8 Institutional change and economic development in the Middle East, 700–1800

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Introduction

The Middle East region had one of the most vibrant economies in the world from the eighth until the end of the eleventh centuries. Economic prosperity during the so called Golden Age of Islam was based, above all, on rising productivity in agriculture. Located between the two major sea areas, the Indian Ocean and the Mediterranean, and at the center of major intercontinental routes, economies of the region also enjoyed a strong urban network and wide range of manufacturing activities. The deepening of the division of labor, the growth of new occupations and skills in manufacturing and services as well as agriculture, high rates of literacy and the long list of technical innovations, all point to an episode of intensive growth and economic efflorescence in Abbasid Iraq. Complex institutions for credit, commercial and other business partnerships, long-distance trade, and shipping were developed during this period. These institutions were imported into Italy in the eighth or ninth centuries and formed the basis of European commenda and contributed to the development of the European institutions of business, commerce, and finance in later centuries (Abu-Lughod 1989; Ashtor 1976; Lombard 1975; Udovitch 1970, 1975). After the eleventh century, however, the center of gravity began to shift away from the urban centers of the Middle East toward the mercantile states of Italy and the later to the Low Countries and England. (Abu-Lughod 1989; Ashtor 1976; Shatzmiller 2011).[1]

It has long been debated whether the cause of this divergence was a series of external shocks such as the Crusades, the Mongol invasion, the Black Death, and shifts in the intercontinental trade routes. Admittedly each of these external shocks had a significant and long-lasting impact on the economies of the region. However, the Black Death had a severe impact on other regions of the world as well, most notably on Europe. It is clear that northwestern Europe absorbed this shock and responded to it much more positively in the following centuries (Borsch 2005; Pamuk 2007). The shift of the intercontinental trade routes to the Atlantic Ocean undoubtedly had an impact on the region. By that time, however, the Middle East had already begun to lag behind southern and northwestern Europe.

In this chapter I will first examine the evolution of institutions in the region in three different areas, land regime, private finance, and public borrowing, to show there were many changes over the millennium from the rise of Islam until the modern era. While these were often in response to the changing circumstances, they also reflected the social structure and prevailing power balances in these societies. I will also argue that how towns and urban areas related to the state, how urban areas are included in state policies, and how they influenced the shaping of institutions are the keys to understanding long-term institutional and economic change in the region. Even though local urban councils led by the notables and local craftsmen, including the guilds in the Ottoman era, enjoyed a good deal of autonomy, political power in the region was concentrated in the hands of the ruler and the state elites around him. In contrast, the influence of various social groups, not only of landowners but also of merchants, manufacturers, and moneychangers over economic matters, including the policies of the central government, remained limited. This political configuration and the related institutions persisted into the modern era. As a result, societies in the Middle East did not develop institutions more independent of the state and the state elites and more in favor of the private sector.

Long-term trends in wages and incomes

I begin with some estimates of population in order to give an idea of the orders of magnitude. The population of the Islamic states of the Middle East including Iran and North Africa but excluding Anatolia is estimated to have varied between 20 to 35 million during the medieval era, from the seventh to the fifteenth centuries. These numbers indicate clearly that the population of the Middle East was much smaller than those of south Asia and China during the medieval era. It was roughly comparable to the population of southern and western Europe early in the medieval era, but the population of the latter began to outstrip the population of the Middle East approximately after the year 1100. Moreover, while the population of these three other areas increased significantly from the sixteenth through the eighteenth centuries, the population of the Middle East did not change very much until the nineteenth century (Issawi 1981; McEvedy and Jones, 1978).

A good amount of wage and price data for the medieval and early modern Middle East has made it possible in recent years to learn more about the long-term trends in wages and incomes in the region and compare them with the neighboring areas. In what follows I prefer to state these findings qualitatively since the margins of error associated with the existing estimates for both the Middle East and Europe do not allow a high degree of precision, especially for the earlier periods.

A recent study has concluded that because of the two long-lasting demographic cycles, the first known as the Justinian plague that began in the middle of the sixth century and lasted until the ninth century and a second one known as the Black Death that began in the middle of the fourteenth century, as well as an episode of intensive growth known as the Golden Age, the purchasing power of the daily wages of unskilled workers as well as average incomes in the Middle East not only exhibited significant medium- and long-term fluctuations but also remained well above the subsistence minimum for a large part of the medieval era. It has been estimated that the purchasing power of unskilled wages in the region remained mostly between 1.3 and 2.0 times the subsistence minimum, and that average incomes remained mostly within an interval that ranged from two to three times the subsistence minimum during the medieval era (Pamuk and Shatzmiller 2014).

Direct comparisons of wages and incomes between the Middle East and Europe for the period before the thirteenth or fourteenth centuries are not possible at the moment since we do not have reliable estimates for the levels of real wages or GDP per capita for most European regions or countries. Nonetheless, it appears that from the eighth through the tenth centuries, and possibly until a later date some time in the eleventh century, real wages and incomes in the more prosperous regions of the Middle East were higher than those in the more prosperous regions of Europe. After that date, however, a divergence between the Middle East and parts of Europe began to emerge. Parts of the Middle East, Iraq, Iran, and Syria but not Egypt were adversely affected by the Mongolian invasions during the thirteenth century, although the long-term implications of these invasions may not have been as significant as many have assumed. More importantly, southern and later northwestern Europe began to experience sustained increases in wages and per capita incomes. Differences in incomes and standards of living between the more prosperous areas of the Middle East and those of southern Europe, if not northwestern Europe, had become apparent by the first half of the fourteenth century, before the arrival of the Black Death.

The initial impact of the Black Death in the Middle East was similar to that in most parts of Europe as real wages and per capita incomes rose sharply in both areas. With the recovery of population, however, real wages began to decline. Recent research points out that in many European countries real wages at the end of the eighteenth century were no higher than those in the fifteenth century. Similarly, recent GDP per capita estimates suggest that in many cases average incomes at the end of the eighteenth century were not higher than the peaks reached in the aftermath of the Black Death (Allen 2001; Alvarez-Nogal and Prados de la Escosura 2013; Broadberry *et al.* 2010; van Zanden 1999). Long-term trends in the Middle East were similar in this respect. Our estimates indicate that real wages in Cairo and Istanbul around the 1780s were no higher than the peak levels attained during the fifteenth century. The major exception to this pattern occurred in northwestern Europe, in the Low Countries and in Britain, where during the early modern era, well before the industrial revolution, it is estimated that per capita incomes but not wages began to exceed the levels attained during the era of the Black Death.

One also needs to be careful not to overstate the differences in real wages and average incomes between Europe and the Middle East in the era before the industrial revolution. Differences in urban wages between the more advanced regions of Europe, that is, England and the Low Countries and the eastern Mediterranean, rarely exceeded two to one before the nineteenth century. Differences between the rest of Europe and the eastern Mediterranean were even smaller until after the industrial revolution. The emerging gap was not due to a decline in the Middle East but due to the rise of wages and incomes first in southern and then in northwestern Europe. For this reason, it is more appropriate to talk about the rise of Europe than the decline of the Middle East during the late medieval and early modern eras (Özmucur and Pamuk 2002; Pamuk, 2007).

