1

The Puzzle of the Middle East's Economic Underdevelopment

At the start of the second millennium, around the year 1000, a visitor from Italy or China would not have viewed the Middle East as an impoverished, commercially deficient, or organizationally primitive region.[1] Although the region might have seemed enigmatic, its oddities would not have painted a picture of general economic inferiority. Now, at the start of the third millennium, it is widely considered an economic laggard, and a plethora of statistics support this consensus. More than half of its firms consider their limited access to electricity, telecommunications, or transport a major obstacle to their business, as against less than a quarter of those in Europe. In the region, life expectancy is 8.5 years shorter than in high-income countries, consisting mainly of North America, western Europe, and parts of East Asia. Its per capita income equals 28 percent of the average for high-income countries. Only three-quarters of the adults in the region are literate, as compared with near-complete literacy in advanced countries (table 1.1).

As of late 1750, the picture was different. Around that time the purchasing power of the average worker in London or Amsterdam was only twice that of the average worker in Istanbul, the largest metropolis and leading commercial hub of the eastern Mediterranean.[2] The gap between Middle Eastern and western living subsequently widened, until World War I. Since then aggregate growth has been roughly equal. Measured as a ratio, in the early twenty-first century the per capita income gap between the West and the Middle East remains what it was a century before.[3]

TABLE 1.1
Comparative Indicators of Economic Performance (2007)

Region, country, or country grouping	*Human Development Index (United Nations)*	*Life expectancy at birth*	*Adult literacy rate (%)*	*Gross Domestic Product per capita (US$)*
Middle East	0.73	69.4	74.7	9,418
Arab League	0.70	68.5	69.6	8,103
Iran	0.78	71.2	82.3	10,955
Turkey	0.81	71.7	88.7	12,955
OECD (except Turkey)	0.94	77.8	99.0	33,755
China	0.78	72.9	93.3	5,383
India	0.61	63.4	66.0	2,753
African Union (excluding Arab League members)	0.49	51.5	62.3	2,029

Source: United Nations Development Programme, *Human Development Report 2007–8* (http://hrdstats.undp.org).

Notes: As of 2007, the Arab League had 22 members; the Organization for Economic Cooperation and Development (OECD) included 30 of the world's industrialized countries; and the African Union included 53 members, of which 10 also belonged to the Arab League. Gross Domestic Product is measured at purchasing power parity in 2007 dollars. Regional and organization averages are population-weighted. Certain indexes were unavailable for three Arab League members (Iraq, Palestinian Authority, Somalia) and four African Union members (Democratic Republic of the Sahara, Gambia, Seychelles, Zimbabwe). These countries were omitted from calculations of the relevant weighted averages. Hence, the number of countries included in the Arab League and African Union averages vary slightly across columns.

What caused the Middle East to lose economic standing toward the end of the second millennium is not an absolute decline in economic performance. On the contrary, its present living standards far exceed those of a millennium earlier. From 1820 to1913, per capita income grew by about two-thirds; following a period of modest growth between the two world wars, it then tripled in 1950–90.[4] There has been only a *relative* decline caused by slower growth than in countries that are now the world's richest.[5] It remains much richer than sub-Saharan Africa, and even India, a star performer since the 1990s.

The Middle East fell behind the West because it was late in adopting key institutions of the modern economy. These include laws, regulations, and organizational forms that enabled economic activities now taken for granted in all but the most impoverished parts of the globe: the mobilization of productive resources on a huge scale within long-lasting private enterprises and the provision of social services through durable entities capable of transformation. Well into the nineteenth century, the private sectors of the Middle East were composed of atomistic enterprises that did not outlive their founders. When individuals pooled resources in profit-making enterprises, their cooperation was meant to be temporary, often no more than a few months. By that time, most of the now-advanced countries had developed institutions essential to the mass mobilization of savings, the lengthening of individual planning horizons, and the exploitation of new technologies through structurally complex organizations. Therein lies a key reason why the Middle East fell behind in living standards and why it succumbed to foreign domination.

In a nutshell, that is the thesis of this book. We shall see that around the year 1000, commercial life in the two regions did not differ palpably. The contractual forms available to Middle Eastern merchants and investors would have seemed largely familiar to their counterparts in western Europe, and vice versa. The differences identifiable in hindsight were not yet of major significance to the rhythms of commercial life, or to economic productivity, or to living standards. Nevertheless, those differences harbored the seeds of a long divergence in organizational development. As the institutional complex of the West gave rise to progressively more advanced commercial and financial institutions, that of the Middle East produced organizational stagnation within those sectors beyond direct state control. The institutions under which Middle Easterners borrowed, invested, and produced did not spawn more advanced institutions; they did not galvanize structural transformations that enabled those functions to be performed more efficiently, over longer time spans, or on a larger scale. In failing to generate major organizational innovations from within, the Middle Eastern institutional complex also hindered opportunities to benefit from innovations produced elsewhere.

