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0521671345 - Institutions and the Path the Modern Economy: Lessons from Medieval Trade

Avner Greif

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ECONOMY

LESSONS FROM MEDIEVAL TRADE

It is widely believed that disparities in economic, political, and social outcomes reflect distinct institutions. There is little agreement, however, among economists, political scientists, and sociologists as to what institutions are, what forces influence their persistence and change, why societies evolve along distinct institutional trajectories, and how we can influence institutional development. This multidisciplinary book develops a concept of institutions that integrates seemingly alternative lines of institutional analysis in the social sciences. It advances a unified framework to study institutional origin, persistence, endogenous change, and the impact of past institutions on subsequent ones.

The benefits of this perspective are demonstrated through comparative studies of institutions – particularly those that supported trade – in the late medieval European and Muslim worlds. This comparative analysis of the institutional foundations of markets and polities and their dynamics also provides valuable insights on the functioning of contemporary economies. Indeed, the analysis highlights the possible particularities of the European institutions and why and how they contributed to the rise of the modern economy by supporting impersonal exchange, fostering the rise of effective states, and leading to advances in useful knowledge.

Avner Greif is the Bowman Family Endowed Professor in Humanities and Sciences, Professor of Economics, and Senior Fellow at the Institute for International Studies at Stanford University. He is a recipient of fellowships from the American Academy of Arts and Sciences, the MacArthur Foundation, the Econometric Society, the Canadian Institute for Advanced Research, and the Center for Advanced Studies in the Behavioral Sciences, Stanford. He has published articles in such journals as *American Economic Review*, *Journal of Political Economy*, *Journal of Economic History*, *American Political Science Review*, *European Review of Economic History*, and *Chicago Journal of International Law* as well as chapters in many edited books. Greif is also a coauthor of *Analytic Narrative* (1998), and some of his works have been published in French, Japanese, Persian, and Spanish editions.

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Lessons from Medieval Trade

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Cambridge, New York, Melbourne, Madrid, Cape Town, Singapore, São Paulo

Cambridge University Press

40 West 20th Street, New York, NY 10011-4211, USA

www.cambridge.org

Information on this title: www.cambridge.org/9780521480444

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First published 2006

Printed in the United States of America

A catalog record for this publication is available from the British Library.

Library of Congress Cataloging in Publication Data

Greif, Avner, 1955–

Institutions and the path to the modern economy: lessons from medieval trade / Avner Greif.

p. cm. – (Political economy of institutions and decisions)

Includes bibliographical references and index.

ISBN-13: 978-0-521-48044-4 (hardback)

ISBN-10: 0-521-48044-2 (hardback)

ISBN-13: 978-0-521-67134-7 (pbk.)

ISBN-10: 0-521-67134-5 (pbk.)

1. Commerce – History – Medieval, 500–1500. 2. Social institutions.

I. Title. II. Series.

HF395.G74 2005

381'.09'02 – dc22 2005006468

ISBN-13 978-0-521-48044-4 hardback

ISBN-10 0-521-48044-2 hardback

ISBN-13 978-0-521-67134-7 paperback

ISBN-10 0-521-67134-5 paperback

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To the living memory of my father, Dr. Leon Arie Greif
לאבי, מורי, ורבי, סא"ל ד"ר לאון אריה גרייף. תנצב"א

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Abbreviations

<i>Annali</i>	<i>Annali Genovesi di Caffaro e dei suoi Continuatori</i> , 1099–1240
Bodl.	Bodleian Library, Oxford, England
CDG	<i>Codice Diplomatico della Repubblica di Genova dal</i> <i>MCLXIII [sic] al MCLXXXX [sic]</i>
DK	David Kaufmann Collection, Hungarian Academy of Science, Budapest
Dropsie	Dropsie College, Philadelphia
INA	Institute Norodov Azii, Leningrad
TS	Taylor-Schechter Collection, University Library, Cambridge, England
ULC	University Library, Cambridge, England (exclusive of the TS collection)

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Preface

This book grew out of an attempt to gain a better understanding of the causal factors underpinning economic and political outcomes during the late medieval period (circa 1050 to 1350). It was during this period that the Muslim (Mediterranean) World reached what many scholars consider to be the zenith of its commercial integration, whereas expansion of markets in Europe was so pronounced that prominent historians dubbed this phenomenon as “the Late Medieval Commercial Revolution.” Gaining a better understanding of this period therefore has the promise of advancing our knowledge regarding why and how effective markets and economically beneficial polities prevailed in some historical episodes but not in others. Although economists have long emphasized the welfare-enhancing implications of market expansion, we know surprisingly little about the source for historical trajectories of market development.

