

History Lessons

The Birth of Impersonal Exchange: The Community Responsibility
System and Impartial Justice

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This occasional feature will discuss episodes and events drawn from economic history that have lessons for current topics in policy and research. Responses to this column and suggestions for future ones should be sent to Kenneth Sokoloff, c/o Journal of Economic Perspectives, Department of Economics, University of California-Los Angeles, 405 Hilgard Ave., Los Angeles, California 90095-1477.

Introduction

On March 28, 1210, Rubeus de Campo of Genoa contracted to pay a debt of 100 marks sterling in London on behalf of Vivianus Jordanus from Lucca (*Lanfranco Scribe* 1210, no. 524). There is nothing unusual about this contract. Thousands of similar ones have survived from the late medieval period from 1050 to 1350. Merchants from remote corners of Europe traveled abroad to exchange goods with each other for both immediate and future delivery and paid in cash or on credit.

What were the institutional foundations of these seemingly well-functioning markets and what lessons do they provide about market development? This paper addresses this question by considering the premodern European institution that supported impersonal exchange, in which a merchant's decision to exchange is independent of expectations of future exchange with the same partner, or on knowledge of that partner's past conduct or the ability to report misconduct to future trading partners.

Economists know surprisingly little about how institutions evolved to support impersonal exchange. The standard story asserts that in the early stages of market development, exchange tends to be personal and is supported by reputation. After an economy becomes sufficiently large, society establishes centralized and impartial courts that, by the threat of coercively imposed sanctions, enable widespread impersonal exchange (North, 1991; Li, 1999; Dixit, 2004). But this standard story usually falters when trying to describe how economies make the transition from reputation-based personal exchange to law-based institutions.

Indeed, this story suggests that impersonal exchange did not prevail during the late medieval period. Even in a relatively well-organized political unit like England, there was no centralized legal system capable of effectively supporting impersonal exchange among merchants from different localities. Although local courts existed throughout Europe, they were not impartial dispensers of justice but were attentive to local interests and were controlled by the local elite.

This paper describes how a particular institution, the “community responsibility system,” nevertheless enabled European merchants to commit to keep their contractual obligations in impersonal exchange from the late medieval to the modern period (Greif, 2006a, ch. 10; 2002; 2004). Fundamental to this institution was a political arrangement in which coercive – legal and political – local power was in the hands of those who stood to benefit from impersonal exchange. Commitment was achieved by providing local and partial courts with the incentives to protect the property rights of alien merchants and to enforce contracts impartially on their behalf. By protecting property rights, the system supported impersonal *spot* exchange among merchants from different localities; by enforcing contract specifying future obligations, it enabled exchange characterized by separation between the *quid* and the *quo* over time and space, including both credit and future delivery transactions.

By fostering impersonal exchange and institutional development, the community responsibility system laid the basis for its own replacement by overarching systems of law-based exchange. Long-distance trade led to institutional change that further fostered growth. More generally, the system had lasting implications on the European trajectory of contractual, organizational, legal, and political developments.

The Community Responsibility System in Action

In 1323 the goods of a merchant from London, John de Grantham, were transported through the important English port of Dover. A local man, William Virgil, captured John’s goods with authorization from Dover’s court, although no legal claim was advanced against John. (*Calendar of Plea and Memoranda Rolls Preserved among the Archives of the Corporation of the City of London at the Guild Hall*, p. 4.) John complained to the court in London about the confiscation and the mayor, who presided over the court, wrote to Dover requesting restitution.

Otherwise, he threatened, Dover's merchants' goods in London will be confiscated in retaliation. Dover's mayor, who headed the local court, responded by explaining the reason for the confiscation. John's goods were impounded because the mayor of London didn't act upon his earlier request to collect a debt that a Londoner, Henry Nasard, had failed to pay to William Virgil of Dover. London's mayor replied that he had no record of this earlier request and asked that it be resubmitted. The evidence suggests that the dispute ended at this point. London verified the default on the debt and collected the amount due. Dover released John's goods.