Chapters ahead substantiate all these claims with a focus on key economic institutions of the Islamic Middle East prior to its period of intense institutional reform, the late nineteenth and early twentieth centuries. Important clues will emerge from cross-regional comparisons involving the bloc of countries now considered advanced.

Until recently the core of that bloc was known as "western Christendom." Now we call it simply "the West." For our purposes here, the West consists of European societies that, from the twelfth to the early sixteenth century, shared a common political, legal, and religious subordination to the papal hierarchy of the Roman Catholic Church. Some of these countries later experienced a "Reformation" directed partly at Roman Catholicism.[6]

The term Middle East itself is subject to many definitions. In the historical sweep of this book it is used in an elastic sense to include the entire Arab world and Iran, but also Turkey, along with the Balkan peninsula, which Turks ruled during a period when key Islamic institutions remained stagnant. Spain belongs to the region up to the Reconquista—its reversion, by the end of the fifteenth century, from Muslim to Christian control. The term excludes India, central Asia, East Asia, and sub-Saharan Africa, all regions where Islam struck roots. As figure 1.1 shows, most of the territories that I am including in the "Middle East" at one time or another remained under Muslim governance from at least 800 to 1880. By 1300, the region expanded to include much of modern-day Turkey, and by 1500 most of the Balkans.[7]

Islamic Institutions and Their Mutability

Institution is another slippery concept that requires definition. By institution I mean a system of socially produced regularities that shape, and are in turn shaped by, individual behaviors.[8] This definition encompasses consciously created social regularities, such as state-imposed litigation procedures and tax regulations. It also encompasses patterns that emerge as byproducts of other choices, such as procedural expectations based on history, customary contractual practices, and organizational norms.

During the period of interest, an institution of great importance to Middle Eastern daily life was the holy law of Islam (*sharīʿa*), also known as Islamic law. In principle, Islamic law covered all human activity. As a matter of practice, certain spheres of life were governed by rules divorced from religious considerations. In the political discourse of the Ottoman Empire (1299–1922) there was even a category of laws known as "ruler's law" (*kanun*), as distinct from Islamic law, and also a third category, customary law (*örf*), which rested on precedent rather than religious scripture or learning.[9]

In commerce and finance, two areas in which the Middle East fell conspicuously behind, right up to modern times Islamic law played a key role. People entered into contracts that followed an Islamic template and were enforced through Islamic courts. They apportioned estates according to Islamic inheritance rules. Residents of the region's great cities obtained services mostly from waqfs, which were trusts formed under Islamic law and supervised by officials with religious training. Almost all lawsuits involving at least one Muslim were litigated by Muslim judges, under Islamic legal principles. Cracking our puzzle thus requires close attention to the practical consequences of Islamic law.

The domains of the three bodies of law were not immutable. Where Islamic law created identifiable handicaps for investors, merchants, artisans, or moneylenders, efforts might have been made to facilitate the circumvention of problematic provisions. Such groups might have sought, for instance, to establish specialized commercial courts operated, without much attention to religion, by judges drawn from their own ranks. Thus, commerce and finance might have become secularized. Yet, until recently no such reforms took place. Prior to the nineteenth century the commercial and financial institutions characteristic of the medieval Middle East did not give way to more complex institutions resembling those of the modern global economy.

