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Willem G. Wolters

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## From Silver Currency to the Gold Standard in the Philippine Islands

Willem G. Wolters

*In 1903, the United States government introduced a gold standard monetary system in the Philippines, with a theoretical gold peso and a token silver peso in circulation. This currency reform was part of a wider American diplomatic offensive to expand the sphere of gold-based currencies in the world, in which American capital could be safely invested. The Philippine currency reform ended a period of monetary confusion in the islands during the late-nineteenth century. The circulation of silver commodity money had tied the Philippines to China, with cross-border flows of products and silver dollars. Under the gold standard, fund trade linkages were shifted to the United States.*

**KEYWORDS:** *Philippine peso, currency reform, American administration, British banks*

In 1903–1904, the new American colonial administration in the Philippine islands undertook a drastic currency reform by introducing a gold standard monetary system in the country. This reform ended a period of monetary confusion, which had been caused by the worldwide decline in the gold value of silver during the last three decades of the nineteenth century. With the shift to the gold standard, the Philippine islands joined the growing league of gold standard countries, which at the time comprised a number of European countries, the United States, Japan, India, and Siam.

The Philippine currency reform was prompted by two different sets of considerations. The first set, most often discussed in contemporary publications, pertained to the local situation and contained a series of complaints about the monetary confusion in the islands caused by the

fact that silver-based coins and U.S. gold-based dollars circulated side by side among the population, with exchange rates that fluctuated in time. A second set of considerations played a role in the background. A few years earlier, the United States adopted the gold standard system, and the government in Washington, D.C., became an ardent advocate of the new monetary philosophy, eager to share its wisdom and experience with other countries in the world, particularly those in Asia and Latin America.

To explain the advantages of the gold standard, we have to make a distinction between two types of money, viz., commodity and fiduciary money. Commodity money consists of objects whose value as a medium of exchange is similar to the intrinsic value of the material from which they are made, mainly precious metals, silver, and gold. Fiduciary money consists of token coins and paper notes whose value is higher than that of the material from which they are made. The state has assigned a value to these objects, and has forced their general acceptance as a medium of exchange within the state territory by demanding the use of only this currency in paying taxes. This distinction has important consequences for the way the different monetary systems function. Commodity money can circulate across borders, as its intrinsic value commands its general acceptance. Fiduciary money is tied to the state which has issued it, and to the territory whose population functions as a "pay community." Under the gold standard, the state kept the gold supply in its treasury and issued fiduciary money, guaranteeing its value with these gold reserves.

The gold standard had two functions, an internal and an external one. Domestically, it was a method of controlling the volume of the currency, as the currency laws stipulated that the government could issue notes only if there was a sufficient backing of gold held in reserve. While this limited the money supply, it gave a certain degree of flexibility to the monetary system, as paper notes could be issued as a response to a growing demand for money in the business community, much faster than metallic coins could be manufactured. Internationally, the gold standard functioned as a method to preserve the stability of exchanges between currencies of gold standard countries. As each currency had its monetary unit expressed in a certain amount of gold,

the exchange rate between the currencies was fixed. The gold standard's main attraction was that it seemed to function automatically. If a country encountered a balance of payment deficit, it had to pay its international debts by exporting gold. This diminished the domestic reserves automatically, leading to a reduction of the domestic money supply. The gold standard thus created a stable payments system, resulting in the formation of global markets for such commodities as wheat and rice.

The international function was the main reason why the United States urged other countries to adopt the gold standard. Between gold standard countries, capital could easily flow across borders. As the international price of silver in gold terms began to decrease continuously in the late 1870s, it was not advisable for capital owners in a gold standard country to invest capital in a silver-based country, as the investment would certainly lose its value over time. If that other country would adopt the gold standard, investments could be made with much less risk.

The last decades of the nineteenth century saw the rise of political and military competition among the western states and a race to conquer new colonies. An imperialistic and expansionistic mood emerged in the United States. The war with Spain in 1898, and the occupation of the Philippines and Cuba, resulted from this political ambition. Economic reasons formed the basis of this imperialistic policy, as the prominent American economist Charles Conant pointed out at the time (Conant 1900). The industrialized western countries in general, and the United States in particular, had accumulated large amounts of capital as savings, but for which there was not sufficient productive employment in the industrialized countries themselves. These countries were facing a growing congestion of capital, leading to depressed profit margins. In Conant's (1900, 27) words: "the great industrial nations should turn to countries which have not felt the pulse of modern progress." The "surplus capital" should be invested in Asia and Latin America. But, first, these countries should be made safe for investment by persuading them to accept the gold standard.

In 1901–1904, the U.S. government sent missions of American economists to a number of countries in Asia and Latin America to urge the governments in these countries to adopt the gold standard as

the basis of a new global monetary and investment system (Rosenberg 1999). As a member of these missions, Conant went to the Philippines in 1901 to devise a new Filipino gold exchange standard monetary system (Conant 1901). Conant's plan was turned into a law that was ratified by the U.S. Congress in 1903 and implemented in the Philippines in the same year. This plan became the model for similar proposals made to other countries, a diplomatic offensive which continued as "Dollar Diplomacy" into the 1920s (Parrini and Sklar 1983). This diplomatic activity clearly served the imperialistic intentions of the United States at the time. By persuading other countries, and particularly China, to adopt the gold standard, the U.S. intended to create a gold-backed dollar bloc, to which American investments could be safely channeled.

### **The Silver Currencies in Asia**

From about 1877 to 1903, the Philippine islands were part of a larger monetary world dominated by silver currencies, which also encompassed the Chinese coastal areas and parts of its hinterland, the British colony Hong Kong, French Indochina, Singapore and the Straits Settlements, British Borneo and Labuan, and the islands of Sumatra and Borneo of the Netherlands Indies. Although Asia hardly produced silver itself, its monetary systems were all based on the use of silver coins. This silver had been supplied from the Americas on a large scale, since the European states had established military and trade links between the old world and the new world. Even China, which hardly found any silver in its mines, had a monetary system based on silver.

This large area in Asia became an export-oriented cash-crop region, supplying agricultural commodities to Europe and the United States. Western trading houses had offices at the main ports and conducted a lively trade in import goods and export products. Western banks had offices in the main port-cities along the Chinese coast and in other capitals as well, primarily as exchange banks. Within this region, there was a significant movement of people, money, and goods.

