

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

Author: Timur Kuran, presented by Yunus E. Kurt

Boston University

November 20, 2019

Overview

- 1 Review of Greif's Argument
- 2 Kuran's Thesis
- 3 (Lack of?) Evidence
- 4 Kuran's Reaction to other Potential Explanations
- 5 Comments

Greif's Theory on Maghribi Traders

- Applies Game Theory to historical context. By using repeated game arguments he offers a solution to the 'commitment problem' involved in over-seas trade.
- Tries to use/interpret giza documents to provide supporting evidence for his 'coalition' theory within which MPS is employed.
- Although not the main focus, it is implied that this 'informal' or 'private order' type of business arrangements along with the absence of legal system initiated a different path-dependent institutional process.
- Greif tells a different story for Late Medieval European traders. What he calls 'Community Responsibility System' was the form of long-distance (inter-community) trade, and it has its own path-dependent institutional consequences.

- Edwards and Ogilvie: They question the use/interpretation of giza documents. Emphasize the lack of evidence on the private-order contract enforcement. No difference with respect to European counterparts in terms of contract enforcement.
- Goldberg: These merchants relied not only private but also public enforcement systems. Expectations, reputational concerns, and norms played an important role, but merchants relied on legal contracts and state institutions as well.
- It is problematic to categorize the European and Islamic world traders of the era, and associate them with binary formal/informal contract enforcement systems to make comparisons about their future economic development.

Kuran's Thesis on the Underdevelopment of the Middle East

- Kuran's Thesis is fundamentally different than Greif's. He argues neither the informal/private-order enforcement mechanism nor the lack of legal system, but instead the idiosyncratic and restrictive nature of Islamic Law caused the economic underdevelopment of the Middle East.
- What is so special about Islamic Law then? 2 key components, he argues, kept size of the businesses (partnerships) small and ephemeral relative to Western counterparts that evolved into complex, and more advanced institutions.
- Law of partnerships (the absence of the concept of a corporate entity) and Islamic inheritance system are the reasons why Middle East stagnated.

Islamic Partnerships

- In pre-modern Islamic world, long-distance trade was carried out by single-venture partnerships called 'mudaraba'. Usually involves 2 partners: investor (finances) and the merchant (conducts the business).
- Sometimes, merchant helps financing or investor would contribute to the work. Then it is called 'musharaka'.
- They split the profits on the terms formulated before the partnership. If loss occurs, merchant is not liable for that. Whoever makes the investment takes the risk.
- Kuran argues, these rules are shaped btw 7th and 10th centuries by ulama (religious scholars and judges) who were also active in long-distance trade themselves. He further claims that the rules are designed to accommodate the the needs of the merchants.

Islamic Partnerships

- If these rules are not the verses of God (they are endogeneous), then why did they change very little over almost a thousand year period? Why did the rules of trade remain 'more or less' same?
- So far, Islamic partnerships (mudaraba) look very much like Italian counterparts (commenda). Then, what is the difference exactly? What are the distinct characteristics of Islamic partnerships?
- Islamic Law requires the principal to be liquid (currency). Partners cannot formulate their contract terms on the basis of commodity. Investing merchandise was prohibited. (why? to limit the disputes over the value of the investment and hence final divisions of profit)

Distinct Characteristics of Islamic Partnerships

- Like in pre-trade period, outcome must be reconverted into currency in post-trade period in order to finalize partnership.
- For third parties, whether be obligator or obligee, they need to deal each partner separately. Partnership is not a legal entity in front of law.
- If one party dies, partnership ends even if the other partner is not aware of the death. Before partnership continues, new terms must be negotiated with the heirs.
- Therefore, there is always a risk of premature liquidation. This uncertainty together with the absence of the concept of corporation in Islamic Law, Kuran argues, kept the enterprises small and make them short-lived. Another reinforcing factor was the Islamic Inheritance system.

Comparison with the West (Partnerships)

- Between 8th and 12th centuries no significant difference: mudaraba and commenda was basically the same.
- Unlike Islamic world (not even a single joint-stock company or financial institution until 19th century reforms), Europe experienced continuous transformations in terms of business scale and organizational form of enterprises.
- In 13th century, commenda turned into different forms of partnerships. For example, Italian financiers, although started as a family business, brought outside shareholders, and formed long-lived partnerships which did not end by the death of a partner.

Comparison with the West (Partnerships)

- In 14th-15th century, linked partnerships (Medici enterprise) emerged. Separate partnerships (each a different legal entity) worked together as a single company under the command of center partnership.
- In 16th century, joint-stock companies (English Levant Company, Dutch, French, and English East India Companies) born. Share transfer became possible.
- From 16th century onward, the corporations which have its own legal status independent from shareholders provided a permanent solution to the durability of the enterprise.

Islamic Inheritance System

- Islamic Law requires one to bequeath two-third of his/her estate to children, spouses, parents, siblings, and distant relatives based on rules stated in Quran. The testator only has a discretion over one-third of his/her estate.
- Whether this is a continuation of pre-Islamic Arab traditions or something new is controversial. No matter what, it restricts individuals' preferences and empowers extended family, especially women.
- In terms of long-run implications, Kuran argues, this system prevented the accumulation of wealth and made it hard to keep estate/property intact across generations. (multiple divisions of land and fortunes)
- Inheritance system reinforced the uncertainties in the business sphere bc of the complicated lawsuits and disputes following the death of a person.

