FOREIGN DEBT AND STRUCTURAL CHANGE IN THE 'SICK MAN OF EUROPE'

The Ottoman Empire, 1850-1875

by

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SUBMITTED TO THE DEPARTMENT OF ECONOMICS
IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE DEGREE OF

DOCTOR OF PHILOSOPHY

at the
MASSACHUSETTS INSTITUTE OF TECHNOLOGY
February 1988

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Submitted to the Department of Economics on September 24, 1987 in partial fulfillment of the requirements for the degree of Doctor of Philosophy in Economics.

ABSTRACT

This study looks at the impact of the external public debt of the Ottoman Empire as a stage in the economic development of Turkey. The focus is on the structural changes that led to, accompanied, and resulted from external borrowing. The central argument is that within the boundaries of the broader global economic context which stimulated exports of primary goods and imports of manufactures, external public debt produced a socio-economic structure that could not sustain domestic investment and accumulation. It was a structure that led to further debt, default, and underdevelopment.

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ACKNOWLEDGEMENTS

I would first like to express my thanks and deep appreciation to my principal advisors: Lance Taylor and Tosun Aricanli. My intellectual debt to Lance Taylor, especially with regard to the horizons he has opened for me within the field of economics, goes far beyond the limits of this thesis. As a thesis adviser, Lance was a symbol of stability, never wavering in his encouragement and not allowing me to take myself either too seriously or too lightly. Much of my intellectual debt for the thesis is to Tosun Aricanli. He discussed each idea with me as the thesis evolved, not only minimizing the isolation that comes with such a project, but also making it an exciting undertaking.

Peter Temin was the third reader. I would like to express special thanks to him for reading the manuscript so closely. His comments and his cheerful insistence have helped sharpen the central argument considerably.

A large number of people read parts of the manuscript and participated in seminars with valuable comments. I would especially like to thank Evsey Domar, Richard Eckous, Michael Plore, and Steve Marglin. Thanks are also due to colleagues who were, at one time or another, forcibly interested in the Ottoman Empire: Robert Barsky, Susan Collins, Linda Kole, Kathy Simonds, Jeff Rosensweig, and Howard Wial.

Three very special friends provided overreaching intellectual and emotional sustenance throughout this period: Francoise Carre, Stephen Herzenberg, and Nurhan Isvan. My heartfelt thanks to them for their enthusiasm, commiseration, and support.

It is not often that one's parents are also one's principal mentors. Their intellectual stimulation and feedback were as invaluable to me as their unwavering encouragement and confidence during this project. In life, as in intellectual development, my debt is above all to them.
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I. INTRODUCTION

The external public debt of the Ottoman Empire, contracted in the period between 1854 and 1914, has a tumultuous history. The first two foreign loan agreements were signed during the Crimean War, in 1854 and 1855. Between 1854 and 1875, the period I will be focusing on, there were a total of 15 issues at an average issue rate of 59 (41% below par) and effective interest rate of about 10%.¹ The proceeds were mostly used to finance budget deficits, convert internal liabilities into external liabilities, and pay back old loans.

By 1875 the Empire had borrowed L220 million (British pounds) and received only L116 million. The burden of the debt had increased rapidly. In the early 1860's the annual finance charges were 10% of total government expenditures; in the late 1860's this figure was 33% and in 1874, 57%. In terms of exports, the figures were 15%, 40%, and 66%, respectively.

In 1875 the government refused to make further payments on the external debt and defaulted. After prolonged negotiations, in 1881, an agreement was signed with the
representatives of the bondholders (England, France, Germany, Italy, Austria-Hungary, and Holland) which officially established the Public Debt Administration (PDA). The executive council of the PDA was composed of representatives of each of the nationalities and a representative each from the Franco-British Imperial Ottoman Bank and the local Galata bankers. The administration and collection of approximately 20% of the Empire’s revenues was turned over to the PDA exclusively for servicing the debt. In return the debt was reduced to approximately the issue value and the interest to 1-1.25%.

Between 1886 and 1914 26 more loan agreements were made, totalling some L93 million in nominal, L77 million in issue value, with an effective average interest of 5.5%. All but four of these loans were administered by the PDA. The proceeds were used mostly for consolidation, conversion, and repayment of old loans and financing railroads.

The PDA was formally abolished in 1928. The final payment on the Ottoman debt of the 1854-1914 period was made by the Republic of Turkey in 1954 --exactly a century after the beginning of the process. (Owen, pp.100-5, Pamuk, 1984, pp.52-78, Suvla)
In the following chapters I will analyze the external public debt of the Ottoman Empire within the context of broader historical forces and as a stage in the economic development of Turkey. I will focus on the social and economic structural changes that led to, accompanied, and resulted from external borrowing.

The most important economic historical process of the 18th and 19th Centuries was the incorporation of parts of the world into a Western European centered capitalist world economic system. This world system originated during what Fernand Braudel has called the "long" sixteenth century, from 1450 to 1640, and proceeded to expand, incorporating surrounding lands. North and South America, and Eastern and Southern Europe were among the first regions to be affected. It was, however, during the 19th Century, after the industrial revolution and the development of steam ships, that the rest of the world truly became a part of the system.

On a purely economic level incorporation implies production for world markets. In the 19th Century, for the non-European world, incorporation entailed transformation of productive and political structures to accommodate production and export of primary goods (raw materials and foodstuffs) to industrial Europe and the development of markets for European manufactures. It was a process that transformed the existing,
self contained societies into ones whose fate would largely be dependent on the world economy. The catalyst of change was European capital -- merchant capital, financial capital, and industrial capital, combined in some instances with European labor.

Although there were not infinitely many variations of modes of incorporation into the world economic system, experiences of different regions of the world did differ radically (North vs. South America, for example). These differences critically depended on the existing social structures and the specific ways they interacted with the forces of the world economy.

The case of the Ottoman Empire is particularly interesting because what existed before the process of incorporation was a highly developed, sophisticated world empire⁶. The economy was bureaucratically controlled and strictly regulated. The economic surplus of the Empire was primarily agricultural⁷. It was produced by more-or-less self sufficient subsistence farming peasants who held use rights to land that formally belonged to the state. It was appropriated through taxation by a hierarchy of lord-bureaucrats⁸ and a significant portion, 50-60%, of total tax revenues flowed to the central bureaucracy in Istanbul. The economy and the flow of goods were regulated politically through guilds, mercantile
licenses, fixed prices, etc., rather than through a market mechanism.

Changes that fundamentally affected the course of events in the 19th Century actually began in the late 16th and early 17th Centuries. Whereas earlier the Ottoman Empire had facilitated the trade in luxury goods between the East and Europe, it not only lost this role with the rerouting of trade flows around Africa, but also began to trade staples. The increased European demand for foodstuffs (mostly grain) and raw materials (cotton, wool, raw silk, dyestuffs, later minerals, etc.) as well as the increased supply of cheap European manufactures combined with other internal and international events to produce a tremendous pressure on the socio-economic organization of the Empire. Trade with Europe, dominated increasingly by European merchant capital, began to destroy the local handicrafts and stimulate the export of primary goods. With the entry of the logic of the market, the strictly regulated Ottoman economy plunged into a systemic crisis. The outcome, by the end of the 18th Century, was loss of central authority and, along with it, tax revenues.

For the central bureaucracy the 19th Century was an era of reform and adaptation to the new world economic environment. The reforms reflected an effort to control the direction of change, recentralize the control of the economic
surplus, and establish a new political and economic machinery that would enable the Empire to deal with Europe on a more equal footing. The question was how to undertake these centralizing reforms without sufficient tax income. The answer, supplied partly by Europeans, was to borrow in the newly developed European financial markets. Thus, European financial capital followed European merchant capital into the Empire.

External borrowing stimulated the process of incorporation. First, it was accompanied by an increase in imports, mostly consumer rather than capital goods, accelerating the decline in the import competing sectors. Secondly, it put pressure on the economy to increase exports in order to repay the loans, accelerating the process of specialization in exportable primary goods. And finally, the central bureaucracy used the funds to initiate "Westernizing" reforms, changing the political institutional structure to accommodate and control the process of incorporation.

Overall, however, the necessary changes in terms of increasing the level of output, centralizing tax revenues in order to run a budget surplus, or increasing net exports to repay the loans did not take place fast enough to warrant the high interest rates at which the Empire was borrowing. The result was default and the establishment of the Public Debt
Administration. As a European controlled, semi-official agency, the PDA would inspire confidence and provide the personal and institutional channels through which European industrial capital followed mercantile and financial capital into the Empire. Foreign direct investment, which was primarily in infrastructure, in turn would expand the process of incorporation, facilitating the export of primary goods and imports of manufactures.

Partly because of intense international rivalry between the European powers and partly because of the reforms that the central bureaucracy undertook with external borrowing, the Ottoman Empire was not colonized, nor did it become a monoculture economy. Although the fact that foreigners did not enter direct production implied a relatively gradual change in the relations of production and in technological transformation, contributing to the default of 1875, it also implied that by the beginning of the 20th Century the Empire had more autonomy than, for example, Latin America vis-a-vis Europe and the world economy. Nevertheless, by the beginning of the 20th Century the economy was fundamentally different and ready to function within the world economic system.

The preceding story is the broader framework for the following chapters. Chapter II gives background information on the Empire's lenders, the extent of borrowing, and the flow of
funds. The section on the Fiscal Crisis of the State (Chapters III and IV) looks at the reasons the state started to borrow from Europe. Chapter III sets up a stylized description of the classical organization of the Empire and discusses the tensions and adaptations the system went through during the 17th and 18th Centuries. Chapter IV extends the analysis into the 19th Century looking at the socio-economic trends resulting from growing trade with Europe and the early reform attempts of the state to control and direct that process of change which culminated in foreign borrowing.

With respect to the literature on Ottoman history, these chapters are an attempt to recast and unify the fragmented information and analyses regarding trade with Europe, emergence of local notables, loss of central authority and tax revenues, the 19th Century reforms, and external borrowing which have usually been treated as disjointed historical events.

In terms of the economic literature, it is an attempt to broaden the analysis of debt processes. The economic literature usually acknowledges three general reasons for foreign borrowing. One reason is to increase future income by using the funds and the accompanying trade deficit to enhance investment. The basic idea is that as long as the country does not overborrow by contracting loans with higher interest
cost than the return on additional investment they are used to undertake, the country will be better off and in a position to repay the debt without strain. The second reason a country may borrow is in order to accelerate the path of absorption, increasing current consumption at the expense of future consumption'. If the country expects strong future growth, due for example to discovery of new natural resources, then it is likely to be in a better position to repay than if it doesn't. A third reason a country might borrow is to smooth the path of absorption in the face of fluctuating income. This would be economically rational to the extent that the decrease in income is indeed temporary.

In terms of these categories, the analysis of Chapters III and IV suggest that the Ottoman Empire borrowed in order to increase current consumption, without necessarily expecting any increase in the rate of future growth. Even though such categorization helps illuminate one aspect of the debt process, it also obfuscates an essential part of it. This section on the Fiscal Crisis of the State essentially argues that the Ottoman state borrowed in order to finance a class conflict between it and the emerging local notables. The local notables had gained economic and political strength through increased trade with Europe and had began to control an increasing portion of the economic surplus that used to sustain the state apparatus. The state borrowed in order to
restore its share of the economic surplus, at the expense of the local notables. It borrowed with the expectation that its revenues would increase and that it would be able to repay. The consequent repayment problems did reflect the fact that the loans were consumption loans, but also reflected a particular outcome of class conflict.

Following this analysis which covers some 250 years, the section on Conditionality in the 19th Century (Chapters V and VI) focuses on the period between 1860 and 1870. The centerpiece is "The Report on the Financial Condition of Turkey" which was prepared by two members of the British Board of Trade, Lord Hobart and Mr. Foster, and submitted to the British Houses of Parliament in 1862. The Report was the result of a formal British mission to the Empire and recommended extensive reforms with respect to both long term growth and short term stability. The favorable impact of this Report and the subsequent reforms led to an acceleration of foreign lending and thus the mission served a function analogous to the "green light" function of the IMF. Chapter V analyses the Report within the context of classical economic theory to understand why the mission recommended the reforms that it did. Chapter VI discusses the reforms that the Ottoman state did and did not undertake and analyzes both the short term financial and the long term structural results of the mission.
The literature on the 19th Century Ottoman-European relations, especially with respect to the external public debt of the Empire, tends to be sharply divided. Some authors portray the European merchants, banking syndicates, and other entrepreneurs as manipulative and greedy profit mongers, with European governments as their international agents and the Ottomans as their helpless victims. (See, for example, Yerasimos). Some portray the Ottoman state as greedy, corrupt and manipulative and the Europeans as trying to do what was best for the country. (See, for example, Hershlag) Others support both negative views. (See, for example, Blaisdell or Jenks) This section on Conditionality in the 19th Century focuses on economics and attempts to understand both the rationale of official Europe as represented by the Report of Lord Hobart and Mr. Foster and the rationale of the Ottoman state as represented by the reforms that it undertook. At the same time it is an attempt to see how classical economic theory interacted with politics and the existing socio-economic structures to give a new direction to the ongoing process of change.

In terms of economic literature, the mission of Lord Hobart and Mr. Foster was, of course, the 19th Century analogue of both IMF and World Bank missions. In the 20th Century the IMF conditions for countries with balance of
payments problems, as a rule, are fiscal contraction, devaluation, and monetary contraction. The World Bank, in its capacity to give project and structural adjustment loans, usually chooses to promote development through allowing the markets' allocative mechanism to work (get the prices right, liberalize trade and financial markets, promote factor movements, etc.), budgetary reform, and a reorganization of government investment priorities. Both institutions have a strong bias towards market solutions to development problems. This section on Conditionality in the 19th Century illustrates that the stability and growth package of classical economic theory was not fundamentally different from that of neoclassical theory today. It also illustrates that the optimism of the mission, especially with respect to increased investment and growth, was ill founded. The classical policy recommendations produced unexpected results when introduced into the context of 19th Century Ottoman-European relations, creating a disarticulated economic structure that could not sustain investment or growth.

The section on Structural Change, Debt, and Default (Chapters VII and VIII) draws on all the previous sections to analyze the economic structures that emerged as part of the debt process, leading to further debt and, eventually, to default. Chapter VII analyzes the economic reasons for default and discusses its aftermath. It illustrates why under the
specific adaptations of the classical organization of the Empire to increasing trade with Europe and the subsequent official European pressures and Ottoman reactions it was improbable that the Empire could run the requisite trade and budget surpluses to repay the debt. As opposed to some authors who seem to argue that the economy outside of the government sector was active and dynamic and that the financial difficulties the state faced were the reflection of a liquidity crisis (see, for example, Pamuk, 1984, and Keyder, 1980), this chapter argues that default was fundamentally due to a solvency crisis. Not only was the state unable to collect tax revenues properly, but the economic structures and the class relations that emerged created a system that could not sustain investment or growth.

Chapter VIII gives a broad and highly stylized summary of the general argument, illustrating how the economic structures that emerged as part of the debt process led to further debt, default, and underdevelopment. Essentially the Empire exported its economic surplus in return for military goods and luxury manufactures. None of the economic actors had an effective incentive to accumulate and increase productive capacity. This slowed down the pace of domestic change and led to a sluggish, underdeveloped economy.
The concluding chapter evaluates the external public debt of the Ottoman Empire as a stage in the process of incorporation into the world economic system and suggests some avenues of research to arrive at a better understanding of debt processes both in the 19th Century and in the 20th.

Availability of data presents an important constraint in this endeavor, and most important is the lack of data on national income accounts. The figures presented in Suvla (1966), Tezel (1972) and Pamuk (1984) give a comprehensive picture of the external debt process. I rely heavily on the balance of payments figures that Pamuk (1984) has estimated by comparing European and Ottoman archival sources and the data available from the Istanbul Mint. Shaw (1975, 1978) has published the 19th Century budget estimates of the Ottomans from the Ottoman archives. These figures, however, reflect planned expenditures and projected revenues, and so wherever possible they are supplemented with the estimates and opinions of contemporary writers, principally from British Consular reports, the British Parliamentary Papers, and the writings of Du Velay, who was an official of the Ottoman Bank.

One must also keep in mind that the Empire was shrinking throughout the 19th Century. The Empire expanded continuously from its inception as a principality in 1280 until 1683, and thereafter started to decline, initially granting autonomy and
then eventually independence to the various provinces. The largest losses in terms of territory as well as revenue were in the 19th and 20th Centuries, with the Treaty of Berlin in 1878, and the Treaty of Bucharest in 1912.

Pamuk's balance of payments figures leave out Egypt, Libya and Serbia for the entire 1830-1913 period and their tribute payments show up as transfers. The figures similarly exclude Wallachia and Moldavia after 1856; Bosnia, Herzegovina, Montenegro, and Bulgaria after 1877; Cyprus and Crete after 1907; and Macedonia after 1912. (Pamuk, 1984, p.22)

In terms of the socio-economic changes that were going on during the 17th and 18th Centuries, I refer principally to what has come to be called the core of the Empire: Anatolia, Thrace, Syria, Iraq, and all the European provinces, except the autonomous, tribute paying principalities of Wallachia, Moldavia, Transylvania, and Crimea. The analyses of the latter part of the 19th Century further limit the European provinces to Macedonia and Thrace.
NOTES TO CHAPTER I

1. It was regular practice to encourage investors to buy shares in foreign loans by issuing them below par. The Ottoman government was deemed to have borrowed the full amount which basically increased the effective interest on these loans. The amount that the government actually received was further diminished by commissions and fees that were paid to the banking syndicates.

2. Galata is the financial district in Istanbul where the Ottoman moneylenders did business.

3. The term "world empire" is due to Emmanuel Wallerstein. It denotes a socio-economic organization with an overarching bureaucracy that absorbs the economic surplus mostly in the form of luxury consumption, and impedes productive investment. In this setting expansion of production is limited, and the bureaucracy is only capable of controlling and redistributing a relatively inflexible output. (see, for example, Wallerstein, 1974)

4. I define the economic surplus to be the portion of total output over and above what the producers (the peasants) receive. This, which we may call the "necessary product", is an amount defined not only in terms of physical subsistence, but also in terms of a traditionally accepted (and therefore variable) level which was formalized through the taxation structure. The surplus can increase either as a result of an increase in the level of output (to the extent that its appropriation is proportional to the level of output) or as a result of a decrease in the necessary product. Evidence suggests that throughout the 18th and 19th Centuries the economic surplus increased more through illegal taxation, that is as a result of a forced reduction in the necessary product, and less through increases in agricultural output. (see, for example, Stavrianos, pp.34-5)

5. The term "lord-bureaucrat" is due to Mubeccel Kiray. (See, for example, Kiray, 1974)

6. Increased investment activity can come about through a number of different mechanisms, by relieving the savings gap or the foreign exchange gap, by directly importing capital goods, or importing consumer goods and freeing domestic factors for the production of capital goods, etc.

7. To the extent that domestic savings and the marginal efficiency of investment are interest sensitive, capital inflows will increase both investment and consumption. To the extent that domestic savings are exactly offset by foreign
savings, loans will be for current consumption only.
II. THE LOANS: 1854-1914

The 19th Century was a period of international lending in Europe. The establishment and growth of specialized financial institutions such as commercial banks and investment houses made foreign investment easier and less risky than before, while the accumulation of savings by a middle class willing to invest abroad supplied the funds needed for an expansion of foreign lending.

Although estimates of total foreign investment and its timing vary, Woodruff calculates that total long term European foreign investment stood at L720 million by 1855. Between 1855 and 1885 it increased by L2080 million, and between 1885 and 1914 by L7420 million, giving a grand total of L9500 million by 1914. (Woodruff, p.150-5) In 1914, 5% of the investments were in Oceania, 9% in Africa, 16% in Asia, 19% in Latin America, 24% in North America, and 27% in Europe, including the Empire. (Woodruff pp. 154-5) If these estimates are correct, then the Ottoman Empire absorbed approximately 10% of all foreign investment between 1855 and 1885 and some 12-13%
of the investment in Europe, or 3-4% of the grand total, in 1914.

England was by far the major international lender of the period, accounting for some 43% of all long term foreign investment by 1914. France became a significant lender after 1852, with the establishment of the Credit Mobilier. Although her position declined somewhat between 1870 and 1878 due to the Franco-Prussian War, in 1914 French foreign investment accounted for 20% of the total. Foreign lending by Germany accelerated after 1870 with the establishment of the Deutsche Bank, and accounted for 13% of the total in 1914. The United States, Belgium, Netherlands, and Switzerland accounted for the rest. (Kindleberger, 1984, pp. 221-30, 265-8; Woodruff, pp.154-5)

Initially England was the most important lender to the Empire as well. Of the £23 million total foreign debt accumulated between 1854 and 1862, for example, 90% had been sold in London, the remaining 10% in Paris. Gradually, however, France would displace England as the primary lender to the Empire. In 1865 sales in London accounted for 52% and sales in Paris for 48% of the total £44 million sold between 1854 and 1865. By 1869 France's share had risen to 66% and England's had fallen to 34%. Germany entered the scene in 1870 and would eventually displace England for second place. In
1881 34% of the outstanding bonds were held in France, 33% in England, and 7.5% in Germany. By 1914 53% of the outstanding bonds was held in France, 21% in Germany, and 14% in England. (Pamuk, 1984, pp.71-3)

Lending to the Ottoman Empire was very attractive. While in England, for example, the average annual interest rate was around 3.5 to 4.5% and those in France even lower, in the cities of the Middle East the annual interest on the best securities ranged between 12 to 20%. For the peasants who borrowed on their anticipated harvest, interest rates of 5-6% per moth were not uncommon. (Landes, p.57; Issawi, 1980, pp.341-3) Lending to the Ottoman state was attractive on other grounds as well. Growth in international trade had established ties and avenues of communication. Ottoman bankers were already borrowing in the European financial markets to lend to the government and elimination of middlemen would bring larger returns. The state had undertaken expensive reforms on insufficient tax revenue and was in constant need of funds. Furthermore, these reforms had the backing of the European governments and this inspired confidence. Lending to the state was the least risky means of realizing high returns. For the underwriters state loans were easy to publicize, flotation involved little risk, and they could make easy profits from commissions and manipulation of prices. (Owen, p.101; Jenks, pp.263-80) For the diplomats, who were watching the reform
efforts very closely, the foreign loan business was yet another avenue through which they could compete with their rivals and increase their influence on the Empire.

Meanwhile, as I will discuss in detail in the following section, the state was in constant need of funds. At the beginning of the 19th Century, with much encouragement and input from the European Powers, the state had decided to undertake a series of reforms in order to centralize the administration and control of both tax revenues and expenditures. Centralization of expenditures proved to be much easier than that of revenues, and it was faced with persistent budget deficits. The usual response was to debase the currency and borrow from the local Galata bankers at 12% interest. Between 1808 and 1830 the form and the name of coinage was changed 35 times for gold and 37 times for silver issues due to debasement. As a result prices increased and the value of the British pound jumped from 23 piastres to 104 piastres and was quite volatile. The uncertainty associated with the value of currency led in many instances to a total halt of trade and widespread discontent as everyone insisted on payment with 'good' coins. (Issawi, 1980, p.326-31)

By the 1840's the budget deficits had reached such a level that neither debasement nor short term loans from the Galata bankers was sufficient. The state began to issue kaima
which were a cross between banknotes and government bonds --
they were declared to be legal tender but also carried
interest. In 1840 160 million piastres worth of kaime were
issued, followed by extensive counterfeiting, and a
significant fall in its value. Eventually the state refused to
pay interest on kaime and they became equivalent to
inconvertible paper currency. The pound, which was officially
at 110 piastres, began to be traded at 200 piastres. (Issawi,
1980, p.327; Yerasimos, p.667)

In 1844 there was an attempt to reform the monetary
system by moving from the silver standard to bimetallism. The
new Turkish pound (TL) was defined as 100 piastres and set at
18 shillings. (Issawi, 1980, p.327) There was also an
unsuccessful attempt to withdraw the old debased currency. In
1847, two Galata bankers, Alleon and Baltazzi, founded the
Bank de Constantinople, with the help of the Ottoman
government. The bank was to stabilize the value of Ottoman
currency by furnishing traders with bills of exchange on Paris
and London at 110 piastres to the pound sterling, for an
annual commission of two million piastres from the state. The
value of kaime was stabilized for a while, but, following the
French revolution of 1848 which disrupted trade the bank went
bankrupt, costing the treasury some 26.3 million piastres.
(Issawi, 1980, p.339) With the bankruptcy the pound jumped
from 110 piastres to 139 in 1850 and to 153 in 1853.
(Yerasimos, p.672) By 1854 the floating internal debt of the Empire had reached L15 million; it had an inflated and volatile currency, an unfavorable trade balance, and large budget deficits.

Although the state was in dire need of funds, it did not enter into what would ultimately be a vicious circle of borrowing lightly. In fact, the sultan resisted the idea of a foreign loan, pushed expertly by the British Ambassador, for some time. In August of 1850, Ambassador Stratford Canning presented a memorandum to the sultan. In it he outlined a comprehensive plan of reform and gave strong support to the idea of acquiring a foreign loan. He argued that the produce of certain mines, a portion of the customs revenues or tribute from some large province of the Empire would be sufficient security to raise an advantageous loan of L5-6 million, at 4% interest, repayable over 25 years. With the loan the sultan could retire the inconvertible paper currency, withdraw the debased coins, and pay cash for purchases. He was confident that the loan would clear the way for reforms and would result in savings of up to L10 million. The sultan need not have any fear: where was there the example of a nation that had been called upon to sacrifice its independence on the demands of foreign capitalists? (Rodkey, pp.348-53)
Although there was much disagreement within the administration, the sultan himself was weary of Western penetration. In November he publicly announced to his ministers that strict economy was the only safe way to reduce budget deficits. Canning then withdrew the pressure, assessing, quite correctly, that it was only a matter of time. In 1851 the budget deficit of the previous year was revealed to be close to £1 million. Ottoman officials renewed the idea of establishing a national bank which would ease the financial problems of the state by drawing capital from foreign sources. There was another stalemate: prospective foreign investors demanded guarantees and immunities which the Ottoman government was not willing to grant. In August another crisis erupted. The government needed to transfer £600,000 in specie to London within two months. Canning, of course, lost no time in reminding the sultan that British and French interests were not to be "trifled with," and that unless hard cash was forthcoming "the very existence of the [Ottoman] administration might be compromised." (cited in Rodkey, p.355) The state did manage to find the cash.

The Empire's resistance broke down, when, in January of 1852, the Bank of England stopped discounting the drafts of the credit institutions in Istanbul through which payments were made to British accounts. The sultan agreed to pledge the tributes of Egypt, Serbia and Rumania as security for a
foreign loan, but wanted the maturity of the loan to be at most ten years. The representatives he sent to Paris, however, contracted a 23 year loan for 50 million francs (about L2 million), at 6% interest and 2% commission. No security was shown and the lenders advanced 11 million francs at once. Some members of the administration had tried to engineer a fait accompli, but when the sultan learned of the terms he refused to ratify it. He publicly denounced the contract, asked Egypt to advance one year’s tribute at any interest they chose, and started a public fund to pay back the 11 million francs, along with the 2.2 million francs in damages.

The Crimean war, however, dealt the final blow to state finances. As the war costs climbed to L11 million, the Ottoman Empire signed its first foreign loan contract, in 1854. The L3 million loan was contracted with Dent, Palmer and Company and Goldsmidt and Company. It carried an interest rate of 6% and amortization rate of 1%. The issue rate was 80% and, with the commissions and the costs of floatation, the treasury received only L2.3 million, bringing the effective interest to 7.9%. The Egyptian tribute was shown as security. The second loan was contracted in 1855 with the Rothschilds of London. It was for L5 million and the interest payments on the loan were guaranteed by the French and British governments who were anxious to sustain the war effort. This was the most favorable loan, issued at 102.6% of face value and 4% interest. Part of
the Egyptian tribute and the customs revenues of Syria and Izmir were pledged as security. It did, however, have strings attached: Lord Hobart and Marquis de Floeuc were assigned as representatives of the British and French governments to exercise control over the funds and verify treasury accounts. (Blaisdell, pp.27-8)

The floodgates had opened. Between 1854 and 1875 the Ottoman Empire contracted a total of 15 foreign loans, incurring a debt of L220 million, receiving L116 million. (For more details see Appendix I) The loans would be raised sometimes at the urgent request of the Ottoman government and sometimes at the insistence of European bankers. Most of the loans were issued for prespecified purposes and accompanied by economic and political concessions.

The legacy of the two war loans was commitment to a new reform programme and the formation of the Ottoman Bank. The reform programme, said to be Canning’s magnum opus, was formalized in the Hatt-i Humayun Decree of February 1856, and promised, among other things, a modern state and landownership rights to foreigners, and would be the formal framework for the subsequent demands of European governments. The Ottoman Bank was founded in 1856 largely with British capital and had most of the immunities and guarantees prospectors had previously demanded. It was established to borrow abroad and
provide foreign loans to the state to help meet budget deficits. (Yerasimos, pp.729-31; Shaw and Shaw, p.98) The legacy of the 1858 loan was the establishment of a financial advisory commission, later named Conseil Superieur des Finance, composed of three foreign (British, French, Austrian) and four Ottoman delegates who were to act as consultants in financial reform issues. The outcome of the failed 1860 Mires loan was a formal British mission to the Empire and more reform recommendations.* The result of the subsequent 1862 loan was the concession for the Ottoman Bank to become the Imperial Ottoman Bank with the addition of French capital in 1863. The bank was given monopoly on note issuing privileges and would be the financial agent of the Empire, keeping track of revenues and expenditures, servicing the debt, and assisting in the floatation of new loans.

This pattern of loans, concessions, and more loans continued throughout the following decade. Each concession boosted the confidence of the lenders and many other banks followed the Imperial Ottoman Bank into Istanbul to get their share from the foreign loan euphoria -- Societe Generale de l'Empire Ottoman in 1863, Credit General Ottoman in 1868, Banque Austro-Ottoman in 1871, Banque Austro-Turque in 1872, Banque Russe, and Banque Itallo-Orientale in 1873, etc. Most of these banks did not survive the 1873 financial crisis which began in Vienna and swept through Europe. Some amalgamated
with the Imperial Ottoman Bank and the rest were liquidated. (Issawi, 1980, pp.341-1) Eventually, of course, euphoria on the part of the lenders and the continuing financial difficulties of the Empire, which I will discuss in detail in the following chapters, led to default and the ultimate concession --the formation of the Public Debt Administration through which the Europeans directly administered and collected the taxes of the Empire.

Although the loans were not used exclusively for the purposes first intended, on the whole there were two war loans (1854, 1855) for a total of L8 million; three loans to withdraw the inconvertible paper currency and retire the domestic floating debt (1858, 1862, 1863) for L23 million; three loans to convert and consolidate various diverse internal bonds (the so-called General Debt issues, 1865, 1873, 1874) for a total of L81 million; only one loan to build a railway in European Turkey (1870) for L32 million; and five loans, totalling L76 million, to meet payments on previous loans or cover budget deficits in general, for a grand total of L220 million. The interest rates on the loans ranged between 3% and 9%, the issue rate between 102.6 and 43.5%. The average issue rate was 59% which was reduced to 56% with commissions, bringing the effective interest rate closer to 10%. (see Figure 2.1) By 1875, the year the Empire suspended
Figure 2.1: Effective Interest Rates on the External Debt

Source: Pamuk, 1978, p.138

Figure 2.2: The Debt Burden (Five year averages)

Source: Pamuk, 1978, p.137
debt payments, the ratio of debt service to exports and to total revenues had risen above 50%. (see Figure 2.2)

In 1877, two years after the Empire suspended debt payments, war broke out with Russia. The war and the subsequent Congress of Berlin had two important consequences. Firstly, the Empire was forced to give up two fifths of its territory and one fifth of its population, thus losing substantial revenues. In addition it was to pay £0.3 million a year, for 100 years, as war reparations to Russia. These losses were partially offset by the tribute to be paid by the remaining vassals and the agreement of the newly independent states to assume some portion of the Ottoman debt. Nevertheless, finances were in complete disarray, and it became clear to the Empire that it still needed access to the European financial markets. Secondly, the Treaty of Berlin itself acknowledged the demands of the foreign bondholders, recommending "the establishment...of a financial commission composed of specialists named by their respective governments, which commission shall be charged to examine into the complaints of the bondholders of the Ottoman debt, and to propose the most efficacious means for satisfying them as far as is compatible with the financial situation of the Porte."

(cited in Blaisdell, p.85)
In 1880 the sultan informed the European powers that he was willing to start negotiations, but that unless the debt was consolidated and service charges reduced, no one would get anything. The European financial and political leaders agreed to the idea of reducing the debt and service payments, but only if their own representatives were given control over certain Ottoman revenues which they would administer, collect, and devote entirely to debt service. The formal agreement, the Decree of Muhtarrem, which established the Public Debt Administration, was signed on December 20, 1881.

According to the Decree, first, the external debt was unified and its nominal value reduced approximately to its issue value. Overall, the total outstanding debt of the Empire, including all the domestic and foreign loans, as well as the war reparations to Russia, was reduced from L215.5 million to L128.6 million and annual charges were reduced from L13.6 million to L2.7 million, though there was some flexibility on charges.

Secondly, various revenue allocations stipulated as security in individual loan agreements were removed. In turn, certain revenues were "absolutely and irrevocably [ceded to the PDA] until the complete liquidation of the debt." (cited in Blaisdell, p.92) Overall, approximately 20% of total Ottoman revenues were ceded to the PDA. In subsequent years,
this would range between 30-35% of total revenues. (For more
details on the agreement, see Appendix I)

The PDA, with an executive council composed of the
representatives of the bondholders who worked very closely
with their respective governments and a staff of about 5000
Ottomans and Europeans, soon took charge of Ottoman finances.
As a European controlled, semi-official agency it inspired
confidence in the European financial markets. Between 1882 and
1914 there were 26 more public loans, on terms that were much
better than before. The Empire incurred a new debt of L93
million and received L76 million. The interest rates ranged
between 3 and 5.5%, and the issue rate between 70 and 100. The
average issue rate was 83%, reduced to 80% with commissions,
bringing the average effective interest to 5.5%. (See Figures
2.1 and 2.2) All but four of these loans were administered by
the PDA.

Overall, there were seven loans to convert and
consolidate earlier issues, five loans to cover budget
deficits in general and six loans to fund the internal
floating debt. Net new debt incurred through these operations
was L73.3 million. In addition, there were three loans,
totaling L5.2 million, to finance arms purchases and build up
the maritime arsenal, and five loans, some L14.5 million, for

35
construction of railways or as kilometric guarantees to the European railway companies.

