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Is Islam Compatible with Capitalism?

The Middle East's future depends on the answer.

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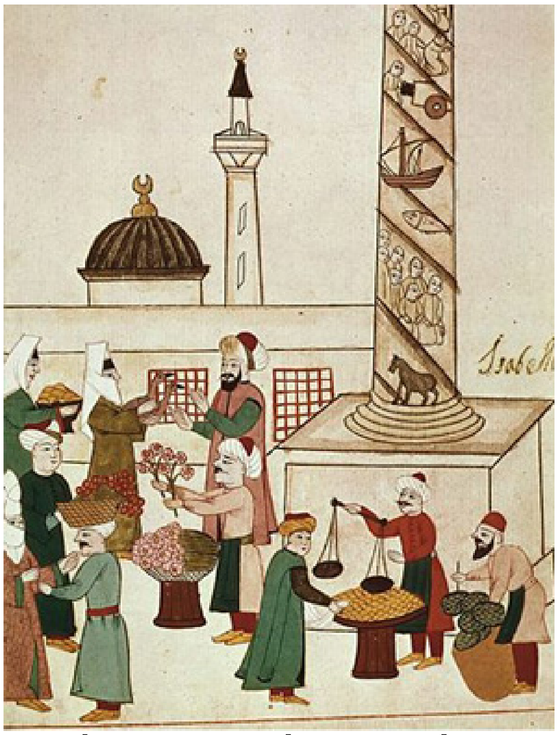

A sixteenth-century Turkish bazaar. Muslim tradition has long accepted the marketplace, though sharia constrained its efficiency.

The moment you arrive at the airport in Cairo, you discover how little Egypt—the heart of Arab civilization—is governed by the rule of law. You line up to show your passport to the customs officer; you wait and wait and wait. Eventually, you reach the officer . . . who sends you to the opposite end of the airport to buy an entry visa. The visa costs 15 U.S. dollars; if you hand the clerk $20, though, don't expect any change, let alone a receipt. Then you make the long hike back to the customs line, where you notice that some Egyptians—important ones, apparently—have helpers who hustle them through. Others cut to the front. It's an annoying and disturbing welcome to a chaotic land, one that has grown only more chaotic since the January revolution. It's also instructive, effectively demonstrating why it's hard to do business in this country or in other Arab Muslim lands, where personal status so often trumps fair, universally applied rules. Such personalization of the law is incompatible with a truly free-market or modern society and helps explain why the Arab world's per-capita income is one-tenth America's or Europe's.

The airport experience, had he been able to undergo it, would have been drearily familiar to Rifaa al-Tahtawi, a brilliant young imam sent to France in 1829 by the pasha of Egypt. His mission: figure out how Napoleon's military had so easily crushed Egypt three decades earlier, a defeat that revealed to a shocked Arab world that it was now an economic, military, and scientific laggard. At the outset of the book that he wrote about his journey, *The Gold of Paris*, Rifaa describes a Marseille café: "How astonished I was that in Marseille, a waiter came to me and asked for my order without my looking for him." Then the coffee arrives without delay. Finally—most amazing of all—Rifaa gets the bill for it, and the price is the same as the one listed on the menu: "No haggling," he enthuses. Rifaa concludes: "I look for the day when the Cairo cafés will follow the same predictable rules as the Marseille cafés." But nearly two centuries later, the only Egyptian cafés that live up to Rifaa's hopes are the imported Starbucks.

Egypt is, of course, a Muslim nation. Should Islam be indicted for what was in Rifaa's time, and remains today, a dysfunctional economy? The question becomes all the more important if you extend it to the rest of the Arab Middle East as it is swept by popular revolts against authoritarian rule. Will the nations that emerge from the Arab Spring embrace the rule of law and other crucial institutions that have allowed capitalism to flourish in the West? Or are Islam and economic progress fundamentally at odds?

Muslim economies haven't always been low achievers. In his seminal work *The World Economy*, economist Angus Maddison showed that until the twelfth century, per-capita income was much higher in the Muslim Middle East than in Europe. Beginning in the twelfth century, though, what Duke University economist Timur Kuran calls the Long Divergence began, upending this economic hierarchy, so that by Rifaa's time, Europe had grown far more powerful and prosperous than the Arab Muslim world.

