"Changes in Financial Institutions in the Ottoman Empire, 1600-1840"

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I- Introduction

The Ottoman Empire stood at the crossroads of intercontinental trade, stretching from the Balkans and the Black Sea region through Anatolia, Syria, Mesopotamia and the Gulf to Egypt and most of the North African coast for six centuries until World War I. Until recently, Ottoman historiography had depicted an empire in decline from the end of the sixteenth century. In contrast, a growing literature has been arguing that Ottoman state and society began to adapt to changing circumstances in the early modern era, well before the nineteenth century reforms known as Tanzimat or "re-ordering". Beginning with the successful centralization drive in the second half of the fifteenth century, Ottoman economic institutions and policies were shaped to a large degree by the priorities and interests of a central bureaucracy. This central bureaucracy managed to contain the many challenges it faced with its pragmatism, flexibility and habit of negotiation to co-opt and incorporate into the state the social groups that rebelled against it.[1]

If pragmatism and flexibility refers to the willingness of actors not to be bound in their actions and in the institutions they adopt by specific and rigid rules based on custom, traditions, religion or past behavior, the Ottomans were familiar with these traits from the earliest period. Emerging in a highly heterogeneous region populated by Christians and Muslims, Turkish and Greek speakers, the Ottomans' success in western Anatolia and later in the Balkans during the fourteenth and fifteenth centuries owed much to their willingness and ability to adapt to changing conditions, to utilize talent and accept allegiance from many sources, and to make many-sided appeals for support. They were thus able attract many followers not only as warriors fighting against the Christians but also Muslims and Christians fighting for the riches to be gained, the positions and power to be won. The Ottomans also displayed

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[1] For a recent example, Sevket Pamuk, "Institutional Change and the Longevity of the Ottoman Empire, 1500-1800", Journal of Interdisciplinary History, Vol. 35, 2004, pp. 225-47.

remarkable openness to technological innovation, to adapt firearms on a greater scale, more effectively and earlier than the neighboring states. Similarly, they exhibited considerable degree of flexibility and pragmatism while expanding the territories under their control. They were prepared to negotiate for the loyalty of local elites whenever the new state was unable to impose full control. They also proved to be quite adept at learning about and borrowing institutions from others. In short, the early Ottoman enterprise was not a religious state in the making, but rather a pragmatic one.

While pragmatism, flexibility, willingness to negotiate, ability to adapt some of their institutions to changing circumstances were traits that enabled the Ottomans to retain power until the modern era, their limitations need to be equally emphasized. Institutional change did not apply equally to all areas of Ottoman economic life. Not all types of institutions were affected to the same degree by these changes. Because the central bureaucracy was able to retain its leading position in Ottoman society and politics, the influence of various social groups, not only of landowners but also of merchants, manufacturers and moneychangers, over economic matters, and more generally over the policies of the central government remained limited until the end of the empire. As a result, most of the pragmatism and flexibility was utilized by the central bureaucracy for the defense of the existing order and of its own position.

In contrast, institutional changes that may threaten the leading position of the central bureaucracy position were resisted more forcefully than others. Institutional change thus remained selective and many of the key institutions of the Ottoman order such as state ownership of land, urban guilds and restrictions on private capital accumulation remained intact until the nineteenth century. Capital markets, especially those related to affairs of the state showed considerable change in the early modern era. In contrast, changes in labor and land markets remained limited as these institutions were defended fiercely by the bureaucracy. The same argument may be stated in different terms: those in favor of greater

institutional change, for example landowners, merchants and manufacturers were not strong enough to overcome the opposition of the bureaucracy and other political forces until the nineteenth century.

Institutions and institutional change have been identified in recent decades as key variables that help explain the widely disparate economic performance of different societies over the last five hundred years. Based on the successful experience of Western Europe and European off-shoots, new institutional economics has argued that long run economic change is attained because the underlying framework persistently reinforced incentives for organizations to engage in productive activity.

Institutional economics and economic historians have come to recognize, however, that institutional change is usually not in the direction of most efficient outcomes and that a society rarely arrives at or creates institutions that are conducive to economic growth. In most cases, institutions have favored activities that that restrict opportunities rather than expand them. Similarly, rather than reinforcing incentives towards productive activity, in most cases states acted as instruments for transferring resources from one group to another or promoting their own survival at the expense of others. In short, the process of institutional change has not always been favorable to economic growth.[2]

Institutional economics proposes a number of causes or determinants of institutions. Most important amongst them are i) geography or resource endowments, ii) religion or more generally culture and iii) social conflict or political economy. Ottoman economic institutions including some financial institutions have

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[2] Douglass C. North, Institutions, Institutional Change and Economic Performance, Cambridge University Press, 1990; more recently, Daron Acemoglu, Simon Johnson and James Robinson, "Institutions as the Fundamental Cause of Long-Run Growth", in Philippe Aghion and Steve Durlauf (eds.), Handbook of Economic Growth, 2005, pp. 385-471.

been influenced by geography or resource endowments. For example, the land regime and fiscal institutions in Egypt were shaped to a large degree by the needs of irrigated agriculture. In the core regions of the empire, low population density tended to support peasant farms as the most dominant unit in the countryside. With the exception of Egypt, however, the geography or resource endowments of the areas covered by the Ottoman Empire were not very different from those of western Europe. For this reason, I will not focus on geography or resource endowments as a primary cause of the differences in economic institutions between the two regions.

