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Sheilagh Ogilvie, *Institutions and European Trade. Merchant Guilds 1000-1800.* Cambridge and New York: Cambridge University Press, 2011. vi + 499 pp. Notes, bibliography and index. $113.39 U.S. (cl). ISBN 978-0-521-76417-9; $47.23 U.S. (pb). ISBN 978-0-521-74792-9.

Review by George Grantham, McGill University.

"Economics is a very dangerous science." -- John Maynard Keynes.[1]

The use of highly refined conceptual tools drawn from theoretical economics has been a defining feature of American social science for over a quarter of a century. Originally confined to its bridgehead in economics, the "rational-choice" programme of interpreting outcomes of social interaction as equilibria sustained by decisions of agents acting in material self-interest has seized the commanding heights in political science and sociology, whence raids have been launched into the more refractory realm of political and social history.[2] One might suppose that the paradigm's success is attributable to discovery of previously undetected facts and causal relations, but this does not generally seem to be the case.[3] Rational-choice theory is not like the sciences that provide tools for recovering past climate, dating prehistoric artifacts, or authenticating documents. The paradigm creates no new body of established fact; it is a hermeneutics. It rearranges known facts under the covering hypothesis of a universal "economizing principle" that interprets institutional forms as products of selection based on relative fitness in securing material welfare. The underlying premise is that unexploited opportunities for material gain are eventually recognized and exploited, which implies that, in the long run, institutional forms can be interpreted as functionally efficient responses to the environment. As Boldizzoni recently pointed out, this approach to human organization usually amounts to little more than thinly disguised theodicy justifying the ways of the market to mankind.[4]

Among the institutions subjected to this approach, the medieval merchant guild holds pride of place. The pervasiveness and persistence of an overtly monopolistic (and hence economically inefficient) institution poses a challenge to a paradigm based on "natural" selection of economically efficient institutions. What rational logic explains an economically irrational institution that was not only widely diffused throughout the medieval and early modern European economy, but survived into the nineteenth century?[5] The merchant guild thus constitutes a test case of the rational-choice paradigm. For the paradigm to hold, the guild must in fact have been economically efficient. The challenge for rational-choice theory is to identify the source of that efficiency. This is not an easy task. Since the time of Adam Smith, economists have considered the merchant guild to be a body endowed with exclusive trading privileges conferred by a ruler in return for a share of the monopoly rent. On this definition, guilds caused prices to be higher (and production lower) than under free competition. When a guild possessed exclusive right of purchase, the prices paid to producers were lower (and quantities purchased smaller). On these grounds, Adam Smith and a long line of liberal economists condemned them as inimical to the economic welfare of the broader community.[6]

The rational-choice response is that guilds must have provided material benefits offsetting the efficiency cost of monopoly; otherwise they would not have survived the selective test. The theorist's task is to identify those benefits. Candidates include allegedly superior enforcement of private contracts, more

effective supervision of mercantile agents by principals, greater ability to secure accurate and timely commercial information, and greater price stability. The most ingenious rationalization, however, is that guilds contributed to economic growth by giving rulers an incentive to respect property rights of foreign merchants domiciled within their territory. This claim presumes that long-distance trade in the central Middle Ages was constrained not so much by high transport cost or limited effective demand of potential customers, as by the proclivity of sovereigns to despoil foreign merchants operating in their territory, what Greif has termed the "fundamental problem of exchange."[7] The alien merchant guild--i.e. a foreign merchant guild licensed by the local ruler--solved the problem by making it possible for offended merchants to declare an embargo on trade within the ruler's territory. Why a ruler might find it in his self-interest to concede power of reprisal to a group of foreigners will be considered in more detail below.

Institutions and European Trade is a lengthy--one is tempted to say overly lengthy--refutation of this approach to the history of economic institutions in general and the merchant guild in particular. The principal object of Professor Olgivie's criticism is an article by Greif, Milgrom, and Weingast which argued that rulers conceded the power to impose an embargo to foreign merchant guilds as a means of lending credibility to a commitment not to expropriate merchant property, thereby providing the necessary security for trade to take place at an economically efficient volume.[8] The alternative (but according to them incorrect) conjecture is that, as participants in profits secured by privileges conceded to foreign merchants, rulers had an obvious incentive both to grant the monopoly and to maintain the sanctity of merchant property, and that nothing more by way of economic argument is required to explain the ubiquity and persistence of merchant guilds. Against this argument, Greif et al. demonstrate analytically that even when a ruler shared the spoils of monopoly, he retained the rational incentive to seize goods temporarily domiciled in his territory as long as the majority of merchants continued to trade there. Something more than a peaceable division of the spoils, then, was required to sustain an efficient level of long-distance exchange. To appreciate the logic of this claim, we must take a brief excursus into the thickets of the game theory that underpins the argument.

