

CHAPTER 1

INTRODUCTION

1.1 Introduction

This chapter consists a brief introduction on Ottoman Empire (OE) economy and the role of Foreign Direct Investment (FDI), External Debts (ED), and Trade Openness (TO) as key drivers towards economic growth. This chapter further provides discussions on the following aspects: problem statement, research questions, research objectives, the significance of the study and the scope of the study. The chapter finally concludes with an explanation of the study organization.

1.1.1 Overview on OE Economy Late 19th Century

The late eighteenth, and nineteenth centuries witnessed a significant changes in the structure of the social and economic environment not only in Europe the eastern societies. The emergence of modernization and the birth of the industrial revolution marked an essential switch in the economic mechanisms. Within the European continent, the new ideology “capitalism” came to the existence as an outcome of the French revolution which promoted the separation between religion and public affairs, allowing the expansion of this concept to occur rapidly (Blyth, 2016; An-Nabahani, 2001). Parallel to this, the concept of economic growth attracted the attention of the elites as well as the policy makers, attempting to figure out the secret receipt of an economic success (Bolt et al., 2014).

Following the European model of reformation, the Ottoman Empire engaged in a thorough changes that designed to align the state and its institutions with the ongoing

modernization in the west (Şentürk & Nizamuddin, 2008). Precisely, the intention to strengthen was not new, rather it was a part of the Ottoman political and social agenda since the seventeenth century. This was a response to the inflationary economy and military backwardness vis-à-vis the major European powers. From the mid of the nineteenth century until 1914, the Ottoman economy was in comparably dire financial shape and heading towards a limited increase in average income (Clay, 1989).

Despite a considerable economic transformation of the neighbouring countries in Europe as a result of the industrial revolution, the Ottoman economy was far behind, and it was mostly driven by agricultural activities. For instance and in terms of the real gross domestic product (GDP), the OE was significantly below the average of central Europe. In addition, historical examples include economic explanations depict a major efforts were made either by the OE to introduce reforms in the fiscal, monetary affairs and financial institution (Kale, 2014). This is to ensure a smooth integration into the global economy (Tuncer, 2009). With the introduction of paper money in 1839, the adoption of a bi-metallic decimal standard in 1844 and the formation of a foreign currency-regulating agency in 1845, the performance of the economy was under threat due to several reasons. A closer look at the macroeconomic policies of OE shows a constant inflated currency, a budget deficit, poor fiscal mechanisms, external debts, and a very unfavourable balance of trade with the West and many other issues.

Prior literatures suggest that the political instability and the economic uncertainty were the main driving factors behind the frequent occurrence of budget deficits which were often supported directly out of the state treasure (Pamuk, 2014). In this period, various military intervention took place during the reign of Sultan Mahmud II (1808 – 1839) where the central government had to deal with a series of wars abroad against Russia (1806 –1812 and 1828 –29), Iran (1820 –28) and Egypt (1831–33 and 1838 –

39). These wars contributed to the financial difficulties of the state. The chronic budget deficits was a constant economic problem throughout the 19th century and to deal with this matter, the government decided to borrow liberally from wealthy European countries (Akarli, 1992). The below statistic presents the trends of the Ottoman budget deficits between 1872 and 1895. Obviously, the year's 1879 - 1880 recorded the highest level of budget deficit and this was attributable to the repayment of external debts and its interest. The existing literature (Pamuk, 1988 , Eldem, 2005 , Tuncer, 2009) suggest that the shift of the OE to finance these deficits over the external borrowing without undertaking a solid fiscal discipline contributed to the chronic malaise of the Ottoman economy.

Table 1.1: Ottoman Budget Deficit, 1872 – 1895 (In 1,000 Ottoman Lira)

Account	1872-73	1874-75	1875-76	1879-80	1880-81	1891-92	1893-94	1892-95 Average
Expenditures	21,405	25,134	28,929	15,814	16,716	18,954	18,886	19,796
Revenues	21,435	24,807	23,883	14,286	16,156	17,817	18,300	18,928
Deficit	(30)	327	5,046	1,528	560	1,137	586	868
Extraordinary Deficit				7,648	2,110	955	645	1,500
Total Deficit				9,176	2,670	2,092	1,231	2,368.

Source: Akarli (1992)

As a matter of fact, tremendous levels of capital transfer took place from Europe to the rest of the world in the 19th century and substantial amounts of funds were given in a form of external debts (Tuncer, 2009). Indeed, the OE experienced a sharp increase in the external debts with unfavourable terms shows that there were no realistic prospects that the Ottoman state can fulfil its external obligation. Referring to the above table 1.1, it is obvious that there was an increase in the tax revenue during the period 1840-1880, yet it remained insufficient to meet the many demands made to the treasury by the various moves towards modernization.