This episode reflects why, when William Virgil extended credit to Henry Nasard, he expected that, despite the partiality of local courts, the mayor of London would collect the debt if the need arose. The mayor was an official of the "Corporation of the City of London," and as such, he had the incentive to advance the interests of London's mercantile elite, whose alderman supervised his actions. Collecting the debt served the interests of London's merchants, because the only way to prevent Dover from recovering the debt through future confiscations was for Londoners to cease passing through Dover. The cost to London merchants of failing to collect one debt would have been losing all gains from future trade in and with Dover. Because this cost was too high, the court of London was expected to provide impartial justice. This outcome was not *despite* the court's partiality, but *because* of it. The court internalized the cost implied by one Londoner's default on others.

As this example illustrates, impersonal exchange was possible because premodern European trade was conducted in the institutional context of self-governed communities (known as communes). Most of the towns west of the Baltic Sea in the north, and the Adriatic Sea in the south, acquired this status. Although there were marked regional differences across communes from the Italian city-states to the English borough, they had much in common. They were controlled by local elites who structured their officials' incentives to advance their economic interests. Communes fell into a gray area between states and communities. They were like mini-states in having autonomous legal, administrative, and executive capacities and having the coercive power to enforce decisions on individuals present in their territory. They were like communities in having the required local information and personal familiarity among members for effective intra-communal legal enforcement, given the monitoring and communication technology of the period.

This communal structure enabled the operation of the community responsibility system.¹ A local communal court held *all* members of another commune legally liable for the default of *any* member in contracts with a member of the local community. If a defaulter's communal court refused to compensate the injured party, the local court acquired compensation by confiscating the property of the defaulter's commune members who were present within its jurisdiction. The only way a commune could avoid compensating for the default of one of its members was to halt future trade with that commune. When this was too costly, a communal court's best response was to dispense impartial justice to the nonmembers who had been cheated by a member of that commune.

For a trader, therefore, worrying about the personal reputation of a particular trader from another community was a secondary issue. His main concern was whether the other community considered the continuation of inter-community trade valuable enough for its court to enforce inter-communal contracts. A commune's concern with its collective reputation supported impersonal, inter-community exchange among individual merchants. It also motivated each commune to establish organizational structures that enabled non-members to verify the personal and communal identity of community members. Similarly, a commune was motivated to increase the cost of joining it to curtail the abuse of its collective reputation by fly-by-night merchants who will cheat and then leave the commune. For a trader, the value of membership and the cost of exiting and joining a new commune motivated the retention of his communal affiliation and submission to its court. One could therefore commit to fulfill contractual obligations in inter-community impersonal exchange.

The community responsibility system was therefore a multi-tiered institution, in which intra-community contract enforcement institutions provided the basis for an institution to support impersonal, inter-community exchange. It also supported the protection of a trader's property rights abroad. The community responsibility system motivated communal authorities to refrain from using their coercive power to abuse the rights of traders from other communes present in their territories. It thereby complemented the merchant guild institution, which secured rights with the threat of responding to an abuse with an embargo (Greif, Milgrom, and Weingast, 1994).

¹ Greif (2006a, pp. 320-8) studies this institution as equilibrium in an overlapping generations, random matching, asymmetric information game. The analysis also exposes why communes were deterred from making false accusations.

I will first document the rules and regulations of the community responsibility system, and then offer evidence showing that these rules and regulations were expected to be followed and, thus, influenced behavior. Although the primary focus will be on Florence, Italy, and England, examining their historical sources and other reveals the prevalence of the system elsewhere in Europe.

The Rules and Regulations of the Community Responsibility System

Evidence reflects the principle of holding every member of a community liable for other members' defaults in intercommunity exchange. Consider, for example, a charter granted to London in the early 1130s by King Henry I. It announced that "all debtors to the citizens of London discharge these debts, or prove in London that they do not owe them; and if they refuse either to pay or to come and make such proof, then the citizens to whom the debts are due may take pledges within the city either from the borough ... in which the debtor lives" (*English Historical Documents*, vol. II: 1012-3, see discussion by Stubbs, 1913; Maitland, 1889, p. 134).

