

The Philippine Review of Economics

Editor-in-Chief

JOSEPH J. CAPUNO

Editorial Advisory Board

EMMANUEL DE DIOS

RAUL V. FABELLA

HAL CHRISTOPHER HILL

CHARLES Y. HORIOKA

KIAN GUAN LIM

ROBERTO S. MARIANO

JOHN VINCENT C. NYE

GERARDO P. SICAT

JEFFREY G. WILLIAMSON

Associate Editors

LAWRENCE B. DACUYCUY

FRANCISCO G. DAKILA JR.

JONNA P. ESTUDILLO

MARIA S. FLORO

GILBERTO M. LLANTO

Managing Editor

HONLANI RUTH R. RUFO

ARTICLES IN THIS ISSUE

The impacts of secondary education reforms on schooling and income of women and men in the Philippines

Ma. Laarni D. Revilla
Jonna P. Estudillo

Who benefits from Dual Training Systems? Evidence from the Philippines

Takiko Igarashi
Pablo Acosta

The impact of Philippine monetary policy on domestic prices and output: evaluating the country's transmission channels

Sanjeev Parmanand

The BSP's Forecasting and Policy Analysis System

Zeno Ronald R. Abenoja
Jasmin E. Dacio
Sarah Jane A. Castañares
Jan Christopher G. Ocampo
Mark Rex S. Romaraog

Azcárraga's critique of mercantilism: trade as an engine of growth

Emmanuel S. de Dios

BOOK REVIEW

Trauma to triumph: rising from the ashes of the Asian Financial Crisis

Sarah Lynne S. Daway-Ducanes



A joint publication of the
University of the Philippines
School of Economics
and the **Philippine Economic Society**





The Philippine Review of Economics

A joint publication of the UP School of Economics (UPSE)
and the Philippine Economic Society (PES)

EDITOR-IN-CHIEF

Joseph J. Capuno
UP SCHOOL OF ECONOMICS

EDITORIAL ADVISORY BOARD

Emmanuel de Dios
UP SCHOOL OF ECONOMICS

Raul V. Fabella
UP SCHOOL OF ECONOMICS

Hal Christopher Hill
AUSTRALIAN NATIONAL UNIVERSITY

Charles Y. Horioka
KOBE UNIVERSITY

Kian Guan Lim
SINGAPORE MANAGEMENT UNIVERSITY

Roberto S. Mariano
UNIVERSITY OF PENNSYLVANIA

John Vincent C. Nye
GEORGE MASON UNIVERSITY

Gerardo P. Sicat
UP SCHOOL OF ECONOMICS

Jeffrey G. Williamson
HARVARD UNIVERSITY

ASSOCIATE EDITORS

Lawrence B. Dacuycuy
DE LA SALLE UNIVERSITY

Francisco G. Dakila Jr.
BANGKO SENTRAL NG PILIPINAS

Jonna P. Estudillo
UNIVERSITY OF THE PHILIPPINES

Maria S. Floro
AMERICAN UNIVERSITY (WASHINGTON D.C.)

Gilberto M. Llanto
PHILIPPINE INSTITUTE FOR DEVELOPMENT
STUDIES

MANAGING EDITOR

Honlani Ruth R. Rufo
UP SCHOOL OF ECONOMICS

Aims and Scope: The *Philippine Review of Economics* (PRE) invites theoretical and empirical articles on economics and economic development. Papers on the Philippines, Asian and other developing economies are especially welcome. Book reviews will also be considered.

The PRE is published jointly by the UP School of Economics and the Philippine Economic Society. Its contents are indexed in the *Journal of Economic Literature*, EconLit, and RePec. PRE's readership includes economists and other social scientists in academe, business, government, and development research institutions.

Publication Information: The PRE (ISSN 1655-1516) is a peer-reviewed journal published every June and December of each year. A searchable database of published articles and their abstracts is available at the PRE website (<http://pre.econ.upd.edu.ph>).

