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Why the Middle East is Economically Underdeveloped: Historical Mechanisms of Institutional Stagnation

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A millennium ago, around roughly the tenth century, the Middle East was an economically advanced region of the world, as measured by standard of living, technology, agricultural productivity, literacy or institutional creativity. Only China might have been even more developed. Subsequently, however, the Middle East failed to match the institutional transformation through which western Europe vastly increased its capacity to pool resources, coordinate productive activities and conduct exchanges. True, the institutional endowment of the Middle East continued to evolve. But in certain areas central to economic modernization change was minimal, at least in relation to the structural transformation of the West and, for that matter, the Middle East's own evolution during the early Islamic centuries. In eighteenth-century Cairo, credit practices hardly differed from those of the tenth century. Likewise, investors and traders were using enterprise forms essentially identical to those prevalent eight centuries earlier. By the nineteenth century, the entire Middle East was clearly "underdeveloped" relative to western Europe and its offshoots in the new world; and by the twenty-first century, it had fallen markedly behind parts of the Far East as well.

This essay offers reasons why the Middle East became underdeveloped. In particular, it points to certain Middle Eastern institutions, including ones rooted in the region's dominant religion, as past and in some cases also continuing obstacles to economic development. The institutions that generated evolutionary bottlenecks include: 1) the Islamic law of inheritance, which inhibited capital accumulation; 2) the strict individualism of Islamic law and its lack of a concept of corporation, which hindered organizational development and contributed to keeping civil society weak; and 3) the waqf, Islam's distinct form of trust, which locked vast

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resources into organizations likely to become dysfunctional over time. These institutions did not pose economic disadvantages at the time of their emergence. Nor did they ever cause an absolute decline in economic activity. They turned into handicaps by perpetuating themselves during the long period when the West developed the institutions of the modern economy.

Beginning in the eighteenth century, the Middle East's indigenous Christians and Jews came increasingly to dominate the most lucrative sectors of the local economy. They did so through the choice of law to which they had been entitled since the dawn of Islam. By exercising their choice of law in favor of modern legal systems of the West, they were able to escape the limitations of Islamic economic institutions. Especially in new economic sectors, including banking and insurance, they became decidedly more competitive than the region's Muslims, who lacked choice of law. Muslims began overcoming Islam's legal obstacles to economic development largely through secularizing legal reforms launched from the mid-nineteenth century onward. Until those reforms, Muslims were required to conduct commerce and finance under Islamic law.

In spite of a long string of institutional reforms over the past century and a half, traditional Islamic institutions remain a factor in the Middle East's economic backwardness. For example, weaknesses of the region's private economic sectors and their deficiencies of human capital are rooted in applications of Islamic law. Nothing in this essay implies, however, that Islam is *inherently* incompatible with economic growth, innovation or progress. If the Middle East failed to develop modern economic institutions on its own and was forced to transplant them from abroad, this was not because Islam expressly blocked economic advancement, but because of unintended interactions among Islamic institutions designed to serve laudable economic objectives, such as efficiency and equity.

The term "Middle East" admits many definitions. In the historical sweep of this paper, I am using it in a broad and elastic sense, to comprise not only the entire Arab world and Iran, but also Turkey, along with the Balkan peninsula, which was under Turkish rule during much of the period of interest. Spain belongs to the region up to the Reconquista—its reversion, by the end of the fifteenth century, from Muslim to Christian control.

The Middle Eastern Economy, c. 1000

Islam's economic institutions did not emerge all at once, during the lifetime of Prophet Muhammad. Key elements were not present in 661, the end of Islam's canonical "age of felicity," which spanned the helmsmanships of Muhammad and his first four successors. Few economic institutions are even mentioned in the Qur'an, let alone described in detail. The distinguishing economic features of classical Islamic civilization evolved over the next three centuries or so, and not until around 1000 were the central economic institutions of the Middle East firmly in place. These institutions were to remain critical to the region's economy up to the nineteenth century. What follows is a deliberately selective account of the region's economic infrastructure around 1000. As we shall see, each of the identified institutions contributed to the observed delay in economic modernization.

Individually Oriented Contract Law

During the first few centuries following the rise of Islam, Islamic law produced a rich set of principles, regulations and procedures to govern contractual relationships. There were rules to support the joint ownership of property. There were also rules to support the pooling of resources for commercial missions. Commercial partnerships established under Islamic law typically involved one sedentary investor who financed a trading mission run by a single traveling merchant. There could be any number of partners, but in practice the number rarely exceeded six. The cooperative enterprise was limited to a single mission. Nevertheless, compared to other legal systems of the time, this legal structure allowed traders and investors abundant flexibility in circumscribing the mission and setting profit shares (Udovitch, 1970; Çizakça, 1996).

To modern eyes, a striking aspect of classical Islamic law is that it provides no room for corporations—collective enterprises possessing legal rights distinct from those of the individuals who finance or serve it. A corporation can make and remake its own internal rules, possess property, make contracts and file legal claims. Its debts are not owed by its members as individuals. Its decisions do not require the approval of each of its members. It can live on after its founders die or retire. Islamic law recognized only flesh-and-blood individuals. Whereas the members of a partnership could sue one another as parties to a contract, their association had no legal standing of its own. A third party could sue one or more partners, but not the partnership itself.

Finance without Banks

At the advent of Islam, money lending was a flourishing pursuit in the Middle East. By one interpretation of the Qur'an, Islam banned the use of interest in loan contracts. However, early Muslims did not achieve a consensus on the scope of this prohibition or even on the definition of "interest." Notwithstanding the persistent controversies, money lending continued, and often it involved transfers recognizable as interest. The jurists of Islam supported credit markets by devising, as in European territories under Christian rule, stratagems that allowed Muslims to circumvent Islam's presumed interest ban without violating its letter (Rodinson, 1966 [1973]).

