

International Monetary Fund.
Research Department.
Mexico's Financial Institutions and the
Capital Market
Prepared by Javier Marquez, Eduardo Lora
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Approved by Allan G. B. Fisher and H. M. H. A.
Van der Valk.
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1. Introduction

Especially during the last fifteen years, several Mexican administrations have made a vigorous effort to develop the country's economy in order to raise the people's standard of living. In this effort, they have had to contend with (a) small savings, (b) the inefficiency of the fiscal system, (c) the spending and investment habits of both the wealthy classes and small savers, (d) a traditional speculative environment which was not conducive to long-term investments, (e) credit deficiencies that normally plague undeveloped economies, and (f) institutional deficiencies.

Savings

In a poor country like Mexico, savings are small. They are perhaps not as small as per capita income figures would suggest, for great inequalities in income distribution tend to compensate to a certain extent for its absolute smallness; the zero or negative savings of a very large sector of the population are somewhat offset by substantial savings by the wealthy class. This, in turn, means that if development is to be carried out by private enterprise in a country where the overwhelming majority of the people have a very low standard of living, it must be done by drawing on the savings of the privileged wealthy group. If increases of income were channeled exclusively to low income groups, the result would be an attempt to increase consumption and not, to any extent, an increase of investment.

Spending and Investment habits

In addition to the effects of small savings, private investments and expenditures in general have not followed the lines which the Government has considered more desirable. In the face of these difficulties, the development of the country has depended to a considerable extent on the creation of new money, spent on projects where private enterprise could not, or would not, enter. The resulting monetary expansion proved inflationary after a time, and action was taken at an early stage to slow down its rate

by reducing the possibilities of expansion by commercial banks and by attempting a selective control of their credit. This selective control is perhaps the main feature of the Mexican banking policy. It has been attempted both by intervention in the granting of credit by different types of institutions and by creating specialized agencies. The results of these efforts, although substantial, have been, however, far smaller than was desired or might have been expected.

The people's belief, whether well founded or not, that political and/or social and/or economic conditions were unstable, together with the wartime supply situation, led to two extremes, hoarding and speculation, both of which habits are certainly not conducive to long-term investment. This attitude is being gradually overcome, as some figures show, but too much of it still exists and has proved a strong obstacle to development. It also provides a justification for the Government's growing intervention in economic life in an effort to fill the gaps left open by private enterprise.

The traditional speculative attitude of Mexican businessmen is apparent from their investment habits. They prefer commerce to industry and are ready to invest in activities which are likely to return high profits in the shortest time, the high returns which are expected from all but the most conservative types of investments, and to engage in currency speculation by holding bank balances abroad even at the cost of substantial interest rates, et cetera. Because of these habits, Mexico has a strong money market but an undeveloped capital market.

Wartime developments

The savings of the Mexican privileged group during the wartime inflation were greatly increased and their possibilities of making investments therefore enhanced. The general world situation also offered abundant opportunities for speculation to those able to obtain scarce commodities. There can be little doubt that Mexican production would have increased much faster during the war years if the real capital and technical ability to carry it out had been at hand, as the inducement was greater than at any other time in recent Mexican history. Mexican capital imports during the war years continued at a very high level, or even increased, in comparison with prewar years. They did not increase, however, to the full extent that Mexican private enterprise could have absorbed them and, accordingly, the privileged position of those who were able to obtain products was correspondingly improved. The already great differences of wealth which existed before the war were accentuated.

This situation had the following effects upon the formation of a capital market and upon development in general: (a) to the extent that it has been possible to invest in inventories, funds have been withdrawn from other uses; (b) new capital formation has been concentrated more than would be desirable on industries supplying goods for the wealthier classes, among which the building industry has been conspicuous; (c) the transitory nature of the opportunity for abnormally high profits was realized, and this affected the attitude of entrepreneurs with respect to the size of some investments and their quality; (d) the desire for liquidity in the expectation

of highly profitable short-term investments or speculation was not conducive to investment in long-term securities or in capital goods with a slow rate of amortization, or even to reinvest in the same industry.

In the absence of governmental control of investments and prices, and considering the difficulty of obtaining equipment, the conditions of the war years were not favorable to the creation of a capital market or the channeling of private investment toward the most desirable activities. This is not meant to imply that the private investments of this period have been a net loss for the community, since many of the activities started then will no doubt continue and, it is hoped, on a less speculative basis. Some of the high-profit private investments were no doubt socially desirable. It only means that a more socially desirable use could probably have been made of the funds that were spent. Government intervention through public works or specialized credit agencies has helped to create, side by side with private investments, a substantial volume of other investments with a more direct bearing on the social and economic welfare of the majority of the people.

Interest rates

In most Latin American countries, and in most under-developed countries in general, the average rate of profits is high, if compared with industrialized nations. This is most apparent in countries with greater developmental aspirations, like Mexico. The means by which high profits are possible is obviously the expansion of money incomes and the maintenance of a privileged position for profit earners. The economics of the problem would certainly warrant a detailed analysis, but for present purposes it is sufficient to set it down as a generally recognized and all too obvious fact.

There are considerable geographical variations in the institutional rates for loans, which depend also upon the nature of the transaction and the time for which the loans are granted. Generally speaking, the longer the loan period the higher the rate of interest, which ranges between 8 and 18 per cent per year, after all charges have been added. The high profits obtained by industrialists and merchants have permitted the payment of these rates, as well as a rapid amortization of the original investments (dividends of some well-known corporations may actually run as high as 40 per cent).

In the securities market, the rates run from 6 to 8 per cent for fixed interest bearing securities with three to ten years maturities; however, except for a few securities, the market is very thin.

The pattern of non-institutional interest rates in Mexico presents some peculiarities. The rates for short-term loans are higher than for long-term investments. Private short-term credit rates for agriculture may reach the level of 5 per cent per month or more, and 3 per cent per month is perhaps an average for this type of transaction. The risk element involved and actual defaults are frequently blamed for this situation. In urban areas, private credit rates may run around 2 per cent per month.

Capital and securities market

The creation of a capital market has been a preoccupation of the Mexican Government for many years, since it is realized that with its development efforts would be far more successful and have less inflationary implications. The main apparent means used for that purpose has been the support given to government bonds by the Bank of Mexico -- that is, its readiness to buy them with a very small discount (one-half of one per cent) at any time. More or less the same policy has been followed by the Bank of Mexico with other securities issued by official institutions, such as the mortgage bonds of the National Mortgage Bank of Public Works (Banco Nacional Hipotecario y de Obras Públicas). At different times it has also intervened in the market to avert wide fluctuations in private securities. The same purpose, that is, to make them so liquid that the public would buy them readily, has been sought through the "certificates of participation"^{1/} of the Nacional Financiera, the Government development corporation. It was thought that once the public had acquired confidence in this security the repurchase guaranty could be gradually eliminated (perhaps by extending the period within which notice has to be given before repurchase). A third link in the efforts to create a capital market has been the establishment of the Securities Commission, with the main purpose of screening the securities handled by the Mexico City Stock Exchange.

It may be argued that some features of the Government's efforts, particularly in regard to the certificates of participation, may have harmed the building of a capital market. It is very doubtful whether paying 6 per cent for money at sight during a period of maximum liquidity could create a good atmosphere for long-term paper at a moderate rate. Obviously, it is not possible to say what would have happened with the funds invested in certificates of participation if these had not existed. It would seem, however, that the offer of liquid industrial paper with high interest rates and without any risk element may have delayed instead of promoted the formation of a strong capital market in Mexico.

Although total private investments in Mexico during the last ten years have been very large, they do not show up to any substantial degree in stock exchange transactions. Total transactions in Mexico City's Stock Exchange almost never reach one and a half million pesos (nominal value of securities) in any one week, and in most weeks they will be under the million mark. Total transactions amounted to 13 million pesos in 1946 and to 30 millions in 1947. Transactions in securities are frequently carried on outside the Stock Exchange, but in general their total volume is very small in comparison with the size of investments. Shares are frequently not listed or withdrawn from the market and kept within a closed group of original promoters to avoid sharing with others the high profits of their investments. If these securities are sold at all, the transactions usually take place within a small group of people. No doubt many stocks and shares of successful industrial corporations would find a ready market, but corporations prefer to finance their needs in the money market rather than issue stocks.

^{1/} An investment trust certificate redeemable at par on 30 days' notice (although in practice it has been redeemed at sight) and bearing a fixed interest rate of 6 per cent.

Credit

Several methods have been tried for selective control of credit. Their success has not always been apparent. (1) Commercial banks have been authorized to invest up to 20 per cent of their liabilities in medium-term paper and 20 per cent in investment. However, in practice, these banks have not used their capacity to extend medium-term credit (one to three years) to the full extent permitted by law; their investments in securities represent mainly a shift to the commercial banks of the Bank of Mexico's portfolio of those securities,^{2/} that is, the purchase with the banks' legal reserve requirements of securities held by the Bank of Mexico.^{2/} (2) The Bank of Mexico has required commercial banks to maintain a loan portfolio represented at least 60 per cent by loans for production in order that the paper thereby created may be eligible for rediscount. Although the percentage to be devoted to these loans is rather high, it has been found difficult to check the accuracy of the statements made by the commercial banks, because when, after paying out high dividends, businesses borrow for working capital funds which might have been drawn from their own earnings, the bank loan is in effect a consumption loan. (3) Banks in the states have been permitted to use part of their reserve requirements for loans to agriculture and cattle-raising; in fact, however, they have not generally used their additional lending capacity to its full extent in this direction. (4) Selective credit control has also been attempted by establishing specialized private institutions; some results have been achieved in this way, but loopholes in the laws have permitted these institutions to diversify their operations and provide ordinary commercial credit. (5) Selective control has been practiced even for rediscounts to official institutions -- for example, the refusal to rediscount paper of agricultural banks which does not represent credit for certain specified crops.

In general, the whole credit and banking policy of Mexico, the multiplication of specialized private and official institutions, may be interpreted as an effort (a) to widen the small savings bottleneck which hampers economic development, and (b) to prevent the misuse of available funds. On the whole, the effort has not been as successful as was to be desired.

It is not possible to estimate the amount of non-institutional credit in Mexico. It is known to be substantial still in the large towns, both for consumption and for small-scale commerce, and it has been stated by several Mexican authorities that the agricultural credit granted by credit institutions represents only about 25 per cent of total agricultural credit that takes place in the country. Part of the private credit which goes on in Mexico, and especially in agriculture, however, is indirectly financed by banks, that is, a bank may lend to the storekeeper in the village, who

^{2/} If government bonds, held as reserve requirements by the private banks, are omitted, it would reveal that probably less than half of all private banks' investment portfolio represents spontaneous long-term investments.

^{3/} By this shift, the Bank of Mexico has tried to soothe the banks' complaints against high reserve requirements.

Table 1. Credit Institutions and Auxiliary Organizations in Existence
between December 1932 and 1947

Institutions		1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947
National Banks	M.*	9	10	10	11	5	6	6	6	6	7	7	8	8	9	9	10
	B.	6	5	5	5	5	5	5	5	5	6	7	7	8	8	8	8
Deposit Banks (or Commercial Banks)	M.	32	48	54	55	53	56	53	59	61	67	76	82	91	97	101	104
	B.	49	49	48	50	56	57	57	58	60	69	81	104	127	156	172	209
Savings Banks	M.	2	3	4	4	4	4	4	5	7	10	17	23	27	34	41	51
	B.	33	32	32	32	37	37	37	38	38	40	44	52	59	83	92	125
Industrial Credit ^{1/} Banks (Financieras)	M.	2	5	8	9	12	15	15	24	28	36	42	54	69	84	106	108
	B.	-	-	-	-	-	1	1	1	1	1	1	2	3	3	3	3
Mortgage Banks	M.	2	2	2	2	2	2	2	2	2	12	12	13	14	20	21	21
	B.	-	-	-	-	-	-	-	-	-	-	-	1	2	2	3	3
Capitalization Banks	M.	-	2	4	6	6	6	8	8	9	10	10	10	10	11	12	12
	B.	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1
Trust Companies	M.	5	6	8	8	8	9	10	12	13	26	33	38	52	65	81	87
	B.	-	-	-	-	-	-	-	-	-	-	-	1	2	3	5	3
Warehouses	M.	7	11	13	16	16	14	14	14	13	13	15	17	17	17	19	20
	B.	-	-	-	-	-	-	1	1	-	-	-	-	-	-	-	-
Credit Unions ^{2/}	M.	-	1	1	3	5	8	8	11	9	5	22	35	40	28	22	30
	B.	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Clearing Houses	M.	1	1	2	4	4	5	5	5	5	5	5	5	6	7	7	7
Stock Exchange	M.	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1

^{1/}Until May 1941 these institutions performed the functions of auxiliary credit organizations.

^{2/}Until May 1941 these institutions were called Unions, Associations and Societies of Credit with Mortgage Functions, but with the enactment of the new law of May 1941, several of these societies were converted into mortgage banks.

Source: Anuario Financiero de Mexico, Mexico D.F., 1948.

*M= Main Office
B= Branches

offers sufficient guarantees, but it will not lend directly to the farmers because, among other things, it is not equipped to collect large numbers of small loans.

The Government and the capital market

Through a series of specialized official credit agencies, the Government has tried to offset the effects of both private investment habits and the policies of private credit institutions. In order to avoid as far as possible the inflationary implications of governmental credit when superimposed upon private credit, the lending capacity of commercial banks has been restricted to a greater degree than in any other Latin American country, by increasing reserve requirements from 20 to 50 per cent of obligations, on the one hand, and by a selective expansion of credit, sponsored through the Bank of Mexico, on the other.

Although no quantitative estimate is possible, the Bank of Mexico's financing of government deficits in the last ten years may merely have offset private hoardings, and credit expansion by specialized official institutions with money created by the Bank of Mexico, therefore, has not exceeded in any significant degree the monetary expansion which would have taken place in any event if the commercial banks had had to maintain only 20 per cent reserves. ^{4/}

The Government is the largest single investor and gatherer of savings. Many of its activities are fairly well known, but an adequate treatment of the topic would require a paper of its own, which could not be adequately done in Washington and in a short time. The inadequacy of the published fiscal and budgetary figures would make continuous consultation necessary in its preparation. The Government's policy with respect to the capital and money market, however, has been explicitly or implicitly stated throughout.

Banking and financial institutions

The development of the present Mexican banking structure is largely an outgrowth of the second world war (Table 1). This development, however, has not been balanced, either geographically or functionally. Table 2 shows the distribution of the different types of institutions throughout the country. It reveals particularly the abnormally large share of Mexico City, and the fact that all the states with a greater concentration of banking are on the U.S. border or on the northern part of either coast. If the resources of the banks are taken into account, the unevenness of the distribution is still more apparent.

As shown in Chart I, the banking system of Mexico includes the central bank, national banks and private banks. It is supervised by the Ministry of Finance and the National Banking Commission.

^{4/} No conclusion should be inferred from the foregoing that the actual monetary expansion which took place in Mexico during the last few years was not excessive, for it certainly was so, at least from a balance of payments point of view.

Table 2. Geographical Distribution of Credit Institutions
of Mexico as of December 31, 1947

State	National Banks		Deposit Banks			Savings ^{1/} Banks			Financieras			Mortgage Banks			Capitalization Banks			Trust Banks		
	H.O.	B.	H.O.	B.	A.	H.O.	B.	A.	H.O.	B.	A.	H.O.	B.	A.	H.O.	B.	A.	H.O.	B.	A.
	2/	3/																		
Federal District	10	-	19	60	11	20	41	5	67	-	-	12	1	1	6	1	3	35	1	-
Coahuila	-	1	8	19	27	2	11	13	5	-	-	-	1	-	-	-	2	5	-	-
Tamaulipas...	-	-	5	19	6	4	11	6	5	-	-	-	-	-	1	-	1	3	-	-
Sonora	-	1	5	10	10	5	11	5	2	1	-	1	-	-	1	-	-	2	1	-
Nuevo Leon	-	1	9	12	4	-	1	-	8	1	1	3	-	1	2	-	-	1	-	-
Sinaloa	-	1	9	7	7	3	5	4	3	-	-	-	-	-	1	-	-	1	-	-
Veracruz	-	-	4	12	4	6	15	4	1	-	-	-	-	-	1	-	1	2	-	-
Chihuahua	-	-	6	10	3	1	4	4	3	-	-	2	-	-	-	-	1	4	-	-
Guanajuato	-	-	3	7	6	-	-	3	2	-	-	-	-	1	-	-	-	-	-	-
Jalisco	-	1	6	5	7	5	4	7	2	-	-	-	1	2	1	-	2	3	-	-
Puebla	-	-	4	7	4	3	6	6	1	-	-	1	-	1	1	-	1	-	-	-
Baja California	-	-	2	8	3	2	6	1	2	-	-	1	-	-	-	-	1	-	-	-
San Luis Potosi	-	-	2	3	6	2	2	5	2	-	-	-	-	1	-	-	-	1	-	-
Chiapas	-	1	4	5	1	2	5	-	1	-	-	-	-	-	-	-	-	1	-	-
Michoacan	-	-	3	4	3	2	4	2	2	-	-	1	-	-	-	-	-	-	-	-
Nayarit	-	-	1	4	3	1	6	3	-	-	-	-	-	-	-	-	-	-	-	-
Mexico	-	-	1	5	2	-	3	1	-	1	-	-	-	-	-	-	-	-	-	-
Guerrero	-	-	1	4	2	-	1	1	-	-	-	-	-	-	-	-	-	1	-	-
Durango	-	-	3	1	3	1	1	2	-	-	-	-	-	-	-	-	-	-	-	-
Zacatecas	-	1	1	2	2	-	2	1	-	-	-	-	-	-	-	-	-	-	-	-
Oaxaca	-	-	1	2	2	-	2	2	-	-	-	-	-	-	-	-	-	-	-	-
Yucatan	-	1	3	2	-	2	1	-	-	-	-	-	-	-	1	-	-	1	-	-
Tlaxcala	-	-	-	3	1	9	8	4	-	-	-	-	-	-	-	-	-	-	-	-
Colima	-	-	1	3	-	-	3	-	-	-	-	-	-	-	-	-	-	-	-	-
Morelos	-	-	1	2	1	1	1	1	-	-	-	-	-	-	-	-	-	1	-	-
Hidalgo	-	-	1	3	-	1	2	-	-	-	-	-	-	-	-	-	-	-	-	-
Aguascalientes	-	-	-	3	-	-	3	-	-	-	-	-	-	-	-	-	-	-	-	-
Campeche	-	-	1	-	2	-	-	2	-	-	-	-	-	-	-	-	-	-	-	-
Queretaro	-	-	1	2	-	1	2	-	-	-	-	-	-	-	-	-	-	-	-	-
Tabasco	-	1	1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Quintana Roo	-	-	-	-	1	-	-	1	-	-	-	-	-	-	-	-	-	-	-	-

Table 2. Geographical Distribution of Credit Institutions
of Mexico as of December 31, 1947
(continued)

1/ The four building associations are included among the Savings Banks. Two operate in the Federal District, one in Veracruz, and the other in Merida.

2/ Head Offices.