The trading of goods, both with the rest of the world and within the region, was based on an elaborate system of western merchant firms, western banks, Chinese merchant firms and native banks, ship-

ping companies, insurance firms, and the like. In this silver currency area, money could more or less flow freely from one country to the next, either in the form of cash shipped from one point to another by couriers, or in the form of bills of exchange and money orders, sent from one bank to another. The largest part of these flows was done as payment for goods and to settle accounts, but there was also a flow of money from one country to another to fill up currency deficits.

The Asian silver currencies could be considered as commodity money, whereby the value of the coin was determined by its intrinsic metallic value. The coins circulating in the East and Southeast Asian Regions during the second half of the nineteenth century had a very similar silver content, slightly differing from the Mexican standard. These coins were all called *dollar*, a corruption of the Austrian word *thaler*, after the valley Joachimsthal, where Austrian silver was mined.

The oldest silver coins circulating widely in Asia were Spanish-American coins, minted in Mexico during the seventeenth and eighteenth centuries (see figure 1). These dollars were minted for wide circulation (almost half a billion were coined) and were exported all over the world, including Asia, and were accepted as commodity money in many markets. After Mexico freed itself from Spanish rule in 1821, coins with the same silver content as their predecessors were struck at the mint, but with the legends "Republica Mexicana" and "Libertad." These Mexican dollars were minted in even larger numbers (about 1,466 million were coined between 1821 and 1903) and acquired a wide circulation. They invaded the Philippines in the 1820s, and China probably at around the same time (Legarda 1976, 163). By 1870, the coin was current not only in the two American continents, in the West Indies, and in the islands of the Pacific and Japan, but throughout large parts of Asia (Andrew 1904). The Mexican dollar attained its widest circulation in China, where an estimated 400–500 million dollars were used in the beginning of the twentieth century (Andrew 1904; Perez 1954; Ganzon de Legarda 1976). Between the 1860s and 1903, western countries striving to extend their sphere of influence in Asia brought their own silver dollars into circulation.

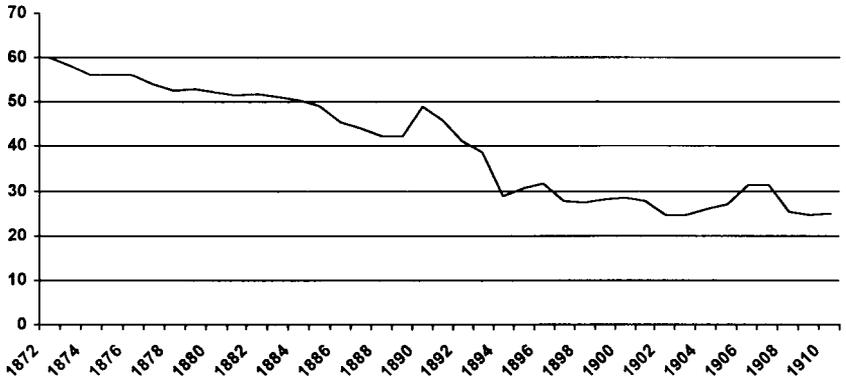
From the mid-1870s until the end of the nineteenth century, this extensive silver region in Asia felt the negative effects of the worldwide



Figure 1. The Mexican silver peso, minted from 1824 to 1909, circulated widely in Asia, and became the monetary standard for most of the trading centers in the western Pacific. The design shows on the reverse a standing eagle and on the obverse the liberty cap with rays. The coin portrayed here shows a Chinese chop mark, certifying its authenticity among Chinese traders.

decline in the value of silver, measured in terms of gold. This decline resulted from the massive move toward the gold standard in several Western countries, which purchased large amounts of gold in the world market, demonetized their silver currency, and started to sell their silver bullion in the open market (Laughlin 1896, 92–105). As a result, the price of silver in gold terms started to go down, which continued until the end of the century (see figure 2). Between 1878 and 1900, silver coins in Asia were worth less and less in terms of the gold-based British pound sterling or the U.S. dollar. There was a growing gap between the western world using the gold standard and Asia remaining on depreciating silver.

The system of silver currencies had both advantages and disadvantages for the Asian populations and the trading communities. One obvious advantage was that these coins could easily cross national frontiers, without cumbersome exchange operations. Large ports with extensive surrounding agricultural hinterlands, even when controlled by other political powers, had a common currency as a basis for commercial integration. In monsoon Asia, the seasonal rhythms of production and trade demanded a high degree of flexibility in the provision of money, and the possibility of physically transporting coins between areas and across borders filled that need to some extent. At the same time, however, this feature showed the limitations of a system of metallic money. Where everybody expected that the silver content of the coin



Source: King 1987 (vol. 1), p. 274, Table 8.2; p. 308, Table 9.3; p. 401, Table 12.1; p. 454, Table 13.1; 1988 (vol. 2), p. 42, Table 1.3.

Figure 2. Average price of silver in London, in pence per ounce, 1872–1910

would determine its intrinsic value, money substitutes were not easily accepted. The system did not allow the use of paper money on a significant scale. In Asia, the big commercial banks issued bank notes, which circulated among their clients in the business community. Checks and bills of exchange could circulate among merchants, but also on a small scale and in limited circles. The name and the reputation of the commercial institutions guaranteed that this paper would ultimately be redeemed. But the system had no room for government issuance of paper money on a larger scale—suggesting that a system based on metallic money was inherently inflexible. Because the cost of producing metallic money was high, the amount of money in circulation could not be easily adjusted to the seasonal fluctuation of money (Conant 1905, II, 128).

Another disadvantage was that huge amounts of silver money could suddenly flow out of or into the country, disturbing prices and causing economic problems. These flows could be caused by political events elsewhere, such as war in China, or by economic events, such as harvest failure, necessitating large-scale importations of rice to be paid with silver money. There were practical problems as well. Large payments required the transportation of heavy loads of silver coins from one place to another, with the necessary costs of packing, shipping, handling, brokerage, and insurance. Another source of transaction costs was the exchange of money. In multiple currency systems, coins had to be constantly converted into each other, requiring the intermediation of

large numbers of moneychangers. Converting coins was an elaborate ritual as the moneychangers had to weigh the coins and test their purity.

The decline in the gold value of silver was another cause of difficulties. In around 1900, many people in the business communities in Asia were convinced that the decline of silver was actually an advantage as exports from Asia became cheaper and therefore larger in volume. In turn, importers feared that prices of goods from gold-based countries would increase. The American economist and banker Conant (1905) already expressed his doubts about this relationship. Later research has shown that the correlation does not hold. After the shift to gold, exports actually increased (van der Eng 1999, 75–78). The main problem for the business community seemed to be that exchange rate instability made business unpredictable.