The London charter is representative; the community responsibility system was the law of the land in England. By 1256, cities that were home to at least 65 percent of England's urban population had clauses in their charters regulating the "distrain" (impounding) of goods under the community responsibility system (Greif, 2006a). Charters regulating the relationships between English communities and merchants from Germany, Italy, France, Poland, and Flanders, similarly reflect that holding community members liable for a member's defaults in intercommunity exchange was the rule (for example, *Calendar of the Patent Rolls Preserved in the Public Record Office*, 20: 1266-1272; 460: 1232-1339; Vecchio and Casanova, 1894).

Florentine historical records similarly indicate that the community responsibility system was the prevailing arrangement in Italy during the twelfth and thirteenth centuries. Of the 44 surviving treaties from Florence prior to 1300, 75 percent refer to the community responsibility system and its regulations. In addition to Florence, the treaties mention at least 23 other Italian towns. The community responsibility system was the law in all the large Italian cities and numerous smaller ones (Arias, 1901; Vecchio and Casanova, 1894; Santini 1886; Wach, 1868). Thirteenth-century treaties between Flanders, German towns, and the Hanseatic League similarly reflect the rule of holding community members liable for a member's default in intercommunity exchange (Dollinger, 1970; Planitz, 1919; Verlinden, 1979; Volckart, 2001).

Laws also held a merchant liable for the cost that his default in intercommunity exchange had imposed on his community. In thirteenth-century Florence, the commune was to force a merchant to pay the damages when he was found guilty of cheating a member of another community. The property of a merchant who refused or could not to pay was to be sold and he was banished from the commune. In twelfth-century Lucca, two officials were designated to collect restitution from merchants who defaulted (Santini, 1886; Vecchio and Casanova, 1894). Various English charters specified that if the default by one community member caused the goods of another to be impounded, the party at fault had to compensate the injured party. The property of someone who failed to make compensation would be confiscated and he would be expelled (Ballard and Tait, 1913, 1923). In some English boroughs, once a foreign creditor established that a member had failed to repay a debt, the city would compensate him and then seek double indemnity from the debtor (Plucknett, 1949, p. 137).

Were the Rules Followed?

The community responsibility system clearly existed in a formal sense. But were these rules and regulations expected to be followed and did they influence behavior? Inter-communal correspondence, court records, and organizational details are among the historical evidence indicating that this was the case.

In the highly uncertain world of medieval trade in which monitoring was imperfect, disputes among merchants were likely to occur. If the community responsibility system prevailed, we then should be able to find evidence of confiscating the goods of a defaulter's community members or threats to this effect; indeed it is plentiful, from England, Italy and elsewhere.

In the surviving correspondence of the mayor of London (1324–33), 59 of the 139 letters dealing with economic issues explicitly mention community responsibility (*Calendar of Plea and Memoranda Rolls Preserved among the Archives of the Corporation of the City of London*, vol. 1). They indicate that the mayor was motivated, and expected the authorities of other English and foreign towns to be likewise motivated, by the threat that all members of a community would be held liable if certain actions were not taken. A quarter of these letters relate to exchange transactions and the rest to alleged abuses of rights, such as illegal tolls.

The rich data on Florence from 1280 to 1298 similarly reflects 36 cases of disputes involving as many as 26 Italian cities, as well as Spain (Aragon) and England (Santini, 1886).

Disputes were more likely to occur when one of the contracting parties died, the debt was old, the contract was not clearly defined, or the contracting obligations were allegedly fulfilled by the agents of one of the parties rather than by one of the principals.²

To illustrate these cases, consider the request by Beatrice, who in 1238 asked the Florentine court for the right to confiscate goods from the people and Commune of Pisa in Florence. The request was for a sum she claimed was owed to her by the heirs of Ubaldo Viscount of Pisa and it was granted after Pisa had denied compensation. A Florentine statute from 1325 (Santini, 1886) identified contractual breaches, damage to property, tax extortion and personal detention as reasons for the appropriate granting the right to confiscate goods (often referred in the historical sources to as the right for reprisal or retaliation).