Institutions and institutional change

Institutions and institutional change have been identified in recent decades as key variables that help explain the widely disparate economic performance of different societies over time. Based on the successful experience of western Europe and European offshoots, Douglass North and others have argued that long-run economic change is attained because the underlying framework persistently reinforced incentives for organizations to engage in exchange and productive activity. Institutional economics and economic historians have come to recognize that institutional change is usually not in the direction of most efficient outcomes and a society rarely arrives at or creates institutions that are conducive to economic growth. In most cases, institutions have favored activities that restrict opportunities rather than expand them. Similarly, rather than reinforcing incentives toward productive activity, in most cases states have acted as instruments for transferring resources from one group to another or promoting their own survival at the expense of others. In short, the process of institutional change has not always been favorable to economic growth (Acemoglu and Robinson 2012; North 1990).

How economic institutions are determined and why they vary across countries is not sufficiently well understood. Institutional economics proposes a number of causes or determinants of institutions. Most important among them are (1) geography or resource endowments; (2) religion or more generally culture; and (3) social conflict or political economy. Economic institutions in the Middle East have certainly been influenced by geography or resource endowments. The most important example in this respect is Egypt, where the land regime, fiscal institutions, and the role of the central government have been shaped to a large degree by the needs of irrigated agriculture. With the exception of Egypt, however, the geography or resource endowments of the region were not very different from those of other temperate areas of the world. A favorable location can also be a substantial stimulus for economic development. In fact, the location of the Middle East between Europe and Asia provided significant opportunities for commercial development as it enabled the region to turn more towards the Indian Ocean in the Middle Ages while Europe was going through its Dark Ages. Similarly, it is difficult to deny that the shift of the intercontinental trade routes to the

Atlantic Ocean had an impact on the region. By that time, however, the Middle East had already begun to lag behind southern and northwestern Europe. For these reasons, I do not consider geography or resource endowments as the leading determinant of institutions in the region or the primary cause of the long-term change in its relative economic standing.

Religion and/or culture have long been offered as a primary cause of the differences in economic outcomes between the Middle East and western Europe. Weber's analysis of Islamic societies emphasized the contrasts between them and those in western Europe in a number of areas including religion and law as well as the political system (Weber 1968). More recently, Timur Kuran (2010) has pointed to Middle Eastern institutions rooted in Islamic law, including inheritance law, commercial law and others, as past and in some cases continuing obstacles to economic development. As a result, he has argued, even though Middle Eastern institutions may not have caused a decline in economic activity, they have turned into handicaps by perpetuating themselves during the centuries when the West developed the institutions of the modern economy. Culture and religion certainly influenced institutions in the region. However, like Weber, Kuran has minimized the considerable differences that has existed within Europe and within the Middle East and has presented idealized versions of societies, institutions, and patterns of long-term economic change in each of these two regions. As a result, he has overlooked institutional changes in Islamic societies, changes in Islamic law, and the varieties of Islam that emerged in response to the many different conditions. He has also tended to minimize if not ignore the large body of evidence that Islamic societies often circumvented or adapted those religious rules that appeared to prevent change, including economic change. Moreover, Islamic law has not been an autonomous sphere isolated from these societies. Recent research in the Ottoman archives has shown, for example, that political authority was closely involved in the interpretation of law and the day-to-day administration of justice in the early modern Ottoman empire (Gerber 1994; Hallaq 2005; Udovitch 1970). Once it is allowed that so-called Islamic rules can and do change or be circumvented, it becomes necessary to understand why and how.

Those in the recent institutional economics literature adhering to a social conflict or political economy explanation of economic institutions argue that because different groups and individuals typically benefit from different economic institutions, there is generally a conflict over the choice of economic institution. Institutional change, even when socially beneficial, will be resisted by social groups who stand to lose economic rents or political power. Consequently, the process of institutional change involves significant conflict between different groups, ultimately resolved in favor of groups with greater economic and political power. The distribution of political power is, in turn, determined by political institutions and the distribution of economic power. For this reason, political economy and political institutions are considered as key determinants of economic institutions and the direction of institutional change (Acemoglu and Robinson 2012; Ogilvie 2007; Rodrik, Subramanian, and Trebbi 2004).

The same literature also argues that for long-term economic growth, institutions should not only offer incentives to a narrow elite but also open up opportunities to a broader section of society. Institutions that provide incentives to invest in land, physical and human capital, or technology are more likely to arise when political power is in the hands of a relatively broad group with significant investment opportunities. The state can be a major player in this context as it often decides on the rules and often maintains the coercive power necessary to enforce them.

In a related recent study, Acemoglu, Johnson, and Robinson (2005a) have offered an explanation for why strong private property rights emerged in western Europe, especially in Britain and the Netherlands, beginning in the sixteenth century. They argue that Atlantic trade – the opening of the sea routes to the New World, Africa, and Asia and the building of colonial empires – contributed to the process of west European growth between 1500 and 1850 not only through its direct economic effects, but also indirectly, by inducing fundamental institutional change. Atlantic trade in Britain and the Netherlands altered the balance of political power by enriching and strengthening commercial interests outside the royal circle, including various overseas merchants, slave traders, and colonial planters. Through this channel, it contributed to the emergence of political institutions protecting merchants against royal power. In short, they argue, the Atlantic trade played a key role in strengthening segments of the bourgeoisie and the development of capitalist institutions in these countries. In contrast, where the power of the Crown was relatively unchecked, as in Spain, Portugal, and France, they emphasize that trade was largely monopolized and regulated, the Crown and its allies became the main beneficiaries of the Atlantic expansion, and the same induced institutional changes did not take place. Areas lacking easy access to the Atlantic, such as Venice and Genoa, on the other hand, did not experience any direct or indirect benefits of Atlantic trade.

This argument also suggests that the causal relationship between institutions and economic development is not necessarily one directional, running from institutions to economic development. Economic development or its absence also influences the institutions and their evolution. In other words, just as the expansion of Atlantic trade helped the merchants shape the capitalistic institutions in northwestern Europe, the low levels of economic transformation in the economies of the Middle East may have limited the economic and political power enjoyed by merchants and manufacturers. These low levels of economic development helped maintain a different pattern of institutions, one that was not friendly to merchants or more generally to the private sector.

Institutional change in the Middle East

Contrary to many clichés and misconceptions, societies of the Middle East experienced a good deal of institutional change during the millennium from the rise of Islam to the modern era. By examining the evolution of institutions in three different areas, land regime, private finance, and public borrowing, this section will argue these changes were not caused by the requirements of Islam or geography but reflected power balances in society as well as responses to changing economic needs.

Land regime

The evolution of the land regime in the Middle East during the late medieval era exhibited a great deal of variation but it is safe to say Islamic law was not the primary determinant of the emerging patterns. Instead, these were closely associated with the changes in social structure and political power. In the early centuries of Islam, states distributed to their notables portions of their territory, and ownership or control of the land was subject to regular payments of the tithe. These transfers were irrevocable. In later centuries, however, along with the increase in military needs and the rise of the new military elite, a new arrangement emerged. When governments began to experience difficulties in payments to officers and the troops, they began to grant military officers the fiscal rights of lands under government control instead of payments in cash. The officers were expected to use the tax revenues from these lands as payments for themselves and the troops. These arrangements were not permanent, however; they ended with the term of office or military service.

