The Islamic Commercial Crisis: Institutional Roots of Economic Underdevelopment in the Middle East

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During the second millennium, the Middle East's commerce with Western Europe fell increasingly under European domination. Two factors played critical roles. First, the Islamic inheritance system, by raising the costs of dissolving a partnership following a partner's death, kept Middle Eastern commercial enterprises small and ephemeral. Second, certain European inheritance systems facilitated large and durable partnerships by reducing the likelihood of premature dissolution. The upshot is that European enterprises grew larger than those of the Islamic world. Moreover, while ever larger enterprises propelled further organizational transformations in Europe, persistently small enterprises inhibited economic modernization in the Middle East.

If one challenge of the social sciences is to account for the rise of the West,[1] another is to explain how the Islamic Middle East[2] became an underdeveloped region.[3] A major symptom of this decline was that Muslim merchants lost ground to Westerners, and eventually also to religious minorities living in their midst. By the nineteenth century, when much of the Middle East fell prey to European colonialism, the Muslim role in the region's trade with Western Europe had slipped to insignificance.[4] Moreover, many lucrative components of the Middle East's internal commerce had come to be dominated by local Christians and Jews.[5] Although these patterns were not uniform across places or sectors, there is no serious disagreement over the general trends of interest here.

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[1] The West is a shorthand for Western Christendom.

[2] For our purposes here, the Middle East includes, in addition to Turkey, Iran, and the entire Arab world, Iberia while governed by Muslims and the Balkans while under Turkish rule.

[3] For a critical survey of major explanations, see Kuran, "Islam and Underdevelopment."

[4] Panzac, "Maritime Trade," pp. 191–94, finds that in the late-eighteenth century both Ottoman exports to Western Europe and Western imports into the Ottoman Empire were carried exclusively on Western ships. He also finds that most of the merchants who carried out this inter-regional trade were from the West. For supportive statistics, see Issawi, "Entrepreneurial Class"; İnalcık, "Ottoman State," pp. 48–54; and Panzac, *Commerce et Navigation*.

[5] Issawi, "Entrepreneurial Class"; Eldem, *French Trade*, esp. chap. 8; and Panzac, "Maritime Trade," p. 193.

The nineteenth century saw the first systematic efforts to overhaul the Middle East's commercial infrastructure. These involved the replacement of Islamic institutions with ones of Western provenance, so they are aptly characterized as Westernization. One achievement of the period was the establishment of secular commercial courts that placed commerce outside the jurisdiction of Islamic courts. Another was the addition of joint-stock companies and corporations to the organizational forms available to entrepreneurs, until then limited to proprietary operations, family ventures, and traditional Islamic partnerships. These Western-inspired reforms amounted to a revolution in the region's business practices.[6]

This article offers an answer to the longstanding but unresolved controversy over why the Middle East's economic modernization entailed Westernization. The gist of my answer is that the region's commercial infrastructure, and specifically the law of Islamic partnerships, remained essentially stagnant during several centuries when Western commercial partnerships gained in complexity, evolving into more advanced institutions. In principle, the Middle East's commercial modernization might have entailed, as in Western Europe, an evolution propelled primarily by indigenous social forces. However, two key components of the Islamic legal system, its law of partnerships and its inheritance system, created self-reproducing incentives to keep business enterprises small, simple, and generally ephemeral. As we shall see, an initially similar law of partnerships in the West, combined with a more diverse and more flexible inheritance system, stimulated enterprise growth, complexity, and longevity. An alternative route to the development of large and durable enterprises might have involved the formation of business corporations. This route was blocked by the absence within Islamic law of the concept of a corporate entity.

The observed divergence in the institutional trajectories of the two regions produced what one may call the Islamic commercial crisis of the eighteenth and nineteenth centuries. This crisis unfolded against the backdrop of a massive rise in the volume of European-Middle Eastern trade. Along the way, merchants and financiers doing business under Islamic law lost market share to those able to rely on Western institutions. This is because the institutional evolution of the West had turned Islam's traditional commercial institutions into sources of competitive disadvantage. Earlier, during the formative period of Islamic law, the commercial infrastructure of the Middle East had adapted remarkably well to the prevailing global economic conditions.

A society's commercial capabilities depend on its legal infrastructure. So when two societies with different legal systems carry on a trading relationship, in the absence of countervailing incentives, the one with the more

[6] For an overview of the transformation, see Owen, *Middle East in the World Economy*.

efficient commercial institutions will enjoy advantages. If the pertinent institutions were fixed, the consequent imbalance would be permanent. In fact, and as shown in what follows, there can be feedback from economic outcomes to the laws that spawned them. Thus, the decline of a society's commercial effectiveness will create incentives for its merchants to pursue institutional reforms. To be sure, pressures to alter laws need not yield immediate results. Economic failure may be accompanied by a period of institutional stagnation.

I reject, then, the view that laws evolve instrumentally to track changing material needs in a perfectly synchronized manner. However, I also reject the counter-view that laws are fully autonomous from market outcomes. In my analytical framework institutions not only constrain activities but they shape the incentives to modify them. In formal terms, I recognize path dependence as well as the impact that material outcomes have on the specific "path" the economy subsequently follows. As such, my argument falls within the rubric of "historical institutional analysis"—an approach to which Douglass North, Thráinn Eggertsson, Avner Greif, Paul David, and others have made seminal contributions.[7] Greif's formulation distinguishes among self-enforcing, self-reinforcing, and self-destroying institutions. In the short run, a self-enforcing institution perpetuates itself as the expected actions of agents motivate and enable other individuals to follow the associated behavioral regularity. Such an institution is also self-reinforcing if it exhibits positive feedback, in other words, it expands the range of situations in which the behaviors in question are observed. Islamic partnerships constituted, we shall see, just such a self-reinforcing institution. A self-enforcing institution is self-destroying if, while perpetuating itself in the short-run, it exhibits negative feedback by sowing the seeds of its own eventual demise. In the West, the partnership forms of the medieval period proved to be self-destroying.

The Westernization of Islamic economic practices is often attributed to top-down measures serving European imperialism and implemented by leaders alienated from their own cultures. What frequently escapes notice is that mounting pressures from a wide range of market participants also played significant roles. At least in the economic sphere, the reforms of the nineteenth century were designed to meet the needs of investors unable to compete in the emerging modern economy. Their beneficiaries included non-Muslims whose forefathers had chosen to operate under Islamic law even when free to do business under alternative rules. They also included Muslims who considered the commercial institutions of classical Islam to have outlived their usefulness.[8]

[7] North, *Institutions* and "Paradox of the West"; Eggertsson, *Economic Behavior*; Greif, "Contract Enforceability" and "Historical Institutional Analysis"; and David, "Why Are Institutions the 'Carriers of History'?"

[8] Contemporary Islamists tend to characterize the local and foreign instigators of the Middle East's economic Westernization as cultural miscreants. My own argument offers a positive counter-interpretation

ISLAMIC PARTNERSHIPS

For an introduction to the relevant elements of Islamic law, let us step back to the tenth century—roughly the fourth century after the advent of Islam. By this time all critical elements of the Islamic legal system were in place. From the perspective of modern commercial practices, a striking feature of this system is the absence of the business corporation.[9] The distinguishing feature of a corporation is that it enjoys legal rights distinct from those of the individuals who comprise its membership. A corporation may make and remake its own internal rules. Enjoying legal personality, it may also possess property, sign contracts, file claims, and be represented in court. The debts of a corporation are not owed by its owners or workers as individuals. Its decisions do not require a consensus of its membership. Furthermore, precisely because it has a legal status of its own, it can live on after its initial members die or otherwise relinquish their rights and responsibilities.[10]

In the pre-modern Islamic world, economic ventures requiring the cooperation of two or more individuals were carried out not by corporations but by family enterprises or partnerships. In the case of long-distance trade, the typical pattern, especially when family affinity was not a factor, was for a sedentary investor to finance a merchant who accepted the task of conducting a commercial mission. When formed under Islamic law, such a single-venture partnership was known as *mudāraba*. Occasionally, the merchant would help finance the enterprise, or the investor would contribute to the work. In either case, the resulting partnership went by the name of *mushāraka* or *inān*. Whatever the exact arrangement, the partners split profits of the enterprise, if any, according to a formula negotiated in advance. The merchant was not liable for any losses generated; unless he contributed to the initial investment, his own business risk was limited to his expended labor. The term "Islamic commercial partnership," or simply "Islamic partnership," may be used to designate the class of contracts under consideration, including the variants just defined.

The rules for forming and executing Islamic partnerships were not developed from scratch.[11] The jurists who shaped them between the seventh and tenth centuries drew inspiration from the customs of regions already under

of the institutional transplants in question. In responding to widely felt needs, Middle Eastern reformers of the nineteenth century initiated a long, if still incomplete, economic recovery.