A key factor in the divergence was Italian city-states' invention of capitalism—a development that rested on certain cultural prerequisites, Stanford University's Avner Greif observes. In the early twelfth century, two groups of merchants dominated Mediterranean sea trade: the European Genoans and the Cairo-based Maghrebis, who were Jewish but, coming originally from Baghdad, shared the cultural norms of the Arab Middle East. The Genoans outpaced the Maghrebis and eventually won the competition, Greif argues, because they invented various corporate institutions that formed the core of capitalism, including banks, bills of exchange, and joint-stock companies, which allowed them to accumulate enough capital to launch riskier but more profitable ventures. These institutions, in Greif's account, were an outgrowth of the Genoans' Western culture, in which people were bound not just by blood but also by contracts, including the fundamental contract of marriage. The Maghrebis' Arab values, by contrast, meant undertaking nothing outside the family and tribe, which limited commercial expeditions' resources and hence their reach. The bonds of blood couldn't compete with fair, reliable institutions (see "Economics Does Not Lie," Summer 2008).

Greif's theory suggests that cultural differences explain economic development better than religious beliefs do. Indeed, from a strictly religious perspective, one could view Muslims as having an advantage at creating wealth. After all, Islam is the only religion founded by a trader—one who also, by the way, married a wealthy merchant. The Koran has only good words for successful businessmen. Entrepreneurs must pay a 2.5 percent tax, the *zakat*, to the community to support the general welfare, but otherwise can make money guilt-free. Private property is sacred, according to the Koran. All this, needless to say, contrasts with the traditional Christian attitude toward wealth, which puts the poor on the fast track to heaven and looks down in particular on merchants (recall Jesus's driving them from the Temple).

But Duke's Kuran believes that Islam did play a role in the Long Divergence. It wasn't the Koran, which the Muslim faithful see as written by God and unalterable, that impeded Muslims economically, he argues, but instead sharia, the religious law developed by scholars after Mohammed's time. Not that sharia was overtly hostile to economic progress; it established commerce-friendly legal rules that, for instance, allowed for bazaars and for the arbitration of economic disputes. Rather, Kuran maintains, sharia became economically counterproductive because it was less efficient than the Western legal framework.

The most significant of the sharia-rooted economic liabilities was the Islamic partnership, which proved no match for the Western world's joint-stock company. Partnerships were short-lived, dissolving with the death of any of the partners, and they tended to be small, often formed among family members. Joint-stock companies, which sharia prohibited, had much greater reach and risk-hedging power. Sharia inheritance rules were a second drag on economic development, Kuran explains. Since the Koran sanctions polygamy, sharia required a husband's wealth, upon his death, to go in equal portions to his widows and children, which worked against capital accumulation. In the Roman law that held sway in Europe until the nineteenth century, by contrast, the eldest son inherited his deceased father's wealth, creating vast fortunes that could be put to economic work. Some economists point to sharia's prohibition of interest as another hamper on development, but this is much less significant than it appears. From at least the twelfth century on, sharia lawyers authorized "fees" that could accompany money-lending, getting around the ban.

Muslim welfare foundations to aid the poor, called *waqf*, also undermined economic competitiveness over time, says Kuran. According to sharia, all money given to these charities was exempt from taxation. But Muslim merchants began to establish *waqf* as fronts for commercial enterprises, depriving the government of sufficient funds to function properly. This tax evasion contributed to the failure of the Arab kingdoms and the Ottoman Empire to build a competent minimal state, which is essential to the effective rule of law.

For evidence that sharia had negative economic effects, consider the Egyptian city of Alexandria. Beginning in the fifteenth century, non-Muslim merchants in the city could opt out of sharia's business rules. Those who did and embraced Western capitalist norms quickly grew richer than those who continued to follow sharia, historians have shown.

Over time, however, sharia adapted to capitalism. In the nineteenth century, it finally allowed Muslims to form joint-stock companies and to borrow other key capitalist institutions from the West. Today, Islamic banks follow the same practices that non-Islamic banks do (including the use of derivatives) but describe them differently, so that they conform with sharia. Yet despite this transformation in Islamic law, Muslim economies still lag behind Western ones. Greif and Kuran may help explain the Long Divergence, but what accounts for the fact that there is no "Arab Tiger" comparable with Asia's remarkable success stories?

Part of the answer may, in fact, be religious: Islam's apostasy law. Sharia holds that a Muslim who breaks with Islam becomes an apostate, an offense punishable by death. And since, at least for Sunni Muslims, there is no central theological authority—the theocratic regime in Iran establishes such authority for Shiite Muslims—any Sunni imam can define what constitutes breaking with Islam. This power may deter potential innovators, including the entrepreneurial kind, from doing anything that could conceivably get them into trouble.