Religion and/or culture have long been offered as a primary cause of the differences in economic outcomes between the Near East and western Europe. Max Weber and more recently David Landes have offered prominent examples of this type of explanation. More recently, in a series of recent articles Timur Kuran has pointed to certain Middle Eastern institutions including ones rooted in the region's dominant religion, as past and in some cases also continuing obstacles to economic development. He has argued that these institutions did not ever cause a decline in economic activity but they turned into handicaps by perpetuating themselves during the centuries when the West developed the institutions of the modern economy.[3]

Some Ottoman financial institutions were influenced by the Islamic prohibition on interest, as I will show below. On the other hand, many of the key economic institutions in the Ottoman Empire, most importantly those related to land and labor, state ownership of agricultural land and the central role of guilds were shaped largely by economic, social and political factors. Similarly, the evolution of Ottoman institutions of public finance during the early modern era was remarkably similar to those of Ancien Regime France. I will

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[3] Timur Kuran,"The Islamic Commercial Crisis: Institutional Roots of Economic Underdevelopment in the Middle East", The Journal of Economic History", 63, 2003, pp. 417-449 and "Why the Middle East is Economically Underdeveloped: Historical Mechanisms of Institutional Stagnation", Journal of Economic Perspectives, 18, 2004, 71-90.

thus argue that by far the most powerful determinant of Ottoman economic institutions and their evolution in the early modern era need to be searched in the social structure and political economy. Because different groups and individuals typically benefited from different economic institutions, there was generally a conflict over the choice of economic institutions, ultimately resolved in favor of groups with greater political power.

How economic institutions are determined and why they vary across countries is still not sufficiently well understood. Those in the recent institutional economics literature adhering to a social conflict or political economy explanation of economic institutions argue that because different groups and individuals typically benefit from different economic institutions, there is generally a conflict over the choice of economic institutions, ultimately resolved in favor of groups with greater political power. The distribution of political power in society is in turn determined by political institutions and the distribution of economic power. Economic institutions that provide incentives to invest in land, physical and human capital or technology are more likely to arise when political power is in the hands of a relatively broad group with significant investment opportunities. For this reason, political economy and political institutions are considered as key determinants of economic institutions and the direction of institutional change. The state can be a major player in this context as it maintains coercive power to enforce these rules. In the Western European case, as the result of political struggles and alliances, the state and associated institutions moved to provide the legal framework that reinforced incentives for organizations to engage in productive activity.[4]

Recent work on long term economic growth and development places a good deal of emphasis on financial institutions, on financial markets and financial intermediation. In what follows, I will examine the evolution of Ottoman institutions of private and public finance during the early modern era. I will argue that the Ottoman

[4] Acemoglu, Johnson and Robınson (2005).

state and society showed considerable ability to reorganize as a way of adapting to changing circumstances in Eurasia from the seventeenth through the nineteenth centuries. This does not mean that Ottoman institutions came to resemble those that gave rise to capitalism. I will argue, instead, that Ottoman society and Ottoman bureaucracy brought about institutional change in selective areas, in military technology and organization, in public rather than private finance, for example, and such selective institutional change enabled the Ottomans to maintain their rule and the empire to survive a much longer period.

In other words, I believe we can best understand Ottoman economic institutions, changes in these institutions and Ottoman economic performance during the early modern era not by referring to some abstract, unchanging concept of Islam but by examining social and political structures, the political economy to determine how and in which direction the latter influenced the economic institutions.

Institutions of Private Finance

Islam and Interest

It has often been assumed that the prohibition of interest in Islam prevented the development of credit, or at best, imposed rigid obstacles in its way. Similarly, the apparent absence of deposit banking and lending by banks has led many observers to conclude that financial institutions and instruments were, by and large, absent in Islamic societies. It is true that a religiously inspired prohibition against usurious transactions was a powerful feature shared around the Mediterranean during the Middle Ages, both by the Islamic world and Christian West.[5] While the practice of riba, the Arabic term for usury and interest, is sharply denounced in a number

[5] For a recent discussion of the classical Islamic views on interest, see N. A. Saleh, Unlawful Gain and Legitimate Profit in Islamic Law: Riba, Gharar and Islamic Banking, (Cambridge University Press, 1988), pp. 9-32.

of passages in the Qur'an and in all subsequent Islamic religious writings, already in the classical era, Islamic law had provided several means by which the anti-usury prohibition could be circumvented just as the same prohibitions were circumvented in Europe in the late medieval period. Various legal fictions, based primarily on the model of the "double-sale" were, if not enthusiastically endorsed by jurists, at least not declared invalid. There did not exist an insurmountable barrier against the use of interest bearing loans for commercial credit.

Neither the Islamic prohibitions against interest and usury nor the absence of formal banking institutions prevented the expansion of credit in Ottoman society. Utilizing the Islamic court records the late Ronald Jennings has shown that dense networks of lenders and borrowers flourished in and around the Anatolian cities of Kayseri, Karaman, Amasya and Trabzon during the sixteenth century. Over a twenty year period which his study covered, he found literally thousands of court cases involving debts. Many members of each family and many women are registered in these records as borrowing and lending to other members of the family as well as to outsiders. These records leave no doubt that the use of credit was widespread among all segments of the urban and even rural society. Most lending and borrowing was on a small scale and interest was regularly charged on credit, in accordance with both Islamic and Ottoman law, with the consent and approval of the court and the ulema. In their dealings with the court the participants felt no need to conceal interest or resort to tricks in order to clear legal hurdles. Annual rates of interest ranged from 10 to 20 percent.[6]

One important provider of loans in Istanbul, the Balkans and the Anatolian urban centers were the cash vakifs, pious foundations established with the explicit purpose of lending their cash assets and using the interest income to fulfill their goals. These endowments began to be approved by the Ottoman courts in the early

