

Tiles of the Karatay medrese, Konya (1251)

Institutional Roots of Economic Underdevelopment in the Middle East

Timur Kuran

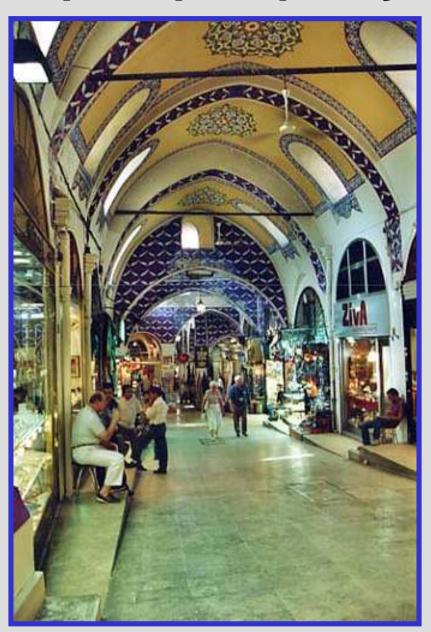
Economic Standing of Middle East, 2007

Country or country group	Life expectancy at birth	Income per capita (\$)
Africa (non-Arab)	51.5	2,029
India	63.4	2,753
China	72.9	5,383
Middle East	69.4	9,418
Arab League	68.5	8,103
Iran	71.2	10,955
Turkey	71.4	12,955
OECD (except Turkey)	77.8	33,755

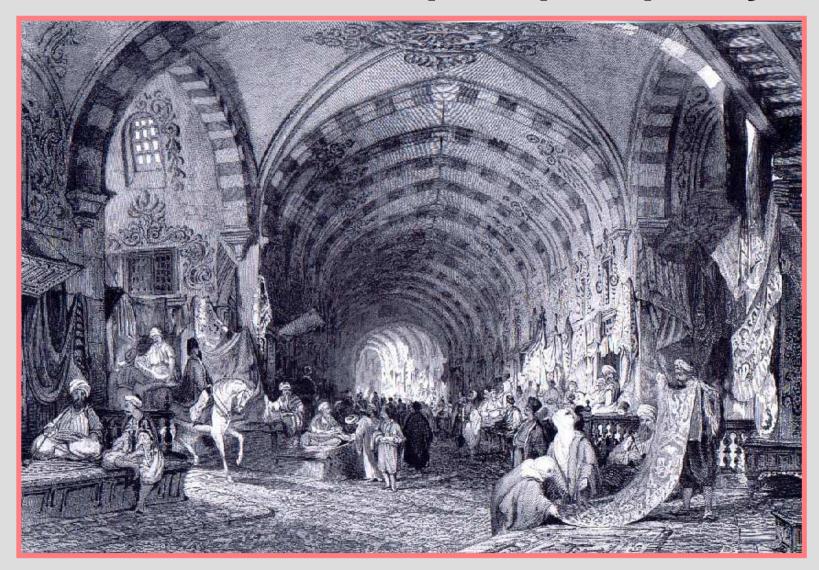
Evidence of past prosperity

Street in Grand Bazaar, Istanbul, 2005

> Built 1460-70 4400 shops



Evidence of past prosperity



Carpet sellers

Street in Grand Bazaar, Istanbul, 17th c.

Causes of underdevelopment

Misguided state policies

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- Stagnant private sector

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 - > inability to compete in global markets
 - > inability to supply capital to the state

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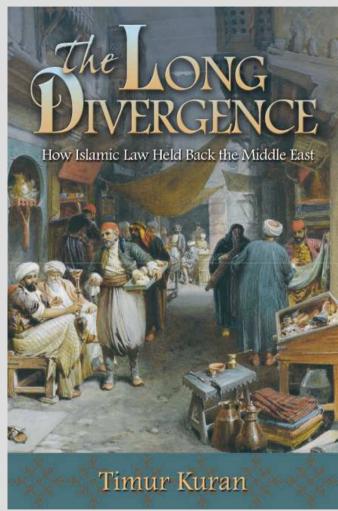
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18th -19th c.: Start of western colonization, initial bankruptcies, massive reforms prompted by failures (LATE SYMPTOMS)

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9th-10th c.: Emergence of region's classical institutions for pooling resources and providing public goods [all incorporated into sharia, known also as "Islamic law"] (CAUSES)

Princeton University Press January 2011



Industrial Revolution

18th-19th c.: Technologies of mass production emerged in W. Europe



Watt steam engine

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... which possessed the organizational means to exploit them.



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London stock exchange, 19th c.