Given the fact that, the government had little knowledge on the annual tax revenues which added an extra layer of complexity to the drastic economic position of the state (Kale, 2014). Hence, OE started looking elsewhere than taxes to lay its hands on additional financial resources to the extent where the external borrowing became one of the main tools for the state to meet increasing expenditures and the repayment of prior debts.

Under this circumstance and with the military defeat, the OE declared its bankruptcy in 1875, which in fact led to tighten the conditions by the European powers to obtain foreign capital (Morawitz, 1902). This comes along with the creation of the Ottoman Public Debt Administration (OPDA) in 1881 as constituted by the decree of Muharrem as a way for the creditors to get back their money from the Ottomans (Ahmed, 2000). In doing so, the main task of OPDA was to collect tax revenues from the taxpayers using unprecedented forms of intervention.

Several fiscal reforms were introduced by OPDA such as the dismantled the traditional *timar* system and replaced by an adopted scheme that designed to expand the revenue base and help to regain the international confidence in the Ottoman economy. The fiscal apparatus under the OPDA has devoted 35% of the revenue to pay the public debts, which called in the Ottoman official documentations as regular debts (*duyun-i muntazama*) (Akarli, 1992). Murat (2010) argues that the OPDA supports the colonization through facilitating external lending and securing the payment of these debts with its high interest rate. From this aspect, the OPDA was seen as an outpost of European domination. According to Blaisdell (1929) this institution was a front line tool of foreign financial control in its least distasteful form.

Another characteristic that distinguishes this particular period was the political unrests in the country resulted in the creation of influential political elites that believed

in the domination of western civilisations. They thought that the situation could only be rectified by adopting the notions of individualism, liberalism, and private enterprise as the correct path to achieve economic growth (Mather, 2014).

From the standpoint of an observer of the Ottoman economy during the last quarter of the 19th century, the outlook appears to be blur and the state was in comparably dire financial shape. Along with continues internal as well as external unfavourable conditions, it is therefore obvious that the uncountable financial issues were making the economic growth unachievable compared with the other peripheries.

Much attention and analytical efforts have been devoted in recent decades to discuss the Ottoman economic failure by focusing on the post-1870 period since it was the period where the major structural changes occurred. However, careful analysis of the Ottoman economy during the 19th century would reveal considerable diversities and complexities that contributed to the dramatic economic collapse of the OE. With that in mind, the following passages intend to highlight the particularity of OE economy by making more emphasis on the three main factors.

1.1.2 The Trend of Foreign Direct Investment (FDI), External Debts (ED) and Trade Openness (TO), During the 19th Century

The 19th century was a remarkably turning point for many respects in the Ottoman state, specifically the economic aspects that influenced by the ambitious projects of European powers in marketing modernization paradigm as a new way of life. The prior literatures on the Ottoman economy put more emphasis on a number of factors such as Foreign Direct Investment (FDI), External Debts (ED) and Trade Openness (TO). These particular economic sectors played a significant role in restructuring of the Ottoman economy along with other socio-political structures. However, for the purpose of this

thesis and to be more precise it is vitally important to shed lights on those three factors to properly explore the Ottoman economy during the last quarter of the 19th century.

1.1.2.1 Foreign Direct Investment (FDI)

The integration into the world economy and transforming the Ottoman economy was a long term project for the Ottoman state. The short cut to achieve this objective was to encourage the flow of FDI into the Ottoman territory allowing the foreign investors in general and European in particular to enjoy a number of privileges. It is estimated that the total FDI inflow in the Ottoman economy on the eve of World War 1 had reached £75 million (Pamuk, 2005). The first wave of FDI inflows started with establishment of maritime transportation firms but due to the incurred expenses and the difficulty of land transportation impeded the progress of these firms.

From legal perspective, the Anglo-Ottoman trade treaty 1838 was the main apparatus that accelerated the FDI inflows. Precisely on 16 August 1838, the agreement was signed at Balta Limanı between both foreign ministers of OE and England, and comprised two parts (Burton, 2000). While the first part was dealing with the domestic trade, the second and important part covered the exchange and the regulations of the transit trade. It forced the state to abolish the protective tariffs and state monopolies so the cheap manufactured goods of the advanced capitalist states were accessible in the OE markets (Ergil & Rhodes, 1975). British manufacturers had the biggest portion of FDI inflows and this treaty provided the legal presence of the British investors who did establish the first foreign bank (Geyikdagi & Geyikdagi, 2011). Precisely, the Ottoman economy was considerably attractive to the European countries who had a political superiority. This enabled them to obtain concessions and made profitable investments

(Pamuk et al., 1996). The below table 1.2 shows the FDI segregation according to home countries using a benchmark years 1888 and 1914.

