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Impact of wrong financial decisions on collapse of an empire: The Ottoman case

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Certain attitudes and moves, otherwise and other times considered to be insignificant, turned out to be significantly determinant in various events throughout the world history. There are eras where financial activities and money play deterministic roles for social, political and military events and actions. In this study, it is aimed to analyze approximately the last 80 years of Ottoman empire lasted for over 600 years as one of the most well known and influential governments in the world history. Through, the context of financial activities since these activities had crucial impacts in social, economical, political and even military lives during the last 80 - 100 years of the empire.

Key words: Ottoman banknotes, industrial revolution, Istanbul bank, Ottoman bank, financial policies, ramandan enactment, muharrem enactment.

INTRODUCTION

As Professor Haydar Kazgan points out, it is impossible to understand and comprehend historical events without understanding general history of economic movements that triggered them. And also, it is impossible to fully understand general history of economy without understanding history of financial movements and financing activities that constitute the core of economic movements. It will enable researchers to develop better economics theories, economics policies and to educate and train individuals to become better economists and even politicians through proper analysis of finance history and investigation of historical facts of financial moves in a detailed manner (Kazgan, 2006). Financing activities depend heavily on founding a system or a network of financial institutions that will perform the activities of rising and allocations of funds for economic activities. The most important financial institutions are composed of banks, securities exchange markets and insurance companies. The manner in which the institutions in financial systems

managed and operated will effect the operations of institutions in other areas varying from health to security, from judicial to transportation and communication systems. Therefore, it is believed to be very helpful to take a look at the last 80 years of Ottoman empire partially through the perspectives of Galata bankers since they were the most significant players in financial system of the Empire (Clay, 2000). The results of financial moves and decisions affected various government policies, social, military, economical decisions and acts will be tried to be presented in a chronological order. It is believed that such an analyses conducted, even in the most superficial manner will provide us a better understanding of reasons, consequences of significant historical decisions, moves and prevent us from repeating the similar mistakes.

Changing economic conditions

The history witnessed many times that survivors are not

necessarily the strongest or the cleverest ones. They are the ones that can adapt to changing conditions. Ottoman empire came to an end in early 20th century because of not being able to cope with changing economical and financial conditions that also showed their effects on almost every area of social, political and military lives (Kiray, 2008). Ottoman empire fell behind reformist activities successfully performed in the fields of science and art by European nations. As a result the empire missed the benefits of Industrial revolution started in England in early 17th century. However, it was inevitable to ignore the effects of this new order.

Industrial revolution started production era where mass production was previously hand made goods became possible through machines. As a result, prices of goods dropped to levels that enabled many more individuals to purchase previously very expensive products. It is possible to state that production era started consumption era and created consumption societies in the places that are reached such as Ottoman empire.

Galata bankers

In order to understand the reasons and impacts of financial activities, it is necessary to take a brief look at history of Galata port that has been a trade center since the 13th century. Galata Port was as important as Marseilles, Venice and Genoa ports. Approximately, 500 trade ships were visiting Galata port for trade as well as maintenance. Fatih the Conqueror realized the importance of Galata port as a trade center and reserved its status as a free trade zone. So in a way, the business people in Galata enjoyed the benefits of privileges granted to them during the times of both Byzantium and Ottoman empire. They had control over both exporting and importing activities (Cinar, 2001). They had also valuable connections with foreign tradesmen and producers as well as domestic wholesalers and retailers. They also occupied the fields of financing and insurance. All of these privileges enabled them to control the trading and financing activities of Istanbul and high income areas in the Ottoman empire. Especially Industrial Revolution empowered the privileges and positions of Galata bankers due to their foreign connections (Pamuk, 2000). They have come to a certain point where they could effect and cause a change in government policies and actions which led to fundamental changes in many other areas of daily life.