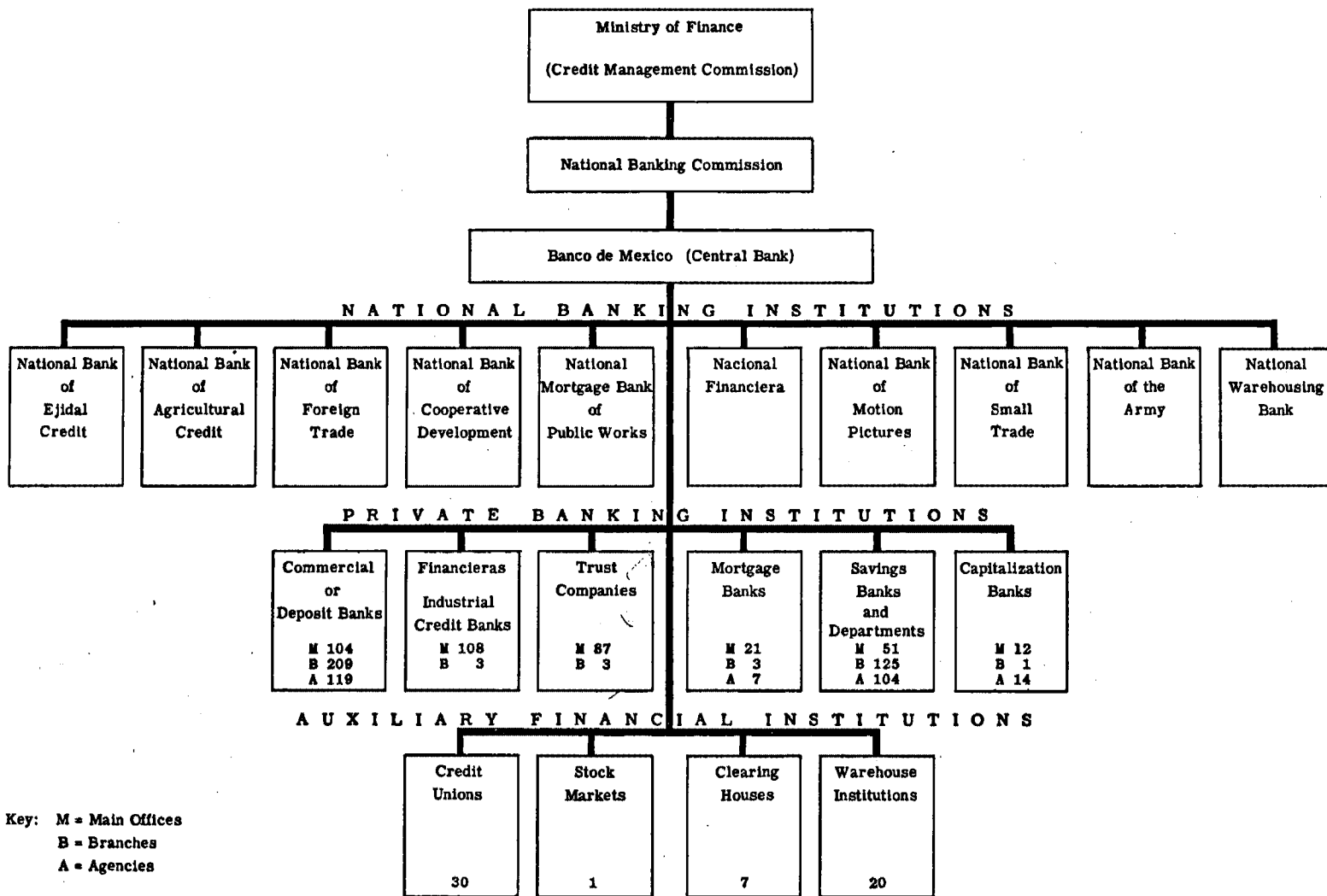
3/ Branches

4/ Agencies

Source: Comisión Nacional Bancaria, Boletín Estadística, December 1947.

BANKING SYSTEM OF MEXICO

* as of December 31, 1947



* Adapted from Anuario Financiero de Mexico - Octavo Volumen 1947, Mexico, D.F. 1948

The Bank of Mexico has been the main active influence with respect to credit and investment policies (Table 3). It has intervened by filling the gaps left by the credit institutions, the corporations and the general public, and by offsetting the effects of their actions or lack of action. It has taken about 90 per cent of the government bonds issued to finance expenditures arising from the public works program. It has backed Nacional Financiera's development program at every stage and provided funds, directly or indirectly, for all government credit agencies and for all private specialized credit institutions. The growth of its portfolio and a comparison of the portfolio with total circulation gives a clear picture of the extent of its activities. Although the extent to which private institutions might have stepped into the investment and specialized credit picture if the Bank of Mexico had not covered it cannot be determined, it may safely be stated that Mexico's industrial development would have been far smaller.

The national banks are credit institutions established and capitalized by the Government, with specific purposes, such as agricultural development (National Bank of Agricultural Credit and National Ejidal Bank), the development of foreign trade (National Bank of Foreign Trade), the development of cooperativism and small manufacturing industries (National Bank of Cooperative Development), the financing of public works -- water systems, schools, pavements, low-cost housing, et cetera (National Mortgage Bank of Public Works), the financing of the motion picture industry (National Bank of Motion Pictures), the financing of small credits for traders in the public markets of Mexico City and for small merchants in the same city (National Bank of Small Trade of the Federal District), the encouragement of savings by the granting of credit facilities to members of the Army, in active service or retired (National Bank of the Army), the furnishing of warehouse facilities by financing the storage of merchandise and the issuance of merchandise receipts (National Warehousing Deposit Corporation) and, finally, the Nacional Financiera, the Government development corporation.

The private banking system is made up of (1) commercial banks, (2) savings banks (3) "financieras" (industrial credit bank), (4) mortgage banks, (5) capitalization banks, and (6) trust companies. There are also various other types of institutions that according to law are considered auxiliary financial organizations, such as the stock exchange, clearing houses, warehouses and credit unions.

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If a critical attitude is taken in this paper toward the performance of both government and private banking institutions, it is on the grounds that not enough was done to direct credit and investment into the most desirable channels. The purpose has been to point precisely to the weak spots in the policy that has been followed. At several points it has been stated that perhaps the accomplishments have been as great as could have been expected, and the difficulties in carrying out the task are emphasized. In the Mexican milieu, with no domestic precedent on which to base a policy, it probably could not be expected that government and private institutions could embark upon a task as complex as economic development without meeting with great obstacles.

Table 3. Banking System of Mexico
Main Accounts as of December 31, 1947
(in millions of pesos)

	Private Institutions	National Institutions		Total ^{1/}
		Bank of Mexico	Others	
TOTAL ASSETS	4,164.6	3,271.9	1,545.0	6,996.7
LIQUID ASSETS	1,191.5	828.7	61.0	890.0
INVESTMENTS	672.3	1,458.0	428.8	2,052.2
Federal Govt. (Domestic Debt)	161.9	784.6	175.4	1,121.9
Short-Term	--	94.0	--	94.0
Long-Term	161.9	690.6	175.4	1,027.9
Federal Govt. (Foreign Debt)	--	133.9	--	133.9
Local Governments	2.1	41.2	6.0	49.3
Nacional Financiera	56.7	--	35.7	92.4
Banking Bonds	142.1	346.1	18.7	--
Commercial Bonds	1.7	--	--	--
General Bonds	23.8	216.4	0.8	--
Mortgage Bonds	24.3	110.5	7.0	--
Other Bonds	0.1	--	--	--
Banking Stocks	92.2	19.2	10.9	--
Bank of Mexico	24.0	--	0.3	--
Other Banking Institutions	68.2	19.2	10.6	--
Industrial Securities	309.5	152.2	193.0	654.7
Mortgage Cedulas	10.8	34.5	1.0	46.3
Mortgage Bonds	11.3	96.6	16.9	124.8
Stocks of National Corporations	221.5	14.7	85.2	321.4
Stocks of Foreign Corporations	0.2	6.3	--	6.5
Other Securities	65.7	0.1	89.9	155.7
CREDIT	2,094.0	817.7	936.5	3,548.6
To Government	--	--	82.9	82.9
To National Banks	--	135.8	86.5	--
To Private Banks	76.6	0.7	--	--
To Private Institutions (also rediscounts)	2,017.4	681.2	767.1	3,465.7
30 Days	38.5	56.8	4.5	99.8
90 Days	416.9	164.0	15.7	596.6
180 Days	771.4	270.9	182.3	1,224.6
360 Days	337.1	189.5	158.5	685.1
More than 360 Days	453.5	--	406.1	859.6
OTHER ASSETS	206.8	167.5	118.7	505.9
TOTAL LIABILITIES	4,164.6	3,271.9	1,545.0	6,996.7
Currency and Metallic Issues		1,894.2		1,757.2
Check and Sight Deposits	1,690.0	862.2	270.2	2,044.5
Saving and Time Deposits	385.1	--	3.6	107.6
Obligations arising from issues of titles	700.9	--	255.5	571.9
Sight and Time Deposits and Obligations in Foreign Currencies	665.3	236.2	774.8	514.1
Capital	453.5	50.0	280.2	658.1
Reserves (Surplus)	70.9	139.9	46.8	257.6
Profits and Losses	57.8	--	14.6	72.4
Other Liabilities	144.4	89.4	127.4	446.5

^{1/} All interbank obligations have been eliminated.

Source: Bank of Mexico, Vigesimosexta Asamblea General De Accionistas, 1948 and information supplied by the Bank of Mexico.

Moreover, no amount of criticism can blind us to the fact that between 1920 and 1946, 1,200 million pesos were spent on the construction of highways, 300 million on railways, 300 million on port facilities, public buildings and water systems, 800 million on irrigation. In 1940, the electric power generated in the country was 160,000 h.p., as against close to one million at the present time. In the industrial field, development has not been less substantial. This fact is sometimes not sufficiently obvious outside Mexico as a consequence of the stagnation or actual decline in mineral production for which Mexico is better known outside its own borders. Food processing of all kinds, cement plants and building industries in general, textiles, chemicals and pharmaceuticals, shoe factories, electrical appliances and a variety of other industries have been created and are successfully operated.

2. Bank of Mexico

Introduction

The Bank of Mexico is unquestionably the backbone of the entire financial structure of Mexico. As a central bank it has been the most important organ in the Government's economic development programs. Not only have its resources been marshalled for this purpose, but its influence in both the banking system and the securities market has also been directed toward supporting the Government's objectives.

The legal structure of the bank places the Government in a position to determine the Bank of Mexico's banking and monetary policies. It is, therefore, difficult to see any other course that the bank might have taken during the war and postwar periods. Although the management of the Bank of Mexico has continuously and energetically fought unsound and inflationary government practices, it has not been able to check the undesirable monetary and credit expansion resulting from an ambitious government-sponsored economic development program.

Monetary and banking policies

The monetary and banking measures adopted to control credit by the Bank of Mexico since 1941 are in effect similar to those employed by other countries. They may be broadly classified as follows: selective credit rationing, increase in reserve requirements, open market operations, and sale of gold to the public.

Selective credit rationing According to the central bank statute, modified in 1941, the Bank of Mexico may discount for member banks or associated credit unions (a) paper which results from trade, (b) paper resulting from the purchase, marketing and processing of industrial products or the cultivation and marketing of agricultural products, including cattle, (c) all paper bearing the signature of a discounting institution or credit union. In addition to rediscounts, it may also make loans to member institutions if guaranteed by certain paper, and buy their shares to the limit of 15 per cent of their capital. It may not grant credit which represents a permanent or semi-permanent investment. Credit to the Government is regulated by the same rules as credit to member institutions.

In general, the law gives the Bank of Mexico as much authority as is necessary to expand and contract circulation through discounts and loans, both to member institutions and to the Government. In its action in this respect and in accordance with the Government's attitude, the Bank has followed a selective policy. The rediscount rate was cut in 1943 to 3 per cent for loans made for agricultural purposes, while rediscount rates on commercial loans were maintained at 6 per cent. In order to have access to central bank credit, private banks were required to have a loan portfolio of which at least 60 per cent must be for specific productive purposes. How ineffective the low rediscount rate, qualified by this portfolio restriction, has been can be seen from the Bank of Mexico's credit operations (Table 4), which show that for the past three years there are very few rediscounts or loans outstanding to private banks. After 1946, the primary reason was that, since

Table 4. Main Accounts of the Bank of Mexico

(in millions of pesos)

	1945	1946	1947	1948-June
TOTAL ASSETS	3,416.8	3,205.9	3,271.9	3,162.9
LIQUID ASSETS	1,819.1	1,341.2	828.7	695.1
INVESTMENTS	835.8	1,176.1	1,458.0	1,370.7
Federal Govt. (Domestic Debt)	675.1	801.9	918.5	959.4
Short-Term	621.8	53.9	784.6	830.0
Long-Term	44.6	53.9	94.0	80.1
Federal Govt. (Foreign Debt)	53.3	133.5	133.9	129.4
Local Governments	17.7	35.2	41.2	31.5
Banking Bonds	95.3	199.3	326.9	200.4
General Bonds	63.2	129.4	216.4	110.8
Mortgage Bonds	32.1	69.9	110.5	89.6
Banking Stocks	15.0	15.3	19.2	22.7
Industrial Securities	32.7	99.2	152.2	156.7
Mortgage Cedulas	3.8	9.3	34.5	26.3
Mortgage Bonds	15.0	25.1	96.6	100.7
Stocks of National Corporations	1.3	28.7	14.7	23.4
Stocks of Foreign Corporations	3.3	36.0	6.3	6.3
Other Securities	9.3	0.1	0.1	--
CREDIT	672.9	655.0	817.7	869.0
To Government	0.2	0.3	--	1.6
To National Banks	231.4	146.1	135.8	140.3
To Private Banks	--	--	.7	.2
Rediscounts	441.3	508.6	681.2	726.9
30 Days	43.9	43.1	56.8	36.8
90 Days	75.7	87.9	164.0	123.1
180 Days	295.3	297.4	270.9	303.2
360 Days	26.4	80.2	189.5	263.8
OTHER ASSETS	89.0	58.8	167.5	228.1
TOTAL LIABILITIES	3,416.8	3,205.9	3,271.9	3,162.9
Currency Issues	1,730.8	1,804.2	1,761.8	1,685.0
Metallic Issues	55.3	65.3	132.4	184.1
Check Deposits	1,299.7	996.1	862.2	685.5
Time Obligations	47.8	57.1	167.9	204.3
Sight Deposits in Foreign Currency	18.7	70.9	63.4	59.9
Sight and Term Obligations in Foreign Currency	7.0	5.4	4.9	3.3
Capital	50.0	50.0	50.0	50.0
Reserves (Surplus)	74.6	103.0	139.9	156.8
Profit and Losses	45.9	--	--	26.4
Other	87.0	53.9	89.4	107.6

Source: Bank of Mexico, *Vigésimo sexta Asamblea General de Accionistas*, 1948 and information supplied by the Bank of Mexico.

the demand for central bank credit for productive purposes by national banking institutions is so large, the Bank of Mexico has actually refused to lend to private banking institutions, whether or not they actually comply with their portfolio requirements. During the war years, moreover, with the increase in deposits, private institutions had little need to rediscount paper with the central bank. Thirdly, some private banks have preferred fewer but much more profitable loans by advancing short-term commercial credit, rather than to attempt to qualify for rediscount privileges by restricting their loans to productive purposes.

Reserve requirements By far the most important credit control measure of the Bank of Mexico, in agreement with the Ministry of Finance, has been the exercise of reserve requirement powers (and for a time, the imposition of portfolio ceilings). Reserve requirements have been raised from 20 per cent on deposits early in the war to 50 per cent at the present time^{5/}. By this policy the Bank has neutralized at least 25 per cent of the money supply of the country, the banking reserves held in the central bank now being in excess of 1,000 million pesos.^{6/} By this restriction the private banking system has been kept in such a liquid position that even if the money supply were substantially contracted, sufficient credit could still be made available to maintain essential productive activities by lowering the present high reserve requirements.

In a further move to tighten banking credit, the Bank of Mexico has, effective January 1, 1949, increased to 24 per cent the penalty rate of 12 per cent previously imposed on the reserve deficiencies of private banks. Inasmuch as some institutions have purposely maintained deficient reserves, since they were apparently able to lend at rates of interest which afforded a good profit even after paying the 12 per cent penalty, they will now be forced to contract credit, since the doubled penalty does not compensate for the high rates which they had been accustomed to charge on certain commercial paper. This measure is not likely to have a very important effect on credit inasmuch as actual bank reserves are only 2 per cent short of legal requirements.

Open market operations The Bank of Mexico early recognized the undesirability of monetizing the growing public debt and exerted every effort to market Government securities among private investors. Through open market operations it was also intended that the Bank of Mexico would be able to regulate the volume of investments and determine the level of capital market interest rates.

A private market for government bonds, however, failed to materialize. Because more profitable commercial investments were available, and also because of fears of political instability that might cause default, neither private banks nor individuals showed much interest in government bonds. The

^{5/} Fifty per cent is the required reserve figure for Mexico City banks. For other parts of the Republic, reserve requirements rose from 15 per cent in 1941 to 35 per cent, the current rate.

^{6/} This figure includes approximately 750 million pesos of cash reserves and 250 million of securities sold by the Bank of Mexico to the banking system, the latter to be held in lieu of reserves.

Bank of Mexico, induced by the Government to meet the financial needs of its public works programs, national defense and economic development, has had to become the principal holder of Government securities.^{7/} This development precluded the use of such securities for capital market regulating operations, and, to a considerable extent, nullified other anti-inflationary measures adopted by the Bank.

Besides purchasing government securities, the Bank of Mexico has had to maintain a market for the securities of various other institutions. Most important of these operations has been the purchase of general bonds ("bono general") issued by the "financieras" to finance long-term industrial credit. In the absence of purchasers for these bonds, the Bank has had to become their principal holder. Similar circumstances have forced the Bank to acquire the largest portion of mortgage bonds, created by the Mortgage Bank of Public Works.

Nearly half of the increase in the money supply of Mexico since 1941 can be traced to these security purchases by the Central Bank.

Gold sales Another anti-inflationary measure has been the sale of gold to the public during the war years. Catering to the hoarding impulses of the Mexican population, the Bank sold 447 million pesos worth of gold between December 1, 1940 and June 30, 1946. The effectiveness of this operation proved to be limited since a considerable portion of the gold was illegally exported.

An issue of 5-peso silver coins was similarly placed in circulation in 1943 for hoarding purposes.

Structure and operations of the Bank of Mexico

The Government controls 51 per cent of the central bank's capital of 50 million pesos. The administration of the Bank is in the hands of nine members, five appointed by the Government, and in all matters dealing with banking and monetary policy the Minister of Finance has full veto powers. This control, in effect, enables the Government to impose its own criteria for the issue of currency, as well as to indicate the type of credit policy that must be followed. That the Bank of Mexico has in fact been the instrument through which the Government has tried to compensate for lack of private support in its development programs is clearly revealed by its portfolio.

Of the Bank of Mexico's total assets of 3,162.9 million pesos in June 1946, 1,370.7 million pesos (43 per cent) were in investments and 869.0 million pesos (27 per cent) in loans. The balance consisted of 695.1 million

^{7/} Through legislation, insurance companies and savings banks have been to a limited extent forced to maintain a certain part of their assets in the form of government bonds. By this method, it has been possible to channel a small amount of government securities to these institutions, since the latter have taken the bare legal minimum.

pesos in gold, silver and foreign exchange and 228.1 million in other miscellaneous assets (Table 4).

