Monetary Sovereignty under the Gold Standard – The Case of the Ottoman Empire

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This research paper aims to contribute to an existing, yet small set of literature on the Ottoman Empire under the gold standard. This helps revise our understanding of how core countries benefited from the gold standard and how monetary arrangements can be used to challenge an entity's sovereignty, not only the monetary, but even more so the economic and political aspect. This paper will adopt a World System/Dependency approach, analysing the central workings of the gold standard, as well as the historical context, most notably European imperialism and the unique institutional arrangement of the Ottoman Empire. The Ottoman monetary history can only be understood in light of its changing relationship with Europe, entailing increasing European encroachment and control of the monetary sector.

This paper investigates how the Ottoman Empire increasingly lost monetary sovereignty with a rising level of debt, culminating with the establishment of the gold standard. It further aims to understand why the Ottoman Empire is considered an anomalous case and seems to be left out in literature about the gold standard. It will do so in two parts: The first part is concerned with theory and reviews literature on the gold standard as well as the institutional arrangements and theoretical framework of this paper. The second part is dedicated to the case study and analyses its economic and political relationships with Europe, the transformation of the monetary institutions and last, the effects on its monetary sovereignty under the gold standard. A brief comparison with the Russian Empire under the gold standard will help shed light on some common and different effects of the gold standard on monetary sovereignty in those two empires, whose position vis-à-vis Europe is rather peripheral. Hence, the adoption of the gold standard is seen as a logical consequence of the economic and monetary relations with Europe.

Part I: Literature Review and Theoretical Framework

This first theoretical part will draw on literature on the central institutional arrangements and theoretical frameworks used in this paper, namely the gold standard, monetary sovereignty and core-periphery relations. Taking into account the historical context will help understand the nature, development and subsequent demise of those institutions.

The Historical and Political Context of the Gold Standard

According to Eichgreen (1996), the gold standard emerged due to a number of "individual choices of countries constrained by the prior decisions of their neighbours and, more generally, by the inheritance of history" (ibid: 7). Its global spread can be traced back to Britain's ascendancy in global financial and commercial matters, having adopted the gold standard in 1717. Before the gold standard started to enjoy prominence, most countries' monetary status was based on bimetallism, "the simultaneous minting and circulation of both gold and silver coins" (ibid: 9). This brought several complications with it, especially maintaining the mint ratio between gold and silver after "gold discoveries in California in 1848 and Australia in 1851" (ibid: 13).

Despite being difficult to operate, bimetallism persisted until the second half of the nineteenth century. This can mainly be explained by "advantages to maintaining the same international monetary arrangements that countries had" (ibid: 15). Only systemic shocks revealed the disadvantages of bimetallism – in this case "the spread of the industrial revolution and the international rivalry that culminated in the Franco-Prussian War" (ibid: 15). Germany's status as the leading industrial power of continental Europe and its close trade and financial links to London made its adoption of the gold standard not only a first decisive step, but also augmented the perceived attraction of gold in general. Countries with a close proximity to Germany followed suit, with the standard spreading globally (ibid: 15-6). Interestingly, while the Austro-Hungarian and Russian Empires are explicitly mentioned in his analysis, the Ottoman Empire is left out. Might this be due to its complex position vis-à-vis the core/periphery relation? Eichengreen emphasises that the European core was characterised by a high degree of cooperation in times of crisis (ibid: 34-5), something that did not extend into the peripheries. According to him, this is due to the lack or the late establishments of central banks, especially in Latin America, as well as the vulnerability of banking systems in general.

Another insightful study by Gallarotti (1993) highlights the "ideological attachment to gold" (ibid: 19) and the "support for gold […] as the most overt manifestation of a growing monetary division of the world" (ibid). However, similarly to Eichengreen, the Ottoman Empire's trajectory is left out from the analysis, most notably when he briefly lists "anomalous" cases adopting the gold standard, such as Portugal, the Austria-Hungary and Russian Empires, Argentina and Italy (ibid: 47).

