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The Cost and Fate of Paying Debt with Debt

A 172-year account of external borrowing from the Ottoman Empire to the Republic of Türkiye (1854–2026): debt stock and interest by year, and the refinancing spiral

Prepared for: H.E. Recep Tayyip Erdoğan, President of the Republic of Türkiye · Chairman of the Türkiye Wealth Fund (TVF), and the TVF Board

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01 Executive Summary

539.0	25.0	274.6	31.8%	100 yrs
$ bn gross external debt, Q2 2026	$ bn external interest 2025 — record	$ bn cumulative external interest 2003–2025	external debt / GDP (Q2 2026 est.)	1854 first loan → 1954 last Ottoman instalment

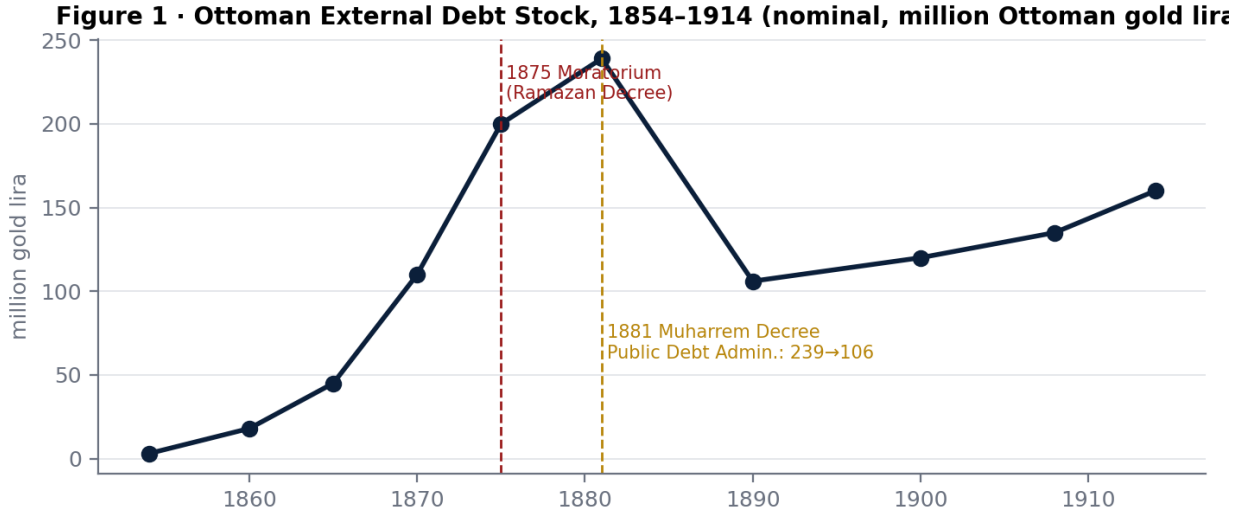
Türkiye's external debt history begins with a £3 million loan raised in London in 1854 to finance the Crimean War and closes its first, hundred-year cycle on 25 May 1954, when the Republic paid the final instalment of the Ottoman debt. The central finding of this report is that a second and larger cycle opened as soon as the first closed: the legacy debt zeroed in 1954 had become $16 bn by 1980, $130 bn by 2002 and $539 bn of gross external debt by mid-2026.

The size of the stock is misleading on its own. At 31.8% of GDP, external debt is well below the emerging-market average and public debt is around 23% of GDP. Türkiye faces not a "debt crisis" but a **cost-of-interest and roll-over-dependency** problem:

- External interest paid in 2025 ($25 bn) is more than four times the 2002 figure ($6 bn); the stock grew 4.3× — interest has grown faster than debt.
- Cumulative external interest 2003–2025 ($274.6 bn) exceeds twice the entire 2002 stock ($130 bn): Türkiye paid its 2002 debt twice over in interest, and the stock grew.
- External liabilities falling due in 2025 totalled $221 bn; with the current account deficit, annual refinancing needs exceed $250 bn — roughly 17% of GDP rolled over every year.
- Public external debt is $197.9 bn (37% of the stock); the cost has largely migrated to the private sector ($16.6 bn of 2025 external interest).

