Sovereign Debt and International Financial Control

The Middle East and the Balkans, 1870–1914

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Political Control and Military Conquest: Egypt, 1862–1914

This chapter documents the functioning of the IFC in Egypt from its early years until 1914. Egypt can be considered as an exception among the cases of this book, because the IFC eventually served as a prelude to de facto colonisation of the country after the British military intervention in 1882. Therefore, unlike other cases, Egypt lost its political sovereignty and the Egyptian government had no choice but to comply with the foreign creditors. Consequently, the IFC functioned in a more complex political and institutional environment, where imperialist rivalry over controlling Egypt gave direction to the formation of a wider range of instruments of political and financial control. Our discussion, therefore, heavily draws on these unique historical characteristics in order to untangle the impact of the IFC from the broader colonial history of Egypt. In the first half of the chapter, I aim to picture the historical context and discuss the milestones in history of sovereign debt in Egypt from the initial sovereign borrowing in 1862 to 1914. In the second half, I examine the characteristics of the IFC in Egypt and try to determine the scope of its activities. A brief summary and conclusion follows to highlight the major characteristics of the IFC in Egypt during the period under study.

3.1 Khedives as borrowers: crisis, default and punishment

From its conquest in 1517 by the Sultan Selim I to World War I in 1914, Egypt remained de jure part of the Ottoman Empire. The Ottoman rule in Egypt was never deeply rooted and pashas appointed by the Porte effectively governed Egypt. Despite this lack of integration with the centre, the Ottoman government was satisfied with this arrangement as long as the Egyptian local powers formally recognised

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the sultan's sovereignty by accepting the governor and other Ottoman representatives, sending the annual tribute and supplying soldiers to fight in military campaigns in Asia, Europe or the Mediterranean.[1] In other words, once appointed, the governor of Egypt enjoyed freedom to decide on local fiscal and political matters and maintained a semi-autonomous status.

For most historians, the French occupation in the last decade of the eighteenth century is considered as a turning point in the history of Ottoman Egypt, since this occupation gave rise to one of the most influential figures in the nineteenth century European and Middle Eastern history, Muhammed Ali, who started ruling Egypt from 1805 onwards. His period was characterised by a wide range of social, economic and financial reforms, which led to economic expansion, modernisation of state apparatus and the army. By 1838, Muhammed Ali began to lobby with European consuls for an independent Egypt free from the Ottoman rule. This led to a military confrontation with the Ottoman centre, resulting in the defeat of the latter. Consequently, a conference was assembled in London in July 1840 and the "Convention for the Pacification of the Levant" gave Muhammed Ali an ultimatum to withdraw from Syria, Adana, Crete and Arabia. When he refused to comply, a British force landed at Beirut in September 1840, defeated Muhammad Ali's army and forced him to withdraw to Egypt. However, despite his defeat, Muhammad Ali managed to secure the title of "governor of Egypt for life" and his male descendants, known as Khedives, were granted hereditary rights to office.[2]

This changed Egypt's legal and official relations with the Porte. Muhammed Ali's reign witnessed developments, which tied Egypt more firmly to the European world at the expense of its former connections with the Ottoman Empire. By a decree issued by the Porte in February 1841, the Ottoman government recognised the provisions of the 1840 treaty and in another decree issued in May in the same year, Egypt was required to pay an annual tribute of £363,636 to Istanbul.[3] The economic and political history of Egypt between 1848 and 1879 was dominated by the reinforcement of the dynastic state of Muhammed Ali and Egypt's further opening to European markets. These developments were associated with three Khedives: Abbas (1848–1854), Said (1854–1863) and Ismail (1863–1879). As regards the political structure, the system of personal government, created by Muhammad Ali, was maintained. Legally the governor could seize and reallocate land, apply taxes as he wished, appropriate forced labour (*corvée*) of peasantry and appoint and

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dismiss officials. The decrees of 1841 did not grant any privileges to the governor of Egypt to issue a state loan, but it neither excluded him from this right. Considering the fact that the first Ottoman foreign loan was issued in 1854, this was not an issue to consider yet for the Porte. On the other hand, 1841 decrees underlined that all the taxes and revenues in Egypt would be levied and collected in the Ottoman Sultan's name thus implying that the Egyptian Khedive would not able to issue a foreign loan as an independent sovereign without first getting the permission of the Porte.[4]

In 1858, in order to finance the construction of Suez Canal, the Egyptian Khedive Said Pasha found a way to get over this borrowing restriction by resorting to the issue of treasury bonds. The next two years saw a large increase in the issuance of treasury bonds and soon the Khedive had to turn to other forms of borrowing. In 1860, to fulfil his obligations to the Suez Canal, the Khedive borrowed 28 million francs from a French banking house on his *personal* account. Eventually, in 1862, for the first time in Egypt's history, the Khedive negotiated a state loan to the amount of £3.3 million with the permission of the Ottoman Sultan. This was followed by several others, and during the period 1862–1867, the Egyptian government issued five other bonds in London and Paris amounting to £18 million with the support of several British and French banking houses including Frühling & Goschen and Anglo-Egyptian Bank. These loans were secured on the revenues of the provinces of the Delta, Dekahlieh, Charkieh and Behera and general revenues of the Egyptian state. Moreover some bonds, for instance, the 7 per cent loan of 1866, were secured on the Dairas or large *personal* estates of the Egyptian Khedive and his family and not on the revenues of the *state* (see Table 3.1).

In 1868, the budget deficit of the Egyptian state reached an unsustainable level. In order to meet the interest payments, the Khedive managed to secure another loan for £11.9 million with an effective interest rate of 8.86 per cent. The loan was issued with the syndicate of IOB, Société Générale and Oppenheim and came with the condition of not issuing another loan for a period of five years "either on the Bourses of Europe, or in Alexandria, or elsewhere."[5] Echoing the loan agreement, the next year in November 1869, the Porte also issued a decree restricting the rights of the Egyptian governor to contract a new loan without the previous permission of the Sultan. The decree reflected the worries of the Ottoman centre on the financial situation of Egypt:

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Table 3.1 List of contracted loans: Egypt, 1862–1873

Year	Size of issue (£)	Price of issue (%)	Nominal interest rate (%)	Effective interest rate (%)	Assigned revenues	Underwriter
1862	3,292,800	83.5	7	8.38	Revenues of provinces of Delta	Frühling & Goschen
1863	310,000	100	8	8	Guaranteed by the Egyptian Commercial and Trading Company	Egyptian Commercial and Trading Company
1864	5,704,200	93	7	7.53	Revenues from the provinces of Dekahlieh, Charkieh and Behera	Frühling & Goschen
1866	3,387,300	90	7	7.78	Private property of the Khedive	Anglo-Egyptian Bank
1866	3,000,000	92	7	7.61	Railways	Frühling & Goschen
1867	2,080,000	90	9	10	Estates purchased by the Khedive	IOB and Oppenheim
1868	11,890,000	75	7	9.59	Customs revenue, lock tolls, salt and fishery revenues	IOB, Société Générale, Oppenheim
1870	7,142,860	78.5	7	8.92	Revenues of the Daira estates	Franco-Egyptian Bank
1873	32,000,000	79	7	8.86	Revenues of railways of Lower Egypt, and proceeds of personal and salt taxes and Moukabala	IOB, Bischoffsheim & Goldschmidt, Société Générale

Sources: Wynne (1951), Landes (1969), CFB (1909–1914), Fenn (1885).

