

Economic Underdevelopment in the Middle East: The Historical Role of Culture, Institutions, and Religion

by

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1. Introduction

The belief that Islam inhibits economic development has enjoyed currency at least since the 19th century, when rapid economic growth in Western Europe and its cultural offshoots in North America made Muslims appear economically underdeveloped. Although political correctness now discourages the public expression of judgments liable to be dismissed as “culturally insensitive,” in off-the-record conversations Islam is routinely treated as an obstacle to economic creativity or progress. Factors invoked as sources of retardation include fatalism, personalism, laziness, lack of curiosity, mistrust of science, superstition, conservatism, and traditionalism. In each case, the attitude or frame of mind in question is alleged to be rooted in “Islamic culture.”

None of these claims can be rejected out of hand. Consider fatalism, which is a tendency to view outcomes as governed by fate rather than human initiative. Fatalism in this sense is integral to Muslim communities, whose members commonly qualify their expressions of intention with the phrase “Inshallah,” literally “if it is God’s will.” Although not every Muslim uses the phrase in a literal sense, there do exist Muslims who act as though a higher being directs their lives and their destiny is set. Those who flaunt traffic rules do so in the belief that if their time has come no amount of precaution will matter. Basic economic logic suggests that fatalism will limit efforts at enrichment.

Yet fatalism is present in every society, and it is correlated with religiosity in general, not just adherence to Islam. Moreover, it may well be more common in some economically advanced countries characterized by high religiosity than in certain predominantly Muslim countries. According to the World Values Survey of 1990, Turks are less religious than either Italians,

Austrians, or Americans, all nations that are economically more advanced.¹ If fatalism is not demonstrably more prevalent among Turks than among much richer Americans, it alone cannot explain why the Middle East is economically underdeveloped.

In any case, fatalism has been present among Muslims from the dawn of Islam, including a long period when the Middle East appeared economically advanced by global standards. So insofar as it has been a source of retardation, one must elucidate why its effect on the relative economic standing of the Middle East has been particularly pronounced in modern times. That task requires the consideration of factors that transcend the attitudinal effects of Islam itself.

Not all of the factors invoked as cultural obstacles to Middle Eastern economic advancement can be dismissed so easily. As globetrotters familiar with the Middle East know, its local exchanges are more likely than those in economically advanced countries to involve personal connections. This is consistent with surveys that find Middle Easterners to have unusually low trust in others. In the World Values Survey of 1990, only 10 percent of the Turks answered “yes” to a question about whether “most people can be trusted.” Among the 43 mostly wealthy countries included in the survey, the proportion was lower only in Brazil; the weighted average of all countries was 35 percent.² Given that the economic supremacy of the West has involved a movement from personal to impersonal exchange, this pattern suggests that differences in attitudes toward strangers may account for the observed shifts in relative economic standings. Insofar as people mistrust others, they will exchange primarily within networks of acquaintances, giving up potentially profitable exchanges

¹ Inglehart, Basañez and Moreno (1998), table V151.

² Inglehart, Basañez and Moreno (1998), table V94. Participants were asked, “Generally speaking, would you say that most people can be trusted or that you can’t be too careful in dealing with people?”

with strangers.

Could such personalism in economic relations have a basis in religion? The traditional Islamic legal system recognizes only real persons, denying standing to fictitious persons, such as a corporation. In the absence corroborating oral testimony, it also denies independent evidentiary value to documents. So Islamic law may well have influenced the prevalence of personalism among Muslims. In requiring exchanges to be conducted with natural persons, and discouraging the formation of impersonal organizations, over many centuries it might have shaped the attitudes that surveys now identify as general mistrust.

Notice that in proposing how Islam might have brought about the observed personalism of Middle Eastern economic life, I have invoked Islamic law as the fount of attitudes harmful to economic growth. Specifically, I have suggested that the mistrust harmful to trade among strangers is among the consequences of certain institutions central to societies that have lived, historically, under historically Islamic rule. That, in a nutshell, is this article's thesis. I argue that Muslim attitudes commonly treated as economically limiting Islamic cultural traits are dependent, not independent, variables. They are among the legacies of mutually reinforcing social institutions that played key roles in the Middle East's economic successes, but also in subsequent economic disappointments.

Our focus will be on two clusters of factors frequently invoked as cultural characteristics harmful to economic progress. The first entails closely related attitudes that breed immobility directly: conservatism, traditionalism, fatalism, lack of curiosity, and low ambition. As for the second, it consists of personalism, which is the tendency to favor personal exchange over impersonal exchange. My thesis is that both personalism and immobilizing attitudes are rooted in classical

Islamic institutions, in other words, those in place by around the start of the second millennium.

Culture is a concept that commands a bewildering array of meanings, and the same can be said about institutions. To make analytical progress on the controversy under consideration, it is essential to specify at the outset what these concepts will mean. Here I am defining culture as a pair of distributions that jointly provide a distinct communal identity: a distribution of attitudes and a distribution of behaviors. This focus on distributions accommodates the heterogeneity that every society shows in both attitudes and actual choices.³ It accommodates, for instance, the mix in religiosity found within every society, as well as the commonness of tensions between attitudes and behaviors. A society that is relatively religious on the whole may contain atheists. Its atheists may feel compelled to practice the dominant religion, whether to avoid isolation or to gain acceptance. To be sure, the two distributions will never be independent of one another. Although attitudes are not the sole determinant of behaviors, they do exert an influence.

By institution, I mean a system of set of social factors that conjointly generate a regularity of behavior.⁴ All of the institutions that affect a certain class of behaviors form what we may call an institutional system. Thus, the legal system of a country forms an institutional system whose elements include, for example, customary legal procedures, rules of promotion within the judiciary, attitudes regarding the role that religion should play in adjudication, and a hierarchy of courts. By itself, none of these elements captures the social function of a legal system, which is much more than

³ This definition draws on Kuran and Sandholm (2007), where further details may be found.

