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Geopolotics and Diplomacy: México´s 1942 Foreign Debt Settlement

GUSTAVO A. DEL ANGEL Y
LORENA PÉREZ-HERNÁNDEZ

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ORCID: 0000-0003-3105-7838 (Gustavo A. del Angel Mobarak)

Carretera México Toluca 3655, Col. Lomas de Santa Fe, 01210,
Álvaro Obregón, Ciudad de México, México.
www.cide.edu

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Oficina de Coordinación Editorial
editorial@cide.edu
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Abstract

This research explains the relevance of geopolitical factors and debt diplomacy during sovereign debt negotiations. We explain how the Mexican government reached an agreement with international creditors for the repayment of its foreign debt in 1942, after more than 25 years of unsuccessful negotiations. The agreement, that included a haircut of 90%, was the result of a change in the geopolitical situation of Mexico, when the United States entered the Second World War and considered that country a strategic ally. The agreement, we argue, also derived from Mexico's proactive stance in debt negotiations and bond repurchasing, in particular the effective strategy and negotiations by Eduardo Suárez, then the Mexican minister of finance. This paper studies the process of negotiations since 1922 and the conditions that allowed Mexico to reach an unusually advantageous settlement. This is a preliminary draft of a chapter to be published in the book *Sovereign Debt Diplomacies* (Juan Flores Zendejas and Pierre Penet, editors, Oxford University Press).

Keywords: Sovereing debt, debt diplomacy, Mexico, Eduardo Suarez.

Resumen

Esta investigación explica la relevancia de los factores geopolíticos y la diplomacia de la deuda durante negociaciones de deuda soberana. Explicamos cómo el gobierno mexicano llegó a un acuerdo con acreedores internacionales para el pago de su deuda externa en 1942, luego de más de 25 años de negociaciones infructuosas. El acuerdo, que incluyó una quita del 90%, fue resultado de un cambio en la situación geopolítica de México, cuando Estados Unidos ingresó a la Segunda Guerra Mundial y consideró al país un aliado estratégico. El acuerdo, argumentamos, también se derivó de la postura proactiva de México en las negociaciones de deuda, así como recompra de bonos, en particular la estrategia y las negociaciones efectivas de Eduardo Suárez, entonces

Secretario de Hacienda. Este trabajo estudia el proceso de negociaciones desde 1922 y las condiciones que permitieron a México llegar a un acuerdo inusualmente ventajoso. Este es un borrador preliminar de un capítulo que se publicará en el libro *Sovereing Debt Diplomacies* (Juan Flores Zendejas y Pierre Penet, editores, Oxford University Press).

Palabras claves: Deuda soberana, diplomacia de la deuda, Mexico, Eduardo Suárez.

Introduction[1]

In November 1942, the Mexican government reached an agreement with international creditors for payment of its foreign debt. This came after a period of more than 25 years with recurrent problems meeting its financial obligations and 20 years of failed negotiations. The settlement ruled that the Mexican government would pay approximately 10% of its total foreign debt, relief that was unprecedented in the history of Mexico and unusual in the global history of foreign debt (only Bolivia in 1950 reached a similar deal). This was extraordinary, given that by that time the government was managing to clean up its finances and had better fiscal tools at its disposal to meet its financial needs. In this paper, we aim to show that this was the result of two factors: first, a change in the geopolitical situation, in light of the United States entering the Second World War; second, Mexico's governments having taken a proactive stance in debt negotiations with its international counterparts.

We believe that this case is relevant because literature in economics typically associates the chances of debt resolution with the debtor's capacity to pay (Sachs 1989; Reinhart and Rogoff 2014), its interest in maintaining a reputation in foreign markets (Eaton y Gersovitz 1981; Eaton 1990; Cole, Dow and English 1995; Reinhart and Rogoff

[1] Gustavo A. Del Ángel is chair of the Department of Economics at CIDE, Lorena Pérez Hernández is researcher at the Fundación Rafael Preciado. The authors thank the comments by Michael Bordo, Juan Flores-Zendejas, Pierre Penet and the assistants at the conference "Sovereign debt in colonial and neo-colonial developments", March 1, 2, 3 2018, Université de Geneve, Paul Bairoch Institute of Economic History.

2014), and the capacity of lenders to gain rights on the borrower's assets (Bulow and Rogoff 1989). The notion that a debtor country is interested in its standing in debt markets might explain part of the story in this paper.

However, we aim to explain a story in which the geopolitical context is what explains that particular settlement. We also aim to show how debt diplomacy explains the course of the negotiations, this in terms of how individual actors negotiate and hence, influence the outcomes. With this, we bring together purely economic elements, such as the fiscal capacity of a debtor country, with other elements like political stability, the political stances of creditor countries, the ability of the debtor country to take a proactive stance and the agency of individual actors.

At the turn of the 20th century, Mexico was in excellent condition in the international financial markets. It had moderate foreign debt, combined with relatively healthy public finances. However, when the Revolution of 1910 broke out, both the armed struggle and the political instability affected the economy as a whole, and particularly the financial system and public finances. The Mexican government entered into a spiral where it needed financial resources from abroad but wasn't in a position to ensure repayment. Even so, the various groups of warlords who had seized power obtained loans from international bankers. At the same time, the government faced international investors who sought compensation for losses incurred due to the Mexican Civil War. By 1921, when it is considered that the most difficult and unstable part of that Civil War was over, the government restarted negotiations with international bankers.

To study the process of public debt negotiations during the period from 1921 to 1942, this study is divided into two stages that reflect the state of the most important agreements reached between those years. In the first, from 1921 to 1934, several agreements took shape but Mexico was unable to comply with them. In addition to the conditions of the agreements being relatively astringent, Mexico's negotiating strategy was erratic. In the second stage, from 1934 to 1942, Mexico had a more proactive strategy in the negotiations, as it initiated buybacks of debt bonds in the market. It also coincided with a historic moment in which the United States gave a central weight to Mexico's strategic situation in geopolitics.

In international negotiations, the agency of a key player is key to explain the outcome reached. Eduardo Suárez, who was the Minister of Finance (*Secretario de Hacienda*) between 1935 and 1946, had participated in debt negotiations since 1926. From 1934, he achieved an important shift in Mexico's position before its international creditors, represented on the International Committee of Bankers on Mexico (*Comité Internacional de Banqueros*). Suárez took advantage of the crisis among creditor countries, and in particular the growing weakness of the United Kingdom and France, the impartiality of American courts, as well as the precarious situation of Mexican debt bonds in the international markets.

In turn, the government of the United States considered Mexico an important geopolitical ally even before entering the Second World War. The North American governments always stressed their concern that Mexico should maintain a clear and unwavering position alongside the Allied Nations and be emphatic in its rejection of the Axis Nations. This was crucial in light of the proximity of the countries and the sympathy that some Latin American countries showed toward the Axis Nations. In that context, the Mexican government did not hesitate to join the Allied Nations and collaborate with the United States during the War. As part of the negotiating package to reach an agreement, resolution of Mexico's foreign debt became an important concession by the North American government.

