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NEO-INSTITUTIONAL CONTRIBUTIONS TO UNDERDEVELOPMENT ANALYSIS: THE ISLAMIC MIDDLE EAST

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Abstract
Recent literature on economic development has shifted its focus towards understanding the intricate interplay between social norms, cultural values, and economic performance. This paper delves into the neo-institutional narratives surrounding the "Paradox of the West," proposing that the remarkable growth and historic transformation experienced in Western Europe between the tenth and eighteenth centuries were primarily attributable to the institutional framework in place. It argues that over time, Western societies developed sophisticated institutional structures, both legal and organizational, that played a pivotal role in fostering economic growth by curbing government power, reducing uncertainty in social interactions, minimizing transaction costs, and safeguarding property rights.
One of the central assertions of this narrative is that the unique amalgamation of individual rights and constitutional parliamentary government, as exemplified by the Glorious Revolution of 1688 in England, laid the essential groundwork for its extraordinary economic performance. Additionally, this paper underscores the significance of private institutions such as guilds, fairs, and coalitions that emerged in Europe. These private institutions effectively supplanted public authorities in shaping compliance with institutional norms for economic activities. Furthermore, the paper explores the pivotal role played by the commercial revolution spanning from 1000 to 1800 in Europe, especially the transatlantic commerce that commenced around 1500, in explaining the trajectory of economic progress.

Introduction

The most recent literature about economic development focuses analysis on the existing interactions between social norms, cultural values, and economic performance. The line of these neo-institutional narratives about the “Paradox of the West” maintains that the “miracle” of growth and of historic evolution that permitted the great transformation which occurred between the tenth and eighteenth centuries in Western Europe was due to the institutional framework. With time, it argues, in western societies complex institutional structures (legal and

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organizational) were designed and which favored economic growth, because they restricted the power of government, reduced uncertainty in social interaction, reduced transaction costs, and protected property rights.
The singular combination of individual rights and constitutional parliamentary government produced in England during the Glorious Revolution of 1688 is argued to be the institutional precondition of its great economic performance. Likewise, they allude to the role of private institutions like guilds, fairs, and coalitions, which developed in Europe and which successfully substituted public powers when creating compliance with institutional norms for economic activity. Lastly, they use the commercial revolution that occurred in Europe between 1000 and 1800 and, above all, that of transatlantic commerce beginning around 1500, to explain economic progress (North &Weingast, 1989; Greif, 2006; Acemoglu& Robinson, 2005).

Even so, from the beginning of the current century, new investigations have questioned the institutional foundations of the prosperity of nations, reducing the protagonism of the progressive perfection of political and economic institutions to the gradual development of more efficient markets as determinants of sustained economic growth. They reaffirm the importance of policies and actions undertaken by local authorities between the mid-eleventh and twelfth centuries for the medieval Commercial Revolution. In addition, theyargue that the overseas expansion of Europe was not only an expression of its mercantile dynamism, and that the historic commercial patterns were heavily influenced by the geopolitical context and the interrelation between commerce, coerce, and colonization (Findlay & O'Rourke, 2007; Ogilvie &Carus, 2014). Researchers of the "Great Divergence" argue that the disparity in terms of growth between the most advanced regions of the East and West occurred later than that established in neo-institutional narratives, and add other explanatory factors, such as economic expansion based on minerals, colonialism and the Atlantic economy (Pomeranz, 2000).

The relatively abundant literature about the "divergence" has barely considered the Middle East, despite its great importance in the transition from a Mediterranean phase to an Atlantic phase in economic development. By the same measure, for a long time economists and economic historians of the Middle East have ignored or only superficially analyzed the role of its institutions and their impact on economic development (Pamuk, 2012; Coşgel, 2015).

Until now, the conventional explanations of the economic decline of the Middle East were centered on cultural and religious factors, through an essentialist vision that focused on the traditionalist character of Islamic civilization, incompatible with economic development, as suggested by the theory of modernization. Others sought the cause of the underdevelopment of the Middle East in negative foreign influence and, in particular, by the colonialist European states and the economic policies of the developing countries. Islamic economic theory, on the other hand, attributed the origin of underdevelopment of the Middle East to the idea that Muslim economic practices had diverged from the teachings of Islam (Platteau, 2008).

