

MERCHANT ASSOCIATIONS IN PRE-INDUSTRIAL EUROPE*

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ABSTRACT: In pre-industrial Europe, many of the functions performed today by large corporations and governments were performed by merchant associations of various types—merchant guilds, regulated companies, merchant-controlled cities, and merchant colonies. Merchant association provided their members with protection and order, represented them in the rivalry for trade, and helped them overcome the problems of agency and financing. This paper examines the nature, function, and evolution of merchant associations.

JEL Categories: N13, D20, D23, K40, L14, L22

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Today's economy is dominated by large corporations and powerful governments. The pre-industrial economy was very different. Firms were mostly small: they were either sole proprietorships or small partnerships. Governments were weaker, less centralized and much less involved in the economy. Such a world of small firms and minimal government might seem like a recipe for atomistic and unstructured interaction, but such was not the case. Individual firms did not act independently. They came together in associations of various types to act together in their common interest. We shall see that in the pre-industrial economy it was the association rather than the individual firm that performed many of the functions we associate today with the large corporation. Similarly, many of the functions we associate today with government were performed by voluntary associations of many types. While our focus here will be on merchant associations, voluntary associations played a vital role in all parts of society.¹

To understand the role of merchant associations, we need to understand what it was that merchants did. A merchant was primarily a trader: he bought and sold, generally leaving production to others. His first task was to seek out a potential trading opportunity—a situation in which goods could be purchased and resold at a profit (usually somewhere else). Having identified such an opportunity, his second task was to defend it against other merchants and to protect it, and himself, against predation by robbers and governments. To realize the potential profit, he had to actually undertake the trade. This meant negotiating with suppliers and customers, finding transportation, and arranging financing. In all of these activities, in addition to the direct costs, the merchant faced the problems and costs of relying on others—on the agents who acted for him in distant markets and on the debtors who owed him money. We shall see how merchant associations assisted the individual merchant in all aspects of his business.²

¹“... medieval society seems to me to have been full of groups of lay people who acted together, or thought of themselves as acting together, sometimes over long periods, and who appear to have done so—as far as the records show—at least partly on their own initiative and with a relatively small amount of formal regulation and physical coercion.” Reynolds (1997) p2

²Avner Greif has done the seminal work on merchant associations: see, for example, Greif (1989; 1993; 2001) and Greif, Milgrom et al. (1994).

TYPES OF MERCHANT ASSOCIATION

A merchant association was a group of merchants who came together for the purpose of joint action. Merchant associations typically possessed a structure of governance to make decisions and to set rules, as well as a system of internal order to deal with violations of those rules and with disputes among its members. Merchant associations, in addition to their economic role, also performed important social and religious functions. As we shall see, however, these functions too had their economic aspect.³

Types of merchant association fell into two broad categories—those formed by merchants at home and those formed by merchants abroad in some distant market center.

Organization at home

The characteristic form of organization of merchants in their home cities was the merchant guild.

Merchant guilds

The institution of the guild was not peculiar to merchants. It was a form of voluntary organization ubiquitous in medieval society—much as the committee is today. As early as the eighth century, groups of people with some common bond were coming together to socialize and to provide one another with mutual aid. Typically, the members strengthened group solidarity by taking an oath of loyalty. Such groups were known as guilds or hanses in northern Europe, but similar groups were found in the south and were

³There is a less structured form of association—the merchant network (the term is due to Powell (1990); Greif (1989) calls it a merchant coalition). The merchant network is a community of merchants with enduring exchange relationships with one another, but with no formal structure of government or formal system of internal order (Podolny and Page (1998)). Networks are usually based on religious or ethnic diasporas. Greif documents the existence of a merchant network (coalition) among Maghribi Jews in the Muslim world in the eleventh century. Merchant networks do not seem to have been important in Europe in this period (although the diaspora of sephardi Jews may have constituted such a network after their expulsion from Spain and Portugal). However, in the seventeenth century, independent protestant sects provided a basis for merchant networks that did become important in British overseas trade—see, e.g., Everitt (1967), Mathias (2000).

known there as fraternities or confraternities. When joint action in the common interest proved necessary these groups provided a natural framework.⁴

There are records of guilds of merchants in England from the tenth century; in northern France, the Low Countries, and northern Germany from the eleventh; and in Italy from the twelfth.⁵ In England, the initial objective of such merchant guilds was to acquire and to defend control of the local market.⁶ On the continent, where merchants were more concerned with long-distance trade than with local trade, the initial emphasis was on joint defense for traveling groups of merchants. However, once a guild came into existence, its functions and activities evolved and expanded to meet the changing needs of its members.

Some guilds, especially earlier on, were very loosely defined and included all sorts of merchants, tradesmen, and artisans (some were even open to members who were not residents of the town, but who did business there).⁷ Later, guilds became more exclusive, with membership limited to merchants alone or even to particular categories of merchant trading in particular types of merchandise or to particular destinations.⁸ At the same time, it became more difficult to join a guild, with membership generally descending from father to eldest son, and outsiders having to purchase entry at considerable cost. The reason for the greater exclusiveness was that over time many guilds acquired valuable rights—monopolies over particular forms of trade or exemptions from various tolls and taxes. Naturally the members wished to keep these hard-won benefits to themselves. Although particular guilds came to be associated with the specific trades over which they

⁴Reynolds (1997) Ch. 3. Cf. Casson (1997) writing on business networks today: “The business community can ‘free ride’ on the activities of numerous social groups which constitute the fabric of society as a whole.” (p136). See also Granovetter (1985) on ‘social embeddedness’.

⁵Nicholas (1997).

⁶On early English merchant guilds see also Gross (1890)

⁷“contemporaries seem hardly to have distinguished between the burgesses of a town, the inhabitants of a town, and the members of its guild, while all rules of membership seem to have been very vague” Reynolds (1997)p35

⁸See Kohn (2001b) for a discussion of craft guilds, which developed in parallel with the merchant guilds. The differences in function between the two stemmed largely from the different requirements of industry and commerce.

had a monopoly, this did not mean that their members were restricted to those trades. For example, in thirteenth century Genoa, “[a] leading *physicus* was much more active as a moneylender with small-fry clients. The biggest wholesale transactions in wine were those of a *draperius*.”⁹

Guilds possessed a formal structure of governance. Typically there was an elected leader—called an alderman, master, mayor, major, or rector—responsible for managing day-to-day affairs. The alderman reported to an elected council of assistants or associates (their number usually a multiple of twelve, up to forty-eight) that was responsible for passing bylaws. There were also stewards and others appointed for special purpose. The members met annually in an assembly to elect the officers.¹⁰

The guild and the city

Guilds were entirely an urban phenomenon, and they usually had a close connection with city government. In northern Europe, where cities were initially subject to local rulers, merchant guilds provided a form of governance and representation for those involved in commerce. Since they typically included most of the substantial citizens of the city, they naturally took on many of the responsibilities of local government. In St Omer, for example, the guild maintained the city’s streets, its wall, and its gates and organized relief for the poor.¹¹ As the cities acquired greater independence, formal city government evolved out of the internal governance structure of the guilds. In Paris for example, the Merchants of the Water obtained a monopoly of trade on the Seine in 1171 and in the 1260s the officials of this guild became the four *échevins* of Paris.¹² With the establishment of formal city government, the guilds themselves either faded away or became a part of the structure of municipal government.¹³

⁹Reynolds (1945) p 17

¹⁰Scott (1912)

¹¹Nicholas (1997)

¹²Nicholas (1997). “In a growing town an association for mutual insurance and protection could readily become the body which campaigned for privileges for the town’s traders and its major or alderman might become the spokesman for the town as a whole.” (Reynolds (1997) p70)

¹³Reynolds (1997) Ch 3

If the relationship between guild and city in northwest Europe was from the bottom up, the relationship in northern Italy was more from the top down. Cities in northern Italy achieved a considerable degree of independence quite early on, and formal city government preceded the emergence of merchant guilds. In some cities, most notably Genoa and Venice, merchants were firmly in control of city government from the beginning, and merchant guilds never developed at all: the city government itself essentially played the role of a merchant association.¹⁴ In other cases, cities established guilds as a form of self-regulating organization to which many municipal functions were delegated. In fourteenth century Prato, for example, “Every citizen, as he reached manhood, enrolled himself—if he could pay the entrance tax of 5 *soldi*—in one of the city’s fifteen guilds... Through the guilds, and only through them, could a man hope either to share in ruling the city or to make his fortune: to be fully a citizen you had to belong to a guild.”¹⁵

Cities in Italy, and elsewhere in southern Europe, also established other structures of commercial governance. One type that appeared in many cities from the late twelfth century was called the House of Merchants (*domus mercatorum*), University of Merchants, or *Mercanzia*. This was a sort of umbrella-organization above the guilds: it regulated the guilds, provided a court to resolve inter-guild disputes, and promoted commerce in general.¹⁶ Another such institution was the Consulate of the Sea, which controlled the organization of the port and of shipping and provided a maritime court.¹⁷ This institution first appeared in Amalfi in the twelfth century, and it was later adopted by other maritime cities.

¹⁴“All the merchant nobles of Venice operated as one large regulated company of which the board of directors was the Senate.” (Lane (1944) Ch 2). “Its frankly avowed purpose was to help Venetian merchants make profits.” (Lane (1973) p125)

Luzzatto (1953): In Venice and Genoa “the commune itself was simply the ruling organ of the wealthy bourgeoisie” (p46). In contrast, early Florence was dominated by the landed aristocracy, and merchants and artisans organized themselves in fraternities to defend their interests. By the fifteenth century, merchants were in firm control in Florence and the importance of guilds declined (Goldthwaite (1987)).

¹⁵Origo (1986) p 44

¹⁶Mazzaoui (1981) Ch. 6

¹⁷Samhaber (1964); Ball (1977)

Organization abroad

Just as merchants organized at home, so did they organize in the distant market centers where they traded. In the early days, when merchants traveled in person to trade, they traveled together with their compatriots for mutual protection and for fellowship. Once at their destination, they stayed together for much the same reason.¹⁸ Later, when merchants came to use agents who resided permanently in distant markets, these agents too tended to keep together. Such associations of alien merchants were known as ‘nations’ (*nazioni*) according to their city of origin or as colonies (*fondachi*) according to the places where they lived—for example the nation of the Siennese or the colony of the Venetians.¹⁹ For simplicity, we shall refer to all such associations as colonies.

