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WHO IS THE 'SOVEREIGN' IN SOVEREIGN DEBT? REINTERPRETING AN OPEN MOMENT IN THE EARLY 20TH CENTURY

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ABSTRACT

Combining legal interpretation with political science analysis, this article highlights the competing 'realist' and 'popular' conceptions of sovereignty at stake in sovereign debt issues. It argues that these two dominant approaches do not exhaust the offerings of intellectual history, and considers an alternative, intermediate approach that emerged in the early 20th century and may be of relevance again today. In emphasizing the historical and theoretical contingency of the current sovereign debt regime, this article problematizes the assumption in international economics that only a narrow conception of sovereignty and a strict practice of debt repayment are consistent with a functioning sovereign debt market. The article contends that U.S. Chief Justice Taft's foundational 1923 Tinoco decision, which grounds the current approach to sovereign governmental recognition, has been misinterpreted to support a purely functionalist or absolutist conception of sovereignty. It argues that a proper interpretation presents an intermediate or 'rule of law' framework that coincides with Taft's domestic jurisprudence, and which provides an alternate conception of sovereignty for the current lending regime. Considering the economic and geopolitical context of Taft's decision, the article also suggests that the disappearance of this intermediate approach may be related to the increasing consolidation of financial actors over the 20th century.

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WHO IS THE 'SOVEREIGN' IN SOVEREIGN DEBT?
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I. INTRODUCTION: THE AMBIGUITY OF THE SOVEREIGN
II. CONSTRUCTING SOVEREIGNTY: AN EARLY 20TH CENTURY AMERICAN APPROACH
    A. Background & Facts of the *Tinoco* Arbitration
    B. An Intermediate Conception of Sovereignty
        1. A Functionalist Foundation
        2. Escaping the Binary: Rule of Law as a Facet of Effective Control
        3. Governmental Purpose as a Requirement for Valid Sovereign Action
    C. Situating Taft's Approach in the Legal Tradition
III. THE OPENNESS OF A 'PRO-MARKET' CONCEPTION OF SOVEREIGNTY
    A. A Closer Look at What is 'Pro-Market'
        1. A Pro-Market Finding Consonant with Taft's Policy Commitments
        2. Rule of Law and a Pro-Market Approach
    B. The Appropriate Sovereign for Sovereign Debt
IV. CONCEPTUAL CONSOLIDATION AND REALPOLITIK IN THE CARIBBEAN
    A. The Openness of a 'Pro-Creditor' Concept of Sovereignty
    B. Creditor Competition and Realpolitik in the Caribbean
V. CONCLUSION

WHO IS THE 'SOVEREIGN' IN SOVEREIGN DEBT?
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I. INTRODUCTION: THE AMBIGUITY OF THE SOVEREIGN

Sovereign debt has been a focus of discussion in international law and international relations since capital markets first opened to sovereigns in the credit fairs of Italy. The interest paid to this topic has scarcely died down in the intervening three centuries, and financial pages today heatedly discuss the fate of the Argentine, Russian, or Iraqi debt. Conflicts surrounding sovereign debt have been proffered as the explanation for wars launched, and the recent push for developing country debt cancellation has illuminated the potentially devastating economic effects of debt payment on states recovering from poverty and political upheaval. Even more contentious arguments have centered around the potential illegitimacy of debt contracted by dictatorial or corrupt regimes. Notwithstanding this considerable discussion and conflict, surprisingly little attention has been paid to the conceptual question at its center: who, really, is the 'sovereign' in sovereign debt?

The very practically minded may dismiss the question out of hand – international political economy has largely assumed that this is a closed issue in global financial practice. But there has been considerable disagreement in political and constitutional theory, international politics, and international law as to who really constitutes the 'Democratic Republic of the Congo.' Is it the people or only the juridical state form? Translating the question into the domestic context highlights the practical importance of the issue. No one would lend to 'DRC Inc.' without a clearly thought out account of who in fact counts as 'DRC.' The entire purpose of agency theory in the domestic arena is to make explicit the relationship between the agent who signs the contract and the principal against whom the contract is ultimately enforced. A theory of sovereignty should serve the same purpose at the international level: to make explicit the relationship between the sovereign government – the agent who signs the contract – and the principal – the population against whom the contract is ultimately enforced. The current sovereign lending regime finds itself in the uncomfortable situation of functioning without a clear theory of what it means by 'sovereign.'[1]

[1] The recent discussion of post-invasion Iraqi debt highlights this lack of clarity. The new Iraqi government and the U.S. have argued that the people of Iraq never consented to or benefited from much of the debt contracted by Saddam Hussein's regime, and thus should not be obligated to repay it. The U.S. Congress went so far as to pass a resolution grounded in this approach. *See* Iraqi Freedom from Debt Act, H.R. 2482, 108th Cong. (2003). Of

This practical instability has been exacerbated by the fact that 'sovereignty' has competing meanings in the two dominant schools of jurisprudence and international relations theory. On the one hand we have the functionalist or realist idea of the sovereign: the 'sovereign' is the juridical body (usually a state) that has control and authority over a given people and territory. It is functionally similar to other sovereigns, and its internal structure and legitimacy are largely irrelevant to its external relations. On the other stands the idea of a 'sovereign' people, whose consent provides legitimacy to the state and authority for its external interactions. Compounding this theoretical ambivalence, it is very difficult to study in *practice* whether any particular conception of the sovereign is at play in sovereign debt. The issue of sovereignty is notoriously slippery and does not easily lend itself to concrete examination. This is even more so in international economics, which accepts the category of 'sovereign debt' as fairly unproblematic and has remained largely free of analyses drawn from political philosophy or legal theory.

Although this complexity raises challenges for practical empirical analysis, it does not constitute a complete bar. This article is premised on the contention that the underlying conception of sovereignty in sovereign debt issues can be operationalized through the idea of 'odious debt.' The legal doctrine of odious debt, first developed after the Spanish American War of 1898 and formalized in 1927,[2] argues that sovereign state debt is 'odious,' and should therefore not be transferable to successor governments, if (1) the nation's people do not consent to the transaction incurring the debt, and (2) it does not benefit the people.[3] The doctrine throws into stark relief the competition between the popular and the functionalist ideas of sovereignty that exist in 20th century international relations. As such, the historical treatment of arguably 'odious' debt should effectively offer a window into the concept of sovereignty that dominates at any given moment. Accepting or rejecting the idea of odious debt in any practical instance

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particular relevance is Section 3, entitled 'Relief of the Odious Debt of Iraq.' Other states, primarily European creditors of Iraq, as well as some members of the financial community, have insisted that this more popular approach to sovereignty has no place in the sovereign credit market. *See, e.g.*, Leader, *Iraq's Debt*, THE FINANCIAL TIMES (UK), June 16, 2003, *available at* http://www.odiousdebts.org/odiousdebts/index.cfm?DSP=content&ContentID=7670.

[2] *See* A.N. SACK, LES EFFETS DES TRANSFORMATIONS DES ÉTATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIÈRES 157 (1927).

[3] While the particular formulation may differ, the essential elements of lack of consent and lack of benefit are consistent. *See, e.g.*, ASHFAQ KHALFAN ET AL., ADVANCING THE ODIOUS DEBT DOCTRINE 1-2 (McGill U. Centre for Int'l Sustainable Dev. L. Working Paper, 2003), *available at* http://www.cisdl.org/pdf/debtentire.pdf; PATRICIA ADAMS, ODIOUS DEBTS: LOOSE LENDING, CORRUPTION AND THE THIRD WORLD'S ENVIRONMENTAL LEGACY (1991); Michael Kremer & Seema Jayachandran, *Odious Debt*, BROOKINGS POL'Y BRIEF 103 (2002).

corresponds to an inclination toward either the popular or the functional conceptions of sovereignty, respectively. To the extent that we view the people as sovereign agents, then their payment of debt not authorized by them and from which they derive no benefit is incongruous. To the extent that we view the functional state form as sovereign, then the continuity of debt obligations makes sense so long as successive regimes control the same territory and people. In short, the issue of odious debt acts as an enlightening proxy for the larger question of who counts as 'sovereign' in international economic relations. Perhaps more importantly, it emphasizes that the somewhat abstract question of the proper definition of 'sovereignty' in fact has substantial distributional consequences in international credit markets.

This essay aims to begin a conversation on who constitutes the 'sovereign' in sovereign debt. It argues that the conception of sovereignty in sovereign lending is theoretically and historically less stable than has been assumed, and contends that an intermediate or 'rule of law' framework drawn from the early 20th century may be relevant to contemporary problems. The essay further suggests that three sub-questions – of doctrine, policy, and social science – must be part of any discussion on this topic, and offers an analysis from each of these three angles.

First, there is the doctrinal question of which understandings of sovereignty are analytically available to lawyers and policymakers today. Are we really only left with a binary choice between the purely functional and purely popular accounts? Although the conflict between these two dominant approaches has been at the core of theoretical and policy discussions, these polar opposites do not exhaust the offerings of intellectual history. This article considers an alternative, intermediate approach that emerged historically and is pertinent to contemporary debates.

Second, there is the policy question of whether a purely functionalist or 'realist' approach to sovereignty is required for a healthy sovereign credit market. Such a view assumes the continuity of sovereign obligations across successive regimes and therefore mandates the payment of all debt, regardless of its potential illegitimacy. Conventional wisdom holds that this strictly functionalist conception is essential for the stability and certainty required for cross-border lending. The discussion of Iraqi debt cancellation after the fall of Saddam Hussein thus raised some alarm, with the *Financial Times* claiming that, "Without [the principle of sovereign

continuity], there would be no lending to governments."[4] While a requirement that creditors lend only to truly popular governments may seriously burden the lending system, this article contends that an intermediate conception of sovereignty is entirely consistent with a fully functioning sovereign credit market.

Finally, there is the social scientific question: if there is variation in the idea of sovereignty, what accounts for this variation and its associated treatment of sovereign debt? Although much positivist international political economy accepts the ideas of 'sovereign state' and 'sovereign debt' as unproblematic, there is a growing literature in constructivist international relations theory that highlights the contingent quality of central concepts in international politics.[5] Alexander Wendt has asserted that 'anarchy is what states make of it,'[6] and similar arguments have been made as to the contingent ideational structure of sovereignty.[7] But this contingency and the historical and theoretical variation that it implies only invites additional explanation. If sovereignty is what we make of it, how has it been made? Given the political and economic stakes at issue in the definition of 'sovereign,' which factors have led to the dominance of one conception of sovereignty over others at any given historical moment? This article contends that the degree of geopolitical and economic competition in the broader international sphere may affect the approach to sovereignty taken in sovereign lending.

Although these questions are framed through the issue of sovereign debt, they have consequences for international policy and practice more generally. This paper aims to offer

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[4] *The Financial Times* further argued that, "…the US should not pursue the idea of odious debt, since the precedent is certain to come back to haunt it." THE FINANCIAL TIMES, *supra* note 1. Maintaining the strict functionalist approach discourages what the *Financial Times* calls "theological discussions" of whether a sovereign state borrower be 'legitimate' in any way. In a similar vein, Raghuram Rajan, the Director of the IMF's Research Department, referred to the challenger doctrine of odious debt as a "neutron bomb." Raghuram Rajan, *Odious or Just Malodorous: Why the odious debt proposal is likely to stay in cold storage*, FIN. & DEV., Dec. 2004, at 54, 54-55.

[5] This essay may be understood as responding in part to calls for interdisciplinary legal scholarship. *See generally* Kenneth Abbott, *Modern International Relations Theory: A Prospectus for International Lawyers*, 14 YALE J. INT'L L. 335 (1989); Anne-Marie Slaughter Burley, *International Law and International Relations Theory: A Dual Agenda*, 87 AM. J. INT'L L. 205 (1993) (arguing that international law and international relations "should aspire to a common vocabulary and framework of analysis that would allow the sharing of insights and information"); Anne-Marie Slaughter, *International Law and International Relations Theory: A New Generation of Interdisciplinary Scholarship*, 92 AM. J. INT'L L 367 (1998).

[6] Alexander Wendt, *Anarchy is What States Make of It: The Social Construction of Power Politics*, 46 INT'L ORG. 391 (1992). Wendt further discusses both the contingency and the independent power of distributions of norms in a later work. *See* ALEXANDER WENDT, SOCIAL THEORY OF INTERNATIONAL POLITICS (1997).

[7] *See, e.g.*, JENS BARTELSON, A GENEALOGY OF SOVEREIGNTY (1997).

insight into all three queries of the concept of sovereignty by returning to an open moment in early 20th century jurisprudence and international relations. The post-World War I era saw the twilight of European imperial competition and the dawn of a universalized idea of popular sovereignty and self-determination. It also witnessed the United States step more fully into the international arena, bringing with it a pragmatic and distinctly American approach to international law. Against this larger ideational backdrop, U.S. Chief Justice and former President William Howard Taft issued his foundational arbitral decision in the *Tinoco Case* between Great Britain and Costa Rica in 1923.[8] The *Tinoco* decision is generally considered the leading arbitral authority on 'sovereign recognition' – that is, the practice of recognizing the existence of a sovereign state or government and thus granting it legal status in the international arena.[9] This article not only presents a reinterpretation of this key decision, but also uses the case to shed light on the three questions surrounding the contemporary sovereign lending regime highlighted above.

Perhaps because of its long-settled status, lawyers have tended to emphasize only one portion of the *Tinoco* decision, which states that a sovereign government exists so long as it has 'effective control' and is able to establish order over a state's population and territory.[10] This one-sided interpretation associates Taft's foundational decision with the functionalist or absolutist conception of sovereignty in legal and political theory, which regards the internal constitutional practice of a state as irrelevant to its sovereign status. Part II of this article argues that this conventional presentation overlooks a more complete interpretation of Taft's decision, which in fact presents an *intermediate* or 'rule of law' account of sovereignty. This intermediate framework resonates with Taft's general jurisprudential commitment to basic constitutionalism and escapes the binary imposed by popular and functionalist schools. It also fits into a distinctly American tradition of international law, which moved away from the functionalism and

[8] Tinoco Case (Gr. Brit. v. Costa Rica), 1 R. Int'l Arb. Awards 369, 376-84 (1923), *reprinted in* 18 AM. J. INT'L L. 147 (1924). For reference purposes, this essay uses the pagination of the *American Journal of International Law* reprint.

[9] The case is frequently the lead citation for a discussion of sovereign recognition, and in some shorter legal treatises constitutes the only case actually discussed. *See, e.g.*, PETER MALANCZUK, AKEHURST'S MODERN INTRODUCTION TO INTERNATIONAL LAW 82-84 (7th ed. 2003); Colin Warbrick, *States and Recognition in International Law*, *in* INTERNATIONAL LAW 238 (MALCOLM D. EVANS ED., 2003); IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 200 (1998).

[10] *See, e.g.,* texts cited in *supra* note 9. A search of *Tinoco Case* in major law journals will reveal numerous citations of the award as support for a simplified principle of 'effective control' in the recognition of sovereign governments.

absolutism of the 19th century positivist model. This section situates Taft within a more conservative 'legal idealist' strand that emerged in the U.S. in the early 20th century, and which is distinct from the liberal democratic tradition conventionally understood to be the American approach to international law.

Part III of the article highlights Taft's pro-market ideological commitment and suggests that, notwithstanding the discomfort of latter-day business concerns about the doctrine of odious debt, an intermediate or 'rule of law' conception of sovereignty is actually consonant with pro-market policies. In the context of unifying Taft's conservative market ideology with his commitment to judicial reform, this section suggests that adopting a more flexible intermediate account may act as a stopgap to radical and potentially disruptive claims for popular sovereignty in international economic relations. It also points out how Taft's ability to distinguish between market interests and creditor interests grounds both his general outlook and his decision in *Tinoco*.