Perhaps more importantly in terms of the overall picture of the economy, the PDA provided the institutional and personal channels through which industrial capital entered the Empire. Most of the investment was in infrastructure (railroads, harborworks, municipal public works), expanding and intensifying the process of incorporation. The earlier process of loans, concessions, and more loans was repeated during this period as well, but this time the concessions had to do with foreign direct investment, rather than increasing control over state finances which they now had. (For a discussion of this cycle see Blaisdell, pp.124-76) During the most active period, between 1888 and 1900 there was a net capital inflow of L42 million in direct foreign investment, profit repatriation of L19 million, giving a net inflow of L23 million. For the earlier period, 1859 to 1881, the respective figures were L13 million in net capital inflows, and L7 million in profit repatriation, giving a net inflow of L6 million'. (See Figure 2.3)

In terms of international capital flows, that is accounting for the debt held by Ottomans, foreigners, or foreign financial institutions residing in the Empire, the overall debt picture was as follows. Between 1854 and 1881,
Figure 2.3: Flow of Funds Due to Direct Foreign Investment
(Million British Pounds Sterling; five year moving averages)

Source: Panuk, 1978, p.145
including the 1877 war loan, the Empire accumulated a foreign held debt of L189 million. The treasury received L106 million, and used L72 million of this in interest and amortization payments. Thus, over these 28 years there was a net inflow of L34 million. Between 1882 and 1914, under the PDA, total new foreign debt held abroad was L91 million; of this L75 million was received by the treasury, and L124 million was paid in debt service. Thus, over these 32 years there was a net outflow L49 million. The totals for the entire 1854-1914 period were: L280 million debt held abroad, L181 million received by the treasury, and L196 million paid in debt service, giving a net outflow of L15 million. These figures and annual average flows for different periods are presented in Table 2.1. (Also see Figure 2.4)

What is perhaps most surprising about the balance of payments data presented in Table 2.2, is that there was no significant increase in the trade surplus during the period under the PDA. While the impact of capital flows is reflected in a substantial increase in the trade deficits during the period between 1854 and 1875 when there were net capital inflows, and a fall in the trade deficits during the period between 1876 and 1881 when there were net outflows, such is not the case for the period after 1881. During the latter period average annual exports increased by 22%, but imports increased by 32% as compared to the period 1876-1881,
Table 2.1: International Flow of Funds
Due to the External Public Debt

A: Annual Averages (L000)

<table>
<thead>
<tr>
<th>Years</th>
<th>Nominal Value</th>
<th>Amount Received</th>
<th>Amortization Payments</th>
<th>Interest Payments</th>
<th>Net Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td>1854-75</td>
<td>8.36</td>
<td>4.66</td>
<td>0.68</td>
<td>2.43</td>
<td>1.55</td>
</tr>
<tr>
<td>1876-81</td>
<td>0.83</td>
<td>0.43</td>
<td>0.06</td>
<td>0.61</td>
<td>-0.24</td>
</tr>
<tr>
<td>1882-1914</td>
<td>2.75</td>
<td>2.27</td>
<td>0.86</td>
<td>2.89</td>
<td>-1.48</td>
</tr>
</tbody>
</table>

B: Totals (L000,000)

<table>
<thead>
<tr>
<th>Years</th>
<th>Nominal Value</th>
<th>Amount Received</th>
<th>Amortization Payments</th>
<th>Interest Payments</th>
<th>Net Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td>1854-75</td>
<td>184.0</td>
<td>103.4</td>
<td>14.96</td>
<td>53.46</td>
<td>35.44</td>
</tr>
<tr>
<td>1876-81</td>
<td>5.0</td>
<td>2.6</td>
<td>0.36</td>
<td>3.66</td>
<td>-1.44</td>
</tr>
<tr>
<td>1882-1914</td>
<td>91.0</td>
<td>75.0</td>
<td>28.52</td>
<td>95.48</td>
<td>-49.00</td>
</tr>
<tr>
<td>1854-1914</td>
<td>280.0</td>
<td>181.0</td>
<td>43.84</td>
<td>152.60</td>
<td>-15.00</td>
</tr>
<tr>
<td>(Total)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Pamuk, 1984, pp.56,163-66. Discrepancies between Pamuk's estimates which look at the international flow of funds and Tezel's estimates which look at the consolidated foreign debt of the Empire arise from the fact that some L46 million of the total L326 million debt was held by individuals or financial institutions within the Empire.
Figure 2.4: Flow of Funds Due to External Borrowing

(million British pounds sterling; five year moving averages)

--- capital inflows
--- debt service

Source: Pamuk, 1978, p.134
resulting in substantial trade deficits. (Pamuk, 1984, pp.199-205) Whereas the earliest trade deficits (1830-1853) were largely financed by the Egyptian tribute, these seem to have been financed partly by direct foreign investment and mostly by short term mercantile credit. (Pamuk, 1984, p.198)

<table>
<thead>
<tr>
<th>Years</th>
<th>Trade Balance</th>
<th>Debt Flows</th>
<th>Foreign Direct Investment Flows</th>
<th>Other Items</th>
<th>Bop</th>
</tr>
</thead>
<tbody>
<tr>
<td>1830-53</td>
<td>-0.9</td>
<td>0.0</td>
<td>0.0</td>
<td>0.9</td>
<td>0.0</td>
</tr>
<tr>
<td>1854-75</td>
<td>-3.1</td>
<td>1.55</td>
<td>0.35</td>
<td>1.8</td>
<td>0.6</td>
</tr>
<tr>
<td>1876-81</td>
<td>-0.9</td>
<td>-0.24</td>
<td>-0.36</td>
<td>1.9</td>
<td>0.4</td>
</tr>
<tr>
<td>1882-1913</td>
<td>-2.2</td>
<td>-1.97</td>
<td>0.69</td>
<td>4.1</td>
<td>0.1</td>
</tr>
</tbody>
</table>

(a): Debt Flows are amounts received due to foreign loan floatations less amortization and interest payments.
(b): Foreign Direct Investment Flows are net foreign direct investment capital flows less profit repatriation.
(c): Other items are due to transportation, tourism, transfers, migrant remittances, tribute payments and war reparations. Most important among these are the tribute payments, principally from Egypt, war reparations, and short term mercantile credit.

Source: Pamuk, 1984, pp.197,199-205.
Overall, then, the Ottoman public debt absorbed a significant portion of 19th Century European foreign investment, especially during the period from 1854 to 1881. During these years there was a net inflow of L34 million, reflected in import surpluses. Although there was a net outflow of L49 million from the state coffers in the period between 1882 and 1914, this was not matched by a resource transfer as the economy continued to run large trade deficits financed partly by foreign direct investment and partly by mercantile credit. The whole debt process was accompanied by economic and political concessions and ultimately by foreign control of state finances.

In the following chapters I will concentrate on the structural changes that led to, accompanied, and resulted from this debt process.
NOTES TO CHAPTER II

1. The calculations for the Empire are necessarily rough, but conservative. They are based on Pamuk's and Tezel's estimates, and are (as Woodruff's seem to be) the nominal value of the new debt incurred, less amortization payments, plus net capital flows due to foreign direct investment for each of the relevant periods. Platt has argued that these traditional estimates of 19th Century foreign investment are grossly exaggerated, perhaps by a factor of two or three. Since, however, part of his argument stems from the difference between nominal and issue values of the bonds, it is not quite clear how the Ottoman Empire's share would be affected in terms of actual capital flows. (See Platt, 1984)

2. The rest were held in Austria (6%), Holland (5.3%), Belgium (5%), Italy (4.15%) and the Empire (5.6%).

3. Mr. Palmer of Dent, Palmer, and Company was apparently especially adept in persuading the state to borrow. He was sufficiently powerful to cause the downfall of one grand vizier who did not agree with Mr. Palmer that the treasury needed another loan. The successor was more amenable to the idea and Mr. Palmer floated his loan. (Blaisdell, p.29)

4. The mission of Lord Hobart and Mr. Foster and its aftermath is the focus of Chapters V and VI.

5. There was a third war loan in 1877 during the interim period while negotiations were continuing on how to resolve the default issue.

6. The General Debt issues were floated both domestically and in the European financial centers. L26 million of the L81 million was the face value of the converted domestic bonds; nevertheless that debt too was incurred during the 1854-1875 period. Rest of the L81 million was newly incurred debt, held both domestically and abroad. Pamuk's calculations suggest that L184 million of the total L220 million in debt was held abroad, the rest by Ottomans, foreigners, or foreign financial institutions (e.g. the Imperial Ottoman Bank) resident in the Empire. (see, Pamuk, 1984, p.56)

7. For the entire 1854-1913 period, there was a net foreign direct investment of L77 million and profit repatriation of L66 million, giving a net inflow of L11 million. (Pamuk, 1984, pp.167-70)

8. The figures for the consolidated debt of the Empire were as follows. Between 1854 and 1881: L233 million debt incurred, L127 million received, L86 million paid out in debt service, giving a net inflow into the treasury of L41 million. Between 1882 and 1914: L93 million debt incurred, L76 million received, L127
million paid out in debt service, giving a net outflow out of the treasury of L51 million. For the entire 1854-1914 period: L326 million debt incurred, L203 million received, L213 million paid out in debt service, giving a net outflow of 10 million. (Tezel, pp.93-5)
PART I: FISCAL CRISIS OF THE STATE

It should be clear from the previous chapter that the immediate reasons for the Ottoman external debt, especially in the period before the default, had to do with the financing of wars and budget deficits in general. But there is still the question of why an Empire which spanned from Yugoslavia to Baghdad, from Crimea to Egypt, from Tunisia to the Persian Gulf needed external financing to cover its budget deficits. It simply is not good enough to attribute the growing external debt to the ignorance, corruption, or greed of the leaders. It is necessary to look at the structural changes that were taking place both within and without the Empire to explain the fiscal crisis of the state.

Analyzing how the revenue and expenditure patterns of the central government changed over time requires that we look at the socio-economic organization of the Empire as a whole. Since in the Ottoman Empire the state was the most important controller and redistributer of the economic surplus, we need especially to see how control and claims over the economic surplus changed over time.

In chapter III, I first describe the classical organization of the Empire in stylized form, and then trace
out the changes that took place during the 17th and 18th Centuries with respect to both the impact of the European economies and the internal dynamics of the system. The central argument is that incorporation into the Europe-centered world economy through international trade triggered conflict between the provincial forces and the center, and that eventually the central bureaucracy lost its traditional control over the economic surplus, leading, also, to a decentralization of political power.

In chapter IV, I first give an overview of the evolution of foreign trade in the 19th Century and how it tended to decentralize of the control of the economic surplus. I then describe the attempts by the central bureaucracy to reestablish its traditional control over the tax base. The central argument is that it was the basic inability of the state to divert enough of the economic surplus to the central treasury that first led to external borrowing and then to default in 1875.
III. HISTORICAL ROOTS OF THE CRISIS

1. Classical Organization of the Empire, 1400-1600

The economic basis of the Ottoman Empire was agricultural. Technology was based on oxen and the plough in production, horses, donkeys, and camel caravans in overland transportation, and galleys and galleons in naval transportation. The central problem of the state was to control and expand the economic surplus it regulated and ensure its continuity over time. This implied regular wars of expansion to increase the land and labor controlled by the Empire and the establishment of a rational system of land-labor relations that would minimize social conflict and reproduce the system.

In terms of vertical differentiation, the Ottoman society consisted of two distinct classes: the ruling class and the subjects. The subjects -- nomads, peasants, artisans, and merchants -- produced wealth and paid taxes to the ruler. Members of the ruling class did not engage in production, but, acting as instruments of the sultan, had the right to collect
taxes to support themselves and the ruler, thus ensuring the continuity of the state and the military. The ruling class was divided into four functional groups: Palace, scribal, military and religious institutions. The palace and the scribal institutions, with the help of the relatively small standing army (27,000 in a total of 100,000 in 1527) looked after the general administrative and financial affairs of the Empire. The provincial military organized and administered the provinces under the direction of Istanbul. The relatively autonomous religious institution was provided overall legitimacy and took care of legal affairs. (Tekeli and Ilkin, pp.18-23; Shaw, 1976, pp.112-5)

It was through the provincial military organization that the economy of the Empire was regulated and the economic surplus drawn out. In theory, all the land belonged to the sultan. The privilege of the ruling class was the right to collect taxes, its obligation, to provide services to the state. In the provinces that have come to be called the core of the Empire (Anatolia, Aleppo, Tripoli of Syria, Damascus, and all the European provinces, excluding the autonomous tribute paying principalities of Wallachia, Moldavia, Transylvania, and Crimea) the right to collect taxes was given as life-time income to members of the ruling class in fiefs (timars), in return for providing mainly military services to the state. There were three types of timars. Regular timars,
with annual revenues of no more than 20 000 akchas' were given to cavalrymen who distinguished themselves in battle. Those producing annual revenues of 20 000 - 100 000 akchas, called zeamet, were given to people who had demonstrated extraordinary bravery or ability, as well as to those members of the ruling class who held high positions in the central administration in Istanbul. Those bringing in revenues of more than 100 000 akchas, called has, were usually set aside for the sultan and his family, or used for the maintenance of high offices, like governorships.

The backbone of the provincial structure was made up of the regular timar holders. They resided in the villages that constituted their holdings and used the tax revenues to maintain themselves and their retainers, ready to join military campaigns. Their forces formed the bulk of the army (80 000 to 90 000 men in 1527). This system enabled the Empire to maintain a large military force without large cash outlays or extensive specie movement. It also ensured law and order in the provinces.

The most important tax collected from the peasantry was the tithe amounting to one tenth of the produce in kind. Peasants also had to pay an annual tax of 22 akchas per "unit of land", which was theoretically defined as the amount of land that could be plowed by a pair of oxen in one day. The
tithe and the land tax were the two most important sources of income for the timar holder. In addition, there were a number of other taxes collected by the timar holder, but sent to the central treasury through the governors. The head tax was collected from non-muslim heads of households, in three tiers according to ability to pay, in return for exemption form military service and retention of traditional laws within the millet system. The animal (or sheep) tax was levied on all animals not used in cultivation or transport as one head in ten, or as one tenth of the monetary value of the animals as evaluated locally. The state also collected a mines tax, one fifth of the yield of all mines. These basic taxes were supplemented by ninety or so additional specific excise taxes to provide revenue to both the state and to the timar holders.

Timar assignments and revenues were controlled by the central government through cadastral surveys which were undertaken upon the conquest of a region and at times renewed under the direction of Istanbul. In addition, each province had a kanunnname which codified the taxes that applied to that province, spelled out the obligations of the subjects, and set limits on what the administrators could extract from them. (Iztkovitch, pp.11-13)

Peasants held inheritable cultivation rights to the land. If the land was left uncultivated for a period of three years,
the revenue holder could sell the usufruct to others. As long as they cultivated the land and paid their taxes, peasants could not be dispossessed. Since the Empire had a shortage of labor, rather than land, peasants were required to stay on land.

The areas outside the core of the Empire, including Egypt and North Africa, were tax farm provinces. The basic tax obligation of the peasantry was the same, but the governors of these regions had the obligation to make fixed annual payments to the central treasury and could retain the balance as personal profit. (Shaw, 1976. pp.124-6)

Within the timar structure the right to collect taxes from some of the revenue sources was granted to religious foundations (vakoufs) which maintained mosques, churches, synagogues, schools hospitals, hotels, as well as roads or bridges. Members of the religious institution derived their income from these foundations and from fees collected directly for services performed. Vakouf was an unusual category of land/property, because it was exempt from all state taxes and was relatively immune from confiscation. In the 17th and 18th Centuries conversion of privately held property into vakouf would become a convenient means for the wealthy to gain autonomy from the state and leave their wealth to heirs without being subject to the regulations and taxes imposed on
normal inheritances or to threat of confiscation. (Shaw, 1976, pp. 161-62)

Thus, overall, the principal provincial revenues that came directly to the central treasury were: revenues from the tax farm provinces, the head tax, the animal tax, the mines tax, and the extraordinary taxes imposed during war time. In addition, the central treasury also received revenues from the regulation of artisans and merchants: market taxes and customs duties. These were usually collected through tax farmers, and sometimes through salaried government agents. Merchants and artisans could accumulate substantial amounts of capital that potentially threatened the stability of the system. In order to minimize this, the artisans and the merchants within cities and towns were organized into guilds that regulated the standards of each craft, limited entry of new members, and fixed prices, wages, and profit margins. The market inspector (muhtesip) was in charge of policing the markets, enforcing the sultan's price, profit, and quality regulations, and collecting the market taxes. (Shaw, 1976, pp.112-169)

Merchants of regional and international trade were largely exempt from the strict regulation and taxation to which the peasants and artisans were subject to. There was, however, extensive regulation of the internal flow of goods. Since the provisioning of the cities could not be left to the
production and movement of goods in response to price differentials, the state regulated what was grown in which provinces and sent to which cities. The state established and maintained various product-specific markets throughout the Empire to facilitate the sale of taxes-in-kind and the movement of goods toward major cities. The right to purchase from these markets was limited to officially sanctioned merchants who were granted concessions. This flow of goods was further regulated through a system of internal and external customs duties. There were customs duties of 10% on all imports and exports, and 2.5% on internal or transit trade, in practice levied not as ad valorem, but as specific taxes. (Genc) Nevertheless, the regulation and control of merchants, especially of those involved in regional and international trade, proved to be the most difficult, and they succeeded in accumulating substantial amounts of capital. (Inalcik, 1969) The ultimate form of regulation was the right of the sultan to confiscate private wealth.

Foreigners living in the Empire as official representatives, merchants or visitors usually held the most advantageous status. Treaties, generally referred to as capitulations, were signed with individual nations specifying the privileges to be granted to their subjects with respect to legal and commercial affairs. Until the Anglo-Ottoman Commercial Treaty of 1838, however, foreign merchants were not
allowed to trade in the interior parts of the Empire and engaged only in long distance trade. (Tekeli and Ilkin, pp.18-23)

Here, then, was a system of administration, which, though extremely centralized in spirit with the sultan having absolute power, was in practice quite decentralized. In a manner which was consistent with the existing production and transportation technology, the costs associated with provincial administration and maintenance of a large army were taken care of at the local level with the assignment of fiefs to officers, commanders, and governors. Palace expenses and salaries of higher officials were met by larger fiefs and the expenses associated with central administration and the standing army through the tax farming of market and customs duties, the agricultural taxes of some areas, and the state taxes on fiefs.

This is not to imply, of course, that the economy was decentralized or subject to market forces. To the contrary, the economy was subject to strict regulation with political, rather than economic factors dictating the mode of extraction of the economic surplus and its redistribution. A critical tension within the system was the distribution of the economic surplus and political power between the central government and the provincial groups. Thus, it was important to the state to
try to limit the accumulation of capital in the hands of provincial groups or groups that were not incorporated into the state apparatus. The state ensured the continuity of the system by maintaining a strict control over the economic surplus and by continually redistributing the surplus among contending groups. This, then, was a delicate, self contained system, and bound to undergo tremendous strain as the world economy changed and closer economic relations were formed with Europe.

2. Crisis in the 17th and 18th Centuries

One of the earliest Ottoman budgets on record is the one for the fiscal year 1527/28. This is rather an unusual budget in that it records the taxes collected by the timar and vakouf holders as well as the tax revenues that came to Istanbul. According to this budget, total tax revenues collected throughout the Empire equalled 538 million akchas, and of this, 277 million akchas came to the central treasury, the rest was collected and kept by the various timar and vakouf holders. In other words, the central government controlled 51% of all the revenues raised in the Empire. The only other comparable budget on record is for the fiscal year 1669/70. According to this budget, total revenues raised in the Empire equalled 2 400 million akchas, and of this only 593 million
akchas came to the central treasury. In other words, by the end of the 17th Century the central government was controlling only 25% of the total revenues raised in the economy. This later budget also showed a deficit of 45 million akchas for the central treasury; whereas the earlier one had a surplus of 174 million akchas. (Yerasimos, p.491)

Although these are only two data points covering a very long period of time, they corroborate other historical sources which suggest that the end of the 16th and beginning of the 17th Century was an important turning point for the Empire in general and for the central treasury in particular. The period is characterized by the emergence of new trends that would persist through the 17th and 18th Centuries: dissolution of the timar system of land tenure, increasing use of tax farming to try to collect tax revenues, the emergence of wealthy local notables, decentralization of the control of the economic surplus, and the beginnings of the fiscal crisis of the state.

A number of internal and external factors contributed to this reorientation. Among these, three changes relating to the Empire's trade with Europe were of critical importance. First, as the Europeans rounded Africa, the Mediterranean lost its importance in Europe's luxury trade with the East (in spices, silk, coffee, etc.). The Ottoman Empire, as the facilitator of this transit trade, began to lose considerable customs revenue
and mercantile profits which had supported its urban
civilization. The Ottomans were well aware of the changes. In
1625 Omer Talib noted:

Now the Europeans have learnt to know the whole world;
they send their ships everywhere and seize important
ports. Formerly, the goods of India, Sind, and China used
to come to Suez and were distributed by Muslims to all
over the world. But now these goods are carried on
Portuguese, Dutch, and English ships to Frangistan
[France], and they are spread to all over the world from
there. What they do not need themselves they bring to
Istanbul and other Islamic lands, and sell it for five
times the price, thus earning much money. The Ottoman
Empire must seize the shores of Yemen and the trade
passing that way; otherwise before very long, the
Europeans will rule over the lands of Islam. (cited in
Sunar, p.29)

Secondly, the inflow of abundant Spanish silver from the
Americas to Europe had disturbed the relative value of silver
with respect to gold. Whereas the ratio of gold to silver in
Europe was 1/13, that in the Near East was 1/10. Consequently
silver flowed into the Ottoman Empire and Iran, in exchange
for gold as well as silk. This resulted in inflationary
pressure on silver prices. (Vilar, p.101; Tekeli and Ilkin,
p.33)

Perhaps more importantly, the nature of trade with Europe
began to change from one of trade, and mostly transit trade,
in luxury goods to trade in staples. The economic development
spurred on in Europe by the new centralized mercantilist
economies resulted in increased demand for various
agricultural goods -- cotton, wool, raw silk, and dyestuffs
for their expanding textile industries and grains and foodstuffs for their growing urban population. While the relative price of these goods increased in Europe, they remained comparatively low in the controlled economic environment of the Ottoman Empire. Consequently, these goods drained out of the Western provinces of the Empire and gave rise to serious shortages throughout the cities of the Empire. The most serious shortages, of course, occurred in Istanbul and other large coastal cities, which, because of the low transportation costs, used to bring their food from the same Western provinces. The Ottoman government tried to reestablish its control over the flow of goods by issuing decree after decree that tried to maintain fixed prices and prohibited the export of "strategic" grains. Despite these efforts, the net result was a flourishing contraband trade and increasing internal prices for agricultural goods. (Shaw, 1976, pp.172-3)

These developments also set the trend for the dissolution of import competing manufactures. The local artisans suffered both because of the high prices of exportable inputs and because of the low prices of imported final goods. The importation of cheaper and better quality European manufactures was to have full impact in later centuries, but already the influence was felt in textiles. When the state ordered cloth from the weavers Western Anatolia in 1567, for example, they responded by saying that there was not enough
yarn to fill the order, because the Europeans had bought it wholesale. (Yerasimos, p.410) Cizakca reports that between 1621 and 1721 raw silk exports from the Ottoman Empire and Iran increased by 275%; and that raw silk prices in the Ottoman ports increased by 293% between the 1560’s and 1630’s. Similarly, mohair yarn exports to England alone increased by 400% during the early 17th Century. Balkan wool prices moved in tandem with Venetian woolen output between 1530 and 1610, and continued to increase with demand from Holland and France even as Italian demand fell. With the import of Flemish sayettes and Suffolk broadcloth, production of silk cloth in Bursa, Aleppo, and Tokat and of woolens in Salonica declined. (Cizakca)

In addition to these factors relating to the Empire’s economic relations with Europe, two other factors, population increase and change in European military technology, contributed to the systemic crisis. During the 16th Century the population of the Empire doubled, while similar population increases were occurring throughout the Mediterranean basin. Although tracts of marginal land were brought under cultivation, specialists in the field have concluded that the population increase outpaced the increase in agricultural output. (Cook; Islamoglu and Faroqui) The impact of this was twofold: additional pressure on the relative prices of foodstuffs due to the inelastic demand for food, and the
emergence of a large number of frustrated landless peasants which would provide the ruling class with an ample source of willing soldiers and mercenaries.

A final factor that influenced the course of events was the change in military technology. One of the first reactions of the Empire to the change in trade routes was to try to break out of this new constraint by expanding into Europe. But, as they found out in their frustrated efforts, modern warfare had began to depend on the use of gunpowder, rifles, heavy cannons, and highly disciplined standing armies. The provincial cavalry, the timar holders and their retainers, were not well suited for this new warfare. As the wars ended in defeat, military expeditions ceased to be a source of booty and revenue for the central treasury and became a drain. (Inalcik, 1980) Financing a modern standing army, however, implied changing the whole land tenure system.

The interaction of these forces put tremendous pressure on the socio-economic structure of the Empire with profound impact on the distribution of income and political power. The catalyst was to be inflation.

At a time when military defeats drained the coffers and the state made plans to expand the salaried standing army and to provision them with new weapons, the treasury began to lose
### Table 3.1: Ottoman Revenues and Expenditures

<table>
<thead>
<tr>
<th></th>
<th>1527/28</th>
<th>1669/70</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total tax revenue</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Akcha</td>
<td>537 929 006</td>
<td>2 400 000 000</td>
</tr>
<tr>
<td>Gold coin</td>
<td>9 780 572</td>
<td>20 000 000</td>
</tr>
<tr>
<td>Revenue of the Central Treasury</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Akcha</td>
<td>277 244 782</td>
<td>592 528 960</td>
</tr>
<tr>
<td>Gold coin</td>
<td>5 040 818</td>
<td>4 937 741</td>
</tr>
<tr>
<td>Expenditure of the Central Treasury</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Akcha</td>
<td>203 261 931</td>
<td>637 206 348</td>
</tr>
<tr>
<td>Gold coin</td>
<td>3 695 672</td>
<td>5 310 053</td>
</tr>
<tr>
<td>Budget Surplus</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Akcha</td>
<td>173 982 851</td>
<td>-44 677 388</td>
</tr>
<tr>
<td>Gold coin</td>
<td>3 163 327</td>
<td>-372 312</td>
</tr>
</tbody>
</table>

Source: Barkan, p.17; Yerasimos, p.491.

### Figure 3.1

*Price Indexes of foodstuffs from inarct records, 1490-1655; solid lines in akçes, broken lines in grams-silver*

Source: Barkan, p.15
its relative share of the economic surplus. The important point here is that most of the revenues of the central treasury were nominally fixed. Tributes, revenues from the tax-farming provinces, and the head tax were nominally fixed. The customs and market duties, as well as all the other excise taxes were levied independently of price movements, as specific taxes. Theoretically, the animal tax and mines tax were proportional to output and/or price, but these too tended to be assessed on the basis of past values. Thus, while the increase in relative prices of agricultural goods due to both the population increase and the staples trade with Europe reduced the purchasing power of central revenues in terms of agricultural goods, the inflation in silver prices imposed an additional burden. As noted before, the pressure of prices was greatest in and around Istanbul, because it was those agricultural goods which would supply the Palace and the army that were drained to Europe.

The response of the state was three-fold. The first reaction of the Ottoman state, like those in Europe, was to debase the currency. Between 1566 and 1618, for example, the silver content of the akcha was reduced from 0.731 grams to 0.306 grams. (Barkan) The result of these competing claims was an increase in the rate of inflation. As can be seen from Figure 3.1, whereas the silver index of food prices between 1585 and 1605 showed an inflation of 3.4% per year due to real
demand pressures and the inflow of silver from Europe, inflation in terms of the domestically used debased currency, the akcha, was 6.4% a year, which incidentally was the highest in Europe. (Braudel and Spooner)

The second policy adopted by the state was to make permanent a series of extraordinary taxes which had traditionally been levied only during times of war. (Inalcik, 1980) Most of these taxes were levied in cash and their collection entrusted to the governors and timar holders. These gave the local powers an additional avenue through which they could extract the economic surplus: they lent the equivalent of the tax to the peasants at usurious rates, to be collected after the harvest.

The final policy, made possible by the increasing monetization and commercialization of the economy, was to start auctioning the right to collect the revenues that had traditionally accrued to timar holders. The state began to confiscate the fiefs of those timar holders who had not fulfilled their obligations, to retain the fiefs as older timar holders died, and "buy" back some of the other fiefs. The right to collect taxes from these lands and many of the palace hases that had supported the Sultan and high offices, were then auctioned to the highest bidder as tax farms for a specified period of time, usually three years. Generally the
auction price was paid with a cash downpayment, followed by monthly, quarterly, or semi-annual installments. (Inalcik, 1980) The tax farmer could keep any tax revenue in excess of this established sum. Many of the timar holders themselves preferred this new form of tax collection, because it freed them from military and other service obligations to the state, while allowing them a freer hand with the peasantry. Nevertheless, in this way the central treasury hoped to get at least a part of the two most important sources of revenue, the tithe and the land tax, that had traditionally been the source of income of the timar holder.

Inflation and the increase in the price of agricultural goods had important consequences on the Ottoman class structure. In addition to the artisans in the import competing sectors, those members of the ruling class who were on fixed salaries and the smaller timar holders who found it increasingly difficult to buy provisions for their retainers were the losers. On the other hand, those merchants and revenue holders (governors, timar holders, religious men, etc.) who were in a position to participate in the trade with Europe and otherwise take advantage of the high external prices for agricultural goods accumulated large amounts of wealth, giving rise to a class of local notables. Increasingly, land became a lucrative source of income and there was the impetus to expand land/revenue holdings and also
to extract as much produce as possible from the peasants. (Shaw, 1976, pp.171-3) Ottoman mercantile capital which had been displaced from the Mediterranean transit trade flowed into the new trade with Europe and into controlling land and revenues.

Another group of beneficiaries was the European merchants. With the changing nature of trade, capitulations that were first granted as a grand gesture of imperial power and mutual concessions for trade acquired a different status. By allowing the foreign merchants to trade freely under their own flag, be judged according to their own laws, be exempt from Ottoman taxation, and face much lower customs duties than the Ottoman merchants, the capitulations provided the institutional channel through which European merchant capital began to penetrate the Empire. (Yerasimos, pp.401-3) The British Levant Company, for example, which had acquired its Ottoman charter in 1581 and which held the British monopoly on all Levant trade, was making profits of up to 300% by dumping cloth on Ottoman markets and by selling Ottoman and Indian silk, currants, mohair, and aniseed at monopoly prices in England. (Braude)

Ironically, the efforts of the central bureaucracy to divert resources from the provinces to the central treasury through the extension of tax farming had unexpected results.
By and large, the government was not successful in meeting its expenditures or in directing enough of the revenues to the center. The nature of the contract failed to insulate the center from loss of revenue due to price movements. In stylized form, the treasury gave the right to collect taxes from a specified province to the highest bidder in auctions held for members of the official ruling class. The amount that the contract obliged the tax farmer to pay to the treasury each year was a nominally fixed amount and independent of price and output movements. The amount that the contract entitled the tax farmer to collect from the peasantry was proportional to real output. (İnalci, 1980; Genç) This implied not only that the purchasing power of central revenues would be undermined to the benefit of the tax farmers during inflationary periods, but also that in the short run an increase in the relative price of agricultural goods (exportables) in terms of manufactures (importables) --the 17th and 18th Century trend-- would redistribute the economic surplus away from the treasury towards the tax farmers.

In the medium/long run one would expect the auction prices to reflect the present discounted value of expected profits and restore the treasury's share, but such adjustment would depend on the frequency of tax farms auctions and on whether there were barriers to entry. The frequency of auctions was something the state could not make up its mind
about --frequent auctions helped maintain the treasury's share of revenues, but also led to the greater abuse of peasants as the tax farmers tried to reap their profits in that short period of time. In addition, there were barriers to entry: the eligible persons were limited to the official ruling class and, since a portion of the auction price had to be paid up front, eligibility was further limited to those who had access to financial (in this setting, mercantile) capital. The result was a close alliance between a small number of tax farmers, money lenders, and merchants who colluded to keep the bids down. (see Inalcik, 1980) This was the legal institutional structure upon which the power struggles were played out. Anecdotal evidence also suggests a great deal of abuse. The tax farmers not only collected more than the legal portion of the product as taxes from the producers, but they withheld the payments they promised to the treasury.

Overall, the transition from the timar system to tax farming resulted in a closely knit hierarchy of wealthy and powerful notables. The big merchants of international and interregional trade who also specialized in money-lending headed this hierarchy. They sponsored the big tax farmers, provincial governors and high ranking military officers by lending them the up-front portion of the auction price. Old timar holders, religious men, and the smaller tax-farmers
completed the hierarchy and sub-farmed the revenue sources for the bigger tax farmers.

The landed notables also eventually acquired coercive power by establishing personal armies. Given the large number of landless peasants roaming the land, the Ottoman government not only recruited mercenaries from them, but also encouraged the governors and other large tax farmers to form their own armies, in an attempt to revive the provincial armed forces. (Inalcik, 1980) This, the notables were more than willing to do in order to protect their newly found wealth and cajole peasants to pay up. These personal armies were instrumental both in the extraction of the economic surplus from the peasantry and in establishing the autonomy of the landed notables against the central bureaucracy.

Throughout the 18th Century the notables sought to increase their autonomy and land holdings. They seized control of many lands by occupying land abandoned due to overtaxation or debt; by seizing pastures, woods and other lands customarily used by peasants in common; by foreclosing on lands given in pawn by peasants seeking loans; or by brute force. (McGowan, pp.62-3) Through mostly illegal ways many then transformed their land holdings into the non-taxed category of vakouf (religious foundations). It is estimated that as early as the middle of 17th Century the loss of
revenue to the central treasury due to such conversions was
 equivalent to the total annual salaries of 40 to 50 thousand
 soldiers and that by the end of the 18th Century three fourths
 of all land in Anatolia was under the control of religious
 foundations. (Yerasimos, p.417; Aricanli, 1976, p.118) The
government responded by declaring that all categories of land
had to pay state taxes --i.e. the head tax for non-Muslims,
the animal tax, and all the extraordinary taxes that had been
imposed at the end of the 16th Century-- but with little
result. (Yerasimos, p.420)

Another way of establishing control over land was to
acquire and keep it as a tax farm. Such life-time tax farms
(called malikane, meaning "like property") were legalized in
1695 and hereditary rights given to some in 1774. (Yerasimos,
p.482) As an extension of the earlier tax farming contracts,
the contract for the life-time tax farm consisted of the
auction price and a small nominally fixed amount to be paid to
the treasury annually. (Genc) Now, however, this fix price
contract was valid for a much longer period of time, as long
as the revenue holder lived. An additional problem, from the
point of view of the central treasury, was the difficulty
associated with determining whether the revenue holder had in
fact died, so that the revenue source could be re-auctioned.
Although the collection and marketing of the taxes-in-kind within the tax farmer-peasant relations of production was lucrative enough, some lands, mostly in Rumelia, Western and Southern Anatolia, were converted into cash crop farms (chiftliks) employing slave labor, seasonal wage labor, or sharecropping arrangements. By the second half of the 18th Century, for example, Macedonia and Thessaly were exporting 40% of their grain and 50% of their cotton to Europe from such cash crop farms. (Wallerstein and Kasaba)

Thus began the long and uneven process of commercialization and integration into the world economy, accompanied by an increasingly decentralized control of the economic surplus. The central government tried to hold on to its traditional political power and to reestablish its tax base. But it could not halt the encroachment of the logic of the market or maintain the political mechanisms of redistribution. The notables were successful in avoiding central authority and accumulating wealth at the expense of the central bureaucracy.

By the end of the 18th Century some of the notables had become full-fledged local magnates with their own armies, treasuries, and administrations. The Karaosmanoglu controlled South-West Anatolia; the Capanoglu, the Central Anatolian plateau; and Canikli Ali Pasaoglu, North-Eastern Anatolia. In
Egypt, Syria, and Iraq some Ottoman officials established their own *de facto* autonomy with the help of the Mamluks. In Egypt the Ottoman governor played the factions of Mamluks against each other to maintain his own autonomy, though the Mamluk Ali Bey ul-Kebir was able to secure full control between 1760 and 1773, and Murat and Ibrahim Beys after 1783. The Mamluk governor Ahmet Cezzar Pasha controlled much of Syria, Lebanon and Palestine and Umar Pasha (1764-1780) and Suleyman Pasha the Great (1780-1802) maintained their autonomy in Iraq. The Sa’ud family, leaders of the puritanical Wahhabi movement, controlled the Arabian peninsula. In the Balkans the Dagdevirenoglu dominated in the area around Edirne; Tirsiniklioglu Ismail Aga, in Nicopolis, Sistova, and Ruscuk along the Danube; Ali Pasha of Janina, in Central and Southern Albania as well as Northern Greece; the Busatli, in Northern Albania; Pasvanoglu Osman Pasha, in North-Western Bulgaria; and Peter I Niegos Petrovich, in Montenegro. (Shaw, 1976, pp.253-67)

They sent little revenue to Istanbul and defied all efforts of the sultan to remove them. In fact, the sultan was forced to rely on them for men and armies, using them in external military expeditions as well as against each other. Sometimes he would grant them official positions in an attempt to incorporate them into the state apparatus, which usually
enabled the magnates to legitimize and extend their power. (Shaw, 1976, p.267)

Effectively, then, by the end of the 18th Century the central bureaucracy had lost its control over the tax base. In response, at the beginning of the 19th Century, the state made a more concerted effort to centralize both revenue collection and its, primarily military, expenditure. Centralizing expenditures, not surprisingly, would prove to be a lot easier than centralizing revenues.
NOTES TO CHAPTER III.

1. Horizontal differentiations in Ottoman society were based on religious differences -- Muslim, Orthodox, Armenian, and Jewish. This tension was resolved by formally instituting what is known as the millet (nation) system, whereby these groups maintained their autonomy with respect to functions not carried out by the state -- in matters of education, religion, justice, welfare programs, etc.