⁴ This definition is drawn from Greif (2006), especially pp. 35-45.

the sum of its parts.⁵

Both attitudes and behaviors may, then, enter into the nexus of factors forming a particular institutional system. The latter concept subsumes what I am treating as culture. Having defined these concepts, let us now critique some influential arguments that ascribe the Middle East's economic shortcomings to the culture of Islam.

2. Attitudes Inimical to Development

During the institutional transformation that turned the West into a global powerhouse economically, politically, and militarily, and concomitantly the Middle East into a laggard on all these counts, certain knowledgeable observers of the Islamic world inferred that the culprit is the latter's dominant religion. Islam stands, they proposed, for unchangeability. One variant of this argument was put forth by Lord Cromer, the British governor of Egypt from 1883 to 1907 and a keen student of the Arab world. "Islam cannot be reformed" he wrote, because it promotes a mindless attachment to tradition. By implication, practicing Muslims cannot implement the changes necessary for economic modernization, as they are bound to consider innovations sinful.⁶

In the late 19th century the French scholar Ernest Renan advanced a complementary view. Islam and its Arab propagators have always been hostile to science and philosophy, he claimed. Knowledge advanced under Arab domination only up to the 12th century, by which time Persian and Hellenic influences had faded. As Islamic culture freed itself of foreign influences, it quashed

⁵ Institutions may be nested within broader, more comprehensive institutions. A country's legal system is part of its system of government which belongs, in turn, to a system of global governance. Higher institutions constrain lower ones, but they are also shaped by them.

⁶ Cromer (1909), vol. 2, especially pp. 228-29.

scientific and philosophical inquiry in an effort to suppress findings incompatible with Islamic beliefs. Renan understood, of course, that the essence of all religion is acceptance of certain claims on faith and certain restrictions on inquiry. But Islam stands in a class by itself, he thought, because in refusing to compartmentalize life, “it extends the rule of dogma to the temporal realm.”⁷

In principle, Islam seeks to control not just matters of faith, worship, and morality but the whole of human civilization, including governance, science, and economics, realms that Christianity eventually recognized as secular. As a matter of practice, however, Islam’s span of control has always been limited. Arab scientists who made huge advances in optics and metallurgy were not expected to ground their findings in the Qur’an. Likewise, Muslim merchants of the early Islamic centuries hardly relied on the Qur’an, or on other religious teachings, in deciding when, where, how, or what to trade. There were always many realms that Islam effectively treated as secular, even if it did not recognize any formal separation between “mosque and state,” or “religion and science” or “faith and economic reality.”

Insofar as religious control hindered the Middle East’s economic advancement, understanding its record requires then, the specification of why the freedom to make changes was more limited in certain areas than in others. Convinced that Islam not only promoted but also achieved immobility, neither Cromer nor Renan explored why Muslim practices proved more flexible in the early centuries than later, in military technology than in philosophy, and in Ottoman Turkey than in the holy cities of Mecca and Medina. Vastly oversimplifying the historical record, they imagined “Islamic culture” to be monolithic and eternally fixed, when in fact it has harbored much diversity and movement.

⁷ Renan (1883).

Cromer and Renan lived well before intellectuals began to shy away from criticizing foreign ways of life openly.⁸ But their views have not died out. Although explicit condemnations of Islam are now rare, arguments that treat it as a fount of economically hazardous attitudes do find their ways into scholarly debates. One such argument appears in *What Went Wrong?*, a best seller by Bernard Lewis. Its thesis, found also in earlier Lewis books, including *The Muslim Discovery of Europe*, is that the Middle East fell behind because Islam discouraged curiosity about civilizations it treated as inferior. Early on, Lewis observes, Muslims learned to look down on Europeans on the grounds that they followed a superseded religion. Medieval Arabic writings about Europe depict it as a remote and unexplored wilderness inhabited by exotic and essentially primitive people from whom there was nothing to fear and little to learn. The attitude of disdain was reinforced by Arab military victories in Spain and, later, Turkish conquests in the Balkans. Among its manifestations is that few Muslims considered it useful to learn European languages. The notion that Europeans are inferior gradually hardened, making Muslims oblivious to various European innovations that were ushering in the capabilities and comforts of modern life. People cannot adapt to developments that they do not observe. If Muslims failed to embrace European scientific, intellectual, political, and economic advances, a major reason, says Lewis, is that they lacked awareness of them.

In sharp contrast to Muslims, European Christians took an interest in Islam and Muslim practices early on, for they saw Islam as a formidable rival. They wanted to understand it so as to determine how best to eliminate a danger, just as centuries later Americans would pour resources

⁸ After their time, Max Weber (1963), especially pp. 263-265, and the modernization theorists who followed, such as McClelland (1961), p. 340, treated Islam as a fount of attitudes harmful to economic development. More recently, Guiso, Sapienza, and Zingales (2003) have offered partial empirical support for this view. Scholarly critiques of it include Rodinson (1973), Turner (1974), and Noland (2005).

into the study communism in order to deal with the Soviet threat. European studies of the Middle East were spearheaded by monks, who wanted to save Christian souls from conversion to Islam, keep territories from falling under Muslim rule and, over the long run, reclaim Jerusalem and convert Muslims to Christianity.

The asymmetry between European learning on the Middle East and Middle Eastern learning on Europe is evident in the production of foreign-language dictionaries and grammar books. By the late 18th century Europeans had produced dozens of books on Arabic, Persian, or Turkish grammar, along with more than 20 dictionaries. Yet, Arabs, Persians, and Turks had not produced a single grammar or dictionary of any western language. What makes the asymmetry particularly puzzling is that the Middle Eastern disinterest in learning about Europe continued in the face of mounting evidence of economic slippage vis-à-vis the West. Prior to the 19th century, practically no Middle Eastern ruler showed awareness of the new economic values and institutions that undergirded Europe's growing might, and no work of economic content was translated into Arabic, Persian, or Turkish.⁹ They took an interest mainly in the weaponry that helped to defeat Muslim armies, in evolving techniques of shipbuilding, and in new medicines.