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> [T]he financial question is a vital one for every country, if the rate of the taxes is beyond the means of the tax-payers, or if the yield of these taxes is absorbed in fruitless expenditure, instead of being employed for the real requirements of the country, there is undoubtedly a risk of losses and incalculable dangers… all taxes and dues should be assessed and levied in my name [Sultan]. I could not, therefore, in any way consent to the sums yielded by these taxes being employed otherwise than for the real requirements of the country, or to the inhabitants being burdened with new taxes without legitimate and recognised necessity.
>
> Moreover, as foreign loans pledge for many years the revenues of the country, I cannot permit that sums raised from the revenues of Egypt should be applied to the service of a loan, unless all the details of the reasons for having recourse thereto have been submitted to my Imperial Government, and unless my permission has been previously obtained.
>
> It is therefore my desire that no loan should ever be made unless the necessity for having recourse to it be clearly established and my permission previously obtained.[6]

This quote illustrates the awareness of the Ottoman government on the seriousness of excessive indebtedness and potential consequences of pledging future revenues of the state. Whether the Sultan was following his own advice is a subject we revisit in the next chapter. As for the Khedive, however, neither the condition on the loan contract nor the decree of the Sultan were effective as the international markets and intermediaries were still willing to lend to the Egyptian government due to attractive effective interest rates. As a result, the Egyptian government managed to secure another loan in 1870 with the help of Franco-Egyptian Bank. Although the Khedive tried to justify the issue of this loan by stating that the money was required to carry out "on a large scale the growth of the sugar cane" and secured the loan with the revenues of Daira estates, the first reaction of the Ottoman Sultan was to declare the issue as illegal.[7] However, this conflict would soon be resolved, and in 1872, the Ottoman Sultan would be convinced that "restrictions [on issuing foreign loans] were creating serious obstacles to the complete development of the prosperity of Egypt" and reinstate the privileges of the Khedive to issue loans without the permission of the Porte.[8] The purpose of this chapter is not to explain these big swings in official Ottoman views towards Egyptian borrowing; however, it would

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not be wrong to speculate that the Porte was echoing the changes in the views of the foreign creditors to secure its own position in the international financial markets.

In 1872, the large sum borrowed a few years earlier was already spent on costly projects and interest service of the outstanding debt, and in order to overcome the shortage of money, the Egyptian Khedive this time resorted to the method of "Moukabala." This name was originated from the "compensation" introduced by the Egyptian government and it provided landowners the option of paying six years' land tax in advance with a 50 per cent discount.[9] Those who paid this contribution in one sum received an immediate reduction of their tax; those who preferred the option of making the payment in instalments received a discount of 8 per cent on their advance and the amount was reduced only on completion of their contribution. In effect, this was contracting a domestic loan with landowners at about 9 per cent interest rate.[10] At the time of the law, the land tax amounted to about £4.8 million per year, therefore the law implied a sacrifice of half of this amount in order to address short-term liquidity needs of the government. During the first three years of its operation, Moukabala yielded in total £9.9 million, which was not enough to cover the deficits.[11]

In 1873, the Egyptian government contracted the largest external loan in its history, amounting to £32 million, with the Imperial Ottoman Bank, Bischoffsheim, Société Générale and other banking houses in Alexandria, Istanbul and Amsterdam. This loan was secured by all the revenues of the railways of Lower Egypt, the proceeds of the personal and indirect taxes, the proceeds of the salt tax and annual receipts to be taken from the proceeds of the Moukabala. Taken together with the previous ones, the overall guarantees corresponded to almost all the general revenues of the Egyptian government. Although acquiring this loan was seen as a success for the government, the crises in the international markets had an immediate effect on Egyptian credit, as it was impossible to borrow further. In need of money, the Khedive sold to the British government 45 per cent of the shares of the Suez Canal, for around £4 million with the intermediation of Rothschild in November 1875.[12] Moreover, in September 1875, as a result of an agreement between the Khedive and the Great Powers, a system of "Mixed Courts" was introduced. Under this scheme, foreigners were empowered to bring cases in Mixed Courts against the government, the administration and the estates of the Khedive and of the members of his family, if an established private right was violated by

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an administrative act. Thus the Khedive's loans were brought within the jurisdiction of the Mixed Courts.[13]

At the same time, with the purchase of the Canal shares and the establishment of the Mixed Courts, the Khedive requested from the British government to send a special mission to Egypt, with the object of inquiring into the condition of the country's finances. In response, the Foreign Office assigned a committee for this purpose under the supervision of Stephen Cave, who issued a report in March 1876 on the financial condition of Egypt, known as "Cave's Report." It interpreted the critical state of the finances of Egypt as mostly due to its being in "a state of transition." Cave explained this transition state as follows:

> "[Egypt] suffers from the ignorance, dishonesty, waste and extravagance of the East, such as have brought her suzerain to the verge of ruin, and at the same time from the vast expense caused by hasty and inconsiderate endeavours to adopt the civilization of the West."[14]

Furthermore Cave suggested that the situation was aggravated by the immense sums expended on unproductive works and/or productive works carried out in the wrong way. The report also includes valuable information on the general economic conditions of Egypt and the sources of its revenues at the time. After a detailed assessment of Egypt's public finances and its budget deficit (see Figure 3.1), Cave's Report concludes by

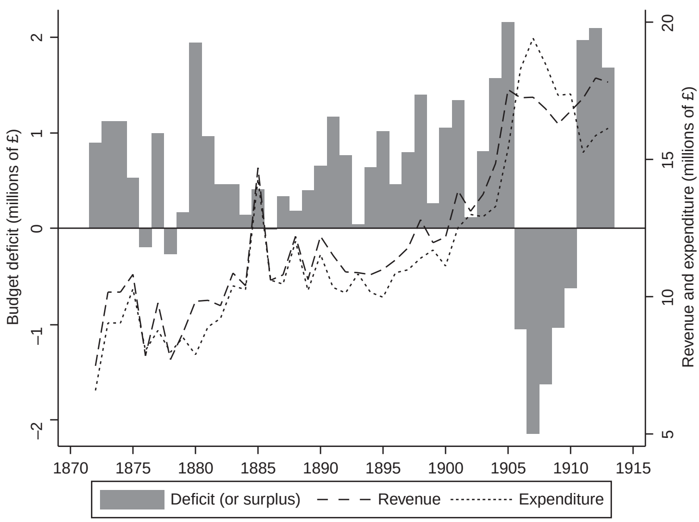

Figure 3.1 Budget deficit: Egypt, 1872–1913

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recommending paying off the short-term loans and consolidating other debt into a stock of £75 million. Although Cave's recommendation was financially well grounded, it was not suitable for all the interested parties. French banking houses, which owned most of the floating debt, especially objected to the proposed solution, and the negotiations between the creditors towards a settlement of the Egyptian debt problem came to a deadlock.[15]