> **Thesis:** the cost of paying debt with debt is interest; its fate, when interest grows faster than income, is first shorter maturities, then currency risk, and finally a narrowing of sovereignty. Türkiye stands today at the first link (high interest cost); the second (32% short-term, 78% foreign currency) is visible; the third should stay on the table as a historical warning.

02 Ottoman Borrowing: From the First Loan to Moratorium (1854–1881)



Source: Blaisdell (1929), Pamuk (2007), VMA compilation. Nominal stock; post-1881 figure is the amount recognised by the Public Debt Administration.

The Ottoman state avoided foreign borrowing until the Crimean War. The first bond (24 August 1854, Palmer & Co./Goldschmidt) — £3 m, 6% coupon, issued at 80, secured on the Egyptian tribute — set the pattern of the next twenty years: **nominal 3, received 2.3, interest on the nominal.** Between 1854 and 1874 about £212 m nominal was raised at an average issue price near 60; only ≈ £116 m reached the Treasury. The effective cost of a 6% coupon on money actually received was 10–12%. By 1874 debt service (≈ £14 m) absorbed 55–60% of revenue (≈ £22–25 m), and the 1874 loan was explicitly raised to pay interest.

Year	Loan	Nominal £m	Issue price	Net £m	Coupon	Security / purpose
1854	Palmer–Goldschmidt	3.0	80	2.3	6%	Egyptian tribute; Crimean War
1855	Rothschild (Anglo-French guarantee)	5.0	102.6	5.1	4%	Tribute + Smyrna/Syria customs
1858	Dent, Palmer	5.0	76	3.8	6%	Istanbul customs; paper-money retirement
1862–63	Imperial Ottoman Bank (2)	16.0	68–71	11.1	6%	Tobacco, salt, stamp duties
1865	General Debt + IOB	42.4	50–66	22.2	5–6%	Domestic debt consolidation; deficit
1869–70	Comptoir d'Escompte; Rumelia Railways (Hirsch)	53.9	32–54	22.2	3–6%	Deficit; railway lottery bonds
1871–73	IOB; Treasury bill consolidation; Crédit Mobilier	44.6	54–98.5	30.1	6–9%	Short-term roll-over; deficit
1874	General Debt	40.0	43.5	17.4	5%	**Borrowing to pay interest**
Total 1854–1874 (≈)		**≈ 212**	**avg ≈ 60**	**≈ 116**	**avg 5.6%**	**45% of nominal lost on paper**

6 October 1875 (Ramazan Decree): half of debt service to be paid in new 5% bonds; within a year cash payments stopped too — de facto default in 1876. The moratorium was not unwillingness to pay but arithmetic: once debt service exceeds 50% of revenue, paying interest with new debt grows the stock 8–10% a year, and each 100 units of interest creates 160–180 units of new nominal debt because of issue discounts.

03 The Public Debt Administration (1881–1923): The Cost of Lost Fiscal Sovereignty

The **Muharrem Decree (20 December 1881)** consolidated 239 m gold lira of nominal debt plus 53 m of arrears into 106.4 m lira at 1–4% interest — a haircut above 55%. In exchange the Ottoman Public Debt Administration was created and the salt and tobacco monopolies, silk tithe, fishing, stamp and spirits duties, the Eastern Rumelia tribute and Cyprus surplus were assigned to it. By 1912 the Administration employed over 5,000 staff — larger than the Finance Ministry — and directly managed silk, salt and tobacco production.

Item	m gold lira	Note
Pre-1881 nominal debt	239.0	1854–74 loans + 1875 bonds
Accrued unpaid interest	53.0	1875–81
Consolidated debt, Muharrem Decree	106.4	> 55% haircut
Revenues assigned to the Administration, 1882 / 1912	≈ 2.5 / 3.5 per yr	20–30% of state revenue
Collected by the Administration 1882–1914	≈ 95	Interest + amortisation + costs
New borrowing 1886–1914 (guaranteed by the Administration)	≈ 160	Baghdad Railway, Hejaz, navy, 1908–14 deficits
External debt stock 1914	**≈ 160**	**New loans exceeded the consolidated old debt**

> **The paradox:** debt cut to 106 m lira in 1881 was back above 160 m by 1914. The haircut did not change behaviour; it merely restarted the cycle. In investment-banking terms the Administration was a revenue-secured restructuring with escrow — perfect for creditors, who recovered nearly the whole consolidated amount by 1914. For the borrower, the true cost was thirty years' lease of the most liquid part of its tax base: customs increases required creditor consent, and ≈ 20,000 died in clashes between Régie guards and tobacco farmers.

