

**HOW AND WHY ECONOMIES DEVELOP AND GROW: LESSONS  
FROM PREINDUSTRIAL EUROPE AND CHINA**

**CHAPTER 7**

**THE DEVELOPMENT OF COMMERCE**

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**ABSTRACT:** Commerce continued to develop after the Commercial Revolution, shaped by external forces and by the need to address its internal problems. By the early seventeenth century, the medieval pattern of traveling merchants, merchant guilds, and highly regulated organized markets had been replaced by something recognizably more modern. The fundamental change was the emergence of ‘bourse markets’ in Antwerp, Amsterdam, and London. This induced changes in the nature of the commercial enterprise and in the role of merchant guilds.

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In the previous chapter we focused on how commerce was organized; in this we focus on how it developed. Its development was driven by forces both external and internal—by fluctuations in the extent of trade and by the need to respond to problems within commerce itself.

Both the contraction of the long fourteenth century and the subsequent expansion of the long sixteenth century exerted pressure on the organization of commerce to increase efficiency and lower trading costs. In the contraction, it was shrinking markets and the resulting intensification of competition among merchants that did so.<sup>1</sup> In the expansion, it was the growing importance of trade in price-sensitive mass market goods.

The organization of commerce at the close of the Commercial Revolution was still rudimentary and it suffered from several serious problems. One was the high cost of using organized markets—a result of their exploitation by those who controlled them. A second was the lack of a satisfactory way for merchants to obtain representation in distant markets. A third was the difficulty of reliance among strangers: the guarantee of the merchant association provided some sort of solution, but it was far from being adequate. As commerce responded to the pressure of external forces, its development was shaped by the need to address these internal problems.

The development of commerce, like that of production, took the form of reorganization and of technological progress. Technological progress in commerce was primarily institutional, involving the development of new forms of organization, legal innovation, and new techniques of management. All three components of the organization of commerce—the enterprise, the association, and the market—were affected. We begin with the market.

## **THE MARKET**

The ‘market’ element of the commercial structure consisted of the network of organized markets. Its transformation involved two changes. First, merchants used organized markets less. Second, and partly in response, a new and very different type of organized market emerged—the ‘bourse market’.

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<sup>1</sup>de Roover (1971)

## Private trading

Even during the Commercial Revolution, not all commerce was mediated by organized markets. Within market centers, some trading took place ‘off market’ on the fringes of the official market. And some trading took place away from market center altogether. Over the centuries, such private trading increased in importance. In seventeenth century England, for example, its volume may have equaled the volume of trading in official markets.<sup>2</sup>

Private trading within market centers meant trading without the aid of an official broker. Indeed, as we saw in Chapter 6, unofficial brokers were common: innkeepers, in particular, often played this role. But merchants increasingly dispensed with a broker altogether and traded with one another directly. In Bruges, for example, English merchants commonly traded directly with their Italian counterparts.<sup>3</sup> The increasing use of resident representatives made this easier. Continued residence allowed the representative to discover trading opportunities on his own and to learn the reputations of other traders; it also enabled him to establish his own reputations. There was, consequently, little additional a broker could do for him.

Private trading away from market centers was often the result of the parties having met first at an organized market. There they had arranged to get together later somewhere else “unhampered by... formalities and tolls”.<sup>4</sup> For example, by the mid-thirteenth century, rather than purchasing woolen cloth at the fairs of Champagne, Italian merchants increasingly traveled to the towns of northern France and Flanders where the cloth was made and purchased directly from the producers.<sup>5</sup>

Private trading away from market centers was driven, not only by the desire to avoid the costs of using an organized market, but also by competition among merchants for sources of supply. For example, in the thirteenth century, the Italians largely succeeded in capturing the lucrative trade in English wool from the long dominant Flemish by going

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<sup>2</sup>Muldrew (1998)

<sup>3</sup>Nicholas (1979)

<sup>4</sup>Farmer (1991)

<sup>5</sup>Bautier (1970)

into the English countryside and buying directly from large producers.<sup>6</sup> Similarly, the expansion of private trading in sixteenth century England was driven by competition among merchants to supply the rapidly growing London market.<sup>7</sup>

While private trading avoided the cost of using an organized market, it also sacrificed some of the benefits—use of the formal order it provided, for example.<sup>8</sup> One benefit that did not have to be sacrificed, however, was the organized market’s facilities for settlement. Indeed, private transactions concluded elsewhere were often settled through the facilities of some organized market.<sup>9</sup> For example, the Italian merchants who purchased cloth privately in Flanders typically arranged to have it delivered to the fairs of Champagne. There they would take advantage of the Fair’s excellent system of settlement and remittance to make payment.<sup>10</sup>

Of course, the steady increase in private trading meant a loss of business for organized markets and a loss of revenue for those who controlled them.<sup>11</sup> Individual cities and towns could do little about this, but some territorial rulers, for whom organized markets were an important source of revenue, tried to limit private trading. England, for example, passed a series of laws in the sixteenth and early seventeenth centuries to suppress private trading, especially in grain, but to little effect.<sup>12</sup>

### **The emergence of bourse markets**

Increased private trading and the interruption of commerce by war during the long fourteenth century reduced the importance of international fairs. The great fairs of

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<sup>6</sup>Masschaele (1997)

<sup>7</sup>Everitt (1967)

<sup>8</sup>Bailey (1999)

<sup>9</sup>Today, off-market trading in stocks is cleared and settled through the systems of organized stock exchanges. Kohn (2003) Ch 17.

<sup>10</sup>Bautier (1970)

<sup>11</sup>Farmer (1991) p 421

<sup>12</sup>Everitt (1967); Overton (1996); Nielsen (1998). The laws against private trading did, however, succeed in creating a great deal of resentment against the king. Merchants engaged in private trading were among the most enthusiastic supporters of the Great Rebellion, and one of the first acts of the Long Parliament was to repeal the laws against private trading.

England, for example, ceased to mediate the country's foreign trade, and the fairs of Champagne disappeared entirely. Indeed, partly because of increased private trading, Champagne had already lost its importance as a trading center by the late thirteenth century. However, it continued to function as a center for settlement and financing for several decades longer.