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London stock exchange, 19th c.

Middle East lacked organizational capabilities to use new technologies.

Lack of industrialization in Middle East

Physical technologies are easily transferable, organizational capabilities are not.

First modern Ottoman company

Şirket-i Hayriye ("Auspicious Company"), 1851.



A Şirket-i Hayriye passenger ship

First modern Ottoman company

Şirket-i Hayriye ("Auspicious Company"), 1851.

- Joint-stock company
- > 1500 shares
- Predominantly Muslim-owned
- ➤ Largest shareholder: Sultan Abdülmecit



Abdülmecit, Ottoman Sultan (1823-61)



A Şirket-i Hayriye passenger ship

Abdülmecit's motive

Through Şirket-i Hayriye, Abdülmecit tried to break a vicious circle that kept Muslim businesses minuscule.



Şirket-i Hayriye ships Istanbul (1890)

Basic organizational forms

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

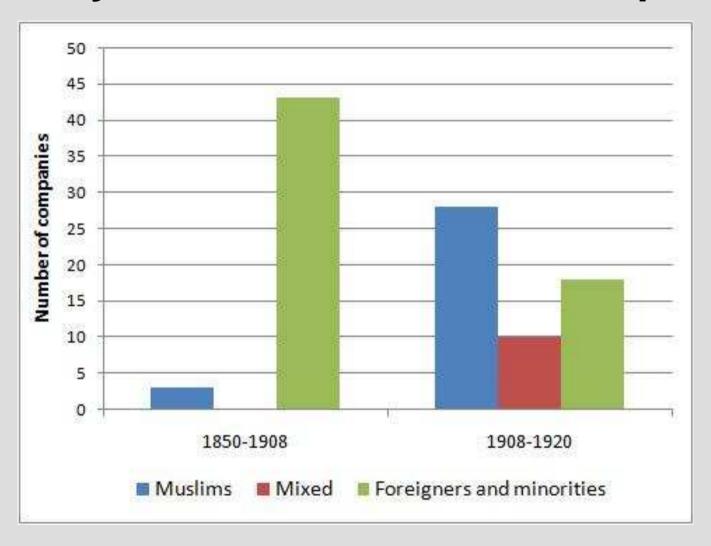
Basic organizational forms

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Joint-stock company	Yes	No	Suitable to larger, longer-lived ventures. Third parties can sue only individual partners.
Corporation	Yes	Yes	Can outlive owners and managers. Can sue and be sued. Shareholders have limited liability.

Publicly traded new Ottoman companies



Source: Akyıldız, Ottoman Securities

Commercial partnerships, c. 1000 (1)

Mudaraba (type of partnership)

labor of merchant or producer + capital of passive investor

Profit shares negotiated freely in advance

Losses shared up to a point

investors had limited liability



Judge's decision on a partnership dispute: Galata (1682)

Commercial partnerships, c. 1000 (2)

Mudaraba (type of partnership)

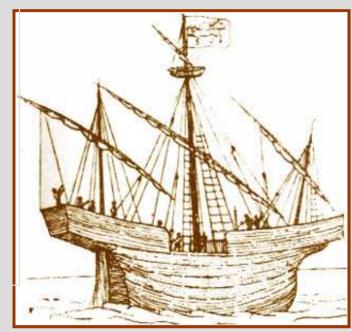
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Similar partnership form in W. Europe: commenda