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[6] R. C. Jennings, 'Loans and credit in early 17th century Ottoman judicial records', Journal of the Economic and Social History of the Orient 16 (1973), 168-216.

part of the fifteenth century and had become popular all over Anatolia and the Balkan provinces by the end of the sixteenth century. An interesting development that became more pronounced during the eighteenth century was the increasing allocation of the funds to the trustees of these endowments. The trustees then used the borrowed funds to lend at higher rates of interest to large-scale moneylenders (sarraf) at Istanbul who pooled these funds to finance larger ventures, most importantly, long distance trade and tax-farming.[7]

Not surprisingly, a lively debate developed during the sixteenth century within the Ottoman ulema regarding whether the cash vakif should be considered illegitimate. The cash vakifs were opposed by those who believed that only goods with permanent value such as real estate should constitute the assets of a pious foundation and that the cash vakifs contravened the Islamic prohibition of interest. The majority of the ulema, however, remained eminently pragmatic and the view that anything useful for the community is useful for Islam ultimately prevailed. During the heated debate, Ebusuud Efendi, the prominent, state-appointed religious leader (seyhulislam) of the period, defended the practice from a purely practical point of view arguing that abolition of interest taking would lead to the collapse of many pious foundations, a situation that would harm the Muslim community.[8] Ottoman institutions of credit and finance retained their Islamic lineage and remained mostly uninfluenced by the developments in Europe until the end of the seventeenth century.[9]

Despite this pragmatism, however, the cash vakif faced serious shortcomings. The interest they charged was fixed by the original

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[7] M. Çizakça, A Comparative Evolution of Business Partnerships, The Islamic World and Europe with Specific Reference to the Ottoman Archives, (Leiden: E. J. Brill, 1996), pp. 131-34.

[8] J. E. Mandaville, 'Usurious piety: the cash waqf controversy in the Ottoman Empire', International Journal of Middle East Studies 10 (1979), 289-308.

[9] Çizakça, Murat (1996), A Comparative Evolution of Business Partnerships, the Islamic World and Europe, E. J. Brill, Leiden.

founders and could not respond to later changes in market conditions. More importantly, their capital was limited primarily to the original endowment and whatever additional could be made by ploughing back the profits and other marginal means. Since the original capital essentially composed of the savings of a single individual, no matter how wealthy, such funds were bound to remain small and the potential for growth remained limited over the long term. Moreover, the Ottoman cash vakifs never lent to entrepreneurs, they provided consumption credit although financiers began pooling the funds of large numbers of small cash vakifs in the eighteenth century and lending these funds to the state.

Business Partnerships

Even though there did not exist an insurmountable barrier against the use of interest-bearing loans for commercial credit, this alternative was not pursued in the medieval Islamic world. Instead, numerous other commercial techniques were developed which played the same role as interest-bearing loans and thus made the use of loans unnecessary. These included a variety of business partnership forms such as mudaraba or commenda, credit arrangements, transfers of debt and letters of credit all of which were sanctioned by religious theory. Long distance trade was thus financed not by simple credit relations involving interest but by a variety of Islamic business partnerships the specifics of which depended on the nature of the risks and the resources provided by the different partners.

Ottoman merchants widely used the varieties of Islamic business partnerships practiced in the Islamic world since the classical era.[10] The most frequently used method in the financing of long distance trade and certain other types of business ventures was the mudaraba partnership of classical

[10] A.L.Udovitch, , Partnership and Profit, Princeton University Press, 1970, pp. 170-217; and Çizakça, A Comparative Evolution, pp. 66-76.

Islam in which an investor entrusted his capital or merchandise to an agent who was to trade with it and then return the principal. The profits were then shared between the principal and the agent according to some pre-determined scheme. Any loss of the capital resulting from the exigencies of travel or the business venture itself were borne exclusively by the principal. The liability of the agent was limited to his time and efforts.[11] To a lesser extent the Ottomans also used mufawada partnership of the Hanefi school of Islam in which the partners were considered equals in terms of capital, effort, returns and liabilities. In the related musharaka or inan arrangement, the partners were free to invest different amounts and agree to share the returns and liabilities in unequal but pre-arranged rates.

Evidence from Islamic court records on commercial disputes and their resolution until the middle of the nineteenth centuries indicate that in Anatolia and Istanbul, at least, the Ottoman jurists were well informed about the teachings of medieval Muslim jurists and, in general, adhered closely to the classical Islamic principles in disputes arising from these partnerships. There were some innovations over the centuries; for example, some interesting combinations of mudaraba and putting out activities were developed. On the whole, however, evidence from hundreds of business partnerships indicate that classical Islamic partnership forms not only survived but were applied, with minor exceptions, true to their original forms until the nineteenth century. Çizakça suggests that the continued dominance of small scale firms or partnerships was

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[11] In essence, this was identical to the commenda of Europe. For discussions of the Islamic origins of European commenda, see A. L. Udovitch, 'At the origins of the Western commenda: Islam, Israel, Byzantium', Speculum 37 (1962), 198–207; J. H. Pryor,"Origins of the Commenda Contract", Speculum 52 (1977); Çizakça, A Comparative Evolution, pp. 10–32; also E. Ashtor, 'Banking instruments between the Muslim east and the Christian west', Journal of European Economic History, 1 (1972), 553–73.

probably the most important reason for the limited changes in this area.[12]

Ottoman institutions of private finance reflected the high degree of pragmatism and the willingness to circumvent the Islamic prohibition on interest. There were some innovations; for example, some interesting combinations of mudaraba and putting out activities were developed. On the whole, however, archıval evidence from hundreds of business partnerships indicate that classical Islamic partnership forms underwent limited changes in the early modern era. They were applied, with minor exceptions, true to their original forms until the nineteenth century. There was limited progress in both the institutions of lending and in the institutions of business partnership.