Subscription Information:

Subscription correspondence may be sent to the following addresses:

- css@pssc.org.ph
- PSSC Central Subscription Service,
PSSCenter, Commonwealth Avenue, 1101, Diliman, Quezon City, Philippines.
P.O. Box 205, UP Post Office, Diliman, Quezon City, Philippines 1101
PHONE: 922-9627, FAX: 924-4178/926-5179

Submissions: Authors may submit their manuscripts to the addresses below:

- pre@econ.upd.edu.ph or pre.upse@upd.edu.ph
- The Editor, The Philippine Review of Economics, Rm 237, School of Economics, University of the Philippines, Diliman, Quezon City, 1101.

Manuscripts must be written in English and in MS Word format. All graphs and tables must be in Excel format. Submission of a manuscript shall be understood by the PRE as indicating that the manuscript is not under consideration for publication in other journals. All submissions must include the title of the paper, author information, an abstract of no more than 150 words, and a list of 3–4 keywords. Complete guidelines can be viewed in the PRE's website.

Copyright: The *Philippine Review of Economics* is protected by Philippine copyright laws. Articles appearing herein may be reproduced for personal use but not for mass circulation. To reprint an article from PRE, permission from the editor must be sought.

Acknowledgements: The PRE gratefully acknowledges the financial support towards its publication provided by the Philippine Center for Economic Development (PCED). The Review nonetheless follows an independent editorial policy. The articles published reflect solely the editorial judgement of the editors and the views of their respective authors.



The Philippine Economic Society

Founded 1961

BOARD OF TRUSTEES 2022

PRESIDENT

Charlotte Justine Diokno-Sicat
PHILIPPINE INSTITUTE FOR DEVELOPMENT
STUDIES

VICE PRESIDENT

Philip Arnold P. Tuaño
ATENEO DE MANILA UNIVERSITY

SECRETARY

Ruben Carlo O. Asuncion
UNION BANK OF THE PHILIPPINES

TREASURER

Kevin C. Chua
WORLD BANK

BOARD MEMBERS

Agham C. Cuevas
UNIVERSITY OF THE PHILIPPINES-LOS BAÑOS

Jovi C. Dacanay
UNIVERSITY OF ASIA AND THE PACIFIC

Sarah Lynne S. Daway-Ducanes
UNIVERSITY OF THE PHILIPPINES-DILIMAN

Alice Joan G. Ferrer
UNIVERSITY OF THE PHILIPPINES-VISAYAS

Emilio S. Neri, Jr.
BANK OF THE PHILIPPINE ISLANDS

Majah-Leah V. Ravago
ATENEO DE MANILA UNIVERSITY

Marites M. Tiongco
DE LA SALLE UNIVERSITY

EX-OFFICIO BOARD MEMBERS

Faith Christian Q. Cacunio
BANGKO SENTRAL NG PILIPINAS
IMMEDIATE PAST PRESIDENT

Joseph J. Capuno
UNIVERSITY OF THE PHILIPPINES-DILIMAN
EDITOR, *PHILIPPINE REVIEW OF ECONOMICS*

The Philippine Economic Society (PES) was established in August 1962 as a nonstock, nonprofit professional organization of economists.

Over the years, the PES has served as one of the strongest networks of economists in the academe, government, and business sector.

Recognized in the international community of professional economic associations and a founding member of the Federation of ASEAN Economic Associations (FAEA), the PES continuously provides a venue for open and free discussions of a wide range of policy issues through its conferences and symposia.

Through its journal, the *Philippine Review of Economics* (PRE), which is jointly published with the UP School of Economics, the Society performs a major role in improving the standard of economic research in the country and in disseminating new research findings.

At present the society enjoys the membership of some 800 economists and professionals from the academe, government, and private sector.

