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RECENT DEVELOPMENTS IN MEXICO
IN THE FIELD OF MONEY AND BANKING

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For almost a year the Government of Mexico has been engaged in putting into effect a thorough-going program of reform in the monetary and banking system of the country. Inaugurated in the Monetary Law of July 25, 1931 and developed and rounded out in the subsequently enacted Law Reorganizing the Bank of Mexico and the General Law of Credit Institutions (with their respective amendments) this program of financial reformation and reorientation has had, and is having, profound and far-reaching consequences for all types of business, commerce and industry. It is the purpose of this report to make a brief survey of the various laws which have been passed and, in so far as may be possible, an analysis of the course of events in the economic life of the country prior and subsequent to their enactment.

FINANCIAL HISTORY OF THE POST-REVOLUTIONARY PERIOD

The problem of currency, credit and finance with which the Mexican government has been attempting to deal in the laws under consideration in this report, date back in large part to the period of general economic and social disorder introduced by the 1910-21 revolution. For the purpses at hand, however, it will not be necessary to review the intricate financial history of that dark and unhappy interlude. Suffice it to say that by 1916, thanks among other things to various issues of fiat currency by the several momentarily triumphant revolutionary governments and the seizure of some 50 million pesos of bullion and coin from the banks by one of these governments, the whole monetary and credit structure of the country had been almost completely wrecked.

The creation of the Monetary Commission by decree of April 3, 1916 and the return shortly thereafter to hard money marked the first steps in the reconstruction of the basic financial machinery of the country.

Post-Revolutionary Currency System

On the legal side, the return to hard money was marked by the decree of November 13, 1918, reestablishing the monetary unit in use before the 1910 revolution: the peso of 100 centavos, representing 833.33 milligrams of gold 0.900 fine (750 milligrams of fine gold) with a par value in United States currency of $0.4985.

The gold coins placed in circulation were in pieces of 2, 2 1/2, 5, 10, 20 and 50 peso denominations. The silver peso by decree of Oct. 27, 1919 was established at 16.6667 grams (257.206 grains), 0.720 fine (i.e. 12 grams of pure silver). The legal fractional currency authorized consisted of silver, copper and bronze coins in various centavo denominations.

It was not until 1925, with the establishment of the Bank of Mexico, that paper currency of any type was allowed to circulate. The gold bills issued by the Bank of Mexico never, however, attained any very large circulation.

It should be noted here that because of export restrictions and the inability of the Government to redeem other currency in gold, Mexico throughout the post-revolutionary period has been only nominally on the gold standard.

Bank of Mexico

The first instrument by which the Government of Mexico sought to regain control over its wayward currency after the worst of the revolutionary disorder had passed was the already mentioned Monetary Commission established by the decree of April 3, 1916. This Commission functioned with varying success for a number of years. With the return of relative peace and stability in 1921, however, there was increasing agitation for an institution of much larger scope and more comprehensive powers. This need was finally met in the establishment of the Bank of Mexico on Sept. 1, 1925. In view of the fact that a large part of the recent program of reform in the field of money and banking has centered around the Bank of Mexico, it is necessary at this point to review in some detail the originally decreed structure and functions of that institution.[1]

The general powers of the bank as defined in the law establishing it were:

(1) to issue bank notes;

(2) to regulate the coinage, currency and foreign exchange (exercising control of the money regulating fund) and the rate of interest;

(3) to rediscount commercial paper;

(4) to act as financial agent of the Federal Treasury;

(5) to engage in general operations of discount and deposit.

In order to insure the permanent control of the Government over the Bank of Mexico, the law authorizing its establishment, made it mandatory for the Federal Government to purchase 51% of the shares of the authorized capital of 100 million pesos.

These shares (known as "A" shares) were inalienable and carried with them the right to designate a majority of the members of the Board of Directors. The remainder of the capital stock ("B" shares) was offered to the general public and to banks associated with the Bank of Mexico.

The notes which the Bank of Mexico was originally empowered to issue were redeemable in gold on demand at the central bank or any of its branches and were issued against gold coin or bullion or bills of foreign exchange or short term commercial bills (payable in gold). Gold reserves of at least 50% of the outstanding notes were required to be maintained. The gold bills were not legal tender, but were receivable without limit by Federal,state and municipal governments.

