The Failure of the Multezim System in the Ottoman Empire: A Game-Theoretic Assessment

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*** First Draft***

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The multezim system provides major insights on the place of the rule of law in the Ottoman Empire. The multezim system is a version of tax-farming contract. It carries all the problems of similar contracting mechanism. However, there is not much in the literature that look at the multezim system with an emphasis on the institutional characteristics and issues. Multezims had a unique place in the Ottoman economic system. They were not pure entrepreneurs, nor were they agents of the State. The multezim undertook risk and followed his own economic interests. The multezim system encouraged opportunistic behavior on both sides of tax-farming contracts. This paper addresses the nature and consequences of the Multezim system in terms incentives it creates. We study tax-farming contracts from 1582 to 1826, signed between the State and multezims. More than 250 contracts are examined. We look into contract duration, the correlation between rents paid to the State and opportunistic behavior, and the reasons for the failure of the Multezim system as a tax-revenue source. In this way, the evidence of why contracts between the State and multezims could not be maintained in the long-run will be presented with a game-theoretic perspective that highlights institutional problems.

The question of why opportunistic behavior appeared on both sides of the contract as dominant strategy rather than turning it into an assurance game is addressed. The role of opportunistic behavior is related to the absence of rule of law in terms of the Multezim system. The inability of the involved parties of resolving the prisoners' dilemma problems through contracting is addressed in the paper as well. We find that rent transfer and short-sighted opportunistic behavior was institutionalized instead of efficiency-increasing entrepreneurial activity by multezims.

INTRODUCTION

A major area of the new institutional economics deal with the question why some societies could adopt institutions that enhance economic growth and others could not. During the pre-industrial ages, the vast majority of countries faced similar economic and political problems. These problems were mostly based on fiscal pressures due to the increasing war expanses and technology. In order to solve financial issues, each country run different mechanisms to increase revenues of the budgets. These mechanisms also determined the direction of the economic performances of countries. Not only the factors of production, but also the incentive mechanisms that shaped by institutions, and hence, the decision-making processes of players (political and economic) played an important role in determining economic performance.

In the game-theoretic context, cooperation is rewarding for each player to obtain maximum gains from exchanges. However, achieving and sustaining cooperation among players are difficult in a world of many players, unrepeated and finite games, and limited information. While cooperation can be the equilibrium in small societies where games are played repeatedly and continually with full information about past conducts of other players, transaction costs hinder cooperation in large societies. Large communities create searching costs for each player to find out proper partner in order to establish a contract for exchanges. Furthermore, information costs about past conducts of potential partners becomes higher for each player. As a matter of fact, imperfect or asymmetric information problems occur, thus creating additional transactions costs. To achieve cooperation, these transaction costs should be lowered. So, institutions matter.

WHAT ARE INSTITUTIONS?

Douglass North (1990: 3-4) describes institutions as humanly devised constraints that consist of both formal (law, legislation, rules etc.) and informal rules (norms, traditions, culture etc.). He also adds that institutions are formed in order to create and sustain order in transactions, and reduce uncertainty. In addition, well-defined choice sets and the rules of the game under an institutional structure entail to achieve optimum outcomes or equilibriums. From this point of view, the direction of an economy through growth, decline or stagnation depends on the structure of institutions. Ronald Coase (1960), on the other hand, emphasizes transaction costs in an economy, and adds that when transactions are costly, institutions matter. Institutions, of course, are not decisive on their own. The interaction between institutions and

other organizations (players, the state, third party enforcers, etc.) determines the direction of institutional evolution in an economy.

This study examines contractual mechanisms at play for the Ottoman Empire with an emphasis on iltizam (tax-farming) contracts. It shows that contractual parties (the state and the agents) prefer to be opportunistic depending on economic and political institutions. The key variable is the institutional structure and its evolution. We focus on whether it solves coordination, commitment and enforcement problems or not under tax-farming and life-time tax-farming contracts. This study analyzes implications of models through a data set composed of tax-farming contracts and life-time tax farming contracts issued in the Ottoman Empire between the state and its agents during the period starting the from 1530s to the 1830s.