As the fairs of Champagne faded, Bruges replaced them as the center of trade between the two zones of Europe. Even when that trade was interrupted by the wars of the long fourteenth century, Bruges continued to prosper, sustained by trade with the Baltic. However, by the end of the fifteenth century, Bruges was being pushed aside by the rising market center of Antwerp.

Antwerp had long been one of the two cities hosting the fairs of Brabant. As the volume of trading grew, it had increasingly extended beyond the official term of the fairs—much to the annoyance of Bruges.<sup>13</sup> By the 1530s, Antwerp had eclipsed Bruges to become the principal market center, not only for the northern zone, but for the whole of Europe and for much of the world besides.<sup>14</sup> The fair had become permanent.<sup>15</sup>

Antwerp's displacement of Bruges was partly due to its favorable location, but it was mostly the result of its superior trading environment. The 'bourse market' that developed in Antwerp was quite unlike the organized markets of medieval commercial cities like Bruges.<sup>16</sup> The Antwerp market was exploited neither by its ruler nor by its own merchants: taxes were low and trading relatively unrestricted.<sup>17</sup> Indeed, Antwerp was a highly cosmopolitan city where foreign merchants were welcomed and treated as equals.<sup>18</sup> Its trading system was different too, with trading in warehouses and exchanges rather than in pitched markets and trading halls. And, as we will see in Chapter 8, its methods of settlement were also new and different.

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<sup>13</sup>Van Houtte (1977)

<sup>14</sup>Braudel (1984)p 142

<sup>15</sup>Bindoff (1958); Van der Wee (1963)

<sup>16</sup>Ehrenberg (1928) coined the term 'bourse center' for this type of market.

<sup>17</sup>Ramsay (1975) Cox (1959)

<sup>18</sup>de Roover (1956) p 105

Antwerp was not the only city to develop a bourse market. The organized markets of Amsterdam and London—both satellites of Antwerp in the sixteenth-century—evolved along similar lines. Lyons, another satellite, began as a fair, like Antwerp, and like it slowly became a permanent market with similar structure.<sup>19</sup> Indeed, competition eventually forced even Bruges to imitate the arrangements of Antwerp.<sup>20</sup>

### **Samples and commission**

The trading system of Antwerp and of other bourse markets came to differ from that of the typical medieval city because of changes taking place in commercial practice and in business organization. Apart from the increase in private trading, merchants increasingly sold by sample, and they increasingly used commission agents rather than representatives to trade for them. These changes facilitated and necessitated modification of the trading system.

As we saw in Chapter 6, medieval commerce had generally taken the form of venturing: uncertainty about product quality meant that goods had to be brought to distant markets ‘on spec’. However, as private trading became more common, greater trust between the parties made it possible to strike a deal on the basis of a sample and a down payment. Goods were then delivered at a convenient place, with full payment contingent on inspection. Sale by sample reduced market risk, because goods no longer had to be sent off to be sold at uncertain prices. It also minimized the unnecessary shipment of goods from place to place.

As early as the late thirteenth century, the Italian merchants who purchased cloth in Flanders for delivery at the Fairs, were doing so on the basis of samples.<sup>21</sup> By the sixteenth century, sale by sample was common. In England, for example, the agents of London merchants purchased cloth from clothiers in the provinces on the basis of samples or ‘scantlings’. When the cloth was ready, it was sent directly to the merchant’s warehouse for export or for sale at retail. By the end of the sixteenth century, London merchants were ordering textiles by mail on the basis of patterns the manufacturers sent

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<sup>19</sup>Van der Wee (1977)

<sup>20</sup>Bindoff (1958)

<sup>21</sup>Reynolds (1952)

them in the same way.<sup>22</sup> At Antwerp, wool, wine, grain, and wood all traded by sample and were delivered not to the city itself but to a variety of ports that served the city.<sup>23</sup>

The use of commission agents rather than resident representatives was another practice that became increasingly common (we will examine why presently). Like a resident representative, a commission agent bought or sold for his principal and conducted financial transactions for him. But instead of receiving a salary or a share of the profits for doing so, he received a fixed percentage of the value of each transaction he undertook: typical commissions for sales and purchases were 2-3% and for financial transactions, 0.5-1%.<sup>24</sup>

Commission developed naturally out of brokering: brokers and innkeepers started to act as agents for their customers rather than simply as mediators who brought the parties together.<sup>25</sup> In London, clerks and porters at the cloth halls were able to supplement their incomes by acting as commission agents for provincial clothiers—selling their products and purchasing materials for them.<sup>26</sup> Foreign merchants resident in a market like Antwerp found it easy and natural to act as commission agents for merchants at home.<sup>27</sup> For example, merchants in England often relied on compatriots living in Antwerp to act for them.<sup>28</sup>

As these examples suggest, commission was initially a part-time activity. Merchants who acted as commission agents, for example, also traded on their own account. However, as the commission business expanded, some came to specialize in it.<sup>29</sup>

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<sup>22</sup>Kerridge (1988)

<sup>23</sup>Van der Wee (1963)

<sup>24</sup>Boyer-Xambeu, et al. (1994); Lane (1944); Edler (1938). Westerfield (1915) reports, for a later period, that commission rates increased with distance, greater risk, less desirable living conditions for the agent, and lower trading volume.

<sup>25</sup>See Gras (1915) on brokers; Kiessling (1996) on innkeepers in Germany.

<sup>26</sup>Kerridge (1985) Ch. 15

<sup>27</sup>Van Houtte (1966); Van Houtte (1977)

<sup>28</sup>Willan (1959) Ch 1

<sup>29</sup>Edler (1938)

## Warehouses and exchanges

Private trading, increasingly through commission agents, and sale by sample made the traditional trading systems of organized markets—open markets and trading halls—obsolete. Instead, trading increasingly took place in warehouses and on exchanges.

