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FOREIGN CAPITAL: BORROWING

What has been termed 'the first globalization' was the economic development process that lasted from the Industrial Revolution to World War I, coinciding with a period of decline for the Ottoman State. As indicated in the previous chapter, the volume of trade rose significantly during this period. The rising supply of cheap European industrial products led to an increase in the demand for Ottoman primary products. In order to accommodate this increasing trade, which necessitated a better level of infrastructure than already existed, and to cover the seemingly unending budget deficits of the State, foreign capital in various forms began to move into the Ottoman realm.

Eric Hobsbawm describes the 1848–75 period as 'the age of capital'. This period of great progress for industrial capitalism was marked by private capital striving to buy everything, including labor, at the lowest price and selling at the dearest. This period was described by Hobsbawm as the 'drama of progress'. Millions of tons of iron were used to build railways across continents, submarine telegram cables were laid beneath the oceans, and there was large-scale emigration to the New World. This drama of progress was a real one for those who, despite remaining outside capitalism, suffered from its effects. They had two options: either they would resist in vain, trying to protect their traditional structure, or learn the tricks of the West and use them against the West. Hobsbawm writes that there were victors and victims during this period[1] and the Ottomans lived the drama of the victims.

According to several Western observers, the Ottomans had for centuries lagged behind their contemporaries in matters of financial and fiscal administrations. It was only after the Industrial Revolution and the developments at the end of the eighteenth and the beginning of the nineteenth century, that the Europeans learned to use modern financial skills, such as raising funds for their governments as well as for industry. Then, as explained by Eliot Grinnell Mears, they used such skills to gain political and economic gains outside their own countries.

> Looking around for fields for financial expansion, the Western bankers soon began to appreciate the availability of Turkey. Here was a country of vast potential resources, with a strategic geographical location and with a government too ignorant, irresponsible and corrupt to protect its interests. It was an ideal field for political intrigue and it did not long remain uncultivated.[2]

First Attempts at Borrowing

During the years of financial difficulties for the Ottoman State, loans were often considered. While the idea of borrowing from Christian countries did not please those in Ottoman administrative circles, foreign countries were not willing to lend. Starting from Murat IV (1623–40), in the seventeenth century, and later under the reigns of Ahmet III (1703–30), Selim III (1789–1807) and Mahmut II (1808–39) attempts at borrowing abroad came to nothing.[3] As Selim III was determined to establish a reliable army, his financial administrators attempted to borrow from the Netherlands but were turned down. Consequently, they even thought about borrowing from countries like Spain and Morocco.[4] The Ottomans had to recourse to debasing gold and silver coins in order to balance budget deficits arising from heavy military expenses. During Mahmut II's reign, gold and silver coins were debased 35 and 37 times respectively, leading to the depreciation of the Ottoman currency relative to the British pound sterling by 352 percent.[5] The economic and social costs of price increases and the fall in purchasing power was enormous. As soon as he was enthroned, Mahmut II made an attempt to borrow from England. King George III declared that a sum of one million pounds sterling could be lent in return for timber, wheat and copper to be delivered to the British Mediterranean fleet. However, the Ottomans were so slow in trying to find out how this debt was to be paid back that this attempt yielded no results.[6]

Expanding trade after the 1840s led to an increase in customs tax revenues, with a positive effect on the State budget. The Government was able to start paying back its accumulated debts to the Galata bankers and merchants who were happy with this new turn of events. However, as imports eventually surpassed exports, Ottoman gold, silver and copper coins were used to cover the foreign trade deficit.[7] The liquidity crisis that arose as a result of the depletion of the metallic coins could no longer be dealt with by debasements or by recourse to borrowing from the Galata bankers. Foreign banknotes began to circulate in the Ottoman market.

At a period when commercial activities increased significantly, the lack of banks and banknotes created problems with payments. European countries which issued banknotes with a 20–30 percent gold backing were able to resolve their liquidity problems in a much less costly way. The issuing of banknotes (*kaimes*) which could be used for payment was therefore an important and positive step. Banknotes, which were declared by the Government to be the equivalent of money, were issued at the end of 1839. These handwritten banknotes looked more like government bonds than money, even though they were named 'cash equivalent banknotes' (*kaime-i mutebere nakdiye*).[8] When reaching maturity in eight years, the principal amount would be paid in gold, and the yearly interest would be eight percent.[9] An agreement was reached with the Ricardo Investment Bank of London for the sale of banknotes issued in 1840 with a yearly interest rate of 12 percent and a nominal value of 25 piasters (*kuruş*). As these banknotes had no serial numbers, they lost a great deal of value when fake ones invaded the market.[10] With the issuing of banknotes, the Galata bankers lost revenues. Instead of paying them 20 percent interest, the State was able to issue banknotes with interest rates ranging between 8 and 12 percent. The Galata bankers sent out agents who spread rumors that the banknotes had no gold equivalency and were not real money.[11] These rumors, as well as the fake banknotes, led to a loss of confidence and merchants started to require gold for their goods. Printing fake Ottoman banknotes turned into an international industry. In addition to the fake banknotes manufactured by the Galata bankers, counterfeit Ottoman banknotes were even made as far away as the United States of America. Thus, Americans were making a profit without paying anything in return.[12]

As the production of real and fake banknotes increased, the State reduced the interest rate paid on this hybrid financial instrument from eight percent to six percent, and later to two percent.[13] In fact the *kaimes*, which were really debt instruments, eventually turned into banknotes which could not be converted into gold. This initially unsuccessful implementation of banknotes might have created some doubts about obtaining loans through issues of securities. Despite the insistence of the British ambassador, the Sultan and the higher government officials were unwilling to obtain external loans. The British ambassador, Stratford Canning, in a long memorandum to the Sultan on 22 August 1850, asserted that the Ottoman Government needed external loans in order to realize the reforms that had been proposed for many years.[14] However, the collateral for such loans would deprive the State for a long time of some of its most important sources of revenues. As the State Treasury was in penury, salaries of government officials had to be reduced.[15]

