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Market Comment

CLARMOND

## Sultans of Insolvency

**In the first of a two-part Market Comment we look at the collapse of the Ottoman Empire. In this first part we look at the lessons that can be learnt from how the Empire defaults and then restructures. In part two we look at the equally timely issues surrounding the Empire and energy.**

IN THE THROES OF THE CRIMEAN War (1854), the 400 year-old Ottoman Empire, proclaimed as the 'scourge of God' by Martin Luther, turned to the capital markets of Christian Europe for funding.

Over the next two decades the Ottoman central government, the Sublime Porte, borrowed over £200m. This was partly used to complete the Sultan's sumptuous Dolmabahce Palace, partly used to cover its budget deficits, and most critically as the debts amassed, was partly used to pay interest on the debt itself; this is never a good sign. The Imperial Ottoman Bank, a joint venture of British and French investors, acted as the de-facto central banker to the empire and facilitated these borrowings.

By 1873 the global credit boom had ended. Germany de-monitised silver and effectively moved all global players to a gold standard. Credit contracted, capital evaporated, and asset prices collapsed, especially the popular and high-yielding American railroad bonds. Within three years the Ottoman Empire defaulted, declaring a moratorium on all external debt payments.

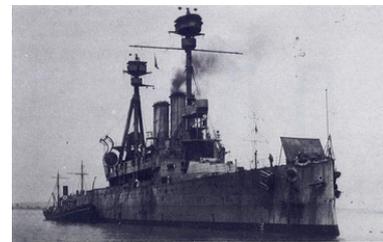
By 1881 the Ottoman Empire and its creditors had come to a restructuring agreement: the external principal debt would be reduced from £200m to £96m, interest payments due would be reduced from £62m to £10m, and the interest service on the remaining debt would go from £14m to £3m.

In return the Porte transferred taxes on fishing, silk, spirits, tobacco, and stamp duties to the Ottoman Public Debt Administration (OPDA), a European bureaucracy in excess of 5,000 people, which was based in Istanbul and that collected these taxes, and directly paid interest and capital to the foreign creditors. Essentially, the Ottoman authorities gave up 33% of their state revenues and their fiscal power to an external bondholders' committee that was based in the heart of their capital city.

### Familiar path

One does not have to look too far to find a modern-day comparison. A country running on budget deficits? A country being lent to heavily by the private sector in Europe? European governments stepping in to safeguard those private interests in case of a default? A country having concluded a debt restructuring with its own version of OPDA (renamed the 'Troika')?

Greece finds itself in the same precarious situation with its creditors. However, past history does provide some glimpses of the future. If Greece plays by the rules of their creditors, like the Ottomans, they will suffer multi-decade austerity. On the plus side, their interest rate spread will reduce; the spread between Ottoman bonds and British consols, contracted from over 20% to 2%, allowing the Porte to borrow another £150m over the next 20 years at lower rates. The message for Greece is clear; give up fiscal power



**Sailing into history....**

and in return receive lower rates and additional funding. If not then unconvertible money and closed external borrowing markets await. The OPDA (Troika) was a double edged sword; it improved tax collection and brought in Foreign Direct Investment, but it removed one-third of investable capital from the Empire and left the Porte with limited funding to invest in its modernisation. This explains the current 'push back' in Greece; the Ottomans limped along till the start of the Great War.

In October 1918, the Ottomans signed the armistice on the *Lord Nelson*-class battleship, the HMS Agamemnon, which then sailed an allied Armada into the Bosphorus past the Dolmabahce Palace. But the fates of both the Porte and the coal-powered Agamemnon were sealed by a shift to oil during the War. This transformation led to the Agamemnon being decommissioned and, by 1921, being used for target practice and also the dismemberment of the Ottoman Empire, with the Allies realising that the real prize lay in access to untapped Ottoman oil. ■