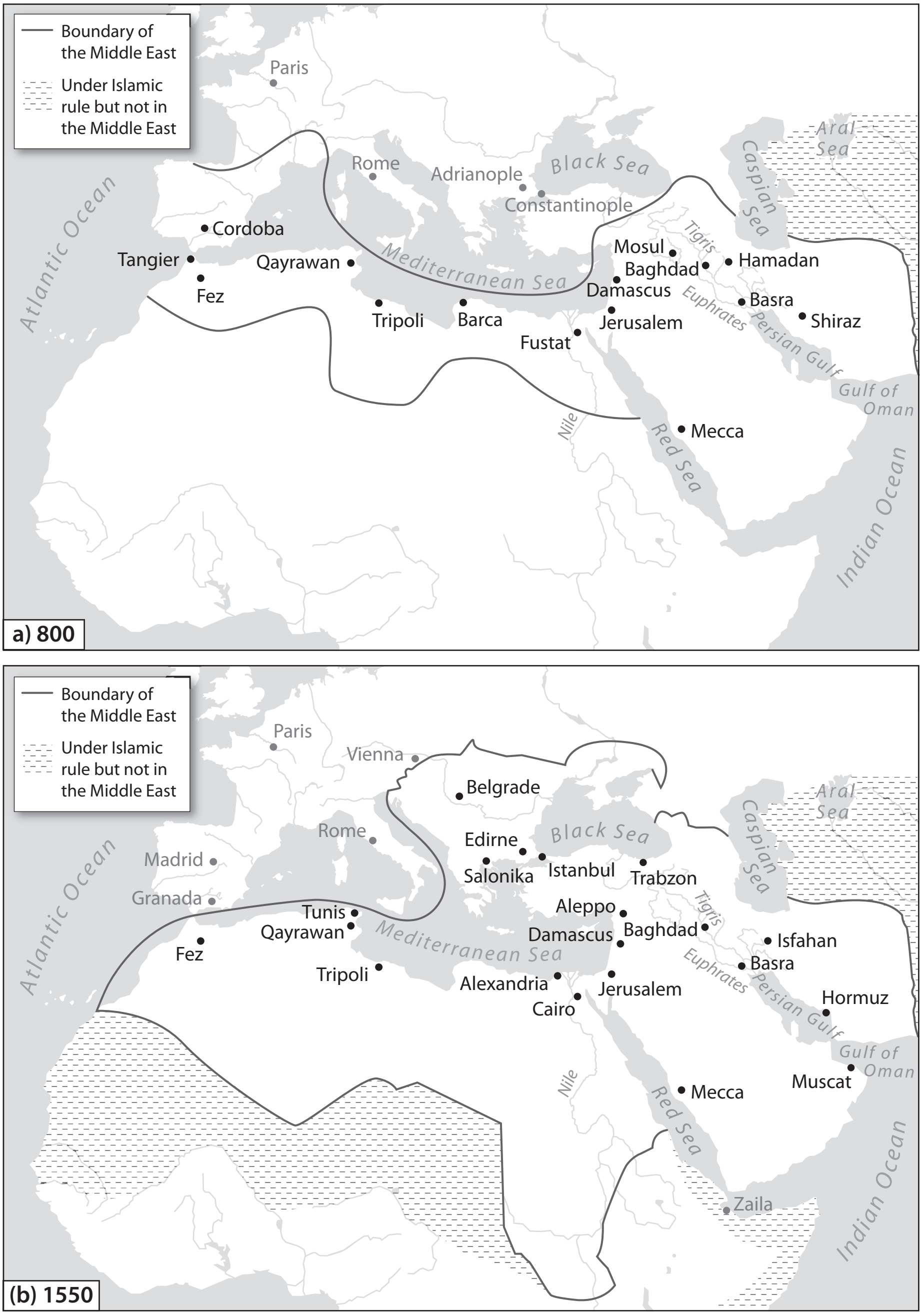
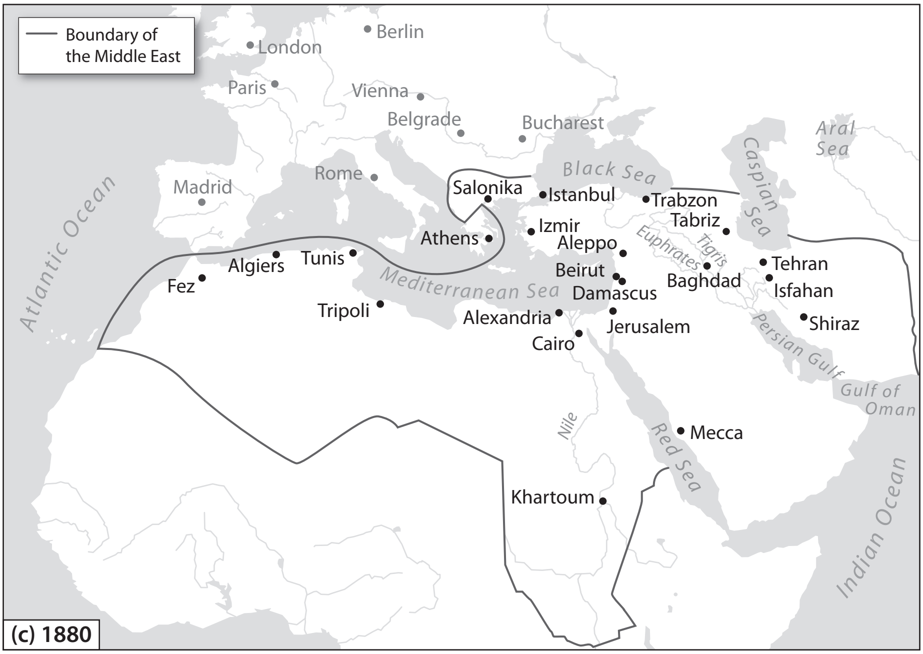


Figure 1.1 Boundaries of the Middle East in 800, 1550, and 1880



The relevant segments of Islamic law did not remain frozen in a literal sense. Historians of the Middle East identify numerous legal reinterpretations that occurred before the modern era. For instance, they offer the long tenure of Ebussuûd, chief judicial officer of the Ottoman Empire in the mid-sixteenth century, as a shining example of Islamic legal adaptability. Ebussuûd did indeed reinterpret the law on many occasions, often subtly, and typically with an eye toward eliminating ambiguities, facilitating interactions, and preventing conflicts.[10] However, he did not alter the substance of the law in ways that laid the foundations for revolutionary changes in the scale or scope of economic activity. In relation to the ongoing process of global economic modernization, which was to turn into a typhoon leaving no coast untouched, his legal adjustments appear as mere ripples in a pond. If a man born in Cairo in 1000 came alive a few decades after Ebussuûd's death, no aspect of this city's commercial life would have surprised him. Major changes in the scale and scope of Egyptian commerce had to await the 1850s.

