

Article

Who is the “Sovereign” in Sovereign Debt?: Reinterpreting a Rule-of-Law Framework from the Early Twentieth Century

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I. INTRODUCTION

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 on the potential illegitimacy of debt contracted by dictatorial or corrupt regimes. Notwithstanding this considerable discussion and conflict,

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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, for example, 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.¹ The current sovereign lending regime finds itself in the uncomfortable situation of functioning without a clear theory of what it means by “sovereign.”²

This practical instability has been exacerbated by the fact that sovereignty has competing meanings in two dominant schools of jurisprudence and international relations theory. On the one hand, we have the narrowly statist idea of the sovereign: the sovereign is the juridical body that has control and authority over a given people and territory. It is functionally similar to other sovereigns in this way, and its internal structure and legitimacy are largely irrelevant to its external relations.³ On the other stands

1. Lee C. Buchheit, G. Mitu Gulati, and Robert B. Thompson discuss some of the issues involved in applying U.S. agency law (as well as other areas of domestic law) to a sovereign government context. Lee C. Buchheit, G. Mitu Gulati & Robert B. Thompson, *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201, 1237-45 (2007). Deborah A. DeMott discusses the applicability of common law agency doctrines to issues of arguably illegitimate sovereign debt even more directly. Deborah A. DeMott, *Agency by Analogy: A Comment on Odious Debt*, 70 LAW & CONTEMP. PROBS. (forthcoming 2007), available at <http://ssrn.com/abstract=982213>.

2. The discussions of Iraqi debt after the 2003 invasion highlight this lack of clarity. U.S. officials in particular 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. A bill to this effect was introduced into the U.S. House of Representatives. Iraqi Freedom from Debt Act, H.R. Res. 2482, 108th Cong. (2003). Of 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, insisted that this more flexible approach to sovereignty has no place in the sovereign credit market. See, e.g., *Iraq’s Debt*, FIN. TIMES (London), June 16, 2003, at 20, available at <http://www.odiousdebts.org/odiousdebts/index.cfm?DSP=content&ContentID=7670>.

3. As will be discussed below, this approach resonates with international legal positivism and with neorealist assumptions in international relations theory. See *infra* text accompanying notes 45, 48. This statist conception is also sometimes understood to be a traditional “Westphalian” approach to international relations, which disallows intervention in the internal affairs of other states, particularly on the basis of regime difference. But see STEPHEN D. KRASNER, SOVEREIGNTY: ORGANIZED HYPOCRISY 9-25 (1999) (noting that the 1648 Peace of Westphalia has very little to do with a “Westphalian” approach to sovereignty, and that Westphalian sovereignty is only a subset of the capabilities that can be associated with complete sovereignty); Darel E. Paul, *Sovereignty, Survival and the Westphalian Blind Alley in International Relations*, 25 REV. INT’L STUD. 217 (1999) (arguing that the “statist” Westphalian ontology ignores the reality of overlapping political authority existing at different scales in a single territory).

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 the case 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 1927,⁴ argues that sovereign state debt is “odious” and should therefore not be transferable to successor governments if (1) the debt is incurred by a “despotic” power, and (2) it does not benefit the people.⁵ The basic concern underlying the doctrine throws into stark relief the competition between the popular and the statist ideas of sovereignty that exist in twentieth-century international relations. As such, the historical treatment of arguably “odious” debt should effectively offer a window into the concept of sovereignty that prevails at any given moment. Accepting or rejecting the idea of odious debt in any practical instance corresponds to an inclination toward either the popular or the statist conceptions of sovereignty, respectively. To the extent that we view the people as sovereign agents, 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, 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

4. See A.N. SACK, LES EFFETS DES TRANSFORMATIONS DES ÉTATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIÈRES [THE IMPACT OF STATE TRANSFORMATIONS ON THEIR PUBLIC DEBTS AND OTHER FINANCIAL OBLIGATIONS] 157 (1927). Sack also suggests an additional requirement of creditor knowledge: odious debts are those “contracted and utilized for ends which, *to the knowledge of creditors*, are contrary to the interests of the nation.” *Id.* at 157 (“Les dettes ‘odieuses,’ contractées et utilisées à des fins lesquelles, *au su des créanciers*, sont contraires aux intérêts de la nation . . .”). Buchheit, Gulati, and Thompson emphasize that all three elements—despotism or lack of consent, lack of benefit, and creditor knowledge—must be present for a debt to be deemed “odious” under the Sackian framework. Buchheit et al., *supra* note 1, at 1218. Although Sack is frequently presented as a preeminent early scholar of sovereign debt (as well as a Russian Tsarist Minister), Sarah Ludington and Mitu Gulati have written a draft article that problematizes his mythic status. Sarah Ludington & Mitu Gulati, A Convenient Untruth: Fact and Fantasy in the Doctrine of Odious Debts (Sept. 18, 2007) (unpublished manuscript, on file with author).

5. While the particular formulation may differ, the essential elements of despotism/lack of consent and lack of benefit are consistent across various presentations of Sack’s formalized doctrine of odious debt. See, e.g., PATRICIA ADAMS, ODIUS DEBTS: LOOSE LENDING, CORRUPTION, AND THE THIRD WORLD’S ENVIRONMENTAL LEGACY 165 (1991); Buchheit et al., *supra* note 1, at 1218; Anna Gelpern, *Odious, Not Debt*, 70 LAW & CONTEMP. PROBS. (forthcoming 2007), available at http://www.sps.cam.ac.uk/pol_sawyer/conference/papers/gelpern_odious_140907.pdf; Seema Jayachandran & Michael Kremer, *Odious Debt*, 96 AM. ECON. REV. 82, 82 (2006); Ashfaq Khalfan, Jeff King & Bryan Thomas, *Advancing the Odious Debt Doctrine* 14-16 (Ctr. for Int’l Sustainable Dev. L., Working Paper, 2003), available at <http://www.cisd.org/pdf/debtentire.pdf>; see also 70 LAW & CONTEMP. PROBS. (forthcoming 2007) (double issue on odious debt); 32 N.C. J. INT’L L. & COM. REG. 605 (2007) (special issue on odious debt).

an enlightening proxy for the larger question of who counts as sovereign in international economic relations.⁶ Perhaps more importantly, it emphasizes that the somewhat abstract question of the appropriate conception of sovereignty in fact has substantial distributional consequences in international credit markets.

This Article aims to further the conversation about 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 twentieth century may be relevant to contemporary problems. The Article 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 statist and 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 “rule of law” approach that emerged historically and is pertinent to contemporary debates.

Second, there is the policy question of whether a purely statist approach to sovereignty is required for a healthy sovereign credit market. Such an approach 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 statist conception is essential to 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.”⁷ 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

6. It is important to point out that the legal doctrine of odious debt as formalized by Alexander Sack does not constitute the entire universe of arguably illegitimate sovereign debt. In discussing the issue of “odious debt,” I refer to the broader idea of illegitimacy or odiousness rather than to the narrower doctrine. As will be noted later in this Article, Chief Justice Taft’s vision in the *Tinoco* arbitration differs somewhat from that presented by Sack, although Taft is frequently cited as a precedent for the formalized legal doctrine. For an overview of the types of debt that might be candidates for repudiation, see Buchheit et al., *supra* note 1, at 1208-24.

7. 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.” *Iraq’s Debt*, *supra* note 2. Maintaining the strict statist approach discourages what the *Financial Times* calls “theological discussions” of whether a sovereign state borrower is “legitimate” in any way. Raghuram Rajan, the Director of the IMF’s Research Department, went so far as to refer to the 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.

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 international relations theory that highlights the contingent quality of central concepts in international politics.⁸ Scholars as diverse as John Ruggie, Stephen Krasner, and Jens Bartelson have pointed out the ambiguity and variable ideational structure of sovereignty.⁹ But this contingency, and the historical and theoretical variation that it implies, only invites additional explanation. If any given conception of sovereignty results from political and social construction, how has it been constructed? Given the political and economic stakes at issue in the implicit definition of “sovereign,” which factors have led to the dominance of one conception of sovereignty over others at any given historical moment? This Article suggests that the degree of competition in the international credit system may affect the approach to sovereignty taken in sovereign lending.

This Article aims to offer insight into all three queries of the concept of sovereignty by returning to an open moment in early twentieth-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 stepping 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 1923.¹⁰ 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.¹¹ This Article not only offers a reinterpretation of this key decision but also uses the case to shed light on the three questions surrounding the contemporary sovereign lending regime presented above.

8. This Article seeks to incorporate some of these insights from international relations theory and may be understood as responding in part to calls for interdisciplinary legal scholarship from Kenneth Abbott, Anne-Marie Slaughter, and others. *See, e.g.*, 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, et al., *International Law and International Relations Theory: A New Generation of Interdisciplinary Scholarship*, 92 AM. J. INT’L L. 367 (1998).

9. *See, e.g.*, JENS BARTELSON, A GENEALOGY OF SOVEREIGNTY (1995); KRASNER, *supra* note 3; John Ruggie, *Territoriality and Beyond: Problematizing Modernity in International Relations*, 47 INT’L ORG. 139. *See generally* STATE SOVEREIGNTY AS A SOCIAL CONSTRUCT (Thomas J. Biersteker & Cynthia Weber eds., 1996) (highlighting through theoretical analysis and case studies how various components of sovereignty, including territoriality, authority, and population, are socially constructed).

10. *Tinoco Case* (Gr. Brit. v. Costa Rica), 1 R. Int’l Arb. Awards 369, 375-85 (1923), available at 18 AM. J. INT’L L. 147 (1924).

11. The case is frequently the lead citation for a discussion of sovereign recognition and, in some shorter legal treatises, it is the only case actually discussed. *See, e.g.*, IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 87 (5th ed. 1998); PETER MALANCZUK, AKEHURST’S MODERN INTRODUCTION TO INTERNATIONAL LAW 82-84 (7th ed. 1997); Colin Warbrick, *States and Recognition in International Law*, in INTERNATIONAL LAW 205, 238 (Malcolm D. Evans ed., 2003).

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.¹² This one-sided interpretation associates Taft’s foundational decision with the statist 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 assessment 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 statist schools. It also fits into a distinctly American tradition of international law, which moved away from the absolutism of the stricter nineteenth-century model. This Part situates Taft within a more conservative legalist strand that emerged in the United States in the early twentieth century and that 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 idea of odious debt, an intermediate or rule-of-law conception of sovereignty is actually consonant with pro-market policies. The Part points out that Taft does not require absolute knowledge of the ultimate use of loan proceeds on behalf of creditors, which would indeed be a prohibitive burden. Instead, the *Tinoco* decision suggests that creditors can meet their burden by making reasonable effort to comply with the borrowing country’s internal rule of law and to determine that funds will be used for a legitimate government purpose. Part III also considers how Taft’s more flexible intermediate approach promotes a stable environment for foreign investment and may act as a stopgap to more radical and potentially disruptive claims for popular sovereignty in international economic relations. These arguments are made in the context of Taft’s broader political commitments, highlighting his conservative market ideology, investment-oriented foreign policy, and commitment to judicial reform.

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 initial 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 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

12. See, e.g., BROWNIE, *supra* note 11; MALANCZUK, *supra* note 11; Warbrick, *supra* note 11. A search for the *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.

sovereign debtors. However, when creditors are noncompetitive and perceive themselves as part of the same interest group, a more strictly statist approach should dominate. The Part draws this tentative 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 stronger explanatory claim is not tenable in the context of a single case study, this analysis raises questions about whether the dominance of a stricter vision of sovereignty over the course of the twentieth century may be related to decreasing competitiveness among international financial actors. 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 should be considered as an option for international law and foreign policy in the twenty-first century.