That interest payments were common does not mean that credit markets resembled those of a modern economy. Uncertainty about the legitimacy of interest, combined with the lack of corporate law, meant that lenders as well as borrowers were usually individuals. Although some loans were provided through small and short-lived partnerships, there were no banks capable of pooling vast resources and of outliving their initial shareholders (Udovitch, 1979).

Arbitrary Taxation and Weak Private Property Rights

Muslim-governed states of the Middle Ages followed two basic principles of governance: provisionism and fiscalism. Provisionism entails an emphasis on securing steady supplies of critical commodities, usually to keep urban populations content. Often it required the encouragement of imports and the discouragement of exports. Fiscalism signifies the relentless drive to extract resources from one's subjects.[1]

Starting with Muhammad, the earliest Muslim statesmen imposed taxes that were defined in relation to commodities known in the economy of Arabia. Within the span of a generation, as Islam spread to areas whose pre-Islamic civilizations were relatively complex—Palestine, Syria, Iraq, Iran—these policies became obsolete. Precedents thus emerged for adjusting tax rates to suit prevailing needs.

In principle, Muslims paid lower taxes than non-Muslims. In practice, since rulers imposed new taxes and fees wherever possible, faith-based tax discrimination was unsystematic, and Muslims did not necessarily receive more lenient treatment. Any community could also endure expropriation and the corvée—the requirement to contribute labor to state-sponsored projects, for example, road building. In times of crisis, rulers often resorted to confiscation and imposed new taxes.

Egalitarian Inheritance System

Of the few economic rules set forth in the Qur'an, the most detailed and most explicit pertain to inheritance. Two-thirds of any estate is reserved according to intricate rules for a list of extended relatives of both sexes, including children, parents, spouse(s), siblings and, under certain circumstances, also more distant relatives. The individual's testamentary powers are limited to one-third of his or her estate. In addition, at least in the Sunni interpretation, no mandated heir may also be included in a will (Fyzee, 1964, chapters 11–13; Powers, 1990).

This inheritance system limited the concentration of wealth. By the same token, it hindered the preservation of successful enterprises, or other assets, across generations. True, one could hold any property undivided by forming a proprietary partnership or having a single heir buy out the rest. Nevertheless, the system's net effect was to fragment property, especially financial wealth.

Private Provision of Public Goods through the Waqf System

Before the modern era, states in the Middle East did not seek to micromanage their economy. They intervened only to pursue limited ends. Nor did they seek major roles in such areas as productivity, sanitation, health, welfare and mass education. By modern standards, they were strikingly disinclined to provide public or semipublic goods. Thus, few of the great mosques, libraries, caravanserais and charitable complexes of the time were financed or built by a state.

[1] These are two of the three principles that Genç (2000, chapters 1–4) identifies as the pillars of economic governance in the Ottoman Empire after it reached maturity. But they apply with equal force to earlier Muslim-governed states. The last of Genç's three principles, conservatism, was not yet an identifiable principle around 1000, which followed a period of sustained institutional innovation.

A vast array of social services, including public and semipublic goods, were supplied through an institution called the waqf, known also as a pious foundation or an Islamic trust. A waqf is an unincorporated trust founded under Islamic law by a person for the provision of a designated service in perpetuity (Çizakça, 2000; Kuran, 2001). One establishes a waqf by turning immovable private property into an endowment to support any social service permissible under Islamic law: a school, a lighthouse, an orphanage, a neighborhood's water supply, a mosque, among innumerable other possibilities. The beneficiaries need not be Muslims. The waqf came to play an increasingly important role in Muslim-governed states. In the memorable words of Marshall Hodgson (1974, p. 124), it became the primary "vehicle for financing Islam as a society." The incentives for founding waqfs were intimately related to certain institutions already presented.

Islam's original institutions did not include the waqf, which the Qur'an does not mention. The waqf was incorporated into Islamic culture a century after the rise of Islam, almost certainly as a creative response to the precariousness of private property rights. The lack of safeguards against opportunistic taxation and expropriation was an enormous source of concern to high officials, many of whom were major landowners. As individuals, they stood to gain from a device to shelter personal assets and enhance the material security of their families. Older civilizations of the eastern Mediterranean had developed various trust-like institutions. From these prototypes, Muslim officials of the eighth and later centuries developed a form of trust suited to their own needs.

Because waqfs were considered sacred, rulers were reluctant to confiscate their assets. Endowing a property as waqf thus gave it substantial immunity against expropriation. But if the founder's goal was to shelter assets for personal or family use, what was gained by converting them into an endowment to finance, say, a soup kitchen? The founder of a waqf enjoyed the privilege of appointing himself—less frequently, herself—its first mutawalli (trustee and manager). The mutawalli of a waqf could pay himself a handsome salary and appoint family members to paid positions. He could also circumvent Islam's inheritance regulations by designating a single child as his successor and disinheriting relatives of his choice. Establishing a waqf was not, then, merely an expression of charity. In addition to enhancing his control over the disposition of his wealth, its founder reduced the risk of losing it all to a revenue-hungry ruler. Could a person found a waqf to support a soup kitchen, and then reserve 99 percent of its revenue for personal use? No formal ceiling existed. Yet the prevailing norms typically required waqf founders to provide meaningful social services.