In traditional organized markets, goods were displayed for sale at stalls in open markets and in trading halls. Before displaying them in public, merchants or their representatives stored their goods at an inn or in a storehouse (sometimes brokers brought potential buyers there to show them the goods before they were shown in public). When traders left for home, they would usually commit any unsold goods to the innkeeper, broker, or sales-hall clerk, to sell for them. It was only a small step simply to send the goods to the commission agent. In this way, sales halls, storehouses and cellars evolved into warehouses—permanent trading places, principally for wholesale trade, but also for retail sale to the wealthy.

Warehouses facilitated trading among strangers. Their existence and continued presence made it easier for traders to find what they were looking for. Their continued presence also meant that they could establish a reputation for price and quality. The value of this reputation acted as a bond that provided buyers with some assurance they would be treated fairly.

While goods that had to be inspected before sale were traded in warehouses, goods that could be sold by sample or sight unseen were traded on bourses or exchanges.<sup>30</sup> In an exchange, traders came together regularly, usually one or twice a day, to find and close deals. Because the goods themselves did not need to be present, and because payment was deferred, a large volume of trading could be concentrated at a single time and place, with all the attendant advantages. The goods that were the object of the trading could be sent directly to their final destination and payment made at a convenient time and location.

For such ‘pure’ trading to work, several conditions had to be met.<sup>31</sup> Obviously, the good in question had to be relatively homogeneous, so that it could be traded in its

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<sup>30</sup>Ehrenberg (1928)

<sup>31</sup>Ehrenberg (1928)

absence. Also, market participants had to be reasonably well informed about factors affecting the price. This allowed a market price to emerge, based on ‘market opinion’. Transactions could then be based on this market price, eliminating the need for lengthy individual bargaining.<sup>32</sup> Finally, there had to be a volume of trading large enough to support regular sessions of the market.

These conditions were met first for trading in financial instruments—specifically, in the markets for bills of exchange and inter-fair loans. Organized markets for these instruments could be found in many commercial cities and fairs as early as the thirteenth century.<sup>33</sup> In Bruges, the exchange market took place in the square outside the inn of van der Beurse—hence the name ‘bourse’. Of course, merchants coming together to buy and sell bills of exchange often took the opportunity to trade in other things, such as insurance, shares, and sometimes even commodities. However, exchange markets dealt primarily in exchange, and the traders were mostly the Italian merchant bankers who dominated the medieval money market. This pattern first changed in Antwerp, which established separate exchanges for securities and commodities, and where merchants of all nations participated in the market.

In the trading system of the new bourse markets, the central player was the commission agent. He acted for his customers much as a stock broker does today. Receiving from his clients commissions to buy and sell or to borrow and lend, he executed them by whatever means offered the best terms—trading on the exchange, in his own warehouse, in some other warehouse, or engaging in private trading.<sup>34</sup>

### **Speculation**

It was only natural that ‘pure’ trading on the exchange should expand beyond bargains for immediate delivery to bargains for delivery in the future (forward transactions). Indeed, for spices—one of the most important commodities traded at Antwerp—forward trading was almost a necessity.<sup>35</sup> Cargoes of spices due from the

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<sup>32</sup>Van der Wee (1963)

<sup>33</sup>More on these instruments and markets in Chapter 8.

<sup>34</sup>Edler (1938)

<sup>35</sup>Strieder (1931)

Indies were normally sold by the king of Portugal to merchant syndicates long before the spices actually arrived. Since prices were extremely volatile, the syndicates faced the considerable risk that prices would fall before they could sell their purchases, leaving them with a loss. To hedge this risk, they sold the spices forward on the exchange, for delivery when the fleet arrived. There were forward transactions too in other commodities such as grain, timber, and salted herring.

Forward trading opened the way for various kinds of speculation.<sup>36</sup> Merchants hoping to profit from a rise in price could buy commodities forward with the intention of an offsetting sale before the date of delivery. Those hoping to profit from a fall, could sell short: that is, they could sell forward commodities they did not actually have, intending to cover with a forward purchase some time before the date of delivery. If the price was lower than the price at which they had sold, they would make a profit.

Initially, it was possible to profit from a rise or fall in the price of a commodity only by actually trading in it.<sup>37</sup> However, as the market developed, various types of derivative contract emerged that allowed traders to take a position without this inconvenience. One, known as a ‘premium transaction’, was a conditional forward transaction that gave either the buyer or the seller the right to cancel the contract at the time of delivery on payment of a premium.<sup>38</sup> If the buyer had the right to cancel, it was equivalent to a modern call option; if the seller had the right to cancel, a put option. Forward and premium transactions later spread to the exchange market and to the market in shares.<sup>39</sup>

There were also futures-like contracts—wagers on a future price. These were settled by the loser paying the winner the difference between the wager price and the actual price.<sup>40</sup> These contracts first appeared in the exchange market, with dealers entering into

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<sup>36</sup>Cox (1959) Ch. 14

<sup>37</sup>Ehrenberg (1928) p 241

<sup>38</sup>Van der Wee (1977)

<sup>39</sup>Wilson (1941)

<sup>40</sup>Van der Wee (1977).

wagers on exchange rates, and later spread to the commodities market, with wagers on commodity prices.<sup>41</sup>

The development of speculation improved the functioning of the market. The presence of speculative buyers and sellers improved liquidity for other traders (it was easier to find someone to sell to or to buy from). And the ardent pursuit of information by speculators and their eagerness to trade on it helped ensure that market prices quickly reflected all the information available. Moreover, instruments of speculation could also serve as instruments of hedging to reduce risk. Bourse markets, and the warehouse trade in particular, were characterized by the holding of substantial inventories. The owners of these inventories were exposed to the risk of fluctuating market prices; by taking an offsetting position in one of the speculative instruments they could hedge that risk.