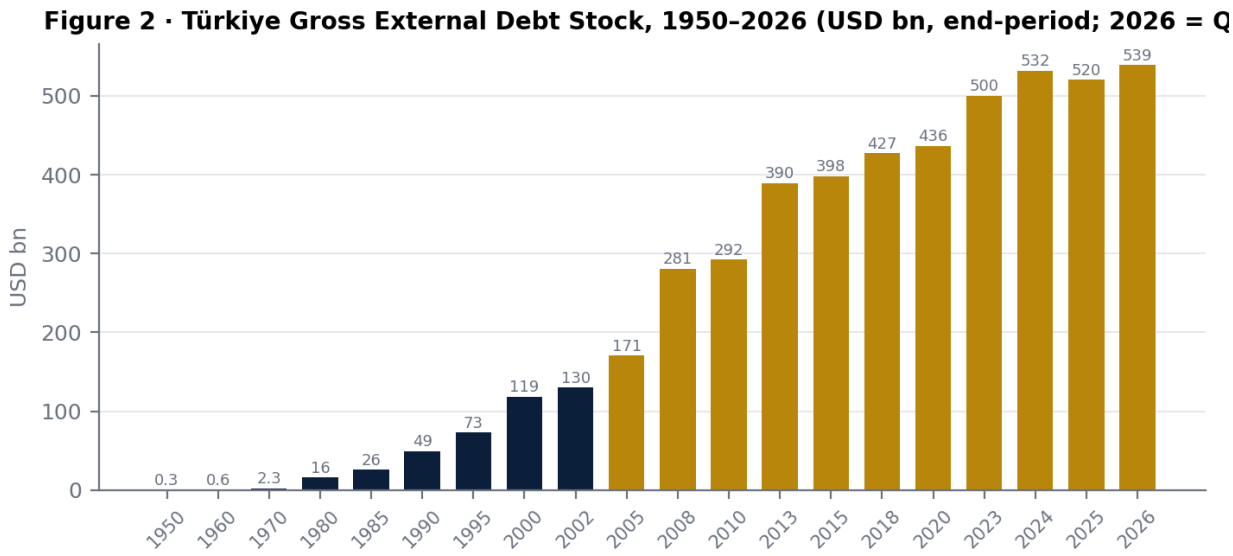
04 From Lausanne to the Last Instalment (1923–1954): The Only Net-Reduction Period

At Lausanne (24 July 1923, Articles 46–57) the Turkish delegation secured apportionment of the Ottoman debt among successor states on a revenue basis: Türkiye assumed 62% of pre-1912 and 67% of post-1912 debt — ≈ 84.6 m gold lira of principal, ≈ 107 m with interest — while Greece, Syria-Lebanon, Iraq, Palestine, Bulgaria, Yugoslavia and others took the remainder (≈ 130 m in total).

Period	Regime	Annual (≈)	Period total (≈)	Note
1923–28	Negotiation — no payments	—	—	Interest accrual disputed
1929–30	1928 Paris Agreement, gold lira	2.0 m gold lira	3.5 m	Suspended 1930 after the gold standard collapsed
1933–39	1933 Paris Agreement, French francs (962 m FF; maturity 1952)	45 m FF	300 m FF	1936 and 1938 franc devaluations cut the real burden
1940–44	War; partial payment	varies	150 m FF	Balance reduced to 8 m TL in 1944
1945–54	Turkish lira instalments	0.8 m TL	8 m TL	**25 May 1954: final instalment**

> **Why it worked:** (i) no new foreign borrowing between 1923 and 1933 — a deliberate refusal of the "pay debt with debt" reflex; (ii) global monetary disorder (collapse of the gold standard, franc devaluations) used in the borrower's favour. The Republic's first thirty years are the only net-reduction period in 172 years of external debt history.

