Credible commitment and cartel: the case of the Hansa merchant in the guild of late medieval Tallinn

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Abstract

This paper contributes to the ongoing debate of institutional research in economics and the methodological debate over the plausibility of using analytic narratives, in social sciences in particular. Using a single historical case we argue that in Tallinn by and large the merchant guild solved a commitment problem in the Hanseatic League and the organisation-institution of the guild was meant for efficient enforcement of inter-city trade. We show that this argument holds in the late medieval period by using an extensive form of punishment and sanctions game. We also argue that after the breakup of the Hanseatic League, guilds turned into protectionist and rent-seeking cartels.

Keywords: economic history, credible commitment, analytic narratives, reputation mechanism, Hanseatic League

JEL Classification: C72, D81

1. Introduction

This paper contributes to the ongoing debate about the role of the guilds in the late medieval city-state, and most of all to institutional research using the analytic narrative. First we state that territorial craft guilds efficiently solve coordination problems in the early days of the Hanseatic League and are thus economic growth-enhancing organizations, partly substituting missing markets. The second argument is that merchant guilds create growth by generating trade through credible commitment to honest trade. In this case a credible threat is created through the “reputation mechanism”. The third argument is that in later periods – starting from the declining era of the Hanseatic League – guilds started to perform as rent seeking organizations or cartels. Historical empirics or narratives concentrate on one specific case – one of the most important city-states in eastern trade: Tallinn (known in history as Reval).

Institutions are rules of the game, writes North (1990). Institutions set the standards, structure society, and limit our freedom. The study of institutions seeks to answer at least two ques...
tions: why institutions are needed, and how institutions are enforced. Our paper investigates governance of the medieval town through the institutional framework. We ask why guilds were needed, whom they benefited, and how they structured the medieval world. Neither economists nor historians completely agree upon the role of the market in medieval society. Moreover, the question of institutions as substitutes for or complements to markets is still open to debate. We intend to show that institutions can be market-, trade-, and growth-supporting, as well as restricting.

Medieval society appreciated the status quo. Appreciation of a static world, including the relevant symbols, social structure, and social norms, can be expected in societies where uncertainty and risks prevail. Fostering the status quo was enforced through the social structure, where materialistic well-being was not an objective, rather a social status-related privilege (Le Goff 2000: 308). However, there is an exception: European economic growth between the tenth and the fourteenth centuries was facilitated by the “commercial revolution of the Middle Ages” – the re-emergence of Mediterranean and European long-distance trade (Lopez 1976). This European growth was not a general phenomenon but was rather geographically concentrated in the “clubs” of city-states (in Italian and other Mediterranean cities) and inter-city unions (e.g. the Hanseatic League).

Starting from the Cliometric “revolution” in the 1950s, economic historians began to utilize econometrics for assessing the functioning of markets in many historical episodes. However, altering the methodology to study case-specific or comparative institutions is relatively new. In most literature about medieval Tallinn, the fact of prosperous international trade during the Hanseatic League is largely assumed without much formal testing. However, as Greif (1995) asserts:

[...] the neo-classical approach to the study of institutions through economic history established that contrary to the claims of traditional historians, it is not true that the governance of exchange markets is a very recent phenomenon. Furthermore, by revealing the economic rationale beyond various contractual relations and patterns of ownership it tends to support the Coasian view of non-market institutions as substitutes for the markets (Greif 1995:5).

The New Institutional Economics attempts to explain even more: to show “why institutions that produce poor economic (and political) performance can persist” (North 1993:12). In most cases, economic outcomes depend on efficient institutional change. The most intensively studied historical institutional tracks are property rights, and institutions which enabled technological change. In medieval studies, North and Thomas (1973) investigated the spectacular economic expansion of the late medieval period. Greif (1995) asserts that many questions which then remained unanswered demanded methodological improvement or change, which was provided by clear concepts of institutions and game theory.

Organizations are non-technologically determined constraints (other than expectations) that impact behavior by introducing a new player (the organization itself), changing the information available to players, or changing payoffs associated with certain actions. The court, the regulator, the credit cooperative, the credit bureau, the firm, and the merchant gild are examples of such organizations (Greif 1995:8).

