

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

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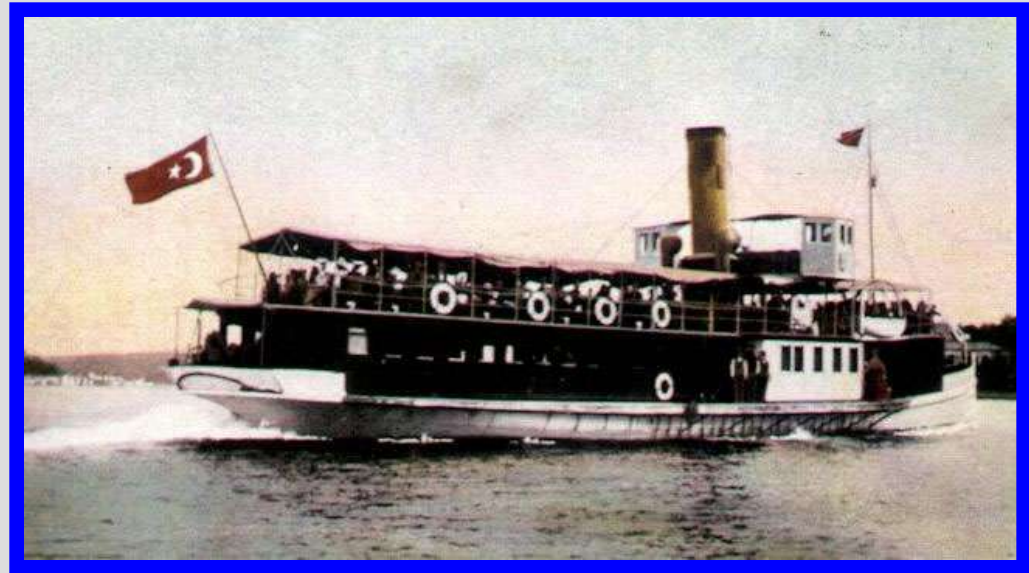
Middle East lacked organizational capabilities to use new technologies.

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.



A Şirket-i Hayriye passenger ship

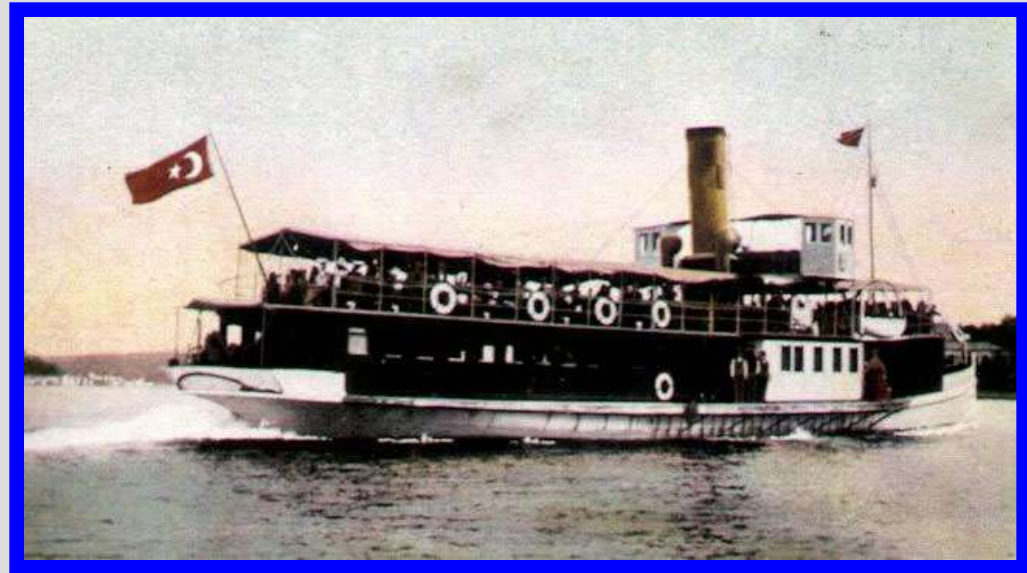
First modern Ottoman company

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.