The Long divergence, a decade later

A decade has passed since its publication, and "The Long Divergence" remains the reference work for studying the gap between the West and the Islamic World from a neo-institutionalist perspective.

Its impact on the literature on the subject and its permanence as a reference work justify these notes, aimed at glossing the main ideas that guide its arguments. In "The Long Divergence" there is a very different analysis from that of the essentialist theorists and the ideologues of Islamist economics. He is also very critical of the interpretations of economic underdevelopment linked to the dependence model, and that of defenders of modernization. In his opinion, the latter approach confuses "economic modernization" with "economic westernization", that is, with the adoption of western institutions and doctrines. In the work "The Long Divergence", TimurKuran revisits the "old puzzle" of underdevelopment in the Islamic world (Kuran, 1997) in order to unimaginably solve an important historical enigma: why the Islamic Middle East fell behind in relation to Western Europe in the post-medieval period. To resolve this question, he centers his analysis on the causes of institutional stagnation and underdevelopment, and proposes a theory of institutional change associated with the inexistence of demand of organizational innovation (LópezCastellano, 2016).

From the theoretical and methodological point of view, Kuran strides the frontier of historic investigation, in two senses. On one hand, based on the idea that the progress of social science depends on a comparative study of history, he adopts historic and comparative institutional analysis (Aoki, 2001). In this regard, Kura contrasts the trajectories of institutions and economic practices in the Islamic Middle East, in particular of the Ottoman Empire, with those of analogous institutions of places like northern Italy, France, England, and the Low Countries, from the rise of Islam until now. On the other hand, he employs a key element of New Institutional Economics by considering as the crucial element of growth and economic modernization: the transition from personal to impersonal transactions. This transition – qualified by North (1996, 2005) as dramatic, and associated to the increasing complexity of exchange and to economies of scale connected to the growing volume of trade – requires the development of political institutions and mechanisms of coercion to guarantee the fulfillment of contracts, and organizational innovations for reducing information costs. Kuran shares with North and Greif the idea that the basic role of institutions is to favor this transition.

Precisely, the most polished explanation of the "dramatic" transition from personal to impersonal transactions was provided by Greif (2006), in his investigation about the effect of cultural values on institutional development and economic success. For this, he compared the trade policies of Genovese merchants to those of the Maghreb (Jewish merchants in Morocco and North Africa) during the eleventh and twelfth centuries to demonstrate that the Genovese, with individualist beliefs surpassed the Maghreb merchants, who were marginalized from Mediterranean trade, because the Genovese implemented an institutional and organizational framework that favored more complex trade and exchange. As for the Maghreb merchants, of collectivist beliefs, managed commerce through private networks and institutions called "coalitions" and based on their common Jewish religion, on family connections, and on informal sanctions, which were efficient for homogenous and relatively small ethnic groups, but which were inadequate for impersonal trade.

Kuran associates modern economic growth with the organizational innovation that resulted from institutional transformations, and starts from the hypothesis that the Middle East fell behind in respect to the West, because of its late adoption of key instruments of the modern economy. Among them, Kuran highlights the legislation, the organizational models that favored the mobilization of productive resources on a large scale, through long-lasting private societies, and within an impersonal framework of exchange. Thus, he underscores, while the West gradually transitioned to more advanced institutional and organizational structures, from the commercial and financial point of view, and passed from personal to impersonal transactions, the "institutional complexity" inherited from the classic Islamic system provoked the appearance of "institutional traps" that led to stagnation and made institutional reforms difficult in the Middle East. Such was the case of the Ottoman Empire which, in his opinion, like the other Muslim empires before it, failed to produce key institutions for the modernization of the economy, in particular institutions that limited the power of government, which was manifested in arbitrary taxes and very weak private property laws.

For Kuran, another important aspect of the historical jigsaw puzzle that deserves explanation consists of identifying the precise moment of the decline and fall of the Middle East in relation to the position it occupied in the world. In the face of the tendency to situation the point of inflection in the nineteenth century, our author justifies the beginning of his narrative at the beginning of the second millennium. To this end, it stresses that the premodern Middle East did not show great institutional differences between the *commenda* and the *societasmaris* of Europe and the Islamic analogues, the *mudāraba* and the *mushāraka*, in either size nor duration. In this sense, he underscores that it was at this time when the social status of the merchants began to fall with the passage of time, favoring the expansion of anti-mercantile ideas.

