Introduction

Déjà Vu All Over Again

Martín Reyes Vayssade, author of a recent book about Jean-Baptiste Jecker – the Swiss financier whose bonds proved crucial to the French intervention in Mexico in the 1860s – made a revealing comment when asked about the financial maneuverings in which Jecker was involved. "It seems like recent history," Reyes Vayssade commented in a newspaper interview, "It's like the Fobaproa business."[1] To anyone familiar with the politics of high finance in Mexico, the simile is arresting. The "Fobaproa business" to which Reyes Vayssade alluded is one of the largest and most complex financial scandals in Mexican history. It involved a list of public officials and private businesspeople that were a virtual *Who's Who of Mexico* at the end of the twentieth century. It grew out of the catastrophic results of the devaluation of 1995 and involved the government's assumption of the debts and nonperforming assets of Mexico's largest banking, industrial, and financial groups. At bottom, it involved the commingling and conversion of private into public debt at a cost to Mexican taxpayers estimated by Enrique Cárdenas at more than 552 billion new pesos.[2] The scandal generated a heated political conflict between the major parties that eventually involved the national leadership of the Partido de la Revolución Democrática and Andrés Manuel López Obrador, the narrowest of losers in the presidential campaign of 2006.

A cabdriver in Mexico City in his rueful comment on my research on the origins of Mexico's foreign debt on the London market in the 1820s suggested that the Spanish title of my book might well be *La Deuda Eterna* rather than *La Deuda Externa:* a pun on "eternal" and "external," thus *The Eternal Debt* rather than *The External Debt.* Although seemingly an unending problem to Mexicans profoundly affected by the debt crisis of the

1 *El Financiero*, August 8, 2005.
2 "FOBAPROA III," http://www.cddhcu.gob.mx/cronica57/contenido/cont2/fobapro3.htm (accessed April 29, 2007); [Secretaría de Hacienda y Crédito Público] *Fobaproa. La Verdadera Historia* (3rd ed., México, 1998).

1980s, such crises in Mexico and, indeed, elsewhere in Latin America were not so much continuous as cyclical. This was driven home by economists such as Albert Fishlow and Barbara Stallings, but for historians, it was the pioneering work of Carlos Marichal, aptly entitled *A Century of Debt Crises in Latin America: From Independence to the Great Depression, 1820–1930* (Princeton, 1989), that became indispensable. Marichal demonstrated that there had been episodes of foreign lending and domestic default in the past. Their origins and consequences may well have differed, but there were nevertheless earlier examples from which one could draw instruction.

What made the first Mexican debt crisis unusual was that if not precisely eternal, it was long lasting. Sovereign default occurred in 1827, but was not finally resolved until 1887. For a surprising number of the intervening sixty years, the consequences of this default were an active issue. The cast of characters involved changed substantially over time, and there were few major (or minor) figures of historical import who were not involved. Virtually every president, finance minister, and foreign minister from the First Republic through the presidency of Porfirio Díaz spent significant time on what Mexicans called "the London Debt." In one way or another, the London Debt was associated with the defeat of the Spaniards; with the Texas rebellion and annexation; with the War of 1847 and its settlement; with the amortization of church property in 1857; with the reform wars; with the intervention and Second Empire of Maximilian; and with the rise of Díaz, the fall of Manuel González, and the economic origins of the Porfiriato. The London Debt was a heated domestic political issue from the 1820s through the 1850s. It was every bit as divisive in the 1880s – more so, in fact. Some of Mexico's greatest writers and polemicists – Francisco Bulnes, Joaquín Casasus, José María Luis Mora, Manuel Payno, and Guillermo Prieto – all wrote extensively about it. It is no exaggeration to call the London Debt one of the great issues of nineteenth-century Mexican history. Indeed, as late as *1891*, several years after the London Debt had finally been resolved, the great liberal newspaper, *El Siglo Diez y Nueve*, termed the "contracting of the loans of 1823 and 1824 with the houses of Goldsmith and Barkclay [*sic*]" one of the great economic disasters of the century, the fruit of precisely the sort of economic ignorance that the paper had been launched to eradicate.[3]