II. CONSTRUCTING SOVEREIGNTY: AN EARLY TWENTIETH-CENTURY AMERICAN APPROACH

Efforts to infuse discussions of sovereign debt with considerations of governmental legitimacy tend to engender hostility and charges of impossibility from some in the international financial community. For example, Raghuram Rajan, the Director of the International Monetary Fund’s Research Department, referred to the doctrine of odious debt as a “neutron bomb.”¹³ After the fall of the dictator Suharto in 1998, the Republic of Indonesia attempted to renege on a contract for two geothermal power plants that had been signed just prior to Suharto’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 was met with charges not just of financial irresponsibility or short-sightedness, but of nothing less than “arbitral terrorism.”¹⁴ 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. 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.

13. Rajan, *supra* note 7, at 54. In issuing a recent discussion paper entitled *The Concept of Odious Debt: Some Considerations*, the World Bank refrained from such editorialization. It did, however, clarify that the paper “does not reflect the views or positions of the World Bank’s management, Board of Executive Directors, or member states.” Econ. Policy & Debt Dep’t, World Bank, *The Concept of Odious Debt: Some Considerations* 1 (Sept. 7, 2007) (unpublished discussion paper, on file with author), available at <http://siteresources.worldbank.org/INTDEBTDEPT/Resources/OdiousPaper07.pdf>. The paper provides a simple summary of the main aspects of the odious debt debate and examines how the underlying concerns of the proponents of this doctrine may more constructively be addressed in other ways than advocating a “unilateral repudiation of debts.” *Id.* at 24.

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

This Part looks more closely at the unique framework of sovereignty and valid sovereign action presented by Chief Justice Taft in the *Tinoco Case*, placing it in the context of early twentieth-century discussions of sovereignty and situating it within an American style of pragmatic international law. It first 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 statist 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 statist 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 for internal legal requirements would undermine a contract's enforceability. By contrast, such disregard for internal rules would be acceptable under the purely statist view of sovereignty. The discussion then points out how the *Tinoco* decision suggests that the validity of sovereign obligations can rest, as an additional requirement, on the intended purpose or outcome of a contract.

A. *Background and 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 served as Minister of Defense. González had been elected president by a "loose coalition in Congress" in 1913 and had lost support in his three and one-half years in office.¹⁶ His popularity sank further when he responded to trade difficulties from 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 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 considered the Tinoco

15. The American interests involved are discussed *infra* Section IV.B, 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 AMERICAS 3, 5 (1965).

17. DANA G. MUNRO, INTERVENTION AND DOLLAR DIPLOMACY IN THE CARIBBEAN 1900-1921, at 427 (1964).

18. *Id.* at 433.

19. *Id.* at 433. Although Costa Rican politics were generally far more orderly and accountable than those of its Central American neighbors, business interests, including the coffee elite and the United Fruit Company, held considerable sway. *Id.*

20. Thomas M. Leonard, *Central America and the United States: Overlooked Foreign Policy Objectives*, 50 THE AMERICAS 1, 12 (1993). There is some intimation that key players in the United Fruit

regime to be an affront to both the 1907 Central American treaty system and his own resolve to support only constitutional governments across the isthmus.²¹

At the insistence of the United States, Great Britain also withheld official recognition from Costa Rica, and this nonrecognition policy formed a core part 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 to Chief 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 to Costa Rica, under the control of Frederico Tinoco.

Although Wilson's nonrecognition policy was not able to forestall all political and economic relations with Costa Rica, it did eventually help to weaken the Tinoco regime, in part by throwing the local economy into disarray.²³ The Tinoco 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 counterrevolutionaries had convened at the border. The United States and the United Kingdom continued to withhold both recognition for Tinoco and any support for the counterrevolutionaries, insisting on a noncoercive restoration of the constitutional government. However, a U.S. Naval Commander's independent decision to land his 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 Costa Rican Congress's repudiation of the contracts at stake in the 1923 arbitration followed the restitution of constitutional government in the

Company had been involved in the Tinoco coup. Certainly the interests of the landed gentry, with whom these American investors had intermarried, were initially aided by the coup, 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. See Leonard, *supra* note 20, at 12. 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 that the British approach to recognition during World War I, particularly with regard to Costa Rica, was "really that of the United States and not [Britain's] own invention." Richard V. Salisbury, *Revolution and Recognition: A British Perspective on Isthmian Affairs During the 1920s*, 48 THE AMERICAS 331, 335 (1992) (quoting Seymour's Minute on Graham to Foreign Office, F.O. 371/4535, PRO (July 1, 1920)).

23. Baker, *supra* note 16, at 11-17.

24. MUNRO, *supra* note 17, at 435.

25. Leonard, *supra* note 20, at 12.

26. *Id.*

country. After the December 1919 election of Julio Acosta, friends of the previous 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 By 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 either the Costa Rican government or 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 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 bank claim 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 rejected this suggestion and counter-offered ex-Costa Rican President Jimenez.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.

Chief Justice Taft made his award on October 18, 1923, deciding for Costa Rica but in a somewhat roundabout way. Both sides centered their

27. This relatively orderly approach to governmental transitions was a hallmark of Costa Rican politics throughout the twentieth 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. Telegram from Chase, U.S. Consul in Costa Rica, to Alvey A. Adee, Acting U.S. Sec'y of State (Aug. 11, 1920), in [1920] 1 FOREIGN REL. U.S. 838.

29. Great Britain had been especially 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 United States initially intimated that it might bring claims on behalf of the Sinclair Oil Company (the controlling interest in the "Costa Rican Oil Company"), which had signed an agreement for subsoil rights with González that was then confirmed by Tinoco. Telegram from John F. Martin, Chargé in Costa Rica, to Alvey A. Adee, Acting U.S. Sec'y of State (Dec. 13, 1920), in [1920] 1 FOREIGN REL. U.S. 845-46. However, the United States soon realized that Costa Rican oil riches had been overestimated. See MUNRO, *supra* note 17, 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. Telegram from Thurston, Chargé in Costa Rica, to Charles Evan Hughes, U.S. Sec'y of State (Aug. 12, 1921), in [1921] 1 FOREIGN REL. U.S. 665.

31. Telegram from Thurston, Chargé in Costa Rica, to Charles Evan Hughes, U.S. Sec'y of State (Feb. 14, 1921), in [1921] 1 FOREIGN REL. U.S. 646.

32. Telegram from Thurston to Hughes, *supra* note 30. 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.

33. Telegram from Thurston, Chargé in Costa Rica, to Charles Evan Hughes, U.S. Sec'y of State (Aug. 18, 1921), in [1921] 1 FOREIGN REL. U.S. 666.

claims on whether the Tinoco regime constituted 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, Chief Justice Taft held that the Tinoco regime *was* in fact the sovereign government of Costa Rica between 1917 and 1919, and that the British nonrecognition 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 or Rule-of-Law Conception of Sovereignty*

There has historically been a strange disconnect among international 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 consider the potentially problematic origins or the internal legitimacy of a state and resonates with the statist 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 sovereign debt debate. 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

34. *Tinoco Case* (Gr. Brit. v. Costa Rica), 1 R. Int’l Arb. Awards 369, 381-82 (1923), available at 18 AM. J. INT’L L. 147, 153-54 (1924).

35. As noted above, it is a central case for discussions of sovereign recognition in international legal treatises. See, e.g., BROWNLIE, *supra* note 11, at 200; MALANCZUK, *supra* note 11, at 82-84; Warbrick, *supra* note 11, at 238. The case is also frequently cited in practical applications of international law. See, e.g., D.J. Devine, *The Status of Rhodesia in International Law*, 1974 ACTA JURIDICA 109, 161; 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); Amin M. Husain, *Who is the Legitimate Representative of the Palestinian People*, 2 CHINESE J. INT’L L. 207, 215 (2003); Steven R. Ratner, *The Cambodia Settlement Agreements*, 87 AM. J. INT’L L. 1, 11 (1993); W. Michael Reisman, *Criteria for the International Legal Use of Force*, 10 YALE J. INT’L L. 279, 284 (1985).

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

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

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 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 This latter attentiveness to internal governmental legitimacy is frequently associated with the competing school of popular sovereignty. While these two interpretations of Taft's decision seem contradictory at first glance, they make sense as part of a unified decision once we set aside the binary discourse of popular versus statist 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 twentieth century.

1. *A Statist 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. . . . [T]hrough 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

38. See, e.g., *Iraq's Debt*, *supra* note 2.

39. See, e.g., Khalfan et al., *supra* note 5, at 41-42; see also Anaïs Tamen, *La Doctrine de la Dette "Odieuse" ou: L'Utilisation du droit international dans les rapports de puissance* [The Doctrine of "Odious" Debt or: The Use of International Law in Power Relations] 13-14 (Dec. 11, 2003) (unpublished master's thesis in International Politics, l'Université Libre de Bruxelles), available at <http://www.cadtm.org/spip.php?article459>.

40. See, e.g., sources cited *supra* note 35.

41. *Tinoco Case* (Gr. Brit. v. Costa Rica), 1 R. Int'l Arb. Awards 369, 377-78 (1923), available at 18 AM. J. INT'L L. 147, 150-51 (1924) (quoting 1 JOHN BASSETT MOORE, DIGEST OF

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 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 nongovernmental character.⁴³ Taft concluded that although Great Britain’s nonrecognition 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 statist conception of sovereignty in legal and constitutional theory and international law, and with the realist (and neorealist) idea of sovereignty in international relations.⁴⁵ 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.”⁴⁶ 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.⁴⁷ 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.⁴⁸ Within international law, Taft’s

INTERNATIONAL LAW 249 (1906)). Chief Justice Taft cites several other authorities to the same effect. *Tinoco Case*, 1 R. Int’l Arb. Awards at 381-82, available at 18 AM. J. INT’L L. at 154-55.

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, may have been Wilson’s own non-recognition policy. Wilson indicated that he would not recognize a government established through a counter-revolution, which might have dampened Costa Rican efforts to overthrow Tinoco, extending the period during which Tinoco had effective control of the country.

43. *Tinoco Case*, 1 R. Int’l Arb. Awards at 381-82, available at 18 AM. J. INT’L L. at 154-55.

44. *Id.* at 381, 18 AM. J. INT’L L. at 154.

45. Both realism and neorealism are associated with the idea that, although sovereign states vary greatly in terms of power and internal political form, they are basically like units in their ultimate control and decision-making power. Stephen Krasner points out, however, that the ontological assumptions of neorealism are clearer than those of traditional realism. KRASNER, *supra* note 3, at 45 n.1.

46. JEAN BODIN, ON SOVEREIGNTY: FOUR CHAPTERS FROM THE SIX BOOKS OF THE COMMONWEALTH 1 (Julian Franklin trans., Cambridge Univ. Press 1992) (1583).

47. See, e.g., THOMAS HOBBS, LEVIATHAN 109 (Edwin Curley ed., Hackett Pub. 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., Dover 1951) (1670).

48. Such a view is presented most clearly in neorealist works of international relations theory, which conceive of state structures and preferences as subservient to larger structural factors in explaining international conflict. See, e.g., KENNETH WALTZ, MAN, THE STATE, AND WAR: A THEORETICAL ANALYSIS (1959) (reviewing human nature, internal state structure, and international system structure as explanations for international politics, and arguing that international system structure provides the best explanatory framework).

decision on recognition corresponds to the framework of sovereignty offered by international legal positivism. Positivist international law, which rejected the moral foundations and judgments implied by natural law approaches, sought to organize international relations on the basis of sovereign equality and state consent.⁴⁹ 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.⁵⁰

To this extent, Taft's decision countered the idea of a valid sovereign government put forward by Woodrow Wilson's nonrecognition policy, which acknowledged only those states formed by democratic constitutional means. Wilson's approach resonates with the school of popular sovereignty in political and constitutional theory and international law. In this approach, the ultimate power and autonomy associated with sovereignty does not lie in the mere fact of governmental control. Rather, sovereignty lies with a "sovereign people," whose consent provides legitimacy to the government and authority for its decisions. Jean-Jacques Rousseau is perhaps the paradigmatic early political theorist in this vein, arguing that legitimate government must be grounded in a "social contract" in which the force of the government or prince "is merely the public force concentrated in him. As soon as he wants to derive from himself some absolute and independent act, the bond that links everything together begins to come loose."⁵¹ Immanuel Kant formulated his preference for constitutional republics in the context of foreign affairs, suggesting that a federation of constitutional republics constituted one essential element for world peace.⁵² Kant's insights inspired not only policymakers such as Wilson, but also subsequent international relations scholars, who have theorized how the domestic structure of states can affect their external relations.⁵³ In international law, the strong form of a commitment to more popular forms of sovereignty explicitly seeks to link a state's internal respect for democratic ideals and individual rights to the validity of its external, international actions. As such, this approach rejects

49. Perhaps the best known formulation of positivist international law is offered in LASSA OPPENHEIM, *INTERNATIONAL LAW: A TREATISE* 20-22 (2d ed. 1912).