But a bigger reason for the Arab world's stagnation is political. In nearly every Arab Muslim country, the prime enemy of entrepreneurship and the free market is an abusive government—and the strong, unaccountable, and usually despotic regimes that have dominated Arab Muslim populations for decades owe neither their origins nor their legitimacy, such as it is, to Islam. All emerged from the decolonization struggles of the 1950s and 1960s, which, since the primary colonizers were Europeans, provoked angry anti-Western and anticapitalist attitudes in Muslim societies. The decolonization of the Arabs did not go well. Violent confrontations were the norm, even when full-blown war didn't break out, as happened in Algeria. The upheavals brought military regimes to power in most of the decolonized Arab states; even when the military wasn't officially in charge, it controlled puppet governments, as in Morocco. All these regimes espoused nationalism and resisted any rule of law that might limit state power—or give entrepreneurs a freer hand.

Worse, independence took place at a time when the Soviet Union was influential and many believed that centrally planned socialism was a shortcut to power and prosperity. Arab governments thus found it tempting to confiscate private property, eradicate the existing bourgeoisie, and create massive state monopolies in resources like copper, oil, and phosphate. In the name of national independence and economic modernization, all the wealth could be concentrated in the hands of the ruling militaries and bureaucracies.

After the fall of the Soviet Union showed socialism to be far less efficient than the free market, Arab Muslim governments began to free up markets somewhat, but without surrendering their tyrannical authority. This resulted in an Arab crony capitalism, which is now the dominant economic arrangement in the Muslim Middle East. In today's pseudo-market Arab economies, it makes little sense to be an independent entrepreneur. If you want to open a business, you'll need a license, and the only surefire way to obtain it is to belong to (or be close to) someone in the ruling elite; even then, you'll share your profits with the bureaucrats. It's far easier to seek a rent—a benefit based on your position in society. Rent-seeking is particularly prevalent in countries overflowing with natural resources like oil and gas, which bring in massive revenues that reduce the incentive to diversify the economy.

Egypt exemplifies the crony-capitalist model. During the 1990s, corrupt privatizations transferred state monopolies in energy, steel, cement, and other industries to private "entrepreneurs," most of whom were members of President Hosni Mubarak's family, top military officers, and other well-connected people. Meanwhile, economist Hernando de Soto has calculated, opening a modest bakery in Cairo required two years of slogging through the bureaucracy, at each stage of which the would-be owner would need to grease official palms—and if his bakery finally opened, he would then have to pay ongoing protection money to the local police. Small wonder Egypt suffers from slow growth, massive unemployment, and a large black market.

The authoritarian nature of today's Muslim governments also generates social norms that harm entrepreneurship. For example, a survey conducted by the Casablanca-based business magazine *L'Economiste*compared the organizational structures of Moroccan firms with those of Western companies operating in Morocco. It found that the boss of a Moroccan firm tends to have a larger office and more assistants, secretaries, and chauffeurs than his Western counterpart does and that his behavior is more autocratic. The likely reason is that the Moroccan boss, mimicking the king and his entourage, finds power—and the exhibition of power—more compelling than profits.

The prosperity-crushing influence of government on Muslim entrepreneurship has nowhere been more evident than in Turkey. In the early nineteenth century, the Turkish sultan, like the Egyptian pasha, tried to import Western science and military methods without introducing Western rule of law. "The Ottoman Empire fell into poverty because the dominant concern of the sultans was always to avoid the emergence of a competing power," explains Turkish economist Evket Pamuk. And the possibility that they feared the most was the birth of a Westernized Turkish bourgeoisie, its power based on private ownership.

When the empire became the Turkish Republic in 1921, little changed. The republic's founder, Mustafa Kemal (later called Atatürk, a name he chose that means "Father of the Turks"), was fascinated by the fashionable Italian fascist ideal. The Turks lacked entrepreneurial spirit, he believed, so it was up to the government to act as a collective entrepreneur and pick those who deserved to start new businesses. Under his regime, which became a military dictatorship after his 1938 death, the Turkish economy made little progress, though a small group of well-connected businessmen grew extremely wealthy.

