# Is Islam Bad for Business?

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**The Long Divergence: How Islamic Law Held Back the Middle East.** By Timur Kuran. Princeton: Princeton University Press, 2011. 405p. $29.95.

In this beautifully crafted book, Timur Kuran provides a remarkably rich analysis of how Islamic law impeded economic progress in the Middle East and North Africa. Kuran's views are fresh and powerful, and they are subtle. He does not claim that Islamic law was generally bad for economic activity. He does not claim that prohibitions on interest denied credit to merchants or entrepreneurs. Nor does he claim that predation by absolutist states blocked capitalist accumulation or inhibited commerce.

Instead, Kuran shows how Islamic law originally provided Middle Eastern states up until the Ottoman Empire with one of the most effective legal regimes to encourage commerce and industry that existed anywhere in the world. Yet built into those laws was a set of self-reinforcing characteristics that led away from the more complex, impersonal, and flexible organizational forms that came to characterize European commerce. Over the period from the sixteenth to the eighteenth century (hence the "long" divergence), these characteristics inhibited change in Middle Eastern commercial operations, while European merchants evolved novel legal and organizational forms that taken together gave Europeans systemic advantages in commerce. By the nineteenth century the Middle East lagged so far behind that the region's only way forward was to accept these legal and organizational forms, and seek ways to insert them into Islamic society.

In what follows I will outline and critically engage Kuran's key arguments. While I believe that *The Long Divergence* is an exemplary work of historical social science from an institutionalist perspective, I also think that Kuran places too much emphasis on the historical role of Islamic law, and too little emphasis on the role of the state. Further, I suggest that there is a bit too much "path dependence" in his account. As a consequence, he is more pessimistic than I think necessary about the possibilities for change in the wake of the Arab Spring.

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## Key Features of Islamic Law for Commerce

Kuran's method in his book is admirable. He does not seek out institutions that might be harmful to commerce. He starts from the indisputable fact that from the tenth through the sixteenth century, Muslim merchants dominated trade networks from Africa through the Middle East to India and southeast Asia, in both caravan trade and shipping. Thus he begins with the assumption that Islamic legal institutions, as they developed during this period, were quite favorable to commerce. It was only after the sixteenth century that Europeans began to rival, and eventually surpass, Muslim merchants; and from the mid-nineteenth century onward even Christian and Jewish minorities in Muslim lands pulled away from their Islamic countrymen in their success in trade.

To explain these trends, Kuran examines the key features of Islamic law that were highly supportive of commerce for centuries and asks what made these laws problematic compared to European rivals from the sixteenth century onward. Why was it difficult or impossible for Islamic laws to adapt or change as needed to enable Muslims to meet this competition?

Throughout, Kuran is always questioning, testing his own conclusions, and sifting the evidence; he never assumes anything inimical or negative about Islamic law. Every negative effect has to be proven, and shown to be not a foolish or deliberately harmful choice, but an unforeseen outcome of rational decisions made by Islamic merchants and states seeking to advance their interests.

Kuran focuses on several features of Islamic law that were present from the early decades of Islam's development, and other features that developed mostly or entirely after the initial half-century of Islam's rise. These features are analytically separated, but Kuran shows how they were in fact closely interrelated and formed a self-reinforcing pattern that made it nearly impossible to change just one or two if desired.

The first feature is Islam's inheritance system. The Prophet was concerned to raise the status of women and protect the claims of junior heirs, considering it immoral

doi:10.1017/S1537592711004920

for a family leader who had enjoyed economic success to leave any direct relatives without support when he or she died. Thus the Quran provided strict and highly detailed rules for the disposition of estates. The individual could direct only one-third of his estate through a will and testament; the remaining two-thirds were required to be disbursed "to children, spouses, parents, and siblings of both sexes, according to . . . the exact composition of the legally recognized heirs" (78).

The result was a high degree of fragmentation of family fortunes at each generation. In the Islamic world there were hardly any examples of successful businesses or merchant families that remained dominant for more than a few decades; instead the typical successful business enterprise was fractured among multiple owners at the founder's passing.

