Timur Kuran

The Long Divergence: How Islamic Law Held Back the Middle East

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Maha-Hanaan Balala

Islamic Law and Finance: Theory and Practice in a Globalized World

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The relative economic decline of the Middle Eastern Moslem world after 1500 requires some explanation. Comparing Istanbul, or Cairo, and London or Paris at the turn of the 16th century would not show up any great differences in living standards, cultural sophistication, or comfort. How could it be that a civilization that was able to conquer much of Europe, toppling even the once-mighty Eastern Roman Empire, could become so atrophied that it lost almost all its territory by 1920? How could a civilization that preserved the wisdom of the ancient Greeks, and gave the world the system of numerals that it uses today, find itself marginalized and forced to accept many innovations from outside its borders even to survive? Why did the industrial revolution not take place in the Middle East? Why the long divergence between the West and the East?

The divergence is easy to document, as Timur Kuran carefully and engagingly does, but is less easy to explain. His thesis is easily stated (p. 5) – the Middle East fell behind because it was slow to adopt certain institutions that allowed for the pooling of (financial) resources for an extended period of time. The lack of appropriate banking arrangements; the absence of a partnership structure that allowed the easy transfer of a business to the original partners' heirs; the failure to develop joint-stock companies; are the key ingredients that are missing.

Rather in the tradition of Max Weber (although critical of Weber's actual thesis), Kuran searches for an explanation in the realm of ideas and religion. There are some *prima faciae* attractions in this approach, perhaps, most tellingly, that by the mid-19th century the Jewish and Armenian Christian minorities of Istanbul were becoming wealthier than the majority Muslim population, despite the impediments and taxation that the minorities faced (and the fact that they made frequent use of the Islamic legal structures). He agrees with Weber that the absence of an Islamic version of incorporation was a hindrance to the development of city administration – but argues that this begs the question, as Middle Eastern cities seemed to do just as well as Western ones up to 1600 or so.

Instead, Kuran fingers Islamic inheritance patterns as a possible cause. While corporations in the west could be structured so as to survive the deaths of the original partners, Islamic practice was that enterprises were dissolved on the death of one of the partners, unless all the deceased partners' heirs could agree to keep it going (a likely impossible task). As a result, the preconditions for joint stock companies were not there, and, further, Moslem enterprises would lose out to western ones. The greater risk of doing business with a Moslem enterprise that might unexpectedly have to be wound up gave an advantage to western companies in third countries where the two were in competition. This, magnified and extended, could account for the divergence in success of western and Islamic countries. The seeming lack of interest in developing commercial ties (exemplified by the very small numbers of Middle Eastern

Consulates in other countries) set up the conditions for the failure of the Moslem world to take advantage of the commercial opportunities that were being developed by Western merchants and businessmen.

Kuran finds other explanations lacking. Islam has often been characterized as allowing religious dogma to impede progress: inflexible rules made it impossible for new commercial forms and ideas to take root and flourish. He argues, however, that, Islam did not rule out innovation; indeed, it is true that Moslem means of avoiding the ban on charging interest were at least as creative as those of the Caursine money-lenders of Mediaeval Christianity. In addition, Islam does have an organizational form which allows for an operation to last indefinitely – the trust, or *waqf*. It was the custom for the rich to endow a *waqf* (just as rich Christians might leave land to the church), with the revenue being used for the upkeep of a mosque, or for the relief of poverty. Couldn't the *waqf* format be used for commercial undertakings? Or couldn't the trustee of a *waqf* use the fund to generate income in this way? Kuran's answer is that the trustee is highly constrained by what he is able to do – the *waqf*'s endower's instructions must be followed very carefully, to avoid the possibility of legal disputes, which rendered innovation from this source unlikely in the extreme. Similarly, though, trustees of Church land in Europe would also keep strictly the letter of the instructions in the will of the person leaving land or other property to the church. The difference seems to have been that in the West the development of a banking system in Italy that later provided the financial mechanism to payroll the long voyages of discovery to trade with the Americas and India. England's granting of state monopolies to groups of merchants then paved the way for the development of incorporation.

As Kuran points out, path dependency is significant: new ideas grow out of past failures and successes. While Islamic forms and structures functioned at least as well as western forms until the 17th century (*waqf*s provided better and cheaper social services than in the west, for example), thereafter the value of western innovations began to become apparent, at least to an historian exercising decent hindsight. The greater stock of commercial ideas in the west led gradually, but inexorably, to the divergence between east and west. Perhaps it was the very success of Islamic institution for the century after the Prophet that discouraged the types of innovation and reinterpretation of sacred texts that served the west so well.

Kuran has inaugurated a new and significant research agenda: untangling the details of the process of the divergence will continue to exercise the minds of scholars in the years to come, as will suggesting ways for the Middle East to escape what might be seen as its destiny as an underdeveloped region. On this, Kuran is cautiously optimistic: as most of the institutional innovations whose absence held back Moslems' economic development have been accepted over the past 150 years, there is the potential to see the fruits of these reforms. Apart, possibly, from the Taliban, even conservative Islamists have made no attempt to close down corporations for being unIslamic, nor to restore pre-modern economic structures.

