Why the Middle East Became Economically Underdeveloped: Historical Role of Islamic Law

Timur Kuran

Iznik tile, 1575  Garner Museum
Industrial Revolution

18th-19th c.: Technologies of mass production emerged in W. Europe ....
Industrial Revolution

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... which possessed the organizational means to exploit them.
Industrial Revolution

18th-19th c.: Technologies of mass production emerged in W. Europe ....

... which possessed the organizational means to exploit them.

Middle East lacked organizational capabilities to use new technologies.
Lack of industrialization in Middle East

Physical technologies are easily transferable, organizational capabilities are not.
First modern Ottoman company

Şirket-i Hayriye (“Auspicious Company”), 1851.
First modern Ottoman company

Şirket-i Hayriye ("Auspicious Company"), 1851.

- Joint-stock company ("kumpaniye")
- 1500 shares
- Predominantly Muslim-owned
- Largest shareholder: Sultan Abdülmecit

Abdülmecit, Ottoman Sultan (1823-61)

A Şirket-i Hayriye passenger ship
Abdülmecit’s motive

Through Şirket-i Hayriye, Abdülmecit tried to break a vicious circle that kept Muslim businesses minuscule.
## Basic organizational forms

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<td>Can outlive owners and managers. Can sue and be sued. Shareholders have limited liability.</td>
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Publicly traded Ottoman companies

Source: Akyıldız, *Ottoman Securities*
Commercial partnerships, c. 1000 (1)

Mudaraba (type of partnership)
- labor of merchant or producer + capital of passive investor

Profit shares negotiated freely in advance

Losses shared up to a point
- investors had limited liability

Judge’s decision on a partnership dispute: Galata (1682)
Commercial partnerships, c. 1000 (2)

Mudaraba (type of partnership)
- labor of merchant or producer +
  capital of passive investor

Profit shares negotiated freely in advance

Losses shared up to a point
- investors had limited liability

Contracts enforceable over vast area

Source: Chaudhuri, *Trade and Civilisation in the Indian Ocean*
Commercial partnerships, c. 1000 (3)

Mudaraba (type of partnership)
- labor of merchant or producer + capital of passive investor

Profit shares negotiated freely in advance

Losses shared up to a point
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Contracts enforceable over vast area

Similar partnership form in W. Europe: commenda
Scale, longevity

No limit on number of partners or duration

In practice,

- usually 2
- enterprise limited to single trade mission / production project
Partnerships in Istanbul, 17\textsuperscript{th} century

No statistically significant difference between distributions in two halves of the century.
Recontracting

• Recontracting possible
• Partnership not a durable enterprise
  ➢ If a partner dies, partnership ends, his assets pass to heirs
Islamic inheritance system

• At least 2/3 of estate reserved for extended relatives
• Female share = $\frac{1}{2} \text{ (male share)}$
Islamic inheritance system

• At least 2/3 of estate reserved for extended relatives
• Female share = ½ (male share)
• Hinders keeping property intact over generations
  ➢ Heirs could reconstitute a dissolved business, but cost rose with numbers
  ➢ Probability of fragmentation greatest for most successful merchants
    ▪ Multiple wives ➔ more children ➔ more heirs
Choice of size, longevity

- Risk of premature dissolution rises with
  - Partnership size
  - Anticipated duration of partnership mission
- Merchants and investors minimized risk by keeping partnerships small, ephemeral
Choice of size, longevity

• Risk of premature dissolution rises with
  ➢ Partnership size
  ➢ Anticipated duration of partnership mission

• Merchants and investors minimized risk by keeping partnerships small, ephemeral

• Same threat to continuity in W. Europe

• Variety of inheritance laws
  ➢ Primogeniture: business falls to oldest son

• Enterprise continuity through side-agreements
Effects on organizational development

• Stagnation in enterprise size
• No need to improve organizational techniques, develop new occupations
  ➢ No standardized accounting
  ➢ No stock markets
Effects on organizational development

• Stagnation in enterprise size
• No need to improve organizational techniques, develop new occupations
  ➢ No standardized accounting
  ➢ No stock markets
  ➢ Stagnant division of labor in commerce, finance
## Distinct occupations in Arab Middle East

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<th>8(^{th})-11(^{th}) c.</th>
<th>12(^{th})-15(^{th}) c.</th>
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Division of labor lags in commerce at 99.9% level of statistical significance
New occupations in Arab Middle East, 1101-1500

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<th>% new</th>
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<td>Commerce</td>
<td>50.9</td>
<td>49.1</td>
</tr>
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<td>10.9</td>
<td>89.1</td>
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<td>75.3</td>
</tr>
<tr>
<td>ALL</td>
<td>24.7</td>
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Data: Shatzmiller, Labor in the Medieval Islamic World (1994)

Commerce least innovative part of economic system at 99.9% level of statistical significance
The onset of underdevelopment

A. Commerce between Middle East and Europe fell under control of Westerners
B. As West industrialized, Middle East could not exploit new technologies
The onset of underdevelopment

A. Commerce between Middle East and Europe fell increasingly under control of Westerners
B. As West industrialized, Middle East could not exploit new technologies

Organizational forms could not be borrowed, because complementary institutions were lacking

- Firms require modern bookkeeping
- Capital limited in absence of stock markets, banks
Alternative path to organizational modernization?