In the meanwhile, the bankruptcy of the Ottoman Empire in late 1875 had a direct impact on Egyptian credit abroad and it was no longer possible to obtain new loans from the international financial markets. First, on 6 April 1876, the payment of Egypt's treasury bonds was suspended. This failure led to the release of two Khedival decrees: the first decree of 2 May 1876, by which an institution named the *Caisse de la Dette Publique* (Caisse) was established, under the direction of foreign commissioners nominated by their respective governments; these commissioners were authorised to receive the revenues intended to service the debt direct from the local authorities. Taxes from several Egyptian provinces, Cairo and Alexandria, the salt and tobacco taxes along with customs revenues were assigned to the Caisse for the purpose of servicing various public loans.[16] The Egyptian government committed itself not to modify these revenues or to contract any new loans without the consent of the commission. French, Italian and Austrian creditors agreed to the establishment of the Caisse in order to have control on the collection and disbursement of the public revenues and therefore nominated their respective commissioners. However, the British government was at this stage unwilling to commit itself to any course of action, which might involve interference with the internal affairs of Egypt. The second decree, on 7 May 1876, called for the unification of the entire indebtedness of the country, which at the time amounted to £91 million.[17]

These two decrees, in particular the second decree of 7 May, evoked dissatisfaction among various groups of creditors. Therefore, in July 1876, the British Corporation of Foreign Bondholders applied to G.J. Goschen – a member of the Corporation and head of a major banking house, which acted as intermediary for most of the Egyptian loans – to represent the bondholders' interests in Egypt. Goschen proceeded to Egypt together with M. Joubert, the representative of a French syndicate and the director of the Banque de Paris et des Pays-Bas. Within a few weeks, Goschen and Joubert had developed a plan of settlement, known

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as "Dual Control" which was accepted by the Khedive and embodied in a decree dated 18 November 1876.[18]

According to the decree:

- The law of Moukabala was to be re-established and was to be considered as never having lapsed. The whole sum produced by the Moukabala would be applied to redeeming the loans of 1864, 1865 and 1867.
- A special administration of the railways and of the port of Alexandria was to be established, which would be placed under the direct control of a special commission of five members: two English, one French and two Egyptians.
- The revenues of the railways and of the port of Alexandria would be directly applied to the payment of the interest and the sinking fund of a series of Preference bonds, having a special mortgage on the railways and the port of Alexandria. These bonds were offered to the holders of the loans of 1862, 1868 and 1873 and were consolidated into £17 million with a 5 per cent interest rate.
- Two controllers-general would be appointed: a controller-general of receipts and a controller-general of audit and public debt – one of whom would be British and the other French, nominated by their respective governments and chosen by the Egyptian government.
- The controller-general of receipts would have full rights to collect and administer all the revenues of the state. The tax collectors in the provinces would be chosen from Egyptian subjects.
- The controller-general of audit and public debt would control the general account-keeping of the treasury and of all the government receiving offices.
- The controllers-general would take part in preparing the budget and issuing its strict execution.
- The *Caisse de la Dette Publique* was to be permanent until the entire debt was redeemed. The merchandise given for paying the taxes in the provinces specially set apart for the service of the debt would be displaced at the exclusive discretion of the Caisse, which would have power to sell it.
- Finally, the capital of the Unified debt was reduced to £59 million. The rate of interest was fixed at 6 per cent, to which a sinking fund of 1 per cent was added.[19]

With regard to international law, perhaps the most controversial issue in all these arrangements was to differentiate the personal debt of the

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Khedive from the public debt of the Egyptian state. Having relied on the Mixed Courts, the decrees of 1876 implied a unification of the two areas of debt and this resulted in the hypothecation of the revenues of the Egyptian state and the personal wealth of the Khedive for the purpose of compensating the creditors for their losses. Moreover, as the dual control suggested, this meant a complete loss of fiscal sovereignty and opened the way to the eventual loss of political sovereignty. In this context, the creditors' control established in Egypt in 1876 not only meant the foundation of the Caisse, but also further international control over Egypt's finances. The two controllers-general would exercise supervision over the entire fiscal administration of the country, one mainly responsible for expenditure and the other for revenues. The budget was still to be framed by the Khedive and his ministers, though with the assistance of controllers-general. Moreover, the railway and port commission and the Khedive's personal lands in Upper Egypt would also be administered internationally. Finally, as far as the debt consolidation was concerned, although the capital of the debt was unified and reduced, this did not lead to a decline in the outstanding amount (see Figure 3.2) because of the floating debt. Therefore, even after the arrangement, the fiscal difficulties were not over and the Anglo-French administration had to confront this challenge.

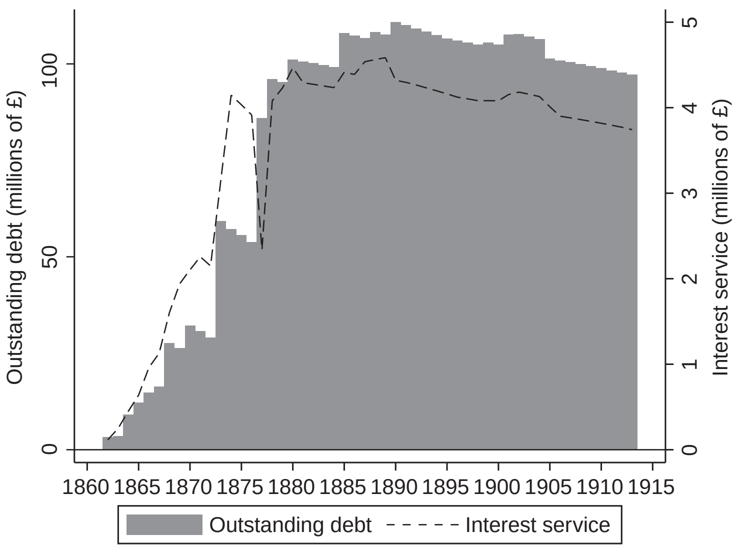

Figure 3.2 Outstanding debt and interest service: Egypt, 1862–1913

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The 1876 arrangement established the Caisse as the main authority to receive all revenues from relevant sources and qualified authorities, and to disburse them for the service of the debt. All revenues assigned to the service of the debt were to be paid by the collection officials directly into the Caisse agents, and not through the treasury. The receipt of the Commissioners for such sums was alone valid. The Caisse could sue the government before the Mixed Courts, in the event of any breach of the agreements. Moreover, the government without the consent of the Caisse could not change the taxes nor raise a loan. The decisions of the Caisse were taken by majority of four commissioners; but any single member could sue the government, of his own initiative, before the Mixed Courts.[20] In the next section we explore the second phase of financial history of Egypt and outline the major activities of the Caisse and the evolution of sovereign debt from 1876 to World War I.