Ottoman business partnerships as well as the cash vakifs thus remained relatively small, of short duration and with limited capital. Under these conditions it is not surprising that European business organizations began to dominate Ottoman overseas as well as domestic trade. It would be interesting to discuss the reasons why there was little change in these private partnership forms during the Ottoman era.

The continued dominance of small scale firms or partnerships has been cited as the most important reason for the limited changes in institutions of private finance. In other words, it has been argued that demand for further changes in these institutions was not sufficiently strong. This line of reasoning suggests that the causal relationship between institutions and economic development is not one directional. Just as economic institutions influence the degree and direction of economic development, economic development or its absence also influences the institutions and their evolution.

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[12] Çizakça, A Comparative Evolution, pp. 65-85 and 126-131; also M. Çizakça,'Financing silk trade in the Ottoman Empire: 16th-18th centuries" in S. Cavaciocchi (ed.), La Seta in Europa secc. XIII-XX, (Prato: Le Monier, 1993), pp. 711-23.

There is another reason for the limited nature of institutional changes in this area. The private sector, the merchants and producers were never in a position to influence the Ottoman state elites and push for institutional changes that would favor the growth of the private sector during these centuries. In other words, because the central bureaucracy was able to retain its leading position in Ottoman society and politics, the influence of various social groups, not only of landowners but also of merchants, manufacturers and moneychangers, over economic matters, and more generally over the policies of the central government remained limited until the end of the empire.

Institutions of State Borrowing

The evolution of Ottoman fiscal institutions during the seventeenth and eighteenth centuries provides a good example of the ability of the Ottoman state to contain the challenges it faced with pragmatism, flexibility and habit of negotiation to co-opt and incorporate into a broad alliance, if necessary, the social groups that challenged its authority.

While loans to kings, princes and governments were part of the regular business of European banking houses in the late medieval and early modern periods, in the Islamic world advances of cash to the rulers and the public treasury were handled differently. In the face of the prohibition on interest, they took the form of tax-farming arrangements in which individuals possessing liquid capital assets advanced cash to the government in return for the right to farm the taxes of a given region or fiscal unit for a fixed period. Tax-farming thus dominated the Islamic world from the Mediterranean to the Indian Ocean, from the earliest days through the early modern period.

From the very beginning the Ottomans relied on tax-farming for the collection of urban taxes. Until late in the sixteenth century, however, the agricultural taxes which constituted the largest part of the tax revenues were collected locally and mostly in kind within the pre-bendal timar system. Sipahis, state employees who resided in

the rural areas were expected to spend these revenues to equip and prepare a given number of soldiers for the military campaigns. Until the second half of the sixteenth century state finances were relatively strong thanks to the revenues obtained through the rapid territorial expansion of the empire and the state did not feel the need to increase the revenues collected at the center. There are examples of short-term borrowing by the state during the sixteenth century. These services earned the financiers, mostly Jews and Greeks, the inside track on some of the most lucrative tax-farming contracts.[13]

With the changes in military technology during the sixteenth century and the need to maintain larger, permanent armies at the center, however, pressures increased to collect a larger part of the rural surplus at the center. As a result, the timar system began to be abandoned in favor of tax-farming and the tax units were auctioned off at Istanbul.[14] The shift away from the timar system had been designed to increase the cash receipts at the center, but the decline of the state power vis-à-vis the provinces reduced the expected benefits from this change. Bureaucrats in the capital and provincial groups began to share tax farming revenues with the central government during the seventeenth century.

Further deterioration of state finances during the seventeenth century increased the pressures on the central government to take greater advantage of the tax-farming system for the purposes of domestic borrowing. Especially during periods of war when the fiscal pressures were greatest, the central government thus began to increase the length of the tax-farming contracts from one to three

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[13] Inalcık, "The Ottoman State: Economy and Society, 1300-1600" in Inalcik and Quataert (eds.), An Economic and Social History, pp. 212-14.

[14] Linda T. Darling, Revenue-Raising and Legitimacy, Tax Collection and Finance Administration in the Ottoman Empire, 1560-1660, E.J. Brill, Leiden, 1996; H. İnalcık, 'Military and fiscal transformation in the Ottoman Empire, 1600-1700', Archivum Ottomanicum 6 (1980), 283-337.

years to three to five years and even longer. It also demanded an increasingly higher fraction of the auction price of the contract in advance. Tax-farming was thus converted to a form of domestic borrowing with the actual tax revenues being used as collateral by the central government.

Further steps were taken in the same direction with the introduction, in 1695, of the malikane system in which the revenue source began to be farmed out on a life-time basis in return for a large initial payment to be followed by annual payments.[15] One rationale often offered for this system was that by extending the term of the contract, the state hoped that the tax contractor will take better care of the tax source, most importantly the peasant producers, and try to achieve long term increases in production. In fact, the malikane allowed the state to use tax revenues as collateral and borrow on a longer term basis. In comparison to the straightforward tax-farming system, it represented an important shift towards longer term borrowing by the state.