2. In theory the timars were not inheritable, but in practice they tended to be.

3. Akcha, or the asper, was the standard Ottoman silver coin. There were also larger silver and gold coins used mainly in international trade. Later the kurush, or piastre, another silver coin, would become more common. During the 16th Century one piastre equaled 60 aspers, during the 18th, 120 aspers. (Issawi, 1966, pp.520-24)

4. As a contemporary European observer put it: "The Turk shall surely be beaten, because his infantry, except the few battalions of Janissaries [the standing army], is worthless and cannot stand against the properly marshalled regiments of pikemen and arquebusiers." (cited in Inalcik, 1980, p.286n)

5. Currently there is a debate on how wide-spread the chiftliks were. An article by Stoianovich in 1954 identified chiftliks as the wide-spread response to commercialization and growing trade with Europe in the Balkans and similar research followed for Western and Southern Anatolia. More recent research, however, questions the importance of chiftliks (see, for example, McGowan for the Balkans and Veinstein for Western Anatolia) and illustrates that commercialization did take place within the more traditional forms of land tenure and labor control -- peasants and tax farmers. Huri Inan's research on North-Central Anatolia, Veinstein's research on the Izmir region, and Schatkowski-Schilcher's research on Syria point to the role of tax farmers and other notables in facilitating and benefiting from increased commercialization. The latter findings also support the thesis expanded here that the emergence of local notables and general decentralization in the 18th Century was not a transition from the Asiatic mode of production to feudalism, fueled by internal dynamics of the system, but the initial response of the Ottoman system to incorporation into the world economy.
IV. THE 19TH CENTURY

The 19th Century was a period of intensification of the trends and conflicts that had emerged during the 17th and 18th Centuries. It was an era of reform and attempts at centralization on the one hand, and an era of rapid commercialization and decentralization on the other. It was this torque on the social fabric of the Empire which lead first to external public debt and then eventually to default in 1875.

The first section of this chapter gives an overview of the international trade of the Empire, which was the driving force behind the social changes taking place. The second section discusses the efforts of the central bureaucracy to reform and control the direction of change. The final section focuses on the fiscal crisis of the state and foreign debt.

1. Foreign Trade and the Economy

Throughout the 19th Century the volume of trade with Europe increased and its rate of growth increasingly reflected
the cycles of the world economy. The Commercial Treaty of 1838, signed first with England, then extended to other European countries, provided the legal framework through which incorporation into the world economy proceeded and European merchant capital began to dominate the economy.

Following the world recession of 1650-1730, between 1730 and 1780 the total value of trade with Europe increased at an annual rate of 1% and between 1780 and 1830, at a rate of 1.5%. After 1830 there was a big jump and the annual growth of trade with Europe rose above 5%. (Pamuk, 1980, p.172) The Empire imported mainly European manufactures: cotton, woolen, and silk textiles, military equipment, hardware, tin, iron, and steel, as well as some agricultural goods like sugar, tea and coffee. It exported raw materials and foodstuffs: cotton, wool, raw silk, mohair, grains, tobacco, raisins, figs, valonia¹, madder root, opium, and later some minerals. Overall, as can be seen from Figure 4.1, there tended to be a trade deficit. During the first half of the century there was a trade surplus with France, which had lost its competitiveness, especially in cotton textiles, to England after the Napoleonic wars, but relied on the Empire for raw materials and grains. (See Table 4.1) Trade with England was brisk and showed a deficit for the Empire. (See Figure 4.2) Indeed, although the Empire lost its importance in British trade later on in the 19th Century, by 1850 it was the third
largest market for British exports. (See Table 4.2) The trade deficits of the early 19th Century were financed partly by specie outflows and partly by capital inflows from the tribute paying regions of the Empire. (Pamuk, 1984, p.197)

Table 4.1: Ottoman Trade with France  
(Annual Averages, millions of francs)

<table>
<thead>
<tr>
<th></th>
<th>Imports</th>
<th>Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-1791</td>
<td>32.0</td>
<td>38.0</td>
</tr>
<tr>
<td>1816-17</td>
<td>11.0</td>
<td>12.5</td>
</tr>
<tr>
<td>1827</td>
<td>13.9</td>
<td>23.5</td>
</tr>
<tr>
<td>1832-35</td>
<td>17.1</td>
<td>18.7</td>
</tr>
<tr>
<td>1840</td>
<td>13.3</td>
<td>26.2</td>
</tr>
<tr>
<td>1841-44</td>
<td>23.7</td>
<td>46.6</td>
</tr>
<tr>
<td>1847-56</td>
<td>29.1</td>
<td>51.8</td>
</tr>
</tbody>
</table>

Note: Geographical definition of the Empire varies.  
L1 = 25 francs

Source: Owen, p.87

Table 4.2: Destination of British Exports in 1850  
(Millions of British Pounds)

<table>
<thead>
<tr>
<th>Region</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hanse Towns</td>
<td>6.755</td>
</tr>
<tr>
<td>Holland</td>
<td>3.542</td>
</tr>
<tr>
<td>Turkey</td>
<td>2.811</td>
</tr>
<tr>
<td>Italy</td>
<td>2.791</td>
</tr>
<tr>
<td>France</td>
<td>2.401</td>
</tr>
<tr>
<td>Russia</td>
<td>1.455</td>
</tr>
<tr>
<td>Austrian Territories</td>
<td>0.607</td>
</tr>
</tbody>
</table>

Source: Bailey, p.83.
Figure 4.1
Ottoman Foreign Trade, 1830-1913
(million British pounds sterling)

Source: Pamuk, 1980, p. 191

Figure 4.2: Ottoman Trade With Britain

Source: Bailey, p. 75
Table 4.3: Average Annual Rate of Growth of Ottoman Foreign Trade (%)

<table>
<thead>
<tr>
<th>Years</th>
<th>Current Prices</th>
<th></th>
<th>1880 Prices</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Exports</td>
<td>Imports</td>
<td>Exports</td>
<td>Imports</td>
</tr>
<tr>
<td>1840-53</td>
<td>5.3</td>
<td>5.5</td>
<td>5.3</td>
<td>6.4</td>
</tr>
<tr>
<td>1857-73</td>
<td>5.0</td>
<td>4.9</td>
<td>6.2</td>
<td>5.2</td>
</tr>
<tr>
<td>1879-98</td>
<td>1.1</td>
<td>0.6</td>
<td>2.7</td>
<td>2.5</td>
</tr>
<tr>
<td>1898-1907</td>
<td>4.3</td>
<td>6.0</td>
<td>3.4</td>
<td>4.3</td>
</tr>
</tbody>
</table>


The increase in foreign trade was definitely larger than the expansion of output during this period. According to Eldem's calculations, later in the 19th Century, between 1894 and 1914, during one of the most active periods in the Empire's history, output increased at an annual rate of only 1.5% and population at 0.8%. Thus, throughout the 19th Century the economy was becoming more and more commercialized and more fully integrated into the world economy, but without much growth in total output.

During this period, as the Empire became more fully integrated into the world economy, foreign trade also began to reflect the broad fluctuations in the world economy. As can be seen from Table 4.3, excluding the period of the Crimean War
(1853-56), between 1840 and 1873 Ottoman foreign trade grew at a high rate, and then declined during the European downswing of 1873-1895. According to Arthur Lewis, although different European countries had differing experiences during the latter period, overall industrial production in Europe came to a standstill, reducing the growth of demand for raw materials from peripheral countries. (Lewis, pp.33-68) Growth in foreign trade picked up again following the European upswing of 1895-1913.

The important turning point for foreign trade was the Anglo-Ottoman Commercial Treaty of 1838. It set the institutional and legal framework for further incorporation into the world economy.

By the early 1830's the British had recognized (and possibly overestimated) the potential of the Ottoman Empire as a source of raw materials and as a market for British manufactures. In October of 1834, in a report prepared for the British foreign minister Lord Palmerston, the first secretary to the Istanbul Embassy David Urquhart complained about "those administrative chains, those commercial prohibitions that lock its [the Empire's] resources from the light," and wrote:

[As] a manufacturing people our first element of prosperity is abundant and cheap materials, what unlimited supplies this country cannot afford?...What bounds to the production of cotton, the finest qualities of silk, of tobacco, of wool, drugs, of corn, oil, hemp, tallow, floss. The facilities of exchange render
production comparatively cheaper than in any other of the countries from which these articles are at present exported in quantities... Were the commerce of Turkey thus emancipated [from administrative chains] so immense would be the production that the price of raw materials would fall throughout the world and a revolution would take place similar to that produced by the discovery of America. (Cited in Bailey, p.164n)

The British were well aware and very optimistic about the changing patterns of production and trade. As Urquhart wrote in his book on Turkey:

It is established that our cottons, muslins, chintzes, etc., are if not better, infinitely cheaper than those of the East. Taste is gradually directing itself to our manufactures... We may calculate, at no remote period, if, indeed, political troubles are arrested, on supplying the necessaries as well as the luxuries of the whole of the Eastern population, whose energies will thus be exclusively directed to agriculture and the furnishing of raw produce... (cited in Issawi, 1966, p.442.)

Before the Commercial Treaty of 1838, through earlier capitulations, duties on imports and exports had been reduced from the traditional 10% to 5% for imports and to 3% for exports. The tax on transit trade was at 2.5% and that on internal trade was at 8%. (Issawi, 1966, p.38; Bailey, p.120) But the government had maintained monopoly restrictions and prohibitions on exports of certain goods like wheat, rice, and opium, as well as on internal trade. British merchants wanted the abolition of all prohibitions and monopolies, the arbitrary taxes and fees, as well as the duties on transit and internal trade. The Ottoman government wanted a means to
increase tax revenues and ensure the provisioning of the large cities. Furthermore, the central bureaucracy was anxious to break the power of the Ottoman merchants who were allied with the tax farmers. After much negotiation, the Treaty of 1838 was signed. It stipulated duties of 5% on imports, 12% on exports, and 3% on transit trade. All prohibitions, monopolies, extraordinary taxes and fees as well as the duties on internal trade were removed for British merchants, thus promoting trade and allowing them greater access to the interior parts of the Empire. This, meanwhile, was a one sided import liberalization: whereas the duty on British imports into the Empire was now 5%, the duty on Ottoman exports into Britain was 60%. (Bailey, p. 120) The Treaty was to apply to all parts of the Empire, and most especially to Egypt, where, British Ambassador Ponsonby hoped, it would "cut up by the roots the power of Mehemet Ali in Egypt and Syria." (Cited in Bailey, p.124) Other European countries then acceded to the Treaty.

As noted before, the volume of foreign trade increased sharply following the Treaty. Widespread trade with dynamic capitalist economies, however, now accelerated both the disintegration of handicrafts in import competing sectors and the change in the composition of agricultural output, to meet international demands. Agriculture began to move significantly away from subsistence to cash crop farming, and those
handicrafts for which there was an international demand, most notably carpets, flourished, while others stagnated.²

Throughout the 19th Century exports grew rather irregularly, mostly in response to sharp price increases in Europe which helped overcome transportation costs. Ottoman Turkey never became a monoculture economy but had a wide variety of exports. For example the repeal of Corn Laws in 1846 resulted in a sharp increase in wheat and barley exports to England. Wheat, which had been in 18th place among exports to England jumped to 4th place in 1850. (Bailey, pp.76-77) Similarly, when during the Crimean War Russian grain shipments to Europe fell, allied armies' demand increased, and prices increased, Ottoman grain exports increased spectacularly. (Owen, p.100) Raw silk production and exports increased in the late 1850's when French silk worms were attacked by disease, and cotton exports rose from 5-7 thousand bales in 1860 to 80 thousand bales in 1865 when European cotton prices increased five fold due to the American Civil War. (Owen, pp.111-113) In the 1870's the growth of American demand for opium, the expanding market for valonia, and the high price for grapes and raisins due to the phylloxera disease in French vineyards sustained the volume of exports. (Owen, p.113)

The Europeans, of course, could form similar relations with countries all over the world. To the extent that there
was no significant social or technological reorganization of agriculture that would improve productivity in the Empire, many Ottoman cash crops were eventually displaced by the crops of other countries with lower unit costs --cotton by American cotton, wool by Australian and Argentinian wool, silk by Chinese silk, etc.

Local notables and Ottoman merchants continued to be the chief domestic beneficiaries of trade with Europe. It was however the European merchants and European merchant capital that played the most important role in mobilizing resources and creating markets. The most significant aspect of the 1838 Treaty was that it had opened up internal trade to European merchant capital. European merchants who had gathered in the port cities and exchanged manufactures for raw materials with the Ottoman merchants now began to differentiate and expand their operations. In the cotton boom of the 1860's, for example, it was the resident European merchants and their local intermediaries who created the infrastructure to expand production. Europeans imported gins and steam cleaning machines and erected cotton presses; they made arrangements to provide cultivators with working capital and borrowed money from Europe to buy the crop. Local intermediaries, in turn, established themselves in the interior as retailers, money lenders, and purchasers with credit from European merchants. (Owen, pp.112-113)
The Commercial Treaty of 1838 had given Europeans preferential treatment over Ottoman merchants. Whereas European merchants did not have to pay the 8% internal trade duty, for example, the native merchants did. The foreigners were, as always, also exempt from all forms of personal taxation. Thus, they gradually displaced the Ottoman merchants. After 1840 hundreds of foreign merchants came to settle in the Empire, forcing out the relatively inexperienced and undercapitalized native Ottoman merchants. (Shaw and Shaw, p.122) Moreover in an economy where credit was short and the use of money relatively limited, European capital played the critical role in opening up the subsistence sector to commercial exchange. In stylized form, for exports, European merchants advanced payment to local intermediaries, who then lent the money to cultivators as working capital on promise of delivery of the output after harvest. For imports, European merchants sold the goods to local intermediaries on credit, who then advanced credit to the peasants payable, again, after the harvest. Foreign merchants did try to contact producers directly, but for the large part there were many intermediaries ranging from the Istanbul merchant to the village grocer. Interest charges increased at each successive stage, reaching usurious rates at the village level. While interest income supplemented the mercantile income of buying low and selling high, it also put the peasant in bondage,
giving the local merchants and notables additional leverage. (Keyder, 1981, pp.97-126)

Transportation and personalized communication networks, financed by European merchant capital, then eventually replaced the tax collection network of the state in controlling the economic surplus. During the 19th Century, for example, the fertile valleys of Western Anatolia became a prime supplier of wheat and legumes to the European economies. In the 1860's Europeans proposed, financed, and built a harbor in Izmir, the main port city, and a railroad network that linked Izmir with the valleys. A highly organized Ottoman camel caravan system facilitated transportation between the train stations and the villages. The Ottoman employees of the European merchant houses routinely travelled from the city to the villages to set up personal contacts. This enabled the European merchants and the local intermediaries to penetrate the remotest parts of the region. (M. Kiray, 1972, pp.4-53) According to Mubeccel Kiray, the standard of living of the peasantry did not change, and while much more than 10% of the agricultural produce flowed through Izmir to Europe leading to significant capital accumulation in the foreign trade sector, the Ottoman treasury was unable to utilize its state apparatus to collect the tithe revenues from the peasants. (M. Kiray, 1972, pp.53-5) Thus, increasing commercialization tended first to lead to further decentralization of the control of the
economic surplus and then to its recentralization in the European controlled foreign trade sector. This trend continued throughout the 19th Century.

2. Reforms

By the beginning of the 19th Century, the central bureaucracy understood that if they and the Empire were to survive, radical reforms were necessary that would enable the Empire to relate to Europe on a more equal footing. It gave up the usual goal of reestablishing the classical system and undertook some explicitly "Westernizing" reforms. The ultimate goal, however, remained to reorganize the administrative and military structure of the Empire to enable the centralized control of the economic surplus and check the power of the local notables. Attempts at reform began at the end of the 18th Century and proceeded more systematically after 1839, during the period known as Tanzimat, or "ordering".  

Central administrative and military structures were reorganized to enhance state power and to identify the interests of the members of central bureaucracy with the state apparatus. There was extensive provincial reform to subordinate the magnates and the local notables to central state power. Accompanying reforms in the tax structure and tax
collection methods attempted to divert the economic surplus towards the center.

The aim of administrative and military reforms was to abolish the traditional power of the military and religious classes in favor of an expanding central bureaucracy. The traditional component of the standing army (the jannisaries) was abolished and the remaining timar holders finally dissolved. A new central army, which would be subservient to the government, was created. New military schools were opened and foreign advisors were invited to reorganize the military, train soldiers and officers, help map frontier areas, improve fortifications and modernize supplies factories. (Shaw and Shaw, pp.20-28)

The central administration was reorganized into departments and ministries by function. The executive and legislative branches were separated. The executive branch, composed of the ministries, was coordinated by the powerful grand vizirate. The most important legislative body was the Council of Tanzimat, in charge of the reforms, though many others were formed and dissolved through time. All bureaucrats were to be paid by salary, according to rank, rather than with timars, tax farms, or fees. (Shaw and Shaw, pp.71-89) Thus, a new bureaucratic hierarchy was created along more modern lines. There was, however, a tendency not to dissolve older
institutions as new ones were created due to the political
difficulties involved in such actions, putting an additional
burden on revenues.

Provincial reform aimed to improve tax collection and
consolidate central power. First, the central bureaucracy had
to come to terms with the local magnates. In 1808 there was an
try to forge an alliance between the magnates and the
sultan. A Document of Agreement (Sened-i Ittifak) was signed
in which the magnates confirmed their loyalty to the sultan,
promised to apply the Ottoman tax system throughout the Empire
without diversion of revenues rightfully belonging to the
sultan and pledged to support the central government against
any opposition to its reforms. The sultan in turn confirmed
the rights and privileges of the magnates as local leaders and
promised to levy taxes justly and fairly. (Shaw and Shaw,
pp.2-3) Nevertheless, throughout the 19th Century, and
especially in the 1830’s, the state confiscated large
landholdings and redistributed them to the peasantry. (Issawi,
1980, pp.220-3)

In the 1840’s the government tried to reduce the power of
the governors, who had become the most influential notables*,
by giving privileges to the lesser notables. It set up
provincial advisory councils. The members would be elected and
would receive salaries from the government. Throughout the
1840's the state extended the powers of the councils, in effect giving the smaller local notables political recognition. This system was more effective, but it was still unable to provide sufficient funds for the treasury. Thus, in 1864 the provincial Reform Law was drafted which once again extended the scope of authority of the governors. (Shaw and Shaw, pp.84-89) There was, in effect, much searching and trial-and-error with respect to the reorganization of relations between the notables and the government.

Tax reform was also a critical component of the government's bid for central power. Its goals were three-fold: to shift the burden of taxation away from the peasants towards the wealthy urban and rural notables; to abolish all the exemptions that had been granted to religious foundations and private property; and to institute direct tax collection by salaried government agents instead of the tax farmers.

With a decree in 1839 all the customary and extraordinary taxes were abolished, with the exception of the tithe, the animal tax, and the head tax for non-muslims. The tithe was set at one tenth of the value of the produce and was to be the sole tax on the produce of the land. The head tax was standardized at 60, 30, and 15 piastres according to ability to pay, and the animal tax was set at 5 piastres per head. Instead of the market and urban taxes that merchants and
Artisans used to pay, a 3% profits tax was instituted on individuals engaged in trade, commerce, and industry. All individuals, except, of course, foreign nationals who were protected by capitulations, were subject to these taxes. In addition, all the taxes, except the poll tax, were to be collected by salaried government agents, rather than tax farmers and governors. The collection of the poll tax was also taken away from tax farmers and entrusted to the leaders of the autonomous millets. (Shaw, 1975)

A detailed census and cadastral survey was taken and the tax reforms were applied to each province as the surveys were completed. Under pressure from continuing budget deficits, this basic tax structure was later modified. New taxes were added, existing taxes increased, and methods of collection changed. The stamp tax was instituted in 1845, which in its final form required citizens to purchase and affix special tax stamps onto most commercial and legal documents. Another important tax, instituted in 1858, was the property tax, levied annually at two fifths of one percent of assessed value on all cultivated land, urban plots and buildings, and at four percent on rental income. (Shaw, 1975) This was the 19th Century incarnation of the land tax.

Legal reform in the tax structure and the tax collection methods, not surprisingly, proved to be much easier than their
implementation. The new urban taxes were collected with more efficiency than the rural ones. Even here, however, the collection of customs duties and other excise taxes on spirits, tobacco, snuff and lumber was given back to tax farmers after a brief and unsuccessful attempt at direct collection. Direct collection did not work in the countryside either. This was partly due to the geographical and technological difficulties involved in setting up such a centralized system, but mostly because of the tension between the local notables and the central bureaucracy. The notables continued to collect and market their "taxes," and since the new arrangement was certainly not agreeable to them, offered no help with local connections or knowledge.⁵ (Shaw and Shaw, pp. 96-103) The central government could not reestablish its legitimacy.

In fact, most of the 19th Century was devoted to improving the efficiency of tithe collections, which still constituted the largest item in total revenues. The state tried and retried direct collection, one-year tax farms, two-year tax farms, five-year tax farms, life-time tax farms; they tried auctioning the tax farms in Istanbul, in the provinces, and to assign them by the recommendation of the governors. Success was slow.
3. Fiscal Crisis of the State and Foreign Debt

Overall, then, as European merchant capital penetrated the economy, drawing both the Ottoman merchants and the tax farmers into its own network as intermediaries and suppliers, it tended also to replace the state's tax collection network as the primary controller of the economic surplus. The central bureaucracy, while successful in containing the local magnates and in centralizing administrative and military expenditures, was simply unable to recentralize the collection of revenues. It would eventually turn to European financial capital for help.

There is extensive anecdotal evidence regarding the growing problems associated with the tax farmers in the 19th Century. The stories range from corruption and withholding payments from the treasury, to abuse of peasants and collusion to underbid at auctions.

In The Present State of Turkey, published in 1807, for example, Thornton estimated that while around L20 million was being squeezed from the peasants, only about 3.75 million of this was being passed onto the treasury. (Owen, pp.59-60) Similarly, as late into the century as 1878, during the
discussion of war reparations to Russia at the Berlin Congress, the Russian delegate pushed for a higher sum by arguing that only one third of the revenues raised entered the state coffers and that there was much room for reform. (Pamuk, 1984, p.54)

In a book entitled The Present State of the Turkish Empire, published in 1839, Marshal Marmont noted that many tax farmers in the highly commercialized Izmir area demanded not one tenth, but one sixth or even a fifth of the peasants' annual product, and wrote:

The same oppression prevails throughout the whole of the pashaliks [provinces], as each pasha [governor] wrings from those dependent on him everything that he can obtain for his own profit ...[and] not even a fourth part of what is levied reaches the coffers of the sultan. (cited in Bailey, p.18)

Similarly, a Foreign Office report filed by the Vice Consul in Larnaca, Cyprus, in 1858 states:

The contractors commit all kinds of wrongs; with arrogance and threats, and often with beatings they tax the peasants arbitrarily and forcibly take away from them not the tenth, but the third part of their produce. Their remonstrances pass unheeded, owing to the connivance of the government functionaries the greater number of whom are interested in the matter. (in Issawi, 1980, p.357)

Yerasimos gives the example of a notable in Jerusalem who leased a tax farm for the annual sum of LT200. The value of the tithe from this area was LT1000. He would actually collect LT1400, send the LT200 to Istanbul and pocket the rest. (Yerasimos, p.911) In 1850 the British Consul in Erzurum
reported that the customs of that region had been farmed out for L230 000, but that even if the duties were "fairly levied," they would bring in "a little short of L1 million," (in Issawi, 1980, p.326) Similarly, in 1858 another Foreign Office report stated that "The cultivator who would comparatively pay less than in any other country in Europe, if taxes be levied by the government itself, pays in reality double." (in Issawi, 1980, p.326)

In another report from the Consul in Erzurum in 1850 the auctioning of agricultural taxes is described:

The large number of buyers who had come from all parts of the province, and the competition that should have ensued, would have led one to expect a large profit for the Treasury. But here, as often when the financial interests of the state are at stake, the sales were carried out with an unheard of degree of favoritism, and most often it is the most influential who gets the tax farms, not the highest bidder. (in Issawi, p.356)

Apparently, according to the Consul, in this particular case, a powerful notable named Cennet Zadeh had spread around the names of the districts or villages whose tax farms he wished to buy. The other buyers understood this as a formal order to abstain from bidding for those tax farms. After Cennet Zadeh had gotten the tax farms he wanted at the previous year's price, he had held a true auction at his home. (in Issawi, pp.356-7)

Such abuses were going on at the higher levels as well.
In his book *Tezakir-i Cevdet* Ahmet Cevdet Pasha describes the 1840's:

People with influence and connections made money through the leasing of tithes and other revenues. Thus through a moneylender a person would guarantee the payment of a certain sum in lieu of the revenue of a district [as a tax farmer] and agree on the sum with an influential person in the government. The influential person in turn would request from the government a contract for the payment of a revenue at a lower price. If the Grand Vizier agreed, he received a contract from the minister of treasury calling for payment of a few thousand purses less than the farmed out revenue. Thus much money was made easily. This, in fact, meant the stealing of the funds of the Imperial Treasury through ingenious machinations. (in Issawi, 1980, p.349)

Given the basic failure of the administration to improve the efficiency of tithe collection, monetary policy and deficit financing had to provide the balance, as administrative reforms, the enlarged central army, and war expenses increased the budget deficits.

Monetary policy of the government ranged from melting the gold and silver plates of the palace, to declaring jewelry to be sinful under religious law and forcing its donation to the state; from debasing the currency and forcing people to give up good coins for bad, to issuing inconvertible paper currency and borrowing at 12% interest from the Galata Bankers.

The latter course, though economically perhaps the most rational under the circumstances, was particularly damaging to the long run interests of the central bureaucracy -- the
centralization of the control of the economic surplus. It allowed the bankers to retrench their positions as absentee tax farmers or sponsors of tax farmers by holding claims on a bankrupt government. When the value of the bonds to be reimbursed became a considerable sum, the ministers, unable to withstand further pressure, were forced to "auction" off tax farms well below their value and accept the bonds as payment.* (Suvla; Issawi, 1980, p.339; Blaisdell, pp.11-12)

Such was the state of affairs when the Crimean War broke out and the Empire could no longer withstand the official European pressure to borrow (see Chapter II). In other words, the Empire did not borrow in order to invest the proceeds, to increase the productive capacity of the economy, and thus be able to pay back without strain. The state did expect its future income to be higher than its current income, but this was not due to the discovery of new natural resources nor, indeed, belief that production would increase due to incorporation into the world economic system. The central bureaucracy borrowed from Europe in order to undermine the power of the local notables, the tax farmers and the local merchant-money lenders, and to reestablish its traditional political legitimacy and control over the economic surplus. It was in order to finance a conflict over the distribution of the economic surplus, rather than to finance its production.
It is in this context that the use of funds as well as the seeming indifference of the central bureaucracy to the displacement of Ottoman merchants and entrepreneurs by Europeans make sense. Throughout the centuries the state had distributed and redistributed the economic surplus between different contenders by incorporating them into the state apparatus, by playing them against each other, and by forming shifting alliances, but always managing to reestablish ultimate control. In this setting, after partly incorporating the local magnates and the strongest of the notables and partly having them destroy one another, the state decided to ally with European financial capital against the notables, in order to increase its control and share of the surplus.

A quick look at Table 4.4 indicates the major expenditure targets. One is military expenditure, undertaken both to increase the coercive power of the state vis-a-vis the notables, as well as to maintain territorial integrity. Another is expenditure on general administration, financing the extensive institutional reforms undertaken to enhance central authority. The third is the transformation of politically burdensome internal liabilities to the Galata Bankers into external liabilities to the new allies, the European financiers. Spending on public works, education, or even the private purse of the sultan fall far behind.
### Table 4.4: Planned Expenditures of the Ottoman Government 1860-1874 (Million Turkish Lira)

<table>
<thead>
<tr>
<th>Years</th>
<th>Total</th>
<th>Military</th>
<th>Administration</th>
<th>Sultan's Purse</th>
</tr>
</thead>
<tbody>
<tr>
<td>1860-1</td>
<td>14.76</td>
<td>6.21</td>
<td>4.25</td>
<td>2.03</td>
</tr>
<tr>
<td>1862-3</td>
<td>14.91</td>
<td>6.25</td>
<td>3.86</td>
<td>1.60</td>
</tr>
<tr>
<td>1863-4</td>
<td>14.85</td>
<td>5.38</td>
<td>3.43</td>
<td>1.57</td>
</tr>
<tr>
<td>1866-7</td>
<td>16.80</td>
<td>4.33</td>
<td>5.24</td>
<td>1.41</td>
</tr>
<tr>
<td>1868-9</td>
<td>17.01</td>
<td>4.94</td>
<td>7.81</td>
<td>1.02</td>
</tr>
<tr>
<td>1869-70</td>
<td>16.97</td>
<td>5.30</td>
<td>7.17</td>
<td>1.01</td>
</tr>
<tr>
<td>1870-1</td>
<td>22.77</td>
<td>5.18</td>
<td>9.56</td>
<td>1.30</td>
</tr>
<tr>
<td>1872-3</td>
<td>21.40</td>
<td>4.73</td>
<td>8.25</td>
<td>1.31</td>
</tr>
<tr>
<td>1874-5</td>
<td>25.13</td>
<td>6.05</td>
<td>9.02</td>
<td>1.32</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Years</th>
<th>External Debt</th>
<th>Internal Debt</th>
<th>Education</th>
<th>Public Works</th>
</tr>
</thead>
<tbody>
<tr>
<td>1860-1</td>
<td>0.92</td>
<td>1.32</td>
<td>0.03</td>
<td>n.a.</td>
</tr>
<tr>
<td>1862-3</td>
<td>1.23</td>
<td>1.92</td>
<td>0.05</td>
<td>n.a.</td>
</tr>
<tr>
<td>1863-4</td>
<td>1.76</td>
<td>2.61</td>
<td>0.05</td>
<td>n.a.</td>
</tr>
<tr>
<td>1866-7</td>
<td>2.90</td>
<td>2.80</td>
<td>0.12</td>
<td>n.a.</td>
</tr>
<tr>
<td>1868-9</td>
<td>2.90</td>
<td>0.01</td>
<td>0.06</td>
<td>0.27</td>
</tr>
<tr>
<td>1869-70</td>
<td>2.90</td>
<td>0.01</td>
<td>0.08</td>
<td>0.32</td>
</tr>
<tr>
<td>1870-1</td>
<td>6.20</td>
<td>0.01</td>
<td>0.11</td>
<td>0.41</td>
</tr>
<tr>
<td>1872-3</td>
<td>6.51</td>
<td>0.01</td>
<td>0.08</td>
<td>0.51</td>
</tr>
<tr>
<td>1874-5</td>
<td>7.84</td>
<td>0.01</td>
<td>0.13</td>
<td>0.76</td>
</tr>
</tbody>
</table>

n.a.: Not Available

L 1 = TL 1.1

Military expenditures include the budgets of the Ministries of the Army, the Navy, the Police and Gendarmerie, and of the Imperial Arsenal Department.

Administrative expenditures include the budgets of the Ministries of the Interior, Foreign Affairs, Justice and Sects, and Finance.

Sultan's Purse reflects only the contributions of the state treasury. The treasury of the Sultan also had substantial revenues of its own from estates, investments and other sources.

Public Works include the budgets of the Ministry of Public Works and of the Post Office and Telegraph Services.

NOTES TO CHAPTER IV

1. Valonia are dried acorn cups used in tanning or dressing leather.

2. For example, in his Letters on Turkey, published in 1856, Ubicini wrote:

   Manufacturing activity has greatly declined from what it formerly was in the Ottoman Empire. At present the greater part of the exports of Turkey consists in raw materials, which it hands over to Europe, and which the latter returns to Turkey in manufactured form. The numerous and varied manufactures, which formerly sufficed not only for the consumption of the Empire, but which also stocked the markets of all parts of the Levant, and of several countries of Europe, no longer exist or have completely declined...Anatolia, Diarbekir, and Broussa, which were formerly so renowned for their velvets, satins, and silk-stuffs, do not now produce a tenth part of what they yielded from thirty to forty years ago. The latter scarcely manufactures 40 000 piastres' worth of silk annually, while its exports of raw silk and dry cocoons amount to a value of nearly eight million piastres. (Cited in Issawi, 1966, p.43)

   Similarly, "In the past there were 82 mines working at full capacity in Asia Minor; today, however, there are only 14 and they produce only one third of what they could." (Cited in Yerasimos, p.569) During this period Turkey imported increasing amounts of iron and coal. Later in the century, as Europe began to develop its heavy industry, so did the Empire began to export its minerals.

   By the 19th Century the piastre, another silver coin, had replaced the akcha as the most common coin. 100 piastres equalled one Turkish Pound, (LT).

3. It is important to point out that although the move towards centralization and reform originated internally, it progressed under the urging and sometimes the direction of the Europeans, especially the British. Britain had a lucrative trade with the Ottoman Empire. Perhaps more importantly, with the advent of railways, the Empire had acquired a new importance as an overland route to India. 1833 was an important turning point. In 1833 Egypt's de facto ruler, Mehmet Ali Pasha rebelled; his forces invaded Syria and came into Central Anatolia. Rebuffed by Britain and France, the Empire turned to Russia for help. In May of 1833 the sultan relinquished Syria and Adana to Egypt and signed the Treaty of Hunkar Iskelesi with the Russians. This was in effect a defensive alliance, but it created panic among the European powers, and led to a new Near Eastern policy in Britain. In order to prevent the southern expansion of Russia, preserve the
overland route to India, and maintain open economic relations with the Empire, Britain committed itself to preserve the territorial integrity of the Ottoman Empire and to encourage its internal development. (Bailey, pp.129-139)

Policy inclinations changed from direct intervention to non-interference to discreet persuasion. In 1835 Foreign Secretary Lord Palmerston instructed the British Ambassador Lord Ponsonby to exhort the Turkish ministers to pursue "with increasing energy and perseverance that wise system of organization military, naval, financial and administrative which had already been so successfully begun." (cited in Bailey, p.145) Thus, the British helped find a role for the central bureaucracy in a society where their function as lord-bureaucrats was becoming obsolete.

4. The governors tended to be the most influential tax farmers. Through contacts in high offices they usually obtained the privilege of collecting the tithe for a price that was much lower than that realizable at a real public auction. After paying the downpayment with funds borrowed from the Galata bankers, they would sub-farm the revenue and collect sums far out of proportion to the tithe for which they were accountable. The difference was then shared between the banker, the governor and his subordinate tax farmers. (e.g. Blaisdell, pp.11-12)

5. In his "Lords or Bandits? The Derebeys of Cilicia," Gould tells the story of two salaried tax collectors in South East Cilicia who had so little power and so few troops at their disposal that they were forced to ally themselves with one or the other of the notable factions which formed the Adana Council.

6. In his A Journal Kept in Turkey and Greece, 1857-58, Nassau Senior reports that according to an English merchant in Istanbul one of the reasons for Turkey's existence was "for the benefit of some fifty or sixty bankers or usurers and some thirty to forty pashas who make fortunes out of its spoils," (p.84)

7. For a most intriguing paper on this concept of the Ottoman state, see Aricanli, 1986.
PART II: CONDITIONALITY IN THE 19TH CENTURY

The previous chapters have presented an aggregate picture of the external public debt of the Ottoman Empire from 1854 to 1914 and analyzed the larger historical forces which led to external borrowing. The next two chapters concentrate on the period between 1860 and 1870, focusing on the Europeans' conception of the events leading to default, their prescriptions to prevent it, and the responses of the Ottoman state.

The central component of the chapters is the "Report on the Financial Condition of Turkey" prepared by two members of the British Board of Trade, Mr. Foster and Lord Hobart, and submitted to the British Houses of Parliament in 1862.

The Hobart-Foster mission was sent to the Ottoman Empire by the Foreign Minister Lord Russell when, after three foreign loans, the Empire's attempts to raise yet another one in 1860 failed and it was unable to meet its foreign obligations. The Report details the financial and administrative reforms the authors thought that the Empire needed to undertake in order to gain solvency in the short run and attain growth in the long run. As such, this mission was the 19th Century analogue of both IMF missions, which deal with short term...
stabilization, and Word Bank missions, which deal with prospects of long term growth.

Although the historical context was quite different, a comparison can also be drawn in relation to the practical importance of the Report. In the 20th Century the IMF and the World Bank are internationally recognized agencies and "conditionality" refers to the set of economic prerequisites that they impose on the LDCs before they extend loans. These prerequisites are formally binding. In the 19th Century the British government, the Board of Trade, or the Foreign Ministry did not have such internationally recognized legitimacy and so the recommendations of the Report were not formally binding. However, the success of foreign loan flotations in the private capital markets critically depended on the confidence of the investors, which in turn was largely determined by the official evaluation of the country in question. The official evaluation of the country, in turn, relied on the technical expertise of the mission and depended on whether the reforms were undertaken or not. The country, in other words, would ignore the recommendations at the risk of not having further access to the European capital markets. Thus, the practical impact of the Report and its recommendations was two-fold. On the one hand, in a manner analogous to the "green light" function of the IMF, it signalled that financial order had been or would easily be
restored, and on the other, gave the Foreign Ministry of Britain ample ammunition to push for further reforms.

