which helped pull Britain out of its post-war depression (Feinstein 1994:105-106).

The IMF, being an institution intertwined with the Bretton Woods system, regulated exchange rates, where currencies could either be exchanged for US dollars or for gold. In 1971, this changed when the United States made the US dollar a 'fiat' currency. The move away from the gold standard effectively dismantled the Bretton Woods System "producing an atmosphere of crisis in monetary relations" (Foreman-Peck 1987:345). The dollar was then said to "float" against other currencies on the foreign exchange markets and was increasingly subject to the whims of the market (346). After three years of ups and downs, the first financial crash since the Great Depression occurred in 1974, due to an increase in oil prices. This event is noteworthy because it is the first significant recession to hit the United States and the United Kingdom in over forty years, yet not as significant in the scope of this thesis because the recession was not spurned by financial practice (349-351). 'Deregulation' would produce similar effects less than twenty years later.

2.2 Deregulation and the Savings and Loan Crisis

From the 1970s until the present, the financial world can be characterized by a loosening of controls on capital; where the Bretton Woods system allowed for trade to flourish, but focused capital nationally, the new system that began to take shape, via both formal and informal mechanisms, progressively lightened capital control and allowed it to flow internationally (Abolafia 1998:3). Foreman-Peck noted the establishment of a new world economic order which divided the world into exporters of primary resources and manufactured goods, with different trade standards for developing countries, as well as a mutual dependence on capital from the developed countries and primary resources from the developing (Foreman-Peck 1987:371). This posited developed countries like the United States and the United Kingdom as having the responsibility for raising and accruing capital. With relaxed border controls, the process of capital accumulation was hastened and prioritized by the state. It was in the 1980s that the cultural climate had changed markedly. Where before the 1980s, high-finance investors had invested their own money conservatively, the new wall street had adopted a mentality where "making a hit meant making a billion dollars on a single successful speculation" (Ferguson 2009:314). The dissolving of the Bretton Woods System, helped create a finance culture where capital accumulation was not only a duty, but necessary for the growth of the world economy. A shift in international governance, specifically the liberalization of capital, directly affected the practices of financiers.

A report published by the Federal Insurance Deposit Corporation describes how legislative amendments in the United States had been 'modernized' and a widespread project of deregulation had been taken on by the US legislature. It can be said that the modernization of legislation reflects principles being generated by economic institutions, as well as academics. As such, this process reflects how economics affects state practice. In general, these legislative factors opened the banks up to less protection and thus more exposure to market conditions. Specifically, some of these deregulatory measures included less risk protection, as well as controls regarding interest rates (Federal Insurance Deposit Corporation [FDIC] 2000:8-10). Britain similarly underwent a process of deregulation during the same time period, specifically through Thatcher's supply-side economic policies (Supple 1994:345). During this period, the foundations of the Savings and Loan Crisis of the 1980s and early 1990s began to form in the United States. Initially, Savings and Loan Associations developed to help home-buyers finance mortgage, and worked cooperatively in the sense that the association was owned by its depositors; these organizations were also insured by the government. These Associations, initially subject to government regulation, were deregulated in the 1980s, allowing them to invest in other things besides mortgages, ranging from credit cards to commercial real estate. The catch being that the United States still backed these institutions. In some cases, fraudulent practices came into play, but as was the case in residential real estate in Dallas, TX, the supply began to exceed the demand for the housing that was being produced (Ferguson 2009:253-258). The Savings and Loan crisis can be seen as an example of how financial deregulation led to rampant speculation in the market: how state practice influences economic activity. The next major financial crisis occurred roughly ten years later and involved similar speculative tendencies. The dot.com bubble, as it came to be known, was a speculative bubble which "had been based on exaggerated expectations about the future earnings of technology companies", particularly web-sites (124). Both of these instances show how the state inspired a shift from a conservative to a speculative market.

After World War II, the regulatory climate was one in which financiers invested their money safely. After the Bretton Woods System dissolved in the 1970s, speculative sentiments began to arise. As such, the modern economy can be said to produce a cyclical *boom* and *bust* in the business cycle inspired by speculative practice; wealth is generated during the *booms*, and the economy then suffers a widespread bust because of it. It is important to emphasize that changes in state policy, partially inspired by innovations in market ideology, have created the conditions for this type of economic activity. The next section will provide a general overview of the Sub-Mortgage Crisis of 2008, a product of the modern market conditions.

2.3 The Sub-Prime Mortgage Crisis in Perspective

This section will not attempt to theorize the role of the state and the market in regards to the financial crisis, but rather provide the background for which such an analysis can take place. The Sub-Prime Mortgage Crisis has its roots in the passing of the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Alternative Mortgage Transaction Parity Act in 1982, which respectively abolished government led controls on deposits and allowed for adjustable rate mortgages to legally exist (Chomsisengphet and Pennington-Cross 2006:38). This set the stage for the sub-prime mortgage market, which differed from traditional prime mortgages. The distinguishing feature between prime loans and sub-prime loans are "upfront costs" which include various fees, ranging from application fees to appraisal fees, as well as longer term costs like mortgage insurance, higher principles, and fees associated with delinquent payments (32). Typically, these loans were given to people who did not qualify for prime loans, which, by contrast, entails a lower payment scheme; these applicants tend to have poor credit histories, including frequent late payments, bankruptcies, or high amounts of outstanding debt (34). By contrast, prime loans were given to customers with good credit histories and low outstanding debt, and were considerably cheaper than sub-prime loans. The sub-prime sector did not see much growth until after 1995, where the market totaled about $65 billion, "when [mortgage backed securities] with sub-prime loan collateral became more attractive to investors; the market would grow to $332 billion by 2003 (37, 41). Thus, the growth of the sub-prime mortgage market is intertwined with the growth of sub-prime mortgage securities.

The process of securitization is notably complex. The process begins when a company *originates* a mortgage for a borrower. The originator has an incentive to lend to the borrower because the cost of the loan to the borrower is higher. A pool of mortgages begins to accumulate and the originator sells them to an arranger. The person assesses the quality of the loan by ranking the loans into different ‘tranches’ and verifies this with the ratings agencies, finds a safe buyer for the loans, and then files the loan portfolio with the Securities and Exchange Commission (Ashcroft and Schuermann 2008:5). A person might have an interest in purchasing a mortgage backed security because of the high pay off of the investment. When someone does this, they are purchasing a body of mortgages which will theoretically pay the investor plus interest. The role of credit ratings agency in this process is crucial; they assess the quality of the loans for purchase and assign them a rating. For example, Standard & Poor’s, a rating agency in the United States, would rate a security in terms of the likelihood that the loan would default; a AAA rated bond would be less likely to default than a BBB (Lewis 2010:50-51). The ratings agencies, who are private companies, are paid by the arranger to assign a rating. (Ashcroft and Schuermann 2008:10). After the security was rated, an investor was given the option to buy any tranche in a security, hoping to reap the benefits of the loans that the security contained.