Table 1.2: Foreign Direct Investment by Home Countries

	1888		1914	
	('000 £)	%	('000 £)	%
French	5,020	31.7	37,383	45.3
British	8,895	56.2	11,516	14.0
German	166	1.1	28,007	34.0
Others	1,744	11.1	5,500	6.7
Total	15,825	100.0	82,406	100.0

Sources: Geyikdagi (2011)

It also shows that between 1888 and 1914, the rate of growth of FDI was relatively higher than the growth rate of foreign loans. This was mainly due to the large wave of FDI during the period 1888 and 1896 where £30 million was recorded. The three countries namely France, Britain and Germany were the dominant investors and despite the economic motivation, there was a political aim as well. Further, the OE allowed the European investors to use government property and buildings for free. This privilege was accompanied by the tax exemptions offered to foreign investors (Geyikdagi & Geyikdagi, 2011).

The main economic sector that received a large portion of FDI was the railways, especially in Anatolia and Syria. With the aim of exporting goods and services, the European countries paid more attention to infrastructure such as ports, utility companies, insurance, and shipping. In contrast, the FDI in the industrial sector such as mining and manufacturing remained significantly low and less attractive. However, the lack of a proper infrastructure within the Ottoman territory created numerous difficulties to foreign merchants in expanding their trade volume (Kula, 1997). For this reason, it was necessary for European investors to direct their capital towards building new

railroads and enhancing port capabilities (Kalemli & Nikolsko, 2010). With close to two-thirds of the total FDI, the railroads was the most important area for the foreign investors (Pamuk, 1987). As shown in the below table 1.3, the banking and commerce were also receiving tremendous amounts of FDI as part of diversifying the shares of investments with a 40% out of the total FDI. It was apparent that the existence of OPDA helped the emergence of banking and insurance companies in the Ottoman financial sector. This mainly pertained to the fact that an increased number of foreign investors created a need to launch number of banks and insurance companies that served them. Between 1861 and 1876 there were seven foreign banks and the most important bank was the Ottoman Bank. More details on the banking sector is found in chapter two. The shares of the commercial FDI out of total investment was 78.7%. The below table shows the distribution by sector of FDI in 1888 and 1914.

Table 1.3: The Distribution By Sector of FDI in Ottoman Empire 1888 and 1914

	1888		1914	
	(‘000 £)	%	(‘000 £)	%
Railways	5,283	33.4	48,373	58.7
Banking	5,000	31.6	14,788	17.9
Insurance	-	-	460	0.6
Ports	-	-	4,025	4.9
Utilities & urban transport	1,472	9.3	4,150	5.0
Commerce	1,280	8.1	5,000	6.1
Mining	895	5.6	2,700	3.3
Industry	1,895	12.0	2,910	3.5
TOTAL	15,825	100	82,406	100

Source: Geyikdagi (2011)

Geyikdagi (2011) argues that the FDI was negatively affecting the Ottoman economy and the industrialization process. She added the primary motivation behind these FDI inflows was not purely economic and instead the political intention was

present as well in the decision to engage in FDI. According to McLean (1976), Ottoman economy had long been a central feature of British foreign policy to defend its trading interests. Another motivation was to facilitate the acquisition of raw materials needed by the manufactories in Europe. The total FDI increased from 15 million pound in 1888 to 82 Million Pound in 1914 with a growth rate of 80% and the share of British invertors was 56% in 1888. With such deterioration, backwardness and the domination of industrialized countries over the Ottoman economy, the Ottoman economy was facing numerous challenges that impeded the state to move forward with the projection of modernization.

It is important to mention here that European economists paid more attention in documenting the flow of FDI into OE and this could be pertained to their desire to have a database that might help them to direct their investments. In this regards, perhaps the most common source is the statistics provided by Pech in his book "*Manuel des Sociétés Anonymes Fonctionnant en Turquie*". Pech worked as head of the Statistical Office at the Ottoman Bank and this role allowed him to be relatively closer to the source of data. Additionally, the Near East Journal published a detailed list containing amounts of capital, investments and companies classified by sectors in OE between 1888 and 1914. Recently, the Turkish statistical centre in partnership with economic historian initiated an interesting plan to disclose and publish the Ottoman economic data. Interestingly, the centre has published a booklet of Ottoman financial statistics covering a 77 years from 1841 to 1918. This provides a data on all the economic sectors including FDI inflow and such piece of information will certainly motivate the researchers to conduct comprehensive empirical studies. Having said, this study intends to bring into attention the historical aspect of FDI inflow determinants during a critical period.