Şirket-i Hayriye ships
Istanbul
(1890)



Basic organizational forms

Form of organization	Shares tradable	Legal person	Usual characteristics
Partnership	No	No	Minority has veto power. Suitable to small, short-lived ventures.

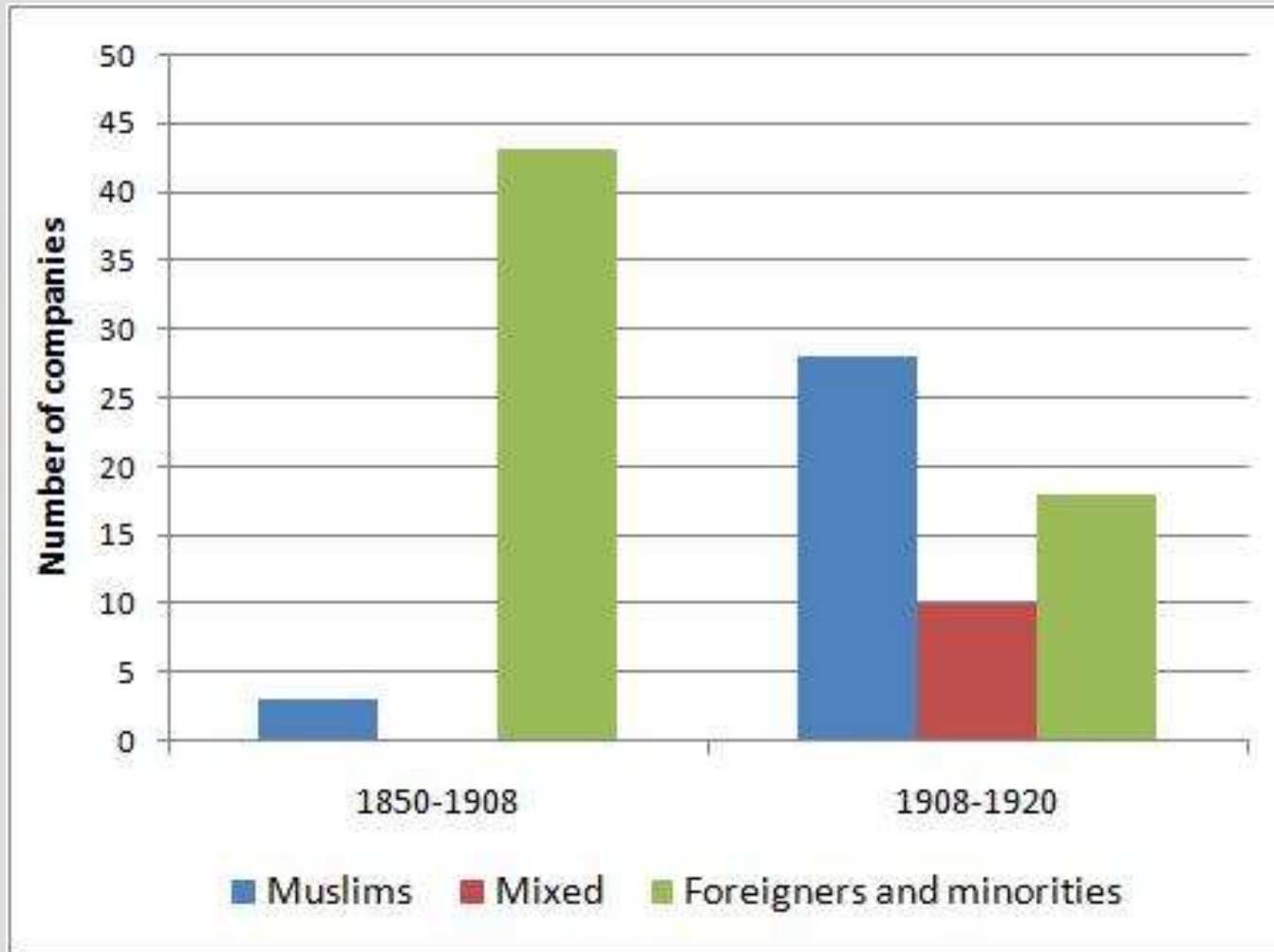
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Corporation	Yes	Yes	Can outlive owners and managers. Can sue and be sued. Shareholders have limited liability.

