PREFACE

A visitor to midtown Manhattan will likely stroll down Fifth Avenue and witness one of the most cosmopolitan retail centers in the world. That same visitor might stroll down Sixth Avenue and view the Rockefeller Center, international bank offices, and other heights of today's modern commerce. But should that visitor wander from Fifth to Sixth along 47th Street—crossing from high fashion to high finance—she would find herself in what looks like an ancient barter economy.

New York's 47th Street is the epicenter of America's diamond industry, and to the visitor it might feel like a time bubble. Instead of midtown's stylish shoppers and elegant businesspeople, pedestrians on 47th Street are a cross-section of the global economy, with their ethnicities, languages, and energy unfurled in the street. The street bustles with merchants speaking English, Yiddush, Hebrew, Hindi, Bucharan, Maharashtani, Rajastani, and assorted Slavic languages. Many are marching with briefcases attached to their wrists with handcuffs and barking on cellphones; others are inspecting stones in open storefronts, holding a jeweler's loupe to their eye, or removing them from small envelopes of folded paper. And a diversity of hats: Ultra-orthodox Jews wearing black fedoras with full beards and traditional 19th Century black garb; Jewish merchants from across the globe wearing yarmulkes—some knitted, most black, some tucked beneath baseball caps; merchants from central Asia with traditional karakul and papakha hats; old-style Europeans in long overcoats wearing ascot caps, flat caps, and an occasional derby. Merchants with similar hats coalesce together in small gaggles, walking briskly or gesturing aggressively to each other, evincing a determined energy that makes this lucrative center feel like an outdoor market in a developing economy.

The diamond industry is unusual in many respects, and 47th Street—which the *New York Times* called "an anachronism, a 17th-century industry smack in the middle of a 21st century city"—offers a glimpse into the industry's majesty and mystery. An academic inquiry, especially one that aims to offer some generalizable theory on frequently dry matters such as market structures and contractual relationships, risks losing sight of how the fascinating the people, objects, and practices are that comprise the industry. Nonetheless, this book explores the diamond industry with an academic agenda, and it does so with two ambitious objectives: it hopes to understand the roots of the industry's unusual features, and it hopes to glean lessons that might explain features of the modern economy. In short, it asks: what causes the diamond industry to appear so extraordinary, and why doesn't the rest of the economy exhibit those same features?

This book is an effort to bring together over a decade of research and writing on the diamond industry. It began when I studied under Oliver Williamson, who impressed upon his students the value of being interdisciplinary – or as he put it in class, the value of pursuing a research project "with multiple arrows in your quiver." Combining the insights of a cultural anthropologist (Roy D'Andrade) and a Nobel Prize winning economist (Robert Solow), he later wrote:

> D'Andrade (1986) captures the [interdisciplinary] spirit in his contrast between authoritative and inquiring research orientations. Whereas the former is characterized by an advanced state of development, is self-confident, and declares that "This is the law here," the latter is more tentative, pluralist, and exploratory and poses the question, "What is going on here?" The first is commonly of a top-down kind; the latter favors bottom-up constructions. Theoretical physics is widely regarded as the exemplar of the imperial tradition, but parts of economics also have these aspirations – as witness Solow's observation that "there is a lot to be said in favor of staring at the piece of reality you are studying and asking, just what is going on here? Economists who are enamored of the physics style seem to bypass that stage." (Solow, 1997).

(Williamson 2007)

Just what is going on here? That is the question with which I began studying the diamond industry, and it is the question I find myself continuing to ask. There surely is a lot going on here. This book begins with asking *what* is going, and then proceeds to ask *why* it is going on. I have spent a lot of time, in Solow's words, staring at this piece of reality, and hopefully I offer both an accurate description of that reality and some lessons that accompany it.

