Throughout the period 1920-27, the principal reason for the coinage of silver was to permit the Government from the seigniorage profits to cover deficits in the national budget.[15] (In 1924 to 1926, part of the seigniorage profits were used to build up reserves for the then proposed Bank of Mexico, and Bank of Agricultural Credit.)[16] Moreover, in view of the existence of a law (1920) making it illegal to export silver coins, and what is much more important because the decline in the value of the metallic content of the peso made export operations unprofitable, all coinage represented new additions to the existing currency in circulation.

By 1926 it would appear that the currency had already been saturated with silver, and although it is difficult to establish at all points a one to one correspondence between the issuance of silver coins and a drop in the value of silver currency,[17] without doubt the overloading of the market with new silver coins during 1926 was in large part responsible for the high discount of silver from gold ruling from the latter part of 1926 to the first part of 1928. (See Chart 2.) Moreover, although the Government on February 25, 1927 issued a decree (which remained in force down to March, 1932 suspending the coinage of silver pesos and half pesos, and restricting the coinage of other silver; and, although attempts were made to withdraw silver already coined from circulation, the vast bulk of the silver issued from 1920 on remained in circulation.

From the first part of 1928 to the middle of 1930 (see Chart 2.) apparently there was sufficient expansion in business and sufficient increase in the demand for money to prevent the large stock of silver coins from greatly affecting the gold discount rate. By the middle of 1930, however, when Mexico began to feel in real earnest the effects of the world-wide depression, the excess of silver coinage again became evident and the large stock of silver began to weigh heavily on the market with the result that the gold discount rate once more began to rise. In a word, the difficulty of the Mexican monetary system based on silver coins was that the system was almost completely inelastic; it was possible to inflate but not to deflate. And this brings the discussion down to the second failure of the Government - the failure to establish and maintain a regulatory fund.

In support of this point no evidence need be offered other than the statement of the former Minister of the Treasury in the preamble to the Monetary Law of July, 1931:[18]

"Even though since 1927 the coinage of silver pesos has been completely suspended, prior to that date large amounts of that currency were issued... for the purpose principally of satisfying budgetary needs. At the same time, however, due reserves for a regulating fund were not constituted. The fund [now in existence] has suffered considerable shrinkage in comparison with previous times (due to unwise investment at the beginning and later on to an appropriation of a considerable part thereof) and today shows a very small balance. In other words, the fundamental principle which underlies our legal monetary regime - the conservation of a regulating fund which might be employed to restrict circulation within the nation by means of the withdrawal of silver coins in exchange for gold and to cover any transitory deficit in the balance of payments - has not been able to operate properly...

"The whole functioning of our monetary system has been misdirected for some time past and, faced with an intense and protracted crisis such as the present one, the various elements in the system have not been able to operate efficiently, thus aggravating the results of the general economic maladjustment."

Finally, attention should be called to the fact that the high hopes of establishing the Bank of Mexico as a "central bank of rediscount and issue" were never realized. The keystone of the whole banking and monetary system was really never put in place. Instead, for the first six years of its existence, the Bank of Mexico functioned for the most part simply as another commercial bank - with the difference that, being a government institution, it was placed in a privileged position in its competition with other banks.[19] Without a directing head, without any organized mechanism for the control of credit, it was inevitable that the exchange market in Mexico should be at the mercy of the winds of chance. And worse still, fluctuations and depressions in the value of the silver peso which should have been controlled by the Bank of Mexico oftimes were accentuated by the operation of that bank as a commercial institution, rather than in its true role as a central bank. But to this matter further consideration will be given in connection with the discussion of the Law of April 1932.

<u>Declining Price of Silver Bullion:</u> There remains for consideration one final etiological factor in the clinical picture of the case history of the Mexican silver peso. In attempting to deal with the question of the relation between the price of silver bullion and the value (price in gold or in dollars) of the Mexican silver peso, however, one enters upon controversial ground.

It is a well known fact that the price of silver has been dropping more or less steadily for more than a decade. The average price of silver in dollars per fine ounce in New York for the year 1919, for example, was $1.12;[20] for 1930, the average price was $0.381.[21] In the last year and a half the price has on a number of occasions dropped below $0.28 and at the present time (July, 1932) the quotations in the New York Times are fluctuating around $0.26. One very simple and obvious explanation of the decrease in value of the Mexican silver peso would appear to be: the value of the Mexican silver peso has declined because the value of the metallic content thereof has decreased.

The only trouble with this type of explanation is that it is too simple to explain all of the facts all of the time. Undoubtedly, the decline in value of silver has had some relation to the decrease in the value of the Mexican peso, but that this relation has been one of simple cause and effect, a direct relation involving a one to one correspondence, is patently not the case. And this may be proved very easily by comparing over a period of years the curves for the price of silver bullion and for the value of the peso as quoted in terms of gold or in terms of dollars.[22] The curves simply do not vary together. Nor has the quotation of the Mexican silver peso, even at its lowest, ever more than approximated the current market value of its metallic content.