When a civilization that has enjoyed dominance starts falling behind, one expects it to produce diagnoses. Indeed, in the 17th and 18th centuries increasing numbers of Muslims took to speculating about the ongoing erosion of their global power. On the economic front, they noticed budget deficits, markets taken over by foreigners, and inflation. Typically they attributed such economic difficulties to internal factors such as corruption, oppression, greed, and high taxes. Things had gone wrong at home, not right elsewhere. And domestic problems had arisen because institutions

⁹ Lewis (1982), p. 196. Even Adam Smith's *Wealth of Nations* went unnoticed.

supportive of past glories had eroded. The appropriate remedy, most thought, was to rediscover and restore institutions that had once proven effective. In Europe, incumbent social institutions were being challenged in the name of progress. However, until well into the 19th century the Middle East spawned no major movements pursuing radical social change. No one thought of examining European institutions for clues to solving domestic problems.

Lewis' observations raise the question of why the imperviousness to European developments persisted. There were two barriers, he suggests, both involving the practice of Islam.

For one thing, the system of education, which was run by religious functionaries, taught people a finite set of information, rather than how to use their own judgment, evaluate claims critically, and make decisions for themselves. More so than in Europe, schools made students memorize facts and venerate classic texts, so their graduates saw knowledge as something to be acquired rather than discovered and expanded. The scientific method, which relies on observation and experiment, failed to take hold.

The second barrier to recognizing the advantages of reforms was the so-called “closure of the gate of *ijtihād*.” In early Islam, scholars and theologians more or less freely developed answers to problems that scripture and tradition left unresolved. In other words, they responded to emerging opportunities creatively. Their innovations helped sustain an internal engine of growth and contributed to the fluidity of Muslim worldviews. However, between the 9th and 11th centuries, freedom of innovation ended when it was declared that independent judgment was no longer permissible—in the traditional formulation, “the gate of *ijtihād*” was closed. This closure meant that all answers were already available: thenceforth, one needed only to follow and obey. In treating Islamic learning as having attained perfection and the Islamic world as self-sufficient, it gave

legitimacy to values, attitudes, and practices that promoted stability and discouraged inquisitiveness. Helping to legitimize an educational system that emphasized rote learning and memorization, it also fueled a culture that limited curiosity about the outside world.

Historians have not identified a time when Muslims assembled and declared all problems solved. Nor does Lewis claim otherwise. He knows that the decline in creativity occurred through a decentralized process rather than by decree. Yet he does not elucidate the mechanism that drove the decline. If the end of independent judgment was widely accepted, what accounts for the shift? Why did the malcontents within Muslim communities—as in any society, they existed—not see the spread of conservatism as a source of deepening problems? What, precisely, restrained the impulses of people who stood to gain from introducing one innovation or another? Even if the prevailing educational system limited inquisitiveness, it could not have extinguished the desire for change.

So Lewis' thesis consists of observations rather than what a social scientist would consider a complete causal explanation. A satisfactory explanation of obstacles to the Islamic world's quick economic recovery must make sense of why they could not be overcome through individual or collective action. It must also put forth the mechanism that kept Muslims who came in contact with Western Europe from appreciating the huge transformations underway. Intellectuals were not the only group in contact with Westerners. Many merchants had dealings with their counterparts across the Mediterranean.

What Went Wrong? does not explore why groups outside of intellectual circles accepted the freezing of Islamic institutions. There is a methodological bias at work here, which is common in scholarship focused on ideas. It entails the idealist fallacy, whose most prevalent form treats all

history as the history of thought.¹⁰ In Lewis' variant, innovations emerge exclusively from producers and guardians of knowledge, including scholars, teachers, and religious functionaries. In fact, people of all walks of life are capable of seeing a need for change. Merchants unable to raise capital in credit markets emaciated by an interest ban will pressure officials to create ways to circumvent the ban. Peasants unable to meet their tax obligations will communicate their frustrations by revolting, petitioning state officials, or migrating, and such responses may stimulate fresh thinking on the part of intellectuals, but also policy makers and landowners.

The key point is that the starting point of an innovation need not be the mind of an intellectual. The demand for change may emerge from any part of a social system, just as anyone can take part in the supply of change. It follows that a satisfactory explanation of why the Middle East fell behind economically must go beyond the identification of attitudes originating from intellectuals and religious leaders. A full explanation requires consideration of the understandings, incentives, and opportunities of every social group.

Remember now that a culture consists of a distribution of attitudes and a corresponding distribution of behaviors. To say that a society is conservative and that this conservatism accounts for its underdevelopment is to make a claim about the attitudes of its members and to suggest that those attitudes explain observed behaviors. It is to attribute the observed economic shortcomings to its culture, treated as fixed. Like Renan and Cromer before him, Lewis effectively identifies an attitudinal distribution that appears to have shown stability over some period of time. He does not go on to explain that stability, or link it to corresponding behaviors.

¹⁰ Fischer (1970), pp. 195-200.

3. Personal Exchange

_____ Analogous weaknesses are present in arguments that treat personal exchange as the main cultural factor responsible for the Middle East's observed economic failures. This point may be developed with reference to the works of Abraham Udovitch, a leading economic historian of the Middle East.

Among the puzzles that Udovitch has addressed in numerous writings, one pertains to the stagnation of the Middle East's financial system. In the Middle Ages the region had a sophisticated financial system by standards of the day. Yet this system did not develop further, and by the middle of the second millennium it looked underdeveloped vis-à-vis its counterparts in Western Europe. A major obstacle to the Middle East's financial development, suggests Udovitch, lay in the "social context of the region's economic life."¹¹ In economic relations, he says, personal relations and reputation played central roles. The people of the region operated within networks in which they were known, rarely doing business with strangers. It is precisely because personal relations mattered so much, Udovitch goes on, that banks did not emerge prior to the 19th century. By construction, banks are impersonal entities that intermediate among borrowers and depositors who need not know one another. For the regions financiers to develop banks, they would have had to extricate themselves from the "personalism" of Islamic culture. But the culture proved far too powerful.