How much Beatrice was able to collect is unknown and uncertain, given that the merchants of Pisa probably refrained from frequenting Florence to avoid having their goods confiscated. Indeed, retaliation often lasted for a specific time, after which a “suspension” was announced and trade resumed; suspension was not necessarily conditional on full compensation (for example, Arias, 1901; Santini, 1886; Vecchio et. al., 1894). Such mutually costly retaliations reflect the real-world complications that arose when courts from different communities genuinely disagreed about whether cheating had taken place. Game theory reveals that in such a setting with imperfect monitoring, mutually costly conflicts of finite durations are necessary to sustain cooperation. The costs of such conflicts deter each court from misrepresenting its private information (Green and Porter, 1984; Abreu, Pearce and Stacchetti, 1990).

Commercial treaties reflect that contemporaries considered retaliation unavoidable in cases of disagreements between courts. A treaty between Pisa and Florence signed in 1214 specified that retaliation would follow if the judges were unable to settle the dispute (Santini, 1886). To limit these costly disputes, communes often agreed that community responsibility would apply only to transactions in which default could be more easily verified, as in credit relations.

The practical importance of the community responsibility system is well reflected in the organizational details of premodern trade. Consider, for example, the most important European

² For additional evidence and the associated legal procedures see Moore (1985), Plucknett (1949), Santini (1886), Vecchio and Casanova (1894), Catoni (1976), Arias (1901), Wach (1868), Bateson (1901), *Select Cases Concerning the Law Merchant: A.D. 1270-1638*, 1: Local Courts: 9-10.

trade center of this period, the fairs of Champagne. The fairs were not organized as a meeting place for individual merchants from different localities but as places for merchants from different *communities* to meet. Communities had their own places of residence, storage facilities, permanent representatives, scribes, and consuls. Although the authorities at the fairs contracted with rulers in the surrounding areas to secure rights of passage for merchants and safeguarded their property rights at the fairs, these authorities relinquished legal rights over the merchants once they were there. An individual was subject to the laws of his community – represented by a consul – not the laws of the locality in which a fair was held. The law was personal, not territorial.

The rationale behind these arrangements is clear in the context of the community responsibility system. The fairs' authorities had to have the ability to identify members of a particular community and its representatives. Similarly, if a community is held liable for the actions of its members, it has to be able to verify who they are and to discipline them when necessary. Furthermore, these arrangements enabled a trader to establish his communal and personal identity in interactions with merchants who did not know him personally. Indeed, they enabled a merchant to credibly reveal his identity (in the age prior to the modern identity-verification technology) although this also rendered him punishable. (For additional evidence and discussion, see Patourel 1937; Thomas 1977; Verlinden 1979; and Greif 2006a.)

In smaller fairs and within cities, less extensive arrangements provided the means to identify an individual's communal and personal identity. In general, merchants of the same community traveled together, lodged together (often in their own special residences), and witnessed each other's contracts. Communal identification was facilitated by the fact that members of distinct communities had different dialects and customs. Indeed, contracts and court cases reflect the great extent to which medieval merchants knew of one another's communal affiliations.

In regions with a relatively strong central political system, a fair's authorities followed the procedures of the community responsibility system so that they would not be sued in the courts of the central authorities if they broke the rules (e.g., *Selected Cases Concerning the Law Merchant*, vol, II, no. 7: 11-12.) More generally, a fair's authorities imposed community responsibility because providing inter-communal contract enforcement made a fair more attractive to traders and hence increased the profits of the fairs' authorities.

