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Book Review

Greif, Avner, *Institutions and the Path to the Modern Economy: Lessons from Medieval Trade.* Cambridge University Press, 2008, pp. 452, Price £19.99.

In a comparative study of the late medieval European and Muslim worlds, Greif analyzes the effect of institutions—especially those that facilitated impersonal exchange, such as trade—on the performance of modern economies. His argument rests on the premise that past institutions have an effect on consequent ones, and he contributes the disparity in performance of the Muslim and European economies to their distinct institutional trajectories. The book comprises several parts. It defines institutions in great detail; provides a comparative account of institutions in the medieval European and Muslim worlds; and applies a theoretical, analytical, and empirical framework—particularly game theory—to studying institutions.

The author identifies long-distance trade in the late medieval period as the driving force behind economic progress. He conjectures that institutions initiated and contributed to the expansion of international trade in this era. Greif explains from a historical perspective how reputation-based economic institutions enabled *Maghribi* (Western) traders to trade in the eleventh century. He emphasizes the importance of these institutions by acknowledging that pre-modern trade involved merchants supplying their goods abroad by entrusting their business to overseas agents; he argues that, without institutional support, international trade would not be possible as agents were likely to indulge in opportunistic behavior and embezzle merchants. Greif explains how the detection of opportunistic behavior through information sharing among merchants was intrinsic to the reputation-based institution, and the conditionality that merchants in that group would not hire dishonest agents in the future. Through game theoretical analysis, he shows how merchants ensured their agents' honesty by making future employment attractive through per-period premium payments. He concludes, however, that the Maghribi coalition in the long run proved to be inefficient as agents were more concerned about their actions and the consequences than profit maximization.

One of the political institutions examined in this book is the "*podestria*" in Genoa during the late medieval period. Greif describes the podestria system as a limited government in which a committee of representatives hired a *podesta* (translator) to serve as Genoa's military leader, judge, and administrator. Greif highlights how the podesta had the desired effect of bringing peace to Genoa by deterring each clan from attacking the other to gain control of the city through the threat of intervention. He argues that, because the podestria was based on the balance of military strength among clans, and that each clan wanted to be militarily prepared in case of need, it helped contain but not eliminate inter-clan rivalry. Greif concludes, however, that, in the long term, this institution proved to be unsuccessful in undermining clan culture.

The author also studies the impact of culture on institutional development and path dependence. He argues that institutions persist in spite of exogenous changes due to a network of externalities, sunk costs, and coordination costs. He highlights how organizations in Europe—in the form of corporations—in contrast with the Muslim world in the medieval era, were based on interest rather than kin. Greif argues that European institutions in the late medieval period were so strong that, even in the absence of legal contracts, property rights were secure enough to allow merchants to travel to foreign lands without their wealth and trusted agents to handle goods on their behalf internationally. With the help of a historical and theoretical analysis, he shows how impersonal exchange in pre-modern Europe was supported by institutions based partly on law and partly on reputation; it was known as the community responsibility system. He explains how, under this system, each merchant paid a fee to receive information about an agent's past conduct and that dishonest agents were brought to compensate traders on condition that their past experience would not be revealed to potential future merchants.

The analysis in this book shows that contemporary developing economies such as the Muslim world are collectivist in nature whereas the West/developed world—in common with Medieval Latin society—is individualistic. Greif highlights how, in developing countries, the social structure is segregated: members of different groups remain insular and do not trade with each other, while contract enforcement is achieved through informal institutions. In developed countries, on the other hand, economic exchange takes place between individuals from different groups and formal institutions such as courts facilitate contract enforcement. He highlights how tribes and ethnic groups continue to remain prominent in the Muslim world's kin-based social structure, and how consanguineous marriages—aiming to preserve lineage and wealth—remain popular in the Muslim Middle East and North Africa even today. In an in-depth study of religious institutions, Greif shows how medieval Christianity supported the ideas of individualism while Islam did not, for instance, advocating communal prayer over individual.

Greif indicates that good institutions foster an environment conducive to specialization and exchange by securing contracts and protecting property rights, and facilitate production by encouraging savings, investment in human and physical capital, and technological development. He correlates stronger rule of law, greater trust, and secure property rights with better economic outcomes. He argues that countries that developed their formal legal order internally and adapted imported codes to local conditions ended up with far stronger legal institutions than those that adopted codes exactly from the West. Many critics believe that International Monetary Fund (IMF) policies are ill suited to the needs of the developing world for this reason.

The collectivist nature of the Muslim world described by Greif can be compared with present-day Pakistan, where tribal kin-based social structures prevail in regions such as the Federally Administered Tribal Areas (FATA) and in Balochistan. Consanguineous marriages remain highly popular in Pakistan even today. Informal institutions such as *panchayaats* (courts) continue to play a significant role in some parts of Pakistani society, especially tribal areas. The reputation-based institutions described by Grief are an intrinsic part of Pakistani culture, which places a great deal of emphasis on "honor." The age-old tribal custom of "*watta satta*" is a prime example of informal institutions, where a brother and sister in one family are married to a sister and brother in another, to ensure that the contract of marriage is enforced: this leads to a host of social ills. This closed insular social setup inhibits the growth of the economy. Nonetheless, the author underscores how collective responsibility can play a vital role for developing economies in microfinance, if used constructively, i.e., by using the insights provided by a historical analysis of the sociocultural setups of various communities. This argument is best understood by the success of the Grameen Bank in Bangladesh.

The book makes a valuable contribution to the field of institutional economics by presenting a unique game theoretical framework within which to study the effects of institutions on economies; the author writes from sociological, historical, and economic perspectives to explain the performance of contemporary economies. The book is reader-friendly and useful to students of any discipline. Greif assumes no prior knowledge of institutional economics and game theory, and describes both throughout his book and especially in the appendices.

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