Looking more closely at the political and economic context of the decision offers a first cut at the social scientific question as well. Part IV argues that reading *Tinoco* in light of larger geopolitical concerns of the day offers an explanatory hypothesis for variations in the concept of sovereignty in sovereign lending and the concomitant treatment of arguably illegitimate debt. In particular, it suggests that the degree to which creditors are competitive or consolidated will affect the narrowness or openness of the view of sovereignty underlying sovereign debt. In times when creditors are competitive and perceive *each other* as significant risks, the conception of sovereignty is likely to be more flexible and receptive to the claims of sovereign debtors. However, when creditors are non-competitive and perceive themselves as part of the same interest group, a more strictly functionalist approach is likely to dominate. The section draws this initial hypothesis from the context of British and American political and economic rivalry in the Caribbean, suggesting that this competition may have given Taft greater leeway in his decision. Although a larger explanatory claim is not tenable in the context of a single case study, this analysis suggests that the rise of a stricter vision of sovereignty over the course of the 20th century may be related to an increasing consolidation and decreasing competitiveness among

international financial actors.[11] The article concludes with the suggestion that, in light of the complex relationship between international frameworks of sovereignty and local state autonomy, the intermediate or 'rule of law' conception formulated by Taft may be appropriate for international law and foreign policy in the 21st century.

II. CONSTRUCTING SOVEREIGNTY: AN EARLY 20TH CENTURY AMERICAN APPROACH

Efforts to infuse discussions of sovereign debt with considerations of governmental legitimacy tend to engender hyperbolic hostility and charges of impossibility from much of the international financial community. For example, Raghuram Rajan, the Director of the IMF's Research Department, referred to the doctrine of odious debt as a "neutron bomb."[12] After the fall of the dictator Suharto in 1998, the Republic of Indonesia attempted to renege on an oil contract that had been signed just prior to the dictator's demise and which, Indonesia argued, had been signed not in the interest of the country but as a final effort by a corrupt elite to make away with generous side payments. Upset that the international arbitral award granted full expectation damages for the contract, upon which the foreign claimant had not even begun performance, Indonesia appealed to its own courts. This unusual twist met with charges not just of financial irresponsibility or short-sightedness but of nothing less than "arbitral terrorism."[13] This alarmism fits into broader trends at the turn of the twenty-first century, in which absolutist rhetorical positions have been adopted by both powerful creditor representatives and third world debt advocates.[14] Such alarmism only makes more pressing the need for alternative approaches to sovereignty in sovereign debt and for fresh considerations of what really may be feasible in international economic relations.

This section looks more closely at the unique framework of sovereignty and valid sovereign action presented by Justice Taft in the *Tinoco Case*, placing it in the context of early

[11] The empirical findings of this article constitute part of a larger project on the framework of sovereignty in sovereign debt over the course of the 20th century. A more comprehensive assessment of the hypothesis on creditor consolidation is feasible only in the larger format.

[12] Raghuram Rajan, *Odious or Just Malodorous: Why the odious debt proposal is likely to stay in cold storage*, FIN. & DEV., Dec. 2004, at 54, 54-55.

[13] Michael D. Goldhaber, *Arbitral Terrorism*, AM. LAW./FOCUS EUR., Summer 2003, *available at* http://www.americanlawyer.com/focuseurope/aterror.html.

[14] Although defaults, threatened defaults, and debt write-downs remains common, all take place within the discursive framework of debt 'forgiveness,' which already assumes that debts are valid and grants in advance the moral high ground to creditors. *See* Stephen O'Connell, *Debt Forgiveness: Plainer Speaking Please* (2000), *at* http://www.swarthmore.edu/SocSci/soconne1/documents/forgive.pdf.

20th century discussions of sovereignty and situating it within an 'American' style of pragmatic international law. It argues that a proper interpretation of the *Tinoco* decision offers what can be understood as an intermediate or 'rule of law' conception of sovereignty that walks the line between a strictly functionalist account and an account grounded in popular legitimacy. This intermediate alternative identifies the existence of valid sovereign action on the basis of 'effective control' rather than consent; to this extent, it aligns with the functionalist or realist approach to sovereignty. However, the decision insists that the *mechanism* for effective control, and thus the procedure for entering into internationally enforceable sovereign contracts, must be grounded in the internal rule of law. Under a proper interpretation of Taft's decision, disregard by sovereign governments and their creditors of internal legal requirements would undermine a contract's enforceability. By contrast, such disregard for internal rules would be acceptable under the pure form of functionalist or 'realist' sovereignty. In addition, this discussion points out how the *Tinoco* decision suggests that the validity of sovereign obligations may also rest on the intended purpose or outcome of a contract.

A. BACKGROUND & FACTS OF THE *TINOCO* ARBITRATION

This first section introduces the background and facts of the case very briefly, leaving more extensive discussion of the geopolitical and economic interests involved to Part IV of this article.[15] Frederico Tinoco came to power in a coup in January 1917 against Alfredo González Flores, for whom he had been Minister of Defense. González had been elected president by a loose congressional coalition in 1913 and had lost support in his three and a half years in office.[16] His popularity sank further among economic elites upon his decision to respond to trade difficulties caused by World War I by instituting property taxes and a progressive income tax.[17] Tinoco stepped in to depose González and establish a new cabinet, holding elections of questionable validity in April 1917.[18] He seems to have gained the acquiescence if not the enthusiasm of the population, and at least initially garnered support from domestic business

[15] The U.S. interests involved are discussed in Part IV:B below, in the context of American investment, oil exploration, and geostrategic concerns in the Caribbean.
[16] George W. Baker, Jr., *Woodrow Wilson's Use of the Non-Recognition Policy in Costa Rica*, 22 THE AM. 3, 5 (1965).
[17] DANA G. MUNRO, INTERVENTION AND DOLLAR DIPLOMACY IN THE CARIBBEAN 1900-1921 427 (1964).
[18] *Id.* at 433.

interests.[19] The United States under Woodrow Wilson, however, withheld recognition of the new regime despite the concerted efforts of the Tinoco government and those of the powerful American-owned United Fruit Company and its founder, Minor Keith.[20] Wilson was personally involved in the decision not to recognize the Tinoco regime, considering it an affront to the 1907 Central American treaty system and to his own resolve to support only constitutional governments across the isthmus.[21]

At U.S. insistence, Great Britain also withheld official recognition from Costa Rica, and this 'non-recognition policy' formed part of the core of the 1923 arbitration.[22] Notwithstanding their government's decision, and thus potentially forfeiting diplomatic protection if things went awry, several British companies took the risky step of extending their economic involvement in Costa Rica. Of particular significance for Justice Taft's decision are two transactions. First, a British company purchased the 'Amory concession' for oil exploration. British companies had been unable to gain a foothold in Costa Rican oil exploration despite earlier efforts, and took advantage of the opportunity presented by the new government to gain extensive rights in the Amory concession. Second, the Royal Bank of Canada provided a line of credit for Costa Rica, under the control of Frederico Tinoco.

Although Wilson's non-recognition policy was not able to forestall all political and economic interest in Costa Rica, it did eventually help to weaken the Tinoco regime and restore constitutional rule, in part by throwing the local economy into disarray.[23] The Tinoco

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[19] *See* MUNRO, *supra* note 17, at 433. Although Costa Rican politics was generally far more orderly and more accountable than that of its Central American neighbors, business interests, in particular the coffee elite and (after the turn of the century) Minor Keith and the United Fruit Company, held considerable sway. *Id.* at 433.

[20] Thomas M. Leonard, *Central America and the United States: Overlooked Foreign Policy Objectives*, 50 THE AM. 1, 12 (1993). The non-recognition jeopardized the United Fruit Company's considerable investments in Costa Rica, and there is some intimation that these U.S. interests had been involved in the coup. Certainly the interests of the landed gentry, with whom these investors had intermarried, were at least initially aided by the overthrow of Gonzalez, and Minor Keith himself was related to Tinoco. Wilson perceived the American coterie in Costa Rica as displaying a lack of patriotism, and asked the Department of Justice to consider prosecuting Keith. *See* MUNRO, *supra* note 17, at 430, 439.

[21] Leonard, *id*. at 12. *Central America and the United States: Overlooked Foreign Policy Objectives*, 50 THE AM. 1, 12 (1993). For more on Wilson's commitment to political stability through constitutional reform, *see* MUNRO, *supra* note 17, at 271.

[22] British foreign office telegrams indicate the British approach to recognition during World War I, and particularly with regard to Costa Rica, "was really that of the United States and not our own invention." Great Britain was eager to recognize Acosta in light of the oil concessions granted under Tinoco, but to no avail. Richard V. Salisbury, *Revolution and Recognition: A British Perspective on Isthmian Affairs during the 1920s*, 48 THE AM. 331, 335 (1992).

[23] George W. Baker, Jr., *Woodrow Wilson's Use of the Non-Recognition Policy in Costa Rica*, 22 THE AM. 3, 11-17 (1965).

government became increasingly repressive and unpopular over the course of its two year tenure. By the end of 1917, less than one year after coming into power, Tinoco's financial policies and militarization of the bureaucracy diminished any local support he may have had.[24] By 1919, the capital of San José had experienced considerable domestic unrest, and a small group of counter-revolutionaries had convened at the border. The U.S. and the U.K. continued to withhold both recognition for Tinoco and any support for the counter-revolutionaries, insisting on a non-coercive restoration of the constitutional government. However, a U.S. Naval Commander's independent decision to land U.S. forces at the coastal city of Limón in June 1919 engendered suspicion of a U.S. policy change.[25] Tinoco subsequently entered into negotiations that led to his resignation on August 12, 1919, and his government fell the following month.[26]

The repudiation of the contracts at stake in the 1923 arbitration followed the restitution of constitutional government in Costa Rica. After the December 1919 election of Julio Acosta, friends of the former González regime sought to expunge the Tinoco contracts from Costa Rica's debt. Although regular elections and direct voting were not established until 1912, Costa Rica had achieved considerable political stability relative to other Latin American countries.[27] In passing the 'Law of Nullities' (No. 41) to repudiate Tinoco's contracts, the Costa Rican Congress distanced itself from the aberration of military rule and cleared itself of that regime's debt obligations. However, this legislation was not uniformly supported by the Costa Rican government or within Costa Rican society. It was driven by the legislative branch, which reenacted the law in August 1920 to override President Acosta's executive veto.[28]

The Costa Rican administration, thus bound to support the law despite its own apparent ambivalence, was anxious for international support. Although British, German, Spanish, American, and local interests seem to have been affected, only Great Britain pursued international arbitration.[29] In one of the last hurrahs of European gunboat diplomacy in the

[24] DANA G. MUNRO, INTERVENTION AND DOLLAR DIPLOMACY IN THE CARIBBEAN 1900-1921 435 (1964).
[25] Leonard, *supra* note 21, at 12.
[26] *Id.* at 12.
[27] This relatively orderly approach to governmental transitions has been a hallmark of Costa Rican politics over the 20th century. With the exception of the Tinoco coup, Costa Rica has experienced regular elections with direct voting since 1912, and it constitutionally abolished the military in 1949. *See* HECTOR PEREZ-BRIGNOLI, A BRIEF HISTORY OF CENTRAL AMERICA 113, 115 (1989).
[28] FOREIGN REL. U.S. 1920 VOL. I, at 838, *available at* http://digital.library.wisc.edu/1711.dl/FRUS.FRUS1920v01.
[29] Great Britain had been eager to obtain oil exploration rights in Costa Rica and, aside from the Amory concession, all other oil interests in Costa Rica were American. The U.S. also intimated that it might bring claims on behalf of

Western hemisphere, a British minister arrived on a warship in December 1920 to support the Amory oil concession and the Royal Bank loan. Given the threat of a commercial boycott, President Acosta agreed to an arbitration settlement in early 1921, but the Costa Rican Congress insisted that the British claims be brought in Costa Rican courts,[30] delaying the conclusion of an arbitration treaty until March 1923. Great Britain initially recommended the Spanish Foreign Minister as arbitrator,[31] but Costa Rica counter-offered ex-Costa Rican president Jimenez, on the grounds that the Spanish minister was sure to vote for Great Britain.[32] In August of 1921, President Acosta suggested the newly appointed U.S. Chief Justice Taft as sole arbiter,[33] and an arbitration agreement was signed in early 1923.

Justice Taft made his award on October 18, 1923, deciding for Costa Rica but in a somewhat roundabout way. Both sides centered their claims on whether or not the Tinoco regime comprised the government of Costa Rica, assuming that this would determine the existence of a valid sovereign contractual obligation. Great Britain argued that the Tinoco regime had controlled the state's territory and population and constituted Costa Rica's only sovereign government, and that the subsequent Acosta administration therefore had to perform its contracts under international law. Costa Rica in turn argued that the Tinoco regime had not been a *de facto* or *de jure* government, and that it had furthermore violated the 1871 Costa Rican constitution. It pointed out (in an argument akin to estoppel) that Great Britain had not even recognized the Tinoco regime as a valid sovereign government, and argued that these contracts were thus unenforceable by Great Britain in particular. In the portion of the *Tinoco Case* most frequently cited in international law textbooks, Justice Taft held that the Tinoco regime *was* in fact the sovereign government of Costa Rica between 1917 and 1919, and that the British non-

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the Sinclair Oil Company (which controlled the 'Costa Rican Oil Company'), which had signed an agreement for sub-soil rights with Gonzalez that was then confirmed by Tinoco. FOREIGN REL. U.S. 1920 VOL. I, at 846, *available at* http://digital.library.wisc.edu/1711.dl/FRUS.FRUS1920v01. However, the U.S. soon realized that Costa Rican oil riches had been overestimated. *See* MUNRO, *supra* note 24, at 448. It does not appear that the Spanish or German claims were pursued; they may have been overshadowed by more pressing domestic problems in post-World War I continental Europe.

[30] FOREIGN REL. U.S. 1921 VOL. I, at 665, *available at* http://digital.library.wisc.edu/1711dl/FRUS.FRUS1921v01.

[31] *Id.* at 646.

[32] *Id.* at 646, 665. It is unclear why this perception prevailed. Spanish interests had also been repudiated in the Law of Nullities and it is possible that Costa Rica perceived Spain as having fewer long-run interests in maintaining positive relations with Costa Rica.

[33] *Id.* at 666.

recognition policy did not bar suit by British companies.[34] Notwithstanding this classification of the Tinoco regime as a valid sovereign government, Taft ultimately – and perhaps surprisingly – decided in favor of Costa Rica on both substantive claims.

B. AN INTERMEDIATE CONCEPTION OF SOVEREIGNTY

There is a strange disconnect among lawyers and debt activists in their interpretation or emphasis of the *Tinoco* decision. Taft's award is the lead case cited for the dominant approach to sovereign recognition, which identifies the existence of a valid government on the basis of its 'effective control' of a state's territory and population.[35] This approach does not attend to the potentially problematic origins or the internal legitimacy of a state, and resonates with the functionalist or realist schools of political and international relations theory. Some early readers advocated this portion of Taft's decision as a wise choice for a stable foreign policy.[36] Contemporary critics denigrate this portion of the award for trampling on a fuller notion of popular sovereignty and human rights.[37]

Perhaps the most puzzling aspect of the *Tinoco* decision, however, is its explicit or implicit use by opposing sides of the contemporary debate on sovereign debt. On the one hand, the case is considered a legal-theoretical support for the idea of effective control and 'sovereign continuity,' which means that the same 'sovereign state' remains and thus is subject to the same contractual obligations, regardless of any internal governmental or constitutional changes. This doctrine is now considered central to sovereign credit markets; without the assurance that debts will be repaid even in cases of regime change, creditors may be unwilling to take the risk of sovereign lending in the face of political volatility.[38] On the other hand, Taft's finding for Costa

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[34] Tinoco Case (Gr. Brit. V. Costa Rica), 1 R. Int'l Arb. Awards 369, 376-84 (1923), *reprinted in* 18 AM. J. INT'L L. 147 (1924), at 153-154.

