

The role of institutions in driving economic change: Comparing the thoughts of Ibn Khaldūn and Douglass C. North

Haniza Khalid*

Abstract: This article compares various elements of Ibn Khaldūn's and Douglass C. North's thoughts on the role of institutions in influencing or forcing economic change. There are a number of interesting similarities in ideas, thoughts, approaches, and methodologies, which prove that New Institutional Economics may actually mirror much of (and can benefit from) Ibn Khaldūn's fourteenth century ideas than was previously thought. Both Ibn Khaldūn's continuum of *badāwah* to *ḥaḍārah* and North's theory on changes from informal to formal institutions lead to the same fundamental conclusions: (i) change is incremental as it is a result in small cumulative changes in the cost-benefit outcomes of the market agents over time, and therefore (ii) economic performance inevitably depends on the existence and effectiveness of formal institutions that alter those outcomes. It is also noted that *'aṣabiyyah* or group feeling, another cornerstone of Ibn Khaldūn's thought, corresponds perfectly to North's treatise that social cohesion and institutional efficiency are more important than the amount of resource endowment in bringing about economic development and change. In addition, Ibn Khaldūn's views on the government's commercial activities are reviewed in the study in light of North's transaction costs and property rights framework.

Keywords: Douglass C. North; history of economic thought; Ibn Khaldūn; New Institutional Economics; structure, scope, and performance of government.

Abstrak: Kertas kerja ini membandingkan pelbagai elemen di dalam pemikiran Ibn Khaldun dan Douglass C. North terutamanya berkenaan peranan institusi

* Haniza Khalid is an Assistant Professor in the Department of Economics, Kulliyah of Economics and Management Sciences, International Islamic University Malaysia (IIUM), Malaysia. Email: hanizamv@iium.edu.my.

dalam mempengaruhi atau mencetus perubahan ekonomi. Kami mendapati beberapa persamaan yang menarik di dalam idea-idea, pemikiran, metodologi dan pendekatan mereka yang membuktikan bahawa *New Institutional Economics*, yang didokong oleh North, sebenarnya tidak banyak berbeza dari pada konsep-konsep asas yang dibawa oleh Ibn Khaldun. Ibn Khaldun membincangkan kesan ke atas ekonomi daripada peralihan masyarakat daripada struktur *badāwah* ke *ḥadārah* manakala North membincangkan kesan peralihan yang sama, iaitu dari institusi informal kepada formal. Kedua-dua analisis ini memberi sekurang-kurangnya dua kesimpulan penting iaitu (i) perubahan ekonomi berlaku secara marginal kerana ianya terhasil dari pada perubahan kecil yang terkumpul ekoran keputusan kos-faedah agen-agen di dalam pasaran dari masa ke masa, dan oleh itu; (ii) prestasi ekonomi tidak dapat tidak, bergantung kepada kewujudan dan keberkesanan institusi yang mempengaruhi keputusan kos-faedah setiap ahli masyarakat secara amnya. Kita juga mendapati kedua-dua pemikir ini meletakkan peranan hubungan sosial, yakni *aṣabiyyah* (Ibn Khaldun) atau perpaduan sosial dan kecekapan institusi (North), sebagai faktor yang sama penting atau lebih penting daripada jumlah kekayaan sumber semulajadi sesebuah negara dalam menentukan pembangunan ekonominya.

Kata Kunci: Douglass C. North; sejarah pemikiran ekonomi; Ibn Khaldun; institusi ekonomi; struktur; skop dan prestasi kerajaan.

There have been a number of studies comparing Ibn Khaldūn's ideas and concepts with those of modern Western scholars. These have mostly been done with the objective to contribute towards the theoretical integration of Ibn Khaldūn's theories into contemporary social sciences. Notable comparisons include that with Karl Marx (Mohammad, 1998), Emile Durkheim (see for instance, Gellner, 1975), Joseph Schumpeter (Andic and Andic, 1985; Baeck, 2002), Frederick Jackson Turner (Newby, 1983), Auguste Comte (Baali, 1986), Arnold Toynbee (Irwin, 1997), and Max Weber (Ardic, 2008). In the field of economics, Ibn Khaldūn's themes have been discussed extensively either in general or via comparison with specific economic thinkers (Oweiss, 1988; Boulakia, 1971; Soofi, 1995; Chapra, 1998, 2008a, 2008b). Whilst Ibn Khaldūn's contributions to economic theory are certainly considerable and wide-ranging, in making a comparative analysis of thinkers and theories, one must be able to show that there is a common denominator that can reasonably justify the selected pairings.