As it later developed, a very significant article in the law creating the Bank of Mexico was the one granting the bank the right to engage in direct loan and discount transactions with the general public provided that such transactions "were guaranteed by sufficient collateral or by the signature of three notoriously solvent persons who were not associated together in business."

To make possible the operation of the Bank of Mexico in its principal role as a central bank of issue and rediscount, it was provided that solvent banks and banking institutions organized according to the General Law of Banks and Credit Institutions might by the purchase of "B" shares to the amount of 6% of their subscribed capital and surplus become associated banks. To become a member or associate bank it was also required that the institutions in question keep on deposit with the Bank of Mexico in gold 10% of their deposits, to be counted as part of their legal reserves. Associated banks were entitled, within certain limitations and restrictions, to: (1) rediscount commercial paper due in not more than 90 days; (2) discount acceptances; (3) receive advances on bills of exchange; (4) to have opened for them credits in current account; and (5) to discount debenture bonds issued by promotion, agricultural and industrial banks, or secured paper issued by public warehouses.

The Bank of Mexico began operations with a paid-in capital of 57,389,500 pesos distributed as follows:

"A" shares:	subscribed by the Federal Government, fully paid	51,000,000
"B" shares:	subscribed by the Federal Government, 10% paid	4,734,500
	subscribed by associated banks, fully paid	1,500,000
	subscribed by private companies (2) and individuals (16)	155,000

From some points of view (but see below p.43), the Bank of Mexico has been unusually successful. Its business has increased year by year and its management has been sound. At the end of 1930, for example, it had some 26 branches and 5 associated banks. Depositors numbered 26,037 with total deposits amounting to some 48.6 million pesos, including deposits of associated banks of 1.9 million, deposits of 2.7 million from public service enterprises, and Government deposits of 3.8 million pesos. Its ordinary loans and discounts and loans against collateral amounted to some 61.9 million pesos, its loans to the Government to 6.2 million pesos, and its other loans to 7.8 million pesos.

Course of Exchange Fluctuations

Having noted the reestablishment of the monetary system on the basis of hard money and the creation of the Bank of Mexico as the chief agency for the regulation of currency and credit, we may now turn to a review of the fluctuations in the value of Mexican money in the post-revolutionary period. This review will involve not only a statement of the variations in the exchange rates but also an attempt to account for these fluctuations in terms of economic and political forces and events.

Course of Gold Exchange

With the exception of short periods at the beginning of 1920, 1921 and 1925 when on several occasions it was above par, the gold peso has been below the export point during the entire post-war period. For the purposes at hand here - the presentation of the events leading up to the Monetary Law of July 1931 and other subsequent monetary and banking legislation - we may omit any detailed consideration of the first years in the post-revolutionary decade and concentrate our attention on the period 1925 to July 1931.

During the above mentioned period, as may be noted on Chart 1 and in Table 1, (see appendix) starting at a little above par in the Spring of 1925, the gold peso began an almost uninterrupted slide downward until it hit a temporary low in December 1926 when the average selling rate for the month (in New York) was $0.4667 or about 7% below parity ($0.4985) with the American dollar. Thereupon the gold peso remained in a depressed state until the middle of July 1927.

By way of explanation of this drop and continued depression in the value of the gold peso it may be noted that exports, especially oil, were decreasing at an alarming rate from month to lations between the United States and Mexico under the guiding hand of Ambassador Morrow.

Except for another seasonal drop during the summer months of 1928, the gold peso continued a more or less steady climb upward until it reached a high of $0.4857 average selling price for the month of August 1929. From that point there began another steady decline which finally hit bottom in December 1930 with an average selling price for the month of $0.4555, or something more than 8.6% below parity. There followed a rapid rise and by June 1931 just before the new Monetary Law was promulgated gold exchange rates had reached the highest point since 1925 ($0.4903 average for the month). In order to understand these more recent fluctuations in the gold exchange, it will now be necessary to turn for a time to a consideration of the silver peso.