### **A market for information**

Like all market centers, bourse markets were centers of information. When merchants met to trade in public or private, at an exchange or in a warehouse, they exchanged news and gossip. Political news was no less important to traders than strictly commercial news. War and peace, royal marriage or succession—all of these affected market prices. Not surprisingly, therefore, market centers were the best place to pick up the latest news. Indeed, for much of the sixteenth century, governments across Europe relied on their agents in Antwerp to keep them informed.<sup>42</sup> A few enterprising individuals in Antwerp and Amsterdam saw a way to profit from this and brought out the first newspapers—weekly newsheets (*tijdingen*) that they sold to subscribers.<sup>43</sup>

One of the important advantages of trading on exchanges is price transparency: trading takes place at ‘market prices’ rather than at prices negotiated individually, and these market prices are easily observed by all. In order to attract trading volume, exchanges made information on market prices available both locally and in distant markets. They did this by publishing regular ‘price currents’, which reported the prices at

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<sup>41</sup>Ehrenberg (1928)

<sup>42</sup>Ehrenberg (1928); Wilson (1925 [1572])

<sup>43</sup>Limberger (2001); Tielhof (2002)

which commodities were trading. Price currents first emerged in sixteenth-century Antwerp and Amsterdam, and in some other commercial centers.<sup>44</sup>

The availability of price currents gave a boost to the commission business. Commission agents could send them to their clients to prove they were obtaining for them the best available prices ('best execution').<sup>45</sup> This made it more attractive for merchants to employ commission agents and attracted more business to the market.

Price currents were not, however, an unmitigated plus for the markets that published them, because they facilitated private trading away from the market. They did so by providing those engaged in private trading with a reference point for their bargaining.<sup>46</sup> One important reason for using a market is to find out the prevailing price: if this is available away from the market, there is less need to use the market.

The publication of price currents contributed to the emergence of an actual market in information. Among the subscribers to the currents were a number of specialized information brokers, who supplied information to merchants in other cities. They would send out reports that included the latest price current together with additional information of specific interest to the particular client.<sup>47</sup>

The new technology of printing was a help in producing both newspapers and price currents: Antwerp, and later Amsterdam, were both major centers of printing and publishing.<sup>48</sup> However, printing was not the reason for the emergence of a market for information. That reason lay in the changing nature of commerce in general and of organized markets in particular.<sup>49</sup>

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<sup>44</sup>McCusker and Gravesteijn (1991)

<sup>45</sup>McCusker and Gravesteijn (1991)

<sup>46</sup>Muldrew (1998)

<sup>47</sup>Christiensen (1941) p219; quoted by Tielhof (2002). These information brokers performed much the same function as today's 'quote vendors' in financial markets, taking published market information and 'adding value'.

<sup>48</sup>Limberger (2001)

<sup>49</sup>McCusker and Gravesteijn (1991) Smith (1984)

## Support services

Commission agents and bourse markets depended on an array of support services. Commission agents and their principals needed to send each other goods, information, and money. So the ready availability of transportation, communications, and remittance was essential. While these services had long existed, they underwent considerable refinement. We will focus here on transportation and communications (when information had to be carried by hand the two were inseparable). We will look at remittance in Chapter 8.

Earlier, long-distance transportation had required considerable effort on the part of the individual merchant. To send goods by sea, he had had to acquire a ship and outfit and man it. As we saw in Chapter 6, groups of merchants often did this together in a joint venture. Or, if space was available on someone else's ship, it had to be found and terms negotiated. To send goods by land, merchants had to coordinate with a chain of agents (usually innkeepers) along the intended route.<sup>50</sup>

In the fifteenth and sixteenth centuries, however, new specialized carriers emerged, ready to undertake all the necessary arrangements in exchange for a single, inclusive payment.<sup>51</sup> Amsterdam in particular developed a well organized market in shipping services. Specialized charter houses bought up shipping capacity and then resold it to merchants. Shipowners could reduce their risk by chartering their ships in advance to these middlemen, who bore the risk of uncertain business and fluctuating freight rates. Merchants could reduce their shipping costs by relying on these specialists rather than having to seek out ships themselves. The charter houses relied on networks of overseas agents to supervise the unloading of cargo, to find back cargo, and to supply the home office with information.<sup>52</sup>

Overland transportation developed in much the same way. By the 1540s, overland transportation between Italy, Germany and Antwerp was dominated by about a half dozen specialized carriers. The largest of these was the Taxis firm of Milan, with other

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<sup>50</sup>Hunt and Murray (1999) Ch 2. citing Pegolotti (1936); Reyerson (2002)

<sup>51</sup>Ball (1977) Ch. 8.

<sup>52</sup>Gelderblom (2003) Christensen (1941); Unger (1998 [1979])

firms from Genoa, Germany, and Lorraine.<sup>53</sup> England, by the late sixteenth century, boasted an extensive network of professional carriers providing weekly or fortnightly service between London and all major towns.<sup>54</sup>

Inland water transportation, too, became more professionalized. In the sixteenth and seventeenth centuries, the Netherlands developed an extensive and well-organized system of barge transportation. Pairs of towns set up regularly scheduled services between them—the *beurtveren*—to carry freight, parcels, and passengers.<sup>55</sup>

Common carriers often carried letters as well as freight. Taxis, for example, provided a regular service between Antwerp and Italy that carried both small packages and letters.<sup>56</sup> States also established postal services. In England, for example, Henry VIII appointed a Master of Posts to set up a mail service throughout the kingdom: innkeepers, under contract, provided horses and riders and acted as local postmasters, delivering mail and packages locally.<sup>57</sup>

### **The growing importance of informal order**

Market expansion during the Commercial Revolution required an increase in trading between strangers. Much of the commercial development of the period was devoted to making this possible by reinforcing trust: merchant associations provided guarantees; organized markets and governments provided formal order. As we saw in Chapter 6, while these mechanisms helped, they suffered from significant problems of their own.

In later centuries, commercial development took a different tack. Rather than attempting to reinforce trust between strangers, commercial development increasingly eliminated the need for it. It did this by making it unnecessary for strangers to trade with one another directly. What made this possible was the expansion of private trading and the growing use of commission agents.