This research is based on contemporary reports by the Ministry of Finance[2] and Bank of Mexico, the central bank, press information from the archives of the Ministry of Finance, the published memoirs of the Ministers of Finance – Eduardo Suárez and Alberto J. Pani – and secondary literature.

The next section discusses possible conceptual frameworks for the story. Section 3 explains, as a point of departure, the events after the 1910 Revolution and the reopening of the debt negotiations. Section 4 and 5 describe the first series of negotiations, which were unsuccessful and ended in suspension of payments in 1934. Section 6 explains the shift in the relationship with the United States. Sections 7 and 8 bring perspective onto the 1942 settlements.

[2] Mainly, the Colección Archivos Económicos at the Biblioteca Miguel Lerdo de Tejada, as well as the Memorias de Hacienda, the anual reports in their archives.

An attempt to frame the story

Jorgensen and Sachs (1989, p. 71) assert that: "It is interesting to note that the longer a debtor held out, the better it fared in the conditions of settlement". Table 1 shows the arrangements of other Latin American countries. Compared to those nations, Mexico's "present value ratio post-default" was 0.10 in 1942. However, as explained in this paper, the strategy was far from intended. Historical evidence shows that the Mexican government was interested in recovering reputation in the international financial markets rather than delaying the negotiations, but the conditions from achieving a good arrangement were far from optimal.

Table 1. Latin American Debt Settlements. Source: Jorgensen and Sachs (1989)

	Year of settlement	Present value ratio post-default
Bolivia	1950	0.08
Chile	1948	0.31
Colombia	1940	0.63
Peru	1947	0.39

Proposing a conceptual frame for the events under study is a task yet to be developed. Our task is two-fold. First, we seek to have a rationale that explains why the Mexican government, as a debtor, was not able to honor its foreign debt and to reach an agreement during almost two decades. Second, we need a rationale that explains that unique and unprecedented settlement.

The spiral of war and political instability that Mexico experienced after 1911 led, among other consequences, to a deterioration of its financial system and public finances and consequently, the inability to pay its external public debt. The Mexican government had learned how to build a good reputation, after foreign debt defaults, repudiation and reentrance to the international debt markets during the 19th century. Apparently, the government of that country "learned from its mistakes", in the way portrayed by Reinhart and Rogoff (2008). However, civil war and political instability is an unexpected cause of disruption in public finances; these also create uncertainty about who (what administration/government) would take care of the government's debt; mostly if that debt was acquired by an enemy faction.[3]

In the economics literature on sovereign debt, an accepted explanation of why governments repay their foreign debt relies in the notion that they need to maintain a good reputation, as borrowers, to be able to access lending in the future (Eaton and Gersovitz 1981; Eaton 1990; Cole, Dow and English 1995; Reinhart and Rogoff 2014). This argument has been contested, but it still is intuitively valid and is a consensus among practitioners. However, this idea assumes that governments are stable. In the case of the Mexican government, this concern about its standing in foreign debt markets is found in several sources.

For Bulow and Rogoff (1989), international lending to a less-developed country cannot be based on the debtor's reputation for making repayments. Less developed (or any) countries always have an incentive to default. They argue that loans to developing countries depend on the legal and political rights of lenders. Their argument obviates that a precondition for this is that institutions (legal and political) are relatively stable and relatively functional; this also implicitly assumes that governments are stable enough to maintain commitments. The argument of Bulow and Rogoff can explain the position of some of the creditors, however does not fully applies to the story.

A model that might provide insights for a rationale for the case under study is Amador (2004). The author explains that when international financial markets are complete, political considerations restrain a country from implementing the saving sequence that the Bulow and Rogoff argument requires. The model is built on the insight that politicians are not continuously in power. The incumbent politicians have a bias towards the present, due to the uncertainty on who will be in power in the future. They know however, that when tomorrow arrives, whoever is in power will be impatient in the short-run as well. This time-inconsistency can generate strong inefficiencies in the savings done by governments. However, even under a situation of shifting governments, foreign debt obligations can be maintained. Lienau (2014) emphasizes the importance of debt continuity when a political regime changes.

[3] Sachs (1989) explains as the main origins of debt crisis bank lending behavior, global shocks, debtor's policies and trade regime.

A different frame is needed to explain the rationale of how and why creditors can forgive the foreign debt of a borrower that has continuously defaulted. This study bases its argument in two empirical facts of this story: a form of debt diplomacy, and more important, how geopolitical circumstances contributed to establish a debt settlement.

THE POINT OF DEPARTURE IN THE MEXICAN STORY

At the beginning of 1911, Mexico's foreign public debt was 441,453 pounds sterling (Bazant [1968] 1995, p. 174). Porfirio Díaz' regime, from 1876 to 1911, led to a situation of relative order in the country's foreign public debt and prestige in international markets.[4] But the Mexican Revolution, which broke out in 1911, initiated a new cycle of public credit. The Civil War and political instability, ever-growing throughout the decade, altered the country's economic conditions.[5] This is the starting point to explain our story.

After Porfirio Díaz left Mexico, the government received three international loans. The first was brokered in 1911 by the provisional president, Francisco León de la Barra, and the second by President Francisco I. Madero in 1912; each was for 10 million pounds sterling and both had an annual interest rate of 4.5%. The last loan was taken out in June 1913 by Victoriano Huerta, a warlord who deposed Madero. This was for 16 million pounds with a 6% nominal annual interest rate. Foreign public debt grew to almost 500 million pesos. This amount including the so-called railroad debt bonds, for the railroad company, which were guaranteed by the government.[6] It was hoped that these loans would help control the instability facing the country.[7]

However, the continuing civil war suspended all possibility of payment. On December 17, 1913, Victoriano Huerta presented Congress with an initiative to declare

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[4] There is a strand of literature studying the external debt of the Mexican government from the first loans in 1824 to 1911. See Ludlow and Marichal (1998) for a chronology of relevant events during that period.

[5] See Haber, Maurer and Razo (2003) for general economic conditions and Anaya (2001) for the financial outcomes of the Revolution.

[6] See Bazant ([1968] 1995, pp. 179-183), Secretaría de Hacienda and Crédito Público (1960, pp. 40-41) and Meyer (1991, pp. 118-128).

[7] See Weller (2018) for the capacity of Mexico to access loans in that context, understood as a problem of asymmetric information.

the suspension of debt payments, which was approved in January 1914. The suspension would last six months. But it was not possible to resume payment of the debt. The period between 1914 and 1918 was the most violent of this episode. Consequently, for the Mexican government, international sources of credit disappeared between 1914 and 1921, as did markets for any new issuance of bonds. Moreover, bonds circulating in the world stock exchanges had decreased in value (Secretaría de Hacienda y Crédito Público 1960, p. 53). Mexico was the only Latin American country that suspended payments completely at that time (Ludlow and Marichal, 1998, p. 22). It was only at the beginning of the 1920s, seven years later, that the government renewed efforts to resume negotiations surrounding public debt.