Nevertheless, this monograph has several specific purposes and is new in the following ways:

First, it is, above all, a financial history. The London Debt involved not just a random series of moratoria, restructurings, and financial maneuverings. These reflected the state of public finance in Mexico in a systematic way. Thus, an implicit argument, and a source of novelty, is the effort made

3 *El Siglo Diez y Nueve*, October 10, 1891, cited in Irma Lombardo García, *El siglo de Cumplido. La emergencia del periodismo mexicano de opinión (1832–1857)* (México, 2002), p. 138.

to "read" the history of the debt in the context *of* and as a window *on* public finance. To this end, the study provides estimates, usually for the first time, of the returns to bondholders, of the costs of the debt to Mexico, and of the fiscal sources of Mexican conduct. To do so, it relies on an ongoing analysis of the market for Mexican bonds on the London Stock Exchange, and is especially concerned with "explaining" changes in the price of these securities. Such changes can yield insight into the collective thinking of the Mexican government, its agents, financiers, and creditors, frequently with shifting focus, but always with the conviction that there is some pattern to things. Some accounts of the London Debt give the impression that its history is "one damn thing after another." One damn thing after another it may have been, but the "things" followed a certain logic and displayed an overall coherence that yields to systematic analysis.

Second, the book is both *international* history and international political economy. Many of the primary sources may be Mexican, but there is an equal emphasis on the nature and content of British diplomacy. Neither side operated in a vacuum, but responded to the incentives and disincentives that the shape of international affairs provided. These incentives changed with events, and as the essence of an historian's explicandum, these must be followed carefully and in detail. While studies of the London Debt are not in themselves new, the patterns of interaction between ministers, financiers, markets, and bondholders considered here are, at least insofar as they involve a rewritten historical narrative.

Third, the book incorporates, insofar as possible, the insights and the findings of a new generation of Mexican historians. This synthesis is tentative, sometimes incomplete, and occasionally contradictory, but then so is the work that is emerging. The quickening pace of publication in Mexico, its decentralized nature, and its frequently limited circulation makes nonsense out of claims of comprehensiveness. It is an exciting time to become immersed in the nineteenth century, but a challenging one as well. The intellectual energy that once transformed our understanding of Mexico's colonial past is now also transforming our understanding of much of the nineteenth century. Some regional politics, some institutional changes, and some emerging economic trends are documented far better than others, but that only makes the need to cast a wide net over what is being done all the more imperative. In order to place the London Debt in its broadest fiscal, commercial, and economic context and to avoid duplication of their efforts, I refer the reader to two outstanding Mexican surveys of the period, by Enrique Cárdenas Sánchez, María Eugenia Romero Sotelo, and Luis Júaregui.[4]

4 Enrique Cárdenas Sánchez, *Cuando se originó el atraso económico de México. La economía mexicana en el largo siglo XIX, 1780–1920* (Madrid, 2003), and María Eugenia Romero Sotelo and Luis Júaregui, *Las contingencias de una larga recuperación. La economía mexicana, 1821–1867* (México, 2003).

Fourth, the book frames, both in the introduction and throughout the text, a simple but nevertheless powerful framework for considering the relation between domestic finance, foreign borrowing, international diplomacy, and foreign and domestic politics. This is not a new statistical test, an improved means of time-series analysis, or even an event study, all popular and fruitful means of approaching the history of international bond markets. It is, rather, the application of the most basic of economic concepts, *opportunity cost*. This is only to say that one course of action not only precludes another, but that the choice involves a distinct calculation of costs and benefits, or of winners and losers, if you will. Thus this book essentially views the historiography of Mexico's high-yield government finance (*agiotaje*) in a negative light as less a reality, or even a value judgment, but as a reading of the past that was shaped by those *who bore the costs* of *agiotaje*. These were not solely Mexican taxpayers: the British bondholders in the 1830s and 1840s collaborated in forging the view of the *agiotistas* as the "vampires of the Treasury" because it was the British bondholders, among others, who could not be paid if the agiotistas were. Financial resentment helped create if not a Black Legend of Mexican finance, then at least a dark view of it. True enough, there was roguery, thuggery, dishonesty, swindling, and sharp practice – actions that would (or should) swiftly bring down the wrath of financial authorities or complaints of serious fraud in countries with a tradition of prudential supervision. The dark view may well be justified, even accurate in broad outline, but it is not and cannot be objective truth.

