Chapter 6. Leveraging Foreign Control: Reform in the Ottoman Empire

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Comparative studies in economic history label international financial control organisations as "fiscal house arrest" and discuss them in the context of other "supersanctions" which helped reduce the cost of borrowing for the defaulting countries and restored access to international financial markets.[1] The Ottoman case is usually referred as one of the most successful cases of supersanctions. Following the default of the Ottoman Empire in 1876 and the subsequent foundation of the Council for the Administration of the Ottoman Public Debt (hereafter the *Council*), the representatives of foreign bondholders were assigned the task of administering and collecting certain tax revenues to compensate for the unpaid interest and capital of the debt and they enabled the Ottoman government to carry on funding mounting military expenditure until World War 1.[2]

Yet opinions differ in the Ottoman historiography on the role of the Council and its contribution to the Ottoman empire's economic and financial development. Traditional views argue that the Council was a symbol and instrument of European imperialism, which led the Empire to economic destruction, whereas revisionist views emphasise the fact that the Council restored the creditworthiness of the Ottoman government, contributed to the modernisation of its fiscal system and acted as a third party that was independent of European powers.[3] Besides

1 Kris J. Mitchener and Marc D. Weidenmier, "Supersanctions and sovereign debt repayment," *Journal of International Money and Finance*, 29, no. 1, (2010): 19–36.

2 The method of establishing foreign control over state finances following defaults was not unique to the Ottoman Empire. Similar international financial control organisations became the dominant form of dealing with defaults in the Middle East and the Balkans from the 1870s to 1914 including Tunisia, Egypt, Serbia, Bulgaria and Greece. For a comparative study of international financial control in the Ottoman Empire, Egypt, Greece and Serbia see Ali Coşkun Tunçer, *Sovereign Debt and International Financial Control: The Middle East and the Balkans, 1870-1913* (Basingstoke: Palgrave Macmillan, 2015). For Bulgaria see Roumen Avramov "Advising, conditionality, culture: money doctors in Bulgaria, 1900- 2000" in *Money Doctors: The Experience of International Financial Advising 1850–2000*, ed. Mark Flandreau, (London: Routledge, 2003), 190-215. Adam Tooze and Martin Ivanov "Disciplining the 'black sheep of the Balkans': financial supervision and sovereignty in Bulgaria, 1902–38", *The Economic History Review*, 64, (2011): 30-51.

3 Some of the seminal works in this literature are Parvus Efendi, *Türkiye'nin Mali Tutsaklığı* (İstanbul: May Yayınları, 1977); Donald C. Blaisdell, *European Financial Control in the Ottoman Empire* (New York: AMS

Ottoman historiography, the role of the Council is also debated in the broader historical literature on pre-1914 international financial control. In line with contemporary studies, these studies outline the major functions and legal-administrative structure of international financial control organisations and analyse them in the context of international law and enforcement of loan contracts.[4]

This chapter aims to elaborate on the political economy dimension of the question by focusing on the relationship between the Ottoman government and the executive organ of the Council from the 1880s to the start of World War 1. To provide historical context and identify some key actors, I first document the process which led to the default of the Ottoman government in 1876 and the emergence and formation of the Council in 1881. I then elaborate on the activities of the Council, its relationship with the Ottoman government, and its fiscal performance. I aim to show that in the short term the Council had a positive impact on the Ottoman state finances as it restored the trust of foreign bondholders and reinstated creditworthiness successfully – more significantly than other instances of international financial control (IFC) in the region. Unlike the previous line of historiography, however, I attribute this success primarily to the fact that the Ottoman government was *willing* and *able* to cooperate with its foreign creditors, and that it complied with the policies of the Council. I maintain that the willingness of the Ottoman government to cooperate with its foreign creditors was mainly driven by the high costs of tax collection as the Ottoman fiscal system relied heavily on direct taxes from the agricultural sector collected by tax farmers. The Ottoman government was also able to cooperate with its foreign creditors, thanks to the absence of political pressure from taxpayers. Thus, it transferred the economically and politically costly tax collection business partly into the hands of foreign creditors in exchange for future creditworthiness. On the negative side, the low cost of borrowing in international financial markets delayed the reforms in Ottoman fiscal institutions and improvements in fiscal capacity, as the government managed to meet its increasing spending with the help of the Council and without entering negotiations

Press, Inc., 1966), Emine Zeynep Kiray, *Foreign Debt and Structural Change in 'The Sick Man of Europe' - The Ottoman Empire – 1850- 1875,* (PhD diss., MIT, 1988). For a more recent contribution see Murat Birdal, *The Political Economy of Ottoman Public Debt Insolvency and European Financial Control in the Late Nineteenth Century*, (London: Tauris Academic Studies, 2010).

[4] François Deville, *Les contrôles financiers internationaux et la souveraineté de l'état* (Paris: Limoges, 1912) ; A. Andreades, *Les Contrôles Financiers Internationaux*, (Athens, 1925) ; Edwin Borchard and William Wynne, *State Insolvency and Foreign Bondholders* (New Haven : Yale University Press, 1951); and Herbert Feis, *Europe, the World's Banker 1870–1914* (New York : Kelley, 1974). See Michael Waibel, *Sovereign Defaults before International Courts and Tribunals* (Cambridge: Cambridge University Press, 2011) as a recent contribution on the subject.

with its taxpayers. These findings are consistent with one of the main threads of this book that the interactions between global and domestic politics of public debt played an important role in the modernisation of political and fiscal institutions in the peripheries of the global economy before 1914.