An important aspect that has to be emphasised more strongly is the power that Britain, and the core more generally, exercised over the periphery by denominating the currency and affecting exchange rates (Strange, 1994: 90). This fact is important in order to understand how the gold standard affected the peripheries, beyond a standard approach that focuses on weak institutional design. Politics is inextricably linked to the spread, the supposed stability and the way the peripheries were affected by the gold standard. In Strange's words: "It was a series of politically effective arrangements imposed for a variety of reasons, most of them domestic, by one particular government on its financial institutions and financial markets" (ibid: 101). She bases her analysis on Polanyi's seminal work *The Great Transformation,* where he characterises the nineteenth-century civilisation as resting on four institutions, namely the balance-of-power system, the international gold standard, the self-regulating market and last, the liberal state. Not only shows this the link between politics and economics, but also how the domestic sphere, of a powerful actor, is projected into the international (2001: 3). Using financial power served as a powerful instrument for Britain to project its power by other means than warfare. "Gold standard and constitutionalism were the instruments which made the voice of the City of London heard in many smaller countries which had adopted these symbols of adherence to the new international order" (ibid: 14). Moreover, Polanyi claims that the Great Powers in Europe had to avert the dangers of war among themselves by "the iron grip of finance on the prostrate governments of backward regions" (ibid: 15). This pattern can easily be discerned in the case of the Ottoman Empire. After the Serbian-Ottoman War from 1876-1878 was settled by the Treaty of Berlin and implemented by the Decree of Muharrem in 1881, a Debt Commission was established, which in fact "was not a body representative of the private creditors, but an organ of Europe's public law on which *haute finance* was only unofficially represented" (ibid). This will be investigated in more depth in the second part of this paper.

Monetary Sovereignty and Core-Periphery Relationships

This section will reiterate central concepts on which this paper will draw, namely monetary sovereignty and core-periphery relations. Cohen (1998) offers a very insightful analysis of monetary sovereignty. He distinguishes between varying degrees of monetary sovereignty and surrendering it to foreign control. While complete surrender to foreign control, i.e. adopting a foreign currencies, seems rather anomalous,

[…] a government might embrace a more limited degree of subordination: an exchange-rate rule of some kind. Domestic money remains in existence, but its value is tied directly to a more widely circulated counterpart elsewhere (ibid: 51).

The realisation of this form of subordination can happen in different degrees, "ranging from tight linkage of a formal currency board to flexible and informal pegged-rate arrangements" (ibid).

This theoretical section will mainly focus on core-periphery economic relations between countries. This is not merely a classification of countries according to their economic wealth, but involves the constitution of a large-scale social system. According to Wallerstein, as discussed by Skocpol (1977), two such systems can be discerned:

(1) Empires, in which a functional economic division of labour, occupationally not geographically based, is subsumed under an overarching, tribute-collecting imperial state, and (2) world economies, in which there are multiple political sovereignties, no one of which can subsume and control the entire economic system (ibid: 1077).

The world economy is made up of three main zones with a specific economic structure, namely core, semiperiphery, and periphery. Following this, "the different zones are differently rewarded by the world economy, with surplus flowing disproportionately to the core areas" (ibid). This very feature lends this system its stability, "for the strong states reinforce and increase the differential flow of surplus to the core zone" (ibid).

Bordo and Flandreau (2003) applied this notion to the exchange rate regimes in the nineteenth and twentieth centuries. They show that already in the nineteenth century "there was a core that followed the high road of more or less complete gold convertibility, and an infamous periphery that had trouble pegging but resented floating" (ibid: 418). Their comparative analysis of the form of globalisation that occurred in the nineteenth and twentieth century reveals "a profound transformation of the international monetary system" at the core of the international system (ibid). This transformation is based on a shift from fixed to flexible exchange rates, which leads to the conclusion that "'globalisation appears to mean surprisingly consistent things in the periphery, but radically opposite things in the core" (ibid). Consequently, globalisation and global economic integration seem to be independent of the nature of exchange rate systems. Yet the important conclusions that Bordo and Flandreau draw are that "quite distinct dynamics of exchange rate regimes depending on whether we focus on the centre or on the periphery" can be identified (ibid: 419). Adopting the gold standard was quite a costly endeavour for the periphery, yet as they argue, the lesser of the two evils since "floating could be just as deadly as today" (ibid: 436). The backwardness of the financial markets of the periphery led them "to issue their debts in the large financial markets of the core countries, such as London, Amsterdam, Paris, or later Berlin" (ibid). Moreover, a logical consequence was that foreign currencies were introduced into the domestic markets by these foreign loans. Logically, with the spread of the gold standard in the European core, gold clauses imposed on peripheral countries started to increase. Moreover, the gold standard served as an insurance mechanism, and coupled with the gold inflation between 1896-1914, it started to expand as an increasing amount of countries "found it less dangerous to borrow with gold clauses since the risk of being tipped off gold declined" (ibid: 446). Therefore, indebted to the core countries, the gold standard served as a tool for the core to tie the periphery even closer, while the periphery used it to signal to the core its performance of appropriate financial policies.