When an institution appears stagnant, it could be because of personal attachments to the status quo. Thus, the exponents of "modernization theory," which held sway in the mid-twentieth century, cite traditionalism and conservatism as Muslim characteristics inimical to reform.[11] Other writers invoke anti-scientific and fatalistic attitudes as cultural elements harmful to Muslim economic progress.[12] However, fatalism is widespread in today's scientifically advanced countries as well, especially among devout people.[13] Likewise, conservatism is commonplace even in countries growing at dazzling speed; no one wants to live in a relentlessly changing environment lacking fixed points of reference. By themselves, universal and permanent social traits cannot explain variations across societies.

An equally serious problem with ascribing explanatory power to attitudes is that societies governed under Islamic law have enjoyed periods of remarkable structural dynamism. With respect to economic institutions, for instance, the eighth and ninth centuries saw the emergence of an Islamic law to govern the trusts known as waqfs as well as the refinement of the Islamic law of partnerships.[14] In some areas, such as tax collection, innovations and cross-cultural borrowings never ceased. Evidently, precedents were relatively less constraining at certain times and in certain domains. What requires elucidation, then, is not that the Middle East cannot free itself of tradition, or that it lacks creativity. It is that over much of the second millennium, traditions exhibited more resilience in private economic life than in public policy.

A related pattern, also at odds with the central premise of old modernization theory, is that in contexts critical to economic development, satisfaction with the status quo appears to have varied. Egyptian merchants and financiers of the sixteenth century did not find it problematic that their commercial contracts looked much like those of their forefathers. By contrast, in the nineteenth century growing numbers of Egyptian businessmen considered traditional commercial and financial institutions inadequate.[15] By that time foreigners were encouraging local communities to change their business practices. Although some of their advice fell on deaf ears, the local business community was remarkably receptive to reforms aimed at modernizing the region's commercial and financial infrastructure. When banking was introduced to Ottoman realms, diverse communities started clamoring for a branch office in their own localities.[16]

Increasing contacts with foreigners constitute a proximate cause of the attitudinal transformation. In the mid-nineteenth century, a period of reforms, major cities of the eastern Mediterranean contained upscale districts filled with European expatriates. Indigenous residents could see that these foreigners lived better and that their lavish lifestyles reflected higher productivity. They sensed that it would be profitable to adopt new business practices. Successful imitation of foreigners would require the transplantation of alien institutions, such as stock markets, municipalities, and laws supportive of large companies capable of outliving their founders. Such transplants did occur eventually—proof that conservatism and fatalism, insofar as they played roles, were hardly decisive.

Evidence of Institutional Underdevelopment

In the early nineteenth century, right before the Middle East's first structural reforms aimed at modernizing its private sectors, local economic life looked primitive in relation to emerging western practices. Whereas commercial partnerships formed under Islamic law typically involved a few partners who pooled resources for short-lived ventures, westerners were forming indefinitely lasting enterprises with tens, hundreds, and even thousands of shareholders. In traditional Middle Eastern credit markets, suppliers typically were individuals capable of making small loans. Westerners had access to commercial banks that could channel capital mobilized from the masses into large-scale productive ventures. No stock markets existed for trading shares of indigenous Middle Eastern companies, which tended to be ephemeral. Stock markets were gaining prominence in the West, where investors in long-living enterprises liquidated shares at will.

The supply of urban social services offers another contrast. In the Middle East, the traditional provider was the waqf. In the face of breathtaking technological advances, this form of trust proved inadequate as a vehicle for keeping services up to date. The municipality, a standard instrument of local governance in western Europe, was better suited to the rapidly changing needs of cities.

From the mid-nineteenth century onward, in Egypt, Turkey, and elsewhere in the region, institutional transplants curtailed the domain of dysfunctional Islamic institutions. The commercial courts established in the mid-nineteenth century offer an example. These courts adjudicated cases according to the French commercial code. Although Islamic courts continued to handle commercial disputes, their share of the legal workload declined precipitously. Because such legal reforms involved the spread of western commercial patterns and a waning of traditional Islamic ways, they are often characterized as economic westernization. However, transplants did not always amount to replicating western institutions. Institutions borrowed from the West were used also to limit western influences, preserve old customs, and even invent new traditions.