The rest of the chapter is structured as follows. Section 2 provides a brief overview of the history of sovereign debt of the Ottoman Empire from its beginning to the establishment of the Council. Section 3 is an overview of the Council and its activities, introducing its administrative structure and organisation as well as key turning points in its history. Section 4 presents the evidence on the performance and extent of the control in terms of administering revenues and restoring the creditworthiness in international financial markets. It also puts forward a framework to interpret the interaction between fiscal-political institutions of the Ottoman Empire and the Council. A brief conclusion follows.

State Modernization, International Credit, and the Road to Default

Until the late eighteenth and early nineteenth centuries, the Ottoman empire relied on two traditional sources of revenue like other states: taxation and seigniorage. The idea of borrowing to finance budget deficits emerged for the first time in the late eighteenth century when the government was urgently in need of funds due to the Russo-Turkish War of 1787-92. However, shortly after the start of the Crimean War, in 1854, the Ottoman government signed its first foreign loan agreement. For the next sixty years, this would become the most important means of dealing with budgetary difficulties. In the early stages of this process, the Ottoman government issued loans in London and relied on financial intermediaries such as Dent Palmer and Rothschild. In the following two decades Paris also became a popular destination and the Ottoman government contracted loans with the Imperial Ottoman Bank (IOB)[5], Crédit Mobilier and Comptoir d'Escompte. From 1854 to 1881 the Ottoman government issued 18 loans with a total face value of £219 million sterling and an average effective interest rate of 8.6 per cent.

These loans were secured on a wide range of direct and indirect tax revenues including the Egyptian tribute, customs revenues from Istanbul, Izmir and Syria, tithes of several

[5] This bank, originally named the Ottoman Bank, was founded by British capital in 1856. Following its merger with a French capital group in 1863, it was renamed the Imperial Ottoman Bank (IOB). In addition to acting as the major intermediary between the Ottoman government and the European financial markets, the IOB held the monopoly of issuing gold convertible bank notes across the Ottoman Empire –acting as a central bank of issue. Edhem Eldem, *A History of the Ottoman Bank* (Istanbul: Ottoman Bank Historical Research Centre, 1999).

provinces, revenues from tobacco, salt, silk, fisheries, olive oil, sheep tax and stamp duty. Although most of these pledges were quite valuable, creditors were aware that the securing of future revenues for the payment of a loan did not mean that the Ottoman government would, in fact, use them for this purpose or manage them in a way that was beneficial to the lenders.[6] Financial markets were aware of the unsustainability of the rapid increase in debt, especially after the Franco-Prussian war in 1870, when a new Russo-Turkish war was only seen as a matter of time. Moreover, on the supply side, with the crisis of 1873, surplus capital started to deplete, and it became almost impossible for the Ottoman government to contract a new loan.[7] In October 1875, the Ottoman government first partially suspended the interest payments, and from January-March 1876, the coverage of suspension was extended and the government defaulted on all its outstanding debt, which then stood at around £191 million.[8] This was a "long-predicted catastrophe"[9], but what made it exceptional was the scale of it, as it was the biggest sovereign default to date.[10]

The international financial markets remained closed to the Ottoman Empire until the government reached a reasonable deal with the bondholders. The successful settlement of the debt, however, was not achieved until 1881 due to a series of domestic and international crises. In March 1876, the uprisings in the Balkans started and this was followed by the deposition of the existing Sultan Abdülaziz. In December 1876, Sultan Abdülhamid II acceded to the throne and introduced the first constitution of the Ottoman Empire. This was, however, a short-lived experiment as both the constitution and the parliament were suspended due to the war with Russia, which started in April 1877 and came to an end with the Congress of Berlin in June 1878. It was also during the Berlin Congress that the claims of the bondholders first received official acknowledgement by the Powers, leading to formal negotiations with the Porte.[11] Yet, progress was slow due to the conflicting interests of the creditors and the Ottoman government.

6 Although some of the initial bond issues in 1855 and 1858 stipulated the formation of special commissions composed of foreign delegates to monitor the spending of the funds and collection of pledged revenues, these efforts were eventually ineffective. Şevket Kâmil Akar and Hüseyin Al, *Osmanlı Dış Borçları ve Gözetim Komisyonları, 1854-1856*, (İstanbul: Osmanlı Bankası Arşiv ve Araştırma Merkezi, 2004).

7 Kiray, *Foreign Debt*; Şevket Pamuk, *Foreign Trade, Foreign Capital and the Peripheralization of the Ottoman Empire 1830–1913*, (PhD diss., University of California, Berkeley, 1978).

8 Şevket Pamuk, *A Monetary History of the Ottoman Empire* (Cambridge: Cambridge University Press, 2000), 213-214; Edhem Eldem "Ottoman financial integration with Europe: foreign loans, the Ottoman Bank and the Ottoman public debt", *European Review*, 13, no. 3, (2005): 431–445.

9 "The Turkish Repudiation." *Economist*, 9 October 1875, 1190

10 The other two significant cases were Spain, which defaulted on an outstanding debt of £170 million, and Egypt on around £100 million. Christian Suter, *Debt Cycles in the World Economy: Foreign Loans, Financial Crises and Debt Settlements, 1820–1990*, (Boulder, Colorado: Westview Press, 1992), 67-69.