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<sup>53</sup>Laven (1966)

<sup>54</sup>Postan (1987); Clay (1984)

<sup>55</sup>de Vries (1981); de Vries and van der Woude (1997) Ch. 5

<sup>56</sup>Edler (1938)

<sup>57</sup>Kerridge (1988)

Rather than trading with strangers at a fair, a producer could sell privately to a merchant with whom he developed a continuing relationship. With the relationship itself serving as a bond, the seller could extend credit with some expectation of being paid, and the buyer could have reasonable confidence in the quality of the product.<sup>58</sup>

Commission too reduced the need for strangers to trade with one another directly. In a medieval organized market, merchants came from afar to trade with a large and shifting population of strangers. In a bourse market, while many merchants still traveled to the market or kept representatives there, many others sent goods and orders to commission agents who traded for them. Much of the trading, therefore, took place among a relatively small and stable group of professional traders, who knew one another well and had a strong interest in maintaining their reputations.

With the growth of private trading and commission, informal order once more came into its own. Informal order can only work within a community. Because the expansion of long-distance commerce initially required trading outside of the community, it had to rely to a great extent on formal order. However, as commerce continued to develop, it created a new kind of community—a community of those who traded with one another on a regular basis. Within such a ‘community of the market’ an informal order once more became possible.<sup>59</sup> That is not to say, of course, that the courts were idle: on the contrary, the volume of litigation continued to increase.<sup>60</sup> However, the relative importance of informal order in long-distance trade steadily grew.

## **THE ENTERPRISE**

Changes in the market component of commercial organization induced changes in the enterprise component. In particular, size became less of an advantage.

### **Small enterprises**

We saw in Chapter 6 that there were significant advantages of scale in trading. More so than in production, advantages of scale in commerce were captured within the

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<sup>58</sup>The relationship was often strengthened by ties of family, religion or place of origin. Everitt (1967)

<sup>59</sup>Van der Wee (1963), Dahl (1998), Gelderblom (2008).

<sup>60</sup>See Everitt (1967) on sixteenth century England.

individual enterprise. Commercial enterprises tended to be larger, therefore, than those typical of production. We saw too that as enterprises grew larger they suffered increasingly from offsetting organizational disadvantages of scale stemming from problems of reliance. With the emergence of bourse markets, commercial enterprises were able to capture many of the advantages of scale in trading externally rather than internally. This gave the edge to smaller enterprises that could avoid the organizational disadvantages of scale.

Bourse markets enabled commercial enterprises to ‘outsource’ many of the functions that had previously been integral to their operation. Information and transportation services could now be purchased. As we will see in Chapters 8 and 9, remittance and finance were readily available. Perhaps most important, however, was the emergence of the commission agent as an alternative to the use of the traveling or resident representative.<sup>61</sup>

A representative was retained for a given period of time and paid a regular salary or received a share of the profits. The cost of the representative was therefore largely fixed and indivisible: it depended little on the volume of business he transacted. In contrast, a commission agent was paid as needed, by the transaction. Moreover, unlike the representative who served a single principal, a commission agent could serve many—dividing the fixed cost of representation among them in proportion to their use of his services. Because the use of commission agents was relatively inexpensive, it enabled even small firms to trade with multiple distant markets. They could thereby achieve a degree of diversification that had previously been available only to much larger firms. Moreover, since commission agents could be retained or not as needed, their use offered considerable flexibility.

The use of a commission agent also entailed less of a reliance problem, because the relationship was more arm’s-length than it was with a representative. The employers or partners of a representative, because he acted in their name, had unlimited liability for his actions. In contrast, a commission agent acted in his own name. So the potential loss to

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<sup>61</sup>Lane (1944); Luzzatto (1953); Van der Wee (1963); Origo (1986); Price (1991); Alonso (2001); Harreld (2007)

those he served was limited to the value of the goods or money they committed to him: their liability was, *de facto*, limited.

While the problem of reliance was lessened, it was not eliminated entirely. Merchants consequently preferred to use relatives as commission agents or those who shared with them a place of origin or religious affiliation<sup>62</sup> There was less need for such ties when dealing with specialized commission agents, because these had a greater incentive to serve their clients faithfully. The volume of their business—both repeat business and referrals—depended on how well they carried out their commissions.

The emergence of commercial services—commission, transportation, information, finance, and remittance—offers yet another example of the division of labor. Once as much a part of the merchant's business as trading itself, these services became available from specialized enterprises and could be purchased in the market. Such a division of labor depended, of course, on the 'extent of the market'—on the potential demand for the services in question. And the demand for these services depended on the volume of trade. So the general expansion of trade in the long sixteenth century was a cause of the development of commerce as well as a consequence of it.<sup>63</sup>

### **Large enterprises**

The main exception to the increasing predominance of the small family firm in commerce was in the area of finance. Enterprises whose business was predominantly financial, such as merchant banks, were subject to financial advantages of scale that continued to favor larger firms. Financial intermediaries borrowed in order to relend to others. Being larger enabled them to borrow more easily, because it made them more trustworthy. Larger firms had a greater incentive to pay, because the reputational cost of default was greater. They also had a greater ability to pay, because their larger size allowed for greater diversification and, through the pooling of liabilities, better liquidity.

In addition to financial intermediaries, there was another group of commercial enterprises that experienced financial advantages of scale—those that purchased monopoly trading rights from rulers. The creation and sale of monopoly trading rights

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<sup>62</sup>Price (1991).

<sup>63</sup>A phenomenon we named 'the trading cost multiplier' in Chapter 2.

became increasingly common from the middle of the fifteenth century. Some rulers—especially those of Spain and England—depended on it for a significant part of their revenue.<sup>64</sup> In Spain, the crown sold trading monopolies to *consulados* (merchant associations)—the monopoly of trade with the Low Countries to the *consulado* of Burgos and that of trade with the Americas to the *consulado* of Seville.<sup>65</sup> In England, the crown sold monopolies both to merchant associations and to large enterprises, and by the end of the sixteenth century almost all of England’s foreign trade had been carved up into monopolies.