[35] As noted above, it is a central case for discussions of sovereign recognition in international legal treatises. *See, e.g.*, PETER MALANCZUK, AKEHURST'S MODERN INTRODUCTION TO INTERNATIONAL LAW 82-84 (7th ed. 2003); Colin Warbrick, *States and Recognition in International Law*, *in* INTERNATIONAL LAW 238 (MALCOLM D. EVANS ED., 2003); IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 200 (1998). The case is also frequently cited in practical applications of international law. *See, e.g.*, Steven R. Ratner, *The Cambodia Settlement Agreements*, 87 AM. J. INT'L L. 1, 11 (1993); Michael Reisman, *Criteria for the International Legal Use of Force*, 10 YALE J. INT'L L. 279, 284 (1984-1985); Amin M. Husain, *Who is the Legitimate Representative of the Palestinian People*, CHINESE J. INT'L L. 207, 215 (2003); A.M. Greig, *The Effects in Municipal Law of Australia's New Recognition Policy*, 11 AUS. Y.B. INT'L L. 33, 54, 62 (1984-1987); *The Status of Rhodesia in International Law*, 1974 ACTA JURIDICA 109, 161 (1974).

[36] *See, e.g.*, Lawrence Dennis, *Revolution, Recognition and Intervention*, 9 FOREIGN AFF. 204, 207-08 (1930-1931).

[37] *See, e.g.*, Michael Reisman, *Sovereignty and Human Rights in Contemporary International Law*, 84 AM. J. INT'L L. 866, 870 (1990).

[38] *See, e.g.*, Leader, *Iraq's Debt*, THE FINANCIAL TIMES (UK), June 16, 2003, *available at* http://www.odiousdebts.org/odiousdebts/index.cfm?DSP=content&ContentID=7670.

Rica is employed as a precedent for resurrecting the odious debt doctrine, which explicitly asserts that the debts of an illegitimate government may fail to bind a state after that government's downfall.[39] While these two interpretations seem contradictory at first glance, they become sensical as part of a unified decision once we set aside the binary discourse of popular versus absolutist sovereignty. What has been neglected in the *Tinoco* decision is how Taft ultimately constructs an intermediate or 'rule of law' conception of sovereignty that challenges the polarized framework of debate dominant in the late 20th century.

1. A Functionalist Foundation

The Taft decision is properly taken to be a case about the recognition of sovereign states in international law, standing for an 'effective control' test as to what constitutes a sovereign government. On the question of whether the Tinoco regime comprised the sovereign government of Costa Rica, Taft actually agreed with Great Britain: the Tinoco regime, at least for the majority of its tenure, was in *de facto* control of the state. This assessment accorded with the principles of international law at the time, and continues to have resonance today.[40] In his decision, Taft quoted J.B. Moore, a prominent American jurist and member of the Permanent Court of International Justice, on the relevant principles of law:

> Changes in the government or the internal policy of a state do not as a rule affect its position in international law.… though the government changes, the nation remains, with rights and obligations unimpaired. ….The principle of the continuity of states has important results. The state is bound by engagements entered into by governments that have ceased to exist; the restored government is generally liable for the acts of the usurper. … The origin and organization of government are questions generally of internal discussion and decision. Foreign powers deal with the existing *de facto* government, when sufficiently established to give reasonable assurance of its permanence, and of the acquiescence of those who constitute the state in its ability to maintain itself, and discharge its internal duties and its external obligations.[41]

Taft pointed out that for two years Tinoco and the legislative assembly ruled Costa Rica without serious revolutionary activity and with the apparent acquiescence of the people, despite the

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[39] *See, e.g.*, ASHFAQ KHALFAN ET AL., ADVANCING THE ODIOUS DEBT DOCTRINE 41-2 (McGill U. Centre for Int'l Sustainable Dev. L. Working Paper, 2003), *available at* http://www.cisdl.org/ pdf/debtentire.pdf. *See also* ANAÏS TAMEN, LA DOCTRINE DE LA DETTE "ODIEUSE" OU: L'UTILISATION DU DROIT INTERNATIONAL DANS LES RAPPORTS DE PUISSANCE 13-14 (CADTM, 2003), *available at* www.cadtm.org/IMG/pdf/La-doctrine_de_la_dette_odieuse.pdf.

[40] *See, e.g.*, texts and articles cited in *supra* note 35.

[41] Tinoco Case, 18 AM. J. INT'L L. 146, 150-51 (1924), *citing* JOHN BASSETT MOORE, A DIGEST OF INTERNATIONAL LAW, VOL. I, 249 (1906). Justice Taft cites several other authorities to the same effect. *Id.* at 150-151.

country's economic despondency.[42] He discounted the importance of other states' failures to recognize the Tinoco government, which Costa Rica presented as definitive evidence of the regime's non-governmental character.[43] Taft concluded that although Great Britain's non-recognition policy might have evidentiary weight as to a regime's status, it was not dispositive. This was particularly the case given that the policy was, "determined by inquiry, not into [the regime's] *de facto* sovereignty and complete governmental control, but into its illegitimacy or irregularity of origin…."[44]

This *de facto* control requirement aligns with the functionalist conception of sovereignty in legal and constitutional theory and international law, and with the realist idea of sovereignty in international relations. A government's 'sovereign' status does not draw from any deep legitimacy, such as the existence of a divine monarch or an ultimately sovereign people. Rather, its sovereign character derives from the command and control of internal affairs, and from its functional likeness on this ground to other states in the international system. Such an understanding is akin to Jean Bodin's definition of sovereignty as "the highest power of command" and "the absolute and perpetual power of a commonwealth."[45] Bodin's tradition in political theory is carried forward by Thomas Hobbes and Benedict de Spinoza, both of whom considered the sovereign as embodying the supreme political authority, free from limitations on its own actions.[46] In the preferred metaphor of international relations theory, this account of sovereignty conceives of the state as a 'unitary black box' whose internal machinations are irrelevant to its foreign interactions.[47] Within international law, Taft's decision on recognition corresponds to the framework of sovereignty offered by positivism. Positivist international law, which rejected the moral foundations and judgments implied by natural law approaches, sought

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[42] It is also worth pointing out that one reason for the acquiescence of the people to the Tinoco regime even as its popularity plummeted was Wilson's non-recognition policy, the force of which Taft's decision minimized. Wilson indicated that he would not recognize a government established in a counter-revolution, and this dampened Costa Rican efforts to overthrow Tinoco for a time, extending the period for which Tinoco had effective control of the country.

[43] *Tinoco Case*, *supra* note 41, at 149, 154-155.

[44] *Id.* at 154.

[45] JEAN BODIN, ON SOVEREIGNTY: FOUR CHAPTERS FROM THE SIX BOOKS OF THE COMMONWEALTH 1 (Julian Franklin trans., 1992) (1583).

[46] *See, e.g.*, THOMAS HOBBES, LEVIATHAN, ch. XVII, ¶ 13, 109 (Edwin Curley ed., 1994) (1651). Spinoza similarly identified the sovereign as having, "the sovereign right of imposing any commands he pleases." BENEDICT DE SPINOZA, A THEOLOGICO-POLITICAL TREATISE 207 (R.H.M. Elwes trans., 1951) (1670).

[47] Such a view is presented most clearly in Realist works of international relations theory. *See, e.g.*, KENNETH WALTZ, MAN, THE STATE, AND WAR: A THEORETICAL ANALYSIS (1959) (reviewing human nature, internal state make-up, and international system structure as explanations for international politics and arguing for the latter).

to organize international relations on the basis of sovereign equality and state consent.[48] As with realist international relations theory, the internal culture or political form of a state was immaterial to its international legal status, and the preference or consent of the population was irrelevant to the state's external relations.[49]

To this extent, Taft's decision countered the idea of a valid sovereign government put forward by Woodrow Wilson's non-recognition policy, which acknowledged only those states formed by democratic constitutional means. Wilson's approach resonates with the school of popular or democratic sovereignty in political and constitutional theory and international law, in which sovereignty lies with a 'sovereign people,' whose consent provides legitimacy to the government and authority for its international actions.[50] It also aligns with the cosmopolitan school of political thought, which puts individual rights at the center of any legitimate polity or legal system.[51] The strong versions of the popular and cosmopolitan frameworks present a conception of consent, sovereignty, and human rights that comes into tension with the 'effective control' element in the *Tinoco* decision.[52]

Justice Taft's criticism of the Wilsonian view, if he meant it as such, was not explicit. Taft accepted that the decision of whether or not to recognize a foreign regime was a matter of national policy, in which different countries and presidential administrations might follow contrary courses of action.[53] However, he effectively mandated that the international *legal* principles of sovereign recognition were separate from any national *political* decision to challenge another regime's legitimacy. In this assertion, Taft took a step toward insulating

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[48] Perhaps the best-known formulation of positivist international law is offered in LASSA OPPENHEIM, INTERNATIONAL LAW 20-22 (2d ed., 1912).

[49] OPPENHEIM, *id.* at 19.

[50] Jean-Jacques Rousseau is perhaps the paradigmatic thinker in this vein, arguing that government should be grounded in a 'social contract' in which "each one, uniting with all, nevertheless obeys only himself and remains as free as before." JEAN-JACQUES ROUSSEAU, ON THE SOCIAL CONTRACT, OR THE PRINCIPLES OF POLITICAL RIGHT, Bk. I, ch. VI, *in* THE BASIC POLITICAL WRITINGS 148 (Donald A. Cress trans., 1987) (1762).

[51] Immanuel Kant is the primary theoretical proponent of the cosmopolitan school, in arguing that individuals be treated as 'ends in themselves' and associating enlightenment with self-legislation at both the political and moral-intellectual level. *See, e.g.*, IMMANUEL KANT, WHAT IS ENLIGHTENMENT? (1784). Although Kant did believe that international peace would most likely result from a world of democratic republics, his eventual political goal was an even more universal and cosmopolitan world federation, which would reach beyond the bounds of a territorial state. *See, e.g.*, PERPETUAL PEACE (1795).

[52] This school of thought is most commonly associated with Immanuel Kant's political and moral theory, which insisted that individuals be treated as 'ends in themselves' and whose most famous writing on the international arena is PERPETUAL PEACE (1795).

[53] Taft specifically stated that, "The merits of the policy of the United States in this non-recognition it is not for the arbitrator to discuss…" and noted that he was drawing purely from international law principles. Tinoco Case, 18 AM. J. INT'L L. 146, 153 (1924).

international relations from the normative or value-driven preferences of particular states. Modern-day proponents of a Wilsonian ideal of popular sovereignty criticize this finding in Taft's decision, which may well be used as a shield by oppressive regimes seeking to avoid international censure. Michael Reisman, among others, expresses concern that the *Tinoco* decision "stands in stark contradiction to the new constitutive, human rights-based conception of popular sovereignty."[54]

2. Escaping the Binary: The Rule of Law as a Facet of Effective Control

Given the finding of a valid Tinoco government on the basis of 'effective control,' Justice Taft's conclusion that the Amory and Royal Bank contracts were not enforceable may appear incongruous. Although Taft agreed with Great Britain that the Tinoco regime embodied the government of Costa Rica, he did not therefore determine that the regime's contracts were internationally valid. It is on the basis of this ultimate decision for Costa Rica that proponents of the odious debt doctrine embrace Taft as a predecessor. In deciding for Costa Rica on both the oil concession claim and the Royal Bank claim, Taft formulates an intermediate or 'rule of law' conception of sovereignty that escapes the binary understandings of sovereign power presented by modern realists and democratic idealists alike.

Although Taft's decision falls far short of instantiating a commitment to popular democracy, a closer look reveals that his 'effective control' requirement is not entirely functionalist or absolutist. Unlike a pure functionalist, for whom the *fact* of control is sufficient to define valid sovereign action, Taft pays attention to the *mechanism* or procedure of control in his formulation. In this intermediate framework, a sovereign government's international action is valid and binding on successor governments only if it has followed its own internal legal requirements for competence or ratification. Although this theoretical structure does not mandate any particular set of internal laws, for example liberal democratic constitutionalism, it does insist on the primacy of respecting legal and constitutional requirements. As with the functionalist school, such basic constitutionalism is not concerned with whether governmental mechanisms are democratic or grounded in popular consent. However, this view does conceive of a sovereign government as both constituted and constrained by law, rather than 'above the law' as presented by either Jean Bodin or Thomas Hobbes.

[54] Michael Reisman, *Sovereignty and Human Rights in Contemporary International Law*, 84 AM. J. INT'L L. 866, 870 (1990).

As such, Taft's framework does not ultimately support the continuity of sovereign obligations in *all* cases. If an international contract is signed in contravention of a government's own internal laws, then that contract may risk repudiation by a subsequent regime. Although this intermediate approach to sovereignty and valid sovereign action does not go so far as to insist on popular or democratic consent, it does promote both internal and external transparency by insisting that any laws in existence are in fact followed. In what would be an unwelcome development for many 20th century government elites, as well as for their creditors, Taft effectively maintains that even a dictatorial regime must live up to the laws on its books for its actions and debt contracts to be internationally enforceable.

This interesting theoretical framework emerges from Taft's decision on the Amory oil concession, which on its own makes for a fairly dry narrative. Taft states that the validity of the concession is "to be determined by the law in existence at the time of its granting," namely the law of Costa Rica under the Tinoco government.[55] In line with the *de facto* control rule of recognition, Taft considered irrelevant the fact that the Tinoco government itself had emerged in contravention of the previous constitution and counter to democratic principles. He made no reference to any deeper underlying concept of sovereignty, such as inherent popular ownership of a country's natural resources, and de-linked the validity of state action from the underlying legitimacy of the state. Having established this formalist framework, however, Taft's decision follows it strictly. His ultimate finding for Costa Rica on the Amory oil concession rested on an assessment of Tinoco's own governing laws, and in particular on the legislative approval requirements of Tinoco's 1917 Constitution.[56]

The Amory concession contract had been signed by Aguilar, the Minister of Public Works, and John M. Amory & Son, a technically American firm that was an agent for British Controlled Oilfields, Ltd.[57] As part of the Amory-Aguilar enterprise, Costa Rica had exempted the British company from national tax increases for fifty years, as well as from payment of local or municipal taxes. As a result, Taft points out that the grant of this concession, "involved the power to approve laws fixing, enforcing or changing direct or indirect taxes."[58] This taxing

[55] Tinoco Case, 18 AM. J. INT'L L. 146, 172 (1924).
[56] *Id.* at 173-174.
[57] *Id.* at 169. Taft quickly acknowledged that the British assignees of the concession had acted properly under the contract, and dismissed Costa Rica's argument that Great Britain could not bring a claim on behalf of a company incorporated in the U.S. *Id.* at 171-72.
[58] *Id.* at 173.

power, however, was among those enumerated by the Tinoco Constitution as belonging exclusively to the Congress sitting *jointly*, and thus including both the Chamber of Deputies and the Chamber of Senators.[59] Notwithstanding this requirement, the Amory concession had been approved only by the Chamber of Deputies. Rejecting Great Britain's urging of a modified construction of the Constitution, Taft found that, "As the Chamber of Deputies was expressly excluded from exercising this power alone, Article X [of the concession contract, which granted the tax exemption] was invalid."[60] Taft also refused to separate out the tax exemption clause from the remainder of the concession, considering the fifty-year exemption, "one of the great factors of value in the contract."[61] In refusing to limit or rewrite the contract, Taft invalidated the Amory concession as a whole.[62]

Abstracting from the particular facts and rule of the case, the *Tinoco* decision on the Amory concession makes a critical theoretical move. As stated above, the foundation of Taft's approach to international law initially seems functionalist: a sovereign state government exists when it has *de facto* control of a country. Considerations of legitimacy drawn from a strong understanding of individual rights or democratic consent, linked to cosmopolitan or other explicitly value-driven accounts, are set aside. Taft takes a similarly formalist view of the relevant law for a sovereign state contract as being the law in force at the time of the contract; again, normative concerns are irrelevant. However, the Amory concession decision sets a limit on the *de facto* sovereign government's power, forcing any regime, whether dictatorial or democratic, to abide by its own laws in entering internationally enforceable sovereign contracts. In this, Taft steps away from understanding law in the stark terms offered by John Austin, as merely "the command of the sovereign backed by force."[63] In its place, Taft formulates a vision

[59] According to the facts of the case, the taxing power was one of the ten exclusive Congressional powers enumerated under Article 26 of the 1917 Costa Rican constitution. *Id.* at 172.