To sum up, the periphery faced a limited choice of either pegging their currencies to the gold standard, or coping with the risks associated with a floating currency. Interestingly, both Eichenberg's and Bordo and Flandreau's analysis fail to take into account the experiences of the Ottoman Empire.

In his volume *The Age of Empire* (1987) Hobsbawn attempts to describe the economic and political differences between, what he refers to as, "the two world sectors" (ibid: 17). The core was made up of north-western and central Europe, including their overseas settlements, whereas "large parts of Europe were [… considered] on the margins of the core of the capitalist economic development and bourgeois society" (ibid). The Ottoman Empire had been pushed back "from the enormous areas of Europe it controlled in the sixteenth to eighteenth centuries" (ibid) especially by the Habsburg and Russian Empires, which granted these two empires "in spite of the notorious backwardness of all or parts of their peoples and territories" a powerful status as European powers (ibid). It is therefore yet again crucial to note that the form the world economy assumed, the division into developing and developed parts – core and periphery – was inextricably linked to the age of imperialism, where the world was divided and ruled by a small number of great powers (ibid: 56-7). Consequently, the monetary system has to be seen as part of a wider picture, namely

the creation of a single global economy, progressively reaching into the most remote corners of the world, an increasingly dense web of economic transactions, communications and movements of goods, money and people (ibid: 62).

Part II: The Ottoman Empire and the Gold Standard – A Case Study

The aim of this second part is to find answers to following questions: (1) Considering its political and economic relationship with Europe, how did the evolution of the monetary institutions affect the Ottoman Empire's monetary sovereignty? (2) Is the Ottoman Empire really an anomalous case? A brief comparison to the Russian Empire seems useful in trying to find an answer for this question.

Political and Economic Relations with Europe

As Eldem (2005) notes in his analysis of the Ottoman financial integration with Europe, determining the nature of the relationship between the Ottoman Empire and Europe is not an easy endeavour – based on a "long process of coexistence and gradual rapprochement" (ibid: 432). The important turning point for him was around the 1850s, when the Ottoman Empire pronounced "an avowed aim of […] integration into the European world" (ibid). France and Britain supported the Ottoman Empire against the Russian Empire during the 1853-1856 Crimean War, a novel situation for the Ottomans, which fuelled Sultan Abdülmecid's desire to "see his Empire admitted into the family of European nations" (ibid). The initiated reforms, shortly before signing the Paris Peace Treaty in 1856, should not only revive some of the major principles of the Tanzimat Decree of 1839, but most importantly send a signal to Europe that the Ottoman Empire is ready to pledge "alliance to the western system and its values" in order to be admitted (ibid: 433). However, it was obvious that by making the signature of the peace treaty dependent on the fulfilment of the reforms, the Ottoman Empire gave the European powers a legitimate right to interfere in its domestic affairs. Consequently, "the Ottoman Empire was viewed as a passive extension of the system that needed encouragement, monitoring and, eventually, control" (ibid).

While these initial steps were based on converging interests on both sides and political integration, a reform of the financial system under European leadership was made part of the integration process. This is a very striking feature of the reforms, denouncing previous policies adopted by the empire. These included:

the introduction of paper-money in 1839, followed by the adoption of a bi-metallic decimal standard in 1844 and the establishment of a foreign currency regulating agency in 1845, [the Banque de Constantinople] (ibid: 1847).

However, these measures were accompanied by heavy mismanagement, with the Banque de Constantinople facing bankruptcy since it was not able to meet the government's demand for cash, and the uncontrolled circulation of paper money, which led to the depreciation of the currency (ibid). Thus, in light of this critical situation, coupled with the western-oriented outlook, "a western-oriented programme of financial mobilisation" was considered highly expedient (ibid).