As we saw in Chapter 6 the English wool monopoly had been sold to the Company of the Staple in the fourteenth century. Despite the name, this was not an enterprise but an association. It was not, however, an existing merchant association of a particular city, but one created *ad hoc* to purchase the wool monopoly.<sup>66</sup> Several more such ‘regulated companies’ were formed in the sixteenth century, purchasing monopolies of trade with the Low Countries, with France, with the Baltic, and with Spain.<sup>67</sup>

Members of a regulated company, while subject to the rules of the association, traded individually—either singly or in small partnerships. Sometimes, a group might purchase goods together ‘in joint stock’ (stock meaning inventory), presumably to avoid competing with one another and driving up prices. The goods purchased in this way were divided up for each member to trade on his own account.<sup>68</sup>

It was but a small step to extend the idea of trading ‘in joint stock’ from the purchase of goods to their sale. When this was done, the participants became shareholders in a

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<sup>64</sup>We will see why in Chapter 11.

<sup>65</sup>Parry (1967); Grafe (2001)

<sup>66</sup>Indeed, the Company of the Staple numbered among its members merchants from a number of English cities and even some foreigners.

<sup>67</sup>By far the most important was the Company of Merchant Adventurers, an association of merchants exporting woolen cloth to the Low Countries. It was incorporated in 1407 and purchased the monopoly of the trade in 1560. By 1600, it accounting for some 75% of the export of woolen cloth (England’s principal export). It had some 3,500 members, of which perhaps 200 were active, with the largest 30 accounting for over half the total trade. (Clarkson (1971))

<sup>68</sup>Scott (1912)

joint venture rather than individual traders. The first association set up specifically to trade in this manner was the Muscovy or Russia Company.<sup>69</sup> This was formed in 1553 to finance an expedition in search of a northeast passage to the Indies. Although it found no such passage, it did find a new northerly route to Russia, and in 1555 it purchased from the Crown a monopoly of the new trade it had opened up. The charter of the Russia Company served as a model for all subsequent ‘joint stock companies’. These included the Levant Company, the Africa Company, and the most famous—the East India Company.

The advantages of the joint stock company—a large enterprise—over the regulated company—a merchant association—were financial. Because shareholders in a joint stock company were not themselves required to trade, participation was open to a much larger public of potential investors. For example, in the case of the Russia Company, some 200 Londoners, mostly merchants, purchased shares. This facilitated the spreading of risk, which was in this case considerable: two of the three ships sent out on the initial expedition were lost.<sup>70</sup> A second financial advantage was the greater ease with which an enterprise was able to borrow. As we saw in Chapter 6 with the Italian supercompanies, a large enterprise could exploit this advantage to finance substantial lending to rulers. Since rulers were often desperate for liquidity, this gave the enterprise the edge in the rivalry for trading privileges. The English joint stock companies did not initially engage in this sort of financial intermediation, but by the end of the seventeenth century it had become significant.

Offsetting the financial advantages of a large enterprise were the organizational disadvantages—the usual problems of representation and governance. The main problem with representatives was that they often traded on their own account, undermining the monopoly of their employer. This was already a problem for the Russia Company, and was to remain a problem for later joint stock companies, most notoriously for the East

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<sup>69</sup>Willan (1956)

<sup>70</sup>It was clearly risk rather than the size of investment that was the issue: the initial amount raised was only £6,000: the Merchant Adventurers annually traded ten times that sum.

India Company.<sup>71</sup> The joint stock company inherited its structure of governance from the regulated company from which it had evolved, but the power of its officers were greatly enlarged given their control over trading. Not surprisingly, they ran things for their own benefit at the expense of the inactive shareholders.

The advantages and disadvantages of scale must have been closely balanced, because companies went back and forth between enterprise and association.<sup>72</sup> The East India Company, for example, switched from one form to the other several times before it became a joint stock company permanently late in the seventeenth century. By then, the financial advantages were sufficient to outweigh the organizational disadvantages.

In the Netherlands, there emerged a structure similar to that of the English joint stock company, although by a very different route.<sup>73</sup> When Spain cut off the access of its rebellious Dutch subjects to Asian spices via Lisbon, they responded by sending their own ships to Asia.<sup>74</sup> These ventures were so successful, that their number increased to the point that competition among them threatened their profitability. As a result, the Dutch Republic, moved in 1602 to monopolize the trade in the hands of the Joint East India Company, which absorbed the many independent enterprises already engaged in the trade.<sup>75</sup> Although the government received no direct payment for this monopoly, it did obtain the aid of the new company in the war against Spain.<sup>76</sup>

The large enterprise—in both its Dutch and English forms—continued to develop in subsequent centuries. It never overcame, however, the internal problems already evident in the sixteenth century. Large enterprises succeeded despite these problems only when the advantages of scale were sufficient to outweigh the disadvantages. For the great

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<sup>71</sup>Willan (1956); Baskin (1988)

<sup>72</sup>Braudel (1982), Harris (2000)

<sup>73</sup>More on this in Chapter 9.

<sup>74</sup>Çizakça (1996) based on van Dillen (1970)

<sup>75</sup>Riemersma (1950)

<sup>76</sup>Steensgaard (1982)

trading companies, the advantages were in obtaining and managing trading monopolies and in intermediating public loans.<sup>77</sup>

It is a mistake, therefore, to think of large enterprises as being more ‘advanced’ than small. Commerce in general was dominated by the small enterprise: the great trading companies accounted for a very small proportion of total trade.<sup>78</sup> The development of commercial organization did in general produce increasingly complex and more differentiated structures. However, these did not involve larger individual enterprises.

### ASSOCIATIONS

Changes in the nature of market and enterprise steadily eroded the role of associations. Associations provided benefits, but they also involved costs. Apart from obligatory contributions of time and money, members had to sacrifice trading opportunities because of embargoes and to endure losses from the system of reprisal. There were also problems of governance within the association, especially if the association was a city, that allowed some members to gain at the expense of others.

Because of the costs of membership, an association could retain the loyalty of its members, and impose on them the necessary discipline, only if the benefits were sufficiently large. However, the benefits of merchant associations declined over time as substitutes developed for many of the functions they had previously performed.

Merchant associations had addressed the problem of reliance by maintaining internal order, formal and informal, and by providing external guarantees. As we have seen, new types of informal order developed in private trading and in bourse markets, and states increasingly provided an effective formal order.