In the medieval era, Middle Easterners received financial services from other individuals rather than from firms. They borrowed from money lenders working on their own account or as members of small and temporary partnerships enjoying no legal standing. The parties to financial disputes were always individuals. Because borrowers and lenders operated within networks, this

¹¹ Udovitch (1985), pp. 272-73.

system worked remarkably well for the time. But the very factor that facilitated financial relations in the medieval era also prevented the transformation of financial providers into banks. In particular, the fact that business was restricted to small and intimate circles blocked the development of large organizations specializing in credit, deposit taking, lending, and all the other things banks do.

In the Middle Ages there were no banks anywhere in the world, not even in Western Europe, which was to spearhead financial modernization. Credit relations were as personalistic in Florence and London as they were in Aleppo and Tunis. So personalism, which Udovitch presents as a key ingredient of Islamic economic culture, is not unique to the Middle East. Where the regions differ is that exchanges became progressively less personal in Western Europe, even as they remained highly personal in the Middle East. Personalism need not be a fixed attribute of an economic system. The types of relations that prevail in a region's financial markets can become less personal over time. Indeed, the move from personal to impersonal exchange is among of the most conspicuous manifestations of the institutional transformation that ushered in the modern global economy.¹²

Regional differences in the "social context of exchange" do not explain fully, then, the divergence that took place between the Middle Eastern economy and that of the West. I hasten to note that the "social context" was hardly irrelevant to the divergence. It was critical, though not for the reasons Udovitch offers. The cultural elements that Udovitch includes in the "social context" proved adaptable in certain respects but not in others. So to link Middle Eastern cultural features, or Islamic principles, with the region's observed economic trajectory, one must identify why as a matter of practice the degree of flexibility was highly variable.

¹² This is a central theme of institutional economics. See, in particular, Greif (2006), North (2005), and Platteau (2000), chaps. 6-7.

Consider the large body of Islamic law on the regulation of commerce. Called *mu'amalat* (literally, “commercial relations” or “transactions”) and usually translated as the “law of sale,” it specifies in intricate detail how voluntary transactions are to be conducted. According to the law of sale a transaction must be free of arrangements construable as unjustified enrichment. Someone would enrich himself unjustly if he obtained an advantage without yielding something equivalent in value.¹³ To ensure that everyone gives up an equivalent amount, it is necessary for all parties to know everything knowable about the goods being exchanged. Ignorance in any respect can lead to unjustified enrichment. In other words, transparency is vital to commercial legitimacy.¹⁴

Moreover, no exchange is to take place until the goods are precisely identified and measured. Thus, the fruits growing on an orange tree cannot be sold legitimately, because the number and quality are unknown. They can be sold only after they have been picked, counted, weighed, and individually examined. Likewise, a pregnant cow cannot be sold, but she can be sold with her calf after the birth. The difference is that during the pregnancy no one knows whether the calf will be born alive and healthy. The logic of these bans is to prevent disappointment. No one pays too much or receives too little, thus minimizing the possibility of discord.

To ensure the absence of unjustified enrichment, it is generally necessary also to have the buyer and seller hold a face to face meeting. The two sides must look each other in the eye and

¹³ Udovitch (1985), p. 448.

¹⁴ Medieval legal treatises carried this insistence on transparency very far. For an illustration, suppose that a store owner sells a customer a water jug. After consummation of the sale, the buyer discovers a crack in the jar, unnoticed during inspection. The law gives the buyer a “right of rescission”: he can cancel the exchange unilaterally, because the jug is now worth less to him, implying that the store owner has enriched himself by taking money from the buyer without giving something of equivalent value in return. See Udovitch (1985), p. 449.

indicate through a gesture or handshake that the deal is satisfactory.

In practice, of course, not all transactions involved a formal face to face meeting. Nor did people take the time to inspect fully and carefully every good being traded. Exhaustive inspections would have raised transaction costs to the point of eliminating the gains from trade. Exchanges often took place within networks of people who knew one another quite well. The members of these networks considered it a waste of time to conduct the detailed inspections demanded by law. Trusting their trading partners, they felt confident that they would not get cheated. This is not to say that they knew all the knowable specifics of the exchanged commodities. Even though they were shielded against cheating, they traded in a condition of ignorance about the goods changing hands, meaning that surprises were possible. Accordingly, they broke the Islamic law of sale routinely.

One might have expected the legal community to take measures aimed at improving enforcement of the law of sale. To the contrary, it tried to adapt interpretations of the law to realities of the marketplace. An instructive example lies in a treatise of the renowned legal scholar Shamseddin al-Sarakhsi (d. 1090), the *Book of Sale*. Sarakhsi notes that if you order a pair of shoes from a shoemaker, technically that transaction is illegal. This is because you have negotiated over something nonexistent, and the sale of a nonexistent object is not permissible. The seller cannot sell what is not in his possession, and the buyer cannot inspect an object that remains to be produced. Does it follow that made-to-order shoes should be prohibited? Sarakhsi answers in the negative, on the grounds that people have been buying made-to-order shoes happily from time immemorial. The underlying logic is that a practice is legitimate if it is common and causes no problems. To justify this logic he invokes a saying attributed to the Prophet: “Anything which Muslims consider

appropriate is also appropriate in the eyes of God.”¹⁵ Sarakhsi thus finesses the highly stringent requirements of the law of sale by appealing to social custom. If something is commonly done, he seems to be saying, then it is legitimate.

Here is another example of this logic at work. In the medieval Middle East people bathed not at home but at public bathhouses (*hamams*). The fee was paid up front. In principle, the practice violated the Islamic law of sale, because at the time of payment, the prospective bather did not know the service he would get. Would the water be warm enough? Would the bathhouse be too crowded? Under a strict interpretation of the law of sale, all bathhouses would have to close. The only way to make their operations legitimate would be to seek refuge in customary practice. Charging a fee for a bath not yet taken may be seen as legitimate because the practice has been common for centuries on end. In fact, Sarakhsi justified the practices of bathhouses on the grounds that they were customary.