In game theory we are after organizations which are self-enforcing. This makes multiple equilibria games fascinating tools which can be enriched with historical data. The multiplicity and indeterminacy of equilibria in strategic situations indicate that details of the his-
torical context are potentially important in the selection of institutions, the implications of a particular institution, and institutional path dependence (Greif 1995:9). In order to construct such an enriched game theoretic model, it is vital to capture the choice-specific details of the historical situation. In ideal cases, we need a micro level study for model specification. Historical institutional studies using microeconomic or game-theoretic tools have a relatively short history. In Greif's (1989, 1993) analysis of “Maghribi traders”, contractual relations between merchants and their overseas agents in eleventh-century Mediterranean trade are analyzed, to show how to motivate merchants to participate in sanctions when necessary. A created institution can be called a coalition, which made reciprocal information transmission and collective punishment self-enforcing. Similarly, Milgrom et al. (1990) argued that the use of merchant courts in the Champagne Fairs during the twelfth and thirteenth centuries can be analyzed as an institution that created proper incentives for gathering information, honouring agreements, and reporting disputes. All these lowered transaction costs and allowed reliance on markets. There are also other game theoretic studies; for example, Greif (1998) analyses agency relations in twelfth-century Genoa, showing the rationality of creation of inter-clan cooperation and enforcement of external governance institutions called the podestá. Using an infinitely repeated complete information game, Greif et al. (1994) examined the operation of an organization that enabled late medieval rulers to commit to the property rights of alien merchants. This study is of particular interest to us, because it uses the merchant guild as an example of a particular organization that supported a multilateral reputation mechanism. A multilateral reputation mechanism can potentially overcome the commitment problem at the efficient level of trade, but only when an organization exists with the ability to coordinate the responses of all merchants to abuses against any merchant (Greif 1995:18). Greif (1995:748) also states that the argument concerns merchant guilds and not craft guilds. In the latter, the “common knowledge” or monopolization argument (e.g. Hickson and Thompson 1991, Gustafsson 1987, Ekerlund and Tollisson 1981) still holds. We may say that the literature provides evidence of growth-enhancing and retarding institutions or organizations.

Our methodology is the analytic narrative. The analytic narrative is a combination of rational choice based game and historical-anthropological or qualitative study. Our narrative combines various sources of historical material. Compared to Scandinavian and German merchant guilds, some unique documents are available about Tallinn merchant guilds, but no comprehensive study has been undertaken. Thus a synthesis of the narrative is of value in itself. This of course opens us to criticism if the narrative is not well presented. However, we are sure that the case of Tallinn is too interesting to leave aside. And in this study historical narrative is used for explanatory purposes – to show that the guild was a solution to the collective action problem. The analytical part of the narrative derives from analysis of choice rules and payoffs of individuals using an extensive form game.

The paper proceeds as follows. Section 2 reports the relevant pre-knowledge about the Hanseatic League’s history. Our study covers approximately 100 years, from the foundation of the merchant guild in approximately 1363, until the closing of the Novgorod office in 1478. Section 3 introduces the problem of credible commitment. Then, in section 4 we propose the model of the agency which enforced unilateral sanctions as a credible threat. Later we discuss the historical context in the case of the Tallinn merchant guild, showing that the guild was the only mediator of trade and that the threat of punishment was accompanied by the guild’s regulations. Finally, we follow the guild’s further development into a rent-seeking institution.
The last section concludes the paper by considering the subsequent history of the decline of the Hanseatic League, and proposes a course for further studies including elaboration of a theoretical framework from neighbouring disciplines.

2. Introduction to the narrative: the Hanseatic League

Long distance trade in late medieval Europe was based on exchange of goods through different towns or fairs located in geographically or politically favourable places. Yet the gains from trade were insecure not only because of technological constraints (North and Weingast 1989), but also because of many political and institutional constraints: wars, piracy, cheating. The narrative will show that in response to these uncertainties, two possible risk-pegging mechanisms were available: 1) military action or 2) a mechanism for sanctioning shirkers. Which mechanism was more cost-effective? It is argued (Greif et al. 1994:751) that before the fifteenth century, defensive technology was superior to an offensive one. Thus, compared to military action, “diplomatic” action or even “trade sanctions” such as embargos were cost-effective measures for enforcement of mutual benefits from trade. We will argue that the merchant guild, which enforced a unilateral reputation mechanism, helped to protect trade from shirkers.

In 1189, the Hanseatics – Germans and Gotlanders – signed the oldest known treaty with the Russian Prince Jaroslav, stipulating similar privileges to Russian and German merchants. In 1205, merchants created the Peterhof – a base for traders in Novgorod, which then created the first trade organization called a kontor (Dollinger 1970). In 1229, free trade was re-confirmed under the “Gotland Community” (Sartorius 1830). Starting from 1280, Lübeck was called the caput et principium of all Hanseatic towns (Christensen 1957:107). The first trading routes to Novgorod crossed Tallinn via Lake Ladoga and the rivers Neva and Volga. “Eastward expansion” created a profitable trading route for the Hanseatic League and Tallinn was a trading establishment for the east-bound trade. In 1230, two hundred German merchants accompanied by Danes and Swedes settled in Tallinn. Tallinn became a base for operations and assembly-point for German merchants travelling to Novgorod by sea.