Islamic Inheritance System

- This is not to say that these inheritance rules are followed strictly. Some regimes tried to modify the system in order to limit the division of land which is harmful for agricultural production.
- Similarly, to keep estate intact, different strategies/circumventions are employed as: arranged marriages, side payments, postponement of division or conversion of estate into a waqf. Last two methods gave an ability to strong men to keep his property undivided for some time.
- Yet, these exceptions, Kuran argues, does not prove that the Inheritance law was irrelevant. Opportunities were limited to powerful people.

Comparison with the West (Inheritance)

- In Medieval Europe, inheritance system look quite similar to Islamic system although practices show major variations across Europe and over time.
- According to Kuran, there are 2 key differences: First, legal heirs were limited to nuclear family unlike Islamic world where family defined more broadly.
- Second, Challenging Bible became much less risky than challenging Quran over time because of the reformation process and secularization afterwards.
- Primogeniture (inheritance to oldest son) was the common practice in 16th and 17th centuries when Western merchants started to dominate Middle East. Obviously, this gave them an advantage in keeping their estate together over many years.

Static Institutional Consequences

- Premature dissolution of a partnership is more likely in Middle East due to the high number of relatives. One of the heirs can ask for the liquidation of partnership bc dissolution requires the liquidation of assets according to the law.
- This is more problematic when the asset is indivisible. Other partners may be forced to sell the asset at a low price in order to pay the share of impatient heir.
- Number of heirs are positively correlated with the wealth of a merchant bc strong men are able to have larger HHs. That strengthens the negative effect of inheritance system on wealth accumulation and size of the enterprise.
- There is less incentive to form large partnerships and make long-term commercial commitments in Islamic world.

Dynamic Institutional Consequences

- Commenda became a self-destroying institution. Why? Because, wealth accumulation, greater partnership size and duration required better solutions. New institutions emerged. Then, larger partnerships posed more complex problems, and required better solutions, and so on..
- On the other hand, mudaraba became a self-reinforcing institution. Why? Because the legal system's closeness to corporations and inheritance regime kept the size of partnerships small and short-lived. So, no innovation needed regarding the organizational form.

Religious Minorities: Test(?) of The Theory

- So far, no data or evidence is provided. Just court records documenting the disputes over inheritance or cases where the land is divided multiple times across generations.
- Actually, his argument tries to explain the absence of organizational transformation and large enterprises. How can you provide evidence for the absence of large enterprises if those enterprises are nonexistent until 19th century? Challenging.
- Is there a way to test his theory? Is there a way to find a control group maybe? Focus on minorities in Islamic world.

Religious Minorities: Test(?) of The Theory

- Ideally, we should observe what would have happened if Islamic world had different partnership and inheritance rules? Minorities provide a natural experiment.
- Minorities are free to choose their legal system for personal or business matters. Evidence shows that they preferred Islamic Law for both inheritance practices and partnership arrangements until 18th century.
- In 18th century things started to change: minorities became 'proteges' of European powers which enables them to use consular courts. Historical evidence suggests that from 18th century onward, minorities started to dominate commercial life and overseas trade with Westerners under consular courts.
- Author's conclusion is that this shift illustrates how inefficient commercial institutions were compared to Western institutions in 18th century.

Other Potential Explanations

- Middle Easterners traded (imported) mostly with East (Asia, India), and domestic market was large enough that they did not need to export to West. (Claude Cahen)
- Middle Eastern traders lacked the political power needed to compete against Europeans in Indian Ocean trade. (Chaudri)
- Helping merchants was an alien ideology for the ruling elite. (Genc)

Kuran's Answers to these Explanations

- First, Middle Easterners stayed competitive for some time bc modernization is delayed in East too. Second, production capacity is not fixed. If they were able to transform the form of their enterprises, profit opportunities would push them to trade in the Mediterranean.
- If merchants lacked the political power, why were they not strong enough to influence the politics? Early traders succeeded to influence jurists to modify the Islamic Law. Because legal infrastructure kept them weak.
- Similarly, why were the merchants not strong enough to affect the ideology of the ruling class then?

- Mudaraba is not the only business relationship form. There are other kinds of partnership and companionship ('suhba') forms. At least in geniza documents, dominant form is suhba which fits neither Islamic nor Jewish Law.
- Variety in business relationship forms shows the adaptation capacity of merchants under Islamic or Jewish Law. There is a room for innovation within the legal system if needed.
- Kuran's 'stagnation theory' is then not explaining the existence of business forms that seem more enduring (suhba is open-ended relationship form), flexible, and more importantly not clearly defined in religious texts.

Conclusion/Comments

- Main conclusion of the paper: commercial and financial institutions stagnated bc of the Islamic inheritance system and ultra-individualism of Islamic Law.
- I think, there is an imbalance between theory and empirical evidence in the paper. Too much theory, very few evidence.
- It is understandable because the nature of the problem poses severe restrictions. Very hard to falsify/verify what he argues.
- Causal inference requires exogeneous variation/randomness. Hard to find in historical context.
- What would have happened had they...
- My general view on the issue: Categorical thinking overemphasizes the difference btw Islamic world vs West, and underemphasises similarities. Also, does not explain the heterogeneity across Islamic world.

The End