[60] *Id.* at 173. Taft did not consider five other instances in which the Chamber of Deputies alone granted tax exemptions as modifying the practical construction of the Tinoco Constitution, given that these minor incidents did not amount to an amendment of the fundamental law. Taft additionally referenced a situation in which Frederico Tinoco himself vetoed a law granting future tax exemptions on the grounds that only Congress as a single body could grant such an exemption. *Id.* at 173.

[61] *Id.* at 173. *See also id.* at 174, in which Taft writes that this exemption was "too vital an element in its value" to be excluded from the contract.

[62] *Id.* at 174.

[63] JOHN AUSTIN, THE PROVINCE OF JURISPRUDENCE DETERMINED (1832). Another formulation of this is "the command of the sovereign backed by a sanction." John Austin, *Law as the Sovereign's Command*, *in* THE NATURE OF LAW: READINGS IN LEGAL PHILOSOPHY 77-98 (M.P. Golding ed., 1966).

of 'effective control' that privileges law over both force and democratic ideals, navigating an intermediate position between the popular and the strictly absolutist forms of sovereignty.

It is important to point out that the Amory concession decision rested upon a central constitutional principle: the apportionment of powers among branches of government. It is less certain how Taft would have decided on the oil concession if a lesser legal rule had been implicated. Certainly, the important constitutional principles touched upon by the grant of the concession seem to have carried weight in the decision. Taft felt that the Amory contract was so defective that, "the government of Tinoco itself could have defeated this concession on the ground of a lack of power in the Chamber of Deputies to approve it."[64] At the very least, the *Tinoco* decision represents more than just the recognition of sovereignty on the basis of a minimal requirement of 'effective control.' It stands as well for the proposition that, if the procedural execution of a sovereign contract contravenes a significant element in that sovereign government's own internal laws, then the contract may not be enforceable under international law. Although the *Tinoco* decision focuses on the apportionment of governmental powers as the central legal element invalidating the Amory concession, other important legal or constitutional principles might implicate federalism, minority or local autonomy, and injunctions against high-level corruption, among others.

This conception of sovereignty and valid sovereign action as constituted and constrained by the rule of law does have some precedent in political and legal theory. Max Weber modified the definition of statehood from one grounded in control or force alone to one that involved the "monopoly of the legitimate use of physical force within a given territory."[65] While the additional element of legitimacy or inner justification could derive from traditional forms (such as monarchy), charismatic authority, or 'legality,' this last mode of legitimacy has been most developed. Perhaps the paradigmatic thinker in this approach is the legal theorist Hans Kelsen, who considers the identification of legally valid sovereign action as possible only within the context of a state's internal norms or legal rules, which in turn build from the basic norm (*grundnorm*) or constitution of that polity.[66]

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[64] Tinoco Case, 18 AM. J. INT'L L. 146, 174 (1924).

[65] Max Weber, *Politics as a Vocation*, *reprinted in* FROM MAX WEBER: ESSAYS IN SOCIOLOGY 78 (H.H. Gerth & C. Wright Mills eds., 1946).

[66] This basic norm itself "cannot be derived from a higher norm," but instead "constitutes the unity in the multitude of norms by representing the reason for the validity of all norms that belong to this order." HANS KELSEN, LEGAL FORMALISM AND THE PURE THEORY OF LAW 195 (1967).

While this constitutionalist tradition has not been well represented in contemporary debates of political theory and international relations, the resulting theoretical gap may be due in part to the misinterpretation, or rather the under-interpretation, of Taft's award in the *Tinoco Case*. Although Taft's decision is considered foundational in international legal practice, a narrow focus on his finding of sovereign recognition on the basis of 'effective control' neglects what makes the case distinctive. In particular, it ignores that the *Tinoco* decision presents a coherent framework for understanding internationally valid sovereign action on the basis of a state's internal rule of law. This domestic or *internal* legalism then becomes the relevant procedure for controlling and committing a state's resources at the *external*, international level. Thus, while the decision does not mandate any substantive rules for domestic law – and Taft himself was wary of claims of substantive justice – it insists that basic internal laws must actually be respected. Both the decision's commitment to basic constitutionalism and its technical and formalistic aspect accord with Taft's jurisprudence more generally. As will be noted in Part III of this article, Taft viewed law as the principal defense against disorderly government and unruly populism, and in particular considered the separation of powers (preferably with a strong and paramount judiciary) essential to maintaining political order. Although Taft's conception of a sovereign government is not linked to a deep idea of popular legitimacy, the sovereign is not absolute in the sense of being able to break its own laws and is, at least to some degree, *defined* by its law. In other words, a close reading of Taft's resolution of the *Tinoco* claims lays the ground for a valuable intermediate approach to the concept of the 'sovereign' in sovereign debt issues and in international relations more generally.

3. Governmental Purpose as a Requirement for Valid Sovereign Action

Although the discussion of the *Tinoco Case* so far has focused on its presentation of procedural requirements for valid sovereign action, the decision also suggests an outcome orientation as an element of legitimate government contracts. In particular, Taft's finding on the Royal Bank's monetary debt claim indicates that a sovereign debt contract may not be internationally enforceable unless it intends to serve a legitimate governmental purpose. This separate requirement would be equally applicable to all regimes, regardless of their internal rule of law or of whether that internal law had actually been obeyed. Thus, a sovereign contract not intended to serve the underlying state might be invalid even if it followed the relevant internal legal procedures.

The facts of the Royal Bank claim make clear that the legitimate governmental purpose requirement cannot exist only on paper. The Royal Bank of Canada, the second claimant in Great Britain's suit against Costa Rica, had furnished $200,000[67] of funds to Frederico Tinoco in the regime's last days, ostensibly to fund the "representation of the Chief of State in his approaching trip abroad" as well as for four years advance remuneration to Tinoco's brother as the ambassador to Italy.[68] Taft used a contextual approach to determine that these funds were not actually grounded in valid governmental objectives, and thus were not the debt obligations of Costa Rica after the fall of the Tinoco regime. In the quote most used by proponents of the odious debt doctrine, Taft found against Great Britain and the Bank because "all the circumstances should have advised the Royal Bank that this [loan] was for personal and not for legitimate government purposes."[69] The relevant circumstances for determining the private as opposed to the public nature of the credit included a transaction full of irregularity and informality, and a lack of underlying legal authority for the initial credit fund. Filling out this narrative, Taft highlighted the "most unusual and absurd course of business" involved in paying salaries four years in advance, and pointed out that the bank knew that this money was to be used by the Tinoco brothers for their personal use. Taft denied that either the Royal Bank or Frederico Tinoco, "could hold [the Costa Rican] government responsible for the money paid… for this purpose."[70] As further evidence of the private rather than the public nature of the funds, Taft pointed to the fact that the popularity of the Tinoco regime had disappeared by the spring of 1919 and that the movement to end that regime continued gaining strength until Tinoco's resignation.[71]

It may be argued that the Tinoco regime was not actually in effective control of the country when the Royal Bank notes were drawn, and that Justice Taft's award on this portion of the case follows necessarily from his threshold test for recognizing a sovereign government. The 'legitimate use' arguments would then be secondary, as the very existence of a sovereign government legally competent to enter international contracts would disappear along with the control itself. However, Taft does not regard the political disorder and lack of control as

[67] This is about $2,173,900 in 2004 dollars, calculated using a CPI Conversion Factor of 0.092. For CPI conversion factors for years 1800-estimated 2015, see http://oregonstate.edu/Dept/pol_sci /fac/sahr/cv2004.pdf.
[68] *Tinoco Case*, 18 AM. J. INT'L L., at 168.
[69] *Id.* at 168.
[70] *Id.* at 168.
[71] *Id.* at 167.

dispositive on the Royal Bank claim, instead presenting them as part of the evidence that the loan was unlikely to serve valid state interests. After enumerating the sinking popularity of the Tinoco regime among other factors, Taft holds that, "all the circumstances should have advised the Royal Bank that this… was for personal and not for legitimate government purposes."[72] The existence of a legitimate government purpose appears to be the deciding point, with the extreme circumstances acting as supporting evidence.

Taft also offers a suggestion as to the burden of proof on the issue of a creditor's knowledge regarding a loan's ultimate purpose. The remedy of debt repudiation may not be available under an odious debt framework unless the lender knew about the illegitimate nature of the debt contract itself, i.e. that the end uses were not designed to serve the interests of the underlying state or people. Thus, if a lender makes a loan in good faith, it should be able to collect on that loan despite its ultimate ill use. However, Taft seems to allow for the possibility of constructive knowledge, or the idea that a creditor may be held to the level of knowledge obtainable through ordinary care and diligence. This idea that a party 'knew or should have known' of relevant facts or conditions has been used in domestic contract law to prevent willful ignorance or a failure of due diligence. Moving to the level of international sovereign contracts, this may put the burden of proving good faith on the creditor claimant rather the sovereign debtor. With regard to the Royal Bank claim, Taft states, "[the Bank] must make out its case of actual furnishing of money to the government for its legitimate use."[73] He even suggests that evidence of knowledge may derive from the circumstances of the loan, in stating that, "all the circumstances should have advised the Royal Bank" of the illegitimate end use of the loan at issue.[74]

Although theories of sovereignty generally focus on the procedural element in the relationship between ruler and ruled,[75] Taft's attention to legitimate purpose has a corollary in

[72] *Id.* at 168.
[73] Tinoco Case, 18 AM. J. INT'L L. 146, 168 (1924).
[74] *Id.* at 168.
[75] There are exceptions to this general tendency. For example, both David Hume (a monarchist) and Joseph Emmanuel Sieyès (a democrat) focused on how sovereign debt or 'public credit' might undermine the basic responsiveness of the government to the underlying needs of the state. For a discussion of Hume, *see* ISTVAN HONT, *The Rhapsody of Public Debt*, *in* JEALOUSY OF TRADE: INTERNATIONAL COMPETITION AND THE NATION-STATE IN HISTORICAL PERSPECTIVE 325 (2005). Sieyès expresses similar concern that sovereign debt will undermine this responsiveness in the context of the French Revolution. *See* JOSEPH EMMANUEL SIEYÈS, *Further Developments on the Subject of a Bankruptcy*, *in* POLITICAL WRITINGS 60-67 (Michael Sonenscher ed., 2003). For a more extensive theoretical discussion of both the procedural and outcome-orientation aspects of sovereignty in sovereign obligation,

domestic business transactions. Although the officers and directors of a company or corporation may have considerable leeway in making decisions on the company's behalf, these decisions must at least ostensibly be in the best interests of the company itself. This constitutes the core of the 'Business Judgment Rule,' which provides a bar against the use of company contracts to serve merely private ends. Taft's presentation of a legitimate purpose requirement effectively constitutes what might be understood as a parallel 'Government Judgment Rule.' Sovereign governments have considerable leeway to make decisions on behalf of the state, so long as they work within their own internal legal frameworks. However, and regardless of the government's constitutional form, these decisions must serve a goal related to the underlying state. This basic attention to legitimate purpose can act as a partial obstacle to the use of international 'sovereign' debt as a source for the private enrichment of a regime's ruling elite. In a sense, Taft's discussion of legitimate intention incorporates an element of mainstream corporate law into requirements for international sovereign contracts.

Once we attend to both the rule of law and the governmental purpose aspects of the *Tinoco* decision, Taft's puzzling role as a precursor to both the doctrine of sovereign continuity and the doctrine of odious debt can be reconciled. On the one hand, Taft's award identifies the existence of a valid government on the basis of its 'effective control' rather than its popular legitimacy, and thus allows for the continuity of sovereign obligations across different regimes controlling the same people and territory. However, he insists that the mechanism for controlling and committing state resources in an international contract must lie in the internal rule of law, thus rejecting a purely absolutist or functionalist approach to sovereignty. The *Tinoco* decision also suggests a legitimate purpose requirement for internationally enforceable sovereign debt contracts. In so doing, Taft provides two avenues for the repudiation of arguably illegitimate or 'odious' debt: either through an internal legal failure, or due to a failure to meet the requirement of a valid governmental purpose.

Legal scholars have similarly highlighted two elements in the formalized doctrine of odious debt, both of which must be present for the definition to hold. Sovereign state debt is odious and should not be transferable to successor states if the debt was incurred (1) without the

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see [author, redacted], Competing Frameworks of Sovereignty and their Ramifications for Sovereign Obligation (January 2007) (unpublished manuscript, on file with author).

consent of the people, and (2) not for their benefit.[76] Unlike Taft's formulation, *both* prongs must be satisfied to allow repudiation; if either the debt was incurred for popular benefit, *or* it was contracted with popular consent, then the debt would not be 'odious' under this definition. Thus, an early presentation of odious debt states,

> If a despotic power incurs a debt not for the needs or in the interest of the State, but to strengthen its despotic regime, to repress the population that fights it… [t]his debt is not an obligation for the nation; it is a regime's debt, a personal debt of the power that has incurred it, consequently it falls with the fall of this power.[77]

Even without a strict commitment to democratic or popular sovereignty, both the odious debt doctrine and Taft's formulation maintain some link between the government and the underlying state and people. Whereas Taft's Amory concession decision suggests that even an 'illegitimate' or non-democratic government may enter into enforceable contracts by following its own internal laws, the Royal Bank portion of the case suggests that any government must at least intend to benefit the underlying sovereign state in its international actions.

What becomes clear in this closer reading of Taft's *Tinoco* decision is that the binary framework of democratic versus functionalist sovereignty does not exhaust the offerings of 20th century political and legal thought. Imposing this polarized discourse on sovereign debt issues and international relations more generally has limited the scope of discussion and the range of possible solutions to complex problems of international economic practice. It has also, potentially, hindered a more complete interpretation of Taft's foundational decision on the practice of 'sovereign recognition.' This discussion has presented Taft's *Tinoco* ruling as ultimately constructing an intermediate or 'rule of law' conception of sovereignty that escapes the binary imposed by the two dominant approaches. This conception, which has some precedent in political and legal theory, conceives of sovereignty and valid sovereign action through basic constitutionalism and the internal rule of law. As will be discussed in Part III of the article, this intermediate account may well be appropriate for a functioning sovereign credit market, despite the objections of members of the contemporary international financial community.

C. SITUATING TAFT'S APPROACH IN THE LEGAL TRADITION

[76] *See* A.N. SACK, LES EFFETS DES TRANSFORMATIONS DES ÉTATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIÈRES 157 (1927).