Under such dire economic circumstances, and without a bank, banknotes issued solely with the authority of the mint led to difficulties in foreign trade payments. It was for this reason that an agreement was struck with two important Galata bankers, Alleon and Baltazzi. They would carry out the necessary market operations to protect the gold parity of the banknotes. These two bankers established, under the aegis of the State, the Banque de Constantinople (Bank-ı Dersaadet) and secured some stability for the value of the banknotes.[16] This bank lent 130 million piastres to the Ottoman Treasury, which was then in dire straits. To do this, it borrowed the money from Europe with the Ottoman debt as collateral. However, when the state was unable to pay the debt, Grand Vezir Reşit Pasha signed a credit agreement in 1850 with Becket Dethomas et Co. of Paris, and Deveaux and Co. of London, in order to pay off the now internationalized debt of the Banque de Constantinople, and to finance the reforms promised to the British. Accordingly, bonds worth 55 million francs (55,000 bonds at 1000 francs each) were to be issued and paid back in 27 years. About 20 million francs from the sale of these bonds, which were issued without the approval of the Sultan, were deposited in the account of the London agent of the Banque de Constantinople. [17] Sultan Abdulmecit was furious when he learned about this and refused to be the first sultan to take external loans. He did not sign the agreement, and dismissed the Grand Vezir.[18] As a result, the state had to pay not only the 20 million francs, but also an indemnity of 2.2 million francs.[19] However Abdulmecit eventually gave in after incurring heavy expenses during the Crimean War.

The Persistence of Financial Crisis and Foreign Loans

The Ottoman State not only had to bear the financial burden of the Crimean War, but also had to defray the heavy expenses of basing foreign troops on its soil. It was clear there was no way the Ottoman treasury could meet such expenses. The State had to issue security notes for internal loans (called *iane-i umumiye*), and compelled bureaucrats as well as merchants to purchase them.[20] When all state revenues were deemed to be insufficient, Sultan Abdulmecit issued a *firman* (decree) on 4 August 1854 authorizing foreign loans amounting to five million pounds sterling. Three million would be in the form of bond issues and an agreement was struck with Dent, Palmer and Company of London and their Paris agents, Goldschmid and Company. This 15-year debt issue had a nominal interest rate of six percent, an annual one percent amortizing rate, and was sold at a 20 per cent discount. The revenues of Egypt were established as collateral. Since only 2.29 million pounds were to go to the Ottoman Treasury, the effective rate of interest came to nine percent.[21]

It was not possible to cover the total war expenses, calculated at 11.2 million pounds sterling by the Ministry of War, with the 1854 borrowings.[22] The ever-increasing budget expenses necessitated a new round of borrowing in 1855. This time, Britain and France convinced the Ottomans to borrow five million pounds sterling and guaranteed the interest payments of the debt. Even the most cautious bankers became interested in this loan. While the rate of interest was four percent, it was sold at a premium of 2.62 percent above its nominal value. In Blaisdell's opinion, this loan marked the beginning of foreign control over the Ottoman Empire.[23] According to the agreement, the British and French Governments imposed condition that these sums would be used exclusively to finance the war, and two delegates, one British and one French, would be appointed to audit Ottoman Treasury accounts. The collateral for this loan was again the revenues from Egypt in addition to the revenues from the customs of Syria and İzmir. It appears that Lord Hobart of Britain and Marquis de Ploeuc of France met the determined and astute resistance of the Ottoman authorities in their auditing efforts.[24]

The exclusive use of the loan to finance the war meant killing two birds with one stone for the Western powers. With these loans, the Ottoman economy not only became dependent on the West, but also offered a significant market for developing the armaments industry in France and Britain. The fact that there was no objection to the French guarantee, while the issue was debated in parliament, was perceived to be the result of the lobbying efforts of the French armaments producers.[25]

The ease with which the loan was obtained must have instilled some optimism at the Porte since, thereafter, they frequently had recourse to new loans, resulting in ever-increasing indebtedness until the moratorium of 1875. When it was announced on 7 October 1875 that the obligations to repay the loans would not be met, a total debt amounting to 5,297 million francs had been incurred since the initial loan of 1854. The bond repayment allocations in the budget kept increasing, so much so that while they represented 18.8 percent of the 1862–3 budget, this rose to 43.9 percent of the budget of 1874–5.[26] According to Morawitz, this huge sum left an amount that slightly exceeded half of its nominal value to the Treasury. Only ten percent was allocated to public investments and more than 1,250 kilometers of railways were laid in the Balkans. With the remaining 90 percent 'a few palaces were built on the Bosphorus along with some warships which never sailed. One can add to these buildings the beautiful mansions constructed in the vicinity of Parc Monceau belonging to the Galata bankers who chose to retire in Paris.'[27]

These loans were obtained in return for very hard terms. Among these were conditions, essentially set by the British, such as the right of foreigners to rent or purchase real estate belonging to the Ottoman State. Other terms included the creation of extremely favorable conditions that existed nowhere else for foreign traders. These included the lifting of government monopolies and the control of Ottoman finances by an international commission. When the established British and French financial institutions were reluctant to issue bonds, the Ottoman Government borrowed either by dealing with bankers of poor reputation, such as Mirès,[28] or by selling bonds at market prices much below their nominal values. Taxes on salt, tobacco, silk, olive oil and copper, and stamp duties, in addition to tax revenues from important provinces, were shown as collateral.[29]

According to Rodkey, the inability of the mid-nineteenth-century Ottoman State was not merely the result of the corruption, fatalism and ignorance of the Ottoman authorities, as claimed by some Western authors. The Ottomans could diagnose their national weaknesses and the means of overcoming them in a perhaps more realistic way than the pro-reform Westerners, who wantonly and unabashedly described the Ottomans as 'weak' and 'vacillating'.[30] Rodkey maintains that the Ottomans' seeming unwillingness for reforms was not due to their lack of understanding of the issues, but rather their feeling that the economic influence of the West would destroy the financial and political power of the Ottomans.

In order to facilitate trade with the Ottoman Empire, the British promoted the establishment of a bank. The Ottoman Bank, with headquarters in London, was started in 1856 totally with British capital. It opened branches in important trading centers such as Beirut, İzmir (Smyrna), Galatz and Salonica.[31] It was initially established as a commercial bank. However, when the Ottoman State had to negotiate loans, especially after the crisis caused by the infamous financier Mirès in 1860, it was transformed to meet this situation. In 1863, with the participation of French capital, it became the Imperial Ottoman Bank (Banque Impériale Ottomane). Even though its area of activity was in Istanbul, it was run under the direction of committees in London and Paris. This bank played a major role in the Ottoman economy. It performed the basic functions of state financial operations such as opening a credit line, assisting in external borrowing, and issuing banknotes. Moreover, it made important contributions to the economy by giving loans to the commercial, mining and industrial sectors.[32] The confidence felt by this privileged bank facilitated the issuing of bonds and attracted foreign banks which also started to carry out financial and commercial operations in the Ottoman capital. These foreign banks, which acted as intermediaries in bond issues, were able to secure much higher commissions than they could in Europe.