Moreover, the global environment changed significantly in those years. The First World War dramatically changed international diplomatic and economic relations, because it altered the financial positions of Great Britain, France, Germany and the United States as creditor and debtor countries. After financing the Allies in that War, the latter became the main creditor worldwide. Under these new circumstances, Mexico was definitely within the American sphere of influence (Riguzzi, 2010, p. 402).

A special concern for the US government was the status of the economic interests of US citizens in Mexico – particularly oil and agricultural companies – and payment of claims for losses caused to its citizens and properties by the Revolution (Meyer, 2000, p. 846). This was no coincidence – the Mexican Constitution, passed in 1917, gave the State power over private property, weakening private property rights. Additionally, Article 27 of the Constitution affected foreign investors because it declared State ownership of natural resources underground (Del Angel and Martinelli, 2009; Medina, 1995, p. 88).

The end of the First World War created the conditions needed for foreigners with investments in Mexico to resolve their outstanding issues. To begin with, in 1919 the so-called International Committee of Bankers on Mexico was created by a group of banks from the United States, England and France (Germany, which was also a creditor, was not represented). Despite the fact that 80% of bonds were held by Europeans, the Committee was controlled by the New York company J. P. Morgan and Co. One of its partners, Thomas W. Lamont, presided over the Committee from October 1921 to

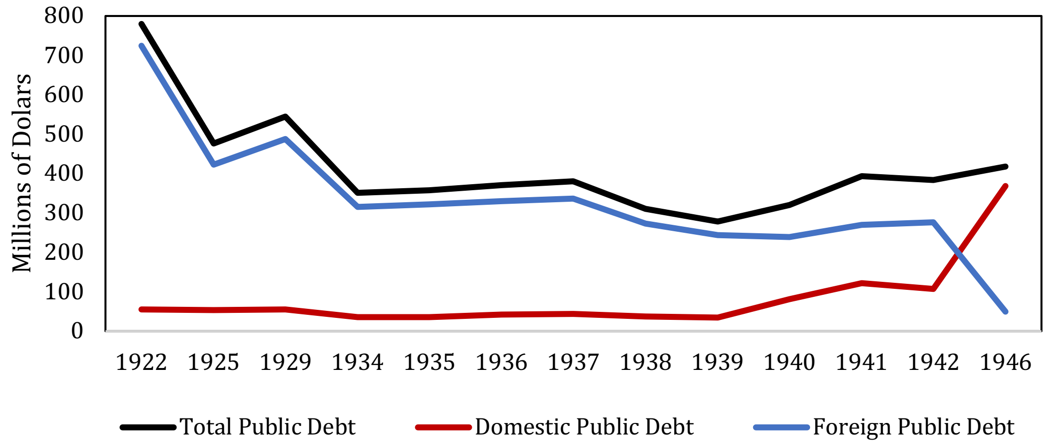
November 1942. A timely reflection of this new situation was the relocation of the Mexican Finance Agency (*Agencia Financiera Mexicana*), a financial representation of the Mexican government, from London to New York (Bazant, [1968] 1995, pp. 190-191, 221; Meyer, 1991, p. 393; Riguzzi, 2010, p. 402).

However, the outlook of the Mexican financial system was bleak. As a result of the Revolution, the banking system had collapsed, damage had also been caused to the transport infrastructure, and markets had been disarticulated by the War (Haber, Maurer and Razo, 2003; Medina, 1995, p. 85; Suárez Dávila, 1988, pp. 350-353). Furthermore, payment was pending of compensation for loss of life of foreign citizens and damage to their property. But of all the problems, the one the government gave most immediate attention was public debt. A key aspect for governments that followed after 1920 was recovering foreign credit, but regaining international financial confidence first required an agreement to be reached regarding recommencement of payment of the debt (Medina, 1995, pp. 87-88).

Before explaining the negotiations, the data is eloquent about the evolution of the government debt and finances. Charts 1, 2a and 2b, show the evolution of the public debt, total and foreign, in value and as a ratio of fiscal revenues, for the period 1922-1946. Charts 3 and 4 show the evolution of the public finances.[8] The behavior of the data series reflects the events explained in the following sections of this paper, for instance, the different agreements and the repurchase of bonds by the government after 1932.

[8] Data of the charts is from the Estadísticas Históricas de México.

Chart 1. Public Debt 1922-1946 (Millions of Dollars)



≤Chart 2a. Ratio Foreign Public Debt / Fiscal Revenues 1922-1946

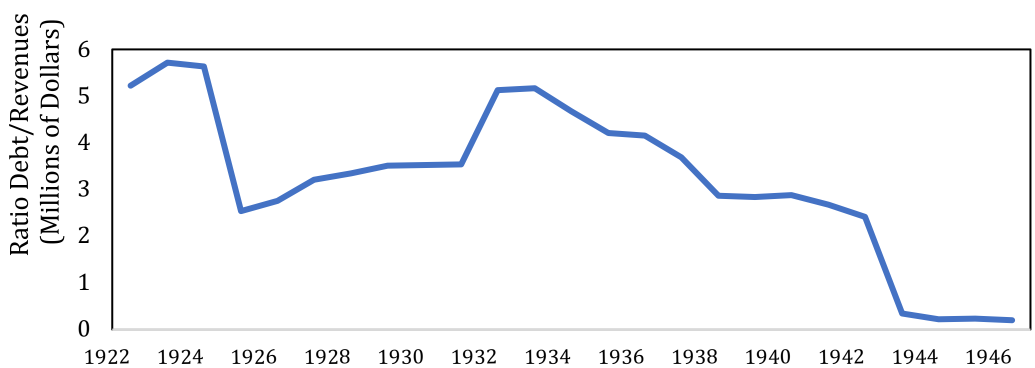


Chart 2b. Ratio Total Public Debt / Fiscal Revenues 1922-1946

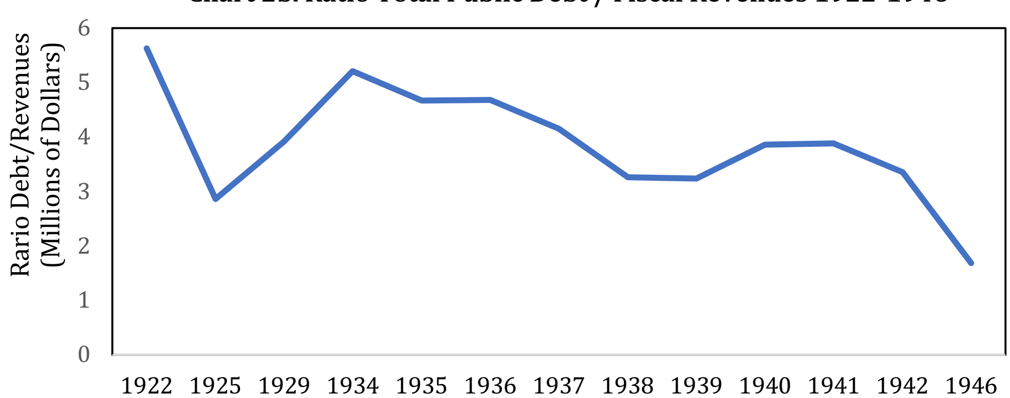


Chart 3. Budget balance of the federal government (Millions Pesos MX)