[9] With one major exception, the *waqf* or pious foundation, classical Islamic law recognizes no economic entity consisting of a collectivity of individuals. But even the waqf lacked many freedoms of a corporation. See Kuran, "Public Goods under Islamic Law."

[10] Davis, *Corporations*, vol. 2, chaps. 7–8; Coleman, *Foundations of Social Theory*, chap. 20; and Ramseyer, "Corporate Law."

[11] Udovitch, *Partnership and Profit*, covers the rules in detail.

Islamic rule.[12] Yet, they refined the rules they borrowed, largely to accommodate the needs of the mercantile class. Their sensitivity to the requirements of commerce is not surprising, because in this period many of the religious scholars (*ʿulamāʾ*) who served as jurists were themselves active in long-distance trade, most as investors, a few as merchants.[13] Although Islam's principal schools of law did not agree on every detail, their partnership rules by and large facilitated commerce. Moreover, the most widely followed school, the Hanafi school, was particularly eager to legitimize the prevailing mercantile customs. Remarkably, this exercise of mercantile power occurred about two centuries before the governments of North-Western Europe took to enacting commercial rules established by the "law merchant"—the voluntarily produced, adjudicated, and enforced rules of the merchant communities.[14] However, the Islamic rules underwent few subsequent changes. This could not have been due to an absolute barrier to modifying or reinterpreting Islamic law. Changes did occur in other areas, such as taxation and statecraft. If the rules of commerce remained more or less unchanged, one must explain why.

Several aspects of Islamic commercial partnerships require consideration. The parties to an Islamic partnership enjoyed considerable latitude in setting profit shares. A merchant could claim an advantage on the basis of intangibles such as reputation for honesty, geographic knowledge, and commercial expertise. Likewise, an investor could constrain the merchant's mandate in order to lessen his risk from the venture (or *her* risk—a significant minority of the investors were women). In particular, it was possible to place geographic and temporal limitations on a mission, restrict the people with whom the merchant could trade, or make the profit shares contingent upon the merchant's choices.[15] In such ways, Islamic law bestowed religious approval on mercantile customs.

Anyone familiar with modern institutional scholarship will see these customs and the associated Islamic partnership rules as instruments for economizing on transaction costs. The partnership rules developed by the

[12] Certain Qur'anic verses have been linked to the rules of Islamic partnership. The most commonly invoked verse is 62:10: "And when the prayer has ended, then disperse in the land and seek of Allah's bounty, and remember much, that ye be successful." But the implied associations are tenuous. The identified verses say nothing about the organization of trade.

[13] H. Cohen, "Economic Background," table C-1, estimates that in the ninth and tenth centuries 75 percent of all the religious scholars living in Islam's Arab heartland earned a living primarily from business. Although most were artisans or producers, many participated in commerce as investors. Seven percent of the scholars in Cohen's sample earned a living exclusively from trade or moneylending. On the power merchants wielded during Islam's initial half-century, see also Ibrahim, *Merchant Capital*.

[14] Benson, "Spontaneous Evolution"; and Hunt and Murray, *History of Business*, chap. 4.

[15] For example, the investor's share could be set at, say, 40 per cent if the merchant transported wheat but 60 percent if he chose to carry cloth. Udovitch, *Partnership and Profit*, pp. 74–75, 209–10, 257–58; Pryor, "Origins of *Commenda*," pp. 30–31; and Gedikli, *Osmanlı Şirket Kültürü*, pp. 129–32, 156–67.

maritime cities of Italy, including the *commenda* (or *societas maris*), which is practically identical to the Islamic *mudāraba*, were undoubtedly motivated by similar considerations, namely, the efficient allocation of risks and expected returns.[16] Both the *commenda* and the *mudāraba* offered investors and merchants more flexibility than the closest contractual form found in the Talmud, the Jewish *ʿisqa*. For all its commonalities with other partnerships, the *ʿisqa* required equality between the investor and merchant in terms of either profit shares or shares of liability. Although Maimonides's (1135–1204) codification of Jewish law, the *Mishneh Torah*, relaxed this condition, it still required the merchant to be liable for part of the principal; in addition, it required his profit share to exceed his share of liability.[17] One purpose of these restrictions was to promote fairness. But this objective often collided with the risk-return tradeoffs considered optimal by partnership members. It is noteworthy, then, that the shapers of Islamic law generally allowed the preferences of merchants and investors to trump the concerns about fairness that Islam shares with other religions.

Islamic partnership law was inflexible, however, in its insistence that the principal consist of currency. Also, under one of the four schools of jurisprudence, if more than one partner contributed to the principal, the currency had to be the same.[18] Investing merchandise directly was prohibited, ostensibly to prevent unjust enrichment, more plausibly to forestall disagreement over the value of the initial investment and disputes over the division of profits. Finally, the merchant's mission was considered incomplete until all merchandise bought on behalf of the partnership had been reconverted into the selected currency.[19]

Insofar as these rules were followed, they imposed a burden on investors driven to sell merchandise where the price was low. True, as in other economic contexts, traders could use legal devices (*hiyal*) that allowed the circumvention of inconvenient rules.[20] By one such device, the sedentary investor would sell his goods to a trusted third-party and pass the proceeds to the impending partnership's traveling member; and the latter would then repurchase the same goods on behalf of the now-constituted partnership. This procedure was obviously designed to accomplish in two individually legitimate steps a task that would violate Islamic law if performed through a single step.[21] Although this and functionally similar legal devices saw

[16] Lopez and Raymond, *Medieval Trade*, pp. 174–84; and Hunt and Murray, *History of Business*, pp. 60–63.

[17] Udovitch, *Partnership and Profit*, pp. 199–201.

[18] If one contributed silver aspers, the other could not contribute Venetian ducats.

[19] Gedikli, *Osmanlı Şirket Kültürü*, pp. 76–77, 225–26.

[20] Rodinson, *Islam and Capitalism*, esp. pp. 35–37, 43–46; and Udovitch, *Partnership and Profit*, esp. pp. 11–12, 63–64, 182–83. For a general analysis of the role that these played under classical Islamic law, see Schacht, *Introduction to Islamic Law*, chap. 11.

[21] Udovitch, *Partnership and Profit*, p. 183; and Gedikli, *Osmanlı Şirket Kültürü*, pp. 175–83, 263.

frequent use, examples of partnerships consistent with the spirit of the law are plentiful.[22]

In an Islamic partnership, obligations arising from dealings almost always fell on the individual partners rather than on the enterprise as a whole. A person who performed services for the partnership had to collect from each partner separately. Likewise, injured third parties could press claims only against partners with whom they had direct dealings, although a partner who settled a claim might seek restitution from his fellows according to their shares of liability. The same principle applied to the partnership's own claims against third parties. Its members could demand compensation as individuals, never as a collective enterprise.[23]

If I have reviewed the distinct characteristics of Islamic partnerships, this is because their most common form, the *mudāraba*, might have spawned the development of joint-stock companies and eventually the modern corporation.[24] Like today's giant firms, the typical Islamic partnership united individuals lacking blood ties. The rules of Islamic partnerships were designed to strengthen, if not to create, mutual trust among individuals who could not necessarily rely on pre-existing trust grounded in kinship. Significantly, Islamic law supported partnerships among individuals differing even by faith. Three of the four major Islamic schools of law, including the Hanafi school, explicitly allowed partnerships between Muslims and non-Muslims. True, one of these three schools required every active party of an interfaith partnership to be a Muslim, ostensibly to prevent the diversion of Muslim capital into un-Islamic pursuits such as the wine trade.[25] Nevertheless, the Islamic law of partnerships constituted a step toward the creation of enterprises capable of pooling the resources of large and diverse groups. Helping

[22] In any case, even if the ban on investing merchandise was *always* violated, it need not have been inconsequential. In seeking to overcome its inconveniences through roundabout ways, partnerships incurred additional transaction costs. And the anticipation of these costs may well have deterred the formation of some potentially profitable partnerships. There could also have been dynamic consequences favorable to commerce. All else equal, the greater the inconveniences of establishing a partnership, the larger were the incentives to develop alternative institutions.

[23] Udovitch, *Partnership and Profit*, pp. 48–51, 98–101. The sole exception to these rules arose with the unlimited commercial partnership (*mufāwada*). This contract required complete equality among partners in all financial matters. Accordingly, each member was considered partially liable for the actions of the others. To third parties, therefore, it was equivalent to a single person. In this one respect, the unlimited partnership resembled a corporation. This hardly means, however, that it constituted a likely starting point for the indigenous emergence of corporate law. Precisely because of its equality requirement, it never gained popularity. Besides, not even through unanimous agreement could its members modify their rules of operation.

[24] Each of these terms has assumed many meanings. By "joint-stock company" I mean an enterprise whose capital is held in transferable shares of stock by its joint owners. As defined in the introduction, a "corporation" is an enterprise that is legally recognized as a separate entity enjoying rights and liabilities distinct from those of its members. The critical distinction between a joint-stock company and a partnership is that the former's shares are transferable. The corporation differs from both in being recognized as a juridical person.