The Seljukids extended this practice throughout their wider empire and began to confer whole provinces in Iran, Iraq, Syria, and Anatolia. These land grants similarly expanded in Egypt during the Fatimid and Mamluk eras. Their status was subject to long swings of the pendulum depending on invasions, conquests, and the strength of the central government. During periods of decentralization or weakening of the central government, the revocable nature of the grants faded and they became more hereditary. During periods of increasing power by the central government, on the other hand, the hold of former military officers and their descendants on these lands weakened and their control reverted back to central government which often chose to distribute the fiscal rights to new individuals (Ashtor 1976: 168–331; Borsch, 2005: 26–27; Cahen 1971; Lambton 1953; Tsugitaka 1997).

Conquest of new lands from non-Muslim populations, the periodic repetition of conquests, and invasions also weakened hereditary control over land by military elites. In the longer term, states remained strong enough to prevent the emergence and consolidation of private ownership on land. As a result, private property on land remained precarious and was never firmly established in most parts of the region. In Egypt, for example, where geography gave a stronger hand to the government, the individual *ikta* was unhereditary, short term and constantly subject to the winds of political and military fortune in the late medieval centuries. Mongol invasion in the thirteenth century tended to weaken the central governments in the region and strengthen control by local rulers. With the disintegration of the Ilkhanids, the Mongols of Persia, however, local control over land began to take root once more. On the other hand, the rise of Ottoman control over large areas of the region in the fifteenth and sixteenth centuries strengthened state control and the establishment of state ownership over land. While the extent of control over land by local elites varied over time and space, it is clear that a land-based, hereditary aristocracy did not emerge in the region during the millennium before the modern era.

The spread of the *ikta* did not benefit the peasantry, since it eroded their status as free cultivators even though the recipients of an *ikta* were not, strictly speaking, the possessors of an estate but merely the recipients of fiscal revenues. They usually resided in urban areas, many in distant towns, and had little contact with the actual cultivators. They dealt with the cultivators through intermediaries, representatives who would go down to the estate to collect the taxes. These fiscal rights did not take root for periods of time long enough to evolve into private property, however.

The evolution of the *ikta*, and more generally the land regime in the Middle East during the late medieval centuries, remains an understudied subject. It is not possible to do justice to its complexities here. Two things are clear, however. The *ikta* showed significant variations, across the region. Even more importantly, these variations and more generally the evolution of the land regime, was not due to Islam but was linked, above all, to the changing power balances between the central governments and state elites, on the one hand, and various other groups in the provinces. The same applies to the Ottoman land regime during the early modern era.

During the early stages of Ottoman territorial expansion, lands taken over from the neighboring states in the Balkans began to be registered as state lands. In contrast, private property on land continued in areas taken from the Islamic principalities in Anatolia. With the centralization drive in the second half of the fifteenth century, however, state ownership of agricultural lands was established as the basic form in most core regions of the empire, in the Balkans, Anatolia, and Syria. Hereditary usufruct of state lands was then given to peasant households, which typically cultivated with a pair of oxen and family labor. The peasant family farm thus emerged as the basic economic and fiscal unit in the countryside. Ottoman central administration refused to recognize private ownership in agricultural lands with the exception of orchards and vineyards in urban areas until the reforms of the nineteenth century (Inalcik 1994: 103–179).

In the state lands, taxes collected from the peasant cultivators were converted to a large provincial army under the *timar* system. In this prebendal system, *sipahis*, state employees, often chosen for their wartime valor, lived in the rural areas, collected mostly in-kind taxes from agricultural producers and spent the revenues locally on the training and equipment of a predetermined number of soldiers as well as their own maintenance. The Ottoman central administration did not attempt to impose the *timar* regime in all of the conquered territories, however. Eastern Anatolia, Iraq, Egypt, Yemen, Wallachia, Moldavia, and the Maghrib remained outside the *timar* system.

The power of the Ottoman central administration declined and the influence of the provincial notables (*ayan*) rose after the sixteenth century. Even though the *ayan* obtained greater control of the tax collection system in the provinces, they could not extend their power to establish private property of land. The central administration refused to recognize private ownership in agricultural lands, with the exception of orchards and vineyards in urban areas, until the reforms of the nineteenth century and the Land Code of 1858. Local courts, which had jurisdiction over matters of property, rarely approved sales of agricultural land during the seventeenth and eighteenth centuries. When records listing the assets of the provincial notables are examined, it is clear that land ownership was only a small part of their holdings. Their economic power was achieved and extended through the control of the tax collection process. In these state lands usufruct thus remained in the hands of peasant households. In other words, the *ayan* were unable to translate their power into a more lasting autonomy (Keyder and Tabak 1991).

State power was not the only obstacle in the way of private ownership of land, however. Commercialization of agriculture, including exports of agricultural commodities, remained limited until the nineteenth century. In addition, in a landscape dominated by small peasant holdings, it was not easy to find wage labor. Large farms or estates using year-round labor thus remained few in number. The exceptions were mostly in the Balkans, where expansion of long-distance trade and greater population density provided greater support for larger estates oriented toward commercial agriculture. In Egypt, on the other hand, institutions of land ownership and taxation, as well as the techniques and organization of cultivation, depended closely on the irrigation of fertile land. Large holdings and sales of agricultural land were more frequent there (Cuno 1992; Shaw 1962).

Another important category on land was the *vakif* or pious foundation. Islamic law allowed individuals who had private property, including land under private ownership, to convert some or all of these assets to *vakif* status and direct their future income for a predetermined purpose. At the time of the endowment, private ownership terminated. A board of trustees was then appointed to rent out or otherwise manage the property designated as *vakif* and direct the revenues towards the designated purpose. Control of the board of trustees over these lands usually weakened over time and tenants began to enjoy greater autonomy and pay less in rent. Despite occasional state expropriation, substantial amounts of agricultural land as well as urban real estate remained under *vakif* status throughout the Ottoman centuries, but the extent of both *vakif* lands and legally recognized private property on land was only a fraction of the land under state ownership until the nineteenth century.

Institutions of private finance

It has often been assumed that the prohibition of interest in Islam prevented the development of credit, or at best, imposed rigid obstacles in its way. Similarly, the apparent absence of deposit banking and lending by banks has led many observers to conclude that financial institutions and instruments were, by and large, absent in Islamic societies. It is true that a religiously inspired prohibition against usurious transactions was a powerful feature shared around the Mediterranean during the middle ages, both by the Islamic world and Christian West. While the practice of *riba*, the Arabic term for usury and interest, is sharply denounced in a number of passages in the Qur'an and in all subsequent Islamic religious writings, already in the medieval era, Islamic law had provided several means by which the anti-usury prohibition could be circumvented just as the same prohibitions were circumvented in Europe in the late medieval period. Various legal fictions, based primarily on the model of the "double sale" were, if not enthusiastically endorsed by jurists, at least not declared invalid. It is thus clear that neither the Islamic prohibitions against interest and usury nor the absence of formal banking institutions prevented the expansion of credit and trade in the medieval Middle East.