Any investor that bought a security was said to be going “long” on a security, which is to say that they are hoping that the investment pays off as expected. By the same token, one could also go “short” on a security, which says the investor is betting that a security will default; credit default swaps (CDS) were used to fill this role in the sub-prime mortgage market. A CDS is theoretically an insurance policy, where the person purchasing makes payment to the issuer for a fixed term. If the loan defaults, the person is paid a large sum of money to cover the losses they incurred on the investment (Lewis 2010:29). Unlike insurance, however, CDSs do not require that the person buying owns the security they are insuring, which makes these instruments a speculative tool (75). They were also unregulated, and traded as an over-the-counter derivative. The popularity of CDSs was immense; "[b]etween 2000 and 2008, the market for [credit default] swaps ballooned from $900 billion to more than $30 trillion" (Times Topics 2011).

The final piece of the sub-prime mortgage crisis puzzle is the Collateral Debt Obligation (CDO). Similar to the CDS, a CDO was initially a tool to help minimize the risk inherent in sub-prime mortgages (Lewis 2010:72). It was constructed of the riskiest tranches from pools of sub-prime mortgages from different geographic locations, and then repackaged as a different bond, prefaced on the idea that not all of the loans would default in the same place at the same time. In doing so, these initially low-rated tranches would be given higher ratings upon repackaging (73). Often times, these were packaged with a CDS to form a synthetic CDO, thus improving the rating on the investment because it included an insurance policy (76). CDOs were risky and mis-rated; it is this financial instrument which contributed the most damage to the financial system. This is because CDOs were intertwined with other CDOs, as a CDO arranger "simply repackaged tranches of other CDOs, presumably those tranches their Wall Street creators had found difficult to sell….CDO "A" would contain a piece of CDO "B"; CDO "B" would contain a piece of CDO "C"; and CDO "C" would contain a piece of CDO "A"" (131). Thus, when one of the tranches failed in one package, it likely failed in another, making for a very potent crisis (Ferguson 2009:8).

A report written by the *Congressional Research Service* in 2010 summarizes what can be deemed the official causes of the financial crisis. It claims that "it is generally accepted that credit standards in U.S. mortgage lending were relaxed in the early 2000s, and that rising rates of delinquency and foreclosures delivered a sharp shock to a range of U.S. financial institutions" (Jickling 2010:2). The report produces a chart outlining the arguments including global imbalances in trade, where underlying tensions in the deficit put financial strain on the institutions, no oversight regarding mortgage finance, poor criteria used for rating loans within the ratings agencies, faulty accounting, government deregulation, financial innovation, poor risk management, bad economic models, and a preference for short term gains (4-8). Some have refuted the report's initial claim, saying that a lenders credit score did not necessarily have an effect on whether or not a person would default; this implicitly counters the theory outlined above, which claims that relaxed lending standards, specifically during the credit assessment process was a factor in a borrowers chances of defaulting (Demyanyk 2008). Others have suggested that knowledge about a turn in the housing market should have been predicted (Gerardi et. al 2008). Some researchers attribute the root of the crisis to changes in government policy. Christopher Wahlen of the Network Financial Institute at Indiana State University notes three factors: 1) US government regulatory agencies having a policy of creating housing via new financial techniques like securitization; 2) encouragement from the Securities and Exchange Commission of derivatives and securities being traded outside of a formal trading institution (also known as OTC, or over-the-counter securities); 3) regulatory bodies, like the SEC, advocating a change in reporting standards (Wahlin 2008:2-3). By contrast, the United States own financial report lists a whole host of conclusions, many of which were mentioned above. One of the conclusions not mentioned in detail is the role of predatory lending practices in the financial crisis. Predatory lending practices were said to be a major contributor to the financial crisis, according to the commission report. These stem from relaxed lending standards on behalf of sub-prime lending firms (Financial Crisis Inquiry Commission 2011:23-24). Each of these causes outlines a different aspect of what caused the financial crisis. They fail to understand the role of the market and state in creating such a climate. Where much of the criticism deals with atomized state or market actors, this thesis will show that an actor-network created the conditions for the financial crisis.

Chapter Three: Theorizing Financial Markets

This chapter will highlight patterns in financial markets highlighted by scholars from a historical perspective, as well as more contemporary accounts. The emphasis in the first section will be on historical, 'macro' level processes, which theorize implications about cyclical nature of markets, as well as more contemporary theories regarding globalization. The emphasis in the second section will be on the construction of financial markets as an actor-network, where the state factors as a prominent player.

3.1 Markets from Above

For many scholars, the financial crisis fits within a broad range of macro level processes, ranging from one hundred years to thirty. Giovanni Arrighi associates the Sub-Prime Mortgage Crisis, as well as the Savings and Loan Crisis and the Dot.com Bubble, with a period of "financialization", which indicates the decline of a hegemonic power (Arrighi 2000). He cites two other hegemonies as evidence: the Dutch after the treaty of Westphalia (1645-1800) and the "peace" enjoyed during Britain's colonial conquests (1800-1914). In both cases, the powers turned to financial mechanisms to maintain their empires, before petering out, and passing the torch to the next global power (132-135). More specifically, Samuel Knafo shows how state structure aided the innovation of British financiers in the nineteenth century (Knafo 2008). By creating structures which inhibited speculation, specifically regarding currency exchanges, the state asserted control over the flow of capital, which had the adverse effect of directing financial innovation (183-187). As such, the period of financialization that swept Britain at the end of the nineteenth century and early twentieth century would not have been possible without the aid of a national regulatory framework.

Following this train of thought, Leo Pannitch and Martijn Konings show how this process similarly unfolded in the United States. For Pannitch and Konings, the regulatory frameworks, both international and national, were ways to assuage the working classes and integrate them into the political system (Konings and Pannitch 2008:229). This had the effect of creating a veil of expertise over the financial world (241). Financial institutions had maintained a conservative attitude toward finance during the 1950 and 1960s and, as such, had cultivated a kind of trust. For the Konings and Pannitch, this made it possible for the financial world to create new mechanisms, which would feature prominently in the deregulated state of the 1980s. This period would eventually allow for the liberalization of capital from national borders, allowing it flow international, albeit unevenly (Abdelal 2006:3-4, Baines 2002).

Karl Polanyi understands the role of the state as crucial to the development of a market economy. For Polanyi, all market and state activities take place within a closed network of social relations (Polanyi 1957:56-57). While it is possible to see that the state and economy function as separate entities, he claims that “[m]arkets are not institutions functioning within an economy but without”, obscuring the distinction between economic activity and society as a whole (58). It then comes as no surprise that the transformation of economic activity is noted by transformations in regulatory functions. Markets themselves do not govern themselves by their own activity, but rather evolve with other societal forces.