[25] Gedikli, *Osmanlı Şirket Kültürü*, pp. 140–47.

to emancipate the individual from networks based on kinship, it also set the stage for replacing the "limited group morality" of the pre-industrial world with a "generalized morality" consisting of abstract rules applicable to a broad range of social relations.[26] Although most *mudāraba* agreements were formed between members of the same ethno-religious group—Turks with Turks, Arabs with Arabs, Jews with Jews, Greeks with Greeks, and so on—in some places and periods interfaith partnerships were common. Even *kadi*s, or Islamic judges, formed partnerships with non-Muslims.[27]

Well into the nineteenth century Islamic partnership law served as the basis for commercial cooperation throughout the Islamic world.[28] Exhibiting little variation over time, it remained an organizational form conducive to trade ventures formed across familial and even communal boundaries. However, it did not give rise to radically more complex enterprises capable of mobilizing vast resources from the masses and living on indefinitely. As will be shown, the Western experience was different: centuries before the Industrial Revolution the *commenda* spawned enterprise forms that were more durable as well as structurally more complex. Why, then, did the two civilizations follow markedly different organizational trajectories? Why, starting from nearly identical partnership rules around the tenth century, did one civilization develop progressively more complex commercial institutions while the other's commercial infrastructure remained more or less stagnant? Why, to restate the puzzle, did the West produce ever more powerful solutions to the problem of generating trust outside the family while Islam's own initial solution—mainly the *mudāraba*—proved self-reproducing?

OBSTACLES TO ENTERPRISE GROWTH AND LONGEVITY

Whatever its exact form, an Islamic partnership ended with the demise of any of its members, whether or not the surviving partners learned of the death. The heirs of a deceased partner did not automatically replace him. If the enterprise was to continue, a new partnership had to be negotiated.[29] Every additional partner thus increased the risk of premature liquidation, so there were advantages to keeping partnerships small and limiting their planned duration. The added vulnerabilities of large partnerships were

[26] The two terms are drawn from Hirschman, "Rival Views of Market Society."

[27] See Goitein, *Mediterranean Society: Abridgment*, esp. chap. 10, for data from Cairo around the eleventh century; and Gedikli, *Osmanlı Şirket Kültürü*, esp. chap. 4, for figures from sixteenth- and seventeenth-century Istanbul. Against such evidence, Panzac, "Maritime Trade," pp. 200–01, finds that in the eighteenth century mixed partnerships were rare in the maritime trade of the Ottoman Empire; and Abdullah, *Merchants, Mamluks, and Murder*, pp. 91–92, reports that the same pattern held in coeval Basra.

[28] Firestone, "Production and Trade"; Çizakça, *Business Partnerships*, chap. 1, 3; and Gedikli, *Osmanlı Şirket Kültürü*. See also Labib, "Egyptian Commercial Policy," p. 68.

[29] Udovitch, *Partnership and Profit*, pp. 117–18; and Gedikli, *Osmanlı Şirket Kültürü*, pp. 236–32.

doubtless understood by third parties, who would have charged a premium to serve them. Still another obstacle to large Islamic partnerships was that they lacked legal personality. Third parties had to deal with partners as individuals rather than as representatives of an entity with legal standing. Accordingly, they would avoid providing services beyond the financial capacity of the particular partner with whom they were dealing. In principle, these limitations could have been surmounted by incorporating the enterprise. But this option was blocked by the simple fact that classical Islamic law harbors no concept akin to the corporation.

To put these observations in perspective, note that a modern economy harbors firms with thousands of employees. Each such employee acts daily on behalf of an organization that may be sued and is expected to outlive its workers and shareholders. If the employees of even a modest modern firm were made personally liable for obligations incurred through their actions, they would find the risks intolerable. Consequently, they would discourage the firm from making long-term commitments. In any case, the firm itself would have difficulty finding outsiders willing to do business. Mindful of the costs of collecting from individual employees and of the meagerness of most personal portfolios, third parties would insist on advance payment for their services. Moreover, the firm could borrow only for minuscule periods, lest a death or retirement void its contracts.

What is critical is that the Islamic partnership was poorly suited to large and long-lasting business ventures requiring the active or passive participation of many people. Not surprisingly, the typical Islamic partnership consisted of just two members, who pooled their resources for a single trade mission. Although the mission could last a year or two, ordinarily it ended within a matter of months.[30] True, *mudāraba* contracts with as many as 20 participants have been found.[31] But even in these exceptional cases, the agreement covered a single mission. As for the principal invested in the typical mission, it was quite small, because risk-averse investors tended to disperse their capital among multiple trade ventures. Consequently, even a merchant performing a trade mission financed by a dozen investors could be carrying merchandise of limited value. The participants in the caravan trade of the pre-industrial Middle East consisted largely of pedlars who bought and sold small quantities as the convoy moved from market to market.[32] Like the caravan trade, maritime trade was the province of small traders

[30] Nothing prevented the renewal of a successful trade mission. But even the longest-lasting cooperative commercial effort was terminated by the retirement or death of any partner.

[31] Çizakça, *Business Partnerships*, pp. 66–77; and Gedikli, *Osmanlı Şirket Kültürü*, pp. 237, 254, 259.

[32] Steensgaard, *Carracks, Caravans and Companies*, chap. 1; and Chaudhuri, *Trade and Civilization*, esp. chap. 10. The latter source (p. 205) reviews a commercial letter written by an Egyptian investor of the eleventh century. The letter refers to merchants carrying goods on the investor's behalf to various lands, suggesting that he had fragmented his investments.

traveling with packs and baskets that could be loaded on a single animal. Major commercial investors diversified their risks by contracting with many merchants traveling in different directions.[33] Surviving records point to merchants who commanded loads valued at many times those of a typical pedlar; many of them were financed by high-ranking officials.[34] Significantly, even these elite merchants belonged to partnerships that tended to have few members. In any case, wealthy officials themselves pursued risk diversification, which meant that their resources got divided among many partnerships.

The pre-modern Middle East never lacked investors willing to risk capital in pursuit of financial gain. Yet it did not develop organizations capable of pooling the resources of large numbers of investors. This failure was hardly predictable early on. In the early Islamic centuries the Middle East was teeming with money changers, moneylenders, and pawnbrokers, along with "merchant bankers" who, in the course of their commercial activities, accepted deposits, provided credit, and intermediated payments through the delegation of credit (*hawāla*) and bills of exchange similar to modern checks (*suftaja*s). These financial operations took on "fairly complex forms" as early as the mid-eighth century, observes Abraham Udovitch, "at least three or four centuries before anything comparable is recorded for medieval Europe."[35] So in the early Islamic centuries one might have expected modern banking to emerge in the Middle East. Yet, however impressive their operations by the standards of the day, premodern Middle Eastern financiers delivered services either as individuals or through temporary, small, and generally unspecialized partnerships. Despite the advantages of a head-start vis-à-vis Europe, the Middle East did not develop locally owned banks until after it launched radical reforms based on Western models.

In principle, Islamic partnerships could have been used to pool vast amounts of capital and make large loans to consortia of merchants. Accordingly, societies governed by Islamic law might have seen the emergence of bank-like organizations—durable and specialized associations lending pooled deposits for a profit. Exploring why the Islamic Middle East did not develop such organizations, Udovitch suggests that personal relations played a critical role in financial operations, making it awkward to pool the resources of savers unknown to each other; so credit transactions occurred mostly within the confines of tight communities.[36] This insight raises the question—not posed by Udovitch—of why the act of extending credit long remained so personal. The argument in progress suggests a possible reason. Personal relations might

[33] Steensgaard, *Carracks, Caravans and Companies*, chap. 1; and Chaudhuri, *Trade and Civilization*, chaps. 9–10.

[34] Ashtor, "Discussion on Udovitch," p. 549; and Gedikli, *Osmanlı Şirket Kültürü*, p. 88.

[35] Udovitch, "Institutions of Credit," p. 6.

[36] Udovitch, "Bankers without Banks," p. 272.

have remained important precisely because partnerships remained small enough to allow the providers and users of funds to know each other.[37] Had Islamic partnerships been able to accommodate multitudes of investors, Middle Easterners would have learned to trust organizations and grown accustomed to impersonal finance. In other words, the enlargement of the region's financial intermediaries would have brought about the very social transformation essential to their acceptance and expansion.

As things turned out, Middle Eastern financiers refrained from forming financial intermediaries capable of supporting large ventures of indefinite duration. The reasons are analogous to those that account for the persistent smallness of commercial partnerships. The requirement of disbanding a financial partnership at the death of any depositor or borrower raised the cost of running financial intermediaries. It also hampered their growth.[38]

INSTITUTIONAL COMPARISON WITH THE WEST

Examining the West European and Islamic records between the eighth and twelfth centuries—the period Udovitch associates with Islamic financial creativity—one finds no significant differences in regard to business scale or longevity. Nor does one encounter specialized organizations identifiable as banks. Neither observation is surprising, for the *commenda* was no more hospitable to large and durable enterprises than was the *mudāraba*.