50. *Id.* at 19.

51. JEAN-JACQUES ROUSSEAU, *On the Social Contract, or the Principles of Political Right*, in *THE BASIC POLITICAL WRITINGS* 141, 176 (Donald A. Cress trans., Hackett Pub. 1987) (1762). Rousseau continues:

[i]f it should finally happen that the prince had a private will more active than that of the sovereign, and that he had made use of some of the public force that is available to him in order to obey this private will, so that there would be, so to speak, two sovereigns, one de jure and the other de facto, at that moment the social union would vanish and the body politic would be dissolved.

Id.

52. IMMANUEL KANT, *PERPETUAL PEACE* 3-23 (Lewis White Beck ed., Bobbs-Merrill 1957) (1795). Although Kant's insights have been taken up in what is now called "democratic peace theory," Kant explicitly stated a preference for constitutional republics rather than majority democracy, which he considered a potential threat to liberty. *Id.* at 11-15.

53. Democratic peace theory is a subset or variant of what explanatory international relations theory calls "liberalism," i.e., the idea that a state's international preferences and actions will vary with its internal make-up. See Andrew Moravcsik, *Taking Preferences Seriously: A Liberal Theory of International Politics*, 51 *INT'L ORG.* 4, 513 (1997). These explanatory approaches are frequently contrasted with Kenneth Waltz's neorealist theoretical approach. See WALTZ, *supra* note 48.

international legal positivism’s separation of law from moral and political considerations.⁵⁴ In contrast to the statist sovereignty suggested by the “effective control” element in *Tinoco*, the Wilsonian tradition understands a state’s internal governing relations and political form as central to its international legal status.

Chief 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.⁵⁵ However, he effectively mandated that the international *legal* principles of sovereign recognition were separate from any national *political* decision to challenge the legitimacy of another country’s government. In this assertion, Taft took a step toward insulating 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.”⁵⁶

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, Chief 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 contemporary 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 conception of sovereignty that escapes the binary understandings of sovereign power presented by modern statist 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 statist or absolutist. Unlike a pure statist, for whom the *fact* of control is sufficient to define valid sovereign action, Taft pays attention to the

54. Benedict Kingsbury points out that although Oppenheim’s positivism rejects the connection of law to morality at the international level, Oppenheim’s own support for this international legal form may have derived from political and moral considerations. Benedict Kingsbury, *Legal Positivism as Normative Politics: International Society, Balance of Power and Lassa Oppenheim’s Positive International Law*, 13 EUR. J. INT’L L. 401, 402-03 (2002).

55. Taft specifically stated that “[t]he 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 on international law principles. *Tinoco Case* (Gr. Brit. v. Costa Rica), 1 R. Int’l Arb. Awards 369, 381 (1923), available at 18 AM. J. INT’L L. 147, 153 (1924).

56. Reisman, *supra* note 37, at 870.

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 statist school, such basic constitutionalism is not concerned with whether governmental mechanisms are democratic or grounded in popular consent. However, this intermediate 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.

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.⁵⁷ In what would be an unwelcome development for many twentieth-century government elites, and perhaps 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.⁵⁸ 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 delinked 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

57. It is important to point out that this approach does not present a clear substantive vision of the good, and that its emphasis is largely procedural. Taft's intermediate framework thus would allow particularly brazen government elites to change internal laws to suit their purposes and then sign contracts on the basis of these new and more accommodating laws. It may be argued that it is to a large degree an empty standard, particularly if the standard for "good law" is drawn from human rights or popular sovereignty. This Article does not aim to participate in legal philosophy's debate about whether the rule of law is itself intrinsically linked to ethics or the moral good. (For more on the separation thesis, see the work of Lon Fuller, Ronald Dworkin, Gustav Radbruch, Robert Alexy, H.L.A. Hart, Joseph Raz, and others.) However, it does seem that promoting transparency, consistency, predictability, and the like at least helps to clear away the self-important obfuscation of many oppressive regimes and better exposes the true nature of ruling elites to a state's population. It is also worth pointing out that few government elites explicitly admit to and legalize corruption, nepotism, and collusion, perhaps in part because of myths they have developed about their own rulership. As such, holding governments to their own internal rule of law may well have some substantive effect.

58. *Tinoco Case*, 1 R. Int'l Arb. Awards at 397, available at 18 AM. J. INT'L L. at 172.

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.⁵⁹

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.⁶⁰ 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.”⁶¹ This taxing 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.⁶² 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 “[a]s 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.”⁶³ 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.”⁶⁴ In refusing to limit or rewrite the contract, Taft invalidated the Amory concession as a whole.⁶⁵

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 very statist: 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, democratic consent, or other value-orientations 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

59. *Id.* at 398-99, 18 AM. J. INT’L L. at 173-74.

60. *Id.* at 396, 18 AM. J. INT’L L. 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 United States. *Id.* at 396-97, 18 AM. J. INT’L L. at 171-72.

61. *Id.* at 398, 18 AM. J. INT’L L. at 173.

62. According to the facts of the case, the taxing power was one of the ten exclusive congressional powers enumerated under Article 76 of the 1917 Costa Rica Constitution. *Id.* at 397, 18 AM. J. INT’L L. at 172.

63. *Id.* at 398, 18 AM. J. INT’L L. 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 393, 18 AM. J. INT’L L. at 173.

64. *Id.* at 398, 18 AM. J. INT’L L. at 173; *see also id.* at 398, 18 AM. J. INT’L L. at 174 (stating that the exemption was “too vital an element in its value” to be excluded from the contract).

65. *Id.* at 399, 18 AM. J. INT’L L. at 174.

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.”⁶⁶ In its place, Taft formulates a vision of effective control that privileges law over both force and democratic ideals, navigating an intermediate position between the popular and the strictly statist 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.”⁶⁷ 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 a sovereign contract may not be enforceable under international law if the procedural execution of the contract contravenes a significant element in that sovereign government’s own internal laws. 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 internal rule of law does have some corollary in political and legal theory. Published only four years before the *Tinoco* decision, Max Weber’s seminal *Politics as a Vocation* 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.”⁶⁸ Although the “physical force” element is frequently emphasized, one of Weber’s key contributions was to add the additional element of *legitimacy*. Similar to the *Tinoco* decision, and unlike democratic or liberal theorists, Weber himself did not insist on any substantive internal requirements for this ultimate legitimacy and considered that different types of domestic regimes would be consonant with legitimate statehood.⁶⁹ Perhaps an

66. This is a common shorthand for Austin’s conception of the law; another frequently used formulation is “the command of the sovereign backed by a sanction.” In laying out the essential elements of “law properly so called,” Austin highlights three key features: (1) a command from a determinate body, (2) a sanction or “eventual evil annexed to a command,” and (3) the source of the command from a political superior. JOHN AUSTIN, *THE PROVINCE OF JURISPRUDENCE DETERMINED* 101-02 (David Campbell & Philip Thomas eds., Dartmouth 1998) (1863). Austin also makes clear that “the sovereign power is incapable of legal limitation . . . without exception.” *Id.* at 183.

67. *Tinoco Case*, 1 R. Int’l Arb. Awards at 399, available at 18 AM. J. INT’L L. at 174.

68. MAX WEBER, *Politics as a Vocation*, in FROM MAX WEBER: ESSAYS IN SOCIOLOGY 77, 78 (H.H. Gerth & C. Wright Mills eds., 1946).

69. He viewed traditional patrimonialism, charismatic authority, and more modern forms of “legality” as equally possible legitimations or inner justifications for state domination. *Id.* at 78-79. Although Weber identified legality as only one among different potential sources of legitimacy, he

even more paradigmatic thinker in this approach is the legal theorist Hans Kelsen, an early progenitor of legal positivism.⁷⁰ Kelsen considered 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.⁷¹ He did not, however, insist on any substantive content (such as democratic or liberal ideals) for those internal rules to constitute valid legal action.

While this basic constitutionalist tradition has not been well represented in contemporary debates in political theory and international relations, the resulting theoretical gap may be due in part to the historical misinterpretation, or rather underinterpretation, 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 especially distinctive. In particular, it ignores the fact 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 aspects 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 a rule-of-law framework 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

considered that increased rationalization of the government and economy—in part through a strengthened rule of law—would be a (potentially problematic) corollary of modernity.

70. Later thinkers associated with positivism in legal philosophy, such as H.L.A. Hart and Joseph Raz, departed from Kelsen’s stricter vision.

71. 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, *PURE THEORY OF LAW* 195 (Max Knight trans., Univ. of Cal. Press 1967) (1960).

internationally enforceable unless it intends to serve a legitimate governmental purpose. This separate and additional requirement would be equally applicable to all regimes, regardless of their internal rule of law or 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.⁷²

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 US\$200,000⁷³ in 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 of advance remuneration to Tinoco's brother as the ambassador to Italy.⁷⁴ 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."⁷⁵ 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."⁷⁶ 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.⁷⁷

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 Chief

72. This means that in Taft's framework, a contract can be invalidated on one of two grounds: either as a violation of the internal rule of law *or* as inconsistent with legitimate government purpose (both prongs would be contingent on creditor knowledge, as discussed later in this Section). This differs somewhat from Alexander Sack's formalized doctrine of odious debt, in which a government contract must meet all three prongs (despotism/lack of consent, nonbeneficial purpose, and creditor knowledge) before being considered odious. SACK, *supra* note 4. A range of frameworks for understanding the validity of sovereign debt can be imagined by combining different conceptions of sovereignty (statist, rule of law, or popular) with varying requirements for governmental purpose.

73. This is about \$2,272,700 in 2006 dollars, calculated using a CPI Conversion Factor of 0.088. For CPI conversion factors for years 1665 to estimated 2017, see Robert Sahr, Inflation Conversion Factors for Dollars 1665 to Estimated 2017, <http://oregonstate.edu/cla/polisci/faculty-research/sahr/sahr.htm> (last visited Nov. 6, 2007).

74. Tinoco Case (Gr. Brit. v. Costa Rica), 1 R. Int'l Arb. Awards 369, 394 (1923), *available* at 18 AM. J. INT'L L., 147, 168 (1924).

75. *Id.*

76. *Id.*

77. *Id.* at 393, 18 AM. J. INT'L L. at 167.

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 into international contracts would disappear along with the control itself. However, Taft does not regard the political disorder and lack of control as 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.”⁷⁸ 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 Taft’s 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 public. 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” relevant facts or conditions has been used in domestic contract law to prevent willful ignorance and a failure of due diligence.⁷⁹ Moving to the level of international sovereign contracts, this may put the burden of proving good faith on the creditor claimant rather than 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.”⁸⁰ He even suggests that evidence of knowledge can 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.⁸¹

Although theories of sovereignty generally focus on the procedural element in the relationship between ruler and ruled,⁸² Taft’s attention to

78. *Id.* at 394, 18 AM. J. INT’L L. at 168.

79. Considerable case law has developed to explain the standard of care and investigation involved in meeting this requirement. For an extensive discussion of how requirements vary across different types of business transaction, see GARY M. LAWRENCE, *DUE DILIGENCE IN BUSINESS TRANSACTIONS* (1994).

80. *Tinoco Case*, 1 R. Int’l Arb. Awards at 399, available at 18 AM. J. INT’L L. at 174.