Other theorists have analyzed these processes more precisely, such as Phillip Cerny, who noted four new structural changes to modern financial markets (Cerny 1993). The first is decompartmentalization which are processes which expand the breadth of capital markets, from the national to the global scale; the second is the increased use of securities, which stems from a decreased profitability of loans; the third are financial innovations which aid in the accumulation of capital; and, the fourth are processes of globalization (56-68). Through this lens, it is possible to interpret the events leading up to the financial crisis as the decompartmentalization of capital, since the dissolution of Bretton Woods, by which the flow of complex financial securities has been able to spread across the globe to help aid the accumulation of profits for financiers everywhere. For Neil Brenner, these processes would not be possible if it were not for the geographic expansion of capitalism, which is predicated by an expansion of state authority (Brenner 1999). This goes hand in hand with the creation of different scales of authority, urban, regional, national, and global, where the latter two are said to be "revitalized" and "intensified" respectively (50-52). The "revitalization" of the nation state can be said to be synonymous with the making of a competitive state, where states compete for capital flow: a process which is precluded by a liberalization of trade restrictions (Fougner 2006). As we will see, the *competition state* will prove to be a vital aspect in the making of a financial market; the effects of this theoretical claim can be seen in the dispersion of financial instruments on a global scale. However before this can be discussed, it is important to understand the production of financial markets, which will be outlined in the section below.

3.2 The Makings of Modern Finance

This thesis understands culture in terms of *economization*, which is to say that culture is created in a set of behaviors, as well as the institutions that they form. For Michel Callon and Koray Caliskan, the process of 'economization' is the process of market making (Callon and Caliskan 2009). They understand this as "the processes that constitute the behaviours, organizations, institutions, and more generally, the objects in a particular society which are tentatively and often controversially qualified, by scholars and/or lay people as 'economic'" (370). With this as a base, it becomes possible to understand the economy as something that is produced out of behavior, not what governs behavior. It is in this sense that market forces go from being atomized, to a network of influence, which could constitute what could be called a culture of economic activity. In this sense, culture is both discursive and performative. Mark Granovetter has stated that economic activity is an ongoing process in a network of social relationships; the idea being that an actor is neither entirely embedded within a social context, nor are they acting purely out of self-interest (Granovetter 1984:487). In this sense, it is neither purely a spatial network or a body of intellectual activity, but a combination of both social relations and concrete objects, which change in unfolding tapestry of dispositions. The financial market is the coming together of these different influences, practice, materiality, and discourse into a web of social relations. This section will elaborate on this notion.

Martin Carnoy and Manuel Castells have noted similar processes to those noted by Cerny in regards to globalization and the use of innovation and securities, but instead place an emphasis on the deregulation of markets and the creation of digital networks (Carnoy and Castells 2001). They particularly emphasize the role of a technological infrastructure which "combine the present and future value of stocks, options, commodities, currencies, and are traded in various markets" (4). Without the ability to transfer funds instantly, the financial world would not be able to exist globally. For Saskia Sassen, the rapid rise of these digital networks has gone hand-in-hand with a transformation of the state (Sassen 2000b:19). Sassen notes two features of this network: first, states impose technical standards on other states, and as such, exercise authority over those states; second, this power is limited to a select number of nations (28-29). The first of these two points is important for the contents of this essay because it emphasizes a global cultural hegemony of high finance, where particular state-led technical practices permeate foreign boundaries. The creation of a digital economy is an essential component, as well as the type of commodity that is created.

The flow of commodities over digital networks would not be possible if they were tangible, concrete objects. It is important to remember that securities, collateralized debt obligations, credit default swaps are not tangible commodities, but intellectual ones. That is to say that their profitability is derived from their *theoretical* value deriving from the value of a tangible asset. For example, a sub-prime mortgage security derives its value from a sub-prime mortgage; the value in the security stems from payments made on the mortgage. This transformation from a tangible commodity into a financial instrument is possible only through a process James G. Carrier describes as *virtualism*, which is understood as economic practice increasingly based on abstraction (Carrier 1998). The production of financial instruments, which can be traded via digital networks, can be said to be a type of knowledge production.

As such, it is possible to view how these instruments are an extension of Polanyi's notion of fictitious commodities, which existed prior to the development of capitalism, but were appropriated by capitalism and the state for profit. For Polanyi, the appropriated forms of nature, work, and value are land, labor, and money (Polanyi 1957:72). Others, like Bob Jessop, have expanded upon this idea, including knowledge in Polanyi's list. Jessop, like Polanyi, sees a distinction between economic practice and non-economic practice, where the fictitious commodity forms a common prior to its appropriation (Jessop 2000: 72-73). Jessop sees a distinction between knowledge *a priori* and *a posteriori* capitalism. The process of securitization is an appropriation of non-economic knowledge activity, where knowledge is redirected to suit the purposes of capital accumulation. Thus, the production of knowledge becomes one component in the making of financial market.

Thomas P. Hughes describes industry as forming as a *seamless web* of technology, by which science and technology form a tapestry of production (Hughes 1986) and it is possible to view financial markets in a similar light. He describes how industrial production utilizes network of components, by which an artifact is produced. For example, the production of an industrial artifact, might be the outcome of a network of “electric-light, and power systems….[as well] as physical artifacts, mines, manufacturing firms, utility companies, academic research and development laboratories, and investment banks” (287). Similarly, there exists a network for the production of sub-prime mortgages and sub-prime mortgage securities. Given the abstraction of knowledge production network, and also the necessity that the information be transferred digitally, the production of financial commodities forms a *seamless web* of different components: abstract components like originators (sub-prime mortgage lenders), assemblers, traders, mathematicians, economists, and value; and concrete components such as computers, power lines, paper, and homes. Similarly, Michel Callon’s notion of the “actor-world” elaborates on this structure, emphasizing a network of entities, social relations, as well as actors that come together in the production of an object (Callon 1986). For Callon, actor worlds tend to do differ in scope and influence, but without them, the production of the artifact in question would not happen (24-25). Where Hughes emphasizes the physical network of social relations, Callon emphasizes the world-views of those involved. The network, as well as the social relations that surround them, are entangled in practice, discursive structures, and materialities, constituting an actor-network, which together form the basis for the processes of *economization*.

Callon and Fabian Muniesa have shown how 'microstructures', i.e. algorithmic practices in economics, have become an essential part of the creation of financial commodities (Callon and Muniesa 2005). Citing the example of 'the double auction', they note how trading is both a human function, as well as a mechanical function performed by machines, both of which utilize algorithms in their calculative functioning (1241). This forms the basis of what can be called "performativity" in financial markets. Callon notes that the financial market is *performed* by a variety of actors, by which rational calculation is only an element. The interplay of ideas, as well as these ideas becoming a part of daily interaction, not only drives the market, but *is* the market (Callon 2006). The theory of performativity in financial markets "enables us to study the incorporation of theories, statements and tools which, transformed into algorithms, into routines, become infrastructures and revive the possibility of a new cycle of performations and counterperformations" (335). Thus, it becomes possible to speak of *agencements*, which are social and technical arrangements, which perform and give meaning to performance. Ian Hardie and Donald MacKenzie note how hedge funds, as *agencements* (see also 'associations', Latour 2005), both disseminate and receive knowledge via an actor-network (Hardie and Mackenzie 2007). In doing so, they both perform and reinforce the legitimacy of their action. In other words, it is in this network that the market is made as both a meaningful enterprise. It is not simply that these markets remain static, but are subject to a variety of influences in space and through time.