1.1.2.2 External Debts (ED)

External borrowing is not a new phenomenon and it is known as a situation where a state attempt to finance the gap between its national savings and required domestic investment (Oke & Sulaiman, 2012). In other words, it is the outstanding amount of loans that a certain government owes to financial institutions within and across its border. In general, external debt can be linked to one or more of the three types of creditors; 1) Multilateral creditors which are international financial situation. 2) Official bilateral creditors where the government agencies such as the Paris Club and 3) Private creditors such as, commercial banks and other bondholders.

The period between 1870 and 1914, the international market observed a tremendous level of capital transfer from Europe to the rest of the world. Interestingly, some commentators named Europe as the world's bank as a result of such a noticeable movement of money (Tuncer, 2009). Substantial amounts of funds were given in a form of external debts to the governments in America, Africa, and Asia to finance their budget deficit or any other expenditure (Pamuk, 2004). More importantly, great amounts were also attributed to the infrastructure in these countries such as railroads, aimed at expanding trade (Pamuk, 1988). The decisions to modernize the state started during the era of Sultan Selim III had forced the state to fall under foreign domination and to lose its political and economic independence. With the passage of time, the OE faced a continuous demand for fund in order to finance the military needs and to confront the political and military movements that destabilized the state (Pamuk, 2006).

To deal with such financial constraints, the decision to borrow from the international market was proposed by the grand Vesir Ressit Pasha in 1850 but the agreement was rejected by the Sultan "*Abdulmejid I*" due to his fear that foreign loan would accompanied by foreign interventions (Ferguson & Schularick, 2006).

Four years after and during the Crimean War 1854, the OE began to sell long-term bonds in the European financial markets to obtain the necessary fund to finance the war and its reparations (Pamuk, 2004). Private bankers, the so called Galata bankers with connections in Europe provided short terms loans to the state at high rates of interest. With unfavourable terms, in 1863 a total of six loans with a total a value of 39 million pounds sterling had contracted and secured by various direct and indirect tax revenues such as: custom duties and the Egyptian tribute. Interest rates cited in the contracts were always around 4 to 5% of the nominal values of the bond. The exposure to surrendering the sovereignty of the state was something unprecedented and unavoidable as a result of poor economic policy. The below table depicts the trend of external debts from 1854 –1888.

Table 1.4: The Trend Of External Debts In Ottoman Empire From 1854 –1898

State Debt (Million pounds)		
Years	Capital Inflows from New Borrowing	Total Debt Payments
1854–1875	4.7	3.1
1880–1898	0.9	2.8
1899–1913	2.7	4.6
1854–1864	2.0	0.8
1865–1875	7.3	5.4
1876–1879	0.7	0.6
1880–1887	0.8	2.1
1888–1898	0.9	3.4

Source: Pamuk (1984)

By 1914, the unpaid external debts had reached £140 million or close to 60% of the GDP of the state. Unlike the British investors who had 15% of the debts, both French and German invests held more that 70%. Arguably, the main drivers behind the accumulation of debts are war, banking crises, fiscal policies and external shocks (Pamuk, 2005). For OE, the debts were accumulated as a result of series of wars against

Russia, Iran and Egypt which created a major pressure on the state finances deficits and the performance of the economy (Pamuk, 2006). Undoubtedly, the reliance on the external borrowing exposed the state to the threat of losing its control over the economic policies and ultimately reducing the efficiency of the state in generating wealth. The below table shows the creditors to the OE between 1881 and 1913.

Table 1.5: Foreign Debt of the Ottoman Empire 1881-1913

	1881	1898	1913	1881	1898	1913
	(Million Ottoman Lira)			(Percentage %)		
France	36.72	35.00	65.00	40.0	44.9	49.5
Britain	26.62	8.50	9.00	29.0	10.9	6.9
Germany	4.32	9.50	26.30	4.7	12.2	20.1
Belgium	6.61	14.00	14.40	7.2	17.9	11.0
Holland	6.97	3.50	3.90	7.6	4.5	3.0
Italy	2.41	1.00	1.30	2.6	1.3	1.0
Austro-Hun Emp.	0.89	1.50	1.70	1.0	1.9	1.3
Local Investors	7.28	5.00	9.40	7.9	6.4	7.2
Total	91.82	78.00	131.00	100	100	100

Source: Eldem (1999)

To overcome the issue of indebtedness, the OE declared a moratorium on its outstanding debt with 200 million pounds sterling and a formal negotiation with the creditors happened on 1881 in Istanbul, which produced the decree of *Muharrem* in 20 December 1881. The representative of the European powers, British, French, Dutch, German, Italian and Austro-Hungarian bondholders agreed that the OE' debts reduced from about 191 million pounds to 96 million pound. Outstanding interest payments, which were around 62 million, were reduced to approximately 10 million. Finally, the interest service on the debt was also reduced from approximately 13.6 million to 2.7 million pounds sterling (Birdal, 2010). As mentioned above, the *Muharrem* decree also stated the establishment of Ottoman Public Debt Administration (OPDA). The OPDA

established during the reign of Sultan “*Abdul Hamid II*” the 34th sultan of the OE, who drafted a plan of general economic policy in 1879.

