**Democracy, Coffee, Banana, and Default: Sovereign Debt in Costa Rica, 1871-1911**

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July 2019

Costa Rica is the oldest democracy in Latin America. In spite of its exceptional polity, the country shares a history of default on the sovereign debt with the rest of the continent. What is more, democratisation started in 1901, the same year when the government suspended payments on obligations it had issued in London thirty years earlier. This article investigates if these two events - democratisation and default - were somehow connected. The Costa Rican case is at odds with the influential literature that sprang from the work by North and Weingast (1989), according to which democracies make more responsible borrowers than autocracies. The authors claim that credit costs fell in post-Glorious Revolution Britain because the Parliament limited the Executive's power to borrow and to spend. More recently, Stasavage (2008) and Karaman and Pamuk (2013) argue that this democratic advantage was specific to early modern Britain. This article contributes to this literature by applying the democratic advantage to the context of Latin America in the first financial globalisation, from circa 1870 to 1914. Similarly to most of the continent in that period, Costa Rica borrowed abroad and depended on commodity exports to honour its debt.

In order to assess why democracy came with default in Costa Rica, we research archival material produced by the country's Finance Ministry, Congress and press, besides reports of Corporation of Foreign Bondholders, from London. Based on these primary sources, we built a narrative on Costa Rican sovereign debt during the first financial globalisation that is, to our knowledge, the most comprehensive study on the topic.

Evidence indicates the exitance of a cleavage across main political groups over the issue of taxation on exports. Coffee growers and traders composed the most powerful group in Congress, where a liberal opposition operated but faced governmental persecution. President Iglesias (1894-1902) resorted to authoritarianism to tax coffee in spite of legislative votes against the duty. However, Iglesias granted a fiscal exemption to the booming banana sector, an enclave economy owned by Minor Keith, the founder of the United Fruit. Keith and Iglesias were not only allies; they were also family relatives. Coffee prices slumped in the turn of the century, uniting growers and liberals. Several attempts of coups disturbed political stability until an agreement between the government and the opposition restored peace in 1901. Iglesias stepped down, and a succession of liberal administrations governed the country more democratically in the 1900s and 1910s. The political compromise involved the end of the coffee tax, which left the Treasury without funds to pay services on the foreign debt. Hence, the default was the price of democracy. The politically powerful coffee sector remained free from taxation thereafter, and the government only resumed honouring its financial obligations in 1911, when it finally taxed banana exports.

The article is divided into three sections, besides this introduction and the conclusion. The first two sections describe Costa Rica's political and financial history. The fourth section analyses the political economy of taxation to explain the 1901 default. The final section compares Costa Rica with early modern Britain, the most studied case in the literature, and autocratic Nicaragua, a Central American coffee exporter that did not default on its debt in the 1900s.

[1] This research has been financed by British Academy's Newton Fund. It is part of the project *Democracy, autocracy and sovereign debt: How polity shaped government-creditor relations in the first age of globalisation*, which has been developed in partnership with Dr. Ali Coskun Tuçer (UCL). The author is deeply indebted to Tunçer for his conceptual contributions.

**Autocracy and Democratisation**

Costa Rica's democratic exceptionalism attracts attention and the literature on why it has democratised relatively early is extensive. Facio (1942) was the first to propose that the lack of precious metals and a small indigenous population kept the country isolated from the Spanish Crown during colonial times, when Spaniards scaping persecution built an egalitarian rural democracy. However, posterior research has shown a more mixed picture. Gudmundson (1986) found evidence that society was divided across regions and races. Stone (1969), Carballo (1972) and Cardoso (1976) claim that the rise of the coffee economy in the mid-nineteenth century created a new elite that impoverished the peasantry. Although Lehoucq (1998) and Molina and Palmenr (2007) argue that small landholding prevented the coffee boom from causing a steep rise in the ratio between rents from land and wages, Guillén (1989) confirms that a coffee elite controlled trade, finance and politics. Costa Rica was not the tropical New England Facio depicted, but it was clearly less unequal than its neighbours, as Deborah (1997) and Cruz (2005) have shown for the cases of Guatemala and Nicaragua, respectively

The democratic myth is also at odds with Costa Rica's post-independence political history. The republic broke from the Central American Federation in 1848, around the period when coffee became the country's main staple. The first Costa Rican presidents were members of opposing clans of coffee growers that disputed the support of army leaders to launch a succession of coups.[2] The army became a more impersonal institution after it defeated an invasion of US mercenaries in the 1850s, but the conflict among coffee barons continued to shake the country in the following decade.[3] Politics only pacified under the long dictatorship of Tomás Guardia (1870-82), a war hero who governed with the support of the army and the whole coffee aristocracy.[4]

In the beginning of Guardia's regime, Congress wrote the 1871 Constitution, which persisted until 1919. The chart established a two-stage electoral system, in which first-degree elected second-degree voters, who chose the members of Congress and the head of state. Franchising was limited by gender, age, literacy and income, but the income threshold for first-degree voters was low and around one-fifth of the population voted, not far from open democracies such as the United States.[5] What is more, most second-degree voters were members of an intermediary class composed by medium land-owners and shopkeepers.[6] However, the constitution empowered the Executive vis-à-vis Congress, whose General Assembly met only three months every year. A Permanent Commission composed of five deputies operated the remaining of the time. It became common for presidents to influence the formation of the Permanent Commission, which allowed them to rule by decree with the support of a handful of allies.[7] Guardia did so until 1876, when he suspended constitutional rights and closed Congress, governing as a typical autocrat until he died in office in 1882.[8]

Liberals governed Costa Rica in the decade that followed Guardia's death. Presidents Próspero Fernández (1882-85) and Bernado Soto (1995-89) introduced a series of anti-clerical laws and promoted secular education. The separation of Church and state caused a reaction among the clergy and their followers, who organised the Catholic Union, a party that supported the conservative candidate José Rodríguez (1890-94) in the 1889 elections. Rodríguez wan the majority of votes thanks to the supports of the Catholics, but president Soto declared the victory of the liberal candidate Ascención Esquivel. Rodríguez's nephew and future president Rafael Iglesias (1894-1902) organised a popular rebellion that forced the government to capitulate. The liberals avoided what could have become a civil war by reaching a compromise that enabled Rodríguez to take office in the following year.[9]

[2] Jiménez (2005, pp. 42-44)
[3] Loría (1991).
[4] Carballo (1981, pp. 263-64), Mora (1990, p. 31).
[5] Jiménez (2005, pp. 48-9), Deborah (1997, p. 53).
[6] Guillén (1989, p. 173)
[7] Lehoucq (1999, pp. 33-41).
[8] Loría ( 1995, 341-363).
[9] Mora (1990, p. 46-8).

Rodríguez (1891-1894) suspended constitutional rights and exiled opponents already in his first year in office. He then closed Congress after a landslide victory of the liberal Republican Party in the 1892 legislative elections and governed without the parliament for two years. During this period the dictator passed an election reform that extended suffrage but also increased the grip of the president, who became in charge of supervising ballots.[10] In this way, he guaranteed the victory of his Civil Party in the elections that reopened Congress in 1894.[11] Rodríguez also interfered in that year's presidential election, in which Catholic candidate won. The president declared the Catholic Union illegal, which nullified their victory and allowed his co-religionary Iglesias to take office in the following year. In his autobiography, Iglesias acknowledged that his election was not "the genuine wish of the majority."[12]

Iglesias was also an authoritarian president. He suspended civil guarantees several times, always in the absence of the General Assembly, and interfered in local elections to prevent the liberals from forming a majority in Congress. Iglesias passed a constitutional amendment that opened the way for his re-election in 1897, just before that year's general voting. The liberals boycotted the elections, in which Iglesias ran as the single candidate. During his second his Iglesias persecuted the most radical liberals, such as Mora and Alvarado, who plotted coups against the president.[13] The president called for a new Constitutional Assembly that would write a new chart to expand the power of the Executive and allow unlimited presidential re-election. The liberal reaction was strong, and contemporaries feared that a civil war was about to start. In an abrupt strategical change, Iglesias suspend his plans for a new constitution, agreed to step down, and proposed an alliance with moderate liberals, who left Republican Party to form the National Union Party with Iglesias' followers. The different groups that composed the new party failed to agree on a common candidate to run against the radical liberal Alvarado. Iglesias then proposed the candidature of Ascención Esquivel (1902-1904), the liberal who had run for office against Rodríguez in 1889. The president justified his surprising appointment in the following words: " Esquivel is the person who can better synthesize the idea of a transition in Costa Rica."[14] Esquivel won the election and took power in 1902, pacifying the opposition to Iglesias and normalising the political game.[15]