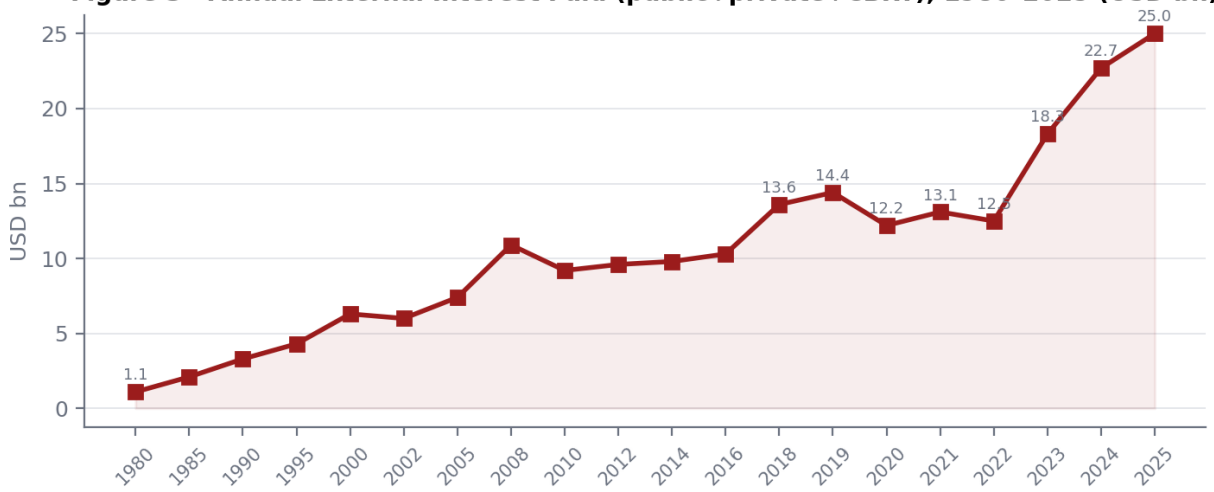
05 The Republic's Own Borrowing: Stock and Interest by Year (1950–2026)



Source: World Bank IDS; Ministry of Treasury and Finance; CBRT. Navy: 2002 and earlier; gold: 2003 onwards. 2024 approximate; 2025 year-end derived from the CBRT Q1 2026 revision.

Year	Gross external debt $bn	Public share	External interest $bn	Debt/ GDP	Event
1958	0.90	≈95%	0.03	≈10%	First rescheduling; 69% devaluation
1970	2.3	≈90%	0.08	≈13%	Devaluation; convertible FX deposits begin
1978	14.9	≈70%	0.7	≈22%	Payment difficulties; second rescheduling
1980	16.2	≈75%	1.1	27%	24 January decisions; 33% devaluation
1990	49.4	≈70%	3.3	32%	Capital account liberalised (1989)
1994	65.6	≈65%	3.9	50%	April crisis; short-term outflows
2001	113.6	≈55%	7.1	58%	February crisis; IMF 19th Stand-by
2002	130.3	≈55%	6.0	56%	Transition to a Strong Economy programme
2008	281.1	28%	10.9	37%	Global crisis
2013	389.5	30%	9.7	41%	Investment grade (briefly)
2018	427.2	33%	13.6	56%	Currency shock
2020	436.3	39%	12.2	60%	Pandemic; reserve erosion
2023	499.9	41%	18.3	45%	Return to orthodox policy
2025	≈520.5	≈38%	25.0	≈35%	Record external interest
2026 Q2	**539.0**	**37%**	**—**	**31.8% (est.)**	**Short-term 170.7; long-term 368.2; 49% USD, 29% EUR, 12% TL**

Figure 3 · Annual External Interest Paid (public+private+CBRT), 1980–2025 (USD bn)