81. *Id.* at 394, 18 AM. J. INT’L L. at 168.

82. 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: David Hume and Voluntary State Bankruptcy*, in *JEALOUSY OF TRADE: INTERNATIONAL COMPETITION AND THE NATION-STATE IN HISTORICAL PERSPECTIVE* 325 (2005). Sieyès expresses a similar concern that sovereign debt will undermine this responsiveness in the context of the French Revolution. Emmanuel Joseph Sieyès, *Further Developments on the Subject of a Bankruptcy*, in *POLITICAL WRITINGS* 60 (Michael Sonenscher ed., 2003). For a more extensive theoretical discussion of the relationship of sovereignty to agency, and of the procedural and outcome-orientation aspects of sovereignty in sovereign obligation, see Odette

legitimate purpose has a corollary in 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 corporate contracts to serve illegitimate or poorly considered ends.⁸³ 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, 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.

Attending to both the rule of law and the governmental purpose aspects of the *Tinoco Case* reconciles the decision's use as a precedent for both the doctrine of sovereign continuity and the doctrine of odious debt. On the one hand, Taft's decision 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, thereby rejecting a purely absolutist or statist 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.

As noted above, legal scholars have similarly highlighted two main 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) by a despotic regime or without the consent of the people and (2) not for their benefit.⁸⁴ As in *Tinoco*, creditor knowledge is relevant to assessing creditor

Lienau, *The Missing Agency Question: Competing Frameworks of Sovereignty in Sovereign Contracting* (Dec. 2007) (unpublished manuscript, on file with author).

83. See, e.g., *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971) (offering clear application of the business judgment rule). See also Kenneth B. Davis, Jr., *Once More, the Business Judgment Rule*, 2000 WIS. L. REV. 573 (discussing explanations for the business judgment rule and how it relates to the legal duty of care).

84. See SACK, *supra* note 4, at 157; see also sources cited *supra* note 5. Sack emphasizes the importance of beneficial *public* purpose as follows:

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 against 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.

ADAMS, *supra* note 5, at 165 (quoting SACK, *supra* note 4, at 157).

wrongdoing on both of these elements.⁸⁵ 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. Unlike Taft’s formulation, however, *both* prongs of Sack’s formalized doctrine must be satisfied before a debt may be declared “odious” and subject to repudiation; if either the debt was incurred for public benefit, *or* it was contracted with popular consent, then the debt would not be odious under Sack’s definition.⁸⁶ The *Tinoco* decision severs these elements, allowing invalidation on either of these two prongs. Whereas Taft’s Amory concession decision clearly finds that even an “illegitimate” or nondemocratic 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.⁸⁷

What becomes clear in this closer reading of Taft’s *Tinoco* decision is that a binary framework of popular versus statist sovereignty does not exhaust the offerings of twentieth-century political and legal thought as applied to international economic issues. Imposing this polarized discourse on sovereign debt issues and international relations more generally limits the scope of discussion and the range of possible solutions to complex problems of international economic practice. It also, potentially, hinders a more complete interpretation of Taft’s foundational decision on the practice of sovereign recognition. The discussion here 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. The *Tinoco* decision combines this rule-of-law framework with a requirement for legitimate government purpose to determine the validity of international sovereign action. 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 some in the contemporary financial community.

C. *Situating Taft’s Approach in the Legal Tradition*

Taft’s decision in the *Tinoco Case* does not lend itself to easy classification within a tradition of American or international legal thought. However, the decision marks a unique strain in approaches to international law that may still be identified as part of the American tradition. Analyses of American approaches to foreign policy and international law frequently highlight the utopian or missionary element in U.S. history. Generally, this

85. See SACK, *supra* note 4, at 157; see also sources cited *supra* note 4.

86. See SACK, *supra* note 4, at 157.

87. The severability of the “rule of law” and the legitimate government purpose elements in a strict reading of Taft’s framework is apparent in the finding on the Amory concession. The exploration and development of potential oil fields is presumably a legitimate government purpose. Notwithstanding this public purpose, Taft voided the contract on the basis of inconsistency with key elements of internal constitutional rule alone.

utopian impulse is associated with a commitment to the promotion of liberal democratic constitutionalism.⁸⁸ 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 Taft's vision, 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.⁸⁹ Such legal orthodoxy, popular during the nineteenth century, imagined law as an autonomous sphere in which neutral legal principles could be applied objectively to situations of fact.⁹⁰ 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.⁹¹ Its conception of individual rights drew from the tradition of liberalism formulated by John Locke and John Stuart Mill, a tradition which privileged rights of contract and property. As will be discussed in the following Part, Taft himself espoused these general values, and his tenure as Chief Justice of the Supreme Court can be considered an instantiation of legal classicism or legal orthodoxy in American jurisprudence.⁹²

This form of legal classicism is usually contrasted with the school of pragmatism that gained popularity in the early twentieth 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 sociopolitical and economic contexts.⁹³ 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

88. 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).

89. For a brief introduction to the basic philosophical tenets of classical legalism, see, for example, WILLIAM M. WIECEK, *THE LOST WORLD OF CLASSICAL LEGAL THOUGHT: LAW AND IDEOLOGY IN AMERICA, 1886-1937*, at 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*, at 9-32 (1992). Wiecek identifies the Taft Court as a return to the basic foundations of classicism in Supreme Court jurisprudence. WIECEK, *supra*, at 162-64.

90. WIECEK, *supra* note 89, at 5-7.

91. See *id.* at 7-10.

92. The Taft Court can be understood as a return to the basic tenets of classical legal thought popular in the nineteenth century (notwithstanding the powerful dissents written by Justices Holmes and Brandeis), although Taft himself did not quite adhere to strict *Lochner* doctrine. *Id.* at 162. This period continued past Taft's resignation and death until the challenges presented by executive and legislative responses to the Great Depression. See *id.* at 164.

93. Philosophical pragmatism was 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* 59-75 (1949).

jurisprudence” of the classical model must make way for a new results-oriented “sociological jurisprudence.”⁹⁴ Pound extended his analysis to the international sphere and argued for a “critique of international law in terms of social ends.”⁹⁵ Following World War I, this approach was adopted more broadly in what might loosely be called a pragmatic “American” international law.⁹⁶ This American account challenged the nineteenth century’s statist 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 strictly statist sovereignty⁹⁷ by constructing international institutions such as the League of Nations and also by paying greater attention to the internal characteristics of sovereign states.⁹⁸ Drawing from the larger American impetus toward regime reform, this project involved linking substantive requirements for *internal* governmental sovereignty to the acceptance of sovereign states *externally* into the “family of nations.”⁹⁹

At first glance, this approach seems more akin to Woodrow Wilson’s policies and quite antithetical to Taft’s more conservative 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.¹⁰⁰ Reflecting on the American world court movement in the first decades of the twentieth 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 a tension as well.”¹⁰¹ As is evident from Chief

94. See Roscoe Pound, *Mechanical Jurisprudence*, 8 COLUM. L. REV. 605 (1908); Roscoe Pound, *The Need of a Sociological Jurisprudence*, 19 GREEN BAG 607 (1907).

95. Roscoe Pound, *Philosophical Theory and International Law*, 1 BIBLIOTECA VISSERIANA DISSERTATIONUM IUS INTERNATIONALE ILLUSTRANTIUM 72, 89 (1923).

96. See Antony Anghie, *Colonialism and the Birth of International Institutions*, 34 N.Y.U. J. INT’L L. & POL. 513, 521-22 (2002).

97. Although the metaphor of a state as a “black box” (or sometimes a “billiard ball”) is drawn from the neorealist school of international relations theory, it is equally applicable for statist approaches in international law. Both paradigms consider the state to be opaque for analytical purposes. Although different states have different internal political regimes, economic structures, and cultural preferences, realism (and neorealism) and international legal positivism each minimize the importance of these variations. They consider such internal differences irrelevant for understanding states’ external relations (variants of realism) or for assessing a state’s legitimacy under international law (international legal positivism). See also discussion *supra* notes 45-48.

98. 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. Cohen, *supra* note 88, at 569.

99. Anghie, *supra* note 96, 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 of states.

100. This liberal democratic strain is that most commonly associated with “idealist” American foreign policy. See, e.g., Cohen, *supra* note 88, at 555-67.

101. David S. Patterson, *The United States and the Origins of the World Court*, 91 POL. SCI. Q. 294 (1976). In fact, Taft did join with American pragmatists in his international commitments, particularly to establish the Permanent Court of International Justice and the League of Nations.

Justice Taft's decision in *Tinoco*, incorporating the requirements of the rule of law and the public good into a conception 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 entrenching a substantive vision of global justice, but rather as a mechanism for maintaining order and discipline.¹⁰² In this context, Taft campaigned for both the League of Nations and the World Court several years before Woodrow Wilson became associated with the League.¹⁰³ In a similar vein, Taft pressed for a comprehensive international arbitration treaty in Congress, which would make justiciable any international controversy among "civilized nations."¹⁰⁴

In short, Taft's *Tinoco* decision is of a piece with the larger project of American international law, but it instantiates a more conservative and legalistic doctrine than that imagined by conventional understandings of 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 basic international legalism in which the primary purpose of international law is not the promotion of liberal democracies or human rights, but rather the encouragement of the rule of law as such. The *Tinoco* decision takes a step in this direction by incorporating a domestic rule-

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 an alternative formulation 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.

102. Taft's concern at the international level extended beyond particularistic diplomacy to "a mechanism to preserve world order." DAVID H. BURTON, WILLIAM HOWARD TAFT: CONFIDENT PEACEMAKER 115 (2004). Even during his time as a Supreme Court Justice, Taft remained involved with efforts to deepen and formalize international law, for example, by participating in *l'Institut international de droit public*. See Gaston Jèze, *l'Institut international de droit public* [The International Institute for Public Law], 21 AM J. INT'L L. 768-69 (1927). In these efforts, he interacted with a group of French scholars of public finance and debt, which was led by Gaston Jèze and may have included Alexander Sack (who borrowed Jèze's idea of "debts de regime"). See Ludington & Gulati, *supra* note 4, at 36 (citing SACK, *supra* note 4, at 157-58).

103. For a discussion of participation in American projects to promote the rule of law prior to World War I, see David S. Patterson, *The United States and the Origins of the World Court*, 91 POL. SCI. Q. 279 (1976).

104. Taft himself stated his willingness to submit to arbitration even "a question of national honor." HENRY F. PRINGLE, 2 THE LIFE AND TIMES OF WILLIAM HOWARD TAFT: A BIOGRAPHY 737 (1939) (quoting XXIII ADDRESSES OF WILLIAM HOWARD TAFT 299). Commentators highlight that Taft felt that any issue of international relations was ultimately justiciable, including those of vital national interest. See, e.g., BURTON, *supra* note 102, at 143 ("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."). 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 (Oct. 21, 1923), quoted in ALPHEUS THOMAS MASON, WILLIAM HOWARD TAFT: CHIEF JUSTICE 272 (1965).

of-law requirement into the standards for judging and enforcing sovereign obligations at the global level.¹⁰⁵

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

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 cancellation. 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 had 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. Reading Taft’s ruling against his own ideological tendencies undermines the idea that a commitment to the sovereign credit market *logically* mandates a statist account of sovereignty.¹⁰⁶ While a requirement that creditors lend only to truly popular governments could seriously burden the system, the intermediate conception of sovereignty should cause less alarm.¹⁰⁷

This Part highlights a series of policy questions raised by the intermediate or rule-of-law concept of sovereignty presented above. Does a commitment to supporting the sovereign credit market mandate a purely statist approach to sovereignty? Can the rule-of-law approach to sovereignty presented in Taft’s opinion be reconciled with a commitment to property rights and investment stability in sovereign contracts? And why might an intermediate approach be preferred over a strictly statist conception of sovereignty? This Part first considers how the basic *Tinoco* finding effectively uses international law to insulate foreign investment from political instability. It then draws from Taft’s domestic commitments to suggest how a rule-of-law approach might be a better fit for the market in the long-run. Finally, the Part highlights possible responses to the claim that the adoption of an odious debt-type legal framework results in too much uncertainty to prove workable in practice.