This plan intended to boost the revenue of the state through paying more attention to these economic sectors: commerce, agriculture and industry. However, due to the political unrest in the country and default in the public funds, an empty treasury, the 1875 insurrection in Bosnia and Herzegovina proved that the change to be nearly impossible (Birdal, 2010). In 1909, Abdul Hamid II was overthrown from the throne and his brother was proclaimed sultan as Mehmed V.

High levels of external borrowing have always addressed as a serious impediment towards economic growth and it is not a new phenomenon. The historical facts as well as recent economic crisis show that a feedback effect occurs between financial crises and the indebtedness of a country (Gokmenoglu & Rafik, 2018). Countries tend to finance the gap between its national savings and the required investment through the channel of external borrowings which hinders investment, leads to scarce capital stock, and creates a vicious cycle of poverty. This obviously creates undesirable outcomes of the economic growth and reduces the chances of the debtors to meet their debt – service obligations (Tiruneh, 2004) and thus making its economy vulnerable to financial crises (Gokmenoglu & Rafik, 2018). In this respect, this study provides a better understanding on how the external debt functioned during the 19th century using Ottoman paradigm as an example.

1.1.2.3 Trade Openness (TO)

Following the industrial revolution 1760 which began in Britain and spread all over the European continent and the United States, the manufacturing sector was able to produce goods and services in a large scale (Geyikdagi, 2011). For European

merchants the Ottoman market was comparatively attractive and this is because the OE stood at the crossroads of intercontinental trade, stretching from Balkans in Europe to Black Sea region and gulf in Asia and most of the North African coast countries exceeding a population of 30 million (Pamuk, 2004).

The 19th century was a remarkable century for OE in the sense of rapid integration into the world economy. The foreign trade expanded more than tenfold with 13% of the Ottoman products allocated for exportation. These commodities were mainly agricultural and raw materials such as, tobacco, cotton, barley, raisins, figs, raw silk, and raw wool. In the same time, the integration into the world economy opened the door for manufactured goods to be imported for example, cotton textiles, both cloth and yarn, and machinery. The trading partners were mainly the European powers namely, Germany, France, and Great Britain (Pamuk, 2005).

More unexpected perhaps was the fact that the rural handicraft products were destroyed as a result an influx of cheap manufactured goods from European powers. Ergil & Rhodes (1975) found that the weakness of OE's economy led to an acute increase in the rate of the foreign trades and prevented the birth of infant industries within the Ottoman territory.

Based on the Ottoman Industrial Census of 1913, about 600 manufacturing companies employed almost 35,000 workers or about 0.2 per cent of the population (Pamuk, 2005). This number shows that the state tended to import the majority of its manufactured goods. The economic policies were in a favour of encouraging the imported goods through implementation of 3% as an import tax whereas the exports were subject to 12%. Issawi (1995) interpreted these unprecedented trading measures as a particularity of the socio-political structure of Ottoman society.

The period between early 1840s and the mid-1870s witnessed a fivefold increase in the volume of exports while the imports rose by 4.6 times. Ottoman terms of trade (ToT) against the industrializing center countries appear to have improved until the mid of 1850s. Ottoman external trade exports plus imports also expanded rapidly during the years 1850 to 1870 averaging over 5% per annum in both constant and current price.

It should also be pointed out with respect to 1873 to 1896 in which the great depreciation took place in which the Ottoman center ToT declined with a decrease of 25%. This period was characterized by rapidly declining prices worldwide. For instance, the prices of manufactures imported by the OE declined by 35% between 1871 and 1896. The Ottoman exports witnessed a more rapid decline for the primary commodities with a rate of 48%. Tobacco provides the most interesting case among the Ottoman exports and it gained its importance after the creation of Tobacco Regie in 1884, which was founded with European capital.

This company was granted the monopoly of the administration, cultivation and exportation and in return Regie Company was required to pay annual fixed sum to OPDA. The below table presents the trade deficit 1830 to 1913.