A striking example of creative borrowing lies in the development, beginning in the mid-twentieth century, of Islamic banks. From a historical perspective the concept of an "Islamic bank" is a contradiction in terms. An Islamic bank operates on a scale far larger than any private enterprise the Middle East knew before the nineteenth century. It is a corporation, an organizational form alien to Islamic law. Islamic banking thus constitutes an "invented tradition."[17] Its architects have used western institutional models not to make Muslim economic life more "western" but, rather, to encourage saving, investing, borrowing, and lending in ways at least cosmetically "Islamic."[18]

In view of the motives behind the transplants in question, their collective accomplishments are better described as "economic modernization" than "economic westernization." The modernization theorists of the mid-twentieth century, already criticized for treating conservatism as an explanation rather than an observation requiring elucidation, erred also in equating these two concepts. To them, economic modernization entailed the wholesale adoption of western institutions and beliefs. Here the concept has a narrower meaning. Consisting of institutional changes to support economic transactions of rising scale, duration, and complexity, and to provide economic actors greater flexibility, modernizing economic reforms are vehicles for catching up with the wealthiest countries in productivity and consumption. They need not amount to blind imitation or eradication of differences.

This narrower meaning accords with the agendas of various Turkish, Arab, and Iranian reformers of the past two centuries. None wanted to erase the cultural distinctions of his own country. Borrowing selectively, each adjusted transplanted institutions to local circumstances.[19] Their shared goal was to replicate specific western achievements, not to appropriate western culture indiscriminately. In the traditional economies that they sought to modernize, people borrowed from moneylenders, usually for short periods at a time. Credit contracts often involved no more than an oral promise, and the adjudication of commercial disputes did not necessarily rely on documentation. The banks established in the 1850s under the auspices of Turkish and Egyptian reformists could not operate on the basis of oral agreement. Their transactions, far more numerous and often much larger than those of a traditional moneylender, had to be documented according to standardized procedures. One function of the new commercial courts established outside the Islamic legal system was to resolve disputes involving the nascent banking sector.

By the mid-nineteenth century, which marks the initiation of major reforms, the world had entered a new economic epoch, that of modern economic growth.[20] As the designation suggests, its chief characteristic is self-sustaining economic expansion at an unprecedented rate; although contractions can occur, they amount to temporary reversals along an upward path. This epoch has additional characteristics: rapid technological change, a doubling of life spans, massive urbanization, and the means of mobilizing abundant capital through complex private organizations. Muslim reformists of the nineteenth century may not have understood the origins of these characteristics, or their connections. Nevertheless, they sensed that the characteristics had become critical to economic advancement.

The view that modern economic growth depends on certain organizational capabilities does not presume a unique path to high economic productivity or high living standards. It *does* assume that these ends require fundamental institutional transformations to enable savers, investors, lenders, borrowers, merchants, and producers to operate on much greater scales than ever before, through organizations incomparably larger, and over time horizons far longer than would have made sense in the Middle Ages. If this is granted, it is simply a matter of record that until well after 1750, considered the start of modern economic growth, the Middle East lacked the organizational forms and techniques that distinguish the present epoch from two previous epochs—prehistory to 8000 BCE and settled agriculture from then to 1750.

Other Sources of Underdevelopment

The first *Arab Human Development Report*, issued in 2002 by a commission composed entirely of Arab thinkers, points to a "freedom deficit" and a "human capabilities/knowledge deficit" as two characteristics of the Arab world today.[21] The former deficit refers mainly to governance patterns inimical to civil and political freedoms and the latter to low educational attainment, access to information, and intellectual creativity. Though the terms are new, the handicaps themselves are not. Two centuries ago, observers of the region would have recognized instantly what they meant. Far-reaching reforms were launched partly because the Middle East had become a technological laggard, its states discouraged investment, its inhabitants were poorly educated, and its intellectual life lacked vigor.

If the crisis of the nineteenth century was multidimensional, one may reasonably question whether focusing on deficiencies of private economic organization provides the most fruitful approach to solving our puzzle. Might some other problem be the fundamental cause of underdevelopment, and organizational stagnation merely its byproduct? Might governance patterns, for instance, have limited the menu of organizational forms available to entrepreneurs?

A credible account of the region's economic misfortunes could be developed by focusing on the state's role as a provider of economic infrastructure and enforcer of property rights. As another alternative, one could direct attention to the production of knowledge, investigating its transformations and the ways in which intellectual life constrained responses to economic challenges. In truth, the many patterns associated with the Middle East's troubles all affected one another. To consider one factor the root cause of the Middle East's historical trajectory and all the rest as derivatives would be to commit the "fallacy of absolute priority."[22] This is the illusion that any causal sequence must have a first term. In the proverbial relationship between chicken and egg, there is no absolute starting point. Each entity serves as both source and product, making the relationship bidirectional.

A bidirectional causal relationship existed between any two of the variables that reformers of the nineteenth century endeavored to shape. Each was endogenous to a social system whose variables were all interlinked. General knowledge, technologies of production, commercial institutions, and state structures all evolved together. For a genuinely independent factor of consequence for economic performance we would need to fall back on geography or climate, which Jared Diamond uses to explain global patterns spanning tens of millennia.[23] However, the near-fixity of those factors rules them out as determinants of the institutional trajectories of interest here. A stable climate cannot explain the development of Islamic contract law in the early Islamic centuries, or the adoption, a millennium later, of the French commercial code. If we stick, then, to the socially constructed patterns called institutions, none will be independent of the rest. Legitimate concerns about endogeneity, known in casual discourse as circularity, will emerge whether we focus on technology, knowledge, the state, or private organization. Hence, the starting point for an inquiry is ultimately arbitrary. Whatever causal relationship starts the analysis, sooner or later a relationship in the opposite direction will emerge. Feedback effects will come into play, transforming what started as a linear and unidirectional model into a complex system harboring circularities of the chicken-and-egg type.