3.2 Loss of political sovereignty and imperial rivalry

From the perspective of the foreign creditors, although the Egyptian state had enough resources to pay its debts, the main problem was the mismanagement of the Egyptian revenues. As regards the effect of the reformed administration on the revenues, British representative Goschen was optimistic:

> it appears certain that a thorough European administration of the indirect taxes, which will put an end to much disorder, will materially increase the yield of those imports. The post office was not long since placed under the superintendence of an intelligent and able English official. It used to yield a loss; it now yields a considerable profit … A few years will show, when the controllers-general and the other Europeans appointed have thoroughly got to their work, what revenues of Egypt will be under improved administration. If evidence should then be forthcoming which is wanting now that the burden to be borne by Egypt under the new arrangements are heavier than the country could bear, measures could be taken accordingly, but I see no reason for believing that this will be the result.[21]

In line with the decree of November 1876, in August 1877, the contract with respect to the Daira debt was published; it unified the entire debt stock of the country (see Table 3.2) under preference and unified stocks amounting together to £66 million. Moreover, by a separate arrangement, the Daira floating debt were also converted into a Daira Sanieh

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debt for £8.8 million, bearing a minimum interest of 5 per cent, which would rise to 7 per cent on the reduction of the capital to £5 million. This was secured on the net revenues of the Daira Sanieh. The Khedive was allowed to continue managing the estates but under the strict supervision of the two controllers. While these changes were being implemented, an exceptionally bad harvest and the Russo-Turkish War 1877–1878 aggravated the financial situation of Egypt. Although the interest on the unified debt was paid, a new debt arrangement was necessary to reduce the yearly debt charges. After extensive negotiations with the Egyptian government, in March 1878, a new commission of inquiry was assembled to reassess the whole financial situation of Egypt.

The commission reported that among the important causes of Egypt's difficulties were an arbitrary tax system, the lack of a proper budget system, the unequal distribution of lands and water for irrigation, and forced labour used in the Khedive's personal estates.[22] Implicitly, the fiscal reform was linked to a reform of the state. The Khedive accepted the report of the committee and therefore agreed to establish a constitutional government, which included a British-headed Ministry of Finance and a French-headed Ministry of Public Works. This was an extension of the controller system established in 1876, and soon after its establishment the new government attempted to raise a new loan. In 1878, Egypt was enabled to borrow the sum of £8.5 million with the intermediation of Rothschild, and the loan was secured again with the Khedive's personal property. However, according to the terms of the agreement, the Khedive's personal estates were no longer under his own administration. They were to be transferred to the state, and accordingly, an international commission of three members, consisting of an English, a French and an Egyptian national, would be responsible for administering this property and revenue.

The political consequence of all these new regulations was to exclude the Khedive from the administration of Egyptian finances and a transition from the personal government of the Khedive to government by an executive council whose leading members were foreigners. In fact, this situation led to violent protests, which the Khedive and rich landowners supported, to undermine the new administration. The outcome was a *coup d'état*. The initial attempt to govern Egypt without the Khedive had failed and a new government was formed consisting entirely of Egyptians. The new government ruled out the possibility of pursuing the fundamental reforms suggested by the commission of inquiry and therefore the debt settlement process was suspended.[23]

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As noted above, the Mixed Courts of Egypt were a special arrangement for foreign creditors, through which they could sue the Khedive for unpaid debt. Although many foreign creditors succeeded in obtaining judgements in their favour, the Egyptian government as a rule refused to implement these decisions on the basis of the claim that the government lacked enough money to pay off the claims.[24] As far as the creditors were concerned, the existence of Mixed Courts was seen as an obstacle to reaching a general arrangement, which would benefit all the creditors, because it encouraged individual action for the sake of collective one. Therefore, the Great Powers suggested a new system, which would be binding on all groups of creditors and would exempt the Mixed Courts from accepting suits by those who did not agree with the general arrangement. The new government formed by the Khedive in 1878 refused any kind of arrangement involving foreign intervention, and the negotiations came to a dead end. To overcome the crisis, the six Great Powers pressed the Porte to replace the Khedive, who was forced to abdicate in favour of his son. The replacement took place on 26 June 1879 by an imperial decree deposing the Khedive Ismail and declaring Prince Tewfik as the new ruler.[25]

The new Khedive expressed his willingness to re-establish the system of two controllers-general introduced in 1876. By a decree issued on 10 November 1879, it was once again agreed that the entire administration of the country would be supervised by England and France through the controllers-general. They would have full powers to investigate every public service of the state, including that of the public debt. Under this decree, Mr E. Baring and M. de Blignières were appointed as British and French controllers-general, respectively.[26] It is important to note for our discussion in the forthcoming chapters that the controllers-general represented not only the foreign bondholders but also their respective governments. They reinstated some of the suspended reforms and secured the repeal of the law of Moukabala and the adoption of the various other fiscal reforms recommended by the commission of inquiry. In January 1880, the controllers-general reported that Egypt was not in a position to fulfil its engagements and suggested the appointment of a Commission of Liquidation.

After negotiations between the Great Powers, a decree of 31 March 1880 established the International Commission of Liquidation. It was composed of two commissioners named by each of the governments of France and Great Britain and by one commissioner named by each of the governments of Germany, Austria-Hungary and Italy. The Egyptian government was represented at the Commission by a delegate. By the

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decree of 17 July, the recommendations of the Committee became law under the name of the Law of Liquidation. The principal points of this law can be summarised as follows[27]:

- The balances of the floating debt were consolidated into a unified debt with a total amount of £98.3 million. The security remained the same as before: customs revenues and the revenues of the four provinces (Garbieh, Menoufieh, Behara and Siout).
- There would be a permanent reduction to 4 per cent in the interest on the unified debt and the Daira loans, while the rate on the preference debt and the domains loans was fixed at 5 per cent.
- The Caisse, instituted by the decree of 2 May 1876, would receive the funds intended for the service of the interest, the redemption of the privileged debt and the unified debt and would employ these funds accordingly. No new loan of any kind could be made without the advice of the Caisse.
- The revenues of the state were divided into "assigned" and "unassigned" revenues. The former would be used for meeting the charges of the debt and would be under the control of the Caisse; the latter was left to the government for administrative expenses.
- The Moukabala, which implied an undertaking on the part of the government to reduce the land tax to one-half, was abolished.
- Consent of the commission was required before the Egyptian government could contract any new loans.