*Transition to democracy*

Costa Ricans celebrate the outcome of the 1889 election on a national holiday called Democracy Day (*Día de la Democracia*). This official view is consistent with the Polity IV index, which qualifies Costa Rica as an imperfect democracy in after 1890 and a full-democracy, at the same level as Britain and the United States, after 1893. The qualification of Costa Rica as a democracy in the 1890s is clearly inconsistent with simple facts –Rodríguez governed without the Legislative tutelage and Iglesias was elected in rigged elections. Perhaps Iglesias was less authoritarian than his predecessor, but his government operated in a context similar to an anocracy, which Polity IV defined as a "combination of democratic and autocratic authority."[16]

Instead of using Polity-IV uncritically following Costa Rica's official calendar, we follow a periodisation proposed by Mora (1990) in *The Apogee of the Liberal Democracy in Costa Rica, 1870-1914*, a book divided in the following chapters: "dictatorship and its heroes" (1870-1888), "liberal authoritarianism" (1889-1901), and "liberal democracy" 1902-1914. The compromise arranged between Iglesias and the moderate liberals ahead of the 1901 election is a better watershed for the beginning of democratisation in Costa Rica than the 1889 elections. The transition following 1901 was a process rather than a sharp change, for President Esquivel intervened in the second-degree election of 1904 in favour of his protégé González (1906-1910), although he had won the first-degree

[10] Jiménez (2005, pp. 109-111).
[11] Salazar (1986) and Jiménez, 2005, p. 226.
[12] Quoted in Peralta, 1968, p. 40.
[13] Loría, 1981, pp. 242-248.
[14] Quoted in Vega (1981, p. 120)
[15] Loría (1981, p. 248-9), Jiménez (2001, p. 44)
[16] Marshall (2017. p. 9).

voting.[17] However, these new presidents did not suspend civil rights and impose legislation to Congress as did Iglesias in the 1890s. Democratisation was also institutional: in 1905 Congress approved laws that instituted the role of independent fiscals in elections and, in 1909, it abolished the Permanent Commission, empowering the General Assembly.[18] Democratisation allowed the opposition Republican Party to form a parliamentary majority in 1907 and to elect its candidate Ricardo Jiménez (1910-1914) for office in 1909. Iglesias was still in politics, but he never managed to win presidential elections after the advent of democracy.

**Sovereign debt, railways, coffee and economic policy**

The transition from authoritarianism to democracy in the turn of the century was concomitant to a financial crisis in which the sovereign debt went in default. This section reviews the economic history of Costa Rica, providing background for the following section to assess why the government suspended payments while the country was starting to democratise.

The history of Costa Rica's foreign-denominated sovereign debt started in 1871, in early Guardia regime, when the government borrowed in London to finance the construction of a railway from the Central Valley to the isolated Caribbean coast. The line would link the coffee-producing provinces of San José, Guanacaste, Heredia, Cartago, and Alajuela to the coastal city of Limón. Until the building of that railway, the country exported coffee through the Pacific port of Puntarenas, which was only reachable on the back of mules. The 1871 loan was for £1 million, issued at 6 per cent interest through the London bank Mischoffsheim & Coldschmit in two equal instalments. The discount rates were low: 73 and 74 percent, respectively.[19] It is not clear how much the government received in the operation, for the commission was undisclosed. According to Guell (1975), the bank only transferred half of the nominal value of that loan to Costa Rica.[20] That revenue did not cover the costs of the projected railways, and the government issued a second loan through Knowles & Foster at the high interest rate of 8 percent interest but more reasonable 82 percent discount rate. The bank issued £1.5 million in bonds, but Guell (1975) states that the government received only £900,000.

Stewart (1964) describes a scam in his biography of Minor Keith, the contractor from the United States in charge of building the railway. Keith negotiated the 1871 loan in London on behalf of Costa Rica and paid £100,000 to Guardia so that the president would agree on the operation. The government lacked funds to build the railways and pay services on the debt, which went on default in 1874.[21]

Table 1 shows the disproportional rise in expenditure in public works, most of which involved the railway. The government attempted to cover that cost by collecting more from its monopoly on liquor, besides transitorily increasing the flows from other sources of revenue such as the sale of public land, customs on imports, and a tax on coffee exports. Nevertheless, revenue was not enough to match the cost of both the railways and the debt: the fiscal deficit was about two times the revenue in 1872. The deficit fell thanks to the default, but it remained significant thereafter. The government financed its unsound accounts by borrowing at home, and the domestic debt totalled the equivalent of half a million British pounds in mid-1880s. However, the lack of credit at home maintained interests high, at around 13 percent, limiting the government's capacity to borrow. It then printed money to cover expenditure, and the monetary stock doubled from 1883 to 1885, when the construction of the railway was nearly completed.[22] Such loose monetary policy depreciated the peso by 76 percent in those three years, which raised the costs of building the railway in domestic currency, creating a vicious cycle.

[17] Molina and Palmer (2007, p. 76),
[18] Jiménez, 2005, Lehoucq, 1998, Molina (2007).
[19] CFB (1885, pp. 31-51).
[20] Guell (1975, p. 46).
[21] CFB (1885, pp. 31-51).
[22] Calculated from *Memoria de Hacienda*.