- Lifetime Membership – Any regular member who pays the lifetime membership dues shall be granted lifetime membership and shall have the rights, privileges, and responsibilities of a regular member, except for the payment of the annual dues.
- Regular Membership – Limited to individuals 21 years of age or older who have obtained at least a bachelor's degree in economics, or who, in the opinion of the Board of Directors, have shown sufficient familiarity and understanding of the science of economics to warrant admission to the Society. Candidates who have been accepted shall become members of the Society only upon payment of annual dues for the current year.
- Junior Membership – This is reserved for full-time college or graduate students majoring in economics. Affiliation for junior membership is coursed through the Junior Philippine Economic Society (JPES).

For more information, visit: www.phileconsociety.org.

The Philippine Review of Economics

Vol. LVIX No. 1
June 2022

ISSN 1655-1516
DOI: 10.37907/ERP2202J

- 1 The impacts of secondary education reforms on schooling
and income of women and men in the Philippines
Ma. Laarni D. Revilla
Jonna P. Estudillo
- 26 Who benefits from Dual Training Systems?
Evidence from the Philippines
Takiko Igarashi
Pablo Acosta
- 46 The impact of Philippine monetary policy on domestic prices
and output: evaluating the country's transmission channels
Sanjeev Parmanand
- 77 The BSP's Forecasting and Policy Analysis System
Zeno Ronald R. Abenoja
Jasmin E. Dacio
Sarah Jane A. Castañares
Jan Christopher G. Ocampo
Mark Rex S. Romaraog
- 108 Azcárraga's critique of mercantilism: trade as an engine
of growth
Emmanuel S. de Dios
- 156 Book Review
Sarah Lynne S. Daway-Ducanes

Azcárraga's critique of mercantilism: trade as an engine of growth

Emmanuel S. de Dios*

University of the Philippines

Manuel Azcárraga y Palmero's *La libertad de comercio en las islas Filipinas* (1872) was an unequivocal and consistent tract advocating free trade as a commercial policy for the Philippines. It is remarkable for its explicit and frequent reference to free-trade theory and the example of other nations (notably Britain and its colonies) as a guide to policy. It uses a historical approach in its critique of Spanish mercantilist ideas and biases, which are held responsible for centuries of foregone development opportunities for the Philippines. This article traces Azcárraga's arguments and links them to Smith's [1776] theory of international trade and its later elaborations (Myint [1958, 1977] and Schumacher [2015, 2016]). The protectionist mindset and policies Azcárraga believed to have held back Philippine progress one hundred fifty years ago are a striking portent of issues hounding the country's development in the 20th century and even later.

JEL classification: B12, B17, B31, F13, N75

Keywords: mercantilism, free trade, Spanish liberalism, galleon trade, carrying trade, Adam Smith's trade theory, Spanish commercial policy in the Philippines

1. Introduction

For both researchers and the general readership, much of the interest in Philippine commercial policy under Spain is attached to the galleon trade or the "Nao de Acapulco", the trans-Pacific trade between the Philippines and Mexico dominated by Chinese goods exchanging for Mexican silver.¹ Such attention is unsurprising given the system's longevity (roughly from 1565 to 1815), the obvious achievement of a maritime feat that first linked Asia and America, and the fact that it was a major issue in the Propagandists' later indictment of Spanish policy in the Philippines. With regard to the latter, Rizal's article "The indolence

* Address all correspondence to esdedios@econ.upd.edu.ph.

¹ See for example the recent work by Giraldez [2015]. The route of the galleons is briefly described in Fish [2011: 350-359] and in greater detail in Schurz [1985 (1939):178-203]. An interesting paper by Arteaga, Desierto, and Koyama [2020] relates the chosen traditional route of the galleon to deliberate attempts to delay departure from Manila to accommodate overloading.

of the Filipino” notably puts up the galleon trade as a prime example of Spain’s wrong-headed policies for the archipelago and effectively attributes to it what would now be known as a “booming sector” or Dutch Disease that drew attention and resources away from the country’s internal development:

The trade with China, which was the whole occupation of the colonizers of the Philippines, was not only prejudicial to Spain but also to the life of her colonies; in fact, when the officials and private persons at Manila found an easy method of getting rich they neglected everything. They paid no attention either to cultivating the soil or to fostering industry; and wherefore? China furnished the trade, and they had only to take advantage of it and pick up the gold that dropped out on its way from Mexico toward the interior of China, the gulf whence it never returned. [Rizal 2004 (1890):62]

But while a summary judgement and caricature of Spanish policy may be understandable given the purposes of the Propaganda, later historians and students of economic policy can afford to take a more nuanced view of the changes in commercial legislation and practice throughout the long period of Spanish occupation. It was the distinct service of the late Benito Legarda, Jr. to establish work in this tradition. His major opus, *After the galleons: foreign trade, economic change and entrepreneurship in the nineteenth century Philippines* [1999], a thorough reworking of his 1955 Harvard dissertation,² was a detailed examination of the large-scale economic and commercial developments in the Philippines under Spain. Legarda’s work documents the changes in Spain’s economic policy towards the Philippines particularly after the loss of the former’s American colonies, the entrepreneurial and commercial response to these late reforms, and the resulting changes in Philippine trade patterns and economic structure, along with their social implications.

An indispensable source for Philippine commercial history on which Legarda frequently drew was Manuel Azcárraga y Palmero’s treatise, *La libertad de comercio en las islas Filipinas*, published in Madrid in 1872 and denoted *Libertad* or *LC* henceforth.³ Apart from its value as a historical account, this work is significant as a critique of past Spanish mercantilist policy from a liberal viewpoint and as an explicit advocacy of free trade as an alternative economic policy for the Philippines. It therefore reflects and informs the contemporary liberal thinking that led to the late Spanish economic reforms and their consequences, as documented by Legarda. To the extent members of Propaganda

² A major influence in this later rewriting was Professor Jeffrey Williamson of Harvard, whose account appears in Williamson [2020].

³ One cannot miss the mock-provocation on the book’s title page, where the words “La libertad” and “en las Islas Filipinas” are printed in a larger majuscule font than “de comercio”, giving the impression that the treatise deals with the more sensitive issue of political or civil liberty in the archipelago, rather than just commercial policy.

(e.g. notably Gregorio Sancianco and Rizal himself) ventured into economic issues, they appear to have drawn inspiration from the liberal perspective and proposals contained in Azcárraga's work. That this valuable tract has not received more attention may be largely due to its non-availability in translation and its non-inclusion in the famous Blair and Robertson [1903] compendium of primary sources for Philippine history.⁴ The present article remedies that neglect in part by examining the economic thought implicit in Azcárraga's critique and his proposed remedies to address Philippine underdevelopment. At the outset, however, it should be clear this is not an essay in economic history—for which the reader is referred to Legarda [1999] as the preeminent reference—but in the history of thought and ideas.

2. Azcárraga himself

Manuel Azcárraga y Palmero was one of two brothers born in Manila, both of whom made prominent careers for themselves in mainstream Spanish society and politics, a rare achievement for *insulares* or “Filipinos” in the pre-revolutionary sense. Both were children of a Spanish general from the Basque region who had settled in the Philippines and a Spanish mestiza from Albay. The younger brother, Marcelo (1832-1913), pursued a distinguished military career, successfully navigating the turbulent politics of late 19th century Spain and rising to become general, senator for life, and minister of war in the cabinet of Antonio Canovas. Upon the assassination of Canovas in 1897, Marcelo succeeded him as Spanish prime minister, serving a few more terms in an interim capacity (1900-1901, 1904-1905) in various governments—the only *insular* to achieve such a distinction.⁵