Figure 1. Overview of the Hanseatic League’s history and our study (1363-1478)

In Germany, cities emerged through a political process (Greif 1995:21) that led to the establishment of relatively small cities. Hence, the community or organization of the Hansa – or as Greif (1995) states, an inter-city merchant guild – emerged to govern relations between Ger-
man merchants. Trade started only after negotiating appropriate safety arrangements (Dollinger 1970). The organizational unit for this coordination abroad – the office or kontor – was the conditional residence of Hansa merchants in a particular town. Any “common merchant” who arrived in a non-Hanseatric town could join the local kontor, which coordinated disputes and financial obligations. Hanseatic privileges were conditional on citizenship of the member town. The number of active Hanseatic member-towns varied between 55 to 80, but more than 180 towns were somehow related to Hansa trade (Dollinger 1970:88). Active members had to attend annual conferences or diets (held in Lübeck): the only official organizational tool for central planning, since the Hanseatic League had no official administrative, military, or fiscal apparatus. From 1356 onwards the regularly held annual Hansetag, the general assembly of Hanseatic towns, was the only controlling organ of the league. Assemblies were mainly held in Lübeck and because of the heavy cost of travel, not all members participated. Delegates from the town councils voted over regulations of the Hansa under a simple majority rule (Dollinger 1970:95), although Lübeck, being always present, played a vital role in Hansa affairs. Starting from 1347, in the Hansa statutes the three “thirds” of the cities were mentioned – Tallinn was one of the leading figures in the Gotland-Livonia “third” (Dollinger 1970:95). Several times yearly, local or regional assemblies were also held: these sent their deputies to the general diet and decided “more local affairs”:

It [the nature of the Hanseatic League] was neither a society, nor a college, nor a corporate body, but a permanent federation of towns owing allegiance to various princes, having no common institution – even the Hanseatic diet was not admitted as such – and consequently not responsible for the acts or undertakings of any of its members (Dollinger 1970:106-107).

Thus the question arises – how could this loose “organization” expand and create growth for many centuries? Greif (1995) believes that this could have only been accomplished through mutually beneficial cooperation. Merchant guilds emerged and supported trade expansion and market integration “[…] and their function was to ensure the coordination and internal enforcement required to make the threat of collective action credible” (Greif 1995:19). Was it really so? According to Dollinger (1970), first, in the case of conflicts, the matter had to be discussed in the circle of neighbouring towns (any participation by the territorial ruler in this mediation had to be avoided). Second, if this was unsuccessful, the matter was brought up in the Hansa diet, which made the final decision – in the most severe cases, exclusion of the town from commercial privileges, never military action. In some cases, exclusion could apply to individuals, but then sentence was pronounced by the town where the merchant was a burger or by the kontor – including confiscation of goods (in the case of smuggling), or exclusion from the rights of a “common merchant”. Third, only in extreme cases were more severe sanctions used such as suspension of trade by embargo or war. An embargo or a war is clearly damaging for all sides, making enforcement in a loose organization even more complicated. The ultimate sanction – war – was used only against piracy, not for economic domination, and even then a great number of towns tried to evade the burden because of heavy military expenses (Dollinger 1970:112). Thus the “optimal” institution of the Hansa was neither able nor willing to provide the public good with military action for protection but provided the public good with economic growth through trade.
3. Setting up the problem: credible commitment

As Bardhan (2005) points out, literature on the economic analysis of social and political institutions has focused mainly on the role of those institutions as protectors of property rights. A more neglected role of institutions is to correct coordination failures or commitment problems that sometimes plague the most basic type of economic interaction. In our study, the merchants’ welfare was dependent on efficient trade. “International prices” signalled relative scarcity and gave information about efficient exchange, but huge risks were involved in trade. Formal business organization of the merchants was practically non-existent – a merchant was an entrepreneur with full responsibility over risks taken. Risks in inter-city trade, especially in the thirteenth century, were remarkable. At the same time, increase of trade volume would have benefited both foreign and local merchants. Therefore it was in the common interest to decrease the risks of being cheated, attacked by pirates, or constrained by local rulers. Later, credit risks were included. However, as in the case of many social situations, a single merchant has neither the incentives nor the means to make investments for provision of the public good in the shape of security of trade. Without an external enforcer, we are faced with the classic problem of an empty promise of punishing the cheated party even in the case of perfect information (see Figure 2).

In Figure 2, Merchant I has two alternatives – to cheat (C) or not (N), and Merchant II in the second stage of the game has two options: to punish (P) by ostracizing or prohibiting further trade or not (N). A simple extensive form game with perfect information indicates the payoff profiles, and it is evident that the strategy “never punish” strictly dominates over “always punish” and weakly dominates over “punish when cheated and not punish when not cheated”. Thus cheating is the optimal strategy of the first player.