The second feature was the acceptance of polygamy. Multiples wives were not common to all Muslims (few could afford it!). But wealthy Muslim men typically did take advantage of the Islamic allowance to have up to four wives, as long as all were treated equally. Muslim law also required that all wives and their children counted as legal heirs. This of course compounded the fragmentation of the most successful businesses, as the wealthier the merchant or business owner, the more heirs would have legal claims on the estate.

The third feature, closely related to the first, was the absence of the corporation—that is, there was no legal status for a business enterprise that would treat it as anything but the personal property of the principals or partners in the enterprise. Islamic law of course did permit large-scale partnerships involving dozens of principals and partners; such partnerships lay at the heart of successful Muslim caravan and shipping enterprises, as well as large-scale silk and paper manufacturing and retail businesses. Islamic law also recognized the difference between active and passive partners, and allowed the latter to shield themselves from liability that went beyond their investments. Yet Islamic law did not take the next step and give legal "personhood" to the business enterprise itself. This meant that at the death of any partner in a business, all of that partner's heirs could claim their disbursements of his or her share—even if that meant the business or its assets had to be sold off immediately to satisfy their claims.

Because of this liability, partnerships were rarely very large or long-lasting. Too many partners would mean constant disruption from the deaths of partners at any time; and deaths could result in claims on the enterprise from literally dozens of legally recognized heirs. Similarly, predictability was enhanced if partnerships were organized to run for just a decade or less; that too reduced the risk of a partner's untimely demise. Many partnerships in commerce lasted only for the voyage of a particular ship or the transit of a particular caravan. When the journey was completed and the profits divided up, the partnership would often be dissolved, ending all claims against the joint enterprise, and individuals would then create a fresh partnership for their next endeavor.

To create corporations that placed business assets in a status legally independent from their principals would have raised serious questions about inheritance rights. Of course, transmissible property rights could have been created by dividing an enterprise into shares. But if the shares themselves were to have value independent of the partner's original stakes, a market in shares would have to exist, and the value of the enterprise would have to be tracked with a transparent accounting of profit and losses, and periodic documentation of those transactions and accounts made public.

All of this of course happened in the West with the rise of chartered trading companies such as the Levant Company, the Dutch and British East India Companies, and others, which were granted corporate privileges by rulers anxious to expand their country's share of overseas trade. The development of these companies included the evolution of joint-stock corporations, independent markets for shares, publication of business periodicals giving information on company accounts and share prices, more sophisticated forms of insurance, and the growth of corporate law. Kuran argues that these innovations made it possible to create larger, longer-lasting firms that could accumulate profits, invest for the long term, handle operations of much greater complexity, and tap extensive impersonal credit markets at relatively low rates.

However, Ottoman rulers were not inclined to grant privileges to encourage large groups of merchants to form permanent associations. They viewed such associations as a risk to their authority. Where a similar kind of association formed around tax farms, the Ottoman rulers sought to limit their scale and finally dissolved them as soon as they could. Moreover, by the sixteenth century, the Ottomans controlled all the main land and sea routes from the Orient to Europe; there was no need to empower merchants to seek entry into those routes. Finally, most Muslim partnerships operated by verbal agreements among principals who were in direct contact and could count on Islamic courts for speedy enforcement of those agreements based on witness testimony (and often, bribes). To replace those enforcement mechanisms with a complex of documentary records and varying value imputations would have created a huge burden for both Islamic courts and the merchants, one that was wholly disproportionate to the needs of the kind of limited size and duration partnerships that were the norm in Muslim commerce.

Thus neither merchants nor judges nor states in the Islamic lands saw a pressing need to create corporations for commerce. But not taking this step meant that the accompanying suite of legal and social innovations that arose in the west after 1600—corporate law, joint-stock

companies, and so forth did not develop in Islamic societies. The lack of corporate organization and supporting law, and the details of Muslim inheritance law, acted to rule out long-lived and very large-scale business firms. This was not a negative for many centuries, when such firms did not exist anywhere in the world. But it became a major disadvantage vis-à-vis western firms as the latter reaped the benefits of corporate organization and law.

There was, under Islamic law, one institution that did have legal recognition of permanent, self-governing status, and that was the charitable foundation, or *wakf*. A wakf was an endowment, established by bequest, which allowed an individual to dedicate resources in perpetuity to a charitable cause. Wakfs were used to fund schools, fountains, orphanages, hospitals, and other charitable organizations. In addition to serving this moral purpose (which protected wakf assets from the state), the endowment could specify relatives and descendants to be officers of the foundation with salaries to be funded by the endowment and its earnings. Wakf endowments could include property or businesses whose funds were to support the charitable activities.