As the Mexican economist, Antonio Espinosa de los Monteros, has pointed out on more than one occasion, the phenomena under consideration "is much more complex than it appears to be at first glance. It cannot be denied that the fundamental cause of that with which we are confronted [i.e. the low value of the silver peso] is the drop in the value of silver bullion. But this is very far from saying that the silver peso is worth less, simply because its metallic content is worth less. A decline in the value of silver metal undoubtedly has an effect on the value of our money, but it is an indirect effect making itself felt through a large number of phenomena, such as the suspension of mining activity, the diminution in the supply of dollars, the shrinkage in the volume of business, the fear on the part of the holders of silver pesos which causes a rush to convert them into gold or dollars, etc., etc. Thus it is erroneous to believe that our silver money, because it is made of that metal, is subject to the fluctuations of silver bullion in the market. These fluctuations affect the value of our money simply because Mexico is one of the principal producers of silver and because, as a consequence, the oscillations in the value of that metal increase or diminish the economic activities of the country, intensifying or reducing the uses of money. And this would be true even though our money were made of paper or of some other kind of metal..."[23]

Attempts to Deal with the Monetary Problem

From time to time during the last ten years or more in which the Mexican peso, and more especially the silver peso, has been ailing, the Government has attempted to rally the patient by the application of one kind or another of economic medicine. Practically all of these attempts to "deal with the situation", however, have been in the nature of stimulants - mere shots in the arm, giving only passing and temporary relief. Without undertaking to review in detail the history of these various attempts made by the Government to cure the Mexican currency of its ills, the following may be listed as the most important of what one Mexican economist has called the "monetary palliatives" applied during recent years:

(1) In March 1924 a law was passed forbidding the export of gold bullion. (The exportation of gold coins had already been prohibited by law for sometime past.)

(2) During 1927 and 1928, the Government called in and melted down some 2.7 million silver pesos.[24]

(3) On March 25, 1927, a decree was issued suspending the coinage of silver pesos and half pesos, and restricting other silver coinage.

(4) In May 1929, a law was passed giving the Minister of the Treasury the right to decree "in view of the conditions of the market" in what specie the banks would be required to keep their legal reserves against silver deposits. (Previous to this law the banks were allowed to keep these reserves either in gold or silver.) The purpose of this law was to give the Minister of the Treasury power to restrict or expand the circulation of silver by forcing the banks whenever he deemed it necessary to reconstitute the reserves held against silver accounts. Action under this law was taken in July 1929 when a decree was issued requiring the banks to hold only silver reserves against "silver deposits already made or to be made in the future."[25]

(5) By a decree published in April 1930 the importation of all silver coins, whether Mexican or foreign, regardless of date of coinage, was banned. (Prior to the issuance of this decree, silver coins of the current coinage could be imported into Mexico, although the importation of all other silver coins was forbidden.)

(6) Still another of the attempts to "correct the discount of silver" from gold is to be found in a decree taking effect on Novem-

ber 1, 1930 requiring exporters of mineral and metallurgical products for a period of six months to reimport gold in bars or in coins equal to the value of the gold contained in the minerals or metallurgical products exported. As may be seen from the fact that the exporters in question were not required by law actually to import gold but were allowed, if they so desired, to sell drafts on New York at par ($0.4985 per peso) to the Bank of Mexico, the purpose of this law was to enable the Bank of Mexico to increase its sale of dollar bills of exchange. It was hoped that such an increase in the number of dollar bills of exchange available would lessen the tension of the demand for such bills on the part of importers and thus have a salutary effect on the depreciated silver peso. In a word, this law was simply a back-handed way of prohibiting the export of gold and as such was similar in purpose to various other decrees which the Government had previously issued. (Compare, for example, the decree in 1929 which ordered the exporters of gold to sell to the Bank of Mexico drafts on New York "at the intrinsic par value of the peso compared with the dollar" equal to the amount of gold exported.)[26]

(7) On December 24, 1930, an Executive decree was issued creating an Exchange Regulating Commission (Comisión Reguladora de Cambios). This Commission was charged with "the carrying out of measures which, directly or indirectly, may be designed to achieve stabilization in the value of the National currency, and normalization of the rates of foreign exchange." A few days after the publication of the decree just mentioned, it was announced that the Government had arranged with the National City Bank for a six months credit (with the possibility of extension up to two years) of

30 million pesos gold.[27] With this fund plus 15 million pesos more which the Ministry of the Treasury was to supply from other sources, the Exchange Regulating began operations in January, 1931. The plan was to hold up the value of the peso by selling dollars in the Mexican market and buying gold. However, after several million dollars worth of gold had been purchased in this fashion and shipped to New York, the Government apparently decided to abandon this method of sustaining the value of the peso. At any rate, the gold in New York was sold and the National City Bank reimbursed.