Michel Foucault, and those associated with the *governmentality* school, have argued that the state is a dispersal of techniques of governance (Foucault 1991, Mitchell 1991, & Rose and Miller 1992). For these thinkers, the governance is discipline; it is the self-policing of an individual in the ideal image of government (Foucault 1991:92). In this sense, *governmentality* on a *performativity* of government: it is acted, and in a sense, its action derives its meaning. For

Timothy Mitchell, “[t]he state needs to be analyzed as such a structural effect. That is to say, it should be examined not as an actual structure, but as the powerful, metaphysical effect of practices that make such structures appear to exist” (Mitchell 1991:94). Thus, governance, which does not exist separate from society, leaves its mark on ‘economic’ practice. It becomes possible to see modern economic exchange as showing the signs of governance, not as a distinct entity, but as a structural effect. For Nikolas Rose and Peter Miller, neo-liberal governance is a discourse which attempts to sustain market forces (Rose and Miller 1992:199). Their insight gives a crucial distinction for the *economization* of the globalized market. If we are to understand the economy and the state as a closed system of social relations, articulated as an actor-network, then the *governmentality* school incorporates state practice into the web of social relations this section has elaborated upon. The next section will emphasize the state effects in this entanglement, tugging on the thread of discursive structures, so as to reveal the state’s role in the Sub-Prime Mortgage Crisis.

Chapter Four: Methodology and the Sub-Prime Narrative

For this thesis, I analyzed eighty articles taken from the *Lexis Nexus* database after searching the keywords "sub-prime mortgage" and "mortgage backed securities". They were selected based on two factors: first, their relevance to the keyword; second, the time in which they were published. The sample of articles is from 1997-2006, with a notable dip in output between 2002 and 2004. The research took place in two stages. The first phase was a careful reading of the articles, where I attempted to trace the main ideas. In doing so, I was attempting to 'deflate the social context' which had formed around these commodities, and devise a narrative based on associations. Once common themes had been established, it became possible to trace "a trail of associations between heterogeneous elements" (Latour 2005:5). The coding scheme I established is based on four primary themes: OL for opportunity for lender or investor; and OB for opportunity for borrower G+ and G- for positive and negative growth respectively; C for competition; I also used two secondary codes to help identify certain discursive features within the text: E for euphemisms; and, D for dissent or doubt. The latter is accompanied with a list of qualifiers: DA for abuse or predatory lending; DD for downturn; DI for bad investment strategies; and, DC for petty critiques.

These themes represent a tapestry of associations by which a narrative surrounding sub-prime mortgages and mortgage backed securities were constructed. This is not something that has been derived from context, but rather from the articles themselves. As such, I see the ontological status of these articles as artifacts of actor-worlds. In a sense, these articles "encapsulate the world that their author wants to build. They juxtapose elements, suggest their appropriate relationships, and they simultaneously make an argument about how the reader should fit into that world" (Callon et al 1986:223). The abundance of common themes in each of the articles would suggest similar *associations* held by each of the actors in relationship to the sub-prime mortgage market. As such, I understand each code as linked together, and by taking a broader view, it becomes possible to see a narrative woven from the threads.

As the data will show, the narrative qualifies a few things about the way the sub-prime mortgage market operated. Its principle justification was that it was providing homeownership for those who did not qualify for a traditional loan. Those who took out a sub-prime loan were expected to eventually re-finance for a traditional loan after they had improved their credit history via the sub-prime loan. This was a process known as credit migration, which was seen as being beneficial for both the borrower *and* the lender. Not only did it allow people to reasonably procure a home, but it also theoretically guaranteed that the mortgage payment would be made in a relatively short period of time. This made for a relatively safe investment when it came to mortgage backed securities, since the borrower was contractually obligated to pay the loan back to the lender. This process was entangled with a state ideology, the details of which will be elaborated on in chapter five.

Each of the codes represent different themes in the narrative outlined in the paragraph above and it is possible to see the narrative unfold from the bottom up. Each of the sections below will unfold temporally, emphasizing key articles which articulate particular conceptions about each theme. I will show how being denied homeownership is an injustice, and that the sub-prime mortgage market corrects that injustice by giving borrowers a chance at home ownership. I will then move to how the creation of a sub-prime mortgage market represents a good opportunity for investors, despite the high risks involved. I will then follow with discourses surrounding the growth of the market, followed by a discussion on the influence of competition.

It should be noted that the secondary codes (euphemisms and dissent) were used primarily to document discursive features. The following chapter will emphasize the role of the state in the sub-prime mortgage narrative, by analyzing a document issued by the United States Department of Housing and Urban Development, but before this occurs, it is important to establish the narrative as it conceived before the crisis. The following sections do not present the entire sample, but rather archetypal articles which form the basis for the narrative outlined above.

4.1 Opportunities for Borrowers

The articles coded for opportunities-for-borrowers numbered nineteen in the sample of eighty, or about 23% of the articles. The distribution by year is one in 1998, two in 1999, two in 2000, one in 2001, four in 2005, and eight in 2006. Much of the material described specific loan deals, which are meant to entice the borrower into taking out a loan with a given company. In some cases this was marketed directly to the borrower via a newspaper outlet, but in most cases, the articles are marketed to independent financial advisers. In these cases, the independent financial advisor would pass the information on to the future borrower. In other cases, the articles would posit the sub-prime mortgage market as correcting an injustice inherent in the housing system. In these cases, the opportunity for the borrower was implicit, and in one case, this was directly aimed at minority groups. It is possible to allocate two functions in the opportunity-for-borrower discourse: the first being that it was a positive way for people to secure a home; the second being that it functioned to correct a problem inherent within capitalism.

In early 1999, *Money Marketing* ran an article title "A Sub-Prime Opportunity" which describes how the sub-prime mortgage market had recently gained legitimacy due to some sub-prime lenders accession into a subset of the Council of Mortgage Lenders titled Non-Conforming

Lenders Working Group (Money Marketing 1999b). The Council of Mortgage Lenders is an industry oversight commission in the UK, whose aim is “to foster a favourable operating environment in the UK housing and mortgage markets” (Council of Mortgage Lenders 2011). This established the sub-prime mortgage market as a respectable entity as “[c]onfidence is established with [independent financial advisors] that they are building better business relationships with people they can trust.” Thus, for the borrower the world is opened: those within the sub-prime market are finally able to borrower with confidence due to their accession into an industry run and regulated oversight group. At this point in time, major financial firms “[showed] no appetite for [sub-prime borrowers]. It is as if one and four of the working population has been disenfranchised from the financial service industry” (Money Marketing 1999b). This article reveals a very important facet of the sub-prime mortgage market; those who qualified for sub-prime loans were seen as having an injustice done to them.