Merchant colonies

Merchant colonies served many functions. They provided their members with protection. They negotiated with the local authorities for rights and privileges and regulated trade with the locals. They resolved disputes among their members and interceded for them when necessary with the local authorities. And they provided a social and religious framework. For a foreign merchant, membership of the colony was often required—either by the local authorities or by the colony itself—and even if not required it was indispensable.²⁰

Alien merchants first established colonies in the early twelfth century in the markets of the East—such as Acre, Antioch, Alexandria, and Constantinople—and soon after that in Rome, Naples, and Palermo. By the end of the thirteenth century, colonies of alien merchants were to be found in cities throughout Europe.²¹ And not only in the cities, but also at the great fairs. At the fairs of Champagne, for example, there were some fifteen associations of merchants from different cities and regions.²² At the great English fairs of

¹⁸Favier (1998) Ch 6

¹⁹The word *fondaco* is derived from the Arabic *funduk* for inn or caravanserai. In Moslem lands, the *fondaco* was generally a walled compound. (de Roover (1948) de Roover (1971))

²⁰Refusal of an Italian merchant to join the appropriate colony in Flanders meant ostracism by his compatriots and commercial boycott. de Roover (1948)

²¹Spufford (1988); Coornaert (1967)

²²Verlinden (1971); Bautier (1970)

the thirteenth century, not only foreign merchants, but also merchants from major English cities like Lincoln, York, and London had their own associations.²³

Larger and more important groups had greater clout with the local authorities. So merchants from different cities of a given province or region would often work together. Sometimes they would do so through an umbrella organization under which the separate associations joined forces. At the fairs of Champagne, for example, the Italian ‘nations’ joined together in a *universitas*—a multi-city association that represented them in dealings with the count of Champagne and with the king of France.²⁴ Similarly, merchants of the cities of Flanders and northern France trading at the fairs had an umbrella organization known as the Hansa of the Seventeen Towns.²⁵ Flemish merchants from different cities formed a similar Hansa to represent them in England and another to represent them in the Rhineland.²⁶

Sometimes, merchants from different cities would have no colony of their own but belong directly to a single colony with members from many cities. The most famous multi-city colonies were the *kontore* of the north Germans.²⁷ German merchants from many cities who trade at Wisby (on Gotland—an island in the Baltic) established a joint colony there. Other colonies followed in London, Bruges, Bergen, and Novgorod. The London *kontor*, called the Steelyard, was typical. Established under royal protection in the mid-twelfth century, it consisted of a compound enclosed by a wall and gates for security. The compound contained warehouses and storerooms and had its own wharf and crane on the Thames. It also contained an assembly hall, kitchens and sleeping quarters.²⁸ Merchants from most, but not all, of the cities of north Germany and Westphalia used

²³Moore (1985) p102

²⁴Verlinden (1971) Other groups such as the Provençaux had similar organizations. Later, the Italians in Bruges had no formal umbrella organization, but the various ‘nations’ did sometimes work together in pursuit of common interests. de Roover (1948)

²⁵Pirenne (1937)

²⁶Postan (1987); de Roover (1971); Power (1942); Stabel (1997) Ch 7; Moore (1985)

²⁷The term *kontor* was first used in the sixteenth century (Mauro (1990)).

²⁸Carus-Wilson (1978) Bruges was an exception from this pattern: there, presumably assured of their safety, the German merchants did not live apart. de Roover (1971)

these *kontore*, together with merchants from Cologne and from some Dutch cities east of the of Zuider Zee, such as Groningen and Zwolle.²⁹

A colony in a foreign market center usually possessed a formal structure of governance much like that of the guild at home. The Lucchese colony at Bruges was typical. It was governed by a council consisting of a consul, three councilors, and two ‘ushers’. The consul was elected at an annual meeting of all Lucchese merchants living in Bruges: the vote was by written ballot, and all males over fourteen were eligible to participate. The consul appointed the other officers. The consul represented the members in dealings with the local authorities, and the council adjudicated disputes among the members.³⁰

Relations between colonies and home cities

The degree of autonomy of a colony from its domestic authorities varied considerably. In some cases, the colony was entirely or largely under the control of the merchants actually present. For example, each of the *kontore* was separate and independent and governed exclusively by the merchants residing there.³¹ In other cases, the domestic authorities exerted some measure of control. Sometimes, for example, the consul was appointed by the domestic guild or city rather than being elected by the merchants present.³² In yet other cases, the domestic authorities were totally in control. For example, the Flemish merchants traveling to the fairs of Champagne and England were accompanied by guild wardens and inspectors who had absolute authority over them.³³ (This may have been one reason for the existence of the multi-town Hansas, which seem to have been more representative.)

²⁹de Roover (1971)

³⁰de Roover (1948). The governance of other colonies and ‘nations’ was very similar. See Moore (1985) p 289 on the organization of the Londoners at the Boston fairs and Nicholas (1979) and Nightingale (1995) on English merchants at Bruges and Antwerp respectively. On the governance of the *kontore*, see de Roover (1971), Mauro (1990), and Postan (1987) p272-282.

³¹Postan (1987) p272-282

³²de Roover (1971); Bautier (1970). For example, Barcelona’s Consulate of the Sea (Nicholas (1997)) and Florence’s *Arte di Calimala* (Favier (1998)) appointed consuls abroad.

³³Moore (1985)

Sometimes, however, the direction of influence was reversed., The regulated companies of England and the *consulados* of Spain in the sixteenth century were domestic associations that were formed by merchants who had worked together at colonies abroad. For example, the Castilian colony in Bruges in the fourteenth and fifteenth centuries gave rise to a domestic association in Burgos—the *consulado*—that succeeded in obtaining from the king of Spain a monopoly of trade to the Low Countries.³⁴ The parallel English association was the Merchant Adventurers. This was a group of merchants that had traded at Bruges and Antwerp, and associated together in the colonies there. They later obtained a monopoly on the trade from the English Crown.³⁵ The most extreme case of reverse influence was the Hanseatic League. This was a political alliance of cities that grew out of the joint participation of their merchants in the various *kontore* abroad.³⁶

THE STRUGGLE OVER THE GAINS FROM TRADE

Merchants were middlemen, facilitating trade between ultimate buyers and ultimate sellers. Their reward was a slice of the resulting gains from trade. Merchants needed to protect this from those who would take it from them. First, there were the predators who tried to take it by force. Then there were the other merchants who vied with them for the trading opportunities that generated the reward. An important function of merchant associations was to protect their members against predation and to assist them in their rivalry with other merchants.³⁷

In the struggle over the gains from trade, merchants frequently found themselves coming up against governments in the for of lords and kings and the governments of cities. Governments generate revenue through the exercise and the threat of violence.

³⁴Grafe (2001)

³⁵Gross (1890); Scott (1912).

³⁶de Roover (1971)

³⁷Middlemen also find themselves in a struggle with ultimate buyers and sellers to capture as large a slice of the gains from trade as they can. However, their success depends largely on their ability to suppress competition from other middlemen. Competition among middlemen tends to reduce the reward of the middleman to the cost of providing his services, leaving the remainder of the gains from trade to the ultimate buyer and seller.

They did this directly through predation—through robbery, expropriation, and the imposition of tolls and taxes. They also generated revenue by selling protection against the predation of others. More subtly, governments could generate revenue by intervening in the rivalry between merchant and merchant. Governments relied on violence to establish trading privileges and monopolies which they then sold to merchants.

In dealing with governments, merchants were much more effective when they acted together as a group rather than alone as individuals. Indeed, the need for joint action in dealing with governments was one of the main important reasons for the existence of merchant associations.

Protection against predation

Merchants were subject to two types of predation. The first was the forcible seizure of property and persons. This included banditry on land, piracy at sea, and various forms of expropriation—for example, the rights of *aubain* and salvage.³⁸ The second type of predation was the exaction of payment under threat of forcible seizure—tolls, taxes, fines, and the ‘royal prise’.³⁹ Exaction would take place at any of a variety of unavoidable ‘choke points’ such as bridges, passes, rivers, ports, and markets. The exaction of payment was less harmful economically than forcible seizure, because it was more predictable, and because it avoided the cost of armaments and the damage resulting from their use—dead-weight losses that benefited neither side. Because the exaction of payment was more ‘efficient’, it tended to replace forcible seizure whenever feasible.⁴⁰

Economies of scale in protection against forcible seizure made joint action a virtual necessity.⁴¹ Economies of scale in armed defense led merchant associations to organize

³⁸The right of *aubain* was the right of a lord to seize the goods of a foreign merchant who died while in the lord’s territory; the right of salvage permitted the owner of a shore to take anything that washed up when a ship ran aground there (Favier (1998)).

³⁹ The ‘royal prise’ was the king’s right to have first pick of a foreign merchant’s goods—at a price and at a time of payment set by the king (Moore (1985)).

⁴⁰For a more extensive discussion of predation, see Kohn (2001c).

⁴¹Many historians see this as the principal reason for the establishment of merchant association: for example, Hickson and Thompson (1991), Nicholas (1992), Volckart and Mangels (1999). Cawston and Keane (1896) describes the Hanseatic League as a union of towns “banded together against the rapacity of

caravans and convoys that were better able to defend themselves than individual travelers or ships. For example, Flemish merchants attending the English fairs in the thirteenth and fourteenth centuries traveled together in convoys organized by their municipal guilds.⁴² Protection was also an important function of the English regulated companies and of the Spanish *consulados* that controlled much of their countries' overseas trade in the sixteenth century.⁴³ Such merchant associations regulated the times of sailing of convoys, and collected fees to pay for soldiers and accompanying warships. Sometimes, merchant associations 'outsourced' protection and purchased it from the king—for example, in the transoceanic trade of Portugal and Spain.⁴⁴

Dealing with governments

Much of the forcible seizure was either carried out by governments or authorized by them. Merchant associations therefore negotiated with governments for safe conduct, usually paying for the privilege—essentially converting forcible seizure into a 'toll'. For example, the Italian maritime cities tried to ensure the safety of their ships by concluding treaties of friendship with the powers bordering the Mediterranean.⁴⁵ Similarly, Genoa reached an agreement with the Duke of Burgundy (then waiting to take ship to the Holy Land) to provide safe conduct to Genoese merchants traveling to the fairs of Champagne.⁴⁶

Negotiating such agreements with the local authorities was an important function of the consuls of merchant colonies. Italian consuls in Bruges negotiated freedom from retaliatory arrest and arbitrary seizure of property for their members and limitations on the rights of *aubain* and salvage. They also negotiated explicit and fixed rates for tolls

kings, princes, and other local potentates—both civil and ecclesiastical—as well as against the land and sea robbers, by whom the highways, estuaries, and coasts of Northern Europe were infested far into the fourteenth century". p4

⁴²Moore (1985)

⁴³Lane (1944) Ch 2; Stein and Stein (2000)

⁴⁴Steele (1994) Merchants paid to participate in state-defended fleets.