The growing power of states reduced the need for protection against (non-government) predation. For example, in the sixteenth century, the emergent Danish and Swedish states eliminated piracy in the Baltic thereby depriving the Hansa of much of its *raison d'être*.<sup>79</sup> In addition, the development of naval cannon, particularly of cheap iron cannon in the sixteenth century, made it easier for individual ships to protect themselves.

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<sup>77</sup>Jones and Ville (1996)

<sup>78</sup>Grassby (2001); Price (1991).

<sup>79</sup>Glete (1999) Ch. 7

There was also less of a role for merchant associations in the rivalry for trade. The fair and equal treatment of foreigners by bourse markets obviated the need for merchant colonies and for bargaining by associations to obtain special privileges for their members. When governments created and sold monopolies, they were more likely to sell them to large enterprises than to traditional merchant associations because the former could act more effectively as intermediaries for government borrowing.

Some merchant associations, like the Hansa, simply faded away. Others were subsumed in associational governments: the territorial government of the Dutch Republic acted as a grand association of merchants much as did the Republic of Venice. And some associations, like the regulated companies of England, were transformed into large enterprises.

Merchant associations had been important during the Commercial Revolution largely because there had been no other way to exploit advantages of scale, address externalities, and provide public goods. However, as associational governments and large enterprises came increasingly to play this role, the need for merchant associations disappeared.

#### **THE CONSEQUENCES OF COMMERCIAL DEVELOPMENT**

Commercial development lowered every component of trading costs. Private trading lowered predation costs: it did so by reducing the burden of tolls and taxes collected in official markets—both by evading them and by undermining them. Private trading, bourse markets, and commission all lowered transactions costs. Reorganization and technological progress in transportation lowered transportation costs. And, as we will see in Chapter 9, financial development lowered financing costs. Lower total trading costs facilitated competition and undermined monopoly. Indeed, official trading monopolies were plagued by interlopers—small enterprises encroaching on their trade ‘illegally’ to undercut them.

Lower trading costs increased the overall volume of trade by making trade worthwhile where it had previously been unprofitable. The boundaries of commerce—of trade mediated by merchants—expanded both inwards and outwards. They expanded inwards as mediated trade reached deeper into the country, integrating a larger part of the population into the market economy. They expanded outwards as trading zones grew larger and merged with one another.

### **The inner boundary of commerce**

Producers in the country increasingly sold to merchant intermediaries rather than directly to consumers in town markets. At the same time, consumers in the country increasingly purchased from retail intermediaries rather than directly from local producers.

We saw in Chapter 3 that there was an expansion, during the long sixteenth century, of manufacturing in the villages and small towns of the country. Most of the trade in these rural manufactures was mediated through private transactions with urban merchants rather than through organized markets. The nature of rural manufacturing favored this arrangement.<sup>80</sup> Rural producers, unsupervised by any guild, turned out inexpensive goods of uncertain quality. Buying such goods from anonymous producers in an open market would have been risky. However, an intermediary had a continuing relationship with producers and came to know their work: the continuing relationship also gave producers an incentive to maintain quality.<sup>81</sup> Similarly, the intermediary, because of his continuing relationships with his customers, had an incentive to provide them with satisfactory products.

Town markets faced increasing competition from specialized retailers. Shops had first emerged in the bustling commercial cities of the Mediterranean as early as the twelfth century.<sup>82</sup> By the sixteenth, they were common even in the smallest towns of the northern zone.<sup>83</sup> Shops offered several advantages over town markets. While markets were held only once or twice a week, shops provided continuous and easy access to a wide selection of goods.<sup>84</sup> Shopkeepers also provided their regular customers with credit, payment by installment, and sometimes even cash loans.<sup>85</sup> And for those too distant from a shop or

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<sup>80</sup>Moore (1985)

<sup>81</sup>As we saw in Chapter 3, the merchant intermediary also typically provided raw materials and financing.

<sup>82</sup>Lopez (1987)

<sup>83</sup>Muldrew (1998)

<sup>84</sup>In the jargon of markets, shops offered immediacy and liquidity.

<sup>85</sup>Marshall (1999)

too poor to patronize one, a growing number of peddlers and chapmen made the rounds of the villages selling cheap wares door to door.<sup>86</sup>

The steady expansion of mediated trade in the country ate into the business of markets and fairs. Consequently, many ceased to be profitable and disappeared.<sup>87</sup> In England, for example, the number of town markets declined by about two thirds between the thirteenth and sixteenth centuries.<sup>88</sup>

The penetration of commerce into the country meant a deepening of the market—an increase in the share of output produced for exchange. Instead of producing basic foods for their own consumption, people in the country, particularly those in England and the Netherlands, increasingly engaged in domestic manufacturing and in the cultivation of industrial and horticultural crops for the market. They used the proceeds to purchase a widening range of non-local consumer goods.<sup>89</sup> The shift from subsistence to market raised household income, both by channeling effort into more remunerative activities and by eliciting greater effort (“the industrious revolution”).<sup>90</sup> The increase in income “made all the difference between a precarious existence and a modicum of comfort.”<sup>91</sup>

The penetration of commerce into the country meant an expansion of the market. Rather than country people producing for themselves or buying locally, they increasingly purchased from distant producers—often themselves country people in other regions. Consumers were connected to producers via a chain of increasingly specialized intermediaries. Some of these intermediaries specialized in gathering up output in the producing regions and selling it to other intermediaries in the regional centers. These, in turn, sent the output for sale to the bourse markets of Antwerp, Amsterdam, or London.<sup>92</sup>

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<sup>86</sup>Thirsk (1978) Ch. 5. Chapmen also purchased rural manufactures.

<sup>87</sup>Bailey (1999) Dyer (2005) Ch. 5

<sup>88</sup>Everitt (1967); Britnell (1996); Dyer (1989)

<sup>89</sup>Thirsk (1978)

<sup>90</sup>De Vries (2008)

<sup>91</sup>Thirsk (1978) p8. See also de Vries (1993).