11 This was mainly because private bondholder organisations such as the London-based Corporation of Foreign Bondholders had little leverage with the Ottoman government in reaching a deal. Moreover, the Porte during these

By the time of the Ottoman default, British and French bondholders jointly held almost 90 per cent of the Ottoman debt; and their representatives were keen to introduce a strong international control over Ottoman finances with their joint representation. The Ottoman government, however, wary of what was going on in Egypt at the time, was determined not to hand too much sovereignty over to its foreign creditors.[12] As the frequent meetings between French and British bondholders were taking place to agree on a solution, a group of domestic bankers based in the Galata district of Istanbul took the first steps to reach a deal with the Porte in November 1879.[13] The Galata bankers had provided vital financial support with short term advances to the Ottoman government during the Russo-Turkish war when the European markets were entirely closed to the Ottoman government. Most of these loans were concluded by using taxes from certain indirect revenues and monopolies as collateral. These revenues formed the basis of the agreement between the Ottoman government and the Galata bankers. The deal gave the Galata bankers the right to administer indirect revenues from stamps, spirits, fisheries and silk, as well as the monopolies of salt and tobacco for ten years.[14] The Porte also reserved the right to denounce the agreement to make it more advantageous to the other bondholders.

From the perspective of the government, the deal was an attempt to reassure its foreign creditors while safeguarding the rights of local bankers and avoiding official European intervention. Through interlocking directories, Galata bankers were represented in important financial institutions such as Crédit Générale Ottoman, Banque de Constantinople and the IOB. At the time, the total debt of the government to the Galata bankers and the IOB was around 8.7 million liras, three-quarters of which was held by the IOB. Other holders of the debt were George Zarifi (600,000 liras), Solomon Fernandez and Alfred Barker (1.8 million liras). [15] The annual payment of this debt, 1.1 million liras, was to be met from the revenues from six indirect taxes. It was also expected that the revenues of the Administration would exceed the interest payments and in that case, they would be used for the claims of foreign bondholders. The management of the Administration consisted of three representatives of the IOB and a group of

years were occupied with a range of domestic and international crises. Joseph Yackley *Bankrupt: Financial Diplomacy in the Late Nineteenth-Century Middle East*, (PhD diss., University of Chicago, 2013), 134 and Blaisdell, *European Financial Control*, 84-85.

12 On debt imperialism in Egypt see Chapter 7 by Malak Labib in this volume.

13 On the importance of domestic interest groups in the context of Latin America, see Chapter 5 by Juan Flores in this volume.

14 The official name of this administration was *Rüsum-ı Sitte*, hereafter the Administration.

15 Haydar Kazgan, "Düyun-i Umumiye" in *Tanzimat'tan Cumhuriyet'e Türkiye Ansiklopedisi*, Volume 4, (İstanbul, İletişim Yayınları, 1985), 701.

Galata bankers.[16] The bankers appointed Robert Hamilton Lang as the director of the Administration. This was a strategic move, as Lang was a well-known and credible name amongst the European bondholders, and he had a success record of reforming Romanian state finances. Despite the attempts of the Ottoman government and the Galata bankers to increase the credibility of the deal, European bondholders were not favourable to this agreement. First, Galata bankers had acted on their own without consulting them, and second, the arrangement was considered unfair to foreign bondholders as it gave seniority to the domestic debt over the foreign debt. While European bondholders started making counterproposals to avert the arrangement, the Administration started its operations and started acting as a modern tax administration for the first time in the history of the empire. Its first year in operation was a great success, which led European bondholders to put even more pressure on the Ottoman government to transfer the Administration to them.[17]

Following a series of exchanges, in October 1880, the Great Powers and the Porte agreed on the provisions of the debt settlement. In January 1881, the bondholders finally chose their representatives and sent them to Istanbul. In the meantime, the Porte turned to Germany that held no more than 8 per cent of the Ottoman debt and hired German advisors to help the government with the negotiations. During the talks, while Britain and France were pushing for a harsher deal, the German bondholders' representative was keener on finding a compromise. Eventually, in December 1881, the *Decree of Muharrem* was signed between bondholder representatives and the government. Thanks to German support, the Ottoman government secured an advantageous deal involving a 50 per cent write-down of its outstanding debt and more than 80 per cent of its interest arrears. Furthermore, the international financial control was shared between the representatives of all European creditor nations, large and small: Britain, France, Germany, the Netherlands, Italy and Austria-Hungary. In the meantime, the previous arrangement with the Galata bankers was denounced and the bankers were to be paid 590,000 liras per annum for the outstanding debt of 8.1 million liras. This payment was granted with seniority from the revenues of the Council. The IOB also bought the debt of the other Galata bankers and became the sole holder of the domestic debt.[18] The settlement of the claims of the

[16] On behalf of the IOB, Morgan H. Foster, Emile Deveaux, Johan von Haas; and on behalf of the Galata bankers, George Zarifi, Solomon Fernandez, Bernard Tubini, Eustace Eugenidis, Theodore Mavrocordato, A. Vlasto, Alfred Barker, Z. Stefanovitch, Leonidas Zarifi, George Coronio, Ulysses Negropontis, and Paul Stefanovitch Schilizzi took seats in the managing council.

[17] Blaisdell, *European Financial Control*, 88; Kazgan, "Düyun-i Umumiye", 701.

[18] Pamuk, *Foreign Trade*; Christopher Clay, *Gold for the Sultan. Western Bankers and Ottoman Finance 1856-1881*, (New York: I. B. Tauris, 2000); Yackley, *Bankrupt*, 125-181.