[77] PATRICIA ADAMS, ODIOUS DEBTS: LOOSE LENDING, CORRUPTION, AND THE THIRD WORLD'S ENVIRONMENTAL LEGACY, ch. 17 (1997), *available at* http://www.probeinternational.org/probeint/OdiousDebts/OdiousDebts/chapter17.html, *citing* A.N. SACK, *id.* at 157.

Taft's decision in the *Tinoco Case* does not lend itself to easy classification within a tradition of American or international legal thought, in part due to the standard categorization of thinkers as either 'realists' or 'idealists.' However, the decision marks a unique strain in approaches to international law that may still be identified as part of the American tradition. In particular, the *Tinoco* approach brings together the legal orthodoxy dominant in Taft's domestic jurisprudence with an international commitment to using law for social purposes that are more akin to the competing school of American pragmatism. Analyses of American foreign policy and perceptions of international law frequently highlight the utopian or missionary history at the root of U.S. understandings. Generally this utopianism is associated with a commitment to liberal democratic constitutionalism.[78] However, Taft is part of a tradition that maintained the utopian element but distinguished it from an insistence on popular self-determination, transcribing it instead onto a narrower dedication to the rule of law. In what can be called 'legal idealism,' the commitment to proper procedure and the rule of law itself becomes a central substantive feature of international law.

Taft's domestic legal practice is associated with the tradition of legal classicism or legal formalism, which embodied a type of reasoning that has been characterized as relatively abstract, formal, and conceptualistic.[79] Such legal orthodoxy, popular during the 19th century, imagined law as an autonomous sphere, in which neutral legal principles could be applied objectively to situations of fact.[80] The social values of this approach generally included an exaltation of individual will and a related hostility to state intervention, and were manifested economically in a *laissez-faire* commitment to free markets, particularly in labor.[81] Its conception of individual rights drew from the tradition of liberalism formulated by John Locke and John Stuart Mill, which privileged rights of contract and property. As will be discussed in the following section, Taft himself espoused these general values, and his tenure as Chief Justice of the Supreme Court

[78] *See, e.g.*, Harlan Grant Cohen, *The American Challenge to International Law: A Tentative Framework for Debate*, 28 YALE J. INT'L L. 551, 554-67 (2003) (identifying liberal constitutionalism as a utopian world vision that makes coherent initially contradictory strains in the American approach to international law).

[79] For a brief introduction to the basic philosophical tenets of Classical Legalism, see, e.g., WILLIAM M. WIECEK, THE LOST WORLD OF CLASSICAL LEGAL THOUGHT: LAW AND IDEOLOGY IN AMERICA, 1886-1937, 4-7 (1998). For a review of the structure of Classical Legal Thought in the context of American jurisprudence between 1870 and 1905, see MORTON HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1870-1960, 9-32 (1992). Wiecek identifies the Taft Court as a return to the basic foundations of classicism in Supreme Court jurisprudence. WIECEK, *supra* note 79, at 162-75.

[80] WIECEK, *supra* note 79, at 5-7.

[81] *Id.* at 7-10.

can be considered an instantiation of legal classicism or legal orthodoxy in American jurisprudence.[82]

This form of legal classicism is usually contrasted with the school of pragmatism that gained popularity in the early 20th century. Generally speaking, legal pragmatism engendered a commitment to understanding law not as existing within its own abstract, formal, and separate sphere, but rather as grounded in a commitment to human well-being against the background of particular socio-political and economic contexts.[83] Perhaps its most distinctive claim, famously formulated in Roscoe Pound's early writings, is that law should be rooted in a sense of social purpose, that mere formalistic 'legal justice' should give way to 'social justice,' and that the 'mechanical jurisprudence' of the classical model must make way for a new results-oriented 'sociological jurisprudence.'[84] Pound extended his analysis to the international sphere, and argued for "a functional critique of international law in terms of social ends."[85] Following World War I, this approach was adopted more broadly in what might loosely be called a pragmatic 'American' international law.[86] This American account challenged the 19th century positivist or functionalist conception of international law, which posited a largely unfettered sovereign government limited only by its own consent, and which came under attack after the disorder and violence of World War I. In its place, jurists and politicians sought to constrain the 'black box' approach of functionalist sovereignty by constructing international institutions such as the League of Nations and also by paying greater attention to the internal characteristics of sovereign states.[87] Drawing from the larger American impetus toward regime reform, this project involved

[82] The Taft Court can be understood as a return to the basic tenets of classical legal thought popular in the 19th century (notwithstanding the powerful dissents written by Justices Holmes and Brandeis), although Taft himself did not quite adhere to strict Lochner doctrine. This period continued past Taft's resignation and death until the challenges presented by executive and legislative responses to the Great Depression. *See* WIECEK, *supra* note 79, at 162-75.

[83] This school of legal thought drew essentially from philosophical pragmatism, formulated by William James and John Dewey, among others. *See, e.g.*, WILLIAM JAMES, PRAGMATISM, A NEW NAME FOR SOME OLD WAYS OF THINKING (1907). For a discussion of the incorporation of pragmatism into legal theory at the time, see MORTON G. WHITE, SOCIAL THOUGHT IN AMERICA: THE REVOLT AGAINST FORMALISM (1949).

[84] *See* Roscoe Pound, *Mechanical Jurisprudence*, 8 COLUM. L. REV. 605 (1909); Roscoe Pound, *The Need of a Sociological Jurisprudence*, 19 GREEN BAG 607 (1907).

[85] Roscoe Pound, *Philosophical Theory and International Law*, 1 BIBLIOTECA VISSERIANA DISSERTATIONUM IUS INTERNATIONALE ILLUSTRANTIUM 73, 89 (1923).

[86] Antony Anghie, *Colonialism and the Birth of International Institutions*, 34 N.Y.U. J. INT'L L. & POL. 513, 521 (2001-2002).

[87] Cohen highlights the creation of international legal distinctions between legitimate and illegitimate sovereign states as a feature that illuminates American approaches to international law more generally. Harlan Grant Cohen, *The American Challenge to International Law: A Tentative Framework for Debate*, 28 YALE J. INT'L L. 551, 569 (2003).

linking particular requirements for *internal* governmental sovereignty to the acceptance of sovereign states *externally* into the 'family of nations.'[88]

At first glance, this approach seems more akin to Woodrow Wilson's policies, and quite antithetical to Taft's formalist domestic jurisprudence and his suspicion of using law for progressive social purposes. It makes more sense, however, if we distinguish between two schools of American 'missionary' thought in international law, separating out a commitment to basic constitutionalism and rule of law from the promotion of liberal democracies.[89] Reflecting on the American world court movement in the first decades of the 20th century, David Patterson argues that, "students of diplomatic history should talk with caution about the moral-legal tradition in American foreign relations. As applied to American internationalists, the hyphen between the two words should indicate not only a complementary relationship but tension as well."[90] As is evident from Justice Taft's decision in *Tinoco*, incorporating the requirements of the rule of law and the public good into the definition of 'sovereign' in international law does not necessarily take the next step of instituting liberal democratic constitutionalism as a final goal. Taft was explicitly involved in the promotion of the international rule of law, not as a means for instantiating a substantive vision of global justice but rather as a mechanism for maintaining order and discipline.[91] His concern at the international level extended beyond particularistic diplomacy to "a mechanism to preserve world order."[92] Even before Woodrow Wilson became involved in the League of Nations, Taft campaigned for both the League and the World Court.[93]

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[88] Anghie, *supra* note 86, at 535-38. Anghie argues that Western nations embarked on a project of defining and constructing sovereignty for mandate nations, with ramifications far beyond this narrower group.

[89] This liberal democratic strain is that most commonly associated with 'idealist' American foreign policy. *See, e.g.*, Cohen, *supra* note 87, at 555-67.

[90] David S. Patterson, *The United States and the Origins of the World Court*, 91 POL. SCI. Q., Summer 1976, at 294. In fact, Taft did join with American pragmatists in his international commitments, in particular to the establishment of the Permanent Court of International Justice and the League of Nations. However, as Patterson discusses in his essay, the general outlook and background philosophical commitments of the international legalists and the broader international pragmatists should not be confused. For a more extensive discussion of a somewhat different conception of the 'legalist' approach to U.S. foreign policy on international law and organizations, see FRANCIS ANTHONY BOYLE, FOUNDATIONS OF WORLD ORDER: THE LEGALIST APPROACH TO INTERNATIONAL RELATIONS, 1898-1922 (1999). Boyle also insists on the difference between a legalist and a utopian-moralist approach to international law. *Id.* at 8.

[91] Taft considered that "respect for law, constitutional and statute… would bring about a disciplined international community, just as it had for a domestic society in the advanced nations." DAVID H. BURTON, WILLIAM HOWARD TAFT: CONFIDENT PEACEMAKER 115 (2004).

[92] *Id.* at 115.

[93] For a discussion of participation in American projects to promote the rule of law prior to World War 1, see generally David S. Patterson, *The United States and the Origins of the World Court*, 91 POL. SCI. Q., Summer 1976, at 279.

He was a strong supporter of the procedure of international arbitration, and pressed for a comprehensive international arbitration treaty in Congress. He went so far as to argue that any international controversy should ultimately be justiciable among 'civilized nations,' and stated himself willing to submit to arbitration even "a question of national honor."[94]

In short, Taft's *Tinoco* decision is of a piece with the larger project of American international law, but it instantiates a more conservative doctrine than that proposed by conventional understandings of 'idealist' American foreign policy. Although the missionary zeal remains, it does not lie in policing foreign governments for their liberal democratic principles or human rights compliance. Rather, it encourages their commitment to a more *procedural* utopian vision of rule by law, which in *Tinoco* is married to a basic requirement for legitimate government purpose. In short, Taft's vision corresponds to a tradition of international legal idealism, in which the primary purpose of international law is not the promotion of liberal democracies but rather the encouragement of the rule of law in the international arena. The *Tinoco* decision takes a step in this direction by incorporating a domestic rule of law requirement into the standards for judging and enforcing sovereign obligations at the global level.[95]

III. THE OPENNESS OF A 'PRO-MARKET' CONCEPTION OF SOVEREIGNTY

The intermediate or 'rule of law' concept of sovereignty presented in this essay raises more immediate and specific questions than those of American and international legal theory. In particular, it highlights a pressing policy question: does a commitment to supporting the sovereign credit market mandate a purely functionalist approach to sovereignty? And additionally, can the intermediate approach to sovereignty presented in Taft's opinion be reconciled with a commitment to property rights in sovereign contracts?

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[94] W.H. Taft, "But, it is asked, would you arbitrate a question of national honor? I am not afraid of that question. Of course I would." ADDRESSES OF WILLIAM HOWARD TAFT, VOL. XXIII, at 299, *quoted in* HENRY F. PRINGLE, THE LIFE AND TIMES OF WILLIAM HOWARD TAFT 737 (1939). Commentators highlight that Taft felt that any issue of international relations was ultimately justiciable, including those of vital interest and national honor. *See, e.g.*, "The underlying premise of the arbitration treaties as Taft had them drafted was that advanced, civilized nations, sharing common values and historic bonds, must take the lead in demonstrating that no issue that might arise between them was not justiciable." BURTON, *supra* note 91, at 143. Just after the publication of his award in the Tinoco decision, Taft stated himself personally "glad to help judicial settlement of international controversies." Letter from W.H. Taft to H.D. Taft of 10/21/1923, *quoted in* ALPHEUS THOMAS MASON, WILLIAM HOWARD TAFT: CHIEF JUSTICE 272 (1965).

[95] Unsurprisingly, early 20th century conservative lawyers – such as Taft – were at the forefront of this approach to international law. Patterson highlights the founders of this more conservative legalist element as coming initially from, "lawyers who wanted the United States to lead in the quest for pacific alternatives to international violence but were reluctant to have their nation join in boldly innovative schemes of world order involving potentially far-reaching limitations on national sovereignty." Patterson, *supra* note 93, at 295.

There is the puzzling fact that Taft – of all people – is one of the inadvertent founding fathers of a doctrine that is popular with advocates of debt forgiveness. As the twenty-seventh president and tenth Chief Justice of the United States, Taft is best known domestically as an economic conservative bordering on the reactionary. Internationally, he was the chief architect of 'dollar diplomacy,' in which the U.S. government has been accused of using its power to protect elite economic interests abroad. Accounts of Taft as Chief Justice make scant (if any) note of his role in this international arbitration, and it is worthwhile to ask what can be learned at a policy level from the *Tinoco* decision. A broader empirical study than is possible in this paper would be necessary for a definitive recommendation. However, reading Taft's ruling against his own ideological tendencies gives lie to the idea that a commitment to the sovereign credit market *logically* mandates a functionalist account of sovereignty. While a requirement that creditors lend only to truly popular governments could seriously burden the system, the intermediate conception of sovereignty that Taft presents should cause less alarm.

A. A CLOSER LOOK AT WHAT IS 'PRO-MARKET'

Perhaps the most widespread and somewhat caricatured view of Taft in American politics is as "a stubborn defender of the status quo, champion of property rights, apologist for social privilege, inveterate critic of social democracy."[96] Although the nuances of Taft's approach changed over the course of his career, at his 1921 appointment to the Supreme Court, the fact that "the new Chief Justice was conservative, if not reactionary, in his political and social views is not open to question."[97] It would be reasonable to expect that this ideological lens might inform Taft's international policy, which only makes his finding against the validity of the bank debt and oil concession more puzzling. On closer study, however, Taft's ideological approach, although deeply conservative, is less simplistic than the big business caricature frequently placed upon him. The nuances of Taft's ideological predispositions, which unified property protection with judicial reform and which distinguished policies that favored business from those that favored particular businessmen, can help shed light on the practical ramifications of his international approach. In particular, it suggests that what appears to be progressive reform may in fact be supportive of a fairly conservative, pro-market framework in sovereign lending.

1. A Pro-Market Finding Consonant with Taft's Policy Commitments

[96] MASON, *supra* note 94, at 13.

[97] "To Taft, clearly, the difference between conservatism and radicalism was the difference between right and wrong, between the known and the unknown, between the sound and the unsound." PRINGLE, *supra* note 94, at 967.

In concluding that the Tinoco regime constituted Costa Rica's sovereign government, Taft's ruling defended a relatively stable investment environment within international law. As Taft points out in the J.B. Moore passage highlighted above, the rule of 'effective control' is consistent with the idea of sovereign continuity.[98] So long as we conceive of the sovereign as the juridical body controlling the same territory and people, then the continuity of sovereign obligations makes sense. Recall that this is the idea that *Financial Times* editors considered so central to foreign investment, without which "there would be no lending to governments."[99] Taft's finding of a sovereign government in the Tinoco regime, despite the regime's unsavory origins and militarization, may be understood as a victory for certainty in investment – a boon to investors themselves and perhaps to those governmental administrations that incorporate foreign borrowing into their development strategy. As long as both the foreign creditor and the sovereign government comply with the internal rule of law, then a sovereign contract should be internationally enforceable.[100] Even if the political circumstances of a sovereign borrower shift, the country's international legal status and thus the investor's legal rights remain the same.

It is important to note that Taft's insulation of stable legal rules from any political change extends to the creditor's country as well as to the sovereign contractor. Taft marks a clear distinction between a politically-chosen national recognition policy and his own ostensibly policy-neutral finding of sovereign recognition as a matter of international law.[101] Thus even if an investor's *own* country has not recognized a foreign government, as an implicit warning to its nationals not to invest, an investor can feel secure of its property rights in international law. As long as investors are willing to risk an inability to bring claims through their own government – or are willing to bet on a friendlier administration coming into power – they can continue to engage in economic activity even with a non-recognized regime. Furthermore, the sovereign host or debtor country cannot respond to the policy of a creditor's country with a counter-policy of its own (i.e. expropriation of U.S. companies in retaliation for U.S. non-recognition), at least not in a way that would be recognized by international law. Thus, investment and trade can continue even in the face of one or both countries' opposing policy frameworks. Woodrow

[98] *See supra* text accompanying note 41.