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)

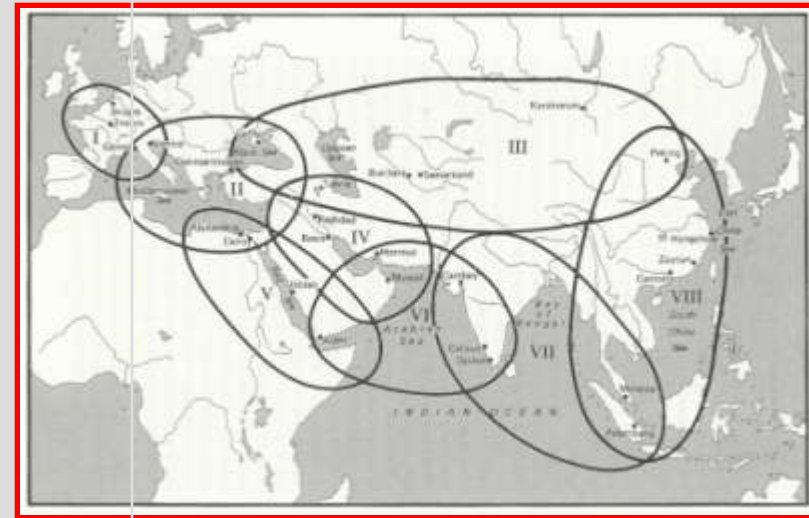
- labor of merchant or producer + capital of passive investor

Profit shares negotiated freely in advance

Losses shared up to a point

- investors had limited liability

Contracts enforceable over vast area



Eight major trade circuits of the world, 1300s

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

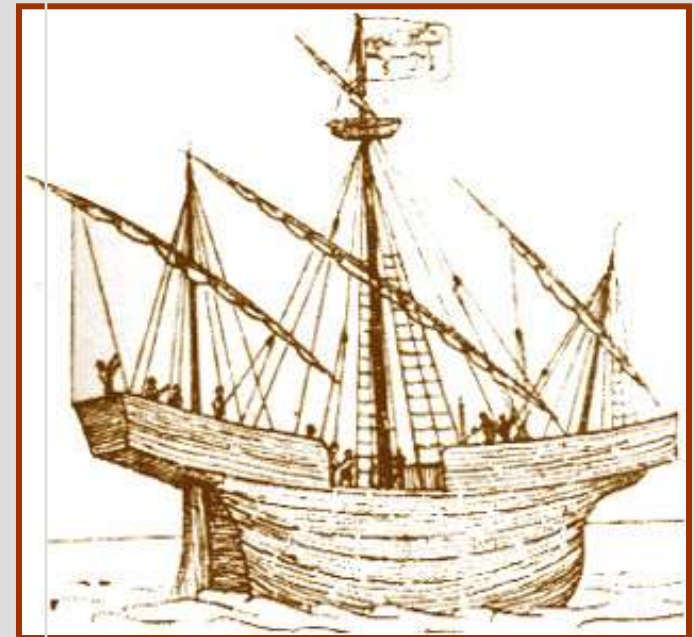
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Similar partnership form in W. Europe: commenda