⁴⁵de Roover (1971)

⁴⁶Scammell (1981) Ch. 4 Genoa

and port dues to protect their members from arbitrary impositions by port officials.⁴⁷ The English consul at Bruges obtained a charter from the Count of Flanders that stipulated, among other things, that in the event of war with England, English merchants would have 60 days to remove their goods and their persons to safety.

Another approach to the danger of forcible seizure was insurance. Members of merchant associations sometimes agreed to share the cost of a random imposition upon one of their number. For example, members of Flemish guilds agreed to help pay any ‘fine’ imposed on one of their members by a foreign ruler (essentially a form of ransom).⁴⁸ Similarly, Flemish merchants traveling to England agreed to share the burden of the royal prise which typically fell on only a few of them.⁴⁹

Merchant associations also negotiated with governments the level of ‘tolls’. For example, the *universitas* of Italian merchants attending the fairs of Champagne negotiated the level of tolls, as well as safe passage, with the territorial rulers along the way.⁵⁰ And in the fifteenth century the Merchant Adventurers’ Company of York negotiated a cap on the fees its members had to pay in Bruges, Antwerp, Barrow, and Middleburg.⁵¹ Domestic tolls were no less important than foreign. In England, cities purchased from the king exemptions from the tolls imposed on their merchants by other cities.⁵² Similarly, the *consulado* of Burgos obtained from the king of Spain an exemption for its members from all tolls throughout the kingdom.⁵³

Embargo

Negotiation with governments was in the hands of merchant associations rather than in those of individual merchants, partly because of economies of scale in representation,

⁴⁷de Roover (1948)

⁴⁸Nicholas (1997)

⁴⁹Moore (1985)

⁵⁰Verlinden (1971)

⁵¹Kermode (1998)

⁵²Masschaele (1997) The king also granted cities the right to impose tolls on the merchants of other cities. Not surprisingly, these rights often conflicted and the resulting disputes brought a great deal of business to the royal courts.

⁵³Mathers (1988)

but mostly because of economies of solidarity. To negotiate a deal on good terms, and to defend that deal against possible *ex post* violations by the other side, requires a credible threat. The two threats available to merchants were violence and embargo. Both types of threat carried greater weight when they came from an association of merchants rather than from a single merchant.

Merchant associations did sometimes resort to violence. In 1231, for example, Genoa responded to Cueta's expropriation of its merchants by attacking that city.⁵⁴ And the Hanseatic League frequently responded militarily to expropriations of its members or to violation of their rights.⁵⁵

The merchants' most common and effective weapon, however, was embargo—the withholding of trade. For example, when the ruler of Tabriz seized the goods of the Genoese merchants there, Genoa declared a *devetum* (embargo) until the ruler paid an indemnity and swore better behavior in the future.⁵⁶ Similarly, when the Sultan of Egypt monopolized the trade in spices in 1430 and doubled their price, Venice responded by declaring an embargo.⁵⁷

To be effective, an embargo had to be total: all the members of the association had to participate. This was a problem, because an individual member could do better for himself by ignoring the embargo, even though this undermined the position of the group as a whole. So it was important that a merchant association was able to impose discipline on its members: an effective system of internal order was indispensable.⁵⁸ The Hanseatic

⁵⁴Reynolds (1945) p12

⁵⁵Mauro (1990)

⁵⁶Greif, Milgrom et al. (1994) The ruler reneged on this promise and robbed and murdered the Genoese merchants who flocked back to Persia when the embargo was lifted. However, this second violation killed the goose, as Genoese merchants never again returned to Tabriz.

⁵⁷Lane (1944) Ch 2

⁵⁸Greif, Milgrom et al. (1994) discusses this issue at length. Greif argues that it was the solidarity required to enforce an embargo that was the primary motivation for the emergence of merchant guilds. He also makes the point that a credible threat of punishment through embargo was in the interest of rulers as well as of merchants, since it led to more trade to the mutual benefit of both.

League's relatively weak control over German merchants made its embargoes largely ineffective, and this may have been why it resorted so often to violence instead.⁵⁹

Predation costs and competitive advantage

The cost of predation was an important part of the overall cost of trading. If the cost was too high, it made trading unprofitable. Consequently, the ability of merchant associations to lower the cost of predation for their members was an important factor in opening up trade and in expanding its volume. As one example, Genoese trade with north Africa doubled after 1161 when Genoa signed a 15-year treaty with the ruler of Cueta securing safe-conduct for its merchants.⁶⁰

Predation costs for a particular trade were not necessarily equal for different associations of merchants. An association that was better at lowering the cost of predation gave its members an important competitive advantage over members of other associations.⁶¹ Venice was particularly successful in this respect, lowering the predation costs of its merchants by organizing fleets and working hard to secure them privileges in foreign markets.⁶² Of course, an equally effective way for an association to gain an advantage was to raise the cost of predation for its rivals. Venice was pretty good at this too.⁶³

Differences in predation costs, however, were just one factor in a much broader struggle among merchants over trading opportunities.

Rivalry for trade

Today, we think of the trade rivalries as struggles among large corporations or among states. In the pre-industrial economy, there were no large corporations and territorial states thought of trade, if at all, purely as a source of revenue. The rivalry for trade was a rivalry among merchants and, in particular, among merchant associations. Guilds within a

⁵⁹Greif, Milgrom et al. (1994)

⁶⁰Greif, Milgrom et al. (1994)

⁶¹Lane (1941). Lane calls the advantage conferred by lower predation costs a 'protection rent'.

⁶²Lane (1973) Ch. 10: "The resulting flow of trade through Venice raised most gratifyingly the tax receipts of the Commune."p125. See also González de Lara (2000) p 179, Mazzaoui (1981) p35, 38

⁶³Lane (1941).

single city and cities within a single country competed with one another as fiercely as corporations and countries do today.⁶⁴ For example, in fifteenth century Florence the *Arte della Lana* and the *Arte di Calimala* were bitter rivals.⁶⁵ When the merchants of York formed a company (an association) in 1430, they were motivated as much by their rivalry with the merchants of London as they were by their rivalry with the German merchants of the Hansa.⁶⁶

Merchant associations pursued their rivalry for trade by various means. Sometimes they resorted directly to violence or to the threat of violence—especially when the associations in question were city states with armies and navies of their own. More usually, however, merchant associations relied on violence indirectly by competing to secure trading rights from governments.

Government control of access to trade

Governments, through their mastery of violence, were able to control access to trade and to create trading rights and trading monopolies.⁶⁷ They rarely exploited these rights and monopolies themselves directly.⁶⁸ Rather, they found that it more remunerative to sell the rights and monopolies to merchants who were able to exploit them more efficiently.⁶⁹ The privileged rights and monopolies that governments sold to merchants were known as ‘freedoms’: “The freest man, according to medieval ways of reckoning such things, was the most privileged, according to modern Western ways of thinking.”⁷⁰

⁶⁴“Indeed, medieval towns of one and the same country regarded each other, from the mercantile point of view, with much more jealousy and hostility than different states now do.” Gross (1890) p51

⁶⁵Favier (1998)

⁶⁶Kermode (1998) “Hostile competition at home and abroad characterized relations between northern and London merchants.”

⁶⁷For more on this see Kohn (2003d)

⁶⁸The transoceanic trades of Spain and Portugal were partly in the hands of the state.

⁶⁹An example of the Coase Theorem at work. One version of this theorem states that “the initial allocation of legal entitlements does not matter from an efficiency perspective so long as they can be freely exchanged”.Cooter (1987)

⁷⁰Bridbury (1986) p81 “When medieval people spoke of freedom, particularly in connection with trade, they meant what we should mean by privilege. They meant a right, incorporated into a charter or engrossed in a licence, which emancipated a named person or institution from an obligation; or entitled

Governments had a second interest in controlling access to trade: it facilitated predation, mostly in the form of tolls. For example, instituting a staple—a single market where a particular good had to be traded—offered a government a dual benefit. Control of the staple—the right to trade the good—could be sold to a particular association of merchants. And the trade, having to pass through a single choke-point, became much easier to tax.

Earlier in the period, while city governments often controlled access to their domestic markets, territorial governments did so only rarely. Two notable exceptions were England, which controlled its export of wool, and Sicily, which controlled its export of grain.⁷¹ By the sixteenth century, however, territorial governments had learned that selling trading rights and monopolies could be a major source of revenue, and the practice had become ubiquitous.⁷²

Gaining trading privileges from governments

It was generally merchant associations rather than individual merchants that negotiated with governments to purchase such trading rights. Associations had the advantage in dealing with governments for much the same reason they did in the case of protection from predation—economies of scale in representation and negotiation, and economies of solidarity in protecting the rights acquired. Indeed, negotiations for trading rights often accompanied or closely followed negotiations for protection from predation. For example, the English colony at Bruges received trading privileges from the Count of Flanders in 1359 in the same charter that assured them safe conduct.⁷³

such a person or institution to enjoy certain lucrative perquisites or advantages to the exclusion of everyone else.”

⁷¹These two examples illustrate that exports were generally easier to control than imports, and that trade in bulk commodities was easier to control than trade in high-value, low-volume goods.

⁷²In the sixteenth century, there was a “...the growing tendency towards monopolies. The examples are well known: copper syndicates, the spice contracts, the alum monopoly and the efforts to concentrate the international supply of wine and salt in a few hands. Complete success was only achieved in a few limited fields.” Van der Wee (1963) p 319

⁷³Nicholas (1979) They received essentially the same rights as the merchants of Bruges themselves.

Merchants associations tried to ensure their members as favorable a position as possible in their home markets. As we have seen, this was the original economic motivation of the English merchant guilds.⁷⁴ Where cities were independent, merchant associations in the form of city governments or working with city governments could do this directly. Where cities were subject to lords or kings, cities had to acquire their privileges in the form of a charter. A typical clause in a borough charter might read: “We grant a Gild Merchant with a hanse and other customs belonging to the Gild, so that no one who is not of the Gild may merchandise in the said town, except with the consent of the burgesses.”⁷⁵

Formal legal protection of trading privileges was not always essential: sometimes superior information was enough. For example: “Merchants in Leicester expected to beat their competitors to the supplies of wool in the hinterland of the town because they knew where and when to go for the best markets, and they probably also counted on personal contacts and established reputations in their dealings with the region.”⁷⁶ The Leicester guild tried to keep this information secret by forbidding its members from helping outsiders find supplies. Leicester also required outsiders to use the formal city market to prevent them from seeking out the sources of supply on their own.