105. Unsurprisingly, early twentieth-century conservative lawyers—such as Taft—were at the forefront of this approach to international law. Patterson highlights the impetus for 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 101, at 295.

106. It is interesting to point out that Alexander Sack was also consistently pro-creditor in his writings. See Ludington & Gulati, *supra* note 4, at 21-25.

107. This Article does not intend to present Taft’s framework as a specific policy program. Indeed, a broader empirical study than is possible in this paper would be necessary for a definitive recommendation. However, Taft’s presentation of an intermediate rule-of-law conception of sovereignty in sovereign lending, as well as his separate requirement of legitimate government purpose, should be considered a feasible option in debates about sovereign debt.

A. *The Tinoco Case as a Pro-Investment Decision*

Although Taft's decision is properly cited as a precedent for odious debt cancellation, the *Tinoco Case* remains foundational to a basic commitment to international lending and sovereign debt repayment. In concluding that the Tinoco regime constituted Costa Rica's sovereign government, Taft confirmed that even "illegitimate" and oppressive governments may enter into binding sovereign contracts. By adopting the basic framework of effective control—with rule of law and legitimate purpose modifications—he solidified the continuity of sovereign statehood and sovereign obligations.¹⁰⁸ As such, Taft's ruling used international law to defend a relatively stable investment environment.

Recall that sovereign continuity is the idea that *Financial Times* editors considered so central to foreign investment, without which "there would be no lending to governments."¹⁰⁹ Taft's finding of a sovereign government in the Tinoco regime may thus 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 strategies. 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. 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.¹¹⁰ 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 works in both directions. It buffers against volatility in both the creditor's home country (i.e., the United States or Great Britain in the *Tinoco Case*) and in the borrowing country (i.e., Costa Rica). 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.¹¹¹ 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 through the mechanism of diplomatic protection—or are willing to bet on a friendlier administration coming into power—they can continue to engage in economic activity even with a nonrecognized regime.

Furthermore, under the *Tinoco* framework, the sovereign host or debtor country cannot respond to the policy of a creditor's country with a counter-

108. As Taft points out in the J.B. Moore passage of *Tinoco*, this rule of "effective control" is consistent with the idea of sovereign continuity. 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. See *supra* text accompanying note 41.

109. *Iraq's Debt*, *supra* note 2.

110. *Tinoco Case* (Gr. Brit. v. Costa Rica), 1 R. Int'l Arb. Awards 369, 397 (1923), available at 18 AM. J. INT'L L. 147, 172 (1924).

111. See *supra* text accompanying notes 55-56.

policy of its own (i.e., expropriation of American companies in retaliation for U.S. nonrecognition), 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 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.¹¹² Chief 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.¹¹³ 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.¹¹⁴

Taft, of all people, may have been expected to support a favorable environment for international investment, and his decision in *Tinoco* can be seen as of a piece with his larger policy commitments. 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.¹¹⁵

112. 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 [business] dealings [with the Tinoco regime], worthy of its diplomatic support.” *Tinoco Case*, 1 R. Int’l Arb. Awards at 380, *available at* 18 AM. J. INT’L L. at 153.

113. Taft extended this analysis to other countries that had failed to recognize the Tinoco regime, notably the United States’s World War I allies, Great Britain and France, which he assumed were deferring to the leadership of the United States. *Id.* at 381, 18 AM. J. INT’L L. at 153.

114. *See* North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 605, 642-49 (formulating the Chapter 11, Section B requirements for bringing investor or enterprise claims against a sovereign party before a NAFTA arbitration tribunal).

115. PRINGLE, *supra* note 104, at 678-79 (quoting XXIII ADDRESSES OF WILLIAM HOWARD TAFT 240-41). Woodrow Wilson’s Secretary of State, William Jennings Bryan, offered a more critical 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

Taft promoted investment and the involvement of American business in each foreign policy area in which he was involved. In East Asia, where he served as Governor of the Philippines, he championed the “open door” policy of promoting trade with all parts of the Chinese Empire.¹¹⁶ He helped to establish customs receiverships through U.S. bank loans in the Caribbean and argued for a trade agreement in the form of a reciprocity treaty with Canada.¹¹⁷ While the geopolitical thrust of Taft’s policies was very much in line with that of Theodore Roosevelt, Taft’s viewpoint was less classically *realpolitik* and more economically oriented.¹¹⁸ A consideration of Taft’s broader foreign policy commitments thus tends to support the argument that the *Tinoco* decision was intended to promote an investment-friendly international legal environment.

B. *Rule of Law as a Pro-Market Approach*

Although the nuances of Chief Justice 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 [was] not open to question.”¹¹⁹ 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 privilege, and inveterate critic of social democracy.”¹²⁰ In light of an economically conservative background, is Taft’s ultimate decision to incorporate rule-of-law and legitimate purpose requirements an anomaly in an otherwise pro-market opinion? At least from the perspective of investors and borrowing government elites, a purely statist approach would seem preferable. The latter guarantees the continuity of sovereign debt under all circumstances, without injecting the additional requirement of good faith compliance with internal legal rule and legitimate government purpose. If Taft’s core

people of these little republics are aroused to revolution by what they regard as a sacrifice of their interests.

4 RAY STANNARD BAKER, *WOODROW WILSON: LIFE AND LETTERS* 437-38 (1931), *quoted in* PRINGLE, *supra* note 104, at 678. The Wilson administration, however, also followed many of the same interventionist policies of its predecessors. The continued involvement of the United States 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.

116. *See, e.g.*, BURTON, *supra* note 102. Nonetheless, 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 when faced with these established interests. *See, e.g.*, WALTER V. SCHOLES & MARIE V. SCHOLES, *THE FOREIGN POLICIES OF THE TAFT ADMINISTRATION* 247 (1970).

117. BURTON, *supra* note 102, at 79.

118. Taft considered “dollar diplomacy” a politically wise and economically savvy alternative to “bullet diplomacy.” As Scholes and Scholes present the intentions of the Taft administration, “[i]n 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 116, at 35.

119. “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 104, at 967.

120. MASON, *supra* note 104, at 13.

commitment was to purely investor-oriented international law, these additional legal requirements and the ultimate finding against Great Britain would be truly puzzling.

On closer study, Taft’s ideological approach 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 approach in *Tinoco*. 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. This Section first considers how a commitment to the intermediate or rule-of-law conception of sovereignty—even when it disadvantages investors in the short run—may be a market-friendly policy in the long run. It then highlights how an ability to distinguish between market interests and creditor interests encourages caution with regard to potential moral hazard problems on the part of creditors and sovereign government elites.

1. *Rule of Law as a Bulwark Against Broader Disorder*

The unexpected dualism in the *Tinoco* decision, which modifies an effective control test for sovereignty with a commitment to internal legal rule and legitimate government purpose, mirrors 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.¹²¹ He was particularly concerned with unequal access to the courts based on wealth and with the corrosive effect this had on the administration of justice.¹²² Commentators have suggested that this dualism of Taft as both an economic conservative and a judicial reformer comes together in his paramount and ultimately conventional concern for law, order, and stability. Reading *Tinoco* in this context hints at a similar interpretation of Taft’s perspective at the international level.

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 protection against instability and radicalism.¹²³ 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.”¹²⁴ 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.¹²⁵ In discussing

121. 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. BURTON, *supra* note 102, at 115-21.

122. *See, e.g.*, MASON, *supra* note 104, at 53.

123. *See id.* at 15.

124. *Id.* at 290.

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

Taft's major 1908 address before the Virginia Bar Association, Alpheus 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.¹²⁶

In this regard, Taft's goal of fair judicial access may have been part and parcel of his general conservatism. Thus, legal progressivism on Taft's part is not inconsistent with a commitment to maintaining the status quo. In addition to feeling genuine concern for wealth-based inequality in access to justice, Taft would also have been aware of the risks to property and capital of doing nothing. Taft noted that 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."¹²⁷ Indeed, Taft viewed the proper administration of law as a bulwark against more serious social demands, in addition to an 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.

This insight forces the question of whether the intermediate conception of sovereignty underlying the *Tinoco* decision—also relatively progressive—can be understood as supportive of market ideals. This would problematize the view that only a narrowly statist conception of effective control, along with the strictest doctrine of sovereign continuity, is suitable for the treatment of sovereign debt. Although some modern creditors treat the odious debt issue as a slippery slope to the collapse of sovereign lending,¹²⁸ understanding Taft's own background presents a different interpretation. While it is possible that Taft felt concern for the debt payment burdens of neighboring countries, he certainly would not have been 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 at least partially aimed to prevent deeper and less disciplined calls for social justice. Consistent with these preferences in the domestic arena, 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."¹²⁹ Taft's commitment to using legal principles as a shield against violent controversy and disorder extended beyond American borders. Although at both the domestic and international levels Taft seemed most interested in the

126. *Id.* at 13-14.

127. *Id.* at 53 (quoting W.H. Taft, President of the U.S., Address at the Virginia Bar Association (Aug. 6, 1908)).

128. See, e.g., Rajan, *supra* note 7, at 54-55.

129. BURTON, *supra* note 102, at 115.

procedural aspect of equal justice, the substantive outcome of his decision for Costa Rica 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. Eliminating the most egregious violations of transnational justice may well be part of a broader market-friendly policy for sovereign lending.

2. *The Risk of Moral Hazard on the Part of Creditors and Government Elites*

However one judges Taft’s political philosophy, it did seem to be guided by genuine capitalist beliefs rather than short-run pandering to particular capitalists. Although Taft’s policy and judicial decisions generally favored business interests, his genuine orientation was to the market as a point of principle.¹³⁰ Indeed, he showed himself willing to take positions antithetical to major American interests in order to serve a broader commitment to smooth economic and market functioning. Although Taft 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.”¹³¹ During his 1907 presidential nomination, he attacked the “use of accumulated wealth in illegal ways” and, according to his major biographers, he was concerned that “[u]nless the abuses under it were stopped, capitalism would be replaced by socialism or some other evil.”¹³² In short, Taft was able to distinguish between elite business interests and market interests more generally, and when he perceived a conflict between these commitments, he favored the latter.

This ability to distinguish between market and creditor interests offers another critical layer to the *Tinoco* decision. Even beyond the idea that a rule-of-law approach can act as a bulwark against broader social demands, there are two ways in which an intermediate account may promote efficient market functioning—albeit at the expense of immediate profits. Although a strict statist conception encourages stability in repayment, it can also create harmful incentives for creditors and borrowing government elites. In particular, a statist approach to sovereign continuity produces a moral hazard problem by acting as insurance that loans—regardless of provenance or use—will be enforced against subsequent regimes. This moral hazard exists at both the creditor level and the borrowing country level. Adopting an intermediate approach may mitigate this problematic aspect of the current statist lending system.

The International Monetary Fund defines moral hazard as existing, “when the provision of insurance against a risk encourages behavior that

130. His view of major corporate actors was decidedly mixed. He wrote in a letter to his brother, “[a]s you say, Wall Street, as an aggregation, is the biggest ass that I have ever run across.” Letter from W.H. Taft to Henry Taft (Feb. 21, 1910), *quoted in* PRINGLE, *supra* note 104, at 655.

131. 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). In prosecuting the major monopolies of the day, Taft perhaps “attempted much more, far less noisily, than [Theodore] Roosevelt.” PRINGLE, *supra* note 104, at 654.