The Road to Bankruptcy

It was possible to solve the debt problem by financial, and especially fiscal, reforms. However, tax farming was still in use. In general, regions of *vilayets* (provinces) and *sancaks* (subprovinces) were arbitrarily determined by a *vali* (governor) and then given to the highest-bidding tax farmer who would sub-contract the region piecemeal to smaller tax farmers. With the new system ushered by the Tanzimat (1839–76), the tax farmers employed a great many collectors in a vertical organization. At every level, collectors would get their own cut – the amount going to the Treasury would be much lower than what was actually collected from tax payers.[33] In any case, it took a long time for this new system to settle. The old order continued even during Abdulaziz's reign (1861–76), 25–30 years after the proclamation of the Tanzimat.[34] Many Western authors think that one of the worst weaknesses of the Ottoman financial administration was to cede the collection of taxes to intermediaries and then borrow to meet expenses.[35]

The Tanzimat sultans, despite the warnings of some farsighted Ottoman administrators, kept squandering vast sums of money, to the amazement of Western observers. They even accepted foreign control in order to facilitate borrowing. The Tanzimat Higher Council (*Meclis-i Valâ-ı Tanzimat*) was established with the Reform Decree (*Islahat Fermanı*) of 1856. This council had seven members: four Ottoman higher officials and three foreign experts. The Austrian ambassador was asked to find an experienced consulting expert as his delegate, and Von Lackenbacher joined the council.[36] The French proposed one of their citizens, Alleon the banker, a founder of the Banque de Constantinople. When Alleon withdrew, the Marquis de Ploeuc was appointed. The British appointed Mr Falconnet, the Director of the Ottoman Bank.[37] However, the Ottoman Government did not know how to use these experts. In October 1859 these foreign delegates sent a note to their governments that Turkey was not implementing the reforms envisaged by the 1856 Reform Decree. Despite the initial lack of attention paid to this committee, its authority and prerogatives were later increased.[38]

Following the unsuccessful Mirès borrowing, the British Government wanted to protect the interest of British investors during the second loan process of 1855. For this purpose, in 1861 it sent Lord Hobart and Mr Foster, an official of the British Ministry of Trade, to Istanbul, to investigate whether the borrowed funds were being properly allocated.[39] The mission of these two men was to examine the situation, and determine the possibilities of reform. As the Hobart–Foster report had a positive impact in London, the unofficial approval of the British Government facilitated the 1861 loan. Under the supervision of Lord Hobart, previously uncollected banknotes were finally withdrawn from the market.[40]

Meanwhile, certain British and French newspapers had started to caution their readers about the Ottoman bonds. *The Times* (London), in particular, displayed an animosity that sometimes reached the level of cursing and insulting. As early as 1856, when the Reform Decree was promulgated and the Ottoman State gave all sorts of concessions under the guise of reform, including the control of its finances by foreigners, this newspaper was still making cynical and pessimistic comments. On 27 December 1856 *The Times* wrote about the auditing of government accounts by members of the Council of State and criticized the way punishment of peculation was entrusted to those members of the council who were themselves notorious for the same thing.[41] When the 1858 bonds were issued, *The Times* declared that this should be for some time to come the last loan given to this 'anomalous' and 'untried state'. Further, the newspaper claimed that since both during and after the Crimean War France and Britain had done their share of spending, it was now the Ottomans' duty to help themselves. According to *The Times*, by furnishing funds to the Ottomans, the British investors would simply encourage the weaknesses of the Turks. The paper warned: 'The faults of Musulman are apathy, sloth and self-indulgence, and if there is one thing more than another likely to encourage these vices, it is the too easy grant of funds which other men are to repay.'[42]

At a period when the Ottomans' ability to repay their loans was viewed negatively, the Ottoman Bank, under British and French administration, was trying to attract the plentiful European funds by demonstrating how rich Ottoman State revenues were. True, the Ottoman budget revenues were on the rise, but expenses were increasing even faster. Between 1871 and 1874 the revenues had increased by 20 percent. However, after Mahmut Nedim Pasha, a Russian puppet, became the Grand Vezir, the situation got worse. The frequent changes he made in the reorganization of provinces as well as in the appointments of governors created new problems in the collection of taxes. In Anatolia, during 1872–5, and in Roumelia, during 1872–3, drought and penury brought about a significant reduction in incomes.[43] The Slavic peoples of Roumelia began to rebel as a result of Russian prodding. During the late 1860s, the Greeks had already kept the Ottoman army and administration active and busy. Substantial expenses therefore had to be incurred in order to fight the rebels and their instigators, namely Russia and certain European states.

In fact, the economic crisis that started in 1873, and subsequently spread to most of the globe, also had its nefarious effects. During the 1870s, Spain and numerous Latin American countries were unable to pay their debts. Italy set limits on its payments. Greece had already stopped paying her debt instalments for some time. While the British Government did not intervene to protect her subjects in these countries, it worked to establish a control mechanism in Egypt and the Ottoman Empire when they encountered problems in debt payments.[44]

The 1874–5 budget had a deficit of five million Ottoman liras and the political situation was not opportune for a new loan. Mahmut Nedim Pasha drafted a plan which would pay only half of foreign debt interest. While this was announced on 6 October 1875, it was officially proclaimed in the *Basiret* and *Vakit* newspapers on 7 October. Accordingly, half of the interest on the debt which had matured would be paid outright while the remaining half would be paid in five-year notes with five percent interest. The collateral for this restructured loan was made up of the taxes from customs, salt and tobacco, as well as tax revenues from Egypt. Should these prove insufficient, the sheep tax revenues would be added.[45] Even though the bankruptcy of the Ottoman State had been expected for quite a while, this situation, nonetheless, was met with surprise and anxiety among European investors. Europeans believed that since the Turks were unlikely to have taken such a sudden decision, the Russian ambassador, Ignatief, was thought to be behind it. According to Morawitz, it was Ignatief's plan to belittle the Ottoman Empire and destroy the confidence of investors lending to the Porte. In addition, this would create an opportunity for Russia to start troubles in Herzegovina and Bulgaria.[46]