Control of shipping was another way to protect trading privileges. In the fifteenth century, for example, Italian merchants trading in Valencia, Barcelona, and Ibiza (all ruled by the kings of Aragon) were required to ship their purchases on Spanish ships.⁷⁷ In the same period, Amsterdam required Dutch ships returning from the Baltic to stop first in the city in order to prevent direct trade between the Baltic and the southern Low Countries.⁷⁸

Merchant associations also secured for their members trading privileges abroad. In exchange for these privileges, they offered foreign governments payments in cash and

⁷⁴“The Gild was the department of town administration whose duty was to maintain and regulate the trade monopoly.” Gross (1890) p43

⁷⁵Gross (1890) p8

⁷⁶Masschaele (1997) p138

⁷⁷Origo (1986)

⁷⁸Glamann (1972)

loans on preferential terms. For example, the German merchants who acquired rights to export wool from England did so, like the Italians, by lending to the Crown.⁷⁹ Sometimes merchant associations could offer other inducements. For example, the Venetians and Genoese offered naval support to secure trading rights both in Constantinople and in the crusader territories of the Levant.⁸⁰

Sometimes merchants with a monopoly on the source of a particularly desirable commodity were in a position to have governments competing for their trade. For example, in the fifteenth and sixteenth centuries the cities of the Low Countries vied with one another to host the staple of the Merchant Adventurers, who had a monopoly on the export from England of the unfinished woolen cloth on which the textile industries of the Low Countries depended.⁸¹

In some cases, merchant associations purchased from their own governments monopolies over the export of a particular good or over trade with a particular foreign market. Perhaps the earliest example was the Company of the Staple at Calais, a group of 26 English merchants who obtained in 1363 a monopoly over the export of English wool.⁸² By the late sixteenth century, such ‘regulated companies’ had multiplied and had come to dominate English overseas trade.⁸³ In contemporary Spain, the *consulados* of Burgos and Seville obtained similar monopolies over Spanish trade with the Low Countries and with the Americas respectively.⁸⁴

Protecting trading privileges

When a merchant association succeeded in procuring trading privileges for its members it had to protect the resulting monopoly rents from erosion. There were two

⁷⁹Dollinger (1970); Cawston and Keane (1896)

⁸⁰de Roover (1971)

⁸¹Ramsey (1994) By the 1520s the Merchant Adventurers had negotiated highly preferential terms: they were paying lower customs charges than the natives and were exempt from a variety of taxes that other merchants had to pay.

⁸²Power (1942)

⁸³Supple (1977)

⁸⁴Parry (1967); Grafe (2001)

potential problems—internal competition among the members of the association and entry by non-members.

Merchant associations used a variety of methods to prevent internal competition. One was for the association to require its members to pool their funds and purchase jointly to prevent competition among them from driving up prices.⁸⁵ For example, in 1283 Venice required all of its merchants who wished to buy cotton in Acre to pool their funds and purchase collectively.⁸⁶ Less frequently, merchant associations tried to prevent competition in sales. For example, in the sixteenth century, the Company of Merchant Adventurers, which had a monopoly of the export of English woolen cloth to the Low Countries and Germany, allocated to its members sales quotas. To enforce them, it required its members to ship collectively and to display collectively at their staple in Antwerp.⁸⁷ One advantage of a staple was that it made it easier to regulate competition among the members of the association.

The existence of rents—a result of protection from predation as well as of trading rights—attracted entry. In foreign markets, merchants of one city sometimes tried to pass themselves off as merchants of another city that enjoyed privileges there.⁸⁸ Regulated companies were plagued by ‘interlopers’, compatriots who were not members of the association but who participated in the trade that ‘belonged’ to the companies.⁸⁹ For example, unaffiliated English merchants passing through Germany on their way to Italy (where they were allowed to trade) would sell some of their merchandise *en route*, infringing the monopoly of the Merchant Adventurers. When they caught such interlopers, the Merchant Adventurers appealed to the royal courts to enforce their monopoly as their charter demanded by means of ‘fines, forfeitures, penalties, imprisonments or otherwise’.⁹⁰

⁸⁵Masschaele (1997) Ch. 6

⁸⁶Lane (1973) At the same time Venice pursued a vigorous policy of ‘antitrust’ at home. For example, it broke up cartels that controlled the production of cement and tiles.

⁸⁷Ramsey (1994); Ball (1977)

⁸⁸Abulafia (1987) p x, quoted by Reyerson (2002)

⁸⁹The word ‘interloper’ was first used around 1590. Willan (1959)

⁹⁰Willan (1959) Ch. 2

THE PROBLEM OF RELIANCE

The business of merchants was trading: buying goods and reselling them for a profit. Because purchase and sale were often in different places, either the merchant himself had to travel with his goods or he had to rely on an agent to represent him in the distant market. Purchase and sale were separated not only in space but also in time: months might pass between the time the merchant purchased the goods and the time he sold them; further months might pass until he was paid. Trading therefore had to be financed. A merchant needed to finance his position between purchase and sale, and in order to sell the goods he often was obliged to extend credit to the buyer.⁹¹ Both agency and financing gave rise to reliance: a merchant relied on his agents to act for him and he relied on his debtors to pay up as promised. Reliance was a problem, because it left the merchant vulnerable to the malfeasance or incompetence of others.

Addressing the problem of reliance took up much of a merchant's time and attention and accounted for a considerable part of his costs. A merchant was very careful in choosing those in whom he placed his trust. As much as possible, he relied on his family and friends. Their personal qualities were known to him and they had reason not to let him down.⁹² In managing relationships of reliance, the key was to create the right combination of incentives—of carrot and stick. Generally, the juiciest carrot was the continuation of the relationship and the biggest stick its termination: an agent who let a merchant down was unlikely to remain his agent; a debtor who failed to pay was unlikely to obtain further credit. Of course, for such incentives to work, the merchant needed to monitor performance. This was especially difficult with agents far away in distant markets. In the case of financing, the risk of reliance could be reduced by guarantees. Families were held responsible for the debts of their members, so that the credit of the individual was backed by the assets of his family (this also gave the family a strong incentive to ensure that he paid up).

The expansion of trade and of markets only worsened the problem of reliance. When traders dealt with one another only occasionally and when alternative employers and

⁹¹See Kohn (2003a; 2003b; 2003c) for a more detailed discussion of agency, finance, and reliance.

⁹²For more on the problem of reliance and the role of the family Kohn (2003a). For more on how merchants managed relationships of reliance see Kohn (2003c).

sources of financing were readily available, the preservation of a particular relationship provided a weaker incentive for performance. Moreover, in this expanded world, merchants increasingly had to reach beyond the limited circle of family and friends to find agents and to obtain financing.

Merchants did not, however, have to rely entirely on their own resources in dealing with the problem of reliance. Not surprisingly given the importance of the problem, merchant associations came to their members' assistance. They acted as enforcers of obligations to strengthen the incentive to perform. They helped merchants monitor agents in distant markets. And they acted as guarantors for their members in relationships with strangers.

The merchant association as enforcer

An enforcer is a third party able to reinforce a relationship of reliance by coercing performance or by punishing nonperformance. To do this, the enforcer must be able to impose or to threaten sanctions greater than those available to the parties themselves. The ability of merchant associations to do this stemmed from the same 'technologies' that enabled them to protect their members against predation and to assist them in the rivalry for trade—economies of scale in violence and economies of solidarity. Economies of scale in violence gave the merchant association an advantage in seizing the property of a defaulting debtor. Economies of solidarity enabled the association to raise significantly the cost to an agent or debtor who failed to perform. It could ensure that such an individual would lose not only his relationship with the merchant directly affected but also any potential relationship with other members of the group.⁹³

Through the use of violence and even more through the denial of potential business relationships, the merchant association could reinforce relationships of reliance, not only among its own members, but also between its members and outsiders. For example, at the English fairs of the thirteenth and fourteenth centuries, if an English merchant cheated a Flemish merchant or defaulted on a debt owed to him, the Flemish 'nation' would declare

⁹³Greif has written extensively on this mechanism as it related, in particular, to the agency relationship (e.g., Greif (1989), Greif (1997)). However, it applied more broadly to any relationship of reliance.

an embargo on the Englishman: no Flemish merchant would have any further dealings with him.⁹⁴

While merchant associations could impose sanctions on outsiders, the sanctions they were able to impose on their own members were more severe. For the member of a merchant association, ostracism meant more than losing the opportunity for any business relationship with other members of the association—although that was serious enough. It also meant losing other benefits of membership. As we have seen, the association provided its members with protection against predation: ostracism meant becoming an ‘outlaw’, with no such protection.⁹⁵ The association gained for its members valuable trading privileges: these too were lost.⁹⁶ We shall see that associations also assisted their members with the acquisition of information and provided them with a social framework and a communal ‘safety net’. Ostracism meant the loss of these benefits too.

Formal systems of order

To play the role of enforcer, the merchant association had to possess a system of order. It needed to have a set of standards that defined acceptable performance. It also needed a mechanism to decide whether those standards had been violated and if so to impose the appropriate sanctions. For example, before declaring an embargo on an English merchant, the Flemish ‘nation’ would hear the case and decide whether an embargo was justified.⁹⁷

Merchant associations usually possessed not one system of order but two—a formal system of laws and courts and an informal system of social norms and reputation. These two systems complemented one another⁹⁸

⁹⁴Moore (1985)

⁹⁵“The debtor who had defaulted and fled to escape his creditors (the *cessans et fugitivus*) was thus placed outside the law and could be injured or killed by anyone with impunity.” Kuehn (1981) p312

⁹⁶For example, the monopoly of the *consulado* of Burgos of trade with the Low Countries “produced considerable rents for factors and intermediaries associated with the guild. Exclusion from the guild was equivalent to economic ruin.” Grafe (2001) p83

⁹⁷Moore (1985)

⁹⁸“Every functioning group or subgroup of a society possesses not only a leader but also its own legal system, which permits the group to function by compelling its members to conform to common principles

The formal system of laws and courts was closely linked to contract. In effect, a contract was a formalization of a relationship of reliance to facilitate enforcement by a court.⁹⁹ Contracts shaped and structured relationships of agency and financing. The different forms of contract that were available offered merchants alternative structures of business organization.¹⁰⁰ Available structures included forms of venture organization such as the sea loan, the *commenda*, the share venture (*locum* or *rederij*), and the joint stock company. They included various forms of company organization. And they included forms of agency such as proxy and commission.¹⁰¹

The role of the courts was to assure performance of contractual obligations.¹⁰² First, the court had to establish the facts: have the parties performed as promised? This inevitably involved interpretation and clarification of the terms of the contract. It involved, too, the establishment of conventions to fill in the gaps where contracts were insufficiently specific.¹⁰³ If the court found that a party had not performed as promised, then its second function was to impose a remedy—to require either performance or compensation.