It will be important to remember that, as a rule, IMF conditions for countries with balance of payments problems are fiscal contraction, devaluation, and monetary contraction; and that the Word Bank, in its capacity to give project and structural adjustment loans, chooses to promote development through allowing the markets' allocative mechanism to work (get the prices right, liberalize trade and financial markets, promote factor movements, etc.), budgetary reform, institution building, and a reorganization of government investment priorities. Both institutions have a strong bias towards market economy solutions to development problems.

I will evaluate the Report in the context of the 19th Century: looking at the socio-economic circumstances of the Ottoman Empire on the one hand and classical economic theory on the other. The goal is to understand why the mission recommended what it did and to see how economic theory interacted with politics and the existing institutions to produce a new direction within the ongoing process of change. The historical comparisons with the IMF and the World Bank, however, are most intriguing, and I will come back to these. What is perhaps most surprising is that the classical stabilization programme as recommended by Hobart and Foster is
not significantly different than those of the IMF and the World Bank.

Chapter V, "European Solutions," details the events leading up to the mission, sets up the theoretical background in terms of classical economic theory, and analyzes the Report within the context of that theory. It concludes with a comparison of the classical programme with the neoclassical. Chapter VI, "Ottoman Responses," discusses the reforms that were and were not undertaken. It concludes with a section on the macro relations that emerged as a result of the interaction between classical economic theory and the existing dynamics of Ottoman society.
IV. EUROPEAN SOLUTIONS

By 1860 the Empire had contracted three foreign loans. The L7.4 million received from the 1854 and 1855 loans was used to finance the Crimean War, which cost the Ottoman Treasury a total of L11.2 million. The L3.8 million received from the 1858 loan was earmarked for withdrawing the paper money that had been issued in the interim, but L0.6 million of it was used to finance a military campaign to Jiddeh and to put down several rebellions. (Du Velay, pp.84-9) By 1860 the financial situation had again become acute. Short term internal debt totalled L20 million and annual charges on the external debt had reached L0.8 million. Thus, the Ottoman government decided to seek another foreign loan to retire L4 million of the floating debt owed to the Galata Bankers, which at 12% interest was doubling every six years. (Yerasimos, pp.745-6) This, however, would not be easy.

Throughout this period very little was known in Europe about the Empire's finances. The opinion of the press was mixed and usually cautious. It was the support of the British and French governments which had enabled the successful
floatation of the 1854 and 1855 loans and the financial markets were reluctant to accept a new floatation without such support.

The story of the 1854-1860 period reveals some of the important dynamics between foreign debt and foreign policy. As noted before, since 1834 Britain had committed itself to preserve the territorial integrity of the Ottoman Empire in order to prevent Russia from expanding southward, to sustain a friendly overland route to India, and to maintain open economic relations with the Empire. As long as the Ottoman government could perform this function, the British Parliament was reluctant to get directly involved in state finances. Once the Crimean War broke out and it became clear that the Ottoman government could not finance such a war, however, both the British and the French governments came to the aid of the Ottoman treasury by supporting it in the international capital markets.

The 1854 loan was supported by the British government. Its prospectus read:

The undersigned [banking house] has the satisfaction to acquaint the public that they are authorized by the Earl of Clarendon, H.M. principal Secretary of State for Foreign Affairs, to state that this loan is negotiated with the knowledge of the English Government;...and Lord Clarendon relies with confidence upon the Turkish Government fulfilling with good faith the engagements they have entered into. (cited in Blaisdell, pp.48-9)
As a result, the 1854 loan was issued at only 20% below par, with an effective interest rate of 7.9% --terms that were substantially better than the average of the period, at 59% and 10%, respectively.

The interest on the 1855 loan was actually guaranteed by both the British and the French governments. There had been strong opposition in the British Parliament when the issue came up in the House of Commons on July 30th. Prominent MPs like Disraeli, Gladstone, Layard, and Cobden were all skeptical about Prime Minister Lord Palmerston's estimate of Ottoman resources and asked why the Empire did not float a loan without the support of her allies, if her resources were as great as Lord Palmerston maintained. The motion was eventually adopted, but only by a vote of 135 to 132. (Blaisdell, p.52) As a result, the most conservative bankers entered the market and the 1855 loan, eventually floated by the Rothschilds of London, became the only loan to be issued at 2.6% above par, with an effective interest rate of only 4%.

Meanwhile, the British Embassy in Istanbul regarded the foreign loans business as a means to increase its influence and force reforms under the rhetoric of improving the Empire's reputation. Ambassador Canning had in fact pressured the
sultan to borrow earlier. As noted before, immediately after the War Loans, he was successful in a campaign to pressure the sultan into a new set of reforms. The result was the Hatt-i Humayun Decree of February 1856 in which promise of a well organized, modern state, exercising full sovereignty and dealing even handed justice to all subjects, combined with promise of public works. The Decree granted full equality to non-Muslim subjects, so that Russia's designs to incite the Balkan peoples might be unsuccessful, and promised banks, roads and right of landownership to foreigners. Even the usually conservative London Times lost its reserve. On February 12, 1856 it wrote:

The removal of all obstacles to the purchase of land by foreigners, [and] the establishment of a sound financial system and of the guarantees for the security of the capital invested in roads and harbors, must be the diplomatic labors most immediately productive of large results. A rich and unworked land is before us, and the industry of the West may go in and posses it! We may be content, therefore, to allow time to aid us in our labors.

Later that year the Ottoman government sought another loan to retire the paper currency and stabilize the Turkish pound. But the 1858 loan would not have any official support and would be quite difficult to float. According to Du Velay, a director of the Ottoman Bank writing in 1902, the Decree of 1856 and the subsequent establishment of the Ottoman Bank had been well received, but the opposition to the guaranteed loan in the British Parliament had left its scar. (Du Velay, p.87)
The London *Times*, which had given its full support to the 1855 loan, was highly skeptical about the prospects of a new loan.

On November 1, 1856 it wrote:

...we may find too late that the guarantees and concessions are but a delusion, and that vast sums of money have been lost...We would advise our countrymen not to trust too sanguinely to [Turkish] political support. The Turkish functionaries are in commercial matters both ignorant and corrupt...The Porte is, we believe, totally untrustworthy in its dealings with foreign enterprise.

In 1857, as a gesture of good will, the sultan asked the Austrian Ambassador to appoint an advisor to the Council of State to help reform the finances. Early in 1858 the president of the Council, Fuat Pasha, came up with a plan to reorganize the finances and went to Europe to raise a loan, but had little success. In August the sultan issued a decree which prescribed stringent discipline in expenditures. (Yerasimos, p.140) The reaction of the press was cautious. On September 13, 1858 the London *Times* commented:

...it would be folly not to recognize the connection between this sudden conversion to economy and the demand for the new loan. Without presuming that the Porte is desirous of enticing foreigners into lending money by a false pretense of reformation...we must take the Sultan's present determination for what it is worth...

The agreement between the Ottoman government and London's Dent, Palmer, and Company for a loan of 5 million British pounds was signed in late August. The customs and octroi (transit trade) revenues of Istanbul were shown as security and the Ottoman government agreed to the establishment of a
special commission which would collect these revenues and finance the service charges. While this loan was in the process of subscription, on September 25, 1858, the London Times warned:

There is at present something like a plethora of capital, and it may well be that our suffering countrymen will seek relief by endeavoring to fill the exhausted veins of Turkey... The crying sin of Turkish governments for many generations has been financial profligacy... To live within its means, to borrow only on great occasions, and then with a certainty of inflicting no wrong on the lenders, are the first duties of an honorable community. Till Turkey has shown a firm resolve to carry out these principles she ought not to expect further assistance as a state.

The Daily News and the Daily Herald were more positive. On September 2, 1858 the Daily News pointed to the particularly liquid nature of the designated revenues and applauded the commission as "a considerable innovation from the political point of view as well as from the point of finance." The Daily Herald of September 3, 1858 went further and claimed:

Everything which has been said in regard to the instability of the Ottoman Government, of the irregular employment of the customs revenues, and of the absence of authority for contracting the loan... has only been circulated to obstruct the course of the loan, or for accomplishing a quotation of discount, and it is affirmed that it is devoid of any foundation.

The 1858 floatation received a mixed reception from the public. Initially, 3 million pounds were issued at 15% below par, but the remaining 2 million pounds, floated in 1859, had
to be issued at 37.5% below par to cover the syndicate's losses, bringing the overall effective interest rate on this loan to 8.7%. According to Du Velay, these events were widely interpreted as evidence that the Ottoman government did not have enough credibility to float loans on its own. (Du Velay, p.88)

Thus, when in 1860 the Ottoman state began to look for a new loan to retire the floating debt, the British capital market was not very receptive. The state turned to the French market and finally found a M. Mires, a Parisian financial wizard of the day, who agreed to underwrite it. The subscription was quite successful until the French Police arrested Mires for misuse of funds in his other companies. Then "the bottom fell out". The Ottoman piastre fell from 129 to the pound to 200 to the pound in five months. (Du Velay, p.95)

The Ottoman government issued another L1 million in paper currency to meet its obligations and at the same time sent Britain and France an ultimatum stating that unless the bills of exchange of the Turkish merchant houses were accepted and unless another loan was forthcoming to the Ottoman government which would enable it to pay its own debt to these houses, not only would several French and British firms go bankrupt, but
that political instability and "the Eastern Question" would reemerge. (Du Velay, p.98)

It was in response to this ultimatum that the British government dispatched Lord Hobart and Mr. Foster of the British Board of Trade to Istanbul to look into the finances of the Empire.¹

Before their departure from London, in a letter dated April 22, 1861, Foreign Minister Lord Russell set the agenda. They were to inquire into the finances of the Porte "with a view to the improvement of the system of collection, appropriation, and account of the revenues." Their primary concern was to be with agricultural taxes and tax farmers. They were to make sure that the tax farmers could no longer intervene to intercept that portion of the revenue which was duly the treasury's. In addition, they were to see if the state could profitably get a portion of what the tax farmers illegally appropriated for themselves. Secondly they were to determine what the expenditures really were. Thirdly they were to establish a proper system of audit and accounting. And finally they were to make suggestions "for the benefit of trade." "If" the letter concluded, "the results of your labors should be to place the Turkish finances on a sound footing, you will have rendered a very essential service, not only to

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the Porte, but to the general interests of all powers having relations, whether political or commercial, with Turkey."

The "Report on the Financial Condition of Turkey" was submitted to Lord J. Russell on December 7, 1861 and to the Houses of Parliament in 1862. The British Ambassador to Istanbul, Sir Henry Bulwer, was charged with presenting the contents of the Report to the Sultan.

1. Theoretical Background

The interesting question, of course, concerns what the mission recommended and why. In order to be able to put the recommendations into a general theoretical context and understand why they made the recommendations that they did, it is necessary to look at the general concerns and perceptions of the economists of the time. The next two sections outline the classical economists' views on growth and development, anticipating some of the reform proposals.

**Growth and the International Division of Labor**

As a school the primary concern of the classical economists was growth. If one looks at the school as a whole, one can see that the 19th Century international division of
labor emerges as a policy prescription, not only through the
theory of comparative advantage as developed by Ricardo and
refined by John Stuart Mill, but also as a means of
maintaining growth in the industrialized countries. In all of
the classical economists there was the idea that eventually
the profit rate would fall to zero or some subjective minimum
for the capitalists and the society would reach a steady state
-- an abhorrent idea for most. In this context, various
aspects of the 19th Century international division of labor
emerge as a means to avoid the steady state in the
industrialized countries. Smith and Ricardo perhaps form the
opposite ends of the range of ideas on this score. Ricardo had
a formally consistent but somewhat static model; whereas Smith
had a more sociological and dynamic approach. Most of the
other classical economists, especially John Stuart Mill who
was the most influential economist of the 1850s, fell
somewhere in between.

For Smith, capital accumulation and growth proceeded with
division of labor which improved productivity and fueled
innovation. As capital accumulated labor demand increased,
increasing wages and, later, the population, thus ensuring a
demand increase for the product. Nevertheless, Smith saw the
society approaching a possible steady state because it could
run out of investment opportunities and because the division
of labor itself was limited by the "extent of the market".

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Acquisition of new territories and finding new branches of trade were two of the counteracting tendencies. Trade as "the vent for surplus," then, was an important means of postponing the steady state. It extended the division of labor, and thus investment and growth, beyond the scope which the domestic market could support. Thus, Smith advocated a search for markets.

Ricardo's Corn Model was more formal. In this model land is non-homogenous and in fixed supply, so there are diminishing returns to scale and decreasing returns to the variable input -- a dose of labor-cum-capital. Real wages in terms of corn are fixed at the (physical) subsistence level through Malthusian population adjustment. That is, when increases in investment and labor demand cause an increase in the real wage, population (labor supply) increases until the real wage falls to its original level. Thus, the demand for corn is directly proportional to the population and inelastic. Price of corn is the supply price at the margin. The intramarginal (AP-MP) surplus due to decreasing returns gives rise to differential rents and the marginal plot of land receives zero rent. Population also determines the wage bill and profits are residual. As capital accumulates and cultivation is extended under favorable profit rates, the population increases and, with constant real wage and decreasing returns, the wage bill captures a larger and larger
portion of the output at the margin. This process continues until the wage bill captures the whole of the output at the margin and profits fall to zero, or until investment stops at some subjective minimum profit rate and the society reaches the steady state. Under these assumptions, it is clear that one way to prolong the road to the steady state was to import cheap foodstuffs, which would increase the profit rate by contracting the margin. This conclusion should come as no surprise, since the model was the cornerstone of Ricardo's argument against the Corn Laws.

John Stuart Mill, perhaps the economist most relevant to our analysis, was somewhere in between Smith and Ricardo. He rejected the idea of a physical subsistence wage and thought that with education it would be possible to limit population growth and thus have higher wages. More importantly for our purposes, he argued that wage costs per unit need not rise with population growth, since there could be technological improvements. Nevertheless, he too was a firm believer in the imminent approach of the steady state, along the Simithian lines of exhausted investment opportunities, and in fact, believed that the steady state was close at hand. He argued that as the profit rate fell, capitalists became more prone to invest in high risk ventures, causing instability and volatility in the economy. Thus, he argued that it was not a bad idea to export capital abroad and if that capital could be
used to provide cheap wage goods, it would be for all the better.

So, there was a rationale within classical economic theory to push for markets for manufactures, to import cheap raw materials and foodstuffs, and to export capital in order to sustain the growth of European economies.

**Theory of Development and Trade**

Briefly, the classical concept of underdevelopment was that most less developed societies had arrived at a steady state with a low level of income, because even though in absolute terms the profit rate may be large, say in comparison to that of England, it was in some sense too low upon subjective or local evaluation due to institutional limitations or undeveloped tastes. Smith, McCulloch, and J.S. Mill, for example, all referred to China as such a stationary economy. For Smith this lack of net investment was due to monopolies and government interference; for McCulloch, due to high risk; and for Mill, due to the overvaluing of present over future pleasures, or undeveloped tastes. In general, lack of security of property, infrastructure, or banks to mobilize hoards and the existence of monopolies, an inappropriate judicial structure, or traditional land tenure patterns that produced underemployment were thought to be among the more
important institutions that discouraged investment and growth. Undeveloped tastes referred to the apathy of capitalists and the backward bending supply curve of the workers. There was a need to incite a desire for betterment -- to push the capitalists to want to accumulate material goods and the workers to work.

The classical theory of trade, of course, was based on the theory of comparative advantage developed by Ricardo and the law of reciprocal demand developed by J.S. Mill. The basic idea was that with trade the countries would specialize in the production of goods that they had a comparative cost advantage in and that both partners would benefit from free trade. Specie flow mechanism would ensure that comparative real cost advantage would be reflected as an absolute price advantage.

Overall then, we may anticipate the Report to recommend policies that promoted trade and the emerging 19th Century international division of labor, as well as policies that changed the institutional structure of the economy to benefit both Europe and the Empire.

2. The Report and Classical Economic Theory
So far, we have developed the theoretical context within which the Report was prepared. In this section I will take a closer look at the Report and discuss its recommendations with respect to the specifics of classical economic theory. Notwithstanding the usual dichotomies between academic and practical economics, this will help provide a further rationale for the recommendations.

The 42-page report is organized around six major sections: revenues, expenditures, administrative structures, accounting practices, balance of revenue and expenditure, and the public debt. In the first two sections the Report evaluates the taxation and spending patterns with a view to promote long term development and growth. The next two sections, on administration and accounting, recommend institutional changes with the same view in mind. In terms of the 20th Century analogue, these are the sections which would correspond to the subject matter of the World Bank. It is in the last two sections that the Report concentrates on the need to run a fiscal surplus in order to pay back the existing debt and lists a series of measures that need to be adopted immediately to promote short term stability --the stuff of the IMF.

The Long Run
Revenues

In the classical (liberal) model, taxation was a bad idea in general, because it interfered with the markets' allocation of resources. Yet it was a necessary evil, since revenues were required for the state to fulfill its responsibilities. In part to minimize the damage of taxation, responsibilities of the state were to be limited to the provision of three things: defense, justice (preservation of the rules of the game), and infrastructure. The state did need to take an active role in promoting institutions conducive to competition, growth and development, but this usually meant curtailing its own ambitions.

The rule of thumb with respect to taxation, then, was that it should interfere as little as possible with the markets' resource allocation, the supply of factors, or growth. Under these circumstances, net rents, which were windfall gains and were spent on luxury consumption, were the ideal source for taxes.\(^2\) Other than net rents, excise taxes on luxury goods (tobacco, tea, beer, sugar, etc.) were recommended, both because the relative price inelasticity of demand would generate revenues efficiently and because Victorian morality condoned a reduction in the consumption of these products.
The overall indictment of the Report on revenues is that taxation is "burdensome only in so far as it is ill-adjusted" (p.32), and that the state plays too great a role in the economy. Most of the changes that are recommended in the tax structure aim to reduce the tax burden to the cultivators without reducing revenue to the treasury. The goal is to remove disincentives, raise the profit rate, and thus allow agricultural output to increase.

The Report approves of the reform plans of the Ottoman government with respect to the tithe which represented 25% of total revenues. In practice the tithe was 10% of the agricultural produce and its collection was auctioned to tax farmers. The proposed reform would institute direct collection and fix the nominal value of tithe payments by village, based on the average annual value of the taxes received in the past five years. Hobart and Foster estimate that the treasury's revenues would increase by 8%, but that the main beneficiaries would be the peasants, both because of the removal of the tax farmers' abuse and because of the upward trend in prices. The idea is that this would lead to higher output and higher revenues in the long run: "On the whole then, the new measure while providing a direct increase of revenue of no inconsiderable amount, will (as may fairly be anticipated) contribute in a very important degree to increase it indirectly by the relief which it will give to the cultivators
of the soil, and the consequent stimulus to production and trade throughout the Empire." (p.7) In response to the foreign minister's inquiry, in other words, in the process of removing the tax farmers they prefer to reduce the tax burden to the peasants rather than increase revenues to the treasury substantially.

In fact, in general, replacement of tax farming (of the tithe, animal taxes, customs duties, etc.) with direct collection is the most emphasized recommendation. The Report states that "tax farms are sold and resold...and thus between the amount that is due to the government by the cultivator and the amount which it receives from the tax farmer there is a margin sufficient to cover several distinct commercial profits." (p.5) It also points out that the tax farmer abuses his power while trying to enhance the value of his share of the product. This type of an analysis is in keeping with the classical economists' who were uniformly opposed to tax farming. Smith, for example, did argue that it increased the tax bill, because tax farmers' profits had to be met. More specifically, he argued against it on the basis of the fact that the tax farmers' income represented monopoly profits, since the need to have access to large amounts of capital and to knowledge of the tax system produced significant barriers to entry.
Another interesting item is the customs duties section. Classical economists, of course, were free traders, and, in general, they were against tariffs, because this led to the misallocation of resources and specie, removed the dynamic stimulation of trade through the vent for surplus, led to smuggling and corruption, etc. Yet, most classical economists agreed that customs duties were a good source of revenue because they were efficient and easy to collect. McCulloch, for example, argued that 12, 15, even 25% duties were permissable for revenue purposes, and that the protective effect could be balanced by excise duties on home goods. Given that the Empire needed to run a budget surplus, one may have thought an increase in customs duties would be recommended.

At the time the Report was being prepared, however, the Ottoman government had just concluded a Trade Agreement with the European powers which would reduce customs revenues. According to the new Agreement, the 12% duty on exports was reduced to 8%, and it would decrease a percentage point each year thereafter until it reached 1%. In return, the 5% duty on imports was increased to 8%, but the 4% duty on transit trade was reduced to 2%.

The Report foresees a reduction in customs revenues under the present circumstances, but argues that they may increase if direct collection is instituted and smuggling is prevented.
Nevertheless, their hopes are in "the relief and impulse which [the Agreement] cannot fail to give to agriculture and commerce," (p.10) thus increasing tithe collections. Once again, they are very optimistic about the price elasticity of agricultural production.

The only two existing taxes they recommend increases in are the **stamp tax** and the **tobacco tax**. The stamp tax was a tax on documents: title deeds, leases, money bonds, etc. The Report recommends an extension of this to bills of exchange, promissory notes, and cheques. In general the classical economists had favored stamp taxes if the incidence fell on consumers and borrowers, but not on sellers or lenders. As noted before, taxation of tobacco, a luxury good with inelastic demand, was entirely appropriate within the classical tradition. The Report notes that "a country containing a population...in which most men, and a great many women smoke incessantly [needs to generate more revenues from this article] which is universally recognised as one of the fittest subjects for taxation," (p.11) and proposes an increase in the tax rates. The Report also laments the fact that Muslims do not drink much alcohol, thus limiting the possibilities for the **spirits tax**. On all the other indirect taxes, the recommendation in addition to direct collection is to unify and/or reduce the rates.
In relation to the other sources of revenue --state properties-- the mission finds the presence of the state in the economy to be much too extensive. The Report argues that in the longer run increase in revenues must come from the sale of properties belonging to the state --real estate, fisheries, forests, mines, and land. If the sale of property is not politically palatable, then they should be leased to private individuals on a long term basis:

Much of this property might probably be sold, with great advantage to the state, especially if the exclusion of foreigners from proprietary rights in Turkey were, as it ought to be abolished. Where the property is retained by the government, the leases, which we believe, are now annual, should be for longer periods, and care should be taken in every case thoroughly to advertise the property for which a tenant is required....If leases were granted for longer periods, a better price would be given for them in the market, and more care be taken by their holders to preserve and foster the [properties] in which they were interested. (p.15)

These recommendations, too, are in keeping with the classical framework. There was, as mentioned before, unanimous agreement among classical economists (or, for that matter, neoclassical economists) that the government could do no good if it got involved in the economy and that its role should be limited to setting up and preserving the rules of the game under the allocative mechanism of the market. Also, as noted before, lack of security of property in underdeveloped countries was considered to be the primary reason behind low investment in the face of high profit rates. In addition, long
term leasing of state property would allow the treasury to get access to net rents -- the proper source of revenue.

It is in the context of state property that the Report first raises the oft repeated issue of foreign capital and foreign ownership. The repeated recommendation is that the government should "lay aside all jealousy of private enterprise, whether national or foreign, and throw its doors open to free competition" and that "it is by foreign capital that the land would be made most valuable both to the government which would receive a higher price for the property and to the community which would profit by the development of its productive power." (p.15) In addition to the classical enchantment with free competition, there is another aspect to this argument, one which also emerges in debates on India: If the country is poor because savings and investment are low, and if the government is not supposed to tax in order to get involved in investment activities, the only other logical source is foreign capital.

The final recommendation that is relevant to this section is for basic (and familiar) structural change: "Remove interferences with the free course of supply and demand" -- end all government monopolies, abolish the system of guilds, and stop prohibiting the peasantry from leaving the estates of landholders-- for "any attempt to artificially regulate labor
and production by government control can only result in injury to the State and to the people." (p.33)

Overall, then, there is an optimism in the Report that revenues to the central treasury can increase without increasing, and in many cases actually reducing, the tax burden to the producers. This would come through the abolition of tax farming in the shorter run and through the resulting increases in agricultural production and agricultural exports in the medium run. In the longer run, giving full reign to free competition between private domestic and foreign capital, within the context of the allocative mechanism of free markets (getting prices right) and a curtailed role for the state, would lead to higher investment, output, and thus also, revenues -- all very familiar recommendations from World Bank missions.

Expenditures

The overall view of the Report on expenditures is that "the material reduction of the aggregate expenditure of the country is an expedient which we should recommend for adoption only in case it is absolutely impossible to devise any other." (p.32)

The Report argues that current expenditures can be reduced and the efficiency of administration be increased at
the same time. The argument is that the salaries of the higher officials and officers are much too high, leading to extraordinary waste, and that the salaries of lower officials and officers are much too low, leading to corruption and inefficiency. It is also argued that the departments are overstaffed. The recommendation is to adjust salaries, to reshuffle the organizational structure and reduce the number of bureaucrats, and to institute promotional ladders to encourage effort.

The savings that can be obtained from these reforms, the Report argues, are urgently needed for other items: the army, the police, the judicial system, and roads. The Empire has, according to the Report, an army "scarcely sufficient to defend the frontier from marauding tribes, powerless against fanatical outbreak", a police force "that does not cast a shadow of restraint", and a judicial system "requiring great and expensive improvements". "Production and commerce," it adds, are "paralyzed for want of roads." (p.32) In other words, very much in keeping with the classical view of the role of the state, the Empire needs to provide better defense (expenditure on the army), set up and preserve the rules of the game (expenditure on the judicial system, the police, as well as the army), and provide infrastructure (roads).
We should note in passing that the last two expenditure items, especially the spending on roads, an issue that the Report repeatedly returns to, would also facilitate trade with Britain. During the 19th Century, roads, and especially railroads, were the primary mechanism through which the international division of labor was expanded and carried into the interior parts. The fall in transportation costs facilitated the export of foodstuffs and raw materials and the import of manufactures, thus changing the productive structure of the interior and, as Senior pointed out, postponing the steady state, as well.

The Report is quite explicit about the impact of roads in facilitating international trade and the international division of labor, but its presentation relates it, rather quaintly, to government revenues. The argument is that, since transportation costs are very large, the local price of the output is very low, and so, the government obtains only the small local value of the produce as tithe. Moreover, since exports from the inland are impossible, production is limited to local demand, and therefore both output and revenues from tithe and customs departments are low. Customs revenues are even lower than they could be, because the lack of roads and the resulting poverty "diminishes the consumption of articles paying import duties." (p.33)
The Short Run

Inconvertible Paper Currency

The first and foremost recommendation for short term stabilization is the immediate withdrawal of the inconvertible paper currency. The Report notes that while the official (par) exchange rate with the British pound is 110 piastres to the pound, the market exchange is 120 gold piastres to the pound and 240 paper piastres to the pound. The paper currency is at 100% discount with respect to the gold. The central argument of the Report is that the issue of inconvertible paper currency not only gives rise to an increase in the price of goods, reduces the value of debts or payments fixed in paper, creates uncertainty and risk in all commercial operations, and leads to wide discontent, but that it also costs the treasury a considerable amount.

Hobart and Foster estimate that the current budget deficit of the Empire is L2.9 million and that of the L2.9 million L1.2 million is a liability representing "a part of the price paid by government for a loan of that most costly and ruinous kind which consists in the issue of inconvertible paper." (p.31) The argument seems to be that whereas the government accepts paper money at face value for tax payments, since the market value of the paper piastre is half that of the metallic piastre, and since most of the liabilities of the
government are specifically in metallic piastre, they lose L1.2 million annually: "The L1,220,000 represent[s] the loss to the government under different items of expenditure which have had to be met by payments in metallic, and which loss is consequent on the high rate of exchange caused by depreciation of paper money." (p.31) Thus, they argue, given "the almost daily fall in the value of paper money...it is most imperative that immediate steps should be taken to add to the means and credit of the state, and to arrest the fall in the value of the circulating medium." (p.39) They strongly oppose the Ottoman proposal to establish a Bank of Exchange as "the futile and mischievous policy of endeavouring to regulate the exchanges by the interference of the government" and as a "measure contrary to the most elementary principles of political economy." (p.39) The repeated recommendation, instead, is the establishment of a National Bank which would facilitate and oversee the fiscal operations of the government. The necessary step with regards to money, they argue, is to immediately withdraw the paper currency with a new foreign loan, or if that is not forthcoming, over time by running a fiscal surplus.

If, [they conclude,] the measures which we have suggested or are about to suggest...are adopted without delay, the effect will, in all probability, be to reestablish public credit, and as a consequence to raise the paper money of the government to its full nominal value....We think, therefore, that in estimating the amount which will be required for future years, this sum of 152,346,500
piastres [L1.2 million] may be excluded from consideration. (pp.31-32)

International monetary theory of the classical school was developed under the Gold Standard Regime, which, in modern terminology, was a flexible exchange rate regime as long as the exchange rate was within the gold points that regulated gold flows and a fixed exchange rate regime without sterilization at the specie points. The classical monetary theory for the Gold Standard was derived from two complementary theories: the Quantity Theory of Money and the Price-Specie Flow mechanism. The theory regarding inconvertible paper currency was hammered out during the Bullionist debates following the suspension of convertibility by Britain in 1797.

In simplified form, the Quantity Theory of Money argues that since the level of output and the velocity of money are constant, increases in the money supply can only lead to increases in the price level, or, equivalently, a fall in the value of money. The Price-Specie Flow mechanism is a theory that explains the automatic adjustment of the balance of payments: If, for some reason, a country runs a balance of payments deficit, the nominal exchange rate will depreciate to improve the balance of payments. If the deficit is large enough so that the exchange rate depreciates to the gold export point -- that is, the point where the domestic currency
price of gold abroad exceeds the price at home (e \( P_g^* > P_g \)) sufficiently to cover transport costs, risk premia, etc.--there will be an export of gold. Without sterilization this will imply a reduction in the money supply and, through the Quantity Theory of Money, a reduction in prices. This will improve international competitiveness (further real depreciation) and increase net exports until the balance of payments is fully restored and the gold outflow stops.

These two theories imply not only that there is a unique real stock of money associated with a given level of output, but also that the nominal stock of money is fixed once the exchange rate moves to either of the gold points and that to try to increase the money supply under the Gold Standard is futile. An increase in the money supply will, through the Quantity Theory of Money, lead to an increase in the price level; this will reduce the international competitiveness of the country (or, lead to a real appreciation), causing a trade and balance of payments deficit. This, in turn, will lead to a depreciation of the nominal exchange rate and (if the increase in the money supply is sufficiently large) to an outflow of gold and a reduction in the money supply, thus causing a fall in the price level and restoring the balance of payments. In other words, as long as one adheres to the international rules of the game and the Gold Standard there would be no reason to want to increase the money supply. (Assuming, as the classical
economists did, that the adjustment process is very rapid and the import surplus does not last for long.)

One important point for our purposes is that as long as both paper and specie circulate, this conclusion is also relevant to an increase in the supply of inconvertible paper. This, as Ricardo pointed out in the Bullionist debates, is due to the convertibility of specie into bullion. The idea is that once the price rise leads to the depreciation of the exchange rate to the gold export point, even though paper is not convertible, the desire of bullion merchants to export gold would cause the price of bullion to increase above the mint price (or the face value of gold coins), specie would be melted into bullion and exported, and thus the money supply would be reduced by the displacement of specie.

Once the country starts to issue inconvertible paper money, however, "overissue" of money could become a concern, in a way it would not be under a convertible system, since in this case sterilization becomes possible -- that is, monetary authorities can continue to increase the supply of paper to offset the gold or specie drain. Determining whether there had been an overissue of money was the central question of the Bullionist debates. According to the principles that emerged during these debates, the money supply was deemed to be in excess if it was greater than the amount that could be
supported under a metallic standard. The Bullionist position, which eventually carried the day, was that a prolonged premium on gold over paper and a depreciation of the nominal exchange rate from par were signs of such an overissue that required the reduction of the money supply. Even with both specie and paper circulating, then, the existence of the premium on gold over paper, implying that specie was being withdrawn, and the depreciation of the paper exchange rate by more than the depreciation of the gold exchange rate, implying that gold was being exported, was clear sign that money had been issued in excess of what would have been supportable under convertibility, and needed to be withdrawn. This would be true even if the fall in the value of paper currency was primarily due to the lack of public confidence, as the Report seems to indicate.

The recommendation of the mission, then, was in keeping with classical theory as it evolved through the Bullionist debates. It is hard to argue that Hobart and Foster knew the intricacies of these debates, but, I would argue, policy recommendations that evolve out of academic trials and tribulations have a way of being accepted and implemented by practitioners even if they do not understand the finer points. Similarly, given that the circulating medium of the Ottoman Empire consisted of metallic currency and inconvertible paper, the implicit recommendation of establishing a purely metallic
medium is in keeping with policy recommendations of the Currency School, who as successors of the Bullionists carried the day in the debate against the Banking School in the mid-19th Century arguing against discretionary monetary policy and for having a monetary system that mimicked a specie circulation system. It is also interesting to note that the withdrawal of the paper money, in this framework, would lead to a reduction in the price level, improve the competitiveness of the country (or, a real depreciation), and increase net exports until the balance of payments was restored and the nominal exchange rate fell below the gold export point to halt the outflow of gold. In other words, overall, the reduction in the money supply would produce a real depreciation in terms of paper, since the price level would have to fall by more than the appreciation of the nominal exchange rate in order to stop the outflow of gold and restore the balance of payments.

New Taxes

With L1.2 million of the L2.9 million budget deficit thus taken care of through the withdrawal of inconvertible paper currency, the Report estimates that another L0.5 million is needed annually to perform the necessary financial reforms, and puts the short run annual need of the treasury at L2.2 million. Since, the authors argue, they cannot recommend a decrease in expenditures, and since the results of the earlier recommendations on revenue and structural change "directly or
indirectly conducing to the increase of the revenue must necessarily be gradual," they are recommending immediate increases in taxation. In addition to the increase in tobacco and stamp taxes mentioned before, which they estimate will bring in L50 000 each, and the direct collection of the tithe, which will bring in L120 000, they recommend three new sources of revenue: taxation of Istanbul, taxation of male domestic servants, and conversion of certain vakouf (foundation) property to freehold.

Taxation of Istanbul, they estimate, would bring in L500,000, even if foreigners, who were exempt from personal taxes, didn't pay. Istanbul as a city was exempt from personal taxes, since in the Classical organization of the Empire, the problem was to bring the agricultural economic surplus into Istanbul. There were taxes on guilds and mercantile licenses, but no equivalent of an income or wealth tax. By the 19th Century, however, with the increase in the number of resident tax farmers and merchants, and the increase in foreign trade, there had been substantial wealth accumulation. Thus the Report urges a wealth tax in the "interests of distributive justice and the urgent necessity of the national exchequer." (p.33)

Classical economists, in general, were against a profit or a wealth tax, arguing it would not provide much revenue, be
extremely difficult to assess and collect, and would lead to the liquidation of low yield capital and capital migration and thus interfere with growth. There was, however, agreement that houses or rents could profitably be taxed, and this is what the Report recommends over an income tax. It approves of an Ottoman proposal to tax the rents of places of commercial business and proposes:

The rent of a dwelling house is, in general, no unfair test of the relative wealth of the person occupying it; and we should propose that a certain fixed sum should be imposed upon Constantinople [annually]...which should be divided among the resident householders, the share which is paid by each individual being proportionate to the rent or annual value of the house which he occupies. (p.34)

**Taxing male domestic servants** at a rate of £1 per servant, they estimate, would net the treasury £450 000. "Every element of fiscal expediency," they argue, would dictate such a tax, as there are an "inordinate" number of servants which results in "waste, idleness and useless display." Such a tax would "yield a large sum to the treasury, and, while falling wholly on the superfluities of life and tending to the restraint of luxurious habits, would at the same time, set free, for productive employment capacity for labour which is now lost to the community." (p.35)

This analysis is also totally appropriate within the framework of the classical economists who spent some energy trying to distinguish between productive versus unproductive
labor. Smith, for example, argued that, given resources, wealth was determined not only by the effectiveness with which labor was applied (a function of the division of labor), but also by the proportion of the labor force employed in "productive" work. For him, productive work depended on the amount of capital employed, and was work that ensured the continuation of production and produced something tangible. Thus, for example, he concluded that the labor of the workers producing luxury goods was more productive than the labor of retainers. Others, Malthus and J.S. Mill for example, distinguished labor that maintained and produced capital as more productive.