Fifth, the book presents two new interpretations in Mexican economic history. One involves a political economy of what is generically (and too simply) termed "centralism," itself a complex movement whose beginnings were played out in the 1830s and 1840s, but whose ultimate realization did not occur until the 1880s and beyond.[5] I show how budgets, debt service, tariffs, and prohibitions – even such hardly perennials as the Banco de Avío – can be regarded as part of a more or less coherent body of practice that I term "centralist political economy." The coherence may have been in improvisation, but it is now clearer as to how these pieces fit together and why the London Debt was the centerpiece of their arrangement. I do not say that the London Debt motivated the centralist reorganization, but it is indisputable that the fortunes of centralism helped drive the London market for Mexican assets. From this I argue that federalist modes of finance – perhaps federalism itself – could never solve the problem of

5 A nuanced understanding of the stages of centralism is presented in Mª del Carmen Salinas Sandoval, "Las autoridades de los Poderes centralistas y del Departamento de México" (1836–1846) (Documentos de Investigación, El Colegio Mexiquense, 1998).

the London Debt and, thus, of Mexico's increasingly urgent necessity of reentering the European capital market after 1867.

The second interpretation concerns the end of Mexico's "first debt crisis." How, why, and when did a solution come about, even as Díaz had previously pronounced himself hostile to its refinance? I consider the standard political explanation, which argues that Díaz wanted none of his rivals to be the beneficiaries of a solution to Mexico's obvious "debt overhang," but I also argue that the nature of the Dublán Convention, which led to the resolution of the issue, represented a belated – but logically consistent – recognition by a new generation of British bondholders that the convoluted quarrels of the past were, by the late 1880s, a matter of sunk cost. That is to say, they had become irrelevant to calculating the costs and benefits of a resolution, and hence, no bar to one. And as Leonor Ludlow has observed, the Dublán Convention worked precisely because it undertook a *simultaneous* settlement of both the internal and external debt, and as such represented a very different approach to reconciling the interests of domestic and foreign lenders, interests that had usually been at odds.

Sixth, I have written this book with the conviction that an issue as important as the London Debt, however complex, convoluted, obscure, or difficult, ought to be explained in plain language – the plainer the better. One very important reason why most of us have lost sight of the centrality of the London Debt to nineteenth-century Mexican history is that its narrative of default, renegotiation, refinance, defalcation, and the rest is hard to follow.[6] The intricacies of bearer bonds, their characteristics, and their technical measures (including coupon rate, yield, duration, and more) are something familiar to those who work in the bond market, but few historians do. Most people tire quickly of the intricacies of financial negotiations. Even fewer are interested in the technical aspects of swaps, conversions, or debentures. I sympathize with their ennui. I have tried to spare the reader all, but the most essential, details of these matters, even, perhaps, at the risk sometimes of concentrating on the forest rather than the trees. Prospective woodsmen will undoubtedly find much choice, not to say crooked, timber to fell, and they are welcome to it. No book can be the last word on a subject as vast as this.

Finally, I have consciously tried to avoid the politics and myth of advocacy. One version of the London Debt story, familiar to most Mexicans, concentrates on the injustice, unfairness, and sheer rapacity of both the

6 Not everyone, especially in Mexico, is oblivious. As the late Araceli Ibarra Bellon put it in her incomplete, but nevertheless very important, book, "The history of independent Mexico is, in more than one sense, the history of the external debt." *El comercio y el poder en México, 1821–1864. La lucha por las fuentes financieras entre el Estado central y las regiones* (México, 1998), p. 47.