Domestic and foreign debt bonds valued at 879.3 million pesos and Treasury certificates of 30.1 million comprised almost three-fourths of the Bank's investment portfolio. The bonds represented approximately 70 per cent of these outstanding long-term Government obligations, while the certificates corresponded closely to the amount of the floating debt in circulation.

Next in importance in the investment portfolio are the general bonds, issued by the "financieras," and of which the Bank held over 216 million pesos, or 66 per cent of the amount outstanding. In order to create confidence in these bonds, the Bank has guaranteed the maintenance of a price near par, and has thus encouraged insurance companies to invest funds in this form. Also, banks have been permitted to maintain part of their required reserves in the central bank in the form of general bonds. This explains the sudden drop in total holdings of these bonds in the Bank of Mexico's portfolio from 216 millions in December 1947 to 111 millions in June 1948, the difference having been shifted to private banks. (Tables 4 and 5.)

The mortgage bonds, of which 89.6 millions were held in June 1948, are instruments of the National Mortgage Bank of Public Works. These bonds can be considered for all practical purposes as part of the government debt since the National Mortgage Bank primarily sponsors Mexico's highway construction programs. The close link to government obligations is further shown by the manner in which interest on these bonds is serviced. The Government specifically sets aside gasoline tax revenue to meet interest payments on and to amortize bonds.

The 101 million pesos of private mortgage bonds^{8/} and the 26 million pesos of mortgage "cedulas"^{8/} are the only types of securities in the Bank of Mexico's portfolio that can be said to have ready marketability. The bonds are instruments of private mortgage banks, organized and sponsored by the Government since 1941 to create the type of paper that would be most appealing to small investors. The market for both bonds and "cedulas" has been far better than for most other private securities. They have been purchased not only by insurance companies and capitalization banks, but also by thousands of small investors. These securities appear in the Bank of Mexico's portfolio because through its open market operations the Bank stabilizes the market for them.

With respect to stocks, the Bank of Mexico holds 23.4 million pesos in shares of national institutions and 6.3 millions in shares of private concerns. The former represent mainly stocks of national banks which the Bank of Mexico is authorized by law to maintain in its portfolio.

In substance, the investment portfolio of the Bank of Mexico reveals the various efforts made by this institution to finance, or help finance, by

^{8/} The bonds are secured by the portfolio of the issuing company, while the "cedulas," or chattel mortgage certificates, are guaranteed by specific lien on a piece of property.

maintaining a market for securities, government or government-sponsored programs;^{9/} that is, it has been the instrument through which the Government has tried to compensate for a lack of private productive investment.

Although the Bank of Mexico does not publish detailed statistics on its loans and rediscounts, the available data (Table 4) show that it has granted very limited borrowing facilities to private banking institutions in the past few years. In June 1948 the only loans appearing in the Bank's portfolio were to the Government (1.6 million pesos) and to national banks (140.3 million pesos). And although rediscounts are published only as to maturities and not as to destination of credit, between 400 and 500 million pesos are generally known to be rediscounts to the Bank of Foreign Trade.^{10/} The paper created by this institution represents mainly short-term credit to agricultural production, especially for export.

The balance of the rediscounts is divided between "Nacional Financiera" and the National Agricultural Banks, probably mainly the latter. In this regard, central bank credit, although substantial, has been hardly sufficient considering that over 65 per cent of the population is engaged in agriculture. Agricultural credit has also been subject to a series of qualitative controls. In order to foster increased production of certain commodities, such as wheat and sugar, the Bank of Mexico has rediscounted only loans promoting their production.

Summary comments

There are thus three intimately related aspects of the Bank of Mexico's policy: (1) very substantial help to the capital market, (2) selective expansion of credit through official or specialized institutions, together with selective control of the credit of private commercial banks, and (3) quantitative restriction of the credit of private commercial banks.

There can be no doubt, as developments have proved, that this policy has had an over-all inflationary effect (for quantitative restriction was insufficient to offset the expansionary effects of points 1 and 2). Whether or not government deficits financed by the Bank of Mexico merely matched the hoarding that went on in the meantime, and whether or not credit expansion by official institutions merely made up for credit which would have been created by commercial banks if their reserve requirements had been kept at 20 per cent, inflation was a fact. There is also little doubt that the monetary expansion which would have taken place in any case, without Government

^{9/} Since 1941, the actual agent for the Government's industrialization efforts has been the "Nacional Financiera". But while operations may be handled by this institution, the Bank of Mexico remains the real backbone of the financial structure. Without this tacit support, the "Nacional Financiera" would have been able to carry out only a fraction of its financial outlay of hundreds of millions of pesos.

^{10/} The magnitude of such operations is not reflected in the balance sheet of the Bank of Foreign Trade (Table 13), because most of this paper, created by other lending institutions such as the Agricultural Banks and "Nacional Distribuidora," is carried in the "Cuenta de Orden", a contra account of the Bank of Foreign Trade.

deficits and without credit for official institutions, would also have been excessive

The Bank has been quite successful in expanding the money supply, and the primary expansion was very useful to the Mexican economy; it has been rather the secondary expansions which had a somewhat adverse inflationary effect. The Bank's powers to control these secondary expansions apparently could not be used to their full extent. Its capacity to contract the money supply, on the other hand, is very limited, as evidenced by the composition of its portfolio. Part of the portfolio, government paper, has a very slow turnover and no market in Mexico at the present time; another part, the general bonds, is at least in principle representative of long-term investments; and a third part, rediscounts to agricultural banks, is intimately linked with social and political considerations. At best, this portfolio can be contracted very slowly and never sufficiently to have a significant anti-inflationary effect. The Bank has moreover been of the opinion that a contraction of its loan portfolio would start a strong deflationary spiral.

The policy of the Bank of Mexico has been in agreement with the Government's policy of development. One part of the Government's objective has indeed been actually achieved through the Bank, that is, the promotion of specific activities, but it is none the less true that its influence on the creation of a capital market or on the attitudes of individual savers and private institutions has not been as great as would have been desirable --probably because the war years have not been the right time for its efforts to bear fruit in that direction. The Bank's activities have, at the same time, been decisive for developments in the field of private credit--primarily by limiting its volume and influencing its direction.

3. The Private Banking System

Development

The revolution of 1913-1917 wiped out most of Mexico's banking system. Of the private banks of issue that survived the civil war, all but one were ordered to liquidate, as they were unable to meet their obligations; and the note issuing privilege was reserved for the central bank by the provisions of the 1917 Constitution. Private capital in the form of gold or silver coins was hoarded or lent by usurers at rates of interest running as high as 4 and 5 per cent per month. With the creation of the Bank of Mexico in 1925 and the establishment of several branches, all conducting commercial banking operations, confidence in the banking system was to some extent restored.

With the passage of the 1931 banking law, the Bank of Mexico withdrew from the private banking field, turning many of its branches, of which there were 26 at the end of 1931, into private commercial banks. A central banking system was created whereby private banks were required to be members of the Bank of Mexico, which was empowered to regulate their credit operations. This development can be said to be the origin of the present Mexican private banking system.

With the monetary expansion of the war years as a result of balance of payments surpluses and government spending, private banking expanded tremendously. From 43 banks with 82 branches in 1932, the private banking system has grown to 387 institutions with 344 branches at the end of 1947 (Table 1, p. 6), with resources in excess of 4 billion pesos (Table 5). Several factors had postponed most of this growth until the war years. By far the most important was the lack of confidence in the banking system carried over from the days of the revolution.^{11/} A second factor, which is gradually being overcome, has been the absence of banking habits among the public. This is attributable primarily to the predominance of the large agricultural population and the low educational standard of the economy as a whole.

The General Banking Law of Mexico designates six principal groups of private banks (Chart I, p. 10); these can be classified according to the importance of their resources as follows: (1) commercial banks (deposit banks), (2) savings banks or savings departments of commercial banks, (3) "financieras" (industrial credit banks), (4) capitalization banks, (5) mortgage banks, and (6) trust companies. Other private auxiliary institutions which form part of the financial structure of Mexico are the credit unions, warehousing deposit institutions, the stock market and the clearing houses.

^{11/} The money supply gives evidence of this distrust. Banking deposits for many prewar years (1932-1939) were only half as important in value as the outstanding currency. Not until 1945 did deposits exceed currency in circulation, and then only by a small margin.

Commercial banks

The Mexican banking law stipulates that commercial banks (or deposit banks) operating in Mexico City must have a minimum paid-up capital of one million pesos and that those operating elsewhere in the Republic must have not less than 250,000 pesos. They are authorized to receive demand deposits (payable at sight or in less than 30 days' notice) and time deposits (payable after 30 days). Total deposits and other current liabilities of a bank are not to exceed an amount equivalent to ten times its paid-up capital, plus surplus. All commercial banks must be members of the Bank of Mexico and keep all their legal reserves therein. These legal reserves have been fixed at different percentages of bank liabilities, depending on whether the banks are in the Federal District or in other parts of the country. For banks in the Federal District, reserve requirements are 50 per cent of demand and time liabilities; for banks outside Mexico City but located where there is an agency of the Bank of Mexico, they are 45 per cent; and for banks located where there are no such agencies, they are 35 per cent. In order to meet the banks' demands for earning assets and to make possible an increase in credit for certain selected activities, the banks have been given an opportunity to invest part of their reserve requirements in national securities and in agricultural and stock-raising credit. (Table 6).

All Mexican banking laws have emphasized liquidity. The increases in minimum reserve requirements, however, are more in the nature of anti-inflationary measures than liquidity devices. To insure liquidity, the law provides that at least 30 per cent of a bank's credits should be at no more than 90 days and that not more than 20 per cent of total commercial bank liabilities may be kept in paper falling due in more than 180 days. Banks may hold in lieu of reserve requirements only securities which have not fluctuated more than 3 per cent during the previous six months. A limit of 250,000 pesos is placed on any one loan, whether to an individual or to an institution. All loans must mature in less than one year, with the exception of loans made for the specific purpose of increasing agricultural production or for livestock, which may have a maturity of 2 to 5 years, depending on the nature of the operation. The total amount of these longer-term loans must not exceed the combined value of capital and surplus. The law was modified in 1946 to permit the Bank of Mexico to pass part of its portfolio of government and other bonds to commercial banks; these investments are not, however, to exceed 20 per cent of the commercial bank's liabilities. Commercial banks may rediscount commercial paper with the Bank of Mexico.

While the law emphasized liquidity for commercial banking institutions' portfolios, these institutions are not, in any case, as interested in making investments as in making loans. Mexican bankers show very little enthusiasm for long-term paper, particularly government bonds, and any of which they have taken up have been as an investment in lieu of minimum reserve requirements. This is not surprising when short-term commercial loans provide a much more profitable return and insure a greater portfolio liquidity.^{12/}

^{12/} Mexican bankers frequently insist on the lack of liquidity of government bonds -- an argument which holds true only as long as the bankers themselves refuse to create a market for these bonds by substantial purchases. Moreover, central bank authorities have given government bonds considerable liquidity by repurchasing them almost at par.

Table 5. Main Accounts of the Private Banks
(in millions of pesos)

	1945	1946	1947	1948-June
<u>TOTAL ASSETS</u>	3,765.5	3,939.2	4,164.6	4,434.2
LIQUID ASSETS	1,575.6	1,397.4	1,191.5	1,091.7
INVESTMENTS	468.8	565.7	672.3	858.3
Federal Govt. (Domestic Debt)	143.0	134.6	161.9	170.6
Local Governments	9.5	2.9	2.1	2.2
Nacional Financiera	40.3	70.9	56.7	87.3
Banking Bonds	27.7	42.1	49.9	154.6
Commercial Bonds	0.5	1.0	1.7	1.1
General Bonds	15.8	23.3	23.8	128.4
Mortgage Bonds	11.3	17.7	24.3	25.0
Other Bonds	0.1	0.1	0.1	0.1
Banking Stocks	73.1	80.4	92.2	99.1
Bank of Mexico	21.2	22.6	24.0	23.4
Other Banking Institutions	51.9	57.8	68.2	75.7
Industrial Securities	175.2	234.8	309.5	344.5
Mortgage Cedulas	6.4	13.2	10.8	10.1
Mortgage Bonds	12.4	12.1	11.3	10.5
Stocks of National Corporations	122.7	162.4	221.5	252.2
Stocks of Foreign Corporations	3.8	0.3	.2	.2
Other Securities	29.9	46.8	65.7	68.5
CREDIT	1,572.0	1,793.3	2,094.0	2,250.3
To Private Banks	50.3	86.2	76.6	83.7
To Private Individuals	1,521.7	1,707.1	2,017.4	2,166.6
30 Days	39.6	44.6	38.5	35.2
90 Days	376.3	339.0	416.9	384.2
180 Days	564.3	618.2	771.4	801.7
360 Days	211.3	268.5	337.1	509.9
More than 360 Days	330.2	406.8	453.5	435.6
OTHER ASSETS	149.1	182.8	206.8	233.9
<u>TOTAL LIABILITIES</u>	3,765.5	3,939.2	4,164.6	4,434.2
Check Deposits	1,850.5	1,705.1	1,672.7	1,778.6
Sight Deposits	20.6	20.4	17.3	23.0
Saving Deposits	256.5	244.2	280.0	314.7
Time Deposits	137.2	109.4	105.1	105.4
Bonded Debt	474.2	588.3	700.9	733.2
Sight and Term Deposits and Obligations in Foreign Currencies	178.8	241.6	216.2	249.5
Capital	323.8	377.4	450.2	458.1
Reserves (Surplus)	46.3	58.7	70.9	124.2
Profit and Losses	48.7	56.1	57.8	44.0
Other	102.1	120.4	144.4	155.3

Source: Bank of Mexico, Vigesimosexta Asamblea General De Accionistas, 1948
and information supplied by the Bank of Mexico.

Table 6. Main Accounts of the Deposits and Savings Banks#
(in millions of pesos)

	1945	1946	1947	1948-June
TOTAL ASSETS	2,904.4	2,857.2	2,883.5	3,045.0
LIQUID ASSETS	1,529.0	1,350.5	1,146.8	1,042.8
INVESTMENTS	224.7	286.6	344.8	498.3
Federal Govt. (Domestic Debt)	114.3	101.8	126.6	133.6
Local Governments	4.1	0.1	--	0.6
Nacional Financiera	29.9	63.1	47.6	73.2
Banking Bonds	10.9	20.6	26.5	132.2
Commercial Bonds	0.5	--	0.8	0.4
General Bonds	8.2	14.1	16.0	121.1
Mortgage Bonds	2.2	6.5	9.7	10.7
Banking Stocks	47.7	53.7	59.1	60.6
Bank of Mexico	17.9	19.4	20.5	20.8
Other Banking Institutions	29.8	34.3	38.6	39.8
Industrial Securities	17.8	47.3	85.0	98.1
Mortgage Cedulas	2.1	6.8	4.6	4.6
Mortgage Bonds	1.5	1.3	1.6	1.4
Stocks of National Corporations	10.3	31.9	55.5	64.3
Other Securities	3.9	7.3	23.3	27.8
CREDIT	1,068.9	1,128.2	1,301.2	1,399.9
To Private Banks	50.3	86.2	76.6	83.7
To Private Individuals	1,018.6	1,042.0	1,224.6	1,316.2
30 Days	35.1	39.0	33.9	32.1
90 Days	357.9	314.1	379.3	358.0
180 Days	511.5	567.5	638.2	728.7
360 Days	81.7	84.3	106.0	115.0
More than 360 Days	32.4	37.1	67.2	82.4
OTHER ASSETS	81.8	91.9	90.7	104.0
TOTAL LIABILITIES	2,904.4	2,857.2	2,883.5	3,045.0
Check Deposits	1,841.8	1,702.9	1,672.2	1,777.6
Savings Deposits	256.5	244.2	277.9	310.5
Time Deposits	132.1	104.7	103.1	102.6
Sight Deposits and Obligations in Foreign				
Currencies	156.2	210.6	183.5	209.9
Capital	169.2	181.8	193.6	202.1
Reserves	32.4	39.1	46.3	55.1
Profits and Losses	28.8	33.7	34.3	25.0
Others	61.1	68.8	82.5	89.1

Source: Bank of Mexico, Vigesimosexta Asamblea General De Accionistas, 1948
and information supplied by the Bank of Mexico.

Separate statistics for savings banks are not available, since for the most part savings institutions are mere departments of commercial banks.

While investments have increased from approximately 5.8 per cent of demand and time deposits in 1941 to 14.4 per cent in 1947, this increase is merely the result of the Bank of Mexico's policy of permitting commercial banks to hold a part of their minimum reserve requirements in securities.

The major function of commercial banking institutions has been to provide short-term credit, both commercial and industrial (Table 7). The former has been very much in demand during the war years because, with rising prices, commodity speculation in building up and withholding commodity inventories has proved very profitable. Both the Bank of Mexico and the "Nacional Financiera" have repeatedly criticized, to little avail, commercial banks for making these loans, which have helped to drive prices up.

Commercial banks have been willing lenders to selected industrial concerns. This credit has not, however, gone directly where it was most needed -- namely, to small new industrial firms. In pre-revolutionary days production credit was extended almost solely to the large land owners ("hacendados") and this privileged position has now been inherited by the larger commercial and manufacturing companies. For these, credit is no problem. The ease with which they are able to borrow from banks has enabled many large commercial companies to become, in turn, lenders to small manufacturing firms and merchants.

There are several reasons why commercial and private banks in general are discouraged from making agricultural loans. The average farmer in Mexico is poor and possesses very few resources, except his land which, by law, cannot be mortgaged.^{13/} Therefore, in obtaining credit he can only pledge his crop. Because of the technical backwardness of Mexican agriculture, the success or failure of a crop depends, moreover, mainly on weather conditions. Necessarily, the lender assumes great risks advancing credit on such a basis, and this is evidenced, although overemphasized, by the low percentage of recovery on agricultural loans made by national banks. Other reasons why private credit is not made available to farmers are: (1) the extreme division of property which increases collection difficulties; (2) the erroneous opinion held by the uneducated farmer that national banks are charitable institutions; and finally (3) because of his ignorance of banking habits the farmer himself turns to the merchant who purchases his crop, even though the latter imposes the most oppressive terms.

Commercial bank credit to agriculture was practically non-existent until the Bank of Mexico used its reserve requirement policy to promote it by giving banks in rural districts the alternative of lending to agriculture or maintaining idle reserves. By this means 100 million pesos of credit were granted to agriculture by commercial banks in 1947 (87 million

^{13/} The Agrarian Reform of 1910 expropriated large private estates and divided the land into "ejidos" and small holdings. The "ejido" is the amount of land assigned to the farmers of a village. It may be subdivided into parcels or exploited cooperatively. Even if the "ejido" is subdivided into parcels, it continues to be a unit for purposes of the Agrarian Law. The "ejido" property is non-transferable, and it is not subject to purchase or sale, nor can it be mortgaged.