Nevertheless, even in studying a complex system there may exist analytical reasons to spotlight initially, and thus to privilege, one particular cluster of variables. In the case at hand, the variables in play did not contribute equally to the *persistence* of the region's underdevelopment. Consider technology and organizational capacity. In the nineteenth century the Middle East was a laggard on both counts. It lacked the know-how essential for mass production as surely as it lacked a law of corporations. England, Germany, and France had both, which enabled their entrepreneurs to form huge companies capable of exploiting new technologies. Hence, Middle Eastern entrepreneurs had trouble competing in the global economy because of both technological and organizational stagnation.

However, these two forms of backwardness did not pose equally intractable problems. A steam engine could be shipped to Cairo, along with the technicians and raw materials needed to make it productive. Transplanting the organizational means to exploit mechanization proved far more difficult. A viable stock market could not be established overnight. It required an intricate legal system, various specialized occupations, and schools to train and certify relevant experts. Only some of the required skills could be supplied by foreigners lacking familiarity with local cultures and vernaculars. Hence, the absence of markets for trading company shares posed a more intractable obstacle to the Middle East's economic advancement than its delays in mechanizing. That is what justifies giving analytic priority to institutional transformation.

It bears emphasizing that organizational capacity affected both technological creativity and the ability to exploit foreign technologies. Just as Middle Eastern schooling patterns affected the region's scientific and technological progress, so its organization of production shaped incentives for technological change and intellectual activity generally.[24] Hence, the region's organizational history is among the factors responsible for its current knowledge deficit.

Private Organizational Development versus Evolution of the State

The foregoing logic would not justify the privileging of private organizational development over the evolution of state structures,

TABLE 1.2
Comparative Indicators of Political Performance (2008–2009)

Region, country, or country grouping	*Civil liberties 1 (most) to 10*	*Political rights 1 (strongest) to 10*	*Corruption perceptions 1 to 10 (least corrupt)*	*Rule of law –2.5 to 2.5 (best)*
Middle East	5.1	5.6	2.9	–0.3
Arab League	5.4	6.1	2.8	–0.6
Iran	6.0	6.0	1.8	–0.8
Turkey	3.0	3.0	4.4	0.1
OECD (except Turkey)	1.4	1.1	6.8	1.2
China	6.0	7.0	3.6	–0.3
India	3.0	2.0	3.4	0.1
African Union (excluding Arab League members)	4.1	4.2	2.6	–0.8

Sources: Freedom House, *Freedom in the World Report*, 2008 (http://www.freedomhouse.org), first two columns; Transparency International, *Corruption Perceptions Index*, 2009 (http://www.transparency.org); World Bank Rule of Law Indicators, 2008 (http://info.worldbank.org/governance).

Notes: For the country groupings, see table 1.1. The population figures used in computing the averages are for 2005.

for institutions of governance are no easier to transplant than those of commerce or civil society. Witness the Arab Middle East's persistently low international rankings relating to civil rights, government effectiveness, and rule of law, in spite of political reforms over the past century (table 1.2). Nevertheless, there are three reasons for starting with private organizational capabilities.

The first is pedagogical. Historians of the Middle East have devoted incomparably more attention to the state than to private organization.[25] This is because official archives, loaded as they are with documents pertaining to state functions, exaggerate the state's role in people's lives and lend themselves to state-centric historical accounts that have been fashionable among historians. Whatever the reasons for the distortion, starting with private economic life raises the likelihood of advancing the debate on why the region fell behind. It makes it possible, as we shall see, to identify complex social interdependencies that states do not, and cannot, control.[26]

The second rationale for starting with private organization pertains to institutional flexibility. Among students of the Middle East a popular view is that traditionalism was a basic principle of governance. This view appears, for example, in Mehmet Genç's influential works on Ottoman economic history.[27] Genç considers traditionalism an integral element of the mind-set of Ottoman elites; his followers link this orientation to Quranic verses that counsel moderation. Yet Middle Eastern administrative history offers abundant examples of adaptation to new circumstances. As already noted, tax rates and collection methods changed repeatedly in the face of new challenges and opportunities.[28] Contrary to a common interpretation, this does not signify efficient administration. A state can react to threats by treating symptoms of trouble rather than addressing the deep causes. To be sure, enough flexibility existed to keep dynasties in power for centuries. When the Ottoman state succumbed to European imperialism at the end of World War I, it was in its 622nd year. Such longevity could not have been achieved through policies chained to the past.