Every form of merchant association had its court. For the merchant guild—as for all medieval communities—the resolution of disputes among its members was one of its basic functions.¹⁰⁴ For example, the *Arte della Lana* of Prato in the fifteenth century

of behavior.” (p54 Pospisil (1978)) Benson (1990) defines law as consisting of (a) rules of conduct and (b) the mechanisms and processes for applying those rules. A legal system is a formalized system of order. Groups may lack a formal system, but still have a functioning order (see, for example, Greif (1989)). Benson’s definition of ‘law’ applies equally well to such an informal system.

⁹⁹“A contract is a promise or set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.” Goldberg (1976)

¹⁰⁰To a large extent, the different forms of contracts also embodied the law: there was very little codification.

¹⁰¹See Kohn (2003b) for a discussion of contracts and the structure of business organization.

¹⁰²“Consistently until the end of the Law Merchant period, the role of the law was to be interpretive of agreements, rather than creative.” Trakman (1983)p10

¹⁰³Another function of the courts was to adapt these standards as the nature of commerce changed over time.

¹⁰⁴Reynolds (1997) Ch 3

appointed four consuls to enforce guild rules and to settle disputes; the consuls sat twice a week in the main hall of the guild.¹⁰⁵ In Italian cities with a *Mercanzia*, it was the court of the *Mercanzia* rather than the courts of the individual guilds that handled disputes involving large sums and disputes between local and foreign merchants.¹⁰⁶ The right to settle disputes in their own court was an important right for ‘nations’ and colonies abroad. In 1245, the Count of Champagne exempted Roman, Tuscan, Lombard and Provençal merchants from the jurisdiction of the fair wardens and granted them the right to hold their own courts.¹⁰⁷ At the English fairs, Flemish merchants had their own court to resolve disputes among them, as did merchants from various English cities.¹⁰⁸ English merchants at Antwerp were granted the right to their own court in 1296.¹⁰⁹ The courts of the *consulados* of Burgos and Seville in the fifteenth and sixteenth centuries were authorized to adjudicate disputes among their members and to rule in all commercial matters.¹¹⁰

The courts of merchant associations were not the only ones available: governments (lords, kings, and the Church) and organized markets also had courts, and these were more than willing to settle merchant disputes.¹¹¹ Merchant associations, however, discouraged their members—sometimes even prohibited them—from using such external courts.¹¹² In Bruges, for example, while the Lucchese colony allowed its members to appeal decisions of their consul to the city court, the Florentine colony prohibited it under pain of expulsion.¹¹³ In 1369, Genoa forbade its citizens, under pain of a large fine, from attempting to escape their debts by appealing to an ecclesiastical court to declare them

¹⁰⁵Origo (1986)

¹⁰⁶Mazzaoui (1981) Ch. 6

¹⁰⁷Verlinden (1971), Mitchell (1904)

¹⁰⁸Moore (1985)

¹⁰⁹Nightingale (1995)

¹¹⁰Mathers (1988), Grafe (2001), Stein and Stein (2000)

¹¹¹See Kohn (2003d).

¹¹²Mitchell (1904)

¹¹³de Roover (1948)

usurious.¹¹⁴ As these examples illustrate, recourse to external courts undermined the role of association courts in reinforcing relationships of reliance. Sometimes, merchants abroad were drawn into local courts despite themselves as a result of lawsuits instigated by locals or by merchants from other associations. An important function of the consul in such cases was to protect the members of his colony from unfair treatment by local courts.¹¹⁵

Informal systems of order

Contracts and courts were most useful in supporting relationships of financing, especially debt financing. With a debt the nature of the obligation was clear, failure to perform relatively easy to establish, and the remedy simple and obvious. In case of default, courts would attempt to coerce performance by seizing the debtor's property to cover the debt or by seizing his person until relatives paid the debt to secure his release. If the defaulting debtor fled to avoid justice or failed to pay up, the court would order his ostracism.¹¹⁶ If there were guarantors, the same steps could be taken against them.

In relationships of equity financing and agency, however, contracts and courts played a more modest role.¹¹⁷ They were able to help in case of egregious violation. For example, merchants did sometimes sue their agents for failing to remit the proceeds of sales or for failing to give account. Andrea Barbarigo, a Venetian merchant of the fifteenth century, won at least three such suits against his agents in the *Curia di Petizion*, the court of commercial jurisdiction.¹¹⁸ However, most problems with agents did not lend themselves to resolution in a court of law.¹¹⁹ Similarly, with equity financing, a provider of financing could sue if he did not receive an accounting and payment of his share of the profits. However, a court could not really oversee the calculation of the profits or monitor

¹¹⁴Berman (1983)

¹¹⁵Grafe (2001) Ch 3

¹¹⁶See Kohn (2003c) for a discussion of bankruptcy procedures.

¹¹⁷Lawsuits against agents and recipients of equity financing were called 'actions of account' in England. (Willan (1959) Ch 1)

¹¹⁸Lane (1944)

¹¹⁹Greif (1989)

the effort and decisions that went into determining those profits (problems that are still with us today).

Contracts and courts were less useful in supporting relationships of agency and equity financing because the obligations were less easy to specify precisely. Because future circumstances were unknown, contracts were necessarily ‘incomplete’. In the case of agency, an agent could in principle have asked for further instructions as circumstances required, but slow communications precluded this. A merchant had no choice but to grant his agent considerable discretion to take the necessary decisions on the spot. The same was true for a provider of equity financing. Unfortunately, this degree of discretion opened the way for self-dealing, laziness and incompetence.

Even in the case of debt, matters were not really quite so simple. In the unpredictable world of pre-industrial commerce, debtors frequently found themselves temporarily short of funds. Their creditors, who often found themselves in the same position, generally showed understanding. Merchants did their best to work things out through negotiation and arbitration, resorting to litigation only as a costly last resort. Here, too, then contracts were ‘incomplete’. There was much more to a debt relationship than was spelled out in the contract.¹²⁰

When performance could not be specified sufficiently precisely in a contract, the gaps could be filled to some extent by generally accepted standards of behavior—by social norms.¹²¹ The norms of the merchant community provided a model against which an agent’s actions could be judged. They helped to define the obligation of a recipient of equity financing to the provider. They established expectations of just how much flexibility a debtor could expect.¹²²

Although there were no courts to enforce these norms, they were enforced nonetheless: the mechanism of enforcement was reputation. Failure to honor the norms damaged an individual’s reputation and led others to avoid entering into relationships of reliance with him. A damaged reputation meant ostracism—at least in commercial

¹²⁰See Kohn (2003c) for more on the resolution of bad debts.

¹²¹Greif (1993)

¹²²To some extent, norms and customs became internalized: members of the group came to feel that violating norms was wrong, improper, or immoral. (Greif (1997))

relationships—no less than did a court decision.¹²³ For reputation to play the role of enforcement mechanism, information on an individual's past behavior had to be available to others.¹²⁴ Merchant associations acted as reputation networks that generated, distributed, and preserved such information.¹²⁵ The means of distribution of this information included correspondence, marketplace gossip, and social interaction.¹²⁶

So the 'soft' or informal system of norms and reputation complemented the 'hard' or formal system of laws and courts.¹²⁷

Where the formal system of order was only of minor help, as with agency and equity financing, the informal system was the primary mechanism of enforcement. For example, in managing his agents Andrea Barbarigo relied more on their desire for repeat business and referrals than he did on their fear of lawsuits.¹²⁸ And even in the case of debt financing, reputation played a vital role. No-one would extend sales credit or make a loan to a merchant whose credit was in doubt.¹²⁹

Help in monitoring agents

Of course, none of this could work unless the quality of performance was actually known: merchants had to monitor those on whom they relied. This was particularly difficult in the case of agents located in distant markets. Merchant associations were able to help merchants monitor their agents in two ways. First, they provided information on the actions and the behavior of agents abroad.¹³⁰ Members of the association traveled together and resided together in 'nations' or colonies; sometimes they were required to do

¹²³Greif (1993)

¹²⁴Milgrom, C.North et al. (1990)

¹²⁵Granovetter (1973) defines such a network as a set of actors who know each others' relevant characteristics or can learn them through referral. (quoted in Rauch (2001))

¹²⁶See Kohn (2003c) and below.

¹²⁷Merchants networks (see fn. 3 above) lack formal systems of order, but they do possess an informal systems of order that can be quite effective.

¹²⁸Lane (1944)

¹²⁹See Kohn (2003c) on the importance of a merchant's credit.

¹³⁰Greif (1989), Greif, Milgrom et al. (1994)

so. They were therefore able to observe one another and to report home on what they observed:

If a member of the Lucchese colony in Bruges misbehaved and neglected his business, for example, it is likely that his principals or his partners in Lucca would soon be informed either directly or indirectly and would thus be able to remedy the situation, before it was too late. On the other hand, the Lucchese in Bruges, because of their frequent contacts with their mother city, would surely find out if their interests in Italy or elsewhere were neglected.¹³¹

The second way that merchant associations facilitated monitoring was by providing the merchant at home with information about the trading possibilities that his agent faced in the distant market. He could use such independent information to check the veracity of what his agent was telling him and to infer whether his agent was making the most of the opportunities available to him.¹³² Venice was particularly active in this respect. Officials accompanying its state-sponsored fleets and stationed in its overseas colonies provided regular and reliable information on trading conditions.¹³³ An important function of the *Mercanzia* was to provide merchants with information on transportation costs, market conditions, and prices in foreign markets.¹³⁴ And the *Consulado de Burgos* in the sixteenth century required its consuls abroad to report on current trading conditions.¹³⁵

It is not surprising, given all of the ways in which merchant associations reinforced relationships of reliance, that members strongly preferred to do business with other members of their association rather than with outsiders. Fellow members of the association shared the same norms and culture, so that their behavior was more predictable. A Florentine merchant in Paris wrote to a correspondent: “As you know,

¹³¹de Roover (1948) p 20

¹³²This sort of information was also provided by organized markets: see Kohn (2003d).

¹³³González de Lara (2000) argues that the availability of this information facilitated a change in the nature of the contracts under which agents operated—from the sea loan (debt) to commenda (equity). The availability of this information also facilitated the growth of another agency arrangement—commission (see Kohn (2003b))

¹³⁴Mazzaoui (1981) Ch. 6

¹³⁵Grafe (2001) Ch 3

those Lucchesi conduct their companies in a diverse manner from our folk, and we cannot understand them well.”¹³⁶ Fellow members of the association were of known reputation. It was easier too to monitor their behavior. Fellow members all had stronger incentives to perform as promised. Nonperformance damaged their reputation within the association, and it was easier to bring a lawsuit against them in the association’s courts. For example, in Marseilles in 1248, foreigners investing in *commenda* contracts preferred to entrust their funds to merchants from their home towns, because in case of dispute they would have recourse to an arbitrator or court.¹³⁷ The tendency of members of an association to trade with other members raised the value of belonging to an association and raised the cost of ostracism.