Kuran warns that prioritizing one of the possible factors as determinant of the historic trajectory of the Middle East would mean to fall into the "fallacy of absolute priority". His analysis is based, thus, on various explanatory sources of this trajectory. On one hand, he studies the system of incentives that motivated individuals to maintain simplicity in organizational models in the Middle East. On the other, he relates the institutional trajectories with the distribution of political power. Finally, he analyzes the institutional dimensions of the interactions between the Middle East and the West, particularly those which he understands to be one of the most important social transformations in the modern era: the economic rise of the religious minorities of the Middle East, and the inherent loss of economic productivity of the muslims beginning in the eighteenth century, produced by Islamic legal pluralism.

Islam and underdevelopment

To explain the sources of the economic failure and the difficulties for transitioning from personal to impersonal exchange, Kuran centers the bulk of his analysis on the particular institutional system that created the judicial order, and on its influence over the accumulation of wealth for productive ends. Beginning with the theory of legal origins (Laporta et al., 2008), he sustains his argumentation on a sort of thesis that "Islamic law matters", singularly on the institutions that, in his judgment, were decisive for leading the Middle East to institutional stagnation and economic underdevelopment. Such institutions would be, in his opinion, theQu'ran's dispositions regarding inheritance, permissiveness of polygamy, the prohibition of *riba*(usury) or interest on loans, the prohibition of apostasy, the absence of the concept of a company, and the choice of applicable law for nonMuslims. To these, he adds other key institutions that arose decades after the birth of Islam, like Islamic contractual law, *waqf*, the Islamic judicial system, and the contractual measures that Muslim governors began to apply to foreign merchants at the beginning of the second millennium.

Kuran argues that from the beginning of the existence of Islam until the middle of the fifteenth century, in Middle East they developed contractual legislation that was very complicated for the time, with very flexible mercantile and financial institutions, with great institutional disadvantages compared to Europe. This combination of institutions provided static advantages, but from a dynamic perspective, the lack of adaptation of these institutions foreclosed on the possibility of the creation of new organizational structures and impeded the appearance of private commerce. Islamic law contained a series of elements, irrelevant in simple commercial systems, but which were very negative when commerce became more complicated. Among these, Kuran underscores that the Islamic law of inheritance favored equality in the distribution of land, but impeded the preservation and transmission of great fortunes through the generations. Such a division of wealth de-incentivized accumulation, a problem that became worse with the allowance of polygamy, which divided the goods of rich merchants with multiple wives and children. The fragmentation of family wealth of prosperous merchants impeded the growth of companies and introduced key organizational innovations regarding competition.

Another negative aspect, he shows, was that Islamic law did not recognize companies, because it was hostile to the judicial personhood of an entity that had not body to be punished nor soul to be condemned. The contract law limited the continuity of companies, because the death of one of the owners implied the liquidation of the society, at the petition of any of the remaining owners, without the inheritors of the deceased receiving any rights or obligations. The continuity of a company required the formalization of a new contractual relationship, which made the creation of large and long-lasting companies difficult, reducing their efficiency and preventing them from taking advantage of technological innovation. The obstacles for creating a large company and maintaining it into the future did not favor the development of more complex commercial institutions for managing them.

The only way of preserving a large fortune through generations was by converting it into real estate and later establish a *waqf*, which amounted to a great obstacle to the rise of a modern society in the Middle East. The functioning of the *waqf*, originally created as a religious, aid-providing institution, was subject to the prescriptions established in the founding document, a circumstance that did not favor its adaptation to changing market conditions. The *waqf* was functional in a pre-industrial society, but lacked dynamism in a modern society, since, as opposed to the western corporations it was economically inefficient due to ther perpetuity, inflexibility, and the absence of judicial personhood. In the Middle East, there was no demand for organizational innovation like that which occurred in Europe, which hampered the rise of business models compatible with large-scale and long-term commercial operations.