Table 1.6: Foreign Trade of the Ottoman Empire 1830-1913 (Million British pounds)

Years	Imports	Export	Balance
1830 - 1839	5.1	4.2	-0.9
1840 - 1849	6.9	6	-0.9
1850 - 1859	12.3	9.8	-2.5
1860 - 1869	18.3	15.4	-2.9
1870 - 1879	20.8	18.6	-2.2
1880 - 1889	16	15.5	-0.5
1890 - 1899	18.6	17.7	-0.9
1900 - 1909	26	23	-3
1910	39.2	26	-13.2
1911	40.4	27.1	-13.3
1912	35.2	27.6	-7.6
1913	39.4	28.4	-11

Source: Pamuk (1988)

The inability of local industry and agriculture to significantly increase the revenue of the state created a serious need to evaluate the fiscal policies by enacting more productive regulations. Along with that and from a fiscal standing point, Pamuk (1988) discussed the frequently fiscal crises as one of the key player in generating revenues. He asserted that European powers were able to obtain numerous advantages over the local products via the fiscal reforms undertaken during the last quarter of the 19th century. He added that with such reform the penetration into the Ottoman economy was noticeable and undeniable. Issawi (1995) makes mention that the OE trade regime was relatively liberal compared to other economies. He added that the British controlled the Ottoman foreign trade starting from year of Anglo-Ottoman treaty 1838 to the 1860s.

The monopoly of Britain over the international trade was derived from two main goals. Firstly, finding new markets to the manufactured goods and secondly obtaining cheap raw materials (Geyikdagi, 2011). Here, the countries that had gone through industrial revolution implemented protectionism measure to protect the infant industries. In contrast and while protectionism regulations were gaining more

popularity in the West, the OE was being forced into a policy of total free trade (Geyikdagi, 2011). Bailey (1942) contends that with the absence of protective tariffs the OE lost the chance to move forward with the industrialisation program and rather it led to the country's industrial backwardness. Similarly, Blaisdell (1929) views the free trade agreement between the OE and Britain on 1838 as a key factor in weakening the economy through the creation of legal framework for the European entities to enjoy the tax heaven.

Pamuk (2004) examined the behaviour of prices inside OE and compared them with those in Western Europe during the period from 1469 – 1914. This study found that the integration was noticeably high during the first half of the 19th century. Focusing on the post-1870 period, Blattman et al., (2007) provide evidence that the ToT volatility had a big adverse impact on economic growth in the pre modern economies. Comparing the Ottoman experience with the rest of the poor nations, Pamuk & Williamson (2011) conclude that the OE, along with Egypt, had gone through one of the greatest upswing in ToT up to 1860s.

Although the existing literature consists valuable attempts to study TO using the Ottoman paradigm, there is however, a void in the literatures in terms of quantitative documentation of the period post 1881 and to fill this void, this study will be emphasizing on the likelihood of relationship between TO and economic growth of the OE.

1.2 Problem Statements

The revenues of the Ottoman central administration were unstable and lagged behind its rival's European neighbours during the 19th century. The cumulative effects of the budget deficits put a massive pressure on the state's finances and economy. FDI

inflow and foreign loans provided much needed resources to the Ottoman state in a form of capital, infrastructure, technology, brand and access to markets. Throughout this period, the expansion of FDI and foreign loans was also followed by the bankruptcies in many debtors' countries including Spain (1873), Egypt (1876), the Ottoman Empire (1876), Argentina (1890), and Portugal (1892).

On the other hand, a much more striking picture emerges causing an ongoing discussion of the historical dimension of Ottoman economy in the nineteenth century and its aftermath is crucial for variety of respects. On this basis, as compared to foreign loans, the FDI inflows was more unstable and volatile especially during the last quarter of the 19th century where the Ottoman state was facing unprecedented decline of its GDP which was significantly below the average of the countries of western and central Europe. The series of changing in the FDI inflows created a weak and dependent economic environment. There is a widespread consensus among economist that FDI plays an enormous role in boosting the economic growth. Such perception is relatively unverified in the senses of Ottoman case. Previous studies on FDI centred on either sectoral division or the country origins without considering the implication on the economic growth. Despite of many attempts devoted to understand this matter, there is a lack of studies that examine the determinants of FDI which seems to be considerably unexplainable. Besides that, the historical aspect of FDI inflow during the 19th century and its related discourse might demonstrate the theoretical possibility of the favourable manipulation of FDI inflow by the European powers and its role in the process of capital accumulation.

External borrowing channels capital resources from resource-abundant countries to resource scarce poor countries. More studies exhibit evidences that external borrowings contribute to the economic growth by providing extra financial resources.

However, there are also concerns linked with move towards foreign loans. A high level of debt to GDP makes a country prone to witnessing a serious economic meltdown. Fundamentally, the issue of borrowing has attracted more attentions of academicians, economists and certainly politicians due to its economic, political and even managerial dimensions is of high significance. Recently, the notion of debt trap is becoming prevalent in the economic literature and media. It is defined as a situation where the borrower ended up with a default of repaying the loan and requesting the scheduled payments on the principal of a loan. This particular scenario is not something new and it was the case for the Ottoman economy which suffered from the grip of external loans causing a devastating result.