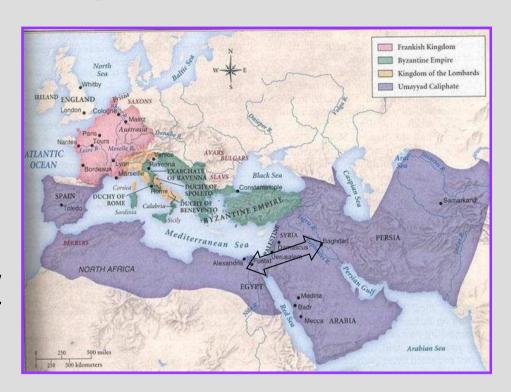


Medieval ship

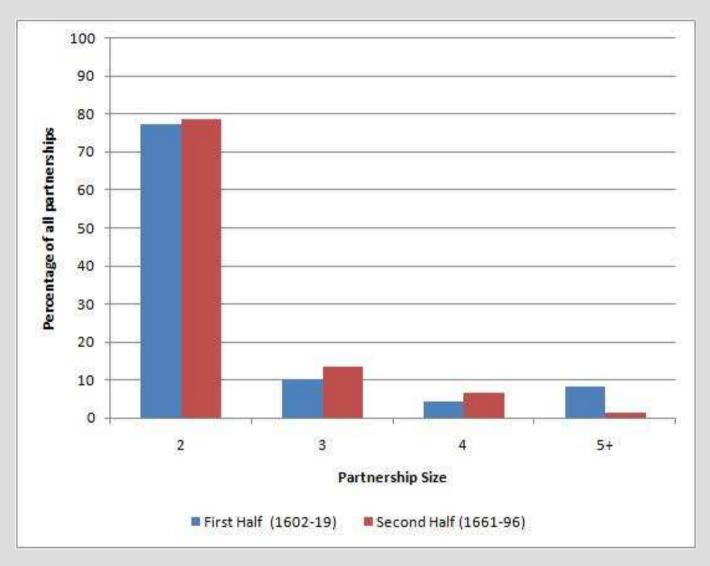
Scale, longevity

No limit on number of partners or duration In practice,

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



Partnerships in Istanbul, 17th century



No statistically significant difference between distributions in two halves of century.



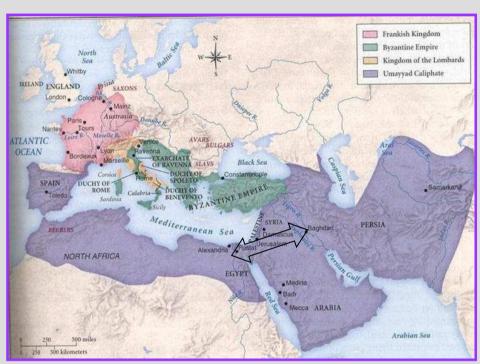
İş Bankası Kültür Yayınları,

Vols. 1-4 published

Vols. 5-10 due May-September 2011

Recontracting

- Recontracting possible
- Partnership not a durable enterprise
 - ➤ If a partner dies, partnership ends, his assets pass to heirs



Inheritance system

- At least 2/3 of estate reserved for extended relatives
- Female share = $\frac{1}{2}$ (male share)
- Hinders keeping property intact over generations
 - ➤ Heirs could reconstitute a dissolved business, but cost rose with numbers
 - Probability of fragmentation greatest for most successful merchants
 - Multiple wives → more children → more heirs

Choice of size, longevity

Risk of premature dissolution rises with partnership size

Merchants and investors minimized risk by keeping partnerships small

Choice of size, longevity

Risk of premature dissolution rises with partnership size

Merchants and investors minimized risk by keeping partnerships small

Risk of premature dissolution rises with partnership duration

Merchants and investors minimized risk by keeping partnerships ephemeral

What was different in Europe?

- Same threat to continuity in W. Europe
- Variety of inheritance laws
 - Primogeniture: business falls to oldest son
- Enterprise continuity through sideagreements

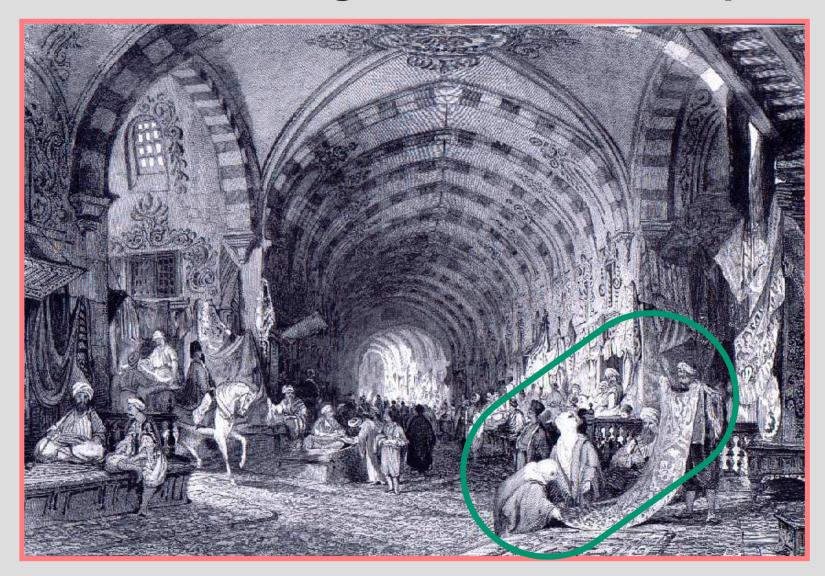


Effects on organizational development

Stagnation in enterprise size and longevity ->
No need to improve organizational techniques

- > No standardized accounting
- No stock markets

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Street in Grand Bazaar, Istanbul, 17th c.