Up until early 19th century, financing of Ottoman empire

used to depend on heavily tax farming, land tenure and taxes obtained through trade and craft guilds. Galata bankers had very close ties with higher authorities governing all these operations, since they were the sole financiers of tradesmen and craftsmen as well as the high ranked government officials in the empire. The relationships between Galata bankers and the group called Gedikliler that govern the operations of trade guild until 1802. However, when Galata bankers realized that the tariff revenue to be earned through products coming from European countries would be much more higher than the tax and interest income generated by Gedikliler, they decided to stop financing that group and devote their capital to financing of other more profitable business ventures (Kazgan, 2006) . This led to conflicts and various unfortunate events, the most well known was Vakay-i Hayriye in 1826. The influences of Galata bankers cooperating with members of foreign embassies are worth to more detailed research, since European countries looking for new markets for their products were pressuring Ottoman empire to open its borders to affordable Euro-pean products. It can be said that European countries used Galata bankers in order to convince Ottoman emperor Mahmut II for letting European products in (Kazgan, 2006).

The first reformist edict - tanzimat fermani

Due to heavy pressures of European countries and recommendations of Galata bankers a very highly trusted and credential group, Mahmut II declared a reformist edict called Tanzimat Fermeni in 1838 (Inalcik and Seyitadanlioglu, 2006) . The same year a trade agreement was signed with France. One year later a similar trade agreement was signed between Ottoman empire and England. According to these agreements, custom taxes of French and British products were dropped from 12 to 3% and even to 1% on certain occasions (Hanhan, 2008). Yet, the Empire enjoyed a very high income from custom taxes since these affordable products were consumed at very high levels.

However, these seemingly beneficial agreements will be the beginning of the end, since it would hurt the balance of trade and balance of payments of Ottoman empire in an incurable way (Kiray, 2008). Both these agreements were signed by Ottoman emperor with the expectation of providing mutual benefits for France, England and Ottoman empire. However, wrong actions of Ottoman Government officials as well as Galata bankers

started a series of events that caused loss of control of Ottoman officials on economy while benefiting Galata bankers. In other words, control on economy was transferred from Ottoman official to Galata bankers.

Tanzimat Fermani created a consumption society (Quataert, 2000). Ottoman citizens were producing almost nothing except agricultural products, since every kind of products at very affordable prices due to industrial revolution were imported from France and Britain. The Ottoman government did not attempt to take any necessary precautions before it was too late. Meanwhile, Galata bankers when controlling trading and financing activities took full advantage of their positions (Cinar, 2001). They had strong ties with the producers and embassies of foreign countries as well as the domestic ones. Therefore, they were the intermediaries of the trade between foreign and domestic tradesmen. They used to import foreign products at reasonable prices and on favorable credit terms and sell them to domestic wholesalers and retailers with a good profit margin and on shorter terms. Moreover, they took the benefits of having strong ties with European bankers. Therefore they were able to obtain loans with lower interest rates which they used to loan them to domestic tradesmen at triple interest rates (Kazgan, 2006). In that way they took control over almost everywhere money circulates.

Emergence of new social classes

Until the early 19th century, Galata bankers were the trustees of Ottoman emperor and some very high Ottoman officials. They were trusted so much that certain families served as Ottoman's Treasurer by tradition. However, after Tanzimat Fermani, Galata bankers started handling financing affairs of lower level of officials such as governors of providences, tradesmen and even wealthy individuals in need of consuming foreign products. Consequently, the habit of consumption was spread from Istanbul to other wealthy providences of the empire (Quataert, 2000; Kazgan, 2006). Due to having a monopolistic power in financing and trading activities, some of them started acting like loan sharks. Inevitably, Galata bankers earned enormous power over exporting activities as well. Since, almost everyone including domestic producers used to owe them, they were able to obtain domestic products at very affordable rates and export them to Europe with a considerably high profit margin.

Ottoman officials could not manage the effects of Tanzimat Fermani very well. This is called reformist action

caused vanishing of craftsmen and producers. These groups could not compete against much cheaper European products. The members of these communes had to look for other occupations. The empire created positions in government institutions mainly to accommodate this sudden unemployed people. This created an Ottoman proletariat. On the other hand, Galata bankers created a new Ottoman bourgeoisie class due to their enormous financial power (Kazgan, 2006). Until 1850, Galata bankers did not pay much attention to education. However, after 1850's they sent their children to European schools where they would get formal education on finance and economy. Even some colleges that would provide education mainly for their children were opened in Istanbul and other important providences of the empire. Eventually, this new bourgeoisie class started to occupy high rank positions in Ottoman bureaucracy and increased their emphasis in both Ottoman and European financial system. The impacts of Galata bankers could be more visible upon these developments.