Yet wakfs never became the basis for business corporations, despite their long-term character. This is because Islamic law governing wakfs required that the conditions of their founding be followed exactly and in perpetuity. Obviously, this was meant to ensure that the assets of a wakf were not directed to self-enrichment by the officers, leaving the charitable purposes unmet. But the result was that once the wakf's purposes and assets and salaries for officers were established, they could never legally be changed. If prices went up, or business revenues went down, there was no flexibility to redeploy assets or reduce expenses. Many wakfs thus ended by going bankrupt. Because of the inheritance-sheltering quality of wakfs, they continued to be founded in large numbers, providing such an array of public services that local and municipal governments did not have to shoulder those burdens. Wakfs thus were a valuable element of Islamic societies; but they never acquired the flexibility or business purposes that could have made them vehicles for sustained profit-seeking enterprises.

As noted earlier, Kuran does not blame a lack of legal interest-bearing loans for handicapping Muslim businesses. He shows that in fact the prohibition on lending for interest was intended mainly to prevent debtors from falling into debt-slavery, and that in practice every major commercial center in the Islamic world had a variety of means of legalizing lending for interest (double-purchase, rental, conditional gift, and other fictions). It was even the case that most commercial centers explicitly recognized reasonable levels of interest, and that lending operations that worked within such limits were condoned by the authorities and their agreements were enforced by Islamic courts.

The limit on credit that Kuran does find applied to Islamic merchants is that they could not raise capital by selling shares in their enterprises on stock exchanges (which did not exist, given the lack of corporate law). In addition, banks did not exist that could tap large pools of savings by impersonal contracts with depositors and lend those funds to businesses or governments.

Finally, Kuran explains the rise of minorities to commercial prominence by noting another long-standing feature of Islamic law—the ability of non-Muslims to choose whether to have their disputes adjudicated by Islamic courts or by their own communities. Until the eighteenth century, the advantages of speed and enforcement and impartiality usually led minorities to choose to have their disputes settled in Islamic courts. However, after the eighteenth century, Christian (Greek and Armenian) and Jewish merchants in the Ottoman Empire increasingly chose non-Islamic jurisdiction. This was to take advantage of the privileges offered to Christian trading companies, who obtained capitulations—licenses to operate under their own laws while carrying out commerce in Ottoman domains.

As we noted, at the outset of the sixteenth century, the Ottomans controlled all the trade routes from the Orient to Europe. This changed only when Europeans began to develop the sea route around Africa and across the Indian Ocean. To regain this trade, Ottoman rulers did not give greater rights to associations of Islamic merchants; instead they offered incentives to Europeans to trade in Muslim ports by offering capitulations. Once established, these capitulations allowed European countries to have legal jurisdiction over their employees and agents and eventually any designated co-religionists trading with them in Muslim lands. This allowed non-Muslim minorities to avail themselves of all the advantages of European corporate law when carrying out their own commercial activities, giving them a major advantage over their Muslim countrymen. Muslims could not avail themselves of these laws unless they gave up their Muslim faith; but since apostasy was punishable by death, this choice was not available to Muslim merchants.

By the nineteenth century, European corporations—mainly banks and merchant trading houses—had become so large, so efficient, so good at raising capital and making long-term investments, and so advantaged in their accounting, use of information, and advantages to local agents, that Muslim merchants were in effect left in the dust. This was not because of any single drawback of Islamic law, but rather because the broad patterns of Islamic law inhibited changes that Europeans were making over several centuries. Indeed, the very provisions of Islamic law that were intended to benefit commerce and public purposes and had worked for centuries—inheritance laws, capitulations, and wakfs—cumulatively acted to prevent the adaptations and innovations in commercial organization that occurred in Europe.

## Does Kuran Explain the Rise of the West and the Lagging of Islamic Societes?

Kuran's arguments are richly supported and I find them persuasive. But is showing how Islamic law prevented the emergence of corporate organization really the key to explaining why Islamic lands lagged behind Europe in economic development? For Kuran's explanation to be critical, two conditions have to be met: First, the development of corporate law and corporate organization must be key to most of the advantages in commerce that European societies developed over Islamic societies, and second, the reason why corporations never developed in Islam must relate mainly to the content of Islamic law. I do not believe either condition is wholly met.