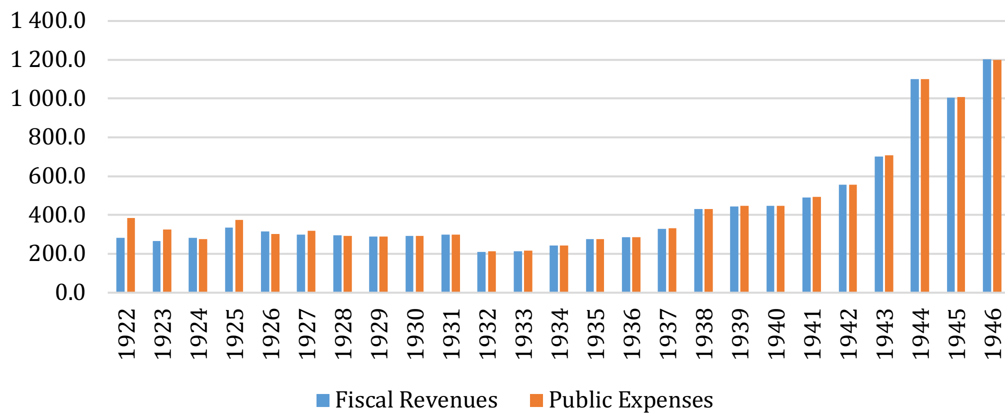
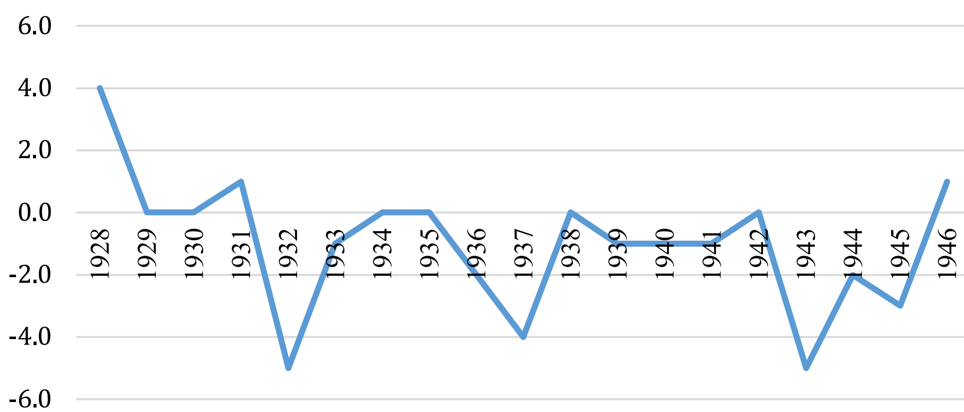


Chart 4. Primary Deficit (Millions of Pesos MX)



THE BEGINNING OF A DIFFICULT PATH FOR NEGOTIATIONS

In 1921, the government of Álvaro Obregón, a warlord, began a new phase of negotiations with foreign creditors. Mexico needed access to new loans to finance a reconstruction process. It was therefore urgent for Obregón that his government be recognized by European countries, and particularly by the United States. This was not easy; on the contrary, it was complicated by the decisions his administration took on tax matters (Medina, 1995, pp. 89).

Furthermore, the US governments took a hard line during most of the 1920s. This started with the Democrat President Woodrow Wilson, and was continued and toughened even further by the Republican administrations of Warren G. Harding and Calvin Coolidge. The first step that Washington took to pressure the Mexican government and satisfy US citizens' claims in Mexico was to condition diplomatic recognition on first reaching a formal agreement regarding each of the outstanding debt issues (Meyer, 1981b, pp. 154-155; Meyer, 1991, pp. 318-319; Hans Werner Tobler, 1997, pp. 463-481). These problems became the central themes of the binational agenda. The British, for their part, had strong economic interests in Mexico. Although they adopted a tougher stance than the Americans in terms of their claims, they let the United States representatives to lead their position with Mexico.

When Obregón's government took office, the situation of public funds was precarious. To gather resources, the government created two taxes in order to ensure payment for future debt maturities (Pani, 1926, pp. 99-100). The first was a tax on the sale of rural properties (Medina, 1995, pp. 89). The second was a tax on oil: on June 7, 1921, the government issued a decree that established a special tax on exports of oil and its derivatives, which worsened relations with oil companies (Meyer, 1981b, p. 176). The oil companies protested but yielded to the government. The companies thus held an agreement, at which it was settled that the tax would be covered by foreign debt bonds.[9] However, Lamont the head of the banker's committee, managed to get Mexico to cancel this agreement with the oil companies in February 1922.[10]

The Minister of Finance, Adolfo de la Huerta, initiated new negotiations with bankers that culminated in the De la Huerta-Lamont agreement, signed on June 16, 1922. With this agreement, the Mexican government pledged that as of January 1, 1923, it would set up a fund for payment of interest over a period not to exceed five years. An initial installment of 30 million gold pesos (*pesos oro*) was set up for the first year, increasing by five million pesos annually. The payment of overdue capital would be covered after 1928.

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[9] Bonds "se aceptarían al 100% de su valor nominal mientras las compañías los adquirirían en el mercado de Nueva York al 50% o 40% de ese valor". See Meyer (1981b, p. 177).
[10] Decree of February 21 1922. See Bazant ([1968] 1995, p. 193).

All the oil export taxes would be set aside to put together this sinking fund.[11] In addition, a new levy of 10% would be charged on the gross income of railroad companies and all their profits. Besides, the old debt remained intact. With this agreement, all the foreign public debt was converted from sterling pounds to US dollars (Secretaría de Hacienda y Crédito Público, 1960, pp. 54-55).

In that agreement, the total public debt was increased by the addition of the railroad debt (known as *Deuda Ferrocarrilera*, 367,648,219 pesos) and the railroad bonds that had previously been guaranteed (137,929,122 pesos). That gave a total railroad debt of 505,577,441 pesos (equivalent to 246.62 millon dollar) – almost half of Mexican foreign debt. In addition to incorporating the liabilities of the National Railroads (*Ferrocarriles Nacionales*) into the public debt, the Mexican government was obliged to return the railroads seized in 1914, during the Civil War, to the private companies (Secretaría de Hacienda y Crédito Público, 1960, p. 55)· The agreement also included bonds from the Loan Fund for Irrigation and Agricultural Development Works (*Caja de Préstamos para Obras de Irrigación y Fomento de la Agricultura*), which were unconditionally guaranteed by the federal government.[12]

Therefore, public debt increased from 667,467,826 pesos to 1,037,116,145 pesos (plus 414,621,442 pesos that corresponded to the payment of interest). In summary, the total debt was 1,451,737,587 pesos (equivalent to 708.16 million dollars). In addition, Lamont secured the representation of bondholders, reaching 90% of bank bonds and 98% of railroad bonds (Bazant, [1968] 1995, pp. 194-199).