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Stagnant division of labor in commerce finance

Distinct occupations in Arab Middle East

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

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

Distinct occupations in Arab Middle East

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

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

Division of labor lags in commerce

New occupations in Arab Middle East, 1101-1500

Sectors	% pre-existing	% new
Commerce	50.9	49.1
Bureaucracy, military	10.9	89.1
Education, law, religion	16.1	83.9
ALL	24.7	75.3

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

Commerce least innovative part of economic system

The onset of underdevelopment

- A. Commerce between Middle East and Europe fell increasingly under control of Westerners
- B. As West industrialized, Middle East could not exploit new technologies

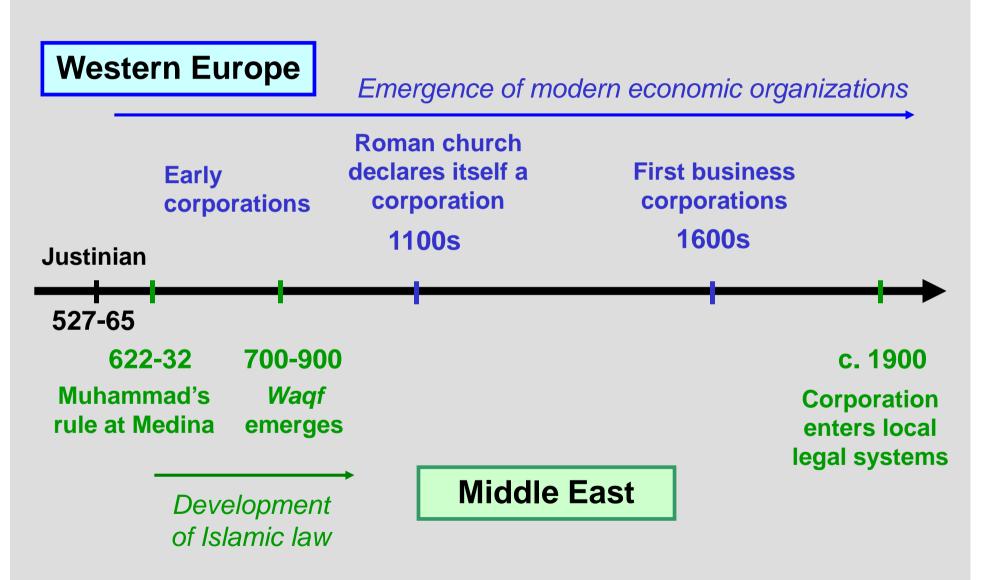
The onset of underdevelopment

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Organizational forms could not be borrowed, because complementary institutions were lacking

- > Firms require modern bookkeeping
- Capital limited in absence of stock markets, banks

Rise of the waqf and the corporation



Waqf

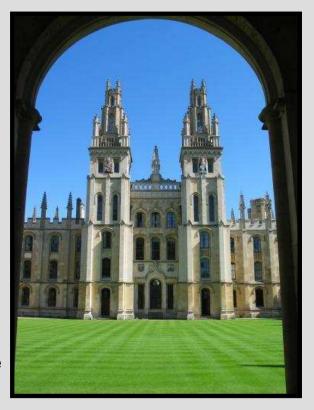
Unincorporated trust founded by an individual through conversion of immoveable property into an endowment to finance a designated service in perpetuity.

Principal vehicle for providing social services, including those provided in West through corporations



Al Azhar College and Congregational Mosque (975)

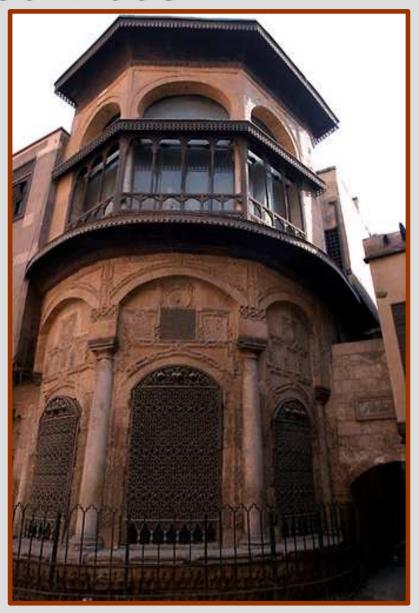
Oxford University (1096), All Souls College