Galata bankers resulted in limiting the opportunities of this strong domestic financial group at the expense of granting power to European financial groups. Unlike the initial era of borrowing (1854 to 1881), as a result of this arrangement, the domestic bankers now lost their influence on the public debt management of the Ottoman government.

As part of the *Decree of Muharrem*, the Ottoman government agreed that an administrative council (the Ottoman Public Debt Administration) was to be established in Istanbul to represent the bondholders and to act in their interests. The Council consisted of bondholder representatives from each creditor country plus a member of the Ottoman government. The government transferred its right to administer revenues from the monopolies of tobacco and salt, stamp duty, duties on spirits and on fishing and the silk tithe of several provinces, which were shown as a guarantee for the payment of previously contracted loans. The Council held the right to decide upon all modifications and improvements that might be introduced in the taxes of these monopolies and revenue items, and it had the direct administration, collection and encashment of them. The net gains from these revenue sources were to be used for the payment of interest and the sinking fund of the Ottoman debt. Thus, in return for a drastic reduction in the debt stock and interest service, the Ottoman government agreed to consign almost one-fifth of the state's revenues to the administration until the complete settlement of the outstanding debt.

The Council at Work

Starting from 1883, building upon the previous administration of the Galata bankers, the Council established more than twenty offices in various provinces of the Empire extending from Yemen to Salonica. These offices were administered from the central headquarrters in Istanbul. This was an extensive tax collection network employing around 4500-5000 officers (including inspectors, collectors, security guards etc.) a majority of whom were employed in the provinces and represented a bigger network than the Ministry of Finance. This was not the first example of foreign control of finances of a sovereign state in the region and it would not be the last. However, unlike the other cases of international financial control in the region, such as Greece, Serbia, Bulgaria and Egypt, the Council operated without the intermediation of the political representatives of the creditor states involved. Bondholder representatives, having complete autonomy in the way that they managed hypothecated revenues, implemented both short- and long-term solutions to compensate for their losses and to increase the ceded revenues. The lessons derived from the Egyptian experience and the fear of resistance from the local population made the representatives of bondholders choose a gradual method of replacing the existing local staff, introducing new techniques of production and reforming the existing collection system for the ceded revenues. From the perspective of the Ottoman government, dealing directly with the private bondholders was also a more acceptable and legitimate solution to the problem of foreign debt as it enabled a partial separation of fiscal/financial matters from broader diplomatic affairs.[19]

The foremost priority of the Council was to increase the revenues under its control. This could be achieved by introducing improvements in the collection methods of tax revenues and/or creating incentives to increase the production of underlying revenue sources. In the first decade of its operation, the Council established new trade links and reinforced the existing ones for this purpose by using the financial and commercial network of bondholders. This was accompanied by importing new production methods from Europe. The Council assigned some of its members the task of transplanting the existing system of monopoly administration for salt and silk. The Council also acted at a micro level to address revenue specific problems, which included establishing several schools and institutions to train local producers with the objective of increasing the quality and the number of goods. To enter the French wine market, it established a nursery in Istanbul to carry out experiments to combat vine diseases. Although to begin with the government hesitated to join in these efforts, the Ministry of Agriculture later actively co-operated with the Council. Similarly, for silk production, in Bursa, European experts started to offer a consultancy service to the producers. This service was later offered under the School of Sericulture, which was established jointly by the government and the Council in 1889. The Council chose to develop the salt monopoly under its own direction, whereas the tobacco revenue was farmed to the *Régie* Company[20] according to an agreement in May 1883 between the Council and the government. The concessionaires were the Credit Anstald of Vienna, Bleichröder of Berlin and the IOB, which held 74 per cent of the shares. The proposal of this syndicate had the support of the Council, as these three banks were also involved in the Ottoman debt as issuing houses. Moreover, the previous director of the administration of the Galata bankers, R. Hamilton Lang, was made the managing director of the Company. According to the terms of the contract, the Company paid the Council an annual rent of 750,000 liras for a period of thirty years. The Council and the government were also to

[19] Tunçer, *Sovereign Debt*, 53-78.

[20] The full name of the company was *Société de la régie cointéressée des tabacs de l'empire Ottoman*, hereafter the Company.