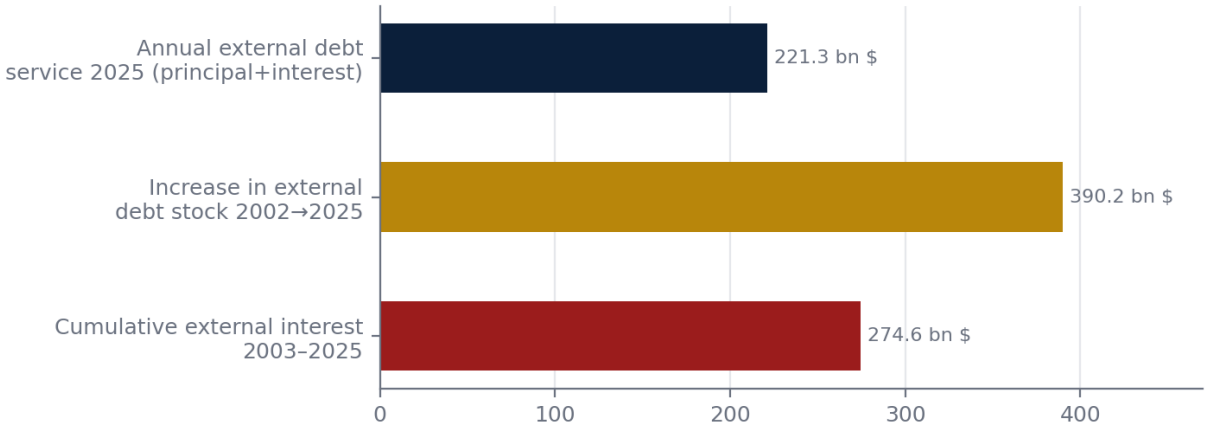


Source: World Bank IDS; Treasury/CBRT balance of payments; CHP Parliamentary Group Economic Report (Feb 2026) for 2021–2025. Cumulative 2003–2025: $274.6 bn ($121 bn public + CBRT; $154 bn private).

Three reschedulings, three lessons. 1958: external debt cannot grow faster than export capacity. 1978–80: private FX debt taken through banks became Treasury debt when the exchange rate was held — the most important warning for today's $318 bn of private external debt. 2001: when interest exceeds tax revenue (103% in 2001) the market closes the cycle by force.

06 The Arithmetic of Paying Debt with Debt

Figure 5 · The scale of paying debt with debt (USD bn)



Source: VMA calculation; CBRT, Treasury. Stock increase: $130.3 bn → $520.5 bn.

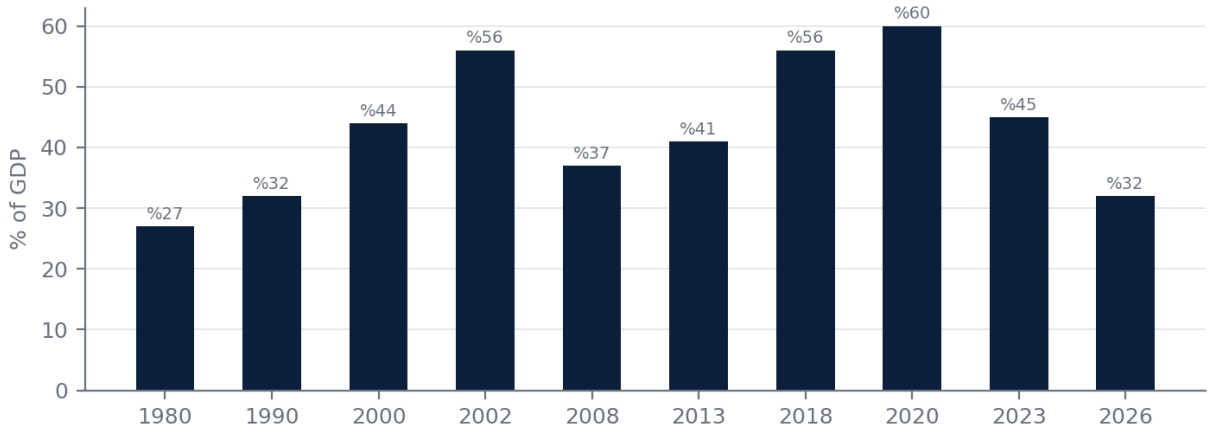
> Δ(Debt/GDP) = (r – g) × (Debt/GDP) – primary balance/GDP. When the effective dollar interest rate r exceeds dollar GDP growth g and no primary surplus is generated, the debt ratio grows automatically. In 2018–2023 r ≈ 4.5–6% and dollar g ≈ 1–3% (currency losses): the ratio rose from 41% to 60%. In 2024–2026 dollar growth (real appreciation) exceeded r and the ratio fell from 60% to 32%.