Let us start with the second issue. Are there reasons beyond the content of Islamic law that explain why business corporations arose in the West and not in the East? I believe more depends on the long-term configuration of power in European and Islamic societies than Kuran allows. After all, as Kuran notes, corporations emerged in the West hundreds of years before corporate privileges were extended to businesses. It was the Church, followed by universities and municipalities, who took advantage of the weakness of the European medieval states to press for legal recognition of their status as permanent collective entities with stipulated rights. Islamic states in the medieval period wielded consistently stronger central authority than their European counterparts—there was no independent Church as a rival for power, and the internal fragmentation posed by dukes and princes operating independently within a loose monarchical or imperial framework typical of Europe arose only in certain periods of state breakdown in the Islamic world. Thus even if Islamic merchant or other groups had wanted recognition as corporations, it seems unlikely to me that they would have had the leverage versus the state to demand such recognition. If any groups had such leverage, I believe they could have gained exception or modification of Islamic laws (as with the laws regarding interest) to make corporate operations possible.

Moreover, when we ask why business firms obtained corporate privileges in the West, we find two answers. First, European monarchs issued corporate charters as a way to gain revenues. Tax farmers, guilds, and certain manufacturers and merchants were granted corporate rights in exchange for agreements to extend loans to monarchs. As we have mentioned, we saw an analog to this in the Islamic world in tax farming. But Ottoman rulers remained strong enough to keep tax farms numerous and fragmented and eventually to suppress them. And given the dominance of their merchants in regional and global trade up to the sixteenth century, and enjoying adequate revenue from war and taxation, there was no need for Ottoman rulers to grant special association privileges to merchants or manufacturers.

Second, starting in the late sixteenth century, European monarchs gave corporate charters to merchant companies seeking to expand operations in the Levant, the Americas, and East Asia. They did so in part because they were competing among themselves for shares in the Atlantic and Oriental trade, and because the merchants doing so were seeking to trade in lands that were not only distant but hostile. Merchants of the chartered trading companies had to raise funds for military protection as well as simply carrying capacity. This meant that their need for capital and their risks were far greater than those faced by most Islamic merchants. The Arab and Indian Muslim merchants engaged in the caravan and Indian ocean shipping trades operated in areas that were protected by Muslim monarchs or largely non-militarized (most Muslim merchant vessels carried little or no arms, which provided the opportunity for Portuguese and later European merchants with efficient canon to muscle their way into the trade). The corporate forms which evolved into joint-stock companies with more sophisticated insurance and other capital and risk-sharing institutions were not just desirable or accidental products of western law; they were demanded because of the different trading context faced by Western merchants.

If corporate business forms were thus a product of the relative weakness of European medieval states, and the higher risks and vulnerabilities of European merchants operating in competition with rival states and in more distant and hostile territories, and not merely of differences in Western versus Islamic law, what of the further question: How decisive was corporate organization to the rise of the West against other advanced civilizations?

It is here that I find Kuran's argument to be the weakest. For he largely assumes, following the New Institutional Economics, that European economic superiority was founded on superior institutions for commerce. Thus he states that "by the eighteenth century the organizational revolution in the West was generating an explosive growth in global commerce" (197) and "the global explorations that fostered Western control over the New World, an explosion in global trade, and the formation of colonial empires all depended, for their financing and execution, on organizational innovations" (284).

But this is only partially true. After all, Columbus' voyage to the New World occurred in 1492 and was financed by the Crown of Castile, not a corporate trading company. Indeed, the Spanish conquest of the New World was complete before the first European international trading company was chartered in 1580. From 1550 to 1800, the explosion of global commerce was financed mainly by bullion exported from the New World by Spain and Portugal, where merchant associations were quite weak (despite the existence of Western law). It is true that once bullion reached Europe, its export to Asia in return for merchandise was dominated by the chartered companies from

England, France, and the Netherlands. But their advantage lay as much in the armaments of their ships, honed in ocean war battles for intra-European power, as in their legal organization. It is by no means certain that without technically superior weaponry, the western trading companies would have been so successful.