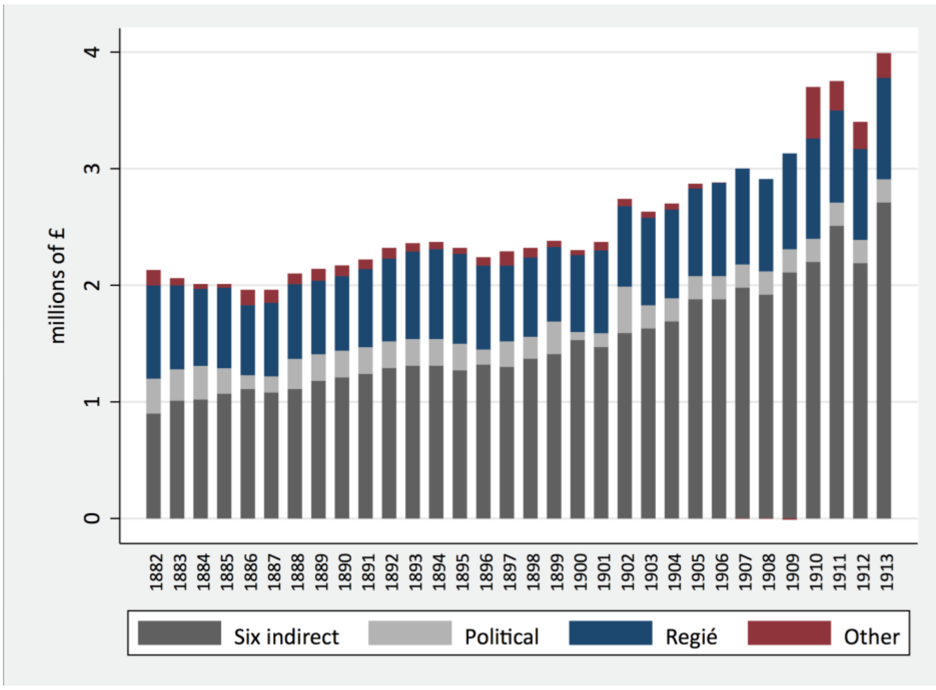
benefit according to a fixed scale in the profits above this sum. Although in theory, the Company had incentives to promote agricultural production and to provide credit to the producers, the unlicensed production of tobacco continued until 1914. As a result, the disputes between the Company and the producers were numerous. In some cases, local power holders were also involved in these disputes. Local governors, as the representatives of the central government, could either side with the producers or not depending on their relationship with the Company.[21] As for the Porte, it adopted a pragmatic approach to avoid widespread social unrest and at the same time direct confrontation with the Company. To fight against "armed banditry" and smuggling, the Council put pressure on the government to organise "corps de surveillance" with the proper powers to use arms when necessary. These efforts were endorsed by the government and the volume of smuggling and trade in contraband declined over time.[22]

As detailed further below, the activities of the Council reshuffled the existing coalitions among producers, merchants, local governors, tax farmers and the Porte. The new alliance created a change in domestic balance of power and gave way to the cooperation of the Porte and the Council at the expense of local powerholders. Thanks to this political cooperation, the Council worked efficiently in its management of the resources for which it was responsible (see Figure 1). Both the revenues from indirect contributions (silk, salt, spirits, stamps and fisheries), and from the *Régie* increased significantly.

21 Filiz Dığıroğlu, *Memalik-i Osmaniye Duhanları Müşterekü'l-Menfaa Reji Şirketi* (İstanbul: Osmanlı Bankası Arşiv ve Araştırma Merkezi, 2007), 87-90.

22 *Council of Ottoman Public Debt Administration*, Annual Reports (London, 1882), 21-22; Donald Quataert, *Social Disintegration and Popular Resistance in the Ottoman Empire, 1881-1908: Reactions to European Economic Penetration*, (New York: New York University Press, 1983). Tunçer, *Sovereign Debt*, 53-78.

Figure 6.1. Revenues Controlled by the Council: 1882-1913



Source and notes: Tunçer, *Sovereign Debt*. Six indirect revenues were from silk, salt, spirits, stamps and fisheries. Political revenues refer the annual taxes from the tributary states (Egypt and Cyprus) of the Ottoman Empire.

The mutually beneficial relationship between the Council and the Ottoman government led to the extension of the rights of the Council in September 1888 upon the request of the Ottoman government. This new arrangement transferred the management of revenues assigned to railway bonds and kilometric guarantees to the Council. These revenues were mainly tithes from the provinces through which the railways ran. Additionally, the Council was asked to collect the surtax of one-and-a-half per cent on the silk and tobacco tithes on behalf of the government. The Council, after collecting and deducting the collection expenses, was then to transfer the entire net revenue to the government. Therefore, the expenses of administration and collection of these revenues were borne by the revenues themselves and did not fall upon the revenues ceded to the bondholders. Given the close link between the railway companies and the Council, this arrangement was in line with the Ottoman government's desire to extend its railway network. Moreover, it reflected the fact that, in the eyes of the Ottoman government, creditors had been shown to be more successful in collecting and administering the revenues. For the creditors, the extension of transfer of fiscal sovereignty was a sign of trust between them and the government, which in return secured the position of the Council in the overall fiscal system of the Empire.[23] As the extension of the Council's duties proved to be successful, similar agreements were concluded in the following years. In 1890 the collection of valonia and opium tithes was handed over to the Council. In 1898 a new one-half per cent surtax was introduced by the government on all tithes assigned as pledges for kilometric guarantees and for the service on the 1890 and 1896 loans. The collection of this surtax was likewise entrusted to the Council.[24] Overall, the ceded revenues, i.e. revenues transferred to the bondholders to compensate for the unpaid interest and capital of the debt in default, were on average 15 per cent of the total revenues of the state. However, counting the revenues administered on behalf of the government, the extent of the Council's power over state finances reached almost one-third of overall revenues of the Ottoman government.[25]

As the confidence of the bondholders increased, first in 1903 and then in 1907, the Ottoman government and the Council agreed to modifications on the 1881 deal with supplementary decrees. In September 1903, a new debt consolidation and further reduction in the outstanding debt and the interest rate was concluded. The nominal value of the new issue was around 32 million liras. The rate of interest was 4 per cent, the rate of redemption was 0.45 per cent per annum. Anything over the fixed sum of 2 million liras, which represented the charges on the new issue, was to be divided between the government and the Council in the ratio of 75 and 25 per cent respectively. In other words, the government could now participate in the distribution of profits from the ceded revenues. Another significant change concerned the increase in customs surtax. Negotiations between the government and the European powers to raise import tariffs from 8 to 11 per cent were started as early as the 1880s but they were finally concluded in 1907. This three per cent increase in the customs surtax contributed positively to the Council's revenues but the government also profited from the balance over the fixed charges. In both 1903 and 1907, the management of several other public bond issues of the Ottoman government was also transferred to the Council as a third party, further reinforcing its role in the Ottoman state finances.[26]