Parameter	1854–74 Ottoman	1990–2001	2018–23	2024–26
Effective borrowing cost (r)	10–12% (gold)	8–10% ($) / 90%+ (TL)	5–7% ($)	6–8% ($)
Income growth (g, same currency)	2–3%	3–4%	0–2%	8–12% (real appreciation)
r – g	+8–9 pts	+5 pts	+4–5 pts	–2 to –4 pts
Interest / government revenue	55–60%	77–103%	9–11%	11–15%
Average maturity	Shortening	Shortening	Shortening (34% short)	Flat (32%)
Outcome	1875 moratorium	2001 crisis + IMF	2021–23 currency shock	Fragile stability

Opportunity cost. The $66 bn of external interest paid in 2023–2025 is more than twice the net FDI received in the same three years (≈ $30 bn): the country pays more to retain capital than it attracts. **Maturity is the silent signal.** Every historical break was preceded by shortening maturities about three years earlier. With ≈ $220 bn due within twelve months against gross reserves of ≈ $180 bn (net far lower), roll-over capacity depends entirely on uninterrupted market access — exactly what closed in 1875 and 2001.

07 Strategic Options and the Role of the Türkiye Wealth Fund

Figure 4 · Gross External Debt / GDP (%), selected years



Source: World Bank, CBRT, Treasury; VMA calculation. 2026 is the Ministry's Q2 estimate.

Lever	Mechanism	Precedent	Scale	Risk
1. Lower the risk premium	BB+ → BBB− cuts new-issue margins 150–250 bp	Türkiye 2005–12; 2013 investment grade	$3–5 bn/yr on $221 bn rolled annually	Gains evaporate on programme slippage
2. Extend maturity, manage currency	Short-term share 32% → 25%; TL share of external debt 12% → 20%	Treasury 2004–07 extension	Cuts 12-month due amount by $40–50 bn	Longer tenor costs more up front
3. Reduce debt from the asset side (TVF)	Partial IPOs / strategic stakes in low-yield TVF assets; proceeds to Eurobond buybacks	Temasek, Khazanah debt-asset swaps	Each $10 bn retired ≈ $0.6–0.8 bn/yr saved	Pricing; perception; strategic control
4. Primary surplus and current account	Current deficit below 1% of GDP cuts financing need $30–35 bn/yr	2001–04 6.5% primary-surplus programme	Breaks roll-over dependency structurally	Growth and political cost

SPECIFIC RECOMMENDATIONS FOR TVF

1. **Debt-for-asset swap programme:** gradual monetisation of TVF assets yielding below the sovereign cost, proceeds to Eurobond buybacks; 20–25% of the $8.4 bn public+CBRT external interest could be eliminated within five years.
2. **Consolidated public balance sheet:** report TVF assets and Treasury external debt as one net public position so agencies rate net rather than gross debt — the cheapest path to an upgrade.
3. **Contingent-liability monitoring:** joint TVF/Treasury stress test of the $318 bn private external debt, pricing the segment likely to be nationalised in a currency shock (energy and infrastructure PPPs with guaranteed FX revenues).
4. **Domestic savings channel:** long-dated TL bonds issued by TVF subsidiaries to raise the TL share of external debt, lengthen maturities and cut currency risk.

> **Closing:** the first cycle (1854–1954) ended in lost sovereignty not because of debt but because paying interest with debt became a habit. The second cycle opened in 1958 and stands at $539 bn and $25 bn of annual interest. The two principles that closed the first cycle — reducing debt without new borrowing and using global conditions in the borrower's favour

> — still apply. What is new is that the asset side (TVF) and the liability side can now be managed at the same table.

SOURCES

CBRT External Debt Statistics Q1–Q2 2026 and remaining-maturity short-term debt; Ministry of Treasury and Finance Public Debt Management Reports and Financing Programmes; World Bank International Debt Statistics (DT.DOD.DECT.CD, DT.INT.DECT.CD); Blaisdell, *European Financial Control in the Ottoman Empire* (1929); Kıray (1993); Pamuk (2007, 2014); Clay, *Gold for the Sultan* (2000); Birdal (2010); Treaty of Lausanne Part II; 1928 and 1933 Paris Agreements. Pre-1980 interest figures are estimates; 2024–25 year-end stocks are derived from CBRT quarterly revisions and marked "≈".