This article has chosen to study the theories of institutions and change by Ibn Khaldūn (d. 808/1406), a well-known intellectual

of the Muslim civilization, and Douglass C. North (d. 2015),¹ an acclaimed institutional economics scholar and the 1993 co-recipient of the Nobel Memorial Prize in Economics Sciences. The rationale for this comparative analysis is that both are, in reality, groundbreaking institutionalists. Despite coming from different philosophical backgrounds and historical eras, Ibn Khaldūn and Douglass C. North have similar theories, most importantly, on how interactions between individuals within the society's informal and formal institutional structures help determine their collective economic outcomes.

It is only until recently that modern economists began to study economic change and development through multi-disciplinary lenses, taking into account major institutional, sociological, historical, and political factors that determine a country's level of development. This approach is best encapsulated in the New Institutional Economics (NIE) school of thought. NIE is an attempt to extend economics by focusing on the social and legal norms and rules (which form the basis of institutions) that underlie economic activity and with analyses that go beyond earlier institutional and neoclassical economics. NIE's premise that economic development depends on much broader aspects of the society, not just on levels of physical resources and technology, corresponds perfectly to Ibn Khaldūn's core idea condensed in his science of civilisation (*ilm al-'umrān*). To the best of this writer's knowledge, this is the first attempt to link Ibn Khaldūn's basic intellectual themes to Institutional Economics theory.

The study also argues that both thinkers adopted methodologies which were uniquely dynamic, original (for their era) yet interestingly similar; fundamental ideas were schematically presented using historical political economic analyses to describe shifts, or inertia, in social and subsequently economic behaviour. The study will show that North's sterling contribution towards the understanding of sources of economic backwardness (from the political and institutional perspectives) is preceded most notably by Ibn Khaldūn through the latter's observations in *Muqaddimah*, written in 1377. Naturally there are ample grounds for comparative analyses to be made of their key economic themes and ideas, not least because they could help bring forth better appreciation of institutions in economic thought and economic development theories.

In NIE context, social cohesion and institutional efficiency have been consistently shown to have an equal, if not more important effect than resources endowment in bringing about economic development and higher civilization. Nonetheless, there is still a dearth of research in politically economic issues such as uneven development, unequal exchange, bureaucratic capitalism, corruption and the role of the state (Alatas, 2000), especially from the Muslim perspective. Manifestations of Ibn Khaldūn's universal and timeless ideas has the potential to enrich and provide new insights and inspiration, in particular with respect to the role of religion as a binding factor in societies and subsequently how it influences the economic progress (or decline) of a society.

Comparison of motivation and approach

Ibn Khaldūn's main aim of embarking on the *Muqaddimah* was to study and understand the nature and causes of the conditions prevailing in the Muslim world during his time, in particular the decline and disintegration of the Muslim empire in Spain and North Africa (Mohammad, 1998, p. 27). His sophisticated inter-temporal analysis of a society evolving economically, politically, and socially eventually presents itself as a comprehensive discourse on economic change. The observations of the history of a society and its organisations revealed clear patterns of human behaviour as individuals and as a group, as they go about organising activities to achieve their wants and needs. Satisfaction of those wants and needs gave rise to new ones, which subsequently forces their economic structure and organisations to change incrementally in response. This process continues and essentially holds the key to economic progress.

Yet, according to Ibn Khaldūn, the individual is not a completely passive recipient nor is he a full agent of the historical process (Lauer, 1991). The society is never dominated by one person, no matter how forceful and influential his thoughts and strengths. The general societal make-up and condition of the time determines the path and degree of their political and economic changes. Ibn Khaldūn observed that societies which are similar in structure and organisation tend to operate using similar laws, despite their differences in resource endowments and climate. In short, laws are sociologically and not physically-determined. The set of laws and constraints develop into an institutional framework that the society lives by and is critical to its economic success. In fact, Ibn Khaldūn himself claims that he has founded a "science of civilisation" (*ilm al-umrān*).

Similarly, North's main motivation is to "understand the process of economic change," simply because it is an essential pre-requisite to answer the question as to why some countries develop and why others do not. In a world of dynamic economic change, static and frictionless economic theories would not be adequate to explain why underdevelopment persists in resource-rich countries. In NIE, institutions create additional costs to market participants if the laws that are relevant to economic activities are deemed insufficient or not credible in protecting their rights. These costs are called transaction costs which have to be borne by the market participants themselves. They can include the costs of search and negotiations with the other firm, verification of vast amount of background and current information as well as the costs of drawing up complex contracts to protect the firm's interest in case of dispute or fraud. In the context of political economy, transaction costs would involve lobbying and rent-seeking costs undertaken by a firm in securing certain advantages, as poor institutional qualities encourage opportunistic behaviour to flourish. North argued that as a result, countries with undeveloped or inefficient markets, legal and political institutions will fail to provide incentives for people to buy and sell at the right prices, or to ensure that resources are productively employed. The most significant type of inefficiencies concerns property rights and the system where contracts and agreements can be enforced. Having to bear huge burdens of transaction costs, many market participants will lose their motivation to stay in the market; thus, economic decline will soon be inevitable.