Figure 2. Punishment is not a credible threat

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  Merchant I
    / \   / \    
   C   N
  / \  / \  /  
Merchant II Merchant II Merchant II
   / \   / \    
  P   N  P   N
(1, 0) (2, 1) (0, 2) (2, 2)
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Although evolutionary games (Axelrod 1984) justify the emergence of reciprocity and cooperation in repetitive situations, we assume that independently operating merchants may not belong (at least initially) to the network of repetitive interactions (there were approximately 180 trading places in the Hanseatic League, each having dozens of independent merchants). However, if punishment can be enforced as a social norm in the case of cheating, then Merchant I will change his behaviour. Obviously, this commitment to punish is beneficial for the second player, and therefore it is very likely that the second player is ready to bear the considerable cost (enforcement costs) of making the threat of punishment credible.
Greif et al. (1994:756) state that the merchant guild’s strategy is conditioning future trade on adequate past protection, using ostracism to achieve security (rather than privileges or lower prices). We will argue that there is one more important strategy – reputation building. “The war of everybody against everybody” created the precondition of the emergence of an organizational form like a merchant guild. On the one hand, a guild was caused by individualistic organisation of “common merchants” as there were no alternative corporations for risk backing and trade mediation. On the other hand, it was caused by the need to enforce credible commitment by “the community label”. This label could make all the merchants from a certain community responsible for the damage created by any member of the community. Thus, as Greif et al. (1994) show, the reputation building of the community was vital and inside the community there was keen surveillance over the behaviour of traders, which made intra-community enforcement mechanisms support inter-community exchange.

4. The solution: the agency model

We will show that agency is an institutional structural solution to the credible commitment problem. Later, we will demonstrate how the narrative supports our argument. But first we have to admit that forming an organization (like a merchant cartel), which will transfer information, stand for the members in conflicts with local rulers, and most of all, commit sanctions towards its own members, is costly. The benefits from the efficient ‘community label’ or quality mark are related to the volume of trade accompanied by decreased risks of being cheated. Let us assume that each community member faces a dilemma – the ability to credibly commit to punishment will increase trade volume \( \sum x(p) \), where \( p \) is the number of people committed and \( x \) is the value of traded goods for each merchant. Compared to the model in Figure 2, now we add a local guild brother (who is also a merchant), thus his benefits also come from honest trade. Sanctions (or Axelrod (1997) metanorms) to make punishment a credible threat are used by the local guild brother. To keep the game as simple as possible, we assume that sanctions are costly. The cost of sanctions is \( c_s \). If the discount factor is \( \delta \), indicating preferences over time, and the game is repeated infinitely, then total benefits from sanctioning the guildbrother are \( \frac{x(p)}{1-\delta} x[(p)-x(p-1)+c_s] \). This means that sanctions will benefit future trade but hurt current trade, and of course they are costly. In Figure 3 we substitute the latter three arguments by \( u \), so \( u=x(p)-x(p-1)+c_s \), which indicates the one time difference of trade volume because of punishment plus the costs of sanctions. If sanctions are not enforced, future trade volume will be infinitely lower, so the guild brother benefits stay at \( \frac{x(p-1)}{1-\delta} \).

Thus, in the final stage, the guild brother compares two possible discounted payoffs and chooses to sanction if \( x(p) - (1-\delta)u > x(p-1) \).

The value of the left side of the equation is dependent on the discount factor – the more patient agents are (the bigger the discount factor), the higher the probability of sanctions. Although in economics this conclusion seems trivial, due to the static nature of the medieval worldview, it could be that traders were not just after short term profits. However, the difference in trade volume \( x(p)-x(p-1) \) also matters considerably. In Figure 3, the local merchant’s cardinal preference ordering is also given (the bigger number indicates higher preferences). If we assume that sanctions are beneficial to the guild brother, then “punishment” (P) is also...
beneficial, so that sanctions must be a credible threat to make agency self-enforcing. Assuming that foreign merchants’ benefits are \( X, Y \) and \( y \) accordingly and \( X > Y \) (and this is independent of \( y \)) a foreign merchant chooses “not cheating” (NC) over “cheating” (C), and the game will end in the first stage. Honest trade is established.

The costs of sanctions (\( c_s \)) must also be considered – the lower they are, the more probable that “sanctions” is a dominant strategy. The cost of sanctions depends on compliance with the group and this is also dependent on group size. Thus we may argue that restricted access to the merchant guild in early periods was not caused by the cartelization argument, but rather by the information argument – the more optimal the size of the group, the easier it was to enforce sanctions, and to obtain information about possible misbehaviour by members. Due to cost considerations, certain rules (like membership by nationality) could be justified. To an extent, it defined communities and fostered their internal organization similarly to other norms of identification such as clothing and rituals. This observation is consistent with North’s (1990) claim that “groups of individuals bound by some common purpose of achieving objectives […] come into existence and […] evolve [in response to] the institutional framework”.