For all its mathematical subtlety, game theory is no more than refined common sense. In dealing with other persons, we usually try to select the best (from our perspective) strategy from among those available to us. Since the outcome of our action is affected by the other party's reaction to it, selecting the best strategy necessarily involves predicting that reaction. Game theory presumes that the other party goes through the same ratiocination, which implies that, in the degree to which each party knows the other's options and the pay-offs, a person's best strategy can often (though not always) be determined as the strategy that yields the best outcome for her given the other person's best strategy. This result is particularly helpful for the all-seeing theorist, since all that is required for her to predict the resultant choices is the assumption that both parties are rational and aware of all possible consequences of their decisions.

The best known example of this type of reasoning is the Prisoner's Dilemma. Two prisoners jointly charged with a crime are held in separate cells. If neither confesses both go free for lack of evidence. If one prisoner refuses to confess while the other confesses, he gets shot and the confessor goes free. If both confess they each get ten years in prison. Clearly, both are better off if neither confesses. The problem is that each risks being shot if he does not confess. To avoid the worse-case scenario, a prisoner will therefore confess. Reinforcing that inclination is the knowledge that the other prisoner faces the same dilemma and will also rationally choose to confess. The alternative amounts to deliberate suicide, which is ruled out as irrational. This dilemma holds even for prisoners who agree beforehand not to confess, because individual self-interest in avoiding execution will tempt each prisoner to renege and they both know it. In the language of game theory, such a promise is non-credible.

The crucial element in the fable is that each prisoner assumes the other is as selfish as he is--that he will not risk his own life to guarantee his partner's freedom; in other words, there is no honour among

thieves. What drives the reasoning is the assumption that agents are self-interested. They are presumed to choose what they want, and what they want can usually be described as material goods and services.[9] In the context of rational choice jargon, a term frequently employed to describe this behavior is "opportunistic." Not leaving a tip at a restaurant to which you do not expect to return is opportunistic. Game theory is predicated on the presumption that people act opportunistically unless the penalty exceeds the gain. In the context of long-distance trade, this implies that, unless constrained by the cost of retaliation, traders will welsh on contractual obligations and rulers will seize foreign merchants' goods. This is the "fundamental problem of exchange," as Olgivie explains. One's assessment of how fundamental it is depends on whether one expects people regularly to stiff cab drivers for the fare.[10]

From the perspective of game theory, the ruler's constant temptation to seize foreign merchants' property means that the merchants have no reason to believe he will not eventually succumb to that temptation. That apprehension cannot be resolved by his promise not to do so. For, just as Lucy continually violates her promise never again to pull the football away from Charlie Brown, a ruler's promise not to rob foreign merchants means nothing if it costs less to break than to keep. Greif et al. argued that a guild possessed of the power to impose an effective embargo on foreign trade could impose a significant cost for breaking the promise. A ruler wishing to confer credibility on his commitment to respect merchant property thus has a rational incentive to confer monopoly power on a group of foreign merchants distinct from any profits he might reap from the monopoly.[11]

In the game of mirrors modeled by game theory, the ruler authorizes a mechanism that penalizes him when he breaks his word, thereby lending that word credibility. According to Greif et al., this mechanism, embodied in the privileges granted to the alien merchant guild, solved the fundamental problem of exchange, thereby facilitating the unprecedented expansion of long-distance trade. An important but often overlooked feature of this argument is that a successful guild would never have to impose an embargo, because no rational ruler would have any material incentive to take actions triggering it. Thus, despite its central importance to the argument, the embargo is never (or at most rarely) observed. This makes the theory difficult to test, since the action of embargo implies that the original institutional mechanism was either flawed or incomplete, or that the actors were not acting rationally, both of which lie outside the domain covered by the theory.