Ibn Khaldūn's method of employing historical deductions to understand the sociological-economic evolution of a society is clearly shared by North. The latter's strong appreciation of history as a source of knowledge is most lucid when he states, "History matters. It matters not just because we can learn from the past, but because the present and the future are connected to the past by the continuity of a society's institution..." (North, 1990a, p. vii). North defined institutional economics as a study in economic history which focuses on the costs of human coordination and cooperation through time, which he regards as the key driver of society's change. Just as Ibn Khaldūn argued that social occurrences are only exposed to a single common and natural law, namely the laws of progress and transformation, North contended that the evolution of societies is essentially a function of the quantity and quality of its people, their command over nature, and the structure the

people impose on their interactions over time. Hence, an understanding of the interaction between demographic, technological, and institutional factors is imperative to provide fundamental insights into societal evolution.

Similar to Ibn Khaldūn, North also embraced a multi-disciplinary approach in explaining economic phenomena. While this is fairly standard amongst early scholars of economics, in today's conventional economic framework, this approach of using multiple branches of knowledge such as law, sociology, politics, management, mathematics, and economics is extremely rare. Nonetheless, Ibn Khaldūn's certitude is nowhere found in North's presentations. For example, Ibn Khaldūn predicted that an economy will rise and meet its demise within the span of three generations. In contrast, North was less particular about putting a finite timeframe to the economic cycle. He was more concerned with the nature and rate of incremental changes of institutions that support or inhibit the economic and political progress of the society.

From the above discussion, we can see that both Ibn Khaldūn and North's central propositions are decidedly about (i) markets and institutions being sociologically-determined, basically having derived from the society's own sets of beliefs, values and history, and (ii) institutions having a very important role in determining the economic performance of a country. Effective institutions promote economic growth by reducing transaction costs of operating in the economy, whereas ineffective institutions dis-incentivise market participants and lead to economic decline.

Role of institutional

We will next examine the views of both Ibn Khaldūn and North on the role of formal cooperation in creating surplus and driving societal change. This is followed by special discussions regarding property rights and transaction costs, two central themes in their theses on institutions.

Cooperation and organisation of production

It is widely acknowledged that even before Adam Smith, Ibn Khaldūn had already made the connection between cooperative production and surplus output. The organised interaction and interdependence among actors in the production process provide for specialisation and division of labour. In fact, Ibn Khaldūn's ideas on the development of the firm

as a formal form of cooperation is critical in understanding sources of economic growth. Surplus created from cooperation in production allows for exchange which in turn provides the foundation for income and wealth accumulation. He explained that “the power of the individual human being is not sufficient for him to obtain (the food) he needs, and does not provide him with as much food as he requires to live... but through cooperation, the needs of a number of persons, many times greater than their own can be satisfied” (Ibn Khaldūn, 1958, vol. 1, p. 69).² He further accentuated that “... a great surplus of products remains after the necessities of the inhabitants have been satisfied, (This surplus) provides for a population far beyond the size and extent of the (actual one), and comes back to the people as profit that they can accumulate... Prosperity, thus, increases and conditions become favourable” (1958, vol. 2, p. 244).

Likewise, North (1990a, p. 3) explained that institutions are the humanly devised constraints that shape and facilitate human cooperation, and that institutions such as firms affect the economy through their influence on the production and exchange efficiency. Cooperative behaviour is more significant when the individuals repeatedly interact, have a great deal of information about each other, and when there are only a small number of actors in the group. This results in greater production and wider exchange networks in the economy. In the long run, more advanced levels of organisational cooperation would be developed, especially to deal with international trade and other complex forms of exchanges.³

Changes in economic structure and technology

Ibn Khaldūn observed that with rising wealth there is an increasing need for more sophisticated and differentiated products and services, even luxury, all of which require further specialisation and skills enhancement. Development of new technology and innovation became common. Skilled workers are attracted by the physical and intellectual infrastructure available in the cities; thus, migration increases. Ibn Khaldūn wrote on this that “with regard to the amount of prosperity and business activity, cities and towns differ in accordance with the difference in the sizes of their civilisation (population)” (1958, vol. 2, p. 234).

He argued that dexterity in skills or craftsmanship is not necessarily inherited but can be mastered by anyone who has a strong interest and

persevere in its training. Various forms of skill enhancement or craft centres are established in cities to promote the creation and diffusion of knowledge and technology. He writes:

Each particular kind of craft needs persons to be in charge of it and skilled in it. ...The particular group (practicing the craft) is coloured by it... the craftsmen become experienced in their various crafts and skilled in the knowledge of them. Long periods of time and the repetition of similar (experiences) add to establishing the crafts and to causing them to be firmly rooted (1958, vol. 2, p. 250).