**Table 1 – Costa Rican Fiscal Data, 1870-1911**
**(pesos until 1894, *colones* thereafter)**

| | Revenue | | | | | | Expenditure | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Customs | | | Domestic | Non- | Total | Foreign | Domestic | Public | Defense | Other | Total |
| | Coffee | Banana | Imports | taxes | tax | | debt | debt | works | | | |
| 1870 | | - | 332 | 245 | 479 | 1056 | - | 109 | 244 | 282 | 713 | 1349 |
| 1871 | 83 | - | 539 | 276 | 618 | 1517 | - | 126 | 281 | 246 | 1099 | 1753 |
| 1872 | 166 | - | 755 | 413 | 918 | 2253 | - | 82 | 5261 | 364 | 1108 | 6815 |
| 1873 | 179 | - | 972 | 462 | 1100 | 2714 | - | 179 | 2301 | 381 | 1185 | 4046 |
| 1874 | 162 | - | 621 | 464 | 1227 | 2475 | - | 293 | 680 | 367 | 1164 | 2503 |
| 1875 | 57 | - | 641 | 458 | 1302 | 2458 | - | 247 | 735 | 482 | 1123 | 2586 |
| 1876 | 174 | - | 558 | 447 | 1174 | 2353 | - | 232 | 725 | 463 | 1044 | 2465 |
| 1877 | 164 | - | 847 | 498 | 1101 | 2610 | - | 79 | 631 | 535 | 2451 | 3697 |
| 1878 | 166 | - | 922 | 532 | 1016 | 2635 | - | 57 | 699 | 510 | 1161 | 2426 |
| 1879 | 164 | - | 820 | 544 | 994 | 2522 | - | 50 | 1395 | 713 | 1290 | 3447 |
| 1880 | - | - | 458 | 318 | 601 | 1377 | - | 107 | 227 | 309 | 2082 | 2724 |
| 1881 | 20 | - | 408 | 294 | 753 | 1475 | - | 73 | 389 | 246 | 1049 | 1757 |
| 1882 | - | - | 785 | 314 | 941 | 2040 | - | 87 | 370 | 445 | 1045 | 1947 |
| 1883 | 19 | - | 848 | 594 | 1085 | 2547 | - | 43 | 361 | 838 | 1328 | 2572 |
| 1884 | - | - | 851 | 140 | 1517 | 2508 | - | 115 | 348 | 622 | 2034 | 3120 |
| 1885 | - | - | 1314 | 703 | 1295 | 3312 | - | 277 | 282 | 300 | 2353 | 3213 |
| 1886 | - | - | 1708 | 734 | 1283 | 3725 | 635 | 86 | 427 | 461 | 2458 | 4066 |
| 1887 | - | - | 1807 | 778 | 1559 | 4144 | 880 | 114 | 981 | 574 | 2786 | 5335 |
| 1888 | 23 | - | 2154 | 803 | 1851 | 4830 | 732 | 94 | 590 | 494 | 2887 | 4798 |
| 1889 | - | - | 2288 | 863 | 1838 | 4989 | 650 | 212 | 549 | 457 | 3279 | 5148 |
| 1890 | 13 | - | 1449 | 823 | 1982 | 4267 | 1010 | 152 | 465 | 406 | 4046 | 6078 |
| 1891 | 345 | - | 1909 | 847 | 2122 | 5231 | 586 | 134 | 390 | 664 | 4728 | 6501 |
| 1892 | 703 | - | 2098 | 911 | 2587 | 6318 | 185 | 49 | 342 | 723 | 3939 | 5238 |
| 1893 | 589 | - | 2221 | 909 | 2398 | 6129 | - | 26 | 497 | 705 | 3377 | 4604 |
| 1894 | 737 | - | 2766 | 890 | 2494 | 6902 | - | 16 | 628 | 716 | 3855 | 5215 |
| 1895 | 764 | - | 2749 | 772 | 2586 | 6893 | 551 | 30 | 1080 | 1204 | 4355 | 7220 |
| 1896 | 1137 | - | 2445 | 798 | 2269 | 6662 | 730 | 80 | 1055 | 1330 | 3267 | 6462 |
| 1897 | 831 | - | 2223 | 712 | 2199 | 5964 | 757 | 109 | 442 | 927 | 3068 | 5303 |
| 1898 | 711 | - | 2927 | 718 | 2032 | 6387 | 609 | 53 | 723 | 1022 | 4890 | 7297 |
| 1899 | 62 | - | 2689 | 542 | 1593 | 4886 | 286 | 65 | 664 | 843 | 2758 | 4616 |
| 1900 | - | - | 3043 | 441 | 1576 | 5059 | - | 533 | 762 | 805 | 2838 | 4938 |
| 1901 | - | - | 3477 | 173 | 1241 | 4897 | - | 460 | 905 | 829 | 3254 | 5448 |
| 1902 | - | - | 3692 | 242 | 1321 | 5256 | - | 432 | 592 | 793 | 3035 | 4853 |
| 1903 | - | - | 3970 | 302 | 1913 | 6185 | - | 567 | 1013 | 1018 | 3316 | 5914 |
| 1904 | - | - | 4347 | 271 | 2287 | 6906 | - | 619 | 2152 | 1252 | 4489 | 8513 |
| 1905 | - | - | 5192 | 152 | 2597 | 7941 | - | 718 | 1979 | 1268 | 5228 | 9193 |
| 1906 | - | - | 3204 | 126 | 1837 | 5167 | - | 683 | 826 | 941 | 3607 | 6057 |
| 1907 | - | 226 | 4536 | 123 | 2442 | 7327 | - | 848 | 976 | 1225 | 4783 | 7832 |
| 1908 | - | 194 | 4985 | 135 | 2742 | 8073 | - | 101 | 1969 | 1281 | 5509 | 8859 |
| 1909 | - | 202 | 5969 | 144 | 3344 | 9659 | - | 2157 | 1706 | 1288 | 4443 | 9594 |
| 1910 | - | 232 | 6116 | 214 | 3364 | 9926 | - | | 1917 | 1380 | 6023 | 9320 |
| 1911 | - | 243 | 5584 | 179 | 3577 | 9583 | - | | 2147 | 1364 | 6674 | 10184 |

*Sources: Memoria de Hacienda, Trigo (1995), and CFB.*

In an attempt to solve this fiscal deadlock, in 1884 President Fernández commissioned Minor Keith to negotiate a debt settlement and a new loan in London. The deal included a payment to Keith in the form of 800,000 acres of public land on the Caribbean coast, which corresponded to about 7 percent of national territory. Thanks to this deal Keith created an enclave banana economy that would become the basis for the creation of the United Fruit in late 1890s.[23] The agreement also granted the control of the railway and the port of Limón to Keith, who became known as the "uncrowned king of Central America" and the "regent" of Costa Rica. [24] It is worth noting that in 1883 Keith married Cristina Castro, the daughter of José María de Castro, who served as the foreign minister and had been the president of the Supreme Court and president of Costa Rica for two terms. That connected Keith to future President Iglesias, who was Castro's nephew.[25]

Keith arranged a debt settlement in 1885. The bondholders agreed on a reduction of the principal of the debt to £2,691,300 million, a 50 percent face-value haircut of the original loans. The deal consolidated the new debt at £ 2 million and established that the government would pay the difference between the two values (£691,3000) as payments towards the costs of the commissions

[23] Colby (2011, p. 67).
[24] Dosal (1992, p. 55), Williams (1925, p. 40).
[25] Stewart (1964, p. 50).

involved in the conversion and the interests of the first two years following the agreement. The contract separated the new bonds into two tranches, A and B. The government would pay 5 percent interests on the A bonds and 4 percent on the B from 1886 to 1888, after which it would pay 5 percent on both issues. It was also agreed that the government would amortise 1 percent of the principal of both A and B debt annually from 1898. Finally, the deal consolidated the interests in arrears in £2.1 million, more than the value of the new debt. The government would pay for it by selling shares of the newly-created Costa Rica Railway Company, which was chartered in London under Keith's presidency.

The government failed to borrow fresh money in London. Instead, it borrowed domestically following a deal with Banco de la Unión, which eventually became Banco de Costa Rica. President Fernández granted to the bank exclusivity on monetary emission and the privilege of managing the government's transaction. In return, the bank opened a line of credit at 6 percent, cheaper than the credit until then available in the country. The deal guaranteed a monopoly on monetary emission until 1901 and limited the size of emission in four times the bank's capital. However, the bank over-printed: its notes increased four times in 1887, by half in 1888, and by one-third in the following two years. Monetary printing backed a rise in public credit, and the domestic debt soared by 5.6 times from 1886 to 1892.[26] The rise in paper money also weakened the national currency. It is noteworthy that the exchange rate was already depreciating before coffee prices started to fall in the mid-1890s, as shown in Table 2. Coffee responded to the majority of Costa Rica's exports and the fall in revenue contributed to the weakening of the peso, but the primary source of depreciation was Banco de Costa Rica's loose monetary policy.

**Table 2 – Foreign Trade and Exchange rate, coffee prices, 1892-1911**

| | Exports | | | | Imports | Coffee | Exchange |
|---|---|---|---|---|---|---|---|
| | Coffee | Banana | Others | Total | | price[a] | rate[b] |
| | (£ thousand) | | | | (£ thousand) | (£/bag) | ($/£) |
| 1892 | 802 | 71 | 38 | 911 | 1078 | 3.4 | 7.0 |
| 1893 | 760 | 72 | 43 | 874 | 1167 | 3.8 | 9.2 |
| 1894 | 799 | 64 | 201 | 1064 | 845 | 4.8 | 10.9 |
| 1895 | 854 | 124 | 212 | 1189 | 792 | 4.5 | 10.4 |
| 1896 | 885 | 116 | 150 | 1151 | 976 | 4.5 | 9.4 |
| 1897 | 820 | 160 | 115 | 1095 | 998 | 3.4 | 9.6 |
| 1898 | 842 | 190 | 100 | 1132 | 852 | 2.4 | 12.7 |
| 1899 | 589 | 241 | 156 | 986 | 827 | 2.0 | 13.1 |
| 1900 | 760 | 271 | 233 | 1264 | 1217 | 2.4 | 10.6 |
| 1901 | 582 | 316 | 253 | 1151 | 909 | 1.8 | 9.9 |
| 1902 | 654 | 386 | 124 | 1163 | 907 | 2.8 | 9.7 |
| 1903 | 870 | 475 | 159 | 1504 | 1005 | 3.0 | 9.8 |
| 1904 | 634 | 623 | 132 | 1389 | 1229 | 3.0 | 9.8 |
| 1905 | 775 | 749 | 149 | 1673 | 1077 | 2.6 | 9.7 |
| 1906 | 691 | 913 | 208 | 1811 | 1496 | 3.1 | 9.7 |
| 1907 | 912 | 1045 | 214 | 2171 | 1512 | 3.2 | 9.7 |
| 1908 | 421 | 963 | 213 | 1596 | 1158 | 2.9 | 10.3 |
| 1909 | 543 | 896 | 243 | 1683 | 1257 | 2.8 | 9.9 |
| 1910 | 566 | 871 | 287 | 1723 | 1625 | 2.4 | 10.0 |
| 1911 | 585 | 891 | 361 | 1837 | 1826 | 2.8 | 9.9 |

