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Merchant guilds, taxation and social capital

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ABSTRACT

We develop a theory of the emergence of merchant guilds as an efficient mechanism to foster cooperation between merchants and rulers, building on the complementarity between merchant guilds' ability to enforce monopoly over trade and their social capital. Unlike existing models, we focus on local merchant guilds, rather than alien guilds, accounting for the main observed features of their behavior, internal organization and relationship with rulers. Our model delivers novel predictions about the emergence, variation, functioning, and eventual decline of this highly successful historical form of network. Our theory reconciles previous explanations and the large body of historical evidence on medieval merchant guilds. In doing so, we also shed novel light on the role of the guilds' social capital, and its importance for taxation, welfare, and the development of towns and their government in medieval Europe.
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1. Introduction

Since the pioneering work by Greif et al. (1994), merchant guilds have attracted considerable attention by economists, and for good reason. This celebrated historical institution dominated trade for several centuries, and its development was inextricably linked with the growth of medieval towns and the rise of the merchant class. The merchant guild has also been viewed by many as a shining example of *social capital* – see, e.g., Putnam et al. (1993) – bringing major economic and social benefits, thereby suggesting a very valuable potential role for such social capital even in modern economies – see, e.g., Bardhan (1996), Dasgupta and Serageldin (2000), Raiser (2001), and Stiglitz (1999).

Is this positive view of merchant guilds justified? What role did the guilds' social capital play? What is the rationale for the way merchant guilds operated, and for their relationship with medieval rulers? We address these questions theoretically, and then confront our model's predictions with the available historical evidence. The objective is to shed new light on the reasons for the emergence, organization, functioning, and eventual decline of this highly successful historical form of network.

Our model presents a very different, although complementary, theory of the emergence and role of merchant guilds relative to the existing literature and in particular to Greif et al. (1994), who were the first to provide a formal model of merchant guilds. They developed a theory of *alien merchant guilds* – i.e., associations of alien merchants supported by the rulers of the polities in which they traded. Historically, though, most merchant guilds emerged as *local merchant guilds* – i.e., associations of local merchants that obtained recognition and privileges (including monopoly power over local trade) from their local rulers. Alien merchant guilds were typically formed by the members of local merchant guilds who were active in

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long-distance trade, and remained under the control and supervision of the guilds from the merchants' polities of origin.[1] Moreover, only a subset of local merchant guilds went on to form such foreign 'branches', primarily in the main international trade centers. It is, therefore, of considerable interest to understand the economic rationale for the emergence of local merchant guilds, and the reasons why medieval rulers were willing to grant them recognition and privileges.[2] This is all the more important as local merchants dominated medieval towns, many of which acquired considerable power and autonomy. Hence, studying the roots of merchants' organizations and their relationships with rulers is crucial in understanding the wider political economy forces that shaped the development of towns and states.

Medieval rulers did not possess a reliable civil service to collect taxes, and employed a variety of agents for this purpose. The taxation of trade was costly and inefficient, with many tolls levied in markets, as well as ports, river crossings, and other points of transit. We develop a repeated game between the ruler of a medieval polity and a large number of (local) merchants to show how merchant guilds emerged as a mechanism to foster cooperation between merchants and rulers, raising revenue for the latter more efficiently: merchant guilds were exempted from paying tolls, and made direct transfers to rulers. This apparently straightforward alternative to reliance on tax collectors was far from simple to implement. In order to raise enough revenue for rulers, guild members had to secure collusive profits from trade. We study the conditions under which such collusion could be sustained, and its implications.

Effective collusion required that only guild members be authorized to trade, hence the granting of exclusive trading rights by rulers to merchant guilds. But, these exclusive rights had to be enforced, and used profitably. We identify two main channels through which guilds' social capital affected the sustainability of collusion. When applied to groups or networks, such as merchant guilds, the notion of social capital[3] typically refers to *cohesion* and *trust* among members, and to their resulting ability to enforce group norms and engage in effective collective action. In our model, social capital facilitates cooperation among guild members to achieve two important objectives: first, detecting and intervening to defeat attempts by non-members to undermine the guild's monopoly over trade; second, coordinating on profit-maximizing market strategies for the group, and appropriate punishments of any member who chooses to deviate. By reducing the cost of effective collusion, greater guild social capital tends to make granting recognition and privileges to guilds more attractive for the ruler. On the other hand, greater social capital within a guild also increases its bargaining power *vis-à-vis* the ruler (reflecting the greater degree of cohesion among guild members), allowing the guild to secure a part of the collusive profits it generates.

Our theory identifies a number of other important determinants, beyond the guild's social capital, of the ruler's choice between the merchant guild regime and the tax collector regime: these include the strength and uncertainty of consumer demand, the geographical and population characteristics of the polity, and the degree of patience of the merchants. The model therefore yields a rich set of empirical predictions: we confront these with the available historical evidence in Sections 5 and 6, where they help to shed light on the timing and variation of emergence of merchant guilds; on their organization, norms and behavior; on their relationship with rulers and their role in the development of medieval towns and their administration; and finally on their decline.

The welfare implications of merchant guilds are complex. Our model shows that only those with sufficient social capital would have been granted recognition and privileges by rulers, since they represented a less costly way of raising revenue than reliance on tax collectors. In this sense, merchant guilds represented an efficiency improvement relative to the taxation alternatives available at the time. From the perspective of consumers, we show that the merchant guild regime implied the same level of consumer prices as the tax collector regime, except when demand realizations were large enough to require guild members to coordinate on a price below the monopoly price: in this case, consumers were better off under the guild regime. These implications are favorable to merchant guilds. On the other hand, the guilds' social capital may also have had less favorable welfare implications. Our model highlights one of these: effective collusion implied an upper bound on guild membership, which in some circumstances involved membership restrictions and exclusion. At the same time, the guilds' social capital, by increasing their bargaining power, enabled them to secure a share of collusive profits (net of transfers to the ruler). This generated inequality within the merchant class, with guilded merchants earning much more than other merchants who were excluded from trade.

The remainder of the paper is organized as follows. Section 2 presents a short introduction to merchant guilds and to the medieval taxation of trade, which motivates our model. Section 3 sets out the baseline model. Section 4 studies taxation and trade, and the conditions to sustain collusion. The choice between the tax-collector regime and the guild regime is first analyzed in Section 5. This section also reviews the historical evidence on the model's predictions. We then extend the model in a variety of ways in Section 6, and discuss the evidence on the resulting additional implications. The final Section 7

[1] See, for example, Dessí and Ogilvie (2004, pp. 9–11) and Ogilvie (2011, pp. 24–25, 202–205). This should not be taken to mean that only members of the local merchant guild of the polity of origin could be members of an alien merchant guild: associate membership was sometimes offered to merchants from different cities of origin, although this practice was typically limited to specific times and circumstances (Ogilvie, 2011, p. 108). Similarly, it should be clear that alien merchant guilds were also subject to some control and supervision by their host polities.

[2] For a rich and detailed informal account of merchant guilds, local and alien, see Ogilvie (2011). Our work and hers build to some extent on the extensive review of historical evidence presented in Dessí and Ogilvie (2004).

[3] For definitions see, among others, Bourdieu (1986), Coleman (1990), Dasgupta and Serageldin (2000), Glaeser et al. (2002), Guiso et al. (2004), Putnam (2000), and Sobel (2002). It should be noted, though, that social capital in our analysis is modeled as an exogenous feature of a group (guild), since we are interested in how equilibrium choices by rulers vary when faced with merchant associations possessing different characteristics and different degrees of cohesion among members.

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