Ibn Khaldūn was aware early on that education and a high level of science and technology play a key role in productivity (Weiss, 1995). Once technical capacity is available, it attracts talent which in turn strengthens technical potentials. That is why technology is located in the cities where demand and the income are high and the buyers are more sophisticated. He demonstrated that the cumulative process of development is based on increasing intellectual infrastructure of the society (Boulakia, 1971). It follows that production activities in the cities become increasingly capital-intensive and businesses are able to exploit the economies of scale and scope far more effectively than ever before. Agglomeration benefits in the economy's new structure, in turn, warrant some degree of institutional change. In fact, Ibn Khaldūn argues that penchant for luxury items tends to rise in correspondence with increasing income levels. This tendency is one of the important factors that sustain continued innovation and economic growth in the cities.

Interestingly, Ibn Khaldūn predicted that this cycle of economic sophistication and income creation should continue for two or three rounds, laying the foundation of the income multiplier model that we know today. He wrote that "production there is thriving even more than before. And so it goes with the second and third increase. All the additional labour serves luxury and wealth, in contrast to the original labour that served the necessity of life" (1958, vol. 2, p. 272).

The nexus between demography, technology, and institutions also became the focus of North's thesis, particularly between the last two, because of their impact on transaction costs. According to North, one of the most important vectors of growth-enhancing changes is the development of institutions, either public or private, to support and

diffuse scientific knowledge. It entails more than the restructuring of organisations. In fact, the entire structure of the society will be transformed in the process. Traditional informal constraints centred on tribal or personal relationships and repetitive individual exchanges are ultimately replaced with new formal rules and organisations as well as a larger government presence (North, 1997, p. 158). Technology and the resulting scale of economies are inevitable outcomes of specialisation, minute division of labour, impersonal exchanges, and urban societies. All of these ideas are perfectly summed up in North's adaptive efficiency concept which he defines as, "...the willingness of a society to acquire knowledge and learning, to induce innovation, to undertake risk and creative activity of all sorts, as well as to resolve problems and bottlenecks of the society through time" (North, 1990, p. 80).

Protection of property rights and transaction costs

An important aspect of economic transformation is the changing nature and degree of the state's involvement in the market. According to Ibn Khaldūn, capitalists and royalists should not be allowed to become involved in productive enterprises unless and until there are sufficient structures of governance and enforcement in place to ensure fairness in the market. He was very concerned that existing arrangements in the market are inadequate to protect the properties, intellectual, as well as physical rights of genuine private entities. Unable to compete, the private sector will have its incentive severely diminished and its economic activity will gradually lose its momentum. On this he wrote, "The owner of property and conspicuous wealth in a given civilization needs a protective force to defend him" (1958, vol. 2, p. 250). He further explained that "it should be known that attacks on people's property remove the incentive to acquire and gain more property. People, then become of the opinion that the purpose and ultimate destiny of (acquiring property) is to have it taken away from them" (1958, vol. 2, pp. 103-104).

Even back in the fourteenth century, the cost of protecting property rights was certainly not insignificant. He theorised that towards the end of a dynasty and in the transition phase of setting up a new ruling regime, the real estate sector will be severely affected. Ibn Khaldūn blamed the situation on political chaos and the resultant poor protection of property rights by the rulers. Property's utility is drastically diminished (for

example due to looting and vandalism) and consequently, their market values will decline. According to Ibn Khaldūn, the real estate slump will persist except if a new rule is firmly established and a reasonable degree of order and prosperity is observed. Although Ibn Khaldūn used only real estate as his example, his argument lends itself very well to non-tangible economic assets. In sum, the strength of a ruling regime is necessary (though not sufficient) for an environment that secures property rights, as he eloquently expressed, “the stick or royal authority are absolutely necessary for the building of cities and the planning of towns” (1958, vol. 2, p. 235).

Protection of property rights later became an important component of North’s body of work. He argued that the creation of capital markets and the development of manufacturing firms with large amounts of capital, entails some form of coercive political order. This is because the previous methods of using personal ties, voluntarist constraints and ostracism will no longer be adequate in more complex and impersonal forms of market interactions. Furthermore, international specialisation and division of labour requires institutions and organisations to safeguard property rights across international boundaries. This is to ensure that capital markets as well as other kinds of exchanges can take place with credible commitment on the part of the players (North, 1990, p. 121).