Will the result of our model – credible threat – find any empirical evidence? Although the number of sources is limited, we can combine a narrative to show that considerable evidence exists to support our model.

5. Back to the narrative: Tallinn Merchant guild in the 14th century

Up to the mid-thirteenth century, a Hansa merchant was an itinerary trader, who travelled in groups and traded by barter (Dollinger 1970:163). Later, this tradition was replaced by an independent entrepreneur in charge of his own firm, who conducted business from his office.
at home and used representatives or clerks for travelling. A merchant was the owner in many partnerships and this was the standard form of commercial enterprise. Partnerships involved a small number of associates, for a limited period, and for a specific project:

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\text{[…] there was no single commercial firm, permanent, centralized, having its headquarters in a special building, with subsidiary firms, its own clerk and agents and surviving through several generations – the sort of business represented for example in Italy […] or in south Germany […] (Dollinger 1970:168).}
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Transaction costs (costs of using inter-city markets) were therefore relatively low (which is definitely not the case at the beginning of the trade) and it seems that transaction costs could be lowered by using institutions alternative to the market – a guild or a kontor. The risks in the first period of the Hanseatic League were more related to piracy and security of sea travel; later, credit-risk was included.

A guild is a common organizational feature of all Hanseatic towns, mainly dealing with organizing overseas trade (Hammel-Kiesow 2008). Its relative importance and role varied from case to case, depending on the social power of the princes and the patriciate, on the size of the population, and on a guild’s relative wealth. Our study focuses on the town of Tallinn in the 14th century (see also Figure 1) and we show that in this case the merchant guild (Grosse Gilde) was a cooperative agency which enforced honest trade.

From 1346-1561 Tallinn was ruled by the Teutonic Order. The ruler of the town was not the Grand Master alone but rather the Order as a corporation (Kreem 2002:20). While the relationship between the Order and the Town may not be as unimportant as portrayed by Pullat (1976) and Margus (1939), we consider merchants to be independent players. This follows from the fact that in 1346 the Teutonic Order confirmed all the privileges of the citizens granted by the Danish kings as a part of medieval routine (Kreem 2002:39).

Tallinn’s total trade in 1368 amounted to 99 294 marks (the price of the average stone-built house in Tallinn was 60-80 marks at that time (Kaplinski 1980)). Furs – sable, beaver, lynx, squirrel, and rabbit – all from Novgorod, were in great demand in the Hanseatic League and the amounts imported were impressive – 300 000 pelts between 1403-1415, 30% of which came through the merchants of Tallinn, the rest through Tartu, Parnu, and Riga (Dollinger 1970:325). The town remained small. According to sources from the 14th century, the total population of the lower town was approximately 4000 (Mänd 2004). By adding together approximate numbers of participants from the Christmas and Shrovetide festivals based on Mänd (2004: 138-139) we propose that there were altogether more than 200 merchants in the town. If only guild brothers are included (bachelors and non-citizens are not included) the number would have likely been between 70-150 merchants in 1510-1550. Also, it may be assumed that the number of guild brothers increased considerably over time (Mänd 2005), and that it was smaller during our period of interest.

By the 15th century, the social career of the merchant in late medieval Tallinn was well formalised. First the non-citizens and bachelors were accepted into the Brotherhood of Black Heads. On average, a “blackhead” spent five years in the corporation before being accepted into the Grosse Gilde. Only merchants could be members of that guild. Although all schras (regulations) of the guild had to be accepted by the city council (magistrate), the guild was
rather independent in its everyday “club-life”. The Grosse Gilde (probably founded in 1363) was the only merchant corporation in Tallinn.

Increasing institutionalization (also formalisation due to increasing literacy) is characteristic of that time. In later periods (in the 15th century), as successful merchants became members of the magistracy, increasingly more initiative in merchant affairs is taken over by the magistracy. The Hansetag in Lübeck gradually became a gathering of the aldermen (members of the assembly) of the magistracy, accompanied by the guild brothers. The magistracy consisted of two (Kotter 1991:8) or four (Kala 1998:31) burgomasters and fourteen aldermen procured for their lifetime. Aldermen and burgomasters received no material reward or exemptions for their service. Only the members of the Grosse Gilde could be elected to the magistracy. Aldermen were divided into 11 different sub-courts (Kala 1998:31), which dealt with town affairs in provision of public goods such as the court, military defence, diplomatic relations, minting, and various constructions. Kotter (1999:76) describes the cost structure of the magistracy during 1433-1705, showing that 70% of the town revenues were spent on salaries (usually non-monetary rewards like clothing and footwear) of the magistracy-craftsmen and on other services (such as musicians), court expenses, defence, “foreign affairs” (such as travel costs, gifts, official dinners, letters and translations), building, and renovation. Already in 1282, the Lübeck town law of Tallinn stated that each burgher had to contribute an annual personal tax (Kala 1998: §108). The tax consisted of two parts – the poll tax (a fixed tax of 1/12 of a Riga mark) and property tax approximately 4-5% of the value of property. The largest part of revenues came from excise taxes on beer (levied in 1454 (Jatrusheva 1986:36)) and on export of wine and stones (Kotter 1999). This shows that the town earned directly 15-20% of total revenues on export excise. The wealth of the burgher (the value of his property) was dependent on efficient trade relations, while reliance on trade in town fiscal affairs is obvious.