Sarakhsi evidently had a practical mind. He understood well that many forms of economic exchange would cease if one insisted on having both sides to a contract get themselves fully informed at the outset. If bathers do not mind paying a fee up front, they are content with the service, and they seem to be getting clean, it makes sense to leave the bathhouse sector alone. Presumably, if the services of a bathhouse decline, the number of bathers will decline; people cannot be cheated indefinitely.

The key lesson is that Islamic law proved quite adaptable in certain contexts. The law of sale was applied flexibly and pragmatically, allowing exceptions in certain contexts where the benefits of imperfect transparency appeared to outweigh the costs. So Islamic law was not necessarily applied

¹⁵ As cited by Udovitch (1985), pp. 455-56.

rigidly, without regard for practical tradeoffs or for what we now call transaction costs. Nor were attitudes regarding economic relations were not fixed in stone.

Remember now that Islamic law failed to undergo various transformations that we associate with economic modernization. It failed to generate from within the institutions necessary to achieve the transition from personal to impersonal exchange. To attribute this failure of the Middle East's social context is to confuse *explanans* with *explanandum*, in other words, to treat as an explanation precisely what needs to be explained. The persistence of personalistic attitudes was not a manifestation of generalized inertia. It occurred even as other attitudes underwent refinements and adjustments. Islamic culture offers abundant examples of both change and rigidity.

4. Lasting Impact of the Islamic Law of Sale

Thus far, this paper has provided prominent examples of proposed linkages between culture and economic development, arguing that the suggested cultural obstacles do not elucidate the Middle East's observed trajectory, at least not by themselves. Attitudes considered inimical to economic progress were present also in periods when the region was remarkably creative and adaptable. If they did not block major transformations early on, they could not have been decisive later. As for the rules of exchange associated with Islam, they often yielded to social custom, which points to their malleability.

When a new area was conquered, interpretations of Islamic law adjusted, at least locally, to prevailing practices. This is evident in the plethora and diversity of the legal commentaries generated, over many centuries, in response to questions from believers confronted with problems in their daily lives. There was a steady demand for new legal interpretations, both because social

customs differed across localities and because social needs changed over time.

The social customs of areas brought under Islamic rule influenced legal interpretations over much wider areas. Thus, as Islam spread into former territories of the Roman Empire, diverse practices of these areas were incorporated into legal practices of earlier conquered regions. Although the borrowings in question usually involved creative transformations, they also modified received understandings. The waqf (Islamic trust) and the muhtasib (market inspector) are among the early Islamic institutions whose origins lie partly in Roman prototypes.

Even Islamism, the modern movement that seeks to restructure Muslim communities on the basis of Islamic institutions, promotes a vast array of borrowed institutions. In the economic sphere, the institutions that they promote, or tacitly accept, include banking, double-entry accounting, the corporation, insurance, and warranties, none of which has precedents in pre-modern Islam. Formally, Islamism associates Islam, or at least uncorrupted and thus authentic Islam, with certain values, attitudes, and practices that are eternally fixed. It thus fails to recognize that Islam has been a living structure, that it has been re-interpreted repeatedly in accordance with changing conditions. As a matter of practice, however, Islamism is not hostile to modernization per se. Without acknowledging the fluidity of how pious Muslims have defined, or now define, the “Islamic way of life,” they allow the definition of good Muslim behavior to accommodate modern technologies, goals, and expectations.

In view of past and present adaptations in interpretations of Islamic precepts, certain scholars liken the effects of custom on the interpretation of Islamic law to the role it played in European legal evolution. They note that in the Middle East, as in Europe, laws have been reinterpreted in response

to changing social needs.¹⁶ But there is a huge distinction. In Europe, laws evolved more or less freely, without religious control. There was no pretension that economic rules and regulations stemmed from a fixed religious source. In the Middle East, even as Islamic law accommodated local customs, Islam by and large rejected custom as a valid source of law.¹⁷ This meant that tensions between Islam's original prescriptions and everyday practices could persist indefinitely.

The disharmony between the doctrine and practice of Islamic law is reflected in ongoing clashes within Islam. In diverse contexts, the world's Muslims are divided over whether Islam is an eternally fixed religion or one that is adaptable to the needs of each age and milieu. Although Islamists do not speak with one voice, dominant groups support a return to the distant past even as they tolerate, endorse, and even actively pursue reforms. Many ongoing controversies involve matters that might have been closed centuries ago. Institutions that became dysfunctional in the Middle Ages, but never formally rejected, are now being reconsidered as solutions to post-industrial problems.

The Islamic law of sale offers a striking example. As we saw earlier, it evolved over several centuries to maintain harmony among traders by keeping them satisfied with their exchanges. If followed to the letter, the law of sale would eliminate a huge share of the trades that account for the world's current prosperity. Indeed, most of the trades observed today would have to be banned on the grounds that by waiting, or measuring more, or inspecting further, informational asymmetries

¹⁶ Makdisi (1999), Gerber (1994).

¹⁷ Udovitch (1985), p. 457. Although there were scattered attempts to give local custom a recognized place in the law, these proved controversial, and their influence remained limited. Pragmatic interpretations of the sources of law always remained vulnerable to criticism and revocation. See Berque (1960).

among traders could be lessened. Unlike the Middle Ages, food products are now generally sold in packaging. So someone who buys a cart full of groceries at a supermarket does not know with certainty what he is getting. A case can be made that one should insist on having packages opened prior to any sale. The downside, of course, would be an inordinate rise in transaction costs. Likewise, transaction costs would skyrocket if an electronics store could not sell a radio without opening the box and turning it on to allow the salesperson and customer to gauge the sound quality as a prelude to setting a price and executing the transaction. In fact, a strict application of the law of sale would require an inspection of the radio's individual components. By dismantling the radio itself and evaluating its frame, antenna, speakers, wiring, and knobs, one can become more knowledgeable about its quality, though at the cost of raising the time spent on inspections.