The Economist explained the terms of the repudiation to its readers and commented on other notes sent by the Porte to the Constantinople Stock Exchange. It expressed its view on the preparation of the 6 October Decree: 'There is evidently some mystery about the origin and the framing of the decree, which cannot be applied as it stands, though the issue of a document so defective must of course be more damaging to Turkish credit.'[47] This repudiation showed its negative influence on the prices of Ottoman securities in the European markets. The Turkish securities listed in the London market lost about 30 percent of their value as compared to seven months earlier. The losses in the Vienna Bourse were not heavy, with the exception of the Turkish lottery bonds, the only security quoted there, whose price declined from 49.50 to 40.25 liras within a week. The Vienna correspondent of *The Economist* reported that the share prices of some banks which dealt with Ottoman securities were also negatively influenced by the event. The people concerned were talking about radical reforms necessary to put Ottoman finances in order, including the seizure and sale of *vakıf* (mosque) possessions, a measure that the Turkish Government would not dare to carry out.[48] European newspapers were well supplied with statements from European politicians and statesmen on the 'Eastern question'. Benjamin Disraeli, the British prime minister, spoke of the serious character of 'the Turkish confession of financial impotence', as other well-informed statesmen did. Commentators reasoned that

> a Power which can no longer borrow what it wants for war, and which cannot make war without borrowing, is in much more immediate danger of collapse than a Power which has good credit in the money markets of Europe. And it stands equally to reason, that the European Powers which conceive themselves to be the natural heirs of Turkey in Europe, will begin to make ready for struggle, and to watch each other jealously, as they carefully scan the signs of that catastrophe which the Emperor Nicholas anticipated by almost a quarter-of-a-century, and we may hope by a longer period, when he spoke, in 1853, of the demise of 'the sick man' as even then imminent.[49]

During this turbulent period, in July 1876, the Government was obliged again to borrow, by issuing paper money, a sum of three million Ottoman liras, so long after its first disastrous paper money experience in the early Tanzimat period. However, this time the issue was totally under the control of the Ottoman Bank which would keep one third of the total amount in the Bank as reserve. This 'forced loan' was guaranteed by the estate of the late Sultan Abdulaziz which was handed over to the Treasury by the new Sultan on his accession to the throne. The estate included top-notch property, exemplary farms, and jewels that were found in the late Sultan's coffers, valued at three million Ottoman liras. The mines, including the Heraclea coal mines which were owned by the Sultan, were the most valuable items of the estate. This state property alone was sufficient to guarantee the amount of the 'forced loan'.[50] However, the outcome of the imminent war with Russia was not expected to bring any relief in the foreseeable future. *The Times* special Istanbul correspondent wrote on July 28:

> But the result of this and of all other financial measures of the Ottoman Government is dependent on the issue of a war which is not very rapidly progressing, and to which the War Office here seems bent on giving the most colossal and consequently the most costly proportions. No man can calculate how long it will be possible, even with the aid of paper-money, to bear the burden of so vast a military expenditure in the face of the general impoverishment of all classes of the population, except some of the highest Government functionaries, and of the almost total cessation of labour and industry, consequent on the enlistment of nearly all the able-bodied men.[51]

Three months after the decision on 6 October 1875, the interest payments on the 1858, 1869 and 1873 bonds were deferred. This created discontent among European creditors, who thought that the Ottoman State would not be able to make payments for a long time. Most of the grumbling against this decision took place in France and Britain where the majority of the creditors lived. Creditors, who were organized by the financial intermediaries, formed groups according to the collateral guaranteed by the Ottoman administration. In fact, it would not have been too difficult to restructure the debt, which had solid collateral, and pay it off. However, the Porte was undergoing an extremely bad period before and during the 1877–8 Russo-Turkish War, and the matter was resolved only by the end of 1881. In the Balkans, Russian and Austrian agents, as well as the American missionaries, were constantly inciting rebellions in Serbia, Montenegro and Bulgaria. The indignation felt as a result of the large-scale massacres of Muslims in the Balkans spelled the end of the reign of Sultan Abdulaziz in May 1876. He was replaced by Murat V, but the latter being mentally unfit, Abdulhamit II ratified the constitution and was enthroned in December 1876. Just when the internal problems seemed about to be solved, Russia declared war in April 1877. This war, which brought about great Ottoman losses, was concluded with the Treaty of San Stefano in 1878. However, the Great Powers, led by Bismarck's Germany, organized the Congress of Berlin in order to curb Russian gains and to get a share of the Ottoman territory. At the conclusion of the Congress, the Ottomans lost two-fifths of their territory and one-fifth of their population, half of which was Muslim.[52] In the Balkans, the independence of Serbia and Montenegro was recognized, and a Bulgarian principality, nominally attached to the Ottoman State, was established while Austria took over the administration of Bosnia and Herzegovina. In Europe, a part of Bessarabia, and, in the Caucasus, Kars, Ardahan and Batum, were ceded to Russia. While still nominally under the Ottoman Sultan, Cyprus was loaned to Britain and, in return, the British acquiesced to the French occupation of Tunisia. In addition to the loss of very important sources of revenue, the Ottomans had to pay Russia a war indemnity of 300 million rubles.[53] In order to prevent the total annihilation of the Ottomans under such a heavy burden of debt, the Treaty of Berlin stipulated certain conditions: the Great Powers, which were signatories to the Treaty, would determine an amount of the tribute to be paid by the Bulgarians to the Ottomans; some of Eastern Roumelia revenues would be allocated for the payments of Ottoman debts; Bulgaria, Serbia, and Montenegro would participate in the payments of Ottoman foreign debt in proportion to the territories lost by the Ottomans; and the rights and responsibilities of the Ottomans relating to the Oriental Railway Company (of Ottoman Europe) would be fully preserved.[54] While the sums to be apportioned to Montenegro and Serbia were not likely to reach an important amount, the Bulgarian tribute was expected to be a fairly handsome sum. That is why Russia tried to obtain a lien upon that amount, but the Powers raised their objections to the direct transfer of the tribute, which would make Bulgaria, in reality, a tributary of Russia. *The Economist* wrote:

> Certainly, if the dead weight of this money payment is to be hung round the neck of Turkish finance for an indefinite period, it might effectually prevent the Porte from ever rising its head above water. When first the stipulation of money indemnity was made known, we expressed our disapproval of the demand, which laid Russia open to the charge of attacking a weak state, not only to obtain territory, but money... Altogether, it is a matter of great regret as regards the financial future of Turkey, that this rock-a-head was not removed or sufficiently defined by the Berlin Treaty.[55]

Right after the signing of the Treaty, the foreign creditors started to pressure the Porte to pay its debt. Even before the Treaty, as the Russian war was in progress in 1877, the State renewed its borrowing. The loan agreement, named the Defense Loan, was carried out by the Porte, the Ottoman Bank, and Glyn Mills, Curries and Company of London. When the sale of the bonds, simultaneously in London and Paris, proved to be completely unsuccessful, the Ottoman Bank ended up providing the entire loan.[56] Despite the severity of the conditions, the Ottomans were considered sincere and honest in their endeavors to pay their debt. When *The Economist* put countries into classes – those which cannot, and those which will not pay their debts – the Ottoman Empire was classified together with small and poor Honduras and

Paraguay in the former class. Greece and Mexico were put into the second class of countries which 'had they any real desire to rank amongst solvent nations, might readily do so.' As she was 'utterly powerless to pay her debts' at the time, perhaps under the 'tutelage of England', the Ottoman Empire might not always be so financially helpless, especially if her bondholders should be willing to materially reduce their claims.[57]

The Ottoman Public Debt Administration

The close cooperation between France and England during the Congress of Berlin was not maintained on the question of Ottoman debt payments. As each country wanted to give priority to the interests of its own citizens, no agreement could be reached on any of the proposals and projects. The Ottoman government dragged its feet since it was in great need of funds. It had to start repaying its existing debt before it could borrow again from Europe. Thus, with the efforts of the Ottoman Bank and local creditors, the Government was inclined to agree on the proposals. After long negotiations, the Powers agreed to reduce the amount of the debt on the condition that they would have control over Ottoman revenues. With an *iradé* of 20 December 1881 (28 Muharrem 1299 in the Muslim calendar), the Ottomans ratified the agreement.[58] This document, which would thereafter be known as the Decree of Muharrem, contained 22 articles which regulated the organization and management of the Administration of the Ottoman Public Debt (*Düyûn-u Umumiye İdaresi*). These articles mainly covered the definition of an organ called the Council of Administration, and regulated the administrative organization and its relationship with the State. The methods for the consolidation and reduction of the debts, and rules about revenues, which would be transferred to the Ottoman Public Debt Administration (PDA) to pay off the debts, were also spelled out. Accordingly, the Porte transferred to this Administration 'absolutely and irrevocably' all the following revenues: the salt and tobacco monopolies, stamp tax, taxes on alcoholic drinks and fishing in Istanbul and its vicinity, and tithes from silk in certain districts until all the debts were paid off.[59] In fact, these six taxes (called *rüsumu sitte*) had been set aside in 1880 to pay the debts of the Galata bankers who had provided loans to the State during the 1877–8 Russian War. In addition to those revenues, others with collateral value, such as customs revenues, *tombeki* duties and surpluses of tax on shops and stores, were also ceded to the bondholders. In case of unsatisfactory revenues from these sources, the Bulgarian tribute, the revenue from Eastern Roumelia, and any other income from Serbia, Montenegro, Bulgaria and Greece handed over to the Ottoman Government under the provisions of the Treaty of Berlin and the Constantinople Convention (1877) to be applied to the public debt, were also considered as the property of the bondholders.[60] Still, the British were initially in doubt as to the real significance of the Muharrem Decree. While revenues had been surrendered to the bondholders 'absolutely and irrevocably' by Article 9 of the *iradé*, the right of the Government to take them back into its own hands was perceived to be conceded in Article 21, which stated that 'in the event of the Government annulling or suspending the present arrangements', present rights of the bondholders should be restored. *The Economist* interpreted this latter stipulation as making the present hypothecation of revenues no more binding than those which the Porte had already failed to respect. Nevertheless, the newspaper summed up as follows:

> It must be admitted that if the bondholders could reckon with confidence upon receiving permanently the proceeds of the assigned revenues, they would have reason to be satisfied. It is true, also, that the granting to them of a direct control over the assigned revenues greatly enhances their value, and makes a default much less likely than if the money were to pass through the hands of the Government. But what strikes at the root of the proposed settlement is the fact that the Porte is really not in a position to give up the revenues it now promises to assign.[61]

In 1881, the administration of all domestic and foreign debts came under the authority of the PDA. The first period of borrowing, which had started in 1854, came to an end with the establishment of this Administration in 1881. According to Parvus Efendi (Alexander Helphand), this Administration was neither a political institution nor a representative of the governments of the creditors' countries. It was 'nothing but a private company.'[62] This organization was like a second financial system, in addition to the Ministry of Finance in the Ottoman State. It employed thousands of employees in various branches all over the country. Several Western researchers see the Muharrem Decree as a private contract between the creditors and the Ottoman Government. Du Velay as well as Morawitz related this to the Treaty of Berlin. However, they add that even if no mention was made of international law, this agreement should have been under the aegis of signatory countries.[63] According to the agreement an executive committee, the Council of Administration, was made up of the representatives of the bondholders. The British and Dutch together were represented by one member. The French, German, Austrian and Italian bondholders had one representative each. A representative for the holders of Priority Bonds was to be chosen by the Ottoman Bank. Finally, the local bondholders who convened by order of the Istanbul Prefect were to choose their own representative.[64]

The total amount of borrowing between 1854 and 1874 had a nominal value of 5,297,676,500 francs, of which only 3,012,884,714 francs actually reached the Ottoman Treasury.[65] This meant that the bonds were sold, on average, for only 57 percent of their nominal value. The political efforts of the Great Powers played a greater role in Ottoman loans than financial and economic habits and methods. The Ottoman bonds were marketed simultaneously in London, Paris, Amsterdam, Brussels, Frankfurt, Vienna and Istanbul. This strategy, which had a political *raison d'être*, was not really in the interests of the borrowing country. When a security was put on sale at prices denominated in different currencies and in different markets, the market with the highest cost of capital would set the criterion.[66] This led the market prices way below the nominal value, and a very high effective rate of interest to be paid by the Ottomans. According to Parvus Efendi, the State was paying for an amount that it never borrowed. The inevitable bankruptcy of the State 'would result from the limitless greed of the European financiers who fully benefited from the difficulties of the Ottoman State and also from the thoughtlessness, ignorance, and betrayal of Ottoman officials.'[67] Parvus Efendi also mentions that Ottoman external debts, supposedly reduced by the Muharrem Decree, had really been inflated. They were shown to be higher than the real amounts.