This period is also of interest because it was a point of bifurcation in the histories of the Muslim and European worlds. The Muslim world was probably more advanced economically, technologically, and scientifically than Europe during the late medieval period. Indeed, the Europeans learned a great deal from the Muslim world at the time (e.g., Watt 1987). In subsequent centuries, however, the Muslims developed economically and politically along a different path from the Europeans, and became economically worse off in the long run.

In attempting to understand this period and its implications on subsequent development, I benefited from the training in historical analysis that I received when pursuing an advanced degree at Tel Aviv University. I was particularly fortunate to study under the supervision of Professor Moshe Gil, a specialist in the Muslim medieval world. My training in historical analysis was complemented by further graduate training in economics and economic history at Northwestern University where I had the

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privilege to work under the supervision of Professors Joel Mokyr, John C. Panzar, and William P. Rogerson.

My training in these two disciplines is reflected in this book, which combines historical and social scientific modes of analysis. On the one hand, the book aspires to do justice to historical particularities and processes. Indeed, it argues that they are the keys to understanding distinct outcomes and developments in seemingly identical situations. On the other hand, it also recognizes that a purely historical narrative risks being ad hoc and devoid of general insights.

The analysis conducted here, therefore, also follows the social scientific tradition of relying on explicit theory, using analytical models, and putting conjectures at the risk of being empirically refuted. At the same time, it recognizes the limitations of the social scientific approach: general theory often fails to account for historical particularities; the use of models is restricted by underlying mathematical techniques; and historically specific conjectures often cannot be evaluated using statistical methods.

Historical and social scientific analyses are therefore complements to each other rather than substitutes, as often assumed. My hope is that the studies presented here will demonstrate the necessity, feasibility, and benefit that is derived from integrating these two scientific modes of analysis.

In the course of studying the late medieval period, I realized the need to go beyond invoking different technologies, endowments, or preferences, as classical economic theory directs. To understand the outcomes and processes of interest, I had to incorporate in the analysis the impact of *institutions*. In economics, institutionalists usually identify institutions with either politically determined rules regulating economic activities or contractual and organizational forms chosen by agents interacting within markets. These approaches were too narrow for my purpose because I couldn't take either the political or market orders as exogenous to the analysis. My aim was to examine the endogenous emergence and dynamics of different polities and economies and not merely behavior in them.

To understand the endogenous emergence, operation, and implications of different polities and markets, therefore, I had to go beyond viewing institutions as politically determined rules or as the optimal responses of economic agents interacting within markets. Instead of taking markets and polities as exogenous, I had to consider them as endogenous and study their institutional foundations. To take the analysis to this deeper level, I sought to understand the causal factors influencing behavior in economic and political transactions. Such understanding necessitated going

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beyond studying rules to consider how systems of rules, beliefs, norms, and organizations (social structures) guide, enable, and motivate behavior in various transactions.

Studying institutions as interrelated systems as rules, beliefs, norms, and organizations turned out to be both challenging and rewarding. By the ad hoc invoking of unobservable beliefs and norms, for example, any outcome can be explained, implying that we have explained nothing of consequence. It is therefore imperative to have a way to restrict the set of admissible institutions. In restricting this set, I found it conceptually sound and empirically rewarding to combine historical and microanalytical – particularly game-theoretic – analyses. Combining historical and game-theoretic analyses enabled me to do justice to the diversity of the possible systems of rules, beliefs, norms, and organizations on the one hand, while analytically restricting and empirically evaluating the set of admissible institutions and outcomes.

Moreover, this approach revealed new ways to advance the study of the thorny issue of institutional dynamics. In what ways do institutions influence trajectories of subsequent institutional and therefore historical development? Economists usually assert that institutional dynamics reflect optimal responses of decision makers to current and expected conditions. Social scientists working in other disciplines and historians, however, assert that institutional dynamics reflect the shackles of history. Each side of this debate captures a potentially important aspect of reality, but neither is satisfactory by itself. By considering institutions from the broader perspective advanced here and combining the historical and the microanalytical frameworks, we can bridge these two approaches. It is possible to better understand when and why an institution persists in a changing environment, how it unleashes processes that lead to its demise, and how past institutions – perhaps even those that are no longer effective in influencing behavior – influence subsequent ones.