original agreements and their various reincarnations. This is the "Mexico-deceived and abandoned" tale with which some older works present us. While it is true that few financiers, British, Mexican, Swiss, or otherwise, were out to do Mexico any favors, the story of pillaging and looting needs to be put to rest. While various Mexican regimes did not always act wisely and some acted positively foolishly, it is simply wrong to view the first federal republic as the unwitting victim of the conniving British. *Everyone* was conniving and with reason. There was much at stake in 1824 and 1825, the independence of a nation, for one thing, and as Benjamin Disraeli so memorably remarked, fortunes to be made. *Everyone* in this little drama sought to seize the main chance. There were crooks to be sure, and true patriots as well – sometimes in the same person, although rarely at the same time. But a lot of people lost their fortunes – and some their lives – to the process that the British loans set in motion: the victims were *both* British and Mexican, as were the beneficiaries. By 1827, both British merchant banks that had brought the original loans to market had gone bust, and one of them, Barclay, Herring, Richardson, explicitly blamed Mexican duplicity for the debacle. Many observers of the London market said much the same. Of course, it is equally wrong to view this as a story of predatory Mexicans having their way with Scottish widows, although, to be sure, there were predatory Mexican officials and Scottish widows. The cheaters, scoundrels, and thieves were, refreshingly, a diverse lot, some of painfully and deliberately indefinite nationality, the better to confuse the unwitting on all sides. John Womack remarked many years ago that it was time to get beyond civics in these stories. I trust I have or, at least, I have tried.

Finance in the Time of Cholera: An Overview

In 1836, a sophisticated, cosmopolitan, anonymous, and unusually astute observer of the Mexican economy published an analysis entitled *Algunas Consideraciones Económicas*.[7] While modern historians have considered the problems of the early national Mexican economy from a variety of perspectives, this observer took an unusual tack. Clearly, influenced by political economists such as John Stuart Mill and Nassau Senior, the author of *Algunas Consideraciones Económicas* looked to the Mexican monetary system – and more specifically, to the exchange rate – as the root of the country's problem. Mexico was tied to silver and, in conjunction with the productivity of its mines, was at a distinct disadvantage when Great Britain, the world's most dynamic economy, was linked to gold. Briefly, the price of

7 Richard J. Salvucci, "Algunas Consideraciones Económicas (1836). Análisis Mexicano de la Depresión a Principios del Siglo XIX," *Historia Mexicana*, 55: 1 (2005), pp. 67–97, for a preliminary treatment of this analysis and a full range of textual citations. Much of what follows is based on this study.

silver in terms of gold was determined internationally, by world supply and demand. But prices in Mexico – in terms of silver – were determined locally, because the great bulk of Mexican production was, by virtue of high transportation costs, nontradable. This implied that wage goods in Mexico, especially foodstuffs, bore no necessary relation to the exchange rate, certainly not as theories based on purchasing power parity would have it. But if food costs were typically the largest part of the wage bill in a manufacturing industry like textiles, this fact constituted a serious structural problem. When expressed in terms of gold, the costs of Mexican industrial production were high. Or conversely, when expressed in terms of silver, the price of imported goods, typically British cottons, were low.

In theory, or at least in the vision of David Hume, such imbalances would get righted by monetary flows. The high-cost country would suffer a balance of trade deficit and lose specie to its competitors. This, in turn, would drive down prices and restore international equilibrium. But Mexico was a mining country, and the mines were, at least in the view of the author of *Algunas Consideraciones*, no respecter of relative scarcity. Their output was strictly exogenous – in modern terms, mostly a matter of happenstance. So there was no guarantee that domestic prices and costs would necessarily move in accord with the Humean mechanism, either. Since the exchange rate (in terms of gold) was exogenous as well, the peculiarities of a mining economy affected Mexico in a number of ways. The most obvious, of course, was the misalignment of the exchange rate. Since Mexico had no control over it, devaluation or depreciation was ruled out.[8] Indeed, modern discussions of the implications of a fixed exchange rate – such as the silver standard – emphasize the general ineffectiveness of monetary policy under such a system. It is, rather, fiscal policy that is effective.[9] Ironically, the fiscal policy that the later Bourbons had imposed on Mexico had been highly contractionary, consisting largely of sending Mexican purchasing power abroad in a series of increasingly aggressive taxes and forced "loans" chronicled in detail by Marichal, who estimates that Mexico sent 35 million pesos abroad between 1780 and 1810.[10] Thus, Mexico in the early nineteenth century suffered from stagnation, an economic contraction brought on by the consequences of what amounted to an overvalued exchange rate,

8 It is true that, strictly speaking, Mexico violated the small-country assumption, for disturbances to mining output in Mexico during the instability of the 1810s had repercussions on the international price of silver. But mining was a decentralized, private activity and there seems to have been no effort made to coordinate or direct the production decisions of individual silver miners.