Fundamentally, the development of European financial control over the Ottoman Empire using the external borrowing as one of the most striking forms of historical capitalist penetration. Looking at the Ottoman economy, foreign loans were a vital source of capital and a large number of literatures have highlighted this matter. Yet, the issue of borrowing abroad remains an unresolved issue in the sense of whether external debt was damaging the Ottoman economy or it is just a hypothetical assumption. Given this fact, the prior literatures on external debt provide insights on the interrelated factors as contributors of debt accumulation. However, it seems plausible to argue that these studies might not be comprehensive enough in providing empirical evidences on the determinants of external debt during a critical period where rescheduling of debt had not solved the problem rather it postponed the doomsday. Hence, to further investigate on this matter and to enrich the literature on Ottoman economy, this study aims to scrutinize the determinants of external debt in the last quarter of the 19th centuries using the economic data 1881 to 1913.

In fact, the inherited backwardness gave rise to the domination of the industrialized countries such as England and France over the unproductive Ottoman economy. With that, the incorporation of the Ottoman economy into European financial system helped to expand the manufactured goods towards the Ottoman market and destabilised the industrial sector. This severe situation was discussed in several studies that attempted to provide rational explanation to the decline of Ottoman economy. To further analyse the interaction of these three factors namely: FDI inflows, external debts and trade openness with economic growth, a quantitative research is needed. Indeed, a great focus was given to the OE history but very little attention was directed to the financial performance of the Ottoman economy during the last quarter of the 19th century. Thus, the tales behind the scene is still blurring and the most plausible explanation lies in the book of history, and leaves a vacuum in term of econometric analysis. This thesis is primarily aiming to address these questions within the context of Ottoman economy.

1.3 Research Questions

As per the discussion on the issues mentioned in the preceding sections, the following research questions are raised:

1. What are the macroeconomic determinants that influence foreign direct investment inflows in Ottoman Empire?
2. What are the macroeconomic determinants that influence the trends towards external debts in Ottoman Empire?
3. To what extent do the FDI inflows, external debts and trade openness influence the economic growth in OE?

1.4 Research Objectives

1. To investigate the macroeconomic determinants that influence foreign direct investment inflows in Ottoman Empire.
2. To examine the macroeconomic determinants that impact the external debt in Ottoman Empire.
3. To analyse the relationship between Ottoman Empire's economic growth and foreign direct investment, external debts and trade openness.

1.5 Significance of the Study

The importance of this study can be manifested in a different ways and one of them, is the significance of history in our life. The proverb “*Those who don't know history are destined to repeat it*” presents a powerful justification for us to look back to the history a powerful tool to understand the present using the past facts. Ottoman Empire was one of the greatest empires in the civilization. Ottomans built one of the greatest, longest-lived, and most splendid multi-ethnic and multi-religious state and it existed in in three continents: Africa, Asia, and Europe for more than 600 years. Unfortunately, the Ottoman history experiences a continuous misjudgements by various individuals and institutions specifically in the West, attempting to undermine the glory of this state in the mind-set of people. Their approach is mainly focusing on the political and religious aspects and this can be traced back by looking to the vast number of published studies that pinpointing the Ottoman rulers notably during the 19th century.

For instance, Sultan Abdul Hamid II was nicknamed the Red Sultan or Abdul the Damned. Recently and due to the ongoing political conflicts in the Arabic peninsular and the role of the Turkish government, the attack continues to spillover among some intellectuals who see Ottomans as invaders and political Islam as a threat to the region.

They are not welcoming the Turkish intervention since it represents the comeback of Ottoman Khilafah. Though, this notion is relatively not accurate and it can be defeated easily by referring to the tremendous numbers of declarations that appreciate Mustafa Kemal Atatürk who destroyed the Ottoman Khilafah. Another aspects that needs to be considered is the fear from the political Islam and Islamophobia which indeed creates such widespread misjudgement on Islam and Ottomans. With that in mind, this study aims to shed some lights on Ottoman Khilafah by highlighting the economic dimension. It is an important step to defend the history of Ottomans who carried the Islamic civilisation for several centuries.

Though the Ottoman history literature is rich in the sense of number of studies yet, there is a need to further investigate and enrich the economic aspects to bridge the existing gap in the literatures. Using a scientific approach, this study intends to establish vigorous arguments that accurately describe the economic situation during the 19th century.