### **The Currency System in the Philippines from the 1850s to 1903**

The transformation of the Philippine economy into an agricultural export economy was brought about by the financial stimulus of foreign merchant houses, as economic historian Legarda (1999) has pointed out. These firms, owned by British, American, and German entrepreneurs, were engaged in purchasing agricultural produce (sugar, Manila hemp, tobacco) from Philippine producers and in distributing imported goods. Middlemen managed the marketing channels between Manila and the provinces. Before the 1860s, middlemen in the import-export domain were mostly Chinese mestizos, but when immigration laws were relaxed after the 1850s, ethnic Chinese took over. Between the 1860s and the 1880s, the merchant houses provided loans to middlemen and producers, and extended liberal credit facilities to distributors of imported goods. From about 1860 to the end of the Spanish regime, the Philippines functioned as a cash-crop economy, tied to foreign markets, and at the same time as an outlet of western consumer products. This growing commercial economy needed an enlarged monetary system and modern business practices.

In order to improve the inadequate monetary situation in the islands, the Spanish colonial government established a mint in 1861 and started

to produce coins. Initially, the currency system was on the double standard of gold and silver. The mint in Manila produced gold coins of four, two, and one peso, and silver coins of fractional value. Between 1861 and 1885, the mint produced gold coins at a value of 18.5 million pesos, and silver coins at a value of 6.4 million pesos. Until 1876–77, the exchange rate of gold and silver in the Philippines was stable. However, in 1876, the adoption of the gold exchange standard in a number of countries made itself felt and the resulting decline in the international gold-value of silver started to undermine the system of stable exchange.

Remarkably, the Spanish colonial government in the Philippines did not notice this phenomenon until it was too late. In 1876, it issued a decree stating that the circulation of Mexican dollars in the islands was legal and that the Philippine gold peso and the Mexican silver peso were at par. This opened the possibility for traders to exchange cheaper silver dollars for more expensive gold coins. They imported large amounts of Mexican dollars and bought Philippine gold at the official parity rate. These gold coins were shipped out of the country and melted, a classic example of Gresham's law that bad money drives out good money. In 1877, the disappearance of gold coins from the islands became noticeable and the government quickly tried to remedy the situation. A decree was issued, prohibiting the importation of Mexican silver coins, but stating that Mexican silver already in the country, and coined in 1877 or before, would continue to be received as legal money in the country. However, the outflow of gold could not be stopped. By 1884, gold coins had entirely disappeared from circulation. The mint ceased producing gold coins. Close to 20 million gold pesos had been replaced by the same amount in Mexican silver dollars. The country was *de facto* no longer on a gold standard.

Although the 1877 prohibition on the importation of Mexican dollars was not strictly implemented, it did create a money scarcity in the Philippine islands. The effect was that silver coins in Manila had a higher value than the bullion content of the coins, in other words, they had a "scarcity value," so that in fact, as the American economist Kemmerer (1916, 250–52) observed, the monetary system was not based on a pure silver standard, but on a fiduciary standard.

This fiduciary standard shows from the fact that, for most of the years between the 1870s and the early 1900s, silver coins had a higher value in Manila than in Hong Kong. The Dutch civil servant Wiselius (1876), who traveled to the Philippine islands in 1875, mentioned this exchange difference between Hong Kong and Manila. Wiselius (1876, 108) had been advised in Hong Kong not to bring paper money or gold coins to Manila, but only silver, and he notes that this earned him a profit of 5 percent in a few days. The difference in value between the two places was in the order of 8 to 12 percent in the 1880s, and of 25 percent in 1894 (Foreman 1980, 260).

One effect of this artificial money scarcity in Manila, and consequently the higher value of the coins, was the smuggling of Mexican dollars from Hong Kong to the Philippine islands. Foreman (1980, 260) estimated that, in 1887, the clandestine import of Mexican dollars averaged 150,000 pesos per month. Harden (1898, 6) wrote, "The smuggling of silver into the islands was a recognized industry. It was carried on largely by the rich 'mestizos,' or Chinese half-castes. There was a regular system for the bringing in of these coins, which would be shipped from Hong Kong in a special steamer and the cargo would be landed at some point north or south of Manila Bay."

As the currency was inelastic, an outside money source had to function as a reserve and an overflow area. The Hong Kong-Amoy region could fulfill these functions for the Philippine islands because both regions used the Mexican dollar as standard currency. Moreover, exchange was easy, since there were numerous links between the Philippines and these port cities. The two countries formed as if they were a set of communicating vessels, in which money could flow back and forth, in reaction to the demand for currency.

Figure 3 shows the semi-yearly fluctuations in exchange rate on London and the average bullion value of the Mexican peso in gold terms, both quoted in terms of the number of English pence to the peso.<sup>1</sup> In Manila, the exchange rate on London was systematically higher than the bullion value of the Mexican dollar, and also higher than the exchange rate in Hong Kong, all measured in sterling terms. In Mexican silver terms, the situation was the reverse: the exchange rate on London was cheaper in Manila than in Hong Kong because the silver dollar was

more valuable in Manila than in Hong Kong (Kemmerer 1905, 23; 1916, 250–61). In other words, bills of exchange on London were cheaper in Manila than in Hong Kong, so that “it was more advantageous to get exchange on London from Manila than from Hongkong.”<sup>22</sup>

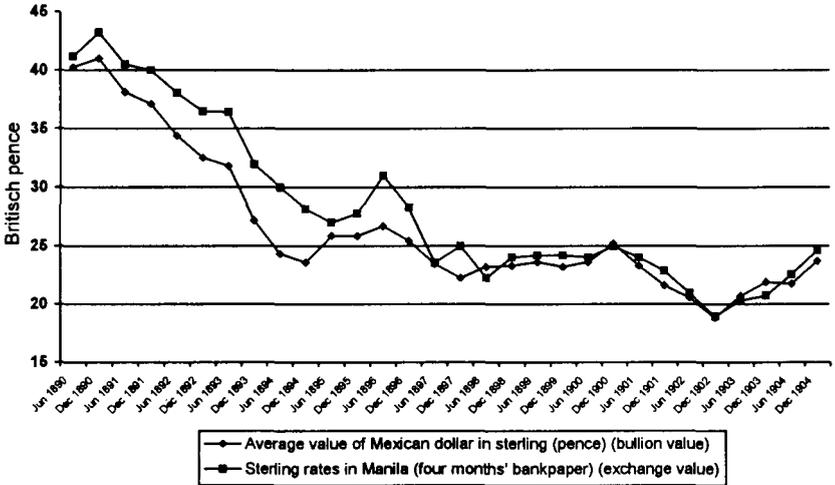


Figure 3. Semi-yearly variations in exchange rate and bullion values of the Mexican peso in Manila.