Possible services

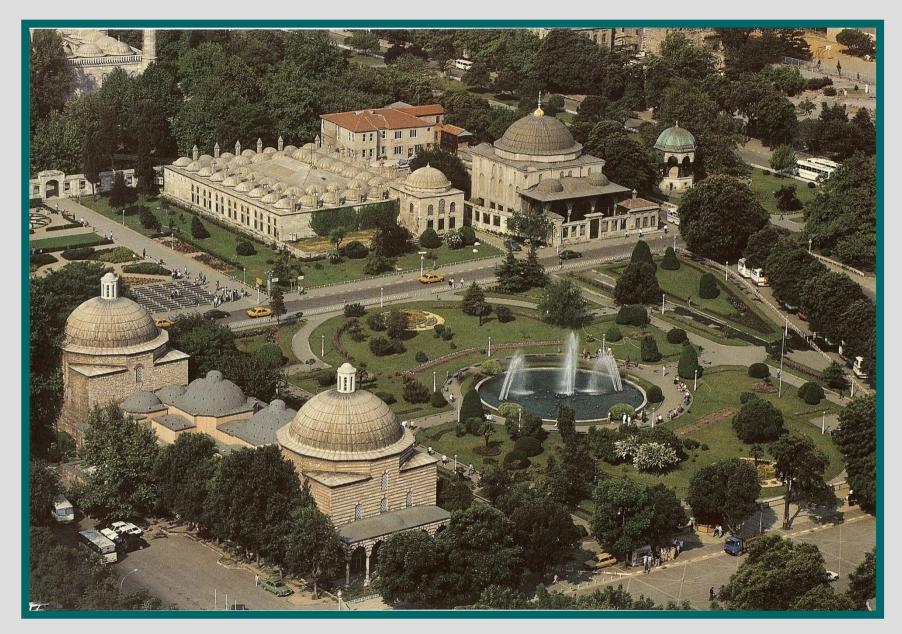
- Anything allowed under Islamic law
 - Mosque, school, hospital, lighthouse,
- Permitted private provision of public goods now commonly supplied by governments

Sabil-kuttab Nafisa Al-Bayda [fountain+Qur'an school], Cairo, endowed in 1796 as a waqf



Medrese (college) of Çoban Mustafa Paşa, Gebze, Turkey (1524).

Financed by a waqf.



Rear. Medrese [College] of Ahmet I (1610) / Front: Haseki Sultan bathhouse (1540s), Istanbul



Caravanserai of Zazadin (Konya, Turkey), 1237.



Charitable complex (külliye) of Seyyit Battal Gazi, Eskişehir, Turkey (1208): Built and financed through a waqf

Origins of waqf

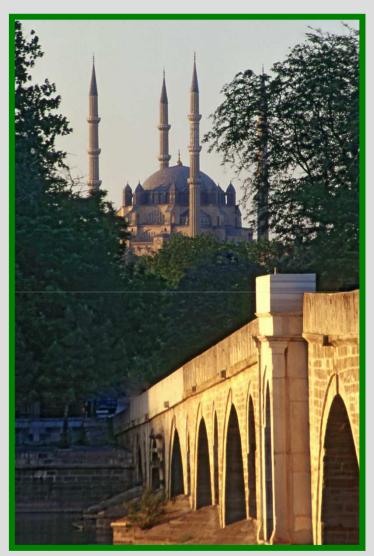
- Earliest evidence: 8th c.
- Private property insecure
 - > During fiscal crises, expropriations & new taxes
- Property holders sought wealth shelter
 - > Richest people were high officials
- Older civilizations had developed forms of trust
- Creative response to weak property rights

Sacredness of waqf

Waqf assets considered sacred

- → Rulers unlikely to confiscate its assets
- → People endow waqfs to protect property

Material advantages



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

- Founder of a waqf could appoint him/herself or friend as its manager for life
- Founder empowered to
 - set employee salaries
 - make appointments
 - designate successor
- Endowed assets could be used to circumvent inheritance law

Organizational consequences over long run

- Corporate characteristic
 - > Could outlive its beneficiaries



Caravanserai of Aksaray (Turkey), 1229. Financed by a waqf for use by merchants.