Relation of the Silver Peso to the Gold Peso and to the Dollar

As shown on Chart 1 and Chart 2 and in Tables 2 and 3, the Mexican silver peso throughout the period under consideration here has been quoted at a discount from the gold peso. From January 1925 to June 1926, this discount never exceeded 2%. (The slight discrepancy at some points between the "percentage of discount" curve on Chart 2 and the relationship between the gold and silver curves shown on Chart 1 is due to the fact that the statistics used for plotting these various curves were derived from different sources - see the footnotes to Tables 1, 2 and 3. The general trends of the curves - the major point of interest here - are, of course, not seriously distorted by the fact that some exchange rates are for the Mexico City market and some for the New

York market.)

The curve for silver pesos, as might be expected, shows the same drop from about the middle of 1925 to December 1926, and the same continued depressed state thereafter already indicated for gold. The lowest point reached by silver during this period was for the month of February 1927 when the monthly average buying and selling rate quoted by the Bank of Mexico was $0.4235. Thereafter, except for a sudden but temporary rise in August 1927, the silver peso limped along parallel with the gold peso in a slow climb out of the "trough" of 1926-27, finally reaching a new high in April 1928 of $0.4740 and at the same time cutting the percentage of discount from the high point of 11.61% in February 1927 to around 3% in April 1928. From this point until May 1930, the silver and gold curves follow each other very closely, the percentage of discount of silver from gold fluctuating between a low of 3.07% in April 1928 and a high of 3.69% in May 1929.

Beginning, however, with May 1930, the silver and gold pesos, although for a few months more their curves moved in the same general direction, very definitely began to part company. By December of 1930 the discount of silver from gold had risen to a new high of almost 14% and the value of the silver peso compared with United States dollars had dropped to $0.3995. In the next few months the silver peso recovered several points and the discount rate was slightly reduced, but in March 1930 once more the silver peso began to drop and the gold peso to rise in value until finally just before the promulgation of the Monetary Law of July 1931 the percentage of discount of the silver peso from the gold peso reached a new high of 31.14% (average for June) in the open market (see footnote 3, Table 3) and the Bank of Mexico was quoting silver pesos in dollars at around $0.3926 (average buying and selling rates for June 1931.)

Factors Affecting the Exchange Rates

In the discussion of the course of gold exchange, passing mention was made of certain political and economic events which at one time or another apparently affected the value of the gold peso. It is now necessary to return to a more detailed statement of these and other factors as they have operated on the silver peso throughout the period 1925-1931, but with especial reference to the critical situation existing in the year or more preceeding the Monetary Law of July 1931.

Economic Depression. Long before the rest of the world began to feel the first pangs of the present economic breakdown, Mexico was already well started along the road to depression. Indeed, except for a few brief years following the World War when the oil and mining industries were booming, it is perhaps not inaccurate to say that the whole post-revolutionary period in Mexico has been one of greater or less depression.

Certainly agricultural production, especially of the principal food crops, has throughout this period, if one may believe the official statistics, been at all times definitely below the levels attained before 1910. The following figures[5] for the pre-revolutionary period 1906-10 and the post-revolutionary period 1925-29 may be taken for what they are worth in support of the statement just made.

	5-yr average 1906-1910 in 000's of kilograms	5-yr average 1925-1929 in 000's of kilograms	% Decrease
Corn	3,219,624	1,941,036	39.8
Wheat	306,783	291,180	5.1
Beans	163,397	128,081	21.6

The two great extractive industries of oil and mining have been on the down grade for a number of years. The oil industry from the peak of a production of 193 million barrels valued at 366 million pesos in 1921, by 1925 had dropped to 115.5 million barrels valued at 299 million pesos. In the period more especially under consideration here there was a still further decline and last year (1931) the total production of the oil industry in Mexico was only 33 million barrels valued at 77.5 million pesos.[6] Since 1925, the total value of gold and silver produced in Mexico has dropped from 166 million pesos to 75.4 million pesos, or about 54% between 1925 and 1931. This has been somewhat offset by the increase in the value of the baser metals produced during the years 1926 to 1929, but the value of the production of these metals (especially of copper) has also decreased in the last two years and the total value of all metals, precious and otherwise, in 1931, was 206.9 million pesos as compared with the high of 366.8 million pesos in 1929, a drop in value of some 43%.[7]