In general, the main medieval fairs, such as the Champagne fairs or the English fair of St. Ives, didn't have affiliated communities of intercommunity merchants and they enforced contracts among members of all communities. Specifically, a fair usually enforced all contracts enacted in it. In contrast, trade centers with intercommunity merchants adjudicated only disputes between their members and foreigners, not disputes between foreign merchants. (Moore, 1985; Vecchio and Casanova, 1894.)

The rationale for this puzzling regularity is clear once the importance of community responsibility is recognized. To see why this is the case, consider a trade center *with* domestic intercommunity merchants. If the trade center's court adjudicates disputes among members of other communities, at some point it will genuinely disagree with another court whether or not cheating occurred. In the subsequent retaliation and suspension of trade, the merchants of the trade center will not be able to exchange in the other court's territory. The trader center's merchants thus pay the price of resolving disputes among members of other communities. If this is anticipated, the trade center's credibility for providing impartial justice in disputes among members of other communities is diminished. Trade centers without domestic intercommunity merchants therefore have a comparative advantage in enforcement of contracts among members of many communes.

Changes in organizational details and rules aimed at facilitating the functioning of the community responsibility system provide further evidence of its practical importance (Greif, 2006a). For example, impounding goods typically implied waste, as capital remained idle and goods spoiled. As trade expanded, the threat of being denied access to future trade could be sufficient to provide the appropriate incentives without the need for impounding. Evidence from twelfth- and thirteenth-century Germany (that is, the Holy Roman Empire) and Italy indeed reflects a transition away from impounding as trade expanded. A 1231 German law established a mandatory "grace period" that began when the right to impound was granted and during which merchants could leave with their goods and capital intact (Planitz, 1919, p. 177). Florentine twelfth-century treaties include the threat of impounding goods, but by the early fourteenth century, grace periods of one month became the default (Santini, 1886, pp. 68-72, 165).

In sum, by the thirteenth century, the community responsibility system prevailed in Europe's most commercialized areas (Italy and Flanders), best-organized country (England), largest political units (France and the Holy Roman Empire), and elsewhere.

Endogenous Institutional Decline and the Transition To Individual Legal Responsibility

The English Close Rolls suggest that toward the end of the thirteenth century the community responsibility system had become less effective in enabling commitment. Throughout this period, English merchants could choose to register debts in the Close Rolls, thereby placing their transactions under the jurisdiction of the Common Law. Although registration was costly, it implied that one's property and goods could be used as collateral for repaying debts (Moore, 1985, n.105; Plucknett 1949, p. 137). When the community responsibility system functioned well, traders could avoid these registration costs. Between 1257 and 1271, however, the number of registered debts expanded dramatically, suggesting that the community responsibility system was failing.³

The system became less effective because intercommunity interactions and the growth in the number and size of communities reduced the cost of falsifying community affiliation and increased the cost of verification. In late thirteenth-century England, people living near towns – but outside their jurisdiction – sometimes presented themselves as citizens of the town when dealing with outsiders, cheated their trading partners, and then moved outside the town's jurisdiction (Plucknett, 1949, pp. 137-38). At the important English fair of St. Ives, the system had by then become “cumbersome and time consuming, both for the creditor and the court: it usually seems to have involved long disputes over whether or not the original debtor and/or the men actually being sued for the debt were truly members of their town, community or guild, with everyone scurrying to disclaim responsibility for the obligation” (Moore, 1985, p. 119).

Evidence from Florence also suggests that increasing intercommunity social mobility was undermining the community responsibility system. Treaties reflect that defaulters were increasingly fleeing their communities and the response was a movement away from personal law toward territorial law. Between 1254 and 1298, Florence entered into at least twelve treaties with other Italian cities in which communes ceded to each other the right to detain any merchants

³ This data includes all the available records in the *Close Rolls of the Reign of Henry III: 1227-1272*. 14 Vols. London. His Majesty's Stationery Office, years 1256-1272. There is only one entry for 1257, four for 1269, and 43 for 1271.

who were fleeing to avoid paying penalties under the community responsibility system (Arias, 1901).