In the modern world, as in medieval times, much can be gained from harmonizing the expectations of transactors and dampening their informational asymmetries. Various new institutions have arisen to do so. Warranties bolster commercial relations by giving buyers the confidence that they will not get stuck with a defective product. For another example, organizational forms that give commercial enterprises longevity made them eager to protect their reputations through careful quality control. In sum, the objectives of the law of sale are now met without requiring buyers and sellers to meet in person and inspect every item exhaustively. Enforcing the Islamic law of sale now would amount, then, to replacing institutions suited to modern economic conditions with ones that reflect the needs of a millennium ago. It would also harm productivity.

Yet, Islamic economics, the doctrine that aims to restructure economies according to prescriptions found in the fundamental sources of Islam, promotes variants of the Islamic law of sale

as the antidote to problems in today's markets.¹⁸ Works in Islamic economics emphasize the need for careful inspections of goods traded. They also characterize as sinful exchanges based on incomplete information, such as the sale of a pregnant cow or that of unripe oranges. In taking such positions, they write as though market institutions have remained frozen since the early Islamic centuries. Markets will generate serious discord, they seem to be saying, unless buyers and sellers abide by the Islamic law of sale. As such, they effectively reject Sarakhsi's flexibility and pragmatism.

Were Sarakhsi still alive, he would probably recognize that modern veterinary science allows people who trade cows to learn a great deal about unborn calfs, that various financial contracts are used to shift the risks of buying unripe oranges onto the shoulders of those best able to carry them, and that in numerous markets warranties obviate the need to inspect traded commodities exhaustively. In his own day, Sarakhsi realized that a useful business would suffer if buyers of made-to-order shoes were barred from paying in advance. He would probably have noticed now that the huge increases in prosperity enabled by impersonal exchange would disappear without a far-reaching reinterpretation of the Islamic law of sale.

Other goals of Islamic economics entail, likewise, the redeployment of policies developed in response to medieval problems. Campaigns to reinstitute the ban on interest are too well known to require detailed commentary here.¹⁹ The Qur'anic ban on *riba*, a pre-Islamic credit institution that fueled serious social conflict, came to be considered a ban on all interest at a time when most

¹⁸ See, for instance, Siddiqi (1979), chap. 3; Afzal-ur-Rahman (1980), sects. I-5 and II-5; and Naqvi (1994), chap. 5.

¹⁹ For critical perspectives on the anti-interest movement and its accomplishments, see Kuran (2004) and El-Gamal (2006).

borrowers were simply trying to survive.²⁰ Now, except in the world's poorest communities, most borrowing finances investment, the purchase of a durable good, or consumption smoothing at levels way above subsistence. No longer, therefore, does a ban on interest protect the poor, if it ever did. It helps Islamists forge a distinct economic identity, differentiate Islamic economics from secular economic doctrines, focus attention on a tangible cause, and give their agenda an aura of historical continuity. In any case, one can now deliver help to Muslims living close to subsistence more effectively through education, social security programs, unemployment and health insurance, employment assistance, and private transfers than through interest restrictions.

Were the prescriptions of Islamic economics actually followed, then, they would pose a huge problem for the Middle East and the rest of the Islamic world. However, the Islamic banks that have mushroomed all over the world do not really accept deposits and make loans in an interest-free manner. They give and take interest in camouflaged form. As for the Islamic law of sale, it is taught in Islamist-controlled universities and recorded in Islamic economics texts, but not even Islamist leaders take it literally, and in no market does it regulate economic behaviors. As with the interest ban, the law serves to give Islamic economics a distinct identity and also to prove that the Islamic heritage contains a rich economic literature and well developed economic institutions.

Does it follow that the economic impact of efforts to restore medieval economic institutions is negligible? Although the intended impact is minimal, these campaigns are not costless. They absorb the energies of economists who could be working on genuine social problems. They divert attention away from potentially useful reformist agendas. They also mislead people into believing that solutions to various problems lie in building a distinctly Islamic economic system, when in fact

²⁰ This was true all over the world. See Homer and Sylla (1996), chaps. 3-5.

more could be gained from studying how a broad range of societies, including both Muslims and non-Muslims, have dealt with universal human challenges.

If it is puzzling that Islamic economics exists, more puzzling still is that more than a half-century after its emergence anyone still takes it seriously. A key reason is that the fear of being stigmatized as a bad Muslim makes many skeptics keep their doubts to themselves. Even as they transgress the prescriptions of Islamic economics in their daily lives, they pay lip service to the need for an Islamic revival and refrain from challenging Islamist agendas. Meanwhile, vocal critics of Islamist agendas tend to be treated as enemies of Islam, causing their views to be discounted. As in other contexts, preference and knowledge falsification feed on themselves.²¹

5. Enduring Effects of Classical Islamic Law

Thus far I have discredited various claims regarding the cultural sources of the Middle East's economic disappointments by suggesting that attitudes and behaviors often considered distinctly Islamic have little explanatory power as determinants of the region's ups and downs. I have suggested that recent Islamist attempts at economic Islamization have had no major impact on Muslim preferences or behaviors. Although the massive literature produced under the rubric of Islamic economics maintains that Islam promotes a distinct economic culture, in areas it targets for regulation actual economic behaviors have hardly been affected. As for suggested links between Middle Eastern economic failures and ostensibly fixed Islamic characteristics such as fatalism, conservatism, lack of curiosity, and proclivity to favor personal exchange, neither alone nor in

²¹ On the dynamics of this process, see Kuran (1995). Although the consequent equilibria would unravel quickly if a critical mass of people somehow rose in opposition, the triggering of a chain of events leading to the formation of such a critical mass is inherently unpredictable.

combination do they explain observed variations in the region's economic performance. Each is at best a symptom of outcomes whose explanation must involve deeper social characteristics.

These deeper characteristics are the region's institutions. Recall that an institution is a set of social factors that jointly generate behavioral regularities. The institutions of a society generate an institutional system.²² Within a web of institutions that form an institutional system, a cultural characteristic such as personal exchange appears as an institution that individuals take as given, yet is also capable of changing through the decisions of those very same individuals. Attitudes such as apathy and conservatism can appear as mutually supporting and jointly evolving institutions that are contingent on other traits and thus specific to particular contexts and time periods.