Table 7. Destination of Credit of Mexican Commercial and Savings Banks
(annual monthly averages in millions of pesos)

	1944	1945	1946	1947
Total Credit (1)	767.3	895.3	995.9	1,102.9
Production Credit (2)	408.7	495.9	535.8	559.8
Percentage (2) : (1)	53	55	51	51
Industrial Credit	282.4	344.3	359.5	417.9
Agricultural Credit	92.6	112.3	104.1	100.0
Livestock Raising Credit	28.4	34.9	37.7	37.3
Mining Credit	5.3	4.3	4.5	4.6
Commercial Credit (3)	358.6	399.5	489.2	543.1
Percentage (3) : (1)	47	45	49	49

Source: Bank of Mexico, Mexico D.F., 1948.

being granted by banks outside the Federal District). In general, much of the credit extended for productive purposes by commercial banks is a result of action by the Bank of Mexico in granting this facility and requiring that, to be eligible for rediscount, banks must have 60 per cent of their credit portfolio composed of credits for productive purposes.

Savings banks

Savings banks must have a minimum paid-up capital of 100,000 pesos if they are located in Mexico City and 50,000 if in other cities. Total liabilities cannot exceed twenty times the capital and surplus. Savings deposits, as defined by the banking law, are deposits bearing interest which may be withdrawn within a time period (not less than 30 days, but running up to 20 years) agreed upon between the depositor and the banking institution. Interest of 4 or 4 1/2 per cent is paid on individual deposits only up to 25,000 pesos. No withdrawals of more than 100 pesos, or 30 per cent of the balance, whichever is lower, can be made, and withdrawals are permitted only at intervals of 7 days or more. In addition to savings deposits, savings banks may also obtain funds by issuing savings bonds, which however have very secondary importance (Table 6, p. 24).

Savings banks assets more than tripled during the war, and by the end of 1947 total savings deposits were in excess of 275 million pesos (Table 6). Being for the most part mere departments of commercial banks, rather than independent institutions, their financing habits are necessarily the same as those of commercial institutions. While in principle they are providers of investment capital, in practice the larger part of time deposits has gone into more profitable short-term loans (Table 7). The fact that time deposits carry interest of only 4 per cent has, no doubt, also influenced this policy. While maintaining considerable amounts in liquid form, a large part of their portfolio is represented by discounts. In the middle of 1946 investments were only 40 per cent of total portfolio; the rest were short-term loans. In 1946, 98 per cent of the credit granted was for less than one year's maturity. In short, it cannot be said that these banks have adequately performed the functions of investment institutions.

Industrial credit banks

The "Sociedades Financieras" were legally authorized in 1932 to finance industry but did not assume great importance until the change in banking laws in 1941, in consonance with the industrialization program which permitted these institutions to extend their operations.

The "financieras" are intended to perform the following functions:

- (1) To promote industrial enterprises by floating securities,
- (2) To purchase and hold stocks,
- (3) To issue their own bonds (called general bonds),
- (4) To make 6-month to 30-year loans and, under special circumstances, loans maturing in less than 6 months,
- (5) To have rediscount privileges with the "Nacional Financiera."

Legally, the "financieras" are thus designed to specialize along investment banking lines. They are to promote and finance enterprises and develop markets for their securities. In order to provide working capital for industry, they are permitted to make loans with a minimum maturity of 6 months. Although in principle the rate of interest on all loans and credit granted by the "financieras" is officially estimated at around 12 per cent, it is actually often as high as 15 or even 18 per cent, depending on market conditions, the specific financial institutions concerned, their connections with the debtors, the security offered, the destination of the funds, et cetera.

Among private financial institutions, the "financieras" or industrial credit banks have contributed most to the industrialization of Mexico. Their growth (Table 1, p. 6) has been aligned with the Government's industrialization efforts, which began in 1941 in the Avila Camacho administration.^{14/} Like savings banks, the majority of "financieras" are subsidiaries of larger commercial banks, rather than independent institutions. This fact has unquestionably influenced their investment and lending habits.^{15/}

The "financieras" have shown little interest in marketing the securities of enterprises which they promote. Instead, they prefer to hold them and issue their own bonds (general bonds), using the stocks and bonds of private business as collateral. The ultimate investor, therefore, through the purchase of "financiera" bonds makes an indirect investment in industry. These operations have grown enormously, as may be seen from the table on loans and investments outstanding (Table 8). About half the "financieras", however, do not use general bonds to obtain funds, but rely on their own

Table 8. "Financieras" - Loans and Investments
(millions of pesos)

Year	Loans	Investments in Securities
1941	63.8	39.7
1942	87.8	32.9
1943	139.6	71.3
1944	201.2	106.3
1945	286.9	128.2
1946	393.4	179.7
1947	534.0	213.3
1948 (August)	536.7	205.5

Source: Boletín Estadístico, Comisión Nacional Bancaria.

^{14/} Prior to 1941, the Cardenas administration made agricultural development the keynote of its program.

^{15/} The General Banking Law of 1941 enables the "financieras" to make loans of less than six months' maturity in special cases. Through this loophole, the "financieras" have made substantial short-term commercial loans, thereby encroaching upon the commercial banking business. From another point of view, and amounting to the same thing, it would appear that commercial banks have utilized the funds of their "financiera" subsidiaries for short-term commercial loans, instead of for long-term industrial financing.

capital and on commercial credit (Table 9). Of the more than one hundred "financieras," nine have issued about 20 per cent of all the general bonds in circulation.^{16/}

The largest purchaser of the general bonds has been the Bank of Mexico (216 million as of December 1947). The private banking system, again in December 1947, held only 22.3 million, the balance, 84.6 million, being in the hands of insurance companies, private banks, and private individuals and businesses.

While the "financieras'" investment operations have been substantial (Table 8), they have been less than half as important as their direct lending operations.

The "financieras" have been able to expand primarily by means of two devices. The more important of the two is the privilege granted to them by the banking law to use commercial paper created through lending operations, in the same way as stocks and bonds of private institutions, as collateral for the issuance of general bonds. The second source of expansion is derived through rediscount operations at "Nacional Financiera". The funds thus acquired go into additional loans and, in a system thirsty for credit, an almost unlimited expansion is thus permitted. If this credit met the need for which the supply was created, there would be little to criticize. In practice, however, this has not been the case.

The "financieras" have used their resources to conduct a commercial loan business on the one hand, and an investment business on the other. The function for which they were established, that is, to promote industrial development, has not been served as fully as intended. Whereas they were created to meet the needs of small infant industries, they have been more interested in extending credit to old and established commercial and industrial firms.

A publication of the official development corporation, "Nacional Financiera," stated in 1947 that, generally speaking, the "financieras" have not tried to promote industries, if this meant incurring high costs for technical services of good quality; if technical investigations had been more thorough, the long-term prospects for their investments would have been better. Most industries have been approached from the point of view of immediate prospects for high prices and high profits. The "financieras" have been accused of unnecessarily financing objectionable consumption industries and of neglecting capital formation industries. In this, they acted in response to certain types of demand arising from high money incomes. At times, the industrial promotion carried out by the "financieras" aimed not at financing, but at securing control of enterprises, a function which is not within their scope. Some "financieras" have done a good job, but this is not the rule.

^{16/} This was the situation in 1946, the latest date for which information is available.

Table 9. Main Accounts of the Industrial Credit Banks (Financieras)
(in millions of pesos)

	1945	1946	1947	1948-June
TOTAL ASSETS	468.0	625.1	774.5	858.7
LIQUID ASSETS	26.1	29.5	22.3	25.3
INVESTMENTS	158.3	179.7	213.3	239.4
Federal Govt. (Domestic Debt)	3.6	0.3	0.6	1.0
Local Governments	5.1	2.5	1.3	1.2
Nacional Financiera	4.2	2.1	0.5	2.1
Banking Bonds	22.2	24.6	26.2	29.4
Commercial Bonds	—	0.4	0.6	0.3
General Bonds	4.6	5.8	2.3	1.8
Mortgage Bonds	0.4	0.6	1.8	1.2
Banking Stocks	17.2	17.8	21.5	26.0
Bank of Mexico	1.8	1.5	1.5	0.9
Other Institutions	15.4	16.3	20.0	25.1
Industrial Securities	123.2	150.2	184.7	205.7
Mortgage Cedulas	0.4	1.3	1.5	1.3
Mortgage Bonds	9.1	9.8	8.9	8.3
Stocks of National Corporations	94.7	112.3	145.6	169.6
Stocks of Foreign Corporations	3.1	0.3	0.2	0.2
Other Securities	15.9	26.5	28.5	26.3
CREDIT	268.3	393.4	504.0	553.0
To Private Institutions	268.3	393.4	504.0	553.0
30 Days	2.4	3.9	2.7	0.7
90 Days	18.4	24.9	37.4	26.0
180 Days	39.4	68.9	123.2	60.4
360 Days	82.7	117.9	144.8	297.0
More than 360 Days	125.4	177.8	195.9	168.9
OTHER ASSETS	15.3	22.5	34.9	41.0
TOTAL LIABILITIES	468.0	625.1	774.5	858.7
Check Deposits	8.7	2.2	0.5	1.0
Sight Deposits	8.2	6.4	3.0	3.1
Time Deposits	5.1	4.6	2.0	2.8
Bonded Debt	184.4	246.6	332.9	348.2
Sight Obligations	87.0	131.8	136.1	153.7
Sight and Term Deposits and Obligations in Foreign Currencies	18.5	30.4	31.9	38.7
Capital	113.2	146.3	201.0	198.7
Reserves	8.9	12.7	15.8	58.1
Profits and Losses	13.0	14.1	13.9	12.7
Other	21.0	30.0	37.4	41.7

Source: Bank of Mexico, Vigesimosexta Asamblea General De Accionistas, 1948
and information supplied by the Bank of Mexico.

Corrected: February 15, 1949.
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The fact that the "financieras" have not served their purpose to the desired extent was officially recognized by President Aleman in his speech of September 1, 1948, when he said that in view of the failure of "financieras" other means would have to be found to promote industrial development.

Capitalization banks

The capitalization banks are authorized to receive deposits repayable on a fixed date, or in exchange for annuities. In exchange for deposits these banks offer either capitalization certificates or policies depending upon the contract the depositor desires. At least 20 per cent of total deposits must be invested, as a reserve, in government bonds.

No more than 5 per cent of current liabilities may be loaned at less than 180 days, and no more than 30 per cent of these same liabilities may be placed in loans in excess of 180 days. In no instance are direct loans to be made in excess of five years. However, credit may be advanced for longer periods where collateral such as securities or warehouse receipts is deposited, provided that the loans do not exceed 80 per cent of the value of such collateral. Credit up to ten years may also be provided for real estate and construction purposes.

Since 1940 these institutions have grown rapidly (Table 1). At that date their total resources were about 56 million pesos. In 1942 they had grown to 88 million, in 1946 they were 234 million, and in 1947, 278 million (Table 10). Their capital has only been a subsidiary source of funds, the main source being the premia paid by holders of capitalization securities, which represent more than 90 per cent of total resources.^{17/} The lottery feature of these securities has probably made them more popular.

The same concentration apparent in other types of banking institutions is found in capitalization societies: most of them are in Mexico City. The two largest capitalization banks account for more than 55 per cent of all the resources of the system.

About half of the 84 million pesos of investments of capitalization banks are in government bonds, while their credit to private individuals and firms amounted in June 1948 to 169 million pesos. Two-thirds of this last figure is represented by loans of less than one year.

Mortgage banks

These banks are not permitted to accept deposits. Their function is to issue mortgage bonds and to guarantee mortgage "cédulas" (a variety of mortgage bonds). Both the bonds and the "cédulas" may bear maturities up to 23 years. The bonds, however, in case of default have preference over

^{17/} As a psychological appeal, these banks conduct a lottery several times a year, and depositors holding winning numbers receive all the benefits of their annuities or lump payments without any further contribution on their part.

Table 19. Main Accounts of Capitalization Banks
(in millions of pesos)

	1945	1946	1947	1948-June
TOTAL ASSETS	185.5	234.6	278.0	302.1
LIQUID ASSETS	3.7	5.2	7.2	8.2
INVESTMENTS	59.1	69.3	79.4	84.2
Federal Govt. (Domestic Debt)	24.6	32.3	34.2	35.2
Local Governments	--	0.1	0.1	0.1
Nacional Financiera	2.6	4.4	6.5	9.8
Banking Bonds	14.8	16.3	19.7	20.1
Commercial Bonds	--	0.4	0.2	0.3
General Bonds	1.4	1.0	2.3	2.5
Mortgage Bonds	7.3	7.9	9.2	8.8
Other Bonds	0.1	0.1	0.1	0.1
Banking Stocks	6.0	6.9	7.9	8.3
Bank of Mexico	0.4	0.3	0.3	0.3
Other Banking Institutions	5.6	6.6	7.6	8.0
Industrial Securities	17.1	16.2	18.9	19.0
Mortgage Cedulas	0.3	0.3	1.3	0.4
Mortgage Bonds	1.5	0.7	0.3	0.3
Stocks of National Corporations	14.7	14.6	16.7	17.1
Other Securities	0.6	0.6	1.6	1.2
CREDIT	101.1	131.6	154.0	169.4
To Private Individuals	101.1	131.6	154.0	169.4
30 Days	0.6	0.6	0.5	0.4
90 Days	--	--	0.2	0.2
180 Days	13.4	11.8	10.0	12.6
360 Days	46.9	66.3	86.3	97.9
More than 360 Days	40.2	52.9	57.6	58.3
OTHER ASSETS	21.6	28.5	36.8	40.3
TOTAL LIABILITIES	185.5	234.6	278.0	302.1
Time Deposits	--	0.1	--	--
Bonded Debt	166.7	209.3	249.1	269.8
Sight Obligations	2.6	5.5	4.4	5.3
Sight and Term Obligations in Foreign				
Currencies	--	0.3	0.3	0.7
Capital	8.3	9.8	11.4	12.9
Reserves	1.8	2.3	2.8	3.4
Profits and Losses	2.1	2.0	2.6	2.5
Other	4.0	5.3	7.4	7.5

Source: Bank of Mexico, Vigesimosexta Asamblea General De Accionistas, 1948 and information supplied by the Bank of Mexico.

all other obligations of the mortgage banks, while the "cédulas" have only specific backing. Capital for these operations is derived from paid-in capital, as well as from assets of other institutions, when bonds are issued for their benefit.

Mortgage banks have specialized in building construction, which they have effectively promoted. Rural development through mortgage credit accounts for less than 5 per cent of all mortgage credit. (In 1944, in order to avoid land speculation, they were prohibited from granting loans on the security of land). A field in urban construction which has scarcely been touched by mortgage credit is low-cost housing.

Private mortgage bonds were first issued in 1942; in 1943 the amount issued was 21 million pesos. A peak was reached in 1946 with 125 million, decreasing to 116 million pesos at the end of 1947 (Table 11). Mortgage certificates ("cédulas") have had more success and have shown a steady increase, although with a tendency to taper off. In 1937 the amount issued was 17 million pesos; in 1944 it had gone to 111 million, in 1946 to 195 million, and in 1947 to 205 million. Both bonds and certificates have a maturity of eight to ten years, although they can be extended to twenty years, and bear interest of approximately 7 per cent.

Most of the mortgage business is done in Mexico City; five institutions in the capital together have as much capital as the other sixteen. Five institutions out of twenty-one have issued almost 80 per cent of all outstanding bonds, and the same is true of certificates. Many of the smaller mortgage banks have had to rely exclusively on their own capital for their operations.

Trust companies

The functions of these institutions are very diversified. They receive deposits consisting of all kinds of personal property, securities and rights, and issue certificates of participation representing such property. They carry out trustee operations and issue trust certificates; they intervene in issuing securities of other firms; they invest funds of private individuals or institutions in accordance with terms agreed upon, and may invest their own capital funds.

These institutions had a rapid development after 1941, when there were only 26 of them. Of the 87 which existed at the end of 1947, 55 were in Mexico City (Table 2, p. 8).

The distribution of their investment portfolio reveals that their most favored securities are, in the following order: mortgage paper (both bonds and certificates); bonds and other securities of "financieras"; shares of credit institutions; securities issued by official institutions; shares and bonds of industrial firms; government bonds (Table 12).

As part of the general financial structure of Mexico, trust companies are a small but important support of the security market.

Table 11. Main Accounts of the Mortgage Banks
(in millions of pesos)

	1945	1946	1947	1948-June
<u>TOTAL ASSETS</u>	179.6	195.6	192.0	191.8
LIQUID ASSETS	5.8	5.7	6.3	8.1
INVESTMENTS	12.5	13.6	13.6	13.9
Federal Govt. (Domestic Debt)				0.2
Nacional Financiera (cer. de par.)	0.2	--	0.1	0.1
Banking Bonds	0.3	0.6	0.9	0.9
Commercial Bonds	--	--	0.1	--
General Bonds	0.1	0.1	0.2	0.2
Mortgage Bonds	0.1	0.3	0.4	0.3
Banking Stocks	0.1	0.2	0.2	0.5
Bank of Mexico	--	0.1	0.1	0.2
Other Institutions	0.1	0.1	0.1	0.3
Industrial Securities	12.0	13.0	12.6	12.7
Mortgage Cedulas	1.7	1.6	0.8	0.7
Stocks of National Corporations	0.2	0.3	0.5	0.2
Other Securities	10.1	11.1	11.3	11.8
CREDIT	132.8	138.8	132.1	125.4
To Private Institutions	132.8	138.8	132.1	125.4
30 Days	1.5	1.0	1.2	1.6
90 Days	--	--	--	--
180 Days	--	--	--	--
360 Days	--	--	--	--
More than 360 Days	131.3	137.8	130.9	123.8
OTHER ASSETS	28.5	37.5	40.0	44.4
<u>TOTAL LIABILITIES</u>	179.6	195.6	192.0	191.8
Bonded Debt	123.1	132.4	118.9	115.2
Sight Obligations	16.8	19.2	26.5	30.5
Capital	19.2	221.3	22.2	22.3
Reserves	2.7	3.7	4.7	5.9
Profit and Losses	2.9	3.9	3.9	2.3
Other Liabilities	14.9	15.1	15.8	15.6

Source: Bank of Mexico, Vigesimosexta Asamblea General De Accionistas, 1948 and information supplied by the Bank of Mexico.