It is in turning our gaze to segments of the social system beyond direct state control that stagnant practices become salient. Subsequent chapters will show that the commercial contracts registered by Ottoman courts of the seventeenth century were essentially identical to those prevalent in the region around the year 1000. Likewise, the system through which communities supplied social services was present many centuries earlier. Hence, insofar as inertia explains the Middle East's failure to keep up with western Europe, it is private economic life, not public administration, that calls for primary attention. To put it in terms of the tripartite legal categorization familiar to historians, religious law and customary law merit analytic priority over ruler's law.

The final justification for giving priority to private organization is that it is among the key determinants of state capabilities.[29] If in the nineteenth century European states lent to Middle Eastern states, and not the other way around, the key reason is that Middle

Eastern credit markets were far less advanced than those of Europe. Their organizational handicaps, including the absence of banks and stock markets, limited the supply of domestic capital to Middle Eastern states. Again, at issue is not what mattered to economic advancement in the Middle East. In an interconnected social system everything influences everything else, so state capabilities and private economic life are interdependent. The issue is the start of the inquiry, not where it leads.

Interactions with Other Regions

In discourses on why the Middle East became underdeveloped, a commonly articulated explanation points the finger at outsiders. The machinations of Europeans, it says, turned the region into a "dependent," "plundered," and "self-doubting" part of the world. Certain variants of the argument rest on the illusion that all social interactions have a "zero sum" quality: if the French and British gained, the Syrians and Iraqis must have lost.[30] The Europeans who colonized much of the Middle East by World War I certainly pursued their own agendas, which were sometimes misaligned with those of local communities. Still, interpretations that attribute the region's underdevelopment to foreign meddling miss vital ingredients of the historical record. They leave unexplained why the region succumbed to imperialism at that time, and not before. The relevant questions of causality and responsibility are addressed in later chapters. What needs recognition here is that the Middle East's economic evolution was indeed linked to that of the wider world.

For several reasons, interactions with western Europe deserve special scrutiny. At least initially, it is in relation to the West that the Middle East became underdeveloped. Also, when this divergence turned into a crisis for the region, it is primarily to the West that leaders looked for institutional responses. Finally, the ensuing reforms instituted practices that were introduced to the Middle East by western merchants who operated under the protection of trade treaties. Known as capitulations, these treaties allowed westerners to trade under institutions of their own.

Certain puzzles concerning the Middle East's economic lag present themselves starkly with regard to the capitulations. Treaties of the seventeenth century allowed traders operating under a foreign flag to have their estates handled according to the inheritance laws of their homelands. Through this privilege, they prevented the fragmentation of their estates, a common occurrence under Islamic law. The capitulations also protected foreign merchants from undocumented claims in local courts. Perplexingly, these and other privileges were withheld from local merchants.

Although the underlying motives are complex, one is that foreign privileges enhanced commercial efficiency. Thus, the protection against undocumented lawsuits replaced dispute resolution procedures characteristic of personal exchange with those of impersonal exchange. As works on European economic modernization have demonstrated, in the period when the capitulations gained increasing significance, Europe was making the transition from personal to impersonal exchange. In other words, economic relations based on personal connections were giving way to ones dependent on complex organization. Under personal exchange, gains depend on expectations of future interactions with the same exchange partners, or on knowledge of past behavior, or on ability to disseminate information about misconduct. As exchange becomes impersonal, we know from the works of Douglass North and Avner Greif, the gains from trade rest increasingly on organizations specializing in contract enforcement.[31] In the period when foreigners won protections against undocumented financial claims, Islamic courts commonly decided commercial cases on the basis of oral testimony alone. That betrays the prevalence of personal exchange.

Hence, investigating institutional dimensions of the Middle East's interactions with the West can yield insights into the global realignment of interest here. Organizational differences between western and Middle Eastern traders emerged at least a half-millennium before the Middle East showed signs of general economic backwardness. Although their impact on living standards was initially minor, they set the stage for the sharp divergence recorded under modern economic growth. The growing gap in economic performance then led, beginning in the nineteenth century, to institutional transplants that also facilitated the transformations that enabled the Middle East to start growing at rates unseen in its history. To be sure, not all foreign institutional influences have been beneficial. Certain capitulary privileges, such as exemptions from various user fees, yielded no obvious gains to the region. Nevertheless, viewed from a long perspective, and with a focus on production and consumption, the balance sheet has been overwhelmingly favorable.

During the second millennium the Middle East benefited also from interactions with other regions, including sub-Saharan Africa, central Asia, India, and China. The difference is that in these other cases the Middle East was often the source of institutional transplants, rather than a recipient. Exchanges with these regions were accompanied by mass conversions to Islam and the diffusion of Islamic institutions. There were resource outflows from Islamicized regions, including tributes sent to rulers in Cairo or Istanbul. But what stands out are the institutional benefits that these regions reaped from Islamization prior to the industrial era, when global economic competition fostered incentives to discard Islamic institutions.