(8) A modification and extension of the effort to control the monetary situation by manipulation of the legal reserves held by banks, first attempted in the Decree of May 22, 1929 (see (4) above), was introduced in a Decree promulgated in December 1930. By this decree the previously existing law (1925) requiring banks to hold reserves of 30% (in silver or gold) against silver deposits was changed in such fashion as to empower the Ministry of the Treasury to determine in what specie the banks should constitute the reserves held against silver deposits and the limits of such reserves were established at a 20% minimum and a 50% maximum. In the official statement accompanying the decree, the Minister of the Treasury stated that the effect of the decree would be to raise the legal reserve requirement against silver deposits to the maximum limit of 50% with a view to "restricting the amount of silver currency in circulation" and thus (presumably) improving the position of the silver peso.[28]

(9) In May 1931, the Government made one last move to "save the peso", before it was finally decided to upset the apple cart in the Law of July, 1931. This move took the form of an agreement

between the banks and the Exchange Regulating Commission to maintain a fixed rate of discount of silver from gold of 26%. This official rate was maintained by the banks during the latter part of May, June and part of July. In the open market, however, the average rates quoted were considerably higher, more than doubling the official rate during the month of July (see footnote 3 of Table 3).

THE MONETARY LAW OF JULY 1931

Recapitulation and Statement of the Problem

In the foregoing pages an attempt has been made to review briefly the events leading up to the Monetary Law of July 1931. We have seen how, over a period of years, the economic situation in Mexico was becoming more and more unstable. Production and exports decreased; the unfavorable balance of payments against Mexico became more and more apparent; gold flowed out of the country; with the loss of gold and the undermining of public confidence, the value of the silver peso as compared with the gold peso and with the dollar declined or was held steady only for relatively short periods; and, finally, although numerous efforts were made on the part of the Government to improve the situation, singly and collectively these efforts brought only temporary and passing relief.

Beginning with the spring of 1930, the cumulative effect of the disorganization of the internal financial and economic system in Mexico was accentuated by the effects on the country of the world-wide depression. The discount rate of the silver peso began a rapid climb upwards. As time went on gold almost disappeared from circulation. Those with either internal obligations (rents, loans, etc.) or external obligations (imports, insurance, loans, etc.) in gold found it next to impossible to meet them. Then, as always in such cases, rumors and gossip began to feed the growing sense of uneasiness. Bank deposits dropped from 174 million pesos in January 1931 to 142 million in June, 1931 - a drop of much more serious proportions in Mexico than it would be in a country with greater banking and industrial resources.[29] Panic was just beginning to raise its head. This was the problem which faced the Mexican Government in July 1931.

Possible Solutions

In the minds of the Minister of the Treasury and his advisers, confronted with the necessity of doing something to stem the fast gathering tide of panic and to restore some sort of direction and order to a rapidly disintegrating financial system, there were three possibilities open to the Mexican Government: (a) "the attempt, at all costs, to reestablish in its complete integrity the current theoretically existing legal monetary system; (b) the total abandonment of the existing monetary system and the adoption of the silver standard; and (c) the introduction into the existing legal system of certain essential reforms, retaining, however, the fundamental principle on which that system is based - the gold standard." Each of these possibilities with their advantages and drawbacks, as they appeared to the Mexican Government, may be considered briefly in turn.

Rehabilitation of the Existing Monetary System

In order to reestablish in actual working practice the monetary system which theoretically had been set up on the statute books in the first years after the revolution of 1910 had run its course, it would obviously be necessary for the Government to return to the gold standard as that term is ordinarily understood. This would mean, among other things, the readiness of the Government at all times to exchange for gold at par any silver currency that might be presented, and the removal of any and all restrictions on the free export of gold whenever such export was necessary to cover payments abroad. But to follow out the program, given the existing situation of the Mexican silver peso in the international exchange market, would require a large fund of either gold or of some foreign currency. Mexico had no such fund of gold nor was it possible to obtain a fund (loan) of foreign currency. Moreover, it was extremely doubtful, in view of the unstable economic conditions of the country, that, even assuming that such funds could be obtained, it would be possible to maintain the parity of the silver peso for any very long period. The investment would therefore be useless and once the funds were exhausted the country would be in a worse state than before. Finally, any effort of this type would be an effort to support a legal regime which in any case was characterized by such "grave defects" as to offer little hope of providing the country with "a healthy and elastic monetary system."