[99] Leader, *Iraq's Debt*, THE FINANCIAL TIMES (UK), June 16, 2003, *available at* http://www.odiousdebts.org/odiousdebts/index.cfm?DSP=content&ContentID=7670.

[100] This would, of course, give all parties advance notice of the legal rules to which they might be held, as Taft asserts that the governing law of a contract ruling is the law in force at the time of the contract. Tinoco Case, 18 AM. J. INT'L L. 146, 173 (1924).

[101] *See supra* text accompanying notes 53-54.

Wilson had in fact made an effort to prevent American companies from working in Costa Rica. He issued a directive stating that American companies could not expect any diplomatic help from the U.S. government in the event of a dispute.[102] Justice Taft's decision on recognition thus countered an investment-unfriendly national policy with an investment-friendly international legal finding, undermining the effectiveness of political decisions such as Wilson's in the long run. At least in principle, Taft's finding removes companies from the purview of *either* country's policy, effectively insulating investment, trade, and property rights from politics at both ends.[103] In the sense of protecting investment from political fluctuations, the *Tinoco* decision can be seen as a precursor to procedures such as those established by NAFTA, which allow individual companies to bring claims against sovereign states without the political considerations implicated by the traditional practice of diplomatic protection.

In light of his association with 'dollar diplomacy,' Taft of all people may have been expected to support a favorable environment for international investment. A substantial portion of his foreign policy work as Secretary of War under Theodore Roosevelt and in his own Presidential administration involved securing overseas environments amenable to American investment and trade. Taft himself stated,

> We believe it to be of the utmost importance that while our foreign policy should not be turned a hair's breadth from the straight path of justice, it may be well made to include active intervention to secure for our merchandise and our capitalists opportunity for profitable investment which shall insure to the benefit of both countries concerned…. [I]f the protection which the United States shall assure to her citizens in the assertion of just rights under investment made in foreign countries, shall promote the amount of such trade, it is a result to be commended. To call such diplomacy 'dollar diplomacy'… is to ignore entirely a most useful office to be performed by a government in its dealings with foreign governments.[104]

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[102] Taft notes that the U.S. government warned investors on February 24, 1917, and reiterated in April 1918, "that it will not consider any claims which may in the future arise from such dealings [business dealings with the Tinoco regime], worthy of its diplomatic support." *Tinoco Case*, *supra* note 100, at 153.

[103] Taft extended this analysis to other countries that had failed to recognize the Tinoco regime, notably the U.S.'s World War I allies Great Britain and France, who he assumed were deferring to the leadership of the United States. *Tinoco Case*, *id.* at 153.

[104] ADDRESSES OF WILLIAM HOWARD TAFT, Vol. XVIII, at 240-41, *quoted in* HENRY F. PRINGLE, THE LIFE AND TIMES OF WILLIAM HOWARD TAFT 679 (1939). Wilson's Secretary of State William Jennings Bryan offered an alternative assessment of dollar diplomacy in a 1913 letter: "[T]o see Nicaragua struggling in the grip of an oppressive financial agreement… we see in these transactions a perfect picture of dollar diplomacy. The financiers charge excessive rates on the ground that they must be paid for the risk that they take and as soon as they collect their pay for the risk, they then proceed to demand of the respective governments that the risk shall be eliminated by governmental coercion. No wonder the people of these little republics are aroused to revolution by what they regard as a sacrifice of their interests." R.S. BAKER, WOODROW WILSON, LIFE AND LETTERS, VOL. IV, at 437-38, *quoted in*

Taft promoted investment and the involvement of U.S. business in each foreign policy area in which he was involved. In East Asia, where he first developed an interest while serving as Governor of the Philippines, he championed the 'open door' policy of promoting trade with all parts of the Chinese Empire.[105] Following the policy of John Hay and Theodore Roosevelt, Taft aimed to limit European spheres of economic and political influence under the slogan 'China for Chinese.'[106] He helped to establish customs receiverships through U.S. bank loans in the Caribbean, and he argued for a trade agreement in the form of a reciprocity treaty with Canada.[107] As will be pointed out below, the geopolitical thrust of Taft's policies was very much in line with those of Teddy Roosevelt. However, Roosevelt's viewpoint was more classically realpolitik and less economically oriented. Taft himself considered dollar diplomacy a politically wise and economically savvy alternative to 'bullet diplomacy.'[108]

Taft's foreign economic policies were consonant with his guiding principles as both a domestic politician and a judge. In line with legal classicism, Taft was committed domestically to the promotion of capitalism and the protection of private property, and he viewed law as a bulwark against instability and radicalism.[109] According to analysts of his time on the Supreme Court, Taft considered that "law, the rock of civilization, made for certainty and order amid inevitable economic and social flux."[110] Property protection stood at the core of Taft's judicial ideology and, during his time as Chief Justice in the 1920s, Taft was particularly concerned about populist attacks on property rights and on the judiciary.[111] In short, the protection of order, free markets, and property rights emerges as a consistent theme in Taft's domestic and foreign

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PRINGLE, *id.* at 678. The Wilson administration, too, however, followed many of the same interventionist policies of its predecessors. The continued involvement of the U.S. in the Caribbean, particularly through its interest in the Panama Canal, made it difficult for any supporter of this larger geopolitical goal to seriously alter U.S. policy in Central America.

[105] *See, e.g.*, DAVID H. BURTON, WILLIAM HOWARD TAFT: CONFIDENT PEACEMAKER 52 (2004).

[106] Taft was considerably less successful in establishing U.S. economic strength in East Asia than in Latin America. In China, the European powers were far more entrenched and Japan had embarked upon its own imperial plans. The open door policy failed in facing these established interests. *See, e.g.*, WALTER V. SCHOLES & MARIE V. SCHOLES, THE FOREIGN POLICIES OF THE TAFT ADMINISTRATION 247 (1970).

[107] DAVID H. BURTON, WILLIAM HOWARD TAFT: CONFIDENT PEACEMAKER 80 (2004).

[108] As Scholes & Scholes present the intentions of the Taft administration, "In practical terms dollar diplomacy meant economic intervention to stave off military intervention or, as the Administration was fond of saying, it meant the use of dollars instead of bullets." SCHOLES & SCHOLES, *supra* note 106, at 36.

[109] ALPHEUS THOMAS MASON, WILLIAM HOWARD TAFT: CHIEF JUSTICE 15 (1965).

[110] *Id.* at 291.

[111] Taft considered the judiciary to be, among other things, the institution designed for the protection of property rights. *Id.* at 291.

policy. These basically conservative guiding principles shaped his *Tinoco* ruling on recognizing sovereign governments through a legalized 'effective control' test.

2. Rule of Law and a Pro-Market Approach

In light of his economically conservative background, is Justice Taft's ultimate decision for Costa Rica a pure anomaly in a pro-investor finding, countering his generally market-friendly legal orientations? To answer this, it is worthwhile to consider the dualism inherent in Taft's own domestic policy. In addition to a general commitment to business interests and private property, Taft was a strong advocate of judicial reform. During the early 1920s, Taft led an administrative reform effort that aimed to make courts more effective and equitable.[112] Taft was particularly concerned with unequal access to the courts based on wealth, and with the corrosive effect this had on the administration of justice.[113] Mason argues that this dualism of Taft as both a class conservative and a judicial reformer comes together in Taft's paramount and ultimately conventional concern for law, order, and stability. In highlighting Taft's major 1908 address before the Virginia Bar Association, Mason describes Taft's view as follows:

> One way to undermine the social reformer's crusade was to meet his legitimate demands for evenhanded justice. Leveling gross inequalities between rich and poor at the bar of justice would remove a major source of social unrest. Improved judicial machinery would make courts potentially more effective safeguards of private property and, perhaps, help disarm its most dangerous enemies – socialists, communists, and progressives.[114]

In this regard, Taft's goal of fair judicial access may have been part and parcel of his general conservatism. Thus, what seems to be progressivism on Taft's part is not inconsistent with a commitment to maintaining the status quo. Although Taft may well have felt genuine concern for wealth-based inequality in access to justice, he was also aware of the risks to property and capital of doing nothing. The unequal burden on the poor litigant constituted, "the inequality that exists in our present administration of justice, and that sooner or later is certain to rise and trouble us, and to call for popular condemnation and reform…."[115] Indeed, Taft viewed the proper administration of law as a bulwark against more serious social demands, in addition to an

[112] Taft had long been concerned with judicial reform and made it one of his central activities upon his appointment as Chief Justice in 1921. Burton has a good description of Taft's court projects during the 1920s. DAVID H. BURTON, WILLIAM HOWARD TAFT: CONFIDENT PEACEMAKER 115-121 (2004).
[113] *See, e.g.,* MASON, *supra* note 109, at 53.
[114] *Id.* at 13-14.
[115] *Id.* at 53.

end in itself. Thus, part of a Taftian strategy for the promotion of market-friendly policy would involve the elimination of the most egregious violations of social justice.

Whatever one feels about Taft's policies, they did seem to be guided by capitalist principles rather than short-run pandering to particular capitalists. This distinction is important to make because it asks whether the *Tinoco* decision against Great Britain (the creditor) can be interpreted as working in the long-run interests of a healthy international credit market. Although his policy and judicial decisions generally favored business interests, Taft's genuine orientation was to the market as a point of principle. His view of major corporate actors was decidedly mixed, writing in a letter to his brother, "As you say, Wall Street, as an aggregation, is the biggest ass I have ever run across."[116] Indeed, Taft showed himself willing to take positions antithetical to major American interests in order to serve a broader commitment to smooth economic and market functioning, though these tensions do seem relatively rare. Although he counseled very slow-moving social legislation, he did admit that the excesses of big business might require "a limitation upon the use of property and capital."[117] In prosecuting the major monopolies of the day, Taft perhaps "attempted much more, far less noisily, than [Theodore] Roosevelt."[118] During his nomination for the presidency in 1907, Taft attacked the "use of accumulated wealth in illegal ways." According to his major biographers, this was a preemptive approach that ultimately supported Taft's dedication to the superiority of the capitalist system. According to Taft, "Unless the abuses under it were stopped, capitalism would be replaced by socialism or some other evil."[119] In short, Taft was able to distinguish between creditor interests and market interests, and, when he perceived a conflict between these commitments, he preferred the latter. Furthermore, his more liberal reform efforts can be understood as part of the larger goal of maintaining economic stability and political order.

B. THE APPROPRIATE SOVEREIGN FOR SOVEREIGN DEBT

Domestically, Taft's relatively progressive approach to judicial reform is consonant with, and may have served, his overarching defense of the market. This insight forces the question of

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[116] Letter from W.H. Taft to Henry Taft of 2/21/1910, *quoted in* HENRY F. PRINGLE, THE LIFE AND TIMES OF WILLIAM HOWARD TAFT 655 (1939).
[117] William Howard Taft, The People Rule: Mr. Taft's Reply to Mr. Bryan at Hot Springs, Virginia (August 21, 1908), *quoted in* ALPHEUS THOMAS MASON, WILLIAM HOWARD TAFT: CHIEF JUSTICE 52 (1965).
[118] Pringle, *supra* note 116, at 654. Taft approved the antitrust prosecutions of companies, including a major U.S. steel corporation, resulting from mergers that Roosevelt had approved. DAVID H. BURTON, WILLIAM HOWARD TAFT: CONFIDENT PEACEMAKER 83 (2004).
[119] PRINGLE, *supra* note 116, at 655.

whether the intermediate conception of sovereignty underlying the *Tinoco* decision – also relatively progressive – can also be understood as supportive of market ideals. This would problematize the view that only a narrowly functionalist conception of sovereignty, along with the strictest doctrine of sovereign continuity, is suitable for the treatment of sovereign debt. The two moves that Taft makes domestically, first to preempt substantive justice claims with procedural justice and second to distinguish investment markets from particular investors, throws new light on the question of who is appropriately 'sovereign' in sovereign debt. Although modern creditors treat the odious debt issue as a slippery slope to the collapse of sovereign lending,[120] understanding Taft's own background presents a different interpretation.

As implied above, Taft's commitment to using legal principles as a shield against violent controversy and disorder extended beyond American borders. While it is possible that Taft felt concern for debt payment burdens on poor countries, he certainly was not a proponent of widespread debt relief. He presented the *Tinoco* decision not as a grand indictment of the lack of genuine agency for borrowing countries, but as a fairly narrow requirement for sovereign loans to comply with internal laws and to serve a legitimate government purpose. Taft's domestic support for the traditionally progressive cause of legal reform ultimately aimed to prevent deeper and less disciplined calls for social justice. Consistent with these state-level preferences, Taft believed internationally in "respect for law, constitutional and statute, which would bring about a disciplined international community, just as it had for a domestic society in the advanced nations."[121] Although at both the domestic and international levels Taft seemed most interested in the *procedural* aspect of equal justice, the substantive outcome of his Costa Rica decision makes sense within this larger strategy. Granting basic fairness in the international arbitral arena can be understood as a stopgap measure against more serious questions about global economic justice. It may well be that Taft considered the elimination of the most egregious violations of transnational justice part of a broader market-friendly policy for sovereign lending.

The second relevant element of Taft's domestic policy is his ability to distinguish between general pro-market policies, including anti-trust measures and judicial reform, and

[120] *See, e.g.*, Raghuram Rajan, *Odious or Just Malodorous: Why the odious debt proposal is likely to stay in cold storage*, FIN. & DEV., Dec. 2004, at 54, 54-55.
[121] Burton, *supra* note 118, at 115.

policies favoring particular market actors.[122] This point is important because any shift away from a strict doctrine of sovereign continuity and a concomitantly functionalist account of sovereignty in the sovereign debt market seems so foreign to Taft's spiritual descendants – the powerbrokers and decision-makers of today's lending system. There are reasonable policy considerations that go toward explaining this latter-day hesitancy. Part of the concern with giving more traction to the doctrine of odious debt and associated conceptual frameworks may be that successor regimes would fail to distinguish between legitimate and illegitimate debt, and would attempt to repudiate all debt under the guise of odiousness.[123] This tendency would aggravate the pre-existing risk already associated with sovereign lending: if a country refuses to continue payment, the absence of a supra-national state enforcement system makes debt collection more difficult.

Under the current system of strict sovereign continuity, however, the opposite moral hazard concern seems to have prevailed. Failing to distinguish between legitimate and illegitimate debt through the general norm of repayment has created a moral hazard problem with regard to creditors. Folding in arguably odious debt with all other sovereign debt effectively obviates the distinct risk of lending to an illegitimate regime for illegitimate or economically unproductive purposes. The strict functionalist approach to sovereignty effectively shifts risk onto borrowing states by absolving creditors of part of their standard due diligence requirement.[124] The intermediate approach to sovereignty taken by Taft in *Tinoco* requires that creditors and borrowers alike make a good faith effort to ensure that the debt has a legitimate government purpose and complies with basic requirements of domestic law. A more successful

[122] In light of discussion over sovereign nationalization over natural resources, a related question might be how Taft reconciles his commitment to property rights with finding for the validity of Costa Rica's repudiation of the Amory oil concession. Again, I would argue that Taft's flexibility is not with the idea of property rights but rather with the designation of the appropriate property right holder. A commitment to protecting property in sovereign contracts does not lead necessarily to any one idea of the 'sovereign,' although historically it has been associated with positivist conceptions.

[123] Kremer and Jayachandran note this concern in their 2002 working paper. Michael Kremer & Seema Jayachandran, *Odious Debt*, BROOKINGS POL'Y BRIEF 103 (2002).