With the extension of their term and the introduction of larger advance payments, the long term financing of these contracts assumed an even greater importance. The private financiers thus began to play an increasingly important role in the tax collection process. Behind the individual, often a Muslim, that joined the bidding in the tax-farming auctions, there often existed a partnership that included financiers as well as the agents who intended to organize the tax collection process itself often by dividing the large initial contract into smaller pieces and finding sub-contractors. Non-Muslims were prohibited from holding most malikane contracts but Greeks, Armenians and Jews were very much part of this elite as financiers, brokers and accountants. These arrangements were mostly in the form of Islamic business partnership involving both Muslims

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[15] M. Genç, 'A study of the feasibility of using eighteenth century Ottoman financial records as an indicator of economic activity', in Huri İslamoğlu-İnan (ed.), The Ottoman Empire and the World Economy, (Cambridge University Press, 1987), pp. 345-73.

and non-Muslims.[16] Over the course of the eighteenth century, some 1,000 to 2,000 Istanbul based individuals, together with some 5,000 to 10,000 individuals in the provinces, as well as innumerable contractors, agents, financiers, accountants and managers controlled an important share of the state's revenues. This grand coalition of Istanbul based elites and the rising elites in the provinces constituted a semi-privatized but interdependent component of the regime.[17] Many provincials were able to acquire and pass from one generation to next small and medium sized malikane shares on villages as long as they remained in favor with local administrators or their Istanbul sponsors. For both the well-connected individuals in the capital city and those in the provinces, getting a piece of government tax revenues became an activity more lucrative than investing in agriculture, trade or manufacturing.

It is significant that these changes in the tax collection and revenue sharing system did not alter the legal basis of land ownership until the nineteenth century. Despite the rise of provincial elites, most agricultural lands remained miri or state land with the peasant households holding the usufruct while the sipahis gave way to tax farmers who were then replaced by malikane owners. State ownership on land combined with usufruct by the peasant household, a key institution of the classical Ottoman order thus remained intact until the modern era.

In the longer term, however, the malikane system did not fulfill the expectations of the central government. It actually led to a decline in state revenues because of the inability of the state to regain control of the revenue sources after the death of the individuals who had purchased them.[18] The central government thus began to experiment with other methods for tax collection and domestic borrowing from the 1770s onwards. Rising military

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[16] Çizakça, A Comparative Evolution of Business Partnerships.

[17] Ariel Salzman, "An Ancien Regime Revisited: "Privatization" and Political Economy in the Eighteenth Century Ottoman Empire", Politics and Society, Vol. 21, 1993, 393-423.

[18] Genç, 'A study of the feasibility'.

expenditures and increasing fiscal pressures during wartime were once again responsible for the institutional changes. After the end of the war of 1768–1774, which had dramatically exposed the military as well as financial weaknesses of the Ottoman system, the financial bureaucracy started a new and related system of long-term domestic borrowing called esham. In this system, the annual net revenues of a tax source were specified in nominal terms. This amount was divided into a large number of shares which were then sold to the public for the lifetime of the buyers. The annual revenues of the source continued to be collected by the tax farmers. The esham generally sold for six to seven times the annual net payments which remained fixed.[19] As the linkage between the annual government payments to esham holders and the underlying revenues of the tax source weakened, the esham increasingly resembled a life-term annuity quite popular in many European countries of the period.

One motivation for the new system was to broaden the base of state borrowing and reach beyond the limited numbers of large financiers who tended to dominate the malikane auctions towards a larger pool of small and medium sized lenders. However, the inability of the state to control or limit the sales of the esham between individuals and the difficulties in preventing the heirs of the deceased from continuing to receive payments seriously limited the fiscal benefits of this system. During the next half century, the state vacillated between abolishing the esham during periods of fiscal stability and expanding it when fiscal pressures mounted and additional funds had to be secured with little regard for their long-term cost.[20]

In the early part of the nineteenth century, the center, supported by the new technologies, was able to re-assert its power over the provinces. After the central government began to undermine

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[19] Cezar, Yavuz, Osmanlı Maliyesinde Bunalım ve Değişim Dönemi: XVIII. yy.dan Tanzimat'a Mali Tarih, Alan Yayıncılık, Istanbul, 1986, pp. 81–83; also M. Genç, 'Esham', İslam Ansiklopedisi, vol. 11, 1995, pp. 376–80.

[20] Cezar, Osmanlı Maliyesinde Bunalım, pp. 128–34, 198–200.

the power of the provincial notables in the 1820s and 1830s, many of the malikane contracts were pulled back to the center and their revenues began to be collected once again by tax farmers. The malikane or the life-term tax-farming system was phased out in the 1840s as part of a larger package of administrative and economic reforms. With the same package of centralizing reforms the central government also attempted to eliminate short term tax farmers. This last step failed, however, due to the administrative limitations of the central government. Short-term tax-farming continued until World War I. Nonetheless, the centralization of the nineteenth century helped raise the central governments share of the tax revenues from about 2 to 3 percent of the underlying economy (GDP) in the late eighteenth century to 10 to 12 percent on the eve of World War I.[21]

The long term evolution of Ottoman institutions of state borrowing illustrates the state's ability and willingness to reorganize as a way of adapting to changing circumstances, albeit slowly and often with considerable time lags. The rise and the evolution of the tax-farming, malikane and esham systems demonstrate the willingness of the central government to come to terms with the limits of its political and administrative power by entering into a broad alliance with elites and financiers in the capital city as well as those in the provinces. The central bureaucracy was forced to share the tax revenues with provincial groups and financiers during the seventeenth and eighteenth centuries. With the centralization of the nineteenth century, however, the power and share in the tax revenues of these partners steadily declined while the ratio of (tax revenues reaching the central government/GDP) rose above 10 percent for the first time in Ottoman history.