Both Ibn Khaldūn and North acknowledged that to safeguard property rights, all political and judicial institutions in the country must be committed to effectively and impartially enforce contracts across space and time. North added that because investments and contracts have to be more and more sophisticated, the resources necessary to protect property rights must be continuously improved. In other words, the transaction costs of firms will increase correspondingly, especially if the ruling government hesitates to enact sufficiently strong property right rules for fear of antagonising powerful constituents (including firms connected to the ruling parties). Firms will have to take costly protective measures on their own, in extreme cases using bribes, payoffs, or black market channels to ensure their profitability. Furthermore, insecure property rights force firms to restrain from making substantial capital investment or long-term contractual commitments (except firms operated or protected by the government). In such scenarios, institutions and eventually economic growth will suffer.

Government presence in the market: productive or redistributive?

The following insights from Ibn Khaldūn and North deal with the subject of the state, the market, and the public/private divide. Both authors began with the same premise that markets should be based on voluntary exchanges. Ibn Khaldūn's views regarding the commercial presence of the government can be seen in various places in the *Muqaddimah*. For example, he said, "The trouble and financial difficulty and the loss of profit which it (the government) causes the subjects take away all incentives to effort, thus ruining the fiscal structure... The trading of the ruler may cause the destruction of civilization" (1958, vol. 2, p. 95). He argued that the government's commercial activities cause undue competition in the market, in which resources of private firms will not be able to cope. "Now, when the ruler, who has so much more money than them, competes with them, scarcely a single one of them will be able to obtain the things he wants...(the subject) thus exhausts his capital and has to go out of business" (1958, vol. 2, pp. 83-85).

Other than the now well-known 'crowding out' argument that is evident above, Ibn Khaldūn also suggested that business entities which represent the interests of the rulers are likely to be inefficient simply because they essentially pursue different objectives and employ different accountability mechanisms (including capital and management structures). He argued that government-related companies do not necessarily rely on efficiency in order to thrive, unlike the privately-owned companies whose ticket to survival is a set of market-optimum decisions. North discussed the same dilemma using the nineteenth century history of the U.S.A., where the basic institutional framework including the Constitution and the Northwest Ordinance encouraged the development of economic and political organisations such as the Congress, family farms, and merchant houses. While they were aimed to directly and indirectly promote investment and growth in the economy, not all of their business decisions were optimal or welfare-enhancing. Tariff creation, exploitation of slaves, and the formation of trusts are some of the examples of government influences that were associated with their involvement in the market.

Productivity and tax revenue collection tend to suffer if the government's presence in the market is in reality more redistributive than productive. Ibn Khaldūn was certainly alluding to this when he

wrote about rulers who prefer to create monopolies rather than promote competitive and conducive conditions for private sector growth. A predatory government acting on its self-interest is prone to squander the wealth of the country and exploit the business community through unjust taxes and misappropriation of resources and profits. In the long run, these self-preservation strategies can eventually lead the ruling dynasty to its destruction. North used the example of the Low counties of Netherlands to illustrate how internal conflicts between the patrician and craftsmen and the consequent creation of local monopolies stifled the economy severely. Only when the Burgundian and later Habsburg rulers gradually removed restrictive practices and improved trade rules and property rights protection, these economies were able to reach unprecedented levels of prosperity (which in turn generated tax revenues) and became “the jewel in the Habsburg empire” (North, 1997, p. 154). North’s overall position regarding the government’s presence in the market is captured in the following quote “...[s]uccessful economic performance, therefore, must be accompanied by institutions that limit economic intervention and allow private rights and markets to prevail in large segments of the economy” (North & Weingast, 1989, p. 808).

On the other hand, predatory governments have the ability to persist for decades even as rulers change. This is because:

- i. the extremely high transaction costs prevalent in the political and economic markets forces the rulers to make the most of their advantageous position in the market, and
- ii. existing subjective models and mindsets of the rulers do not compel them to pursue economically-efficient methods in their business dealings.

For instance, politically-connected firms lobby the rulers so that legal-economic advantages can be secured, even though they essentially mean a more restrictive business eco-system for other firms. In many of his texts, North acknowledged this very clearly. As a result, additional transaction costs are needed to deal with these inefficiencies, and private firms find lesser and lesser incentive to innovate and grow. Institutions are then created (or evolve) into socially-inefficient structures serving the interest of those with bargaining power.

Governments are usually both the participant and the enforcer in the financial market, setting the rules for all players including itself. Today, the involvement of government in the management of the currency provides an instructive case for understanding the debate about its involvement in market activities. Similarly, in the debt market, government issues public debt which also provides liquidity to private debt markets through certain taxations (Davis, 2008). These examples in modern finance led North and Weingast (1989, p. 828) to conclude that "...it appears that the growth of private capital markets paralleled that of public capital markets".

It is obvious that both Ibn Khaldūn and North strongly advocated the establishment of a body to monitor, measure, and enforce accepted rules of trade and contracts especially in the context of large complex economies with impersonal exchange across time and space. According to Ibn Khaldūn, one of the roles of the *hisbah* institution is to prevent and punish abuses, fraud, wrongful measurement, as well as the erosion of public interests.⁴ Public control and support should complement freedom of enterprise. North's own example was the Law Merchant Code in Europe (North, 1997, p. 151). As the size of markets grew between the eleventh and fourteenth centuries, a trading system based on a reputation or ostracism mechanism alone was insufficient.