Organizational consequences over long run

- Corporate characteristic
 - > Could outlive its beneficiaries
- Static organization
 - ➤ Not self-governing
 - Not profit maximizing
 - > Courts enforce waqf deed
 - Prone to becoming dysfunctional



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- Wealth-sheltering function sucked capital out of commercial sector



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

 Corporate form could have been borrowed from abroad, invented

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

- Corporate form could have been borrowed from abroad, invented
- Critical institutional ingredients lacking
 - Persistently small partnerships, due to inheritance law
 - No standardized accounting
 - > No stock markets
 - > Legal system unaccustomed to legal personhood

Beginnings of divergence (c. 700-900)



Codification of Roman Law by Justinian (560), Nebraska State Capitol, outer wall

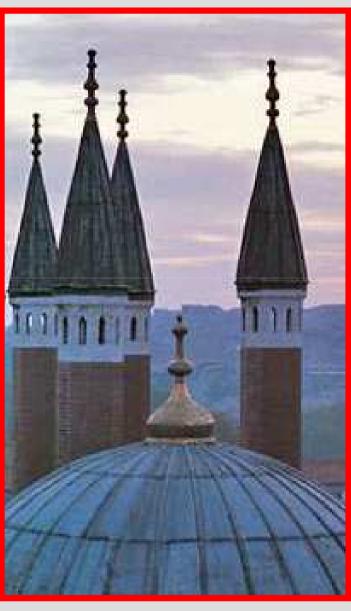
Roman law
Trust
Corporation

West Corporations proliferate to provide order in face of weak states

Middle East Waqfs proliferate as protection against strong states

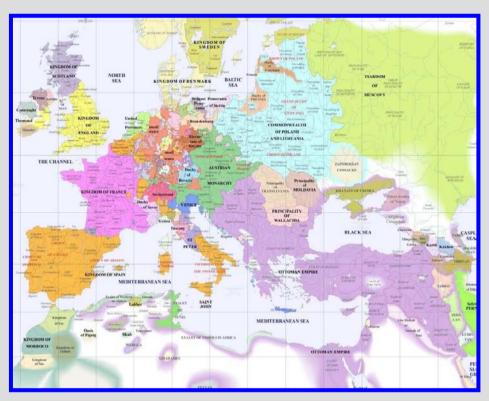
Attitudes toward innovation

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



- Region not opposed to innovation per se
 - As commercial organization stagnated,
 - government organization evolved
 - tax system evolved
- Islamic institutions not inherently static
- Stagnation in commerce was an unintended consequence of early institutions

Trade between Middle East & Europe



Mediterranean world, c. 1600

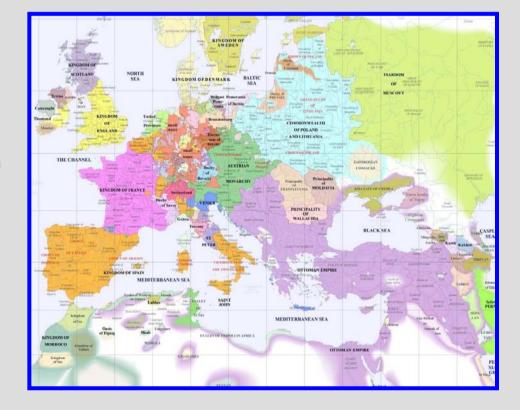
Institutions governing trade, finance, inheritance differed between Europe and Middle East

What institutions governed exchanges between these two regions?

Foreign trade privileges

Capitulations: Bilateral commercial treaties negotiated between Muslim and Christian rulers

Gave unreciprocated rights to subjects and protégés of Christian rulers



Mediterranean world, c. 1600

Progression of capitulations

- 12th-13th c.: Physical security, legal autonomy, tariff concessions
- 15th-16th c.: Fees, relations with local courts, contract enforcement
- 17th-18th c.: Limits on powers of local officials
- 19th c.: Discrimination against local merchants

Standard appraisal

Most Middle Easterners, most historians:

- (1) Capitulations were a colossal mistake
- (2) They invited impoverishment, subjugation

Claims

- (1) Rulers had reasons to make concessions
- (2) Also lasting benefits

Common political & economic explanations

- 1. Geopolitical objectives: Split Western Europe.
 - Sheds no light on substance of the capitulations
- 2. Domestic politics: Limit capital accumulation by local merchants.
 - Does not require foreigners to have own courts
- 3. Easier to raise revenue from foreign merchants:
 Paid higher duties.
 - Precedents for raising taxes on domestic merchants
 - Capitulations lowered duties
- **4. New trade routes:** Stimulate trade through Middle East
 - Unclear why foreigners singled out
- **5. Strategic goods:** Encourage foreign suppliers
 - Unclear why foreigners singled out



Trade routes passing through Middle East on the eve of the global explorations

Missing institutional dimension

- Capitulations needed to stimulate Mediterranean trade
- As they evolved, West was developing institutions essential to impersonal exchange, commercial expansion
- Capitulations substituted for institutional advances in Middle East

A. Pursuit of contractual credibility (1)

Under Islamic law, everyone entitled to sue in Islamic courts

French capitulations of 1536:

Kadis [judges]... may not try any difference between [French] merchants and [French] subjects, even if the said merchants should request it, ...