Moving forward in time, we encounter striking organizational differences. The Islamic world saw the emergence of ethnically based networks that coordinated activities in various cities. In the seventeenth and early-eighteenth centuries, prominent among these was an Armenian network centered in Iran.[39] In terms of wealth and influence, however, the commercial networks of the Islamic world achieved nothing comparable to the business conglomerates formed in Western Europe. More critically, they consisted of family firms that cooperated episodically rather than under the aegis of a centralized organization. Prior to its reforms of the nineteenth century, the Middle East did not produce even one indigenous joint-stock company. Nor did it generate even one case of mass financial mobilization

[37] Greif, "Cultural Beliefs," offers a complementary explanation centered on self-fulfilling perceptions of commercial norms.

[38] A complementary reason for the delay may have been the persistence of Islam's formal commitment to the eradication of interest. Whereas an individual might conceal dealings in interest through undocumented stratagems, a bank expected to keep standardized accounts will have a harder time disguising the nature of its operations. By this logic, wherever the interest ban was enforced even partially, a reluctance to publicize dealings in interest would have weakened the incentive to form large financial intermediaries.

[39] Curtin, *Cross-Cultural Trade*, chap. 9; Kévonian, "Marchands Arméniens"; and Matthee, *Trade in Safavid Iran*, pp. 84–89.

through nongovernmental channels for a major business venture.[40] In 1908 a Turkish commentator would write: “Let us say that somehow we managed to put together 3000 liras and built a fez factory. How could we possibly compete against Austrian factories whose capital is measured in hundreds of thousands of liras?”[41]

At the time this cry of despair was recorded, large-scale finance in the Middle East had come to be dominated by Europeans, who were now playing a huge role in the region’s commerce. The region’s earliest banks, such as the Imperial Ottoman Bank, the Imperial Bank of Persia, and the Anglo-Egyptian Bank, all established in the mid-nineteenth century, were European owned and operated. Equally significantly, not until the early-twentieth century did predominantly Muslim-owned commercial banks emerge, beginning with Bank Misr in Egypt and İş Bank in Turkey.[42] On the eve of World War I very few Muslim-owned firms existed in commerce, finance, or manufacturing.[43]

Given that the early Islamic centuries saw remarkable dynamism in regard to commercial and financial organization, one might wonder when the pace of institutional development slackened. There are signs that the organizational creativity noted by Udovitch was not repeated in commerce or finance, even though other sectors continued to experience institutional transformations. Maya Shatzmiller has found that between the eighth and eleventh centuries, the formative period of Islamic law, the Arab-Islamic lands stretching from Iraq to Spain harbored 233 distinct commercial occupations. Later, between the twelfth and fifteenth centuries, there were roughly the same number of occupations (Table 1). Remarkably, between the same two periods the number of unique occupations in the bureaucracy and military tripled, and the number of educational, legal, or religious occupations more than quintupled. Division of labor is among the correlates of productivity improvements. So Shatzmiller’s figures point to inertia in regard to commercial organization. This inference is consistent, of course, with the persistent smallness and simplicity of the typical Middle Eastern partnership. It also accords with the Middle East’s failure to develop indigenous forms of the joint-stock company and the business corporation.

During the long period when the commercial infrastructure of the Middle East essentially stagnated, that of Western Europe underwent gradual, but cumulatively very important, changes. A long chain of developments trans-

[40] Çizakça, *Business Partnerships*, chaps. 2–4. Gedikli, *Osmanlı Şirket Kültürü*, offers supportive evidence. Even the largest partnerships had a simple form: many investors and a single active merchant. Also, the sums invested were minuscule by the emerging European standards.

[41] Reşad Sami, as quoted by Toprak, *Milli İktisat*, p. 107 (my translation).

[42] Black and Brown, *Modernization in the Middle East*, pp. 73–77, 226–27; Landes, *Bankers and Pashas*; and Pamuk, *Ottoman Empire and European Capitalism*, chap. 4.

[43] Toprak, *Milli İktisat*, pp. 82–83, mentions that in the entire Ottoman Empire there existed only two noteworthy firms whose capital was entirely Muslim-owned.

TABLE 1
DISTINCT OCCUPATIONS IN THE ARAB-ISLAMIC WORLD

Sector	Eighth through Eleventh Centuries	Twelfth through Fifteenth Centuries
Commerce	233	220
Bureaucracy, military	97	303
Education, law, religion	33	180

Source: Shatzmiller, *Labour in the Medieval Islamic World*, pp. 255–318.

formed the *commenda* into a rich variety of partnership forms, including ones suitable to broadly financed and durable commercial enterprises. Already in the thirteenth century Italian financiers were forming partnerships for periods of several years, rather than for predefined ventures, the prevalent pattern in the Middle East. These new partnerships did not dissolve with the death of a partner. Although they all started as family associations, many metamorphosed into enterprises whose family members contributed only a minority of the capital and were consistently outnumbered by outside shareholders.[44]

Moving forward a century, we come across business enterprises consisting of linked partnerships. Headquartered in Florence, the famous Medici enterprise combined many separate partnerships, each a separate legal entity that dealt with the others on the same basis as with outside customers, charging them commissions and interest. One partnership served as a command center, the rest as tributaries. The tributary partnerships reported to the center, which coordinated their activities to make them operate, in effect, as branches of a single enterprise.[45] The key implication is that the dissolution of one partnership through a death or retirement left the rest of the enterprise intact. The Medici enterprise thus foreshadowed the modern holding company. Among its innovations was the facilitation of clearance operations among tributary partnerships.[46]

The period from the sixteenth century to the early nineteenth century saw further developments. Among the new organizational forms was the joint-stock company, which was a partnership with transferable shares. Joint-stock companies could have many members—some had hundreds—so reorganization became a daily matter. Courts took steps to simplify the reorganization process, thus lowering the costs of maintaining continuity.[47] Among the early joint-stock companies were the English Levant Company and the Dutch, French, and English East India Companies. All had horizons longer

[44] Roover, *Bruges*, pp. 34–36; Usher, *Deposit Banking*, pp. 12–14; Hunt, *Medieval Super-Companies*, esp. pp. 12–13, 25, 260; and Hunt and Murray, *History of Business*, pp. 105–06.

[45] Roover, *Bruges,* pp. 34–42; and Roover, *Medici Bank*, esp. chap. 5.

[46] Usher, *Deposit Banking*, chaps. 1, 4.

[47] Harris, *Industrializing English Law*, pp. 142–43.

than a single voyage. Their individual shareholders could invest in particular voyages or commit resources for a number of years; and the companies themselves had some capital considered permanent.[48] The number of merchants within any given company was small by standards of a modern multinational firm. In 1592 only 53 merchants were affiliated with the Levant Company.[49] However, by standards of the day, the companies constituted massive organizations.[50]

This is not the place for a detailed account of Europe's organizational evolution. For our purposes, the critical point is that the West managed to develop a panoply of new organizational forms, including ones suited to pooling large amounts of capital for multiple commercial missions. In the process, Western business communities gradually overcame the obstacles to growth and longevity that continued to limit commercial enterprises in other parts of the world, including the Middle East. By no means, of course, were Europe's new organizational forms free of drawbacks. One member of a large partnership could impose losses on all the rest. Moreover, a joint-stock company had no legal identity independent of the people who made it up; every partner became a party to legal suits by and against third parties, and also to suits between other partners.[51] Although the consequent costs could be reduced by constraining the freedoms of individual partners, it was hardly practical to micro-manage every partner.

In any case, Europe had long known an alternative organizational form that avoided the serious drawbacks of the joint-stock company: the corporation. Employed since the medieval era for municipal, educational, and ecclesiastical purposes, from the sixteenth century onward the corporation was used also for profit-oriented business. Thus, some of the super-companies that conducted trade between Europe and the Middle East came to be chartered as corporations. Enjoying an existence independent of its individual shareholders and employees, a business corporation did not have to undergo a reorganization at each change in its ranks. Its individual members could not encumber it with debts that others would have to repay out of their own assets. Relative to the organizational forms that descended from the medieval concept of a partnership, it thus provided a more secure solution to the age-old problem of establishing durable enterprises able to exploit economies of scale and scope.[52]

Over and beyond the functions of the new organizational forms, what is remarkable is the sheer diversity of the options that became available to the

[48] Steensgaard, *Carracks, Caravans and Companies*, chap. 3; Chaudhuri, *Trade and Civilization*, chap. 4; and Chaudhury and Morineau, eds., *Merchants, Companies and Trade.*

[49] Epstein, *English Levant Company*, p. 36.

[50] Harris, *Industrializing English Law*, pp. 40–45.