Meanwhile the elder brother Manuel, the author of *Libertad*, pursued a successful legal and parliamentary career, at first in the Philippines and ultimately in Spain. Born on July 3, 1832 and spending his formative years in the Philippines, he began his studies at the University of Santo Tomas but received his law degree from the University of Madrid (1853). Returning to the Philippines, he occupied several positions in the judiciary, including an appointment as prosecutor of the Audiencia and of the Court of the Navy. He had begun to work on parts of *Libertad* since 1860 but completed the draft only in 1869, publishing the entire work in 1872, after a return to Madrid.⁶ In 1871 he was appointed to higher judicial and administrative positions in the Philippines, notably: *alcalde mayor* of Cagayan and Bulacan; *gobernador civil* and *corregidor* in Manila; and member of the Council of the Philippines (*Consejo de Filipinas*).

⁴ The work however is among those suggested by Blair and Robertson [1903: 358] for further reading.

⁵ Until 1961, what is now CM Recto Avenue in the city of Manila was known as Paseo de Azcárraga to memorialise Marcelo. Toribio [n.d.] in the The (Spanish) Royal Academy of History's *Diccionario Biografico* provides a brief biography.

⁶ Published in the previous year was Azcárraga's other major work, *La reforma del municipio indígena en Filipinas*.

In 1876, having returned to Spain to seek political office, he gained a seat in the Cortes as part of a party-list submitted by the Conservative Party, representing Lerida district (in Solsona, Catalonia). During this term he was a vocal proponent of free trade policies, particularly advocating the abolition (*desestanco*) of the tobacco monopoly in the Philippines, a measure finally adopted in 1881. He continued to represent the same district in parliament, winning in the elections of 1881, 1884, 1886, and 1890 (as senator). Shifting party affiliations however would later compel him to moderate his free trade advocacies, particularly after 1881, when he pragmatically joined the protectionist bloc of Catalan deputies led by Victor Balaguer. Azcárraga was appointed senator for life in 1895 and in that capacity was several times member of the high state council. Manuel's official biography notes "the powerful influence of his brother Marcelo" in the advancement of his career.

Notwithstanding his pro-government loyalties as a Spanish legislator however—and particularly despite his affiliation with the Conservative party—Azcárraga maintained cordial social, if not necessarily political, ties with the expatriate Filipino community at least in the beginning. This is exemplified by his presence at the 1884 banquet celebrating Luna's and Hidalgo's triumphs at the National Exposition of Fine Arts, during which Rizal delivered his famous toast.⁷ Azcárraga also contributed financially to *España en Filipinas*, the newspaper published (1886-1887) by Filipino expatriates and co-edited by his nephew Pedro Govantes y Azcárraga. Any reader of *Libertad*, however, will realise that Azcárraga took a far more optimistic view of the Philippines' future under continued Spanish rule. This was especially so in light of the liberal economic reforms that he thought were finally gaining traction among policy circles and were likely to become the dominant trend. The continuous if gradual pace of reforms, he believed, boded well for the Philippines as a colonial possession, and for Spain itself as master of a prospering colony. Such an assimilationist viewpoint however was bound to conflict with the more nationalist and increasingly separatist mindset held by the younger generation of the Propaganda and would lead to inevitable division. Owing to the split that occurred among the Filipinos in Spain in 1887—partly along racial lines, with creoles on one side and indios and Chinese mestizos on the other—Azcárraga withdrew his support for *España y Filipinas* (see Schumacher [1973: 69-71] for details). He did not live long enough to witness the outbreak of the Philippine Revolution, although there can be no doubt he would have opposed it. Manuel Azcárraga died in Madrid on May 5, 1896.

⁷ As reported in the newspaper *La Imparcial*, June 26, 1884. While Rizal and Lopez-Jaena's speeches contained thinly veiled criticisms of current local conditions in the Philippines, Azcárraga's own remarks as a counterpoint stressed Spain's positive past achievements in the archipelago, such as the abolition of slavery among the natives as a result of Spanish occupation.