Parallel with the organizational stagnation in the Middle East, argues Kuran, Europe led a process of economic modernization. The withering of the *commenda* beginning around 1000 CE created the ideal framework for the development of lager, wider, longer-lasting economic societies. Organizational innovation was key to overcoming the obstacles to growth by western commercial societies.

These developed a sophisticated accounting system for controlling income and facilitated coordination; a mercantile press emerged which reduced information costs and manuals for commercial arithmetic facilitated the supervision of business for investors and merchants; and financial markets were created to facilitate access to capital. As a result, commerce became an ever-more impersonal activity, and exchanges between unknown people became a common practice.

Political order and institutional trajectories

Kuran shares the arguments of an influential literature in relation to the consideration that the initial organizational condition in Europe was the absence of a large-scale economic and political order after the fall of the Western Roman Empire (North, 1995), and that the immediate cause of the creation of the modern state was the financial need originating with the increasing transaction costs, and which was satisfied through taxes (Tilly, 1990). In this model, the merchants, in exchange for taxes, gained key concessions in the form of greater property security and the creation of relatively free market conditions. These processes solidified the agreement of cooperation between government and merchants, and formed the foundations for the rise of property rights and representative government. Western government encouraged and protected foreign trade through legislation and the creation of commercial monopolies. In both England and Holland, the State – to augment its tax-collection powers – promoted and supported the creation of maritime companies through legal and administrative measures. The English mercantile state created a framework of internal and external security in which laws and rights would be respected, which allowed for the development of a market economy (O'Brien, 2011).

For Kuran, the new business organizational models were the response to the specific political and economic conditions of Europe. In a context of inter-state competition, external expansion, and long-distance trade, European companies innovated organizational modes and financial mechanisms. Propelled by military imperatives, the European states conceded special privileges and monopoly rights to capitalists and business men in exchange for their support for the formation of and extraction from new colonies.

To the contrary, he argues, in the Middle East the political weakness of the merchants favored a situation in which the states that arose after the appearance of Islam undertook anti-commercial policies during a long time.

The government, as was noted by Çizakça (2012), contented itself with war booty, taxes, and remittances from the rest of the Middle East, and paid little attention to the modernization of agriculture, industry, and trade. The Ottoman state did not encourage the development of the production of surplus, hampered maritime exploration and with it naval construction. The merchants did not enjoy opportunities or incentives for innovation, because the Ottoman rulers discouraged the formation of business organizations and even confiscated their goods to frustrate any political or economic power that could challenge their own power.

For a long time, the Middle East benefitted from its geographical location, which placed it at the center of global terrestrial-trade routes, but the development of alternative trade routes that avoided the region made it loose its commercial advantage. With the fall of Constantinople and the discovery of the Cape of Good Hope, the terrestrial-trade routes were replaced with maritime routes, and trade shifted from the Mediterranean to the Atlantic, with the consequential loss of the economic advantage. The Ottoman Empire lost out in long-distance trade and the economic stagnation did not generate any need for modern corporations (Malik, 2012).

Obstacles to the transition to impersonal exchange

To complete the solving of the jigsaw puzzle, Kuran refers to the strong growth of commerce at the global level, including the commercial flow between Western Europe and the Middle East, which was produced in the eighteenth century through the revolution of organizational models in the West. However, the greater commercial flow between the two regions generated two additional problems. In the first place a problem common to all modern states, was the reduction of contractual uncertainties generated through transnational trade, derived from the heterogeneity of national laws and the predisposition of national courts to favor local interests. Secondly, there was a need to decrease the differences in economic achievements between different communities arising from the different judicial structures that regulated commercial activity.

As noted by Kuran, this expansion of trade between the two regions was due, in large measure, to the initiative of western merchants who established commercial colonies in the great commercial centers of the Mediterranean, and in some interior cities with consulates whose function was to gather and share information about market conditions, investment opportunities, and the reputation of traders. These traders belonged to societies that had developed institutions to give greater credibility to contracts, promote impersonal exchange, and limit the tax burden. The traders carried out their activities under the protection of a collection of commercial agreements known as "capitulations" (a sort of public contract), which allowed them the aegis of the institutions of their country of origin, making commercial agreements more efficient.