Medieval ship

Scale, longevity

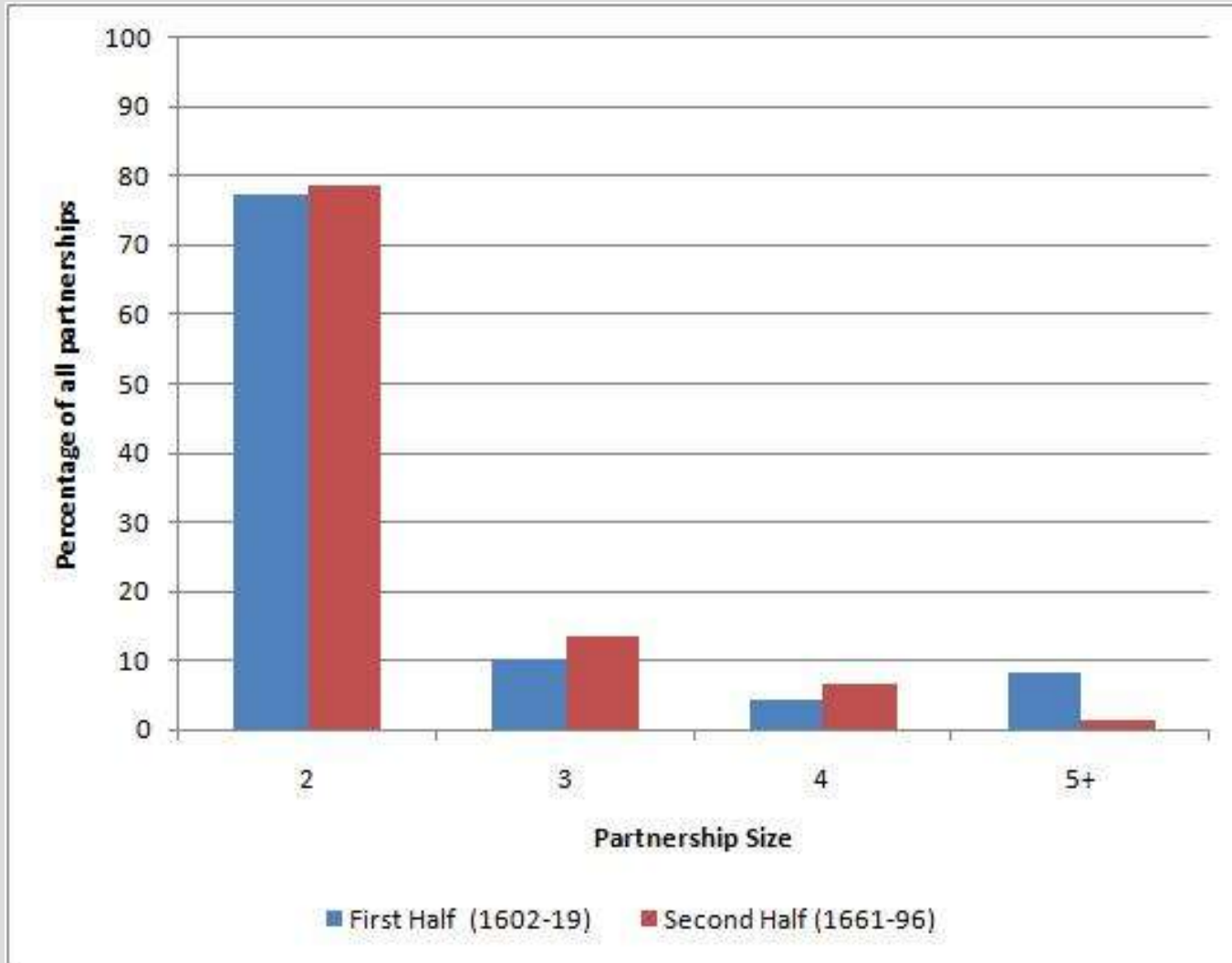
No limit on number of partners or duration

In practice,

- usually 2
- enterprise limited to single trade mission / production project



Partnerships in Istanbul, 17th 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 $\frac{2}{3}$ of estate reserved for extended relatives
- Female share = $\frac{1}{2}$ (male share)

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- Female share = $\frac{1}{2}$ (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

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 - Partnership size
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- 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
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 - Stagnant division of labor in commerce, finance

Distinct occupations in Arab Middle East

Sectors	8 th -11 th c.	12 th -15 th c.
Commerce		
Bureaucracy, military	97	303
Education, law, religion	33	180

Data: Shatzmiller,
*Labor in the
Medieval Islamic
World* (1994)

Distinct occupations in Arab Middle East

Sectors	701-1100	1101-1500
Commerce	233	220
Bureaucracy, military	97	303
Education, law, religion	33	180

Data: Shatzmiller,
*Labor in the
Medieval Islamic
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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

Sectors	% pre-existing	% new
Commerce	50.9	49.1
Bureaucracy, military	10.9	89.1
Education, law, religion	16.1	75.3
ALL	24.7	75.3

Data: Shatzmiller,
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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 → Delayed organizational development in Middle East

Alternative path to organizational modernization?