The merchant association as guarantor

Although merchants preferred to deal with members of their own associations, they had little choice but to enter into relationships of reliance with outsiders. This was especially true with respect to financing. Merchants bought and sold on credit: most trading involved some element of deferred payment. So trading with outsiders inevitably involved merchants in financial relationships with them. There was, however, no corresponding need for merchants to enter into agency relationships with outsiders and they rarely did so until quite late in the period.¹³⁸

In supporting financial relationships with outsiders, available mechanisms of enforcement were of limited value. Merchant association courts were not impartial: they could not be depended upon to enforce for outsiders and against their own members.¹³⁹ As we have seen, they could sometimes enforce against outsiders, but against traveling merchants their power to do so was limited. In the early part of the period, government courts were either not available or if available they were out of tune with the needs of commerce. For example, government courts would not enforce debts they considered to

¹³⁶Origo (1986) p 16

¹³⁷Berlow (1979)

¹³⁸Specialized commission agents appeared in the sixteenth century, especially in Antwerp. See Kohn (2003b) and Kohn (2003d).

¹³⁹Greif (1997) Greif (2001)

be ‘usurious’. And the courts of organized markets which would play an important role later on were only beginning to develop.

The nature of the guarantee

In this environment, relationships between members of different associations came to depend not on enforcement but on guarantee—on the guarantee of the merchant association.¹⁴⁰ This played a similar role in relationship with outsiders as did family guarantees in relationships within the association.¹⁴¹ Guarantees of both kinds were most effective when the obligation in question was clear-cut and nonperformance easy to demonstrate, as was the case with debts. A guarantee, like enforcement by a court, was of limited value in supporting less precisely defined relationships such as equity financing and agency.¹⁴²

There was no need to ‘invent’ or to create the merchant association guarantee. It was implicit in the general medieval culture of community responsibility: “The character of communities in the central Middle Ages was rooted and grounded in older traditions, traditions which simply assumed the existence, rights, and duties of collectivities large and small.”¹⁴³ Communities of all types—not only merchant associations—were held jointly responsible for the payment of taxes, for the bearing of punishments, for the fulfillment of civil and military duties, and for the payments of debts.¹⁴⁴

For any guarantee to work, the credit of the guarantor must be stronger than that of the debtor. A merchant association generally did have better credit than its individual members. One reason was that, collectively, it possessed more property that could be seized by creditors to satisfy a debt. A second reason was that the association stood to

¹⁴⁰Greif, who has written extensively on this (Greif (1997) Greif (2001) Greif (2001)) calls this the Community Responsibility System.

¹⁴¹Kohn (2003a)

¹⁴²Greif (2001)

¹⁴³Reynolds (1997) p5

¹⁴⁴Reynolds (1997) For example: “Collective privileges were no doubt seen in much the same way as collective responsibility, which was universally taken for granted, most unpleasantly in the form of collective punishment.” p 35-6 “The more or less unlimited liability of members of groups for the group’s wrong-doing or debts falls into the same pattern of collective assumptions.” p 61

lose more from the reputational damage consequent on nonperformance, because the value of a reputation increases with the scale of transactions and with the longevity of the reputation's owner.

There is, however, a second requirement for a guarantee to work. A guarantee weakens the incentive of the guaranteed party to perform—a problem of moral hazard. If this weakening of incentives causes the guarantee to be invoked too often, the arrangement soon becomes prohibitively expensive and so unworkable.¹⁴⁵ A successful guarantee is one that is invoked only rarely. This requires that the guarantor be able to discipline the guaranteed party and so keep the moral hazard problem under control. As we have seen, merchant associations did have the capacity to discipline their members through their systems of internal order.¹⁴⁶

By the mid-thirteenth century merchant association guarantees were commonly used throughout most of western Europe.¹⁴⁷ The practice took two distinct forms—joint liability of a 'nation' of traders for debts and the custom of reprisal.

Joint liability

From the twelfth century, merchant 'nations' trading at the fairs of Champagne were held liable collectively for the debts of their members.¹⁴⁸ The goods of all of the members present served as security for the debts of each of them. In effect, the fair courts considered the members of a nation to be a partnership for purposes of trading at the fair.¹⁴⁹ To ensure that this collateral remained unencumbered, the fair courts refused to enforce debts incurred by individual merchants elsewhere. If the collateral proved insufficient, the nation as a whole would be barred from the fair until the debt was paid. This form of merchant association guarantee supported the credit-intensive trading

¹⁴⁵This is precisely the problem that plagues bank deposit insurance and which led to the S&L crisis in the United States in the 1980s. On the economics of guaranties, see Katz (1999).

¹⁴⁶Greif (2001) describes a law passed by Florence in 1280 that held individuals responsible for any cost to the commune that resulted from their actions abroad.

¹⁴⁷Greif (2001)

¹⁴⁸Greif (1997) Greif (2001)

¹⁴⁹Hansmann, Kraakman et al. (2001)

system of the fairs by making it possible for merchants to extend credit to strangers.¹⁵⁰ It seems reasonable to believe that it was the existence of this involuntary collective liability that caused merchant nations at the fairs to organize systems of governance to be able to police their members and to represent them before the fair authorities.¹⁵¹ It is not clear, however, whether this form of merchant association guarantee existed anywhere other than at the fairs of Champagne.¹⁵²

Reprisal

In contrast, the second form of merchant association guarantee—the custom of reprisal (*rappresaglie*) was almost ubiquitous. This custom, which dates back at least to the ninth century, permitted an unsatisfied creditor to seize the property of any member of the merchant association of the debtor wherever he could find it.¹⁵³ For example, in 1164, the *Breve dei Consoli* (a commercial statute) of Pisa ruled that if a citizen of Pisa was unable to collect a debt from a citizen of a foreign city, then he could collect it from any fellow citizen of the debtor who came to Pisa.¹⁵⁴ To exercise the right of reprisal, a private citizen required authorization from the appropriate authorities—a letter of reprisal or *lettre de marque*. Authorization would be granted only after an investigation into the justice of the claim. Some cities, such as Florence, had a special official for this purpose.¹⁵⁵ The practice of reprisal was similar in other parts of Europe, although the association in question might be a guild or colony rather than a city as in Italy. Reprisal was a hazard for any merchant traveling abroad. He might, at any time, find his goods or

¹⁵⁰See Kohn (1999a) and Kohn (2003d) on the trading system and settlement system in use at the fairs.

¹⁵¹Greif (2001); Hansmann, Kraakman et al. (2001)

¹⁵²Joint liability was not in effect, for example, at the contemporaneous English fairs (see Moore (1985), who calls the practice the commercial interdict). Instead, merchants there relied on an embargo of the individual offender by members of the association of the wronged party: see above.

¹⁵³Origo (1986); Greif (1997) Greif (2001); Favier (1998) Ch 4

¹⁵⁴Origo (1986) Various categories of traveler were exempted from reprisals—ambassadors, pilgrims to the Holy Land, students at the University of Bologna, and in some cities merchants (although this would seem to defeat the object).

¹⁵⁵Origo (1986)

even his person seized to satisfy the unpaid debts of another.¹⁵⁶ If this happened, his only recourse was to return home to seek compensation from the original debtor.

Like litigation, on which it relied to a considerable extent, invoking the merchant association guarantee was a costly last resort, to be avoided if at all possible. The existence of the guarantee certainly did not relieve merchants of the need to exercise the greatest possible care in extending credit.¹⁵⁷ So here too reputation played an important complementary role—not only the reputation of the individual merchant but also the reputation of the association as whole. The following story illustrates this well:

Thus in 1292 a London merchant named Lucas was alleged to have left the fair of Lynn by stealth without paying thirty-one pounds for goods he had bought from a German merchant and to have failed to appear to answer charges in the court of the fair according to the law merchant, ‘wherefore no merchant stranger after that deed wished to make any sale to citizens of London before they were paid in full... calling them false debtors.’ Lucas fled from Lynn to St. Botolph, then to Lincoln, then to Hull, and finally to London, the German pursuing him all the way. At the instance of London merchants, who feared for their reputation, Lucas was put in the Tower of London, and eventually his case was reviewed on habeas corpus by the King’s Council.¹⁵⁸

The association as ‘brand name’

Group reputation played an important role in another relationship of reliance—that created by the uncertain quality of products and by merchant assurances of product quality. Merchant associations went to great lengths in policing their members to protect their collective reputations. For example, Flemish merchants attending the English fairs

¹⁵⁶Cheyette (1970)

¹⁵⁷Greif sometimes overstates the extent to which merchants would have relied solely on merchant association guarantees to the exclusion of other, less costly, means of protecting themselves against default. For example, “During the Commercial Revolution, the CRS [Community Responsibility System] enabled inter-community exchange that was impersonal up to one’s community affiliation. One did not have to know the personal history of another community member to exchange or to rely on expectations for future exchange with that individual.” Greif (2001) p 28

¹⁵⁸Hall (1932) p 175, quoted in Berman (1983)p 343

of the thirteenth and fourteenth centuries were supervised by guild wardens and inspectors who accompanied them to England.¹⁵⁹ Merchants brought their cloths to the fairs in large carefully wrapped bundles called *torselli*. They were required to unwrap these bundles in public and have the cloths inspected before sale: no trading was allowed until all the cloths had been inspected.¹⁶⁰

The decline of the merchant association guarantee

Reliance on the merchant association guarantee as a mechanism supporting trade among strangers declined steadily from the late thirteenth century. There were three reasons for this—increasing problems with the mechanism itself as trade expanded and the number of merchants grew; changes in commercial organization that made the mechanism obsolete; and the emergence of substitutes.

Problems with implementation

One problem with the implementation of merchant association guarantees was the increasing difficulty of identifying the affiliation of a specific merchant. To some extent a merchant's origins were betrayed by his language and dress: there was much less linguistic uniformity than there is today.¹⁶¹ However, it was not that difficult for a merchant from one city to pass himself off as being from another.¹⁶² Similarly, it was not uncommon for merchant associations to deny that a particular wrongdoer was actually one of their members.¹⁶³ Reprisals felt to be unjust, because of misidentification or for other reasons, led to counter-reprisals and costly conflict between associations.¹⁶⁴

Another problem in implementing reprisal was the growing number of merchants who were exempt because their association had been granted a license of immunity by the territorial ruler. Such a license exempted members of the favored association from reprisal anywhere in the ruler's territory, although it did not prevent them from taking

¹⁵⁹Moore (1985)

¹⁶⁰See Kohn (2001b) for more on quality assurance by guilds.