Another index of the depressed conditions in Mexico during the last few years is to be found in the statistics relating to the national budget.[7a] Total Federal revenues in Mexico decreased from 318.9 million pesos in 1925 to 244.6 million pesos in 1931, a decrease of almost 30%. The drop in the nation's income was particularly rapid in the six months preceeding the enactment of the Monetary Law of July 1931. Indeed, so sharp was the decrease during these months that by June the actual income (116 million) as compared with estimated income (155.4 million) was only about three-fourths what had been expected and the Government, already behind some 40 million pesos, was threatened with a deficit for the year of about 80 million pesos. Through drastic economies and the use of previously accumulated reserves, the Government was able to see its way clear to making up some 60 million pesos of this threatened deficit. In order to obtain the remaining 20 million, the only recourse was to increase taxes.

The world-wide depression which began in 1929, in sum, has served to accentuate conditions which were already bad in Mexico. The reduced prices already prevailing in the world market for Mexico's principal mineral products have sunk in the last three years to new lows. Moreover, to make matters even worse, the bottom has dropped out of the market of some of Mexico's other principal products, chief among which may be mentioned coffee, henequen, cotton and cattle.

Unfavorable Balance of International Payments: As might be expected, the conditions which have just been briefly reviewed have affected Mexico's balance of international payments in a definite and marked fashion.

In Table 4 are given the figures for Mexico's foreign trade for the years 1920-1931. From this table, it would appear that through the post-revolutionary period Mexico has enjoyed a very considerable favorable balance of trade. However, unfortunately for Mexico's economic well-being, the truth of the matter is that this favorable balance is more apparent than real.

The great bulk of Mexican exports has for many years been made up of mineral products of which the chief items are oil, silver, gold, copper, lead and zinc. In 1931, for example, these products accounted for over 63% of Mexico's total export trade. (Mineral products 253.3 million pesos; all other products exported, 145.4 million pesos.) Now, it is a well-known fact that Mexico's mines and oil wells are for the most part owned and operated by foreigners. The exports and sales of mineral and oil products pay Mexican government taxes, for imported machinery, equipment and supplies used in the industries, and through drafts drawn to pay for wages, salaries and domestic supplies, they serve to cover payments due abroad for other imports, but a very considerable part of the returns from mining and oil go into the pockets of foreigners in the shape of interest and profits on the billion and a half pesos of foreign capital estimated to be invested in the industries in question. And what is true for oil and minerals is to a less extent true of a number of other industries (lumbering, cattle, chicle, fresh vegetables, tropical fruits, etc.) in which large sums of foreign capital are invested and whose products are important items in Mexican export trade.

The significance of the foregoing is the familiar fact, to all students of Mexican affairs, that an analysis of the balance of payments, as opposed to a simple review of trade statistics, seems to indicate that Mexico's apparently favorable balance is in reality unfavorable. Unfortunately, the data necessary for making a complete study of the Mexican balance of payments are not available. The negative invisible items such as interest and profits on foreign capital invested in Mexico and payments on the national debt (if any), are undoubtedly offset to some extent by such positive invisible items as tourist expenditures in Mexico, emigrant remittances, and interest and profits on Mexican investments and bank deposits abroad. But even when all this has been taken into account as well as may be on the basis of the data available, it would still appear that in the majority of years during the last decade the balance of payments has been unfavorable for Mexico. Indeed, even in such a year as 1925, when exports showed an excess of more than 310 million pesos over imports, one authority estimated that the balance of payments was actually unfavorable for Mexico to the extent of 110 million pesos.[8] If this estimate was even approximately correct for the year 1925, it is perhaps not a bad guess to assume that conditions were much worse, for example, in 1930 when the trade balance in favor of Mexico had dropped to a little over 107 million pesos, when immigrant remittances were falling off due to return of large numbers of Mexicans to their native country and when tourist expenditures were diminishing.