[51] Ibid., esp. p. 144.

[52] On the evolution of the business corporation, its significance for European economic growth, and its advantages over partnerships, see ibid., esp. chaps. 2 and 5; and Lamoreaux, "Partnerships, Corporations."

European business community. Through side contracts, entrepreneurs effectively managed to mix and match the characteristic features of the basic organizational forms, broadening their possibilities even further. Thus, they modified partnerships to give them greater permanence and fine-tuned corporations to give minority shareholders protections against the decisions of the majority.[53] The outcome was nothing less than an organizational revolution that made Western economies increasingly efficient at pooling resources and exploiting commercial opportunities.

This brings us back to our central question. Why did the organizational forms available to Middle Eastern business concerns remain essentially fixed at a time when those in the West expanded steadily? For the answer, we must introduce a new consideration: differences between the Islamic inheritance system and the inheritance systems of the West.

THE ISLAMIC INHERITANCE SYSTEM

Of all the economic rules in the Qur'an, the most detailed are those on inheritance. Restricting the individual's testamentary privileges to one-third of his or her estate, the Qur'an reserves the unbequeathed portion to sons and daughters, spouses, parents, brothers and sisters, and possibly even distant relatives, according to rules dependent on the exact composition of the legal heirs. For certain special cases, the applicable rule differs across the two major denominations and, within the Sunni denomination, across the principal schools of law. One difference concerns the right to bequeath property to a relative who is already an inheritor. Only under the Shiite interpretation may the testator make bequests to relatives already entitled to part of the estate.[54]

The degree to which the Islamic inheritance system departed from the norms of pre-Islamic Arabia is a matter of controversy.[55] Whatever the extent of historical continuity, the imposed testamentary restrictions clearly subordinated the individual's personal preferences to the extended family's need for financial security and predictability. Also clear is that they strengthened the inheritance rights of female family members. Although a female heir's entitlement normally amounts to only half that of a male in the same class of inheritors,[56] in seventh-century

[53] For a wide variety of examples, see Lamoreaux and Rosenthal, "Organizational Choice"; and Lamoreaux, "Partnerships, Corporations."

[54] Fyzee, *Muhammadan Law*, chaps. 11–13; and Coulson, *Succession in the Muslim Family*, esp. chaps. 1–2, 8. In either case, the entire estate of a person who dies intestate is divided among his or her legal heirs.

[55] Powers, *Qur'an and Hadith*, finds similarities between the Islamic and Eastern Roman inheritance systems. He also shows that the Qur'anic verses on inheritance mark a smaller shift in Arabian practices than is usually presumed. For a survey of the debates, see Mundy, "Family, Inheritance, and Islam."

[56] For example, a daughter receives half as much as a son, and the mother of the decedent receives half as much as the father.

Arabia this right enhanced the economic security and social status of women.

It is frequently noted that the Islamic inheritance system tended to equalize the distribution of wealth. Another common observation is that its Sunni variants reduced intrafamily tensions by preventing wills from favoring certain heirs. More significant here is that the system's mandatory sharing rules made it difficult to keep property intact across generations. A study on Egyptian landownership trends during the early twentieth century documents the fragmentation of arable land into uneconomically sized plots through the combined effect of population growth and the Islamic inheritance system.[57] Likewise, studies of premodern Syria and Palestine show that fortunes often got fragmented. It was not uncommon for a dwelling or shop to have more than a dozen co-owners. Moreover, the sudden death of a wealthy person was often followed by complicated lawsuits, as family members and business partners fought over the estate's distribution.[58]

The difficulty of keeping wealth undivided is also evident in statistics concerning the intergenerational transmission of wealth. Research on prosperous Ottoman families of the sixteenth-century show that their descendants rarely remained wealthy beyond one or two generations. In contrast to Europe, no major aristocracies developed in either Turkey or the Arab world. Although the prevailing inheritance system was not the only factor at work—expropriations and opportunistic taxation were also significant—what matters is that it contributed to wealth fragmentation. In regard to enforcement of the Islamic inheritance rules, wealthy Ottomans, including the military-administrative elites, were treated more or less like ordinary Ottoman subjects.[59]

Just as the law of Islamic partnerships was sometimes circumvented, so Islamic inheritance practices often diverged from the relevant rules. Successive Middle Eastern regimes took measures to limit the fragmentation of agricultural land.[60] In certain places local norms allowed families to deny

[57] Baer, *Landownership in Modern Egypt*, pp. 79–83.

[58] Marcus, *Middle East*, pp. 209–10; Doumani, *Rediscovering Palestine*, pp. 70–71; and Meriwether, *Kin Who Count*, chap. 4.

[59] Kunt, *Sultan's Servants*, pp. 44–56.

[60] From the early days of Islam, Middle Eastern rulers became acutely aware of the efficiency losses and the reductions in tax revenue caused by property fragmentation. Accordingly, Islamic jurisprudence sought to limit this fragmentation by classifying most arable land as state property (initially *ard al-mamlaka*; under the Ottomans, *miri*). The cultivators of state-owned land enjoyed tenancy rights and paid the land tax in return. However, they could not sell, grant, or endow their plots. While their use rights could ordinarily be passed on to descendants, the land itself was not subject to inheritance rules, and generally it could not be partitioned (A. Cohen, "Mīrī"; İnalcık, "Land Problems"; and Cuno, *Pasha's Peasants*, chap. 4). When and where rulers were able to enforce their will, this measure kept farms as viable production units. But it did not prevent the fragmentation of other property, and it is movable wealth that is of primary interest here. The wealth of a commercial partner would consist partly of cash and merchandise. At least to that extent, it was subject to Islamic inheritance rules.

women their legal entitlements. And various methods were used to keep immovable property undivided: pre-mortem gifts to a relative, bequests to a minor child of the person targeted for favors, arranged marriages between legal heirs, side payments to induce the surrender of inheritance rights, and postponement of the estate's division.[61] The last method was made possible by the Qur'an's lack of specificity about when the division had to occur. The resulting ambiguity permitted powerful men to keep estates intact for years, even decades, without formally denying legal heirs their rights.[62] Still another method for keeping property undivided was to convert it into a waqf, or "Islamic trust." A waqf was statutorily indivisible, and its beneficiaries could include or exclude anyone the founder desired. So establishing a waqf allowed the selection of who would control a property after one's death.[63]

Of course, to identify opportunities for circumventing a law is not to establish that law's irrelevance or to prove that the opportunities were available to everyone. Take the last circumvention method. Because the scale of mercantile activities was generally quite limited, few merchants became wealthy enough to establish a foundation. In any case, setting up a waqf was seldom costless; although the relevant norms varied, founders were usually expected to commit substantial resources to charity. The option of postponing the estate's distribution could present another problem. Some groups of heirs lacked a powerful person capable of consolidating control over the estate and resisting demands for its immediate division.

Because our challenge is to explain why the Middle East's merchants and financiers lost ground to Westerners, let us now consider the inheritance practices of pre-modern Europe. These practices exhibited bewildering diversity, partly because of Europe's political fragmentation. But there could be major variations even within a politically unified region as small as Moravia or Lower Saxony. Moreover, rules and customs could change over a matter of decades. Given this remarkable variability, it is unsurprising that medieval Europe developed certain inheritance systems that were as inflexible as the most rigid Islamic variants. In parts of England, one-third of a deceased man's movable property was reserved for his wife and another third for his children, who had to be treated equally. Under medieval Germanic law, a father had no testamentary powers at all; the postmortem disposition of his property followed a fixed formula.[64]

[61] Mundy, "Family, Inheritance, and Islam" pp. 49–65, offers much evidence. See also Baer, *Landownership in Modern Egypt*, esp. pp. 115–16, 163–66; Meriwether, *Kin Who Count*, chaps. 4–5; and Powers, "Islamic Inheritance System," pp. 19–27.

[62] Meriwether, *Kin Who Count*, pp. 164–65, speaks of estates that remained undivided for as long as 30 years.

[63] Çizakça, *Philanthopic Foundations*; Yediyıldız, *Institution du Vaqf*; and Kuran, "Public Goods under Islamic Law."

[64] Kuehn, "Inheritance,"pp. 454–61; and Platteau and Baland, "Impartible Inheritance," especially sections 2–3.