According to North, ideally, third-party enforcement should involve a neutral party with the ability to measure the attributes of a contract and enforce agreements (North, 1990, p. 15). These conditions, difficult to meet at any time in history, will be even more difficult if the enforcer (government) himself has its own commercial functions and interests in the same market. North argued that if the state has coercive force, then it is inevitable that those who run the state will use that force in their own interest at the expense of the rest of society.

Even assuming that the enforcement institutions are just and fair, private firms may still face other risks of contractual hazards, which leads to increasing transaction costs. As Menard (2004, p. xiv) suitably described the problem in his preface to the "International Library of the New Institutional Economics" series, "In a world in which uncertainties combine with positive transaction costs, contracts remain inevitably incomplete, thus generating hazards that require safeguards. These safeguards may be entrenched in the contracts themselves; they may also rely on complementary governing devices or on external enforces,

among which courts and governments are major actors. Another element that contributes to incomplete contracts is the importance of unanticipated events and the behaviour of parties to the contract.”

Interestingly, the above transaction costs could be easily traced in Ibn Khaldūn’s discussion regarding the relationship between taxes and entrepreneurial incentives. He argued that excessive tax rates may be the implication of (i) greed and declining morality of the ruling parties and (ii) higher social overhead costs of increasing population. High taxes would in turn erode profit margins and ultimately the commercial initiatives of the private sector. The clues are evident in these well-known quotes from the *Muqaddimah*:

...the strongest incentive for cultural activity is to lower as much as possible the amount of individual tax levied upon persons capable of cultural enterprises... It should be known that at the beginning of a dynasty, taxation yields large revenue from small assessments. At the end of the dynasty, taxation yields a small revenue from large assessment (vol. 2, p. 80)

The role of formal institutions is greatly complemented or even guaranteed by the support it receives from informal institutions. The latter’s influences in determining economic growth and societal change are described in the following section.

Institutional change: Informal to formal structures

History shows that the same formal rules and/or constitutions imposed on different societies can produce different outcomes due to the tenacity of informal values and constraints. According to North, even massive and total external change such as revolutions or military conquests are seldom able to replace the importance of culture and informal values of a society. Strikingly similar conclusions can be found if we look into Ibn Khaldūn’s exposition regarding the role of *‘aṣabiyyah* (group solidarity, group consciousness) in promoting development of a society and civilization. Likewise, the collapse of the *‘aṣabiyyah* will unequivocally cause the civilization to fall.

According to Ibn Khaldūn, development of *‘umrān* (civilization) is a continuum with *badāwah* (tribal lifestyle) at one extreme and *ḥaḍārah* (sedentary/settled lifestyle) at the other. In the *badāwah* system, the

small society is bound together by common familial, religious, and cultural ties. The created or organised institutions are simple in nature but effective in accommodating personal and repetitive economic exchanges. More importantly, religious precepts usually impose standards of conduct on the players and a unified political structure or formal rules are usually unnecessary.

For North, the characteristically self-imposed or governed informal constraints found in simple economies are expected. He wrote, “In all societies from the most primitive to the most advanced, people impose constraints upon themselves to give structure to their relations with others. Under conditions of limited information and limited computational ability, constraints reduce the costs of human interaction as compared to a world without institutions” (North, 1990a, pp. 36-39). He also noted the insights of anthropologists into the economic network of the tribal societies, where people have good knowledge of each other’s reputation and the threat of violence or retaliation serves as an effective deterrent to undesirable business practices. How does an informal institution grow and more importantly, how is that growth related to economic change? An analytical perspective of Ibn Khaldūn’s *‘aṣabiyyah* may be able to help answer these questions.

Fortification of ‘aṣabiyyah

As production surplus from division of labour and specialisation grew, the size and nature of economic interactions and networks expanded. This called for stronger and more structured business relationships in order for one to take advantage of newly available opportunities. Existing social solidarity is extremely useful in promoting economic activities while the pursuit for economic surplus gives greater impetus for social binding, inadvertently re-enforcing each other. In brief, Ibn Khaldūn’s *‘aṣabiyyah* is a group feeling and energy that emerges from the unity of religious, social, political, and economic interests. Mohammad (1998) described *‘aṣabiyyah* as the “motor of social change”⁵ and outlined three factors that create and strengthen *‘aṣabiyyah*:

1. Religion is an extremely powerful factor in socialisation and facilitates unity of thought and action among its followers.
2. Organisation of the community’s power structure whose potency and effectiveness, depends, to a great extent, upon

how power is budgeted in society and the ability of those in power to galvanise scattered and incoherent group feelings into an action-oriented cohesive unit. Economic conditions are essentially determined on how well the leader can depend on the goodwill of society.