Similarly, neither the Islamic prohibitions against interest and usury nor the absence of formal banking institutions prevented the expansion of credit in Ottoman society. Utilizing the Islamic court records, the late Ronald Jennings has shown that dense networks of lenders and borrowers flourished in and around the Anatolian cities of Kayseri, Karaman, Amasya, and Trabzon during the sixteenth century. Over a twenty-year period which his study covered, he found literally thousands of court cases involving debts. Many members of each family and many women are registered in these records as borrowing and lending to other members of the family as well as to outsiders. These records leave no doubt that the use of credit was widespread among all segments of the urban and even rural society. Most lending and borrowing was on a small scale and interest was regularly charged on credit, in accordance with both Islamic and Ottoman law, with the consent and approval of the court and the *ulema*. In their dealings with the court the participants felt no need to conceal interest or resort to tricks in order to clear legal hurdles. Annual rates of interest ranged from 10 to 20 percent (Jennings 1973).

One important provider of loans in Istanbul, the Balkans, and the Anatolian urban centers were the cash *vakif*s, pious foundations established with the explicit purpose of lending their cash assets and using the interest income to fulfill their goals. These endowments began to be approved by the Ottoman courts in the early part of the fifteenth century and had become popular all over Anatolia and the Balkan provinces by the end of the sixteenth century. The endowments began to allocate their funds increasingly to their trustees during the eighteenth century. The trustees then used the borrowed funds to lend at higher rates of interest to large-scale moneylenders at Istanbul who pooled the funds to finance larger ventures, most importantly, long-distance trade and tax-farming (Çizakça 1996: 131–133).

Not surprisingly, a lively debate developed during the sixteenth century within the Ottoman *ulema* regarding whether the cash *vakif* should be considered illegitimate. The cash *vakif*s were opposed by those who believed that only goods with permanent value such as real estate should constitute the assets of a pious foundation and that the cash *vakif*s contravened the Islamic prohibition of interest. The majority of the *ulema*, however, remained eminently pragmatic and the view that anything useful for the community was useful for Islam ultimately prevailed. During the heated debate, Ebusuud Efendi, the prominent, state-appointed religious leader (*seyhulislam*) of the period, defended the practice from a purely practical point of view, arguing that abolition of interest taking would lead to the collapse of many pious foundations, a situation that would harm the Muslim community (Mandaville 1979).

Despite this pragmatism, however, the cash *vakif* faced serious shortcomings. The interest they charged was fixed by the original founders and could not respond to later changes in market conditions. More importantly, their capital was limited primarily to the original endowment and whatever could additionally be added by reinvesting the profits and other marginal means. Since the original capital was essentially composed of the savings of a single individual, no matter how wealthy, such funds were bound to remain small and the potential for growth remained limited over the long term. Moreover, the Ottoman cash *vakifs* rarely lent to entrepreneurs; they provided mostly consumption credit. It is interesting, however, that as the borrowing requirements of the central government rose sharply in the eighteenth century, the cash *vakif*s responded quickly to the new and growing demand. Financiers began pooling the funds of large numbers of small cash *vakif*s and lending these funds to the central government. In short, Ottoman institutions of credit exhibited a good deal of pragmatism but changed only to a limited extent during the early modern era. They also remained mostly uninfluenced by developments in Europe until the eighteenth century (Çizakça 1996). We will discuss alternative explanations for this pattern below.

Business partnerships

Even though there was no insurmountable barrier against the use of interest-bearing loans for commercial credit, this alternative was not pursued in the medieval Islamic world. Instead, numerous other commercial techniques were developed which played the same role as interest-bearing loans and thus made the use of loans unnecessary. These included a variety of business partnership forms such as *mudaraba* or *commenda*, credit arrangements, transfers of debt and letters of credit, all of which were sanctioned by religious theory. Long-distance trade was thus financed not by simple credit relations involving interest but by a variety of Islamic business partnerships the specifics of which depended on the nature of the risks and the resources provided by the different partners (Çizakça, 1996:10–32, 66–76; Udovitch

1970: 170–217).[2]

Ottoman merchants widely used the varieties of Islamic business partnerships practiced in the Islamic world since the classical era (Çizakça 1996: 66–76; Udovitch 1970: 170–217). Evidence from Islamic court records on commercial disputes and their resolution indicate that Ottoman jurists were well informed about the teachings of medieval Muslim jurists and, in general, adhered closely to the classical Islamic principles in disputes arising from these partnerships. There were some innovations over the centuries; for example, some interesting combinations of *mudaraba* and putting-out activities were developed.

Ottoman institutions of private finance thus reflected a high degree of pragmatism and the willingness to circumvent the Islamic prohibition on interest. However, there was limited change in either the institutions or lending. Similarly, evidence from hundreds of business partnerships indicates that classical Islamic partnership forms underwent limited changes in the early modern era (Gedikli 1998). Ottoman business partnerships as well as the cash *vakif*s remained relatively small, of short duration, and with limited capital. Under these conditions it is not surprising that European business organizations began to dominate Ottoman overseas as well as domestic trade late in the early modern era.

It is important to explore the reasons why the cash *vakif*s did not turn into more formal lending institutions and why there was little change in the Islamic forms of private partnership during the Ottoman era. One explanation points to the rigidity of Islam and Islamic institutions, assuming that Islamic rules, prohibitions, and forms did not change over time even in the face of demands to change them (Kuran 2010). However, we have already pointed to the pragmatism and flexibility exhibited by various segments of Islamic society, economy, and states in the face of daily, practical demands. In contrast, Murat Çizakça has suggested that the continued dominance of small-scale firms or partnerships was probably the most important reason for the limited changes in this area. In other words, demand for change in these institutions was not sufficiently strong (Çizakça 1996). This line of reasoning suggests that the causal relationship between institutions and economic development was not one directional. Just as economic institutions influence the degree and direction of economic development, economic development or its absence also influences institutions and their evolution.

There is another important and related reason for the limited nature of institutional change in this area. The private sector, the merchants, and producers were never in a position to influence the state elites and push for institutional changes that would favor the growth of the private sector during these centuries. In other words, because the state elites were able to retain their leading position in Ottoman society and politics, the influence of various social groups, not only of landowners but also of merchants, manufacturers, and moneychangers, over economic matters, and more generally over the policies of the central government, remained limited.

Institutions of state borrowing

The evolution of Ottoman fiscal institutions during the seventeenth and eighteenth centuries provides a good example not only of the flexibility and pragmatism of the Ottoman state but also of its ability to contain the challenges it faced with the habit of negotiation to coopt and incorporate into a broad alliance the social groups that challenged its authority (Pamuk 2004).