The waqf system represented, in effect, an implicit bargain between rulers and their wealthy subjects. Rulers made a credible commitment to leave certain property effectively in private hands; in return, waqf founders agreed to supply social services, thus unburdening the state of potential responsibilities. The system was basically decentralized. But rulers used moral suasion to encourage their close relatives and highest officials—two groups that founded most of the largest waqfs—to make choices compatible with the state's strategic objectives. The rule that the designated social service had to be supplied in perpetuity was undoubtedly meant to solve a principal-agent problem. The underlying motive must have been to keep the founder's agents—successive mutawallis—from misusing the resources under their control.

Legal Pluralism

From the early days of Islam in the seventh century, Muslims were required to abide by Islamic law in all spheres of life. On commercial and financial matters, therefore, they had no say over the legal system within which they would operate, except insofar as opportunities existed to switch allegiance between Islam's four major schools of law. By contrast, at least in dealing among themselves, Christian and Jewish subjects could choose among co-existing legal systems; thus, they possessed "choice of law." Mixed cases—ones involving both Muslims and non-Muslims—were under the sole jurisdiction of Islamic courts. Islamic judges, or kadis, had to accept every case brought before them, even those strictly among non-Muslims.

Against this background, consider an investor and a merchant, both of the Greek Orthodox faith. They were free to form partnerships under Islamic law and to have any conflicts resolved in Islamic courts. Unlike Muslims, however, they could opt, alternatively, to use contractual forms prevalent in their own community and have disputes litigated in their own ecclesiastical courts. Indeed, non-Muslims could exercise choice of law both before the stage of contract choice (*ex ante*) and after agreeing to conduct a transaction under one particular law (*ex post*).

Merchants belonging to selected western nations—for example, Venice—enjoyed legal privileges that enhanced their incentives to do business in the eastern Mediterranean. These privileges included security of life and property, tax breaks, exemptions from various tolls and fees, and the right to operate special courts that would handle cases among themselves. Initially, such privileges came with reciprocal entitlements for Muslims.

Comparison with the Medieval West

The foregoing patterns and institutions shaped the course of the Middle East's economic performance over the subsequent millennium. In western Europe, meanwhile, a generally similar, yet distinct, institutional endowment galvanized an extended transformation that culminated in the modern economy. Which elements of the Middle East's initial economic infrastructure differed from their coeval counterparts in the West, and which were functionally similar? Answering these questions will provide vital clues as to why the Middle East lagged in economic modernization.

To start with the similarities, contract law for individuals was essentially identical, and in neither region did the financial sector include banks. In western Europe, as in the Middle East, governments provided few social services. Legal pluralism was the norm in both regions, in each of which courts competed over the supply of legal services. Also shared was the practice of allowing selected foreigners their own legal jurisdictions.

There were also differences. Whereas Islamic law made no allowance for corporate structures, western cities, religious orders and universities were beginning to get organized as corporations (Berman, 1983, pp. 214–221, 239–240). Partly because of this institutional innovation, certain parts of Europe were developing a tradition of limited government, constrained taxation and secure private property. Merchant-dominated city-states, which had a strong interest in rapid economic growth, were emerging and gaining power (DeLong and Shleifer, 1993). Because the Bible does not specify a system for the disposition of estates, inheritance practices were more diverse and variable in the West than in the Middle East. The western trust developed later than the Islamic waqf. In any case, because private property was becoming more secure in western Europe, the incentives for sheltering wealth through a trust were relatively more limited (Kuran, 2001, pp. 876–883).

The consequences for economic performance did not become noticeable immediately. For the better part of the second millennium, the Middle East's institutional endowment afforded it a remarkable level of prosperity. Around 1200, no city in Christian-governed Europe could match the splendors of Baghdad or Seville. When the Turkish Sultan Mehmet II conquered the last remnants of Byzantium in 1453 and declared Istanbul the new capital of his expanding empire, he had the largest, best-supplied and technologically most sophisticated army in Europe—an achievement that would have been impossible if the Middle East were already an economic laggard. Nevertheless, the two regions were already on divergent institutional paths.

Our challenge, then, is to identify the causal mechanisms that contributed to this divergence and, in particular, to the Middle East's structural stagnation. As a prelude to identifying these mechanisms, I shall draw attention to four puzzling inter-regional contrasts of the nineteenth century. The rest of the article links each of these contrasts to initial differences in economic infrastructure.

Four Key Contrasts of the Nineteenth Century

A first contrast is that by the nineteenth century, French, English and other western enterprises established to pursue production or trade were often much larger in size and far more durable than leading enterprises of the Middle East. Established as joint-stock companies or corporations, these enterprises could exploit the economies of scale and scope made possible by new technologies. They also had long time horizons conducive to projects with extended gestation periods. Perpetual financial organizations identifiable as banks were in operation. Joint-stock companies and corporations were being formed through the mobilization of vast resources. Stock markets had been formed, allowing co-owners opportunities for convenient liquidation. The Middle East had not undergone such organizational developments. Although wealthy Middle Easterners invested in production, trade and finance, there were no examples of resource pooling involving mass participation. Pooling on a small scale took place through transient partnerships of the sort common a millennium earlier. There were no stock markets and no banks.

A second salient contrast of the nineteenth century is that the waqf system was failing to supply to the Middle East public services now being provided in the West on a large scale. These included street lighting, piped water, modern sanitation and mass education. The waqf system lacked the flexibility to reallocate its vast resources quickly to meet the emerging demand for these services. Unlike western municipalities and other governmental agencies, which were authorized to tax constituents, change their own budgets and impose new ordinances, the waqf system could not make the necessary adaptations.