In addition to this dichotomy, there was also the idea that development could be stimulated through a change in tastes. If the wealthy could be persuaded to have an increased desire for material accumulation and switch demand from personal services to material goods, entrepreneurial spirit would be stimulated in a way that would allow productive employment. In addition to this, given the tariffs on tradables, a tax on a nontradable good would be in keeping with free trade principles.

Conversion of certain foundation property to freehold, the last item, they estimate would bring in £1.2 million at the very least. Vakouf property was property belonging to
charity organizations, like mosques, and was administered on their behalf by a special state department. It consisted of two general classes of property: those that actually belonged to charity foundations and those that were owned privately, but became vakouf property in the event of the death of the owner without any direct heirs. It is this latter category that the Report has in mind. They argue that if conversion to freehold proper is not palatable, inheritance rights could be extended to indirect heirs upon the payment of a fee. The reasoning is very similar to that applied to the sale of other state property in the earlier sections: It would fetch a very handsome price and "the increased inducement which would be given to the owners of property to improve its condition, and the additional interest which they would take in it, would contribute not only to the material but to the social welfare of the country." (p.36)

The mission, then, proposes to raise L2.37 million from new taxation to meet the short term needs of the treasury. In summary:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Tobacco tax increase</td>
<td>L 50 000</td>
</tr>
<tr>
<td>2) Stamp tax increase</td>
<td>L 50 000</td>
</tr>
<tr>
<td>3) Direct collection of the tithe</td>
<td>L 120 000</td>
</tr>
<tr>
<td>4) Taxation of Istanbul</td>
<td>L 500 000</td>
</tr>
<tr>
<td>5) Taxation of domestic servants</td>
<td>L 450 000</td>
</tr>
<tr>
<td>6) Conversion to freehold</td>
<td>L 1200 000</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>L 2 370 000</strong></td>
</tr>
</tbody>
</table>
"Thus," they simply conclude, "showing an increase in revenue which exceeds by L170,000 the sum (L2,200,000) which was required." (p.37)

3. A Summary of the Report

The overall conclusion of the Report is quite optimistic:

The case with which [the government] has to deal is not the hopeless one of a tax-imposing power stretched to its utmost limit, and yet inadequate to meet the demands of a large and inevitable expenditure; but simply of financial disorder, caused chiefly by inattention to the ordinary rules of political economy and fiscal administration. With a taxation, if it were duly adjusted, extremely light; a system of government, which, even if made thoroughly efficient in all its branches, would be comparatively inexpensive; and a national debt (including under the term every kind of liability) which is less than L42,000,000 sterling, we cannot believe that the Empire will be permitted any longer to remain in a condition bordering upon insolvency. (pp.41-42)

In summary, then, the general scenario that the mission envisions is very similar to the neoclassical scenario of the Bretton Woods institutions. Like the IMF, for short term stabilization they recommend a fiscal contraction, a monetary contraction, and a real devaluation, though the latter item is implicit rather than explicit. Increasing some of the old taxes and imposing new ones without a change in government expenditure directly leads to an increase in the fiscal surplus. Withdrawal of the paper money ensures that the Empire
will play within the international rules of the game. It would reduce the price level by more than the nominal exchange rate, implicitly leading to a real devaluation and a change in the composition of production towards tradables. Explicitly, the withdrawal of paper money will lead to a further fiscal surplus, since the argument is that the inflation tax gained by monetizing the debt is less than the loss of purchasing power due to that inflation.

Like the IMF, the mission does not anticipate a fall in the level of output as a result of these policies. The reduction in the money supply will be reflected on the price level alone, and, like, for example, the IMF policy of removing price support programs, the increase in taxation will not affect the level of output because of the careful manner in which these sources are selected. The overall result will be increased international competitiveness and an ability to pay back the foreign debt.

For long term growth, very much like the World Bank, the recommendation is to get the prices right, provide infrastructure, and to reduce and redefine the role of the state. The mission is very optimistic about the price elasticity of supply, and foresees a substantial increase in output due to the removal of tax farming and export duties. With respect to the role of the state, the recommendation is
to sell "government enterprises" to domestic or foreign
private capital and to remove interferences in the allocative
mechanism of the market -- including liberalization of trade
and capital flows, abolition of state monopolies and artisan
guilds, and increasing the mobility of domestic labor and
capital. The proper role of the state is to provide defense
for security of property, justice to ensure the fulfillment of
contracts, and infrastructure to stimulate trade.
NOTES TO CHAPTER V

1. We know very little about Mr. M.H. Foster, only that he was the deputy paymaster-general at the Board of Trade. We have more information on (Lord) Vere Henry Hobart (1818-1875). He was the son of the sixth earl of Buckinghamshire, Augustus Edward Hobart (later Hobart-Hampden) and Mary Williams. He was educated at Trinity College, Oxford, where he received his B.A. in 1840. The same year he was appointed to a clerkship in the Board of Trade. In 1854 he became private secretary to Sir George Grey, then the Secretary of State for the Colonies, but resigned in 1855 to publicly oppose the Crimean War. In 1861 he was promoted from the senior clerkship at the Board of Trade for this mission, and subsequently served as the director-general of the Imperial Ottoman Bank. In 1872 he was appointed the governor of Madras, and died there of typhoid fever in 1875. (Lee, pp.34-5)

It is important to realize that Hobart was serving at the Board of Trade during the presidency of Gladstone, that is during a time when England and the Board were undertaking a significant policy change, moving towards (reciprocal) free trade, including, in 1846, the removal of the Corn Laws. (Hyde)

2. It is worthy of note, that, in India, James Mill put forth the idea of "scientific taxation" and went about trying to determine the differential rent!
V. OTTOMAN RESPONSES

In this chapter I discuss the reforms that were undertaken and those that were not. The data available are rather sketchy on some of the specifics and it is even more difficult to put a number on the amount of tax revenues actually raised through the adoption of the recommendations. The general picture that emerges is that most of the short term stabilization recommendations were adopted within a reasonably short period of time, but that the long term recommendations either were not adopted or adopted very gradually. The end result, one should keep in mind, was default in 1875.

1. Reforms

Short Term Stabilization

The Report fulfilled its 'signalling' function admirably. In 1862, a loan of £8.8 million was raised (£4.5 million received). Three-fourths of the proceeds was used to withdraw the paper currency, 40% of it replaced with metallic currency and 60% with long term government bonds, and the rest was used
to retire floating debt. The task was accomplished under the direction of Lord Hobart himself. The success of the 1862 loan was largely the result of the Report, which was received very favorably in the British Parliament and in the British capital markets. Undersecretary of State for Foreign Affairs, Mr. Layard, noted the "gratifying feature of the Report" that "there was nothing fundamentally rotten or bad in the state of Turkish finance" and reminded his audience that the Empire had "never failed to pay her debts with the greatest of punctuality." Prime Minister Lord Palmerston delivered a eulogy on the virtues of Sultan Abdul Aziz. The Ottoman government communicated its desire to raise another loan to withdraw the paper money, and added that it was willing for a foreign expert to direct this process. And, thus, the 1862 loan was a phenomenal success in the European money markets, being five times oversubscribed. (Blaisdell, pp.34-35, 49-50)

As The London Times noted on April 1, 1862: "Hundreds of the wisest, the shrewdest, and the richest of Englishmen have been rushing to declare in a language which cannot be doubted their conviction that the 'sick man' is convalescent."

Negotiations regarding the establishment of a National Bank were finalized on February 4, 1863. French capital was added to the English-chartered Ottoman Bank, established in 1856, and it became the Imperial Ottoman Bank. According to the agreement, for thirty years the Bank would be the fiscal
and financial agent of the treasury, have a monopoly over note issuing privileges, and be exempt from all taxes. (Du Velay, pp.113-118) Lord Hobart became the director-general of the Bank, where he served until he was appointed the governor of Madras in 1872. European control over monetary policy was certainly one way to ensure that the Empire would continue to play by the international rules of the game. This establishment of a foreign Central Bank was also well received in the European capital markets, resulting in another loan in 1863, which was underwritten by the Imperial Ottoman Bank. The proceeds of this loan were transferred directly to the Galata Bankers to retire the floating debt. (Blaisdell, p.68-71)

The duty on tobacco was increased in 1862, in direct response to the recommendation of the Report. The mission had recommended increasing the rates which ranged between 1.5 to 6 piastres per okka (weight unit) depending on the quality of the leaves, to a range of 2 to 25 piastres to the okka, and this is what was established. In March 1864, however, a uniform rate of 12 piastres to the okka was instituted to encourage high grade tobacco production. (Du Velay, pp.108-110) The collection of this duty was given to the Excise Tax Administration and was collected directly by salaried government agents rather than by tax farmers. Similarly, stamp taxes were extended to almost all commercial transactions as recommended by the Report. (Shaw and Shaw, pp.102-103)
With respect to the taxation of Istanbul, the Government adopted its plan to tax the rents of places of business, a policy that the Report had approved, extended these taxes to residential rents as the Report had recommended, but also instituted the 3% profits tax that was adopted for the rest of the Empire in 1858, a policy that the Report had argued against. (Shaw and Shaw, p.92-93) There is no information as to whether any taxes were imposed on domestic servants, which suggests that there probably was not. These taxes were formulated and adopted between 1858 and 1864. It appears, however, that the necessary wealth and income surveys in Istanbul were still incomplete in 1873. (Du Velay, p.205)

In response to the recommendation to convert at least some state property to freehold, the government declared, on June 10, 1867, that all landed property that would usually pass to the state in the absence of direct heirs of the holder could now be passed onto indirect heirs upon the payment of a single sum equalling 15% of the annual income of the property. (Du Velay, pp.140-147) Thus, inheritance rights were extended on all state lands in keeping with the short run recommendations of the Report.

The data on the budgets of this period are very sketchy. The main source is Shaw (1975, 1978) who has compiled and
published Ottoman budget estimates from the Ottoman archives. In the 1863/4 budget estimates prepared by the government, the projected increase in tobacco revenues was L273 200, and that for stamp taxes was L95 000 --considerably above the L50 000 predicted for each in the Report. These two revenue sources, it is clear, became very important for the treasury. Estimates of revenues from the taxation of Istanbul first appeared in the 1874/5 budget. The government estimated a revenue of L607 000, which was, again, more than the L500 000 predicted by the Report. Du Velay, an official of the Imperial Ottoman Bank, however, argued that revenues would not exceed L123 000, since the surveys were not yet complete. The contribution of the extension of inheritance rights is a lot harder assess.

Revenues from the granting of title deeds to use rights (tapou) included much of this contribution, as well as other items. To complicate things further tapou revenue estimates are only available for 1863/4 and 1874/5. The projected increase in these two budgets is L607 700, considerably less than the L1 200 000 predicted by the Report.

The direct collection of the tithe was never implemented, a topic I will return to later, but there were adjustments in other taxes and, overall, the 1863/4 budget predicted an increase in revenues of L2.45 million, an amount suspiciously close to the L2.37 million foreseen by the Report to suggest that it was a gesture to the mission. Even though expenditures
did increase, the 1862 and 1863 budgets also predicted a fiscal surplus. There are, however, no systematic data on the actual revenues and expenditures of the state in this period. Fragmentary information can be found in the writings of contemporaries and their consensus is that the state continued to run large budget deficits, while the publicized estimates were mostly drawn to impress the European consuls and investors --either to convince them that the reforms were bearing fruit or to illustrate that further loans were required. The available information is presented in Table 6.1.

The data on international payments, also presented in Table 6.1, are more reliable, thanks to Pamuk who has reestimated each of the items from European archival sources and compared them both with the figures in the Ottoman archives and with the data available from the Istanbul Mint. From these figures, capital inflows to the government (loans) can give us an indication of the budget deficits of this period. We know that while the loans of 1860 and 1865 were used to finance current budget deficits, those contracted in 1858, 1860 and 1863 were used to withdraw all of the paper currency and retire or fund the floating debt. In other words, these funds were used to transform existing internal liabilities into external liabilities. Thus, foreign loans to the government are a good approximation of the fiscal deficits
<table>
<thead>
<tr>
<th>Year</th>
<th>Budget Surplus</th>
<th>Current Account</th>
<th>Trade Balance</th>
<th>Exports</th>
<th>Imports</th>
<th>Interest Payments</th>
<th>Capital Account</th>
<th>Loans</th>
<th>Bop</th>
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<td>0.4</td>
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<table>
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<th>Year</th>
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<th>Current Account</th>
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<th>Exports</th>
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<th>Capital Account</th>
<th>Loans</th>
<th>Bop</th>
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<td>0.4</td>
<td>0.9</td>
<td>-5.1</td>
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Sources: The balance of payments data are from Pamuk who did a reestimation of all the items from mostly European archival data, (pp.199-200). Unless otherwise stated the data on budget surpluses are from Shaw (1978) who published the budget estimates (projections) of the Ottomans from Ottoman archives. (a): Actual budget deficit calculations in the Report. (b): Actual budget deficit reported in Du Velay, (p.110).
of the entire period. Cumulated, the loans to the government in the 1857-1866 period add up to L20.3 million, which would translate into average annual budget deficits of L2.0 million. We still cannot say whether the deficits following the mission were lower than the deficits in the period preceding it, but the figures on the budgets seem to suggest this.

In terms of international payments, the overall result that emerges is that the increased capital inflows led to balance of payments surpluses in the short run (1862, 1863), but that they financed larger imports and larger trade deficits after 1864.

Overall, then, with respect to the performance criteria usually employed in these circumstances, the conclusion must be that the short run stabilization programme of the mission was, in general, a success. To summarize, there is little doubt that the success of the 1862 and 1863 loans was due to the optimism fostered by the Report that there was nothing fundamentally bad with the Ottoman finances. Thus, there was a net inflow of L10.2 million over the next three years, easing the crisis. These loans were used strictly for the purposes recommended by the Report. L9.1 million worth of paper currency was withdrawn, 40% of it with newly minted coin and the rest with newly created domestic government bonds bearing 6% interest. The rest of the proceeds were used partly to
retire and partly to fund the floating debt of about L11 million.

As a result of these operations, the money supply was reduced and the Empire went back onto the metallic standard -- the most important monetary criterion of classical orthodoxy. In addition, that the Empire would continue to play by the international rules of the game was ensured with the establishment of the Franco-British Imperial Ottoman Bank, which held a monopoly over issue rights. Moreover, evidence suggests that the Bank did not exercise its right to issue convertible paper currency (Tekeli and Ilkin, p.69) The Empire, then, was essentially on a specie circulation system, which would have warmed the hearts of the Currency School.

To the extent that the balance of payments data are reliable, there was also a marked improvement in the "reserve position" of the Empire in the two years following the mission, when the Empire ran substantial surpluses. There was also an improvement in export performance between 1862 and 1863, though imports increased much more rapidly, leading to large trade deficits in the longer run.

The government instituted most of the fiscal reforms recommended by the mission, leading to increases in revenue. There is also some evidence, though admittedly not conclusive
evidence, to suggest that the size of the budget deficits decreased, at least in the years immediately following the mission.

**Long Term Growth**

Despite relative success in the short run, however, in the longer run the Empire would run into structural constraints. With respect to proposals that would promote structural change and growth in the long run, *foreigners* were given the right to own land in 1867. They would, however, be tried by the same laws and court procedures as Ottomans and have the same tax obligations as Ottomans. It is important to note that they were still exempt from personal taxes on income that did not derive from landed property. Most notably, mercantile income of foreigners resident in the Empire was still non-taxable. (Shaw and Shaw, p. 119, Du Velay, pp. 148-151)

In relation to *public property*, the information we have in addition to the extension of inheritance rights, concerns mines and forests. Land Law of 1858 had declared that all newly discovered mines, whether on public or private property, belonged to the state. The state was entitled to 1/5 of the produce of all mines, and those on state lands would be administered by tax farmers. The Mines Regulation of 1861 ended state monopoly of mines and allowed owners of private
land with newly discovered mines to develop them. The state would still be entitled to 1/5 of the produce and mines on state land would be leased to private companies which, after 1867, included foreign companies. It is not quite clear how long term these concessions were, but we know that the Department of Mines, established later, in 1887, was awarding concessions for periods ranging between 40 and 99 years. (Shaw and Shaw, pp.101-102, 123, 162)

On the opposite end of the spectrum, the Ottoman Forest Regulation in 1870 put all forests under the control and supervision of the Forestry Department regardless of who owned the land, establishing strict regulations on tree cutting and extending the tithe to forest products. (Shaw and Shaw, p.235) In the Report forests were among the properties that were advised to be sold or leased to private enterprise. Similarly, the government established and maintained monopolies over the sale of tobacco and production and sale of salt. (Shaw and Shaw, pp.103-105).

Perhaps more importantly for our purposes, throughout the 19th Century the government consistently expropriated fiefs, foundation lands, and other large lanholdings and redistributed them to the peasants, making them subject to state taxes. This was a very slow process, but was completed by the end of the Century. (Shaw and Shaw, p.97)
With respect to roads, in 1867 the government began to establish Public Benefit Banks in each province to finance the paving of roads. The revenues of the banks came from a small supplementary tax imposed on the tithe and from lending. Wage labor, however, proved to be too costly, and in 1869 a Road Construction Regulation was passed which required each rural male to work four days out of the year on road construction. The cost of equipment would be borne by the Public Benefit Banks, the corvee workers would bring their own food and draft animals. (Shaw and Shaw, pp. 101, 121-122)

Although by 1876 there was a much better system of roads, the revolutionary transformation of the transportation system would come through railroads. It is hard to argue that this world-wide trend in railroad building or, for that matter, some of the other long term reforms that were implemented were in direct response to the Report, but they were definitely in the spirit of the Report. In 1861 only 452 kilometers of railroads were in operation, half in the Balkans, half in Western Anatolia. The government then began to issue concessions to foreign companies which were granted monopolies to operate the lines that they built for a certain number of years, guaranteed sufficient profits, and offered a fixed sum for each kilometer built. Between 1861 and 1888, 1328 additional kilometers of track was built. Again, these were
mostly in the Balkans and Western Anatolia, linking fertile valleys with the ports. It was after 1888 that a railroad network was developed in the east, linking Istanbul with Ankara, Konya, Baghdad, and the Holy Cities. Between 1888 and 1908, 5883 kilometers of new track opened to operation. (Shaw and Shaw, pp.120-121, 226-227) The railroads had a very important impact in terms of facilitating central control and promoting the further incorporation of the Empire into the world economy, but this did not come about until after default.

The information regarding the establishment of a free market system domestically is rather sketchy. What seems to emerge, however, is that while the government was willing to establish such a system in trade and industry, it was very reluctant to do so in agriculture. In 1865, for example, the government removed price controls on all commodities except bread and meat. (Ortayli, p.153) This weakened the guilds considerably, though they were not formally abolished until after 1908, during the reign of the Young Turks. Similarly, judicial structure pertaining to trade and commerce was readily changed along essentially European patterns. A new Commercial Code was adopted in 1861, and a new Maritime Commerce Code in 1863. A separate system of, so called, mixed courts was established in 1861, to deal exclusively with commercial issues. The tribunals were composed of three judges
appointed by the government and four assessors representing
Ottoman and/or European merchants. (Shaw and Shaw, pp.118-119)
European nationals, however, maintained their privileged
status, as European consuls had the right to represent their
citizens and to appeal the decisions, whereas the Ottomans did
not. (Aricanli, 1976, pp. 94-97)

On the other hand, the government was going to some
lengths to keep the peasantry on land and to maintain a small-
peasant tenure pattern in agriculture, by confiscating large
holdings and redistributing them to the peasants. Similarly,
for example, in 1845 a conscription law had allowed the
conversion of military obligations to cash. In 1871, however,
a decree specified that in order to discourage poorer families
from becoming hired laborers to the wealthy, cash payments
would be accepted in lieu of military service only if it could
be paid without the sale of land. (Shaw and Shaw, p.100) More
generally, in all the laws pertaining to land tenure in this
period, the peasant was prohibited from leaving the land idle
and was essentially prohibited to move. Restrictions were in
place with regards to what could be done with land. The
peasant, for example, could not convert his land into a
vineyard, a vegetable garden, or a brickyard without
permission.
What seems to emerge is that the Ottomans were amenable to changing the institutional and economic structure of industry and trade, but that they were reluctant to undertake radical reforms in agriculture. Undoubtedly the Land Code of 1858 and its amendment in 1867, which extended the use rights of the land, in the sense that holders of the title deeds could freely transfer, mortgage, bequeath, or sell the use rights of those plots, were important changes. Nevertheless, the absolute property right still belonged to the state, it continued to try to appropriate non-state lands, and had a relatively consistent policy of establishing a small-peasant land tenure pattern. This should come as no surprise, since the source of the economic surplus over which it was trying to reestablish legitimacy was agricultural. Private property rights, large landed estates, wage labor were institutions that could undermine both its central power and its legitimacy over the economic surplus.

This brings us to a most important issue --that of the direct collection of taxes. Direct collection of some of the taxes, like the customs duties and the tobacco tax was successfully implemented. The attempts at the direct collection of agricultural taxes, specifically the tithe and the animal tax, which constituted 37.4% of total revenues in 1862, however, failed. The government had tried various methods of collection in various provinces before 1861 and
tried new ones after 1861. It will be instructive to give a brief summary of these different attempts in the period between 1840 and 1868.

In 1840 the government decided that all taxes would be collected directly by salaried government agents sent from Istanbul. The goal was to break the local power of both the tax farmers and the governors. It failed due to the lack of knowledge and local connections of the agents. Tax revenues fell drastically.

In 1841 the government restored tax farming. The auctions were held in the provincial capitals to take advantage of the local knowledge and resources, and they were for two year terms. The two year term, it was perceived however, led to a greater abuse of the peasantry, as the tax farmers tried to recoup their losses in that short period of time, without any interest in the well-being of the tax base.

In 1847 the government decided to grant tax farming rights for five year terms, hoping this would help protect the peasants. This, it appears, led to the formation of decentralized foci of power, threatening central legitimacy and revenues. The ongoing inflation in this period must also have reduced the purchasing power of the agricultural revenues which were nominally fixed.
In 1852 the government began to take over tax farms as their five year terms ended, and tried direct collection once again. Once again the revenues fell.

In 1855 the government decided that the tax farmers could be better controlled, especially with respect to the revenues they transmitted to the treasury, if they had to reapply for their rights at short and regular intervals and auctioned the farms for one to two year terms. To further prevent the formation power bases, tax farming units were divided into individual villages, and adjacent villages could not be held by the same tax farmer.

In 1860 the government decided to let the local notables, rather than absentee tax farmers be responsible for the collection and remittance of taxes. They tried this scheme in Rumeli and realized that this was tax farming under a different name. In fact this is the experiment the Report refers to, mistakenly, as direct collection.

In 1866 the government decided to auction the Rumeli taxes as well. This time, however, the auctions were held by the Ministry of Finance in Istanbul, rather than locally, under the hypothesis that the abuse of peasants by absentee tax farmers would be less than that of the locals. This, however, was not true, since the tax farmers actually collected the taxes by sub-farming their holdings to the local notables.
In 1868 the responsibility of assigning tax farms was again given to the governors, in hopes that the governors' local knowledge would help them regulate the local notables better than the government was able to regulate the absentee tax farmers. (Shaw and Shaw, pp. 97-98)

In other words, throughout this period the state was trying to increase its share of the surplus by playing off the intermediary groups against each other and by changing the frequency of auctions. All these attempts, however, were nuances on the same theme and gave no concrete results in terms of increasing revenues to the center. Tax farming was legally abolished in 1877, but direct collection of the agricultural taxes would become a reality, and that only in a few provinces, when the newly built railroads facilitated the requisite central control, towards the end of the century. The final solution, in fact, was a radical one --tithe dues were abolished in 1926.

2. Macroeconomic Relations

Overall, then, the state adopted most, though not all, of the recommendations. For short term stabilization, it withdrew the paper currency, raised the taxes on tobacco and stamps, taxed Istanbul, and extended inheritance rights on all state lands upon the payment of a fee. For long term growth, it
removed price controls on all goods except bread and meat, granted foreign ownership rights on land, undertook to improve the transportation system, and gave concessions on some state property, most notably on mines.

Throughout this period the rate of growth of foreign trade was the highest for the century. Between 1857 and 1873, the average annual rate of growth of exports, in constant prices, was 6.2%, and that of imports was 5.2%. (Pamuk, p.21) In other words, according to a central indicator of classical economic theory, the economy was quite healthy. Yet, although the state survived the crisis of the 1860's, in 1875, it could not continue to service its debt and defaulted.

One might argue that the Empire defaulted because it did not undertake all the recommended reforms, but that is not an easy argument. Two of the more important violations in this context were the establishment of state monopolies on tobacco and salt, and the failure to collect agricultural taxes directly. It is interesting to note, however, that when the Europeans undertook to service debt through the PDA, they insisted on receiving the tobacco and salt revenues and administered them as monopolies themselves. Moreover, when in 1905 the government decided to institute the direct collection of the tithe in some of the Anatolian provinces, the PDA vehemently objected to the proposal. (Blaisdell, pp.139-40)
Both events suggest that these were still the more efficient methods to collect revenue. Another argument could be that some of the reforms took a long time to implement. This was true for income and wealth surveys and certainly for railroads, and the argument has more merit.

There were, however more obvious problems that were not dealt with. As I have argued in the previous chapters, incorporation into the world economy through international trade had redistributed income away from the central bureaucracy and the peasants towards the merchants and the tax farmers. The state was trying to consolidate central power and gain access to the agricultural revenues by undermining large landholders and tax farmers, but what about taxing mercantile income? There is no doubt that the rate of growth of foreign trade far exceeded the rate of growth of output during this period. The problem was that capitulatory agreements with the European Powers excluded European nationals from personal taxation. Moreover, with the so-called protege system, by far the majority of Ottoman merchants had become European nationals through arrangements with the consuls. (Aricanli, 1976, p.98) Mercantile profits, in other words, accrued to foreigners or Ottomans who had become foreign nationals. The immediate result of this was that the state could not tax the most active sector of the economy.
To be fair to Hobart and Foster, they had realized the absurdity of the situation. In discussing the taxation of Istanbul they wrote:

Foreign residents in Turkey, ... under the 'Capitulations' ... of their respective governments, claim (with what justice it is not within our province to inquire) exemption from all taxation which can in any sense be considered personal ... We would venture to suggest that the time has arrived when those states which desire the prosperity of Turkey should endeavour to effect some equitable arrangement with respect to this anomalous exemption. ... The natural basis of any such arrangement would be, on the one hand, the concession to foreigners to hold property in their own names, and, on the other, the assimilation of their position to that of Ottoman subjects in regard to both the payment of taxes and the authority of the police. (pp.34-5)

But, this was to be the one case where practical interests of the Europeans overrode the dictates of (economic) rationality. At the end of the negotiations, although Europeans agreed to be subject to the same laws as Ottomans in affairs concerning their newly won right to hold landed property, they maintained their privileged status with respect to trade and mercantile income.

Another result of the distributional consequences of international trade was the birth of nationalist movements. The landlords, tax farmers, and merchants who gained economic power in the Balkans naturally transferred their alliance from the Sultan to the European Powers and were able to mobilize peasant discontent in autonomy and/or independence movements.
in order to gain political power. (Aricanli, 1976, pp.98-108)
The Balkans became the area where, under the rubric of the "Eastern Question", the Europeans played out their imperial power struggles, supporting different ethnic and national groups. The immediate consequence of this was a reduction in tax revenues from these regions, and a tremendous increase in military expenditures to try to maintain those revenues. In other words, more budget deficits and, given that monetization was not an option due to the monopoly over note issue held by the Franco-British Imperial Ottoman Bank, more debt.

On a grander scale, what emerges is that through trade agreements, political treaties, semi-formal instruments like the Report, and informal consular pressure Europeans managed to institute their own rules of the game in trade, in a country which, formally at least, was not a colony. They thus helped create a dichotomy between trade and industry, on the one hand, and agriculture, on the other. Foreign nationals were exempt from personal taxes, faced lower import, export, and transit duties than Ottoman merchants, and, as a consequence of the judicial reforms undertaken in response to the Report, maintained a privileged legal status with respect to the Ottomans. The overall result was handsome mercantile profits, and, of course, especially with the removal of price controls, the disintegration of local handicrafts. The response of the Ottoman state was to try to shield agriculture
in order to avoid outright colonization. It was to prevent the expansion of foreign dominance into agriculture that the Ottoman state insisted that foreign land owners be subject to the same laws as the Ottomans. (Aricanli, 1976, pp.111-112) Similarly, the reluctance of the state to undertake radical structural reforms in agriculture was in order to preserve its only source of revenue.

The Ottoman state whose main concern had always been the maintenance of agricultural revenues and the provisioning of cities was predisposed to accept free trade and to try to guard agriculture. Similar external stimuli produce different adaptive responses in different parts of the world. The result of this, however, was a disarticulation between mercantile capital and agricultural production. There was virtually no investment in production. The conflict between all parties was a fight over the distribution of the economic surplus, not its creation. The government and the tax farmers extracted taxes, the European merchants extracted mercantile profits, the European bondholders extracted interest payments. The only point of articulation between mercantile capital and agriculture was that the merchants lent money through the Galata Bankers to the tax farmers who then laid their claims on the surplus and sold it to the merchants; just as the European bondholders lent money to the Ottoman state so that the state could lay its claims on the economic surplus and pay

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interest. Relations of production on land did not change, there was no technological transformation, and, despite the overwhelming optimism of the Report, agricultural output did not increase in any significant degree, certainly not enough to warrant the rates at which the Empire was borrowing.

In conclusion, then, the policy recommendations which made sense within the classical, or for that matter neoclassical, economic framework and promoted international trade produced unexpected results when introduced into the context of Ottoman-European relations of the mid-19th Century. Much like their 20th Century counterparts, the mission had anticipated that the liberalization of trade and direct foreign investment, removal of price controls, establishment of national and foreign private property rights, and a reduction in the role of the state would lead to an outburst of investment and growth. This simply did not happen because of the specific structural constraints of the Empire, which I will discuss in more detail in the next chapter. Furthermore, to the extent that there was increased economic activity, it was in sectors that were non-taxable. It is important to remember that the mission was successful in the short run -- but mostly to the extent that its "seal of approval" increased confidence enough for the government to contract new loans.
PART III: STRUCTURAL CHANGE, DEBT, AND DEFAULT

This section draws on all the previous chapters to discuss the economic structures that emerged as part of the debt process and analyze the reasons for default.

Chapter VII details the events leading to default and analyzes the economic reasons for default within the context of the economic structures that evolved as part of the debt process. It illustrates that the class relations that emerged as a result of the specific adaptations of the classical organization of the Empire to increasing trade with Europe, the European pressures for reform subsequent to the initiation of the debt cycle and the Ottomans' responses to them, created an economic structure that could not sustain budget or trade surpluses to repay the debt. The latter part of the chapter discusses the ways in which these constraints were finally broken.

Chapter VIII is a highly stylized summary of the central argument of the thesis. It sets up the economic relations that emerged as a result of the debt process and discusses the ways in which they impeded accumulation and growth, leading to further debt, default, and underdevelopment.
VII. DEFAULT AND ITS AFTERMATH

In this chapter I discuss the events that precipitated default and the structural constraints that underlied it. The central argument is that the socio-economic relations that evolved throughout the first half of the century—the conflicts between the state, the tax farmers and the merchants, the peasants, and the Europeans—solidified an economic structure that could not sustain a budget surplus, enhance investment, or, related to the latter, produce a trade surplus in order to repay the debt.

The last section discusses the ways that structure was finally broken through, essentially, state capitalism. The central argument is that the increasing foreign domination of the economy, initially through European mercantile and financial capital, and later, after default and the establishment of the Public Debt administration, through European direct investment precipitated an alliance against foreign capital despite internal conflicts. This alliance found political expression through the Young Turks who started
the process of domestic capital accumulation regulated by the state.

1. **Default**

On October 6, 1875 the Ottoman government inserted an announcement in the Istanbul newspapers stating that in view of the LT5 million budget deficit, it had decided to pay only half of the sum required to service the debt in cash, and that the rest would be paid with a new issue of 5% bonds to be delivered to the bondholders. In March of 1876 the government suspended almost all cash payments. At this point in time, the outstanding foreign debt was L200 million and annual charges were L12.5 million. In 1874 government revenues totalled L22 million and exports, L19 million. In other words, the debt-export ratio had climbed to 10.5 and the debt service burden to 66% of exports and 57% of government revenues. There was also a floating debt of some L16 million. (Issawi, 1980, p.360; Blaisdell, p.80)

Although most European observers blamed the bad influence of the Russian Ambassador to Istanbul, Count Nicholas Ignatiev, there were other events which precipitated the default: the famine of 1875 and the so-called "First Balkan Crisis". 
1875 was the worst famine year of the century for the Empire. The harvest was bad in most of the provinces, floods were more severe than for years and epidemics broke out in several localities. The government was compelled to distribute provisions to prevent starvation. 25% of the population and 90% of the livestock, for example, are reported to have died in the Ankara region, between 1873 and 1874. (Issawi, 1980, p.7) The collection of the tithe and other agricultural taxes was undertaken under great difficulty, with serious shortfalls in revenues. (Blaisdell, p.76; Owen, p.108)

The bad harvest was also important in triggering uprisings in the Balkans. As noted before, weakened central authority and the accumulation of wealth in the provinces combined with the nationalistic ideologies of the era and the imperial conflicts of the European powers to give rise to rebellions and wars, most notably in the Balkans. Indeed, between 1800 and 1880 the territories under the Ottomans shrank by half and the population by 30%. (Issawi, 1966, p.4) The uprisings of the mid 1870's were sparked by attacks on tax collectors in Herzegovina in 1874, and spread to all parts of Bosnia and Herzegovina, fueled by arms from Hamburg. This was followed by an uprising in Bulgaria lead by the Bulgarian Revolutionary Central Committee, in May of 1875, and the declaration of war by Serbia and Montenegro on the Empire in May of 1876. (Shaw and Shaw, pp.158-166) These, of course,
meant that revenues fell short and that expenditures exceeded the anticipated sums, leading to increased pressure on the government's budget.

This would have been the time to borrow abroad, both to finance the emergency expenditures and to relieve the cyclical pressure, but funds in Europe had dried up. Europeans were reluctant to lend to the Empire, both because of the declining confidence in the creditworthiness of the Ottoman government and because of the general strain in the international financial markets.

Table 7.1: International Flow of Funds Due to External Public Debt (Annual Averages, L000)

<table>
<thead>
<tr>
<th>Years</th>
<th>Nominal Value</th>
<th>Amount Received</th>
<th>Amortization Payments</th>
<th>Interest Payments</th>
<th>Net Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td>1854-75</td>
<td>8.36</td>
<td>4.66</td>
<td>0.68</td>
<td>2.43</td>
<td>1.55</td>
</tr>
<tr>
<td>1854-68</td>
<td>2.95</td>
<td>2.05</td>
<td>0.30</td>
<td>1.03</td>
<td>0.72</td>
</tr>
<tr>
<td>1869-75</td>
<td>19.76</td>
<td>10.26</td>
<td>1.48</td>
<td>5.45</td>
<td>3.33</td>
</tr>
</tbody>
</table>

Source: Pamuk, 1984, p.56.

As can be seen from Table 7.1, external borrowing had accelerated after the favorable report of Hobart and Foster, but increasingly it became clear that the Empire was borrowing in order to finance the charges on previous debt. The strain
of the increasing debt burden had began to show by the late 1860's. Payments on the General Debt (see Appendix I) due on July of 1866 had been postponed for three months and some of the coupon payments due in 1871 remained unpaid. Furthermore, various railway companies which had constructed lines as a result of concessions had outstanding accounts with the government, dating back several years. (Blaisdell, p.77)

Confidence in the Empire's ability to fulfill its obligations was on the wane. Although the European media continued to express conflicting opinions about the credibility of the Empire, unfavorable ones, like the following became more prevalent. In response to the introduction of the 1873 loan, the Banker's Magazine wrote in its October issue:

Severe fluctuations in the prices of Turkey's stocks have corresponded to the vacillation in public opinion between the belief as to her ability to meet her liabilities, and the fear that her late heavy borrowings had exceeded at last her capacity to pay interest, and has exhausted the patience of her European creditors...[Recently] only eight million pounds of the twenty-eight million [issued] has been subscribed for, and this poor response is naturally regarded as tantamount to proof that, for the present at all events, Europe has had enough of Turkish indebtedness.