The formation and implications of distinct beliefs, norms, and organizations (social structures) have been extensively studied in disciplines other than economics, such as sociology, political science, and cognitive science. Hence, this book builds on analytical and conceptual frameworks developed in disciplines outside economics. It particularly highlights the benefits of merging the study of institutions, as conducted in mainstream economics, with the study of cultural and social factors, as conducted in sociology. By focusing on beliefs, norms, and organizations, which has traditionally been the domain of sociological analysis, this work became a part of the “sociological turn” of institutional analysis in economics.

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Sociological variables are invoked to account for the diversity found in institutional forms and development.

My attempt to gain a better understanding of a particular historical episode necessitated attempting to advance institutional analysis. Many social scientists maintain that institutions matter and that institutional dynamics is a historical process. The ability to study institutions and their dynamics is therefore crucial to understanding the reasons for the uneven distribution of welfare among and within different societies and what can be done to improve this situation. The framework outlined in this book attempts to advance our ability to conduct a comparative analysis of the institutional foundations of past and contemporary markets and polities and their dynamics.

Because this book contains an analysis of a particular historical episode and a general framework for studying institutions, it is made up of several overlapping components. The first is a detailed study of institutions that provided the foundations for markets and polities during the late medieval period; the second is a comparative analysis of institutions in the European and Muslim worlds during that period; the third is a conceptual, analytical (specifically game-theoretical), and empirical framework for studying institutions and their endogenous dynamics. Indeed, the analyses of specific institutions are presented in this book as illustrations of the main aspects of this framework.

This book is therefore multifaceted and hence there are many ways to read it. Some readers will read it as presenting a theory of economic and political institutions in which historical case studies illustrate particular theoretical assertions. Some will read it as a statement of why and how we should introduce endogenous dynamics into institutional analysis, or why a context-specific, theoretically informed, case-study analysis is useful. Some will read this book as a comparative study of the institutional foundations of late medieval markets and states in the European and Muslim worlds that fostered our understanding of these particular historical episodes and their dynamics. Others will read it as a study of the interrelations between institutional development and cultural and social evolution, or as a call for expanding institutional analysis in economics by incorporating cultural and social factors. For some it will be read as a confirmation of the applicability of game theory to empirical institutional analysis, while others will read it as social science history. As for myself, the book reflects an attempt to gain a better understanding of a particular historical episode and to learn about institutions in general from this period.

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My greatest professional debt in producing this book is to my two teachers: Joel Mokyr and Douglass C. North. Joel and Doug spent many hours inspiring, encouraging, and providing me with detailed comments. Their faith in this project was instrumental in moving it forward. Masahiko Aoki, Randall Calvert, Philip T. Hoffman, Timur Kuran, David Laitin, Steve Tadelis, Barry Weingast, and Oliver Williamson have also provided me with detailed comments on various drafts of this manuscript. This preface seems also an appropriate opportunity to thank Elhanan Helpman who influenced my professional development since my undergraduate days.

While writing this book, I was fortunate to benefit from a particularly favorable work environment at Stanford University. I have greatly benefited from interactions, stimulations, and valuable comments regarding this project from members of the Comparative Institutional Analysis and Economic History groups in the Economics Department, particularly from Masahiko Aoki, Paul David, Marcel Fafchamps, Paul Milgrom, Steve Tadelis, Yingyi Qian, and Gavin Wright. Many other Stanford scholars working on institutions also contributed in many ways to this project. James D. Fearon, John W. Meyer, Stephen H. Haber, Stephen D. Krasner, David Laitin, and Robert Powell were particularly instrumental. Paul Milgrom, Barry Weingast, and David Laitin collaborated with me on projects that grew from or were later incorporated into this book. While I was working on this manuscript, I also had the good fortune to collaborate with and learn from Robert Bates, Margaret Levi, Jean-Laurent Rosenthal, and Barry Weingast while coauthoring *Analytic Narratives* with them.