Religious Minorities

The reason that premodern conversions to Islam went hand in hand with the diffusion of Islamic institutions is that Muslims were expected to live according to the dictates of Islamic law. Non-Muslim subjects of Islamic states were compelled to follow Islamic law only on matters of taxation and security. Ordinarily they were free to do business under rules of their own selection.[32] Hence, they could have escaped the commercial provisions of Islamic law simply by restricting their dealings to other non-Muslims and resolving disputes through their own communal organizations.

In 1844, the first date for which comprehensive population figures exist, Christians and Jews comprised at least 45 percent of the population of the Ottoman Empire, the region's largest state. Three centuries earlier, they formed 35 percent of the population in Istanbul, and 18 percent in Damascus.[33] Hence, the privileges of non-Muslims are relevant to the conundrum of whether Islamic law hindered economic advancement. If the priviledges in question constituted a significant factor, non-Muslims need not have been affected, at least not equally. Specifically, any rigidities of Islamic commercial institutions might have been overcome with respect to transactions among non-Muslims. In fact, prior to the eighteenth century commercial practices did not differ fundamentally across religious communities. Only at that time did critical differences emerge. It is then that major religious minorities, including Greeks, Armenians, and Jews, pulled ahead of the Muslim majority.

The foregoing patterns add a twist to the puzzle of why the Middle East's global standing deteriorated. Suppose that the rigidities of Islamic law somehow harmed Muslims economically. If communities free to reject the problematic institutions were held back as well, one of two inferences may be drawn. Either Islamic law was less significant than supposed, or something kept non-Muslims from developing different institutions. These possibilities will be considered, but only after long-term consequences of the Islamic institutional nexus have been identified. Before the eighteenth century, later chapters show, religious minorities had incentives to exercise their commercial freedoms in favor of Islamic business practices. Starting in the eighteenth century, changes in the global economy motivated Jews and Christians to favor practices developed abroad, within different legal systems. The freedom of legal choice that allowed the switch was itself integral to the Islamic legal system.

What Is to Be Explained

Evidently there was an extended period when Middle Eastern institutions pertaining to production, finance, exchange, conflict resolution, and governance were considered reasonably efficient, even worth adopting. Whatever their handicaps, visible in hindsight, prior to the modern era these could not have been significant enough to make the Middle East seem economically dysfunctional.

The distinction between static and dynamic advantages is critical here. The former refer to gains obtainable immediately, the latter to benefits available over the longer run, through induced transformations. Around 1500, a quarter-millennium before the start of modern economic growth, the Middle Eastern mix of institutions provided static advantages to regions that deployed them. Those same institutions proved disadvantageous dynamically, in suppressing the structural creativity necessary to preserve competitiveness. Consequently, wherever Islamic law struck roots the nineteenth and twentieth centuries witnessed far-reaching reforms aimed at stimulating the local economy.

The preceding distinction helps us to identify four broad historical patterns in need of explanation. First of all, we must make clear why the Middle East's economic system was long successful in the static sense of providing living standards similar, if not superior, to those elsewhere. This task requires uncovering the logic of the region's economic institutions grounded in Islamic law. We need to analyze, for example, how Islamic partnerships facilitated long-distance trade.

Second, we must uncover ensuing structural rigidities to identify why those institutions were less successful dynamically than in static terms. Certain Islamic institutions of the premodern Middle East now appear strikingly stable because western institutions performing the same functions *did* give rise, in stages, to the more complex institutions of modern global capitalism. Hence, understanding the factors responsible for the West's dynamism will help to isolate obstacles to self-generated development in the Middle East. They will elucidate also why Islamic institutions well adapted to medieval conditions seemed impoverished a millennium later.

No region as large as the Middle East or western Europe has uniform institutions. Variations must be considered, but only insofar as they help to identify fundamental causes of region-wide underdevelopment. It would hinder our goal to catalogue colorful differences irrespective of dynamic significance, in the manner of a butterfly collector exhibiting variety for its own sake. A key difference is that between the institutional trajectories of western Europe and the Middle East's own Christian communities. The latter, like the Muslims among whom they lived, were institutional stragglers. They may have embraced modern banking faster than Muslims, but the early banks that they formed, served, and used were built on western models, and some were also western-founded and -owned.[34] Our third task, then, is to link these temporal relationships to the pattern of primary interest, namely, the region's loss of economic prominence. Put differently, in interpreting why the Middle East as a whole became underdeveloped, we must make sense of the fortunes of its religious minorities—latecomers to economic modernity themselves, but quick adapters relative to Muslims.

Finally, in explicating interactions between the Middle East and the West, we must recognize that these developed under special rules enshrined in trade treaties. Insofar as the Middle East's structural evolution stalled in contexts critical to economic performance, these rules could have alleviated the resulting handicaps. Examining them will bring to the fore certain key characteristics of the Middle Eastern paths to sustained growth.

The heart of the agenda is to examine the dynamics of private economic organization in the premodern Middle East. Why critical transformations failed to occur is the question we seek to answer. Where the particulars involve religion, it is to religion that the argument must lead.