Financial path to an end

In order to understand the path that led Ottoman empire to an end, it is necessary to take a brief look at significant events after declaration of Tanzimat Fermani in chronological order:

Issuance of banknotes (1839 - 1856)

Ottoman government issued 160,000, Ottoman Liras worth banknotes that were treated as government notes with 8% annual interest rate and 8 years to maturity in 1839. This was an attempt to bring prosperity to trading activities upon declaration of Tanzimat Fermani. Before issuance of banknotes gold, silver and copper currencies were in circulation. However, these banknotes were handwritten and had no serial numbers. Therefore, they were counterfeited and caused complaints. The empire replaced the handwritten banknotes with printed ones. However, they were counterfeited once again. Even, 120,000 Ottoman Liras worth counterfeited banknotes printed in United States were in circulation (Kazgan, 2006). The Ottoman government borrowed money from Galata bankers as these banknotes in circulation collected and new ones issued. Also, speculative rumors were spread about these banknotes and they were dealt in over the counter markets in Havyar Han, a large commercial building, owned and operated by Galata bankers in

Galata neighborhood. Ottoman citizen called these activities in this same kind of informal securities exchange market “air games” and people from every segment of society actively got involved in. Finally after Crimean war, the government collected and paid off for 400,000 Ottoman Liras worth banknotes.

Istanbul bank (1845 - 1858)

As stated before, Galata bankers were in charge of exporting and importing activities of the empire. Domestic tradesmen were having hard time due to Ottoman currencies losing value against foreign currencies and heavy loan payment obligations. They were having difficulties in obtaining goods from Europe and paying their debts. In addition to banknote problems, adulterated Ottoman currencies caused continuously fluctuating exchange rates. In 1843, 1 British pound was worth 2.2 Ottoman Liras whereas it was supposed to be only 1.1 Ottoman Liras. In order to stabilize the exchange rates Ottoman government decided to apply to knowledge and experience of two famous Galata bankers, J. Aleon and M. Baltazzi. Those bankers were able to provide domestic tradesmen with 450,000 French Frank worth bill of exchange with 11% annual interest rates in 1845 (Bayraktar, 2002; Kazgan, 2006). They renewed the same agreement next year. The third year they advised the government to found a bank. So, J. Aleon and M. Baltazzi, found Istanbul bank upon the permission granted to them in 1847. They managed to stabilize exchange rate for 4 years. However, reformist acts took place in 1848 affected trading activities mainly exporting activities of Ottoman empire negatively. This caused a big loss to Istanbul bank. The government paid for the loss experienced by Istanbul bank in Ottoman banknotes that were counterfeited as stated before. These bankers started speculative activities in order to cover their losses in over the counter securities exchange markets. Istanbul bank continued its operations until 1852. Shortly, after closing Istanbul bank, exchange rates turned out to be favorable for foreign currencies again. Also, speculations on banknotes reached to very high levels.

Crimean war (1853 - 1856)

Ottoman empire got involved in Crimean War along with England and France against Russia between 1853 and 1856. However, the empire did not have enough financial

power to finance the necessary military operations. In addition to problems caused by rebelling states banknotes issued in 1839 were worsening the financial situations. Galata bankers could not provide funds since they had already provided Ottoman empire with all they had. Actually, the empire’s domestic debt to Galata bankers reached to 15,000,000 British pounds and therefore became very risky for Galata bankers. They were not willing to loan more money to government that did not seem to be able to repay (Camuroglu, 2003; Clay, 2000). In fact, Galata bankers created that very unfavorable situation by doubling their receivables through 12% compounding interest rate on capital every six month.

Therefore, the Empire had to apply for a foreign loan the first time in history. In 1855, the first foreign loan was borrowed from England. This fund was used to repay a portion of 4,000,000 British pounds worth debt to Galata bankers, solve the problems caused by banknotes and for other necessary military actions. The empire had to borrow more funds when the war lasted longer than expected. Until 1862, Ottoman empire received 4 more loans, totally approximately 20,000,000 Ottoman Liras only in capital, from France and England. Unfortunately, these loans borrowed were not properly allocated to income generating operations as aimed initially. These funds were to be spent on instruction, transportation companies and other income generating investments. However, they were spent through luxurious lifestyles of Emperor and other high rank government officials. Even today, how these funds was spent, is unknown (Kazgan, 2006; Kiray, 2008). But it is enough to take a look at Dolmabahçe Palace built in 1853 during the time domestic and foreign debt reaches to enormous levels.