Over time, the magistracy increasingly started to coordinate the internal and external affairs of the town, while social ties between the magistracy and merchant guilds were tight. Dollinger (1970:135) states that government in some towns was practically a family business. This is not true in our case; in Tallinn it was prohibited to elect brothers, fathers, or sons to the magistracy. The aldermen received no salary for their duties, thus had simultaneously to maintain their merchant activities. Aldermen were elected from among the grosse gilde brothers, mostly from among brothers who had been an alderman or an assessor of the guild (this indicates that before election they had been members of the merchant guild approximately twenty years (Mänd: 2005:180)). An alderman of the magistracy remained a member of the guild; he did not participate in all of the social events of the guild, although he did participate in the guild’s most important festivals and feasts.

It can be assumed that in the early days of the Hanseatic League, merchants gave an oath of commitment to honest trade, including to pay all customs and tariffs (Hammel-Kiesow 2008). Eventually, certain trade norms called Schras were agreed upon. All of the exclusive rights of “common merchant” were granted by citizenship of Hanseatic towns. Becoming a burgher (citizen) simultaneously meant becoming a member of the guild (Mänd 2005:141, and also Lübeck town Rights 1282). No earlier Schras (if they existed at all) are preserved, but the 1395 schra does not indicate any direct trading principles of the guild, but rather states the requirements for guild brotherhood (and sisterhood). “Everyone who belongs to our guild must be honest and trustworthy” (Nottbeck 1885:40); moreover, it is mentioned that un-
til all conflicts between guild brothers or others (it can be assumed that “others” included Hansa merchants) are resolved, a person would not belong to the guild. The Schra states that those who “desecrate” contracts will be ostracized. A 1541 Schra includes a paragraph stating that “if somebody violates general trading principles of the guild, he has to be expelled from it” (Nottbeck 1885:61§93). This is worth stressing, as the rights of “common merchant” related to town citizenship and membership in the guild. The Schra also indicates that a ban was imposed on any illicit trading by non Hansa merchants, and guild members could not belong to other guilds in the same town (Nottbeck 1885:§57). The implication is that the “guild label” was seen as a guarantee of honesty of trade. Ostracising problematic local traders and acceptance (or at least an invitation to guild “club-activities” (Mänd 2005:170)) of all Hansa merchants from other cities justifies our model. The oral culture enforced institutions based on credibility and trust, and reputation building was the most important aspect in efficient enforcement. Most legal procedures relied on oral witnesses, on a social network based on reciprocity of credible commitment to “tell the truth”.

Although only more recent (from the 17th century) cashbooks of the Grosse Gilde have been preserved and although the Schra from 1395 does not indicate fees other than penalties (mainly fines) related to misbehaviour, it still may be assumed that guild brothers paid an entrance fee and a quarterly lump sum membership fee (poll tax). “Project specific” payments (e.g. related to building the guild house 1406-1417 as well as fees for annual feasts and festivals) were also probable. As the cost of building the guild house, organizing feasts, social security and care, was considerable, it can be assumed that the membership fee was relatively high.

The next section will overview the gradual decline of the Hanseatic League for “political” reasons. As the benefits from Hansa trade declined, the guild brothers’ income decreased and the intrinsic reasons for the existence of the Grosse Gilde changed. Protection of the town’s interests against the interests of Hansa merchants or even against other guilds in the town become more important, and membership become increasingly exclusive.

6. Arise of rent-seeking guild: developments from the 1450s to the 1520s

Although Tallinn was still flourishing in the fifteenth century, the period was already marked by the gradual decline of the Hanseatic community. During this period, monarchical power was being consolidated in Northern Europe, increasing the town’s cost of compliance with the Hansa. Ivan III annexed the great urban republic of Novgorod in 1478. This ended the functioning of the kontor because the Muscovite empire was hostile to foreigners.