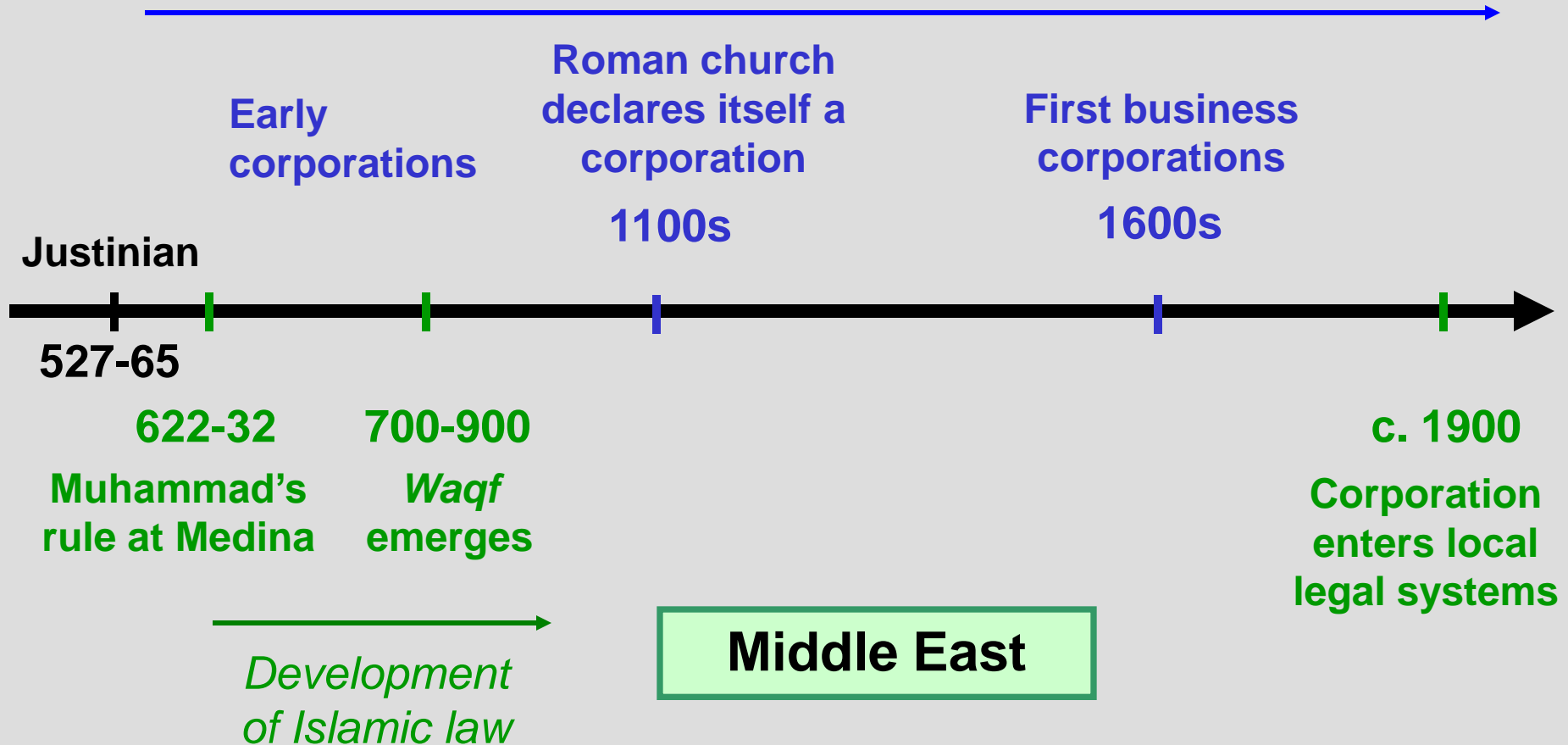
Differences in inheritance systems → Delayed organizational development in Middle East