*Sources: CFB for trade and exchange rate, Memoria de Hacienda for coffee price.*
[a] *Average coffee price in Costa Rica.*
[b] *Annual average*

The weak peso increased the cost of servicing the gold-denominated foreign debt. In 1888, when the first interest payment was due, the cost of the debt was the equivalent of 17 percent of the government's total revenue, including monopoly rents and sale of public land, and 26 percent of

[26] Calculated from *Memoria de Hacienda*.

taxation. As the national currency depreciated, these ratios increased to 24 and 44 percent in 1892. The Corporation fo Foreign Bondholders correctly understood that "the excessive issue of paper money is the chief cause of the financial difficulties of the Republic" because "the principal difficulty (the government has) encountered (to service the debt) has been the high rates of exchange."[27]

*Gold standard, coffee tax and default*

Rodríguez and Iglesias administrations launched two policies designed to improve fiscal accounts and preserve the government's capacity to honour the debt: the taxation of coffee exports and the adoption of the gold standard. The coffee tax was first introduced in the 1870s, during the Guardia regime, when it accounted for about 6 percent of total revenue, as has been shown in Table 1. The government suspended that tax in 1881 and briefly reintroduced it again in 1883, 1885 and 1890, although at much lower levels. Rodríguez restablished the tax as a permanent duty in 1892 and raised it significantly in 1893, according to a law that fixed the duty at 4 shiling per 46-kilogram bag of coffee.[28] The revenue from the coffee tax expanded considerably, raising from only 0.3 percent of revenue in 1892 to 6.6 percent in 1893, after whcih it increased to a peak of 17.1 percent in 1898.[29]

However, the new tax on coffee was not enough to produce fiscal surplus, and the government suspended payments on the London debt between 1895 and 1897. Rodríguez went to London to negotiate a new settlement with the foreign creditors just after he left office. The former president asked for a 50 percent haircut, similar to that arranged a decade earlier, and for the reduction of interests to 2.75 and 2.5 percent on the A and B bonds, respectively. Interests would then increase after 1897 until they reached 5 percent on both A and B bonds in 1905 and 1906. The bondholders refused to accept the large discount on the principal of the debt but accepted the proposal on interests, which would be backed by the coffee tax.[30] Nevertheless, Iglesias did not ratify the agreement. In his annual address to Congress, the president declared his plans to adopt the gold standard, which would appreciate the exchange rate and improve the country's capacity to meet external payments. He stressed that the default was momentary, and that the government would resume paying services once the monetary reform was underway.[31]

According to Iglesias' plan, default would be instrumental in putting the country on gold. Instead of paying services to the foreign creditors, the government used the revenue from the coffee tax to amortise the domestic debt it owed to Banco de Costa Rica. The president expected that the liquidation of that debt would allow the bank to reduce the amount of bills in circulation, which would then appreciate the *colón*, the country's new currency.[32] The plan backfired for two reasons. Firstly, the threat of war with Nicaragua forced the government to raise the defence budget, and the construction of a state-owned railway to the Pacific turned out to be more expensive than expected.[33] The spike in expenditure left the government short in funds to buy back the debt the Banco de Costa Rica owned. What is more, the growing production of coffee in Brazil reduced world prices in the second half of the 1890s, as shown in Table 2.

In spite of these financial troubles, however, the government completed of a new settlement in London and resumed payments on the foreign debt in 1897. The agreement with the bondholders reduced interests on the A and B bonds to 3 and 2.5 percent, respectively, and consolidated interests in arrears in £131,562, of which the government paid £31,561 upfront. The settlement converted the remaining £100,000 into new bonds that would be amortized by £5,000 per year, ending in 1917.

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27 CFB (1893, pp. 94, 105).
28 *ANCR*, Congreso 2427, Law n. 42 of 3 October 1893.
29 See Table 1.
30 Corporation of Foreign Bondholders, 1894, p. 99.
31 ANCR, Congreso 3305, *Mensaje del Señor Presidente de la República Don Rafael Iglesias Dirigido al Congreso Constiotucional de 1895*, 1 May 1895.
32 The domestic debt fell from 1.8 to 1.1 million *colones* between 1895 and 1898. Corporation of Foreign Bondholders, 1895, p. 106, 1897, p. 104.
33 See Table 1 for fiscal data.

Once again, the contract specified that the government would use the revenue from the coffee tax to honour the debt.[34]

The settlement allowed the government to borrowed £150,000 from Barkley at a reasonable 6 percent interest rate. The bank charged a 4 percent commission and held all the debt. The government deposited the net revenue from the loan into Banco de Costa Rica so that it would appreciate the national currency, in accordance to the government's plan to put Costa Rica on gold.[35] In its report to Congress of 1900, Finance Minister Eloy Truque claimed that the measured had been previously agreed with the bank's managers, but he regretted that the bankers printed additional currency to maintain the exchange rate depreciated.[36] Iglesias had to wait for the bank's monopoly on monetary emission to expire to adopt the gold standard in 1901. The government passed a new bank law in Congress that limited monetary emission to bullion deposits and extended the right of monetary emission to the Treasury and Banco Anglo-Costarissence, the second largest bank in San José.[37]

A few months after Costa Rica went on gold, the government defaulted on the foreign debt once again. This time the debt remained unpaid for a decade, a period during which the country remained on gold. The combination of gold standard and default is at odds with the literature, according to which governments in capital-importing countries pegged their currencies to gold as a "seal of approval" that signalled their commitment to debt contracts and reduced the cost of foreign credit.[38] The following section will show that the political economy of the coffee tax explains this strange combination of gold standard and default. For now, it is enough to state that the government defaulted because it stopped taxing coffee exports in 1901. It never raised that duty again. Instead, it imposed a tax on banana exports in 1911, which it used to guarantee a new settlement on the debt arranged that year. Costa Rica then issued a new loan in Paris for £1.4 million, at 5 percent interests and 80 percent discount rates. Mr Albert Kahn, L. Behrens & Sons, and Speyers underwrote the bonds, which were not floated in London, probably a retaliation after decades of debt mismanagement. However, the loan was significant for the government, which used the credit to convert the more expensive domestic debt, including the obligations it raised to complete the Pacific Railway.[39] The new debt did not go into default until the world crisis of the 1930s.[40]

**The Political economy of coffee, banana, and sovereign debt**

Coffee was not only the most important exporting commodity in Costa Rica; it was the transforming element that defied the country economically and socially in the second half of the nineteenth century. The bulk of the economic elite was in a way or another connected to the coffee sector. The inflow of foreign exchange depended on the price of that good, and, crucially for this article, the decisions of the government to tax coffee defined its capacity to pay the sovereign debt.

The Guardia government introduced a tax on coffee exports in accordance with the contracts of the loan Costa Rica issued in London in 1871 and 1872, which specified that the duty would finance service payments.[41] As described in the previous section, the revenue was not enough to pay for the debt, which went in default in 1874. However, the government continued to collect the coffee tax until 1880.[42] The coffee sector became free from that duty in 1881, one year before the death of Guardia. We are not aware of secondary or primary sources that elucidate the reasons behind the suspension of the coffee tax. However, we know that liberal politicians gained influence in the late Guardia era, which explains why, before dying, the dictator called for an election whose only

[34] CFB (1997, p. 93).
[35] CFB (1900, p. 78-79).
[36] *Memoria de Hacienda,* 1900, pp. XII-XV.
[37] CFB (1901, p. 78-79).
[38] Bordo and Rockoff (1996).
[39] CFB (1913, p. 97).
[40] Ibidien (1933, p. 179).
[41] ANCR, Congreso 8226, *Informe poresentado por honorable senor secretario de estado en os despachos de Hacienda y Comercio Don Salvador Laras, al Congreso Constitucional de Costa Rica*, 5 jul 1874.
[42] See Table 1.

candidate was Fernández, a liberal. What is more, coffee growers were umbilically linked to the liberals. Stone (1975) may have exaggerated when he wrote that "everyone was a cafetelero (*coffee grower*)," but most liberals were well-educated sons of the families that had grown rich in the coffee business. Both Presidents Fernández and Soto were members of that coffee elite.[43] Hence, it seems that the liberals were behind the end of the coffee tax in 1881.