3. Leadership which can inspire the people, instil confidence and trust and yet show a level of prudence with which the leader leads his people.

Ibn Khaldūn believed that initial authority develops from one that is “religious and culturally-based” to another that is “politically-based”. He described this transition as the evolution from “*Khilāfah* leadership” to one of “*al-mulk* or royal authority”. The *Khalīfah* is entrusted to protect religion and social welfare by exercising political leadership of the people. The leader is naturally obeyed even if he has no power to force others to accept his rulings, i.e. without formal structure or source of power. On the other end of the spectrum, the *Malik* depends on a particular source of superiority and power (e.g. lineage, politics) to rule and mediate in the society. Royal authority comes from a formal source and is sometime totally dependent on a formal structure to control and ensure public respect towards the authority.

Similarly, North described the formalisation of institutional power as a movement from one extreme of a continuum to another, driven by increasing specialisation and division of labour associated with more complex societies (North, 1990, p. 46). His version of the evolution begins with the shift from using informal constraints (e.g. taboo, traditions) to developing formal institutions (e.g. constitutions, democratic governments, economic contracts, judicial rules) to govern human interactions.

Disintegration of ‘aṣabiyyah

Ibn Khaldūn wrote that as *‘aṣabiyyah* declines (which he contends to be by the third generation), the society is characterised by a larger population with increasing dissension among leaders. As a result, followers are torn between conflicting loyalties. Eventually, sub-groups emerge while outsiders (other tribal groups) enter the fray seeking to wrest power from the current rulers. The struggle would end with the group possessing superior solidarity (*‘aṣabiyyah kubrā*) subduing the ones with lesser or declining solidarity to total submission.

Factors that are said to weaken *'aṣabiyyah* include:⁶

1. Wealth and corruption which become a subtle characteristic of sedentary culture which favours pleasures and indulgence including sexual indiscretions and homosexuality. People are more individualistic causing social solidarity, and its benefits, to decline. Economic injustices (infringement of property rights, business patronage) and inequality (from redistributive and rent-seeking economic activities) increase from day to day, often uncompensated for. To preserve power and maximise material interests, rulers employ mercenaries or elaborate bureaucratic structure, inevitably requiring higher and higher taxes to pay for them. Their behaviour indirectly inflates business transaction costs with dire consequences. He wrote that:

The result is that the interests of the subjects in cultural enterprises disappear, since when they compare expenditures and taxes with their income and gain and see the little profit they make, they lose all hope. Therefore, many of them refrain from cultural activity” (1958, vol. 2, p. 81).

2. Power which Ibn Khaldūn warns can be the narcotic of the mind. Its abuse intoxicates the ruler possessing it. Continuous and glaring abuse of power produces resentment and frustration amongst the followers. The corrupting influence of power demoralises the social system and produces a climate of thought and emotion in which *'aṣabiyyah* becomes ineffective.

With respect to the first factor, a ruler can act like a discriminating monopolist, offering the different groups of people economic protection in return for tax revenue. However, North explains that different groups have different opportunity costs and bargaining power with the ruler, therefore are likely to generate different bargaining results. Overall, he would certainly agree with Ibn Khaldūn in saying that after-tax margins would suffer.

Despite the gains from economies of scale in the provision of semi-public goods of law and enforcement, the government would soon discover that revenue has not increased correspondingly. This is a result of added layers of agents (through bureaucracy) and

their ensuing hazards. In North's extended analyses using a modern democratic context, diverse vocal interest groups tend to call for greatly complicated institutional structures basically to facilitate the exchange between these groups and the ruling parties. Even in planned economies of the twentieth century, Murrell and Olson's (1991) study shows how institutions, which were initially developed for providing support to an authoritarian regime, demands more and more information to be used as to control and to defend against any attack on their validity and authority. This increases the size of the bureaucracy, generates collusion among subgroups, and ends up contributing to the ruin of the economy.

In relation to the second factor, Levi (2000, p. 140) offers an interesting discussion with regards to the impact of distrust or absence in trust, as a result of the *'aṣabiyyah's* breakdown, on the performance of the economy. He succinctly explained that:

The absence of trust is the source of the free-rider dilemma. Potential cooperators perceive their structural interests as similar; all prefer the provision of the collective good to its non-provision... Distrust can lead to inaction, or it can motivate positive action, albeit defensive action against the distrusted. It can lead to a decision not to take a risk, or to make oneself vulnerable to another.