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



Waqf

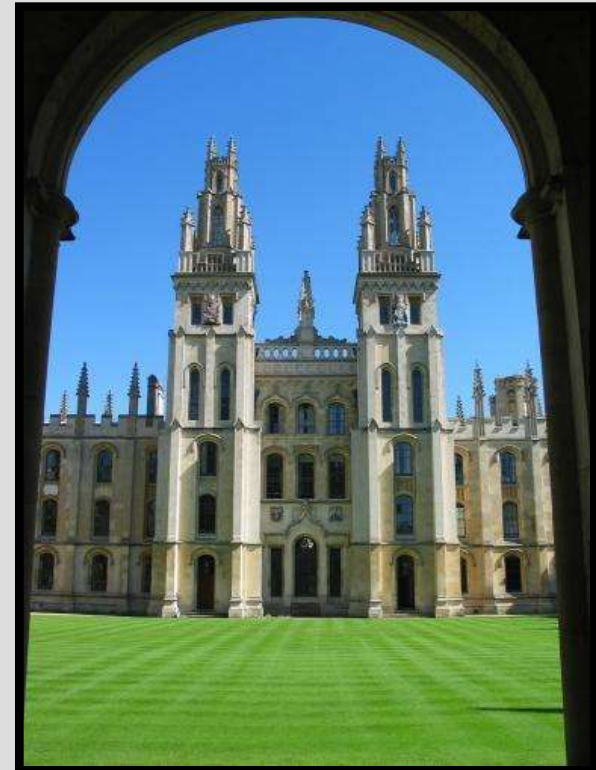
Unincorporated trust founded **by an individual** through conversion of immoveable property into an endowment to finance **a designated service in perpetuity**.