The total amount of money circulating in the Philippine islands was relatively small for the size of the export economy. During the 1890s, circulation was estimated at 30 to 35 million silver pesos, consisting of about 10 million Spanish-Filipino fractionary silver coins, about 20–25 million Mexican dollars, and about 2–3 million in bank notes issued by the Banco Español-Filipino (Camara de Comercio 1895; Foreman 1980, 635; Kemmerer 1916, 249–50). In 1897, the Spanish government imported 6 million Spanish-Filipino pesos, the so-called “Alfonsinos” (see figure 4). One Spanish author estimated the amount of money circulating in the provinces at not more than 12 million, so that most of the money circulated in Manila, part of which consisted of bank notes and checks from the British banks (Feced 1894, 273).

The question arises on the extent to which the Filipino population was affected by the currency fluctuations. The answer is: not very

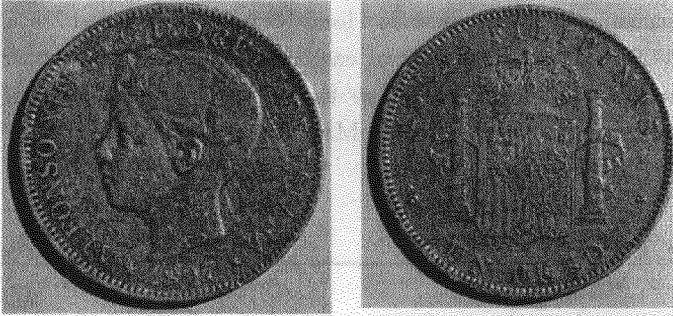


Figure 4. The Spanish-Philippine silver peso, minted in Madrid in 1897 for use in the Philippines. It bore the bust of the young Spanish King Alfonso XIII, and was therefore popularly known as "Alfonsino."

much. Although international advocates of the gold exchange standard argued that the decline in silver prices would cause domestic prices to rise, not much of a price increase was noticed during the 1890s. The price of textiles from Great Britain increased, but there was a significant import of textiles from China, which was on a silver basis. The overall conclusion is that the currency problem was in the first place a problem for the Spanish community, and in the second place for merchants in the import trade, who had problems with the exchange rate fluctuations. The Filipino population was hardly affected by the international decline in silver price.

### **Spanish Views on Currency Problems in the Islands**

In the first half of the 1890s, the Spanish community in the Philippines was alarmed by the steep decline of the silver currency in gold terms, for instance, in terms of the British pound sterling. The people most hardly hit by the decline were the Spanish civil servants, military, and retired persons in the islands who used to send part of their income to Spain, and retired civil servants and military living in Spain who received their pensions from the colony. Since they were paid with silver currency, they lost almost half of their income in gold terms. Importers in the Philippines who purchased their goods from gold exchange countries had to pay their letters of credit at a premium.

Exporters were believed to benefit from the decline of silver, as they purchased their products in the Philippines with cheap silver, and received payment in gold from gold exchange countries, such as Great Britain and the United States. The foreign traders community in Manila and the officials of foreign banks were in favor of the silver standard system and the use of Mexican dollars.

Spanish observers and commentators writing about the monetary situation did so primarily from the point of view of the Spanish community. They despised the fact that the islands were flooded with Mexican dollars, and they often attributed the decline in silver price to the use of what they considered as bad and fraudulent coins. They compared the situation unfavorably with the one in Spain. The Spanish commentator and advisor Francisco Godinez wrote that purchasing one pound sterling would cost 10 Mexican silver coins in China, 8 silver coins in the Philippines, and 5 equivalent silver coins of 25 grams in Spain (Godinez 1894a, 9). The Spaniards looked with suspicion at the Chinese traders who brought the Mexican dollars to the Philippines. Godinez (1894a, 9) pointed out that the price difference between China and Manila of bills of exchange on Europe, in the order of 10 to 15 percent, drew Mexican pesos to the archipelago. A profit of this kind, to be made in less than eight days (the time needed to make the roundtrip from Hong Kong to Manila), presented a strong incentive which could not be resisted.

While most observers agreed that the currency situation in the Philippines was unfortunate, at least for the Spanish administration and for the Spanish community, there were different views on how to remedy the situation. They agreed with the principle that the Mexican silver dollar, controlled by outside forces, had to be driven out of the Philippine economic system, and that the means to achieve this would be to impose stricter border controls.

Three options for a fundamental currency reform were discussed, viz., (1) the introduction of a gold-based currency system; (2) the use of the bimetallic (gold and silver) currency of motherland Spain; and (3) the coinage of a silver coin especially for the Philippine islands (Godinez 1894a, 14–21).

The first option was heavily discussed in the Spanish press. A number of authors favored a switch to gold, in the form of a gold standard system, in which the gold fund would be kept in the treasury and the silver token coins would be supplemented with bank notes to be issued by the Banco Español-Filipino. Others, like Godinez, rejected this solution because they thought this would be an unbearable burden for the treasury of the colony.

The second solution, the use of the bimetallic currency of Spain, was attractive to the eyes of many Spaniards both in the islands and in Madrid because it would create a monetary identity between the motherland and the colony, and promote economic integration between them. Godinez (1894a, 1894b) strongly favored this option. The third option was given less attention because it was feared that the silver coins from the islands would disappear from circulation and be exported to neighboring countries.

In 1895, an advisory commission of the Ministry of Colonies in Madrid chose the first option, with the support of the Manila Chamber of Commerce. The plan was to drive out the Mexican dollar and to shift to a gold standard system (Cámara 1895). The plan was never carried out in its entirety, but the Spanish government undertook the initial preparatory steps. In 1897, the government in Madrid ordered the minting of a Spanish-Filipino peso, bearing the bust of the young King Alfonso XIII, and therefore called "Alfonsinos," with a pure silver content lower than that of the Mexican peso (Ganzon de Legarda 1976, 44). More than six million coins were minted and shipped to the islands, but these well-designed coins did not succeed in driving out the Mexican dollars. The lower silver content and the small number limited their acceptability to replace the Mexican silver in circulation (Ganzon de Legarda 1976, 44–45).