[124] The sovereign credit market, as with any credit market, entails risks on the part of both the borrower and the lender. The borrower generally accepts the risk that the returns on its investment may not be sufficient to repay the funds borrowed; a failed investment in and of itself does not absolve the obligation to repay. The lender generally accepts some risk as well: it must ensure that the borrower is able and willing to follow through on its obligation, i.e. not default on its loans or declare bankruptcy. To that end, creditors generally engage in due diligence to determine the financial viability of the borrower, and also to reasonably assure themselves that the individual or entity signing the debt contract is competent to bind the ultimate payer of the debt. However, if the creditor can enforce all debt regardless of the agent's competency or legitimacy, then it can shift a significant portion of the risk away from itself.

international sovereign debt market might in fact benefit from requiring creditors to undertake basic due diligence as to both the procedural and the purposive elements of a loan.[125]

The practical or 'interest-group' ramifications of this creditor and market dynamic initially seem clear. One would predict that creditors (and their lawyers) would have a strong preference for a strict functionalist version of sovereignty, which ensures the repayment of debt under *all* circumstances. Although Taft's intermediate conception of sovereignty in sovereign debt promotes investment stability, the requirements of legitimate government purpose and basic rule of law preclude a windfall to creditors. It is somewhat surprising, then, that the creditor response to Taft's finding for Costa Rica was far less alarmist at the time of the decision than today's discussions of odious debt. Most commentators in the 1920s seemed unperturbed by Costa Rica's arbitral award. The *British Yearbook of International Law* solely covered the basic discussion on sovereign recognition, adding only that, "On the merits of the British claims the Arbitrator's decision was on the whole favorable to Costa Rica, but this part of his opinion is of less general interest."[126] The *Wall Street Journal* merely reported Taft's decision for Costa Rica on both the bank note and the oil concession claims, without any additional editorialization.[127] By 1924 – two years after the legislation repudiating Tinoco's debts and one year after the arbitral award – Costa Rica was able to float loans in both the United States and France to regain its financial footing.[128] Although there may have been more anger in British foreign policy circles, this did not significantly hinder Costa Rica's financial flexibility or cause its banishment from the sovereign credit market. In a similarly puzzling instance around the same time, New York bankers were eager to lend to the new Soviet Union even after its repudiation of the Tsar's debt in 1917.[129] In short, the creditor response to Taft's decision, and thus implicitly to its underlying theory of sovereignty, was not consistently hostile.

Unlike their contemporary descendants, early 20th century financiers did not uniformly consider a strict functionalist conception of sovereignty their due. The relatively moderate response of these early creditors raises the question of why today's financial actors have become

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[125] Kremer and Jayachandran model the equilibrium that would result from establishing a prospective odious debt regime. *See generally* Kremer & Jayachandran, *supra* note 123.
[126] J.L.B., *Arbitration Between Great Britain and Costa Rica*, BR. Y.B. INT'L L. 199, 204 (1925).
[127] *Costa Rica Wins Amory Case*, WALL ST. J., Oct. 20, 1923, at 4. American newspaper reports tended to focus on the oil concession rather than the bank loan.
[128] *Costa Rica Shows Big Financial Gain*, N.Y. TIMES, May 20, 1928, at 33. At the time, Moody's had begun publishing sovereign credit ratings but did not have a rating for Costa Rica.
[129] *See generally* ANTONY SUTTON, WALL STREET AND THE BOLSHEVIK REVOLUTION (1974).

less responsive to any deviation from a narrow conception of sovereign continuity and a concomitantly strict practice of debt repayment. The puzzle only deepens in light of Taft's own reconciliation of his economic conservatism with a more flexible conception of sovereignty, which unified internal transparency with a commitment to legitimate governmental purpose.

IV. CONCEPTUAL CONSOLIDATION AND REALPOLITIK IN THE CARIBBEAN

Reading the *Tinoco* decision in light of Taft's pro-market ideological beliefs counters the claim of some modern financial actors that only a strict functionalist approach to sovereignty is consistent with healthy sovereign credit markets. This practical open-endedness suggests that ideas of economic rationality, sound market practice, and sovereign creditworthiness are at least potentially theoretically and historically contingent. If there is variation in the idea of sovereignty underlying these concepts, then, what might account for this variation?

The following discussion looks briefly at the political and economic context of the *Tinoco* decision to formulate an initial hypothesis for this more social scientific question. It argues that the degree to which creditors are competitive or consolidated may affect the openness of the conception of sovereignty underlying sovereign debt. In times when creditors are competitive and perceive *each other* as significant risks, the conception of sovereignty is likely to be more flexible and receptive to the claims of sovereign debtors. However, when creditors are non-competitive and perceive themselves as part of the same interest group, a more strictly functionalist approach is likely to dominate. This dynamic plays out in the context of early 20th century British-American rivalry in the Caribbean, which may have given Taft leeway for his finding and encouraged creditors to be more flexible in their approach.

A. THE OPENNESS OF A 'PRO-CREDITOR' CONCEPT OF SOVEREIGNTY

The above discussion makes clear that the initially abstract question of who is 'sovereign' in sovereign debt in fact has significant distributional consequences in international economic relations. A strictly functionalist account of sovereignty, in which the *fact* of control is sufficient regardless of the internal *mechanism* of control, supports the repayment of debt regardless of any internal governmental illegitimacy. Disregarding even Taft's minimal conception of internal rule of law and legitimate purpose as a factor in sovereign lending would allow occasional windfalls to creditors. In asking why an intermediate conception failed to gain strength over the course of the 20th century, one immediate hypothesis therefore rests with the increasing power of creditors. Along this line of reasoning, the defense of a strict functionalist account of sovereignty in

sovereign debt would increase along with creditor power. Such a hypothesis, while initially plausible, offers an insufficiently nuanced view of 'creditor interests.' In particular, it fails to recognize that while creditors may at times have a consolidated perception of interest and threat, tending toward a strict functionalist approach, such creditor consolidation is not inevitable. At other times, creditors may actively compete and thus perceive *each other* as significant threats, in which case the conception of sovereignty underlying sovereign lending is likely to be more flexible and receptive to sovereign debtor concerns. In short, a more nuanced version of a 'creditor interest' hypothesis suggests that the degree to which creditors are competitive or consolidated – rather than 'creditor power' in general – may affect the narrowness or openness of the conception of sovereignty underlying the sovereign debt regime.

How would this dynamic play out in practice? While some intellectually ambitious creditors might independently consider the questions of sovereign legitimacy raised by different conceptual frameworks in political theory, the vast majority are unlikely to do so. The sovereignty issue in sovereign debt is likely to remain in the background until pressed by a sovereign government, either upon repudiation or when seeking to borrow after a repudiation or default. As such, a creditor's *receptiveness to borrower government claims* will be central to how competition or consolidation affect conceptions of sovereignty in international debt.

Although it is fairly common to speak of 'creditor interests,' such imprecise language effectively expresses an oligopolistic perspective. In fact, creditor interests in the arena of sovereign debt are rather ambiguous. Creditors as a whole are generally concerned with maintaining a norm against default and repudiation, and in this sense share a logic of risk vis à vis sovereign debtors. As long as major creditors have similar perceptions of interest in the sovereign market, then a hegemonic response to sovereign debt, including potentially odious debt, makes sense ("pay!"). The concept of sovereignty that best supports such a practice – a purely functionalist definition accompanied by a strict doctrine of sovereign continuity – would gain greater support. Therefore, to the extent that powerful creditors are consolidated in their assessment of risk, a functionalist account of sovereignty will likely dominate in the sovereign debt market.[130]

[130] Such creditors may include private financial houses, bank groups, international financial institutions, and major creditor governments. Credit rating agencies, organizations such as the Paris and London Clubs, and other institutions involved in the regime of sovereign lending may also play a role in this dynamic of competition and consolidation.

This consolidated creditor approach would be more likely to emerge when the market is oligopolistic, in which case the threat posed by competing suppliers of credit disappears. In this case, the risk of sovereign default becomes dominant, and creditors view their own interests and risks as intertwined with those of their fellow creditors. As such, they will be more hostile toward debtors who refuse to pay previous loans and less solicitous of the views of potential borrowers. Borrowers facing a limited set of intermediaries for capital will have little recourse but to accept the terms set by these creditors working together. It is important to point out that, in an oligopolistic situation in which the interest of one is the interest of all, creditors will have little incentive to accept claims based on a non-functionalist view of sovereignty. Even if one creditor considered the odious debt argument valid, its relationship with other creditors, including the discontented debt-holder, might prevent this more flexible view from taking hold.[131] In short, any given creditor's perception of risk expands to include that held by other members of the group or by the group as a whole. Although it is difficult to place a monetary value on the exclusive adoption of a concept, the dominant use of a functionalist definition of sovereignty – with its occasional windfalls to creditors – effectively grants a 'conceptual monopoly' as financially valuable as any other monopoly. Over time, this conceptual monopoly can gain the appearance of naturalness or inevitability, making alternative approaches to sovereignty seem impracticable, and so shaping the underlying theoretical context of sovereign lending.

This naturalized oligopolistic logic, however, neglects that debtors are not the only or even the most pressing source of risk for creditors. The forgotten threat here comes in the form of other creditors. In a genuinely competitive market in which creditors view not only the sovereign debtor but also fellow creditors as risks, the preferred definition of sovereignty should not be so uniform. As with any market, a healthy credit market is driven partially by competition between suppliers of credit for the same borrowing client. As such, the possibility of losing clients to competitors constitutes a central problem for creditors.[132] This competitor-based threat in turn feeds back into creditors' views of the risk posed by sovereign borrowers. When a

[131] Although this presentation is in rationalist terms, it is unlikely that creditor institutions self-consciously go through these steps of rationalization. In situations of consolidation, it is more likely that a functionalist view has been naturalized and assumed necessary.

[132] This vision primarily applies to bank lending, but the form of competition for bond issues may be somewhat different. The distinction between bonds and bank loans will be discussed as part of a larger project on sovereignty and sovereign debt in the 20th century.

sovereign credit market is competitive, creditors should be more anxious to protect their links to existing clients and to lure new clients away from competitors. While the holder of a particular debt instrument will prefer a functionalist conception of sovereignty as to that instrument, other creditors hoping to attract the same borrower may be more flexible. A new creditor may not actually encourage a prospective client to pay a competitor's arguably illegitimate debt, in the hopes of displacing the pre-existing financial relationship. This underlying desire could reasonably lead to a more open perspective on the 'sovereign' in sovereign debt and a weaker insistence on the doctrine of sovereign continuity. So long as a potential borrower looks like a good credit risk overall, a new creditor may exhibit indifference toward or even welcome repudiation on the grounds of odious debt.[133] Repudiation on this logic is not a slippery slope to denouncing the international lending system as a whole, as is sometimes presented today, but a reasonable financial choice in light of recent changes in a country's political situation. Thus, a more aggressive credit market should be more willing to hear arguments made by sovereigns as to why they remain creditworthy after repudiating arguably illegitimate debt.

Questioning the idea of a monolithic 'creditor interest' in sovereign lending only makes more apparent how the conception of sovereignty underlying the sovereign debt regime is historically contingent. Two alternative logics exist for creditor preferences, depending on the degree to which creditors are competitive or consolidated. Although it is impossible to verify the general applicability of this proposal in a single case study, the creditor consolidation hypothesis can help to provide context for the intermediate approach to sovereignty taken by Taft in the *Tinoco* decision.

B. Creditor Competition and Realpolitik in the Caribbean

While Taft's *Tinoco* decision and its underlying vision of sovereignty did provide stability and certainty for international investment, its shift away from a strictly functionalist account precluded a win for the British creditors. Although it is common to hear talk of 'creditor interests,' in fact such interests are not necessarily unified. Two alternative logics exist for understanding creditor interests in sovereign debt markets, depending on whether creditors are

[133] It is important to keep in mind that a genuine repudiation on the grounds of odious debt is not a large-scale repudiation of all the sovereign state's debt. Generally, only a portion of a sovereign's debt may be considered 'odious,' and some debt forgiveness advocates have actually proposed calculations of different country's odious debt burdens. *See, e.g.*, Anaïs Tamen, La Doctrine de la Dette "Odieuse" ou: L'Utilisation du Droit International dans les Rapports de Puissance, Annexe 1, 25 (CADTM, 2003), *available at* www.cadtm.org/IMG/pdf/La-doctrine_de_la _dette_odieuse.pdf.

competitive or consolidated in their perception of threat. These two logics highlight how the conception of sovereignty underlying sovereign debt is contingent not only at the level of market rationality, as discussed in Part III, but also at the level of creditor rationality. While this practical open-endedness is important in its own right, it also sheds explanatory light on the context of the early 20th century and beyond.

The relative nuance and flexibility of Taft's *Tinoco* position may have been enabled by the background context of competition between the U.S. and its European rivals. Such competition, with Great Britain in particular, ruled out an easy identification of 'creditor interests' and thus precluded the kind of unthinking conceptual monopoly that became dominant in the late 20th century. This competition existed along both economic and geostrategic dimensions, deepened by U.S. concerns about oil concessions and the Panama Canal. Given Justice Taft's extensive foreign policy experience as both President and Secretary of War under Theodore Roosevelt, he would have been aware of the broader ramifications of his finding in the *Tinoco Case*. The point here is not that Taft decided in favor of Costa Rica to obstruct British regional involvement, although this strict realist hypothesis could be tested more thoroughly.[134] Rather, the competitive context of sovereign lending in the early 20th century would have mitigated against the oversimplified understandings of 'market rationality' and 'creditor interests' prevalent today.

Part of Taft's foreign policy as President involved supporting American banks in their early efforts to break into areas already supplied by European powers and their financiers. In the early 20th century, American capital sought investment outlets and struggled against the market dominance of British, French, and German banking houses. In the Far East, Taft's presidential administration displayed far greater concern than previous administrations with promoting concessions for American banks and corporations.[135] These earlier efforts failed in part because of the relative immaturity of U.S. capital markets, but also due to the intransigence of Japanese and European interests in the region.[136] Although the U.S. was relatively stronger in Latin America, particularly after World War I, British capital continued to prevail through most of the

[134] Unfortunately, Taft's biographers make very little if any mention of the *Tinoco* arbitration and so it is unclear how Taft himself viewed it in the context of Caribbean competition.
[135] WALTER V. SCHOLES & MARIE V. SCHOLES, THE FOREIGN POLICIES OF THE TAFT ADMINISTRATION 109 (1970).
[136] *Id.* at 247-248.

1920s.[137] While U.S. investments in Latin America doubled to $3 billion between 1924 and 1929, British investments dominated the region throughout this time period.[138] This background of economic competition undermines the tenability of a unified concept of 'creditor interest' in the early 20th century. Although Taft may have aimed to promote market and creditor interests generally, in line with his economic conservatism, the precise content of such interests remained in flux. The U.S. rise as a creditor nation accelerated after World War I, but it had still not solidified a hegemonic status. According to the competitive creditor logic outlined above, this may have enabled more openness in framing the concepts and legal approaches to sovereignty in the sovereign debt market of the 1920s.

This economically competitive context was only enhanced by geopolitical considerations. While the U.S. viewed Great Britain and other Western European nations as an economic risk, this would have constituted only part of Taft's foreign policy outlook. U.S. support for overseas investment was matched if not superceded by geostrategic concerns. The Taft presidency was committed to opening foreign markets as an independent goal, but also aimed to use private capital as an instrument for promoting stable and solvent governments in areas of geopolitical concern. Particularly in Latin America, Taft's "most important consideration was the preservation of vital American interests abroad."[139] The Tinoco coup and the arbitration took place in the twilight of imperial competition in the Caribbean and at the dawn of American global hegemony. As early as 1823, the Monroe doctrine asserted that the newly independent Latin American countries constituted part of a U.S. sphere of influence, and declared that any European attempts at control would be viewed, "as the manifestation of an unfriendly disposition to the United States."[140] U.S. interest in the Caribbean only deepened when it launched its

[137] The British had been historically interested in establishing a Central American foothold in the Spanish Empire, and founded a logging colony at present day Belize as early as 1622. Thomas M. Leonard, *Central America and the United States: Overlooked Foreign Policy Objectives*, 50 THE AM. 1, 4 (1993).