132. PRINGLE, *supra* note 104, at 655.

makes that risk more likely.”¹³³ Part of the concern with giving more traction to the conceptual frameworks associated with odious debt 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.¹³⁴ It is possible that a poorly constructed odious debt framework would encourage this kind of reckless repudiation of loans, which would aggravate the preexisting problems of uncertainty associated with sovereign lending. In practice, however, this kind of recklessness seems unlikely to develop. As Michael Kremer and Seema Jayachandran point out, “[c]urrently, countries repay debt even if it is odious because if they failed to do so, their assets might be seized abroad and their reputations would be tarnished, making it more difficult for them to borrow again or attract foreign investment.”¹³⁵ These basic policing mechanisms need only be minimally altered by the introduction of an odious debt framework, such as that offered in the *Tinoco* decision. The only changed element would be the catalyst for this compliance mechanism; instead of being triggered by repudiation or major default alone, it would be triggered by the repudiation of debt not considered “odious.” The repudiation of only that portion of debt found to be odious or illegitimate should not, ideally, result in retaliation against overseas assets or a country’s general creditworthiness.¹³⁶

In fact, under the current system of strict sovereign continuity, two opposite moral hazard concerns seem to have prevailed. First, the norm of universal repayment, by failing to distinguish between different types of debt, has created a moral hazard problem with regard to creditors. A strict statist account insures against the risk of lending to sovereign states (even arguably “illegitimate” states) in times of crisis and uncertainty. Ideally, this should allow for the productive use of capital even in the face of political volatility. The effect of a purely statist conception, however, seems to have gone beyond this to encourage greater (and perhaps unthinking) lending for questionable ends. It minimizes the risks associated with wasteful lending and shifts additional risk onto borrowing states by absolving creditors of part of their standard due diligence requirement.¹³⁷ Folding in and forcing the repayment

133. This definition is presented in INT’L MONETARY FUND, WORLD ECONOMIC OUTLOOK 8 (1998), available at <http://www.imf.org/external/pubs/ft/weo/weo0598/index.htm>.

134. Jayachandran and Kremer address these concerns and raise counterarguments in their work on odious debt. Jayachandran & Kremer, *supra* note 5. Joseph Hanlon raises the moral hazard problem with regard to Rwanda and South Africa. Joseph Hanlon, *Dictators and Debt*, JUBILEE RESEARCH, Nov. 1998, <http://www.jubileeresearch.org/analysis/reports/dictatorsreport.htm>. See also Michael Kremer & Seema Jayachandran, *Odious Debt*, 2002 BROOKINGS INST. POL’Y BRIEF 103.

135. Kremer & Jayachandran, *supra* note 134, at 4.

136. Omri Ben-Shahar and Mitu Gulati, among others, explicitly consider the possibility of partial repudiation of odious debts. Omri Ben-Shahar & Mitu Gulati, *Partially Odious Debts? A Framework for an Optimal Liability Regime*, 70 LAW & CONTEMP. PROBS. (forthcoming 2007), available at <http://ssrn.com/abstract=970553>.

137. 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 its investment of borrowed funds may not result in a cash flow sufficient for repayment; 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.

of arguably odious debt with all other sovereign debt effectively obviates any risk of lending to regimes that violate their own laws or plan to use funds for non-beneficial purposes. The intermediate approach taken by Taft in *Tinoco*, in both its rule-of-law and its legitimate purpose requirements, might help to direct the international capital stock back to more productive and more transparent uses.¹³⁸

The intermediate approach of the *Tinoco* decision should also encourage better domestic policy decisions by borrowing governments in the long run. Currently, sovereign states have relatively easy access to capital through international markets, which may be willing to lend for insufficiently considered purposes and through processes that violate internal legal rules. This effectively creates a corresponding borrower-side moral hazard problem. Just as a strictly statist approach to sovereign lending encourages creditors to lend in uncertain political times, it encourages sovereign states to borrow in the knowledge that future generations will repay the debt.¹³⁹ Ideally, this would allow all states (again including those of unsavory origin) to make timely and well-priced investments in infrastructure, healthcare, and other productive assets and services. However, strict sovereign continuity may also have the perverse effect of encouraging profligate borrowing for non-state purposes and in contravention of the transparency associated with internal legal rule. This means that government leaders with access to international capital have less need to draw on public resources and are therefore even less accountable to their publics.¹⁴⁰

In contrast, the type of intermediate framework offered in *Tinoco*, by limiting the pool of external funds available illegally or for non-beneficial purposes, might eventually encourage state actors to confront more squarely the political and economic risks of corruption and repression. Future regimes would not have the same (often externally derived) resources at hand as regimes past. This should limit the rents extractable from being a member of the ruling elite and may increase domestic leverage for internal reform. In short, as long as we distinguish between market interests and elite interests, and pay careful attention to the incentives created by different conceptions of

138. I mean “productive” here in the more colloquial sense of using capital to produce goods, services, or infrastructure beneficial to underlying populations. The term may also be used in a purely financial description of capital as productive when it generates financial returns, for example in the form of dividends or interest payments. Certainly sovereign lending has occasionally been productive of interest payments even when gains on the ground have been minimal. The Bataan nuclear power plant in the Philippines is a prime example. Built at a total cost of \$2.3 billion on an earthquake fault line, it has yet to generate usable energy. *RP Pays Off Nuclear Power Plant After 30 Years*, ABS-CBN INTERACTIVE, <http://www.abs-cbnnews.com/topofthehour.aspx?StoryId=80742> (last visited Nov. 6, 2007).

139. Buchheit, Gulati, and Thompson call this the “intergenerational tension” in sovereign borrowing. Buchheit et al., *supra* note 1, at 1204-08.

140. Patricia Adams points out that one problem of “loose lending” is that it severs the relationship that a ruling elite has with a state’s population. In addition to providing elites with additional and often unaccountable funds (with which they can oppress the population), the government is not forced to deal with the oversight and accountability questions generally associated with raising taxes. ADAMS, *supra* note 5, at 151-56.

sovereignty, compelling reasons related to economic efficiency exist for an intermediate approach to sovereignty in sovereign debt.¹⁴¹

C. *Dealing with Uncertainty in Taft's Intermediate Account*

Even if an intermediate rule-of-law account might promote a stable market environment in the long run, contemporary economists have been hesitant to embrace anything other than a strictly statist approach as consistent with the everyday operation of the sovereign lending system. Whereas a statist conception allows for a bright line rule—continuity of debt obligations in all cases—the potential gains associated with an intermediate approach require greater intellectual labor on the part of the sovereign debt regime. An intermediate framework injects uncertainty and variability into sovereign lending. This Section addresses several of these reservations and highlights where the *Tinoco* decision provides a mechanism for dealing with the additional uncertainty caused by its rule of law and governmental purpose requirements.

Given the absence of a clear enforcement mechanism in the international arena (i.e., the lack of a unified judicial and executive system), international borrowing is especially susceptible to concerns of uncertainty about repayment. The strict statist account of sovereignty, by effectively assuring creditors that all of their loans are enforceable under international law, makes credit to sovereign borrowers relatively plentiful and cheap. Without the assurance that debts will be repaid even in cases of regime change or political volatility, creditors may be more hesitant to accept the risk of sovereign lending. Even if they remain willing to lend, increased risk could raise the price (i.e., interest) charged to sovereign borrowers, potentially putting international financing out of reach for the poorest among them.

Taft's *Tinoco* decision does inject several elements that make the repayment of sovereign debt less certain. Although Taft's "effective control" test supports a stable investment environment by promoting the general rule of sovereign continuity, it allows greater flexibility in the repayment of sovereign debt obligations. The requirement that sovereign contracts must comply with the sovereign's own internal laws raises two questions that must be addressed by lenders and borrowers. First, what is the relevant domestic law in place for any given sovereign contract; i.e., which law grants the government agent power to act on behalf of the state? Ideally, this law will be easily accessible and clearly formulated (as was the case, incidentally, in the *Tinoco* controversy as to the Amory oil concession's tax provisions). However, there are likely to be situations in which the law itself is unclear. And second—for the creditor—has the sovereign borrower actually complied with the domestic law such that the contract will be enforceable under international law? This question too might be difficult to answer, particularly from the perspective of a foreign creditor. The requirement of legitimate

141. Although I have focused on Taft's framework, this analysis is relevant beyond his particular approach, and similar gains could be made through other modes of dealing with arguably odious debt. For example, Kremer and Jayachandran model the economic equilibrium that would result from establishing a prospective odious debt regime. Kremer & Jayachandran, *supra* note 134.

governmental purpose similarly raises two questions: What constitutes “legitimate government purpose” under international law? And has the sovereign contractor actually complied with this requirement?

While it would certainly be simpler to ignore these questions in favor of a strictly statist account, which assumes that all debts will be repaid, Taft does offer a mechanism to deal with these issues. In discussing the Royal Bank loan to the Tinoco brothers, Taft implies that a crucial consideration is whether the creditor “must have known” or “should have” known that the loan funds had no “legitimate government purpose.”¹⁴² This language indicates that *actual* knowledge of the loan’s beneficial or detrimental intent is not necessary to grant or deny repayment of a loan. What would be required is that the creditors make a reasonable effort to investigate and attempt to answer the questions presented above. Creditors must comply in good faith with the sovereign contractor’s domestic rule of law and with the general insistence that “government” debt should go to government ends. The *Tinoco* decision effectively incorporates a due diligence requirement—if not actual creditor knowledge—for these issues, which is otherwise weak in the strict statist account.¹⁴³ Given the serious moral hazard problems noted above, such a requirement might actually encourage greater productive use of international capital stocks.

Still, it is important to acknowledge that this due diligence element does not clear up all of the uncertainty involved in the intermediate account. Some aspects of the finding, such as the nuances of “legitimate governmental purpose,” are inherently ambiguous at the edges and may depend on ultimately normative and contextual considerations.¹⁴⁴ The finding also makes the potentially problematic suggestion that international arbitral tribunals would decide on whether a sovereign government had complied sufficiently with its own laws. These elements thus inject an international social judgment on domestic regime issues through the back door—something that a purely legalist account (if such a thing exists) would seek to avoid.

While these problems of interpretation are difficult and deserve additional attention, they can be mitigated. For example, states entering into sovereign debt arbitrations could consent to arbitral determinations on a range of their internal laws (which would presumably still be preferable to having their internal laws ignored altogether). Alternatively, arbitral tribunals could be required to consist of judges from the debtor state’s political or

142. *Tinoco Case (Gr. Brit. v. Costa Rica)*, 1 R. Int’l. Arb. Awards 369, 394 (1923), *available at* 18 AM. J. INT’L L. 147, 168 (1924). Again, a requirement of creditor knowledge also emerges in Sack’s presentation of the odious debt doctrine, although Sack’s formulation does not explicitly address the possibility of constructive knowledge. SACK, *supra* note 4, at 157.

143. For more on the due diligence requirement, see *supra* notes 79, 137.

144. Taft’s finding explicitly distinguishes legitimate lending for public ends (presumably infrastructure, services, and the like) from illegitimate lending for private enrichment. While this is the most clear cut example, questions could be raised as to whether the suppression of popular protest constitutes legitimate government action—particularly given the fine line between “keeping order” and repression. Sack’s formulation seems to suggest that funds incurred for military oppression would be illegitimate (presuming of course that all three prongs of his test had been met). See *supra* note 84.

geographical region or from a shared legal tradition.¹⁴⁵ It is also important to highlight that the alternative of a narrowly statist conception already implicitly makes such social judgments; a strict framework of sovereign continuity effectively determines that compliance with internal laws and attentiveness to legitimate government purpose are of limited importance.

Given that many arguments for a strict statist approach are formulated as protective of sovereign borrowers, it is worth considering that the intermediate alternative might still be preferable from the long-run perspective of the borrowing country. Debt cancellation advocates point out that, under the current lending framework of strict sovereign continuity, many of the world's poorest countries use a considerable proportion of their GDPs for the payment of loans of questionable provenance and utility.¹⁴⁶ In combination with the serious problems engendered by the current statist approach discussed above, Taft's implied mechanism for dealing with questions of uncertainty should encourage serious discussion of the *Tinoco Case* as a workable precedent. At the very least, the decision should disarm the charge that any deviation from a strict statist principle of sovereign continuity is unworkable in principle.