In 1896, the Philippine Revolution started, coinciding with the revolution in Cuba, and soon the Spanish government was confronted with skyrocketing expenses for the war operations, which precluded all reforms. Between October 1896 and June 1897, the costs of the insurrection amounted to more than 38 million pesos (*Gastos de la Insurrección* 1897). In 1898, Spain lost its colony to the United States.

### **American Administrators, British Banks, and Mexican Coins (1898–1903)**

The arrival of American troops on the Philippine islands in 1898 and 1899 increased the degree of chaos and confusion in the monetary system. Immediately after the Spanish forces surrendered, the U.S. military commander allowed the local banks to freely import Mexican dollars in order to ease the monetary situation. With this decision, the Philippines passed from the fiduciary coin standard, in which the Mexican dollar had a higher scarcity value, to a silver standard with the Mexican dollar as the unit of value.

The monetary situation during the first few years of the American colonial regime was complicated by the fact that a silver and a gold system coexisted in the islands. The American administration brought large amounts of U.S. dollars into the Philippine islands as payment for army and navy and for government expenditures. The effect was that two kinds of “dollars” circulated side by side, yet the U.S. dollar was on a gold standard and the Mexican dollar on a silver standard. Although the U.S. dollar was made of silver and contained less silver than the Mexican dollar, in the United States, where it was legal tender, the U.S. dollar had twice the value of the Mexican because it could be exchanged at par with gold-based currency. However, this gold value was not automatically maintained outside the U.S. territory. There, its value was to be seen based on the price the market would assign to U.S. dollars. The American administration in the islands tried to maintain a fixed exchange rate between the two currencies, at the rate of one U.S. dollar against two Mexican dollars. It negotiated with the foreign banks in an attempt to freeze the exchange rate via an agreement. However, to the amazement of the Americans, the exchange rate could not be fixed and fluctuated heavily between 1.80 and 2.66 Mexicans to the U.S. dollar.

During these years, the American administration in the Philippines clashed with the British commercial banks in the islands over payment problems and currency management. In 1898, there were four banks in the islands, two Spanish and two British. One of the Spanish banks, the Banco Español-Filipino (established in 1852), had the right to issue

bank notes, of which about 2.4 million were in circulation. The other one, the Monte de Piedad (established in 1882), was a small savings and loan bank. The two British banks, the Hong Kong and Shanghai Banking Corporation (branch opened in 1876) and the Chartered Bank of India, Australia and China (branch opened in 1873), were exchange banks, financing the trade in import and export products and handling bills of exchange on foreign countries. The Hong Kong Bank had its head office in Hong Kong, and the Chartered Bank in Shanghai.

The coexistence of gold-based U.S. dollars and Mexican silver dollars was bound to create confusion and a fluctuating exchange rate between the two currencies. On 19 August 1898, the two British banks and the Spanish-Filipino bank wrote a letter to the U.S. commanding officer, stating that,

. . . while we are anxious to give the soldiers and your Government every assistance by being in a position to quote an exchange of not worse than \$2 Mexican for \$1 gold, we shall be quite unable to preserve this basis of exchange should there be any scarcity.

In view of this, the banks requested the freedom to import Mexican dollars duty free. If that request would be granted, they added, “we agree to maintain a rate of exchange of not less than two Mexican dollars for one gold to the extent of our imports of Mexican dollars” (*Report* 1900, 101).

An agreement was concluded between the American administration and the banks, whereby it was understood that the two banks would assist the administration in maintaining the exchange rate of two to one between the U.S. dollar and the peso, and that the banks were allowed to import Mexican dollars legally in an unlimited amount. The banks would supply Mexican dollars to the troops for “gold,” and would import Mexican dollars equal to the amount of gold purchased. However, the agreement failed to bring the desired stability in the exchange rate.

There were more irritations. In 1899, the two British banks lobbied the American government to be designated as official depositories of the U.S. treasury funds in the islands. This request was granted, and in

August 1899 the two banks were appointed as official depositories of U.S. government funds. However, the banks only accepted deposits from the government, not from individuals. An American soldier wishing to deposit his pay with the bank had to sell his U.S. currency to the bank in exchange for local or silver currency. And the other way around, if he wanted to send money back home, he had to purchase U.S. dollars from the bank, and for this exchange the bank charged a commission.

In May 1899, the Chief Paymaster of the army wrote to headquarters:

The two English banks seem to be in collusion, and charge exorbitantly for all business transactions over their counters. When an officer or enlisted man goes to deposit his gold with them it is credited to his account in silver, at the current rate—for this is a silver country—and if he wants gold for any purpose they never charge him less than 5 per cent for it. I have noticed that when pay day approaches, the banks put down the rate for gold, so that they can make a greater profit from the soldiers. (Edwards 1900, 8)

In the second half of 1900, a fierce exchange of arguments took place. On 3 August, General MacArthur (the father of the Pacific War hero) reported by telegram from Manila that the exchange rate of the U.S. dollar was dropping rapidly:

Remote cause of fluctuations is Chinese war, which is made pretext by local banks for profitable speculation in United States currency. As a temporary restraint on downward movement have ordered United States currency tendered in payment of customs to be received as heretofore at the rate of two for one. (Edwards 1900, 45)

The Secretary of the Treasury in Washington, D.C., L. J. Gage, responded with strong words on 10 August:

General MacArthur seems to think that the higher price of Mexicans at the bank is due to the perversity and greed of the bank, but it finds its excuse in the disturbance in the movement of money caused by the Chinese troubles. I am more inclined to believe that the banks are giving no new exhibition of sordidness, but that they

themselves are the necessary victims of the unfavorable influences occasioned by the Chinese war. They are obliged to adjust themselves and their actions to the influence of movements they cannot control, and I do not see why General MacArthur is not subject to the same rule of commercial necessity. (Edwards 1900, 46–47).

The agent of the Chartered Bank in Washington, D.C., G. Bruce-Webster, wrote in a memorandum to the War Department in October 1900:

Much has been said and written against the action of the banks in Manila, in converting the gold coin brought to it into local Philippine currency. It has not been understood seemingly that the legal tender in the Islands has not been changed by the transfer of ownership and that so far as the banks are concerned and others interested in large money transactions, the United States money cannot legally be tendered by them in settlement of accounts, and must, therefore, be treated as bullion and be liable to fluctuating local prices as such. For this reason, it is an error to think that the local price of U.S. currency indicates or affects its popularity measured in sentiment, whereas it merely expresses its utility, measured in the local standard of value, the peso.<sup>3</sup>

In short, the Americans found that in an Asian country, U.S. currency could not be handled at par; it was worth less than at home. They also found that Asian legal tender silver coins were subject to the laws of supply and demand, and that their value fluctuated not only according to market forces, but also to the vagaries of political development in China and other Asian countries.