It is interesting that the greatest financial fortunes were being amassed by those who lent to the state and more indirectly by those who lent to those that were involved in collecting taxes for the state. In contrast, the private entrepreneurs engaged in

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[21] My estimates based on series of central government budget documents and our estimates of per capita income in the Ottoman Empire.

agriculture, trade and manufacturing claimed only a small share of the funds being controlled by the larges financiers during the eighteenth century. In short, lending to the state, financing the large government deficits and financing the tax collection process became the biggest financial game in not only Istanbul but also in the provinces during the eighteenth century.

As a result, the central governments' share of the tax revenues did not exceed 3 percent of the underlying economy or GDP for most of the eighteenth century. This rather low level of tax revenues illustrates very well the limited capacity of Istanbul and also help explain its shortcomings in the military field. In comparison, the British government collected 10 to 15 percent of the GDP in the form of taxes during the eighteenth century.

The evolution of Ottoman institutions of public finance from short term tax farming to life-time tax farms to government borrowing with tax revenues as collateral and finally to government bonds was quite remarkable. Malikane probably originated as an Ottoman institution. Ottoman internal correspondence suggests that the malikane was brought to Anatolia and the Balkans from Egypt at the end of the seventeenth century. The esham, that is the life-term annuities, however, was more clearly linked to the European financial institutions of the eighteenth century, most notably to those in Ancien Regime France. European institutions of both private and public finance thus began to grow in influence during the eighteenth century. This trajectory of Ottoman fiscal institutions suggests that the Ottomans were willing to borrow or adapt European fiscal institutions before the nineteenth century. Despite growing research in this area, the causal connections between the evolution of the Ottoman institutions of public finance as outlined here and the evolution of the European institutions of public finance during the eighteenth century have not yet been investigated. In contrast, I have pointed out in contrast that changes in the institutions of private finance during this period were limited.

The trajectory of the institutions provides important clues for understanding the longevity of the empire as well as the key position of the central bureaucracy until the end. It also suggests that the Ottomans were willing to borrow or adapt European financial institutions before the nineteenth century. Despite recent research on the evolution of the Ottoman forms, the causal connections between the evolution of the Ottoman institutions of public finance as outlined here and the evolution of the French institutions of public finance during the seventeenth and especially the eighteenth centuries have not yet been investigated. The parallels between the two are quite striking, however. It appears that increasing economic and financial integration with Europe after the sixteenth century brought about more rapid changes in the institutions of public finance than those of private finance.[22]

Linkages with western European capital markets?

Recent research suggests that western European capital markets experienced a substantial degree of integration during the early modern era. Most international capital flows during this period took the form of lending to private and public borrowers in other countries, not direct investment. These international flows were facilitated by the political and institutional changes taking place in western European countries. As a result of institutional changes and greater integration of capital markets, there occurred from the late medieval to the eighteenth century substantial decreases in and a large degree of convergence of interest rates paid by the western

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[22] G. Parker, 'The emergence of modern finance in Europe, 1500–1730', C. Cipolla (ed.), The Fontana Economic History of Europe, 2 (1974), 560–82; For the case of France, the country most likely to have influenced the changes in Ottoman institutions of public finance, see Eugene N. White, "France and the Failure to Modernize Macroeconomic Institutions", in Michael D. Bordo and Roberto Cortes-Conde (eds.), Transferring Wealth and Power from the Old to the New World, Monetary and Fiscal Institutions in the 17th through the 19th Centuries, Cambridge University Press, 2001, pp. 59–99.

European governments. Nominal rates of interest declined from a range of 10 to 20 percent per annum in the fourteenth century to a range of 5-10 percent in the seventeenth and to less than 5 percent in the eighteenth century.[23]

The Ottoman Empire remained outside the European capital markets network until the second half of the nineteenth century, however. While the Ottoman government did not consider external borrowing until late in the eighteenth century, it is not clear how much interest there would have been in the western European capital markets to lend to the Ottoman government. In part because the it remained outside the western European capital markets network, interest rates in the Ottoman Empire remained significantly higher than those prevailing in western Europe during the seventeenth and eighteenth centuries. Since the Ottoman government used the tax collection process for most of its borrowing as discussed above, it is not easy to identify the rate of interest paid by the state. Nonetheless, one may calculate the implicit rate of interest on the basis of some of the esham auctions in the second half of the eighteenth century. These calculations suggest that, until the middle of the nineteenth century, interest rates at which the state could borrow remained in the 12 to 15 percent range and rose to the 15 to 20 percent range and even higher during periods of distress such as wars or monetary instability.[24] It appears that the Ottoman government's inability or unwillingness to commit credibly to repayment put limits to the amounts they could borrow in the domestic markets. While the successful European pattern of public borrowing during wartime was followed by budget surpluses and paying back in peacetime, the Ottomans resorted to debasements whenever borrowing could not meet the state's financial needs.

Sarrafs: The Bridge between Private and Public Finance

[23] S. R. Epstein, Freedom and Growth, The rise of states and markets in Europe, 1300-1750, Routledge, London and New York, 2000, 16-29.

[24] My calculations as presented in Pamuk, A Monetary History of the Ottoman Empire, Cambridge University Press, 2000, pp. 191-2.