Further, the Ottoman economy was derived from the Islamic thoughts and hence by studying this historical pattern we might come up with a practical guideline that functions as roadmap for Islamic economic studies. Generally speaking, it is believed that the Ottomans used to implement Islamic rules and regulations to govern people. Hence, the examination of economic policies that took place might reveal certain thoughts and understating on the nature of those polices and whether they were purely Islamic or just pragmatic decisions which built upon the concept of generating wealth. More importantly, this study goes hand in hand with the recent movement from the Turkish Statistical Institute (TURKSTAT) who disclosed the economic statistics of Ottoman Empire covering the 19th century. Using this data is significantly vital to

unleash economic causes behind the domination of western countries over the Ottoman economy and to provide reliable explanation of the economic collapse.

More specifically, this study attempts to analyse the following macroeconomic variables namely: foreign direct investment, external debts and trade openness and its association with the economic growth. The inclusion of these factors is more likely to provide the reader with a comprehensive understanding on the economic position of Ottoman economy during a period of political turmoil. Taking the example of FDI, despite many vicissitudes, such as wars and rebellions, the investment climate was welcoming foreign investors and the state was relatively supportive. This goes hand in hand with a corrupt bureaucracy and the internal objection from the Ottoman intellectuals. This sort of contradictory economic environment provides an interesting case to be examined and learn from it.

Another point to be added here, the ED increased tremulously during the last quarter of 19th century. In fact, the external borrowing remains a persistent problem that might not be a treatable for the foreseeable future and the European sovereign debt and banking crises that started in 2010 is a clear evidence on the continues recurring of this issue. More recently, several countries such as Egypt, Tunisia, and Turkey which were under the control of the Ottoman Empire are still struggling with the issue of external debts. Taking the example of Turkey's external debt which reached USD 431 bn in Mar 2020, Egypt USD 112 bn and Tunisia, USD 38 bn. These facts create a serious need to look for the reasons behind the insolvency issues in the history in general and within the OE in particular. Therefore, the outcomes from the findings deliver a historical alert to current policy makers to undertake protective policies and to learn from past episodes of debt crises. This is because the more we comprehend volatility of debts in affecting economic growth, the better our chances are in setting effective strategies to control it.

Second, this study is of great significance as it intends to deviate from the previous studies by using a different scientific approach “quantitative method”. Despite the fact that the prior studies tried to examine certain factor individually within the OE context, these studies have paid less attention in using quantitative approach, which created a serious need to fill this research gap. Thus, this study is a response to such shortage in this field and it is an attempt to establish a platform for the future studies. Moreover, this research offers a quantitative analysis of the financial policies in OE during a very critical period where a transformation economies and politics took place. Such quantitative approach will enable us to provide a more complete assessment of the role of foreign capital in the OE. By providing empirical evidences on what has been largely discussed in a qualitative analysis, this research shall provide a distinct contribution the economic literatures. This is an important contribution, as it would provide a critical analysis on the existing average of gaps in non-western societies that used to be governed by different norms, laws and cultures. Indeed, this study will intend to provide a platform to create a comparable research for non-industrialized economies, which has been slow to develop.

Next, the findings from the three proposed econometric models that depicts the interrelationship between FDI, ED and TO and the economic growth are the main highlights of this thesis. To the author knowledge, there are some vacuum and big gaps in dealing with the mentioned three factors. Hence, the findings of this study will ultimately help formulate a certain understanding among academicians and economists on the played roles of these factors in driving the OE to a disastrous stage.

1.6 Scope of the Study

The study covers the period 1881 to 1913 and a number of reasons have led to choose this particular period. First, the availability of data was the main driving factor to select this timeframe. Indeed, the initiative of Ottoman ministry of finance to release financial data was seen as a step to further modernize the economy and make it more competitive. Second, the political stability of this period as it mainly covers the reign of Abdul Hamid II. Finally, this period witnessed new reforms set by OPDA which was seen a major player in the last quarter of 19th century. With these reasons in mind, the future research might extend the scope of research by including more economic and accounting figures obtained from reliable sources. Also, the inclusion of other explanatory variables such as the monetary policies and taxation would help to enlighten the economic history of OE.

1.7 Organization of the Study

This study contains six chapters. Chapter one, which is the introductory chapter, comprises background to the study, statement of the research problem, objectives of the study, research questions and scope as well as organization of the chapters. Chapter two contains a background of OE economy and its institutions. Chapter three contains the review of literature. The various sections are the conceptual literature review, theoretical literature review, empirical literature review and gap to fill. The methodology for the study is presented in chapter four. Theoretical framework, model specification, data sources and variable description, appropriate expectations and method of data analysis are in this chapter. Chapter five focuses on presentation and analysis of data. Chapter six contains the summary, conclusion and recommendations.