To summarise, under the Law of Liquidation, the special administration established in connection with the railways, Daira and domains, the two controllers-generals and the commission of the public debt were maintained. The members of the commission were recognised as legal representatives of the foreign bondholders and had the right to sue the government before the Mixed Courts. According to contemporaries, with the new system "some of the worst features of the old oppressive system of government had disappeared. The relations between the government and their creditors were established on a legal basis and the charge on account of debt, although still very heavy, had been brought more into conformity than heretofore with the resources of the country."[28] Finally, the Porte, which was, during this process, trying to cope with its own default and with the war with Russia, was still able to take advantage of these events. While appointing the new Khedive Tewfik, the decree issued by the Sultan also limited the right to contract loans without approval of the Porte and it also prohibited the Khedive to cede territory.

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In other words "Egypt lost ground both to Europe and to the Porte." The Law of Liquidation, combined with the dual control, establishment of new tribunals and Porte's repeated decrees transformed Egypt into "the assignee in bankruptcy of Europe, with Great Britain and France as official trustee, and the Sultan as bailiff of the Court."[29]

However, because of the political implications of the Law of Liquidation there were signs of a military opposition to European control, which historians regard as part of a wider nationalist movement. The fundamental reason for discontent in the Egyptian army was the recommendation of controllers-general to dismiss many army officers and to curtail state activities. Later on, this movement acquired a religious character; it helped to build a sense of national unity and assumed an anti-European cast. With ensuing violent attacks on Europeans in Alexandria, English forces occupied Egypt, an occupation in which France, the Ottoman Empire and other powers did not participate. Following the military intervention, the Great Powers assembled a conference in Istanbul on 2 June 1882 and a few months later, on 13 September 1882, British forces defeated the Egyptian army.[30]

As the main aim of this chapter is to examine and present the nature of international financial control, the details of historical events that at the end led to the military intervention of Britain are not going to be discussed. It is, however, necessary to point out that there is more than one answer in the historiography regarding the motivations behind this intervention. For some, it was the fear that nationalist discontent would weaken the control over finances of the country by Britain and France. As Lord Cromer put it: "the origin of the Egyptian Question in its present phase was financial."[31] Others, however, emphasise the political and commercial interests of the Empire. According to Platt (1968),

> intervention of 1882 was no planned operation; it was a forced progress along the lines determined by the security of the Empire. Egypt joined the Empire in 1882 not because it offered a field for the investment of surplus capital, nor because existing British bondholdings were insecure, but because the trade and even existence of the Empire were threatened by anarchy within.[32]

Perhaps the motivation behind the intervention was a combination of commercial, political and financial interests; however, the new government's primary interest was directed towards the state finances. Within a few months after the British took charge, the Anglo-French Dual Control was abolished. The British Consul-General was given overall

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authority and English advisers were placed in the Egyptian ministries. From 1883–1907, Lord Cromer held the position of consul-general, and under the Egyptian Constitution of 1883, he was the real governing power of Egypt. However, the power of the British consuls to modify Egyptian financial affairs was restricted by previous agreement with the bondholders and by the powers of the Caisse. The French government and bondholders refused to permit any reduction in the authority of the Caisse. Moreover, the separate administration of railways, the Daira and the domains, on all of which France was represented, was maintained.[33]

The first thing that the new British administration faced with was a budget deficit due to the costs of the military campaign. The net revenues from the Daira[34] and the domains were insufficient for the amounts required to service the loans secured by these properties. In 1884, the government was in need of a new foreign loan and recognised that it had to expand state revenues to maintain a minimum level of public works and handle the heavy expenditure on account of the war in Sudan. According to Edgar Vincent, then financial adviser to the Egyptian government, "the financial history of the year [1884] may be summed up in the statement that it consisted in a long struggle to stave off bankruptcy."[35]

In fact, from early 1884 the Rothschilds had already started advancing funds to the Egyptian government in order to prevent a default and the British government was quite keen that they carried on this arrangement. In response to Rothschild's request from the British government to guarantee an Egyptian bond issue, Lord Granville responded on 6 August 1884 "her majesty government have no authority to guarantee the repayment of any debt of the government of Egypt, nor can they determine of present the precise amount of the influence to be exercised by them with regard to the financial engagement of that country." Nevertheless, Granville also ensured that "we do not entertain any doubt that the advance of your house ought to be and will be repaid."[36] From early 1884 to July 1885, when a new loan agreement was finalised, Rothschilds agreed to renew their advances to the Egyptian government.[37]

To this effect, in April 1884, the British government invited the representatives of five other powers (Germany, Austria, Russia, France and the Ottoman Empire) to a conference in London. After prolonged negotiations regarding the nature of the guaranty, an agreement was signed by the six powers in March 1885, according to which the Egyptian government was authorised to take out a new loan not exceeding £9 million

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and at a rate not to exceed 3.5 per cent. This loan was jointly and severally guaranteed by the governments of Germany, Great Britain, Austria-Hungary, Russia, France and Italy, which were also to be represented on the Caisse.[38] In accordance with the convention signed by the Great Powers, a 3 per cent loan for £9.4 million was issued (see Table 3.2). The proceeds of the loan served to liquidate the floating debt and funds for irrigation projects, which were essential for Egyptian agriculture.[39] Finally, the 1885 convention introduced another minor adjustment to the financial position of Egypt. During the negotiations Britain had advocated a permanent reduction of interest on the old debt while France had opposed any reduction. As a compromise, the convention in 1885 provided a temporary tax of 5 per cent on the coupons of the preference and unified debts due in 1885 and in 1886 to supplement the funds available to the Egyptian government.[40]

The 1885 arrangement had other financial implications also for the nature of the Caisse and Egyptian state budget. It fixed the administration expenditure of the Egyptian government; however, it also allowed the government to use half of the available surplus from assigned revenues for the purpose of additional expenditure. Prior to 1885 any surplus from assigned revenues after paying the outstanding debt obligations would be transferred to the Caisse as sinking fund; now it would be shared between the government and the Caisse, allowing the Egyptian government a relatively higher degree of sovereignty. Another implication of the arrangement was regarding the international representation on the Caisse. Although the number of Russian and German bondholders of Egyptian debt were relatively small, they raised concerns on the government's action to divert revenues payable to the Caisse and their request to have representation on the Caisse was granted, raising the number of commissioners of the Caisse to six – in addition to British, French, Italian and Austro-Hungarian commissioners.[41]

From 1885 onwards, Egyptian finances started to improve, and by 1890 the budget yielded a surplus and the Caisse accumulated significant reserves. Between 1890 and 1893, several debt conversions took place to reduce the interest payments even further. First in 1890, with the consent of the powers, interest on outstanding preference debt of c. £22.7 million was reduced 3.5 per cent and an additional £7.1 million of new bonds were issued. Moreover, outstanding Daira Sanieh debt was converted into a new bond of 4 per cent with a sum of £7.3 million, which was secured on the Daira Khassa and Daira Sanieh estates. Two years later, a third conversion took place reducing the interest rate on the 1878 domains loan from 5 per cent to 4.25 per cent. [42]

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Table 3.2 List of contracted loans: Egypt, 1877–1903