One might suppose that the prospect of merchants not returning to places where their goods had been seized would provide a sufficient incentive for rulers not to expropriate them. The theoretical objection to this plausible conjecture is that, because the contribution of an individual merchant to the volume of trade is small (and on the margin close to zero), the cost of spoliating only a few merchants who subsequently do not return will be less than the gain from seizure, particularly when other merchants do not quit trading out of solidarity with their offended colleagues--i.e. if there is no guild.

Thus, although reputational considerations can support a certain level of trade even when the ruler cheats, the *optimal* level can be secured only through the credible threat of guild embargo. A ruler interested in optimizing the level of trade will therefore concede guild privileges. This argument is unlikely to impress non-economists, but it was the published article's chief novelty: merchant guilds were critical to medieval economic growth, not because they supported long-distance trade--other mechanisms were capable of doing that--but because in theory they supported an economically optimal level of trade. The authors do not inform us whether the difference between that optimum and plausible alternative level of trade was large or small; the model only demonstrates that if merchants and rulers were rational, the difference should be positive. This is rather weak tea. The authors try to strengthen it by noting that after guilds emerged in the twelfth and thirteenth century, long-distance trade expanded, so the effect must have been large. It is unlikely that anyone apart from persons more concerned with defending the claims of theory than the claims of accurate fact will be impressed with *post hoc proper hoc*, a form of argumentation common to much rational-choice discourse.

Despite its patent flaws, Ogilvie subjects the rational guild theory to vigorous and lengthy rebuttal. Like a lawyer's brief or perhaps a seventeenth-century sermon, she subjects each element of the efficiency theory of the guild to a barrage of logical argument, precedents, and citations. The obvious alternative to the claim that guilds persisted because they benefitted the economy (whatever that might mean) is that as monopolies they lowered economic welfare--that guilds did not persist because they reduced transactions costs resulting from insecure property rights, but because rulers connived with them to share monopoly rents from protected trade. The rebuttal runs through the various efficiency arguments one by one. Did guilds represent an efficient alternative to governments in enforcing contracts? No: The court system did just fine in that regard. Did guilds effectively address principal-agent problems (agents cheating their bosses or principals)? No: The courts seem to have managed this problem as well. Were they the most efficient means of gathering and transmitting commercial information? No. In fact guilds were probably less efficient than contemporary private postal systems. Did they reduce price volatility in the markets they served? No. Did they contribute more to the expansion of trade than counterfactual 'free trade'? Probably not, though the question deserves further analysis. Did they act as monopolists in markets where they appeared as sellers and as monopolists where they appeared as buyers? Yes. The demonstration of each proposition rests on exhaustive survey of the relevant literature. The erudition deployed is impressive, but it is not clear what the piling on of instances adds to the critique, since as a matter of logic the general propositions advanced by the efficiency theorists are disabled by a single counter-example.

The larger question posed by this long and somewhat tedious recitation of examples is whether they engage a debate that needed to be joined. The main objection to arguments concerning the economic efficiency of pre-modern institutions is that in a pre-statistical age they can neither be confirmed nor denied. This holds equally for the claim that guilds increased efficiency and the contrary claim that they diminished it. Just as we cannot know whether the positive effect of the embargo mechanism was large or small, we cannot know whether the negative monopolistic effect of the guild was large or small. Common sense suggests that either way the effect must have been slight, since the value of long-distance trade relative to total production was extremely low, and the debate over the effect of the guild concerns a tiny fraction of that fraction. From the perspective of the history of economic growth, the effect on productivity and output one way or the other is simply too small to matter.

The real debate, then, is not substantive, but ideological. Do models exclusively based on self-interested expediency give a sufficient account of the institutional forms? Beyond that question lies the deeper methodological issue of whether logical sufficiency supplies a legitimate criterion for screening historical explanations, or, indeed, any account of social phenomena. These are not new issues. They were at the core of methodological debates accompanying the first wave of economic accounts of institutions in the late nineteenth century. All the issues regarding the scope and adequacy of the rational choice paradigm then raised remain unresolved.[12]