Third, at the dawn of the modern global economy there was less material security in the Middle East than in the West. This was not simply a matter of disorder on trade routes. Arbitrary taxation and outright expropriations remained more common in the Middle East, where the state was still considered an extension of the ruler. Bribery was endemic. In the West, there had been successful efforts to make governments respect private property rights, to limit taxation and to curb corruption. Democratic rights had emerged, making governance generally more predictable. Furthermore, because economic growth was more rapid in places where government power was in check, places with relatively secure private property rights had gained social, political and economic importance.

Finally, as the Middle East fell into a state of underdevelopment, west European industrialists, merchants, and financiers came to play a growing role in its economy. In the process, moreover, local Christians and Jews began to register economic advances in relation to the Muslim majority. For example, they came to play highly disproportionate roles in trade with the West, local commerce in the largest cities and the nascent sectors of banking and insurance.

My explanations for these patterns will not presuppose that Islam retarded the Middle East's institutional evolution directly or intentionally. Rather, I shall argue that certain economic institutions of classical Islamic civilization interacted in unintended and unanticipated ways to block adaptations now recognized as critical to economic modernization.

Stagnation of Islamic Contract Law

The main form of commercial partnership used in the Middle East around 1000, the *mudāraba*, served to pool the capital of one or more investors with the labor of one or more traveling merchants. According to Islamic law, the contract became null and void if any partner died before fulfillment of the selected mission. The assets of the partnership then had to be divided among surviving partners and the decedent's heirs. The greater the number of heirs, the lower the capacity to renegotiate a new partnership aimed at completing the initially contracted mission. The prevailing inheritance system mattered, then, to contractual practices. In mandating the division of estates among a potentially very long list of relatives, the Islamic inheritance system created incentives for keeping partnerships small.

In turn, the prevalence of small partnerships kept the Middle East free of various organizational challenges that proved essential to economic development in western Europe. No need arose, for instance, to develop new accounting techniques, to create hierarchical management practices, to address problems of multipolar communication or to search for organizational forms conducive to resource pooling on a large scale. The Islamic inheritance system was designed to fragment wealth for egalitarian reasons, but it had the unintended effect of stifling organizational innovation (Kuran, 2003). At the end of the first millennium, Islamic contract law was admirably adapted to economic conditions of the time. But another Islamic institution limited its ability to spawn increasingly sophisticated enterprise forms.

As Islamic contract law stagnated, western Europe developed a series of new organizational forms capable of accommodating more members. Eventually they included joint-stock companies, which allowed partners to withdraw without requiring the remaining partners to renegotiate, and business corporations, which, in addition, had lives of their own. Around 1000, contract law was substantially the same in western Europe and the Middle East. For example, an Italian or French partnership, like its Islamic analogue, ended with the death of any partner. But the inheritance practices of medieval Europe showed far greater diversity than those of the Middle East, and because the Bible does not prescribe rules for transferring wealth across generations, westerners found it relatively easy to vary inheritance practices in response to changing needs. Certain regions of western Europe adopted primogeniture—the practice of leaving all income-producing wealth, if not the entire estate, to the decedent's oldest son. When a partnership had to be dissolved following a death, primogeniture facilitated the mission's resumption by assigning the deceased partner's share to a single heir. In reducing the risk of channeling resources into large enterprises, western inheritance laws thus strengthened the incentive to form them.

Larger commercial and financial enterprises produced new communication and coordination problems, which then stimulated the development of modern forms and instruments of organization. The ensuing innovations include multidivisional management, standardized accounting, stock markets and shareholder protection measures. The West thus experienced cumulatively revolutionary organizational advances that bypassed the Middle East.

Primogeniture never became the norm throughout western Europe. Precisely because the Bible provides no clear rule on inheritance, a wide variety of systems could be justified by picking and choosing among scriptures (Thirsk, 1976). However, by the sixteenth and seventeenth centuries, when western merchants controlled most of the trade between the Middle East and the West, primogeniture was the dominant inheritance practice in Britain, the Low Countries, Scandinavia and parts of France and Austria—areas that modernized relatively early. Also significant is that in the late seventeenth century the practice spread rapidly in Germany, over just a few decades (Fichtner, 1989, pp. 14–21 and 72–75; Goody, 1983, pp. 118–25; Platteau and Baland, 2001, especially section 3). In any case, none of the major inheritance systems in western Europe defined the family as broadly as the Qur'an does. As a rule, therefore, it proved much easier in the West than in the Middle East to keep assets intact across generations without resorting to devices such as the waqf.

Early in the second millennium, the promoters of primogeniture could not have imagined the institutions of the modern economy. Likewise, the interpreters and enforcers of Islamic inheritance rules could not have foreseen how these would put future merchants and financiers at a disadvantage in their dealings with westerners. Although the two evolutionary paths are intelligible with the benefit of hindsight, each is a by-product of numerous adaptations spread across a millennium. This divergence raises, once again, the question of whether Islam somehow imparted rigidity to economic practices of the Middle East. Nothing in the foregoing account points to rigidity across the board, and we know that in some domains, including taxation, there was remarkable flexibility and ingenuity. What caused Islamic contract law to freeze was inflexibility in one specific domain, namely, inheritance.

Dysfunctional Waqfs

The vast waqf system of the Middle East produced another set of adverse organizational consequences. A requirement of the implicit bargain that produced this system was that a waqf's functions be fixed in perpetuity. Specifically, neither the founder nor any mutawalli would be authorized to alter its mission or form of management. They had to follow the stipulations in the waqf deed to the letter. If the founder had specified the workforce, one could not add new employees to meet a new need; and if a new technology made it optimal to operate on a large scale, small waqfs could not pool their resources through a merger. A related difficulty lay in the lack of corporate status in Islamic law. The traditional waqf was a partial exception, for it could outlive its founder. Unlike a genuine corporation, however, it lacked legal status as an organization.