Similarly, on October 9, 1873, the London Times advised:

The only service which can now be rendered to Turkey is to refuse her a single additional shilling of money on any pretext whatever until she shall have placed her system of revenue and expenditure under solemn guarantees in the hands of statesmen conversant with true principles, and protected by checks and restrictions so established as to be beyond even imperial interference.

And again on November 7, 1874:

Subscribers to every new loan must be aware that they are
but feeding a flame which in the end will consume everything if the whole system is not radically altered.

Moreover, official British support had declined with the opening of the Suez Canal in 1869, which implied that the route to India was now under the sovereignty of the formally autonomous Egyptian Khedive. This was also the period during which British foreign investment in general shifted from Europe to the United States and the British Empire. (Kenwood and Lougheed, p.43) Although the Empire had always found it easier to raise a foreign loan in Paris, that alternative was also closed due to the demands made on French capital to meet the Franco-Prussian War indemnity.

In addition to the declining confidence in the Empire, the foreign loan business in general was suffering. In 1872 Honduras, Costa Rica, Santa Domingo and Paraguay defaulted at a time when the legitimacy of their loans was being questioned. In 1873 there was a heavy fall in Spanish bonds when the bondholders consented to fund a portion of the interest to keep King Amadeus on the throne and this was followed by a collapse of credit, abdication of the King, civil war, and default. Foreign government securities in general began to fall in the stock markets. (Jenks, p.292) In May of 1873 there was a financial panic in Central Europe which quickly spread from Vienna to Germany, Italy, Holland, Belgium, the United States, France, Russia, and England. In
response, the Bank of England raised the London bank rate to 9% to prevent further capital outflows. (Kindleberger, 1978, p.132) And, finally, the suspension of interest payments by Bolivia, Guatemala, Liberia, and Uruguay brought about the Foreign Loan Investigation of 1875. The report of the committee revealed extensive market rigging and the foreign loan mania came to an end as resources dried up. (Jenks, p.292)

Although these events were of critical importance, they nevertheless only determined the timing of the Empire's default. They were not the underlying causes. The essential problem was structural and two tiered. The first was the inability of the government to run a budget surplus and the second, the inability of the socio-economic system to enhance investment, productivity and production, and, related to this, a trade surplus.

2. The Budget Surplus

As I have argued in the previous chapters, the Ottoman government resorted to external borrowing in order to reestablish its traditional control over tax revenues. Incorporation into the capitalist world economy through international trade redistributed income away from the central bureaucracy toward merchants and tax farmers. As a result of
political struggles based upon this initial shock, the central bureaucracy lost its authority as well its share of the economic surplus during the 17th and 18th Centuries. Various local magnates and notables began to control large tracts of land, dispossessing peasants and withholding tax payments to the central government. The decision at the beginning of the 19th Century was to undertake a series of radical reforms, to centralize both expenditures and revenues in order to prevent the disintegration of the Empire and to restore the state's share of the surplus. When centralization of expenditures proved to be much easier than the centralization of revenues, the bureaucracy turned to European finance.

The state used the L41 million net loan inflow into the treasury during this period to increase central control and undermine, initially, the local magnates and, later, the tax farmers and the Ottoman merchants. In addition to setting up a highly complex, and at times overburdened, administrative structure, the central bureaucracy used most of the funds on military expenditure. Whereas the new administrative structure was to oversee the implementation of the reforms and ensure the inflow of revenues, the centralized and well equipped military was to enhance the coercive power of the state vis-à-vis both external threats and the personal armies of the local notables. (See Table 7.2)
Table 7.2: Planned Expenditures of the Ottoman Government
As a Percentage of Total Expenditures (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>Military</th>
<th>Administration</th>
<th>Sultan's Purse</th>
<th>Education</th>
<th>Public Works</th>
</tr>
</thead>
<tbody>
<tr>
<td>1860-1</td>
<td>42.1</td>
<td>28.8</td>
<td>13.8</td>
<td>0.2</td>
<td>n.a.</td>
</tr>
<tr>
<td>1862-3</td>
<td>41.9</td>
<td>25.9</td>
<td>10.7</td>
<td>0.3</td>
<td>n.a.</td>
</tr>
<tr>
<td>1863-4</td>
<td>36.2</td>
<td>23.0</td>
<td>10.5</td>
<td>0.3</td>
<td>n.a.</td>
</tr>
<tr>
<td>1866-7</td>
<td>25.8</td>
<td>31.2</td>
<td>8.4</td>
<td>0.7</td>
<td>n.a.</td>
</tr>
<tr>
<td>1868-9</td>
<td>29.0</td>
<td>45.9</td>
<td>6.0</td>
<td>0.4</td>
<td>1.6</td>
</tr>
<tr>
<td>1869-70</td>
<td>31.6</td>
<td>42.7</td>
<td>6.0</td>
<td>0.5</td>
<td>1.9</td>
</tr>
<tr>
<td>1870-1</td>
<td>22.7</td>
<td>42.0</td>
<td>5.7</td>
<td>0.5</td>
<td>1.8</td>
</tr>
<tr>
<td>1872-3</td>
<td>22.1</td>
<td>38.6</td>
<td>6.1</td>
<td>0.4</td>
<td>2.4</td>
</tr>
<tr>
<td>1874-5</td>
<td>24.0</td>
<td>35.9</td>
<td>5.2</td>
<td>0.5</td>
<td>3.0</td>
</tr>
</tbody>
</table>

n.a.: Not available

Military expenditures include the budgets of the Ministries of the Army, the Navy, the Police and Gendarmerie, and of the Imperial Arsenal Department.

Administrative expenditures include the budgets of the Ministries of the Interior, Foreign Affairs, Justice and Sects, and Finance.

Sultan's Purse reflects only the contributions of the state treasury. The treasury of the Sultan also had substantial revenues of its own from estates, investments and other sources.

Public Works include the budgets of the Ministry of Public Works and the Post Office and Telegraph Services. Expenditure items not covered in this list are expected internal and external debt payments.

The state was largely successful in undermining the power of the local magnates and in at least postponing the disintegration of the Empire. In Eastern Anatolia, Egypt, and the Balkan principalities, the state acknowledged the autonomy of the magnates in return for prompt and full payment of taxes. In the rest of the provinces (Macedonia, Thrace, rest of Anatolia, Iraq and Syria) the state essentially defeated the magnates. (Yerasimos, pp.248-51) The state was also successful in reducing its own dependency on the Galata bankers and the Ottoman merchants for loans by turning to European financiers, and in undermining the economic position of Ottoman merchants through the Anglo-Ottoman Commercial Treaty of 1838 which allowed European merchants to penetrate the interior of the Empire.

Perhaps most importantly, the state was able to reverse the trend towards large landholdings, and to reestablish a small peasant land tenure pattern. Throughout the 19th Century, and most especially during the 1830's, the state confiscated large landholdings and redistributed them to the peasants. (Issawi, 1980, pp.220-3; Owen, pp.63-4) According to the information available through the archives and the consular reports, by 1870 80% of all the cultivated land was in the form of small holdings, with an average size of 6-8 hectares (15-20 acres), and only 20% in large holdings, averaging 120 hectares (300 acres)¹. Large landholdings were
dominant in feudal Eastern Anatolia and in highly commercialized Northern Greece. These units employed some annual and seasonal wage labor, but mostly sharecropping arrangements. The small holdings used peasant family labor. (Pamuk, pp. 79-102)

Nevertheless, as I have already argued, the continuing pressures of international trade, the ability of European merchant capital to form alliances with the local merchants and tax farmers to divert the economic surplus for export continued to give an economic, and, contingent upon that, a political edge to the tax farmers. Ultimately, the state was unable to centralize the collection of agricultural taxes in any satisfactory degree. Even as late into the century as in 1878, during the Berlin Congress, the Europeans argued that 60% of the revenues destined to the treasury was diverted by tax farmers. (Pamuk, p. 54)

The government had borrowed and increased expenditures in order to be able to increase its revenues. In the ensuing struggle over the distribution of the economic surplus, the international economic environment favored the tax farmers and the merchants. Thus, despite concerted efforts to reform both expenditures and revenues, the state was unable to increase revenues enough to cover its expenditures. (See Table 7.3)
<table>
<thead>
<tr>
<th>Year</th>
<th>Revenues</th>
<th>Domestic Expenditures</th>
<th>Payments on External Debt</th>
<th>Budget Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>1859-60</td>
<td>n.a.</td>
<td>n.a.</td>
<td>0.67</td>
<td>-1.60&lt;sup&gt;a&lt;/sup&gt;</td>
</tr>
<tr>
<td>1860-1</td>
<td>11.38</td>
<td>12.58</td>
<td>0.81</td>
<td>-2.01</td>
</tr>
<tr>
<td>1861-2</td>
<td>n.a.</td>
<td>n.a.</td>
<td>0.95</td>
<td>-2.90&lt;sup&gt;a&lt;/sup&gt;</td>
</tr>
<tr>
<td>1862-3</td>
<td>15.10</td>
<td>12.43</td>
<td>0.95</td>
<td>1.72</td>
</tr>
<tr>
<td>1863-4</td>
<td>13.68</td>
<td>11.90</td>
<td>1.59</td>
<td>0.19&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>1865-7</td>
<td>14.61</td>
<td>12.64</td>
<td>2.92</td>
<td>-0.95</td>
</tr>
<tr>
<td>1868-9</td>
<td>15.57</td>
<td>12.83</td>
<td>3.22</td>
<td>-0.48</td>
</tr>
<tr>
<td>1869-70</td>
<td>15.73</td>
<td>12.63</td>
<td>3.22</td>
<td>-0.12</td>
</tr>
<tr>
<td>1870-1</td>
<td>17.45</td>
<td>15.06</td>
<td>4.87</td>
<td>-2.48</td>
</tr>
<tr>
<td>1872-3</td>
<td>18.76</td>
<td>13.54</td>
<td>6.33</td>
<td>-1.10</td>
</tr>
<tr>
<td>1874-5</td>
<td>22.55&lt;sup&gt;c&lt;/sup&gt;</td>
<td>15.72</td>
<td>9.72</td>
<td>-2.89</td>
</tr>
<tr>
<td>1875-6</td>
<td>n.a.</td>
<td>n.a.</td>
<td>11.63</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

n.a.: Not available.

Sources: Unless otherwise indicated, Revenues and Domestic Expenditures are from Shaw, 1978, pp.373-8. They are the expected domestic revenues and planned domestic expenditures of the government. (Ottoman fiscal years extended from March to February) External Debt Payments are from Pamuk, 1984, p.163.

(a): Actual budget deficits reported in the Hobart-Foster Report. (pp.3-4)
(b): Actual budget deficit reported in Du Velay, (p.110)
(c): Du Velay's estimate of what he regards as a more realistic projection of expected revenues for the 1874-5 budget. (p.205)
(d): Government's press statement in October of 1875. (Cited in Du Velay, p.208)
Combined with the limitations, set through agreements with the Europeans, on taxing foreign mercantile income or increasing tariff revenues and the emergence of nationalist movements in various provinces as well as all the wars (see Table 7.4), it was highly unlikely that the government could produce a budget surplus to repay its debt.

### Table 7.4: Ottoman Wars, 1798-1923

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1798-1801</td>
<td>French invasion of Egypt and Syria</td>
<td>1853-1856</td>
<td>Crimean War</td>
</tr>
<tr>
<td>1804-1813</td>
<td>First Serbian War of Independence</td>
<td>1866-1868</td>
<td>Cretan insurrections</td>
</tr>
<tr>
<td>1806-1809</td>
<td>War with Russia and Britain</td>
<td>1875-1876</td>
<td>Insurrections in Bosnia, Herzegovina, and Bulgaria; war with Serbia and Montenegro</td>
</tr>
<tr>
<td>1809-1812</td>
<td>War with Russia</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1815-1817</td>
<td>Second Serbian War of Independence</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1821</td>
<td>Rumanian insurrection</td>
<td>1877-1878</td>
<td>War with Russia and Serbia</td>
</tr>
<tr>
<td>1821-1823</td>
<td>War with Iran</td>
<td>1878</td>
<td>Insurrection in Thessaly</td>
</tr>
<tr>
<td>1821-1830</td>
<td>Greek War of Independence</td>
<td>1896-1897</td>
<td>Cretan insurrection, war with Greece</td>
</tr>
<tr>
<td>1827-1829</td>
<td>War with Russia, France, and Britain</td>
<td></td>
<td>War with Italy</td>
</tr>
<tr>
<td>1831-1833</td>
<td>First Turco-Egyptian War</td>
<td>1912</td>
<td>War with Bulgaria, Greece, and Serbia</td>
</tr>
<tr>
<td>1839-1841</td>
<td>Second Turco-Egyptian War</td>
<td>1912-1913</td>
<td>First World War</td>
</tr>
<tr>
<td>1848</td>
<td>Rumanian Insurrection</td>
<td>1914-1918</td>
<td>War of Independence</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1920-1923</td>
<td></td>
</tr>
</tbody>
</table>

Source: Issawi, 1980, p.4
3. Investment

The argument that the state was unable to increase its revenues enough to cover the expenditures it perceived to be necessary to enhance central authority is closely linked to the fact that there was no systematic increase in investment and production that one might expect in a capitalist organization of society.

Although there are no estimates of GNP or other items of the national income accounts for this period, the available evidence overwhelmingly indicates this. Eldem has made some estimations for a later period, 1894-1914, a period when foreign direct investment was at its peak, railroad trackage had more than tripled and average annual government direct investment had risen to 8% of total revenues. According to his estimations, during this period output grew at a rate of only 1.5%, population at a rate of 0.8%, and at no time did total investment reach 10% of GNP². (Eldem, pp.54,78,308) His argument is that partly because of inability to compete with European manufactures and partly because of insecurity with respect to agricultural property (see below) Ottomans tended to hoard their savings, mostly as gold. (Eldem, pp.308-9) It must also be pointed out that his growth estimates are based on the increase in agricultural revenues and that this was
also a period when the efficiency of tax collection had increased due to the centralizing effects of the railroads.

In addition, throughout the 19th Century agricultural technology did not change and agricultural yields did not increase. (Issawi, pp.201-5) During the early 1800's (as in earlier centuries) agricultural production was undertaken with wooden ploughs and oxen. The 1927 census showed that, in Turkey, 85% of the ploughs were still wooden, only 15% were iron, and that there was very little mechanization'. (Issawi, p.367) In the 1870's 80% of the Empire's population were peasants. (Pamuk, p.87) The 1927 census showed that 82% of Turkey's population was in agriculture. (Eldem, p.83)

If indeed the level of output had been growing faster there might have been other ways to resolve the conflict between central authority and mercantile profits. This, in turn, depended on the capacity or inclination of the government, the merchant-tax farmers, or the peasants to invest and innovate. I will argue that these actors did not have the inclination or the capacity to invest and innovate under the prevailing socio-economic structures.

The State
In the 20th Century, in most of the LDCs including Turkey the state emerges as perhaps the most important agent in terms of both direct investment and the overall regulation of investment in the economy. In the Ottoman Empire, however, as we have seen, most of the funds were used to create an administrative structure and a strong central army. There was some public investment and some attempts to stimulate investment, but these were, even at best, marginal activities for the state.

For example, the state did set up factories in some import competing sectors: sewing, textile, and headgear manufactories for uniforms, footwear, canteens, etc.; an artillery foundry for the manufacture and repair of cannons, mortars, and wagons; a gun factory to produce muskets, carbines, pistols, lances, and bayonets; several gunpowder mills and a glass factory. Nevertheless, these were all part of the general attempt to upgrade the military, rather than part of a concerted effort to increase investment and production. (Shaw and Shaw, pp.122-3) In terms of public works, the most extensive investment was made in postal and telegraph services so that by the end of the 1860's all major cities of the Empire were linked. Starting in the 1860's the state also began to issue concessions to European firms for railroad construction, though only 425 kilometers were completed until 1875. (Shaw and Shaw, pp.120-1) The importance
of these, however, was perceived much more in terms of enhanced central control, than improved production. Furthermore, the combined budget for public works and civilian education did not exceed 2-3% of total expected expenditures.

There were also sporadic efforts to stimulate production. During the Crimean war, for example, the state distributed cotton seed to increase cotton production; in the 1860's it imported silkworm eggs from Japan to replace diseased eggs. (Owen, p.117) In 1866 the Ministry of Agriculture established provincial agricultural credit cooperatives to provide low cost credit to the cultivators and to break the power of usurers, but not much of the credit reached the poorer peasants. (Shaw and Shaw, p.102) In order to revive industry, the state established an Industrial Reform Commission, organized trade fairs, and opened a School of Industrial Reform in 1867. Periodically the government would also grant the free use of state owned land and exempt the imports of some raw materials and machines from import duties. (Owen, p.116) Indeed, manufacturing did experience a brief boom in the mid 19th Century -- silk textiles in Bursa, Konya, Diyarbakir, Damascus, and Aleppo; carpet weaving in Izmir and Konya; candle, glass, paper, and canning in Istanbul; cotton textiles in Adana; and rugs in Bursa, Kastamonu, Damascus, Vidin, Bosnia, Salonica, Aydin, Sivas, and Silistra. Nevertheless, the boom was short lived and many of the
manufactories eventually closed down, unable to compete with imports under the free trade agreements signed with the European powers and the Gold Standard maintained by the Franco-British Imperial Ottoman Bank. (Shaw and Shaw, p.125)

The reasons behind these relatively meager and largely unorganized attempts to promote investment, innovation, and production had to do with the identity crisis/transformation of the Ottoman state. The two idealized role models at the opposite ends of the spectrum were the classical pre-capitalist state and the liberal capitalist state.

The traditional Ottoman state was one which closely regulated the appropriation and distribution of the economic surplus, but one which was not directly involved in its production. As I have already described, the socio-economic stratification was such that the peasants and artisans would produce the output as they saw fit, the merchants, under the close supervision of the state, would facilitate the flow of goods and the upper-most strata, the ruling class, would get the right to appropriate the economic surplus, with the proviso that they pass on a part of it to the central regulator, the state. Under this socio-economic organization, and at the prevailing level of technology, the means to increase the economic surplus did not lie in trying to revolutionize production technologies, but in conquering more
land and more labor, a characteristic that was also inherent in the dynamics of the classical state.

The liberal capitalist state, as for example articulated by Hobart and Foster, was, on the one hand, much less of a regulator, yet, on the other, was charged with investment in infrastructure. The socio-economic organization implicit in this vision of the state was a capitalist one with private, rather than state, ownership of the means of production and free markets not only for commodities, but also for the factors of production --land, labor, and capital. Under this socio-economic organization individuals competed in the market for their survival and the primary means to increase economic surplus was through revolutionizing production technologies. In this vision, members of the central bureaucracy were not the ruling class, they had no socially legitimate rights on the economic surplus. That right, earned through the market, was reserved for the capitalists. The state had a limited right to tax in order to provide defense, to set up and preserve the rules of the game most conducive to capitalist development, and, as part of the latter, invest in infrastructure.

In a very real sense the Ottoman state was caught between these two visions of its role. The broad lines of opposition within the state were between the palace, the army, and the
religious institution, on the one hand, and the Porte, the administrative bureaucracy, on the other. The former represented the classical concept of the state and tended to push for reforms that would reestablish the state as the uppermost strata of the ruling class with ultimate control over the economic surplus. The Porte, on the other hand, tended to push for reforms that both centralized state control and promoted economic development based on individual initiative and government support. At any given time, the vision that dominated was determined to a large extent by the fractional fights within the central bureaucracy. The state of political turmoil is reflected by the fact that during the 37 years between 1839 and 1876 there were 39 different terms as grand vizier and 33 as foreign minister, with each position being held several times by the same person.\(^6\)

Thus, on the one hand the state was unwilling to let go of its traditional right over the appropriation and distribution of the economic surplus, on the other it was trying to adapt to the changing times. While on the one hand it opposed private property, large landholdings, and wage labor in agriculture, on the other, with European pressure, it adopted free trade, removed price controls, modernized the legal codes for trade and industry. Similarly, while there was no concerted effort to improve the productive base of the Empire, there were isolated attempts as described above.
The fact that the state did not undertake investment in a systematic fashion implied that investment would come out of private saving. As a result, there were no large scale projects—railroad networks, irrigation systems, dams, etc.—The fact that there was not a wide-spread banking system to mobilize and combine private savings, while it partly reflected the low level of private savings in the economy, also implied that investment would need to come largely from individual private savings. Until the establishment of the Agricultural Bank in 1888 there were only foreign banks in the Empire. These specialized in lending to the state and, after 1881, in financing foreign direct investment. The fact that after the establishment of the Imperial Ottoman Bank the Empire maintained a specie circulation system also limited the possibilities for credit extension. The credit facilities were concentrated in the hands of the Galata Bankers who mostly financed mercantile transactions and mediated between the merchants and the tax farmers.

**Tax Farmers and Merchants**

The tax farmers and the merchants, or in a broader sense the local notables, were the ones in a position to accumulate wealth and therefore, one would think, in a position to save and invest. In a highly stylized fashion, the tax farmers
bought the right to collect the taxes of a province from the state, collected the taxes in kind, and sold it to the merchants who then passed it onto the European merchants for export or marketed it domestically. In turn, the merchants would lend money to the tax farmers as sponsors for the latter to buy the tax farms. Especially with the displacement of the Ottoman merchants by the European merchants after 1839, lion's share of the mercantile profits went abroad. Nevertheless these groups were the domestic groups who benefitted most from increased international trade, both in terms of profiting from the export of agricultural goods and imports of manufactures, and in terms of cheap luxury imports.

As I described before, the relationship of the tax farmers to the state and to the peasants was wrought with conflict. Aside from the legal aspect of the contract with the state which was nominally fixed and in which the tax farmers benefited from a rise in the relative price of agricultural goods, there was also a great deal of collusion to facilitate underbidding at the tax farm auctions. The relationship of the tax farmers with the peasantry was also largely based on force and conflict. Relying on their power as local notables, through intimidation as well as corporal punishment, the tax farmers were appropriating significantly more than the legal one tenth of the produce. (e.g. Issawi, 1980, pp.351-60)
Domestic merchants and tax farmers had little incentive to invest the economic surplus that concentrated in their hands productively. Investment in manufacturing, that is in the import competing sector, was by and large not a profitable option due to the free trade agreements that the state signed with the European governments, partly under pressure from the latter, and partly to undermine the power of the Ottoman merchants. Profitable access to the agricultural surplus, on the other hand, required large political outlays. The tax farmers had to buy the right to collect the taxes. The profitability of this enterprise depended on keeping the bids and the costs of collection low and the appropriated surplus high. Keeping the bids low, in turn, depended on buying off various officials and keeping competitors at bay through collusive agreements or demonstrations of coercive power. Keeping the appropriated surplus high also depended on intimidation and coercive power. Maintaining the privileged status of a tax farmer, in other words, required relatively large outlays to the state and to the officials of the state, on the one hand, and sustaining the status of "local notable" through legitimacy enhancing conspicuous consumption and a personal army, on the other. Not much would be left for productive investment.

Investment to improve productivity and expand production is a risky venture under the best of circumstances. Within the
pre-capitalist production relations of 19th Century Ottoman Empire it was close to prohibitively risky. Most of the tax farmers had access to their own plots of land for their own subsistence. However, especially after the centralizing efforts of the state which succeeded in reestablishing a small peasant land tenure structure on 80% of the cultivated land, they did not have access to large tracts of land or large numbers of landless labor. Moreover, even if they had this access, they were not legally property owners, and always faced the risk of confiscation by the state. Even if a given notable had secured his position in the community and vis-a-vis the state, investment in improving the means of production would have been in contradiction with the coercive relationship they maintained with the peasantry. They would have needed a much more cooperative relationship with the peasantry, for example not to tax more than the legal one tenth of the produce, and/or to employ a much larger group of supervisors, or perhaps to enter into sharecropping arrangements. To the extent, however, large landholdings were not a viable option, it was additionally important to the tax farmer to be mobile and bid for the plots that were the most productive.

Under these circumstances, even if productive investment was seen as an option, it was highly unlikely that the economic surplus that could be extracted from the increase in
output due to productive investment, accounting for the inherent risks as well as increased costs, would be higher than the surplus achieved through political investment and forceful reductions in the peasants' standard of living. Thus it is not surprising that the tax farmers responded to increased profitability of exports and the availability of luxury manufactures largely by decreasing their payments to the state and increasing the taxation of the peasants as described in Chapter IV; and not through productivity improving investments\(^1\).

**Peasants**

With neither the state nor the tax farmers or merchants involved in investment in any systematic fashion, peasants were the only remaining actors. Peasants were also the poorest group in this highly stylized social structure. With the aforementioned lack of non-usurious credit facilities, the investments that they would undertake would by and large be financed through family savings, and thus, would be limited to very small scale projects -- saving more seed or animal feed for the next season, devoting more time to clearing land, or saving enough to buy drought animals or ploughs, etc. They would be motivated much less by a desire to accumulate and much more by a desire to improve their modest standard of living.
To the extent that the peasants could resist the forceful extraction of the tax farmers or limit it to a constant proportion of the output, they would also benefit from the increasing profitability of agricultural exports and availability of cheaper manufactures. If the peasants were able to respond to market signals without any middlemen, they would be able to improve their standard of living by expanding production and would be likely to increase investment. To the extent, however, the tax farmers were able to respond to increased profitability of agricultural exports by increasing the surplus appropriated from the peasants, the peasants would not be able to benefit from international trade, and investment would be especially weak. In either case, given the extensive evidence on the poverty of the peasantry, net investment would largely be a residual activity. One that would be undertaken after the subsistence and other immediate needs of the peasant family were met.

Perhaps most importantly, and this also applies to notables and their individual plots, since the peasants had access to their means of subsistence and did not depend on market exchange for survival, there were no structural forces within the system that would ensure the widespread adoption of any technical innovation that an individual unit might undertake. Better economic performance in one production unit
did not threaten the survival of any other. In other words, unlike competitive capitalism, investment and innovation were not systemic properties of these pre-capitalist relations of production\(^2\). This partly explains the coexistence of modern and ancient methods of production in a given region, as well as the viability of the reluctance of peasants to accept new methods even when they became available\(^3\).

Thus, overall, production methods remained primitive and output increases very small, especially before the 1880's. After 1880, with the greater influx of foreign direct investment in railroads and other enterprises, agricultural technology began to change, but very gradually and unevenly. For example, a Foreign Office report describes agriculture in Erzurum, in 1846:

The plough is of simple construction and is managed by a single labourer, who dexterously guides his oxen with a long slender stick. To increase the depth of the furrow, the yoke is shifted towards the extremity of the beam, which causes the point of the share to depress more vertically into the soil...[The fields] are usually left fallow every other year, the system of rotation of crops being unknown...Barley fields are often manured with ashes of dung that has served as fuel, as well as with those of reeds and rushes. (in Issawi, 1980, p.216)

Another Foreign Office report, in 1856, states that in the relatively advanced island of Rhodes "the implements employed in agriculture are the plough, the spade, the hoe and the sickle, all of which are very imperfect. No machinery has been substituted for human labour." (in Issawi, 1980, p.205)
Yet another describes agriculture in Southeastern Turkey much later in the century, in 1908:

Ploughs require 2 yoke of oxen or buffaloes, each yoke working for one spell of 4 hours per day. The oxen are weak and undersized and draw a lighter plough than the more powerful buffaloes. The plough-share is of the primitive arrow-headed shape and cuts a furrow of from 8 in. to 1 foot....Harrowing is unknown (except for cotton). Manure is not used in Diyarbekir (except for water-melon growing). In Kharpux, stable manure and human extracta are extensively employed. Crops are reaped with sickles...The corn is trodded out by oxen. Flails and threshing machines are unknown...In most districts rough ox-carts are used to carry the corn to the threshing floors. In Diyarbekir, however, there are no ox-carts, and the corn is carried by animals...Winnowers of local manufacture are used in many districts...The corn is ground in water mills, and flour is of indifferent quality. It is husked by a mill-stone revolving on its edge in a circular groove, and worked by horse-power. Corn-crushers, of local manufacture, introduced some 6 or 7 years ago, are now made in Kharpux and Diyarbekir...In Diyarbekir the land lies fallow for two years and is ploughed in the third. In Kharpux it is tilled every year and crops are grown in rotation...The only attempt made at irrigation consists in leading shallow channels from the nearest stream over the fields, where the lie of the land permits it. Any system of dams, whereby water may be stored for the dry months, is unknown. Water-wheels are non-existent. (in Issawi, 1960, pp.219-20)

A Correspondance Commerciale report describes some of the changes that were taking place at the turn of the Century, in the somewhat more developed Central Anatolia region:

Although far from being very enlightened in matters of farming, the peasant of the interior regions is, nevertheless, less ignorant regarding our methods of cultivation; little by little, he is giving up his ancient working habits and is often willing to adopt newer and more profitable ones. Of course we are far from seeing all the land being farmed, or all the old errors given up....However certain fact are clear: agricultural machines, introduced from America a few years ago are becoming more numerous every year...The initiative behind this progress is not solely due to the Anatolians, whose hopes of ultimate gain would not be strong enough to stimulate this zeal. Europeans established in the region

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encourage them strongly in the path of progress, and in this connection the role played by the Ottoman railway of Anatolia deserves to be mentioned...As is known this German company, realizing that the development of the agricultural wealth of this country would have beneficial effect on the growth of its traffic, decided to establish an agricultural service as a supplement to its main business...Mr. Scheiblich [the company agronomist] is under no illusions regarding the difficulties he will have to overcome ...but he observes that the inhabitants are interested in these experiments and willingly take up the steel ploughs which are at present being supplied by the company to farmers [on credit]. (in Issawi, 1980, p.229)

A German official reports in 1919 on the highly commercialized Adana and Izmir regions, former dominated by large landholdings and sharecroppers, the latter by small peasants, both specializing in cotton:

Compared to the methods of tillage used in the interior of Asia Minor [Anatolia], cultivation in the Cilician [Adana] plain can already be termed advanced...A kind of three field system prevails, under which in the first year cereals are planted and in the second cotton only, or sesame and cotton, or only sesame. The third year the land is left fallow, or fallow and pasture...In general, the soil is neither manured nor deeply ploughed. But one should admit that, in the last years before the outbreak of war, the importance of modern methods for securing higher yields has been increasingly recognized by individual large landowners. In the decade preceding the number of machines imported into and used in the Adana [region] was not less than about 1,000 reapers, 100 steam threshers, 25 double steam ploughs, 85 single steam ploughs,...In general, the productivity of the soil has sharply decreased, because of continuous planting without manuring. Deep ploughing is also restricted to a few individuals. Tillage generally consists of 5 to 8 ploughings with the Turkish pointed plough, whose blade does not turn but only loosens the soil. The agricultural implements are very primitive...On some estates European ploughs are to be found, but most are thrown away as scrap. For the workers and managers prefer to work with their traditional ploughs, and the indolence of the managers is such that they cannot accustom the people to using European ploughs, of whose utility they themselves are not convinced...Methods of cultivation differ in the [Izmir] region. We find the three field system,
alternation with grain, and repeated planting of cotton. Cultivation is unbelievably primitive, mainly with a wooden plough which only scratches the soil, seldom with an iron ploughshare. Heavier ploughs cannot be used, for the draft animals are not strong enough. The cultivation of the soil is not as developed as in the [region] of Adana. (in Issawi, 1980, pp.242-6)

Thus, overall, in the Ottoman Empire (and more generally under pre-capitalist relations of production) investment and innovation were largely residual activities and not in any way the driving force of the system. This was especially true during the period leading to default. Therefore, once the Empire was incorporated into the world economic system, that is once exportation of agricultural goods and the importation of manufactures became profitable and the agricultural surplus of the economy began to flow abroad largely in return for luxury imports, the resulting conflicts within these relations of production centered around the distribution of output and essentially did not lead to a systematic increase in its production. It was, if you will, solvency crisis par excellence.

4. The Scenario

If we try to simplify and fit together the pieces of the worst case scenario, investment would actually decline as a result of increased demand for exports. An increase in the demand for agricultural exports would lead to excess demand,
and given that the output was fixed in the short run, cause an increase in the relative price. Since government revenues were nominally fixed, this would redistribute real income away from the state towards the tax farmers, intensifying the fiscal crisis of the state. Since the state consumed both imports (mostly weapons) and agricultural goods (food for the military), whereas tax farmers' expenditures were almost totally on imported luxury goods, this redistribution of income would relieve the pressure on agricultural goods and increase import demand, intensifying the process of incorporation. In addition, to the extent that the tax farmers did respond to the increased profitability of exports by increasing their appropriation of the economic surplus, peasant incomes would decline, further reducing the pressure on agricultural goods and increasing import demand. To the extent that the peasants were living at close to bare subsistence, most of the adjustment to decreased income would come from a decrease in saving and investment, rather than consumption.

In other words, incorporation into the world economy through the initial shock of increased export demand would be accommodated by redistributing purchasing power from high agricultural output consumers to high import consumers through rising relative prices. The decrease in peasant income would have the additional result of reducing investment and
curtailing future growth. Perhaps more importantly, to the extent that foreign lending eased the budget constraint of the state, even more of the adjustment would have to come from declining peasant incomes and investment. (Appendix II presents a model which formalizes this story.)

It is extremely important to point out that this is a snapshot, and a highly simplified snapshot, of the economy as it seemed to have functioned at the time of default. Nevertheless, it does highlight the economic bases of the conflict surrounding the distribution of the economic surplus and the inherently weak investment performance of the Empire, which was, ultimately, the reason for its default.

It will be instructive to look at the recommendations of the Hobart-Foster mission from this perspective. For short run stability the mission had recommended withdrawing the paper currency, but maintaining government expenditures by increasing revenues from the tobacco tax, stamp tax, taxation of domestic servants and of residents of Istanbul. These taxes would bear mostly on the local notables and to the extent that notables spent their income on imports, would reduce import demand, without effecting domestic demand or the domestic price level. However, to the extent that the tax farmers were powerful and they succeeded in maintaining their real income by increasing their appropriation from the peasants,
increased taxation would reduce long term growth of both output and exports and would sustain imports.

Although it is hard to discern exactly what happened, the evidence presented in the previous chapter (Table 6.1) indicates that tax revenues increased and government budget deficits fell, during the 4-5 years following the mission. It also indicates, however, that after improved trade performance in 1863 and 1864, import growth accelerated and trade deficits widened, lending support to the latter proposition.

It is also important to note that within this structure, the preoccupation of Hobart and Foster with removing tax farmers and reducing the tax burden of the peasantry was well-founded, though perhaps not practical. To the extent that taxes could be collected by salaried government agents and without abuse, peasants would respond to increased profitability of exports by increasing investment. If world history is any indication, however, transition to capitalist relations of production would still take a long time, awaiting stratification within the peasantry and the dispossession of the majority by the wealthier minority. Indeed this is ultimately the path that the Ottoman Empire and, later, the Republic of Turkey would follow in agriculture.

5. Socio-Economic Change Into the 20th Century
In 1881 the Public Debt Administration (PDA) was established to service the debt incurred during 1854-1877. To this end some of the most liquid revenues of the Empire were ceded to it, among them the excise taxes on documents, spirits, and tobacco, the government monopolies in salt and tobacco, and the silk tithe. The PDA was highly successful in performing its function and paid out L124 million in debt service between 1882 and 1914. Part of its success lay in the direct reforms it undertook. For example, in order to increase silk tithe revenues the PDA established the Institute of Sericulture in Bursa which provided free instruction and distributed mulberry trees. Some 15-20 million mulberry trees were planted between 1888 and 1905. These measures and sustained world demand for silk resulted in a sharp increase in output and exports. (Blaisdell, p.109) Similarly, the PDA instituted a campaign to raise the domestic consumption of salt, especially in olive and fish processing industries, and sent agents to India to develop demand for Turkish salt mined from the Red Sea salines. Between 1892 and 1909 the volume of salt exports increased six fold and salt revenues doubled. (Shaw and Shaw, p.235) Another part of the success of the PDA was due to its ability to break the constraints imposed by the agreements with the European Powers. For example, revenues from the stamp tax had remained low, because while foreign nationals were the ones who entered into written contracts
most extensively, they were exempt from this tax. In 1894, at
the PDA’s insistence, all foreigners were held to pay this
tax, leading to a 60% increase in revenues by 1902.
(Blaisdell, p.112)

Nevertheless it must be remembered that the debt had been
written down by 40% and the service charges by 80%. Whereas in
1875 debt service had absorbed 57% of total revenues, the PDA
controlled 20-30% of total revenues. At the same time, the PDA
controlled some of the more liquid revenues of the Empire and
this limited the fiscal maneuverability of the government more
than the percentage suggests. Rural taxes had always been
difficult to collect, tariff rates could not be increased,
foreigners could not be taxed, taxes on realty and in lieu of
military service were not susceptible to substantial increase
and possibilities of extending postal and telegraph services,
the only monopoly the government retained, were also limited.
All of this, of course, led to more budget deficits and more
loans, all but four administered by the PDA.