Table 12. Main Accounts of the Trust Banks (Fiduciarias)
(in millions of pesos)

	1945	1946	1947	1948-June
<u>TOTAL ASSETS</u>	28.0	26.7	32.0	29.9
LIQUID ASSETS	11.0	6.5	8.6	6.8
INVESTMENTS	14.2	16.5	17.8	17.8
Federal Govt. (Domestic Debt)	0.5	0.2	0.4	0.6
Local Governments	0.3	0.2	0.6	0.2
Nacional Financiera (cer. de par.)	3.4	1.3	1.7	1.8
Banking Bonds	4.9	6.7	7.7	7.8
Commercial Bonds	--	0.2	--	0.1
General Bonds	1.5	2.3	2.7	2.5
Mortgage Bonds	1.3	2.4	2.3	2.4
Banking Stocks	2.1	1.8	2.7	2.8
Bank of Mexico	1.1	1.3	1.6	1.2
Other Banking Institutions	1.0	0.5	1.1	1.6
Industrial Securities	5.1	8.1	7.4	7.4
Mortgage Cédulas	1.9	3.2	3.5	3.0
Mortgage Bonds	0.3	0.3	0.5	0.4
Stocks of National Corporations	2.8	3.3	2.7	2.9
Other Securities	0.1	1.3	0.7	1.1
CREDIT	0.9	1.3	2.0	2.4
To Private Institutions	0.9	1.3	2.0	2.4
30 Days	--	--	0.2	0.4
90 Days	--	0.1	--	--
More than 360 Days	0.9	1.2	1.8	2.0
OTHER ASSETS	1.9	2.4	3.6	2.9
<u>TOTAL LIABILITIES</u>	28.0	26.7	32.0	29.9
Sight Obligations	10.5	3.7	5.8	5.0
Time Deposits in Foreign Currencies	0.1	0.3	0.5	0.2
Capital	13.9	18.2	19.9	20.0
Reserves	0.5	0.9	1.3	1.6
Profits and Losses	1.9	2.4	3.3	1.8
Other Liabilities	1.1	1.2	1.2	1.3

Source: Bank of Mexico, Vigesimosexta Asamblea General De Accionistas, 1948 and information supplied by the Bank of Mexico.

Auxiliary financial institutions

Credit unions are required to specialize in either agriculture, industry, or commerce, except that associations whose members deal with the processing of agricultural products and raw materials into finished goods are permitted to engage in mixed activities. Their function is to provide credit for their members by small loans repayable in no more than five years. They may occasionally perform other functions, such as building and administering property for members, purchase and sale of members' output, and may even acquire securities of enterprises in the branch of industry in which they specialize. No statistical data are available, but it is known that the volume of their credit transactions, except for the agricultural unions discussed in the next chapter, is relatively small.

Warehouses assume importance in the credit picture only insofar as they are permitted to issue merchandise receipts, which are in turn used in securing commercial credit.

There are seven clearing houses, through which an average of over two billion pesos of checks is cleared monthly. Their facilities have undoubtedly helped to expand the use of checks. It was not until 1945 that bank deposits exceeded currency in Mexico.

The nature and operations of the stock exchange are discussed in a later chapter.

Reform

The endeavors of the private banking system in financing industrial development have been very disappointing. Even the "financieras," specifically created to stimulate and promote industry, have been more interested in short-term lending than in long-term industrial investments. To remedy this situation, the Government is currently taking steps to orient the flow of credit in the proper direction. The reform of the Banking Law of 1941, which was submitted to the Mexican Senate in January 1949 and which is likely to be adopted, is concrete evidence of such intentions.

The reform purports to accomplish two objectives:

1. To assure that a greater proportion of private banking resources will be used in long-term loans and government and industrial paper.
2. To create, or perfect, a credit system to meet the needs of each of those productive activities requiring credit.

The new amendments for each category of credit institutions affected by the reform are as follows:

1. Commercial banks

The 90-day term for commercial loans, which was established by the previous law and which has always been burdensome to creditors,

has been extended to 180 days. Credit may be granted for crop advances for a period of no more than 2 years nor less than one year, and for equipment, livestock and other medium-term improvements, for a period up to 5 years.

Current obligations, which now may not exceed more than ten times the sum of their capital and reserves, may be increased as high as 15 times that amount when monetary policy makes it advisable, which will be at the discretion of the Ministry of Finance.

Investments in bonds cannot exceed 15 per cent of current obligations, and up to 80 per cent of deferred obligations may be applied for the granting of credit for 1, 2 and 5 years and for investment in securities, "cédulas," bonds, stocks, et cetera, with 2-year maturity.

The Ministry of Finance shall fix what percentage of the credit eligible under the foregoing restrictions may be extended for crop advances, for medium-term improvement loans and for securities investments.

The Ministry of Finance shall periodically announce, through circulars, what general activities necessary for the economic development of the country shall be eligible for medium-term credit.

Medium-term credit cannot exceed 50 per cent of the value of the property posted as collateral by the borrower, nor exceed 50 per cent of the combined capital and reserves of the institution obtaining the loan.

2. Savings banks

The credit advanced by these institutions shall be apportioned as follows: up to 30 per cent for 90-day loans; up to 20 per cent for loans from 90 days to one year; up to 20 per cent for crop advances repayable in 1, 3 or 5 years; and up to 30 per cent for mortgage loans.

3. Industrial credit banks ("financieras")

The "financieras" can grant letters of credit for the purchase of machinery and raw materials; subscribe to or contract public loans (for no more than 30 years); issue financial bonds with specific backing; grant secured loans and crop advance loans; grant credit of 5 to 10 years for agriculture and commerce and up to 15 years for industry.

4. Capitalization banks

The capitalization banks must have a capital of not less than one million pesos, and their total capital and reserves must not be less than 20 per cent of their total liabilities; they must maintain a reserve to redeem capitalization securities and annuities when they fall due, and to accomplish these ends they are authorized to invest their liabilities in the following proportions: up to 5 per cent in loans due in 60 to 180 days, up to 15 per cent in crop advance credit repayable in 3 years and medium-term credits repayable in 5 years; up to 30 per cent in bonds and listed securities and up to 20 per cent in loans for low-income housing.

4. The National Banking System

The private banking system is mainly engaged in short-term commercial financing. To promote productive activities, the Government of Mexico has had to create a national system of banking institutions, which includes ten national banks (Chart I, p. 10), designed to provide selective and long-term credits.

"Nacional Financiera"

By far the most important national bank in terms of resources (Table 13) and achievements is the "Nacional Financiera." Founded in 1934 to create a market for government, state and municipal bonds, it had no great importance in the financial structure of Mexico until 1941, when it was reorganized primarily as an investment bank.

The most important reason for its reorganization and, therefore, the main objective for its operation was the promotion of industrial development. The New Organic Law of 1941 allotted the following functions to the "Nacional Financiera:"

- (1) To develop private enterprises that were unattractive to private capital because of the large investment required and the probable slowness of the returns;
- (2) To grant assistance if called upon, where private capital had taken the initiative;
- (3) To act as a central bank for the "financieras" when they were in need of additional credit to finance their own industrial undertakings; for this purpose the "Nacional Financiera" was empowered to make secured loans to the "Financieras."
- (4) To act as intermediary between persons or institutions, domestic or foreign (i.e., Export-Import Bank, International Bank for Reconstruction and Development, etc.), interested in placing capital in Mexico;
- (5) As a further means to stimulate industry, promoting long-term credits by developing a broader security market and improving the existing stock exchange;
- (6) And, finally, to act as agent for the federal, state and local governments in the issue, conversion and retirement of public securities.

To carry out these extensive functions the "Nacional Financiera" was to have an authorized capital of 20 million pesos (increased in December 1947 to 100 million), 51 per cent subscribed by the Government, the balance to be subscribed by national and private banking institutions. It was also granted power to obtain funds by the sale of its bonds, recourse to rediscounting privileges with the Bank of Mexico, and sale of participation certificates backed by designated securities in its portfolio.

Table 13. National Banking System - December 31, 1947
(millions of pesos)

	Total	Nacional Finan- ciera	N.B. of Public Works	N.B. of Agricul. Credit	N.B. of ^{1/} Ejidal Credit	N.B. of Foreign Trade	N.B. of Motion Pictures	N.B. of Co- operative Development	N.B. of Ware- housing Deposits	N.B. Army
<u>Total Assets</u>	1,501.4	732.3	240.2	72.7	293.7	77.5	34.3	22.7	14.3	13.7
Liquid Assets	74.0	14.8	3.8	5.9	14.3	31.9	0.4	2.0	0.7	0.2
Investments	435.6	401.3	7.1	4.9	1.2	3.2	16.6	1.2	-	0.2
Loans	716.9	186.0	196.4	55.0	220.4	29.6	13.1	13.6	-	12.8
Other Assets	264.2	129.2	32.9	6.9	57.8	13.2	4.2	5.9	13.6 ^{2/}	0.5
<u>Total Liabilities:</u>										
Current Obliga- tions	148.6	70.5	4.6	12.7	24.4	32.1	0.8	2.1	1.1	0.3
Deferred Obliga- tions	636.9	496.5	2.0	5.7	117.9	6.3	-	2.9	0.3	5.3
Bonded Debt:	256.0	42.8	189.5	10.5	-	-	23.2	-	-	-
Capital & Surplus	351.1	32.0	38.2	52.5	151.3	32.9	10.1	15.9	12.7	5.5
Other Obligations	162.0	143.3	5.9	1.3	0.1	6.2	0.2	2.2	0.2	2.6

^{1/} Latest data available on the Ejidal Bank is for December 31, 1946.

^{2/} Consist primarily (11.4) of inventories.

Source: Adapted from the Anuario Financiero de Mexico, Bank of Mexico, Mexico D.F., 1948.

Since only 12.7 million pesos had been subscribed to capital by December 1947, and bonds in circulation amounted to 42.8 million, the scope of "Nacional Financiera" operations would have been indeed limited, if funds had not been raised from the sale of approximately 300 million pesos of participation certificates, and through rediscounts with the Bank of Mexico amounting to 68 million pesos in December 1947.

Participation certificates are backed by specific securities, but interest on the certificates is not tied to the yield from the security. The certificates pay a straight interest rate, regardless of the earnings of the collateral securities. Furthermore, the certificates usually have a maturity date of from two and a half to ten years, although there have been issues without maturity dates. The purchaser takes little or no risk since the "Nacional Financiera," backed by the Bank of Mexico's resources, is pledged to repurchase the certificates at par. The participation certificates may, as was originally intended, bear a superficial resemblance to investment trust certificates in the United States, but in effect they resemble much more fixed-interest obligations, redeemable at sight and at par.

This detailed description of the certificates is necessary to explain how far the "Nacional Financiera" has had to go to provide a market for its issues. And, more important still, it also illustrates the safeguards it has had to create to procure savings from the Mexican people, a task made very difficult, on the one hand, by the orientation of their investment habits toward short-term commercial investment, and, on the other, by their desire for real estate property.

The extent to which the "Nacional Financiera" has succeeded in the task of gathering savings is specifically shown by the distribution of certificates in the market, as of August 1948:

	Amount Held (thousands of pesos)	Percentage of Total
Private investors	106,992	35.0
Private credit institutions	79,232	26.0
Commercial and industrial firms	34,111	11.2
Insurance and fidelity companies	18,409	6.0
Mexico Social Security Institute	12,422	4.1
National credit institutions	1,350	.4
Other investors	<u>52,991</u>	<u>17.3</u>
Total Outstanding Certificates ^{18/}	305,557	100.0

The guaranteed return and the repurchase clause at par make it possible to argue that, rather than being attracted to making direct investments in industry, the private investor has had his attention diverted to certificates.

^{18/} The volume of certificates in circulation is somewhat less, since among "Other Investors" there are substantial amounts held by "Nacional Financiera."

Since the nature of the certificates gives the holder no equity risk in industry, it may be said that the investment psychology of the private investor is distorted by his being led to expect guarantees for supposedly venture capital. Evidently the "Nacional Financiera," in this respect, has not been a wholesome influence in the education of the Mexican private investor.

The primary function of the "Nacional Financiera," on the supply side, is to channel savings to uses that promote industrial development in Mexico. This function has been performed by the "Nacional Financiera" through the purchase of securities of industrial companies and by direct loans to industry.

In 1947, the "Nacional Financiera" had approximately 262 million pesos in Government securities, and 312 millions in private investments. Total credit for that year amounted to 883 million pesos (Table 14).

A review of the investment portfolio shows that "Nacional Financiera" has invested in practically all the large industrial corporations of Mexico. Funds from this institution have made possible the formation of the Monclava Rolling Mills and its many subsidiaries, and the construction of the Chapala Hydro-electric Plant, several cement plants, two rayon plants, three large sugar mills, various motion picture studios, a large electrical products enterprise, a fertilizing plant, a paper pulp mill, a glass factory, an electrolytic copper mill, a gas pipeline and several other enterprises.

In view of the investment habits of both private banking and non-banking investors in Mexico there can be little doubt that these investments would not have been made without this type of financing. Investments have been made by purchasing both stocks and bonds of these large companies, although the latter are more important in value. More often than not, "Nacional Financiera" has acquired a controlling interest in the enterprises it has financed through investments.^{19/}

Lending, however, has been the most important medium used by the "Nacional Financiera" in financing industry and extending credit to other entities. Short-, medium- and long-term loans have been made, with the first predominating. The short-term nature of these loans can be inferred from the sizeable credit recovery year after year (Table 14).

Table 14. "Nacional Financiera" Loans
(millions of pesos)

Year	Loans	Per cent of Recovery
1941	29	92.2
1942	51	82.2
1943	53	88.3
1944	184	84.7
1945	394	76.6
1946	536	92.7
1947	833	n.a.

^{19/} Its largest investment of 50,500,000 pesos in "Industria Electrica de Mexico" is 46 millions in bonds. The balance of 4,500,000 pesos held in stocks constitutes only 4 per cent control.

Since the greater part of "Nacional Financiera" lending has been on a six to twelve months' basis, it appears to have encroached upon the commercial banking field. This type of lending has been thought to be necessary, inasmuch as private banking institutions have been reluctant to lend to new industrial firms. As long as they could extend credit to the legal limit to old established firms with whose business activities they were quite familiar, private bankers have not been willing to acquaint themselves with the characteristics of new industries. This accounts for the enormous expansion of this national credit institution. As a result of making loans and investments thought to be most desirable from a national point of view, the profits of "Nacional Financiera" have been small when compared with those of private investment institutions. "Nacional Financiera" has attempted to eliminate, wherever possible, irregular practices by its borrowers. The most common of these practices has been the habit of certain institutions, who had obtained industrial credit but had invested only part of their funds in industrial operations, of channeling credit not so used into the more lucrative commercial type of operation. Irregularities of this kind have been minimized in the case of direct investments, subject to close supervision by the "Nacional Financiera," but some indirect credit, such as rediscounting operations for the "financieras," has leaked into the commercial field.

Although by statute "Nacional Financiera" has not been directed to finance only large industrial enterprises, this has in fact been its policy. To meet the needs of small or medium-sized industrial firms with a capitalization of less than 250,000 pesos, a law extending the operations of the National Bank of Cooperative Credit was enacted on December 31, 1946. This definitely designates credit to large industry as the "Nacional Financiera's" field.

Through its methods in procuring capital, the "Nacional Financiera" has failed in educating the private investor to channel savings directly into productive operations, but through its own financing it has made a substantial contribution to industrial development.

The agricultural banks

The need for the two existing banks for agricultural development, the "National Bank of Agricultural Credit" ("Banco Nacional de Credito Agricola"), and the Ejidal Bank ("Banco Hacienda de Credito Ejidal"), is best shown by the lack of even a single private banking institution engaged solely in agricultural lending, and by the reluctance of commercial banks to operate in this field. The shortage of agricultural credit has been an important handicap to economic development and national welfare. Since the reestablishment of a banking system in post-revolutionary days, several attempts have been made to relieve the credit drought which had plagued farming since colonial days.

The National Bank of Agricultural Credit was created in 1926 to provide credit for small independent farmers. Almost simultaneously an attempt was made to develop a series of credit institutions for assistance to the "ejidatarios," the small farmers whose economic and social interests are linked with the "ejido" units. Four small "ejidal" banks were initiated in 1926, but from the start they failed to achieve the objectives for which they

were intended. Lack of sufficient capital limited their operations so that they were unable to cope with even the most pressing credit needs of the "ejidatarios." The situation was further aggravated by the role played by political influence in the granting of credits. The type of commercial paper thus created proved to be the undoing of these institutions. The great depression of the thirties froze their resources and led to their failure.

Meanwhile the National Bank of Agricultural Credit had achieved such poor results in its first four years of operations that a new law was enacted in 1930 replacing the 1926 statute. Whereas lending had formerly been directly to the farmer, the new law specified that loans were now to be made only through organized cooperative farming societies. The Bank was also empowered to intervene in the control of production, distribution, processing and marketing of the farm products of the entities with which the bank was to be associated. The original agricultural bank thus assumed the position of a central bank for agricultural credit. The insolvent "ejidal" banks were temporarily taken over by the National Bank of Agricultural Credit and regional banks were organized to broaden the operations of the National Bank of Agricultural Credit. Credit unions for independent farmers as well as for "ejidatarios" were formed to deal with the regional banks. The most immediate result of all these operations was the establishment of several warehouses as subsidiaries to either the credit unions or the regional banks.

By the end of 1935, in view of the extent of its operations and the charges of discrimination levelled against it by both the independent farmers and the "ejidatarios," the credit problems of the latter were again separated from the National Bank of Agricultural Credit and assigned to a National Bank of Ejidal Credit.

This dual division of agricultural credit has persisted, and the manner in which credit is channelled to the ultimate borrower by these institutions is summarized in Chart II.

The central principle of today's agricultural credit system is decentralization. An independent or "ejidal" borrower applies to his producers' society or credit union, which in turn has access to credit from a central credit union or central collective society agency, which deals with the national agricultural banks or their agencies.

The principal functions of the Agricultural Bank are the following:

- (1) to encourage, regulate and watch over the organization and functioning of cooperative agricultural societies and local agriculture credit banks;
- (2) to purchase stock in the regional banks and extend credit to them by discounting their paper, guaranteeing their mortgage bonds, securities, etc.;
- (3) to issue cashier's bonds ("bonos de caja"), debentures and mortgage bonds;
- (4) to organize and administer warehouses and companies for the transformation and marketing of the agricultural products of members of the regional banks and cooperative societies;
- (5) to organize and administer a Farmers' Savings Department;
- (6) to colonize the lands of the Federal Government or of companies or persons "when the project is of public interest and the expenses are paid by the proprietor concerned; and
- (7) to take charge of a public registry of agricultural credit.