Playing on this concept, an article printed in 2000 in the *Philadelphia Inquirer* described how, despite the booming economy, there had been little change in the gap between white and minority home ownership in the United States. The article claimed that the booming housing market had limited the opportunity of minority borrowers to obtain a home, but it also describes a possible solution. Nicolas P. Retsinas, the director of the Department of Housing and Development was quoted saying “‘[m]ortgage industry innovation and outreach to low-income and minority borrowers have helped extend homeownership opportunities to many.’” The article goes on to say that “[l]ow-down payment loans have helped all borrowers. Cash-strapped households have flocked to these products, with 30 percent of buyers in 1999 putting down 10 percent or less, 16 percent putting down 5 percent or less, and 4 percent providing down payments of 3 percent or less” (Heavens 2000). Minority borrowers, who have historically been subjected to a myriad of social injustices over the course of US history, finally have the chance to own a home despite all obstacles. Sub-prime mortgages are a beacon of hope for the minority borrower. Where the opportunities for obtaining a home were previously limited to this segment of the population, the discourse shows that the sub-prime mortgage market was a way of alleviating this injustice. This also exhibits a neo-liberal *governmentality* in that it affirms market forces as a reasonable solution.

In 2006, a testimonial about the sub-prime market was printed in London's *The Sunday Telegraph*. The short article stands as an artifact professing the opportunities in store for those who, as the title states, 'bite the bullet to go sub-prime'. The short article reads

> Having found my dream home I was shocked to discover that the only way I could get on the property ladder was to take out a sub-prime mortgage. I turned full-time freelance last autumn but I didn't start getting paid until December, and because of cash flow problems ended up missing a loan repayment. This was to cost me dearly, because in the meantime I found my dream home. Earning a decent income and having a 15 percent deposit I thought I would have no problem getting a mortgage., but I was wrong. The only type of mortgage available to me was a more expensive sub-prime home loan. I decided to bite the bullet and I was offered a two-year fix at 6 percent by Advanced Home Loans. I'll remortgage after the two-year fixed rate ends. By then, I should have a better choice of loan and a good credit record. (Downes 2006).

The article stands as a testament to the virtues of the sub-prime market. The borrower, who found the home of her dreams, could not stand to wait until her credit rating improved. In this sense, the opportunity for her to realize her dreams were closing quickly, and do to an unjust system, because of extenuating circumstances, that opportunity would not be realized if she did not 'bite the bullet to go sub-prime.' Overtime, the sub-prime lending market gained legitimacy as a way for those with a few 'credit blemishes', to right the wrongs of their past. By correcting this injustice, the sub-prime market not only legitimized itself, but opened itself to borrowers, but to lenders as well, where potential profits could be shared by both parties.

4.2 Opportunities for Lenders and Investors

The prevalence of the code opportunity-for-lenders in these articles, are not as pervasive as other codes. There are a total of sixteen, or about 20% of the articles. The distribution of this code by year is as follows: one for 1999, two for 2000, one for 2003, one for 2004, three for 2005, and eight for 2006. The articles come together to form distinct narratives by which securities are understood as opportunities for lenders to make relatively safe investment. Often, these articles would use expert language to further legitimize the transaction being undertaken. Each article also gives a window into the expansion of the market, whereby the sub-prime mortgage securities took on both new forms, as well as new markets. The overarching theme in the articles presented is that the sub-prime mortgage security is a safe opportunity for borrowers, and lenders alike.

Much like sub-prime mortgages, many of the articles dealing with sub-prime mortgages read like advertisements for mortgage backed securities. An article titled ‘Market Prepares for Busy Month’ printed by *Asset Sales Report International* in 2000, described different securities and their eventual payoffs. A variety of securities were advertised, in terms of their credit ratings, tranches and the prices they are demanding, as well as the duration of their pay off. For example, a sub-prime mortgage made available by Kensington Mortgage Company, was given “a life”, or its anticipated pay off, of 0.7 years and a rating of AAA, the highest rating a security could command. The asking price was for this tranche was $150 million. The article does not mention the inherent risks involved with this type of lending, but instead attempts to dissuade the reader from these concerns by claiming that the ‘credit enhancement’ techniques had been employed. These include concepts like ‘subordination’, which means that a creditor has set a priority on a borrower for their repayment, and making available ‘any excess spread’, which essentially means that there is a difference in potential profitability between two assets (Davies 2000). This type of language reassures the borrower that the securities have been assembled professionally because of the use of technical language, but that the upmost caution has been used to protect the investor’s money. It is in this sense that securities are understood to be a safe investment, representing a perfect opportunity for the investor.

An article printed in *Money Marketing* in 2001, titled “Mortgage War Moves to the Sub Prime Market” showed a different opportunity in regards to sub-prime mortgages; the opportunity being presented to the lender. It described General Electric and the Bank of Halifax’s push to enter the sub-prime market and claimed that

> [s]ub-prime mortgages enable lenders to make higher margins which they justify because they are taking a greater risk. People who take out sub-prime mortgages usually leave after little more than three years because of the higher interest rates. However, they will only move to a high street lender when their credit rating has been cleaned up after three or more years with the sub-prime lender. (Money Management 2001)

This excerpt shows that sub-prime borrowers have an opportunity to charge higher fees for lending to sub-prime borrowers. While the risk is substantially higher, it is lowered as the borrower hypothetically repays the loan in a timely manner. It is implied that the borrower will refinance when their credit rating has improved enough to qualify for a prime loan. This is the logic of the sub-prime mortgage machine. For the borrower, the sub-prime loan is a safe investment because no one, as atomized actors, would maintain a loan at the cost of borrowing at sub-prime rates. In theory, the lender would receive all of the money that is owed to them at the end of two years, plus interest. The borrower also had the opportunity to own a home, and if they are responsible and trustworthy, they can refinance later at a better interest rate. The logic was governed by an image of opportunity. Both the borrower and the lender had the ability to realize the dream of profit in both safe loans and a brand new home. In this scenario, it is up to the borrower to improve their credit rating enough to move the loan outside of high interest rates, where the lender, who presumably offered a fair deal to begin with, can simply sit back and reap the profits of their good will.

This carried over to people who purchased sub-prime mortgage securities as well. An article printed in 2003 detailed the year's best short-term investments, as well as making a guess for stable long-term investments. The article claims that "[w]hen homeowners rush to refinance, these [investment] funds, which invest in portfolios of bundled mortgages, find many of their high-yielding bonds paid off early" (Schriffers 2003). Within a year, the market for these types of bonds, their potential to pay off early, as well as their perceived relative stability, spawned a variety of new securities, such as a 'negative equity' mortgage backed-security. This initially occurred in Hong Kong, where the idea was to securitize mortgages whose relative worth compared to the initial investment had *decreased*. The logic behind this was that the process of securitization would offset the cost of the lost for the lender. The article celebrates the process as a way for lenders "'to meet the unique needs of this sector in Hong Kong'" (Davies 2004).

By 2006, the securities market had expanded to the Irish and the Canadian market, both considered late comers to the sub-prime mortgage market (Mavin 2006a, Colomer 2006). The increased diversification, as well as the spread of sub-prime mortgages throughout the globe indicates that the market had begun to grow and become more competitive, while simultaneously creating an image of safe investing. The growth of the market would not be possible without this sentiment.