The private financiers (sarrafs) of Istanbul were quite active in the finance of trade and the guilds during the seventeenth century. In general, they were free to lend with interest. In the closing years of the century, they organized around a guild and began to move their businesses to Galata, a suburb of Istanbul outside the old city walls and across the Golden Horn.[25] While the Jews were not as prominent in moneylending and trade as they had been in the sixteenth century, Greeks and especially the Armenians, often in partnerships of two, emerged as the leading sarrafs of the capital city. The Greek financiers often took advantage of the prominence of Greek merchants in maritime trade in the Black Sea and the Balkans to specialize in the finance of international trade.[26] Similarly, the links of the Armenian sarrafs to the European commercial and financial networks through the Armenian communities there played an important role in their rise. They also remained well connected to the Ottoman bureaucracy. After Greek independence, the Armenians began to assume even more prominent positions. The leading Armenian sarrafs also assumed leading positions within the Armenian community (millet) in the Ottoman Empire, often mediating between the community and the Ottoman officialdom.[27] In addition, many financiers operated in the provinces financing trade and the tax collection process just like their counterparts in the capital city.[28]

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[25] The guild of sarrafs had a membership of 72 around 1750 and 89 in 1835; A. Şahiner, 'The sarrafs of Istanbul: financiers of the empire', M.A. dissertation, Boğaziçi University, Department of History (1995), pp. 78 and 83.

[26] T. Stoianovich, 'The conquering Balkan Orthodox merchant', The Journal of Economic History 20 (1960), pp. 234–313.

[27] Şahiner, 'The sarrafs of Istanbul', pp. 87–99.

[28] Genç, 'Osmanlı maliyesinde malikane sistemi'; and Çizakça, A Comparative Evolution, pp. 169–78.

The rise of the sarrafs to prominence during the eighteenth century and their transformation into large financiers called the Galata bankers during the first half of the nineteenth century was closely related to the financial difficulties of the state and its needs for short and long term finance. The state had relied on the financiers in the capital for short term loans and the financing of the tax collection process eversince the sixteenth century. After the shift from short-term tax-farming to the long term malikane system, the financing of the large advance payments had assumed even greater importance.

On the face of it, the malikanes remained almost exclusively in the hands of the Ottoman askeri or state class, including palace women. Other social groups were usually not allowed to participate in the auctions. In many instances, however, those who won the auctions were not involved in the day to day operations of the malikane after the initial auction. Behind them were often the financiers loaned them the money for the advance payment, arranged the sub-contracting of the tax-farm and paid the annual payments (mal) to the treasury. The net proceeds were then divided between the state, the winner of the auction, the sub-contractors and the sarraf. The original purchasers of the malikanes thus turned into absentee owners of the tax-farms. Murat Çizakça estimates that the central government received only about one third of the net or about one fourth of the gross tax receipts under this system.[29]

During the course of the eighteenth century, these absentee purchasers of the malikanes began to develop portfolios of malikane shares rather than investing their capital in a single tax-farm. Investors maintaining shares in as many as 20 to 30 tax-farms were frequently observed although each of them possessed sufficient capital to buy one or more tax- farm in

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[29] Çizakça, A Comparative Evolution of Business Partnerships; also Salzmann, 'An ancien regime revisited'.

their entirety. The motive for this behavior was risk minimization through portfolio diversification.[30]

The state needed and encouraged the activities of the sarrafs. The growing fiscal difficulties after the 1760s raised their importance as direct lenders. In addition, their connections with the European financial groups enabled them to begin organizing in Europe short term loans to the Ottoman state. Many sarrafs also acted as personal financiers to the sultans and many of the leading Ottoman bureaucrats. In the aftermath of the French Revolution, these financiers were also able to replace the European merchants in Istanbul and assume control of important parts of the trade in bills of exchange.[31] From traditional money lenders and brokers, the sarrafs of Istanbul thus developed into large-scale financiers with well established international connections, forming the embryo of a financial bourgoeisie in Istanbul. In the process they began to be referred to as the Galata bankers although they did not establish banks until the 1840s.[32]

By the 1840s the ranks of the Galata bankers had expanded considerably to include more Jews and Levantines, Europeans who had settled in the eastern Mediterranean, as well as Greeks and Armenians. The abilities and connections of the Baltazzi, Camondo, Coronio, Eugenides, Mavrocordato, Mısırlıoğlu, Ralli, Zarifi and many other families to organize in Europe short term

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[30] Çizakça, A Comparative Evolution, pp. 172-76

[31] E. Eldem, 'La Circulation de la Lettre de Change entre la France et Constantinople au XVIIIe Siecle', in H. Batu and J. L. Bacque-Gremmont (eds.), L'Empire Ottoman, la Republique de Turquie et la France, (Istanbul: ISIS Press, 1986), pp. 87-97.

[32] A. Udovitch has referred to the financiers in the medieval Islamic world as "bankers without banks". This apt term also characterizes the position of the Galata bankers before the 1840s. A. Udovitch, 'Bankers without banks: commerce, banking and society in the Islamic world of the Middle Ages', Princeton Near East Papers, No. 30, 1981, Princeton University.

loans for the Ottoman state had also grown substantially. In 1847, with the financial support of the government, Th. Baltazzi, from a prominent family of financiers and J. Alleon, a member of a French banking family that had settled in Turkey during the French Revolution, finally founded Banque de Constantinople, the first bank of the Galata bankers.[33]

The financial power of the Galata bankers reached its peak around mid-century. In the meantime, however, the borrowing needs of the Ottoman state had expanded even faster. As a result, when Ottoman government decided to turn directly to the European financial markets for its long term borrowing needs, the Galata bankers began to feel the pressure of the more powerful European banks and bankers who began to open branches or establish banks of their own in the capital city as well as the provinces. The establishment, in 1863, by British and French capital of the Imperial Ottoman Bank, which would act a quasi-central bank for the empire in addition to its commercial operations, further consolidated the position of European capital in the Ottoman financial markets.