Theoretically, the gradual increase in the size and number of communes during the late medieval period could also have reduced the system's efficiency by rendering disputes and temporary cessations of trade more likely. Indeed, changes in regulations aimed at mitigating such inefficiencies occurred. In Italy, there was a transition toward replacing impoundment with the imposition of a toll, so that trade could continue during disputes and uncertainty would be reduced (Vecchio and Casanova, 1894).

More generally, by the late thirteenth century, authorities in Italy, England, Germany, and France were attempting to change or abolish the community responsibility system and to institute alternatives. We cannot attribute these attempts only to lower efficiency. Inefficiency is neither necessary nor sufficient for institutional change to occur. What might have led to these attempts, however, is a decline in the intracommunity political viability of the community responsibility system. Such a decline could have resulted from the growth and increasing intracommunity heterogeneity of cities. If heterogeneity implied that the system's costs and benefits were differently distributed among various groups within the community, those who were net losers from the system would quit supporting it politically.

In particular, the increasing inequality of wealth among merchants could have undermined political support for the system. Wealthy merchants had the connections, reputations, and wealth required for trade based on their personal reputations and collateral abroad, yet they bore the greater cost of the community responsibility system exactly because their wealth abroad could be impounded. Hence, wealthy merchants could have benefited from eliminating the system's role in supporting exchange but retaining its role in protecting property rights abroad. Furthermore, doing so would have raised the cost of business to others.

If the above analysis is correct, cities that grew larger were more likely to attempt to abolish or radically change the community responsibility system. Although communes had to be sufficiently large to participate in the community responsibility system, its economic efficiency and intracommunity political viability declined as they grew too large. As size increased, it became easier to falsify and harder to verify communal identities, disputes were more costly, and intracommunity heterogeneity increased.

Indeed, larger cities attempted to abolish the community responsibility system earlier. The Italian cities grew larger sooner than the English towns, and the treaties of Florence reflect an attempt to abolish the community responsibility system by the early thirteenth century (Arias, 1901; Santini, 1886). Flemish towns, which were also larger than English towns, gained exemptions from the system in England during the first part of that century (for example, *Calendar of the Patent Rolls Preserved in the Public Records Office*, 460: 1232-1339). In contrast, during this time charters routinely authorized the smaller towns in England to employ community responsibility. However, the largest English city, London, was an exception. In the 1130s, its merchants were de jure exempt from the community responsibility system, although the city retained the right to impound the goods of non-Londoner (*English Historical Documents*, vol. II, no. 270: 1012-3.)

Similarly, evidence reflects that intracommunity heterogeneity undermined political support for the system. In 1296, for example, some Florentine merchants – whose livelihoods depended on being able to pass through Bologna – proposed setting up a toll to be levied almost exclusively on their goods, just to settle a dispute in which they were probably not directly involved (Arias, 1901, p. 165). The cessation of trade with Bologna was too costly to them, but not to others in Florence. Similarly, the distinct interests of different segments of the population are reflected in a Florentine regulation from 1415 that forbade retaliation against foreign rectors, officials, or traders who were selling edibles (Santini, 1886, pp. 168-72).

In the late thirteenth century, political control in Florence was captured by its wealthy, long-distance merchants. As already noted, such merchants could exchange based on their own reputations and collateral better than others could, but they had a great deal to lose from retaliations. A community responsibility system that enabled less fortunate merchants to enter into exchange was a liability to these wealthy merchants; however, a community responsibility system securing property rights abroad, was an asset. When in control of the commune, they entered into a sequence of treaties aimed at terminating the role of the community responsibility system in supporting impersonal exchange but retaining its role in protecting property rights (Arias, 1901, pp. 170-6, 400-1). Heterogeneity similarly seems to have contributed to the decline of the community responsibility system in other parts of Europe (Greif, 2006a).