Among other privileges, they had their own tribunals to resolve litigation, new financing and organizational models, and the regulation of their property according to European legislation. The West modernized and the privileges of westerners in the Middle East were expanded. While the western merchants created their guilds and named their consuls to represent them; the Middle East did not have this type of organization nor representation because of the simplicity of the Islamic commercial society, and the absence of the concept of a company did not favor them.

On the other hand, Islamic judicial pluralism was asymmetrical, which, in practice, translated into the existence of more legal options in favor of some communities over others. Kuran underscores the idea that "people of the *dhimma*", as the Jews and Christians were known, experienced an economic rise at the expense of the Muslims. From the birth of Islam until the nineteenth century reforms, states Kuran, the enjoyed fundamental rights that the Muslims did not enjoy, in which they could select the applicable laws, except in areas concerning criminal law, which were exclusively under the jurisdiction of Islamic courts. At a time in which the West was developing the legal infrastructure necessary for the transition to the modern economy, Islamic law allowed for the selection of applicable laws in mercantile and financial laws by non-Muslims, and impeded Muslims. This policy granted a considerable advantage to Christians and Jews and contributed to increasing the economic divergence between these communities.

According to Kuran, another important obstacle in the transition to impersonal exchange (characteristic of modern economic relationships) was the persistence until the nineteenth century of verbal contracts and the resolution of conflicts based on oral testimony, because they disdained written evidence. The development of large-scale companies, such as anonymous societies with transferrable stock and banking companies depended on documents and registries. However, Islamic judicial practices did not recognize the evidentiary value of written documents, which impeded the growth of financial instruments and of corporations, contributing to the stagnation of the commercial infrastructure of the Middle East. Kuran underscores that in seventeenth-century Istanbul a written contract was rarely accepted as legal proof, except when its authenticity could be demonstrated before the court. The Islamic judicial institutions continued to resolve commercial litigation based solely on oral testimony, a fact that reflected the prevalence of personal transactions.

"Path dependence" and underdevelopment

As Kuran shows the present Islamic Middle East continues to be an economically backword region despite the fact that during the nineteenth and twentieth centuries reforms were carried out that allowed, in great measure, the adoption of the institutional framework of the West. The explanation of the gap that was produced in the economic behavior of the past and remains open today after centuries of history, and which makes difficult economic development in the twentieth century, is centered on the institutional legacy of the region and in the bad policies maintained in that legacy.

Kuran supports his work in another key concept of the New Institutional Economics, that of "Path dependence" to explain the persistence of historic influences. This persistence is reflected in the lack of complementary institutions, which is to say, in the role of preexisting local institutions when importing foreign institutions; in the weakness of civil society, which favored the intervention of the state in sectors that would have developed through decentralized private initiatives; and, lastly, in the reactions of the traditional judicial structures to the economic failures of the region. Such circumstances were very detrimental to the economy, because they gave rise to social unrest and caused political insecurity, as a consequence of the spread of protectionist economic ideologies, such as Turkish state centralism or Arab centralism, which had laid the foundations for the rise of Islamism.

The Middle East could have adopted modern institutions without maintaining the dysfunctional surviving complementary institutions. But one could not attribute to the religious and conservative philosophy the merit of having been the fundamental cause of the fact that the modernizing process has not yet been completed. According to Kuran, the Middle East experienced large-scale institutional changes during the last two centuries, demonstrating the compatibility of Islam with the institutional transfer from other religions and civilizations.

Kuran maintains that these reflections project a simultaneously optimistic and pessimistic message about the future of the Islamic Middle East and their success in the current global economy. Pessimistic, because it is very difficult for the region to abandon its underdevelopment in the short term, given the weakness of civil society and excessive state bureaucracy, which hinder the political control necessary to guarantee the quality of its democracies. To this must be added the persistence of poor public policies and harmful social normsthat do not favor the competitiveness of the region's countries in the world marketplace. Nor has the negative role of classical Islamic law in the modernization of organizations been accepted.

Society, Kuran insists, has not achieved the transition from personal to impersonal exchange, or, to use his own words, has not laid the groundwork for replacing the "group morality" characteristic of tribal societies with the "generalized morality" that holds back efficient economic cooperation. The positive aspect, he argues, is that the region adopted and culturally accepted the key economic institutions of modern capitalism long ago and these can be applied to new areas without opposing Islamic doctrine.