For the first time in its history, the Ottoman Empire used foreign credits in order to finance the Crimean War. In fact, this should initiate "a long series of loans contracted on the European markets" (ibid). These loans were issued a very favourable interest rate, which was certainly a result of the British and the French desire to support the Ottomans in the war. This incentivised them borrow even more from their European creditors, basing "the future of the Empire on the attractive prospect of a series of loans" (ibid: 434-5). Since the lenders were concerned with a regular liquidation of debts by the Empire and critically observed the wasteful handling of the loans by the Sultan, "the 1855 loan had been accompanied by the setting up of a Franco-British commission empowered with the control of expenditures and the verification of Treasury accounts" (ibid). Therefore, it is crucial to note that the increasing Western encroachment was a result of both the willingness to control the Ottoman Empire's financial domain as well as its critical handling of foreign loans. However, with the increasing indebtedness and "the severe loss of creditworthiness", the Ottoman Empire found itself in a deep crisis at the start of the 1860s. The West concluded that monitoring had failed "and that what was really needed was to place it under direct European control" (ibid: 436).

With the succession of Abdülaziz, the Ottoman Empire changed its course, and with the support of Britain and yet another loan the severe crisis was averted by "redeeming, once and for all, the paper money in circulation" (ibid). However, as the examination of the evolution of the central institutions will show, this could not avert the major financial and existential crisis that the Empire was to face in 1875.

Evolution of Central Institutions in Charge of Monetary Policy

One step towards the aversion of the financial crisis as well as the increase of Western influence on the financial affairs of the Empire was the transformation of the Ottoman Bank into the Imperial Bank in early 1863. In his chapter on the relationship between the Bank and the Empire, Eldem (1999) highlights how its creation was initially "destined to provide the Empire with the infrastructure necessary for the gradual transformation of the whole system into a modern and rational one" (ibid: 51). Yet it was clear from its establishment that it is expected to serve the government rather than imposing conditions on it. However, "the Bank clearly thought that it was necessary that it should control the potentially reckless ways in which the government tended to borrow funds without even making a proper use of the resources in terms of sound economic investments" (ibid: 53). Eventually, this relationship resulted in the financial insolvency of the State, especially "with the extraordinary conditions of the war against Serbia and Russia" (ibid: 54). Consequently, the very institution that was to handle the Ottoman finances independently of foreign intrusion was merely "an instrument of modernisation serving the general purposes of the Ottoman government than as an autonomous actor with the force and prerogative of imposing its own will" (ibid: 56-7).

However, in November 1879 the Imperial Ottoman Bank managed to find a solution between the local creditors and the governments, which "ended up creating a feeling of frustration among foreign bondholders, who felt left out of a successful deal" (Eldem, 2005: 441). This led to negotiations over the foreign debt and subsequently, "to the signing of the *Muharrem Decree,* on December 1881*,* which foresaw the abrogation of the 1879 arrangement and its replacement by the Administration of the Ottoman Public Debt" (ibid). The arrangement stipulated that one fifth of the Ottoman State's revenues would be used to settle its outstanding debt. This marked an even clearer shift towards the direct control of the internal affairs of the Ottoman Empire by Europe. A series of loans were to be contracted between 1886 and 1914, while "the Administration of the Ottoman Public Debt turned out to work very efficiently in its management of the resources for which it was responsible" (ibid: 442). Both control and the flow of foreign capital increased to unprecedented levels after 1881, where the "Ottoman integration with Europe had started to take a substantially different course, much akin to imperialism" (ibid: 443).

From 1880 onwards, "the [Imperial Ottoman Bank] resumed its monopoly on issuing gold-backed banknotes" (Tunçer, 2012: 12). Nonetheless, the circulation of gold coins remained highly limited. Moreover, "in Istanbul, exchange rates were stable between the Ottoman currency and the currencies of other gold standard countries, but in the provinces of the empire, territorial exchange rates and currency zones survive throughout the period" (ibid). In fact, the circulation of silver maintained high levels in domestic transactions, creating this dual monetary system. It is also referred to as "the limping standard", defined by Contant (1903: 216) as follows:

The limping standard is so called because silver limps along behind gold, without enjoying the privilege of free coinage accorded to the standard metal, but nevertheless finding a large use as money, and kept at par with the standard. From a theoretical standpoint, the limping standard may be defined as a monetary system requiring free coinage of the standard metal, with the concurrent use of token coins of other metals, such coins having full legal tender power, but kept at par with the standard by the Government control of their output.