At least in principle, by freezing the waqf's functions, the state kept the mutawalli from misusing resources; and, for his part, the founder kept successive mutawallis faithful to his initial intentions. In practice, of course, the waqf system was not totally rigid. For one thing, waqf deeds contained ambiguities that allowed mutawallis some discretion. For another, judges empowered to oversee waqfs sometimes looked the other way as mutawallis made modifications. Ordinarily, however, it was difficult, if not impossible, for a waqf to restructure itself or redefine its mission in the face of new opportunities.

In a relatively fixed economic environment—one with unchanging technologies, demand patterns and supply conditions—this obstacle to change may not have been critical. In the rapidly changing economic conditions of the eighteenth and nineteenth centuries, it proved disastrous. Because the waqf system kept resources locked into uses decided centuries earlier, it became dysfunctional (Kuran, 2001).

A glaring manifestation of this inflexibility is the system's slowness in providing new urban services; neighborhoods opted to establish western-style municipalities precisely because of barriers to making the existing waqfs modify their services and procedures.

Everywhere, one might observe, there have existed similar obstacles to resource reallocation. The rigidity of trusts is a salient theme in European economic history; and even today, university endowments contain restricted accounts to support awards in disciplines whose popularity has withered. Yet in the Islamic world, the waqf absorbed far more of society's resources than the trust did in the West, where, in the course of the second millennium, many social services came to be provided by self-governing and, hence, more flexible organizations. Also, the West had a greater variety of organizational forms, which allowed more experimentation in the delivery of services.

Why did the waqf not evolve into a genuine corporation able to remake its rules of operation, change its mission and reallocate resources of its own will? In the absence of corporate models to imitate, the required institutional leap was enormous, and to advocate organizational autonomy would have invited accusations of impiety. In the West, by contrast, as early as the tenth century, there existed organizations chartered as corporations. More important, perhaps, is that the usual responses to waqf rigidity—exploiting ambiguities in the founder's stipulations, waiting for a sympathetic judge, making modifications surreptitiously—dampened pressures for fundamental institutional reform. These essentially illegal practices also generated vast constituencies with a vested interest in the status quo. When their privileges came under challenge, these constituencies mounted heavy resistance. In sum, more or less illicit quick fixes inhibited efforts to find an efficient response to the steady demand for organizational flexibility. By the nineteenth century, many Middle Eastern policymakers understood the rigidities of the waqf system. New constituencies developed for supplying services such as water, sanitation and fire protection through alternative organizational forms, which were to be financed partly by dismantling the waqf system.

The rigidities of the waqf system had additional lasting consequences, also unintended and unanticipated. Given the vast economic weight of the system, efforts to circumvent its rules contributed to the prevalence of corruption, which, especially after the sixteenth century, local and foreign observers of the Middle East stressed ad nauseam as a barrier to trade and investment. When laws are commonly evaded, law breaking brings no major stigma and the costs of enforcement increase. Thus, following the imposition of new legal codes in the nineteenth century, actual practices changed very slowly.

The failure to turn the waqf into a self-governing organization prevented the strengthening of "civil society," which consists of segments of the social system that exist outside of direct state control. Forming an extended network of free associations, civil society serves two functions: it meets the fine-grained needs of diverse and possibly overlapping subcommunities; and it serves as a bulwark against despotism (Tocqueville, 1840 [1945], pp. 94–110). Very early in Islamic history, in the eighth century, the waqf system instituted one element of a strong civil society: the freedom to found nongovernmental organizations of one's choice. At the same time, by inhibiting autonomy, it caused established nonstate organizations to become inefficient, and it also kept them from becoming a political force for democratization. Still another consequence was a mindset inhospitable to political association. Insofar as the available organizational forms hindered effective political movements, people would have been reluctant to take the personal risks necessary for forming a strong civil society.

Retardation of Modern Rule of Law

Limits on the powers of rulers developed more slowly in the Middle East than in western Europe. This is not the place to review the vast literature on the political transformation of the West. However, three observations about this transformation are particularly relevant. First, economic security and democratic rights emerged gradually in western Europe, over many centuries. Second, strengthening the rule of law required epic struggles between rulers and the ruled. The peoples of England, France and their neighbors fought hard and long for democratic rights. In particular, they struggled for judicial independence and for the right to sue royalty in independent courts. They strove also to limit government through institutional checks and balances. Third, many landowners and merchants stood at the forefront of these struggles. They financed and led campaigns to delegitimize and prevent capricious rule.

Why did the Islamic world experience such developments with a long delay and then only partially? Why was the first parliament of the Middle East—the Ottoman parliament in Istanbul—established only in 1876, and under western influences? Why, at the start of the nineteenth century, did taxation remain relatively arbitrary, private property rights generally insecure and the state bureaucracy essentially an extension of the ruler personally (İnalcık, 1994, chapters 1, 3–6; Imber, 2002, chapter 4; Findley, 1989, chapter 2)? Critical parts of the answers lie in the evolutionary mechanisms outlined earlier.

The rule of law is a public good. By the logic of collective action, people will tend to refrain from contributing to measures designed to strengthen it, except if they have an enormous stake in the outcome (Olson, 1971). Therefore, insofar as Islamic law discouraged the emergence of large and durable enterprises, it must also have hindered the advancement of political and economic liberties. Few of the relatively small merchants would have had a sufficient personal stake in democratization, or in stronger property rights, to participate in struggles toward these ends.