Other factors also lay behind the decline of the Ottoman economy. Kuran omits much of the economic history of the region, particularly the wide-ranging work of Faruk Tabak.[1] Tabak tells how up to the mid-sixteenth century, the Ottoman economy was a sophisticated and diverse agricultural economy, supplying Europe not only with transshipped oriental goods, but also with locally produced wheat and subtropical commercial crops including sugar, cotton, dyes, and spices. These commercial crops were produced in large-scale plantations situated on the coastal plains of Anatolia and the southern Mediterranean. Yet in the late fifteenth and sixteenth centuries, Europe's development of Atlantic island plantations to produce sugar and other tropical crops, and the development of both the Dutch cod fleet and the Baltic Sea grain trade from Poland and Germany to bring cheap protein to Western Europe, undermined the Ottoman advantage. At the same time, the climate changes of the Little Ice Age led to frequent droughts and floods in the Mediterranean coastal plains, rendering the plantations' output highly volatile. Over the course of the seventeenth and eighteenth centuries, much of the coastal plain fell out of commercial cultivation and instead became malarial swamps, while agriculture shifted to the inland hills and valleys. The end result was the triumph of a simplified agricultural regime based on grains for local consumption, plus olives, wine, and sheep/goat husbandry—what we think of today as the "traditional Mediterranean" staple agriculture.

In addition, by the nineteenth century, European merchants could exploit new forms of transportation and production based on coal-fired steam-powered manufacturing and transport: steamships, railways, and machine-produced textiles, paper, metal goods, and other products. It is certain that Muslim merchants, lacking access to these goods because of the lack of the technology to produce them, would have been disadvantaged even if European merchants had not been operating as corporations. And one cannot say that corporations produced these technical advances, for it is well-documented that until the mid-nineteenth century, corporate charters and joint-stock ownership were generally not available to manufacturing firms. Indeed, after the disaster of the South Sea Bubble in the early eighteenth century, corporate joint-stock firms were out of favor and outlawed in Britain for nearly a century. The firms that pioneered the industrial revolution were simple partnerships—such as that of Boulton and Watt, which monopolized steam engine development in the late eighteenth century—who obtained their capital from family, friends, and reinvestment of profits.

What Kuran's book does persuade any reader is that the reasons for the rise of the West to economic dominance relative to the Islamic lands were many-fold. Both the strengths and weaknesses of Kuran's argument make it clear that there is no one critical or over-riding reason for the great divergence. One can point to the weakness of political authority in medieval Europe and the independent power of the Church that led to the widespread use of corporate legal privileges for various groups. One can point to the climatic changes that weakened the Ottoman economy at the same time that Europe was finding new resources in the Baltic Sea, the Atlantic, and the New World. One can point to advances in naval military technology in the fifteenth and sixteenth century that empowered European trading companies to blast their way into Asian trade. One can point to the role of the Reformation in spreading literacy in Europe and sustaining interstate competition and political and religious pluralism. And one can point to the rise of Western science and technology producing new products and industrial processes and energy sources that no other region could match.

Yet among all these causes, Kuran demonstrates clearly, and with a depth and freshness not yet seen, that one important factor was a divergence in organizational forms of commerce, a divergence rooted in and sustained by a self-reinforcing complex of Islamic law. This divergence left the Islamic world without firms skilled in handling large-scale, impersonal, long-term economic activities. Kuran thus makes a key contribution to our understanding of East/West economic differences, in a book that is elegantly argued and a pleasure to read.

## Will Islamic Societies Continue to Lag?

Kuran's outlook is a mix of optimism and pessimism. On the one hand, he argues that Islamic societies can be adaptive and flexible—they have adopted western science, business practices, banking, and dress. I would add that Islamic countries have developed highly successful, billion-dollar business enterprises, from Saudi Arabia's ARAMCO to Dubai's Emirates Air to Mo Ibrahim's Celtel, and that Muslim economies, from Pakistan and Indonesia to Turkey and Egypt, have been growing faster than those of most European nations. So whatever elements of Islamic law are retained today in these countries, they are not major checks to business success.