The Mexican Congress opposed the agreement for two reasons. First, because it surpassed the country's capacity to pay. And second, because they considered it inconvenient to incorporate railroad debt. However, the agreement was approved by decree on September 29, 1922 (Secretaría de Hacienda y Crédito Público, 1960, pp. 55-56).

Obregón's government was recognized by Washington as a result of the signing of a binational agreement, known as the *Bucareli Agreements*, in August 1923. These

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[11] Decree of June 7 1921.

[12] This fund was established to resolve problems with creditors in agricultural activities, and it was nationalized on June 2 1917. See Pani (1926, pp. 106-107).

agreements limited the government's ability to affect oil companies, as well as protected American landowners. The agreements also set up two claims conventions: a special commission to review complaints proceeding from the Revolution (between 1910 and 1920), and another general one to examine mutual claims since 1868 (Meyer, 1998, p. 237).[13] With this agreement, the Mexican government managed to normalize diplomatic relations with the United States, France, Italy and Belgium. Britain refused to recognize Obregón, a position that changed in September 1925 when it agreed to resume diplomatic relations with Mexico (Meyer, 1991, pp. 33, 344, 375, 398ss and 412).

The 1924 presidential succession pitted the warlords who had risen from the Revolution against each other. It was a military rebellion that cost the public purse 43.2 million pesos (Medina, 1995, pp. 91-92; Bazant, [1968] 1995, pp. 199-200; Garciadiego, 1999, pp. 29-30). This economic bloodletting and the refusal of the Committee of Bankers to grant the government an advance of 30 million pesos guaranteed by the oil production tax obliged President Obregón to suspend payment of the debt by means of a decree on June 30, 1924 (Bazant, [1968] 1995, p. 200). With this decision, Obregón handed down the problem to his successor.

THE PANI-LAMONT AMENDMENT

The new President, Plutarco Elías Calles, and his Minister of Finance, Alberto J. Pani, sought to restore public finances and reduce administrative expenditure. The plan reduced the fiscal deficit from 58 million pesos in 1923 to 23 million in 1924 and it almost balanced out the following year. This situation made possible the establishment of a central bank, the *Banco de México*, in 1925. Likewise, government development banks were established, like the National Bank for Agricultural Credit (*Banco Nacional de Crédito Agrícola*) and the National Program for Roads and Irrigation Works (*Programa Nacional de Caminos y Obras de Irrigación*), both in 1926. That same year, payment of foreign debt resumed (Suárez Dávila, 1988, p. 363).

[13] See also Pani (1936, pp. 279-285).

The last suspension of debt payments allowed the Mexican Treasury to clean up its finances and balance its budgets. This enabled the government to set out negotiations regarding foreign debt between Pani and Lamont. Both parties agreed to accept some amendments and additions to the 1922 agreement. On October 25, 1925, the Mexican government and the bankers reached a new agreement, known as the "Pani-Lamont Amendment", based on which Mexico restarted debt payments in 1926 (Pani, 1926, pp. 103-104).

On that occasion, the Mexican government gained several advantages through the negotiations, reducing the amount of the debt and increasing the government's financial power through the separation of the *Deuda Ferrocarrilera* from the public debt and exchange of bonds for the Loan Fund for Irrigation for public debt bonds (Secretaría de Hacienda y Crédito Público, 1960, p. 58).[14]

Another concession obtained by the Mexican government was the rearrangement of the 1924 and 1925 loans, which came to 75 million pesos. These loans would be paid from 1928 and liquidated in deferred payments over eight years, a period "during which they will be liquidated according to a progressive scale of repayments and with an annual interest rate of 3% on outstanding amounts, incurred from the date upon which payment is due" (Pani, 1926, p. 104). The government also pledged to return the railroads to the companies, which would take over management and payment of the debt (Secretaría de Hacienda y Crédito Público, 1960, p. 59). Regarding the Loan Fund for Irrigation, which was in the process of liquidation due to default of payment by plantation owners of what they had been lent, "the government would assume the debts, and in exchange the Fund would relinquish its rights to land, mortgages and property to the former" (Bazant, [1968] 1995, p. 203). This turned out to be to the government's advantage, because it could dispose of assets that were subject to various levies (Secretaría de Hacienda y Crédito Público, 1960, p. 59).

[14] It managed to separate railroad debt from the public debt, except for interest corresponding to the period from 1923 to 1925 (an amount of 63,964,674 pesos). According to Pani (1926, p. 105), this agreement relieved Mexico of "toda responsabilidad sobre las obligaciones ferrocarrileras no garantizadas por el [gobierno] originalmente y estas obligaciones importaban, por capital e intereses atrasados, nada menos que $671 236 456.11".

As such, Mexican public debt reduced from 1,562,838,348 pesos to 998,217,794 pesos by December 31, 1925 (from 769.88 to 491.73 million dollars) (Bazant, [1968] 1995, p. 204). Moreover, Mexico retained the collateral of the oil export tax. This was strategic by the Mexican government, because it divided the bankers and the oil companies and pitted them against each other (Bazant, [1968] 1995, p. 203).

In 1926, debt service payments resumed. However, once again the government was unable to meet its financial obligations due to a significant drop in trade and oil extraction, which had a negative impact on taxes on production and export (Suárez Dávila, 1988, p. 366). In light of this economic situation, Mexico was just able to pay the debt service but was forced to suspend payments temporarily in 1928. But in that year, the government was able resume debt service, which rose to 77 million pesos. Other payments derived from the national debt – approximately 100 million pesos and a third of the government's regular income – were added to this (Bazant, [1968] 1995, pp. 204-205). This again hindered the government's capacity to pay.

THE MONTES DE OCA-LAMONT AGREEMENT

By July 1, 1929, public debt rose to 1,089 million pesos (523.6 million dollars), of which 656.6 million corresponded to capital and 443.3 million to outstanding interest.[15] In light of the delays of payment by the government, the parties entered into negotiations once again. On July 25, 1930, the Minister of Finance Luis Montes de Oca signed the Montes de Oca-Lamont Agreement. In that agreement, they approved a single emission of bonds for 267,493,240 dollars, divided into two series of similar amounts payable over a term of 45 years, which would be set aside to exchange the government's debt bonds (Secretaría de Hacienda y Crédito Público, 1960, p. 60).

However, the monetary problems that affected the gold standard worldwide, as well as the persistent economic crisis that erupted since 1929, prevented Mexico from complying with the agreement. For this reason, the President at the time, Pascual Ortiz Rubio, decided not to submit the agreement to the Mexican Congress (Secretaría de Hacienda y Crédito Público, 1960, p. 62).

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[15] This amount excludes payments made between 1923 and 1927. See Bazant, ([1968] 1995, p. 210).