Several organizations sponsored conferences and seminars where I gained important feedback on the manuscript. These include the Center for New Institutional Social Science at Washington University, the Center for the Study of Economy and Society at Cornell University, the Mercatus Center at George Mason University and the Liberty Fund, and the Canadian Institute for Advanced Research. These events were organized by Itai Sened, Victor Nee and Richard Swedberg, Paul S. Edwards and Brian Hooks, and Elhanan Helpman, respectively. In addition to their comments, I benefited greatly from input by participants, particularly Lee Benham, Peter J. Boettke, Randall Calvert, Bruce G. Carruthers, Stanley Engerman, Philip T. Hoffman, Jack Goldstone, David Harbord, Jack Knight, Michael Macy, Chiaki Moriguchi, Gary Miller, John V. Nye, and Norman Schofield. Avanish Dixit, Þráinn Eggertsson, Steve A. Epstein, Henry Farrell, Judith Goldstein, Peter Gourevitch, Yaron Greif, Leonard

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Hochberg, Jeffrey Rogers Hummel, Peter Katzenstein, Margaret Levi, Bentley Macleod, Chris Mantzavinos, Tetsuji Okazaki, Daniel Posner, John Pencavel, Robert Powell, Rudolf Richter, Gerard Roland, Andy Rutten, Kenneth Shepsle, Shankar Satynath, Kathleen Thelen, and Carolyn Warner also provided me with valuable comments.

The able research assistance of Saumitra Jha, Navin Kartik, Na'ama Moran, Lucia Tedesco, and Joanne Yoong contributed much to the research reported in this book. I am similarly in debt for the valuable lessons I received from my students and post docs, particularly Kurt Annen, Gregory Besharov, Ryo Kambayashi, Kivanc Karaman, Aldo Musacchio, Mu Yang Li, Nese Yildiz, and Pai-Ling Yin.

Grants from the National Science Foundation, fellowships from the MacArthur Foundation and the Canadian Institute for Advanced Research, and support from the Stanford Humanities Center and the Center for Advanced Studies in Behavioral Sciences at Stanford gave me both the resources and the time to complete this work. My assistant, Deborah Johnston, provided me with valuable support, going over endless versions of the manuscript among many other contributions. Barbara Karni, through her able editing, contributed much to render the exposition accessible. The editorial team at Cambridge University Press – Lewis Bateman, Brian R. MacDonald, and Eric Schwartz – were similarly of immense help.

The endless energy and impressive intellect of my mother, Koka Lea Greif, has always been a source of inspiration for me. Last, and not least, I am in debt to my wife Esther Greif and our children, Adi, Yaron, and Arielle, who stood by me during the years I worked on this manuscript. They were a constant source of support and motivation, and I greatly appreciate the personal sacrifices they willingly made to enable me to complete this book.

Various chapters in this book build on material previously published by the author.

Chapters 3 and 9 draw on “Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders” (*Journal of Economic History*, 1989), by permission of the Economic History Association; “Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders’ Coalition” (*American Economic Review*, 1993), by permission of the American Economic Association; “Contract Enforceability and Economic Institutions in Early Trade: Lessons from the Commercial Revolution” (*American Economic Review*, 1992), by permission of the

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American Economic Association; and “Cultural Beliefs and the Organization of Society: A Historical and Theoretical Reflection on Collectivist and Individualist Societies” (*Journal of Political Economy*, 1994, copyright by the University of Chicago, all rights reserved), by permission.

Chapter 4 draws on “Coordination, Commitment and Enforcement: The Case of the Merchant Guild” (*Journal of Political Economy*, 1994, copyright by the University of Chicago), by permission. A modified version of Chapter 6 was published as “Theory of Endogenous Institutional Change” (coauthored with David Laitin, *American Political Science Review*, 2004), by permission of the *American Political Science Review*. Chapter 8 draws on “Self-Enforcing Political Systems and Economic Growth: Late Medieval Genoa” (in *Analytic Narratives*, 1998), by permission of Princeton University Press.

Chapter 10 draws on “Institutional and Impersonal Exchange from Communal to Individual Responsibility” (*Journal of Institutional and Theoretical Economics*, 2000), with the permission of Springer Publishing Group; “Impersonal Exchange without Impartial Law: The Community Responsibility System” (*Chicago Journal of International Law*, 2004, 5:1, pp. 109–38), with permission of the journal.