INSTITUTIONAL STRUCTURE AND ITS EVOLUTION

Ottoman economy was based on agriculture as in other countries in early modern period. In the beginning, Timar contracts were the dominant institution that was also the main determinant for the conduct of economic policies until the end of 16th century (Inalcik, Encyclopedia of Islam, Timar: 168; Karaman and Pamuk, 2010: 589). Under this institutional structure, contracts were issued among the state and military officers called as sipahi. These kinds of contractual arrangements were simple. Agents were responsible for tax-farming, providing security and training soldiers for the army. The state had reduced transaction costs through these contracts in exchange for giving a share out of revenue from the lands subjected to contracts. However, increasing war expenses and the growing role of technology caused deterioration on the financial structure. In other words, periods of war and their financial pressure became decisive in the change of institutional structure. Furthermore, Halil Inalcik (Encyclopedia of Islam, Timar: 171-172) argued that two other reasons caused to change on institutional structure. Returns from these lands decreased while war expenses were increasing for agents. Expanded territories entailed increasing costs for agents because of long-distance campaigns. These costs were consisting of economic problems, and secondly there were political problems on these contracts. Under the institution of Timar, agents could gain considerable income. For this reason, with the growing army, the number of agents had also increased, and the demand for contracts had also increased while the growth rate of lands was less than the growth rates of agents. Therefore, favoritism and bribery had begun on contract arrangements during the last quarter of sixteenth century (Koçi Bey, 1985; Inalcık,

Encyclopedia of Islam, Timar: 171). In this respect, Timar institution was transformed into a new institution, called as iltizam (tax-farming contracts).

The Tax-Farming Contracts

Iltizam refers to the allocation of tax revenues to private individuals with an entrance fee by the ruler. In other words, the system can be considered as a kind of privatization of taxation (Genç, Encyclopaedia of Islam, Iltizam article: 154). According to Mehmet Genc (2000: 102), Iltizam system became an essential institution for the Empire to increase cash payments to the central government rather than in kind payments. Furthermore, it was expected that the new institution would increase the tax revenues. However, Genc (2000) also argued that the new institution led to the emergence of a new class similar to private enterprises. Members of this new class can be called as multezims (agents). Their duty was to collect taxes from the reaya, convert them to cash in the market, and finally transfer cash to the central government.

Agents could obtain tax-farming rights with regard to an auction that controlled and organized by the state. On the other side, agents could monitor the variables of each tax farming land contracts in order to calculate costs, benefits and annual payments to be paid to the Treasury. After the cost-benefit analysis, each agent could offer tax-farming contracts to the state. These contracts had limited length and assigned to agents with limited periods which were usually between 1 and 3 years (Genç, 2000: 103). Genç (2000) also claimed that the agents acted as an enterprise within the law. Profits of the agents came from the difference between total revenues and taxes to be paid to the central government. In this sense, the tax-farming contracts were established in order to cover increasing costs of the state and to obtain tax based on cash.

According to Şevket Pamuk (2004: 240), "further deterioration of state finances during the seventeenth century forced the central government to take greater advantage of the tax-farming system for the purpose of domestic borrowing"[1]. In this sense, one of the most credible reasons for transforming tax-farming contracts from the fief was to provide domestic borrowing in order to maintain duty of the Treasury. Furthermore, Pamuk (2004) also added that length of tax farming contracts was increased in order to obtain advantages of the contracts. In addition, state also increased the amount of auction prices in advance.

[1] Also see Cezar (1986). Cezar also associated the tax farming contracts (iltizam) with domestic borrowing.

Agents could get involved in the tax-farming contracts alone or with partners. In the beginning of the tax-farming contracts, agents and their guarantors were chosen from local individuals with capital. However, guarantors started to specialize and settle in large cities, especially in Istanbul. Genc (Encyclopaedia of Islam, 155) argued that these guarantors evolved into a new class or institution called as creditors or loan institutions. Furthermore, loan institutions had received a share of the tax-farming contract profits. According to Pamuk (2004: 240), Greek and Jewish financiers who gained liquidity on some of the most lucrative tax farming contracts.