Ottoman bank (1856 - 1881)

After Crimean war in 1856, domestic debt had reached to 20,000,000 British pounds and annual installment of foreign debt was around 800,000 British pounds. Galata bankers were unwilling to grant any more loans to the Government. Instead, they were recommending opening a bank that would handle financial affairs of the empire. Foreign financiers were recommending a similar solution and willing to provide help in founding a bank. Therefore, with the help of British finance group Ottoman bank was founded on 1856. Its central office was in London and had branches in Istanbul, Beirut, Izmir and Thessaloniki.

The bank had the privileges of issuing banknotes convertible to gold, whereas the Ottoman government

agreed on not issue any banknote. The bank would handle every kind of banking activities and could get involved in certain trading activities free from custom taxes and duties to a great extent. Galata bankers handled financing activities in Ottoman empire on behalf of French and British bankers until foundation of Ottoman bank. The shareholders of Ottoman bank were mainly British and French bankers. However, Galata bankers were involved in various activities of the bank since they had strong ties with both British and French financial groups (Bayraktar, 2002; Kazgan, 2006; Kazgan, 1995).

With a new agreement signed between Sultan Abdulaziz and Ottoman bank's shareholders, all of the privileges, rights and capital of Ottoman bank were transferred to a newly founded bank Banka-i Osmani-i Sahane in 1863. This was a kind of continuation of Ottoman bank. It was only a minor change in name and therefore it was referred as Ottoman bank in short. The major interest groups remained same as before in first Ottoman bank founded in 1856. This bank earned the status of the treasurer of the empire in 1875. Meanwhile Galata bankers found a second bank called Ottoman empire General Company with partnership of Ottoman bank founded a year earlier.

Ottoman empire had issued various government notes and bonds that were creating major problems and conflicts because of the so called air games which were quite popular by the confidence taken from having two major banks running financial operations. The empire decided to take off previously issued government notes and bonds from circulation by consolidating them to a single bond with 5% annual interest rate. However, Galata bankers were prepared for such an action since they had been well informed of government actions and policies.

Therefore, they had already been organized and found a more formal securities exchange market in Komisyon Han another large commercial building across from Havyar Han where informal securities exchange operations had been continuing for a while. Therefore, after consolidating three different types of government bonds, speculative games on consolidated bonds continued without any distraction. Besides, they had been able to delay any attempt of the government to formalize securities exchange market until 1871 due to their influences among Ottoman bureaucrats (Kazgan, 2006).

Ramadan enactment (1874 - 1875)

Ottoman empire was granted 15 foreign loans between

1854 and 1874. The total amount obtained through these loans was 127,000,000 Ottoman Liras, whereas, total debt to be paid was 239,000,000 Ottoman Liras. As stated before, funds raised through both domestic and foreign loans had not been managed properly? Ottoman government officials' lack of knowledge and experience about financial models and techniques and Galata bankers' extremely high interest demands had worsened to situation to such an unfortunate level. 1874 - 1875 budget of Ottoman empire showed annual income of 25,104,928 Ottoman Liras. However, the total debt installment due same year was 30,000,000 Ottoman Liras (Yilmaz, 1996; Ortayli, 1987; Kiray, 2008).

Therefore, government officials prepared a plan of payment without hurting domestic producers and capital holders. On 7th October, 1875, the empire declared an enactment stating that only half of the annual foreign debt installments would be paid for the next 5 years and government bonds with 5% annual interest rates and 10 years time to maturity will be issued for the creditors. Later on 10th October, 1875, the empire declared another enactment stating that only the half of the foreign debt will be paid for the next 5 years and the remaining would not be paid at all due to unfortunate financial conditions and lack of financial resources (Unaltay, 2001; Kazgan, 2006). Ramadan enactments were declared without any consensus with foreign creditors, therefore, created big protests of foreign creditors. Upon pressures of foreign governments Ottoman empire declared moratorium and stopped payments of the foreign loans.