¹⁶¹Greif (1997) Greif (2001)

¹⁶²Abulafia (1987) p x quoted in Reyerson (2002) Ch 1

¹⁶³Moore (1985)

¹⁶⁴Greif (1997) Greif (2001)

reprisal on others. For example, in the late twelfth century, English kings granted such licenses to the merchant guilds of London and Ypres.¹⁶⁵

Changes in commercial organization

Merchant association guarantees made sense in a world in which merchants or their agents visited distant markets briefly and then returned home. When the debtor himself was unavailable because he had returned home or when the creditor had returned home and no longer had access to the debtor, it was natural to seek compensation through reprisal.

However the organization of commerce was changing. Increasingly, merchants relied on agents who resided permanently in distant markets. Many of these agents became 'locals' *de facto* by establishing local connections and a local reputation or even locals *de jure* through naturalization.¹⁶⁶ It was easier to hold permanent residents to account for their own debts. Moreover, resident merchants were particularly vulnerable to reprisal, which no longer made much sense and became little more than a form of extortion. For example, in 1458 when a Genoese pirate captured two English ships off Malta, the English government seized all Genoese merchants resident in England and their goods. The Genoese were held in prison until they agreed to pay an indemnity of £6,000.¹⁶⁷

Other changes too reduced the role of merchant association guarantees. The declining commercial importance of the fairs of Champagne from the late thirteenth century led directly to the disappearance of one form of guarantee—the joint liability.¹⁶⁸

Within merchant associations, the political support for guarantees declined, because they disproportionately favored small merchants over large.¹⁶⁹ Small merchants stood to gain more from the guarantee, because their own credit was relatively weak, and they stood to lose less from reprisal because they had less to lose. Large merchants obtained little benefit from the guarantee, because their own credit was relatively strong, and they

¹⁶⁵Moore (1985) Greif (1997) Greif (2001)

¹⁶⁶Grafe (2001) Ch 3

¹⁶⁷Fryde (1976) p 355

¹⁶⁸See Kohn (2001a) and Kohn (2003d) on the decline of the fairs.

¹⁶⁹Greif (1997) Greif (2001).

stood to lose much more from reprisals. This asymmetry was important, because merchant associations of all kinds were typically controlled by oligarchies of large merchants.

Responding to changing circumstances and to changing political support, merchant associations tried to modify the practice of reprisal or even to eliminate it entirely. By the middle of the thirteenth century, some maritime cities were imposing a tax on goods moving through their ports to pay compensation to foreigners who might otherwise have taken reprisal.¹⁷⁰ For example, Genoa established a Robbery Office to compensate foreigners who had been robbed by a Genoese (usually at sea).¹⁷¹ Cities, especially in northern Italy, signed bilateral treaties with each other aimed at eliminating the need for reprisal. These treaties set up joint tribunals to settle commercial disputes between citizens of the two cities.¹⁷² They also agreed to imprison fugitive debtors and to ensure that foreign creditors received justice.¹⁷³ There was also a movement to replace reprisal with negotiation, and if negotiation failed, with embargo of the delinquent debtor's city. Within Italy, embargo largely replaced reprisal by the end of the thirteenth century.¹⁷⁴ In keeping with these changes, it became accepted in the fourteenth century that letters of marque should be granted only if the complainant could show that he had tried unsuccessfully to obtain redress in the home court of the debtor.¹⁷⁵ None of these measures, however, were entirely successful in eliminating reprisal—as the incident of the Genoese in England illustrates.

The emergence of substitutes

Territorial rulers too played a role in eliminating reprisal. The ruler had an interest in promoting uninterrupted trade, which provided him with revenue. And he also had an interest in the presence of foreign merchants who could provide him with loans. Both

¹⁷⁰Cheyette (1970) p 56

¹⁷¹Kedar (1976) p23-4. The Robbery Office would then attempt to collect from the guilty part.

¹⁷²Berman (1983)

¹⁷³Cheyette (1970) Greif (1997) Greif (2001)

¹⁷⁴Greif (2001)

¹⁷⁵Cheyette (1970) p 56. This also addressed a moral hazard problem in that the possibility of reprisal diminished the incentive of the complainant to collect the debt directly Greif (1997) Greif (2001)

trade and lending were threatened by reprisal. The kings of England and France attempted to control reprisal by making the granting of letters of marque a royal monopoly (this had the added advantage of creating a new source of revenue for the king).¹⁷⁶

Rulers also tried to eliminate reprisal by providing an substitute—impartial adjudication of disputes in their own courts. In England a series of statutes between 1275 and 1285 abolished reprisal within England and established a system of registration of debts to facilitate royal enforcement: “It is ordained that in any city, borough town, fair or market, a foreign person who is of this realm shall not be distrained for any debt for which he is not debtor or pledge.”¹⁷⁷

Those who controlled organized markets also had an interest in eliminating reprisal. Organized markets wanted to attract as many merchants as possible. Greater participation increased revenues from market tolls and fees and raised the income of market professionals such as brokers and innkeepers. Greater participation also improved the quality of the market and so attracted yet more participation, further increasing revenues and income. Since the threat of reprisal deterred foreign merchants from participating, organized markets did their best to eliminate that threat.

Charters to colonies of foreign merchants often exempted them from reprisal. For example, the charter that the Count of Flanders granted to the English colony at Bruges in 1359 stated that no English merchant could be arrested in a civil action unless he was either himself the debtor or a personal guarantor for the debt.¹⁷⁸ Organized markets, like territorial rulers, had an interest in offering a substitute for reprisal in the form of impartial courts.¹⁷⁹

¹⁷⁶Cheyette (1970)

¹⁷⁷Statute of Westminster of 1275 (Berman (1983)). This was followed by the Statute of Acton Burnell 1283 (which established enrollment of debts), and this in turn was modified by the Statute of Merchants 1285 (Greif (1997) Greif (2001)).

¹⁷⁸Nicholas (1979) Similar charters were granted to Italian colonies at Bruges: de Roover (1948)

¹⁷⁹See Kohn (2003d) for more on organized markets. Greif calls the reliance on impartial courts, provided by territorial rulers and organized markets, the Individual Responsibility System which he

Substitutes were also emerging in the form of intermediaries. Rather than reinforcing trust among strangers through enforcement or guarantee, intermediaries eliminated the need for strangers to trust one another. They did this by allowing them to transact with one another indirectly via the intermediary. Trust in the intermediary replaced trust in the stranger. Perhaps most important, the growth of merchant banking in this period eliminated the need to extend credit to strangers. A merchant visiting a foreign city, rather than purchasing on credit, could borrow there from a merchant bank and pay for his purchases in cash.¹⁸⁰ Deposit banks and specialized commission agents were other types of intermediary that allowed strangers to trade indirectly.¹⁸¹

By the end of the fifteenth century, reprisals had become a relative rarity.¹⁸² The system of merchant association guarantees had become obsolete, as substitutes had emerged. Where such substitutes were not available, reprisal lingered on longer.¹⁸³ For example in Italy, where there was no central authority to provide impartial justice, reprisal continued after it had largely disappeared in England and France. Similarly, in western trade with the Muslim world, even in the fifteenth century, consuls were considered ‘hostages’ for the colonies of foreign merchants they represented.

INFORMATION

Information was central to everything a merchant did. Market information was the foundation of profitable trading and, as we have seen, it was essential in monitoring agents. As we have also seen, reputational information was vital in choosing and in monitoring relationships of agency and financing. Perhaps the most important type of information—because it affected everything else—was political news, especially anything bearing on the likelihood or progress of wars.¹⁸⁴

contrasts with the Community Responsibility System of reprisal and collective liability for debts (Greif (1997) Greif (2001)).

¹⁸⁰See Kohn (1999b) on merchant banking.

¹⁸¹On deposit banks, see Kohn (1999a). On commission agents, see Kohn (2003b) and Kohn (2003d).

¹⁸²Mitchell (1904)

¹⁸³Greif (1997) Greif (2001)

¹⁸⁴For more on the importance of information see Kohn (2003c).

Information, like agency and financing, involved reliance. Merchants relied on the accuracy of their sources when they took actions and committed resources on the basis of the information they received from them.

Merchants received much of their information from their own agents. For any agent, gathering information and conveying it to his principal was an important part of his work. Agents had the same incentives to supply reliable information as they had to perform their other responsibilities. As we have seen, merchant associations helped to strengthen those incentives.

Merchants also received information from other merchants who were not their agents. Reciprocity was one incentive for providing reliable information. Reputation was another. A merchant who provided inaccurate or misleading information paid a reputational price just as he did for failing to perform in any other way. Merchant associations acted as informational networks, providing their members with an array of sources of information of known reliability:

The most useful information is... that which is obtained from someone whom you have dealt with in the past and found to be reliable. You trust best information that comes from someone you know well.¹⁸⁵

Another type of information that is fundamental to any enterprise is know-how or technology—information on how things are done. Apart from the skills that he could pick up in school—basic literacy and numeracy—a merchant had to be able to judge the quality of the goods he traded and to be familiar with techniques of accounting and methods of financing. He also needed to know the idiosyncrasies of the markets he served. Merchant associations were repositories of such information and vehicles of its transmission. Aspiring merchants largely acquired the necessary know-how through apprenticeship with an established member of the association.¹⁸⁶

¹⁸⁵Powell (1990)p 304. For more on the role of business networks in providing reliable information see Rauch (1996), Rauch (2001) and Casson (1997) Ch 4.

¹⁸⁶Teece (1982)discusses how the firm plays this role. For a parallel discussion of the role of craft guilds in this context see Kohn (2001b).

INFRASTRUCTURE

Joint action is often preferable to individual action in the provision of infrastructure—either because of economies of scale or because the goods or services in question are public goods.¹⁸⁷ As a vehicle of joint action, merchant associations naturally played an important role in providing infrastructure of various kinds.

As we have seen, there was a close connection between merchant associations and city government: some city governments acted as merchant associations and some merchant guilds acted as city governments. Merchant associations were often involved, therefore, in the provision of urban infrastructure such as streets, walls, and churches. Beyond this general involvement, certain categories of infrastructure were of particular interest to merchants—market facilities, transportation, communications, and education.