In spite of the fact that liberal circles in Washington, D.C., expressed sympathy for the point of view of the private banks, the Philippine Commission in Manila took steps to regulate the banks. In November 1900, the Commission regarded the banks' business practice of not accepting private deposits of U.S. dollars "as a discrimination against money of the United States," and passed an ordinance requiring the banks to accept deposits both in the currency of the United States and in Mexican or local currency, and to repay such deposits by checks or otherwise in the kind of money from which they were made, that

is, silver for silver and gold for gold. Although representatives of the two British banks lobbied the politicians to change the policy, the ordinance remained in force until the adoption of the gold standard. This measure stabilized the exchange rate in 1901 and 1902. In 1902, two American banks opened branches in Manila, and the government transferred a large part of its funds to these new banks. In subsequent years, the British banks were subject to closer control than they were used to in Hong Kong.

### **Import and Export of Mexican Dollars**

International political factors had an impact on the Philippine situation. The exchange rate between Mexican and American dollars fluctuated because, internationally, the demand for Mexican dollars fluctuated widely. The U.S. military administration granted the two British banks permission to import silver Mexican dollars legally in an unlimited amount. It was estimated that between August 1898 and August 1900, the two banks imported about 12 million Mexican pesos into the islands. Then the direction of the flow was reversed. Between August and November 1900, at least 3 million Mexican dollars, and probably several millions more, disappeared from circulation in the islands and were apparently exported to China (*Report* 1901). This outflow was caused by a large demand for Mexican dollars in northern China, where western military forces were carrying out military operations around Beijing to crush the Boxer uprising. The outflow of Mexican dollars from the Philippines was so large that, for some time, Manila was reportedly devoid of currency.

The American officials found to their chagrin that most of the U.S. currency that Americans had spent in the Philippine islands disappeared from circulation. Only a small amount returned to the treasuries of the American bureaus. Between August 1898 and June 1901, almost 24 million U.S. dollars were paid out to the troops, and very little was returned to the U.S. government.<sup>4</sup>

An exceptionally large inflow of about 20 million Mexican dollars took place in 1902–1903. The Chinese government required gold-based currency to settle indemnity obligations to western states, and came to

the Philippine market with its Mexican silver to purchase U.S. dollars, which had been brought into circulation through payments of army and navy officers and men. As a result of this silver inflow, the exchange rate between the U.S. and the Mexican dollar went up to 2.60 Mexicans. As the American Collector of Customs reported (1904):

. . . the volume of Mexican silver became so great in Manila that the banks gave notice that they would no longer receive it on deposit from their customers, and for a time it was necessary to store the same under counters and in out-of-the-way places in boxes and sacks about the business houses, much in the same manner as a merchant would store salt or nails.<sup>5</sup>

Between March and November 1903, more than 15 million Mexicans were exported from the islands. Several factors were mentioned at the time. One was that the government of Siam was changing its monetary system from silver standard to gold, and it was expected that Mexican dollars would be redeemed at a higher price than they had been elsewhere. The prospect of big profits stimulated traders to hurriedly import Mexicans into Siam. Another factor was that large amounts of silver currency had been paid for substantial rice importations from Indochina, as the rice harvest in the Philippines failed that year because of excessive drought. However, this outflow of Mexican coins did not create a shortage of currency at the time, since the American administration had just started introducing the new Philippine currency. In fact, the export of Mexicans facilitated the shift to the gold standard system.<sup>6</sup>

### **Views of the Foreign Business Community in Manila on Currency Reforms**

The community of foreign traders and bankers in Manila strongly preferred the silver-based currency system to a gold-based one. That became clear during the hearings which the Philippine Commission, the provisional American governing board in the islands, held with prominent persons in the new colony in 1899. Almost all of the foreign business people, including a Spanish banker, expressed a strong prefer-

ence for the continuation of the silver standard and rejected the idea of a shift to the gold standard. They often used strong words. When asked about his opinion about a shift to a gold basis, the British businessman John T. McCleod answered: "I think it would be a great mistake" (*Report 1900*, 306). The British trader Barnes stated: "This is a producing country, and I believe the silver basis is the best" (*Report 1900*, 185). The director of the Banco Español-Filipino, the Spaniard Balbas, remarked about a possible switch to the gold dollar: "Well, it would be disastrous to the country, I think" (*Report 1900*, 155). Of the eight foreign businessmen interviewed by the Commission, seven were in favor of retaining the silver-based system.

An important domestic consideration for most of these experts was that the switch would affect prices. They thought that the silver dollar would be replaced right away by a gold dollar (having twice the value of the silver), and that the indigenous population would continue to ask for full payment in dollars, regardless of the official value, thereby raising prices. An additional argument was that gold dollars would be "too big" for day-to-day transactions, and that gold currency would therefore circulate much more slowly than silver coins. Most of the experts expressed fear that the wages and payments for agricultural products would go up, and that Philippine export products would no longer be competitive in the world market. The businessmen agreed that it would be advisable to replace the Mexican dollar with an American-Filipino silver peso of the same value.

The only expert interviewed by the Commission who was in favor of a gold-based currency system was the Filipino businessman Legarda, who stated: "The opinion of the majority of Filipinos is that we should have a gold basis" (*Report 1900*, 176). Legarda did not expect a doubling of prices because "people would simply pay one-half of what they pay now in dollars."

In 1902, the New York agent of the Hong Kong and Shanghai Bank, the British businessman Townsend, was heard before a committee of the U.S. Senate in Washington, D.C. In a written statement and in the interview, Townsend took a strong stand against the introduction of the U.S. dollar or a gold-based system in the Philippines, and expressed his preference for an American-coined silver dollar as the ba-

sis for the currency in the islands.<sup>7</sup> He considered a gold currency as unsuitable for the islands because it was too expensive, and it could be expected that gold would leave the country. The advantage of a silver dollar, in his opinion, was that it would facilitate commercial links with surrounding countries, especially China, which were on the silver standard. Silver currency can flow back and forth across the boundaries to pay the debts abroad when the balance of payments is against the country, and can come back when the balance is favorable.