The community responsibility system seems therefore to have contributed to its own demise. Early on, it was self-reinforcing; it motivated communities to define communal

membership, establish identity-certifying organizations, and strengthen their intra-community enforcement institutions. Over time, however, the system's efficiency and intra-community political viability declined due to trade expansion and growth in the size, number, and the economic and social heterogeneity of merchants' communities. Ironically, the system seems to have undermined itself; the processes it fostered were those that increased trade and urban growth — the causes of its decline.⁴

The set of institutional alternatives to the community responsibility system depended on the political situation. In Europe as a whole, there was no third party—such as a king—who could have devised a centralized impartial legal system. For centuries, the community responsibility system governed the relationships among merchants from different European states. England and Florence, for example, were entangled in a series of disputes during the second half of the fifteenth century (Vecchio and Casanova, 1894, p. 262). In the relationships between communes in a given region, however, local political conditions determined possible institutional alternatives. Outcomes in Italy, Germany, and England, for example, were therefore quite different.

In the politically fragmented Italy, a centralized, impartial legal system was not a possible institutional alternative and repeated attempts to completely abolish the community responsibility system after the early thirteenth century failed. Retaliations continued there for centuries and were still occurring at a significant rate during the fifteenth century. Increasingly, however, retaliations were confined to cases involving the abuse of property rights rather than commercial disputes (Vecchio and Casanova, 1894; Barbadoro, 1921). As the Italian communes shifted from republics to oligarchies, their institutions were altered to serve the interests of the wealthy.

The disintegration of the Holy Roman Empire in Germany and central Europe due to civil wars during that time also implied limited ability to replace the community responsibility system. As late as the second half of the seventeenth century, collective responsibility was still widely practiced in that area (Planitz, 1919; Boerner and Ritschl, 2005). Another institution, based on violence, also emerged (Volckart, 2001). If a merchant sought compensation, he hired a feudal lord with a mercenary army to force the community of the offending merchant to pay. Frankfurt-

⁴ Greif and Laitin (2004) and Greif (2006, chapter 6) present a theory of endogenous changes in self-enforcing institutions.

on-the-Main, which held an annual international fair, was involved in at least 229 such feuds between 1380 and 1433; it was a costly system.

In England, the state facilitated the replacement of the community responsibility system. Toward the end of the thirteenth century when the community responsibility system was declining, the political power of the commercial urban sector was on the rise, as reflected, for example, in the transfer in 1295-97 of the right to approve taxes from the Great Council (which represented the nobles) to a parliament with representatives from the urban commercial sector. As the urban commercial sector increased in wealth, population, and military importance, it had the voice required to coordinate the institutional transition, mitigate the collective action problem, and prevent the Crown from using the legal system to abuse their property rights. (Greif, 2005; 2006a, chapter 10.)

The Statute of Westminster I (1275) officially abolished the community responsibility system in England with respect to debt. Subsequent statutes gradually established an alternative contract-enforcement institution based on individual responsibility, territorial law, the central administration of justice, and personal collateral. But such a radical institutional change took time to devise, implement, and perfect. Even after the Statute of Westminster I, the system lingered for a time. Some royal charters that were granted after 1275 still allowed towns to impound goods based on collective responsibility (Ballard and Tait, 1923). The correspondence of the Mayor of London, as noted earlier, reflects the operation of the community responsibility system from 1324 to 1333. It is similarly reflected in a later set of letters from 1360–70 (*Calendar of Letters from the Mayor and Corporation of the City of London*).

Comparing the relative number of domestic and international references to community responsibility in each of these two data sets reveals an interesting pattern. While in the early period the proportions of domestic and international cases were similar, the later data set has 45 percent more international cases. The growth in long-distance, inter-communal trade led to institutional changes. The asymmetric demise of the community responsibility system inside and outside national borders rendered these borders relevant. Institutional distinctions between national and international trade were emerging. International trade was born.

