Legal Roots of Economic Underdevelopment in the Middle East

By Timur Kuran

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One of the great puzzles of world history is that the Middle East became an economically underdeveloped region. As late as the seventeenth century, Europeans marveled at its grand bazaars. They did not consider the region's economic system, which was based in important ways on Islam, inimical to wealth creation. It is in the late eighteenth century, as the Industrial Revolution gathered steam, that the region began to appear relatively poor. By then western Europe was growing much faster. The gap in living standards subsequently widened.

Now it is commonly believed that Islam held back the Middle East by discouraging commerce and innovation. Yet in the Middle Ages the Middle East was remarkably hospitable to merchants. Its businessmen dominated commerce with most neighboring regions. In Africa and Asia, millions of conversions occurred to benefit from Islam's commercial infrastructure. Nor did the Middle East ever close itself off to innovation. In the millennium preceding the Industrial Revolution its tax systems and governance structures changed repeatedly. What made the region fall behind the West is not conservatism or hostility to commerce. Rather, its traditional institutions failed to generate incentives for organizational innovation in the private economy. From the Middle Ages to modern times, the Middle East's commercial system remained unchanged because its merchants, producers, and investors lacked reasons to demand the changes that would have laid the foundations for an industrial economy.

The Industrial Revolution involved mass production, using new technologies. Western Europe had already developed the organizational means to undertake mass production. Its enterprises could mobilize the savings of large numbers and channel them into large investments within indefinitely living companies. Although these capabilities are now taken for granted, they posed immense challenges in the Middle East. Whereas the new physical technologies could easily be carried across continents, the organizational means that enabled the West to use new technologies efficiently could not be transferred at will. A stock market requires a legal system suited to complex business arrangements, various supportive professions, and schools to train the professionals. As the West industrialized, the Middle East lacked a legal infrastructure capable of supporting large and long-lasting companies.

Even in the 1850s, Middle Eastern investors financed merchants and producers through Islamic partnerships that had not changed form since around 1000. Islamic law, until modern times the law of the land in the Middle East, did not limit partnership size or duration. In practice, however, the number of partners who contributed labor or capital was usually two and rarely exceeded six. And typically the expected duration of the resulting enterprise was very short. An Islamic partnership was not a corporation—a company enjoying legal standing and a life of its own. Under Islamic law, if a partner died before completion of the contracted mission, the partnership's assets had to be liquidated and the deceased partner's assets distributed to his heirs.

A cooperative enterprise interrupted by a death could be reconstituted, of course, by the surviving partners and the dead partner's heirs. However, the Islamic inheritance system made this unlikely. According to the Quran, Islam's holy book, two-thirds of any estate are reserved for relatives, male and female. This rule made it difficult to keep successful businesses intact across generations. Middle Eastern entrepreneurs minimized the risk of premature termination by keeping their partnerships small and ephemeral.

Early in the second millennium essentially the same partnerships were used in Western Europe. But unlike the Quran, the Bible does not specify an inheritance system, and that made a huge difference by allowing flexibility in the transmission of commercial wealth across generations. In the regions that would industrialize first, a popular inheritance

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system was primogeniture, under which a dead businessman's property falls to his oldest son. Primogeniture dampened the risk of terminating a partnership prematurely, because a new partnership could be reconstituted easily.

The differences between inheritance practices in the two regions had enormous implications for institutional development through time. In Europe, where businesses expanded and gained longevity, pressures arose to invent more advanced organizational forms and business techniques. Standardized accounting, joint-stock companies, banks, stock markets, and a business press developed to address problems of communication and coordination that arise as business scale grows. In the Middle East such innovations failed to occur because the need was not felt.

We now see why the Middle East became underdeveloped precisely when technological developments made it optimal to deploy modern forms of pooling labor and capital. As the West established enterprises with thousands of employees and shareholders, the Middle East lacked the organizational means to compete.

Another prominent Islamic institution that retarded the region's economic development is the waqf, an unincorporated trust established by an individual to provide a service in perpetuity. Before the modern era a vast number of Middle Eastern public services were financed through waqfs, including many services now commonly provided through governments. Individuals poured assets into waqfs because of a widespread belief that converting assets into waqf property made the assets sacred and, hence, protected against confiscation. The founder of a waqf could appoint himself as its caretaker for life; in this capacity he would set his own salary, make appointments, and designate his successor. His family benefited from these privileges, as did his descendants.

For all its benefits to founders and to society at large, the waqf had drawbacks, which became increasingly serious over time. Its organization and its functions were both meant to be unchangeable. Hence, as conditions changed over time its usefulness would tend to diminish. In the 18th and 19th centuries, as western economies started reallocating resources to exploit new technologies, the waqfs of the Middle East became conspicuously dysfunctional. Yet waqf resources could not be transferred quickly to new waqfs. The West escaped the consequent problems because it used the corporation, a self-governing and thus flexible organization, to provide services supplied in the Middle East through waqfs. European universities were organized as corporations; their Middle Eastern equivalents, the madrasas, were established as waqfs.

Beginning in the mid-19th century Middle Eastern state launched reforms to jump-start economic modernization. Invariably the reforms involved the imposition of secular legal systems. The Ottoman Empire, Iran, and Egypt instituted laws of corporations and contracts, municipalities, and stock markets, usually without even lip service to Islamic principles. The reforms were welcomed by people who grasped that classical Islamic institutions, whatever their historical successes, had outlived their economic usefulness.

Those fundamental reforms now enjoy wide acceptance. Even in Saudi Arabia, where Islamic law remains the law of the land, commercial institutions of western provenance have been absorbed into the indigenous legal culture. Various transplanted institutions seem acceptable even to Islamists, who say that they want to base the social order on Islam. So if the region remains underdeveloped, the cause is not that institutions critical to industrial production and modern economic life are still lacking.

Nevertheless, the region's institutional past remains relevant to the present. The Middle East's participation in global commerce is limited outside of oil, partly because it entered the 20th century with institutionally handicapped and relatively undercapitalized private economic sectors. The region's institutional history is responsible also for the weaknesses of its civil societies. For all its economic resources, the waqf sector did not serve as a vehicle for decentralized political participation. Its very existence blocked the development of a tradition of self-governing organizations outside the state, which is essential to a strong civil society. That is one reason why the region is governed largely by autocracies.

Both problems of the contemporary Middle East–weak private sectors and weak civil societies–are unintended consequences of the Islam's traditional legal system, which achieved its classical form in the Middle Ages.

About the author

Timur Kuran is Professor of Economics and Political Science, and Gorter Family Professor of Islamic Studies at Duke University. He is a leading authority on the economics of the Middle East. His publications include *Islam and Mammon: The Economic Predicaments of Islamism* (Princeton University Press); *The Long Divergence: How Islamic Law Held Back the Middle East* (Princeton University Press); and a ten-volume edited work, *Socio-Economic Life in Seventeenth-century Istanbul: Glimpses from Court Records* (İş Bank Cultural Publications, 2010-11). He is at work on a manuscript focused on how Islamic institutions have shaped political patterns in the Middle East.