Merchant associations, mostly cities, developed the infrastructure of markets. This included the booths, halls, port facilities, and courts in domestic markets.¹⁸⁸ Associations invested too in the compounds and trading facilities of their colonies abroad.¹⁸⁹

In the case of marine transportation, cities and merchant guilds organized convoys and chartered ships. For example, in the fifteenth century, the Merchant Adventurers' Company of York chartered ships for its members and set dates for convoys¹⁹⁰; the *consulado* of Burgos did the same in the sixteenth century.¹⁹¹ Venice went further: beginning in the thirteenth century the city itself invested in fleets of galleys to provide secure shipping for its merchants (the operation of these fleets was auctioned to private contractors).¹⁹² Merchant associations invested too in improving the ports they used: the

¹⁸⁷A public good is 'nonrival' in that it can be 'consumed' by additional individuals at little or no extra cost. It is also 'nonexcludable': once in existence, there is no practical way of excluding individuals from consuming it. Lighthouses and national defense are standard examples. A semi-public good is one that is nonrival but excludable—for example, an uncongested road.

¹⁸⁸See Kohn (2003d) and the discussion of courts above.

¹⁸⁹Greif, Milgrom et al. (1994)

¹⁹⁰Kermode (1998)

¹⁹¹Grafe (2001)

¹⁹²Mallett (1967) Florence later imitated Venice to invest in state-owned fleets of galleys of its own.

consulado of Burgos, for example, invested in the Cantabrian ports it used in its trade with the Low Countries.¹⁹³

Cities also invested in inland transportation. In Italy, cities developed inter-urban roads, built bridges, and improved rivers. In the Low Countries, cities were involved in building canals.¹⁹⁴

Good communications, in the form of reliable mail, was vital to merchants trading with distant markets. Large companies had their own private mail services, and later on there were specialized private providers.¹⁹⁵ However most merchants relied on the mail services provided by their associations. A number of Italian cities and merchant guilds organized regular mail services to the fairs of Champagne. For example, Pisa organized such a *scarsella* in the twelfth century.¹⁹⁶ The *Arte di Calimala* of Florence was sending two messengers a day to the fairs in the thirteenth century.¹⁹⁷ In the fourteenth century, Venice and Barcelona had regular mail services to Bruges.¹⁹⁸ The Hansa had a mail service too, as did the *consulado* of Burgos.¹⁹⁹

Most education for merchants was private—in the form either of private schools or of private tutors—and some education was provided by the Church.²⁰⁰ However, many Italian cities established or subsidized schools, especially at the elementary level (grammar school).²⁰¹ Some cities, for example Lucca in the fourteenth century, provided secondary education in the form of *scuole d'abbaco*.²⁰²

¹⁹³Grafe (2001)

¹⁹⁴See Kohn (2001c).

¹⁹⁵The Taxis company of Milan provided a mail service between Italy and Antwerp in the sixteenth century Edler (1938). In the fifteenth century, governments began to develop their own mail services which sometimes offered to carry mail for others: see Kerridge (1988) on England.

¹⁹⁶de Roover (1971) The word *scarsella* originally meant mailbag, and later came to denote the service itself.

¹⁹⁷On the latter, see Origo (1986)

¹⁹⁸Origo (1986) and Brun (1930) (the service from Barcelona was called the *escarselle*)

¹⁹⁹Favier (1998) and Mathers (1988)

²⁰⁰For more on merchant education, see Kohn (2003c).

²⁰¹Nicholas (1997); Swetz (1987)

²⁰²Goldthwaite (1972)

MERCHANT ASSOCIATIONS AS COMMUNITIES

Merchant associations served not only an economic function but also a social one.²⁰³ This was especially true of guilds and of merchant colonies. Guilds were formed initially in medieval towns and cities by immigrants who presumably missed the support of family and clan that they had left behind them in the villages from whence they came.²⁰⁴ They saw the guild as a sort of extended family: members called each other brethren and sisters.²⁰⁵ Guilds were sometimes created to fulfill an economic need and became communities; sometimes, it was the reverse.²⁰⁶

Guilds and colonies catered to the social and religious needs of their members. Guilds held feasts and processions, organized funerals, built churches, and performed acts of charity.²⁰⁷ Colonies did much the same, but usually on a more modest scale—for example, reserving a pew or chapel in a local church rather than building one for their members.²⁰⁸

Although the social and religious activities of merchant associations were undoubtedly important in their own right, they did also serve an economic function. Social gatherings provided opportunities for the exchange of information.²⁰⁹ Social interaction and communal religious observance served to strengthen group identity. They also facilitated the internalization of group norms, and reinforced these norms through

²⁰³Reynolds (1997)

²⁰⁴Reynolds (1997); Berman (1983). Their situation seems somewhat analogous to that of immigrants in America who, as Toqueville noted, also felt the need to create a civil society

²⁰⁵Reynolds (1997); Scott (1912) Ch. 1

²⁰⁶“Merchants might well use fraternal associations of any sort to further their trade, and craftsmen used them to protect craft interests, but these were not the prime objectives of guilds as such.” Reynolds (1997) p73

²⁰⁷Scott (1912) Ch. 1; Reynolds (1997); Brady (1996); Grafe (2001).

²⁰⁸de Roover (1948)

²⁰⁹A main purpose of the social events organized by merchant colonies in Bruges was “to facilitate the exchange of information on business failures, wars, market conditions, exchange rates, and similar topics of interest to practical merchants and financiers.” de Roover (1948)p 20

social pressure.²¹⁰ Personal friendship reinforced trust.²¹¹ In all these ways, social interaction among the members of the association supported relationships of reliance and so reduced transactions costs. Group solidarity and personal friendships also strengthened the association as a framework of mutual assistance. Indeed, mutual aid was one of the core functions of the association—of great economic value in an uncertain world with little in the way of insurance.²¹² The benefits to members of belonging to a social and religious community raised the cost of the ostracism that would result from the nonperformance of obligations.²¹³

Of course, the economic functions of the merchant association also served to strengthen the social ties. Because of the advantages of dealing with fellow members of one's own association, members tended to socialize almost exclusively with one another.²¹⁴ For examples, members of colonies kept very much to themselves, lived together or close to one another, and frequently intermarried. Social interaction with the locals was discouraged.²¹⁵

THE COSTS OF MEMBERSHIP

The benefits of belonging to a merchant association did not come without costs.²¹⁶ There were both explicit costs and opportunity costs.

Members were required to pay regular dues or taxes to fund the services the association provided them. In the Italian colonies of Flanders and in the *consulados* of

²¹⁰An important function of social events organized by merchant colonies in Bruges was “to bring social pressure to bear upon the members of the group” de Roover (1948)p20. See Hollander (1990) and Greif (1997) on social norms and their internalization.

²¹¹See Greif (1997) on the importance of ‘friendliness’ in reinforcing social enforcement.

²¹²See Scott (1912) and Nicholas (1997) on mutual aid among guild members. See Kohn (2003c) on the management of risk and the role of mutual aid.

²¹³Richardson discusses this in the context of craft guilds (Richardson (2001); Richardson (2001))

²¹⁴Greif (1989)

²¹⁵Boyer-Xambeu, Deleplace et al. (1994) Ch. 2; de Roover (1948); Grassby (2001)

²¹⁶Reynolds (1952); Greif (1997)

Burgos and Seville, for example, this tax took the form of a duty on transactions.²¹⁷

Associations had a supplementary source of revenue in the money their courts collected in fines.

In addition to regular dues and taxes, members had to pay occasional, but sometimes substantial, assessments to cover the payments that their associations made to governments in exchange for the trading privileges they obtained. English merchant guilds, for example, in return for a monopoly of local trade, were 'in scot and lot' with the burgesses of their cities. That is, they agreed to help pay royal taxes imposed on the city and to cover the cost of royal visits. To raise the necessary funds, the guild would typically hold a banquet, with plenty of drink "to loosen the purse-strings of the brethren".²¹⁸ Similarly, regulated companies imposed special levies on their members to fund loans to the English sovereign "and as a result of such assistance, the privileges of the companies were increased from time to time."²¹⁹

Membership had its cost in time as well as in money. As we have seen, merchant associations of all types had structures of internal governance. Those elected to office had to devote considerable time to their responsibilities. Not only were they unpaid, but they often had to put up a substantial bond as security for their handling of the association's funds.²²⁰ Members were also expected to participate in the common defense against predation. And they were expected to take part in important social events such as banquets and processions (which also entailed the purchase of costly liveries). Presumably, participation in such events was not entirely a burden.²²¹

Group solidarity involved opportunity costs. The imposition of an embargo on trade with members of another association or on a foreign market, or the ostracism of a member of the association, meant foregoing profitable trading opportunities. Although such sacrifice was necessary for the greater good of the group, it could involve a

²¹⁷de Roover (1948) on Flanders (the tax was one groat per pound or 1/480); Stein (2000) p 14 on Spain

²¹⁸Gross (1890) p 58

²¹⁹Scott (1912) p 10

²²⁰Watts and Zimmerman (1983)

²²¹Reynolds (1952)

significant loss of business for the individual. As we have seen, there were good reasons why a merchant might prefer to deal with fellow members of his association. However, sometimes he had no choice: merchant associations often prohibited partnerships with outsiders.²²² This too foreclosed potentially profitable trading opportunities. The customs and norms of the association, which were so important in sustaining relationships of reliance, also had their negative side in restricting the freedom of action of its members.²²³

Finally, the greater the power of the association over its members, the greater the incentive to engage in internal politics, rent-seeking, and the subversion of group interests to personal benefit. Such activity, while individually profitable, was socially wasteful: time spent intriguing and protecting oneself against the intrigues of others was time taken away from productive economic activity. Since independent cities had the greatest power, it is not surprising that that is where the problem was most acute.²²⁴

CONCLUSION

Economic theory explains the existence of structures such as large firms and governments in the real world as a response to ‘market failure’—economies of scale, public goods, externalities, and transactions costs. In the presence of such ‘flaws’, joint action can improve on any outcome that individuals can achieve acting separately. In the pre-industrial economy, the framework of joint action that addressed ‘market failures’ was neither the large firm nor government but rather the voluntary association. In the case of commerce, it was the merchant association.

As circumstances changed, merchant associations declined steadily in importance. Other structures—not least governments and large firms—gradually took over many of their functions. In some cases, as we have seen, merchant associations themselves evolved into governments—governments of cities. In other cases, merchant associations

²²²Scott (1912)Ch. 1

²²³“Communities work because they are good at enforcing norms, and whether this is a good thing depends on what the norms are.” p14 Bowles and Gintis (2000)

²²⁴For more see Kohn, chapter on cities, to be written.

evolved into large firms: by the end of the sixteenth century, regulated companies in England and in the Netherlands were reorganizing as joint stock companies.

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