Even though they lost their unrivalled position, the Galata bankers were not easily pushed out of state lending or private finance. They entered alliances with European financial groups and opened new banks for lending to the Ottoman government which continued to rely on them for short term borrowing in between major bond issues in the European financial markets. During the crisis of 1875-1881, when the Ottoman government declared a moratorum on debt payments and faced a costly war against Russia in both the Balkans and eastern Anatolia, the

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[33] Hasan Ferid, Nakid ve İtibar-i Mali, 3. Kitab: Bankacılık, (Istanbul: Matbaa-i Amire, H.1334/1918), pp. 26-66; Kazgan, Osmanlıda Avrupa Finans Kapitali, p. 20; H. Kazgan, Osmanlidan Cumhuriyete Türk Bankacılık Tarihi, (Istanbul: Türkiye Bankalar Birliği, 1997), pp. 25-32; and I. Tekeli and S. Ilkin, Türkiye Cumhuriyeti Merkez Bankası, (Ankara: Türkiye Cumhuriyeti Merkez Bankası, 1997), pp. 53-54.

Ottoman Bank and the European financial markets refused to make new loans. The government then turned to the Galata bankers for the duration of the crisis. It is interesting that the Galata bankers, all of them Ottoman citizens, adopted a variety of patriotic Ottomanist themes to mobilize support for their centuries-old customer during this difficult period.[34]

Nineteenth Century

I now turn to the great commercial, economic and institutional changes of the nineteenth century. From the perspective of Ottoman economic and monetary history, the nineteenth century was a period quite different from the earlier era. On the one hand, it was characterized by major efforts at Western style reform aimed at the centralization of the empire, in administration, education, law and justice as well as economic, fiscal and monetary affairs. On the other hand, it was a period of integration into the world markets and rapid expansion in foreign trade, particularly with Europe.

The new technologies of the nineteenth century provided the Ottoman government with a major opportunity to change the center-periphery balances one more time. In the early part of the nineteenth century, the center, was able to re-organize its army and administration and then re-assert its power over the provinces. After the central government began to undermine the power of the provincial notables, many of the life-time tax farming contracts were pulled back to the center and their revenues began to be collected once again by tax-farmers. The results were dramatic. The political and administrative centralization of the nineteenth century helped raise the central governments' share of the tax revenues from about 2 to 3 percent of the underlying economy (GDP) in the late eighteenth century to 5 to 6 percent by the middle of

[34] Kazgan, Osmanlida Avrupa Finans Kapitali, pp. 120-22; Tekeli and Ilkin, Merkez Bankası, pp. 62-69.

the nineteenth century and to 10 to 12 percent on the eve of World War I.

With greater economic and financial integration to Europe, banks and other modern institutions of private finance began to be established in the Ottoman Empire in the 1840s. Part of the demand for them came from the growth of trade with Europe and the financial needs of the merchants. In fact, the first bank to begin operations in the Ottoman Empire was the Commercial Bank of Smyrna which was founded in London in 1844 by a group of English merchants to meet the growing needs of the European and other merchants in western Anatolia. For most of the banks established during the mid-century, however, lending to the state remained the more important part of their operations. Commercial banks, European owned and to a lesser local and their branch networks began develop in the 1880s.

The Ottoman economy was being rapidly transformed into a producer of raw materials for export during the nineteenth century along with all the commercial and institutional changes it entailed. It was not easy to keep this large empire together, however. Rising military expenditures and the mounting costs of centralizing reform both of which can be viewed as the rising costs associated with keeping the disintegrating empire together generated significant fiscal pressures. Despite the significant increases in tax revenues, state finances ultimately proved to be the Achilles heel of the Ottomans. Large budget deficits arising from the frequent wars had been financed mostly with debasements until the 1840s. After the Ottomans decided to embrace bimetallism and stable coinage, only one alternative remained for the finance of budget deficits: external borrowing. Ottoman borrowing in the European financial markets after 1854 led to a default in the 1870s and partial control of state finances by European creditors. The inability to bring state finances under control during the nineteenth century thus proved to be the major if not fatal weakness of the Ottomans.

Conclusion

Until recently, Ottoman historiography had depicted an empire in decline after the sixteenth century. In contrast, I have argued that the Ottoman state and society were able to adapt to changing circumstances in the early modern era, well before the nineteenth century reforms known as Tanzimat or "re-ordering". Ottoman institutions of private and public finance retained their Islamic lineage and remained mostly uninfluenced by the developments in Europe until the end of the seventeenth century. The extent of the changes in the institutions of private and public differed considerably during the eighteenth century. While changes in the institutions of private finance remained limited, there were major changes in the institutions of public finance related above all to the financial difficulties of the state and its borrowing needs. These latter changes illustrate the ability and willingness of the state elites to reorganize as a way of adapting to changing circumstances, albeit slowly and often with considerable time lags. This pragmatism and flexibility also provides important clues for understanding the longevity of the empire.

One explanation for the limited nature of changes in institutions of private finance has been the continued dominance of small scale firms or the absence of demand. While there is some truth in this explanation, I have argued in favor of a political economy based explanation in this study. The private sector, the merchants and producers were never in a position to influence the Ottoman state elites and push for institutional changes that would favor the growth of the private sector during these centuries. In other words, because the central bureaucracy was able to retain its leading position in Ottoman society and politics, the influence of various social groups, of merchants, manufacturers and financiers, over financial and economic matters, and more generally over the policies of the central government remained

limited until the end of the empire. This difference in political power and capacity to influence economic institutions explain better than geography or resource endowments, Islam or culture this striking divergence in the trajectory of the institutions of private and public finance during the early modern centuries.