NATIONAL SYSTEM OF AGRICULTURAL CREDIT

Sources and Means of Credit Open Directly or Indirectly to Agricultural Producers

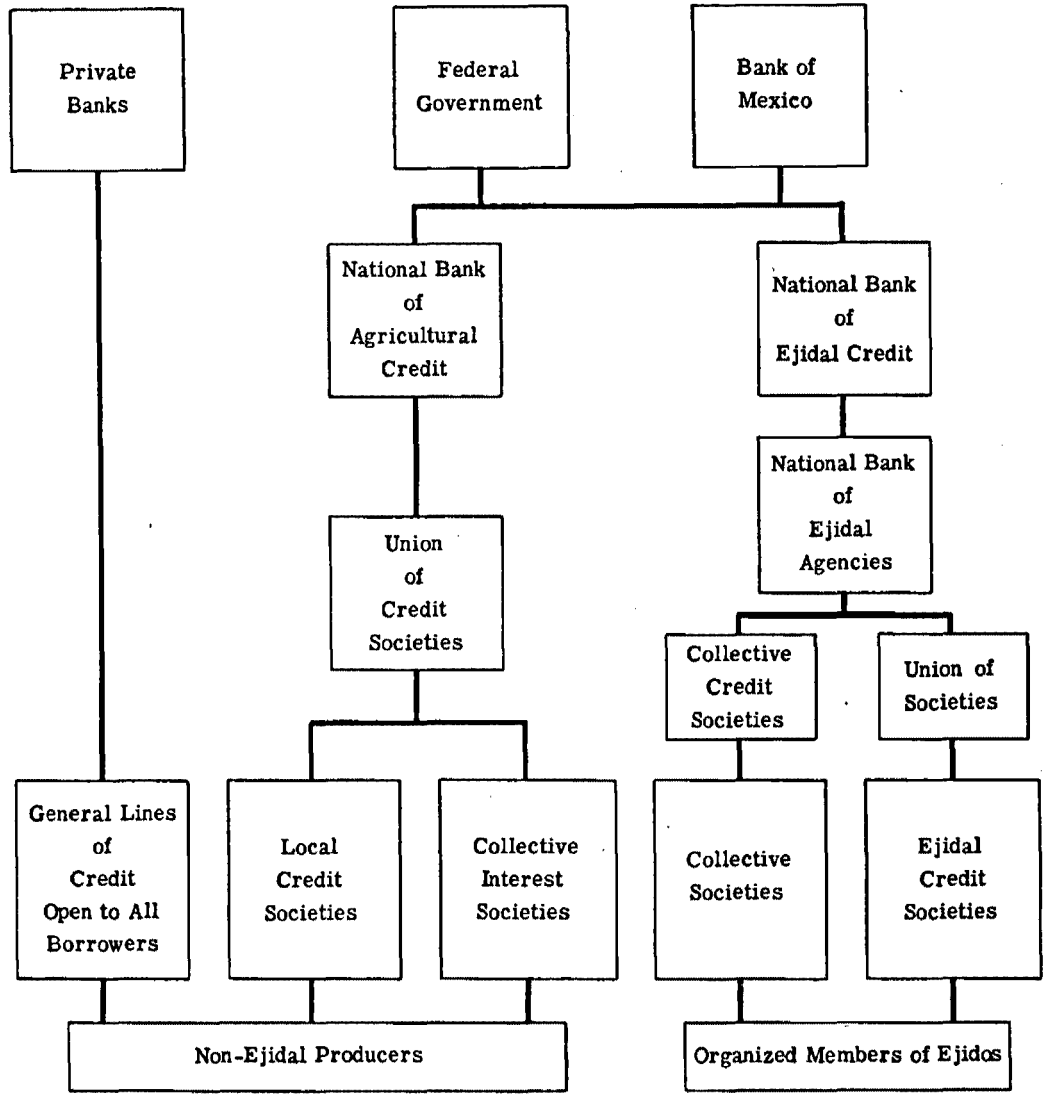


Chart IV

The principal functions of the local member banks (regional banks) are the following: (1) to encourage the organization of and extend credits to cooperative societies in their respective zones; (2) to create commercial and industrial companies, warehouses, et cetera, for the transformation and marketing of the agricultural products of member societies; and (3) in general, to cooperate with the National Bank in its program for economic organization and education of the small farmers.

The Ejidal Bank's functions are the following:

(1) To organize societies of "Ejidatarios" as soon as they receive possession of land;

(2) To grant credit to societies, to organize the production and marketing of crops, including the purchase and resale to members of these societies of seed, fertilizers, and agricultural implements;

(3) To act as agents for the members in all administrative and fiscal dealings related to agricultural matters with the local and Federal governments, and to carry out the development and exploitation of the properties held in common by the "ejido" communities.

Every "ejidal" society is to be organized on the basis of unlimited joint responsibility. It is required to establish a fund, the "fondo social," to be constituted by setting aside 2 per cent of the value of the loans made to its members, 25 per cent of the net profits derived from all operations, 2 per cent of the harvests, and all the cash profits derived from the exploitation of the common lands. "Ejidal" societies are to be closely controlled by the Ejidal Bank through local agencies and inspectors.

The credits or loans permitted by law to the several institutions in the system of agricultural credit are of five types:

(1) "Préstamos de avío," or crop advances for the purchase of seed, fertilizer, tools, etc., to run not more than 18 months and not to exceed 75 per cent of the value of the crop;

(2) "Préstamos refaccionarios" for the purchase of more permanent types of equipment and livestock, and for investment in planting orchards and other slow-maturing crops not to exceed 85 per cent of the value of the articles purchased or of the ultimate value of the product and with a maximum term of five years;

(3) "Préstamos comerciales;" loans made to facilitate agricultural marketing operations of not more than 80 per cent of the value of the product involved and to run not more than 180 days;

(4) "Préstamos inmobiliarios" for the acquisition and construction of works (irrigation, et cetera) of a permanent character--such loans to be amortized by annual payments and to run not more than 25 years;

Table 15. Losses Suffered by the National Agricultural Banks
(Mexican pesos)

Year	Agricultural Bank	Ejidal Bank
1935	9,552,000	---
1936	4,105,000	4,669,670
1937	3,448,000	9,158,178
1938	744,000	8,687,052
1939	446,000	15,053,300
1940	3,588,000	14,576,484
1941	7,941,000	17,577,181
1942	7,276,000	9,400,858
1943	3,013,000	2,009,251
1944	3,748,000	1,022,167
1945	2,948,000	20,866,367
1946	1,376,000	16,394,369
	<hr/>	<hr/>
	48,185,000	119,414,879

Sources: Weekly Letter, Mexican Bankers' Association, 1948;
Annual Report, National Bank of Ejidal Credit,
Mexico D.F., 1947.

(5) "Préstamos territoriales," or loans for the purchase of land in amounts not greater than the value of the land acquired and with maximum terms of 25 years.

The rates of interest on loans to Credit Societies are 9 per cent in the Agricultural Bank (11 per cent to individuals) and 8 per cent in the Ejidal Bank. The Societies tax their members an additional 1 per cent for operating expenses. Those receiving loans are required by law to subscribe to a certain amount of stock in the Bank from which they obtain credit, according to the type of loan involved. This amount is 1 per cent of the commercial or the "avio" loan, 3 per cent of the "refaccionario" loan, and 5 per cent of the "inmobiliario" loan. Actually, this is a surcharge on the interest, for the stocks have never yielded a dividend. These interest rates may seem very high until they are compared with those of private lenders who may extend credit at a rate of 5 per cent per month or more, and in addition charge the difference in price between the seed supplied to the farmer at the time of the loan and the price of such seed at the time of the harvest, that is to say, between the period of scarcity and maximum demand and that of maximum supply.

Of the two banks, the Agricultural Bank is considered to have been the more efficient, despite losses from 1935 to 1946 of 48 million pesos (Table 15). There seems to be a tendency in recent years for repayments of advances to increase as the Bank concentrates its operations in a smaller territory and in fewer crops, following the Government's policy of favoring the production of goods of prime necessity. Cotton, corn, sugar cane, rice, and wheat have been the five products receiving larger "avio", or crop loans. The total area receiving "avio" loans from the Bank of Agricultural Credit in 1947 was 122,307 hectares. The main purposes of its "préstamos de refaccion" have been the opening up of new land, purchase of machinery and tools, purchase of animals for labor, irrigation work and irrigation equipment, and the purchase of livestock for breeding, in that order (Table 16).

The National Bank of Agricultural Credit has also made available considerable commercial credit, that is, credit for the marketing of agricultural products, using for this purpose mainly funds provided by the National Bank of Foreign Trade ("Banco Nacional de Comercio Exterior").

The Ejidal Bank lost around 119 million pesos from 1936 to 1946 (Table 15), in spite of an alleged effort to restrict its operations to the most reliable borrowers. Its transactions have been much larger than those of the Agricultural Bank and it has had to deal with the poorest and least developed sector of Mexican agriculture. In fact it is only recently that its functions have begun to be considered as something more than charitable. From 1936 to 1948 it extended credit for a total of almost 1,300 million pesos. Its credit expansion was particularly great after 1943 and especially in 1947 and 1948. In 1947 the Ejidal Bank's credits amounted to 165 million pesos, and it was expected that in 1948 they would reach 257 million (Table 13, p. 39).

As a result of the restrictions imposed by the Bank of Mexico and the National Bank of Foreign Trade, the two institutions which provide the Ejidal

Table 16. National Agricultural Bank Loans
(in millions of pesos)

Year	Total	Production Credit	Improvement Credit	Mortgage Loans	Loans with Collateral
1943	13.9	10.0	3.7	0.07	0.11
1944	19.9	13.1	5.5	0.66	0.61
1945	25.8	15.2	7.8	0.42	2.45
1946	27.4	13.8	7.2	0.87	5.46
1947	33.8	18.8	13.5	1.28	---

Source: Annual Report, National Agricultural Bank, Mexico D.F., 1947.

Bank with funds, its credit has been concentrated in "aviso" and "refeccion" loans, that is, the two types with shorter terms.

In 1947, the last year for which figures are available, 53 per cent of Ejidal Bank credit was for the production of goods of first necessity, 39 per cent for raw materials for industry and 8 per cent for agricultural export goods. In the first group, the most important have been corn, wheat, beans and rice.

The resources of both the National Agricultural and Ejidal Banks have proved far too small (Table 13, p. 39) for the tasks assigned to them. In comparison with the hundreds of millions of pesos poured into industrial development, the credit granted by these institutions seems relatively small.^{20/} While it has been argued that individuals can best take care of the credit needs of the farmer, it is also important to realize that the high rate of interest which goes with this type of financing makes it almost impossible for the farmer to finance capital improvements from his own savings. First of all, because of the small farming unit^{21/} worked by the average farmer, and also because of the protection which the law affords to the "ejidos" (that is, the inalienability of "ejidos"), he is in a very poor bargaining position. When he can obtain credit it is normally of a short-term nature, and precludes its use for fixed investments--such as land, buildings, farm machinery, orchards, and other similar purposes--for which repayment cannot be made for several years. Since there is also a slow turnover of working capital in agriculture, the farmer can borrow only in the hope that his loan will be renewed until such time as he is able to recover sufficient profit from his investment to pay off the loan. The result has necessarily been little capital accumulation in Mexican agriculture.

While national agricultural banking efforts have produced only limited direct credit, farmers have gained substantially from land redistribution, irrigation and road construction, which are also parts of the Government's agricultural development program. It is indeed clear that the improvement of the position of the agricultural population depends upon coordinated action in many fields, extending far beyond agricultural credit.

National Bank of Foreign Trade

This bank ("Banco Nacional de Comercio Exterior") was established in 1937 to assist exporters of Mexican products. The main operations authorized by its organic law are the following:

^{20/} The Secretary of Finance stated last September that 75 per cent of the credit needs of the farmers were handled by private merchants or individuals, whereas only 10 per cent were covered by the National Agricultural Banks.

^{21/} There are a number of large farms along the coast which normally have no difficulty in securing credit. Similarly, in some areas of northern Mexico, farming is mechanized to the same extent as in the southern part of the U.S. However, in relation both to area cultivated and to farming population, these groups do not represent a large proportion of Mexican agriculture.

- (1) Short-term credit for production and mobilization of export goods, especially agricultural products;
- (2) Discount of bills originating in export transactions, shipping documents and granting of guarantees for future exports;
- (3) Advances to exporters for payment of transportation costs, insurance and storage of export products;
- (4) Insurance of exporters against losses on account of defaults, blocking of foreign exchange and fluctuations in international prices; and
- (5) Organization of exports on account of small producers.

The activities of this bank have been concentrated on the financing of export crops, such as rice, sugar, chick peas and cotton. The financing of these agricultural crops is carried out through the National Agricultural Banks. In other words, it discounts agricultural paper for such crops as the Government is interested in expanding and, in turn, borrows funds from the Bank of Mexico, since it does not issue securities. These operations have made the National Bank of Foreign Trade the largest borrower from the Bank of Mexico (estimated at 400 to 500 million pesos) (see footnote 10, p. 19). These credit operations have been highly beneficial to agriculture, but dependence on central bank credit has made the process quite inflationary.

As a result of the wartime disruption of trade, the functions of the bank were expanded from the promotion of export trade to include operations in domestically-consumed goods and imports. Import operations are carried on through its very important subsidiary "Nacional Distribuidora." This bank, with a paid-up capital of 8.5 million pesos, has earned extraordinary profits, as may be seen in the following table. Its dividends were only 7 per cent, the surplus accumulated since 1937 is nearly three times its paid-up capital (Table 17).

Table 17. Capital, Surplus and Profits of the National Bank of Foreign Trade
(millions of pesos)

Year	Authorized Capital	Paid-up Capital	Profits	Surplus	Dividends Paid
1937	20.0	6.4	.09	--	3
1938	20.0	6.4	1.18	.24	6
1939	20.0	7.0	1.00	.71	6
1940	20.0	7.0	1.67	1.66	6
1941	20.0	7.0	1.34	2.36	6
1942	20.0	7.0	1.70	3.49	6
1943	20.0	7.0	2.84	5.53	7
1944	20.0	8.5	4.84	9.43	7
1945	20.0	8.5	6.25	14.72	7
1946	20.0	8.5	5.75	19.44	7
1947	20.0	8.5	5.84	24.29	7

National Mortgage Bank for Public Works

This institution ("Banco Nacional Hipotecario y de Obras Publicas") was initiated in February 1933 and is currently governed by the Organic Law of December 1946. Its main functions are (1) to promote and direct investments in public works and services of general interest and (2) to invest its own funds. Credit is primarily given by this Bank to federal works, but it is also advanced to state and local governments to purify drinking water, construct sewerage systems, install electricity, build public baths, markets and slaughter houses, and, with the aid of federal funds, construct roads and rural schools. All projects are subject to engineering and economic studies, and the approval of the Department of Public Works is necessary before credit facilities are provided.

The National Mortgage Bank of Public Works advances credit with the understanding that amortization will not exceed 20 years, and preferably extend between 10 and 15 years. In the case of small communities, the Bank will underwrite the cost of an entire project, but when public works are for important cities, it has followed the policy of providing funds for no more than 50 per cent of the total cost of a project.

In practice, municipal works have normally been so unproductive as to be unable to service the credits advanced by the Mortgage Bank. Ultimately nearly all the credit advanced to local governments has been defaulted and become a complete loss.

The situation of federal credit has proved more satisfactory. Government public works financed by the Mortgage Bank have, by and large, consisted of highway construction. To service such credit the Government has empowered the Bank to utilize all the revenue from gasoline taxes. Were it not for these funds, this institution would long ago have been unable to service its own obligations.

The Bank is authorized to issue its own mortgage bonds, which are backed by all its assets. Though these securities are similar to the mortgage bonds issued by private institutions, they have the peculiar characteristic that they may be backed by different types of loans, by public securities and bonds guaranteed by "sociedades financieras." The reason for such varied backing is to prevent loans for public works from being the only guaranty for the mortgage bonds, and thereby to make the bonds more attractive to private investors. During its many years of operation, the Bank has been unable to attract considerable savings (Table 13, p 39). Even though new issues have been marketed every year since 1939, most of its bonds (110 million pesos) have been acquired by the Bank of Mexico. The bonds, currently amounting to 190 million pesos, bear interest of from 6 to 8 per cent, depending on the length of the maturity.

National Bank of Motion Pictures

This bank ("Banco Nacional Cinematografico") was organized first as a "financiera" in 1941, but was transformed into a bank in 1947, mainly because of the distressed conditions in the motion picture industry which followed the wartime boom. Its capital was increased in 1947 to 10 million pesos; the

bank lends up to 60 per cent of the cost of production of motion picture films (Table 13, p. 39).

National Bank of Cooperative Development

This bank ("Banco Nacional de Fomento Cooperativo") was organized in 1941. It performs the functions of a government investment bank for cooperatives and credit unions. In 1946 its functions were enlarged to permit loans to handicrafts and industries with capital less than 250,000 pesos (Table 13, p. 39).

National Bank of the Army

This ("Banco Nacional del Ejercito y la Armada") is the newest of the national banks. Its law was published in December 1946, and it started operations on July 15, 1947. Its objective is to make loans to members of the Army in active service or retired, to receive deposits from them and to stimulate savings and engage in all kinds of credit operations (mortgage, trust and commercial) for the Army. The paid-up capital was 5.1 million pesos on December 31, 1947 (Table 13, p. 39).

National Bank of Small Trade of the Federal District

This bank ("Banco del Pequeño Comercio") was established in 1942 as a depositors' bank, primarily to assist the small traders of the public markets of Mexico City and secondly, the small merchants of the same city and the credit unions formed by them. The local government of the Federal District, the Bank of Mexico and the merchants are the shareholders. The paid-up capital is 1.36 million pesos.

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The national banking system has provided the basis for the development efforts of the Mexican Government. It has performed valuable functions which private institutions have been reluctant to undertake. Especially in the field of industrialization, numerous enterprises have flourished through the financing efforts of "Nacional Financiera" which would not otherwise have been undertaken. The system may, however, be criticized for its inability to influence to the necessary extent the savings habits of the people and the channeling of those savings into productive uses. Very little has been accomplished in educating private individuals and institutions to invest in industry rather than real estate, construction or commercial ventures. This failure to shift savings from the money to the capital market has made the national banking system more and more dependent on central bank credit.

5. The Securities Market

The relative unimportance of the securities market in Mexico is primarily due to the structural characteristics of the economy whereby savings are oriented toward the money rather than the capital market.

This preference for lending rather than investment may be attributed to a desire for liquidity, but may be better explained by the prevailing interest rates in the respective markets. While the rate for fixed interest-bearing securities, ^{22/}with maturities of 5 to 10 years, fluctuates between 6 and 8 per cent, inflationary profits keep the rates for bank loans, normally running for less than a year, between 8 and 15 per cent. Obviously, from a profit and risk point of view, there is no inducement to invest in the securities market. There are, however, many other reasons that condition the investment habits of the Mexican people.

Savings and investment habits

The savings of both rural and small to medium-size income urban groups to a large extent take the form of hoarded silver and gold coins. In 1948, the Mexican Government estimated such hoards to be more than 800 million pesos.^{23/} The main reasons for this habit is the lack of banking habits or the absence of confidence in banking, which dates back to revolutionary days. Also, the public, fearing political instability, has limited confidence in paper currencies, and as a hedge against depreciation prefer to maintain their savings in metallic currencies. Finally, especially in rural areas, gold and silver coins are hoarded as insurance against contingencies, as well as for future purchases of expensive durable articles.

The wealthier classes, as well as private businesses, are affected by the same doubts about political unrest and currency depreciation, and by a third factor arising from the need to maintain liquid working capital. Instead of hoarding precious metals, these groups may hedge against these risks by accumulating capital abroad, especially in the United States. In the absence of exchange controls, therefore, whenever liquidity increases there may be sudden flights of capital from Mexico. The fear of political unrest is distinctly reflected in increases of balances held abroad -- it is a normal feature of Mexican capital movements that there should be withdrawals of funds in pre-election days and a return of these funds when it becomes apparent that the election is not going to be contested by force. Increases of Mexican dollar balances in the U.S. during 1945 and 1946, however, are explained as increases in working balances resulting from the greater availability of export goods in the U.S. In April 1948, Mexican residents had over \$100 million in U.S. banks.

^{22/} As will be shown later in the chapter, equity securities are very rarely available in the market, since they are normally retained by those promoting the enterprise.

^{23/} Minister of Finance Beteta, on April 23, 1948. Other estimates vary from 500 million pesos to over 2 billion pesos.