The private benefits that the Livonian towns and merchants individually gained from eastbound trade initiated the gradual monopolisation of trade. In 1422, Tartu started to control the kontor and decide who could trade with Novgorod, and in 1459 Riga stopped all foreigners, including Hansa merchants, from trading directly with Polotsk (Dollinger 1970:294). These changes in economic policy and foreign affairs created a bankruptcy wave in Tallinn before the Reformation (Margus 1939:87).

Later, in the 1520s the Reformation began almost at the same moment in all the North German towns. At first, town councils were hostile to the new religion: in 1525, the diet of
Lübeck even passed measures against teaching Luther’s doctrine, but only a few delegates approved it (Dollinger 1970:320). The second diet of the year proclaimed that in religious matters, each town had to decide for itself (Dollinger 1970:321). The Reformation made social relations in Tallinn more intense – in the 1530s, conflicts between merchants and artisans often took place (Põltsam 2003:21). In 1526, the craft guilds of Tallinn decided that all who did not support the new religion, and in some cases, even those who visited Catholic masses, were expelled from the guild (Põltsam 2003:22). The reformation, teaching equality of humans in the eyes of God, encouraged craftsmen to defend their rights against the magistrat and patriciate (Margus 1939:88). Guilds became increasingly nationally and socially segregated. This indicates that guilds gradually changed their role in the urban community and became unions to protect artisans’ economic interest against merchants and vice versa.

Based on our model and sources (Hammel-Kieslow 2008; Pagel 1942), it can be assumed that, originally, merchant guilds did not restrict access by nationality. Over time, merchant affairs became increasingly institutionalized, merchants were no longer travelling much, and the merchant guild started accepting members from lower social classes to do the travelling for them. Access to town citizenship was, however, restricted for the lower social classes, as one had to live in the town for at least a year and have recommendations in order to become a citizen. In later periods, access to the guild became increasingly restricted and regulated. Estonians were not accepted into the Grosse Gilde; later, the restrictions applied to everyone who worked for a salary, and finally they also came to apply to local shopkeepers (Mänd 2005:167). Eventually, non-Germans or workers could not even visit the guild house (Mänd 2004). In the 1528 Schra, an additional paragraph stated that issues discussed in the guild house could not be shared with outsiders (Nottbeck 1885:45).

A century after the creation of social norms embodied in the formal rules of town culture, the role of guilds in the social life of the town had become ever greater, and we can assume that compliance with guild regulations was high. Therefore the enforcement costs of sanctions

Figure 4. Optimal versus insiders’ benefits from the protecting organization
(c_\text{e}) were low. Individual enforcement costs were now primary direct costs related to the membership fee. Thus average cost (c) was constant. The members’ total benefits from optimal group size \( \hat{n} \) are now smaller than the individually optimal group size \( n^* \) (see Figure 4).

Figure 4 indicates that each individual had to pay a membership fee (c) for entry to the club, and thus we are dealing with a fixed average cost. The total benefit \( G(n) \) is now a decreasing function due to the competitive provision of an almost private good now – the bigger the group, the less beneficial is the cartel to a single member. Thus each individual has an incentive to become a member of the guild as far as \( \frac{G}{n+1} > C \), and this condition is satisfied when we reach \( n^* \). The insiders’ total benefit is maximized when \( \frac{nd}{dG} = C \), meaning that the optimal size of the group is \( \hat{n} \). As far as \( n^* > \hat{n} \), insiders have the incentive to limit entry to the guild, as in all monopolistic cases. Is there any additional evidence as to restrictions on entry and increasing secrecy to justify our interpretation? There is some, for example dress codes.

Segregation by dress is one additional measure similar to entry restrictions and this was common. However, there is no evidence that dress norms created any tensions in Tallinn before the 15th century. The first sumptuary law regulating the costs of female jewellery was implemented at the end of the 15th century (Põltsam 2002). It is difficult to assess whether it was the relative cost of clothing that did not make sumptuary codes relevant earlier, or if it was relative compliance with informal dress-codes that was higher until the end of the 15th century. Dress-norms enforce segregation. It is clear that at the beginning of the sixteenth century, urban societies became increasingly formally regulated. However, after 1541 no additional paragraphs were added to the Schra of the merchant guild concerning honest trade.

7. Conclusions and discussion

More than 100 years is a long period for a case study. Regarding the limited number of original sources and our ability to perceive the historical context, we assume that the Merchant guilds’ social and economic role in society changed considerably over time. Initially, it was a risk-pegging agency for itinerary travelling merchants, then increasing its social role and finally becoming a rent-seeking cartel. We demonstrated that initial institutionalisation of merchant affairs was self-enforcing by supporting trade and thus also economic growth.