The Islamic inheritance system contributed to this limitation. It did so, first of all, by keeping partnerships small and, hence, commercial wealth limited. Secondly, it fragmented private fortunes achieved, against the odds, through concurrent and consecutive partnerships. Typically a successful merchant had many children, often from multiple wives, which increased the likelihood that his wealth would get fragmented. Third, severe restrictions on testamentary freedoms encouraged people to shelter resources within waqfs, which then dampened incentives to fight for individual rights.

Certain particularities of the waqf system compounded these obstacles to advancing personal rights. Unlike commercial wealth, real estate could be preserved intact within waqfs. On this basis, one might expect the waqf to have provided an economic basis for private coalitions aimed at checking the power of rulers. However, the requirement to follow the founder's wishes to the letter limited opportunities to channel resources into broad political causes. Moreover, mutawallis and other waqf beneficiaries lacked a pressing need for strengthening personal economic rights, precisely because their resources were already sheltered against taxation or expropriation. Put differently, by drawing people into structures that preserved some of their wealth, the waqf system dampened the demand for constitutionally enforced private property rights. Like the prevailing inheritance law, it became an institutional trap. Of course, had the Islamic inheritance system been more malleable, or more conducive to keeping fortunes intact, the waqf system would not have been so popular in the first place; and vested interests protecting the system would have been commensurately weaker.

Limited government, legally protected property rights and predictable taxation are known to stimulate economic development. It is not surprising, therefore, that a major empirical study of the determinants of contemporary government performance finds heavily Muslim countries to exhibit inferior government performance (La Porta, Lopez-de-Silanes, Shleifer and Vishny, 1999). In economically critical contexts, such countries were all governed, at least until the nineteenth century and in some cases until more recently, by Islamic law. As we have seen, certain characteristics of Islamic law, all present long before the Middle East became underdeveloped, galvanized extended processes that delayed improvements in governance.

A related literature finds systematic differences in economic practices between countries with legal systems in the common law tradition, which is of English origin, and those with legal systems in the civil law tradition, which goes back to the Romans and relies much more on statutes and comprehensive codes (La Porta, Lopez-de-Silanes, Shleifer and Vishny, 1998). Islamic law does not fit neatly into either tradition. Laws grounded explicitly in the Qur'an, such as inheritance law, resemble the civil law tradition. Yet, only a small fraction of the Islamic laws pertinent to economic development derive from scripture; for example, the Qur'an does not mention partnerships or waqfs, to say nothing of specifying how they shall operate. Many such institutions emerged gradually, as generations of judges reinterpreted existing practices, much like common-law judges who refine, modify and extend laws in the course of resolving specific disputes (Zubaida, 2003, especially chapter 2; Makdisi, 1999). The findings reported in this essay imply, then, that the substance of a legal system is as important to its evolution as its affinities to common or civil law. Institutional traps may block legal evolution in contexts governed by rules imposed from above, in a centralized manner; they may also do so in contexts in which judges decide cases in a decentralized manner, with opportunities for incremental change.

Rise of Minorities

By the eighteenth century, western Europe was overwhelmingly better equipped to mobilize and accumulate capital than the Middle East. Western commercial and financial enterprises were much larger, more sophisticated and more durable. Western courts were better suited to handling disputes among modern enterprises. But nothing thus far explains why, as the Middle East became conspicuously underdeveloped, its major religious minorities advanced economically in relation to the Muslim majority. Making sense of why the region's indigenous Greeks, Armenians and Jews made remarkable economic leaps at this particular juncture requires attention to intercommunal differences in legal rights and privileges.

Under Islam's characteristic form of legal pluralism, both Muslims and non-Muslims could do business under Islamic law and appeal to a kadi (an Islamic judge) for adjudication of their disputes. However, only non-Muslims were authorized to have cases decided in a non-Islamic court, by non-Muslim judges. Prior to the eighteenth century, on matters of concern here, minorities tended to exercise their choice of law in favor of Islamic law. Three factors account for this pattern. First, because the decisions of Islamic courts were enforced more reliably, Christian and Jewish subjects were motivated to register property claims, credit contracts and partnerships before a kadi. Second, Islamic law offered substantive advantages to certain groups. For example, Jewish and Christian women found the Islamic inheritance system appealing inasmuch as it grants daughters and wives mandatory shares in any estate. Likewise, under Islamic law, business partners enjoyed relatively broader freedoms in setting profit shares. Not surprisingly, a steady theme in accounts of Jewish economic life under Islamic rule is that of rabbis complaining about merchants doing business "in the manner of Muslims" (Goitein, 1999, chapter 6; Shmuelevitz, 1984, chapter 2). Third, for non-Muslims, choice of law did not end with an agreement made under a non-Islamic legal system; a party to such a contract could opt, at any time, to renegotiate it before an Islamic court. Consequently, contracts made outside of the Islamic legal system lacked full credibility. Christian and Jewish communities used social pressures to limit opportunistic jurisdictional switches. But they could not eliminate the threat of opportunism, which is why they also took pains to anticipate challenges under Islamic law. Thus, in dividing estates, non-Muslim families usually gave women shares sufficiently large to keep them from requesting an Islamic settlement. The courts of the minorities tended to accept such adaptations, for the alternative was to compound the use of Islamic courts.

Prior to the eighteenth century, then, the region's religious minorities usually invested, borrowed and traded under the legal system of the Muslim majority. Accordingly, they enjoyed the advantages and endured the disadvantages of Islamic law, along with Muslims. This observation accords with the lack of major gaps in economic achievement among the principal religious communities. The sharing of legal practices also had far-reaching dynamic consequences. For one, non-Muslims must have found it as difficult as Muslims to accumulate private wealth and to preserve successful business enterprises beyond a single generation. For another, they would have remained as unmotivated to develop large and complex organizations.