Savings and capitalization banks, as well as insurance firms, have succeeded in absorbing a relatively large share of individual savings. The liabilities of the first two types of institutions, and especially of the second, are made up of a multitude of small accounts. This shows the beginning of a trend towards saving through specialized agencies, although the lottery feature of capitalization banks may also have a bearing on the increase in the liabilities of these institutions. It is also significant that savings through capitalization banks is mainly by people in the high and middle-income brackets, rather than in the low-income brackets, to whom the capitalization banks were meant to appeal. At the prevailing low standard of living, the majority of Mexicans cannot constitute an important saving group.

Apart from hoarding, saving is primarily a function of a numerically small wealthy group, whose high incomes create a strong propensity to consume luxury goods but who also accumulate savings, which constitute a large percentage of the national income. It is important, therefore, to look at the habits of this wealthy group to understand the pattern that channels savings into investment lines.

In Mexico, as in all Latin America, there is a strong propensity to invest in land. Until the Agrarian Reform of 1910, this habit was reflected in Mexico in the formation of large estates. Since the revolution these estates have been transformed into "ejido" units, with the result that two-thirds of agricultural real estate has been withdrawn from the market. The few estates that still remain do not find a ready market because of the uncertainty as to their future status. The investment preference for real property, however, still persists but has now shifted to urban real estate.

Real estate development around the principal Mexican cities,^{24/} both residential and commercial, has become the typical private investment. Average or large-sized investments in construction are considered as the safest and soundest of all investment. This attitude is reflected in bank practices which have provided the greatest incentive to real estate building. While commercial banks will seldom lend on machinery and equipment, they are always ready to advance credit on real estate security. Insurance companies have invested 50 per cent of their reserves in buildings and hold substantial sums in mortgage paper of different types. Investment in private construction, stimulated during the war years (1940-1945) by increased money incomes, increased bank credit, and a rapid growth in urban population, has exceeded 1,300 million pesos.

Because bank credit, on the security of real estate, has been readily available, business profits which would normally be retained for working capital have been invested in building. The incentive for this diversion is the fact that profits obtained from rents have been considerably greater than the interest paid on real estate secured loans. This movement of profits into construction, and the use of bank loans for working capital purposes, has probably been the greatest inflationary force in Mexico during the last ten years.

^{24/} Mexico City, Monterrey, Guadalajara and Puebla.

No estimate, nor even a guess, is possible as to the place occupied by the reinvestment of profits in capital formation in Mexico. Almost certainly, it is less important than in more developed countries. As stated above, it has been a common practice to withdraw profits from businesses and use bank credit for working capital to the greatest extent possible, and, to the extent that profits have been retained in businesses, they have been used for the expansion of plant, rather than for working capital.

The Mexican investor's preference for real estate investment has also been reflected in the favorable attitude of private investors toward mortgages or mortgage certificates ("cédulas"). Of all medium- and long-term securities, this has enjoyed the best market. The market for all other long-term securities among private individuals has been very thin. The reason for this is that opportunities for investments in speculative ventures, such as real estate and commerce, have been plentiful, and the only security investments in Mexico which are regarded as sound and conservative are mortgage "cédulas."

The lack of confidence in long-term industrial investment has been due to some extent to the fear of both private individuals and banking institutions that postwar foreign competition might destroy new industries. There have also been fears of labor-management disputes in the industrial field -- more than in any other sector of the economy -- and because of the inefficient security market and stock exchange, industrial securities, even though listed, are very slow in finding a market. This is especially true of fixed interest bearing securities, for common stocks are as a rule not marketed publicly.

It is also believed that the "Nacional Financiera," the official development corporation, has, by issuing "certificates of participation," been a strong obstacle to the development of a market for industrial securities. "Certificates of participation" have found a relatively large number of buyers. Successive issues have been taken up in a rather short time. Although repayable upon 30 days' notice, in practice they have been redeemed at sight and at par. They bear interest of 6 to 7 per cent.

Because the revolution caused the Mexican Government to default on its debt, private investors have lost confidence in government securities, even though the Government has met its obligations since the marketing of the first post-civil-war internal bond issues in 1933. Consequently, for this and other reasons referred to above, very few government bonds have been purchased by private investors.

The Mexican private banking system has had an ever-growing chance to help in developing the country, as the wartime favorable balance of payments, government deficits and central bank financing of official credit institutions have increased its resources. All private credit institutions, however, have shown a marked dislike for investments in government bonds and a preference for short-term credit. Commercial banks, on the basis of a fallacious liquidity theory (that is, fallacious when the central bank's support of the market is taken into account), have resisted changes in the banking laws which would permit them to invest in long-term securities. Specialized

institutions have deviated considerably in practice from the purposes for which they were created, and for this reason, not even the meager resources which private savers have put into the specialized banking system have been used in the most advantageous way from the point of view of development, but rather for the immediate short-run advantage of the institution to which they were entrusted, in making quick-return speculative or semi-speculative loans.

Insurance companies

Insurance companies should be one of the strongest influences on the demand side of the Mexican securities market. As of the end of 1947, their total resources amounted to nearly 500 million pesos, and their technical reserves were 327 million pesos. The annual flow of savings into the insurance companies as a result of the expansion of incomes is large as compared with prewar levels; while in 1938 total premiums collected by insurance companies amounted to 36 million pesos, they had grown to 207 million in 1947. Of all branches of insurance, life insurance has shown the most progress. While in 1938 life insurance policies were valued at 121 million pesos, in 1946 they amounted to 1,167 million. This increase in the value of insurance policies was not accompanied by a similar increase in the number of policies, which is an indication of the concentration of wealth in a few hands. As of the end of 1946, 300,849 life insurance policies were outstanding. This is a very small number for a population of around 22 million, especially when account is taken of the fact that many insured persons hold more than one policy.

After the two reforms of 1926 and 1935 in the insurance laws, the insurance business, which before 1926 was to a very great extent foreign-owned, became an almost wholly Mexican activity. The displacement of foreign companies was a result of their reluctance to abide by the Mexican laws concerning investment requirements for their reserves. According to the 1935 law, at least 20 per cent of the technical reserves of insurance companies had to be invested in domestic securities, a percentage which was increased to 30 in 1947. In 1947, they were also forbidden to invest in bank acceptances, a practice which they had followed up to that time. They are permitted to invest up to 50 per cent of their technical reserves in real estate. Insurance companies' actual investments in domestic securities amounted to 2.4 million pesos in 1934, 18.4 million in 1938, and 129 million in 1948. Their investments in buildings amounted to 10 million pesos in 1934 and 106 million in 1947; investments in mortgage loans were 5.5 million pesos in 1934 and 26 million in 1947. Of the total portfolio of securities in 1947, only 60 million were in government bonds, 5 million in general and commercial bonds, 5 million in stocks of credit institutions, 24 million in mortgage bonds, 10 million in certificates of participation, and 16 million in private bond issues. If to their investments in real property (106 million pesos) are added the investments in several kinds of real estate mortgage paper (47 million pesos), insurance companies should thus be considered rather as institutions specializing in the promotion of construction activities. They have not provided the capital market with all the help which they have been in a position to give.

Security instruments

The investment habits of the Mexican investor have unquestionably exerted a decisive influence on the types of instrument issued for the security market. To see what guarantees, privileges, and returns the borrower in the capital market has had to provide to stimulate private investment, we must look at the principal security instruments now offered in the security market. (Table 18).

General bonds

The general bond ("bono general") is issued by the industrial credit banks ("financieras"). These bonds are guaranteed by specific securities or loans^{25/} which the issuing company has acquired in providing credit to industrial and/or agricultural institutions. These bonds may also be backed by stocks and other securities belonging to the issuing "financiera."

Although general bonds may be issued with maturities up to 20 years, they have in practice been issued with maturities averaging less than five years, probably three.

The intended purpose of the general bond was to permit private investors to make an indirect investment in industry or agriculture. The "financieras," when they were unable to market the securities of the enterprises which they promoted, were permitted to issue these bonds, which it was thought would be more appealing to the investor. In practice, this has not been the case.

In the first place, the "financieras" have made little or no effort to market securities of companies which they promote or finance. Because securities so acquired gave high returns, the "financieras" have preferred to issue their own bonds at 7 to 8 per cent and pocket the difference, which often ran as high as 15 to 25 per cent. Secondly, the general bonds have not enjoyed much of a market, since direct lending or investment in other securities have appeared more attractive to private investors, and consequently the bonds have not absorbed substantial savings.

To overcome the reluctance of private investors to purchase these bonds, both the "Nacional Financiera" and the Bank of Mexico have been ready to support the price at par. To make them still more attractive, they were exempted from taxation in February 1946.

The price-support policy has encouraged the "financieras" to issue general bonds without making much effort to market them, and there has been an enormous expansion of the volume in circulation (Table 18), with practically a corresponding increase in the volume of bonds held by the Bank of Mexico (Table 19). Even though the large number of issues permitted a rapid growth of the volume of general bonds, the "financieras" have felt all along that they were not expanding at a rate commensurate with the industrial expansion that was desired. For this reason, in December 1945, in view of

^{25/} Principally long-term loans.

Table 18. Principal Issues in Mexico's Security Market
(millions of pesos)

End of Year	Government Bonds	Participation Certificates	Financing Bonds	National			Private		Savings Bonds	Bank Stocks
				Mortgage Bonds	General Bonds	Commercial Bonds	Mortgage Bonds	Mortgage "Cedulas"		
1941	528.7	7.4	1.5	17.9	2.7	12.8	-	96.5	-	130.2
1942	696.5	41.8	2.7	21.0	23.6	8.6	.5	105.1	1.6	156.3
1943	825.0	146.2	4.6	27.2	76.2	3.2	21.2	102.5	12.3	205.1
1944	697.7	185.5	17.7	57.6	116.8	2.2	63.3	111.1	12.5	262.7
1945	829.3	224.7	16.7	89.0	181.1	2.8	114.6	162.6	13.8	325.2
1946	1,063.5	241.9	43.5	130.6	240.9	5.5	125.4	194.8	9.1	378.2
1947	1,162.0	266.0	42.8	189.5	346.1	9.6	116.5	204.8	6.5	453.5

Source: Adapted from the Anuario Financiero de Mexico, Bank of Mexico, 1948.

the weakness of the general bonds in the security market, "Nacional Financiera" was authorized to rediscount for the "financieras."

As indicated above, the private investor has given the general bond a very cold reception. According to the available figures (Table 19), a relatively small amount (20 per cent) has been purchased by this group. Insurance companies, preferring real estate investment, have also been reluctant to absorb many of these bonds. Their holdings at the end of 1947 were only 4.3 million pesos.

The private banking system has made very small purchases, and its holdings have averaged less than 10 per cent of the issues outstanding. This year, however, the Bank of Mexico has shifted over 100 million pesos of these general bonds to the private banks.

It can be concluded, then, that in spite of the large amounts outstanding and their relative importance in the security market, the general bonds have failed to attract large savings from the investment public necessary for non-inflationary industrial promotion.

Certificates of participation

The participation certificate ("certificado de participación") has already received attention in the chapter covering the operation of "Nacional Financiera," the issuer of these certificates. Additional consideration is necessary here because of the importance of this instrument in the securities market of Mexico.

Between January 1, 1941, when the first issue of 8 million pesos was marketed, and December 31, 1947 (Table 18), "Nacional Financiera" put in circulation sixteen series of participation certificates with an aggregate value of 306 million pesos. Only three issues, amounting to 35 million pesos, have matured, and 5 million of the original series have been repurchased. The total value of the certificates in circulation at the end of 1947 was, therefore, 266 million pesos.

To repeat briefly, the participation certificate is an instrument with a fixed rate of interest and a maturity date, although it is redeemable at par and at sight or at 30 days' notice. While it has not induced private investors to invest directly in industrial securities, it has been able to absorb a substantial amount of savings from the general public.^{25/}

The original purpose of the certificates was to acquire funds to be invested in industrial securities. Experience shows, however, that the

^{25/} Since "Nacional Financiera" has to provide a ready market at par for its certificates, it may be argued that its financing operations may ultimately result, directly or indirectly, in the creation of new monetary media.

Table 19. Holders of Principal Securities
December 31, 1947

(in millions of pesos)

Types of Securities	Total in Circulation	Bank of Mexico	Other National Banks	Private Banks	Insurance Companies	Private Investors
Commercial Bonds	9.6	--	--	1.7	0.7	7.9
General Bonds	323.3	216.4	13.9	22.3	4.3	66.4
Private Mortgage Bonds & "Cédulas"	308.3	110.5	7.9	24.3	16.0	149.6
Participation Certificates	266.3	--	35.7	56.7	9.5	164.1
Financing Bonds	42.8	--	--	1.5	1.3	40.0
Government Bonds	1,162.0	609.0	231.6	162.0	60.0	99.0
National Mortgage Bonds	189.5	107.7	3.6	26.3	7.3	44.6

Source: Bank of Mexico, 1948.

purchaser of the first issues of certificates was actually making an investment in government bonds, because of the predominance of the latter in the portfolio of "Nacional Financiera" (Table 20). In the past two

Table 20. "Nacional Financiera's" Security Holdings

	1943	1946	1947
Government Securities	84.6%	57.0%	45.6%
Private Securities	15.4%	43.0%	54.4%

years the ratio of government securities to private securities has been reversed, signifying a more active channeling of savings into private enterprises.

The repurchase provision and the guaranteed rate of return^{27/} have created a unique active market for the participation certificates. If the significance of this point is emphasized, it is not difficult to understand why the demand for other types of securities has slackened, or at least, not improved. The criticism, then, that the "Nacional Financiera" has discouraged direct private investment, especially of a long-term nature, appears to be justified, for no other security instrument in the Mexican market can offer the liquidity and price guarantees that these certificates provide.

Financing bonds

Another kind of bond issued by the "Nacional Financiera" is the financing bond ("títulos financieros"), so named because it is intended to finance industry. In 1937 the first issue was marketed with a total value of 500 thousand pesos. Since 1941 five dollar issues have been made. The rate of interest is 3 and 5 per cent^{28/} with a ten-year maturity (although for sinking fund purposes they are redeemable by yearly raffles). The issues have been guaranteed 75 per cent by public securities and 25 per cent by mortgage bonds and other marketable securities. On June 30, 1948, the volume of "títulos financieros" issued by "Nacional Financiera" totaled 85 million pesos, of which 40.4 million were still outstanding. The object of dollar issues was to enable the insurance companies to buy securities on the basis of their reserves against policies in foreign currencies. However,

^{27/} As the market for the certificates broadened, "Nacional Financiera" was able to bring out issues at lower rates of interest. The first issue bore a rate of 7.2 per cent, the next four issues 7 per cent, the seventh 6.75 per cent, the eighth 6.50 per cent, and the rest have been at 6 per cent.

^{28/} The first four issues, worth \$5 million, bore a rate of 5 per cent. The last issue, however, valued at \$10 million, carried a rate of 3 per cent.

with the exception of about 3 million pesos held by insurance companies and private banks, all these bonds have found their way to private non-banking investors (Table 19). These securities have been accepted by U.S. investors and are payable in Mexico City or New York.

Mortgage bonds and "cédulas"

The mortgage bond, issued by private mortgage banks, is an instrument guaranteed by certain assets, usually representing mortgage loans or credit of the issuing company.

The mortgage "cédula," also issued by mortgage banks, represents a mortgage created by a borrower on a specific piece of real property and guaranteed by the lending company.

With the prevailing orientation of the Mexican investing public toward urban real estate in mind, it is not difficult to understand why these mortgage instruments have met with general acceptance by private investors.

Between December 1941 and December 1947, the "cédulas" in circulation grew from 96.5 million pesos to 204.9 million pesos (Table 18); and the growth might have been even greater if the Ministry of Finance, through the National Banking Commission, had not restricted their issue in the last months of 1946, fearing a flooding of the market. The private mortgage bond is a security of recent origin, having been introduced in the market in 1942 for the first time. Like the "cédula," however, it has achieved tremendous growth. While less than a half million pesos of these bonds were on the market at the end of 1942, their value is now more than 116 million pesos.

The mortgage bonds of the National Mortgage Bank of Public Works were also issued in quantity during the war period. From 17.8 million at the end of 1941, they have been brought out in such large amounts so as to amount to 189 million pesos today (Table 18). Most of these (108 million) are held in the Bank of Mexico's portfolio (Table 19). The lack of marketability of these securities may be attributed to the type of backing they have -- namely, large public works. The private investor feels that he has practically no lien or claim on a dam or a road. In other words, he prefers an individualized backing, such as a specific piece of real estate, which the "cédulas" provide. One of the advantages which the public attributes to the "cédulas" is said to be the belief that the value of the backing would not be subject to downward price fluctuations.

Commercial bonds

Commercial bonds, issued by the "financieras," are securities guaranteed by drafts or promissory notes resulting from the sale of merchandise. Because of the high prices and scarcity of new goods which could be sold on an installment system, in 1946 the Ministry of Finance restricted the issue of such bonds. The relative unimportance of this type of security may be seen from the amount in circulation (Table 16), which has not exceeded 10 million pesos since 1941.

Savings bonds

In Mexico savings bonds are securities representing a time deposit of six months to twenty years. These bonds are issued exclusively by private saving institutions and, contrary to their intended purpose, have been absorbed principally by the high-income classes.

While they are marketable, savings bonds do not appear on the security market, since normally they are retained by the initial purchasers. Since by law they can only yield 4 1/2 per cent annually, they cannot possibly compete in the market with other securities, the latter normally bearing interest varying between 6 and 9 per cent.

Their main attraction, and the reason why they are concentrated in the hands of high-income groups, is their exemption from federal, state and local taxation. Since their inception in October 1942, about 14 million pesos of these bonds have been issued, with over half already withdrawn from circulation (Table 18).

Government bonds

The Mexican Government, especially in the last ten years, has taken great care in the management of its domestic public debt. In issuing government bonds it has been careful to see that the proceeds were allocated specifically to productive ends. Actually, the Government is obliged by law^{29/} to invest funds obtained through borrowing only in such public projects as will produce increases in revenue. The purposes of government investment from bond issues are indicated by the names of the outstanding issues: highway bonds, irrigation bonds, railroad bonds, electrical industry bonds, public works bonds, banking debt bonds, agricultural debt bonds, et cetera.

Government bonds carry a 6 per cent interest rate and are exempt from any federal, state or local taxes. Interest services have been punctually met, and there have been no defaults on any post-revolutionary issue.

Because of their tax-exempt feature, government securities yield a better net return than other available private fixed interest bearing securities, such as mortgage bonds and "cédulas." The public has, however, been slow in absorbing government bonds. Because of a fear, dating from the revolutionary experience, that the Government may default, plus a distrust for anything that is government-sponsored, the public has refused to support these securities. The Bank of Mexico and the "Nacional Financiera" have, therefore, had to absorb the largest portion of government issues^{30/} (Table 19).

^{29/} Section VIII of Article 73 and Section VIII of Article 117 of the Constitution.

^{30/} To help further the market for these bonds, the Bank of Mexico in 1945 completed an agreement with the commercial banks whereby 10 per cent of their required reserves in the Bank of Mexico could be maintained in government securities.

This development has precluded the use of government securities for capital market regulating operations. Consequently, the Government has been unable, through its own security issues (although in value they account for 25 per cent of the security market in Mexico) to regulate the volume of investment, or to determine the interest rate, especially the long-term rate.