On reflection: the need to broaden the analysis beyond 'Islamic Law Matters'.

If economic historians argue that Europe's rise is the result of multiple cumulative processes and mutually reinforcing factors, it is risky to explain Middle Eastern economic decline and underdevelopment by appealing to the relationship between the legacy of Islamic law and institutional stagnation. The main problem with this line of argument is that it reduces the problem of divergence to a single cause. Assuming that the institutional complex is the result of a historical process, analysing it requires taking into account the interrelationships between institutions, formal and informal, and organisations (Aoki 2001). Historical and comparative institutional analysis emphasises a context-specific approach to the study of institutions, and Kuran's study provides the context of the emergence and persistence of Islamic laws governing trade, a key element of the analysis, but confines the narrative to the Ottoman Empire in the Middle East. On the other hand, by identifying certain aspects of Islamic law related to commercial activity with brakes on long-term economic development, the analysis engages in a nuanced version of the highly contested 'law matters' thesis or theory of legal origins (Lamoreaux and Rosenthal, 2004; Malik, 2012).

Another aspect that can be analysed is the comparison between the lack of political power in Europe with the omnipotent power of the Ottomans (Vries, 2002), to positively link weak state authority with the evolution of enterprise and increased organisational efficiency, and the restriction of arbitrary state in Europe. The Ottoman Empire, as a centralised and monolithic entity, would not have generated the economic and political benefits of the "decentralised and competitive system of states" that Europe offered. By relating institutional trajectories to the distribution of political power, it is argued that the limited political power of merchants resulted in the systematic and long-lasting application of anti-mercantilist policies by Middle Eastern governments. This observation is consistent with an influential literature that stresses that institutions are neither neutral nor solely intended to promote societal development, because powerful actors try to influence their design in order to benefit themselves. Economic institutions determine incentives and disincentives and modulate economic outcomes, benefiting or disadvantaging different groups and individuals, leading to conflicts in terms of social choice, resolved in favour of groups with greater political power (Acemoglu et al., 2005). However, research on the "long divergence" does not pursue this line in any depth.

As Adelman (2000) points out, economic development is a dynamic and multifaceted process, requiring predictable changes in institutions and policies over time. The contrast between economic practices in Europe and the Ottoman Empire is starkly apparent precisely in the area of trade. The history of European business organisations shows that the joint stock company, corporations, maritime trading companies and finance companies were the response to the specific political and economic conditions in Europe. Economic institutions were the result of many other factors, such as scientific discoveries, the use of machines, and improvements in production techniques and changes in the composition of crops, inventions, new markets opened up by the discovery of the new world and the establishment of colonies, both as a source of raw materials and as a market for the sale of finished products, and new sea routes for European trade.

As mentioned above, the Middle East lost the advantage of its strategic location at the centre of the world's overland trade routes, with the replacement of overland trade routes by maritime ones and the shift of trade from the Mediterranean to the Atlantic.

Western governments encouraged and protected foreign trade, through legislation and the creation of trade monopolies. Government-provided protection for industry and foreign trade and capitulations with Muslim governments provided strong support for mercantilism. Conversely, some Muslim rulers monopolised trade with very negative effects on private merchants. The Ottoman state discouraged surplus production, slowed maritime exploration and with it the shipbuilding industry. While Europe advanced in trade, science and technology, Middle Eastern governments neglected the development and modernisation of agriculture, industry and trade. The Ottomans were content with the spoils of war, taxes and remittances from the rest of the Middle East, without bothering to modernise their economic institutions.

As Jones (2003) graphically wrote, while Europe 'navigated its commercial revolution', the Ottomans 'were confined to the land'. Ruling elites in the Middle East lived off the income generated by land and did not engage in trade.

Under the Ottomans, unlike in Western Europe, traders enjoyed neither opportunities nor incentives for innovation, because Ottoman rulers discouraged the formation of business organisations, fearful that they would challenge their power. To thwart any political or economic power that might pose a threat, the assets of wealthy private producers and traders were confiscated. The cause of the merchants' loss of economic and political power lay in these policies, rather than in the system of inheritance.

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