Nothing here implies that the cultural particularities of Middle Eastern economic history are explicable without reference to anything Islamic. On the contrary, these particularities are among the lasting consequences of certain elements of classical Islamic law, which was largely in place by the end of the first millennium. Among its components relevant here is the law of Islamic commercial partnerships. Although these partnerships assumed several variants, often they involved a contract between one or more sedentary investors with one or more traveling merchants, with profits meant to be split among the partners according to a pre-determined ratio. Inspired by various ancient arrangements used to finance trade before the birth of Islam, an Islamic partnership resembled also certain partnerships that European merchants used throughout the Middle Ages. Islamic partnerships stand out as unusually flexible, in that they allowed the profit shares of the partners to depend on such factors as the riskiness of the intended venture and the merchant's reputation. These flexibilities

²² Institutional elements, like the institutions they form, are shaped by individual behaviors. By the same token, they are exogenous to the behaviors of individuals themselves.

were so advantageous that non-Muslim traders and investors of the Islamic world, though under no compulsion to do business under Islamic law, commonly opted to do so anyway. Dating mostly from the 11th to 13th centuries, the “Geniza documents”—so called because they were discovered in the Geniza (store-room) of an Egyptian synagogue—indicate that Jewish merchants of the medieval Mediterranean often formed Islamic commercial partnerships and resolved their disputes before Islamic courts.²³

Right up to the 19th century these partnerships consisted of temporary commercial enterprises with few members, often just two. Moreover, their forms barely changed even as European partnerships expanded in size and gained complexity.²⁴ A key factor that accounts for the stagnation of Islamic partnerships is the Islamic inheritance system, which requires two-thirds of any estate to be divided among members of the deceased person’s extended family according to standard rules. Although there were ways to circumvent these rules, on balance they raised the cost of maintaining enterprises across generations. Because adding members to a partnership increased the likelihood of premature dissolution, they also discouraged the formation of large partnerships. The consequent failure to make the transition to large commercial partnerships critically influenced the region’s economic evolution. The local merchant community saw no reason to pressure local courts to create fundamentally new laws to re-interpret the existing legal code. Thus, the region produced nothing akin to the auto-catalytic process that in the West led, first to increasingly complex partnerships, and then, in the nineteenth century, to a mushrooming of commercial and financial corporations.

Among the manifestations of this divergence is that Europe began the transition from

²³ Goitein (1967), especially pp. 169-179. See also Kuran (2004), sects. 5-7.

²⁴ Kuran (2003).

personal to impersonal exchange earlier than the Middle East. In the Middle East the process started in the 19th century, with the transplant of pertinent European institutions in the context of top-down reforms. In the intervening years, exchange has become generally less personal in the Middle East; today, a much greater portion of the region's exchanges are among mutual strangers who are matched by impersonal intermediaries such as banks and stock markets. Evidently, Islam is not incompatible with impersonal exchange.²⁵ It merits emphasis that this hardly points to Islam's irrelevance to the Middle East's economic trajectory. Although Islam is not inherently incompatible with impersonal exchange, its medieval commercial structures failed to bring about the transition from personal to impersonal exchange endogenously. This failure required the transplant of institutions developed elsewhere.

The region's inability to generate modern commercial institutions from within also had a political consequence, with economic effects of its own. Because the commercial sector remained atomistic, civil society failed to develop, limiting pressures from below for institutional reforms. The resulting inertia helped to make the region's peoples seem apathetic, conservative, and disinterested in outside developments. It also limited the feasibility of democratic rule, allowing authoritarian regimes to form and gain stability. Had the private economic sector developed large and durable organizations, political leaders would have found it harder to rule dictatorially. At a minimum, they would have sought to share power with merchants and financiers, thus stimulating the expansion of democratic liberties, including free speech and the right to dissent. Most relevant here, Muslim societies may never have acquired the attitudinal characteristics now widely associated with Islam.

²⁵ Significantly, this transition has taken place even as the share of Muslims has risen as a result of emigration and population exchanges.

The weaknesses of civil society in the region are rooted also in another historically prevalent institution: the waqf, which is a distinctly Islamic form of trust.²⁶ Known also as a pious foundation, it consists of property immobilized in order to finance a designated religious or charitable mission in perpetuity.²⁷ It is founded through a personal act by an individual property owner. Within the limits of Islamic law, the choice of a waqf's mission is entirely up to its founder. Accordingly, from the early Islamic centuries to modern times, a vast array of social services have been provided through the waqf system. To name a few of varying economic significance, waqfs have been formed to build and maintain mosques, to support inns on caravan routes, to pay the taxes of designated neighborhoods, to finance schools, and to maintain parks. In the great cities of the medieval Middle East waqfs supplied most of the urban services now provided largely by municipalities. They also contributed to poverty alleviation. Every major settlement had waqf-financed public shelters and soup kitchens for the poor. Waqfs proliferated partly because they served also as wealth shelters. A founder could make himself his waqf's trustee for life, compensate himself for his services, choose the waqf's employees from among his relatives, and bequeath his self-conferred privileges to his descendants. Waqf assets were considered sacred, which gave them considerable security against confiscation.²⁸ Rewarding waqf founders with material security thus turned out to be an ingenious

²⁶ The waqf has no basis in the Qur'an. It emerged, and then achieved identification with Islamic civilization, about a century after the advent of Islam, at a time when the Arab-Islamic Empire was governed from Damascus.

²⁷ Kuran (2001), Powers (1999), Lev (2005).

²⁸ Waqf assets were sometimes confiscated, usually under the pretext that their founders had acquired them illegally. But at least until the eighteenth century such confiscations were far less common than those of private property, if only because officials were reluctant to appear impious. So the wealth-sheltering function of the waqf contributed enormously to its popularity, all the more so in times of political instability, when private property generally became less

way to promote philanthropy and reduce the state's role in the provision of social services.