He argues that the limping standard has decreased the pressure for gold, while at the same time "permitted several important States to obtain, without too much difficulty, the supply of the yellow metal necessary for the inauguration of the gold standard" (ibid). While his definition explains the major workings of the limping standard, it also emphasises inherent hierarchies when describing core states as important and powerful.

While the Ottoman Empire aimed at establishing gold as the standard currency and tried to decrease the circulation of silver coinage, "the economy continued to rely heavily on silver for most daily transaction" (Pamuk, 2000: 217). This was the direct result of lacking both financial strength and reserves to "move to a full-fledged gold standard" (ibid). Therefore, this system can be classified as "a compromise between the preferences of European interests and the realities of a low-income, agrarian country" (ibid: 218). The Ottoman Empire saw itself constrained by the gold standard, since its debt was denominated in gold, foreign capital inflows depended on it, and finally, because otherwise it would have been isolated from the European economy, which it saw to avert as argued in the previous section (ibid).

Evaluation – A Comparison with the Russian Empire

As could be seen in the previous section, the increasing foreign debts led to institutional changes that initiated a process of "peripheralisation of the Ottoman economy" (Birdal, 2010: 1), "laying out the institutional foundations of Western imperialism in the Ottoman Empire" (ibid: 7).

What were the consequences for the monetary sovereignty of the Ottoman Empire? The Imperial Ottoman Bank, initially serving the interests of the Ottoman Empire, increasingly came to be owned by more than 80 per cent by the French. It established a dense network of eighty branches and sub-branches while supporting and coordinating "the activities of French capital groups not only in the flotation of Ottoman bond issues but also various direct investment projects, in railways, ports, utilities, mining, and insurance companies" (ibid: 221).

Interestingly, British involvement decreased after 1880, which gave "German groups spearheaded by the Deutsche Bank" the opportunity to challenge French (ibid). In fact, after 1899 more European commercial banks discovered the Ottoman Empire as a market for their branches, aiming at "drawing deposits from local customers to finance trade and agriculture" (ibid). Therefore, commerce was increasingly taken over by European agents. Nonetheless, efforts were made to counteract this development and different domestic banks were established, most notably the Agricultural Bank which "established more than 400 branches, more than any other financial institution" (ibid: 222). While it could not fully meet the cultivators' needs, it provided "an alternative to the high rates demanded by the traditional moneylenders", symbolising "efforts to finance economic development from domestic savings" (ibid). Consequently, this also initiates the period of the development of commercial banking.

Concerning monetary sovereignty, this suggests a move towards less control by the Ottoman Empire and an increasing influence by the European powers. While the limping standard did ensure that the domestic currency was still circulated in order to enable internal commerce, especially in the peripheries of the empire itself, the Ottoman Empire found itself integrated into the world economy, losing monetary sovereignty, and playing by the rules dictated from foreign powers. How does this trajectory compare to other cases? Before concluding, this paper will use the example of the Russian Empire, who adopted the gold standard in 1897, in order to assess how unique or anomalous the Ottoman Empire case is.

The central monetary institution of the Russian Empire was the State Bank (Gosbank), since "the Treasury kept almost all of its accounts with the Gosbank" (Drummond, 1976: 665). Hence, while the Treasury constituted the biggest creditor to the Gosbank, Drummond highlights that "the general public held large deposits in the Gosbank" (ibid: 666). Therefore, its position within the state was important in manifold ways:

It was the banker to the state and sole issuer of paper money; its deposit liabilities included some of the commercial banks' reserves, but it was a net debtor of the Treasury; [and] it lent a great deal to the private sector (ibid: 670).

Drummond then analyses the general flows of money supply, concluding that

money supply moved quite independently of movements in Gosbank gold reserves. Generally, both were increasing, but the money supply often rose when reserves were falling, and sometimes fell when reserves were rising (ibid: 676).