Kuran's fresh approach to the issue of the Middle East's development lag suggests that his book, already extensively reviewed, will be a significant influence on this endeavour. The evidence of the unattractiveness of Moslem economies to outside investment is still obvious: a glance at a map of Transparency International's Corruption Perceptions Index places all Western countries (except Italy) in the cleaner half of the scale, all Middle Eastern countries fall below this mark. But change is not impossible – Turkey, for example, has started to move up

the rankings. If, for example, poor governance is a significant factor impeding progress it is not unlikely that constitutional reform will seek to address this.

In contrast to Timur Kuran's broad vision, Maha-Hanaan Balala's aim is somewhat more modest. A legal scholar, she is concerned with how Sharia-compatible finance might work in the modern, globalized world. The kinds of structural constraints that Kuran examines are important – she sees that more finance for investment (and therefore for economic advancement) could be harnessed if the western innovation of securitization could be used within an Islamic framework. The problem, though, that securitization involves the sale of debt (*bay al dayn*), which is generally frowned upon in Islamic jurisprudence. The problems of the inadmissibility of *gharar* (uncertainty) and *riba* (increase) present problems. *Riba* has traditionally been used as an argument against the charging of interest, which would make the provision of instruments where the return is based on a stream of interest payments problematic.

Balala carefully considers the evidence from the Qur'an and *hadiths* and proposes a new interpretation of *riba* that would resolve the problem. She analyses the *hadith* concerning Bilal and the figs (Book 10, No. 3871 in Sahih Muslim's collection) – what was it about Bilal's bartering of two *sas* of low-quality figs for one *sa'* of high-quality figs that caused the Prophet to condemn the transaction as *riba*? Bilal was told that the figs should have been sold on the open market, and the new figs bought with the proceeds. She argues that the concern of the Prophet was not about Bilal's getting a personal benefit *per se*, but the potential for unequal gains from a barter transaction. Absent some check that the exchange was fair, there is the risk that either Bilal or his merchant was being cheated in the transaction. Only by making public and open transactions (through a market) can such a problem be avoided. This interpretation coheres well with the Mediaeval Christian concept of the just price; that private transactions, even when both buyer and seller were willing participants, were likely to be unfair. Otherwise, why would they try to make an agreement in secret?

Thus, she argues, the purpose of the Prophet's strictures against *gharar* and *riba* were aimed against inequality – to maintain social justice, it is necessary that any gains from trade be equally shared. Modern economic theory, of course, suggests that this is an unattainable gain: as we cannot observe directly each person's utility function, we have no way of knowing that, even at the free market price, that consumer surplus (the gain to buyers) is equal, less than, or exceeds the producer surplus (the gain to sellers). At best, the market price is fair in the sense that anyone who is willing to buy or sell at that price can find a counterparty; but as history demonstrates, there is no guarantee that free market transactions will maintain roughly equal standards of living for members of the community – if anything, history suggests the opposite.

What might be an alternative? Balala puts much emphasis on the virtues of English Common Law, which she sees as being motivated by a similar concern for tradition and social justice. In this she is not alone – a number of Sharia-compliant financial contracts between organizations have specified that the controlling law in the case of a dispute would be English Common Law. For example, the Qatar Global *sukuk*, where bondholders received dividends from the Qatari government for land bought from, but leased back to, the government, was set up as a trust regulated under English Common Law, given the lack of recognition of trusts under Qatari law. (Interestingly, payments to the bondholders were linked to the London interbank interest rate

[LIBOR], albeit in a way that presumably cleared the parties of charges of *riba*.) Using English law has the additional merit of avoiding the uncertainties of Islamic jurisprudence – given the four major interpretive schools of Islamic law differ, and a judge might draw on precedents and arguments from other traditions when coming to a determination makes the outcome of a dispute less easy to predict than with the well-defined parameters of precedent-following in English law. (Interestingly, this regime uncertainty does not seem to fall within the scope of *gharar*.)

Advocacy of securitization reads rather oddly in the wake of the ongoing financial crisis. The exotic financial products that relied on securitization are now blamed by many for the near-collapse of the American financial system in 2008. Even if Balala is correct that the application of the concepts of *gharar* and *riba* are proper subjects for *ijtihad* (interpretation), so that securitization of debt can be squared with Islamic thought, this does not make it desirable.

The book, which has come out of Balala's doctoral thesis at Oxford University, could have benefited from more careful editing – there are a number of minor errors in spelling and grammar, and places where ideas could be better expressed. There are numerous repetitions of ideas, and sometimes of chunks of text. (The important passage from Surah *al-Baqarah* 282 is quoted in its entirety first as a footnote in chapter 5 and then in the text of chapter 6, for example.) Nevertheless, the book develops an interesting approach to Islamic finance, and the argument deserves to be taken seriously. However, as yet the book has failed to excite scholarly attention, and may become lost in the competition for academic attention.

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