While loans to kings, princes, and governments were part of the regular business of European banking houses in the late medieval and early modern periods, in the Islamic world advances of cash to the rulers and the public treasury were handled differently. In the face of the prohibition on interest, they took the form of tax-farming arrangements in which individuals possessing liquid capital assets advanced cash to the government in return for the right to farm the taxes of a given region or fiscal unit for a fixed period. From the very beginning the Ottomans relied on tax-farming for the collection of urban taxes. Until late in the sixteenth century, however, the agricultural taxes, which constituted the largest part of the tax revenues, were collected locally and mostly in kind within the prebendal *timar* system. State finances were relatively strong during this period thanks to the revenues obtained through the rapid territorial expansion of the empire, and the state did not feel the need to increase the revenues collected at the center (Inalcik 1994: 212–214).

With the changes in military technology during the sixteenth century and the need to maintain larger, permanent armies, however, pressures increased to collect a larger part of the rural surplus at the center. As a result, the *timar* system began to be abandoned in favor of tax-farming and the tax units began to be auctioned off at Istanbul (Darling 1996; Inalcik 1980). Deterioration of state finances during the seventeenth century increased the pressures on the central government to take greater advantage of the tax-farming system for the purposes of domestic borrowing. Especially during periods of war when the fiscal pressures were greatest, the central government began to increase the length of the tax-farming contracts from one to three years to three to five years and even longer. It also demanded an increasingly higher fraction of the auction price of the contract in advance. Tax-farming was thus converted to a form of domestic borrowing with the actual tax revenues being used as collateral by the central government.

Further steps were taken in the same direction with the introduction, in 1695, of the *malikane* system in which the revenue source began to be farmed out on a lifetime basis in return for a large initial payment to be followed by annual payments (Genç 1987; Özvar 2003). One rationale often offered for this system was that by extending the term of the contract, the state hoped that the tax contractor would take better care of the tax source, most importantly the peasant producers, and try to achieve long-term increases in production. In fact, the *malikane* allowed the state to use tax revenues as collateral and borrow on a longer-term basis. In comparison to the straightforward tax-farming system, it represented an important shift towards longer-term borrowing by the state.

With the extension of their term and the introduction of larger advance payments, the long-term financing of these contracts assumed an even greater importance. Private financiers thus began to play an increasingly important role in the tax collection process. Behind the individual, often a Muslim, who joined the bidding in the tax-farming auctions, there often existed a partnership that included financiers as well as the agents who intended to organize the tax collection process itself, often by dividing the large initial contract into smaller pieces and finding subcontractors. Non-Muslims were prohibited from holding most *malikane* contracts but Greeks, Armenians, and Jews were very much part of this elite as financiers, brokers, and accountants. These arrangements were mostly in the form of Islamic business partnerships involving both Muslims and non-Muslims (Çizakça 1996). Over the course of the eighteenth century, some one to two thousand Istanbul-based individuals, together with some five to ten thousand individuals in the provinces, as well as innumerable contractors, agents, financiers, accountants, and managers controlled an important share of the state's revenues. This grand coalition of Istanbul-based elites and the rising elites in the provinces constituted a semi-privatized but interdependent component of the regime (Salzman 1993). Many provincials were able to acquire and pass from one generation to the next small and medium-sized *malikane* shares on villages as long as they remained in favor with local administrators or their Istanbul sponsors. For both the well-connected individuals in the capital city and those in the provinces, getting a piece of government tax revenues became an activity more lucrative than investing in agriculture, trade, or manufacturing.

In the longer term, however, the *malikane* system actually led to a decline in state revenues because of the inability of the state to regain control of the revenue sources after the death of the individuals who had purchased them. The central government thus began to experiment with other methods for tax collection and domestic borrowing from the 1770s onwards. Rising military expenditures and increasing fiscal pressures during wartime were once again responsible for the institutional changes. After the end of the war of 1768–1774, which had dramatically exposed the military as well as financial weaknesses of the Ottoman system, the financial bureaucracy started a new and related system of long-term domestic borrowing called *esham*. In this system, the annual net revenues of a tax source were specified in nominal terms. This amount was divided into a large number of shares which were then sold to the public for the lifetime of the buyers. The annual revenues of the source continued to be collected by the tax-farmers. As the linkage between the annual government payments to *esham* holders and the underlying revenues of the tax source weakened, the *esham* increasingly resembled a life-term annuity quite popular in many European countries of the period. Eager to make sure that the Islamic law prohibition against interest rates and usury did not apply to the new instrument, the government declared that an *esham* share was not structured as and did not constitute a loan since the government had the option to redeem them whenever it wished (Genç 1995).

The remarkable evolution of Ottoman institutions of tax collection and state borrowing from short-term tax farming to lifetime tax farms to government borrowing with tax revenues as collateral and finally to government annuities and bonds illustrates, in the face of the apparent prohibition of interest by Islamic law, the state's pragmatism as well as its ability and willingness to reorganize in response to changing circumstances, albeit slowly and often with considerable time lags. The central government not only experimented with new fiscal and financial institutions but it was also willing to come to terms with the limits of its political and administrative power by entering into broad alliances with elites and financiers in the capital city as well as those in the provinces in order to finance its urgent needs, which escalated rapidly and dramatically during periods of war. The option of borrowing in the European financial markets was not available to the Ottomans until the middle of the nineteenth century.

The sharp contrast between the extensive changes in the institutions of public finance and the limited changes in the institutions of private finance during the early modern era is equally striking. This makes it all the more difficult to explain institutional changes or their absence in the Middle East in terms of the rigidities of Islamic law. Instead, such contrasts need to be explained either in terms of the different levels of demand for different kinds of institutional changes and/or in terms of political economy and the disparities between the powers of state elites who needed and favored changes in the institutions of public finance, unlike the economic elites of the private sector, merchants, artisans and financiers who favored changes in the institutions of private finance.

Urban political economy and institutions

The previous section has shown that societies of the Middle East exhibited a good deal of variation and experienced a good deal of institutional change during the millennium before the modern era. It has also argued that these changes were not caused by the requirements of Islam or changes in geography but reflected the changes in economic needs and social structure. This section will focus on how towns and urban areas related to the state, how urban areas were included in state policies, and how they influenced the shaping of institutions as these provide the keys to understanding long-term institutional change in the Middle East. Together with a good deal of regional and intertemporal variation, we can discern some common and persistent features in this respect. Even though the urban councils led by the notables and local producers organized around the guilds enjoyed varying degrees of autonomy, political institutions were often shaped by the sovereign and the state elites around him. Moreover, economic institutions and policies in these societies were shaped to a large degree by the priorities and interests of these state elites. In contrast, the influence of various social groups, not only of landowners but also of merchants, manufacturers, and moneychangers over economic matters, and more generally over the policies of the central government, remained limited. The state elites often exhibited a good deal of pragmatism, flexibility, willingness to negotiate, and ability to adapt their institutions to changing circumstances. Ultimately, however, pragmatism and flexibility were utilized for the defense of an order in which the sovereign and the state elites had the power to shape the political institutions.