With the economic rise of the West, Islamic legal pluralism turned from an obstacle to economic modernization into a vehicle for minority advancement (Kuran, 2004a). Specifically, Jewish and Christian Middle Easterners started using their customary choice of law to access western legal systems. A factor facilitating this access is that western traders had long enjoyed the privilege to settle their internal disputes in local consular courts; these courts began serving indigenous non-Muslims as well. Thus, from the late eighteenth century onward, hundreds of thousands of non-Muslims, including merchants and financiers, switched jurisdiction by obtaining, for a fee, the legal status of a western national. In the process, they became entitled to western tax reductions and exemptions won through bilateral treaties known as "capitulations." They also gained access to consular courts operating in many parts of the Middle East, including all major economic centers. Initially, the ability to use these consular courts was limited to cases involving no Muslims. Eventually, as the balance of military power between the Middle East and the West shifted in favor of the latter, west European diplomats managed to loosen the age-old ban against trying Muslims in non-Islamic courts. The norm came to be for all cases involving even one western citizen or protégé to be tried in a consular court. At least for non-Muslims, the danger of opportunistic jurisdictional switching also diminished, as foreign embassies gained the power to prevent their nationals and protégés from being tried in Islamic courts.

Christians and Jews of the Middle East derived palpable advantages from western legal codes. They could now make agreements involving various new organizational forms, including joint-stock companies and corporations. They could use modern banks. They could purchase insurance without the danger of a judge rejecting the contract as morally repugnant and legally invalid. By the late nineteenth century, practically all bankers and insurance agents in the Middle East were either western expatriates or local non-Muslims operating under a western legal system. Also, local representatives of western companies were drawn almost exclusively from these two groups. The largest and most lucrative businesses in major commercial centers such as Salonika, Istanbul, Izmir, Beirut and Alexandria were disproportionately owned and operated by religious minorities. Moreover, western banks, shipping companies and merchants now preferred dealing with religious minorities over Muslims, largely to avoid lawsuits in Islamic courts.

By the late nineteenth century, many Muslim manufacturers, merchants and financiers recognized the immense handicaps they faced on account of Islamic law. They realized that the region's age-old legal infrastructure precluded permanent organizations and hindered capital accumulation. They saw that Islamic courts were poorly equipped to litigate cases involving recently developed business techniques or organizational forms. Nevertheless, as individuals the vast majority remained reluctant to break with a legal tradition dating back to Islam's earliest period. Thus, practically no Muslims sought foreign legal protection. In any case, foreign consuls were reluctant to protect Muslims, for fear of diplomatic conflict.

For Muslims, the only feasible response to their growing positional losses was to broaden the legal systems under which they could do business. The first major reforms came in the mid-nineteenth century, with the establishment of specialized commercial courts in Istanbul, Cairo and Alexandria. Authorized to try cases without regard to religious affiliation and according to a commercial code largely transplanted from France, these new courts effectively narrowed the jurisdiction of traditional Islamic courts, setting a precedent for later curtailments.[2] In some places, beginning with the Republic of Turkey in the 1920s, Islamic law was abrogated in its entirety. Where it has survived, as in the Arabian monarchies, it has been modified beyond recognition in areas of relevance here (Comair-Obeid, 1996; Wilson, 1983). In most parts of the Middle East, the corporation is now an acceptable and popular organizational form. Insurance contracts are legally enforceable. Banks form an integral component of every economy. Contracts involving interest payments are commonplace, although in certain contexts and places such payments are disguised as "commissions" or "fees."

The Persistence of Middle Eastern Underdevelopment

For the Middle East, as for the rest of the non-western world, the economic transformation of the West presented both a vexing problem and a golden opportunity. On the one hand, it set the stage for a host of military, political and cultural challenges. On the other, it enabled the region to modernize in a hurry by borrowing institutions that in the West had developed slowly, in fits and starts, over many centuries. It might seem, therefore, that the underdevelopment of the Middle East could have been overcome quickly through institutional transplants. Yet even though key components of the western institutional infrastructure have already been adopted, the region as a whole remains underdeveloped. Why is the catch-up process proving so arduous?

Transplanting a legal code or institution is not the same thing as appropriating the entire social system that produced it. The performance of a legal code depends on the norms, other complementary institutions, and capabilities of the community putting it to use (North, 1990, chapter 5; Platteau, 2000, chapters 5–7). Consider the establishment, starting in the 1850s, of commercial courts modeled after those of France. The judges appointed to serve on these Turkish and Egyptian courts did not become proficient at applying the French commercial code overnight, and it took time to train competent lawyers. Likewise, local norms of fairness, responsibility and procedural correctness did not change instantly. Only slowly has the notion of attributing responsibility for an adverse externality to a judicial person, as opposed to a natural individual or group, taken root in the region's legal culture. Centuries of efforts to overcome the inflexibility of the waqf through illicit means presented yet another source of rigidity. These efforts had spawned a culture of

[2] For an overview of the region's economic transformation that began in the nineteenth century, see Issawi (1982) and Owen (1993).

corruption and nepotism, which now undermined campaigns to modify and strengthen the rule of law. In particular, these adverse traits influenced applications of the transplanted commercial code. If nepotism and judicial corruption remain rampant to this day, this is partly because state employees are accustomed to personalizing exchanges involving judicial persons.