For all their variations, practically every inheritance system of premodern Europe differed from the Islamic system in two critical respects. First, none defined the family as broadly as the Qur'an does. Usually the legal heirs were limited to the nuclear family. Second, because Christian canon law did not standardize inheritance requirements, practices were relatively easy to modify, and attempts at reform were unlikely to be resisted as sacrilegious. People on all sides of the issue found it easy to give Biblical justifications for their positions.[65] Barriers to keeping estates intact across generations were thus considerably lower in relation to the Middle East, where it was risky to challenge the authority of the Qur'an, especially on a matter it addressed explicitly.[66] From the Middle Ages to recent times, the un-Islamic—and unmodern—devices of primogeniture (the preference in inheritance given to the oldest son) and ultimogeniture (the preference given to the youngest son) enjoyed legal recognition in many parts of Europe. In the sixteenth and seventeenth centuries, when Western merchants were gaining increasing control over their trade with the Middle East, primogeniture was the dominant inheritance practice in Britain, the Low Countries, Scandinavia, and parts of Austria and France.[67] In the late-seventeenth century, over a few decades, the practice spread also within Germany.[68] This continent-wide trend allowed huge numbers of wealthy families to keep their assets intact without resorting to such costly methods as establishing a waqf.[69]

STATIC INSTITUTIONAL CONSEQUENCES

If Middle Easterners found it unduly costly to prevent the fragmentation of mercantile wealth, we might expect this handicap to have stimulated institutional experimentation. Instead, and as we shall now see, it made Middle Easterners less eager to find ways of increasing the size and complexity of their businesses. As a preliminary step toward identifying the dynamic processes at work, it will be instructive to compare the probable consequences of a partner's death in two particular jurisdictions: one that allows primogeniture and one that does not.

[65] Thirsk, "European Debates on Inheritance."

[66] Another complication in the Middle East is that the pre-Islamic inheritance customs of non-Arab converts, including the Turks and the Mongols, required the splitting of estates.

[67] Thirsk, "European Debates on Inheritance," figure 1. See also Kuehn, "Inheritance," pp. 457–60; Goody, *Family and Marriage*, pp. 118–25; Brinkmann, "Primogeniture"; Fichtner, *Protestantism and Primogeniture*, esp. pp. 14–21, 72–75; and Platteau and Baland, "Impartible Inheritance," esp. sect. 3.

[68] Fichtner, *Protestantism and Primogeniture*, pp. 72–73.

[69] Certain European practices favoring one child were accompanied by compensatory measures for his siblings. For example, where a family's land was reserved for its oldest son, his sisters might receive dowries and his younger son might be trained to take over the family's commercial operations. Such egalitarian measures were consistent with the goal of enterprise continuity. See Platteau and Baland, "Impartible Inheritance," sect. 3.

Consider a five-person partnership established in a European region where primogeniture is in force. It consists of three sedentary investors and two merchants. Each member's designated heir is common knowledge. After the partnership has been formed, and its traveling members have converted their capital into merchandise, one of the investors suddenly dies. The partnership has ended, and its deceased member's share has passed to his eldest son. In principle, the son may use his windfall gain on some other venture or seek to renegotiate the terms of the interrupted enterprise. Alternatively, he may agree to the original terms, letting the venture proceed as though no death had occurred. Historically, the initial terms were often reproduced automatically, for the partners and their heirs agreed in advance to preserve the venture even in the event of a death. Such an agreement was credible because every partner had an single alternate who was typically trained to take over his father's business. It benefited all concerned parties by raising expected profits.

Now suppose that an identical partnership has been formed in a region under Islamic law. Again, one investor dies while the active partners are preparing for their journey. The decedent's share must be divided among his possibly numerous relatives and, if he left a will, one or more nonrelatives. Imagine that there are four heirs. These heirs may agree to join the surviving members of the initial partnership to establish a new, eight-person partnership. They are also free, with or without side payments, to reconstitute the divided share by having three of them relinquish their inheritance rights in favor of the fourth. So there is no formal barrier to the venture's functional continuity under a partly renewed membership. Nevertheless, a single financially strapped heir may insist on the old partnership's liquidation. Such an outcome is all the more likely because the heirs will not have been groomed for carrying on the business. Under the Islamic inheritance system the set of heirs and their shares can change substantially following the birth of a new heir or the death of an existing one. The consequent uncertainty dampens every heir's commitment to ongoing enterprises.

In the Middle East, then, the probability of premature dissolution is particularly high. A further problem is that each heir's entitlement is to a prescribed fraction of every asset in the estate, movable or immovable.[70] Remember that contributions to an Islamic commercial partnership must be in currency, and its dissolution requires the liquidation of all of its tangible assets. In principle, an heir may force the sale of any good owned at the time of death, in order to receive his proper share of its net worth. In the absence of indivisibilities, an impatient heir's demand for immediate settlement might be met by liquidating only his own share of each good. However, a partial liquidation may force the surviving partners to seek additional fund-

[70] Coulson, *Succession in the Muslim Family*, pp. 2, 240.

ing. In any case, indivisibilities were not unusual; a partnership's assets sometimes included items such as slaves and livestock. So partners could well be forced to make sales at inconvenient times and places.

The number of heirs was not always large. If a merchant died intestate, and he was survived by one wife and a single son, his heirs would be limited to two, with the wife entitled to an eighth of his estate and the son to the remaining seven-eighths. Yet, successful and wealthy merchants—precisely those who might have pressured the courts to recognize increasingly complex commercial organizations—ordinarily had larger households, because they tended to have more children and were more likely to have multiple wives.[71] Moreover, it is in cases involving large estates that the wealth at stake made it worthwhile to launch a lawsuit. Reviewing the court records of Galata, Istanbul from the sixteenth and seventeenth centuries, Fethi Gedikli finds numerous suits by heirs demanding their shares of a prematurely dissolved partnership's assets.[72] Some of the merchants included in these records had so many heirs as to make serious fragmentation inevitable.

In the same vein, Abraham Marcus points to two eighteenth-century merchants based in Aleppo.[73] The fortune of the first was split among his wife and 13 children from consecutive marriages; and that of the second was divided among his four concurrent wives, seven sons, and six daughters. When the decedent had no surviving sons, many secondary relatives could gain entitlements. Cases reviewed by Marcus illustrate the possibilities: wife and four nephews; sister, uncle, and aunt; sister and three sons of a cousin; wife, two sisters, and seven cousins; wife, daughter, maternal grandmother, and two sisters. Nor need the rights generated by a partner's death be limited to his own kin. Because co-owners could sell or pledge their shares, the surviving members of a lapsed partnership might be confronted with persons unknown to their deceased ex-partner.[74]

Could the dangers of premature dissolution have been lowered by sticking to family businesses? After all, cooperation is achieved more easily within families than among nonrelatives, which is why family businesses are common even today. But one must not exaggerate their durability within the milieu of concern here. In the premodern Middle East prosperous merchants often invested in land, so successful commercial businesses often died with their founders. In any case, we should not lose sight of the evolutionary significance of partnerships, which may be formed between nonrelatives. Cooperative ventures can pool vastly greater resources by crossing family boundaries. This is why it has made sense to focus on *mudāraba*.

[71] Meriwether, *Kin Who Count*, pp. 94–95.

[72] Gedikli, *Osmanlı Şirket Kültürü*, esp. pp. 117–18, 226–32, 256–60.

[73] Marcus, *Middle East*, pp. 209–10.

[74] Ibid., p. 113. Although Marcus mentions this possibility in relation to shares in real estate, it applies also to shares in a commercial partnership.

Where *mudāraba* differs from its close Western counterpart, the *commenda*, is that the costs of restarting a *mudāraba* are higher. A death could force the liquidation of an Islamic partnership that would easily be reconstituted if it had been formed in a European region subject to primogeniture. In the Islamic world, then, the incentive to form large partnerships would have been weaker than in Western Europe. By the same token, the willingness to make long-term commercial commitments would have been relatively more limited.

If costs are borne by surviving members of a partnership that loses a member, it follows that, regardless of the prevailing inheritance regime, anything that shortens expected life spans will diminish the attractiveness of large partnerships. So it is that in Tuscany average partnership size shrank temporarily during the Black Death. Here is an explanation by Edwin Hunt and James Murray: "[H]igh mortality from the recurring plagues made long-term commercial associations very tenuous, especially when many heirs had become more interested in spending their inheritance than in perpetuating the business. And [large multiple partnerships] had become increasingly risky, requiring the close and dedicated attention of the owner-managers."[75] To this logic one may add that the risks of expanding a partnership depend on, in addition to natural factors, the prevailing inheritance system. Varying the inheritance system, with mortality held constant, will yield an inverse relationship between average partnership size and the difficulty of keeping property undivided. A society that encourages wealth fragmentation will have smaller partnerships than one that provides ways to avoid it.

DYNAMIC CONSEQUENCES

Why, then, did the Middle East's commerce with the West fall *increasingly* under Western domination? For an answer, we need to explore the dynamic consequences of the identified differences among Western and Islamic inheritance regimes.

The larger and more durable partnerships of Europeans unavoidably generated problems of their own, and the ensuing responses extended well beyond the accommodation of impatient heirs. To track resource flows and facilitate coordination, it became necessary to develop sophisticated accounting systems. Increases in the volume of shares changing hands gave rise to formal equity markets, which made it easier to raise new capital. Larger and longer-lasting partnerships instigated the creation of hierarchical control systems to economize on deliberation and decision costs. To list all the adaptations that turned Europe into a financial and commercial power

[75] Hunt and Murray, *History of Business*, pp. 154–55.

house remains, of course, outside our purview.[76] Suffice it to say that each of the European innovations reviewed earlier—linked partnerships, conglomerates, joint-stock companies—contributed to the organizational complexity of the modern global economy.