In the same vein, political uncertainty contributes to corrupt behaviour. As abuse of power is a guaranteed source of dissension and frustration, some of the ruling elites must be aware of impending political instability from culmination of these negative feelings. In their greed to capture maximum economic interest in the limited time frame, they more often than not take actions that aggravate the negative perception and injustices in the economy. Terry Moe (1990, p. 227) observes:

...Because dangers of political uncertainty can be anticipated from the outset, however, today's authorities need not leave their creations unprotected. They can fashion structures to insulate their favoured agencies and programs from the future exercise of public authority. In doing so, of course, they will not only be reducing their enemies' opportunity for future control; they will be reducing their own opportunities as well.

Concluding remarks

This study compares Ibn Khaldūn's ideas on institutions as rules of behaviour and standards by which people interact and fulfil their individual and collective objectives. The basis of these rules is founded both in the people's worldview and how it shapes their interactions with each other. While Muslims fundamentally ground the rules in the *Sharī'ah*, other societies develop their rules of behaviour based on their own ideological and intellectual frameworks. It follows that changes or variations in institutional or rule structures are primarily endogenous, meaning that moral, social, economic, and political reform cannot be simply copied or imported from other civilisations. This is an important lesson for development economists, one that Muslim countries have often ignored at their own expense. Islam played a positive role in the development of Muslim societies in the past, turning desert societies into an intellectual and materially superior force within a short span of time. It is the internal strength of the individuals and the ties that bind them (as derived from their *Tawhīdic* worldview) which propelled them to a greater level of civilisation.

Nonetheless, regardless of the source of the rules, Ibn Khaldūn and North showed that institutions will grow and gradually become more formalised. This process is naturally driven by increasing specialisation, division of labour, creation of more complex political structures, and inevitable cultural evolution. Ibn Khaldūn's continuum of *badāwah* to *hadārah* and North's theory on changes from informal to formal institutional set-ups are, in essence, explanations of this process. Both Ibn Khaldūn and North emphasised the incremental nature of change and that as the society becomes larger, there will be increasing dissension among sub-groups which in turn requires greater extent of bureaucracy and self-protective (economic and non-economic) actions by the rulers. These trends eventually contribute to the ruin of the economy.

The state, which was previously trusted to help people carry on their lawful businesses effectively and prevent them from committing excesses and injustices against each other, is itself increasingly involved in business activities. The "crowding out" of investments is bound to emerge and tax collections will decline as enterprises re-assess their risks and returns from operating in that economy. The people will become more wary of their private property rights and individual freedom. In this scenario, we can derive another timeless economic

wisdom, which few have described as explicitly as Ibn Khaldūn and North. The prevalence of justice promotes security of life and property which in turn encourage integrity, hardwork, entrepreneurship, and technological progress, whilst its absence defeats economic motivation. According to institutional economics, any element that destroys or hampers the public's sense of justice will only add to transaction costs to doing business (as more complex contracts and the alliance between business and politics become the norm) causing the economy to suffer.

This article compared Ibn Khaldūn's thoughts with the New Institutional Economists, focusing mainly on Douglass C. North, with respect to the role of institutions in economic change. Needless to say, the comparison is not exhaustive, nor is it enough for a complete comparative analysis of the two wider paradigms, i.e., Islamic economics and NIE. Despite the limited focus, we found a number of interesting similarities in ideas and logic, proving that NIE may be indeed closer than expected to Ibn Khaldūn's theory, be it in methodology and approach as well as in the theories and rationales underlying them. This exploratory study will hopefully pave the way for more in-depth analyses on how Ibn Khaldūn's ideas can enrich our understanding of institutions and contribute to the discipline of institutional economics. More importantly, the knowledge derived from this comparison can be used to inspire leadership of present-day Muslim countries to evaluate and reform existing informal and formal institutions (social, economic, and political) to eliminate hindrances and corrupt elements and push the society towards genuine development.

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Endnotes

1. Prof. North passed away recently on November 23, 2015.
2. Page numbers in brackets refer to Franz Rosenthal's English translation, Ibn Khaldun (1958) *The Muqaddimah: An Introduction to History. Volume I, II and III*. Translated by Franz Rosenthal. London: Routledge & Kegan Paul

3. In fact many agreed that Ibn Khaldūn's theory of international trade was based on international division of labour (skills of the inhabitants) instead of the comparative advantage of a society's resources.

4. Weingast (1993), when arguing for strong constitutional constraints to govern political decision-making, writes "markets cannot survive without strong political protections from the state itself". Valentinov (2005) also acknowledges that institutional changes are not always be based on the efficiency or cost-minimisation assumptions, but can develop in such ways that maximise the power of stakeholders' ability to influence future course of activities.

5. For excellent discussions on the emergence and genesis of *'aṣabiyyah* development, please refer to Fida Mohamad's article (1998 pp. 36-38) as well as Fuad Baali's works, amongst others.

6. These factors are also discussed in Mohammad (1998 p. 39)

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