... and if perchance the said kadis should hear a case, their judgment shall be null and void.

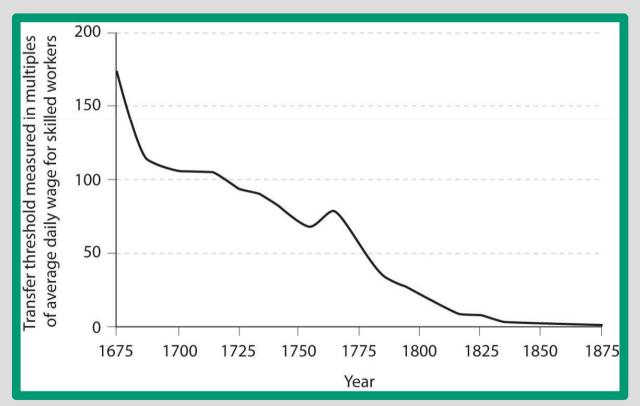
Contracts among French become more credible French contracts with Ottoman subjects continue to lack credibility

Pursuit of contractual credibility (2)

French capitulations of 1675:

cases > 4,000 akçes to be tried by high-level administrators

- High-level tribunals sensitive to international pressures
- Less turnover among high officials than among kadis (judges)



B. Quest for predictable returns

By 17th c. foreigners had "most favored nation" status regarding tariffs

Immunities against opportunistic levies (avârız = avanias)

➤ Made commercial returns more predictable

No collective punishment

> Aligned individual rewards with individual effort

C. Documentation requirement

1442 onward (Mamluk Egypt):

Contracts with foreigners must be in writing

1536 (Ottomans): Lawsuits against foreigners require documentation

In a civil case against Turks, tributaries, or other subjects of [Süleyman the Magnificent], the merchants and subjects of the King [of France] can not be summoned, molested, or tried unless the said Turks, tributaries, and subjects ... produce a writing from the hand of the opponent, or a heudjet from the kadi [judge].

[A kadi] may not hear or try [French] subjects without the presence of their dragoman [tercüman = translator].

Anti-foreign biases of local courts

Pre-modern courts biased against foreigners

- Presumed rule of evidence in Islamic courts
 Muslim testimony carried more weight than non-Muslim testimony
- Not applied consistently, if at all

Foreigners disadvantaged because of

- unfamiliarity with language, legal proceedings
- > oral procedures, which are subject to abuse

Europe's move to impersonal exchange

Enforceability of oral contracts falling in W. Europe

- > Statute of Frauds, England (1677)
- Promoted by literates, resistance from illiterates

Data source: Court cases, 1602-97



Istanbul #9
(1662):
Cover and four pages
(text in Ottoman Turkish, in kırma Divani script)





Registers of 2 courts in Istanbul, Ottoman commercial center: Galata, central Istanbul.

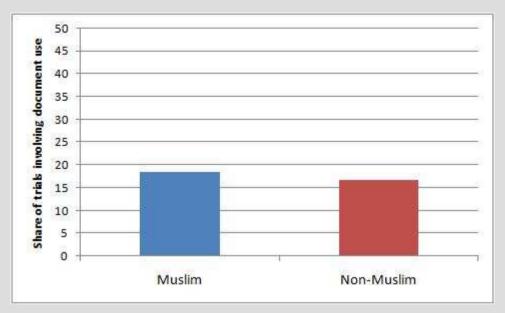
15 of the 400+ registers (*defters*) in this period: 10,080 cases

Document use in commerce

Register	Registration	Trials that used documents	Trials based solely on oral testimony	Total trials
Total	6494	351 (15.3%)	1940 (84.7%)	2291

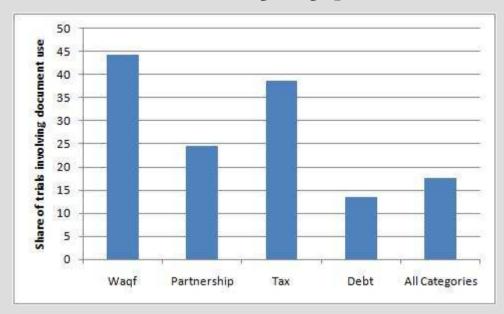
Foreigners doing business in the region deal with an oral legal culture.

Document use by religion: Overall



No significant difference in document use across principal religious groups: Muslims, Christians, Jews.