"Stateless Commerce"

47th Street and its midtown Manhattan environs are an illustration of a paradox that is common to many of the world's commercial centers: the coexistence of the modern and the primitive. The world's urban centers frequently exhibit shiny skyscrapers that house the most sophisticated and contemporary financial institutions alongside pockets of ethnically homogeneous merchants operating a barter economy just as their ancestors did centuries ago. Conventional understandings of economic, cultural, and technological progress suggest that the old commercial world would be displaced by the new, yet this old world persists.

Ethnic trading networks continue to thrive in each of the globe's richest and most modern cities. They are organized around personal exchange, in which transacting parties either have first-hand familiarity with each other or rely on clan- or ethnic-based representations to acquire personal information about each other. Transactions are often paperless, usually lawyerless, and disputes are rarely resolved in state courts. Goods and services, frequently of significant value, are regularly sold on unsecured credit. Deals rely on trust, even as distrust of strangers causes these networks to remain insulated from, and often a secret to, the outside world.

Why, and how, do ethnic trading networks remain a staple of the modern economy? This book's central argument rests simply on principles of efficiency: for some industries, ethnic-based exchange remains economically superior to all available alternatives. This is remarkable only when one considers how much other industries have changed over time. Modern commerce is more frequently associated with complex commercial structures, such as large corporations, banks, and other sophisticated economic entities. Most industries have moved away from "primitive" personal exchange and ethnic networks. Yet in some pockets of modern commerce, pre-modern forms of organization remain the norm.

I call these pockets "Stateless Commerce" because they do not rely on the modern state for support. Noted economist Avinash Dixit—one of several prominent scholars who have become interested in commercial networks that rely on personal exchange—has described this kind of economic organization as "lawless," but I think "stateless" is a more accurate term. The distinction between this commerce and conventional commerce is not the absence of law, since law is very much present in stateless industries: Promises made in personal commercial contexts are legally enforceable, theft is punishable, and parties injured by tortious conduct have a legitimate legal claim. What makes these merchant communities unusual is that members do not enforce these legal claims with state-sponsored instruments. Whereas most industries rely on courts, governmental authorities, and other instruments of the state to enforce contracts, secure property rights, provide regulatory certainty, and preserve the value of financial assets, these industries reject state instruments and instead use private substitutes. Rather than relying on courts and judges to adjudicate disputes, merchants in these industries turn to local and community leaders to resolve disagreements. Rather than relying on state sponsored public servants—policemen and court marshals—to enforce contracts or deter illegal conduct, merchants in these industries orchestrate and implement their own punishments.

The diamond industry is a paradigmatic stateless industry in that the industry rejects wholesale any use of modern legal instruments to resolve disputes—in fact, as is explained in Chapter 2, diamond merchants who invoke the state by filing suits in state courts or seeking other public instruments are deemed to have transgressed an important industry norm. The industry also presents a colorful example of how ethnic trading networks serve the functions that are usually filled by modern state institutions. Focusing on this concrete case study offers an opportunity to examine in great detail the social conventions, industry institutions, community forces, and economic pressures that enable stateless commerce.

The Book's Thesis: Comparative Institutional Advantages

The persistence of stateless commerce poses a challenge to the conventional wisdom—shared by policymakers, economic historians, and probably all shades of academics—that modern legal institutions are a necessary component in the path to prosperity. State-sponsored courts, specifically, play an important role in this standard narrative of economic history. Because public courts can secure transactions between "impersonal" transactors and open markets to new merchants and new ideas, many theories of economic development credit courts for laying a foundation to economic growth. Conversely, personal exchange is associated with primitive, pre-legal societies that are limited in their capacity to create wealth.

In spite of rejecting the very institutions that receive credit for building modern economic development, stateless commerce continues to thrive in the modern economy, and several stateless networks even maintain strangleholds over entire segments of commerce. Their persistence raises two puzzles. The first is the more obvious conundrum: why do these industries retain pre-modern modes of organization when the rest of the world has embraced, and relies upon, modern state-sponsored instruments to support commercial exchange? If market and evolutionary forces favor instruments that offer more efficient economic institutions, why does this pocket of economic activity continue to resort to pre-modern instruments that most of the world has long abandoned? The second puzzle is a converse of the first: if these ethnic economic networks thrive in the modern economy, why do they not dominate a larger portion of modern commerce? If their method of economic organization has withstood all economic and evolutionary forces, why has it not dominated other methods of organization?