<sup>92</sup>Westerfield (1915) describes in rich detail the structure of English commerce a little later, in the period 1660-1760.

Some goods were consumed in the metropolis itself, others were exported overseas, but an increasing proportion went out again to other regions served by the metropolis: as Daniel Defoe later wrote, “Norwich buys Exeter serges, Exeter buys Norwich stuffs, all at London.”<sup>93</sup> The goods that traded between regions in this way, like the serges and stuffs, were relatively inexpensive—mostly agricultural commodities and simple manufactures.

The regions connected to one another via the bourse market of the metropolis constituted a single large ‘metropolitan market’: the sixteenth century saw the emergence of several such in northwest Europe.<sup>94</sup> Metropolitan markets were much larger than merely regional markets. The metropolitan market centered on London, for example, encompassed much of England and Wales.<sup>95</sup> Despite the size of metropolitan markets, prices within them tended to move together, differing from place to place mainly by the cost of transportation.<sup>96</sup> A uniform price, together with the extent of the metropolitan market, induced considerable regional specialization within it, and this further raised productivity.

### **Trade within the zone and beyond**

Trade within the northern zone of Europe underwent a similar sort of centralization. Here, the ‘metropolis’ was not a single city, but the urbanized central region. The leading city within this region changed over time. Initially, it was Antwerp, with Amsterdam playing a satellite role as its gateway to the Baltic. When Antwerp was destroyed by Spanish troops in 1585, Amsterdam took over the leading role, and Amsterdam was itself displaced by London in the eighteenth century. The Low Countries had, of course, always been at the center of trade in the northern zone. However, with falling transportation costs and the development of bourse markets, trade became even more focused on the center.

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<sup>93</sup>Defoe (1869 [1725-7]), writing of the early eighteenth century, and quoted in Kerridge (1985) p 215.

<sup>94</sup>See Van der Wee (1963) on Antwerp, de Vries and van der Woude (1997) on Amsterdam, and Kerridge (1985) on London.

<sup>95</sup>Gras (1915); Kerridge (1988)

<sup>96</sup>Kerridge (1985)

As with the development of metropolitan markets, the result was greater economic integration and increasing regional specialization.

Centralization of trade had the important effect of reducing market risk. This was most notable in the grain trade. Regional grain prices were volatile, because local supply fluctuated widely and demand was inelastic. A local shortage would raise prices, causing merchants in other regions to ship grain there in the hope of a profit. However, their uncoordinated actions could swamp the market, causing prices to plummet and leaving them facing a loss. Fear of this—of market risk—would cause merchants to hold back from responding to a reported shortage.<sup>97</sup> The increasing centralization of the grain trade in Amsterdam eliminated this problem by providing the necessary coordination. The concentration of trading kept the price in Amsterdam relatively stable (averaging out the regional fluctuations).<sup>98</sup> As a result, regions with a surplus preferred to sell there rather than taking the chance of finding a better price elsewhere. Similarly, regions with a shortage could be sure of finding grain at a good price in Amsterdam. There was also some speculative warehousing of grain in Amsterdam, which further helped to stabilize prices there. However, it was the concentration of *trading* that was most important, not the concentration of the grain itself. Indeed, grain that was traded there was often sent directly from its source to its ultimate destination, without physically passing through the city.<sup>99</sup>

Centralization of trading in the bourse market of Amsterdam later transformed transoceanic inter-zone trade in much the same way. The initial opening of transoceanic trade by the Portuguese in the early sixteenth century had had remarkably little impact on the European spice market: the traditional trade via the Levant and Venice remained competitive, and although total imports of spices increased, prices fell only a little. When the conflict with Spain cut off Dutch access to Asian spices in Lisbon, the Dutch, as we have seen, began to send their own ships to Asia. Amsterdam soon became the center of the spice trade and transformed it much as it had transformed the trade in grain.

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<sup>97</sup>de Roover (1948)

<sup>98</sup>Unger (1983)

<sup>99</sup>Lesger (2006, Tielhof (2002)

Concentrated trading on an exchange, warehousing, and speculation all served to stabilize prices and reduce market risk. The reduction in risk and falling trading costs greatly increased the volume of trade, bringing prices down significantly. The Venetian spice trade, unable to compete, withered away.<sup>100</sup>

Falling trading costs led to an increasing volume of trade within the northern zone and eventually to the merging of the two zones of European trade. This is again illustrated by the grain trade. From the middle of the sixteenth century, Baltic grain started to find its way to Iberia. By the end of the century, Spain was so dependent on Baltic grain that it allowed Dutch and English grain ships into Lisbon and Seville despite its wartime embargo on these enemy nations. In the 1590s, a general shortage of grain in the Mediterranean brought northern grain ships to Italy.<sup>101</sup> And by the early seventeenth century, there was a growing English and Dutch maritime trade with Italy and the Levant.

## CONCLUSION

By the early seventeenth century, the medieval pattern of traveling merchants, merchant guilds, and highly regulated organized markets had been replaced by something recognizably more modern. The fundamental change was in the arrangements that facilitated interaction among commercial enterprises—in the ‘market’ component of the structure of commercial organization. As intermediaries developed and became increasingly important, there was less need to deal directly with strangers: as substitutes for trust developed, the need for the reinforcement of trust declined.

The bourse market that developed in Antwerp during the sixteenth century would mature in the seventeenth and eighteenth centuries in Amsterdam and London and would remain the model for organized markets well into the twentieth century. The joint stock company would continue to evolve until, in the nineteenth century, it became the basis for the modern industrial corporation.<sup>102</sup> And it was the development of a large,

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<sup>100</sup>Parry (1967); Musgrave (1981)

<sup>101</sup>Ball (1977) Ch 6 food

<sup>102</sup>Chandler (1977) In this case, it was technological advantages of scale that were sufficient to offset the organizational disadvantages—of which the daily news provides a constant reminder.

integrated metropolitan market for inexpensive goods in England that—more than anything else—laid the foundation for the Industrial Revolution.<sup>103</sup>

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<sup>103</sup>Szostak (1991)

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