Right after the agreement on the customs surtax, in 1908 the Young Turk revolution took place. The new government revised the text of the 1876 constitution and reinstated it. From this year onwards, the representative assembly had the power to pass legislation over the

[23] Blaisdell, *European Financial Control*, 128-130.
[24] Blaisdell, *European Financial Control*, 150.
[25] Tunçer, *Sovereign Debt*, 75.
[26] Vedat Eldem, *Osmanlı İmparatorluğu'nun İktisadi Şartları Hakkında Bir Tetkik*, (Türkiye İş Bankası Kültür Yayınları: Istanbul, 1970), 263; Blaisdell, *European Financial Control*, 93-118.

Sultan's authority, and the dominant political force was the nationalist Committee of Union and Progress, which eventually led the Empire to the World War I. In line with the progressive principles voiced by the leaders of the Young Turk movement, the new regime supported free trade and foreign direct investment until 1912 when protectionism was adopted as the main economic policy. Moreover, in ensuring fiscal discipline and reorganising the administration, the government applied to foreign experts and expertise of the *Council* for assistance. British, French and German experts were appointed as inspector-generals, customs advisors, judicial consultants and military trainers to the different departments of the Ottoman government.[27] In a similar vein, the new government continued to cooperate with the Council. As far as the Council was concerned, the change from autocracy to constitutional government had few drawbacks, as long as their policies were aligned.[28] In the post-1908 period, one of the most notable changes was the increase in the number of issues of railway bonds with greater involvement of German intermediary banks.[29] This shift had already been underway since 1881 in parallel to diplomatic changes. In 1881, following the decree of Muharram, the percentage of Ottoman bonds held by German bondholders increased from 4.7 per cent to 12.2 in 1898, and to 20.1 in 1913. During the same period, France had a share of 40-49 per cent. The significant decline was in the share of British bondholders, which fell from 29 per cent in 1881 to 6.9 per cent in 1913. Other bondholders consisted of Belgium, Austria, Holland and Italy; each had a share of 4-6 per cent in 1881 which had not changed significantly by the end of the period.[30]

Control or Cooperation?

The mutually beneficial relationship between the Council and the Ottoman government can also be observed by looking into the changes in the cost of borrowing following the default. Using monthly prices of the Ottoman government bonds in the London Stock Exchange and

[27] Mika Suonpää, "Foreign Advisers and Modernisation before the First World War: British Diplomacy, Sir Richard Crawford, and the Reform of the Ottoman Empire's Customs Service, 1906–11", *The International History Review*, 37:2, (2015): 386-404. Zafer Toprak, *Türkiyede Milli İktisat, 1908-1918* (İstanbul: Doğan Kitap, 2012)

[28] *Council of Ottoman Public Debt Administration,* Annual Reports (London, 1909); Feroz Ahmad "Vanguard of a Nascent Bourgeoisie: The Social and Economic Policy of the Young Turks, 1908-1918" in *From Empire to Republic: Essays on the Late Ottoman Empire and Modern Turkey*, Vol.1, ed. Feroz Ahmad, (Istanbul: Istanbul Bilgi University Press, 2008), 23-61.

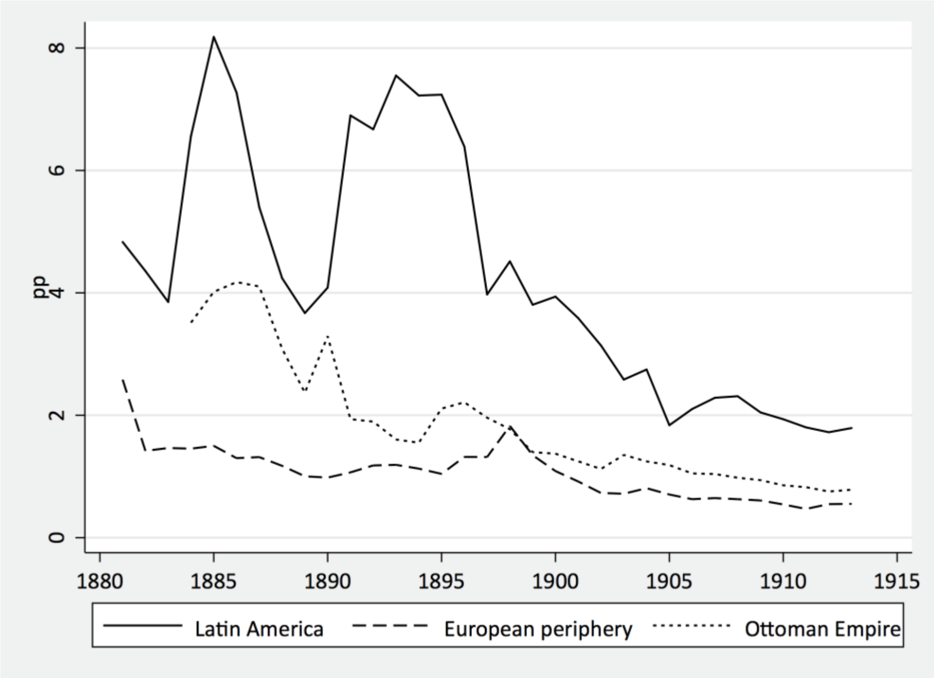
[29] On the links between foreign debt and diplomacy see Chapter 2 by Patrik Winton in this volume.