Professor Ogilvie reviews over a dozen analytically plausible rationalizations of the merchant guild. In most cases the proponents simply claim that their hypothesis is consistent with the facts, although as she notes this is far from always the case. Consistency, however, is not a test of it. It is very much like correlations, which as generations of students have been taught, can be spurious. Ogilvie's reading of guilds as monopolistic cartels to which rulers subcontracted the task of raising levies on trade is a plausible account that fits well with contemporary governmental practice in other spheres. The apparent homogeneity of guild structure across Europe suggests a common cause, and this may be it. But it cannot have been the sole cause. The Company of Merchant Adventurers maintained an office in Hamburg until Napoleon shut it down in 1809, long after its monopoly had been extinguished by interlopers. Perhaps the more interesting question to ask of merchants guilds does not concern origins and persistence, but disappearance. Were they abandoned because long-distance trade became less risky? Was it that territorial states developed more efficient means of raising revenue than taxing

monopolies? Or was it because the rising volume of trade made whatever inefficiencies entailed by the guilds increasingly insupportable?

Readers of this book are unlikely to come away with a better understanding of the merchant guild than they can obtain from any number of older accounts. Its contribution is to show that a set of poorly defended arguments that attempt to justify the guild as an efficient institution are in fact indefensible. This does not mean that the guild was economically unjustified. The ubiquity of the form, ranging from local guilds of butchers to the great associations of masters and doctors comprising the medieval university, suggests common factors at work that generated a subtle mix of individual initiative and corporate control. The constitutional significance of these organizations was worked out at the end of the nineteenth and beginning of the twentieth century. We are still far from understanding their economic significance which, however slight in the aggregate, was important enough at the small scale of medieval craft and mercantile activity to sustain them. Perhaps the biggest question is whether they were natural or unnatural monopolies. The answer to that question requires a deeper understanding of the economic life of the Middle Ages than is currently being deployed to explain their origin and persistence.

NOTES

[1] John Maynard Keynes, "Malthus," *Essays in Biography* (New York: Norton, 1963), p. 107.

[2] For example, see Douglass C. North, John Joseph Wallis and Barry R. Weingast, *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History* (Cambridge; New York: Cambridge University Press, 2009).

[3] One of the chief expositors of rational-choice methodology recently conceded its essential emptiness. "My claim is that much work in economics and political science is devoid of empirical, aesthetic or mathematical interest, which means that it has *no value at all*." Jon Elster, "Excessive Ambitions," *Capitalism and Society* 4/2(2009):9. [italics in the original]

[4] Francesco Boldizzoni, *The Poverty of Clio. Resurrecting Economic History* (Princeton and Oxford: Princeton University Press, 2011).

[5] The English Company of Merchant Adventurers survived until 1808, when its *comptoir* at Hamburg was abolished by Napoleon. By this time, the Company had long lost its monopoly on the sale of English woolens into Central Europe.

[6] The *locus classicus* of this literature is Eli F. Heckscher, *Mercantilism.* (London: George Allen and Unwin; New York: The Macmillan Company, 1935), 2 vols.

[7] Avner Greif, "The Fundamental Problem of Exchange: a Research Agenda in Historical Institutional Analysis," *European Review of Economic History* 4(2000):251-284.

[8] Avner Greif, Paul Milgrom and Barry Weingast, "Coordinaton, commitment and enforcement: the case of the merchant guild," *Journal of Political Economy* 102(1994):745-776.

[9] The relation between choice and 'want' or desire is not as transparent as rational choice theorists suppose it to be. For a critique of this assumption as a general account of human choice, see Amyarta Sen, "Rational Fools: A Critique of the Behavioral Foundations of Economic Theory," *Philosophy and Public Affairs* 6(1977):317-344. For further subtleties, see Kryster Bykvist, "Can Unstable Preferences Provide a Stable Standard of Well-Being?," *Economics and Philosophy* 26(2010):1-26.

[10] The recent case of a Manhattan hedge fund executive who tried to stiff a driver for the fare to Greenwich, Connecticut, suggests that certain personality types may be prone to this behavior.

[11] It must be the guild and not the ruler that enforces the monopoly. Otherwise the ruler could break his promise and, by failing to enforce the monopoly, free himself from the sanction of embargo.

[12] On the history of that first wave, see the exceptionally fine work of Heath Pearson, *Origins of Law and Economics. The Economists' New Science, 1830-1914* (Cambridge: Cambridge University Press, 1997).

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