Securities of private institutions

The capitalization of private commercial and industrial enterprises in Mexico is normally financed by a restricted investment group. Because risk capital is not readily obtainable in the established security market, corporations cannot rely on it for their capital needs. Entrepreneurs are thus compelled to turn to small financial groups, normally private banking institutions which privately market the securities. In spite of the stringent conditions placed on the entrepreneur by the financing institution, this type of service is available only to individuals who are normally well known in financial circles. Other entrepreneurs, especially those attempting to market long-term fixed obligations, are forced to turn to "financieras" or, if large enough, to "Nacional Financiera."

Common and preferred stocks are normally used only for the original capitalization of companies. Because of the high return which these securities yield, they are quickly absorbed in large blocks by wealthy investors. Even equities quoted on the stock exchange, 91 issues of industrial stocks valued at 446.2 million pesos (Table 21) are concentrated in a few hands, and are very rarely traded on the exchange. Consequently, there is practically no distribution of stocks among large numbers of investors.

A After the original capitalization, financing is normally accomplished by borrowing or marketing bonds. There is a limited market for this type of security, and these bonds have to be marketed through private channels. Of an estimated 250 million pesos of industrial bonds issued between 1941 and 1946, more than 50 per cent were offered through six groups of investment underwriters.

Much of this capital has been employed in the purchase of machinery, the construction of plants, and the expansion of production. In some cases, however, it has gone to replenish working capital depleted by large withdrawals of profits by the equity holders.

Stock exchange

There is only one stock exchange in Mexico, located in the capital. It has already been mentioned that for the most part security transactions are effected through private channels. The ineffectiveness of the stock exchange is indicated by the limited volume of operations transacted there:

(thous. pesos)

1941	10,876
1942	9,652
1943	12,419
1944	8,041
1945	17,464
1946	13,179
1947	30,153

The volume of transactions appears even smaller when compared to the 2 billion or more pesos of listed securities (Table 21).

National Security Commission

To remedy the deficiencies of the securities market, a National Security Commission was created by law in February 1946, with the following functions:

1. To approve the public offering of Mexican securities in foreign countries;
2. To determine the securities that the insurance companies may purchase with their reserves;
3. To approve or veto the registration of securities in a stock exchange;
4. To give its opinion, when requested by the National Banking Commission or "Nacional Financiera" on the admission of new members of the stock exchange, or to suggest to those institutions the exclusion of members;
5. To approve the public offering of securities not registered in the stock exchange;
6. To approve the maximum and minimum interest rates for the issuance of mortgage bonds or "cédulas," "bonos generales," "bonos comerciales," and bonds issued with the guaranty of "sociedades financieras;"
7. To keep a national registry of approved securities.

During the short period of time in which the Commission has functioned, it has engaged in several important activities. It has approved several rules specifying the conditions to be fulfilled by enterprises whose securities are registered in stock exchanges so that they may be included in the national registry. It has also established rules that stock exchanges must follow when applying to the Commission for approval of the registration of securities. It has defined the standards that securities must meet to become legal investments for insurance companies. It has created requirements to be met before entrepreneurs can make public offerings of securities not registered in the stock exchange. It has set maximum and minimum interest rates on certain securities.

Table 21. Securities Listed on the Stock Exchange of Mexico City,
June 1948

<u>Types of Securities</u>	<u>Number of Issues</u>	<u>Value (millions of pesos)</u>
<u>Stocks</u>		
Industrials	91	446.2
Credit Institutions	98	352.8
Insurance Companies	32	67.6
Fidelity Companies	8	13.0
Mining Companies	<u>8</u>	<u>8.1</u>
Total Stocks	237	887.7
<u>Bonds</u>		
Industrials	34	125.6
Mortgage	20	216.8
General Commercial Bonds and Participation Certifi- cates	42	469.9
Mortgage "Cédulas"	<u>23</u>	<u>482.4</u>
Total Bonds	119	1,294.7
TOTAL SECURITIES	356	2,182.4

Source: Anuario Financiero, Vol. VIII, Mexico D.F., 1948.

In short, the Commission has sought to increase public confidence by supervising activities in which certain private interests may injure the interests of the community. Its operations have covered the organization and operation of the Stock Exchange, the supervision of security flotations and the inspection and approval of literature relating to securities.

Other market limitations

Besides the structural weaknesses of the security market, other factors also affect investments in Mexico, which may be briefly recapitulated.

National savings not only are very low, but they are badly distributed. A limited wealthy class, with high propensity to invest in real estate, accounts for the greater part of savings.

The capitalization of enterprises is normally effected through the sale of securities to a limited financial group, with no recourse to the security market.

Many industrial enterprises have no access to the securities market inasmuch as they are not incorporated, or, if they are, their paid-in capital is less than the legal limit -- 200,000 pesos -- required for a public offer of securities.

When the business cycle is on the upswing, profits from commercial short-term ventures make investment in securities unattractive.

A certain group of individual investors has traditionally placed its savings in mortgage securities. To this group, industrial securities, which are guaranteed by machinery and other slowly amortizing property, do not appear sufficiently safe.

The funds offered on the Stock Exchange are insufficient to finance all the securities listed there. This has forced many entrepreneurs to place their securities in small private investment groups.

The securities of the most desirable or profitable companies, especially stocks, are privately held, so that there is very little stimulus for individuals to take such securities as the Stock Exchange can offer, since it is assumed that those which are available have not interested the big investors.

Banking institutions, which in other countries are large purchasers of private and government securities, have failed to support the Mexican security market. Industry has, therefore, been forced to borrow on a short-term basis, when long-term credit was the type of financing that most enterprises needed. To facilitate and stimulate transactions in securities, it is necessary that they should be accepted by banks as collateral security for advances, and so far no banking system has extended credit on this basis.

And finally, the securities market has been very volatile, since a few influential groups can artificially control price movements in certain securities.

Foreign investment

This paper is intended primarily to analyze the domestic financial institutions of Mexico, and extensive treatment here of foreign investment would go beyond its proper scope. A brief comment on this subject should, however, be added, in view of the obvious importance of foreign investment for the Mexican economy as a whole.

In the last few years, and particularly since the balance of payments began to show the effects of inflation and of the increased availability of foreign supplies, the Mexican Government has repeatedly expressed its interest in foreign investments. It has not abandoned its decision to control foreign capital or changed its restrictive legislation on the matter, maintaining the reserved attitude which it has adopted in international conferences on the question of guarantees to foreign investments. The Government has emphasized that the guarantees which its legislation provides are as ample as can be desired and that the misgivings of foreign capitalists with respect to Mexico's nationalistic policy are unjustified. It is clear that Mexico wants foreign capital but wants it on its own terms, not without qualifications. The establishment of the National Security Commission, for example, is as much an effort to create a foreign market for industrial securities as to create a domestic market. Even in the field of oil, in spite of its political implications, negotiations have now been going on for some time to renew the flow of American capital.

In some cases, what Mexico has sought has been technical know-how, rather than capital, and several important corporations have recently been created in which technical skill has been the main foreign contribution to industrialization. At other times, foreign know-how has come with the capital and has joined with Mexican capital, official and private. This form of foreign investment is the one which both foreigners and Mexicans have favored most, although there are certainly differences of opinion on the proper location of control; it is also the form most in keeping with Mexican legislation. Foreign funds have rarely been imported to buy bonds of existing Mexican corporations or other securities in the market in order to benefit from the relatively high rate of interest that can be derived from them. It would seem that there is scarcely any inflow of capital induced by high fixed interest rates, in spite of the absence of exchange controls. Safety considerations have had more influence than the profit appeal, so that the net movement of funds has been rather from Mexico, a high-interest country, to the United States, where interest rates are low. The inward flow of foreign funds has usually been for investment in specific new activities.

Although in recent years foreign direct investments in Mexico have not been large in absolute amounts, they were substantial as compared with those made in other Latin American countries. The total figures, however, are still a matter of controversy. According to the Bank of Mexico, total outstanding direct investments in Mexico in 1945 were 2,900 million pesos, compared with 2,590 millions in 1940. (See Table 22). Balance of payments estimates for 1946 and 1947 give total U.S. foreign investments in Mexico in those two years as 68 million pesos. There has been a sharp change in

Table 22. Foreign Direct Investments in Mexico
(in thousands of pesos)

	1938	1939	1940	1941	1942	1943	1944	1945
Agriculture and Livestock	69,191	71,785	74,208	76,014	84,317	103,469	102,045	109,745
Commerce	41,914	41,165	47,238	65,754	92,612	81,498	92,519	116,075
Industry	81,031	92,966	107,598	122,255	146,150	166,522	190,121	246,682
Mining	1,000,568	996,122	1,006,949	1,044,488	1,051,611	1,082,077	1,034,514	1,024,555
Public Utilities & Transportation	1,313,019	1,346,781	1,326,864	1,320,314	1,331,106	1,330,390	1,412,421	1,332,185
Other ^{1/}	20,334	23,082	27,714	37,423	41,486	55,735	65,489	70,666
Total	2,526,057	2,571,901	2,590,571	2,666,248	2,747,282	2,819,690	2,897,109	2,899,908

^{1/} Includes publicity and propaganda agencies, real estate, movies, financial societies, hotel, insurance companies and others.

Source: Vigesimosexta Asamblea General de Accionistas, Bank of Mexico, Mexico D.F., 1948.

the direction of these investments, mining and public utilities showing either no increase or decrease, and manufacturing registering the largest rise.

The largest single foreign influence in Mexico's development in the last few years has been the Export-Import Bank. Total loans authorized by this U.S. agency to Mexico from 1941 to June 1948 amount to \$154 million, of which \$93 million had been used to the latter date and \$24 million had been repaid (Table 23).

Comments

Mexican savings are now primarily oriented toward real estate operations, commercial transactions and short-term speculative dealings. The reason why these savings are not moving into productive investments at a rate commensurate with the needs of Mexican economic development is in large part to be found in the lack of a well-organized securities market. The ineffective ties between investment houses, brokers, stock exchange and investors make it difficult for securities to change hands rapidly. As long as this continues, investors desiring relative liquidity will be reluctant to enter the market. To remedy this situation, the Mexican Government, primarily through the National Securities Commission, has reorganized and strengthened the stock exchange in an effort to tempt private investors to put funds into industrial securities. While limited success has been achieved, the volume of hoped-for direct private productive investment has been disappointingly small. This result is, however, not to be explained exclusively in terms of faulty institutions. The investment habits of the Mexican public have also not yet been adjusted to the changing investment requirements of the Mexican economy. Institutional and psychological factors are indeed interdependent, and the parallel and simultaneous improvements which are needed in both fields are also made more difficult by the distortions imposed upon the economy by continual inflationary pressures. In the circumstances which have prevailed in recent years, the Government has not only failed to educate the private investor, but by the more attractive offer of certificates of participation in "Nacional Financiera" has, in effect, discouraged the investor from making direct investments in industrial securities.

If further industrial development is to be promoted, it will be most important to make more effective use of private savings. If the view prevails that reliance can be placed on central bank credit or foreign investment alone, the problem will only be postponed and aggravated. The Mexican advance toward industrialization might indeed be slowed down if it had to await the gradual education of the private investor and relied exclusively on the resources which a more effective use of domestic savings would make available. A shift of emphasis towards the efficient use of domestic savings could, however, be made without serious or costly distortion of the economic and social structure of the country.

Table 23. Statement of Loans and Credits to Mexico Authorized by the Export-Import Bank as of June 30, 1948
(in thousands of dollars)

Commodity or Purpose	Credits Authorized		Cancellations and Expirations	Balance Not Yet Disbursed		Amount Disbursed		Principal repaid on loans	Principal Outstanding on Loans
	Date	Amount		Amount	Expiry Date	By Eximbank	By commercial bank at EIB risk		
Highway construction equipment and services	8-12-41	30,426.9	4,000.0	---	---	26,426.9	---	6,327.4	20,054.5
"	8-12-41	9,573.1	---	---	---	---	9,573.1	6,695.2	2,877.9
Steelmill equipment -Altos Hornos de Mexico	4-10-42	8,000.0	500.0	---	---	7,500.0	---	1,362.0	6,138.0
Mexican Handicraft	5-18-42	871.2	65.0	5.7	12-31-48	---	800.4	721.2	79.3
Gasoline Refinery Equipment - Petroleos Mexicanos	1-31-44	540.0	---	---	---	540.0	---	140.0	400.0
	1-31-44	9,460.0	50.0	---	---	---	9,410.0	4,810.0	4,600.0
Railway equipment National Railways of Mexico	3-21-45	19,000.0	---	---	---	19,000.0	---	2,450.0	16,550.0
Steelmill Equipment	5-16-45	800.0	---	500.0	12-31-48	300.0	---	---	300.0
Electical Equipment, materials and supplies	3-21-45	20,000.0	---	11,000.0	12-31-49	9,000.0	---	435.6	8,564.4
Equipment, facilities and services	2-13-46	3,000.0	1,500.0	1,500.0	6-30-50	---	---	---	---
U.S. equipment, facilities and services	4-30-47	10,500.0	---	10,500.0	12-31-49	---	---	---	---

Table 23. Statement of Loans and Credits to Mexico Authorized by the Export-Import Bank as of June 30, 1948
(in thousands of dollars) - continued

Commodity or Purpose	Credits Authorized		Cancellations and Expirations	Balance Not Yet Disbursed		Amount Disbursed		Principal Outstanding	
	Date	Amount		Amount	Expiry Date	By Eximbank	By commercial bank at EIB risk	repaid on loans	ing on loans
Materials, equipment and services--Nueva Cia. Electrica Chapala, S.A.	10-1-47	3,500.0	---	3,500.0	12-31-49	---	---	---	---
Agricultural Equipment	11-12-47	5,000.0	---	5,000.0	6-30-49	---	---	---	---
Equipment for beef-canning plant	12-3-47	1,000.0	---	1,000.0	0-30-48	---	---	---	---
Materials and equipment for west-coast highway construction	12-10-47	12,000.0	---	12,000.0	3-31-52	---	---	---	---
Materials and equipment for ammonium sulphate plant	2-11-48	6,000.0	---	6,000.0	12-31-49	---	---	---	---
Railway equipment	12-3-47	7,000.0	---	2,710.0	9-30-48	4,290.0	---	---	4,290.0
Equipment for 2 sugar mills	12-3-47	5,000.0	---	---	---	5,000.0	---	---	5,000.0
Total		151,671.2	6,115.0	53,715.7		72,056.9	19,783.6	22,986.4	68,854.0
Post Operations		2,432.6	1,383.3	---		1,049.3	---	1,049.3	---
		154,103.8	7,498.3	53,715.7		73,106.2	19,783.6	24,035.7	68,854.0

Source: Export-Import Bank of Washington, Sixth Semi-Annual Report to Congress, January-June 1948.

6. Conclusion

1. Because of the inflationary conditions which have prevailed during and since the war, enhancing the traditional speculative attitude of Mexican investors, the small savings of the Mexican people have not always been used in the manner which would have helped most in the long-run development of the country. Commerce and real estate construction have been the favorite investments of private investors. In both these fields there has been a strong boom during this period, which has provided such opportunities for quick high profits that there has been little inducement to invest savings in long-term, low-interest-bearing securities. Government efforts to promote a capital market have, as a result, been rather unsuccessful. The Government, nevertheless, has gone ahead with its efforts to promote development, using central bank credit to fill the gaps left by private investors. By so doing it gave a further stimulus to the speculative tendencies of private individuals, thus adding to the existing inflationary pressures.

No position has been taken in this paper as to whether the ill effects of inflation have been more or less compensated by the favorable effects of the development which has been actually achieved. However, it is contended that the Government has not exercised sufficient control over the activities of private banking institutions and that some of the measures used to channel savings to long-term investments may even have had an adverse effect. The process of educating the private saver should have included both the provision of inducements for private savings to flow into more appropriate channels and the elimination of opportunities for investments which do not contribute to a sound long-term development. The Government's activities have not been effective in either direction.

2. The Bank of Mexico has been used by the Government both to finance its deficit and to promote that part of its development program which is carried out through official credit institutions and specialized private agencies. Although strongly influenced by the Government in its expansionary activities, the Bank has also exercised a considerable tempering influence. Its anti-inflationary credit policy in its relations with the commercial banks has placed them in a highly liquid and strong position. But its own policy of purchasing government bonds and, on a smaller scale, other securities, accounting for over half of the increase in the money supply, has left the central bank in a basically unsound position. The composition of its portfolio is such that it would be extremely difficult for it to follow a contractionist policy. The attitude of the Mexican public toward government obligations and towards long-term and fixed interest-bearing securities in general, means that once the Bank of Mexico absorbs these unmarketable securities, it cannot reverse the process in a short time. And while the original expansion might be thought desirable, the problem has been to avoid its becoming the basis of a secondary expansion by the private banking system. In this respect, the Bank of Mexico has gone further than any other Latin American central bank, but its action has been insufficient to avoid inflation.

3. The private banking system has expanded greatly since the beginning of the war. Because of the limitations imposed by legislation on the commercial banks restricting them to short-term credit operations, the Government has had to develop, as well as to channel, private savings toward government securities. Although some success has been achieved, the over-all results have been very disappointing. These institutions have been more concerned in realizing the high profits which the inflationary situation permitted than to carry out a long-range program which might have been of more lasting benefit to the country. It is questionable whether a private corporation endeavoring to maximize its profits can be blamed for following the policy most conducive to that purpose, that is, in the Mexican case, short-term lending at high rates. Certainly the Government is more to blame than private institutions for not having taken all the necessary precautions for insuring that the funds obtained by the latter from savers and national institutions went into the right types of investment. However, while the Government has no doubt been lenient in this respect, the leniency does not excuse the industrial credit banks from embarking on activities other than those for which they were specifically created.

4. The national or official banking system, created by the Government to carry out its development program in different fields, has compensated in part for the savings and investment habits of the Mexican public and Mexican private banking institutions, in the sense that it has entered into fields which these had scarcely touched. Their work in those fields is extremely difficult to appraise, and perhaps a distinction should be drawn between the results achieved by the industrial and the agricultural institutions.

The first, that is, "Nacional Financiera," has had great influence and has participated in all major industrial corporations which started or expanded during recent years. In some cases, it may have gone to the extreme of supporting firms which would better have been left to disappear, but its over-all beneficial effect in increasing production seems evident. The agricultural banks, on the other hand, have covered only a small part of the field assigned to them, and there are doubts about the effectiveness of their work, because they have not sufficiently concentrated their operations in order to make the best possible use of their resources. Although the policy of spreading their loans over a large area and in small amounts may have some merit from a social viewpoint, it seems that it might have been more desirable economically for the agricultural banks to give adequate credit to fewer borrowers.

A general criticism of official credit institutions is that they have not sufficiently influenced the savings and investment habits of the public, and accordingly have had to depend increasingly on central bank credit for their operations.

5. There is a disequilibrium between the Mexican money and securities markets which favors the former. This is mainly a consequence of the higher

rate of interest which prevails in the money market. The capital market, however, is further restricted by (a) the lack of a well-organized security market; (b) distrust of the Government; (c) an inflationary situation creating doubts about the long-range profitability of investments and about the currency; (d) the smallness of the wealthy saving class; (e) the lack of support from banking institutions; and (f) the inability of small investors to procure equity securities.

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