[30] Eldem, *Osmanlı İmparatorluğ*u'nun, 256; Pamuk, *Foreign* Trade, 105-112.

comparing them with other peripheries of the time suggests that the Ottoman Empire made a significant recovery following the foundation of the Council and the debt settlement in 1881. Moreover, the steady decline in bond spreads continued and the Ottoman Empire benefited from low borrowing costs in the longer term, performing significantly better than the Latin American periphery and closely trailing the European periphery (see Figure 2).[31] The improvement was not only on the "price" of bonds issued under the control of the Council. The Ottoman government managed to contract a significant number of loans under the control of the Council and did not have any problem in securing new loans until 1914. From 1882 to 1914, the government contracted 23 loans with a face value of £90 million and an average effective interest rate of 4.7. Compared to the period before 1882, the initial cost borrowing declined almost 40 per cent, and the debt per capita went down from £8.9 to £6.2. This success was partly due to the revenues assigned as security. In this regard, an important difference was the fact that the Council acted as a trustee by using the surplus funds under its control or acquiring the control of further future revenues to secure each issue. Finally, during this period, the Ottoman Empire managed to benefit from two debt conversions in 1903 and in 1906 with the intermediation of the Council.

[31] Elsewhere, I statistically analyse bond spreads by implementing a structural break test and compare the results with other countries which experienced similar forms of international financial control. The findings point out the significance of international financial control in restoring creditworthiness. See Tunçer, *Sovereign Debt*, 123-151.

Figure 6.2. Bond Spreads: 1880-1913



Source and notes: Latin America represents the average of Brazil, Chile, Colombia, Uruguay and Mexico. European periphery is the average of Greece, Hungary, Portugal and Spain. Calculated from Tunçer, *Sovereign Debt*, P. Mauro, Nathan Sussman and Yishay Yafef, *Emerging Markets and Financial Globalization: Sovereign Bond Spreads in 1870-1913 and Today* (New York : Oxford University Press, 2006) and Niall Ferguson and Moritz Schularick. « The Empire Effect: The Determinants of Country Risk in the First Age of Globalization, 1880-1913. » *The Journal of Economic History* 66, no. 2 (2006), 283-312.

How do we account for this striking international performance despite the bad fiscal record and default history of the Ottoman Empire? A possible explanation for this recovery is the degree of control exercised by the bondholder representatives over the Ottoman state finances. As summarised above, the Council established an extensive network in the Ottoman Empire and worked in harmony with the Ottoman government, which was willing to extend its privileges. In this regard, the Council even made explicit and direct invitations to the bondholders to reward such cooperative behaviour. In 1891, two years after the agreement between the Ottoman government and creditors regarding the extension of the Council's rights on state finances, the director and the British representative of the Council made the following remarks in his annual report to the bondholders:

"I venture here to suggest that it is surely time that English capitalists should forget old sores, and begin to turn their eyes once more to a country so interesting as Turkey, so full of possibilities and lying so close to their doors... It is true that years ago Turkey was overtaken by bankruptcy and in this she did not lead the way. Where she did lead the way, was in honestly recognising her sins and making an arrangement as good as possible and as secure as possible for the creditors whom she had previously wronged. Since that time she has shown complete good faith and has set an example which more than one other country would do well to follow. She surely then is once more to be trusted and believed. Frenchmen think so, Germans think so and they have proved it. Why should Englishman be behindhand in the appreciation of honest action and slow to assist in promoting the prosperity of a well-deserving and naturally favoured country?"[32]

The significant decline in bond spreads suggests that the Council's call for "English capitalists" to invest in Ottoman bonds found a response. Despite the fact that the Ottoman Empire had failed to pay its debts just 20 years before the above remarks, the bond spreads remained at quite low levels with lower volatility. It should be underlined that from the second half of the nineteenth century to World War 1, the Ottoman Empire was in political crisis, characterised by territorial losses, and costly military campaigns against its minority groups and neighbouring countries. It was an export-oriented agrarian economy with a continuous budget deficit and a "chaotic" monetary system. The figures, however, suggest that for the creditors investing in Ottoman loans, these factors were of secondary importance.

These findings together with the preceding discussion to some extent challenge the conventional perception of the Council in the literature as a "sanction" imposed on the government. There were clearly times when the Ottoman government cooperated with the Council in its reform efforts and willingly expanded the extent of its control, as there were also times when the Council was not willing to be deeply involved in the country's financial matters. One way to interpret this relationship is to consider the political and fiscal conditions under which the Council operated. For most of the nineteenth century, the Ottoman Empire remained an authoritarian monarchy despite several reforms aimed at modernising the state apparatus. An Ottoman parliament and the constitution for the first time emerged in 1876, which aimed at introducing accountability over fiscal matters and regularising the authority of the Sultan. However, in practice the only group it empowered was the existing Ottoman political elite and moreover it was suspended a few months later by the Sultan because of the war with Russia. A representative assembly was not successfully established again until after the Young Turk Revolution of 1908.[33] As for the tax revenues, they mostly relied on the traditional tithe collected almost exclusively with the help of tax farmers. In order to finance the costly reforms