Adoption of the Silver Standard

The second possibility - the complete abandonment of the gold standard and the adoption of silver as the legal basis of Mexican currency - the Mexican authorities felt would not only mean the repudiation of long established precedents in Mexico, but to follow this course would so damage the credit and general economy of the country as to create a situation very difficult to remedy once the present crisis had passed.

Modification of the Existing System

The third possible line of action open to the Government, according to the Ministry of the Treasury, was based upon the following principles:

(1) the retention of the gold standard;

(2) the demonetization of gold and the removal of all restrictions on international commerce in gold;

(3) the retention of silver currency as the circulating medium, limiting the volume thereof to the present stock and forbidding any new coinage;

(4) the creation of a system whereby it will be possible, whenever the future necessities of the market demand it, to issue an elastic and guaranteed type of currency (bills);

(5) and the establishment of a system which, as soon as the economic situation of Mexico allows, will make possible the building up of a centralized reserve of gold and foreign currency to be used for the control of the exchange market and for the maintenance of the stability of Mexican currency.

As in all good fairy stories, it was this third road which Mexico elected to adventure upon in the Monetary Law of July 1931 and the subsequent supporting legislation. Before going any further with the present analysis, it will be necessary to stop at this point and review the main features of that law.

Summary of the Law

The principal provisions of the Monetary Law of July 25,

1931 may be summarized as follows:

Legal Currency and the Payment of Obligations

The unit of the Monetary system shall be the Peso, equivalent to 75 centigrams of pure gold (see above p. 2). The coinage of gold in any denominations, however, shall be suspended for an indefinite period and all gold coins previously issued shall no longer be considered as legal tender. Gold coin or gold bullion may be freely exported and imported.

The following currency shall be entitled to circulation:

(1) bills legally issued by the Bank of Mexico;

(2) silver currency of one peso units of the coinage created by the Law of Oct. 27, 1919 (see above p. 2);

(3) silver fractional currency consisting of ten, twenty and fifty centavo pieces and bronze coins of one, two and five centavo pieces created by the Laws of March 25, 1905; Oct. 15, 1914; Oct. 27, 1919; and April 29, 1925.

Bills issued by the Bank of Mexico shall have voluntary circulation and their acceptance shall not be obligatory except in the offices of the Federal, State and Municipal Governments where they must be received without limitation in payment of all kinds of taxes, services and duties. The silver currency in one peso units mentioned under (2) above shall be legal tender in unlimited amounts. Fractional silver currency, however, shall be legal tender only up to twenty pesos and fractional bronze currency only to two pesos in any single payment, except in Government offices where both types of currency must be received in unlimited amounts in payment of taxes, services and duties.

Silver and bronze currency of the coinage hereby established must be accepted at its nominal value in payment of any obligation contracted in Mexican currency. Foreign currency shall have no legal status in the Republic (except in cases specifically authorized by law) and any obligation to pay in foreign currency which is to be complied with in the Republic shall be satisfied by delivering the equivalent in National currency [i.e. silver] at the rate of exchange existing at the place and upon the date payment should be made. Any obligation to pay within the Republic in foreign currency contracted previous to this law in which National currency of any type was employed in the original transaction, may be discharged by payment in national currency at the rate of exchange at which the original transaction was effected.

All obligations contracted in national currency of any kind [i.e. gold or silver] prior to the present law, shall be discharged by the payment of the currency of the coinage established by this law [i.e. silver]. This provision, however, does not apply to those who may have received gold for the account of a third party or who may hold such funds in private deposit or by virtue of any contract which does not serve to transfer the title thereto. In such cases the gold must be delivered to the party to whom it belongs.

Banks and credit institutions shall pay in gold currency thirty percent of the deposits payable at sight or upon not more than thirty days notice which the public may have on deposit in like currency in these institutions. [Note: This provision is based on the fact that the banks were required at the time the Monetary Law was enacted to maintain legal reserves against gold deposits of thirty percent._7

Issuance of Currency

The Bank of Mexico is empowered to issue bank notes under the Law of August 25, 1925. (See above p. 4). The coinage of silver in one peso units is, however, expressly prohibited and the coinage of fractional silver or bronze currency shall be strictly limited and shall be permitted only when silver pesos of the same value are withdrawn from circulation and melted.

Monetary Reserves

A monetary reserve, destined exclusively to cover the expenses or losses incident to foreign exchange operations effected for the account of the reserve, shall be established with the following resources:

(1) the balance of the regulating fund created by the law of March 25, 1905;

(2) profits which may accrue by virtue of exchange operations with foreign countries effected for the account of the reserve;

(3) seigniorage profits from coining operations;

(4) proceeds derived from loans which may be made for the purpose of increasing the reserve;

(5) funds set aside by the Federal Government or taxes assigned to the reserve.

The monetary reserve shall be kept in gold or silver bars or coin having a commercial value based upon the metal therein contained.