[138] Robert Freeman Smith, *Latin America, the United States, and the European Powers, 1830-1930, in* THE CAMBRIDGE HISTORY OF LATIN AMERICA, VOL. IV, 83, 112 (Leslie Bethell ed., 1986).

[139] Scholes and Scholes argue that Taft's use of private capital was analogous to Truman's use of public capital as a method for political and economic stabilization abroad after World War II. SCHOLES & SCHOLES, *supra* note 135, at 105. *See also* DANA G. MUNRO, INTERVENTION AND DOLLAR DIPLOMACY IN THE CARIBBEAN 1900-1921 163 (1964) ("to Taft, using dollars instead of bullets seemed humane and practical"). Commentators frequently remark upon the unity of the motivating factors behind Roosevelt, Taft, and Wilson's approaches to the Latin American and particularly the Caribbean countries. *See, e.g.*, MICHAEL J. KRYZANEK, U.S.-LATIN AMERICAN RELATIONS 51 (1996).

[140] *Quoted in* KRYZANEK, *id.* at 29.

overseas empire in Cuba, Puerto Rico, and the Philippines after the Spanish-American War.[141] The 1904 Roosevelt Corollary to the Monroe Doctrine went even further, claiming an international police power in the Western Hemisphere to correct any "chronic wrongdoing" or disorder resulting from any "general loosening of the ties of civilized society."[142] As part of his corollary, Roosevelt hoped to prevent intervention by foreign powers claiming to protect their national interests in the Caribbean. The central preventive policy of this larger strategy involved the promotion of stable and solvent Caribbean governments and the limitation of new European economic interests in the region, including new loans that might lead to more European gunships in the Western hemisphere.[143] Taft continued the rough trend of this policy in his 'dollar diplomacy,' which repaid European loans with American money and established customs receiverships to guarantee this debt.[144] Wilson, despite his initial wish to stay out of Central America, also followed the policies of his predecessors through World War I.[145] Such prevailing geostrategic competition would have made any theoretical or legal framework that undermined British interests appear more plausible and rational.

The general context of increasing American political concern with the Caribbean was magnified by the development of the Panama Canal. The U.S. had entertained the possibility of building a trans-isthmian canal well before the turn of the century, but initially devoted more energy to preventing other powers from building and controlling any such canal.[146] As the turn of the century approached, however, the U.S. began considering more seriously the possibility and strategic implications of a trans-isthmian shipping route. Although Taft had preferred canal neutrality earlier in his diplomatic career,[147] as Theodore Roosevelt's Secretary of War, Taft took

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[141] The Central Americans had actually made efforts to involve the U.S. as a bulwark against foreign intervention earlier, particularly as Britain had laid claim to the Caribbean coast as far south as the San Juan River (on the border of Costa Rica and Nicaragua) by the mid-1840s. Leonard, *supra* note 139, at 5. Notwithstanding the efforts of Central American elites to become economically closer to the US, Central America remained dependent upon British and German merchants and markets as of 1900. KRYZANEK, *supra* note 139, at 7.

[142] KRYZANEK, *supra* note 139, at 48.

[143] *Id.* at 7.

[144] For an excellent overview of 'dollar diplomacy' in the early 20th century, see DANA G. MUNRO, INTERVENTION AND DOLLAR DIPLOMACY IN THE CARIBBEAN 1900-1921 (1964).

[145] Roosevelt, Taft, and Wilson ultimately shared similar underlying motivations in their approach to foreign policy in Latin America and the Caribbean. *See, e.g.*, MICHAEL J. KRYZANEK, U.S.-LATIN AMERICAN RELATIONS 51 (1996).

[146] The Clayton-Bulwer Treaty of 1850, negotiated in response to the British taking control of the mouth of the San Juan river, provided that neither the U.S. nor Britain would attempt to control any part of Central America or any possible canal. *See* MUNRO, *supra* note 144, at 4.

[147] RALPH ELDIN MINGER, WILLIAM HOWARD TAFT AND U.S. FOREIGN POLICY: THE APPRENTICESHIP YEARS 1900-1908 104 (1975) (citing a 1901 letter to W.H.'s younger brother Horace).

charge of the canal project completed in August 1914. In this role, he paid great attention to ensuring the financial stability and political compliance of the Panamanian government and was not loathe to step on political toes in pursuit of this goal.[148] Taft took a special interest in maintaining stable republics in Central America given American interests, and believed that stability in the Central American republics was even more desirable than peace in South America, due to their proximity to the Panama Canal.[149]

As part of the general policy of limiting European involvement in the region, the U.S. had been particularly wary of allowing the development of British oil concessions in Costa Rica, the latter being "of unusual interest because of its relation to naval bases and the proximity of Costa Rica to the Panama Canal."[150] The State Department aimed to prevent German and British companies from obtaining oil concessions under Gonzalez, Tinoco's predecessor, while the American Sinclair Oil Company was able to obtain a Costa Rican concession in 1916.[151] As noted above, Great Britain's effort to gain a foothold in Costa Rican oil through the 1918 Amory concession constituted part of its claim in the *Tinoco* arbitration. Indeed, the State Department had attempted to prevent the Amory concession, and continued to cautiously encourage Costa Rica's efforts against Great Britain. Although by Taft's 1923 arbitral award there had been sufficient exploration to determine that Costa Rica in fact had very little oil wealth,[152] these broader geostrategic concerns may have made the *Tinoco* decision's theoretical framework more appealing.

In understanding the backdrop of Taft's finding on sovereign government recognition, it is important to keep in mind that the Tinoco regime and Wilson's non-recognition policy took place during World War I. The *Tinoco* decision's legal response to Wilson's political non-recognition policy not only had ramifications for a stable investment environment, but also for

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[148] MINGER, *id.* at 102-117 (discussing Taft's work on the Panama Canal). *See also* DAVID H. BURTON, WILLIAM HOWARD TAFT: CONFIDENT PEACEMAKER 37-40 (2004).

[149] HENRY F. PRINGLE, THE LIFE AND TIMES OF WILLIAM HOWARD TAFT 697 (1939).

[150] Cable from Moore to Hale, Dec. 2, 1913, FOREIGN REL. U.S., 1919, VOL. I, at 866, *cited in* DANA G. MUNRO, INTERVENTION AND DOLLAR DIPLOMACY IN THE CARIBBEAN 1900-1921 431 (1964)., at 431.

[151] Munro provides an excellent narrative of U.S. interests in Costa Rica, paying special attention to oil concerns. MUNRO, *id*. at 426-448.

[152] The U.S. had initially supported the Sinclair Oil Company in their defense of an oil concession granted by Gonzalez but then definitively approved by Tinoco, which had also been repudiated by Law No. 41. The determination by 1923 that there was in fact little oil in the Caribbean basin would have lessened Taft's concerns on this front, however. MUNRO, *supra* note 150, at 448. Furthermore, by 1923 there would have been little love for Sinclair in the American government, as the Oil Company was also implicated in the Teapot Scandal of 1923. PRINGLE, *supra* note 149, at 1020.

realpolitik concerns in the Caribbean. Wilson's policy was at least partly in the same spirit as dollar diplomacy – to protect the canal and U.S. interests by promoting stability and breaking the cycle of revolution in Central America.[153] However, the policy was unpopular even within Wilson's cabinet in light of a possible German threat to the vulnerable Caribbean region.[154] Taft did not appear to share Wilson's particular commitment to self-determining (rather than merely stable and basically law-abiding) foreign governments. Certainly he did not have a deep respect for the inherent rights of Central Americans to sovereign control over their own affairs. Panama enjoyed only titular sovereignty during Taft's administration of the canal project, and he considered "Panama as a kind of opera bouffe republic and nation."[155] He had little respect for the Central Americans' ability to deal with their own affairs, and, he told his Secretary of State Philander Knox, he yearned for the "right to knock their heads together until they should maintain peace between them."[156] Although Taft acknowledged recognition to be a matter of national government policy, his legal finding that the Tinoco regime constituted Costa Rica's sovereign government may also have been bolstered by realpolitik considerations against the backdrop of World War I.

The insight that competition – when it works well – can benefit consumers by lowering the price of goods and monetary credit is not new. However, this discussion introduced the possibility that creditor competition in sovereign lending can have benefits beyond the context of loan pricing. In particular, such competition may undermine the development of a 'conceptual monopoly' on the theoretical approach to sovereignty in sovereign lending. Although a consolidated market will prefer a strictly functionalist account, with its occasional windfalls to creditors, a competitive market would likely prevent such moral hazard on the part of creditors.

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[153] The problem of revolutions was far less of an issue in Costa Rica, which has been surprisingly stable relative to its neighbors. Nonetheless, Wilson felt that he could not make exceptions to his general rule, and hoped to use Tinoco as an example for other Central American republics.

[154] In fact, Wilson may have been the only member of his foreign policy team that whole-heartedly supported the non-recognition policy. His Secretary of State, Robert Lansing, urged for the recognition of the Tinoco government in light of concerns about German interest in the basin. MUNRO, *supra* note 150, at 433-34. There is some intimation among historians that Gonzalez may in fact have been sympathetic to the Germans. However, the seriousness of the German threat is unclear. Leonard notes that a *New York Times* correspondent close to Tinoco, planted stories of German plots against Costa Rica in an effort to encourage recognition. Thomas M. Leonard, *Central America and the United States: Overlooked Foreign Policy Objectives*, 50 THE AM. 1, 12 (1993).

[155] DAVID H. BURTON, WILLIAM HOWARD TAFT: CONFIDENT PEACEMAKER 40 (2004). Taft's Secretary of State, Philander Knox, had particular difficulty interacting diplomatically in the Latin American venue, referring to the citizens of the Caribbean countries as "Dagos."

[156] Letter from W.H. Taft to Philander Knox of 12/22/1909, *quoted in* BURTON, *supra* note 155, at 40.

As a consequence, opening the space for alternative conceptions of sovereignty in the sovereign debt market may well be more economically rational.

This insight plays out in a consideration of early 20th century British-American competition in the Caribbean. The creditor seeking to ensure a return on a previous loan – Great Britain in this case – reasonably championed a strict functional approach to sovereignty in the sovereign debt contract. However, American interests in the region as both a potential creditor and a geostrategic player may have moderated the univocality of the preferred British framework. This is not to suggest a direct causal link between this competitive background and Taft's finding for Costa Rica in the *Tinoco Case*. Rather, the larger context of creditor competition may have granted more conceptual space for Taft's own consideration of legal possibility and market rationality, and for his ultimate adoption of an intermediate conception of sovereignty in his judicial decision. This competition may also explain the muted reaction of the U.S. press and Costa Rica's own ability to float new loans soon after the finding.

Although a larger causal claim cannot be made through a single case study, this explanatory framework suggests that the disappearance of a more flexible intermediate approach to sovereignty in sovereign debt for most of the 20th century may be related to an increasing consolidation and decreasing competitiveness in international finance.[157] While the rise of U.S. banking and American geostrategic interests engendered competition in the early 20th century, this competitive framework arguably disappeared as the century progressed. Cross border-lending effectively halted during the Great Depression, and when sovereign lending re-emerged after World War II, it took on a very different cast. Public lenders such as the U.S. government and the International Bank for Reconstruction and Development (the precursor to the World Bank) took the lead, and would not have been subject to the competitive logic outlined above. When significant private financing returned to sovereign lending after the oil crises of the 1970s, the rise of bank syndicates, credit rating agencies, and other information-sharing and coordinating mechanisms meant that even these private creditors were consolidated in their perceptions of risk. In short, the conceptual space for considerations of alternative approaches to

[157] The empirical findings of this article constitute part of a larger project on the framework of sovereignty in sovereign debt over the course of the 20th century. A more comprehensive assessment of the hypothesis on creditor consolidation is feasible only in the larger format.

sovereignty in the sovereign debt regime may have narrowed, making the conceptual monopoly of a strict functionalist approach more likely.[158]

V. CONCLUSION

This article has argued that U.S. Chief Justice Taft's key *Tinoco* arbitration of 1923, the lead case cited for the doctrine of sovereign recognition, represents an open moment in the question of who is 'sovereign' in sovereign debt. The article suggests that the framework of sovereignty underlying the *Tinoco* decision offers a third alternative to the functionalist and democratic ideas of sovereignty that dominate today. Although Justice Taft's identification of a sovereign government as based on effective control falls in line with functionalist conceptions of sovereignty, his finding for Costa Rica suggests that more is at play. This article reinterprets Taft's foundational decision as ultimately offering an intermediate or 'rule of law' conception of sovereignty, which conceives of valid sovereign action as grounded in internal legal norms and legitimate government purpose. This intermediate conception resonates with Taft's own domestic jurisprudence, and escapes the binary of democratic versus functionalist sovereignty dominant in contemporary discussions. In highlighting Taft's intermediate framework, this article also reconciles two competing interpretations of the *Tinoco* decision, as supportive of both sovereign continuity in debt contracts as well as the claim that illegitimate government debt may be repudiated.

The article contends that the concepts of sovereignty, market rationality, and creditor interest, which underlie the sovereign debt regime, are theoretically and historically contingent. In particular, the flexibility or narrowness of the framework of sovereignty underlying sovereign lending may relate to the degree of competition or consolidation among creditors involved in the sovereign debt market. Early 20th century economic and geostrategic competition may have enabled the emergence of a more open conception of sovereignty in the *Tinoco* decision, while the virtual disappearance of Taft's approach may relate to the increasing consolidation of international financial actors over the course of the 20th century. Although Taft's intermediate theoretical framework does not provide the strong popular legitimacy of liberal democratic accounts, it does move beyond the strict absolutism of functionalist or realist legal and international relations theory.

[158] The role of broader geopolitical issues, particularly the Cold War, may also have played an important role in this consolidation.

But is this intermediate framework actually preferable to the deeper liberal democratic approach to popular sovereignty? Or does the *Tinoco* arbitration offer only a weak second-best to the more complete versions offered in some modern human rights work, as Michael Reisman suggests?[159] Certainly, it may seem that ever-greater attention to the population as the core of legitimacy would be preferable. However, there are good reasons to maintain some link to more traditionalist accounts of sovereignty in the international arena. As Benedict Kingsbury points out, discarding the functionalist model altogether can undermine limitations on coercive intervention, diminish state functions in developing countries, and re-divide the world into liberal and illiberal zones. "A decline in the traditional sovereignty system weakens the relationship of mutual containment between sovereignty and inequality."[160] The strong version of a project of popular sovereignty risks an updated, more legalized, and perhaps more coercive reinscription of the civilized/uncivilized paradigm that existed prior to the 20th century.[161] Justice Taft's intermediate 'rule of law' concept may offer a preferable alternative after all, in light of the complex relationship between international frameworks of sovereignty and local state autonomy at the turn of the 21st century.

[159] *See* Michael Reisman, *Sovereignty and Human Rights in Contemporary International Law*, 84 AM. J. INT'L L. 866, 870 (1990).
[160] Benedict Kingsbury, *Sovereignty and Inequality, in* INEQUALITY, GLOBALIZATION, AND WORLD POLITICS 84-91 (Andrew Hurrell and Ngaire Woods eds., 1999).
[161] *Id.* at 92.