In 1931, Ortiz Rubio authorized his Finance Minister, Montes de Oca, to sign a supplementary agreement with the International Committee of Bankers, modifying the previous one. The agreement was signed on January 29, 1931. It was agreed that the new issuance and payment to bondholders would be postponed for two years, and it also stipulated that during this period the government would deposit in Mexico, in silver pesos, the approximate value of the debt service in gold that had been pledged the previous year.

On January 1, 1933, whatever the exchange rate, the funds would be converted into dollars and the Mexican government would cover the difference, if needed (Bazant, [1968] 1995, p. 216). But nor was the Mexican government able to comply with this commitment once more, due to the global economic crisis which affected the balance of payments. Once again, Mexico was forced to suspend payment of the debt through the Decree of January 21, 1932, canceling the 1931 agreement (Secretaría de Hacienda y Crédito Público, 1960, pp. 62-63).

By 1933, Mexico, the Soviet Union and Great Britain were part of a list of countries that had suspended payment of their foreign debt. In part, this was a result of the Great Depression. Toward the end of that same year, British holders of Mexican bonds had not lost hope of recovering their investment, just they lost their patience. They opted to negotiate independently of the International Committee of Bankers, controlled by US interests. To this end they formed The British Committee of Mexican Bondholders, a group of 500 bondholders whose investment totaled six million pounds. The British Committee established contact with the Mexican authorities. There is no evidence that they succeeded.

The enactment of the Johnson Act in April 1934 might have added stress to the Bankers Committee.[16] And indeed, after tensions during the negotiations, the Mexican government broke off relations with the International Committee of Bankers on May 21, 1934.

[16] The Johnson Act prohibited foreign nations in default from marketing their bond issues in the United States.

SECOND STAGE: FROM THE IMPASSE TO THE BEGINNING OF BILATERAL AGREEMENTS

In December 1934, Lázaro Cárdenas began his Presidency of Mexico. He was undoubtedly one of the most influential leaders this country has ever had. Cárdenas brought stability to the Presidency and consolidated a system of authoritarian government based on one dominant party supported by corporatist organizations. On the one hand, Cárdenas handled mass politics with a popular and anti-business discourse, supported trade unions and operated an unprecedented land redistribution policy. For the latter, he confiscated property from Mexican and foreign landowners. In March 1938, after several confrontations, he expropriated the (mainly English and American) oil companies operating in Mexico, which was a severe blow to the interests of international corporations in the country.

On the other hand, the Cárdenas government maintained a close relationship with large business groups and particularly some Mexican bankers, who provided him with support organizing the country's finances. Cárdenas himself, like his government team, also sought to maintain a harmonious relationship with the United States throughout his term in office. Under Cárdenas regime, public finances improved. The ratio debt/revenues of the government began to drop. Fiscal revenues and expenses increased, and the public deficit was maintained relatively stable (as shown in chart 3 and 4, above).

The outbreak of the Second World War was a crucial event, as it opened a door of opportunity for the government. President Lázaro Cárdenas himself openly took a stance in support of the Allies and against the Axis countries. Similarly, in the later years of his administration, his government actively promoted a new shaping of Mexican trade relations with the United States. But there were still many outstanding issues to resolve with the United States and other countries, and more problems had accumulated with this administration's policies. Debt was one of many issues.

For example, the following negotiating groups all had outstanding historical claims: the American-Mexican Claims Commission (*Comisión General de Reclamaciones México-Estados Unidos*), which operated from 1924 to 1934; the British-Mexican Claims Commission (*Comisión General de Reclamaciones México-Gran Bretaña*), 1928-1932; and the French-Mexican Claims Commission (*Comisión General de Reclamaciones*

México-Francia). In addition, there was railroad debt (*Deuda Ferrocarrilera*). This is without even mentioning government debt – the subject of this research. Solutions to all of them progressed slowly.

While compensation for Americans affected by the Civil War had still not been resolved, mass confiscation of land between 1935 and 1938 made the problem with regard to the United States even worse, as it impacted nearly 300 US landowners. This affected the US government's expectations as to the negotiations (Dwyer, 2008; Riguzzi and de los Rios, 2014, pp. 284-285).

Another aspect that played a part in negotiations was the international silver market, in which both countries were important players. Negotiations between the US Treasury Department and the Mexican Ministry of Finance started in 1936, to establish agreements to purchase silver from Mexico. These agreements in 1936 and 1937 were revealing, because they evidenced the concern of the Secretary of the Treasury, Henry Morgenthau, about potential infiltration of the Axis powers in Latin America, both in trade and military terms (Riguzzi and de los Rios, 2014, p. 286; Suárez Aranzolo, 1977).

The bilateral relationship was changing drastically. For example, two decades beforehand, during the First World War, tensions between Mexico and the United States were exacerbated; at its worst point in 1914, American troops occupied the port of Veracruz. But with the emergence of the Second World War, the relationship was redefined. This was partly a result of Roosevelt's government's concern for the southern flank – principally California and the Pacific area – as well as concern about Fascist interference in Latin American countries. Another factor was the Mexican government's recognition that such opportunities were important for the country (Cramer and Prutsch, 2014; Riguzzi and de los Rios, 2014, p. 312).[17]

After Lázaro Cárdenas finished his term in office in 1940, President Manuel Ávila Camacho continued his politics. In diplomatic matters, Ávila Camacho took a more aggressive stance towards the Axis powers. The rest of the political establishment, including powerful leftist labor leaders, also endorsed the alliance with the United States. In this context, as a signaling that everything was under control, the then ex-

[17] The literature on diplomatic events revolving around these developments is abundant, Riguzzi and de los Rios summarize some of the relevant works.

President Cárdenas became head of the Pacific Military Region and subsequently the Minister of National Defense (*Secretario de la Defensa Nacional*).

From 1941, cooperation mechanisms were activated with greater intensity between the two countries, including on issues relating to trade, the military and international law. Just before the Japanese attack on Pearl Harbor in December 1941, the two governments reached a settlement to form an alliance between their countries and to normalize the relations and outstanding problems from years beforehand.

In light of the attack on Pearl Harbor, the Latin American countries (except Argentina and Chile) reached a consensus at the Rio de Janeiro Conference in January 1942 to break off diplomatic relations with the Axis Nations. Mexico declared war on the Axis in May 1942 (Riguzzi and De los Rios, 2014 p. 314). In this context, Roosevelt visited Mexico in 1943 – the first visit by a US President.[18]

On November 19, 1941, Mexico and the United States signed the *Good Neighbor Agreement* (Suárez Dávila, 1988, p. 381). With this agreement, the Mexican government pledged to pay 40 million dollars to settle the general and special claims, and claims for damages and agricultural expropriation in particular. For its part, the United States agreed to grant Mexico two loans: one for 40 million dollars to create an exchange rate stabilization fund for the peso (against the dollar), and the other for 20 million dollars to straighten out the transport system. Finally, it committed to resume monthly purchases of silver from Mexico. In the case of the oil dispute from the 1938 expropriation, they agreed to set up a commission to assess the confiscated property and determine the terms of compensation. A commitment to negotiate a trade agreement was also agreed (Meyer, 1981b, pp. 388-389; Meyer, 2000, p. 879; Riguzzi and de los Ríos, 2014).