### The Introduction of a Gold-based Philippine Peso in 1903

In spite of the predominantly negative view of the foreign business community in Manila, the Americans pushed through with their plan to provide the Philippines with a gold standard currency system (see figure 5). The American economist and banker Charles Conant formulated a plan (Conant 1901) and lobbied the American Congress to accept it. Two fundamental laws laid the basis for the Philippine currency reform. Congress enacted the Philippine Coinage Act in February 1903, and the Philippine Gold Standard Act in October of the same year.

The Philippine Coinage Act entailed the introduction of a gold standard with a theoretical gold peso, consisting of 12.9 grains of gold .900



Figure 5. The American-Philippine silver peso, minted in the United States beginning in 1903, was based on a design by Filipino engraver and artist Melecio Figueroa. The design shows on the reverse the shield and stylized heraldic American eagle, and on the obverse a standing female figure in a Philippine dress.

fine, as the unit of value. This unit was equivalent to one-half of U.S. dollar. For actual circulation, the theoretical gold peso would be represented by a silver peso, containing 416 grains of silver .900 fine, the same silver content as the Mexican dollar (Kemmerer 1916, 314).

The Philippine Gold Standard Act established the administrative machinery for the currency reform. The new currency system was, in fact, a gold exchange standard. The currency was backed not by a supply of gold in the Philippine treasury but by a reserve fund called Gold Standard Fund, which functioned to maintain the gold value of the currency in transactions abroad. Domestically, the government issued paper money, called silver certificates, against which silver pesos of an equal value would be held in reserve. In this gold exchange system, the silver coins were token coins, the value of which was higher than that of their silver content. The Gold Standard Fund was kept in two locations. Part of it was managed by the Insular Treasury in Manila, and the other was deposited in New York banks (Kemmerer 1916, 319).

The Philippine gold exchange system was supposed to function automatically. Individuals in the Philippines who wanted to make payments abroad could purchase from the Insular Treasury in Manila drafts on the Gold Standard Fund in New York for the payment in dollars in that place. The money which they paid to the Treasury would then be withdrawn from Philippine circulation. In the opposite direction, the depository of the Gold Standard Fund in New York could sell exchange on the Gold Standard Fund in Manila for the payment in pesos in that place, which would increase the money in circulation in the country. Over the years, the Gold Standard Fund had grown in size, covering 40 percent of the monetary circulation in the islands by 1908.

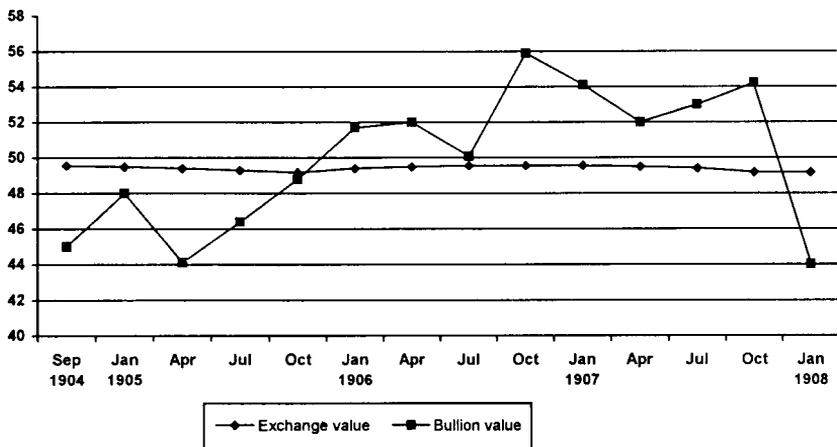
In this policy process of establishing a new currency in the Philippines, monetary theory and practical business interests were closely knit, as shown in the personal history of one of the key figures. Charles Conant was not only the leading advocate of U.S. imperialism and theoretician of the gold standard; he also had a personal interest in the outcome of the currency reforms. From 1902 to 1906, he was treasurer of the Morton Trust Company of New York, a bank owned by the House of Morgan, which had a strong influence on American political circles at the time. The economic historian Rothbard (2002, 232–33) writes:

... it was surely no coincidence that Morton Trust was the bank that held the reserve funds for the governments of the Philippines, Panama, and the Dominican Republic, after their respective currency reforms.

When the new Philippine currency was introduced in July 1903, it initially met unexpected resistance. For many months, Chinese merchants still preferred the Mexican peso and accepted the new Philippine peso, which had a higher fiduciary value than the Mexican dollar but the same bullion content, only as an equivalent to the old. The old money, which was less valuable in terms of gold, had the same purchasing power as the new. The banks used the new coins to purchase drafts on the Gold Standard Fund and, with the foreign balances, purchased Mexican dollars for importation into the islands. In this way, the new currency was returned to the treasury as quickly as it was brought into circulation.

To change this situation, the American government in the Philippines enacted two laws. The first law, passed in October 1903, prohibited the importation into the islands of Mexican dollars or any other foreign currency. The second law, passed in January 1904, announced that from the end of that year, the use of old currency would be heavily taxed. These measures broke the resistance to the new currency. By 1905, the old currency had been practically eliminated from circulation and the islands were firmly established upon the gold exchange standard.

The new currency had hardly begun to circulate when new difficulties arose as a result of the rapid rise in the price of silver from April 1905 to the second half of 1906 (see figure 6). The bullion value of the peso became higher than the money value of the coin. The gold value of the new peso was officially fixed at 50 U.S. dollar cents, but fluctuated in practice to around 49.5 cents. The bullion par of the new Philippine peso was reached when the price of silver in the London market was  $29\frac{1}{4}$  pence per ounce of silver, and the exportation of pesos became profitable when the price for the delivery of silver in sixty days' time (the futures or forward market) would reach  $30\frac{1}{4}$  pence. In 1906, the silver price went even above this level. It became profitable to export the pesos to Hong Kong and to melt them.



Source: Kemmerer 1916, 353-355.

Figure 6. Exchange value and bullion value of the new Philippine peso in U.S. dollar cents, between September 1904 and January 1908.