With regard to the period immediately preceeding and following the Monetary Law of July 1931, the following facts may be noted:

In the year 1931 (see Table 4) Mexican exports dropped 12.8% as compared with 1930, and 32.5% as compared with the average exports for the five-year period, 1926-30.

Mexican imports in 1931, as compared with 1930 showed a decrease of 38.1% and as compared with the five-year period, 1926-30, a decrease of 40.5%.

The balance of trade in favor of Mexico in 1931 showed an increase of some 70% over that existing in 1930, but as compared with the average for the five-year period, 1926-30, the balance in favor of Mexico in 1931 decreased by almost 20%. Moreover, it should be noted that in 1931 exports of gold and silver coins (the silver pesos were of the so-called "old" coinage) made up about 11% of Mexico's total exports; whereas in the previous five-year period gold and silver coins appeared on the average in only very small amounts in the official export figures. If gold and silver coins are subtracted from the total exports and imports in 1931 (exports of gold and silver coins 44.8 million; imports 9.4 million), we find that in that year Mexico's favorable balance of trade as compared with the five-year period 1926-30 decreased not by 20% as indicated above, but by about 35%.

Without entering into any further refinements of analysis, from what has already been said it is now perhaps clear that as near as can be estimated only in those years of great prosperity (a large excess of exports over imports and a large volume of positive invisible items) is it at all likely that the balance of payments has been in favor of Mexico. During the last two or three years of depression (a small excess of exports over imports and a small volume of positive invisible items) the balance of payments has undoubtedly been growing more and more unfavorable for Mexico.

Flight of Gold. Mexico's continued and increasing inability to meet her payments due abroad by the export of goods led inevitably to continued and increasing demands for gold. This demand, as has just been indicated, was particularly strong in the year or more preceeding July 1931. The result was two-fold: gold began to flow out of the country and otherwise to disappear from circulation; and, as the demand for gold and its scarcity increased, the value of silver currency as measured in terms of gold decreased.

Just how much of Mexico's gold reserves took flight before July 1931 is very difficult to state in view of the fact that most of the gold which left the country in the period under consideration was perforce smuggled out and hence no records are available. Mention has already been made of illegal withdrawals of from two and a half to three million pesos monthly during the critical period August 1926 to July 1927. Undoubtedly equal if not greater amounts were lost monthly in the period beginning with the first part of 1930 and extending down to July 1931. In this connection it is not without significance that cash on hand in gold currency in the Bank of Mexico decreased from some 14.5 million pesos as of December 31, 1929 to 8.9 million pesos as of December 31, 1930 and that gold deposits of the Bank of Mexico in foreign banks in the same period decreased from 19.6 million pesos to 3.6 million pesos.[9] Also it might be noted that bank clearings of gold checks in the Mexico City Clearing House (including all important banks except the Bank of Mexico) decreased from 26.8 million pesos in January 1931 to 6.5 million pesos in June.

Whatever may have happened to gold in the critical months before July 1931 (whether it was being hoarded or shipped out of the country, or both), it is clear that there was very little of it in circulation. It is also clear, as shown on Charts 1 and 2, that the value of silver surrency as compared with gold was decreasing steadily and rapidly. The logical assumption is that gold was in great demand for purposes which could not be fulfilled with silver - i.e. to cover payments abroad.

By way of summarizing the argument down to this point under the general heading "Factors Affecting the Course of Silver Exchange", the following paragraphs may be quoted from the preamble to the Monetary Law of July 1931:[10]

"As a result of the economic condition which has been prevalent throughout the world for some time past and also due to serious defects in our own economic organization, Mexico's international trade on the export side has decreased in volume, and more especially in value; and, although imports also have shown a tendency to diminish, the balance of payments has been unfavorable for us.

"The condition of the international market for petroleum, silver and numerous other important items of our export trade; the world-wide decrease of prices and the emigration of our capital - without the compensation of a parallel decrease in imports or of a sufficient increase in national production - have brought about the natural impoverishment of our economy, and, along with it, an increased tendency toward the dimunition of the exchange value of the peso.