From the beginning of the mid-seventeenth century, auction prices reached their peaks and offers for tax farming rights remained at constant level (Genc, Encyclopaedia of Islam, Iltizam article: 156). In other words, entrance fees and annual installments of tax-farming contracts could not be increased by the agents. In addition to economic capacity problem, institutional problems also emerged. Thus, the tax-farming contract was transformed into a new system at the end of 17th century.

The Malikane System (Life-Time Tax Farming Contracts)

Due to the problems of the tax-farming contracts, life-time tax-farming contracts system was established and transformed at the end of seventeenth century. There were structural differences between the former and the latter contracts. First of all, taxable lands were allocated for life-time utility under the new institution instead of short-term tax-farming contracts. It was expected that the contracts that given life-time duration would not be terminated until the agents died.

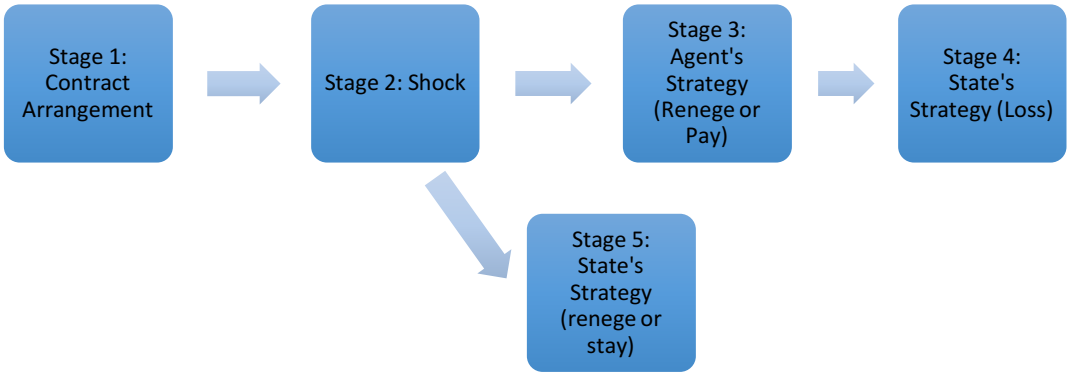
Secondly, life-time tax farming contracts differed with respect to its competition conditions and annual payments. Agents annually had to pay fixed payments to the central treasure. Agents could gain profits from the difference between total revenue and fixed payment. According to Genc (Encyclopaedia of Islam, Iltizam article: 157), the life-time tax-farming contracts were established in order to create incentive for investment and revenues for the agents, which could entail also increases in budget revenues. In addition to fixed annual payments, agents had to pay also an entrance fee or cash in advance to obtain a life-time contract on arable lands. Advance payments were determined with an auction system which was also designed and controlled by the state. It was expected that agents would expand production capacity and value of the lands under the life-rime contract, and the state could re-auction these lands with higher prices to the new agents. Therefore, the main purpose of the

state was binary. First, sustainability of taxable lands would be protected, and secondly, tax revenues would be increased (Genc, Encyclopaedia of Islam, 157).

Genc (2000) also argued that life-time tax-farming contracts created a new class that consisted of secondary and third party agents and added that these agents could be considered as rentiers[2]. The numbers of increased agents were pointed out by Pamuk (2004: 241) that 1.000 to 2.000 thousand individuals based in Istanbul together with 5.000 to 10.000 agents or intermediaries. Therefore, increasing numbers of agents caused to augment tax burden on reaya. While the primary agents were staying close to the sultan in Istanbul, second and third party agents consisted of local rulers or powerful groups who had significant influence on reaya and territory of lands.

The figure 1 illustrates stages of contractual arrangements.

