***Take-Home Essay 1***

*I have neither given nor received unauthorized aid on this assignment.*

Developments in political and legal institutions, improvements in technology, and the creation of modern corporations, among other factors, have significantly reduced the perils of long-distance trade. However, historically, long-distance trade was a high-risk activity that required entrepreneurs to develop sophisticated organizational structures. In this paper, I aim to discuss how historical entrepreneurs organized their enterprises to account for the promises and perils of long-distance trade. I will discuss, with examples, the strengths and limitations of the strategies they employed. I will also explore how legal institutions, or the lack thereof, influenced trade.

Long-distance trade involves several complex logistical factors, such as political risks, transportation risks, market risks, and embezzlement. All these risks increase the expected cost of trade, often making it unviable. Therefore, long-distance trade requires a framework of rules and regulations that ensure the rights of all parties in every step of the transaction. Hence, traders need formal protections in a well-developed legal system to ensure the enforcement of contracts and the resolution of disputes. However, formal legal protections did not exist for much of human history. To minimize risk, and by extension, succeed, entrepreneurs needed to develop clever strategies.

The Maghribi Jewish traders of the 11th century are a prime example of experienced entrepreneurs who faced a commitment problem.[[1]](#footnote-1) Maghribi merchants hired overseas agents to conduct trade-related services, including loading and unloading ships, storing goods, paying fees, finding buyers, and setting prices.[[2]](#footnote-2) In the absence of a strong legal system, we would expect agents to steal goods and flee or exaggerate losses to embezzle revenue. We would also expect merchants to dishonor contracts or be overly suspicious of agents. However, historical records indicate a high degree of mutual trust and affection and very few instances of suspicion.[[3]](#footnote-3) In "Contract Enforceability and Economic Institutions in Early Trade," Avner Greif argues that this was possible due to a coalition between traders that facilitated the exchange of information. Written information about transactions, agents, and merchants was stored in the geniza, a storage area in synagogues. This coalition helped set expectations about implicit contractual relations and helped establish reputations for agents and merchants across trade centers.[[4]](#footnote-4) It also maintained a specific idea of what constituted cheating through a shared set of cultural norms. The coalition operated based on uncoordinated responses at different trade centers, with each individual looking out for their best interests. As this system rewarded obedience to contracts and punished fraudulence, it created a market conducive to long-distance trade.

Nevertheless, this system had several drawbacks. Individuals who were not Maghribi Jews could not participate in this coalition as it necessitated shared norms derived from a specific identity.[[5]](#footnote-5) This created a very insulated system. For instance, the Maghribi Jews were unable to trade with the Genoese despite operating in the same geographical region, having similar merchandise, a similar business structure, and knowing each other's cultural practices. The absence of an information-sharing mechanism created high levels of distrust.

The Genoese used an almost identical business structure to the Maghribi Jews called the commenda.[[6]](#footnote-6) In fact, according to Ron Harris in "Going the Distance," this structure emerged independently all over the world during different time periods.[[7]](#footnote-7) The commenda is a contractual agreement between two parties: a passive investor in a commercial venture, and an agent who manages the venture. The way profits were divided differed from place to place, and at times, from one agreement to another. The commenda was a useful tool for matching capital and labor. According to Harris, the commenda was a form of an early firm.[[8]](#footnote-8) According to Ronald Coase, firms exist as they reduce transaction costs.[[9]](#footnote-9) Transaction costs arise when firms or individuals engage in economic transactions, such as searching for information about potential trading partners, negotiating and drafting contracts, enforcing property rights, and monitoring and enforcing agreements. Commendas helped to minimize transaction costs by reducing the need for costly monitoring and supervision. The commenda partner was personally invested in the success of the venture and had a strong incentive to ensure that it was executed efficiently and effectively. This reduced the need for the trader to monitor and supervise the commenda partner, which in turn lowered transaction costs. Commendas were also a way of sharing risk between the trader and the commenda partner. Because the commenda partner had a stake in the venture, they were more likely to take steps to minimize risk and ensure its success. This reduced the overall risk of the venture and helped to further minimize transaction costs.

However, without formal legal protection, traders lacked the ability to govern their contracts. It also prevented them from developing a more sophisticated form of firm. For instance, a modern corporation benefits from perpetual existence, allowing the firm to continue existing even with a change in its membership.[[10]](#footnote-10) A modern corporation also has transferrable shares, making it easier to raise capital, and limited liability, protecting investors’ personal assets. While limited liability was arguably enforced in some types of commendas, the other features of a corporation, which could decrease transaction costs, required a greater level of legal sophistication. An improved ability to raise capital, and perpetual, existence would allow firms to visit more profitable albeit riskier destinations.

In conclusion, historical entrepreneurs had to develop creative strategies to minimize the risks associated with long-distance trade. While formal legal protections are necessary for effective trade, entrepreneurs were able to find ways to minimize risks and conduct trade without them. These strategies, such as the coalition between Maghribi Jewish traders or the commenda business structure, helped to reduce transaction costs and encourage trade. However, the effectiveness of these strategies depended on the trading environment in which they were employed. As legal institutions have developed and improved over time, the risks associated with long-distance trade have decreased, making it easier for entrepreneurs to conduct business and expand their enterprises.

**Word Count:** 999 words

1. Greif, 525. [↑](#footnote-ref-1)
2. Ibid, 529. [↑](#footnote-ref-2)
3. Ibid, 530-531 [↑](#footnote-ref-3)
4. Ibid 544. [↑](#footnote-ref-4)
5. Ibid, 540. [↑](#footnote-ref-5)
6. Ibid, 542. [↑](#footnote-ref-6)
7. Harris, “Going the Distance,” 131. [↑](#footnote-ref-7)
8. Harris, “132,”. [↑](#footnote-ref-8)
9. Ronald Coase, “The Nature of the Firm”, 388 [↑](#footnote-ref-9)
10. Harris, “The Legal Framework,” [↑](#footnote-ref-10)