In the early centuries of Islam the region had one of the most vibrant economies in the world. It enjoyed strong and expanding urban networks, growing consumer demand, an increasing range of manufacturing activities, and a highly commercialized and monetarized economy well linked to other areas of the ancient world. Economic prosperity was based, above all, on rising productivity in agriculture, thanks to political stability, greater security, expansion of irrigation, and the introduction of many new crops. Growing specialization and division of labor in the non-agricultural sector led to the expansion of manufacturing in food processing, textiles, ceramics, ivory, leather, metal, paper, wicker, wood, and other sectors. The available manuals and scientific works also document a long and impressive list of technical adaptations and innovations in agriculture and food production, ship-building and navigation, textiles, leather and paper, chemicals, soap-making, glass and ceramics, mining, metallurgy, and mechanical engineering, including the use of water power (Pamuk and Shatzmiller 2014). The deepening of the division of labor, the growth of new occupations and skills in manufacturing and services as well as agriculture, and the long list of technical innovations all point to an episode of intensive growth and economic efflorescence in Abbasid Iraq of the kind that has been observed rather infrequently in the preindustrial era (Goldstone 2002).

In addition to the trade across the Indian Ocean, the region developed strong commercial linkages with both central Asia and northern Europe during this period. The very large hoards of silver dirhams found in the Volga region and in Scandinavia points to the access of Islamic lands to large deposits of central Asian silver and the large output of silver coinage by the mints of the Islamic state at a time when the economies of Carolingian Europe and the Byzantine empire suffered from shortages of specie. The rise of long-distance trade and greater commercialization were accompanied by the rise in taxes collected in cash and the growth of the use of Islamic letters of credit (Shatzmiller 2011).

Political leadership in these early centuries had spanned many groups in society, including landowners, merchants, and producers as well as the religious elites. The merchants and more generally the economic elites were able to acquire political power and had a good deal of influence on domestic politics and the government in this period. They were also able to develop extensive trade links and develop long-distance trade from north Africa to central Asia and across the Indian Ocean. The cities of the Middle East became centers of manufactures, producing staple goods for local markets – textiles, metalwork, pottery, leather goods, processed foods, and luxury goods, especially fine textiles for a wider market. The accumulation of capital in the hands of these manufacturers and retail traders remained limited in comparison to those involved in long-distance trade, however. The merchants, and more generally the economic elites, had more autonomy from government intervention and they enjoyed more support during this early period. They also had a good deal of influence on domestic politics and the government (Ibrahim 1990).

Rise of new state elites

Islamic societies began to experience an important change in the middle of the ninth century, however, as soldiers and officers for the Islamic armies began to be recruited from the fringes of the empire rather than the towns and cities of Iraq and Syria or the Bedouin tribes of the Arabian desert. One important reason for this shift was the labor shortages that had their origins in the Justinian plague of the sixth century, which kept recurring at least until the ninth century and possibly later. Another motive was to ensure that soldiers would not be involved in party conflicts and would remain loyal to the central government. The new policy meant that the members of the military began to be recruited from a social group different from the rest of society. While these soldiers, and especially their descendants, gradually assimilated into society, it was virtually impossible for a member of the local indigenous population to become a part of the military ruling elite. This divorce of the military elite from the rest of the society, by origin, custom, and even language, became a distinctive feature of many medieval Islamic societies (Blaydes and Chaney 2013: 9–12; Crone 1980: 74–81; Kennedy 1986: 158–162). Later in the Ottoman era, the reliance on the *devshirme* system for recruiting soldiers and state officials from the sons of Christian peasantry reinforced this division between the state elites and the rest of society, even though the Ottomans abandoned that system after the sixteenth century. While imported slaves played a prominent role as soldiers and officers in the military and as state elites, their numbers and role in the economy remained limited, especially after the Zanj rebellion by black slaves working in plantations in Iraq during the ninth century. Aside from those in the military and government, most slaves in the medieval and early modern Middle East worked as household servants.

With the rise of the power of the new military and political elites, urban politics and social organization began to change. The new state elites, to some extent in collaboration with religious elites, began to dominate urban politics. This new urban political configuration soon began to shape political as well as economic institutions. The economic policies and practices of the government began to reflect the interests and priorities of the new military and political elites. The entrepreneurs or the private sector, consisting of merchants and craftsmen, continued to have a good deal of economic power. There were many rich merchants, and governments both central and local depended on them for various services. However, merchants and private-sector producers played a limited role in the shaping of the institutions (Lapidus 1984: 117–130). It has been observed that Islamic law did not recognize the town as a separate entity and some have argued this is one of the key shortcomings of Islamic law that help explain the long-term economic stagnation of the region (Kuran 2010; Weber 1968). In fact, it was the relative weakness of local participative institutions and absence of political autonomy for the town that explained both the absence of the town in Islamic law and also why merchants were unable to shape the institutions in the direction they preferred (Cahen 1970: 522).

The relationship between governments and the merchants was not a relationship between equals. Governments tolerated and even encouraged the activities of the latter. At the same time, however, the state elites opposed economic and institutional changes when they thought these changes would transform the existing order and make it more likely that they would lose political power. For their part, the merchants could not achieve the sufficiently powerful identity of interests with their rulers which would have enabled them to influence the government to use its material and military resources to further their own commercial interests. They certainly could not declare *l'état c'est moi* but they could plausibly claim, during the best of times, *l'état n'est pas contre moi* (Udovitch 1988).

The apparent and important exception to this picture were the Karimi ("great") merchants who enjoyed the support of the government early on and played an important role in the long-distance trade of Egypt with India and China, especially in the spice trade on the Indian Ocean during the twelfth and thirteenth centuries (Ashtor 1978; Labib 1976). It is clear, however, that the political power or input into government policy enjoyed by them was limited. Towns and cities in the Middle East were under the control of central authorities and the appointed governors during this period. The Karimi merchants took part in politics only indirectly, since the authorities set limits on their capital and their freedom to trade. Even though government policies tended to support the Karimis in the earlier period, they began to turn against them in the fourteenth and especially the fifteenth centuries. In addition to the deteriorating economic conditions in Egypt, the decline of the Karimi merchants was due to excessive government taxation and attempts by the Mamluk rulers to wrest control of the spice trade by setting up government monopolies.

Priorities and policies of the Ottoman state

Late medieval and early modern states all had to address a common range of economic problems. The most basic of these were related directly to the maintenance of the states themselves. The provisioning of the capital city, the armed forces, and to a lesser extent of other urban areas, taxation, support, and regulation of long-distance trade and maintaining a steady supply of money were among the leading concerns of economic policy.[3] In their economic policies, states did not pursue the public interest in some abstract sense of the term. Instead, both the goals and design of economic policies as well as institutions related to their implementation were shaped by the social structure and by the social and political influences acting on the state. In the Ottoman case, economic institutions and the policies of the government in Istanbul began to reflect much more strongly the priorities of the central administration after the successful centralization drive of Mehmed II in the second half of the fifteenth century. The influence of various social groups over these policies remained limited.

One important priority was the provisioning of the urban areas, which was seen as necessary for political stability (Genç 1989; Inalcik 1994: 44–54). The central government wanted to assure a steady supply of goods especially for the capital city and it was very much aware of the critical role played by merchants in this respect. With the territorial expansion of the empire and the incorporation of Syria and Egypt during the sixteenth century, long-distance trade and the control of the intercontinental trade routes became increasingly important and even critical for these needs.