4.3 Growth

From the earliest phases of the sub-prime mortgage bubble, one key idea persisted: the sub-prime sector is growing, both lenders and borrowers a like should seek a piece of the action. It is a key discursive element, represented in the sample by thirty-nine of eighty articles mentioning positive growth, or 48%. The distribution by year is as follows: one from 1997, three from 1999, six from 2000, one from 2001, three from 2003, three from 2004, nine from 2005, and thirteen from 2006. In the sub-prime world, growth is the reason to enter the housing market. For the lender, it is an opportunity to tap into one of the fastest growing mortgage industries. Sub-Prime loans, which are intended for customers with imperfect credit ratings and histories, are to be refinanced after the borrower improves their credit rating by making payments on time. Thus, in theory, the sub-prime mortgage market was a perpetual loan machine and, for investors, a relatively safe investment, given that the borrower should pay off the loan once their credit score improved. The proliferation of sub-prime mortgages, i.e. growth, is a key discursive feature because it centered the production of loans within a framework of legitimacy and potential profitability.

A 1998 article in *The Philadelphia Inquirer* claimed that “as the sub-prime industry has grown, competition has become more fierce, leading sub-prime lenders to offer better, less profitable loan terms” (Fernandez 1998). Thus, the growth of the market is intimately linked with increased opportunities for borrowers to find better mortgages. Conceptions of the sub-prime mortgage market as shown by these media outlets portray the ability for sub-prime mortgage borrowers to get a fair deal. The growth of the market is a good thing for borrowers and lenders alike because it shows that the market is achieving legitimacy. During the same period, it is possible to see this language linked with “new mortgage concepts”, or new ideas about how to lend to people in the sub-prime category. The opening lines of an article published by *The Washington Post* in 1998 read

> if you’re one of the hundreds of thousands of home buyers with less-than-perfect credit who have taken out “A-minus” and “B” mortgages with double-digit interest rates in the last three years, you may be able to save some serious money in the market right now. That’s because intense competition, new mortgage insurance concepts and declining interest rates have turned this summer into the best opportunity in memory for borrowers and homeowners with credit that is dented, but not seriously mangled, to lower their monthly bills or even pull out some equity cash. (Harney 1998).

The article was purporting innovations within the sphere of sub-prime mortgage lending which allowed a sub-prime borrower to refinance. The benefits for the lender and the borrower were that the borrower would be able to pay off the original loan in full, while the lender was able to benefit from the immediate influx of cash: the loan plus accumulated interest. The proliferation of new lending technologies can only come about in a sector which had achieved a degree of success, where increased interest inspired new innovation. Lending technologies were also a claim to legitimacy, growth being the impetus. The same article highlighted another important point about the sub-prime industry; the influx of large, high finance lenders into the market. *The Washington Post* article cited US government sponsored lenders Fannie Mae and Freddie Mac as new players in the sub-prime mortgage lending business (Harney 1998). Other articles deal specifically with the lending market and the influx of major banks into that market.

An article printed by *Money Marketing,* in their series *In the Sub-Prime of Life* which ran in the early 2000s, claimed that despite bad publicity, the market had seen an increase in growth of over the past two years. The article is interesting because it highlights a tension that persists in articles of the period: despite claims that these loans were of "poor quality", the industry continued to grow. The article attributes this to sub-prime lenders joining an industry-created regulatory board, like the Council of Mortgage Lenders, to increase accountability. It notes that "given the ease of getting a mortgage, a large number of borrowers were attracted to the market, subsequently defaulted on their payments and lost a great deal of money" (Money Marketing 2000). Despite reports of abuse, throughout the period between 1997 and 2006, the sub-prime mortgage market saw increased growth. Where reports of abuse were one of the most frequent cries found in the literature, discourses involving growth overpowered them.

In a short article in *The Times* (London), it was reported that "huge growth [in the sub-prime mortgage sector had] been boosted by the increasing presence of high street banks such as HSBC and The Bank of Scotland" (Morgan 2005). In this case, the presence of high finance boosted the growth of the sub-prime mortgage market. Thus, these banks had a vested interest in lending loans to people for high profits. Many of the articles report that banks could make more money off of the sub-prime mortgage sector because of the high interest rates that they could charge borrowers. The articles mentioned in this section do not report how the securitization of these mortgages is also highly profitable for large banks. Another article reports that another large fund doubled their portfolio in the sub-prime mortgage market, claiming that there was "'phenomenal growth….there [seemed] to be good economics to it'" (Shecter 2005). The person quoted is claiming that 'good economics' preceded the 'phenomenal growth', while their use of the word 'seemed' indicates that this is an assumption. It can then be inferred that the person being quoted is only assuming that the growth is being inspired by 'good economics', but is only reaffirming the legitimacy which economic growth indicates. The increased competition from 'high-street banks' furthers these claims toward legitimacy.

In the summer of 2006, *The Observer* (England) printed an article outlining the risks associated with the growing sub-prime market. It claimed at the end of the article that the growth of the sub-prime market brought it increasingly under the spotlight for criticism. With increased growth, the article reported how lower class populations were being targeted, as well as the lending company's willingness to repossess homes (Phillip 2006). A later article made a similar claim attacking advertising campaigns which coerce borrowers into home loans they cannot afford (Financial Advisor 2006). Another criticizes sub-prime mortgage lenders as being 'Ferrari Kings', or people who cull excessive profits from sub-prime lending and then buy Ferrari's with them (Kassam 2006). These articles stand as a few of many expressing an increasing amount of dissent in regards to the growth of the sub-prime market during 2006. As the following chapter will show, the criticisms being drawn by independent journalists at the time were legitimized by a state-led project to increase homeownership. Doubts regarding the fairness or legitimacy of the sub-prime mortgage market can be regarded as statements of legitimacy in and of themselves. This is because doubt works for the case of legitimacy; it inspires competitive market practices. In a market seen as legitimate, criticizing one company implicitly advocates borrowers to find a trustworthy company. Evidence of this stance is seen in the articles. For example, an article printed in *The Sunday Times* (London) titled "Small Mortgage Specialists Face Hard Times" claimed that sub-prime specialist lender Kensington Mortgage Company "is a good company that has a strong track record of handling riskier lending" (Ringshaw 2006). After many companies had faced criticism for their lending practices, Kensington Mortgage Company is a company that can be trusted. It is this sense that dissent helps to legitimize growth discourse within the sub-prime mortgage narrative: creating a sea of doubt by which one company can stand out as honest.

4.4 Competition

Competition was found in forty articles, or 50% of the sample. The distribution of articles by year are as follows: one from 1997, two from 1998, four from 1999, three from 2000, three from 2001, one from 2003, one from 2004, nine from 2005, and sixteen from 2006. Both growth and competition go hand in hand in the discourse of the sub-prime mortgage market. The difference being that increased competition leads to a decrease in prices: the semblance of a fair deal, which consequently legitimizes the sub-prime mortgage market, but in contrast to growth, it emphasizes the tumultuous nature of the market. Competition in discourse signifies that the market to the forces of economics: survival of the fittest as a bid for legitimacy.