Indeed, it is somewhat surprising 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 the odious debt idea. 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. The practical or interest group ramifications of this creditor and market dynamic seem clear. One would predict that creditors (and their lawyers) would always have a strong preference for a strictly statist version of sovereignty, which ensures the repayment of debt under *all* circumstances. Notwithstanding this expectation, most commentators in the 1920s seemed unperturbed by Taft's arbitral award for Costa Rica. The *British Yearbook of International Law* covered solely the basic discussion on sovereign recognition, adding only that, "[o]n 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."¹⁴⁷ 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.¹⁴⁸ 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.¹⁴⁹ Although there may have been more anger in British foreign policy circles, this did not significantly

145. To some degree, this can already be controlled for, as parties to an arbitration have input into the selection of the tribunal members. An additional requirement would place some constraint on the choices of creditors in selecting a tribunal member.

146. For a 1998 review of estimated "odious debt" burdens, see Hanlon, *supra* note 134. For a provocative account in the popular publishing trade, see JAMES S. HENRY, *THE BLOOD BANKERS: TALES FROM THE GLOBAL UNDERGROUND ECONOMY* (2003).

147. J.L.B., *Arbitration Between Great Britain and Costa Rica*, BRIT. Y.B. INT'L L. 199, 204 (1925).

148. *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.

149. *Costa Rica Shows Big Financial Gain*, N.Y. TIMES, May 20, 1928, at 33.

hinder Costa Rica’s financial flexibility or cause its banishment from the sovereign credit market. In a similarly puzzling instance around the same time, some bankers and industrialists were willing to extend credit to the Soviet Union even after its repudiation of the Tsar’s debt in 1917.¹⁵⁰ 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 twentieth-century financiers did not uniformly consider a strict statist conception of sovereignty their due. The relatively moderate response of these early creditors raises the question of why today’s financial actors have become 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. CREDITOR COMPETITION AND REALPOLITIK IN THE CARIBBEAN

Analyzing the *Tinoco* decision in light of Taft’s pro-market ideological tendencies counters the claim of some modern financial actors that only a strict statist approach to sovereignty is consistent with healthy sovereign credit markets. This practical open-endedness emphasizes that ideas of economic rationality, sound market practice, and sovereign creditworthiness are theoretically and historically contingent. It also raises an additional question: if there is variation in the idea of sovereignty underlying these concepts, what accounts 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 first suggests that the degree of competition in the sovereign credit market 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 less competitive and perceive themselves as part of the same interest group, a more strictly statist approach is likely to dominate. The discussion then highlights how this dynamic plays out in the context of early twentieth-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 analysis above makes clear that the seemingly abstract question of who is “sovereign” in sovereign debt in fact has significant distributional consequences in international economic relations. A strictly statist account of

150. See, e.g., ANTONY SUTTON, *WALL STREET AND THE BOLSHEVIK REVOLUTION* (1974) (highlighting economic links between the Soviet Union and major American bankers and industrialists through the 1920s).

sovereignty, in which the *fact* of state 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 twentieth century, one immediate hypothesis therefore rests with the increasing power of creditors. Following this line of reasoning, the defense of a strict statist account of sovereignty in sovereign debt should intensify along with increased creditor power.

Such a hypothesis, while initially plausible, offers an insufficiently nuanced view of creditor interests. In particular, this "creditor power" hypothesis fails to recognize that while creditors may at times have shared perceptions of interest and threat, tending toward a strict statist approach, such creditor consolidation is not inevitable. At some historical moments, creditors may actively compete and thus identify other lenders as primary threats. In such cases, the conception of sovereignty underlying sovereign lending is likely to be more receptive to sovereign debtor concerns. A more nuanced version of the "creditor interest" hypothesis suggests that the degree to which creditors are competitive or consolidated—rather than creditor power in general—should affect the narrowness or openness of the conception of sovereignty underlying the sovereign debt regime.

How would this dynamic play out in practice? Creditors do incorporate the possibility of political instability and regime change when assessing country risk. In this context, lenders may pay attention to sovereign legitimacy if they believe that the debt contracts of less oppressive regimes will result in higher rates of repayment even in the absence of a clear odious debt mechanism.¹⁵¹ However, creditors have no foundational need for a discussion of whether sovereign borrowers are internally "legitimate." Under the statist background rules of the current financial system, lenders are entitled to the repayment of all debt. Therefore, they are unlikely to consider independently the explicit questions of sovereign legitimacy raised by different conceptual frameworks in political theory and international law. 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 a noncompetitive or oligopolistic perspective. There is little reason to expect that creditor interests in the arena of sovereign debt will be entirely uniform, given that they respond to two

151. This would still be done on an ad hoc basis, particularly given that major sovereign credit rating mechanisms remain relatively subjective. See, e.g., Ashok Vir Bhatia, *Sovereign Credit Ratings Methodology: An Evaluation* 12 (IMF, Working Paper No. WP/02/170, 2002) (noting that "the limited predictability" of sovereign economic and political behavior, as well as the absence of widespread statistical testing, "leave[] the task of credit ratings assessment[s] poorly suited to formulaic straightjackets").

principal sources of risk. First, creditors as a whole face the threat of default and repudiation, and in this sense have a shared perspective vis-à-vis sovereign debtors. Debtors, however, are not the only, or even the most pressing, source of risk for creditors; other lenders constitute a second threat. A healthy credit market is driven partially by competition between suppliers of credit for the same borrowing client. The prospect of losing clients to competitors represents a second central problem for creditors.¹⁵²

How might this framework inform conceptions of sovereignty underlying sovereign debt? As long as major creditors identify non-repayment of loans as the central threat in the sovereign market, then a hegemonic insistence on the payment of *all* debt, including potentially odious debt, makes sense.¹⁵³ The concept of sovereignty that best supports such a practice—a purely statist definition accompanied by a strict doctrine of sovereign continuity—would gain greater support. This creditor approach should be more likely to emerge when the market is oligopolistic, in which case the threat posed by competing suppliers of credit recedes. In this case, the risk of sovereign default becomes dominant, and creditors interpret 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. 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-statist view of sovereignty. Even if one creditor considered the odious debt argument valid, its relationship with other creditors, including the discontented debt-holder, could prevent its acceptance of a more flexible approach. Although it is difficult to place a monetary value on the exclusive adoption of a concept, the dominant use of a statist 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 in the long run.¹⁵⁴

However, 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. In this case, creditors may 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

152. 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 twentieth century.

153. 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 sovereign lending regime could also conceivably play a role in this dynamic of competition and consolidation.

154. Although this presentation is set forth 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 statist view has been naturalized and assumed necessary.

instrument will prefer a statist conception of sovereignty as to that instrument, other creditors hoping to attract the same borrower may be more flexible. A new creditor, in the hopes of displacing a competitor, may be indifferent as to whether a prospective client pays that competitor's arguably illegitimate debt. This underlying desire could reasonably lead to a more flexible 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 be willing to extend credit even after repudiation.¹⁵⁵ Thus, a more aggressive credit market should be more lenient toward sovereign governments that repudiate 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 nature of competition in the sovereign credit market. Although it is impossible to verify the general applicability of this proposal in a single case study, the creditor competition hypothesis can help to provide context for the intermediate approach to sovereignty taken by Taft in the *Tinoco* decision.

B. *Economic Competition and Realpolitik in the Caribbean*

While Taft's *Tinoco* decision and its underlying vision of sovereignty provides stability and certainty for international investment, its shift away from a strictly statist account precluded a finding for the British creditors. Although it is common to hear talk of "creditor interests," in fact such interests are not necessarily unified. Drawing from the previous analysis, this Section suggests that the relative nuance and flexibility of Taft's *Tinoco* position may have been enabled by the background context of competition between the United States and its European rivals. Such competition, with Great Britain in particular, ruled out an easy identification of creditor interests and thus may have moderated the statist conceptual monopoly that seems to have dominated the late twentieth century. This competition existed along both economic and geostrategic dimensions, and was deepened by U.S. concerns about oil concessions and the Panama Canal. Given Chief 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.¹⁵⁶ Rather, this Section argues that the competitive context of early twentieth-century lending may have challenged the insufficiently nuanced understandings of market rationality that have become prevalent today.

155. Repudiation on the ground of odious debt is not necessarily a large-scale repudiation of all the sovereign state's debt. It is possible that the "odious" label applies to only a portion of the public debt. Indeed, some debt cancellation advocates have proposed calculations of different countries' odious debt burdens. See, e.g., Tamen, *supra* note 39, app. 1, at 25 (calculating "dictator"-contracted debt burdens for twenty-three countries).

156. Unfortunately, Taft's biographers make very little (if any) mention of the *Tinoco* arbitration. It is unclear how Taft himself viewed the case in the context of Caribbean competition.

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 twentieth century, American capital sought investment outlets and struggled against the market dominance of British, French, and German banking houses. In China, Taft’s presidential administration displayed far greater concern than previous administrations with promoting concessions for American banks and corporations.¹⁵⁷ These earlier efforts failed in part because of the relative immaturity of American capital markets, but also due to the intransigence of Japanese and European interests in the region.¹⁵⁸ The rise of the United States as a creditor nation accelerated after World War I, but it had still not solidified its hegemonic status. Although the United States was relatively stronger in Latin America, particularly after the war, British capital continued to prevail through most of the 1920s.¹⁵⁹ While U.S. investments in Latin America doubled to \$3 billion between 1924 and 1929, British investments dominated the region throughout this time period.¹⁶⁰ This background of economic competition undermines the tenability of a unified concept of creditor interest in the early twentieth 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. 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 United States viewed Great Britain and other Western European nations as an economic risk, this would have constituted only part of Taft’s foreign policy outlook. American 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 was deeply concerned with defending broader U.S. strategic interests.¹⁶¹ 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

157. SCHOLES & SCHOLES, *supra* note 116, at 109.

158. *Id.* at 247-48.

159. The British had historically been interested in establishing a Central American foothold in the Spanish Empire and founded a logging colony at present day Belize as early as 1622. Leonard, *supra* note 20, at 4.

160. Robert Freeman Smith, *Latin America, the United States, and the European Powers, 1830-1930*, in 4 THE CAMBRIDGE HISTORY OF LATIN AMERICA 83, 112 (Leslie Bethell ed., 1986).

161. Scholes and Scholes argue that, for Taft, the “most important consideration was the preservation of vital American interests abroad.” SCHOLES & SCHOLES, *supra* note 116, at 105. They suggest 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. *Id.*; see also MUNRO, *supra* note 17, at 163 (“[T]o Taft, using dollars instead of bullets seemed humane and practical . . .”). Commentators have remarked 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 (3d ed. 1996).

of an American 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.”¹⁶² The United States’s interest in the Caribbean only deepened when it launched its overseas empire in Cuba, Puerto Rico, and the Philippines after the Spanish-American War.¹⁶³ The 1904 Roosevelt Corollary to the Monroe Doctrine went even further, claiming an international police power in the Western Hemisphere to correct “chronic wrongdoing” or disorder resulting from any “general loosening of the ties of civilized society.”¹⁶⁴ As part of his corollary, Theodore Roosevelt hoped to prevent intervention by European 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.¹⁶⁵ 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.¹⁶⁶ Wilson, despite his initial wish to stay out of Central America, also followed the policies of his predecessors through World War I.¹⁶⁷ Such background geostrategic concerns may 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 United States 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.¹⁶⁸ As the turn of the century approached, however, the United States 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,¹⁶⁹ as Theodore Roosevelt’s Secretary of War, Taft took charge of the canal project, which was completed in August 1914. In this role, he paid great attention to ensuring the financial stability and political

162. KRYZANEK, *supra* note 161, at 29.

163. The Central Americans had actually made efforts to involve the United States 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 20, at 5. Notwithstanding the efforts of Central American elites to become economically closer to the United States, Central America remained dependent upon British and German merchants and markets as of 1900. *Id.* at 7.

164. KRYZANEK, *supra* note 161, at 48.

165. *Id.* at 7.