9 This is known as the Mundell–Fleming model. A nontechnical discussion appears in *Finance and Development*, 43: 3 (2006). For an accessible textbook treatment, see Manfred Gartner, *A Primer in European Macroeconomics* (London, 1997).

10 Carlos Marichal, *La bancarrota del virreinato. Nueva España y las finanzas del Imperio español, 1780–1810* (México, 1999), p. 284.

by the crushingly deflationary policies of the Bourbons, by price rigidities, or, most likely, by all of the above. *Algunas Consideraciones* makes for grim, if not fascinating, reading, for it suggests that whatever else ailed Mexico in the early nineteenth century – the heritage of civil war in the 1810s or the beginning of a long period of political instability in the beginning of the 1830s – there were structural foundations to this crisis that virtually no government of the era could have realistically been prepared to confront.

These were the macroeconomics of scarcity, as far as Mexico was concerned. The consequences were clear enough. For example, the author of *Algunas Consideraciones* thought that the backbone of the Mexican countryside, the hacienda economy, had been severely prejudiced by what occurred. The argument went to the root of things, for, historically, the owners of haciendas had drawn on the equity of their properties for finance by the widespread and intricate mechanism of clerical mortgages or *censos*. Rising land prices had encouraged such borrowing in the eighteenth century, but now property values had gone into reverse, especially in those parts of the country, such as the Bajío, where damage from the civil war of the 1810s had been most severe. Here the implications of stagnation were even starker, for they were self-reinforcing. If Mexico was essentially rural and agrarian, with an exiguous share of the population living in cities, the implication of falling property values for aggregate demand was surely disproportional. Unlike other parts of Latin America, and the importance of silver mining notwithstanding, secular movements in output in the Mexican economy were more the product of home than external demand, for in this sense, Mexico was unlike Brazil, Cuba, the River Plate, or what portions of Central America, Chile, and Peru were to become after 1840. And these secular movements had typically been associated with the fortunes of what Victor Bulmer-Thomas calls "domestic use" rather than export agriculture. Enrique Florescano, for example, has famously argued that agricultural crises were the key to understanding economic cycles in the eighteenth century.[11] Here, in slightly different guise, the thesis reappears, but driven by a wealth effect rather than by price shocks propagated by crop failures.

But countries do not grow by aggregate demand alone, at least in the long run. In the short run, aggregate demand drives variations in production. But in the long run, it is aggregate supply, determined by population, resources, and technology, that determines what an economy will produce. *Algunas Consideraciones Económicas*, with its focus on the exchange rate, does think about costs, but costs in the short run. The fundamental importance of the size of the labor force and its level of productivity were not of much interest to its author. But there were Mexicans who were deeply interested in population and resources, just as the wide variety of publications in

11 Enrique Florescano, *Precios del maíz y crisis agrícolas en México (1708–1810)* (México, 1969).

the 1830s and 1840s might suggest.[12] Many of these, it is true, were motivated by fiscal considerations, but they serve to provide us with some notion, however imperfect, of the magnitudes at issue.

The best estimates of the day made allowance for the wars, epidemics, and "other calamities" that had struck Mexico since the time of Humboldt. And these put the population of México at about 7 million souls. With contemporary estimates of product toward 1840 at 300 million pesos, this implied an output per head of around 40 pesos. Combining the famous estimates of José María Quirós and Alexander Humboldt would suggest very nearly the same, about 40 pesos per head, around 1810. By the late 1830s, the inescapable fact was that Mexico was not growing, hence the appearance of studies like *Algunas Consideraciones*, which sought to account for this fact.