An article in *Money Marketing*'s *Sub Prime of Life Series*, published in 1999, described the implications of the competitive market. It was on British lender Future Mortgage Group, a company owned by the US-based investment firm Friedman Billings Ramsey Group. The article claimed that from 1998-1999 that Future Mortgage Group doubled its employee base to help meet the demands of the market. Future Mortgage Group was said to be competitive because it charged “a flat fee of 250bps” on a flexible mortgage and no more than .75% on other loans. Other mortgage groups, like the aforementioned Kensington Mortgage charge higher fees (Paul 1999b). While detailing the competitive aspects of the new sub-prime mortgage market, the article also legitimizes the market for the consumer because increased competition commands lower prices on the market. By offering, by what can be claimed to be a fair deal to the consumer, a mortgage in the range of 5-7% for people with *less than perfect credit,* the market simultaneously claimed that this was not only a reasonable proposition for people, but a leap a person should consider making while competition was at an all-time high. Inconspicuously left out of the article was a definition of "credit blips", which are ambiguously described in a pre-conceived construction of a sub-prime borrower: "'[t]hey may be recently self-employed, contract workers or those with more unusual employment such as having two or three jobs. Perhaps they have experience some degree of difficulty in their credit history with county court judgments or mortgage arrears against their name'" (Paul 1999b). Anyone reading the article is expected to take a reflexive attitude when they read this line, 'Do I fit into these categories? Do I qualify for this loan?' While credit history was mentioned, there was nothing to suggest that the person have a credit rating that met any standards; the article gives the impression that the loan will be granted to those that qualify, but says nothing concrete about the criteria. This is because it had become an imperative for these corporations to increase their customer base in order to stay competitive.

Another aspect of the competitive market that deserves mention is the buy-out. There are a number of articles that have cited the buyout of one firm for another. One example is a short piece about the buyout of The Money Store, an early sub-prime lender, which was purchased by the firm Cabot Square in 1999. Citing financial difficulties as a reason for the buy-out, Cabot Square expressed its optimism in the financial market when it claimed that it believed "there are significant growth opportunities in the sub-prime market. It predicts the economy will continue to grow and people who had financial difficulties will find the confidence to take out mortgages, bringing a boom in the sub-prime market." (Paul 1999a). For sub-prime mortgage lenders, there were winners and there were losers, and it is possible to see here, the acquisition of one company by another: a winner and a loser. It gives the image of a reliable machine. An acquisition was the same as saying that the market was functioning; the hidden hand is governing as it should. It can then be said that the sub-prime mortgage market was one that tried to achieve its own balance, something reliable and trustworthy.

An article written in the *Deal Finder* series in London's *The Independent on Sunday,* examined a range of loans offered by Kensington Mortgage Company, a major sub-prime lender in the British mortgage market. The article claimed that the company could offer a monthly interest rate of 6.75% a month, which would be fixed until after two years. The rate then switched to a rate which is set at one-percent higher than the Libor rate (Independent 2001); the Libor rate is subject to fluctuations in the market. The article was printed in a "Deal Finder" series, it seemed apparent that such a rate is conceived of as fundamentally beneficial to customers, although it criticizes Kensington Mortgage for using this strategy. It instead encouraged those seeking a loan to "shop around".

Between 2004 and 2005, the competition increased as more banks based in different countries entered the market and an article from 2005 describes Canadian Western Banks interest in the sub-prime mortgage market. The interest in entering the market stems from the CEOs glancing at competitor Home Based Mortgage group, who claimed that their share in the sub-prime mortgage market was "'spectacular….it blows you away!'" The article also reported that the Canadian sub-prime market had grown to one-hundred and twenty billion Canadian dollars that year (Shecter 2005a). Another article, written in 2005 about the same companies, claimed that while these companies are expected to make huge profits, investing in these companies might be risky. However, it is not because of the types of businesses these companies were engaged in, but rather because increased competition might undercut the profits of a company in which a person might invest (Berman 2005). From the perspective of financiers, investment opportunities in sub-prime mortgage companies were generally a safe investment. It is very apparent that none of the articles were purporting any *inherent* risk within the industry. In 2005, risk was largely centered in the competitiveness of the market, which was based on who could sell more loans to more individuals and reap the subsequent profits; the risk was based on losing a share of the market. Competition, in this sense, can be seen as good for the mortgage machine. It creates the fodder for which companies can profit from further.

An article printed in 2006 from Canada's *National Post* noted that it was expected for a rise in mortgage defaults, due to the growth of the mortgage market. The article cites the reason for this as "borrowers who have been encouraged to enter the market are a greater credit risk and may not be able to meet payments" (Mavin 2006b). It can be attributed to an increase in the availability of mortgages, as well as the competitive rates that the market forces inspire. The article warns that the housing market is nearing its peak, expressing doubt in the viability of a sustained market. The article legitimizes the mortgage market by claiming that it is open to 'natural' business cycles: when supply begins to exceed demand, the market will retract. The doubt expressed in the narrative, in this sense, does not dissent from embedded market discourses, and consequently legitimizes these forces.

The next chapter will attempt to understand these narratives, opportunity for borrowers, opportunity for lenders, growth, and competition, in terms of a state-led theory. It will show that the market and the state take place within a closed system of social relations, the state having *agencement* on the market and vice-versa. The narrative embodies neo-liberal *governmentality*, expressing techniques of governance which affirm the legitimacy of market forces. The chapter outlined above will be juxtaposed with a document from the United States Department of Housing and Development, which was published in 1995, two years before the first articles in the sample were published. It should be noted that this was not done purposefully; relevant articles before 1997 were not returned in the initial search. The analysis below will suggest that there is a correlation between state and market discourses, which would indicate that the sub-prime market is a product of a state-led campaign to increase homeownership. While the parallel will be apparent, it is important to recognize that the correlation could be spurious, as the research presented does not consult individual actors, but only the artifacts left from a different period.

Chapter Five: Analysis and Discussion

The United States Department of Housing and Urban Development released *Urban The National Housing Strategy* in August 1995, which outlined the benefits of homeownership both on a nationwide scale as well as for individual homeowners. The main points in the policy brief will be compared with the main themes outlined in the chapter above, in an attempt to show how they represent techniques of governance, or put another way, represent a *governmentality*. I will then elaborate on the implications of these government practices and relate them to long-term economic processes in the conclusion. This will show that the sub-prime financial crisis was fueled by a *governmentality*, which considered homeownership to be an essential aspect of a healthy society.

The *National Housing Brief* of August 1995 published by the Department of Housing and Urban Development (HUD) is divided into six sections, which will be elaborated upon below. The first is an introduction, which outlines the basic tenants of the policy brief. The opening lines claim that “[t]he desire for homeownership is deeply rooted in the American psyche” (Department of Housing and Urban Development [HUD] 1995). It goes on to claim that a number of recent US presidents had felt that homeownership was an essential part of a healthy society, and that there had been a significant decline in homeownership from 1980-1991: from 65.6% to 64.1%. It then goes on to outline four ‘fundamental benefits’ to homeownership:

> “Through homeownership, a family…invests in an asset that can grow in value and…generate financial security.”
>
> “Homeownership enables people to have greater control and exercise more responsibility over their living environment”

“Homeownership helps stabilize neighborhoods and strengthen communities.”