166. For an excellent overview of “dollar diplomacy” in the early twentieth century, see MUNRO, *supra* note 17.

167. Roosevelt, Taft, and Wilson ultimately shared similar underlying motivations in their approach to foreign policy in Latin America and the Caribbean. *See, e.g.*, KRYZANEK, *supra* note 161, at 51.

168. 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 United States nor Britain would attempt to control any part of Central America or any possible canal. *See* MUNRO, *supra* note 17, at 4.

169. RALPH ELGIN MINGER, WILLIAM HOWARD TAFT AND U.S. FOREIGN POLICY: THE APPRENTICESHIP YEARS, 1900-1908, at 104 (1975) (citing a 1901 letter to W.H. Taft’s younger brother, Horace).

compliance of the Panamanian government and was not loathe to step on political toes in pursuit of this goal.¹⁷⁰ Taft believed that stability in the Central American republics was even more desirable than peace in South America, due to the republics’ proximity to the Panama Canal.¹⁷¹

As part of the general policy of limiting European involvement in the region, the United States had been particularly wary of allowing the development of British oil concessions in Costa Rica, the latter venture being “of unusual interest because of its relation to naval bases and the proximity of Costa Rica to the Panama Canal.”¹⁷² The State Department aimed to prevent German and British companies from obtaining oil concessions under González, Tinoco’s predecessor, while the American Sinclair Oil Company was able to obtain a Costa Rican concession in 1916.¹⁷³ 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,¹⁷⁴ 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 rise of the Tinoco regime and Wilson’s nonrecognition policy took place during World War I. The *Tinoco* decision’s legal response to Wilson’s political nonrecognition policy not only had ramifications for a stable investment environment, but also for realpolitik concerns in the Caribbean. Wilson’s policy—to protect the Canal and American interests by promoting stability and breaking the cycle of revolution in Central America—was at least partly in the same spirit as dollar diplomacy.¹⁷⁵ However, the policy was unpopular even within Wilson’s cabinet in light of a possible German threat to the vulnerable Caribbean region.¹⁷⁶ Taft did not appear to share Wilson’s

170. *Id.* at 102-17 (discussing Taft’s work on the Panama Canal); see also BURTON, *supra* note 102, at 37-40.

171. PRINGLE, *supra* note 104, at 697.

172. Telegram from J.B. Moore, on behalf of U.S. Sec’y of State, to E.J. Hale, Minister in Costa Rica (Dec. 2, 1913), in [1919] 1 FOREIGN REL. U.S. 866, *quoted in* MUNRO, *supra* note 17, at 431.

173. Munro provides an excellent narrative of American interests in Costa Rica, paying special attention to oil concerns. MUNRO, *supra* note 17, at 426-48.

174. The United States had initially supported the Sinclair Oil Company in their defense of an oil concession granted by González and 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. See MUNRO, *supra* note 17, at 448. In any case, by 1923 there would have been little love for Sinclair in the American government, as the Oil Company was also implicated in the Teapot Dome Scandal of 1923. See PRINGLE, *supra* note 104, at 1020.

175. The problem of revolutions was far less of an issue in Costa Rica, which has been surprisingly stable relative to its neighbors. See PEREZ-BRIGNOLI, *supra* note 27, at 113, 115. 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.

176. In fact, Wilson may have been the only member of his foreign policy team to wholeheartedly support the non-recognition policy. His Secretary of State, Robert Lansing, urged the recognition of the Tinoco government in light of concerns about German interests in the Caribbean basin. MUNRO, *supra* note 17, at 433-34. There is some intimation among historians that González may

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 had little respect for the Central Americans' ability to deal with their own affairs.¹⁷⁷ 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. In short, the overall context of economic and geostrategic competition in the Caribbean may have colored Taft's formulation of the *Tinoco* decision.

The insight that competition—when it works well—can benefit consumers by lowering the price of goods and monetary credit is not new. But in the context of the sovereign debt regime, competition may have benefits that extend beyond loan pricing. In particular, it may undermine the development of a conceptual monopoly in sovereign lending. Although a noncompetitive market would tend toward a strictly statist account, with its occasional windfalls to creditors, a competitive market should allow for greater flexibility. Against a competitive backdrop, flexible conceptions of sovereignty in the sovereign debt market may appear more economically rational than a purely statist framework. This suggestion provides an additional lens for interpreting the *Tinoco* decision in light of early twentieth-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 statist approach to sovereignty. 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 granted more conceptual space for Taft's own consideration of legal possibility and market rationality, and for his ultimate adoption of an intermediate rule-of-law conception of sovereignty in his arbitral decision. This competition may also explain the muted reaction of the American 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 absence of a more flexible intermediate approach to sovereignty for most of the twentieth century may be related to decreasing competitiveness in international finance.¹⁷⁸ While the

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. Leonard, *supra* note 20, at 12.

177. He told his Secretary of State, Philander Knox, that he yearned for the "right to knock their heads together until they should maintain peace between them." Letter from W.H. Taft to Philander Knox, U.S. Sec'y of State (Dec. 22, 1909), *quoted in* BURTON, *supra* note 102, at 66.

178. 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 twentieth century. See Odette Lienau, Who is the "Sovereign" in Sovereign Debt?: A Genealogy of Debt and Reputation in the Twentieth Century

rise of American banking and geostrategic interests engendered competition in the early twentieth century, this competitive framework arguably disappeared as the century progressed.¹⁷⁹ Cross-border lending effectively halted during the Great Depression, and when sovereign lending reemerged 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.¹⁸⁰ 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 more consolidated in their perceptions of risk.¹⁸¹ In short, the conceptual space for considerations of alternative approaches to sovereignty in the sovereign debt regime may have narrowed, making the conceptual monopoly of a strict statist approach more likely.¹⁸²

V. CONCLUSION

The end of the Cold War, the sovereign debt crises of the late 1990s, and the 2003 invasion of Iraq have combined to re-open discussion on the appropriate framework for sovereign debt in the twenty-first century. In particular, these upheavals draw attention to the question of whom we mean by “sovereign” in sovereign lending. Although strictly statist conceptions of sovereignty became dominant over the twentieth century, the current attention paid to human rights and popular sovereignty has put pressure on this conceptual framework. The activism of debt cancellation advocates in both developing and developed states has brought the related issue of arguably “odious” debt to greater public attention. Reconsidering U.S. Chief Justice Taft’s key *Tinoco* arbitration in light of these discussions offers a constructive framework for thinking about sovereign debt today.

The *Tinoco* arbitration, as a central precedent for both the “effective control” doctrine of sovereign recognition and the idea of odious debt, already holds a unique position in the debate. This Article has reinterpreted the case as

(forthcoming 2008) (unpublished Ph.D. dissertation, Harvard University) (on file with author). A more comprehensive assessment of the hypothesis on creditor consolidation is feasible only in this larger format.

179. Although he does not present it in terms of competition and consolidation, Randall Germain discusses some of these basic changes in the structure of the international credit market. RANDALL D. GERMAIN, *THE INTERNATIONAL ORGANIZATION OF CREDIT* (1997).

180. Anna Gelpern discusses the different incentives and interests associated with public creditors, though not in the particular framework of competition. She focuses on how their extensions of credit may not result in “debt” in the traditional sense. Gelpern, *supra* note 5. For a longer discussion of the rise of public creditors in the mid-twentieth century, see Odette Lienau, *Closure in the Mid-20th Century: The Rise of Public Creditors and a Resurgence of Formalism* (2006) (unpublished manuscript, on file with author).

181. This is not to suggest that these coordination and informational mechanisms were the result of oligopolistic collusion on the part of financial actors. Rather, the exogenous (and by no means predetermined) development of these market mechanisms in the mid- to late twentieth century may have resulted in an oligopolistic *effect*.

182. Broader geopolitical issues, particularly the Cold War, may also have played an important role in this consolidation.

presenting an intermediate or “rule of law” conception of sovereignty that offers a third way between a strict understanding of sovereignty as either popular consent or statist control. In particular, it argued that Taft identifies sovereign statehood through its internal rule of law, rather than through control by force or democratic institutions. While this intermediate approach does not mandate any substantive content for internal legal rule, it does insist that sovereign state debt is binding on successor governments only if the contracting regime has followed its own legal requirements for competence and ratification. Taft’s *Tinoco* decision also adds a separate and additional requirement that sovereign state debt must at least intend to serve a legitimate government purpose. If creditors fail to make a good faith effort on these two fronts, the debt contract’s validity may be challenged on either element. This formulation resonates with Taft’s own domestic jurisprudence and reconciles the two competing presentations of *Tinoco* as supportive of both sovereign debt continuity and the repudiation of odious government debt.

The circumstances surrounding the *Tinoco Case* also offer insight into the contingency of the concepts of sovereignty, market rationality, and creditor interest that underlie the sovereign debt regime. Taft’s decision—which might be characterized as overly risky by some contemporary analysts¹⁸³—can best be understood as promoting a stable environment for cross-border investment. The disappearance of Taft’s and other odious debt-type frameworks for much of the twentieth century raises questions about variation in the concept of sovereignty underlying the sovereign lending regime. This Article tentatively suggested that the openness or narrowness of sovereignty in sovereign debt may relate to the degree of competition among creditors involved in sovereign lending. Early twentieth-century economic and geostrategic competition between the United States and European powers may have enabled the emergence of a more open conception of sovereignty in the *Tinoco* decision, hinting that the less competitive creditor structure after World War II undermined the traction of Taft’s and similar approaches until relatively recently.

The questions and analyses presented here are insufficient to ground a strong policy proposal. However, they can contribute to the debate on how best to approach the most contentious issues in sovereign lending. Developing country debt advocates have called for far-ranging assessments of the validity of sovereign debt burdens, and U.S. courts have heard cases on arguably odious and unbeneficial sovereign debts.¹⁸⁴ A rule-of-law approach should be among those considered for how to identify enforceable sovereign debt. In representing Taft’s framework, this Article joins recent legal scholarship that encourages the development of an international debt regime balancing financial workability with greater attention to states’ underlying populations.

183. See, e.g., *Iraq’s Debt*, *supra* note 2; Rajan, *supra* note 7.

184. See, e.g., Hanlon, *supra* note 134; Africa: Debt Arbitration, AFRICA ACTION, Mar. 8, 2002, <http://www.africaaction.org/docs02/debt0203.htm>. See also, for example, the series of cases related to the Philippines Nuclear Power Plant Unit in Bagac, Bataan in the Philippines, built by Westinghouse Electric. *Philippines v. Westinghouse Elec.*, 43 F.3d 65 (3d Cir. 1994); *Philippines v. Westinghouse Elec.*, 714 F. Supp. 1362 (D.N.J. 1989); *Westinghouse Int’l v. Nat’l Power Corp. (U.S. v. Phil.)*, 7 Int’l Arb. B-1 (1992) (litigation related to a debt contract frequently listed by debt cancellation advocates as “odious”); see also *RP Pays Off Nuclear Power Plant After 30 Years*, *supra* note 138.

As a final question, it might be asked whether Taft’s intermediate framework is only a stepping stone to a stronger liberal democratic conception of popular sovereignty. Does the *Tinoco* arbitration offer only a weak second-best to the more complete approach offered in some modern human rights work?¹⁸⁵ 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. The strong version of a project of popular sovereignty risks an updated, more legalized, and perhaps more coercive re-inscription of the civilized/uncivilized paradigm that existed prior to the twentieth century.¹⁸⁶ Given the complex relationship between international law and local state autonomy that exists at the turn of the twenty-first century, a more cautious rule-of-law conception of sovereignty may offer a useful third way that extends even beyond the arena of sovereign debt.

185. Michael Reisman suggests as much, though he focuses on the “effective control” element of the decision. Reisman, *supra* note 37, at 870.

186. Benedict Kingsbury, *Sovereignty and Inequality*, in *INEQUALITY, GLOBALIZATION, AND WORLD POLITICS* 66, 86-91 (Andrew Hurrell & Ngaire Woods eds., 1999). As Kingsbury points out, “[a] decline in the traditional sovereignty system weakens the relationship of mutual containment between sovereignty and inequality.” *Id.* at 92.