The emphasis on provisioning also necessitated an important distinction between imports and exports. Imports were encouraged as they added to the availability of goods. As a result, the Ottomans never used protectionism as an economic policy. They did not attempt to protect domestic producers from the competition of Indian textiles during the seventeenth and eighteenth centuries, for example. In contrast, exports were tolerated only after the requirements of the domestic economy were met. As soon as the possibility of shortages emerged, the government did not hesitate to restrict the activities of the merchants and prohibit the exportation of basic necessities, especially foodstuffs and raw materials.

Another priority for the Ottoman central administration was to keep other social groups in check. Just as it tried to prevent the emergence of powerful landed elites in the rural areas, so the Ottoman central administration tried to prevent rapid accumulation in the hands of merchants, guild members, former state employees, and tax-farmers. Local guilds enjoyed a good deal of autonomy throughout the Ottoman era. Urban notables whose roots lay in local councils acquired substantial power and began to control large parts of the tax-farming system during the seventeenth and eighteenth centuries. The central bureaucracy was reluctant to give these groups greater power. Nonetheless, it continued to negotiate with them and play one group off against the other. In part because of the opposition of the central administration, local notables were unable to coordinate collective action and change the formal political institutions in their favor even at the height of their power during the eighteenth century.[4]

The state and the private sector in the early modern era

The government's attitude toward merchants and more generally the private sector remained ambiguous. On the one hand, the private businesses were considered indispensable for the functioning of the urban economy. The state often encouraged the activities of merchants, large and small, domestic manufacturers more or less independent of the guilds, and moneychangers as long as they helped sustain the urban economy. When the merchants found opportunities to pursue their activities with less intervention from the government, they often flourished (Hanna 1998). Yet the activities of merchants occasionally led to higher prices of raw materials, bringing pressure on the guild system and more generally the urban economy. Thus the central administration often considered as its main task the control of merchants, not their protection. The control of merchants was much more difficult than the control of guilds, however. While the guilds were fixed in location, the merchants were mobile. Needless to say, the official attitude toward financiers, and moneychangers was similarly ambiguous (Inalcik 1969; Islamoğlu and Keyder 1977).

One of the most extreme examples of Ottoman state policies toward domestic merchants involved the meat supply of the capital city. By the second half of the sixteenth century, Istanbul had emerged, once again, as the largest city in Europe. The state strove to keep food prices at low levels in the capital city. For this purpose, it often tried to make use of the price ceiling system. For its meat supply the capital depended on large numbers of live animals transported on foot or by sea. When the announced price ceilings for meat were established below market prices, however, merchants refused to bring livestock to the capital. In response, the Ottoman state began to identify wealthy merchants and assign to them the task of supplying meat to the capital city. Merchants who were given this assignment often ended up with large losses and faced sharp declines in their wealth. Not surprisingly, they tried to avoid this responsibility. The state soon began to assign for this task merchants who were engaged in illegal activities or who offended the government. This example suggests that while the state needed the merchants for the provisioning of the cities and especially the capital city, on important issues, it could follow practices rather unfriendly to the merchants. These harsh practices were softened after the sixteenth century and the capital city began to rely increasingly on markets for its meat supply (Greenwood 1988).

Such practices did not mean, however, that the Ottoman state regularly expropriated the property of merchants or guild members. In fact, the Ottoman state made a distinction between the property of private merchants and guild members and the property of employees of the state. Assets accumulated by public servants, especially high-ranking officials during their careers, were considered as the property of the state and they were often if not regularly confiscated after they died or left office. In contrast, the state usually did not intervene to expropriate the assets of private individuals. One important exception occurred during the power struggle between the central government and the urban notables in the provinces around the turn of the nineteenth century, when the central government began to expropriate the properties of prominent urban notables with the argument that many of these assets had been accumulated through tax-farming and other dealings with the state. It may be useful in this context to make a distinction between institutions that shape and enforce contracts and those that enforce property rights (Acemoglu and Robinson 2005). As was the case in many other pre-modern societies, institutions that tended to support markets and enforce contracts tended to function better in the early modern Ottoman empire than the institutions related to the protection of property rights.

In a recent study Nelly Hanna (2011) offers important insights into the activities and life trajectories of the artisan entrepreneurs of Egypt during the Ottoman era. The artisan entrepreneurs stood at the top of the artisan community but were more modest than the largest of the merchants. They were usually not constrained by the guilds and acted as small capitalists, engaging in textiles, sugar, oil, and leather manufacturing. They maintained strong links to the countryside, diversified their activities and their investments into local and long-distance trade and tax-farming. Hanna emphasizes the limits of the command economy and argues that the economic expansion in Egypt during the seventeenth and eighteenth centuries provided many opportunities for accumulation for artisan entrepreneurs as well as merchants. Nonetheless, neither the artisan entrepreneurs nor the merchants received much support from the state. On the contrary, even during the good times they had to watch for the intrusions and encroachments by the state and the state elites. The latter not only levied and collected taxes and tried to regulate the activities of merchants and artisans but they also engaged in entrepreneurial activities themselves, most importantly in tax-farming where they had privileged if not exclusive access. The economic expansion ended with the outbreak of a power struggle within the state elites during the 1760s. The Mamluks or imported state elites with slave origins eventually gained control of the Egyptian economy as well as politics, pushing out the merchants and artisan entrepreneurs and establishing their own networks not only in tax collection but also in production and trade.

Just like the merchants of the region during the medieval period, Ottoman merchants were able to develop trading networks and large presences in south Asia and north Africa. However, the inability of Ottoman and especially the Muslim merchants to control a significant share of the trade with Europe hurt them in the longer term. One important obstacle faced by the Muslim merchants was the restrictions against them created in Europe. From the twelfth century onwards, most European countries promulgated laws forbidding the lengthy sojourn, permanent settlement, or engagement in commerce by foreign nationals, including Muslims. Other factors contributed to the weak presence of Ottoman merchants in Europe. While the governments of European countries often encouraged, backed, and supported merchants who were their subjects or citizens, the rulers or governments in the Middle East did not view the protection of the merchants who were their subjects and who operated outside the boundaries of their countries a matter worthy of their attention. One major reason for this was that the governments felt that the activities of the merchants abroad did not yield any revenues or otherwise provide a fiscal advantage to the central treasury.

The basic message to local merchants operating abroad was that their state was indifferent to their activity and hence no backing or protection was granted to them when they needed it. As a result, those Muslim merchants who wished to operate in foreign lands directed their energies to areas where the population was mostly Muslim or in which large Muslim communities existed, in central Asia, south and southeast Asia and to some extent in north Africa. They had also been active in the trade with Europe but began to lag behind non-Muslim Ottoman merchants who were able to take advantage of their growing international networks and connections with European merchants (Gilbar 2003). By the eighteenth century, Muslim merchants were mostly excluded from the rapidly growing European trade. The fact that the wealthiest Ottoman merchants were non-Muslims, mostly Greeks and Armenians, made it even more difficult for their economic power to be converted to political influence during the eighteenth and nineteenth centuries.