Rusum - u Sitte 1879 (Duty of six important merchandise)

Ottoman empire was having great economical, political and financial especially since 1854. Galata bankers were pressuring the officials for collecting their receivables, which also could be considered as foreign debt. In order to protect the rights and benefits of its citizens, on 22nd November, 1879, the empire started an action plan called Rusum - u Sitte which was mainly for repaying the debt to Galata bankers. According to this action plan, the income generated from duties of certain merchandise would be used primarily to repay the loan installments to Galata bankers for the next 10 years. Total debt owed to Galata bankers was 8,750,000 Ottoman Liras, whereas the annual installments would be 1.100,000 Ottoman Liras for the next 10 years. If the duty revenues earned exceeded the amount of annual payments to be made to Galata

bankers, the remaining would be used to repay the installments on foreign debt (Kazgan, 2006; Unaltay, 2001; Guler, 2006).

Muharrem enactment (1881)

Rusum - u Sitte was giving privileges to Galata bankers over foreign creditors. This caused great complaints and protests of foreign investors. Even the governments got involved in and turned the conflict between debtors and creditors into a political matter. The empire did not approved the involvement of foreign countries and on 23rd October, 1880, notified those governments that only foreign creditors would be the addressee of discussing financial matters in question. This note was an invitation to foreign creditors and an attempt for repaying the debt owed to them. A series of mutual meetings were arranged between representatives of Ottoman empire and foreign creditors.

Finally, a consensus was reached. Foreign creditors accepted to offer significant discounts on their receivables that the empire agreed to pay through a payment plan. This consensus was declared through and enactment called Muharrem enactment on 20th December, 1881. According to Muharrem Enactment, authorities, duties and responsibilities, Rusum - u Sitte administration would be transferred to Duyun - u Umumiye (General Debt) administration that would start its operations in 1882. In order to clearly demonstrate how the empire came to this stage, data related to debts obtained between 1854 and 1881 are presented in Table 1 (Kiray, 2008).

Conclusion

Foundation of Duyunu - u Umumiye administration is an important milestone for Ottoman empire. With this administration, Ottoman empire prepared its own end. The empire was able to raise funds through more foreign debt rather easily after 1882, since Duyun - u Umumiye commission were protecting rights of foreign creditors and ensuring full back payment. All of the economical activities of Ottoman empire were organized and controlled by Duyun - u Umumiye administration. They were able to control all the expenses and revenues of the empire. Ottoman financial system got introduced modern economic and financial models through applications and operations of Duyunu - u Umumiye.

However, it was too late to get together and solve financial problem for the empire. The empire became dependent to European countries and directly affected by their financial, economical, political and military moves and decisions. Because of pressure of financial ties and connections, Ottoman empire had to take part in World War I, the empire kept borrowing money from foreign creditors till its end. After the World War I, upon the collapse of Ottoman empire, the newly found Turkish Republic bared the debt of the empire. During Lausanne Conference, it was demanded that the debt of Ottoman empire need to be shared between Turkish Republic and other 16 independent states out of the borders. The same demand was carried on during the Paris Conference held in 1925 and Turkish Republic accepted 62% of the foreign debt borrowed before 1912 and 77% of the ones borrowed afterwards. The amount of debt accepted was 84.6 million Ottoman Liras that approximated to 6 million US Dollars according to Paris agreement signed in 1933. The last installment of foreign debt started in 1854 by Ottoman empire was fully paid a century later by Turkish Republic 25th May, 1954.

As it was stated early in this study, it is really important to fully understand and learn lessons from history. A comprehensive analysis of historical events can prevent repeating the same mistakes over and over. Unfortunately, financial moves of the last 100 years of Ottoman empire have great resemblances to the ones of the last 50 years of Turkish Republic. These resemblances can be analyzed briefly as follows:

The most important reasons that led Ottoman empire to financing through foreign resources were free trade agreements signed. These improperly planned agreements on behalf of Ottoman empire along with falling behind changes and improvements of the production era back then caused the Ottoman land to turn into an open bazaar for foreign countries. This caused deficits in both balance of trade and balance of payments for Ottoman empire. Besides, laws and regulations governing the financial system were improper. Therefore, banking and trading systems dominated and operated by Galata bankers were not controlled properly by the authorities. The empire relied solely on Galata bankers for financing every kind of activity. High interest rates demanded by Galata bankers eventually led to very high liabilities and forced Ottoman empire to look for financing alternatives elsewhere. Combined with mismanagement of the funds obtained, this had led to a series of actions that prepared the bankruptcy of Ottoman empire in 20 years.