The *commenda*, like the general partnership in use in medieval Northern Europe, turned out, then, to be a self-destroying institution. In creating opportunities for wealth creation, it also set the stage for enterprises of greater size, scope, and longevity. And the resulting complex partnerships generated new problems, which fueled further organizational innovations. Not that every new organizational form met immediately with sweeping approval. As in other contexts, vested interests put up resistance. For example, the British crown long inhibited the formation of business corporations by making it expensive to obtain a corporate charter, and existing corporations opposed new ones to limit competition. But with every new organizational form, as its advantages grew, adoptions eventually spread. In turn, these successes prepared its destruction by stimulating a need for institutions conducive to even larger and even more complex business enterprises.

The persistently small partnerships of the Middle East did not face the accounting, coordination, and liability problems that demanded innovative solutions in Europe. So the Islamic inheritance system effectively closed off one path to economic modernization. In principle, of course, the Middle East could have developed modern organizational forms through some alternative path. Realizing that Westerners dominated the cross-Mediterranean trade, Middle Eastern merchants might have sought to emulate, say, the linked partnerships of the Medicis. However, it was not until the eighteenth century that trade with Europe loomed large in the Middle East's external economic relations. Until then, its trade with other regions remained more important. Moreover, Middle Easterners remained competitive in trading emporia where they did not have to compete with merchants backed by advanced institutions. In fact, in certain emporia, including South East Asia and East Africa, Islam's commercial institutions offered palpable advantages over their indigenous counterparts, as evidenced by the eagerness with which local communities borrowed key institutions of the Muslims with whom they came in contact. Emulating Western business practices did not become a pressing need until the eighteenth century. Significantly, a century after this point was reached, reforms were undertaken to enable all Middle Easterners, including Muslims, to conduct business under borrowed Western legal codes.

By the seventeenth century it was possible to establish business corporations simply by emulating the European super-companies active in the

[76] Hunt and Murray, *History of Business*, review developments to 1550. For the subsequent evolution of Western business structures, see Harris, *Industrializing English Law*; Ireland, "Capitalism without the Capitalist"; Freedeman, *Joint-Stock Enterprise in France*; and Neal, *Rise of Financial Capitalism*.

Middle East. So another path to economic modernization would have involved amendments to Islamic law *before* it became necessary to adopt Western institutions on a wholesale basis. Alternatively, a creative person might have conceived of an organization akin to the business corporation independently, while seeking a way to build a durable enterprise resistant to fragmentation. But the Islamic world's lack of familiarity with the corporate form made such innovation in commercial organization improbable. In Europe, where the corporation had long served diverse functions, extending the concept to the commercial domain did not require a major conceptual leap. Besides, the courts were already accustomed to dealing with corporate bodies. In the premodern Middle East, by contrast, the business corporation would have represented a revolutionary concept. Lacking experience with cases involving fictitious persons, the Islamic courts would have had to alter their operations fundamentally.

Perhaps the most obvious alternative to the modernization path actually followed—the wholesale adoption of institutions born in Europe—would have involved liberalizing the inheritance rules that constrained enterprise growth and durability. However, the explicitness of the Qur'anic provisions on inheritance assured that they would not be openly questioned or resisted, except in a grave crisis.

For many centuries, therefore, all these alternative paths remained paths not taken. While the *commenda*'s successes undermined its own viability, not even the failures of the *mudāraba* induced fundamental institutional changes in the Islamic Middle East. On the contrary, the *mudāraba* turned out to be a self-reinforcing institution. Indeed, by spreading to regions beyond Islam's heartland, it limited the trading emporia in which Middle Eastern traders encountered difficulties, thus dampening pressures for reforms. The resulting organizational stagnation prevented Middle Eastern merchants from staying competitive with their Western counterparts. As late as the sixteenth century, of course, the resulting gap in commercial capabilities remained small. However, it was bound to grow.

As already mentioned, around the tenth century the West and the Middle East had functionally more or less identical commercial institutions. What differed was the inheritance system and the legal system's openness to corporations. Why these differences in institutional preconditions? In particular, why did the Islamic inheritance system rule out primogeniture while European laws proved flexible enough to allow it? And why did the founders of Islam's legal schools not leave room for corporate entities? S. D. Goitein offers a plausible answer to the first puzzle.[77] In ancient Western Arabia, the birthplace of the Islamic inheritance system, most wealth belonged to traders and nomads whose possessions consisted of movable and easily partitioned

[77] Goitein, *Mediterranean Society: Abridgment*, p. 190.

goods, such as animal herds and cash. So the Islamic inheritance rules took shape in a society unconcerned with asset fragmentation.[78] By contrast, the Roman and Germanic legal systems, the founts of the Western institutions of concern here, developed in agricultural societies whose members sought to keep land in units large enough to sustain a family. As for why Islamic law turned out to be thoroughly individualistic, a key factor was probably the factionalism that created the Sunni-Shiite rift just a few decades after Islam's emergence. Fearing further divisions, the jurists may have endeavored to keep factions weak by denying them opportunities for achieving legal standing as collectivities.

Perhaps small events—intrinsically insignificant events that would not have left historical traces—helped to close off certain evolutionary paths. But whatever the full explanation for the differences in preconditions, they clearly had unintended and unforeseeable long-term consequences. Most critical here, for all its virtues, including the brakes it put on hereditary inequality, the Islamic inheritance system dampened incentives to enlarge partnerships. A further ominous consequence was the absence of institutional advances that would have allowed large enterprises to form and operate efficiently.

COMPARISON WITH RECEIVED EXPLANATIONS

There have been other attempts to explain why the Islamic world lost economic ground to the West. Until the mid-twentieth century, a popular explanation was that Islam defines a timeless, closed, and unadaptable economic system. By this account, the fixity of Islamic law blocked the organizational adaptations necessary for the Middle East to remain commercially competitive.[79] Yet, Islam's first few centuries saw fundamental institutional changes. For example, Islamic partnership law took shape over three centuries. In any case, certain economic institutions of the Middle East—for instance, its diverse tax systems—continued to evolve even after the legally formative period. Insofar as commercial and financial institutions stagnated, it is essential, then, to provide a mechanism, or a set of mechanisms, to account for the historical record. This article has offered mechanisms centered on the Islamic inheritance system and the ultra-individualism of Islamic law.

In a still influential paper, Claude Cahen observes that the commodities Middle Easterners wanted from abroad were found primarily in the East.[80]

[78] The details of the Islamic inheritance system were worked out over the next few centuries, with inputs from heavily agricultural societies. But its egalitarian principles endured, doubtless because they are spelled out in the Qur'an.

[79] For one variant of this view, see Cromer, *Modern Egypt*, esp. vol. 2, pp. 228–35. This argument is critiqued by Kuran, "Islam and Underdevelopment," sect. 4.

[80] Cahen, "Déclin Commercial."

In addition, he says, Middle Eastern markets were large enough to absorb the region's entire production. From these premises, Cahen infers that it was natural for the Middle East's merchants to concentrate on business with Central Asia, India, and the Far East, leaving the Mediterranean emporium largely to Westerners. Moreover, it made sense for Middle Easterners to use their exportables mainly for fabled luxuries from the East. While avoiding the fallacy of institutional unchangeability, this explanation makes the mistake of treating production volumes as fixed. Even if trade with the East was more important, profit opportunities might have induced some local merchants to seek their fortunes in the Mediterranean emporium; and these opportunities would have stimulated the production necessary to meet the Western demand. If it is granted that Middle Eastern traders could have been active in the West as well, we are left with the task of explaining why the Middle East's experiences differed across trading emporia. Europe's institutional advances put Middle Eastern merchants at a disadvantage, but, at least initially, only in their interactions with Europe. Because economic modernization was delayed also in the East, right up to modern times the Islamic legal system kept Middle Easterners competitive in Eastern markets.

K. N. Chaudhuri offers still another explanation that suffers from an assumption of fixity.[81] As a rule, he observes, the Middle Eastern and Far Eastern traders active in the Indian Ocean wielded little political power. Consequently, few earned much, and they failed to achieve the scale economies necessary for effective competition against European companies. But why was the requisite political influence lacking, when earlier merchants were powerful enough to have significant representation among the jurists who shaped Islamic law? Reversing Chaudhuri's causality, I would suggest that merchants were persistently weak because the legal infrastructure of the Middle East (and of the Far East) discouraged large-scale commerce. Had Islamic law made it easier to keep commercial fortunes intact over generations, the merchant class might have gained sufficient strength to induce the institutional changes essential to remaining competitive. The same criticism applies to Mehmet Genç's theory of the Ottoman Empire's failure to keep up with Europe.[82] The concept of helping merchants to prosper was alien, maintains Genç, to the ideology of the Ottoman ruling class. True enough, but why, say around the seventeenth century, were Ottoman merchants too weak to reshape the dominant ideology in their own interest?