On the other hand, Kuran argues that the region's lack of history with corporate legal status has left the Middle East with weak civil societies, dominated by corrupt governments that remain unchallenged by strong non-government organizations. In this he is partly correct; many Arab societies in recent years have been characterized by dominant authoritarian states and weak autonomous or opposition organizations. I would argue, however, that the weakness of civil society in Middle Eastern states

is simply the result of recent repression by strong state authorities, rather than a function of Islamic law as such. Moreover, one can identify non-state organizations in many Islamic states in recent history that are or have been quite formidable. So in my view, if states should weaken, civil society should be able to organize spontaneously and create parties, corporations, and other organizations that will step into the breach.

For example, Kuran oddly leaves out any mention of tribes or clans, or Shi'a mosque-based networks, which are a *very* strong source of non-state organization in many Muslim states. Kuran focuses his analysis somewhat on Egypt and Turkey, where tribes are weak and Shi'a mostly absent. But in Jordan, Yemen, Libya, and Iraq it is overly strong tribes and not weak civil societies that seem to threaten peace and hinder progress toward democracy. And in Iran and Iraq, Shi'a mosque networks—used by Ayatollah Khomeini to mobilize opposition to the Shah of Iran, and by Muktada al-Sadr in Iraq to challenge the US-supported government—have proved enormously powerful in challenging the state. Finally, quasi-political social movements such as Hezbollah in Lebanon and Hamas in Gaza, which began as civil society organizations, have challenged and even taken political power.

The Arab Revolutions of 2011 have created a perfect experiment to test whether Kuran or I am right about the lingering impact of Islamic law and the historical absence of corporations. If Kuran is right, then the historical weakness of any non-governmental organizations with autonomous legal status and accumulated power and management capabilities will leave these countries bereft of democratic leaders, and likely to fall again under the spell of over-powering corrupt states. Indeed, Kuran has said this in a recent *New York Times* editorial: "without strong private players willing and able to resist undemocratic forces, nascent Arab democracies could easily slip back into authoritarianism" ("The weak foundations of Arab democracy," *NY Times,* May 28, 2011).

If I am right, then Tunisia, Egypt, and even Libya have a better chance than Kuran thinks at achieving stable democracy. That is, if it was the historical strength of the state, and not the absence of corporate law and organizations, that has kept civil society weak in this region, then with the dictatorial regimes destroyed, these countries should be able to evolve fresh organizational forms rather quickly. Political parties, legislatures, constitutions, private businesses, NGOs, and religious associations should emerge or be strengthened in the aftermath of their revolutions.

I do not expect stable democracy to emerge full blown in a matter of months in these cases—history has shown that revolutions can take years to achieve stable change. What is more, many of the recent "color revolutions," such as those in the Philippines, Georgia, and Ukraine, have produced democracies of dubious quality, or partially reverted to authoritarianism, so expectations for the quality of democracy in the new regimes of the Middle East should be low.

Moreover, strong tribal organizations in Libya may hamper a transition to a national democracy. And in Tunisia and Egypt, it may be clashes between an aroused secular civil society and newly empowered conservative religious parties that undermine democracy, not the lack of any groups that could oppose military or traditional dictators.

A history of Islamic law was not a barrier to the emergence of democracy in Turkey or Indonesia, both of which emerged recently from military or personal dictatorships. We have just seen that recently formed civil society movements, along with older Islamist political movements, proved strong enough to bring down the weakened authoritarian regimes of Tunisia, Libya, and Egypt. I thus am hopeful that a further development of civil society, through private business, political parties, and social movements, will provide the basis for a strong move to democracy in at least one or two of these states.

Kuran makes a powerful case that a lack of corporate law and organizations was one of the factors that handicapped Islamic merchants relative to Western commercial firms after 1600. Yet he somewhat overstates that case. Many other factors contributed to a declining commercial sector in the Middle East. And the lack of corporate law may have reflected the strength of states vs. merchants and other actors in Islamic societies, rather than being a direct consequence of Islamic law *per se*.

If this point is valid, it would be good news for the future of the Middle East. For it suggests that as the configuration of power changes, even in Islamic states, their organizational structure will shift as well. This implies a potential for rapid change, and for a shift from the region's long history of dictatorship to a democratic dawn.

## Note

1 Tabak 2008.

## Reference

Tabak, Faruk. 2008. *The Waning of the Mediterranean 1550–1870: A Geohistorical Approach*. Baltimore: Johns Hopkins University Press.