Document use by type of dispute



- Fear of overtaxation made people keep documentation of their tax obligations and payments.
- At its founding, a waqf (Islamic trust) was registered in court by law.
- Merchants and investors did not like to record partnerships for fear of supplying information to tax collector.
- In credit markets, people dealt with acquaintances, which reduced need for documentation.

Use of oath in civil trials

Dates	Resolved through oath		Total trials
1602-97	428	18.7%	2291

Anti-foreign bias in the courts?

Foreign merchants considered courts biased against them

Outcomes of foreign-Ottoman trials

Litigants	No decision	Resolved trials	Trials won by foreigners	
			number	%
Ottoman plaintiff - foreign defendant	2	12	10	83.3
Foreign plaintiff - Ottoman defendant	0	6	6	100
Foreign & Ottoman partners as plaintiffs - Ottoman defendant	0	3	2	66.7
Total	2	21	18	85.7

Because of forum transfer option, foreigners would have used courts when confident of winning

Case involving foreigners

Mehmet vs. English ambassador (1665)

Mehmet: I made a loan to English merchants. They won't repay me.

Ambassador: Capitulations require cases against foreigners to be based on documentation.

Mehmet: I have none.

Judge: Case dismissed.



D. Preserving wealth across generations

Estates of foreigners to be handled by their consuls.

> Reduced fragmentation of successful businesses

Islamic inheritance system relatively egalitarian

→ Difficult to maintain capital across generations, preserve successful businesses

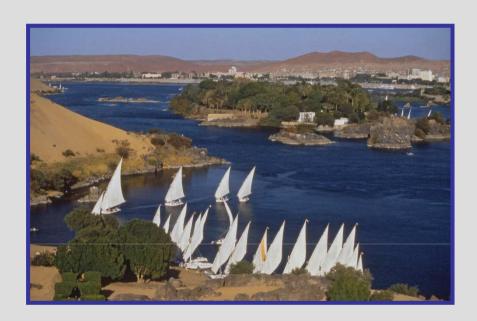
What capitulations accomplished (1)

Initially, both sides gained

- Foreigners: Safety, trade under evolving institutions
- Local rulers: Reliable trade without supplying necessary institutions

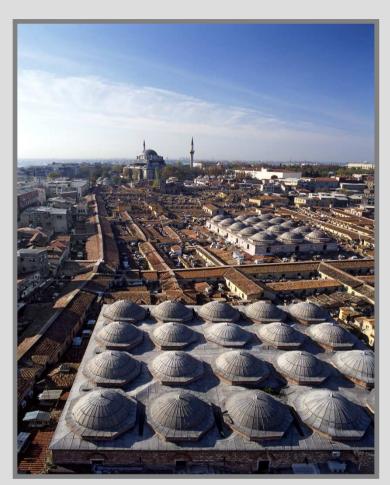
Unintended consequence 1: Growing inequalities between foreigners and unprotected subjects

- Taxation
- Justice



Feluccas crossing the Nile, Aswan, Egypt

What capitulations accomplished (2)



Roof and coupolas of Grand Bazaar, Istanbul (1470s)

<u>Unintended consequence 2</u>: Economic modernization in stages

- Introduction of new organizations, techniques by foreigners
- II. Traditional institutions become dysfunctional → Reforms of 19th c.

Summary

- Large, long-lasting, and self-governing private organizations are critical to success in a modern economy
- In Middle East they did not emerge indigenously because
- Inheritance and marriage laws created incentives to keep partnerships small
- 2. Islamic law precluded corporations
- 3. Public services organized as waqfs, which lacked self-governance, sucked capital out of commercial sector, and were prone to becoming dysfunctional.

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- 3. Public services organized as waqfs, which lacked self-governance, sucked capital out of commercial sector, and were prone to becoming dysfunctional.
- 4. Middle East's trade with Europe was conducted under European institutions, which were more conducive to large-scale and durable enterprises.

Pro-foreign discrimination: Forms

By mid-19th c.:

Discrimination in taxation

- Locals paid taxes, fees from which foreigners were exempt
- Separate tax, penalty schedules for foreigners

Further legal privileges

- Foreigners could insist on foreign trials
- Consul's decision could be appealed only in home country

Foreign legal privileges: Consequences

Muslims reluctant to establish business relations with foreigners, for fear of having to deal with foreign authorities

Local Christians and Jews can level the legal playing field by purchasing foreign "legal protection"



Minorities become partners, suppliers, clients of foreigners

Sources of pro-foreign discrimination

Foreigners sought advantages

Inequities aimed at

- (1) binding government,
- (2) making foreign contracts enforceable in courts adapted to impersonal exchange