An interesting anecdote is that Eduardo Suárez, the Minister of Finance, appointed Salvador Ugarte to begin negotiations for the trade agreement in 1941. Ugarte was a renowned banker in Mexico, close to Suárez. His American counterpart was Nelson Rockefeller, who was then a young civil officer in the Department of State (Suárez Aranzolo, 1977, pp. 265-266). Rockefeller was the Coordinator of Inter-

[18] The visit was to Monterrey, near the US border, as a cross border exchange with his Mexican counterpart.

American Affairs.[19] In his memoirs, Suárez notes that the deep friendship that formed between the two men streamlined negotiations. But President Roosevelt's decisiveness was instrumental for official approval.

The trade agreement, signed in December 1942, was important as it turned Mexico into a US supplier of raw materials during the war. The treaty not only formalized the trading partnership between the two countries, but it was also a trigger for future trade agreements in the bilateral relationship. Likewise, and hand in hand with the negotiations for this agreement, the Bracero Program was signed in August 1942 to transfer labor from one country to the other. This program would initiate a completely unexpected, nevertheless significant, cycle in the future bilateral relationship.

An important actor in the negotiations was Eduardo Suárez, the Minister of Finance under Presidents Lázaro Cárdenas and Manuel Ávila Camacho. Suárez was appointed Minister of Finance on June 18, 1935. Suárez had gained experience of international negotiations throughout his career. He had participated in the British-Mexican Claims Commission since 1928 and the French-Mexican Claims Commission in 1930, and he was head of the Mexican Delegation to the League of Nations in 1932. Another important experience was negotiating the debt with the International Committee of Bankers. That path would help him to finally resolve the government's debt.

DEBT DIPLOMACY: NEGOTIATION OF THE DEBT FOR THE 1942 AND 1946 AGREEMENTS

Suárez and his context

This story has a protagonist, and it is undoubtedly Eduardo Suárez Aranzolo. Suárez was part of the generation that contributed to the rejuvenation process of the government in post-revolutionary in Mexico.[20] Suárez was born in 1895, in Texcoco, State of Mexico. In January 1913 he entered the National School of Jurisprudence at the then National University of Mexico. The professional mobility in government careers that the revolution brought about gave Suárez the opportunity to get his first public

[19] Rockefeller headed the Office of Inter-American Affairs for most of its existence. See Cramer and Prutsch, (2014).
[20] Garciadiego, 1999 and 2000.

position of high responsibility when noticeably young. Thus, at age 22, the governor of the state of Hidalgo, Nicolás Flores, appointed him in charge of the Secretaría de Gobierno del Estado (during the period 1917-1919). However, Suárez had to settle permanently in Mexico City due to the reorganization of the local Hidalgo political elite and by a conflict between the warlords Venustiano Carranza and Álvaro Obregón.[21] His return to Mexico City triggered an ascending career in the public administration, reaching an important point in 1932, when he represented Mexico in the League of Nations and three years later appointed Secretario de Hacienda.

Public officials with talent and education, as Suárez was, became indispensable for the government of those years. The civil war during the period of the Mexican Revolution affected the administrative organization of the country, firstly because it dismantled the personal, professional and institutional networks that the ruling elite built during the Porfirian regime, and secondly because it interrupted the learning curve in the high command of public administration. In addition, the technical experience accumulated by lawyers such as Pablo Martínez del Río, Joaquín Casasús, Pablo Macedo, Salvador M. Cancino, and Luis Riba y Cervantes, who had training in financial centers such as London and New York, was lost. Those attorneys were replaced by very young and inexperienced professionals.

The dismantling of the Porfiriato's bureaucratic apparatus as a result of the civil war, the entering governments undertook the task of reorganizing the public administration. [22] In those circumstances, the new rulers incorporated young people into their governments to occupy "prematurely a big number of political and bureaucratic positions". [23] In his memoirs, Eduardo Suárez refers to the capabilities of the international negotiators who participated in the commissions to resolve claims for damages caused by the civil war to foreign citizens. For example, he mentions Cornelio Van Vollenhover, whom he describes as “a Dutch jurist, professor of Law at the University of Leyden; man of great legal knowledge, who was fluent in and wrote English, French and Latin correctly. […]. He was also a perfect gentleman, a severe man

[21] Suárez Dávila, 1977, pp. LVIII-LXIX.
[22] Garciadiego, 1999 and 2000.
[23] Ibid.

as a judge, and absolutely impartial in his duties".[24] In contrast, Suárez believed that some Mexican negotiators did not have the minimum legal knowledge to negotiate.[25] However, Suarez also mentions that the Mexican Commissions also had lawyers with extensive diplomatic experience, as was the case of Bartolomé Carvajal y Rosas, who had served as ambassador in different countries. Also part of the team was the "enlightened economist" Enrique Martínez, Sobal, of Guatemalan origin, but a Mexican national, who was fluent in English. Other members were Óscar Rabasa, Francisco Urzúa and Enrique Munguía, all three had graduated from American universities and spoke fluid English. [26]

For instance, Manuel Gómez Morin is a pristine example of the contribution of this youth in drafting an important part of the fiscal, banking and financial legislation and in the creation of institutions. Suárez was another of these institutional builders of Mexico at that time, as well as an important actor in diplomacy and in the insertion of the country in the negotiations of the global financial system.

[24] Eduardo Suárez Aranzolo, 1977, pp. 7.
[25] Suárez Aranzolo, 1977, p. 7.
[26] Suárez Aranzolo, 1977, pp. 10-11.

Negotiations

During his stay in New York in 1932, for the trial of a 6.5-million-dollar fund held by the International Committee of Bankers, Eduardo Suárez realized that it was easy "to purchase Mexican bonds on the New York Stock Exchange for ridiculous prices, completely discredited by virtue of the several suspensions in payment" (Suárez Aranzolo, 1977, p. 267). To that end, he asked his US lawyers on the case to advise him on how to purchase the bonds. He also received support from his friend Gustave Galopin, a Swiss man who trained him on the mechanics of the Stock Exchange and put him in contact with brokers. He then ran an experiment and purchased "some Mexican bonds at the price of one dollar cent per bond with a face value of 100 dollars, with coupons for overdue interest that were worth the same" (Ibid). In 1934, convinced of the feasibility of this transaction, Suárez advised Marte R. Gómez (then Minister of Finance) that the Ministry and the central bank, *Banco de México* should purchase these bonds. But he warned that the deal should be done with complete discretion to avoid speculators beginning to invest in these bonds and drive up their price (Suárez Aranzolo, 1977, p. 266).

Once appointed Minister of Finance in 1935, Suárez continued to purchase bonds through the *Banco de México* and employed several brokers from the New York Stock Exchange for this purpose. Suárez subsequently made the *Banco de México*, through the *Chase National Bank* (its correspondent in New York), propose to bondholders that the bank would pay ten dollar cents per 100-dollar bond with all its coupons. Plenty of bondholders accepted the proposal (Ibid, p. 267).