The Fernández administration did raise that duty again in 1883 and 1885, although only limitedly.[44] The years are telling, for they correspond to the period during which Keith negotiated a settlement with the foreign bondholders. It is likely that the government taxed coffee to convince the bondholders that it was willing to commit to the debt contracts signed in the 1871 and 1872 loans, which specified the imposition of that duty. The commitment was insincere, however, for the tax disappeared after the debt settlement. Between fiscal austerity and coffee profitability, Fernández administration chose the latter.

The government would only tax coffee again in 1890, at the beginning of Rodríguez administration. The revenue from that duty soared in 1893, when the president establishes a high tax rate by decree while Congress was closed. Rodríguez dissolved the Legislative Power to persecute liberals rather than to tax coffee, but he did take advantage of his unlimited powers to impose a heavy coffee tax. After all, the liberal Assembly that had been elected in the previous year would most likely have blocked the presidential decree raising the coffee tax.

So far, the analysis of the political economy behind the coffee tax is based on assumptions rather than hard evidence due to the lack of archival material on the topic. The main source on Costa Rica politics of the period is the discussions and votes carried out in Congress, a primary material held by the National Archive of Costa Rica (ANCR). The fact that Costa Rica was an autocracy until the 1890s means that decisions were taken behind closed doors. That changed during the Iglesias presidency, which operated as an anocracy that maintained the opposition active in Congress and the press free, although he governed in an authoritarian manner. Indeed, after 1894 the discussion and voting in Congress and their repercussion in the press tell us much about the politics of the period, including the political economy of the coffee tax.

A deputy presented a bill on the coffee tax for the first time in 1894, the first year of the new Assembly that compose the Legislative Power after the two years of interruption. Deputy Zacaríaz García, from the coffee-producing province of Cartago, protested against the tax and proposed its elimination in the following year, until when the government would collect the duty in national currency rather than in British pounds.[45] That would prevent the exchange rate depreciation from raising the value of the tax in pesos. The bill was not voted, although a few deputies declared their positions: three people supported García's bill, two of whom (Manuel Brenes and Ramón Loría) were coffee producers and traders from the also coffee provinces of Cartago and Alajuela.[46] The third deputy that supported the petition was Antonio Segura, who apparently was not in the coffee business but was from Alajuela. Three deputies (Félix Pacheco, Víctor Orozco, and Carlos Sáenz) were against the bill, all of whom were members of the Iglesias' Civil Party and had been elected for San José.[47] The coffee sector was relatively less important in that province than elsewhere in the Central Valley because of the capital city of San José, which made it more urbanised.[48] Surprisingly, Carlos Sáenz had business in the coffee sector, which means that his personal interests conflicted with the government's fiscal needs; between both, the deputy chose (momentarily, as we will see below) the latter.

Congress discussed and voted a second bill abolishing the coffee tax in 1898. Falling coffee prices conditioned strong support for the bill, and the Assembly approved it by a landslide: 22 against

[43] Yashar 1997, p. 52; Ameringer (1982, p. 20)
[44] See Table 1.
[45] *La República*, 5 June 1894, vol. 8, no. 2.320, p. 2, cols. 2, 3.
[46] Gutiérrez (2007) and Jiménez (2003).
[47] Loría (1995, P. 385), Jiménez (2003), Solórzano (2004).
[48] Gutiérrez (2007).

6.[49] This time Deputy Sáenz switched sides and voted "yes". With the exception of two votes from Cartago and Heredia, the coffee provinces (these plus Alajuela) voted in favour of the bill. The support of the coffee sector is even clearer once the analysis includes individual names. We have found that 11 deputies had business in the coffee sector, all of whom voted "yes". Party politics also played a role. The project was presented by deputy Manuel González, an imminent liberal from San José who was not in the coffee business but opposed Iglesias administration.[50] We have identified links between seven deputies and the liberal opposition, all of whom also in favour of the bill. Although the opposition voted in a single block, that did not apply to the members of the government's party, which we have identified a group of ten deputies, seven of whom voted in favour of the bill and only three against it.

The few congressmen who voted "no", in favour of the coffee tax, had strong reasons to do so. Two were from or had business in Guanacaste (Rodolfo Alvarado and Octavio Quesada, respectively), the only province that did not produce nor exported coffee.[51] Guanacaste also benefited from strong fiscal accounts, for the government was building a railway to the Pacific coast, where it was located. Two other deputies had strong links with President Iglesias: Ismael Alvarado, the only "no" vote from Cartago, had business with Keith in the banana country;[52] and Víctor Orozco was a leader of Iglesias' Partido Civil in the labour movement of San José. The remaining votes were apparently ideological: Francisco Sáenz, from San José, had delivered speeches in favour of higher taxation not only on coffee, but also on land, banana and railways, which makes him a fiscal orthodox;[53] father Ezequiel Martínez, the only "no-vote" from the Heredia, was the last reminiscent of the Catholic Union, which had an anti-coffee elite bias.[54]

Summing up, the bill against the coffee tax received the support not only from the entire coffee sector and the opposition, but also from the majority of Iglesias' co-religionary. Nevertheless, the president vetoed the bill. The only compromise was the suspension of taxes on the inferior class of coffee, which suffered direct competition from Brazil but comprised a minority of Costa Rican coffee output.[55] The revenue from the coffee tax fell by 27 percent between 1898 and 1899, but the duty remained significant, accounting for 14 percent of total government's revenue in the latter year.

Iglesias blocked the original project to suspend tax coffee entirely because of the negative impact it would have in fiscal revenue and, more specifically, on the government's capacity to pay the London debt. This appears in reports published by *La República*, a major Costa Rican newspaper that clearly supported the Iglesias government - for instance, it praised the president for taking office after the dissolution of the Catholic party, and again, a few years later, for suspending individual civil rights and for re-establishing it the following month.[56] *La República* criticised the parliamentary vote, stressing that it did not consider the sustainability of fiscal accounts. The paper then asked: "how will the bill replace that revenue?"[57]

On the other political spectrum, the movement against the coffee tax had a target: the London bondholders. The newspaper *La Prensa Libre* supported the bill, claiming that it would "reduce the effects of the crisis caused by the fall in coffee." The article encouraged the government to cover the eventual fall in revenue by "using its credit abroad."[58] A few days later, the editors of the newspaper explained that they were not in favour of further borrowing, but that the government should "postpone the payments of the debt abroad."[59] In other words, *La Prensa Libre* advocated a default to

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49 ANCR, Congreso 2427, May 18 – June 16 1898. See Table A1 for the details of the voting.
50 Fonseca (1974).
51 Cabrera (2007, p. 279).
52 *La Gaceta* (3 March 1905).
53 ANCR, Congreso 13677, Seción 61, 26 July 1900, art. 3, p. 106; *Memoria de Hacienda* (1890, p. 4).
54 Morales (2010).
55 ANCR, Congreso 3626, May 18 – June 12, 1899.The outcome of the 1898 project on coffee tax and the analysis on the coffee sector appear in a similar project presented in the following year.
56 *La República* (5 June 1894, p. 2, col. 2; 1 April 1898, p. 2, cols. 1, 2; 1 May 1898, p. 2, col. 1).
57 Ibidien (21 May 1898, p. 2, col. 1).
58 *La Prensa Libre* (1 June 1898, p. 2, cols. 1,2)
59 *La Prensa Livre* (3 June 1898, p. 2, col. 1).

compensate for the end of the coffee tax. In response, *La República* criticised the "arbitrary" suggestion of *La Prensa Libre*.[60]