Every religion affects economic performance by helping to shape the legal framework for economic exchange. But religious interpretations, like the laws these underpin, are changeable. If they stagnate, one must identify the underlying causes. In the Middle East, common knowledge about the risks

[81] Chaudhuri, *Trade and Civilization*, chap. 10, esp. p. 212.
[82] Genç, *Devlet ve Ekonomi*, chaps. 1–4.

of forming large partnerships led merchants and investors to avoid developing them. The simple organizational form typically used to conduct long-distance trade, the *mudāraba*, was thus self-enforcing. In was also self-reinforcing, because the stability of the Middle East's commercial infrastructure contributed to the conditions noted by Chaudhuri and Genç. Specifically, the social standing of the merchant class weakened over time, facilitating the spread of anti-mercantile ideologies. It thus became all the more difficult for merchants to get new contractual forms accepted as properly Islamic.

THE COMMERCIAL ASCENT OF RELIGIOUS MINORITIES

The essence of my argument has been that the Middle East found itself engulfed in a commercial crisis as the West developed commercial institutions more efficient than those of Islam. How might this argument be tested? The experiences of the Islamic Middle East's religious minorities—chiefly the Greeks, Jews, Armenians, and Christian Arabs—offer a pertinent natural experiment. Unlike the Muslim majority, these minorities were entitled, especially on matters of personal status but to an extent also on business matters, to choose among legal jurisdictions. From the early days of Islam, they could establish Islamic partnerships and take their disputes to Islamic courts; they could also use non-Islamic contractual forms and opt for arbitration within their own community. Their recorded choices can provide valuable information about the relative efficiency of competing legal systems. And variations in these choices may yield clues as to changes in relative efficiency.

For the better part of the millennium that our narrative has spanned, from around the tenth century to the eighteenth, the Middle East's Christian and Jewish traders routinely opted for Islamic contractual forms. Writing in Spain in the twelfth century, Maimonides complained of Jewish traders doing business in an "Islamic manner."[83] What bothered him was that his co-religionists were favoring Islamic partnerships over the Jewish *ʿisqa*, because the former offered broad options with regard to profit shares. Other rabbis complained about Jewish merchants taking disputes among themselves to Islamic courts. Like Jewish merchants, Greek merchants made heavy use of the Islamic legal system. The Islamic courts were popular among minorities partly because of their superior enforcement capability.[84] However, also relevant was the relative efficiency of Islamic law. Its local alternatives were not fundamentally different, so the advantages of better enforcement tipped the balance. These observations accord with the fact

[83] Udovitch, "Institutions of Credit," pp. 199–201.
[84] Fischel, *Jews*, p. 29; and Goitein, *Mediterranean Society, 1*, chap. 3.

that in this period the region's minorities did not dominate its internal commerce.[85] As traders of all faiths generally relied on the same institutions, this is not surprising.

Evidence from later centuries shows that religious minorities continued to conduct much of their business under Islamic law. In seventeenth-century Kayseri, Greeks and Armenians took their financial and commercial disagreements to Islamic courts at about the same per capita frequency as the city's Turks.[86] There is more evidence of Jews using rabbinical courts. But the rabbinical *responsa* are loaded with complaints about Jews flouting Jewish law. Among Ottoman Jews of the fifteenth and sixteenth centuries the use of Islamic courts was widespread.[87] Evidence pertaining to Christian courts in the Ottoman Empire is quite limited relative to evidence of Christians appearing in Islamic courts as litigants, witnesses, guardians, agents, buyers, and sellers, most certainly because Greeks, Armenians, and other minorities generally took their disputes to Islamic courts.[88] Data from late-eighteenth and early-nineteenth century Damascus show that non-Muslims often appeared before Muslim judges with complaints against their co-religionists, even against their own relatives.

If the Islamic inheritance system did indeed help to give the Islamic commercial system a self-reinforcing character, might the religious minorities have escaped the consequences of this stagnation? After all, their "choice of law" applied with special force to inheritance, considered a matter of personal status. In principle, moreover, the inheritance systems of the minorities could have shown the same variations found in Europe. There was no legal obstacle to the use of primogeniture among, say, the Greeks. Yet, the inheritance practices of non-Muslim subjects resembled those of Muslims. This was because anyone, regardless of faith, could challenge an inheritance arrangement in an Islamic court. Mindful of this right, which disgruntled Christians and Jews routinely exercised, minority families took care to accommodate their members who might demand an Islamic settlement. For instance, a daughter would receive a share of her father's estate, lest she seek redress in an Islamic court. Consequently, fragmentation was as much a threat to enterprises owned by non-Muslims as it was to ones of Muslims.

The foregoing pattern started to change significantly only in the eighteenth century, when huge numbers of Christians and Jews became protégés of one European power or another, partly to benefit from the growing competitive advantages conferred by Western laws. As protégés, they gained the

[85] Although certain sectors and regions could be controlled by one religious community or another, Muslims were by no means unsuccessful in the most lucrative arenas.

[86] Jennings, "Kayseri," pp. 181–82. For further evidence, see Argenti, *Chios*, p. 208; Faroqhi, *Men of Modest Substance*, pp. 183, 191; and Jennings, *Ottoman Cyprus*, p. 133.

[87] Shmuelevitz, *Jews of the Ottoman Empire*, chap. 2.

[88] Al-Qattan, "*Dhimmīs* in Muslim Court," p. 439.

ability to use consular courts operated by European functionaries familiar with Western legal developments. The consular courts enforced formal insurance contracts, recognized judicial personalities, made room for lawyers, and attached evidentiary value to documents even in the absence of corroborating oral testimony. In addition, they were accustomed to dealing with large and complex organizations, including joint-stock companies and corporations. In all these respects, the traditional Islamic courts, which did not recognize any of the new organizational forms, were at best unreliable.

The region's Muslim merchants—Turks, Arabs, Persians, and others—might also have started changing jurisdiction. They could observe that the religious minorities were gaining ground in local commerce and finance, and making inroads into the trade with Europe. But jurisdictional switches by Muslims would have entailed a huge break with the time-honored legal tradition that denied them the choice of law available to religious minorities. Hence, their only realistic option was to demand modern commercial courts, in the expectation that new legal opportunities would enable them to overcome their handicaps. In the nineteenth century, at a time when political and military weaknesses made local statesmen increasingly receptive to reforms, the Middle East entered a new legal era with the creation of essentially secular commercial courts in Istanbul, Alexandria, and Cairo. These new courts, which were followed by others, did not instantly restore the competitiveness of merchants accustomed to doing business under Islamic law. For one thing, the new courts did not become proficient overnight. For another, precisely because of past institutional handicaps, few Muslim merchants possessed adequate financial and human capital.

Individuals signal something about the relative efficiency of alternative legal systems when they walk away from one and embrace another. From the developments of the nineteenth century we can thus infer that the long stagnation of Islamic commercial law had reduced its appeal to profit-seeking merchants.

CONCLUSION

Economic history is replete with unanticipated long-term consequences, both good and bad. The Islamic commercial crisis that accompanied the rise of the modern global economy is an example of an unfortunate consequence that could not possibly have been foreseen a millennium earlier. The Islamic law of partnerships was well suited to the medieval economy in which it developed. And the Islamic inheritance system served as an equalizer of wealth by providing mandatory inheritance shares to all sons and daughters. What could scarcely have been predicted a millennium ago is that these institutions, in the face of developments outside of Islamic domains, would end up incapacitating Muslim merchants in their dealings with the West. Nor, at the time, was there reason to fear that certain provisions of Islamic law would give Christians and Jews of the Eastern Mediterranean commercial advantages over the Muslims among whom they lived.

Ever since the Middle East became an economically underdeveloped region, thoughtful observers have wondered whether Islam has discouraged commerce, enrichment, and growth. It is hard to find intentional measures that make Islam stand out among the world's great religions as a source of economic inefficiency or retardation. On the contrary, it is easy to link early Islam to institutions supportive of enrichment. Nevertheless, some of these very institutions turned into sources of inefficiency. Islam's law of partnerships limited enterprise continuity by requiring reorganization at every death or retirement. Its inheritance system compounded the problem by raising the cost of reorganization. And the lack of an Islamic concept of corporation blocked alternative paths to economic modernization.

Given the important role that Islamic law played in the economic life of the premodern Middle East, it is hardly surprising to find that it contributed to the region's economic frustrations. But the underlying mechanisms have never been clear. Part of the explanation, we have seen, lies in certain organizational constraints that Islamic law imposed on economic life. Another part, also critical, is that the legal systems of the West allowed greater opportunities for organizational advances. It is the resulting divergence of civilizational paths that turned Islamic law into a commercial handicap.

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