It was also possible that the new pesos would be exported not as silver bullion but as money. In Hong Kong, Shanghai, Tientsin, Peking, and other Chinese cities, the circulating medium was composed of a great variety of coins; old and new Mexican dollars, old Hong Kong dollars, new British dollars, and new Straits dollars readily passed current at different rates. These dollars all commanded a premium of about 3 to 4 percent in terms of sterling exchange. In Hong Kong, the unit of account was the bank notes of the Hong Kong Bank, redeemable in chopped dollars, that is, dollars stamped with a mark to certify their authenticity. Philippine pesos had the same silver content as these other coins, and could be easily absorbed in circulation along the Chinese coast. The total expense of shipping coins from Manila to Hong Kong would be only about a fourth of 1 percent. As the premium was more than 3 percent, the exporter would still make a profit. At one time, it would be more profitable to export Philippine currency as bullion, at another, as money.<sup>8</sup>

It was estimated that between 0.5 and 1 million pesos were exported, all of them probably going to China. The head office of the Hong Kong Bank at Hong Kong was reported to have held in its

vaults at one time as much as 400,000 pesos (Kemmerer 1916, 355). The government prohibited the exportation of the coin or the bullion obtained from melting them, with an Act adopted in early 1906. However, it was difficult to control the borders, and there was constant danger that the coins would be smuggled out of the country.

The government therefore decided in July 1906 to recoin the money into coins with a smaller fine silver content. As a protection against silver price increases in the future, the government decided to drastically reduce the weight of the new coins to 308.64 grains and their silver content to 246.912 grains. Between late 1906 and 1908, coins of the first issue were withdrawn from circulation, recoinced, and brought back into circulation. The silver coinage of the first issue was 32.7 million, and, eventually, only 30 million coins were withdrawn from circulation and recoinced, leaving 2.7 million unaccounted for (Kemmerer 1916). These coins had probably been smuggled out of the country to be melted into silver. Apparently, the American colonial government was not yet able to fully control cross-border traffic.

## Conclusion

In the late 1930s, the Filipino banker and economist Miguel Cuaderno passed his judgment on the Philippine currency system. At the time, the country had experienced years of economic hardship as a result of the depression, the Americans had transferred part of their sovereignty to the Philippine government of President Quezon, and the expectation was that full independence would be acquired within a few years. The country's political leaders and newspaper writers hotly debated the desirability of a fundamental change in the currency system. Cuaderno, who had acquired a reputation as an economic nationalist and who would put his ideas of monetary independence into practice after the Pacific War, when he became the first governor of the newly established Philippine Central Bank (1949), made the following statement:

Taken by and large, the experience of the Philippines with its present currency system, during a period of over thirty years, has been quite satisfactory; indeed it has stood the test of time better than the systems in many of the principal countries, not excepting the United States. With the principal countries of the world still

grappling with huge problems of currency stabilization, . . . it would seem untimely and illogical to discard a monetary system which has served the country comparatively well. (Cuaderno 1937)

“Comparatively well”: a positive but somewhat reserved judgment. The question thrusts itself upon us: Why has the American colonial administration in the Philippines been able to successfully carry out a currency reform, where the Spaniards had failed in the early 1890s? Various factors could have played a role, but an important difference was that the American government had at its disposal a number of well-informed economists eager to play the role of policy advisers, whereas Spain had not been able to mobilize this level of theoretical and practical knowledge. The most prominent among the American advisers was Charles Conant, who designed the plan for the new currency system. Conant and his colleagues had studied currency reforms in other countries, particularly the monetary experiment in India, which they considered as unsuccessful, and the successful reform in Japan. They conceived of the new type of monetary system, the gold exchange standard, as “a system founded from the outset on scientific principles and sustained by the whole moral power of the Government of the United States” (Conant 1901, 28). Conant’s student, the economist Edwin Kemmerer, who supervised the introduction of the new system in the islands, served for more than thirty years as adviser to the American government, and spread the Philippine monetary model to other countries in the world.

Conant proceeded cautiously in designing the new system. He rejected the idea of introducing the U.S. dollar as legal tender in the islands to humor local sensitivities. He designed the new Philippine peso in such a way that the silver content of this gold-based coin would be similar to that of the old Mexican dollar to make it acceptable to the people. He modeled the larger financial architecture, with the provision of a currency reserve fund to maintain international parity, after similar systems elsewhere. And, in the end, the American administration used its political power, proclaiming the new currency as legal tender and driving out the old coins.

The shift from foreign commodity money into a territorial currency in the Philippines was part of a more general process of colonial state

formation. A territorial currency enables the government to better control the money supply, to intervene in the domestic economy, and to provide for the fiscal needs of the state. The gold exchange standard increased the flexibility of the money supply, as paper money could be substituted for metallic coins. However, the system did have serious drawbacks, as had been manifested in the course of time. Money circulation was closely tied to the balance of payments, and there was little space for the creation of credit to stimulate economic development. These problems were felt strongly in the following decades, and were openly discussed in the late 1930s. Addressing these problems became the chief concern of Philippine economists after the Pacific War. It required the brilliant minds of Miguel Cuaderno and his colleagues, theoretically and practically knowledgeable and internationally well connected, to design a new monetary system. The creation of the financial architecture of the 1949 Philippine Central Bank, with its managed currency system and pragmatic monetary policy, stimulating economic development throughout the 1950s, was an intellectual and political feat comparable to and at least equal to the achievements of the 1903 reformers.

## Notes

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1. These figures were compiled by the Chief of the Division of the Currency, the American economist E. W. Kemmerer, from the daily records of the Manila branch of the Hong Kong and Shanghai Bank (Kemmerer 1905, 23).

2. *Report* 1900, 148, US National Archives, War Department, Bureau of Insular Affairs, Record Group 350, File 808-373:5.

3. US National Archives (24 October 1900), War Department, Bureau of Insular Affairs, Record Group 350, File 808-45:6-7.
4. Memorandum (27 February 1912), US National Archives, War Department, Bureau of Insular Affairs, Record Group 350, File 808-373:16.
5. Memorandum (27 February 1912), US National Archives, War Department, Bureau of Insular Affairs, Record Group 350, File 808-373:14a.
6. Memorandum (27 February 1912), US National Archives, War Department, Bureau of Insular Affairs, Record Group 350, File 808-373:48-49, quoting from the Report made by the Secretary of War, November 1904, House Document No. 2.
7. Statement on the Philippine Currency by A. M. Townsend, submitted to the Subcommittee of the Committee on the Philippines of the US Senate on 13 February 1902, US National Archives, War Department, Bureau of Insular Affairs, Record Group 350, File 808-53.
8. Kemmerer, E. W., Memorandum concerning the effects on the Philippine currency system of a rise in the price of silver above the bullion par of the peso (11 November 1905), US National Archives, War Department, Bureau of Insular Affairs, Record Group 350, File 808-290.

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