The interconnected issues of debt payment and coffee taxes appeared, although not as explicitly, in Congress one year later, when Deputy González presented another bill to abolish taxes on all classes of coffee. In his petition, the deputy recognised that the "Public Treasury is in an afflictive circumstance" because "the country needs to meet strong commitments that one does not know for sure how it will honour." However, he declared that "before this consideration (that is, the need to pay the debt), rises unbreakable the conservation of taxpayer's lives, the unblocking of the sources of wealth in the country." This time the bill was not voted, or at least there is no registry of that in the archives.[61]

Congress finally liquidated the coffee tax in 1901, the last year of Iglesias administration and the beginning of Costa Rican democracy. Deputy Félix Mata presented a new bill in May 1901. Unfortunately, there is no records of the voting in which the Assembly approved the bill, but the discussion that followed its introduction indicates a division across deputies that resembles the 1898 voting. Deputy Alberto Saénz, a coffee exporter, supported Mata's project, which was criticised by deputies Félix Pacheco and Ezequiel Martínez.[62] Pacheco was a member of the Iglesias' party and a labour leader from San José, and Martinez was the priest who had voted against the same project in 1898.[63] Iglesias not only did not veto the bill, which became a legislative decree in May; this time he approved it in the following month, immediately ending the collection of the coffee tax.[64]

*The democratic pact: coffee, banana, gold, and default*

Why did Iglesias accept the Congress' decision to abolish the coffee tax in 1901 and not in 1898? Why did he respect the 1901 election and stepped down rather than pushing for re-election, as he had done in 1897? A chain of events suggests that the transition to democracy followed a multi-dimension compromised that involved taxes on coffee, the adoption of the gold standard and the default on the sovereign debt. To put it in chronological order, the list of events are: the legislative vote approving the end of coffee tax in early May 1901; later that month, President Iglesias calls for a Constitutional Assembly that he expected would grant him dictatorial powers;[65] in May Congress approves Iglesias' project on the gold standard, and in the following month the president ratifies the parliamentary bill suspending coffee tax; two months later, Iglesias invited the liberals to form a collision in the 1901 election; both groups created the alliance in September;[66] and in that same month the government suspends payments on the sovereign debt. The first-stage elections took place later that year, and in May 1902 Iglesias handed the presidency to the liberal Esquivel.

In the first dimension of the compromise, Congress traded the adoption of the gold standard for the end of the coffee tax. This appears in Mata's tortuous bill, according to which:

> "The tax over coffee exports should have disappeared when gold was put in circulation, for while it was justified when coffee was the only important product sold for gold abroad and the only one that benefited from high rates of exchange, with costs to all other national industries, it is logic that today, as gold in circulation has solved the unbalance that used to exist, the coffee industry has bared all the burden of the tax."[67]

In plain language, the adoption of the gold standard appreciated the *colón*, which compressed the profit of coffee exporters, putting an end to the period when the exchange rate depreciation increased

[60] *La República*, 4 June 1898, p. 2, cols. 1, 2).
[61] ANCR, Congreso 2680, May 6 – June 19, 1899.
[62] ANCR, Congreso 13677, Actas del Congreso Constitucional, Seción 1 art 5, p. 156, 2 may 1901.
[63] La República (9 June 1894, vol. 8, no. 2,320, p. 2, cols. 2, 3).
[64] CNCR, Juluy 19 1901, Congreso 2680.
[65] Mora (1990, p. 55).
[66] Loría (1981, p. 248-9)
[67] ANCR, Congreso 2680, 6 May 1901.

their margins. Besides the coffee sector, the Banco de Costa Rica also opposed the project on the gold standard because it terminated its monopoly on monetary emission, and hence its capacity to manipulate the exchange rate. It is worth noticing that members of the coffee sector controlled that bank, as explained in the previous section. The literature on the gold standard stresses its role in helping the government to pay the foreign-denominated debt.[68] Oddly, in Costa Rica the pegging of the *colón* to gold conditioned the end of the coffee tax, which precipitated a default on the foreign debt. The connection between the gold standard, the end of the coffee tax and the default appears in the also tortuous but revelling quote by finance minister Truque, in his annual address to Congress of 1901:

"Until now, the service of the external debt has been paid regularly with the product of the tax on the exports of coffee. Having abolished that tax, because the conditions of that industry, in terms of exchange, have been levelled out in respect to all other industries in the Republic since, due to the circulation of gold, that same exchange has been regularised at a level that do not apply as before superior advantage to the exported goods, and because that industry peremptorily demands efficient support in the crisis it faces, the service to that debt implies now a serious difficulty to the Government, unless until there is an economic regeneration in the country."[69]

The minister openly expected a default, which indeed materialised three months later. Politically, one may read it as follows: the government was so concerned in advertising the end of the coffee tax domestically that it did not take much into consideration the eventual costs of a default abroad, stating that it was going to happen to whoever read its reports. On the other side of the market, the connection between the abolition of that tax and the suspension of payments appears in a letter from the Corporation of Foreign Bondholders to Iglesias, sent just after the default, which stated that the creditors expressed:

"surprise and regret that the Government of Costa Rica should have again suspended the payment of the interest on its foreign debt. (…).Your Excellency further stated that the export duties on coffee had been specially assigned as security for the service of the Foreign Debt (…) the Council and Committee have therefore been astonished to hear that the coffee export duty has been abolished."[70]

The question then is why Iglesias was so keen on putting Costa Rica on gold, which brings us to the second dimension of the democratising deal of 1901. In August 1900 the government established that Costa Rica railways would fix fares to gold, which benefited its foreign owners, the most important of whom was Minor Keith. The gold standard prevented the *colón* from depreciating, and thus maintained the gold-fares stable in that currency, which ensured that the struggling Costa Rican economy would be able to pay gold-pegged train fairs. The government also benefited Keith when it exempted banana exports from taxation until 1911. Deputy José María Castro Fernádez, a member of Iglesias' Civil party, had proposed the measure in parliament April 1900. The bill received the support of deputy Felipe Gallegos, from the banana province of Limón, but was not approved in Congress. Iglesias then used his prerogative to decree the abolition of banana taxes in September, when the Permanent Commission approved it.[71] The law crystallised an already well-known inclination of Iglesias to support the enormous business his relative Keith had in the banana industry. One year earlier, the government lent money to Keith so that he could deal with losses caused by a hurricane that destroyed his banana plantations in Cuba. According to Colby (2011), the credit was crucial for Keith to form the United Fruit shortly after.[72] Iglesias did not pass the loan in Congress –

[68] Bordo and Rockoff (1996).
[69] *Memoria de Hacienda* (25 July 1901, p. XIX).
[70] CFR, 1901, pp. 74-76.
[71] ANCR, Congreso 13677, Actas del Congreso Constitucional, 1900-1901, Seción 61, 26 July 1900, art. 3, p. 106.
[72] Colby (2011, p. 69),

he was exercising his authoritarian power to benefit Keith before stepping down. The gold standard was part of that plot.

The outcome of this multi-dimension compromise can be summarized according to winners and losers. The coffee sector lost with the gold standard but managed to get rid of the coffee tax. The moderate liberal opposition won the 1901 election. Iglesias stepped down but avoided what could have been a civil war that would have made him a target to the radical liberals. Before leaving office, Iglesias approved the gold standard and guaranteed that banana taxes would not be taxed, making Keith a winner. The losers were the foreign creditors, who stopped receiving the revenue from the coffee tax.