But the absence of economic growth is a real problem, not just a matter of numbers. It does not require particularly complicated economic models to demonstrate how rapidly problem will arise – an elementary account will suffice.[13] Aggregate demand (AD) determines – and in return, is determined by – production or current income (Y). In a simple closed economy, the largest component of demand is personal consumption (C), itself a function of income. Savings (S) is nothing but "nonconsumed output" ($S = Y - C$). If income is stagnant (abbreviate this $\mathrm{d}Y = 0$, where "d" is "the change in" what follows), if C rises ($\mathrm{d}C > 0$), S must fall ($\mathrm{d}S < 0$). Conversely, if greater savings are required ($\mathrm{d}S > 0$), then consumption must fall ($\mathrm{d}C < 0$).

Under what circumstances would greater savings be needed? There could be many. In a closed economy, private investment (I) must be financed out of home resources. So the volume of savings ("nonconsumed output") limits the size of investment, famously $S = I$, as another equilibrium condition. It is the iron law of common sense: if you consume everything, you have no resources left over with which to create productive assets. This in itself is a serious enough issue, one that bears heavily on Mexican history, because it explains the sharpness of class struggles over distribution, the ongoing tendency for the expropriation of the peasantry, and much more. Yet this is not even the principal focus of our interest, which is public finance.

Define savings (S) as the sum of private (S_{PR}) and public savings (S_{PU}), which occurs when we introduce the idea of public or government expenditure (G). Government savings can then be defined as the difference between

12 Virginia Vargas Rangel, "El Primer Presidente de la Sociedad Mexicana de Geografía e Estadística," *Elementos*, 62 (2006), pp. 35–41; *Católgo de documentos históricos de la estadística en México (Siglos XVI–XIX)* (Aguascalientes, México, 2005).

13 Keynes put the matter simply enough in Book III of his *General Theory*. Say's law did not apply to a modern economy because the marginal propensity to consume out of income was less than 1. See, for example, Benjamin M. Friedman, *The Moral Consequences of Economic Growth* (New York, 2005), pp. 400–411, for a nontechnical discussion.

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Richard J. Salvucci
Excerpt
More information

Table I.1. *Budget Balance of the National Government*

Year	Revenue	Expenditure	Balance
1825–1826	11.0	12.2	−1.2
1826–1827	11.4	12.6	−1.2
1827–1828	10.4	11.0	−0.6
1828–1829	11.0	12.2	−1.2
1829–1830	9.8	12.0	−2.2
1830–1831	13.4	16.5	−3.1
1831–1832	11.8	15.7	−3.9
1832–1833	10.3		
1833–1834	11.5	18.6	−7.1
1835–1836	13.8	24.9	−11.1
1836–1837	18.5	17.6	0.9
1837–1838	22.6	24.1	−1.5
1839	27.5	25.7	1.8
1840	19.9	19.9	0.0
1841	21.3	20.3	1.0
1842	26.7	26.6	0.1
1843	29.3	29.2	0.1
1844	15.8	25.3	−9.5
1845	20.4	19.6	0.8
1848–1849	16.7	17.5	−0.8
1849–1850	13.8	15.8	−2.0
1850–1851	7.3	12.6	−5.3
1851–1852	9.2	8.6	0.6

Note: Values are in millions of pesos.
Source: Adapted from http://biblioteca.itam.mx/recursos/ehm.html#finanzas, 17.3.1 (accessed September 25, 2007).

G and taxation (T), or ($T - G > 0$). This is nothing more than a fiscal surplus. A deficit ($T - G < 0$) has the opposite sign and represents dissavings. If a government runs a deficit, it reduces (total) S because the public component (S_{PU}) has a minus sign. A fall in S must reduce I in a *closed* economy, something known as "crowding out." If the reduction in investment reduces the growth of income, private consumption and savings will also stagnate in the long run. So, assuming that foreign capital or increased exports cannot come to the rescue (i.e., this is not an open economy), budget deficits would have exacerbated the problems that the author of *Algunas Consideraciones* had fixed on. And in particular, the distributive conflicts to which we referred could have only sharpened.

The idea that fiscal deficits accompanied slow growth in Mexico is more than a theory. If we look at the sparse data we have on actual deficits of the national (i.e., either federal or central) government between 1825 and 1850 in Table I.1, about two-thirds of the time, the budget was in deficit.