The share of the debt that was the responsibility of the Balkan States under Ottoman suzerainty was not paid to the PDA. For some reason, the creditor European countries showed a great degree of tolerance in this respect. The Europeans, who seized the most important sources of Ottoman revenues, made no attempt to collect the debt owed by the Balkan States.[68] According to the Decree of Muharrem, the tax to be collected from Eastern Roumelia was fixed at 240,000 Ottoman liras. Upon the objections of the Roumelian Assembly, this was reduced to 180,000 Ottoman liras. This sum, which was not paid regularly, was later arbitrarily fixed at 130,000 liras.[69] Following a series of manipulations, even this amount was left unpaid. The surplus of the Cyprus revenue was to be paid to the PDA. However, by taking over Cyprus, the British declared that the surplus would be paid to the 1855 bondholders. Therefore the Ottomans did not get any revenue from Cyprus after 1878.[70] Even after losing this source of revenue that was granted by agreements, the Ottomans were asked to show new sources of revenues for the PDA.

Thereafter, from 1882 to the advent of the First World War in 1914, Ottoman borrowing was under the control of the PDA. After the 1877–8 Russo-Turkish War, the reign of Abdulhamit II (1876–1909) did not witness any major war, except the Greek–Turkish War of 1897. Yet the State had to bear the costs of various rebellions. From the Congress of Berlin until the First World War, Macedonia was a persistent source of problems for Ottoman and European statesmen.[71] Each of the Balkan States tried to become the regional power by conquering Macedonia. The Ottomans did not want to lose a considerable source of revenue, but more importantly did not want to leave to their fate a Muslim population numbering at least a million. Moreover, they wanted to hold at bay the over-ambitious Greeks. The Albanians, who lost an important part of their land to the Serbs and Montenegrins began to show signs of discontent. Armenians, prodded by the Russians since the 1877–8 war, became organized to commit systematic acts of terror and massacres. In 1896, they raided the Ottoman Bank and threatened the Government. The Greeks never stopped plotting about Crete and even started a war in 1897. Despite being soundly defeated, the Greeks were able to unite Crete to Greece in 1912 thanks to the support of the European Powers. Nonetheless, this relatively calm period, which lasted until 1908, created a more opportune climate for the Ottomans to borrow under more favorable terms, compared to the pre-1878 period. The guarantees provided by the PDA reduced the risks of the creditors. During this period, the State borrowed seventeen times for a total of 120,314,473 Ottoman liras, of which 107,858,796 liras went to the Treasury.[72] According to Earle, there was no group who knew the needs of the Ottoman State better than the PDA. Their main concern was to get the interest and the principal of the Ottoman bonds on time. However, the prevailing political instability and economic recession hampered this. It was necessary to feed the goose that laid the golden egg. For this reason, it was essential to maintain internal order, to reduce the ever-present danger of foreign occupation, and to provide the basic economic needs of the people.[73] Consequently, the PDA supported direct investments such as the building of railways.

The delegates of the creditors regularly reported financial developments related to the revenue collection to the bondholders whom they represented. In one subjoined note to the Council of Foreign Bondholders, Vincent Caillard, the British delegate on the PDA, detailed how the bondholders would receive their payments even in the case of diminished revenues from the provinces. The delegate did not seem concerned about the reforms in the Ottoman administration which were so urgently needed according to the Powers, because 'even if Turkey were to be absolutely dismembered', there could be no question that the pledges given to the bondholders by the 'international' PDA would continue to be fulfilled. The publication of such notes and statements in journals had the purpose of reassuring those 'bondholders, who might be induced to sacrifice their holdings through fears of a dénouement in the Turkish Empire'.[74] This meant the complete removal of the default risk from the Ottoman bonds under the PDA.

A problem arose between the Council of Administration and the bondholders at the turn of the century when the Council began to be involved with the financial transactions of the Ottoman Government. According to *The Economist*, in 1901, when the Government negotiated a loan of 1,234,000 Ottoman liras with the Ottoman Bank, the Council, at the request of the Government, undertook the collection of revenues assigned as security for the loan. H. Babington Smith, the representative of the British and Dutch bondholders, expressed his apologetic views about the matter, in the annual report of the Council to the creditors:

> By acceding to the request of the Government, and by co-operating in the service of the loan, we may appear to be giving support to an unsound system. I believe, however, that greater evils would have resulted, if owing to a refusal on our part, or from any other cause the Government had been prevented from obtaining the proposed loan.[75]

The Council had also considered it right to be involved in certain important matters as an agent of the Ottoman Government. A similar loan assistance had taken place in 1896, and the representative at that time assumed a similar apologetic attitude, stating that the Council of the PDA would 'not be induced again to lend its name to an operation of this kind'. But this time, the PDA went so far as to itself make advances from the bondholders' funds to meet the financial exigencies of the Turkish Treasury. According to *The Economist*, this was 'most inimical to the interests of the bondholders that the Council should engage itself in these loan-mongering schemes.'[76] In addition to assisting in government loans flotation, the Council also undertook the collection of tithes set apart for the payment of government railway guarantees. The Government, of course, paid a commission for the collection of such revenues:

> The amount of that commission exceeds the cost of collection. Instead, however, of accounting for that profit to the bondholders, who are their employers, and who pay them £2,000 a year each for

> their services, the members of the Council have arrogated it to themselves, and are consequently some £800 or £900 a year the richer by the transaction.[77]