The project that ended the coffee tax included a rise of 50 percent across all import duties, which was expected to create a stream of revenue with which the government would be able to pay the external debt.[73] However, the measure was too little and too late. That revenue did increase in 1902 but the rise was the equivalent of only half of the funds the government collected from coffee in 1900, the last year it did so, and even less if one considers the previous years. Most importantly, the debt went on default already in 1901, *before* any rise in import duties reflected in greater funds from taxation.[74] The government had no intention to pay the foreign debt after so many actors in Costa Rica had approved the grand political compromise of 1901. The domestic political economy was preponderant, putting the British creditors in a weak position. This explains why the government did not suspend payments on the domestic debt, which was held by creditors such as Banco Nacional de Costa Rica. Such as default would have disturbed the arrangements that prevented the country from going to civil war. That did not pass unnoticed in London, and the CFB complained that "these obligations (the domestic public debt) are paid in full while the External Debt received nothing."[75]

While British creditors were too weak over Costa Rica to avoid a default, the development that took place in the 1900s made US investors stronger. That was not only the case of Keith as an individual, but also the United Fruit as a corporation. The banana tax exemption became a hot topic in the late 1900s, when an anti-imperialistic movement demanded the introduction of tax on its exports. In 1908 Congress approved a project of law that stipulated a 30 and 15 cents of dollar duties on the exports of class A and B banana bunch exports, respectivelly.[76] The González government presented the revenue of that tax as a guarantee in a project of settlement on the external debt presented to the bondholders in London.[77] However, United Fruit rejected any deal that involved the end of the tax exemption and threatened to place a formal complaint to the government of the United States. Under a potentially dangerous diplomatic pressure, Congress and the González administration backed off.[78] The opposition candidate Jiménez capitalised on the anti-imperialistic speech to win the 1909 presidential election. Yet Jiménez did not confront the United Fruit once in office, waiting for the end of that company's decade tax exemption to introduce a duty on banana exports in 1911, which the government used to guarantee the debt settlement that cleared the country's credit abroad.[79]

**Costa Rica in perspective: early-modern Britain and autocratic Nicaragua**

Costa Rica defaulted in the 1870s, during Guardia dictatorship, and settled that debt in 1911, when the country was already a democracy. Taken at face value, these two developments are consistent with the seminal work by North and Weingast (1989), according to whom democracies tend to produce better borrowers than autocracies because of the capacity of the Legislative branch to restrain the Executive to spend and borrow. The authors propose that limited governments create a credibly commitment in public debt contracts, for it protects the property rights of creditors against the action

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[73] ANCR, Congreso 2680, May 6 – June 19, 1901.
[74] Calculated from Memoria de Hacienda.
[75] CFB (1901, p. 79).
[76] ANCR, Congreso 10279, 11 May 1908.
[77] CFB, 1908, pp. 97, 98.
[78] Colby (2011, p. 101).
[79] ANCR, *Mensage de señor president de la República, exposición de la Secretaría de Hacienda, contrato para la liquidación de la Deuda Exterior de Costa Rica,* 1911, Congreso 20841.

of sovereigns. This is not the case of autocracies, where too powerful governments are under the inevitable temptation to expropriate creditors. Post-Glorious Revolution Britain is, so the argument goes, the quintessential example of a country whose government, bounded by a parliamentary democracy, managed to borrow at cheaper rates than autocratic regimes such as Spain and France.

Nevertheless, Costa Rica honoured the debt in the 1880s and 1890s, when authoritarian governments ruled the country and defaulted during the first decade of democratisation in the 1900s. It is striking that the default happened in 1901, right when the pact that established democracy was arranged. The default was the consequence of the end of the coffee law, an old and until then repressed demand from Congress that Iglesias had to accept in stepped down peacefully. The transition to democracy in 1901 is more nuanced and telling than the default of 1874 and the settlement of 1911. What is more, it is hard to compare the Guardia years, when Costa Rica lacked a railway and the world economy was facing the depression of the 1870s, with the booming early 1910s, the heydays of the *belle époque*, during which world liquidity and coffee prices were high. The incentives for defaulting were much stronger in the earlier than in the later period, and we cannot tell whether a democratic government would have defaulted in the 1870s or an autocracy would have arranged a settlement in 1911. The transition to democracy in the turn of the century is more analytically telling because it provides a single discontinuity: the economic conditions in world markets and Costa Rica were overall the same in the late 1890s and early 1900s, the only significant change was the 1901 democratisation compromise in Costa Rica.

Recent scholarship criticises the democratic advantage hypothesis of North and Weingast and, in doing so, provide useful insight for the case of Costa Rica. Karaman and Pamuk (2013) show that, depending on polity and urbanisation, war raised taxation in early modern Europe. They find that, under military threat, limited governments were more efficient than autocracies in raising taxes in relatively urbanised countries, such as Britain, but autocratic governments did so better in rural countries such as France.

Costa Rica was a predominantly rural country, which implies that, according to the dichotomy proposed by Karaman and Pamuk, authoritarian rulers such Rodríguez and Iglesias were more likely to raise taxes under the pressure of war than the democratic administrations of the 1900s. This is consistent with the fact that the end of the coffee tax in 1901. It is worth noticing that four out of the six deputies who opposed the abolition of the coffee tax in 1898 were urban: two lawyers and a labour leader from San José city, and the priest from Heredia city. Perhaps if Costa Rica were more urbanised, the Assembly would have been composed in a way that Congress would have favoured that duty. The threat of war with Nicaragua was imminent in the late 1890s, which helps to understand the imposition coffee tax in that period. An agreement between both countries consolidated Costa Rica's northern border in 1900, reducing the threat of invasion.[80] The peace treaty was signed just a few months before the beginning of democratisation and the suspension of coffee tax, and thus we cannot be certain if the more democratic Costa Rica of the 1900s would have continued to tax coffee and pay the debt as before had it continued to face a military threat from Nicaragua.

While the application of the dichotomy proposed by Karaman and Pamuk in the Costa Rican case has limitations in respect to the existence of military threat, the work of Stasavage (2008) is useful to understand the political cleavages that led to default in 1901. Stavasage asserts that the credible fiscal commitment that appeared in early modern Britain was the outcome of the rise of the Wight party, which united large landowners and London financiers around social ideals such as religious freedom and constitutional rights. This consensus on social issues enabled both groups to reach a compromised on fiscal sustainability: The landowners agreed to pay taxes on their property, which enabled the government to honour the debt it owed to the financiers. Together, the Whigs outnumbered the Tories, who were mainly landowners that opposed religious freedom and taxes on land. Such "cross-cutting cleavage" existed in Britain but not in France, which explains why the British government taxed enough to meet its financial obligations, which did not happen on the other side of the channel.

[80] Sánchez (2011, p. 41).

Costa Rican political landscape was divided between those connected to presidents Rodríguez and Iglesias, and the liberals who governed in the 1880s and were persecuted in the 1890s. The coffee sector was pivotal in that dispute. Although most liberals were in coffee, not everyone in that sector was a liberal – as shown in the previous section, a deputy who owned coffee farms supported the coffee tax in 1894 because of he was a member of Iglesias' party. However, the continuing imposition of that tax while coffee prices collapsed in the second half of the 1890s antagonised the whole coffee sector against the government's decision to tax that product. Iglesias's project on gold standard also antagonised the coffee growers, for it prevented a weak national currency from supporting profits. The only pressure groups that continued with Iglesias were the labour movement from San José and the banana industry built by Keith in Limón. The problem for Iglesias is that these groups elected one deputy each, while the liberal opposition and the coffee growers composed most of Congress. It was therefore not a surprise that the president needed to be authoritarian to tax coffee and pay the external debt. The opposition grew so strongly that, by the turn of the century, Iglesias had two options: to maintain the coffee tax and honour the debt under a proper autocracy or to allow for a democratisation process that included a default. Fortunately for Costa Ricans - and unfortunately for the foreign creditors -, the president chose the latter option.

It is telling that the 1901 default was exclusively on the London debt. The government continued to pay the domestic debt in the 1900s for two reasons: it was smaller and therefore cheaper as a whole than the foreign debt and, most importantly, it was owned by the country's elite. Had the Costa Rican government borrowed only domestically as did the Whig administration of early-modern Britain, the outcome could have been similar to that described by Stasavage, with the liberal elite of San José united with the also liberal coffee elite in a government that raised taxes to pay its debt. However, Costa Rica because it borrowed abroad and depended on commodity exports for tax revenue, like the rest of Latin America in the turn of the twentieth century. The combination of democracy and debt payment was less likely in the peripheries of the first financial globalisation than in early modern Britain.

*Autocratic Nicaragua*

At this stage, one may ask whether Costa Rica would have continued taxing coffee and paying the foreign debt had Iglesias became a proper dictator in the 1900s. There is no way to know what would happen in such a counterfactual, but the case of neighbouring Nicaragua suggests that, if anything, Iglesias would have likely continued to run economic policy as before had he pushed for an autocratic constitution in 1901, as he initially intended to do.