Figure 1. Stages of the Game



According to Pamuk (2004: 240), the life-time tax-farming contracts were established in order to increase the amount of domestic borrowing when the fiscal pressures were the greatest because of wars during the last decades of the seventeenth century. By applying life-time contract, state could gain much more entrance fee in advance from the agents. Pamuk (2004) also added that the state expectations with regard to life-time contract were to encourage better care for the taxable lands by the agents. Thus, long-term increases in production and productivity could be realized. By contrast, Pamuk (2004) argued that the life-time contract allowed the state to use tax revenues to borrow a longer term in fact.

[2] We prefer to renamed these classes as agents.

THE DATA SET AND PRELIMINARY FINDINGS

So far, 435 tax-farming contracts are obtained and examined. These contracts include the name of the tax-farming contract, years, total price, intended duration, actual duration (some of them), and annual payments. 219 tax-farming contracts are terminated before its intended duration by the state. However, more than these 219 contracts, annual payments show huge variations and fluctuations.

In the game-theoretic context, a prisoner's dilemma game occurred between the state and its agents. The state started to reallocate taxable areas with an auction mechanism through a new class, mültezims (elites, local elites or economically powerful groups) in order to decrease costs of increasing revenues and financing fiscal pressures under the new institutional structure. This new institution also determined the rules of the game. Contracts were transferred with auction through mültezims, and hence, the state could collect tax revenues in advance. The difference between the payment of the agent and excess gain from tax farming was the profit of the agent. According to the auctions, this game is considered as a Prisoner's Dilemma game, because the game was not played repeatedly and one player had an information problem about past conducts of other player. Under this environment, the dominant strategy will be defect for each party.

This study examines tax-farming contracts from the mid 16th century to 17th century in order to analyze and reveal explicit findings that supports Prisoner's Dilemma game in the Ottoman Empire. The preliminary findings demonstrate that the dominant strategy of the state and its agent was defect, and maximize short-term gains instead of long-term gains.

Fluctuations in low-scale contracts are occurred because of regional competition of the local powers. As it was mentioned above, each agent could offer a new fee to obtain a contract to the state. If this offer was higher than former contract fee, the state could terminate the contract and transfer it to the new agent. The institutional structure or the rules of the game cause opportunistic behavior for each contracting party. An agent could easily increase costs of obtaining contracts, and hence, the other agent, who held the contract, concentrated on maximizing his short-term gains. Thus, these agents preferred rent-seeking activities rather than profit-seeking. The extracted contracts show that the payments had fluctuated and increased more than % 30 and % 50 percent in short-term. However, these contracts with increasing amounts of payments were also terminated because of the commitments that had not been met or the acceptance of a higher offer of another agent by the state.

On the other side, fluctuations in bigger contracts depended on discretion of the state and high-ranking bureaucrats. The main problem on these contracts is mostly commitment problem. These contracts had both higher value and political importance. They were mostly transferred to high-ranking bureaucrats and their agents. In other words, these contracts provided high returns to its contractors in both economic and political area. However, the preliminary findings of the study ascertained that these contracts were mostly terminated by the state in order to reallocate them through other powerful groups, who committed more returns to the state. According to the findings, high-scale contracts were transferred to powerful groups under "Political Opportunism". When a change in high-ranking bureaucrats or power balance among local powers, these contracts were terminated and transferred into a new group. Approximately %90 percent of high-scale contracts were terminated before the intended duration of the contract, and new payment amounts of these contracts were differentiated according to the political and economic according to situations of the state in that time such as warfare, political crisis or fiscal pressures.

To sum up, opportunistic behavior is the dominant strategy for each party, the state and its agents. This can be deduced from high rate of changes on the payments of the contracts, and from terminated contracts before intended durations in order to transfer these contracts to other powerful groups or agents. These findings make something a current issue: why the Prisoner's Dilemma game could not have transformed into an Assurance Game in the Ottoman Empire? Why the institutional structure could not diminish the costs of commitment problem and coordination problem? And most importantly, what was the main failure of the mültezims as an agent of the state or powerful groups?

The aim of this study is to answer these questions. However, contracts are still extracted from archives for the mid 17th century to the Tanzimat Era. By doing this way, institutional change can be tracked with diverse variables such as changing conditions of the contracts, values of payments or changes of the rules of the game.

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