Perhaps more importantly, the PDA provided the
institutional and personal channels through which European
industrial capital flowed into the Empire. In close
cooperation with the European Embassies and the three major
banks (The Imperial Ottoman Bank, now under French domination;
The Deutsche Bank, the Istanbul branch established in 1888;
and the British controlled National Bank, established in 1906), the PDA coordinated European direct investment. (See Blaisdell, pp. 133-46, 222-35) Between 1854 and 1881 19 foreign joint-stock companies had been established in the Empire. Between 1882 and 1907 this number increased by 63, and between 1908 and 1914 by 130. Those formed in the latter period were mostly joint enterprises between Europeans and non-Muslim Ottomans. (Toprak, pp.57-60) Between 1882 and 1913 there was a net capital inflow of L64 million, profit repatriation of L59 million, giving a net inflow of L5 million due to foreign direct investment. (Pamuk, 1984, pp.167-70) These investments were in infrastructure, primarily in railways and port facilities, and as such extended the incorporation process into the interior rather than intensifying it by changing the relations of production. (See Table 7.4)

Between 1876 and 1909, for example, railway trackage more than tripled, increasing by 5883 kilometers. (Shaw and Shaw, p.227) In 1909 the Ottoman government was paying the railway companies L773 000 annually in kilometric guarantees through the PDA. (Yerasimos, p.972) Between 1881 and 1895 there was a sharp increase in grain exports, carried from Central Anatolia to the ports by the new railroads.(Owen, p.202) Between 1889 and 1911 tithe revenues from the areas reached by the railroads increased by 114%, reflecting partly
increased output and partly the greater central control afforded by a railway network. (Yerasimos, p.964)

<table>
<thead>
<tr>
<th>Sectors</th>
<th>1890</th>
<th>1914</th>
</tr>
</thead>
<tbody>
<tr>
<td>(L000)</td>
<td>(%)</td>
<td>(L000)</td>
</tr>
<tr>
<td>Railroads</td>
<td>875</td>
<td>4.1</td>
</tr>
<tr>
<td>Harborworks</td>
<td>500</td>
<td>2.2</td>
</tr>
<tr>
<td>Municipal Services</td>
<td>2 452</td>
<td>11.5</td>
</tr>
<tr>
<td>Banking &amp; Insurance</td>
<td>5 040</td>
<td>23.5</td>
</tr>
<tr>
<td>Trade</td>
<td>1 230</td>
<td>6.0</td>
</tr>
<tr>
<td>Industry</td>
<td>2 145</td>
<td>10.0</td>
</tr>
<tr>
<td>Mining</td>
<td>1 190</td>
<td>5.6</td>
</tr>
<tr>
<td>TOTAL</td>
<td>21 392</td>
<td>100.0</td>
</tr>
</tbody>
</table>


As foreign domination of the economy grew, so did local resentment. While there was accumulation of wealth in the hands of the Ottoman tax farmers and merchants, most of the benefits of production and trade accrued to foreigners or Ottoman (non-Muslim) merchants who had become foreign nationals. The Ottoman state had acquiesced to these developments, because it saw the strengthening of Ottoman notables as a threat to its central authority. These developments, however, also laid the ground for the emergence of a domestic alliance against foreign capital'. It was this
alliance which eventually brought the Committee for Union and Progress and the Young Turks to power as part of the constitutional monarchy set up in 1908.

The Young Turks fully recognized the importance of investment and capital accumulation. Indeed, they saw capital accumulation as a catch-all solution to all the country's economic ills, just as the constitution was for the political ills. (Iswan-Katircioglu, pp.1-4) Initially they espoused the laissez faire, laissez passer policies of classical economics. They encouraged foreign investment, but also tried to foster an Ottoman bourgeoisie through improved credit facilities and exemptions from tariffs and taxes, concessions that were equivalent to the ones the Europeans enjoyed through the capitulations. (Toprak, pp.23-25) At the same time they tried to direct foreign investment into mining, agriculture, and industry, areas they saw as most beneficial to the Ottoman economy. Foreign investment, however, remained confined to financial and commercial enterprises, and public works. (Toprak, p.97)

As a result, the Young Turks eventually turned against foreign capital and embraced the "national economics" of Germany and Friedrich List. (Toprak, pp.25-35) They did not, and perhaps could not, however, take the necessary steps until the outbreak of World War I. It was in September of 1914
that the Ottoman state unilaterally abolished the capitulations. Foreign nationals were made subject to Ottoman laws and taxes, and the customs duties were increased by 4%. (Shaw and Shaw, p. 313) Whereas before 1908 there had only been 9 Ottoman joint-stock companies, by 1918 there were 129, most of them established after 1914\(^9\). (Toprak, p. 63)

This was the beginning of the process which would ultimately lead to state capitalism, after the War of Independence, under Ataturk. In terms of industry, the policies relied on protective tariffs, exemption of capital goods and intermediates from import duties, cheap credit, as well as direct government investment. A full blown import substitution industrialization policy, however, would await the 1960's.

In terms of agriculture, three policies seem to have been of critical importance. The abolition, in 1926, of the tithe finally destroyed the power of the tax farmers as appropriators of the economic surplus\(^{10}\). In addition to this, the availability of agricultural credit through the Agricultural Bank and exemption of agricultural machinery and fertilizers from import duties accelerated the process of change.
Sociological studies indicate that in areas where large landholdings and sharecropping had dominated, as in Western and Southern Anatolia, the landlords utilized credit to import machinery and improve irrigation. As a result, agricultural output increased from three- to eight-fold. The mechanization process also pushed the peasantry from the land. Some became daily wage laborers in agriculture, others migrated to the cities waiting to be absorbed as a result of the ISI policies. (M. Kiray and Hinderink) Two different mechanisms appeared to be at work in the areas where small holdings dominated. In areas where profitable cash crop production required mechanization and better irrigation, there was stratification and concentration of landownership. In Central Anatolia, in the 1960's, for example, peasants who held less than 50 acres and who borrowed to mechanize their operations, tended to lose their land within five years. They either became sharecroppers or wage laborers in agriculture, or migrated to the cities. The land was bought by one or two of the wealthier peasants who then moved on to large scale mechanized and irrigated agriculture. (M. Kiray and Hinderink) In areas where profitable cash crop production did not necessitate increased capital, as for example in the tobacco growing Northern Anatolia, farming continued with peasant family labor. These peasants, however, grew dependent on local merchants for organizing marketing and usually ended up in a debt cycle. This was the slow change path, since the merchants used their
leverage to appropriate a larger portion of the peasants' output, rather than enter direct production. (M. Kiray, 1964, part V; M. Kiray, 1968)

5. **Conclusions**

As can be seen, the conflict between the Ottoman state and the local notables over the distribution of the economic surplus created a political structure that could not sustain the requisite budget surplus to repay the debt. The state borrowed in order to increase its central authority and tax revenues. It was only partly successful and the tax farmers continued to divert a substantial portion of the tax revenues destined for the treasury. While the capitulatory agreements the state signed with the Europeans undermined the power of the Ottoman notables, enhancing central authority, these also helped concentrate income in the hands of foreign nationals and simultaneously prevented the state from taxing it. Even then the state was unable to prevent the disintegration of the peripheries of the Empire, losing revenues and increasing expenditures.

At the same time, the nature of the conflict between the peasants and the tax farmers over the size of the economic surplus created an economic structure which hindered
productive investment. Transition to capitalist relations of production in agriculture could have ameliorated this, but the state perceived the emergence of large landholdings, dispossession of peasants, sharecropping and wage labor as threats to its central authority. Although it is hard to judge the validity of this perception, the experience of decentralization and second serfdom in Eastern Europe or colonization in India and Africa, for example, lend credibility to the state’s fears. As a result of this economic structure, neither the exports nor the output of the Empire increased sufficiently to warrant the rates at which it was borrowing. Default was the natural result, once the funds in Europe dried up.

The period following default was the culmination of a number of trends. While foreign domination of the economy increased under the sponsorship of the PDA, the domestic groups that had accumulated capital managed to form an internal alliance against foreign capital. The Young Turks who came to power in 1908 were successful in combining the aspirations of domestic capital with the regulatory role of the classical state and accelerated the move towards state capitalism.
NOTES TO CHAPTER VII

1. These figures apply to Anatolia, Iraq, Syria, Thrace, and Northern Greece (Macedonia).

2. During comparable periods, Japan was growing at a rate of 4.1%, the US at a rate of 3.3%, Germany at a rate of 3.1%, and Britain at a rate of 2.4%. (Eldem, p.316) World agricultural output expanded at a rate of 1.8%, and world industrial output at a rate of 8.2%. (Eldem, p.35)

3. In the 1860's Europeans made some attempts in the Izmir region to use better implements, but these died out with the cotton boom. In 1878, a Foreign Office report described the situation: "Little or no real progress has been made of late years in the introduction of agricultural machinery and British-made implements. The English firm I alluded to in a former report has energetically strived to bring them into notice, going so far as to offer English ploughs, threshing machines, etc. for trial for one or two months without charge, and to impress constantly upon the Government the importance of establishing model farms in the neighbourhood ... Perhaps the first thing to be understood is the necessity of admitting all agricultural machinery duty free." (in Issawi, 1980, pp.202-3) Things began to change during the 1880's. By 1913 there were some 300 steam ploughs and threshing sets in the cotton growing Adana region, and some 200 to 250 reapers were being imported annually from the United States, as well as some bullock ploughs from Britain and Belgium. Nevertheless, even by 1923 only the plains of Adana, Esksiehir, and regions around Edirne, Bursa and Izmir were using the modern plough. (Issawi, 1980, pp.203-4)

4. The underlying theoretical framework of the following sections is largely based on Brenner.

5. The most famous of the reformers representing the Porte were the British ally Mustafa Resit Pasha (1800-1858) who served six times as grand vizier and three times as foreign minister, and the French allies Mehmet Emin Ali Pasha (1815-1871) who served five times as grand vizier and seven times as foreign minister, and Mehmet Fuat Pasha (1815-1869) who served twice as grand vizier and five times as foreign minister.

Outside of the state apparatus was the Young Ottomans Society (predecessor of the Committee for Union and Progress and the Young Turks) established in 1865, mostly by the members of the new intelligentsia, children of the bureaucrats. They were the most liberal elements of the society and pushed for a constitution, a parliament, and equality for all Ottomans under the law. Their closest ally within the state apparatus was Midhat
Pasha (1822-1884) who after serving as the governor of Nis and the Danube, authored the Provincial Reform Law of 1864, served as the head of the Council of State (1867-68) and as grand vizier in 1872. He was one of the authors of the constitution in 1876. This constitution established an elected Chamber of Deputies, which represented the local notables and an appointed Chamber of Notables, which actually represented the bureaucrats and the Porte. Midhat Pasha served again as grand vizier between 1876 and 1877, but was dismissed by Sultan Abdulhamit II and later assassinated, as the Sultan dissolved the parliament and consolidated his autocratic rule which would last until the Young Turk Revolution of 1908. The quintessential supporter of the vision of the liberal state was Cavit Pasha (1875-1926), the first Minister of Finance under the Young Turks; though he would later embrace the idea of "national economics" and state capitalism.

The difference in the styles of the Porte and the palace can be seen in the different ways they dealt with unrest in the provinces. When Midhat Pasha was appointed the governor of Nis and later of the Danube in the 1860s, in order to stem the rise of Slavic nationalism in Bulgaria, he attempted to find out the reasons for the discontent. He then built roads and bridges, established steamship lines on the Danube, created a postal system, developed secular schools, pardoned back taxes, organized agricultural banks to rescue the peasants from usurers, and formed local advisory councils at all levels of government. He applied similar reforms after his exile from Istanbul as governor of Syria (1878-1880) and Izmir (1880-1881). (Shaw and Shaw, p.161) In contrast, when Mehmet Emin Pasha (1813-1881), an army man and representative of the palace, was appointed the governor of Aleppo in 1850, he only brutally suppressed the bedouin revolts. He later served three times as grand vizier and reportedly earned a reputation as the most stupid and pompous of all the politicians of the era. (Shaw and Shaw, p.72)

6. Some of these projects, especially railroads and municipal public works, would eventually be undertaken by foreign capital, but only after the establishment of the Public Debt Administration and its role as an overseer reduced the riskiness of these ventures. As I mentioned in Chapter 2, there was virtually no foreign direct investment prior to default.

7. Since there are no data available on the national income accounts of this period, it is very difficult to quantify any of these categories. There is, however, a Foreign Office Report, reprinted in Issawi (1980, pp.45-50), which looks at the standard of living and budgets of various sections of the society in Northern Anatolia in 1870. Unfortunately there is no information on government officials, merchants, or tax farmers. According to this report, an average (married) day laborer earned about L18 per year, and after expenditures on housing, clothing, food, and sundries and payment of taxes, retained 0.2% of his gross income.
An average workman (carpenter, mason, smith, etc.) earned L31 a year, and similarly retained 5.4% of his income. An artisan (tailor, shoe-maker, weaver, silver-smith, etc.) earned L50 a year, and after expenses including the rent on his shop and license payments, retained 20% of his income. A peasant landowner earned L17 a year, and after expenses including those for the upkeep of his animals and implements, retained 5% of his income. And finally, a sharecropper earned L10 a year, and similarly retained 9.3% of his income.

Suppose we take a leap of faith and assume that these "balances in favor" of the recipients, as the report calls them, were saved and that these saving rates were typical of the Empire. Suppose also we assume that the average saving rate in the urban areas was high, 10-15%, accounting for the tax farmers and bureaucrats. Then using the information that 80% of the population was in the rural areas and 20% in the towns; and that 80% of the rural population were peasant landowners and 20% sharecroppers, we arrive at a low (population weighted) average saving rate of 7-8%. Eldem's estimates indicate that in the period between 1894 and 1914, agricultural income represented 50% of the GNP. This seems too low for the 1855-1875 period, but an income weighted calculation on this figure gives average savings rates of 8-10%.

9. A Preussisches Handelsarchiv report in 1864, for example, describes the state of industry in Istanbul:

...Local industry in Istanbul was unable to withstand the powerful flow of imports in 1862 and 1863. Local industry, in the European sense of the term, does not in general yet exist. Nothing produced here is exported, except for a few fancy goods which because of their oriental character, are bought by travelers as curiosities and souvenirs. Craftsmen work solely for local consumption; most of them are natives... European master-craftsmen and work supervisors are to be found, in general, only in those trades catering to the Europeans living here ... and they too employ native workers.

Only one branch of industry has, strictly speaking, passed beyond the handicraft stage: milling. There are six steam mills, one of which produces 20 million kilograms of flour a year and the others between 500,000 and 1,500,000 kilograms. They belong respectively to two Frenchmen, a Greek and three Turks...

In addition, there are some copper and iron foundries, workshops making furniture and billiard tables, breweries and distilleries, several printing presses, an oil factory, a sawmill and a marble quarry in the Istanbul area. The activity of these enterprises, of which some at present idle, is very insignificant. They produce only for local consumption and even in this field are outstripped by the importation of foreign goods, which recently has been
9. Indeed sharecropping was the main mode of labor control on 20% of the cultivated land that was in large holdings.

10. In the literature on Europe much emphasis has been put on the fact that the peasants were enserfed, and that this was the means through which the landlord could extract rent in the face of alternate employment in the towns or a labor scarce-land abundant economy. It is interesting to note that in the Ottoman Empire, once the alternative of urban employment declined due to competition from imports, the same effect was achieved by declaring all lands to be taxable state lands and having a mobile group of "landlords".

11. It is also important to note that given that methods of cultivation and yields on land did not change significantly, if indeed output growth outpaced population growth during this period as in the later 1894-1914 period, it must have come about not only through extension of cultivation, but also through the intensification of labor.

12. Investment and innovation are systemic properties of competitive capitalism where the survival of both capitalists and workers depend on market exchange. The workers do not have access to their means of production and need to sell their labor power to the capitalists in order to earn income and buy the necessities of life. The capitalists do not have direct access to labor, and need to buy and combine capital, materials and labor power in production and then be able to sell the output with profit in order to earn an income. Neither has access to the means of subsistence other than through market exchange. Under these relations of production, good market performance, the need to produce at the market rate of profit, and therefore to adapt each technical innovation becomes a necessity. Moreover, the principle means to increased profit (economic surplus) lies in innovating and increasing productivity before the competing unit does.

13. This apparent resistance to "bettering oneself" is described extensively with disgust and surprise in the European communications of the period.

14. If the tax farmers spend all of their income on imports, trade will also be balanced.

15. Indeed, it was because the economy adjusted to external demand more through higher prices and less through higher output that its exports were eventually displaced by the exports of
countries having higher productivity and lower cost.

16. Since in the Ottoman Empire there was no well developed money market, changes in the money supply did not affect aggregate demand through interest rates, but mostly through a wealth effect. Since the paper currency was redeemed partly by coin and partly by government bonds on the basis of their face value, rather than the much higher market value, to the extent that prices did not follow suit its withdrawal meant a reduction of wealth and purchasing power. Again, this would effect mostly the local notables who had a high propensity to import.

17. Resentment against foreign capital did not come solely from the upper strata of tax farmers, merchants, and discontented bureaucrats, but from all levels of society. In his book *Social Disintegration and Popular Resistance in the Ottoman Empire, 1881-1908: Reactions to European Economic Penetration*, Donald Quataert describes the reaction and resistance of tobacco growers, merchants and consumers to the French controlled *Regie*, a private company which administered the tobacco monopoly on behalf of the FIDA; of the coal miners to the French Eregli Coal Company; of the railroad workers to the German Anatolian Railway Company; and of the Port Worker Guilds to the French Istanbul Quay Company. He argues that in many cases the conflicts between the Europeans, the peasants and the workers, the state and the local authorities caused both the lesser bureaucrats and the workers to support the Young Turk Revolution.

18. The Young Turks had tried time and again to increase tariffs and to tax foreign nationals with the consent of the European powers, as the capitulations required. The response, as exemplified by the following memorandum from the British Embassy, was usually blunt: "As the Imperial Ottoman Government are aware, His Majesty's Government have consistently maintained that, inter alia, their right to veto the increase of taxation on British subjects and merchandise is derived from the capitulations, and this right they are not prepared to abandon." (Cited in Isvan-Katircioglu, p.6)

19. 42 of these were commercial firms, 42 industrial, 16 financial, 15 transportation and construction, 9 insurance, and 6 agricultural. (Toprak, p.63)

20. The shortfall in government revenues were made up by tariffs, and higher urban taxes.
VIII. FOREIGN DEBT AND ECONOMIC STRUCTURE: A SUMMARY

The previous chapters have analyzed the debt process of the Ottoman Empire as part of a continually changing reality. They have concentrated on detailing the evolution and interaction of the various institutional, political, and economic forces, providing as much texture as possible. In this chapter I simplify this story in order to draw out the dominant economic actors, institutions, and relations that emerged as part of the debt process around the third quarter of the 19th Century. What follows is essentially the core economic argument of the thesis as well as the context for the simple model presented in Appendix II.

The central argument is that within the boundaries of the broader global economic context which stimulated exports of primary goods and imports of manufactures, external public debt in the Ottoman Empire produced an economic structure that could not sustain domestic investment and accumulation. It was a structure which lead to further debt, default, and underdevelopment.
As I described in Chapter III, the process of incorporation into the world economic system as an exporter of primary goods and importer of manufactures not only changed the composition of output in the Empire, but also shifted the balance of power in favor of the notables in the provinces. The state lost its central authority and its traditional access to the economic surplus. It was in order to reverse this process that the state undertook centralizing reforms in the 19th Century. This, in turn, accentuated the fiscal crisis of the state and eventually led to external debt.

External debt itself had two important consequences. In addition to sustaining a larger import surplus and further undermining local manufactures, it gave both the borrower (the state) and the lenders (Europeans) leverage to control the direction of change and shape the institutional terrain of the Empire. The dominant economic structures that emerged facilitated the export of the economic surplus of the Empire in return for imports of luxury and military goods. It was an economic structure that did not enhance productive investment or growth. This not only led to default, since the system could not sustain the requisite budget surplus or the requisite trade surplus to repay the debt, but also slowed down the pace of domestic change.
The dominant economic actors in this structure were: the state, the peasants, the local notables (the tax farmers and the Ottoman merchants), and the Europeans (European merchants and, primarily British, diplomats). Perhaps the most important economic institution was tax farming. The tax farmers not only mediated the relationship between the state and the peasantry in terms of taxation, but they were also the link between the economic surplus and the European merchants who exported it. By the middle of the 19th Century, the Ottoman merchants formed merely an additional link between the tax farmers and the European merchants, as agents of the latter.

In the following sections I discuss this structure and how it evolved. The first section looks at the economic structure and the economic relations that emerged in terms of the domestic economic actors. The next section discusses the role that European merchants and diplomats played. The final section describes how these economic actors and institutions interacted within the global economic context to produce debt, default and underdevelopment.

**Tax Farming and the Domestic Economic Actors**

As I discussed in Chapter III, the state extended the use of tax farming during the 17th Century in an attempt to get direct access to the two most important taxes, the tithe and
the animal tax, that had traditionally accrued to the timar holders. The state auctioned the right to collect taxes from the provinces to the highest bidder for a specified period of time and allowed the tax farmer to keep any tax revenue in excess of this established sum as profit.

As I have also already described, the transition to tax farming, when coupled with the profitability of agricultural exports and the decline of the provincial military (the timar system), resulted in a closely knit hierarchy of wealthy and powerful notables who eventually threatened the integrity of the Empire. By the end of the 18th Century the provinces were controlled by local magnates who refused to send taxes to Istanbul, by large landholders who had transformed their holdings into religious foundations and thus did not pay any state taxes, or by life-time tax farmers, an arrangement which made state revenues particularly sensitive to price movements since it implied infrequent tax farm auctions.

It was with the 19th Century reforms and with the help of borrowed funds that the state managed to alter these structures. Most importantly, the state was able to build and use its military power to contain the threat of the local magnates and to confiscate the large landholdings and re-establish a small peasant land tenure structure. It was, however, left with tax farming as the dominant tax collection
institution, although it experimented with direct collection as well as with different frequencies of auctions.

In stylized form, the tax farming arrangement was one in which the treasury periodically gave the right to collect taxes from a specified province to the highest bidder in auctions held for members of the official ruling class. The amount that the contract obliged the tax farmer to pay to the treasury each year was a nominally fixed amount. The amount that the contract entitled the tax farmer to collect from the peasantry was proportional to real output. The tax farmer could keep any tax revenue in excess of the sum contracted with the state as profit. The real tax revenues that the state received would in principle be regulated through re-auctioning, so that the auction prices would reflect the real present discounted value of expected profits.

Although this was the legal contractual framework, in reality tax farmers had considerable market power; whereas both the state and the peasants were relatively weak. In general terms, the market power of the tax farmers derived from the fact that they were both powerful local notables and members of the official ruling class. Participation in tax farm auctions was limited to members of the official ruling class. This created barriers to entry and gave the tax farmers market power with respect to the state. In addition, the
requirement that a portion of the auction price be paid up
front further limited participation to those members of the
ruling class who had access to financial capital, raising the
barriers to entry. Thus, there emerged a hierarchy of bidders.
Wealthy merchants and money lenders sponsored the big tax
farmers, who in turn, sub farmed the revenue sources to the
lesser tax farmers. It was the uppermost strata of this
hierarchy which dealt directly with the state and they
colluded to keep the bids down. With respect to the peasantry,
the contract which allowed the tax farmers to keep any
revenues over and above the auction price as profit gave an
incentive to the tax farmers to appropriate as much of the
peasants' output as they dared, even though legally they were
to collect only one tenth of the produce in kind. Since they
could bid on different plots of land, the long term interests
of the tax farmers did not necessarily include the welfare of
any given group of peasants for any period longer than the
life of the tax farming contract.

The specific outcome, both in terms of revenues to the
treasury and in terms of the exploitation of peasants,
depended on the capabilities of the state, whose long term
interests did include the welfare of the peasantry. It is
important to recognize that the main problem of the state
during the 19th Century, was to maintain a small peasant land
tenure structure and prevent the tax farmers from becoming
large landholders or full-fledged magnates, openly defying central authority as they had during the 18th Century. The option of abolishing tax farming was not a real one. In the few instances when the state did challenge the tax farmers by trying direct collection of the taxes, it had found that the peasants were reluctant to deal with the agents of the state and that tax revenues actually declined. This particular focus of tax farmers’ power stemmed from the fact that the tax farmers were the locally acknowledged leaders of the provinces. In many instances, in the previous centuries, their families had been the governors, timar holders, or the local magnates. They had traditionally mediated the relationship between the peasants and the state in terms of taxation, conscription, etc., and had a better knowledge of the local circumstances. Perhaps more importantly, many also had their own personal armies, with which to intimidate both the state and the peasantry.

Even though the state did not have the power to dislodge tax farming as an institution, by the third quarter of the 19th Century, with the help of borrowed funds, it had acquired the military and political power to destroy any given tax farmer. Thus, overall, the tax farming structure that emerged was a stalemate of sorts between the local notables and the state. The outer boundary of this stalemate was one in which the notables remained collectors of taxes, but did not become
large landholders. They continued to mediate the relationship between the peasantry and the state, but had to make some reasonable tax payments to the state and refrain from overexploiting the peasantry.

There was, of course, conflict within this broader framework, surrounding the definitions of "reasonable tax payment" and "overexploitation". For the state, frequency of auctions was the principle mechanism through which this conflict manifested itself. Frequent tax farm auctions allowed the state to tighten its control over the tax farmers and, at the same time helped maintain the real value of state revenues. This, however, reduced the tax farmers' concern for peasants' welfare and led to greater exploitation. Infrequent tax farm auctions, on the other hand, did increase the tax farmers' concern with longer term peasant welfare, but also allowed them to increase their power as local notables, potentially threatening the state's central authority and revenues.

Nevertheless, it is possible to further simplify the relationships that emerged with respect to income distribution as well as expenditures on consumption and investment. Since the annual payments of the tax farming contract were nominally fixed and since in most of the anecdotal evidence describing underbidding and collusion the central point is that the tax
farmers get the contract at previous auction's prices, a highly stylized description of the annual tax revenues of the state is that they were nominally fixed.

Similarly, evidence clearly indicates that the tax farmers were appropriating more than their legal share of the output and that the standard of living of the peasantry declined over the course of the 19th Century. Since the profitability of tax farming partly depended on the price for the appropriated surplus, it can be postulated that the tax farmers gained courage and appropriated a larger portion of the peasants' output when agricultural prices increased. In other words, within the global economic context, the tax farmers responded to higher export demand by increasing their exploitation of the peasantry.

In addition, since the tax farmers' payments to the central treasury were nominally fixed, higher export demand and increasing agricultural prices reduced the purchasing power of state revenues and led to further external borrowing. In other words, the economic structures that emerged with the help of foreign finance led to further debt, as the Ottoman economy opened up to international trade.

On the expenditure side, both the state and the tax farmers had to spend most of their income in preserving the
balance of power. The state's expenditures were directed to preserving and increasing central control --essentially feeding, equipping, and increasing the capabilities of the armed forces. Partly because of the tenuous nature of its central control (as for example manifested in the rebellions in the Balkans and the Fertile Crescent) and partly because of the identity crisis I described in Chapter VII, the state was not in a position to undertake direct investment in any systematic fashion.

In a similar manner, the tax farmers had to maintain their position as local notables. This required large, nonproductive outlays for bribes, collusive agreements, conspicuous consumption, and the maintenance of a coercive retinue. More importantly, since they did not have property rights and, because of the state, could not consolidate their power as notables over large tracts of land, productive investment in agriculture was very risky. The means to higher profit was not through investment and increased productive capacity, but through the appropriation of a higher portion of the peasants' output. This is, in fact, why they responded to higher profitability of exports by increasing the exploitation of the peasantry. Thus, the tax farmers' income was essentially spent on luxury consumer goods.
Peasants were the only actors in a position to save and invest in this highly stylized description of the social structure. They were also the poorest section of the society. Net investment for the peasants was largely a residual activity, undertaken only after the needs of the family were met, and even then, limited to very small scale projects. Furthermore, to the extent that the tax farmers had the capacity to appropriate any increase in output, investment was made even less attractive. Thus, peasant income was essentially spent on agricultural goods, largely as subsistence consumption and partly as investment in the form of time to clear more land, more seed or animal feed for the next season, purchases of drought animals, etc. Perhaps most importantly, since the peasants had direct access to their own plots of land and the state successfully prevented dispossession, investment and innovation in any one unit would not necessarily be adopted by any other. Since survival did not depend on market competitiveness, there was no systemic pressure to invest and innovate within this economic structure.

The Europeans

The domestic economic structure that emerged during the third quarter of the 19th Century is essentially the one that I described above. Before describing how these institutions
and actors interacted to give rise to debt, default, and underdevelopment, I will discuss the role the Europeans and the world economy played in this structure.

Within the world economy, the Ottoman Empire was a small economy, in the process of opening up to international trade. The general global context was one which stimulated exports of primary goods and imports of manufactures. In fact, it was initially the profitability of agricultural exports that drew private Ottoman resources away from the declining transit trade in luxury goods with the East into agriculture and, in the fight over the control of the agricultural surplus, eventually gave rise to the tax farming institution and the stalemate between the state and the tax farmers.

As I described in Chapter IV, during the 19th Century, a close relationship developed between the tax farmers and the European and Ottoman merchants. After 1839, European merchants were allowed to trade in the interior of the Empire under circumstances that were more favorable than for Ottoman merchants. The state agreed to this partly because of European pressure and partly because undermining the power of the Ottoman merchants enhanced its central power. As a result, the Ottoman merchants lost their market position and became the agents of the European merchants, eventually even attaining foreign national status and avoiding personal taxation. With
the help of the Ottoman merchants, the European merchants established transportation and communications networks that penetrated the interior of the Empire, bringing in imports and mobilizing the output for export. In other words, European merchants were the agents who carried the price signals of the world economy into the Empire. Since there was little competition from the Ottoman merchants and competition among European merchants in any given region was limited, they had substantial market power.

In a stylized fashion, then, in this general economic environment of high export demand and rising agricultural prices, the tax farmers appropriated the economic surplus, sold the output to Ottoman merchants who then passed on the product to the European merchants for export. The tax farmers, in turn, remitted a nominally fixed amount to the state in taxes. With the increase in agricultural prices, the real value of the taxes declined. In this manner the trading and communications networks of European merchants displaced the tax collection network of the state in controlling the economic surplus, with the tax farming institution playing the pivotal deflecting role. The profits were shared between the tax farmers, Ottoman merchants and the European merchants, with the Europeans having more of the market power in that relationship.
There was tension between official Europe and the state as well. As I have indicated, access to international capital markets largely depended on the official economic and political evaluation of the borrowing country. Thus, foreign debt provided European governments political leverage to influence the course of events and also to shape the institutional terrain. Not surprisingly, the primary economic concern of the European diplomats was to promote the interests of European merchants and businessmen. On the other hand, their political concern, especially of the British until the 1870's, was to promote a strong Empire.

As I have discussed in Chapter V, the economic reforms they recommended in order to promote development as well as to attain solvency were informed by classical economic theory. Overall, they pushed for free trade, free markets for commodities as well as for factors of production, reduced government involvement in the economy in areas other than building infrastructure, increased foreign investment, and maintenance of the gold standard. These aspects of classical economic theory coincided with the interests of the European merchants. At the same time, the European governments did not give in on the capitulations, specifically, vetoing proposed increases in tariffs for revenue purposes and, despite the explicit recommendations of the Hobart-Foster mission,
maintaining the exemption of foreigners from personal
taxation.

The general response of the Ottoman state, as I described
in Chapter VI, was to give in to the recommendations
pertaining to trade and commerce, but to resist changes in
agriculture in order to preserve its most important tax base.
In order to enhance its control over agricultural taxes, that
is to limit the power of the tax farmers to the realm of tax
collection and prohibit colonization in agriculture, the state
continued to resist policies that could lead to the
dispossession of peasants and the emergence of large
landholdings and wage labor. At the same time, largely in
order to enhance its image in international capital markets,
the state gave in to demands to lower tariffs, remove price
controls and guilds, maintain the gold standard, and undertake
commercial judicial reforms.

The end result of these negotiations was a disarticulated
economic structure with a dynamic foreign trade, a non-
existent manufacturing, and an inert agricultural sector.
While lower export tariffs promoted the export of the
agricultural surplus, low import tariffs, the fixed exchange
rates maintained under the gold standard, and the abolition of
the guilds promoted imports of manufactures, destroyed
handicrafts, and prohibited the development of a domestic
manufacturing sector. These policies made investment in the manufacturing sector untenable. Thus, the accumulated wealth in the hands of the notables remained in the agricultural sector and, given the nature of the tax farming institution, went to unproductive expenditure. Moreover, since domestic handicrafts and manufacturing eventually disappeared, their expenditures, as well as the nonagricultural spending of the state, went to imports. Thus the Empire exported its economic surplus in return for imports of luxury and military goods.

This disarticulated economic structure, then, helped to stabilize and perpetuate the domestic economic relations that had emerged. Both the state and the tax farmers continued to spend their income unproductively, trying to sustain the power balance. At the same time, the increased dependence on imports and the sluggish growth implicit in this structure undermined the state's capacity to service the debt it incurred in an effort to preserve that power balance. This eventually led to financial crisis and default.

If, in fact, a domestic manufacturing sector had been allowed to develop, the demand for luxury and consumer goods could have stimulated domestic investment in manufacturing and helped transform the economic structure earlier. The net impact, however, would still have depended on the extent of
domestic accumulation as opposed to profit repatriation by European merchants.

In addition to this disarticulated structure, the shrinking nonagricultural sector, lower tariffs, and the exemption of foreigners from personal taxation, including the large number of European merchants resident in the Empire and the increasing number of Ottoman merchants who became foreign nationals under the protection of the capitulations, seriously limited both the tax-base and the options of the state. In essence the state could not effectively tax the most dynamic sector of the economy. Under these circumstances, maintaining the tax revenues from the agricultural sector became all important and helped retrench the position of the tax farmers. In effect, the option of abolishing the tithe and shifting the tax burden to the commercial sector and the urban populace, the policies that the state eventually undertook in the 20th Century to break the stalemate, did not exist.
The Model

In this section I will describe the ways in which these economic institutions and actors interacted to give rise to debt, default, and underdevelopment.

To summarize in broad outline, the economic structure that emerged in the Ottoman Empire during the third quarter of the 19th Century was as follows. There was essentially only an agricultural sector and the economy was open to international stimuli. The economy produced and exported agricultural goods, which had an inelastic supply in the short run, and imported manufactures, which had an elastic supply.

Peasants produced the output and spent their income on agricultural goods, either in the form of subsistence consumption or as investment. A portion of the peasants' output was appropriated by the tax farmers. The exact portion depended on the profitability of marketing the agricultural output and the tax farmers tended to increase their appropriation with rising agricultural prices. The tax farmers sold their part of the output to the Ottoman merchants, who essentially passed on these goods to the European merchants for export, though some of it was also sold to the state. The tax farmers spent their income on imports of luxury goods. The
state's income came from the nominally fixed amount the tax farmers remitted to the state. Its expenditures were on agricultural goods to feed the military and on imports of arms to equip the military.

As I indicated earlier, the global economic context was one which stimulated exports of agricultural goods, so the prototypical shock to the system was an increase in export demand. In this context, an increase in the demand for agricultural exports led to excess demand, and given that the output was fixed in the short run, caused an increase in the relative price. Since government revenues were nominally fixed, this redistributed real income away from the state towards the tax farmers, intensifying the fiscal crisis of the state and eventually leading to foreign debt. Since the state consumed both imports (mostly weapons) and agricultural goods (food for the military), whereas tax farmers' expenditures were almost totally on imported luxury goods, this redistribution of income relieved the pressure on agricultural goods and increased import demand, intensifying the process of incorporation. In addition, to the extent that the tax farmers responded to the increased profitability of exports by increasing their appropriation of the economic surplus, peasant incomes declined, further reducing the pressure on agricultural goods and increasing tax farmers' import demand.
In other words, in the short run, incorporation into the world economy through the initial shock of increased export demand was accommodated by redistributing purchasing power from high agricultural output consumers to high import consumers through rising relative prices. At the same time, the reduction in the state’s purchasing power led to an incentive to borrow abroad. To the extent that foreign lending to the state eased the budget constraint of the state, however, even more of the short run adjustment came from declining peasant incomes.