Moreover, he concludes that the Gosbank saw the protection of the "Russian monetary system from the frequent fluctuations that characterised Berlin, or, even more markedly, London" (ibid: 678).

As showed by Gregory (1994), the adoption of the gold standard integrated the Russian economy and financial system with the West, with Russia becoming "the world's largest debtor" before World War I, attracting foreign investment and last, with the "gold ruble [exchanging] at a fixed and stable rate with the currencies of other industrialised countries" (ibid: 57). Similarly to the Ottoman Empire, Russia deliberately oriented itself to the West – which came to be known as the Witte system, initiated by the minister of finance. Consequently, being able to adopt the gold standard required adequate monetary and fiscal policies (ibid: 59). In order to create a stable currency, the two decades before the gold standard were characterised by stringency (ibid). The most contended issue concerns the role of the state vis-à-vis industrialisation. Gregory argues that not only did state enterprises not play a role in industrialisation, but also constitute and impediment rather "than a source of assistance" (ibid: 61).

Orienting itself westwards revealed the need to initiated great structural reforms of the economic sector in both the Russian and the Ottoman case. Russia's integration into the world market seemed to have unfolded rather successfully during the gold standard: "The susceptibility of the Russian economy to short-term fluctuations in the world economy indicates the extent to which the Russian economy was integrated into world product an capital markets" (ibid: 77).

In particular, an investigation of investment cycles reveals that the Russian ones were mostly related to the German and Swedish ones, and that turning points of those cycles are transmitted from the core (Britain, France, Germany) to the periphery, in this case Russia and Sweden (ibid: 78). Last, similar to the Ottoman Empire, French and German investment was to dominate on the market towards the turn of the century. In the Russian case this meant a high concentration of "German and French portfolio capital" (ibid: 75), in the Ottoman case this resulted in imperial domination.

Therefore, as this brief comparison shows, both the Ottoman Empire as well as the Russian Empire decided to follow the 'western' path. The Russian Empire adopted the gold standard, whereas the Ottoman Empire a limping standard. As Tunçer (2013: 38) reveals in his table, data suggests that the Ottoman Empire's economic situation, with a GDP of 0.4 per cent, was much worse than Russia with 10.7 per cent, suggesting a successful process of industrialisation. Last, comparing the central bank of issue activities and legal status of several peripheral and semi-peripheral countries, Tunçer shows that the relationship between the bank and the government in the Russian Empire was much more integrated and balanced than in the Ottoman Empire, where the state was neither a shareholder, nor appointing the head, nor had a share of the profits – which was all the case in the Russian Empire. However, despite this institutional weakness and a low economic growth, as showed previously, the British played an immense role in providing loans and creating direct control of the Ottoman Empire's financial and monetary institutions. This direct foreign encroachment was not witnessed in the Russian case.

Conclusion

This paper analysed monetary sovereignty of the Ottoman Empire under the gold standard, by focusing on the historical context, institutional arrangements and increasing European encroachment. Central to the increasing influence by the European powers were hence the foreign loans, granted at a highly favourable rate, which gave the Ottoman Empire more incentives to borrow. This initiated the process of transformation "from a self-responsive, auto-centric 'world Empire' into a peripheral economy governed by the dynamics of the world economy" (Birdal, 2010: 10). Internally, it is crucial to point out the increasing indebtedness and the severe crises that the empire faced before adopting the gold standard. This triggered European involvement, which saw its interests jeopardised by the threat of insolvency. The adoption of a limping standard – keeping silver for domestic transactions and pegging the currency to gold externally – is one of the central differences between the Ottoman and Russian Empires. The Ottoman Empire lost its monetary sovereignty because of a much higher level of foreign intrusion than in the Russian Empire, because of weak institutional design and because the economy did not seem to be able to adapt to the changes as successfully as the Russian case. It was beyond the scope of this paper to analyse the Russian case as thoroughly as the Ottoman case, yet the conclusions of the comparison suggests that the Ottoman Empire yielded indeed atypical results for these reasons.

Analysing the centre-periphery relations within the empire and the dynamics within the European core in more depth can reveal more accurate conclusions for both the Ottoman and the Russian Empire.

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