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

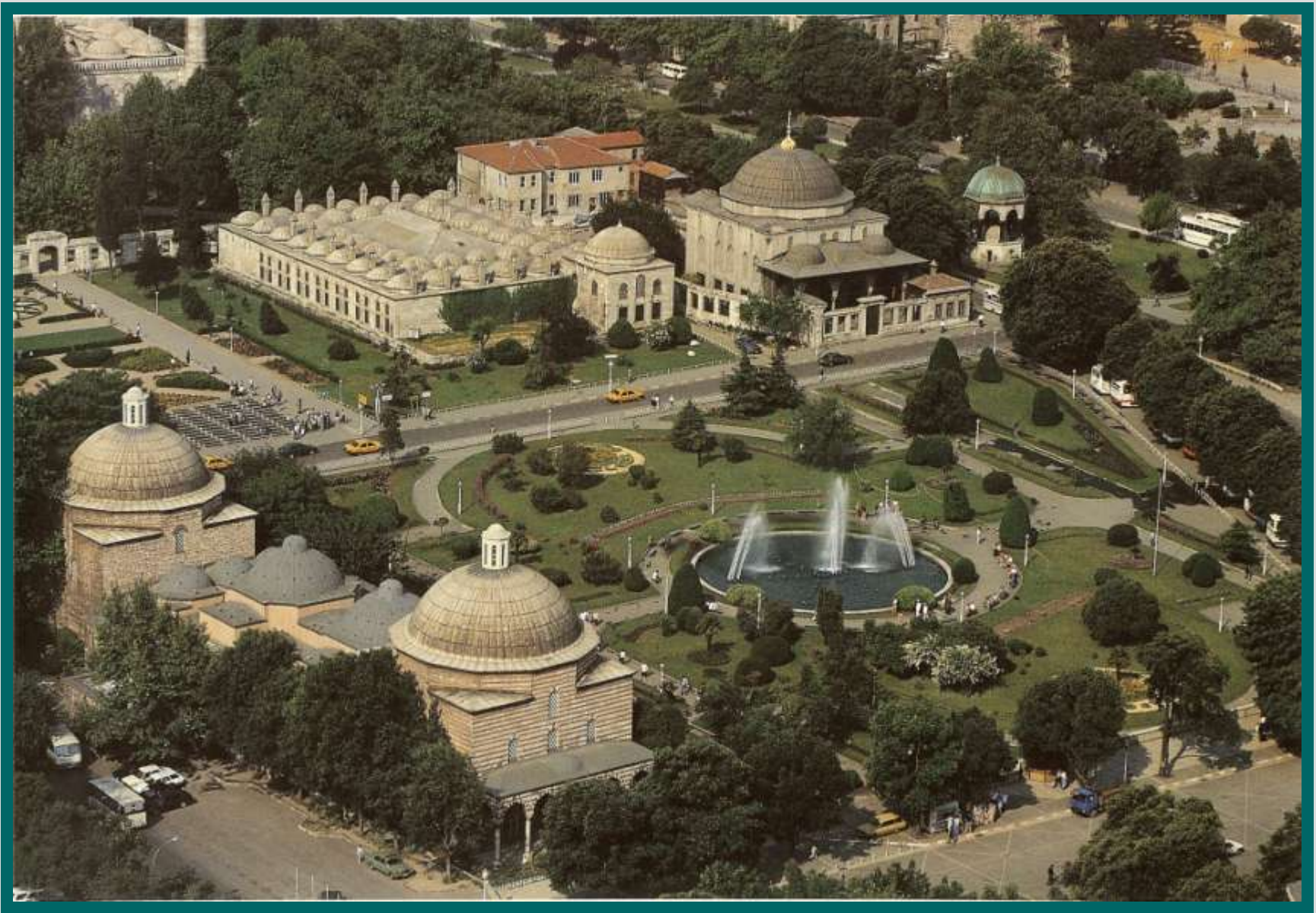


Karl Streit (1874), Sabil [*Drinking fountain*],
Abou Nabout Courtyard, Jaffa

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



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

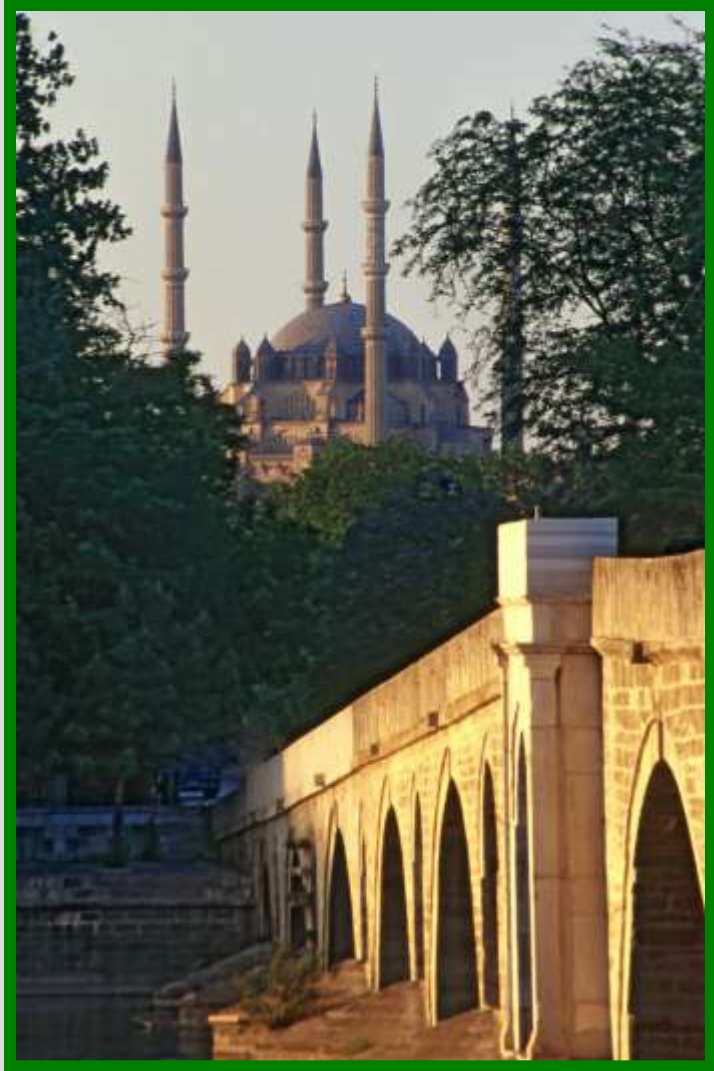
Sacredness of waqf

Waqf assets considered sacred

→ Rulers unlikely to confiscate its assets

→ People endow waqfs to protect property

Material advantages



Selimiye mosque and bridge,
Edirne, Turkey (16th c.)

- 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

