APPENDIX - C


I.
The Baghdad Railway

... Memorandum prepared by the Direction of the Prime Minister.

The General Staff, in a memorandum of the 16th November 1904 (45 E), has noted the military aspects of the Convention of 1902 (section 3), and has pointed out the disadvantages, political, commercial, and strategic, which the control by Germany of a line to the Persian Gulf would entail upon Great Britain (sections 7 to 9).

2. The history of the proceedings in regard to this railway down to the end of 1904 is summarised below (see Appendix), and it will be seen that the line has now reached Eragli. Further progress depends upon the arrangement of a kilometre guarantee embracing the next two sections, which prolong the line through the Taurus Range as far as Tell-Habesh. The crossing of the Taurus is estimated to involve about 100 miles of blasting and tunnelling.

3. Under the Convention, the German Anatolian Railway can be extended to the Persian Gulf, and Article 29 provides that no section of the
line between Baghdad and Basrah may be worked before the completion of the portion between Konia and Baghdad. This provision was intended to prevent the construction of a British line from the Gulf to Baghdad, which is now possible only as part of the German scheme, or on condition of the grant by Turkey of a separate concession to this country.

4. When British co-operation was sought, on terms which could not be granted, political considerations were probably in the ascendant. The German Government was apparently anxious not to stand alone in the prosecution of a scheme which Russia viewed with dislike, and British support was, therefore, desired in view of eventualities. Now that the war in the Far East has disclosed inefficiency throughout the Russian army, and will probably have the effect of curbing Russian activities for some years, the desire for British co-operation in the Baghdad Railway scheme from the purely political point of view only may be somewhat abated.

5. The main question at the present moment is whether the German Government can secure sufficient financial support to complete the railway to the Gulf, even if the Turkish Customs duties are not raised sufficiently to serve as a security for the kilometric guarantees. In other words, can Germany complete the
line without British co-operation?

6. The financial arrangements made by the German promoters of the railway with the Turkish Government are somewhat remarkable. That Government is to issue its own bonds at the rate of 10,700 £ per kilom. (equivalent to 17,186 £ per mile), in respect to each section of 200 kilom. Such bonds are to bear interest at 4 per cent, with a sinking fund providing for their redemption during the period (99 years) of concession. They are to be secured by the particular section of the line in regard to which they are issued and in addition by such other special security as may be agreed upon between the Railway Company and the Government. Thus, in the case of the Konie-Bregli section, the special security - up to the value of £7,36,000 - is an assignment of the tithes in certain cases of the Vilayets of Baghdad, Aidin Mosul, and Diarbeikr. As the total annual amount so hypothecated is 50,000 £, the margin of security is ample. In a letter to Mr. Townley of the 26th November 1904, Vice-Consul Townsend states that the Company is only spending about 50 per cent of the guarantee, and is thus getting 9 or 10 per cent interest on its actual outlay. As a single 5 feet 6 inches gauge line in India costs about 10,000 £ per mile, this statement is probably correct. The expenditure on the Taurus section will, however, be largely in
excess of the average.

7. It appears, therefore, that bond-holders are fully secured in so far as Turkish credit is to be trusted, and that the raising of the Customs dues is required in order to provide an ultimate guarantee by the hypothecation of a definite branch of Turkish revenue over which foreign creditors might hope to exercise some control.

8. From the Turkish point of view, the arrangement seems to leave much to be desired. There is nothing to prevent undue expenditure upon railway plant in the interests of the German producer. In other words, Turkey is saddled with the responsibility for providing interest upon money, the expenditure of which lies outside her control, and which might be saved by the regard to economy. At the same time, there is a curious provision that, if there is a defalcation in the special security allotted to any section of the line (as, for example, that referred to in paragraph 6), the Company can foreclose upon the section in question. On the other hand, the Convention allows the Turkish Government to redeem its indebtedness to the bond-holders by stipulated cash payments. As that Government rarely has cash at its disposal, this provision can only be regarded
as a practically valueless set-off to the arrangement enabling the Company to assume possession of the line in certain circumstances.

9. The Turkish Minister of Public Works is to receive a monthly statement of the receipts of the railway. If the gross receipts exceed 4,500 fr. per kilom., but not 10,000 fr., the excess over 4,500 fr. is to be handed over to the Turkish Government. If the gross receipts exceed 10,000 fr. per kilom., the excess over this figure will be divided between the Turkish Government and the Railway Company in the proportion of 60 to 40 per cent. The scrutiny of the railway accounts will require to be exceedingly severe if the above provisions ever become operative.

10. The Turkish Government bonds will be replaced by Company bonds when the financial situation permits.

11. The general arrangements are such that, while the railway is nominally an undertaking financed by the Turkish Government, the powers wielded by the Company will be very large, and are certainly capable of being exercised in various ways not immediately apparent in the letter of the Convention. If the security of the Turkish Government were equal to that of France or Germany, the whole of the necessary capital would doubtless be immediately available, and
the construction of the line could proceed to completion without hindrance.

12. The only present obstacles are the uncertainties of Turkish credit, and the political considerations, arising from the susceptibilities of Russia, which appear to have been partly instrumental in inducing Germany to seek British co-operation. As pointed out in paragraph 4, these considerations may now possibly have less weight in certain directions than at the time when His Majesty's Government was originally approached.