Year	Size of issue (£)	Nominal interest rate (%)	Price of issue (%)	Assigned revenues	Underwriter
1877	17,000,000	5	100	Preference stock: secured upon the railway and port of Alexandria revenues	Bank of England, Comptoir d'Escompte
	59,000,000	7	100	Unified stock: customs receipts, revenues of four provinces, the *octrois* of Cairo and Alexandria, the tobacco duties and salt tax	Bank of England, Comptoir d'Escompte
	8,815,430	5	100	Daira Sanieh	Bank of England, Comptoir d'Escompte
1878	8,500,000	5	73	Khedival family property transferred to the state, and to be administered by three commissioners appointed by British, French and Egyptian governments	Rothschild
1880	5,743,800	5		Preference stock balance increase: additional security from telegraph services	
	1,958,240	4		Unified stock balance increase: the security reduced to the customs receipts, the revenues of four provinces and the import duty on tobacco	
	9,512,890	4		Daira Sanieh balance increase: secured by Daira Sanieh	
1885	9,424,000	3	95.5	Guaranteed by the Great Powers	
1888	2,330,000	4.5	93		
1890	29,400,000	3.5	91	Preference stock conversion and additional £7.1 million bonds	
	7,299,360	4	99.25	Daira Sanieh conversion: secured on Daira Sanieh and Daira Khassa estates	Stern Bros.
1893	8,500,000	4.25		Conversion of the 1878 loan	
1901–1903	1,734,200	3.5		Preference bonds to be applied to railway improvement	

Sources: Fenn (1885), Kimber (1920), CFB (1877–1914), Wynne (1951). The nominal interest rates shown in the table refer to the changes made by the Law of Liquidation.

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In the period 1885–1903, the Egyptian government contracted another four foreign loans with an effective interest rate of 4 per cent. In terms of issue size, the amounts of new loans were relatively small, but in terms of effective interest rates there was a significant improvement over the rates in the pre-1876 period (see Table 3.3). Moreover, the three conversions that took place from 1890–1893 reduced the interest service on outstanding debt even further. Perhaps more importantly, after 1885, a greater amount of capital came into the country in the form of private investments (i.e., companies, banks, businesses, insurance, etc). The economic effects of this capital inflow were reflected in the construction of canals, roads and railroads. By the middle of the nineteenth century, a number of banks had already been established in Egypt, chiefly for negotiating loans to the government. In 1898, the National Bank of Egypt was established by the British government with the exclusive privilege of note issue. In 1902, the Agricultural Bank of Egypt was established to grant peasants small loans at low interest rates.[43]

In the meantime, the Caisse kept servicing the debt and accumulating extensive amounts of reserve funds and refused to give authorisation to the Egyptian government to use any balance for the purposes of additional expenditure. The commissioners were content to maintain the Caisse as an agent managing the servicing of the debt; however, its extensive privileges started becoming too restrictive. Contemporaries observed the situation as follows:

> The spectacle of Egypt with her Treasury full of money, yet not allowed to use that money for an object, which, on a moderate calculation, should add twenty per cent, to the wealth of the country, is as distressing as it is ludicrous. Every year that passes illustrates more forcibly the injustice of maintaining, in these days of insured solvency, the restrictions imposed upon the financial freedom of the Egyptian Government at a time of bankruptcy restrictions justifiable then, but wholly unjustifiable now. No one would object to the continuance of the arrangement by which certain revenues are paid in the first instance to the Caisse de la Dette. But so long as these Revenues suffice to cover the interest on the debt, and to provide any sinking fund which the Powers may deem adequate, the balance ought simply to be handed over to the Egyptian Government to deal with it as it pleases, and the antiquated distinction of "authorized" and "unauthorized" expenditure should be swept away. No reform is more necessary than this, if the country is to derive the greatest possible benefit from the improved condition of its finances, which has been attained by such severe privations.

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> The functions of the Caisse, originally limited to receiving certain assigned revenues on behalf of the bondholders, have in practice become much more extensive. Its members have claimed to control on behalf of the Powers of Europe, the due execution by the Egyptian Government of all the complicated international agreements, regarding the finances of the country. Their assent is necessary before any loan can be used without their sanction; and all assigned revenues are paid directly to them by the collecting departments without passing through the Ministry of Finance. In the same way the receipts of the railways, telegraphs, and port of Alexandria, administered by a Board consisting of three members an Englishman, a Frenchman, and an Egyptian are paid, after deduction of expenses, into the Caisse.[44]

Thanks to these pressures, the issue of abolishing the constraining privileges of the Caisse was finally addressed in April 1904 with a new agreement Britain and France, the *Entente Cordiale*, which introduced a change in the constitution of the *Caisse de la Dette Publique*. After the agreement, the Egyptian government obtained full control of the reserve funds, leaving the Caisse a small reserve plus a working balance. The rigid model of keeping the balance was abandoned and the Egyptian government regained full control over fiscal matters.[45] On the eve of this agreement, four separate debts remained: the guaranteed debt created in 1883 at 3 per cent; the privileged debt, bearing interest (since the conversion of 1890) at 3 per cent; the unified debt, bearing interest at 4 per cent and finally the Daira and domains loans. These debts were secured on identical securities. Finally, the Caisse was charged with administering all of them. Theoretically, the Caisse still possessed considerable powers of control, but in practice it retained no power of initiative and was unable to exercise any general or systematic over policy, as in the Ottoman, Serbian, and Greek cases. With the 1904 treaty[46]:

- All the revenues assigned for the service of the abovementioned debts were freed, and for the rest of the period the interest service was pledged by the net revenue of the property tax alone.
- The international body in control of the railways, telegraphs and port of Alexandria was abolished.
- The Caisse was declared permanent so long as any portion of any of the debts remained unredeemed; however, its role was restricted to receiving and paying over to the bondholders the sums which were due to them.
- The reserve funds accumulated by the Caisse were entirely freed, and all the limitations on the administrative expenditures of the government were removed.

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- The government was no longer obliged to obtain the consent of the *Caisse* before securing a new loan.