The Ottoman central administration's success in keeping the merchants, urban notables, and other groups in check does not mean that the enduring cliché about the strong and despotic states in the Middle East is true. In fact, the Ottoman state had only limited power and capacity in many areas. For example, only a small fraction of the taxes collected from the peasant and urban producers in the large empire reached the central treasury. Most of the tax revenues were actually retained by the local elites who controlled the tax-farming system. A recent study found that per capita tax collections of the Ottoman central administration lagged significantly behind all European states during the seventeenth and eighteenth centuries, even after corrections are made for the differences in per capita income levels (Karaman and Pamuk 2010). Geography also played an important role in this respect. The large size and great geographical diversity of the empire made it much more difficult for the Ottoman state to collect taxes and more generally to pursue effective policies. The large scale also made it difficult for the local elites to coordinate their actions and challenge the central administration to change the political institutions and acquire greater power.

Privileges to European merchants

While the policies of governments in the region toward local merchants were characterized by a great deal of ambiguity, the same governments were willing and ready to offer legal, commercial, and other privileges to European merchants, beginning as early as the twelfth century. These privileges were granted not because the Islamic governments were coerced by the more powerful European states. Through these privileges, the rulers sought to increase the circulation of goods, especially luxury goods, in their local markets and to increase state revenues from trade. Another motive was to use the privileges as an instrument of foreign policy and gain influence and friendship in Europe. The privileges for the European merchants included lower tariffs or even exemptions from certain kinds of duty. It is clear that local merchants did not have much say in this process as the privileges often put them at a disadvantage against their European counterparts (Inalcik 1973).

These privileges played an important role in the transfer of large segments of the long-distance trade of the Middle East as well as coastal and long-distance shipping to Euroepan merchants in the following centuries. As local merchants became weaker, it became even more difficult for them to provide input into their government's trade policies or change the commercial or economic institutions in the region. With the rise of the Atlantic trade, the merchants of northwestern European countries increased their power substantially. They were then able not only to bring about major institutional changes in their countries but also to induce their governments to defend and develop their interests in the Middle East more forcefully. Merchants of the region thus found it even more difficult to compete against their European counterparts after the sixteenth century.

As European states and merchants increased their economic and political power, they also began to influence the direction of institutional change in the region. The privileges provided to the European merchants were expanded substantially during the eighteenth century. They ceased to be unilateral grants and began to be referred to as the "capitulations" due to the many headings they were grouped under in the original Latin texts in the medieval era (van den Boogert 2005). By the nineteenth century, these privileges made it increasingly difficult for the local merchants to compete on an equal footing with the Europeans, and they became a striking example of exclusionary institutions. The capitulations could be abolished only after World War I and the dissolution of the Ottoman empire.

Conclusion

Until the end of the eleventh century, the Middle East region had one of the most vibrant economies in the world. The Islamic states enjoyed a strong urban network, wide range of manufacturing activities, and a highly commercialized and monetarized economy well linked to other areas of the Old World. After the eleventh century, however, the center of gravity of the ancient world began to shift away from the urban centers of the Islamic states and toward the mercantile states of Italy, the Low Countries, and England.

Nonetheless, the differences in the standards of living between the two regions remained limited until the industrial revolution. Urban wages in the Middle East did not exhibit a long-term downward trend during the early modern centuries. This and other evidence suggests that it is probably more appropriate to talk about the rise of Europe than the decline of the Middle East.

This chapter has argued that despite the growing divergence with western Europe, many institutional changes took place in the medieval and early modern Middle East. For an explanation of the direction of institutional change, it focussed on the internal organization of societies in the Middle East and how their social and political organization may have influenced political and economic institutions. In the late medieval and early modern Middle East, political institutions and economic policies and practices of the government often reflected the interests and priorities of the state elites. The private sector, landowners, merchants, manufacturers, and moneychangers enjoyed a good deal of local power and autonomy, but formal political institutions did not sufficiently allow the representation of their interests in central government and in central government policy. Moreover, these groups were never able to achieve the sufficiently powerful identity of interests with their rulers which would have enabled them to influence the government to further their own commercial interests. For their part, the state elites considered the merchants and the private sector indispensable for the functioning of the economy. The state tolerated and even encouraged their activities. When the merchants found opportunities to pursue their activities with less intervention from the government, they often flourished. At the same time, however, the state elites opposed economic and institutional changes when they thought that these changes would transform the existing order and make it more likely that they would lose political power. Institutional change thus remained selective and reflected, above all, the interests and priorities of the state and the state elites.

Differences in government policies and the institutional environment between western Europe and the Middle East remained limited during the medieval era. With the rise of the Atlantic trade, however, the merchants in northwestern European countries increased their economic and political power substantially. They were then able not only to bring about major institutional changes in their countries but also to induce their governments to defend and develop their commercial interests in the Middle East more forcefully. Merchants of the region thus found it even more difficult to compete against them after the sixteenth century. As they began to lag behind the European merchants even in their own region, it became even more difficult for them to provide input into their government's trade policies or change the commercial or economic institutions in the direction they preferred. Beginning early in the nineteenth century, economic policies and institutional changes in the Middle East also began to reflect the growing power of European states and companies.

The weaknesses of the merchants, and more generally of the private sector in the Middle East, persisted well into the twentieth century. When the Great Depression led to the collapse of an economic model based on agriculture and accelerated if not initiated the debates about industrialization, it was argued throughout the region that the private sector could not undertake this kind of resource mobilization. Reliance on private entrepreneurs and on the law of supply and demand would be wasteful, it was believed, and would not extricate the economy from its trap. As a result, it was the state elites and state enterprises that took the lead in industrialization in Turkey during the 1930s, a strategy called *étatisme*. This model was replicated after World War II in Egypt, Syria, Iraq, and across North Africa as import-substituting industrialization was led not by private enterprises but by the state sector (Richards and Waterbury 1996: 173–204).

As a leading political scientist of the region recently observed, one of the most important historical legacies in the Middle East today is the large discrepancy between the economic and political power of the merchants and more generally of economic elites. As was the case in the past, merchants in most parts of the modern Middle East can become wealthy but they cannot expect to attain political power or influence (Özbudun 1996: 135–137). This absence, on the part of the economic elites, of political power and capacity to influence economic institutions explains better than any other single factor, better than geography or resource endowments, Islam or culture, the growing economic divergence between western Europe and the Middle East during the late medieval and early modern eras.

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1 The term Middle East was coined only recently, during the last century or two. Nonetheless, I prefer to use this term rather than the earlier Near East because of its convenience.

2 In essence, the *mudaraba* was identical to the commenda of Europe; for discussions of the Islamic origins of commenda, see Ashtor (1972), Pryor (1977), and Udovitch (1962).

3 One should add the qualification that for most societies in the late medieval and early modern periods, it is difficult to talk about an economic sphere separate from the political, administrative, and fiscal (Miller 1963).

4 Acemoglu and Robinson (2006) have developed a model to examine the circumstances under which political elites, fearing political replacement, are

likely to block technological and institutional change.

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