After the 1908 Revolution, the internal and external problems took a turn for the worse. The Young Turk Revolution raised hopes for stability and peace. Ottoman intelligentsia hoped that the Government would be able to pay back its external debt, abolish the PDA, and secure its economic freedom.[78] However, the restoration of the constitution created only a short-lived euphoria. After a short while, differences among nationalist groups re-emerged along with old hostilities. Three months after the new Government came to power, Bulgaria declared her independence on 5 October. The same day, Vienna announced the annexation of Bosnia and Herzegovina whose administration she had taken over at the 1878 Congress of Berlin. Austria and Bulgaria stopped paying tribute to the Ottoman treasury by renouncing the Sultan's suzerainty.[79] Greece did not miss the opportunity to announce the annexation of Crete, evacuated by the European powers, a week earlier. The protests of the Porte to the signatories of the Treaty of Berlin, to remind them of their responsibilities on this violation of the Treaty, fell on deaf ears. The Ottomans again lost land and resources that were financially minimally compensated by the Austrians and Bulgarians. In 1911, Italy declared war and attacked Libya, with hostilities lasting until 1912. In October 1912, the Balkan states, with Russian encouragement, started the Balkan Wars (1912–13). For this reason, the governments of the Second Constitutional Period had to borrow more money. As a result of these wars the Ottomans lost 83 percent of their European territory and 69 percent of its population.[80] Once again, the loss of important sources of revenue reflected negatively on the terms of borrowing, despite the presence of the PDA. From the end of 1908 to 1914, the State issued bonds seven times, totaling about 46 million Ottoman liras of which only 39 million reached the Treasury. The average market value, which was 90 percent of the nominal value during 1882–1908, fell to 85 percent.[81]

The loans, obtained during the period of the PDA, were less frequent than the pre-1881 borrowings, and were put to better use. They were either used to pay off the previous debts or for military infrastructure expenses.[82] However, from 1911, inopportune conditions accelerated the process of borrowing, and in 1914 the State was forced to borrow 22 million Ottoman liras. The First World War, undesirable as it was, most likely prevented a new financial disaster.

The Distribution of Foreign Debt by Country

The initial Ottoman loans took place under the initiative of Britain, and the first four bond issues were denominated in British pounds. Thereafter, with the exception of two loans, all the bonds floated until the establishment of the Ottoman Public Debt Administration were denominated in French francs.[83] In a short time, the French became the most important lenders to the Ottoman State. Starting from the 1870s the Paris capital market grew in leaps and bounds, and was able to compete comfortably with London. Between 1874 and 1914, the official rates of interest never rose above four percent. In fact, throughout most of this period, the rates did not exceed three percent in Paris.[84] These low rates of interest were due to the very high propensity of the French people to save, a source of amazement to foreign observers. In 1871, following France's defeat by Prussia, the French Government issued bonds worth 2,000 million francs in order to pay the war indemnity demanded by Prussia. The demand for these bonds was three-and-a-half times higher than that amount. For the 3,000 million francs loan issue of 1872, the demand was a staggering 43,800 million francs, one-and-a-half times more than France's gross national product at the time.[85]

These fast and consistently growing savings turned into investments. Until the 1890s, the French industrial sector was growing at a slower pace than the industrial sectors of England and Germany and consequently was using less machinery and equipment. The capital needs of industries, consisting of small-scale businesses, were relatively low. The slow growth of population led to lower levels of expenses for infrastructure and urbanization. Thus, there were no significant increases in internal borrowing. Even though the French had a level of income inferior to that of the Americans, they had a greater propensity to save which meant a significant investment potential. Given the low rates of interest in France, the external investment opportunities were tempting. As noted by Feis,

> out of the small black purse of the French bourgeois, the Russian monarchy could draw the substance for its monumental plans, the Austro-Hungarian Empire equip itself with railroads, banks, and factories, the Turkish Sultan spend without accounts, Italy endure the anxieties of the first years of unification, the small Balkan States establish their national existence.[86]

England, together with Holland, was one of the two countries where the financial markets were most developed. In the first half of the nineteenth century, British capital was the most important source of funding for non-European countries. The government loans that financed the Napoleonic Wars turned Britain into a country of creditors. In the first quarter of the nineteenth century, the British depository banking system made great strides. Between 1816 and 1818, the establishment of 250 savings banks turned the people's savings into investments.[87] During this century, increased maritime and railway travel, the large-scale installation of cable wires, the lower postal and daily periodical costs, and the ease with which people could travel, speeded up capital movements. British capital was the most unhindered and fast-moving.[88]

Until the bankruptcy of the Ottoman Treasury in 1875, official British policy was to support the sale of Ottoman bonds. Before all else, Britain directed her investments in accordance with her political requirements. Britain supported the Ottomans in order to hold off Russian expansion. However, the British investors were very cautious. Starting with the first Ottoman loan, words of caution against the Ottoman financial situation appeared in the British press.[89] In 1871 *The Economist* wrote that very few people familiar with the securities market would buy 'Turks' (Ottoman bonds).[90] British investors, who were used to the advice of their official bodies, encountered apathy and neutrality when consulting their government after 1875. However, the British press, with an attitude of 'we told you so', blamed both the Ottoman administration as well as the insurrections and disturbances in the European provinces. *The Economist* wrote:

> The event will not surprise our readers. We have repeatedly said for many years that countries with an unstable and incapable administration were unsafe borrowers, and that the system of borrowing money to pay interest on old debts by which their credit was artificially maintained, was always in danger of collapse. The longer the delay the greater would be the crash in the end. The finances of Turkey, the most conspicuous offender in this line, have also been frequently discussed in our columns, in order to enforce our general lesson... The Herzegovina insurrection and the disturbance in Bosnia are assumed to have precipitated the catastrophe, while the end has also been heralded by the Turkish Government having to pay 18 per cent per annum interest for the last short advance, to meet the October dividends.[91]

The Economist continued to remain pessimistic and skeptical even after the promulgation of the Muharrem Decree, stating that this 'illusory scheme' could not permanently benefit either Turkey or her creditors. It was perceived to be the preparation for, and preliminary towards, further borrowing.[92] Based on the prevalent belief that the financial position of the country could in no way be improved until the Government began to live within its means, *The Economist* erroneously predicted that the Ottomans would not only be unable to repay their debts but would also face a more complete collapse. However, even though the Empire incurred tremendous expenses arising from wars and insurrections, the PDA encountered no difficulties in arranging payments to the bondholders for the three decades to follow.