The long run implications of this economic structure were even more compelling. To the extent that the peasants were living at close to bare subsistence, most of their adjustment to decreased income would come from a decrease in saving and investment, rather than consumption. The decrease in peasant income, then, had the additional result of reducing investment and curtailing future growth.

In addition to slowing down the pace of domestic change, lower rates of growth and increased dependence on imports also served to reduce the state’s ability to service the debt and eventually led to default. In other words, within the context of this highly stylized model, incorporation into the world economy through higher export demand simultaneously reduced
the real income of the state, leading to foreign debt in the short run, and undermined the state’s capacity to repay, leading to default in the longer run.

Conclusion

Thus, within the economic structures that emerged as part of the debt process, incorporation into the world economy through increased export demand not only led to further debt, but also to a lower rate of growth and to default. Increasing relative prices for agricultural goods reduced the real income of the state and led to more external borrowing. Increased profitability of exports also gave an incentive to the tax farmers to appropriate a larger portion of the peasants’ output and led to higher import demand. The decline in peasant income, in turn, reduced what little investment there was in agricultural production and lowered the growth rate. This essentially eroded the debt servicing capacity of the state, both because of slower output growth and because of the reduced capacity to increase exports and lower imports, and led to default. At the same time, of course, that the Empire exported its economic surplus in return for imports of luxury and military goods, without any of the actors having an effective incentive to accumulate and increase productive capacity meant a sluggish, underdeveloped economy.
IX. CONCLUSION

The history of the Ottoman Empire illustrates that foreign capital, be it mercantile, financial, or industrial, whether it is accompanied by direct foreign control or not, does not simply flow in and out of a country changing only the level and composition of economic activity. It is accompanied by strain and structural change, both internally and with regards to the position the economy holds within the international division of labor. For the recipients the crucial question is one of controlling and directing the process of change.

In the Ottoman Empire, the growing European demand for foodstuffs and raw materials and the search for markets for manufactures resulted in a systemic crisis during the 17th and 18th centuries. While the classical system in which the central state regulated the appropriation and distribution of the economic surplus through a hierarchy of lord-bureaucrats dissolved, there emerged a hierarchy of local notables who, in alliance with European merchant capital, began to control and
export the economic surplus in return for luxury imports and at the expense of the central treasury.

The process of incorporation into the world economic system accelerated during the 19th Century. European merchant capital was the catalyst of change as its local networks of Ottoman merchants and tax farmers, and transportation and communication facilities displaced those of the state in extracting the economic surplus. Agricultural production moved away from subsistence towards cash cropping, and local handicrafts in the import competing sectors dissolved.

The state turned to European financial capital in an effort to control and direct this process of change. Loss of revenues and weakening central authority had threatened its very existence. While the transition from the classical timar system to tax farming under international economic pressure allowed the state access to the tithe and the land tax that had traditionally accrued to the timar holders, it also helped legitimize the hierarchy of local notables, some of whom became full fledged local magnates by the end of the 18th Century, exercising de facto control over most of the provinces. Efforts to centralize the control of revenues and expenditures, primarily the formation of a strong central army, accompanied efforts to undermine the power of the local notables. It was partly in order to undermine the power of the

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Ottoman merchants, for example, that the state agreed to the 1838 Commercial Treaty which allowed the European merchants to trade in the interior of the Empire and displace the Ottoman merchants. Similarly, it was partly in order to finance the centralizing reforms and partly to reduce its dependency on the local Galata bankers that the state yielded to official European pressure to raise a foreign loan.

External public debt helped restructure the internal and external constraints that the Empire faced. To a large extent the state was successful in abolishing the power of the local magnates, and in at least postponing the disintegration of the Empire. It was also successful in undermining the power of the Ottoman merchants and moneylenders, though at the expense of greater European domination. Perhaps most importantly, the state was successful in reversing the trend towards large landholdings and reestablishing a small peasant land tenure structure. The focus of the conflict that remained was between the state and the tax farmers who colluded to keep the bids down, withheld payments from the treasury, and, through coercion, appropriated a large chunk of the output from the peasantry.

In addition, external funds helped finance the institutional transformation of the state. During the 19th Century, the Ottoman state eventually transformed itself from
the classical state into a capitalist state. It transformed itself from a state which, as the uppermost strata of the ruling class, regulated the appropriation and distribution of the economic surplus, into a state which regulates both production and distribution on behalf of other social classes, usually as an arbitrator.

At the same time, however, the debt process, which was accompanied by political and economic concessions, multiplied the external constraints that the state faced. The vision of official Europe was a strong Ottoman Empire which specialized in the production of primary goods and imported manufactures within the broader framework of a market system. To this end the state was forced to undertake many reforms, which included liberalization of trade and foreign direct investment, judicial reform, removal of price controls, guilds, and monopolies, provision of infrastructure, and a foreign central bank through which the Europeans controlled monetary and exchange rate policy. While these reforms and the capitulatory agreements the state signed with the Europeans accelerated the Empire's incorporation into the world economy as an exporter of primary goods and importer of manufactures, they also concentrated income in the hands of foreign nationals and simultaneously prevented the state from taxing it.
The end result of this new terrain of internal and external constraints was a socio-economic structure which could not sustain a budget surplus or enhance productive investment. As opposed to the prototypical historical experience where mercantile capital gradually moves into production, in the Ottoman Empire there emerged a disarticulation between mercantile capital and production.

While the state was willing to undertake many of the reforms suggested in the realm of commerce and industry, it was not willing to allow radical change in agriculture, its principal tax base. The reforms in commerce and industry, which essentially established free trade and favored foreigners, closed the option of investment in the import competing sectors. In agriculture the state continued to promote a small peasant land tenure system and to struggle with the tax farmers. To the tax farmers who did not have access to large tracts of land, but who had the legal right to appropriate a part of the peasant's output, the means to a larger income was not through productive investment, but through the appropriation and export of a larger portion of the output. Thus the ensuing struggle was a struggle over the distribution of the economic surplus and not its production. The merchants lent money to the tax farmers who then laid their claims on the economic surplus and sold it to the merchants; and the bondholders lent money to the state so that
the state could lay its claims on the surplus and pay interest.

In addition to this structure of production, the inability of the state to tax foreign trade or foreign nationals and the emerging wars of independence in the peripheries of the Empire meant that the state could not sustain the requisite budget surpluses and the economy the requisite trade surpluses to repay the debt. The story after default and the establishment of the PDA was essentially the same, except that now foreigners controlled state finances and European industrial capital entered the Empire with handsome concessions from the state and extended this process of incorporation into the interior parts.

It was not until after World War I, and a radical political and economic break with Europe, that this structure changed. Then, with the abolition of the capitulations the state was able to protect and encourage domestic industry, shift the burden of taxation to the urban areas, abolish the tithe and thus break the power of the tax farmers as appropriators of the economic surplus and turn them into producers.

Thus, the very processes which allowed the survival of the state and the incorporation of the economy into the world
capitalist system eventually threatened both. Collection of tax revenues through a tax farming system rather than through lord-bureaucrats, who maintained the provincial army and administration, accommodated both the state and the incorporation process. While the state got access to taxes that had traditionally stayed in the provinces, tax farmers, a mobile group of "lords", were effective in mobilizing the surplus for export. The weakening of provincial administration at the time that the notables grew rich and powerful, however, threatened the integrity of the Empire. Then, with the help of external financing the state took measures to regain central authority.

Internal and international conflicts that followed, however, produced an economic structure which had a dynamic commercial sector through which the surplus flowed abroad, but an inert agricultural sector, that was not capable of sustaining high growth. The Empire became an exporter of primary goods, but not a dynamic producer. At the same time, the inability of the state to centralize enough of the agricultural revenues -- that is, a stalemate of sorts between the state allied with European financial capital and the tax farmers allied with European merchant capital -- and the fact that the state could not tax the foreign dominated dynamic sector meant that the state could not repay its debt.
Much can and should be said about the displacement of Ottoman merchants by the Europeans, the disintegration of local handicrafts unable to compete with European manufactures under the free trade agreements, and the political mechanisms through which European merchants houses, banks, railway companies, and other firms realized high profits. These were the concessions the state had to give as a result of entering the debt process and the mechanisms which limited the domestic accumulation of capital, slowing down the internal process of change. Equally, if not more, important, however, was the emergence of relations of production in agriculture which hindered productive investment. That is why the economic surplus of the Empire, which should have sustained domestic capital accumulation, flowed abroad, leaving behind nothing but imports of luxury and military goods. That is partly why Ottoman Turkey was incorporated into the world capitalist system as an exporter of primary goods and importer of manufactures, and not the other way around. Had there been substantial domestic capital accumulation, it is likely that this would have found some political expression and the constraints imposed on the Empire by the Europeans would have been broken much earlier, as they were in some parts of the world. It is very hard to speculate about whether, and under what circumstances such an outcome, as opposed to, say, complete disintegration or formal colonization, would have
been possible. Comparative studies would help shed some light on this question.

Ultimately the role of the economic historian is to observe what happened in order to understand what may happen. In terms of future research on the debt processes of the 19th or the 20th Centuries, it seems to me that it is critical to understand the role that debt plays in restructuring an economy within the broader framework of global economic forces. Funds bestow power and freedom of action to the groups that borrow as well as to the groups that lend. In order to understand what happened, or is likely to happen, one needs to understand the position of these groups within the class structures of their societies, and the constraints, conflicts and alliances that they face both internally and internationally. This becomes more difficult, but all the more important when it is modern states that are borrowing and states or international agencies that are lending, for they are in the business of coalition building among their own constituents.

While improving productive capacity needs to be the overriding question in terms of economics, we do need to ask productive capacity in what. We need also be aware that macro adjustment both in the process of borrowing and in the process of repaying may come through a redistribution of income,
reshuffling of the balances of power, and a restructuring of
the capacity for productive investment. The answers to these
questions will lie in who is borrowing and who is lending, as
well as the way internal and international economic structures
interact.
APPENDIX I: LOANS

The primary sources for this appendix are Pamuk, 1984, Suvla, and Tezel. The information is complemented by other sources, primarily Du Velay and Blaisdell.

1. Loans: 1854-1877

1854: face value: L3 mil.
interest: 6%
rate of issue: 80%
effective interest: 7.9%
amount received: L2.29 mil.

Loan taken to finance the Crimean War. Contracted with Palmers Goltschmidt. The Egyptian tribute was shown as security. The loan was supported by the British government.

1855: face value: L5 mil.
interest: 4%
rate of issue: 102.6%
effective interest: 4%
amount received: L5.13 mil.

Loan taken to finance the Crimean War. Contracted with the Rothschilds. Remainder of the Egyptian tribute and the customs revenues of Izmir and Syria were shown as security. The interest payments were guaranteed by the British and French governments. A French-British joint commission was sent to Istanbul to supervise the use of the loan for war expenses.

1858: face value: L5 mil.
interest: 6%
rate of issue: 76%
effective interest: 8.7%
amount received: L3.44 mil.

Loan taken to withdraw the paper currency issued during the Crimean War and support the depreciating Ottoman currency. Contracted with Dent, Palmers, and Co. The Istanbul customs and octroi (transit trade) revenues were shown as security. The contract stipulated that these revenues be collected under the direction of delegates chosen by the bondholders. Negotiations lead to the formation of a financial commission composed of three foreign delegates (British, French,
Austrian) and four Ottoman officials, which was attached to
the Ministry of Finance in a consultative capacity. L0.6
million of the loan was used to finance a military campaign to
Jiddeh and put down rebellions.

1860 : face value: L16 mil.
interest:
rate of issue: 53.25%
effective interest:
amount received:

The so-called Mires loan which was not ratified. The
failure of this loan prompted the British government to send
the Hobart-Foster mission to Istanbul to advise the government
on fiscal and financial issues.

1860 : face value: L2 mil.
interest: 6%
rate of issue: 62.5%
effective interest: 9.8%
amount received: L1.23 mil

The money acquired from the sale in France of some of the
bonds of the loan contracted with Mires. Taken to finance
budget deficits. Some of the indirect taxes and tithes were
shown as security.

1862 : face value: L8 mil.
interest: 6%
rate of issue: 68%
effective interest: 9.4%
amount received: L5.15 mil.

Loan taken to withdraw the paper currency and retire the
floating debt under the direction of Lord Hobart. Contracted
with the Ottoman Bank and Devaux and Co. of London. Revenues
from tobacco, salt, licenses and the stamp tax were shown as
security. The prospectus indicated that a six-member permanent
commission would be set up to monitor payments and advise the
Empire. L3.6 million of the loan was used to withdraw all of
the paper currency (L9 million worth of paper currency was
retired, 40% of it with newly minted coins, 60% of it with
newly issued government bonds), the rest was used to partially
retire the floating debt.
1863: face value: L3 mil.
    interest: 6%
    rate of issue: 71%
    effective interest: 9.7%
    amount received: L4.96 mil.

Loan taken to retire the floating debt and issue metal coins. Contracted with the newly established Imperial Ottoman Bank and Credit Mobilier. Customs revenues and silk, olive oil, tobacco, and salt tithes were shown as security. The equivalent of the amount of the loan was transferred to the Galata bankers in payment of debts.

1865: face value: L6 mil.
    interest: 6%
    rate of issue: 66%
    effective interest: 9.7%
    amount received: L3.7 mil.

Loan taken to service the foreign debt and cover budget deficits. Contracted with the Imperial Ottoman Bank and Credit Mobilier. The so-called mutton-loan, as the sheep taxes of Rumelia and Archipelago were shown as security.

1865: face value: L32.9 mil.
    interest: 5%
    rate of issue: 60% av.
    effective interest: 8.3%
    amount received: L19.8 mil.

Loan taken to convert the floating internal debt (face value pound equivalent L26.36 million) into a 5% bond called General Debt. The remaining L6.54 million was offered to subscribers at 47.5% of face value, bringing in L3 million. The figures above include the face value of converted bonds. Contracted with General Credit and Societe Generale. No special security was shown.

1869: face value: L22 mil
    interest: 6%
    rate of issue: 57%
    effective interest: 11.5%
    amount received: L11.56 mil.

Loan taken to cover budget deficits and pay off various floating debts. Contracted with Comptoire d'Escompte. Tithes of various provinces were shown as security.
1870 : face value: L31.68 mil.
        interest: 3%
        rate of issue: 32.125%
        effective interest: 10%
        amount received: L9.54 mil.
        
        Bonus loan, called Lot-Turc, taken for the construction of the Rumelia railway. Contracted with Baron Hirsch. No special security was shown. Lottery was banned from London and Paris, it was floated mostly in Berlin and Vienna.

1871 : face value: L5.7 mil.
        interest: 6%
        rate of issue: 73%
        effective interest: 8.5%
        amount received: L4.05 mil.
        
        Loan taken to cover budget deficits and pay off floating debt. Contracted with Louis Kohensons and Dent, Palmer, and Co. The increase in the Egyptian tribute, negotiated with the Khedive in 1866, was shown as security.

1872 : face value: L4.82 mil.
        interest: 9%
        rate of issue: 98.5%
        effective interest: 9.3%
        amount received: L4.65 mil.
        
        Loan taken to cover budget deficits. Contracted with the Imperial Ottoman Bank and Credit General Ottoman. The revenues of Salonica, Edirne and Danube and the sheep tax of Anatolia were shown as security.

1873 : face value: L20.23 mil.
        interest: 5%
        rate of issue: 54%
        effective interest: 11.5%
        amount received: L10.96 mil.
        
        Loan taken to consolidate the treasury bonds issued in 1872; the second series of General Debt. L11.45 million of the bonds was used to convert L6.27 million of the 1872 loan (not included in the figures for 1872 above), the rest sold at 54% of face value. No special security shown.
1873: face value: L27.78 mil.  
interest: 6%  
rate of issue: 54%  
effective interest: 11.5%  
amount received: L14.44 mil.

Loan taken to cover budget deficits. Contacted with Credit Mobilier de Paris and Credit General Ottoman. Revenues of Danube and Aleppo and the sheep tax of Anatolia were shown as security.

1874: face value: L40 mil.  
interest: 5%  
rate of issue: 40%  
effective interest: 12.3%  
amount received: L15.09 mil.

Third series of General Debt, taken to meet floating debt and the interest on other loans. Contracted with the Imperial Ottoman Bank. No special security shown.

1877: face value: L5 mil.  
interest: 5%  
rate of issue: 52%  
effective interest: 9.6%  
amount received: L2.6 mil.

Loan taken to meet war expenses in the conflict with Russia. Contracted with the Imperial Ottoman Bank and Glyn Mills, Currie, and Co. of London. Egyptian tribute was shown as security.

2. The Decree of Muharrem

The Decree of Muharrem, which established the Public Debt Administration and reduced the outstanding debt, was signed on December 20, 1881. According to the Decree, first, the external debt (excluding the 1854, 1855, 1871 and 1877 loans) was unified under four categories according to priority of amortization. The nominal value of this debt was reduced to its issue value and charges of LT1.1 million (L1 million) on the most recent loan acquired through the Galata bankers were reduced to LT590 000 (L536 364) in return for repayment priority as "Privileged Securities." In sum, as can be seen from Table 1, the total debt of the Empire, including all the domestic and foreign loans, as well as the war reparations to Russia, was reduced from LT237 million (L215.5 million) to
LT141.5 million (L128.6 million) and annual charges were reduced from LT15 million (L13.6 million) to LT3 million (L2.7 million), though there was some flexibility on charges.

Secondly, various revenue allocations stipulated as security in individual loan agreements were removed. In turn, certain revenues were "absolutely and irrevocably [ceded to the PDA] until the complete liquidation of debt." (cited in Blaisdell, p.92) These revenues were: 1) all the excise taxes levied on spirits, documents, tobacco, and the hunting and fishing licenses of Istanbul; revenues from the state monopolies in salt and tobacco; and the silk tithe, 2) revenues received from Montenegro, Serbia, Greece, and Bulgaria as tributes or for debt service under the Treaty of Berlin; and any increase in revenues from Cyprus, and 3) revenue increases from a projected customs surcharge and from any additional taxes on income or wealth. Thus, approximately 20% of the total Ottoman revenues were ceded to the PDA. In subsequent years, this would range between 30-35% of total revenues.

The schedule of repayment was quite complex. The PDA would first pay the annual LT590 000 on the domestic Privileged Securities. Then it would make semiannual interest payments, at annual interest rates ranging from 1% to 4%, on the external debt. If 80% of the revenues net of payment on domestic bonds was sufficient to meet interest, then the remaining 20% would be used for amortization at a rate not to exceed 1%. Between 1882 and 1903, in addition to the LT590 000, the PDA paid out 1% interest and 0.25% amortization, redeeming some 22% of the outstanding bonds. In 1903 it was ready to start paying 1.25% interest. The Ottoman government disagreed with the proposed change and negotiations produced the Supplementary Decree of 1903. The value of the debt was adjusted once more, the interest rate was increased to 4% and the amortization rate to 0.45%. In return, 75% of the annual surplus above this amount (some L2 million) would be turned over to the treasury.

3. Loans: 1881-1914

1886 : face value: L5.91 mil.
      interest: 5%
      rate of issue: 100%
      effective interest: 5%
      amount received: L5.79 mil.

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Loan taken to consolidate the advances from the Imperial Ottoman Bank. Contracted with the Imperial Ottoman Bank. Customs revenues were shown security, to be paid directly into the Bank. L4 million was retained by the Bank, the rest given to the treasury. This loan was converted in 1902.

1888:  
- face value: L1.47 mil.  
- interest: 5%  
- rate of issue: 70%  
- effective interest: 7.4%  
- amount received: L1 mil.

Loan taken to pay for munitions bought from Germany. Contracted with the Deutsche Bank, and administered by the PDA. Surplus of the PDA administered fishing revenues were shown as security. This loan was converted in 1903.

1890:  
- face value: L7.8 mil.  
- interest: 4%  
- rate of issue: 75%  
- effective interest: 5.3%  
- amount received: L1.47 mil.

Loan taken to convert 1881 privileged bonds held by the Galata Bankers. L5.87 million was used for the conversion. Net new debt from this operation was L1.956 million. Contracted with the Imperial Ottoman Bank and administered by the PDA.

1890:  
- face value: L4.55 mil.  
- interest: 4%  
- rate of issue: 98% av.  
- effective interest: 4.7%  
- amount received: L3.9 mil.

Loan taken to settle floating debt. Contracted with the Imperial Ottoman Bank and administered by the PDA. Cereals tithes of various provinces were shown as security.

1891:  
- face value: L6.33 mil.  
- interest: 4%  
- rate of issue: 90%  
- effective interest: 4.5%  
- amount received: L1.27 mil.

Loan taken to convert the 1877 defense loan. Contracted with the Rothschilds and administered by the PDA. Part of the Egyptian tribute was shown as security. L4.3 million was used for the conversion, the remaining L2.03 million floated at 90%
of its face value. The treasury received L1.27 million. Net new debt from this operation was L2.03 million.

1893 :  
face value: L0.9 mil.  
interest: 4%  
rate of issue: 70%  
effective interest: 5.7%  
amount received: L0.61 mil.

Loan taken to cover budget deficits. Contracted with Count Zogheb. Tobacco taxes shown as security.

1894 :  
face value: L1.6 mil.  
interest: 4%  
rate of issue: 73.5%  
effective interest: 5.6%  
amount received: L1.4 mil.

Loan taken to liquidate the debt for the Eastern Railways. Contracted with the Deutsche Bank group and administered by the PDA.

1894 :  
face value: L8.2 mil.  
interest: 3.5%  
rate of issue: 91%  
effective interest: 4.5%  
amount received: L0.36 mil.

Loan taken to consolidate the 1854 and 1871 loans. Contracted with the Imperial Ottoman Bank and the Rothschilds, and administered by the PDA. Egyptian tribute was shown as security. L6.95 million was used for the conversions; the treasury received L0.36 million. Net new debt from this operation was L1.27 million.

1896 :  
face value: L2.98 mil.  
interest: 5%  
rate of issue: 84%  
effective interest: 6%  
amount received: L2.47 mil.

Loan taken to repay loans to the Imperial Ottoman Bank and the Rumelia railways, and to meet expenses related to the Crete and Armenian incidents. Contracted with the Imperial Ottoman Bank and administered by the PDA. Sheep taxes and tithes were shown as security.
1902: face value: L7.8 mil.
interest: 4%
rate of issue: 80%
effective interest: 5.1%
amount received: L1.471 mil.

Loan taken for the conversion of the 1886 loan. Contracted with the Imperial Ottoman Bank. Customs and other indirect taxes were shown as security. L4.67 million was used for the conversion; the treasury received L1.47 million. Net new debt from this operation was L3.15 million.

1903: face value: L2.16 mil.
interest: 4%
rate of issue: 81.5%
effective interest: 5%
amount received: L1.72 mil.

Loan taken for Plan I of the Baghdad Railway. Contracted with the Deutsche Bank and administered by the PDA. The crop tithes of Aleppo, Urfa, Aydin, Baghdad, and Diyarbakir were shown as security. The proceeds were given to the company as kilometric guarantees.

1903: face value: L2.36 mil.
interest: 4%
rate of issue: 80%
effective interest: 5.1%
amount received: L1.2 mil.

Loan taken to convert the 1888 loan. Contracted with the Deutsche Bank and administered by the PDA. Fishing revenues were shown as security. L0.89 million was used for the conversion, L1.2 million given to the treasury. Net new debt from this operation was L1.52 million.

1903: face value: L29.76 mil.
interest: 4%
rate of issue: 100%
effective interest: 4%
amount received: L2.43 mil.

Loan taken to consolidate and convert some of the bonds created in the decree of Muharrem in 1881. L27.3 million used in the conversion, L2.43 million given to the treasury. Net new debt created by this operation was L2.43 million.
1904: face value: L2.5 mil.
interest: 4%
rate of issue: 80%
effective interest: 5.1%
amount received: L1.96 mil.

Loan taken to cover budget deficits. Contracted with the Imperial Ottoman Bank and Comptoir d’Escompte and administered by the PDA. Excess of the tax revenues turned over to the PDA was shown as security.

1905: face value: L4.82 mil.
interest: 4%
rate of issue: 80%
effective interest: 5.6%
amount received: L2.33 mil.

Loan taken to repay debts to the Imperial Ottoman Bank. Contracted with the latter and administered by the PDA. Customs revenues of various provinces and a 0.5% addition to the PDA-administered tithes were shown as security. L1.45 million was used for conversion, L3.3 million floated. The treasury received L2.33 million. Net new debt from this operation was L3.3 million.

1905: face value: L2.4 mil.
interest: 4%
rate of issue: 81%
effective interest: 5%
amount received: L1.9 mil.

Loan taken to import military equipment from Germany. Contracted with the Deutsche Bank and administered by the PDA. A 6% addition to the revenues managed by the PDA and customs revenues were shown as security.

1906: face value: L8.67 mil.
interest: 4%
rate of issue: 87%
effective interest: 4.7%
amount received: L1.24 mil.

Loan taken to convert 1890 "privileged bonds". Contracted with the Imperial Ottoman Bank and administered by the PDA. L6.17 million was used for the conversion and L1.24 million was given to the treasury. Net new debt from this operation was L2.5 million.
1908: face value: L9.1 mil.
interest: 4%
rate of issue: 100%
effective interest: 4%
amount received: L8.9 mil.

Loan taken for Plans II and III of the Baghdad Railway. The surplus of PDA administered revenues shown as security and given to the Baghdad Railway Company as kilometric guarantees.

1908: face value: L4.28 mil.
interest: 4%
rate of issue: 82.5%
effective interest: 4.8%
amount received: L3.5 mil.

Loan taken to cover budget deficits. Contracted with the Imperial Ottoman Bank and administered by the PDA. Surplus of PDA administered revenues and customs revenues shown as security.

1909: face value: L6.36 mil.
interest: 4%
rate of issue: 86%
effective interest: 4.8%
amount received: L5.31 mil.

Loan taken to cover budget deficits. Contracted with the Imperial Ottoman Bank. Tithes and animal tax of various provinces shown as security.

1910: face value: L1.57 mil.
interest: 4%
rate of issue: 89%
effective interest: 4.6%
amount received: L1.35 mil.

Loan taken to construct the Soma-Bandirma railway through the Izmir-Kasaba Railway Company. Administered by the PDA. The gross revenues of the railway and the guaranteed balance of the 1894-95 Izmir-Kasaba and Extension Loan pledged as security.

1911: face value: L0.91 mil.
interest: 4%
rate of issue: 84%
effective interest: 4.9%
amount received: L0.75 mil.
Loan taken to build the Hudaida-San’a and Extension Railway. Administered by the PDA. The customs revenues of Hudaida and Jabana shown as security.

1911:  
face value: L6.4 mil.  
interest: 4%  
rate of issue: 81.5%  
effective interest: 4.9%  
amount received: L5.21 mil.

Loan taken to cover budget deficits. Contracted with the Deutsche Bank. Customs revenues of Istanbul shown as security.

1913:  
face value: L0.75 mil.  
interest: 5%  
rate of issue: 100%  
effective interest: 5%  
amount received: L0.75 mil.

Loan issued by the Anatolian Railway company and appropriated to the debt resulting from the Konya plain irrigation project. Administered by the PDA. Remaining tithes of this district and those of the PDA, and the revenues from drained and sold lands were shown as security.

1913:  
face value: L1.35 mil.  
interest: 5.5%  
rate of issue: 100%  
effective interest: 5.5%  
amount received: L1.35 mil.

Loan taken for the construction of docks and the improvement of the maritime arsenal. Contracted with Armstrong Vickers and administered by the PDA. The tithes of Sivas shown as security.

1914:  
face value: L20 mil.  
interest: 5%  
rate of issue: 88.75%  
effective interest: 5.6%  
amount received: L17.75 mil.

Loan taken to consolidate the floating debt that resulted from the Libyan and Balkan Wars. Contracted with the Imperial Ottoman Bank and administered by the PDA. The surplus of PDA revenues and the remainder of the subsidy tithes and customs were shown as security.

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APPENDIX II: A MODEL

The model presented here formalizes the story in "The Scenario" section of Chapter VII. We assume that the country produces, consumes, and exports agricultural goods. It also consumes imports. Imports have elastic supply. In the short run the agricultural output is fixed.

(1) \( X = bK \)

where \( X \) is the supply of agricultural goods, \( K \) is the capital stock (or capital-cum-land), and \( b \) is the output-capital ratio. The implicit assumption behind a price clearing exportable market is that there is enough of a price differential between world and domestic prices as the country opens up to international trade that the (European) merchants are willing to absorb domestic price changes through varying profit margins.

Sources of Income:

There are three social classes. Peasants produce the output, tax farmers appropriate a part of it in the form of taxes and pass on a nominally fixed amount to the state.

Peasants:

(2) \( Y_p = (1-t)PX \)

(3) \( t = t(P) = qP \) where \( t' > 0 \) and \( 0 < t = qP < 1 \)
Peasant income \((Y_p)\) is the value of output \((PX)\) less taxes that the tax farmer appropriates. If the tax farmers appropriate more of the output when the profitability of marketing agricultural goods (e.g. exports) increases, then the tax rate \((t)\) will be an increasing function of price \((P)\). For simplicity we assume that the tax rate is directly proportional agricultural price \((qP)\).

**Tax Farmers:**

\[
(4) \quad Y_t = tPX - T
\]

Tax farmers' income is the amount they appropriate from peasants less the nominally fixed amount they pay as taxes to the state \((T)\).

**The State:**

\[
(5) \quad Y_s = T
\]

The state receives the nominally fixed amount \(T\).

**Uses of income:**

Peasants are assumed to consume only agricultural goods, and the tax farmers only imports. The state consumes both agricultural goods, to feed the army, and imports, to equip the army.
Peasants:

(6) \[ Y_p = P (C + I) \]

Peasants spend all their income on agricultural goods. Part of it is used for subsistence consumption \((C)\) and part of it is saved and invested in the form of seeds or animal feed to expand production in the next season \((I)\). Planned net investment, then, is:

(7) \[ I = (1-t)X - C \]

Tax Farmers:

(8) \[ Y_t = C_m \]

Tax farmers spend all their income on imports of luxury goods. Their food needs are satisfied by the produce of their own plots of land, from outside this system. Price of imports is set equal to one.

The State:

(9) \[ Y_s = P_G + G_m \]

\[ = (1-a)Y_s + aY_s \]

The state spends a fixed portion of its income, \((1-a)Y_s\), on agricultural goods, to feed the army \((P_G)\), and the rest, \(aY_s\), on imports of military equipment \((G_m)\).

Combining the equations and dividing by the price level, the demand for agricultural output is:
\[(10) \quad DX = C + I + G + E \]
\[= (1-t)X + (1-a)T/P + E\]
\[= (1-qP)X + (1-a)T/P + E\]

and excess demand is:
\[(11) \quad EDX = C + I + G + E - X\]
\[= (1-qP)X + (1-a)T/P + E - X\]

Where \((1-qP)X\) is the peasants' income which is spent on subsistence consumption and investment; \((1-a)T/P\) is the state's demand for agricultural goods; and \(E\) is exports.

Setting \(EDX = 0\), gives the equilibrium price(s) as:

\[(12) \quad P^1 = \{ E + [E^2 + 4qX(1-a)T]^{1/2} \} \quad 1/(2qX) > 0\]
and \(P^2 = \{ E - [E^2 + 4qX(1-a)T]^{1/2} \} \quad 1/(2qX) < 0\)

Restricting the price to be positive, \(P > 0\), since \(d(EDX)/dP < 0\), the positive solution is locally stable. (Also, since \(E/X < 1\), the condition \(qP < 1\) will be satisfied for a small enough \(q\).)

\[(13) \quad d(EDX)/dP = -1/P \quad \{ qPX + (1-a)T/P \} < 0\]

An increase in agricultural price reduces peasant income to the extent that the tax farmers appropriate a greater portion \((qP)\) of output and reduces the purchasing power of state revenues \((T/P)\). Both these effects reduce the demand for
agricultural goods by redistributing income to the tax farmers who spend it on imports.

The balance of payments is:

\[ (14) \quad \text{Bop} = E - (Cm + Gm)/P = E - (Yt + aYs)/P \]
\[ = E - [(qPX - T/P) + aT/P] \]
\[ = E - [qPX - (1-a)T/P] \]

and imports increase when agricultural price rises:

\[ (15) \quad \frac{d(\text{Bop})}{dP} = -1/P \left[ qPX + (1-a)T/P \right] < 0 \]

**Comparative Statics:**

**Increase in Export Demand**

Now, suppose starting out from a position of equilibrium and Bop=0, there is an autonomous increase in export demand, dE. In the short run, this will increase the demand for agricultural goods and cause the equilibrium price to rise and redistribute income away from agricultural good consumers (peasants and the state) to importers (tax farmers). The equilibrium price will rise until the fall in the domestic demand for agricultural goods exactly offsets the increase in export demand.

\[ (16) \quad \frac{d(EDX)}{dP} = \frac{dE}{P} - \frac{1}{P} \left[ qPX + (1-a)T/P \right] dP = 0 \]
so that

\[ (17) \quad dE = \frac{1}{P} [qPX + (1-a)T/P] \, dP \]

At the same time, tax farmers income and therefore imports will increase by \( \frac{1}{P} [qPX + T/P] \, dP \), while the state's import demand will fall by \( \frac{1}{P} [aT/P] \, dP \), thus exactly offsetting the increase in exports and giving Bop=0:

\[ (18) \quad d(Bop) = dE - \frac{1}{P} [qPX + T/P - aT/P] \, dP \\
\quad = dE - \frac{1}{P} [qPX + (1-a)T/P] \, dP \]

from equation (17):

\[ d(Bop) = dE - dE = 0 \]

**Foreign Lending**

If foreign lending to the state, \( dF \), eases the budget constraint of the state, then a larger portion of the adjustment will have to come from declining peasant incomes. In this case:

\[ (11') \quad EDX = (1-qP)X + (1-a)(T/P + F) + E - X \]

\[ (16') \quad d(EDX) = - \frac{1}{P} [qPX + (1-a)T/P]dP + (1-a)dF + dE = 0 \]

\[ (17') \quad dE + (1-a)dF = \frac{1}{P} [qPX + (1-a)T/P] \, dP \]
Now the price increase needs to offset both the increase in export demand and the increase in the state's consumption of agricultural goods financed with foreign borrowing.

The change in balance of payments will again equal zero:

\[(14') \quad \text{Bop} = E + F - \{(qPX - T/P) + a(F + T/P)\}\]

\[(18') \quad d(\text{Bop}) = dE + dF - \{1/P[qPX + T/P]dP - aT/P dP + adF\} = dE + (1-a)dF - 1/P \left[qPX + (1-a)T/P\right] dP\]

from equation (17'):

\[= dE + (1-a)dF - [dE + (1-a)dF] = 0\]

**Dynamics**

In the long run, to the extent that the reduction in peasant income is met by a decrease in net investment rather than in consumption, an increase in export demand will reduce the rate of growth.

Investment is normally financed by private savings, government savings (the budget surplus) and foreign savings (the import surplus or, equivalently, capital inflows). In this "disarticulated" model, however, the state spends all its income, and if the system starts out with balanced trade, it maintains this. Or, if, for example, foreign lending eases the budget constraint of the state, the resulting increase in the agricultural price ensures an equivalent import surplus. Since
the state and the tax farmers do not save or invest, and since the sum of government and foreign savings is always zero, the only source for investment is the private savings of the peasants. If we assume that the consumption of the peasants is fixed at a subsistence level and includes the saving necessary to reproduce that standard of living, then planned net investment is:

\[(7) \quad I = (1-t)X - C\]
\[= (1-qP)X - C\]

Actual saving, investment and growth will depend on how price changes.

\[(1) \quad X = bK\]

\[(19) \quad \frac{dK}{dt} = I = (1-qP)X - C\]
\[= (1-qP*1)X - C\]

From equations (12) and (1):

\[(20) \quad I = bK - E/2 - 1/2 \left[ E^2 + 4q(1-a)TbK \right]^{1/2} - C\]

Assuming that exports, peasant consumption and state's tax revenues are a constant proportion of the capital stock, and defining \(e = E/K; c = C/K; z = T/K\), we get a constant growth rate:

\[(21) \quad g = I/K = b - 1/2 \left[ e^2 + 4q(1-a)zb \right]^{1/2} - [c + e/2] \]
and \(0 < g < 1\)
Thus, an increase in export demand will reduce the rate of growth:

\[(22) \quad \frac{dg}{de} = -\frac{1}{2} \left[ e^{e^2 + 4q(1-a)zb}^{-1/2} + 1 \right] \]

\[-1 < \frac{dg}{de} < 0.\]
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