Conclusion and Implications

The community responsibility system constitutes the missing link in understanding the institutional developments that led to the rise of impersonal exchange and modern markets. It enabled impersonal exchange characterized by separation between the *quid* and the *quo* over time and space among merchants from remote corners of Europe.

The community responsibility system was a public-order, reputation-based institution (as in Gonzalez, 2004). By rendering a commune's collective reputation a valuable asset, the system motivated partial communal courts to protect alien merchants' property rights and to dispense impartial justice. Legal, legal sanctions were conditioned on verification of conduct after the completion of transactions while the system enabled individuals to credibly reveal their identities before transactions occurred. The rents and barriers to entry implied by the system motivated merchants to retain communal affiliations. Thus the system differed from the private-order, reputation-based institutions emphasized in the literature in which incentives are provided by economic agents who condition economic sanctions and rewards on information regarding past conduct available before transacting.

We have no systematic analysis of the contractual and organizational implications of the community responsibility system. It seems reasonable, however, that by supporting intercommunity impersonal exchange it motivated the invention and enabled the use of such financial instruments as letters of credit, letters of exchange, and insurance contracts that became widely used in Europe during that time. The community responsibility system was central to the development of Europe's financial markets. Similarly, the rise and decline of the community responsibility system probably contributed to the emergence and development of the first European multinationals. The system provided the security and contract enforcement required for large firms with branches abroad to emerge and to attract investment from and trade throughout Europe. Once the community responsibility system declined, the goods these firms held in their foreign branches constituted collateral that enabled them to commit in intercommunity exchange. Multinational firms constituted an alternative to the community responsibility system; but this alternative supported only personal exchange benefiting the wealthy.

This history suggests considering the ramifications of the fact that contemporary organizations also constitute units of collective responsibility. Decisions regarding the boundaries of the firm and its internal organization, for example, are arguably influenced by the fact that a firm's customers considering it as a unit of collective responsibility. Indeed, collective

responsibility plays various roles in modern economies; for example, it fosters the incentives to repay micro-loans in developing countries (Besley and Coate, 1995; Bouman, 1995) and motivates members of cooperatives to monitor each other (Guinnane, 1997). The modern and pre-modern notions of collective responsibility, however, differ in one important aspect. Contemporary collective responsibility is contractual and voluntary, while in pre-modern times it was neither contractual nor voluntary on the individual level. We have no theory exposing the conditions under which either voluntary or involuntary collective responsibility is efficient (Levinson, 2003).

While contractual and voluntary collective responsibility is currently common throughout the world, the pre-modern community responsibility system analyzed above may have been uniquely European. It rested on the two pillars of self-governed communities and man-made law, neither of which was common in other pre-modern societies. In the Muslim world, for example, communities were not self-governed, partly because Muslim (divine) law rejected the validity of self-governed corporations and the principle of collective responsibility (Schacht, 1982). Future research will hopefully shed light on what, if any, institutions supported impersonal exchange in non-European, pre-modern societies, to what extent they relied on collective responsibility and how they influenced subsequent contractual, organizational, and legal developments. Similarly, there is more to learn regarding the growth and decline of the community responsibility system in various European areas, its asymmetric demise within and across national boundaries, and the nature of its complementary and alternative institutions. Yet its history indicates that the modern European state's involvement in contract enforcement was not a precondition to impersonal exchange. Furthermore, this involvement seems to have been provided in response to the void created by the decline of the community responsibility system that had previously supported impersonal exchange.

When the state is involved in providing contract enforcement, however, markets are threatened by its increased ability to abuse rights. To foster markets, institutions supporting limited government and the rule of law are therefore required. As noted above with respect to England, the emergence of European states in the context of economically and militarily strong self-governed communes played an important role in the development of these institutions. (Greif, 2005; 2006a; 2006b.) This communal-based market and political development presents an alternative to the state-based and the community-based models of development recently

attempted in developing countries. The evolution of impersonal markets and effective polities in Europe therefore highlights the need to consider the developmental ramifications of social structures that, like the communes, fall into a gray area between states and communities.

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