As Table 2.1 shows, the borrowing from Britain fell both in absolute and relative terms. In fact, as the bonds changed hands daily in the securities markets, it was not possible to establish their values with precision. However, according to a study made by the PDA, and private estimates made by the Germans in 1913, data shows a secular variation of debt.[93]

***Table 2.1* Foreign Debt of the Ottoman Empire**

	1881	*1898*	*1913*	*1881*	*1898*	*1913*
	(Million Ottoman Lira)			*(percentage)*		
				%	%	%
France	36.72	35.00	65.00	40.0	44.9	49.5
Britain	26.62	8.50	9.00	29.0	10.9	6.9
Germany	4.32	9.50	26.30	4.7	12.2	20.1
Belgium	6.61	14.00	14.40	7.2	17.9	11.0
Holland	6.97	3.50	3.90	7.6	4.5	3.0
Italy	2.41	1.00	1.30	2.6	1.3	1.0
Austro-Hun. Emp.	0.89	1.50	1.70	1.0	1.9	1.3
Local Investors	7.28	5.00	9.40	7.9	6.4	7.2
Total	91.82	78.00	131.00	100.0	100.0	100.0

Source: V. Eldem, *Osmanlı İmparatorluğu'nun İktisadi Şartları Hakkında Bir Tetkik*, Türk Tarih Kurumu, Ankara 1991, p. 188, and C. Morawitz, *Les Finances de la Turquie*, Guillaumin et Cie, Paris, 1902, p. 237.

The German investments, as opposed to the French ones, did not depend upon the presence of a class of *rentiers* who sought diversification and high returns. German foreign investments were carried out, under the leadership of the Government, by the banks and industrial organizations to develop trade, and to serve political ends. At the end of the nineteenth century, the Germans increased their investments in neighboring countries, especially to the east. These countries needed capital to develop their resources and for infrastructure investments, while Germany needed their raw materials. The banks not only acted as intermediaries, but were also controlling shareholders and proprietary representatives. Foreign bonds, reaching the German market, were bought by the banks even when the investors did not buy them. With their ever-growing capital and solid knowledge, banks developed various specialties. They became the guides and supporters of German firms investing in foreign countries.[94]

The political and economic events that took place after the Ottoman bankruptcy in 1875 showed that the European powers, with Russia in the forefront, wanted to partition the Ottoman Empire. The attitude exhibited by the Europeans, during and after the Congress of Berlin, greatly eroded Ottoman confidence in Europe. During the 1880s, when Gladstone returned to power in England, he clearly displayed anti-Ottoman attitudes. He seized every opportunity to back the Greeks and the Balkan Slavs and to harass the Turks. The British occupation of Egypt in 1882 led to anti-British sentiments at the Porte. Even the Sultan said that England was the country among the Powers that the Ottomans should not trust.[95] Under these conditions, it was not difficult for Germany to infiltrate the Ottoman political and economic structure. The balance tilted with Germany's role in the destiny of the Ottomans, and the imperial rivalries took another turn and shape.

Under the influence of her Russian ally, France started to scrutinize Ottoman loans after 1899. Since Russia perceived the Baghdad Railway as a threat to her interests in the Near East, the Ottoman bond issues would not be listed in France. By the early 1900s, the French stipulated that countries borrowing from France should use the loan to purchase French goods and equipment. Since the Ottoman loans of 1903 and 1905 were attached to very comprehensive economic stipulations, issues were allowed to be sold in France. However, when the same stipulations resurfaced in 1910, the Young Turk Administration leaned toward Berlin.[96] It should be noted that, with the initiative of Ernest Constans, France's ambassador in Istanbul, the French market was closed to Ottoman bond issues. The ambassador wanted the Ottomans to pay for the losses incurred ten years earlier by the Ereğli (Heraclea) Coal Monopoly, a creation of French capital. The claim was that the losses emanated from the Ottoman regulations. But it was known that the ambassador had a personal financial interest in this coal operation.[97] In the 1910 loan negotiations, Russia even asked France that the Ottomans should agree not to increase their military strength.[98]

All these factors led the Ottoman Administration to turn to Germany. As seen in Table 2.1, the German share in the Ottoman debt grew constantly, surpassing that of Britain before the turn of the century and, in 1913, it tripled that amount. France, however, continued to have the largest share. As for creditors with smaller shares, barring the local creditors, Belgian and Dutch credits were significant. Even though they were not officially represented on the Ottoman Public Debt Administration, the Belgians had the second largest share, with 18 percent, at the end of the nineteenth century, and eventually declining to third place after Germany's rise. The Dutch creditors had greater shares than their Italian and Austrian counterparts. Investors from countries with lower shares bought the Ottoman bonds with the expectation of high returns.

According to Article 15 of the Muharrem Decree, during the first five years starting from the establishment of the Ottoman Public Debt Administration, Britain and France, being the largest creditors, would take turns in heading this administration. However, in case of changes in the number and composition of bonds, the Council of Administration would elect a president on its own. The idea of a presidency taking turns every year was launched in 1892 by the Rome Chamber of Commerce that appointed the Italian delegate.[99] Italy, which had the lowest share among the creditor countries, was very anxious to join the community of Great Powers. By occupying Abyssinia (Ethiopia), it wanted to show that it had joined the rank of colonizing powers. However, when France seized Tunisia in 1881 there was a deeply-felt disappointment in Italy, which had itself coveted that land. In the end, no changes took place in the Council of Administration of the Public Debt. In fact, the loan share of Germany had grown by leaps and bounds. However the Germans perceived the selection of a president merely as a matter of prestige and did not dwell upon the matter.

This chapter has examined the first foreign capital movements, in the form of debt, into the Ottoman Empire. European countries, which were initially hesitant to provide loans, started to compete with each other. There were political and economic reasons behind this development. The political motive was based on the lending country's wish to further her influence, and to attempt to control the Ottoman realm politically and economically. The economic reason was to channel the surplus funds of Europe to countries where the highest possible return could be obtained. The Ottomans were a case in point as a haven for high returns. The Europeans killed two birds with one stone. On the one hand, they were obtaining high returns for their loans, and on the other, they were able to sell their production surpluses in a country that acquired more purchasing power after receiving the loan. One of the most flagrant examples in the 1860s was the European ambassadors' urging Sultan Abdulaziz to buy ships which the State did not have the economic and technical means to use or maintain. Thus, the Ottomans would have borrowed money for useless spending.[100]