There are many similarities between Nicaragua and Costa Rica. Both are small Central American countries that depended on coffee exports to generate wealth with which their governments built state capacity. From the 1850s to 1880s, the elites from the cities of León and Granada ruled Nicaragua in an oligarchic pact that resembles the polity that existed in Costa Rica before the 1890s.[81] Yet there are clear contrasts too. Nicaragua was a latecomer in coffee, and the coffee elite was less influential. Most groves were located around Managua, then a smaller city. The elites of León and Granada chose Managua as the national capital to maintain the balance of power between these two groups.[82] The late start of coffee tells why in Nicaragua, an alliance between liberals and the coffee sector only appeared in the 1890s, in a revolt that involved the liberal party of León and a group of coffee growers from Managua headed by José Zelaya (1893-1909).

Zelaya strengthened the central government vis-à-vis to the local elites. Similarly to what happened in Nicaragua, Iglesias empowered the state, but in Costa Rica the central government was already strong vis-à-vis local elites thanks to the work of previous authoritarian rulers such as Guardia. Until the 1890s, the Nicaraguan presidents were weak so that the local elites would not fight for power. Zelaya changed that radically, imposing a stereotypical autocracy in which he centralised power in detriment all political groups. The dictator built an army and railway lines, which he

[81] Martínez (2013, p. 57)
[82] Charlip (2003).

financed by imposing forced loans - that is, expropriation – virtually everywhere. He took office with the support of León and, once in power, expropriated Granada. But León revolted three year later. Zelaya crushed the rebellion and subsequently expropriated León. The event enabled the president to approve a new constitution that granted him with powers to expropriate everyone.[83]

Zalaya's project of a strong Nicaraguan state included a unified Central America, which he pursued through wars. His expansionist adventure began with the annexation of the British protectorate of Mostic, today Nicaragua's Atlantic coast. Zelaya seized the region by force thanks to US diplomacy, which prevented Britain from sending troops to support the helpless Mostic population. The dictator then occupied Honduras, where he imposed a puppet administration. Nicaragua also contested its southern border and nearly invaded Costa Rica, but both countries were in peace in the 1900s. Although Costa Rica was spared from Zelaya's ambitions, Honduras and El Salvador were invaded again.[84] Zelaya attempted to attract US capital to build a canal in Nicaragua, and turned to Japanese and German investors once the United States chose Panama for a similar project. The dictator became a threat to the Monroe doctrine and US troops joined local rebels to depose him in 1909. Nicaragua became a semi-protectorate of the United States in the following two decades.[85]

Under Zelaya, Nicaragua was autocratic and expansionist, while Costa Rica was in a transition to a peaceful democracy. Besides this clear contrast, another difference separates both countries: Zelaya administration honoured the foreign debt. In 1886 City Bank had underwritten a Nicaraguan loan for £285,000 in London at 6 percent interest and 92.5 percent. Zelaya administration momentarily suspended payments in 1895 and arranged a settlement in the following year, just after Congress had approved the constitution that imposed his autocratic regime.[86] The settlement stipulated that the government would tax coffee to pay the debt, an arrangement that Zelaya administration never failed to honour.[87] While autocratic Nicaragua continued taxing the coffee sector to honour the foreign debt, in Costa Rica Iglesias accepted the Congress' will to abolish a similar tax, which lead to a default. Stakes were higher in Costa Rica, which had a larger debt and raised more coffee tax than poorer Nicaragua, but matters were significant in both countries. The services on the foreign debt and the revenue from coffee tax were, respectively, 4 and 5 percent of the Nicaraguan government's revenue in 1897, the only year for which we have data.[88] The comparison with Nicaragua shows that international coffee prices on their own do not explain why Costa Rica stopped taxing coffee and eventually defaulted, for Nicaragua was exposed to the same international coffee market.

Geopolitics may partially explain Nicaragua's insistence in taxing coffee in spite of falling prices, but polity is the ultimate factor. A US bank had issued Nicaragua's debt. Although the debt was predominantly traded in London, it is likely that Zelaya understood that a default would have reduced the US support to his expansionist project. The bottom line, however, is that Zelaya used war abroad to legitimate his autocracy at home, and thus needed the blessing of the United States. International stakes were higher in expansionist Nicaragua than in peaceful Costa Rica, whose government depended less on regional geopolitics.

**Conclusion**

The Costa Rican government serviced its foreign debt with the revenue it collected from a tax on coffee exports in the 1890s. Together with the liberal opposition, coffee growers and traders controlled Congress, which voted to abolish that duty. Yet Iglesias authoritarian administration continued to tax coffee. Falling prices increased stakes to the point that the opposition violently attempted to depose Iglesias. Government forces prevented the coups from materialising, but the

[83] Cruz (2005, pp. 95-96).
[84] Vargas (2001, p. 232).
[85] Martínez (2013, pp. 75-79), Cruz (2005, pp. 98-99)
[86] CFB (1895, p. 233)
[87] CFB (1897-1909).
[88] CFB (1898, pp. 278-281).

country was on the edge of an imminent civil war. In an attempt to resolve matters autocratically, Iglesias called for a Constitutional Assembly that would have approved his indefinite re-election. The president suddenly changed his strategy in 1901, when he aborted the new constitution and arranged a compromise with the liberal opposition, which elected a new president. That deal marked the beginning of democracy in Costa Rica, but it also led the country to default. The democratising compromise depended on the end of the coffee tax, which left the government without funds to pay the foreign creditors. Taxing banana exports was not an option, for Iglesias had granted a ten-years fiscal exemption to Keith's United Fruit before stepping down. Costa Rica only resumed paying services after that exemption expired in 1911, which allowed the government to use a newly-launched banana tax to fund a settlement on the foreign debt.

The government defaulted to accomplish a deal that democratised Costa Rica. This case is, therefore, at odds with the democratic advantage proposed by North and Weingast (1989). Costa Rican democratisation empowered Congress, which represented taxpayers who preferred to see the national debt on default than to pay taxes. The contrast between this case and the one studied in the mainstream literature is telling. Alike Britain in the seventeenth century, Costa Rica was both a commodity exporter and a foreign debtor in the first financial globalisation. The combination of a narrow tax base with volatile world markets prevented Costa Rica from servicing the debt while it democratised. Fortunately for the Costa Rican people, Iglesias did not follow the example of autocratic Zelaya in Nicaragua, who taxed coffee to honour the country's debt in spite of falling prices. Costa Rica won from the democratic breakthrough at the expense of the creditors in London.

## Appendix

A1 - Deputies in congressional vote on the bill abolishing the coffee tax, 1898

| Deputy | Province | Coffee | Opposition | Government |
|---|---|---|---|---|
| | | Vote YES | | |
| Francisco Jinesta Aqueche | Alajuela | X | | |
| Ignacio Aguilar Barquero | Alajuela | X | | |
| Pedro Quirós | Alajuela | X | | |
| Ramón Loría Iglesias | Alajuela | X | | X |
| Tranquilino Chacón | Alajuela | | X | |
| Félix Mata Valle | Cartago | | X | |
| Francisco Jiménez Oreamuno | Cartago | X | X | |
| Marcelino Robles | Cartago | X | | X |
| Moisés Castro Fernández | Cartago | X | | X |
| Federico Faerron | Guanacaste | | X | |
| Alberto J. Sáenz | Heredia | X | X | |
| Moisés Rodríguez | Heredia | X | | |
| Felipe Gallegos | Limón | | | |
| Juan Rafael Lizano | Puntarenas | | | X |
| Ramón Castro Fernández | Puntarenas | | | X |
| Andrés Sáenz Llorente | San José | | X | |
| Carlos Sáenz Esquivel | San José | X | | X |
| Federico Tinoco | San José | | X | |
| José Quirós M. | San José | X | | |
| Miguel Pacheco | San José | | | |
| Pedro León Páez | San José | | | X |
| Manuel González Zeladón | San José | | X | |
| | | Voted NO | | |
| Ismael Alvarado | Cartago | | | X |
| Rodolfo E. Alvarado | Guanacaste | | | X |
| Ezequiel Martínez | Heredia | | | |
| Octavio Quesada Vargas | San José | | | |
| Víctor Orozco | San José | | | X |
| Francisco V. Sáenz | San José | | | |

Source: ANCR (Congreso), Gutiérrez (2007), Jiménez (2003), Solórzano (2004).

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