In our case we can say conclusively that by the middle of the thirteenth century the Hanseatics already held a near-monopoly in trade in two seas, and their commerce was organized around the great axis Novgorod-Tallinn-Lübeck-Hamburg-Bruges-London, also enlarging later to southern Germany, Italy, France, Spain, and Portugal. At the same time, the Hansa remained an anomalous institution which can puzzle contemporary political scientists and economists:

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It was not a sovereign power, for it remained within a framework of Empire and its members continued to owe some measure of allegiance to many different overlords, ecclesiastical or lay. It was an amorphous organization, lacking legal status, having at its disposal neither finances of its own nor an army or a fleet. It did not even have a common seal or officials and institutions on their own except for the Hanseatic diet or Hansetag, and even then met rarely, at irregular intervals and never in full strength (Dollinger 1970: xvii).
In spite of the structural weaknesses and the conflicting interests inevitable in an association of towns so different and so distant from another, the Hanseatic League lasted for nearly five hundred years. In 1630, a closer alliance was set up between Lübeck, Hamburg, and Bremen as a substitute for the Hanseatic League. In 1669, the Hanseatic diet met for the last time, and a final attempt at restoration proved unsuccessful (Dollinger 1970: xix). The secret of its longevity is not to be found in coercion, but in the realisation of common interests binding the members of the community together. The common interest was based on voluntary cooperation, and was not easy to enforce under medieval technological, informational, and institutional constraints.

Our study indicates that the guild acted as a substitute for formal state or legal institutions. While “common knowledge” among economists often views guilds as monopolistic cartels or rent-seeking organizations, Merges (2004) states that guilds were efficient information transferers solving the asymmetric information and quality assurance problems in medieval society. Greif et al. (1994) describe merchant guilds as organizations vital for efficient trade. Both the rent-seeking argument and the credible commitment argument demand that organizations fulfil certain criteria: (a) the segregation principle (differentiates insiders from outsiders); and (b) shared norms by insiders (Merges 2004:4). We have seen that the role of segregation increased in importance throughout the history of the merchant guild. Various social norms of segregation – by clothing, by profession, or by nationality – eventually appeared. In order to be self-enforcing, norms have to be beneficial to follow. Merchants benefited from an inter-community exchange that included common merchants, but excluded all local shopkeepers and craftsmen, and eventually all non-Germans. Traders applied a principle of community responsibility that linked the conduct of a trader and the obligations of each and every member of the community. Through decreased trade volume, the “community label” made all the merchants from a certain community partly responsible for the damage created by anyone inside the circle. Greif et al. (1994) also confirm that communal punishment or sanctions became a credible threat and traders were able to use intra-community enforcement mechanisms to support the inter-community exchange. The system created the need for restrictions on membership due to cost considerations which led to constraints such as membership by nationality. The restrictions defined communities and fostered their internal organization like other norms of identification, such as clothing and rituals.

Institutional studies reveal a variety of reasons that lead to institutional change, but we believe that a change in private benefits had an important role in this gradual change. In institutional literature, the most elaborated cause of change is called the “critical juncture” (Pierson 2002, Rittberger 2003), which can be an unanticipated technological change (Guinnane, 1994), political changes (Greif et al. 1994), or population increase (Hoffmann et al. 1994). In our case, private benefits changed mainly due to changes in the political situation brought on by the closure of the Novgorod kontor. Whereas most institutional studies concentrate rather on path-dependency or on the inability to change, we also note the gradual decline of the Hansa, and the gradual transformation of the function of the guilds.

The most elaborated causes of path-dependency are “cultural beliefs” related to some institutional settlement (Greif 1995:23), and vested interest or assets specificity (Pierson 2002:205). When the guild as an organization was firmly established and functioning, then the new role of protection of economic rights was a logical continuum under changed economic and po-
itical circumstances. The guild became beneficial for a narrow circle of insiders, partly at the expense of outsiders. The days of the positive-sum game ended for Livonia and Tallinn.

The most severe criticism of institutional studies is presented by Clark (2007), who states that narratives do not allow for demonstrating universal knowledge or any policy recommendations, because everything depends on the specific cultural and historical context. This has also been duly noted by one of the promoters of the method, Margaret Levi (2002), who calls the (in)ability to make generalizations the Achilles’ heel of the method. Our case suffers from the same limitation, but we believe that although the specific game may not be totally portable, it does yield explanations that can be tested in different settings. As Levi (2002:16) states, “The comparisons can be done by other area specialists, historians, and others who must conquer languages, archives and other sources to acquire in-depth authority over the subject matter”. That is why it can be said that demonstrating generalisability may rest on the wider community of scholars. We also encourage comparative studies about the impact of similar contemporary institutions. Will political change or the current turmoil in the world economic climate transform our current “guilds” – national or other – into organizations hostile to new entrants? What about international “guilds” like the EU?

References