“Homeownership helps generate jobs and stimulate economic growth.” (HUD 1995)

Each of these themes are elaborated on in more detail in the rest of the policy brief. They simultaneously correspond to a few of the themes outlined in the preceding chapter. The discursive strategies outlined in the sample of articles corresponds to the discourse being promoted by the policy brief.

The first section in the policy brief, titled ‘Homeownership and Wealth Accumulation’ cites a series of statistics, as well as studies, which espouse how a home is essential for establishing wealth. It discusses how a home serves as a sturdy initial investment, which help homeowners increase wealth, but also allow for tax breaks. It goes on to claim that more home loans should be given to minorities who could potentially benefit from the associated increases in wealth associated with owning a home. The article also points out that the risks of giving loans to low-income borrowers should be balanced, because they are particularly vulnerable to economic downturns. The next point in the policy brief corresponds to two discursive features, both growth and increased competition. The section titled ‘Homeownership and Economic Growth’ discussed how stimulating the housing economy would also help aid in job creation, as well as the expansion of the secondary market, including the sale of mortgage-backed securities among investors. The policy brief “fuels an immensely powerful engine of economic activity” and in doing so, helps breed a competitive environment and a sound economy (HUD 1995). This corresponds to the discourse surrounding positive growth in my sample of articles. These discourses give the impression that the market has achieved some legitimacy as well as potential profitability. The sub-prime market in this case is the cornerstone of a state led campaign for wealth creation among the lower-classes. Potential profitability affects both the borrower and the lender alike. In this case, by viewing the housing market as an engine for economic growth, the hidden hand of the market is being allowed to even out the ruffles, smoothing the market toward an ideal equilibrium. Thus, the articles, utilizing discourses of growth and competition are promoting this market stability, or a neo-liberal *governmentality* as outlined above by Rose and Miller. This technique of governance runs the gamut from the top to the very bottom of the social ladder, where wealth creation is a key driving factor.

The policy brief discusses in detail how increasing homeownership improves the quality of life for homeowners. The section titled ‘Homeownership and Personal Well-Being’ described how owning a home is associated with increased ‘self-esteem’, ‘control’ in regards to the homeowners own life, and ‘life satisfaction.’ It is possible to associate these claims with discourses involving opportunities for the borrower, where owning a home is of upmost importance for the borrower. As the lead in line for the article suggests, it is something embedded deep within the American psyche, but is it a tool of governance? The next section, titled ‘Homeownership and Neighborhood Stability’ holds the answer. The article outlines how homeownership is associated with positive neighborhood trends such as ‘length of residence’, ‘neighboring’, ‘upkeep’, ‘crime prevention’, and ‘social political activism’, with the overarching claim that those that own homes in a neighborhood wish to preserve the quality of that neighborhood (HUD 1995). At this point, the article takes a discursive turn, because what are outlined in this section are social factors of homeownership. Veiled behind discourses of opportunity are also discourses for good governance. By promoting homeownership for the lower-classes, the state is similarly promoting policies for greater self-policing. The discursive elements represented in the articles carry out a function that theoretically promotes greater selfgovernance among lower-class citizens. It can then be said that the financial crisis was fueled by a process to extend a greater amount of control over its citizens.

There are other reasons for wanting to promote greater homeownership among the lower classes. With Fougner and the *competition state* in mind, there is a reason that sub-prime mortgage discourse varies little from nation to nation. Promoting homeownership, not only extends control over citizens, but makes a nation-state more competitive by creating a sound economic foundation for wealth creation. The *competition state* follows the logic outlined in the discourse in the sample. For Fougner, the competition state attempts to bring global capital into the nation state itself (Fougner 2006:180). Thus the sub-prime market serves as a means of capital creation, through the sell and trade of securities in the global market place, acting as a selling point for global firms. In this way, both the state is legitimized by the increased presence of global capital, as well as a country's competitiveness in the global market place. The state is acting in accordance with a neo-liberal *governmentality* as it attempts to emphasize market forces above itself.

In doing so, the state contributes to the process of *economization*. Remembering the Bretton Woods System, it is possible to see how the state created the conditions for economic activity by controlling the flow of capital and liberalizing trade. The *competition state* mirrors this process by deregulating the flow of capital. The *agencement* of the state is allowing the process of the *economization* to extend across borders. Thus, the *competition state* both legitimizes market forces by allowing them to spread from nation-state to nation-state. The globalization of the sub-prime mortgage market is a product of this process. As such, the state directive to increase housing among the lower classes had its impetus in the United States and then spread globally via the digital networks outlined by Castells and Carnoy, and more specifically Sassen. Within these networks, the altruistic aspects of the HUD brief were downplayed, for their capital accruing capabilities. It can then be said that the directive itself acts as the impetus for a new market, where the process of *economization* made for new market practices which simultaneously bear the mark of governance. It is in this sense that it is possible to speak of sub-prime mortgage discourse as *governmentality*.

Chapter Six: Concluding Remarks

If we are to remember Arrighi's thesis, that the past two global powers experience a period of *financialization* before collapse, and that the United States is currently experiencing that period, then it could be said that the state had a role in its own demise. In creating the impetus for the sub-prime mortgage machine, the climate for catastrophe began to form. It became established as it travelled the capital networks, evolving into an instrument of capital. While there is no conclusive evidence showing that individual actors were directly influenced by the state via a testimony, I would argue that no such evidence is possible. The process of *economization* is not one which the actors conceive of as atomized individuals. Rather, it is a process which can only be seen when the actors are considered together as a network. And while gaps exist, combining the narratives put forth in the analysis show an undeniable correlation in content. As it has been throughout recent history, the state and economy, if conceived as separate institutions, are working toward the same project.

Implicitly, this thesis has sought to overcome the break between macro processes and micro processes. It instead asserts a difference of perspective, but ultimately a discussion centered on the same network of social relationships. Thus, in each epoch of financial history, similar relationships were manifest among actors. The Sub-Prime Mortgage Crisis is certainly no different: actors assembled into different institutions, influencing each other, and creating both the market and the crash. But it is important to note that the processes of history have manifested in the current crisis. It is no wonder that Arrighi's thesis contains an eerie sense of validity: the specters of the past haunting the present. This is because the social relations surrounding the reproduction of capital have been passed down from generation to generation in an ever-unfolding network of associations. Large scale patterns reflect the continuity of relationships over time, but it is always a network of actors which reproduces these relationships.

The articles themselves represent a kind of network. They mirror a widespread conception of financial instruments, the role of finance in society, and greater cultural sentiments. I have attempted to show the cohesion in these conceptions, attempting to understand their similarities, while overlooking petty differences. The nuances of the narrative are not expressed in this thesis, because actors themselves are not dealt with. Instead, I have analyzed the artifacts of their production, part of a greater network of knowledge production, which bear the signs of this network. It is in this sense that the state is said to bear an effect, and it is this aspect that I have chosen on which to focus. In doing so, it is possible to see the makings of a crisis, where its impetus stands with a seemingly benevolent ideology.

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