32 *Council of Ottoman Public Debt Administration*, Annual Reports (London, 1893), 88.
33 Nathan J. Brown *Constitutions in a Nonconstitutionalist World.* (Albany: State University of New York Press, 2002), 23-26; Kemal Karpat, "The Transformation of the Ottoman State, 1789–1908", *International Journal of Middle East Studies*, 3, (1972), 243–281.

and shift the tax burden from the countryside to the urban centres, the government repeatedly but ultimately unsuccessfully attempted to replace tax farming with salaried tax collectors. While customs duties had the potential to be a significant revenue source, due to the capitulations and bilateral trade treaties, the Ottoman government was not able to modify the rates unilaterally. Finally, the personal tax, a symbol of transition to the modern tax state, was only introduced in 1903.[34] Overall, most of the revenues of the Ottoman government were based on direct taxes levied mainly upon the land, despite an increase in the share of indirect taxes throughout the period. Moreover, the Ottoman Empire struggled to introduce a centralised tax collection system and had to share most of the tax revenues with other intermediaries such as local notables and tax farmers. Given its lack of monopoly over taxation, the Ottoman government was willing to cooperate with foreign creditors in transferring revenues. It is, however, important to note that the Council in the Ottoman Empire represented an unusual case of taxation *without* representation and negotiation with taxpayers, and with a "foreign" and semi-autonomous character. Unlike many European countries during the same period, representation and negotiation with local elites played a very minor role in the evolution of fiscal institutions in the Ottoman Empire.[35] The ability of the Ottoman government to borrow was determined exogenously with no links to its monetary system and fiscal regime, and the Council acted as a mechanism of a "good housekeeping seal of approval" and credible commitment mechanism in the eyes of foreign creditors. This greater access to the international financial markets meant a loss of incentive to tax.

Thus, the Council was an effective tool in improving the creditworthiness of the Ottoman government. It achieved this by regularly transferring the surplus from assigned revenues to the bondholders in order to compensate for their losses, and by the close collaboration of the Ottoman government with the Council. In political terms, the existing system of tax farming supported by the provincial powers was challenged by the Council's tax collection efforts. The interference of the Council in fiscal affairs disturbed the old alliances in the Ottoman fiscal system. The Ottoman government had historically struggled to introduce a centralised tax collection system and had to share most of the tax revenues with local

[34] Kıvanç Karaman and Şevket Pamuk "Ottoman State Finances in European Perspective, 1500–1914", *Journal of Economic History*, 70, no. 3, (2010), 598; Nadir Özbek "Osmanlı İmparatorluğu'nda Gelir Vergisi: 1903–1907 Tarihli Vergi-i Şahsi Uygulaması", *Tarih ve Toplum Yeni Yaklaşımlar*, no. 10, (2010), 43–80; Stanford J. Shaw "The Nineteenth-Century Ottoman Tax Reforms and Revenue System 1517–1798", *International Journal of Middle East Studies*, 6, no. 4, (1975): 421-459

[35] On the links between legitimacy of the political regime and the nature of public debt see the contributions in Part 1 of this volume.

powerholders. At the time the Ottoman Empire defaulted on its foreign debt, it had a limited ability to levy taxes. Given its lack of monopoly over taxation, the Ottoman government was willing to cooperate with the foreign creditors in transferring revenues at the expense of local powerholders. In this context, the cooperation with the Council and the accompanying low costs of borrowing delayed the process of fiscal consolidation even further, as the Ottoman government could now borrow without going through the costly route of negotiation with local elites and producers.

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The Ottoman Empire joined the international financial markets during the Crimean war in 1854 as part of the Great Power rivalry of the time. From this year onwards, both financial and political factors determined the ability of the Ottoman government to borrow publicly in European financial centres. The availability of surplus capital in London, Paris and Berlin and the official encouragement of the respective European governments combined with the continuous budget deficits of the Ottoman government resulted in one of the biggest debtors and defaults of the time. In the process of debt settlement, the rivalry among the Great Powers, and domestic and foreign bondholder groups helped the Ottoman government to reach a relatively favourable deal in 1881. The Ottoman government managed to secure a considerable reduction in its outstanding debt and interest payments, but in return agreed to the foundation of the Council of the Ottoman Public Debt Administration, a foreign-led control over its state finances. The establishment of international financial control over state finances meant a partial loss of fiscal sovereignty in the Ottoman case.

This essay has highlighted the multi-dimensional character of this pre-1914 sovereign debt enforcement mechanism implemented by foreign bondholders. The extent and the success of foreign control were driven by the interaction between global politics and domestic political/fiscal institutions. The enforcement of creditors was effective in improving the creditworthiness of the Ottoman government, primarily because the Ottoman government was willing and able to cooperate with its foreign creditors. The lack of fiscal centralisation in the Ottoman Empire created an incentive for the central authority to cooperate with its foreign bondholders instead of leaving the control of taxable revenues to the tax farmers and/or local elites. This cooperation helped to contain local powerholders and provide access to cheap foreign capital at the same time. Although the Ottoman Empire was able to borrow during this period on a long-term basis at a very low cost, the speed of transformation of political institutions and fiscal centralisation remained slow compared to the other debtors of the region. Reinforced credithwothiness combined with the lack of well-developed political institutions slowed down the fiscal centralisation even further, as the government was more willing to choose the less costly path of borrowing. These findings point out that the local political conditions of debtor countries, especially the balance of domestic power and the interaction among interest groups, may act as a constraint over the economic impact of public debt and shape its management.