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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

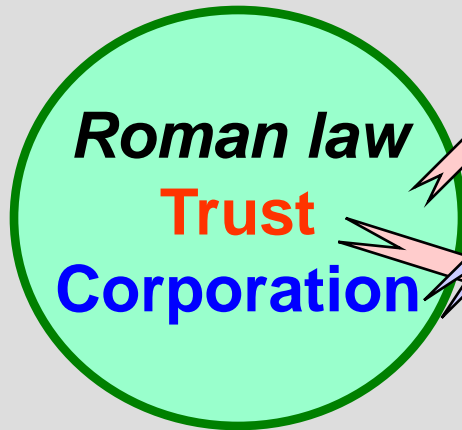
Lack of demand for business corporation (c. 1000-1850)

- 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 (529),
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

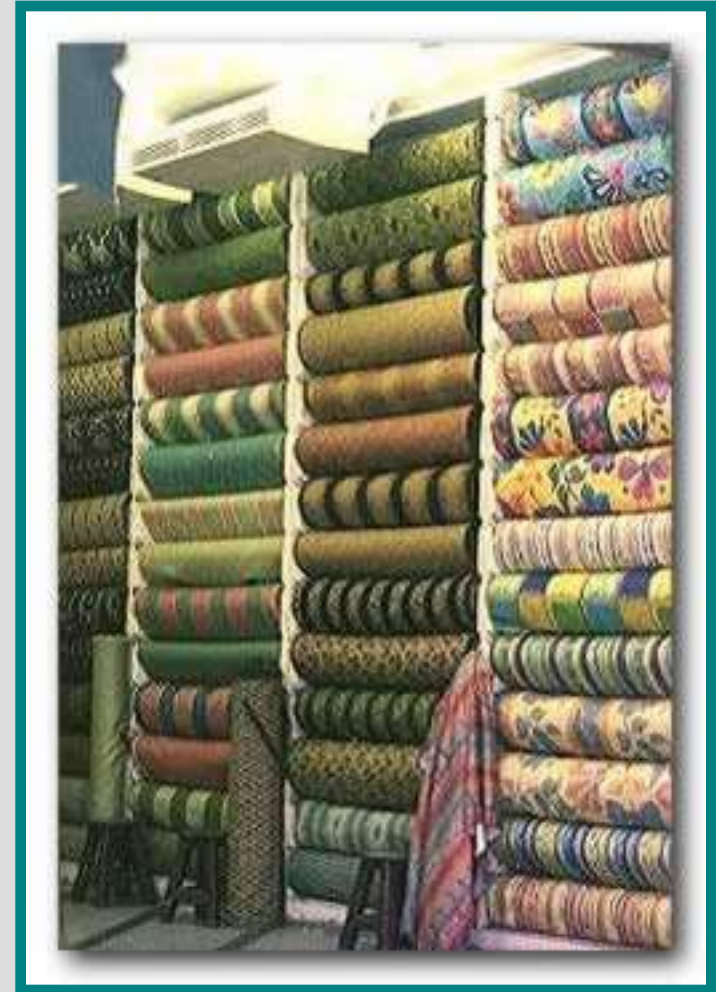


Topkapı
Palace,
Istanbul,
seat of
Ottoman
sultans
until 18th c.

- 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



Al-Balah market, Cairo, Egypt

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.