This book explains both the persistence of and the limits to stateless commerce with a very simple argument: for certain kinds of commercial transactions, personal exchange remains superior to court-supported impersonal exchange, and for certain industries, pre-modern mechanisms remain superior to our modern institutions. This argument piggybacks off the key insight in Ronald Coase's 1937 paper that launched institutional economics. Coase asked why certain transactions are organized inside firms and others within markets; this book asks why certain transactions governed by personal exchange and others by state-sponsored institutions. Both questions suggest that there are both virtues and limits to different kinds of economic organization. Therefore, the endurance of commerce that does not require support from public courts—and remains structured much as it was in pre-modern times—suggests that there are meaningful limitations to what our modern public institutions can do.

Overview of the Book

As is noted above, this book begins with asking _what_ is going on here, and then proceeds to ask _why_ it is going on. It thus begins with a detailed empirical examination of the diamond industry—its particular industry rules, its customary norms, and the elaborate mix of commercial and community institutions that structure the industry—and then inductively extracts some theoretical arguments. Chapter One presents an overview of the diamond industry, tracing a diamond's long, global, and multi-step path from its mining from the ground to its purchase by a jewelry manufacturer. It also recounts the long history of Jewish diamond merchants, who have played a leading (but not exclusive) role in the industry for nearly one millennium. Domination by ethnically homogeneous merchant communities is both a salient characteristic of today's industry and a persistent feature of the industry over centuries.

Chapter Two then elaborates on the industry's structure and describes how diamond merchants manage to enforce contracts and secure credit sales without relying on state support. It begins by examining the features of a typical diamond transaction and it paves the groundwork to one of the book's foundational arguments: the unusual organization of the entire industry is a natural consequence of the particular challenges of a conventional diamond sale. Nearly all of the remainder of the book flows this microanalytic understanding of the diamond transaction. Chapter Two then provides an in-depth description of New York's Jewish diamond merchants and focuses on how family, religious, and community institutions support economic exchange. It explains how the industry has managed to remain stateless into the Twenty-First Century.

Chapters Three and Four offer a theoretical framework with which to understand the diamond industry. Chapter Three reviews the academic literature that describes the many communities that self-enforce agreements, and it examines the diamond industry within the context of these related case studies. It distinguishes among the various mechanisms, identifies important characteristics that vary across the assorted case studies, and offers a framework to understand the literature's assorted enforcement mechanisms. This chapter lays the groundwork for Chapter Four, which constitutes the heart of the book's theoretical contribution. This chapter offers a positive theory of statelessness that predicts when industries and merchants will opt for personal exchange and private contract enforcement, even when state-sponsored courts are available. It will also explain why the diamond industry is one such industry that relies exclusively on private ordering.

Chapters Five through Seven then explore the implications of the empirics in Chapters One and Two and the theory articulated in Chapters Three and Four. Chapter Five describes certain economic downsides to statelessness and, as an illustration, documents both the inefficiencies that currently plague New York's system of private enforcement and the current struggles to modernize the diamond industry. Chapter Six describes what might be called the dark side of statelessness and reports how the very institutions that support the diamond trade also support transactions that courts have intentionally refused to enforce. Chapter Seven explores how the pre-legal organization of ethnic commercial networks has interfaced with globalizing commerce. It explores the role that ethnic trading networks play in facilitating globalization and, conversely, the effects globalization has had on ethnic trading networks. Chapter Eight then concludes, observing that the diamond exchanges and many generations-old merchant families find themselves at a crossroads that might lead to significant changes to the industry's millennia-old structure.

…..