13. The life of the present Sultan is not likely to be prolonged. The Germans are well aware that the exceptional position they have succeeded in obtaining at Constantinople will probably not endure after the disappearance of Abdul Hamid. They have, therefore, strong inducement to take full advantage of the Convention before any change occurs, and they wish, on political grounds, to secure our co-operation before any change takes place.

14. As matters stand, it would be unwise to assume that money will not be found to finance the whole line, if the support of the German Emperor is forthcoming on behalf of a project which is evidently regarded as important for the furtherance of German policy. On the other hand, it is probable that the German Government would be reluctant to press
the project upon capitalists and investors, as such action would have the effect of drawing attention to German motives.

15. It seems clear that our position at the head of the Persian Gulf provides no means of obstructing the progress of the railway, if the requisite capital is available. Kowait is not essential as a terminus, as other suitable harbours, directly under Turkish control, exist; but it offers special advantages as implying the countenance of the naval powers at present paramount in these waters. There will apparently be no scope for diplomatic action at Constantinople until the death or deposition of the present Sultan.

16. We are, therefore, confronted with a project which if carried out under German auspices, will undoubtedly inflict injury upon our commerce, and must ultimately destroy our political influence in Southern Persia, and in the deltas of the Tigris and the Euphrates. We have the strongest grounds for preventing the control of a railway from Baghdad to the Gulf from falling wholly under the control of a Power which regards its own interests exclusively, and which well understands the manipulation of railway rates.

17. The main obstacle to the completion of the
railway is financial. Already, as pointed out in paragraph 1, difficulties have arisen in regard to the kilometric guarantee for the two sections beyond Bagdad. If these difficulties are now overcome, others of a similar nature will probably arise later, since the country to be traversed is for a long distance unproductive and inhabited by unruly tribes who would require to be controlled. The prolongation of the line through this country could be justified on economic grounds only, if the section from Bagdad to the Gulf is certain to be completed. It is from the profits which this section may be expected to secure that the loss on the non-paying portions of the line must, in great measure, be recouped.

18. It would be unwise to minimize the financial difficulties with which the German Company is confronted, or to assume that the line cannot be completed without British assistance. There seems, however, to be a probability that we shall again be approached with a view to securing our co-operation, and it appears essential, therefore, that we should consider the conditions on which such co-operation might be practicable.

19. A railway connecting two seas must usually be an advantage to this country, whatever may be its status and ownership. In the present case,
however, British interests require -

(a) that freight rates discriminating against British goods shall be impossible; and

(b) that our political influence in Southern Persia and the delta of the Tigris and Euphrates shall not suffer at the hands of a foreign Railway Company controlling communication between the Gulf and Baghdad, and consequently able to undertake the irrigation works, by the agency of which a great development of the region of the lower Tigris and the Euphrates can be brought about.

20. Under Article 9 of the Convention, it is provided that the Railway Company is to have a monopoly of the provision of the materials required for the line, and is to be granted the privilege of transporting its agents and workmen on the waterways of the Shatt-al-Abab, the Tigris, and the Euphrates. This privilege is to last "only during the period of construction", and is to be "under the surveillance of the Minister of Marine." It is, however, extremely doubtful whether the use of steamers, river wharves, buildings, improvements in navigation, &c., made at considerable expense for the purposes of railway construction, would suddenly lapse when the line was completed.
21. The Sultan is already taking part in water transport on the Tigris, and his steamers, the management of which has greatly improved, compete with the limited means permitted to the British firm of Lynch Brothers. The probability is, therefore, that water transportation, with any developments arising in the process of railway construction, may tend to pass largely to the control of the Sultan, whose private purse would benefit. If this view is correct, an attempt to develop navigation in British hands as a scheme competing with a German railway would probably fail.

22. The conditions of co-operation which would best satisfy British interests appear to be -

(a) The construction of the Baghdad-Persian Gulf section of the line, together with the contemplated branch from Baghdad to the Persian frontier, by British capital under British direction.

(b) The retention of this section under British Government.

(c) Pooling the general traffic under a working arrangement, giving Great Britain adequate representation on the directorate.

23. Mr. Gainner, President of the Board of Directors, in conversation with Sir N.O'Conor in December 1903, stated that the personally would agree
to an arrangement of this nature, if the Anatolian section of the line were left in the hands of Germany. He doubted, however, if the German Government would consent, in view of the possible displeasure of Russia, which would place them in a delicate position in regard to that power.

24. From information I have received, there appears to be no doubt that the German Foreign Office stands behind the Railway Company, and that the idea of a line to the Persian Gulf under full German control is cherished at Berlin. If, however, financial difficulties dictate a further attempt to secure British co-operation, private agencies will doubtless be employed for the purpose.

25. In this case I believe that our best policy would be to sound the French Government, with a view to ascertain whether they would be prepared to co-operate in the scheme. Isolated co-operation on our part would probably be turned to political account at Berlin as a means of weakening Anglo-French "entente".

26. Summing up the considerations above set forth, I submit the following general conclusions, viz.,-

(1) It is vital to British interests that the railway should not be completed to
the Persian Gulf under German auspices alone.

(ii) Existing international conditions render it probable that the Germans may desire to hasten the progress of the railway. Financial considerations will apparently induce them again to seek British cooperation. In this case, it should be our policy to co-operate if sufficiently favourable terms can be secured.

(iii) British interests require the fulfilment of the conditions laid down in section 22.

(iv) Political conditions appear to demand that we should, if possible, go hand in hand with France, or at least that we should not conclude a separate agreement with Germany until we have approached the French Government.

26th January 1906. O.S. Clarke.