The prevalence of corruption is evident in the "Corruption Perceptions Index" of Transparency International, an organization that monitors the business climate in most major countries. According to this index, businessmen consider corruption a significantly greater problem in the Middle East than in western Europe. On a zero to ten scale running from "least clean" to "most clean" government, the five most populated countries of western Europe (France, Germany, Italy, Spain and United Kingdom) received an average score of 7.1 in 2003, as against an average of 3.1 for Egypt, Iran and Turkey (Transparency International, 2003). Modifying the region's business cultures is proving far more difficult than rewriting formal laws.

Because the Middle East began to modernize without a strong civil society, states took the lead in many economic sectors that, in the West, had developed through decentralized private initiatives. The state-centered development programs prevalent in the region are often criticized, with much justification, for limiting private enterprise. Yet, state-centrism gained currency because the states formed after World War I had weak private sectors to start with; and that weakness itself was a legacy of Islamic inheritance practices. Whatever the benefits of state-centered development programs, they reinforced the prevailing infirmity of civil society. Furthermore, they fostered a suspicion of organized dissent and political decentralization, both essential to self-correction and innovation. The commonness of autocratic rule in the region stands, then, among the continuing legacies of traditional Islamic law.

The very condition of chronic economic underdevelopment has created obstacles to reform. By making the region chronically vulnerable to foreign meddling, and many individual countries ever dependent on foreign protection, it has bred complacency toward autocratic rule. The underlying logic is that steps toward democracy, by exposing previously hidden political cleavages and inviting further foreign interference, may cause political instability and, ultimately, economic collapse.

Through mechanisms discussed above, various Islamic institutions had hindered the accumulation of private capital, especially by Muslims. At the start of the twentieth century, almost all large commercial enterprises in the Middle East were owned by either foreigners or local religious minorities. With the departure of most of these entrepreneurs through nationalist movements partial to Muslims, population exchanges (most importantly, the Turkish-Greek population exchange of 1922–1923), and emigrations associated with the founding and Arab rejection of Israel, the Islamic Middle East's private sectors have been accumulating physical and human capital from low bases.

Nothing in my account makes the assumption, common in contemporary writings on the plight of the Middle East, that Islam is hostile to commerce, or that it discourages wealth creation or that it promotes irrationality.[3] Although Islam, like other religions, harbors elements inimical to economic productivity and efficiency, these elements have not formed an absolute barrier to economic growth or creativity. This is easily seen by examining the whole of the Middle East's economic history since the rise of Islam, as opposed to the last quarter-millennium in isolation. It is worth reiterating that only recently has this region qualified as "underdeveloped." What made the Middle East fall economically behind is not only that its own legal infrastructure essentially stagnated but that in the West a similar, but not identical, institutional endowment carried within it the seeds of economic modernization. Likewise, Middle Eastern Muslims fell behind the region's non-Muslims because the latter found it easier, partly as an unintended consequence of Islamic law itself, to overcome the economic handicaps rooted in that stagnation and begin benefiting from advances generated elsewhere.

The region's economic failures, combined with associated political insecurities, have contributed to the rise of Islamism—the diffuse global movement that aims to restore the primacy of traditional Islam by shielding Muslims from the transformative influences of globalization. Oddly enough, Islamists are eager to restore premodern economic relations in only certain areas. They seem to have little quarrel with corporations, joint-stock companies, stock markets or modern accounting, among other economic novelties of the past two centuries. Their opposition to the modern economy focuses on a few pet issues: the immorality of interest and insurance, the unfairness of certain inequalities, and the destructiveness of unregulated advertising and consumerism. Even on these matters, Islamists are divided among themselves, with some displaying acceptance of modern practices that others condemn as un-Islamic (Haneef, 1995; Kuran, 2004b). Yet, even militantly antimodern Islamists have had no notable successes in reversing past economic reforms. Islamism harms development mainly in two ways. In breeding political uncertainty, it lowers investment. It also induces policymakers and business leaders, including secularists, to eschew plans that might subject them to charges of impiety, thus reducing experimentation and discouraging creativity.

Of the institutions identified here as obstacles to indigenous economic modernization, one that remains largely in place is the Islamic inheritance system. Even in countries that have repudiated Islamic law to one degree or another, the prevailing inheritance system shares basic features with the traditional Islamic system, including rules against disinheriting relatives. Yet, now that the corporation and the joint-stock company are widely available organizational options, the Islamic inheritance system no longer poses a problem in regard to enterprise continuity or longevity. If these inheritance practices have any adverse effects today, they involve the monitoring of corporate managers and the fragmentation of agricultural land. They may be compounding the principal-agent problem inherent in the corporate form of organization, because, in fragmenting large blocks of shares, they dampen the incentive to monitor management. They also fragment agricultural land into

[3] For a critical survey of these writings, see Kuran (1997).

uneconomically small farms, although the resulting inefficiencies are attenuated by land markets that reconsolidate divided plots.

The foregoing interpretations carry both a pessimistic message and an optimistic one. To start with the bad news, the Islamic Middle East cannot be lifted from its state of underdevelopment in the near term. Even if all the misguided government policies in the region were to disappear today, strong private sectors and civil societies could take decades to develop. The good news is that economic reforms are achievable without opposing Islam as a religion. Whatever the outcome of ongoing struggles over the interpretation of Islam in other areas—education, women's rights, expressive liberties—key economic institutions of modern capitalism were borrowed sufficiently long ago to make them seem un-foreign, and thus culturally acceptable, even to a self-consciously antimodern Islamist. Moreover, given Islam's long tradition of limiting the government's economic role, there is no fundamental conflict between Islam and an economic system based primarily on private enterprise.

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