With some success states endeavored to influence the most significant investments made through the waqf system. A dignitary planning to establish a major waqf would be advised to take account of the state's strategic priorities. Nevertheless, the Middle East's huge network of waqfs took shape largely through the uncoordinated decisions of individual property holders. One might have expected this network to stimulate the development of civil society, for waqfs did not depend on state handouts. By virtue of their financial independence, waqfs might have given private groups bases from which to assert democratic rights and impose checks on arbitrary government rule. Yet a waqf is not a corporation; once chartered, not even its founder can amend its mission. The consequent rigidity limited its contributions to the growth of civil society. Insofar as modern capitalism requires strong "intermediate" organizations situated between the individual and the state, this rigidity ultimately retarded economic modernization by keeping waqfs inherently conservative and unresponsive to evolving social needs. If the Western experience offers any guidance, waqfs capable of genuine self-governance might have stimulated experimentation as well as reformist movements from below. In the West, the emergence of greater and lesser corporate bodies in the early Middle Ages gave rise, over subsequent centuries, to new laws that gradually strengthened civil society.

Lack of incorporation is also a striking feature of other social structures of the pre-modern Middle East. Not even the region's world-class cities were chartered as corporations, and not until the 1850s did any boast a municipality. Although certain urban craft guilds exercised considerable

secure.

autonomy in their internal affairs, the state reserved the right to meddle in their activities. Colleges were not free to alter their curricula as educational needs changed. Generally chartered as waqfs, they were required, in principle but to a degree also in practice, to teach what their founders had stipulated.

Just as Islam's inheritance and partnership rules jointly kept commercial enterprises small and short-lived, thus hampering the advancement of civil society, its waqf rules and lack of incorporation opportunities limited civil society by contributing to the rigidity and political impotence of its philanthropic organizations. A legacy of these weaknesses, still apparent across the region, consists of its limited capacity to solve social problems through the mobilization of private resources. Another is widespread apathy and complacency, which are defensive responses to feelings of powerlessness in the face of vexing problems.

Attitudes commonly viewed as elements of a fixed Islamic culture are thus among the effects of specific institutional handicaps. When the problematic institutions were discarded, the associated attitudes would have started to fade away. The transformation has been slow, however, because political structures accustomed to filling the void left by weak civil societies had a stake in keeping them weak. Significantly, although Arab businesses and philanthropic organizations have now been able to incorporate for decades, Arab civil societies remain strikingly weak. There is still little in between Arab dictators and the masses they rule—no real labor unions, no influential human rights groups, no free press, and no parliaments with political power. That is why an Arab nation will fragment and descend into chaos when its dictator is removed from power—as the aftermath of the American occupation of Iraq so clearly shows.

A complementary reason why the attitudinal transformation in question could drag on

indefinitely is that in a system of interconnected institutions the functioning of each institution depends on the others. The efficiency of large organizations requires, among other things, a competent and honest cadre of accountants, a legal system equipped to handle expeditiously disputes within and among such organizations, and an impartial judiciary. Accordingly, the introduction of a law of corporations need not lead to a proliferation of corporations, or keep established corporations efficient. In the absence of a legal system capable of adjudicating corporate cases, people will be reluctant to form corporations, preferring to conduct commerce and finance through smaller, shorter-lived, and less complex forms of organization. The movement from personal to impersonal exchange will thus be delayed. Moreover, technologies whose efficient exploitation requires large-scale organization will remain unexploited, strengthening the impression of a lethargic society.

Such a scenario has been played out, in fact, from the mid-19th century onward, when Middle Eastern governments initiated chains of institutional reforms aimed at overcoming economic handicaps. Each reform transformed one element of the system within which the region's merchants, producers, financiers, and investors must operate. With key preconditions of modern growth still absent, the results have been disappointing, and the region remains underdeveloped.

6. The Primacy of Islamic Institutions over “Islamic Culture”

Having asked whether the Middle East's economic shortcomings are somehow attributable to cultural factors associated with Islam, I have ended up suggesting that distinct Islamic institutions lie at the roots of the region's slip into a state of economic underdevelopment. Economically harmful attitudes and behaviors that are often treated as manifestations of Islam are symptoms of institutional

deficiency, rather than immutable traits independent of institutional evolution.

Both culture and institution are concepts used in many different senses and imprecisely. The primacy I have given here to institutions rests on specific meanings given to these terms. By culture I have meant a pair of distributions, one of attitudes and the other of behaviors. Observers who ascribe the Middle East's economic deficiencies to "Islamic culture" maintain that conservatism, fatalism, personalism, and incuriosity are more prevalent among Muslims than among non-Muslims. They claim, moreover, that these attitudes stem from Islamic teachings, making them essentially fixed. Therein lies the problem. There have been periods when Muslim societies exhibited remarkable dynamism. And although personal exchange remains common in the Middle East by the standards of advanced countries, its share among all exchanges has fallen greatly since the Middle Ages. Today, the region's banks, stock markets, and credit card companies intermediate huge numbers of exchanges among parties unknown to one another.

An institution, as defined here, consists of a set of social factors that produce interconnected social regularities. Being part of a system, its operation may depend on other institutions. Islamic law, which for many centuries gave the Middle East a distinct and persistent identity formed a system of institutions. Its elements directly relevant to the region's economic development include a law of partnerships, inheritance regulations, and the waqf. Individually and jointly, these elements of Islamic law delayed the transition from personal to impersonal exchange, discouraged the use of the technologies of mass production, kept civil society weak, and set the stage for sustained authoritarian rule. Their consequences have included the very traits that are commonly considered integral to "Islamic culture."

Institutions are not immutable, and neither are the cultural features that they produce. As

institutions change, so does the associated culture. This is not to posit a monotonic relationship between the trajectory of any given institution and associated attitudes. Because the effects of each institution, like the incentives to preserve them, depend on many others, a law can be reformed, or a new law introduced, without much impact on economic attitudes. By the same token, certain reforms may yield results in short order. This is consistent with the proliferation of local Middle Eastern banks once various institutions supportive of banking, including corporate law and modern accounting, fell into place.

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