Islam wasn't to blame for Turkey's poor economy. Indeed, the new republic was fiercely secular; for decades, no openly devout Muslim could hold any significant position in public service, in the military, or even in business. Modern Turkey started to grow economically only after it began to free up the market under former World Bank economist Turgut Özal, a devout Muslim whom the military had installed as prime minister in 1983 to bring inflation under control. Özal's reforms opened the way for the openly Islamic, pro-market Justice and Development Party, or AKP, which has ruled Turkey since 2002. Whatever criticisms one might make of the AKP—it has on occasion sought to impose religious norms on a secular society, among other troubling signs—it has brought about an astounding transformation of Turkey's economy. The state's budget is balanced, prices are stable, free trade is enthusiastically embraced, and crony capitalism has been constrained. As a consequence, the Turkish growth rate has been one of the world's highest: 8 percent annually for several years now. Turkey's per-capita income is now higher than Saudi Arabia's—and Turkey has no oil.

Fueling this economic expansion is a new generation of entrepreneurs from Anatolia, in eastern Turkey. These businesspeople are conservative Muslims, but they aren't extremists. The Anatolians are astonishing; no one can say for sure how they arrived on the scene as the dynamic engine of Turkish modernity. Ask an Anatolian entrepreneur about this success and he may credit a strong work ethic, combined with family values ingrained in the Muslim faith. Or he may mention the business traditions of Anatolia, a crossroads between Asia and Europe under the Ottoman Empire. Pamuk, a secular Turk, points to mundane factors like the Anatolians' low labor costs and Turkey's proximity to the vast European market: Turkey now exports 25 percent of its national production, up from 3 percent in 1980. Whatever the reason for the Anatolian breakthrough, Islam has not impeded it.

Will the Turkish model spread to nearby Arab countries? This year's revolutions in Tunisia and Egypt may answer that question. Remember the man who inspired the revolutions: Mohammed Bouazizi, a young Tunisian who earned a university degree but could find no decent formal employment, a situation all too common for educated young Arabs. Bouazizi sought to make a living from a tiny fruit-and-vegetable stand, but last December, because he hadn't registered it with the authorities, police confiscated it. Bouazizi then set himself on fire.

Bouazizi's suicide brought millions of Arabs to the streets because they could identify with him. Human rights leaders didn't start the revolutions; neither did long-banned Islamic movements like the Muslim Brotherhood. The upheavals weren't characterized by Islamic banners or by Israeli flags going up in flames (though there were disturbing reports of Muslims attacking Christian churches in Egypt after the police had vanished from the streets). No, the dominant message of the Arab Spring was that the Arabs didn't want to remain separated from the rest of the world. The Egyptian students in Tahrir Square couldn't have put it more clearly: they wanted democracy, globalization, and market prosperity, not Islamicization. "We want a normal country, which means free enterprise and democracy," said one of their leaders, Amr Salah of the Cairo Institute for Human Rights, in Paris this April. Even the notorious Muslim Brotherhood is on board with capitalism: "Our economic program is a free-market society in order to pursue social justice," says Sameh al-Barqui, an American-educated economics expert with the Brotherhood.

The transition from the Arab world's authoritarian regimes to democracy, markets, and the rule of law is far from guaranteed, of course. For a reminder of the difficulty of installing successful Western-style capitalism, consider Rifaa, who returned to Egypt after seven years in France and became the pasha's main advisor—overseeing the translation of French scientific books into Arabic, founding the first Arabic newspapers, and opening schools for girls. Though Rifaa faced the hostility of Muslim conservatives, his reforms, accompanying the era's shifts in sharia, inaugurated an era of modernization in Egypt. By the late nineteenth century, Cairo was starting to look like a European city, with electricity, sanitation, universities, and an independent press. But the renaissance didn't last long, because Rifaa repeatedly failed to persuade the pasha to accept a Western-style constitution, which would have limited the ruler's arbitrary power. What kept Egypt back was its failure to establish the rule-governed institutions familiar in the West.

It should be sobering, therefore, that the military isn't likely to surrender its political privileges easily in any Arab country. Still, most of the political parties emerging in the ferment are supporters of free markets. (Some socialist parties remain in Morocco and Tunisia, where the French influence left its mark, but they are socialist in name only.) The young men and women behind the Arab Spring will continue to push for more open markets where millions of Bouazizis will be able to become entrepreneurs—where it won't take two years and countless bribes to open a bakery. And there appears to be no cultural or religious reason that someday, in the not-so-distant future, we won't find cafés in Cairo that run as efficiently and reasonably as those in Marseille.

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