After draining the market of bonds that were held by investors as well as speculators, Suárez decided to resume relations with the International Committee of Bankers. For this, it also helped that the Court of Appeals of the State of New York overturned a judgment in Mexico's favor relating to 6.5 million dollars that the International Committee of Bankers had retained. The Court instructed the Committee to distribute the funds among bondholders (Ibid and Bazant, [1968] 1995, p. 217).

When talks resumed between the Ministry of Finance and the International Committee of Bankers in 1942, Suárez set out two proposals for a new agreement to Thomas Lamont. First, he requested that the bonds the Committee had retained be used to help Mexico pay its foreign debt commitments, and that only bondholders who abided by this rule would be eligible to enter the agreement. Second, he suggested that the agreement exclude "bondholders who were in Central Europe, dominated by the Axis countries […], in accordance with the recommendation of the 1942 International American Conference on systems of economic and financial control" (Suárez Aranzolo, 1977, pp. 250-252).[27] In this way, Mexico rid itself of "payment of bonds with a nominal value of several million dollars". The government estimated that there were Mexican bonds with a nominal value of 50 to 60 million dollars in continental Europe dominated by the Axis countries. That's why it was "necessary to avoid that any adjustment and payment agreement benefit the aggressor nations" (Bazant, [1968] 1995, p. 222).

Moreover, Suárez reminded Lamont that, since the 1932 Montes de Oca-Lamont Agreement, the then US ambassador, Dwight Morrow, had declared to him "that it was completely unfair and inappropriate, both for the Mexican government and for bondholders, to enter into an agreement that would be beyond Mexico's capabilities to comply with". As a result, Mexico was able to pay the foreign debt with the following conditions: full write-off of interest up to the date of signing, and conversion of the principal of the bonds to pay one peso for every one US dollar. Moreover, it made it a requirement for holders to present their bonds for registration (Secretaría de Hacienda y Crédito Público, 1960, p. 65).

In his memoirs, Suárez said that it was very hard work to convince Lamont, but he eventually agreed because the United States had already entered the World War. Lamont undertook to persuade US and English bondholders, but not the French. In order to persuade the French, he recommended that Suárez ask Agustín Legorreta, the CEO of the Banco Nacional de Mexico, then the largest bank, to go to Paris and use "the great influence he had at the Banque de Paris et des Pays-Bas" to get them to accept the Mexican government's proposal. Suárez spoke with Legorreta, who agreed to meet with

[27] The amount was 29.7 million dollars.

the French. The mission was successful, because Lamont told Suárez that French bondholders approved the agreement as proposed by the Minister of Finance (Suárez Aranzolo, 1977, pp. 268-269).

The Agreement was finally signed on November 5, 1942, and "established the basis for the adjustment and payment of 'direct foreign debts' ". For the 1922 Convention, the Committee was composed of American, English, French, Swiss, Dutch and German representatives. However, due to the wartime context, only the American, English and Swiss divisions attended this convention (Secretaría de Hacienda y Crédito Público, 1960, p. 64). This convention proposed that Mexico pay one peso for every dollar, which represented a write-off of capital. In this way, the government's direct liabilities reduced from 230,631,974 dollars to 230,631,974 pesos, with the caveat that it would be paid at the holders' discretion in dollars or pesos at the exchange rate of 4.85 pesos per dollar (Ibid, p. 65).

In short, the 1942 agreement reduced Mexico's foreign debt from 509,516,220 dollars in capital and interest to 49,560,750 dollars, i.e. less than 10% of the original amount. The bonds purchased by Mexico in the market should be deducted from this figure (Suárez Aranzolo, 1977, p. 270). The debt was reduced further by subtracting the so-called enemy bonds. In the end, Mexico's actual debt decreased from 49.5 to 43 million dollars (Bazant, [1968] 1995, p. 227).[28] Finally, the government pledged to submit a proposal for settling the consolidated railroad debt (Secretaría de Hacienda y Crédito Público, 1960, p.66). However, the agreement to settle the debt would not be signed until 1946.

Unlike the US bondholders, who accepted the agreement, the British considered the settlement too advantageous for Mexico.[29] This disagreement was clearly reflected by the British press. In the midst of this disagreement, Eduardo Villaseñor, head of the Banco de México, traveled to London to ensure fulfillment of the debt settlement, which the Mexican Senate approved on December 24.[30]

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[28] The enemy bonds were estimated to be originally equivalent to 29,760,000 dollars.

[29] *El Nacional*, 20 de octubre de 1943, DO9081 (1941-1949), Deuda Exterior: México, Archivos Económicos, Fondo Biblioteca Miguel Lerdo de Tejada, SHCP.

[30] *El Nacional*, 20 de octubre de 1943, El Nacional, 24 de diciembre de 1943, DO9081 (1941-1949), Deuda Exterior: México, Archivos Económicos, Fondo Biblioteca Miguel Lerdo de Tejada, SHCP.

In an editorial in 1943, the newspaper *Financial News* stated that "Mexico's position is stronger today than it was decades ago [which is why] there may be a case for the country paying more to bondholders abroad". The editorial revealed that demands had already been made in the House of Commons, but that the Chancellor of the Exchequer was waiting for a formal offer to bondholders to proceed. The English government's attitude acknowledged the "fact that Mexico is an ally of England against the Nazis, coupled with the Committee of Bankers in New York having already accepted the offers of settlement and liquidation".[31]

For the liquidation of capital, the agreement set out that the "secured" debts should be repaid no later than January 1, 1963, and the "unsecured" debts by January 1, 1968. It is worth mentioning that the agreement would only be implemented a year after it was signed. To this end, they drew on the services of banks in Mexico, New York and London. However, the war prevented solving existing obligations in continental Europe. After the conflict ended, there was interest in extending the agreement's offer to bondholders residing in that area (Secretaría de Hacienda y Crédito Público, 1960, pp. 66-67).

On February 20, 1946, the government made an offer to railroad company bondholders, via the International Committee of Bankers, for their adjustment and payment. There was a similar reduction in that agreement to the 1942 one. The debt was reduced to 233,112,385 pesos, which was equivalent to 48,064,409.28 dollars. The interest owed between 1914 and 1946 was minimized and the maximum term for the government to repay the bonds in full ended on January 1, 1975 (Secretaría de Hacienda y Crédito Público, 1960, pp. 67-69). In 1960, the Mexican government announced the early repayment of all those bonds, bringing a chapter in Mexico's history to a close.

After the end of that episode, from 1946 to 1967, Mexico had little involvement in international debt markets, with occasional lending from multilateral banks for specific developmental purposes. Most public debt was domestic. However, in the early seventies, Mexico began again to embark as a major borrower in international markets.

[31] Novedades, 12 de agosto de 1943, *El Nacional*, 20 de octubre de 1943, DO9081 (1941-1949), Deuda Exterior: México, Archivos Económicos, Fondo Biblioteca Miguel Lerdo de Tejada, SHCP.

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