"The emigration of our capital, or the payment of the surplus of imports over exports, has been necessarily affected to a very large extent by the exportation of gold. In view of the fact that the reserves of that metal available in the country hitherto have been in the shape of gold coins... our currency of that metal has been losing its peculiarly monetary character and function and retaining merely its character of an international commodity...

"Our interior monetary market has been gradually deprived of gold coins and, worse still as a natural consequence of this phenomena, gravely affected by a disparity in value between the two national monetary sources: gold and silver."

<u>Lack of Confidence</u>. A much more intangible factor affecting the value of the Mexican peso is the general lack of confidence both on the part of foreigners and of Mexicans themselves in the political stability of the country. The importance of this factor is often exaggerated and the present writer is not disposed to give it undue prominence. It cannot, however, be entirely left out of consideration.

The pervasive feeling of uncertainty and lack of stability in Mexico is more manifest at some times than at others, but it is always present as a potential threat, and any untoward event serves to release it like a jack-in-the-box to frighten the public and destroy confidence. That Mexico has had to face perhaps more than its share of such untoward happenings during the last few years is a matter of common knowledge to all readers of the daily press. As the then Minister of the Treasury, Sr. Luis Montes de Oca, put the matter in a speech before Congress in December, 1930, Mexico "in the last few years has had to face the following situations: a religious crisis which produced a revolution; then the crisis over the oil controversy; two revolutions; three presidential elections and one attempt against the life of the President. And all this in less than four years. .... It is the situation created by these events which undoubtedly has caused a restriction in business and created an atmosphere of lack of confidence. In the words of the President.... if the people do not have confidence, they will not work, they will not invest; and, if they will not work and invest, undoubtedly they will not produce; and, if the nation does not produce, it cannot export."

To the incidents mentioned above by the Secretary of the Treasury as the causal factors behind the general feeling of instability, other observers would add the agrarian reform and the long struggle over labor legislation. An editorial,[12] for example, in one of the leading newspapers in Mexico City (written before the enactment of the new Labor Law) states:

"The most important factor which we have been able to discover as an explanation of our economic difficulties is the psychological factor - or the question of public confidence, of security, certainty, tranquility and stability...

"Take, for example, that most difficult of problems, the labor law. For years, interests and passions have been stirred up unceasingly on the matter of a law regulating Article 123 of the Constitution. And every pronouncement which has been made speaks of radicalism, of the protection of the laborers at the expense of capital, and of ... attacks on the owning classes... It would be a thousand times better if the law would be passed once and for all (even though it be as radical as has been announced) in order that production might be planned on a firm basis.

"The same thing has been true of the agrarian problem and of fiscal, educational and legislative questions... [In these matters] a policy of threats and promises has been developed which is neither carried out nor abandoned, but which remains, in the last analysis, as a scarecrow.... As a result capital is withdrawn, initiative is curbed and the spirit of enterprise diminished."

One other important factor contributing to the lack of confidence in Mexico has been the failure of the Government to balance the national budget. This factor has been perhaps particularly effective in preventing the reestablishment of the Government's credit and in discouraging the influx of new foreign capital. Without going into a detailed analysis of the facts and figures involved, it may simply be said that the national budget during most of the post-revolutionary period has never really been balanced principally because: (a) no adequate provision has been made for controlling the issuance of agrarian bonds or for the retirement of these bonds; and (b) payments on the national debt are in default and no arrangement has been made for resuming service on the debt either for payments past due or for those due in the future.

Failure of Government Control. It is admitted on all sides by Mexican economists and financial experts, both official and private, that the Government during the post-revolutionary period failed on a number of counts to develop and put into practice an intelligent and statesmanlike monetary policy.[13] This failure could not but have a definitely depressive effect on the value of the silver peso and to some extent on the gold peso as well.

In the first place, for a period of years extending from 1920 to 1927, there was undoubtedly an excessive coinage of silver pesos. The following table gives the silver coinage from 1920 to 1930:[14]

Year	Value in 000's of pesos
1920	23,155
1921	20,199
1922	33,620
1923	35,280
1924	33,060
1925	11,625
1926	29,398
1927	5,622
1928	1,253
1929	-- ---
1930	400