In other words, as a result of the convention, the Caisse preserved its position in Egypt until the complete repayment of the debt; however, its functions were now limited to receiving certain assigned revenues on behalf of the bondholders, and ensuring the due payments. It no longer had the right of interfering in the general administration of the state finances. Moreover, the type of revenues assigned to the service of the debt had also been changed from customs duties and railway receipts to land tax, due to its stability and steady increase. Consequently, after 1904 the Egyptian government regained its control over the administration of the customs and railways, telegraphs, and port of Alexandria. Finally, the reserve fund of the Caisse, which had been accumulating since 1890 and reached the amount of £5.5 million, was handed over to the Egyptian government.[47]

As seen by Figure 3.3, the immediate effect of the 1904 regulation was seen on the share of total Egyptian revenues controlled by the Caisse, which declined significantly. Whereas before 1904 the Caisse controlled on average 45 per cent of total state revenues, between 1904 and 1914

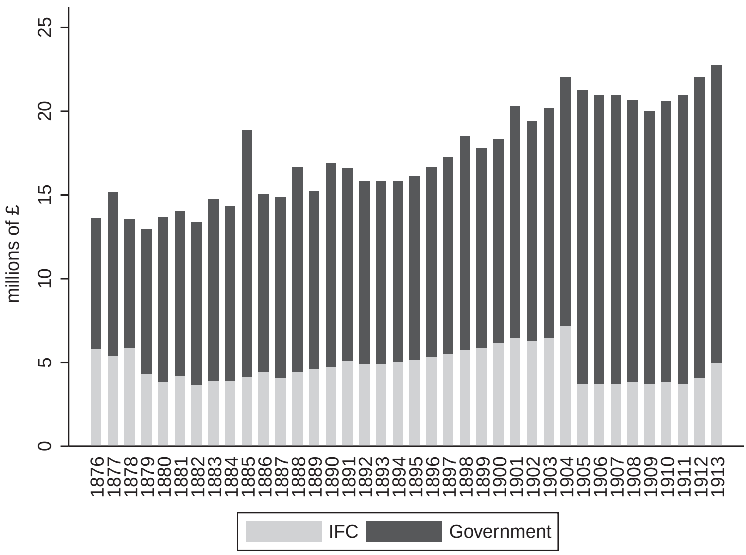

Figure 3.3 Revenues controlled by the Caisse and the total revenues of the state: Egypt, 1876–1913

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this share was around 20 per cent. In 1878, the control of the Caisse was at its most extensive, at a level of 75 per cent of total state revenues. This year (1878) was also characterised by the suppression of the peasantry and resistance in the rural sector to foreign control. It should be noted that the Egyptian Caisse was different from the Ottoman and Greek cases, for it did not introduce any modification or improvement in the assigned revenue streams. Therefore, with regard to the Caisse, the increase can be attributed to a more efficient way of collecting rural taxes.

However, the Caisse was not the only representation of foreign control in Egypt. The Egyptian default led to the establishment of other instruments of financial control, which meant a complete loss of fiscal and political sovereignty. Besides the Caisse, the administration of railways, telegraphs, post office, the tobacco monopoly and the port of Alexandria were in the charge of the British and French Dual Control. In a purely economic sense, the Dual Control was successful, and from 1880 to 1914 the net revenues from these items increased significantly. For instance the revenues from the newly opened and existing railways constituted almost 20 per cent of the total state revenues on the eve of the World War I (see Figure 3.4). If the aim is to gauge the extent of the foreign control, the revenues under the control of the Caisse, together with

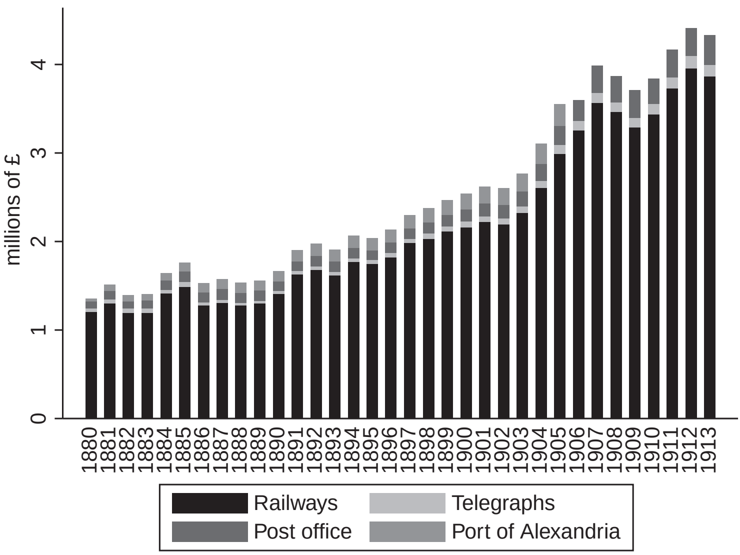

Figure 3.4 Revenues from railways, ports and telegraphs: Egypt, 1880–1913

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the above revenues from the railways, ports, telegraphs, post office and tobacco monopoly constituted 55 per cent of total state revenues. The successful management of them was reflected in the regular payment of interest for the rest of the period.

3.3 Summary and conclusions

Egypt's history of sovereign debt, which began in 1862, went closely hand in hand with its political history, and it eventually became a chapter of the history of the British Empire in the Middle East. Although it is difficult to separate these histories from each other, it is still possible to highlight some of the distinguishing features of the Egyptian debt and IFC during the first era financial globalisation. Khedives were initially drawn into the process of heavy borrowing due to their mismanagement of state finances and miscalculation of the consequences of a potential repudiation – as the Caisse would be the first notable example of IFC in the region. At the same time, foreign creditors were aware of the weaknesses of the Egyptian political and fiscal institutions, and yet, having been attracted by high returns, they contributed to the process of overborrowing. Investing in Egyptian bonds was often regarded as a risky business by contemporaries; and correspondingly, during the pre-IFC period, average effective interest rates on Egyptian bonds reached the level of 8.5 per cent (see Table 3.3).

In Egypt, although the role of the Caisse was originally planned to play the modest role of managing hypothecated revenues and transferring funds to the foreign creditors, it eventually became a prelude to British military take over and it was reinforced by other means of political and economic control. The weight of the Caisse in overall tax collection remained significant: starting from its foundation in 1876 until 1904, the Caisse controlled more than 45 per cent of government revenues. From the *Entente Cordiale* in 1904 to the eve of the World War

Table 3.3 Summary of foreign loans: Egypt, 1862–1913

Period	Number of loans	Nominal value (millions of £)	Average nominal interest rate (%)	Average price of issue (%)	Average effective interest rate (%)
1862–1876	9	69	7.3	86	8.5
1876–1913	10	55	4.2	92	4.5

Sources: See the sources and notes for Tables 3.1 and 3.2. To avoid double counting, I did not include issues for debt conversions into the calculations.

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I, this ratio declined to 20 per cent thanks to the agreement between Britain and France to modify the constitution of the Caisse. In return, despite the record of past default, the credibility of the Egyptian government and its ability to borrow were reinforced in international markets. Even if we ignore the significant conversions and "haircuts" that took place from 1876 onwards, Egypt managed to contract ten new foreign loans with a face value of £55 million. More importantly, the average effective interest rates on these new issues declined almost half, from 8.5 per cent to 4.5 per cent, suggesting that the creditors took seriously the existence of "foreign control" despite the existing institutional and reputational problems of Egypt. In the next chapter, we turn our attention to the suzerain state, the Ottoman Empire, which went through a very similar path with its tributary state up to the point of default but managed to secure possibly a better deal with its foreign creditors.