Table 1. Foreign Debt Obtained Between 1854 and 1877.

Year	Nominal Value (£)	Actual Amount Obtained (£)	Interest (%)	Rate of Emission (%)	Reason for This Debt	Intermediary
1854	3,000,000	2,290,000	6	80	To finance Crimean War	Palmer-Goltschmidt
1855	5,000,000	5,130,000	4	102.6	To finance Crimean War	Rothschilds
1858	5,000,000	3,440,000	6	76	To call Banknotes off of circulation	Dent, Palmers and Co.
1860	2,000,000	1,230,000	6	62.5	Tithes	
1862	8,000,000	5,150,000	6	68	To call Banknotes off of circulation and to pay off installments on short term debt	Bank-i Osmani-i Sahane and Devaux and Co. Of London.
1863	8,000,000	4,980,000	6	71	To pay off installments on short term debts and to coin money	Bank-i Osmani-i Sahane ve Credit Mobilier
1865	6,000,000	3,700,000	6	66	To pay off installments on foreign debt and to close budget deficit	Bank-i Osmani-i Sahane and Credit Mobilier
1865	32,900,000	19,800,000	5	60	To convert domestic debt of 26.36 million British Pounds into government bonds with 5% interest rate.	General Credit and Societe Generale.
1869	22,000,000	11,560,000	6	57	To pay off installments on short term debt and to close budget deficit	Comptoir d'Escompte
1870	31,680,000	9,540,000	3	32.125	To build railways in Rumelia	-----
1871	5,700,000	4,050,000	6	73	To pay off installments on short term debt and to Close budget deficit	Louis Kohensons vd dent, Palmers and Co.
1872	4,820,000	4,650,000	9	98.5	To close budget deficit	Bank-i Osmani-i Sahane and Credit General Ottoman
1873	20,230,000	10,960,000	5	54	To consolidate government bonds issued in 1872	-----
1873	27,780,000	14,440,000	6	54	To close budget deficit	Credit Mobilier de Paris and Credit General Ottoman
1874	40,000,000	15,090,000	5	40	To pay off installments on short term debt	Bank-i Osmani-i Sahane
1877	5,000,000	2,600,000	5	52	To finance the war against Russia	Bank-i Osmani-i Sahane and Glyn Mills, Currie and Co. Of London.
Total	227,711,000	118,610,000				

The situation described above is very similar to the one still being experienced by government of Turkish Republic. Firstly, when the custom agreement was signed by Ozal administration, Turkey has become an open market for European countries. Secondly, with the permission of the same administration, private Turkish banks acting as agencies of foreign financial institutions (most of them have foreign affiliates now) have been allowed to lend credits to Turkish government. The most significant and unfortunate point is the credibility ratings of these banks are better than the one of Turkish Republic. Therefore, these banks can raise funds with very low interest rates from European credit institutions. However, they lend loans to government with much higher interest rates. The banking system in Turkey has been so irrational, since then there were times where private banks charged the government three times more interest rates they were paying. Turkish government applied to support of International Monetary Fund, a Duyun - u Umumiye administration like organization because of very unfavorable terms and conditions imposed by its own private banking industry. It is believed to best summarize the situation by stating the fact that Turkish government's foreign debt was two times more in capital than its domestic debt, whereas the interest due on domestic debt was two times of the interest on foreign loans. The empire experienced a trade deficit of more than 100 million Ottoman Liras in a period of 12 years between 1873 and 1890. This makes an annual trade deficit of 8.4 million Ottoman Liras in average. The trade deficit of Turkish Republic is 62.83 million US Dollar in 2007 only. As a result, among all the governments of Turkish Republic is paying the highest interest rates in whole world.

The resemblances are not only in the financial areas; Ottoman empire faced rebellious movements from various states due to losing power as a consequence of wrong financial decisions. Actually, the need of financing military actions against rebelling states had worsened the situation. Similarly, the biggest expenditures of Turkish Republic are composed of military spending, since Turkish government has been facing continuous terrorist attacks in the last 34 years. However, there is no need to pessimistic. Actually, there are many reasons to be hopeful for the future. Since the Izmir Economy Congress held in 1924, many things have changed. Entrepreneurs in Turkey seem to be coping with changing market and economic conditions. Economists are well aware of the current situation and can produce action plans and remedies for the government.

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