Differences in inheritance systems \(\Rightarrow\) Delayed organizational development in Middle East
Alternative path to organizational modernization?

Differences in inheritance systems ➔ Delayed organizational development in Middle East

Middle East might have developed large and durable organizations suitable to modern commercial life through a distinct path.
Rise of the waqf and the corporation

Western Europe

Emergence of modern economic organizations

- Roman church declares itself a corporation: 1100s
- First business corporations: 1600s

Early corporations

- 527-65: Justinian
- 622-32: Muhammad’s rule at Medina
- 700-900: Waqf emerges

Middle East

Development of Islamic law

c. 1900: Corporation enters local legal systems
Waqf

Unincorporated trust founded by an individual through conversion of immoveable property into an endowment to finance a designated service in perpetuity.

Principal vehicle for providing social services, including those provided in West through corporations

Al Azhar College and Congregational Mosque (975)
Oxford University (1096), All Souls College
Possible services

• Anything allowed under Islamic law
  
  Mosque, school, hospital, lighthouse, ....

• Permitted private provision of public goods now commonly supplied by governments

Karl Streit (1874), Sabil [Drinking fountain], Abou Nabout Courtyard, Jaffa
Medrese (college) of Çoban Mustafa Paşa, Gebze, Turkey (1524).

Financed by a waqf.
Rear: Medrese [College] of Ahmet I (1610) / Front: Haseki Sultan bathhouse (1540s), Istanbul

Photo: Rossi
Sarı Han, Kayseri, Turkey (1238)
Caravanserai of Zazadin (Konya, Turkey), 1237.
Charitable complex (külliye) of Seyyit Battal Gazi, Eskişehir, Turkey (1208): Built and financed through a waqf
Origins of waqf

• Earliest evidence: 8th c.
• Private property insecure
  ➢ During fiscal crises, expropriations & new taxes
• Property holders sought wealth shelter
  ➢ Richest people were high officials
• Older civilizations had developed forms of trust
• Creative response to weak property rights
Sacredness of waqf

Waqf assets considered sacred
→ Rulers unlikely to confiscate its assets
→ People endow waqfs to protect property
Material advantages

- Founder of a waqf could appoint him/herself as its manager for life
- Manager empowered to
  - set own salary
  - make appointments
  - designate successor
- Endowed assets could be used to circumvent inheritance law
Broad benefits

- Wealthy obtained material security
- State did not have to supply public goods
- Local needs served at low cost

Detail of water fountain, Cairo
Organizational consequences over long run

• Corporate characteristic
  ➢ Could outlive its beneficiaries

Caravanserai of Aksaray (Turkey), 1229. Financed by a waqf for use by merchants.
Organizational consequences over long run

- **Corporate characteristic**
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- **Static organization**
  - Not self-governing
  - Not profit maximizing
  - Courts enforce waqf deed
  - Vested interests
  - Prone to becoming dysfunctional

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- Wealth-sheltering function sucked capital out of commercial sector

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Lack of demand for business corporation (c. 1000-1850)

- Corporate form could have been borrowed from abroad, invented
Lack of demand for business corporation (c. 1000-1850)

• Corporate form could have been borrowed from abroad, invented

• Critical institutional ingredients lacking
  - Persistently small partnerships, due to inheritance law
  - No standardized accounting
  - No stock markets
  - Legal system unaccustomed to legal personhood
Beginnings of divergence (c. 700-900)

Codification of Roman Law by Justinian (560), Nebraska State Capitol, outer wall

**West** Corporations proliferate to provide order in face of weak states

**Middle East** Waqfs proliferate as protection against strong states
The beginnings of re-convergence

- 19th c.: New urban services supplied through municipalities with corporate powers rather than waqfs

**Waqfs:** Resources used as specified by founders

**Municipalities:**
- Can devise own budgets
- Impose ordinances
- Reallocate resources
- Impose / change fees
Attitudes toward innovation

• Region not opposed to innovation per se
  ➢ As commercial organization stagnated,
    ▪ government organization evolved
    ▪ tax system evolved

• Islamic institutions not inherently static

• Stagnation in commerce was an *unintended* consequence of early institutions
Islam and commerce

• Islam not inherently hostile to commerce and enterprise
• Founder was a merchant
• Inheritance system contributed to underdevelopment as an unintended consequence
Summary

Large, long-lasting, and self-governing private organizations are critical to success in a modern economy.

In the Middle East they failed to emerge indigenously because:

1. Inheritance and marriage laws created incentives to keep partnerships small
2. Islamic law designed as individualistic, with no room for corporations
3. Public services organized as waqfs, which lacked self-governance, sucked capital out of commercial sector, and were prone to becoming dysfunctional.