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54. Esteves (2013).
55. Esteves (2013).
56. BLM (1869a: 5).
57. Mauro and Yafeh (2003).
58. BLM (1869b: 12).
59. Kelly (1998).
60. Esteves (2013).
61. Borchard (1951: 285).
62. Eichengreen and Portes (1989).
63. Suter (1992).
64. Esteves (2013).
65. Flandreau and Flores (2010: 683), Flandreau (2013).
66. Borchard (1951: 82–84). A more particular type of securing loans was to use international guaranty or credit of other sovereigns. For a discussion of guaranteed bonds see Esteves and Tunçer (2014).
67. Borchard (1951: 86).
68. Hyde (1922: 534); Borchard (1951: 89).
69. Vizcarra (2009).
70. Borchard (1951: 87–88).
71. *The Economist* (1860: 1417).
72. Hyde (1922: 534).
73. Hyde (1922: 535); Borchard (1951: 91).
74. Deville (1912); Andreades (1925); Feis (1974); and Wynne (1951).
75. Borchard (1951: 93).
76. Waibel (2011: 42).
77. Mitchener and Weidenmier (2010).
78. See, for instance, Levandis (1944); Blaisdell (1966); Crouchley (1938).

3 Political Control and Military Conquest: Egypt, 1862–1914

1. Dali (1998).
2. Fahmy (1998) and (2002); Aharoni (2007).
3. This sum remained fixed until May 1866, when it was increased to £681,818. HCPP (1878–1879) [C.2395] and Wynne (1951: 580).
4. Shaw (1962); Cole (2007); Dykstra (1998); Fahmy (1998).
5. Fenn (1885: 422).
6. HCPP (1878–1879) [C.2395].
7. Fenn (1885: 422).
8. HCPP (1878–1879) [C.2395].
9. McCoan (1877: 122).
10. Fenn (1885: 483).
11. Wynne (1951: 582).
12. Crouchley (1938: 122).
13. Hoyle (1986) and Cannon (1972).
14. HCPP (1876: 1) [C.1425].
15. HCPP (1876: 10) [C.1425] and Wynne (1951: 588).

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16. It should be noted that to understand the extent and evolution of financial control in Egypt, it is necessary to discuss several decrees issued between 1876 and 1904. What is presented in the following paragraphs is only a small part of this legislation, which in reality extended to almost 60 decrees. None of these internationally binding documents had been formally repealed, and they included four comprehensive settlements of the debt question, those of May 1876 and November 1876, 1880 and 1883. All the decrees referred in the text are based on a contemporary collection: Holland (1885). For decrees issued after 1885, I relied on the relevant issues of CFB (1876–1914) as referred to in the text.
17. Wynne (1951: 587–588).
18. CFB (1877: 21–22).
19. Goschen (1876: xiv), Cromer (1908: 25).
20. Colvin (1905: 97).
21. Goschen (1876: xi).
22. Feis (1974: 386); Wynne (1951: 596).
23. Wynne (1951: 600); Feis (1974: 386–387); Cromer (1908: 46–110).
24. Hoyle (1986) and Wynne (1951: 600–601) for various examples.
25. Cromer (1908: 128–146).
26. Fenn (1885: 432) and Wynne (1951: 605).
27. HCPP (1880) [C.2662]; Kaufmann and Wallach (1892: 241); Wynne (1951: 606–610); Fenn (1885: 432); Abdel-Monem (1946: 132); Crouchley (1938: 124).
28. Cromer (1908: 173).
29. Fitzmaurice (1905: 250).
30. Cromer (1908: 175–375) documents in detail the events, which led to the British intervention, and the negotiations, which took place between the powers. Moreover, see Cain (2006); Hopkins (1986); Cameron (1898: 259–269); Milner (1892).
31. Cromer (1908: 11). A similar opinion is elaborated by Atkins (1974: 264).
32. Platt (1968: 180).
33. Feis (1972: 391); Wynne (1951: 616–617).
34. Dairas or "administrations" refer to large estates of the Egyptian Khedive and his family; McCoan (1877: 146).
35. Sir Edgar Vincent (1857–1941, later Viscount D'Abernon) spent most of his career in the Middle East as imperial administrator, international civil servant and financier. He served as the Financial Adviser to the Egyptian Khedive and Director-General of the Imperial Ottoman Bank; Auchterlonie (2000). HCPP (1885: 51–52) [C. 4421].
36. RA (1884).
37. HCPP (1885: 85) [C. 4421].
38. Holland (1885: 194–205).
39. Wynne (1951: 620); HCPP (1885) [C. 4341].
40. Wynne (1951: 621) and RA (1885).
41. Wynne (1951: 621–622).
42. Crouchley (1938: 169–171); Feis (1972: 393); Brunyate (1906).
43. Crouchley (1938: 178–179).
44. A. Z. (1905: 102–103).
45. Bank al-Ahli al-Miṣri (1949: 21); Crouchley (1938: 169–171); Feis (1972: 393).

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46. Brunyate (1906: 55–65); Feis (1974: 395).
47. Colvin (1905: 343).

4 Fiscal Control and Political Cooperation: The Ottoman Empire, 1854–1914

1. Karpat (1972); Quataert (1994).
2. Pamuk (1978).
3. Pamuk (1978: 106).
4. Esteves and Tunçer (2014).
5. The first non-interest-bearing paper money experiment of the Ottoman Empire then took place from 1853 to 1862. These "state notes" were also not backed by gold or silver reserves. In order to finance the extraordinary state expenditures, the government issued large amounts of kaime and before long the kaimes had depreciated heavily against silver; Akyıldız (1996).
6. Wynne (1951: 358).
7. HCPP (1862: 39), [c.2972].
8. Tunçer (2013).
9. Wynne (1951: 401).
10. Economist (1873: 1110).
11. Eldem (1999: 128–139); Wynne (1951: 411).
12. Eldem (2005); Al (2007).
13. Economist (1875: 1190).
14. The other two significant cases were Spain, which defaulted on an outstanding debt of £170 million, and Egypt on £100 million as discussed more in detail in previous Chapter 3; Suter (1992: 67–69).
15. Economist (1875: 1310).
16. Clay (2000: 369–380); Wynne (1951: 424).
17. Yackley (2013: 125–181).
18. Wynne (1951).
19. Blaisdell (1966: 84–85).
20. Clay (2000: 383).
21. The treaty recognized the complete independence of the principalities of Romania, Serbia and Montenegro and the autonomy of Bulgaria.
22. HCPP (1878: 268) [C. 2083]; Blaisdell (1966: 85).
23. Blaisdell (1966: 86).
24. Wynne (1951: 429–430); Times (1880: 3).
25. The negotiations lasted until December 1881. During this period the parties organised 24 meetings; Sağlam (2007).
26. Muharrem was the name of the month in the Islamic calendar, in which the decree was signed.
27. HCPP (1911: 672–675) [Cd. 5736].
28. HCPP (1911: 675–683) [Cd. 5736].
29. Blaisdell (1966); Wynne (1951). See also Birdal (2010); Pamuk (2000: 216); Kiray (1988).
30. Approximately one-third of an acre.
31. Turkish word for "state officer".

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