3. Liberalism and free trade ideas

Azcárraga's strongly liberal economic views cannot have come from other than his law studies at the Universidad Central de Madrid. A free-trade tradition had already firmly established itself in the university since the late 18th century,⁸ with the faculty of law being the first to include a course in economics and statistics in its curriculum. A summary account [Rodríguez Martín 1989: 90] of the state of university economics in Spain puts it as follows: between 1779 and 1806 "the hegemony of Smith was practically absolute in academic circles"; between 1807 and 1834, JB Say became the dominant figure "although [Smith] partially maintained his previous influence"; while from 1835 to 1857, the various currents of European economic thought became known and available. Much of Spanish economic thinking was filtered through French economists and French translations of English work. Notwithstanding other influences, however, the continuing predominance of Smith at least in the theory of trade can be inferred, given the continued reliance of French writers on Smithian trade concepts and their somewhat slow acceptance of Ricardo and JS Mill's ideas of comparative advantage [Bloomfield 1989].

Given the long prior history of liberal influence in academia, therefore, it is not surprising that Adam Smith [LC 211, 235] and Frederic Bastiat [LC 232] are the two major economists Azcárraga refers to by name. Among contemporary Spanish economic writers, he mentions [LC 174] Gabriel Rodríguez, Segismundo Moret,⁹ Laureano Figuerola, and Luis María Pastor, all of whom were members of the free trade advocacy group *Sociedad Libre de Economía Política*. Moret and Figuerola became professors at the University of Madrid, though somewhat after Azcárraga had graduated.

Aside from his academic milieu, Azcárraga's liberal views on trade cannot fail to have been influenced by the changed world conditions of his time. Europe after the Napoleonic wars and until the 1870s witnessed a gradual but universal trend towards trade liberalization, reinforced by falling transport costs brought about especially by transport technologies from the Industrial Revolution [Findlay and O'Rourke 2007:378-382; 395-396]. Britain led the way in the 1820s, but was soon emulated by almost all European countries including Spain. Such trends did not escape Azcárraga's attention and bolstered his optimism that free trade indeed represented the trend of the future. He was well aware of the "liberal movement" in Europe, citing England's repeal of the Corn Laws (1846) [LC 203], as well as the

⁸ The *Wealth of nations* was first translated into Spanish in 1794, and prominent writers and statesmen such as Gaspar Melchor de Jovellanos (1744-1811) were strong adherents of Smith and advocates of free trade, whose ideas influenced intellectual opinion, if not necessarily state policy.

⁹ Moret, in particular, who later served as minister for the colonies under Sagasta, was sympathetic to Filipino reformers before and even after the outbreak of the Revolution. An admirer of the *Noli*, he sought out Rizal personally in Paris in 1889 and intervened as late as 1898 to have Antonio Luna freed from prison [Schumacher 1973:187, fn. 56].

United States,¹⁰ with the most advanced nations “recognizing their [protectionist] errors” and moving towards freer trade [LC 215]. Alluding to characteristic elements of the Industrial Revolution (a term which of course did not then exist), he calls trade taxes “incompatible with steam and electricity” and “an anachronism in the present century” [LC 215] and looked forward to the completion of the Suez Canal as offering a more promising future of trade between the Philippines and Europe [LC 15].

Because *Libertad* is less a theoretical treatise and more a critical history of commercial policy, we are left to infer many of Azcárraga’s economic ideas only from the substance and counterfactuals of his policy critique and some obiter dicta. In relation to the theory of trade and the gains from trade, however, his admiration for and reliance on Smith’s general ideas¹¹ is explicit:

The balance-of-trade system¹² is obsolete; the solid doctrines of Adam Smith have spread to all nations, and *no one today believes that the prosperity of one country is obtained at the cost of another’s misery or loss: science has shown that a people’s progress and expanded production, far from harming others, contribute under a free-trade regime to the greater welfare of all others;* which is why Europe is interested in all parts of the globe thriving, increasing, and producing more cheaply, since in that way they might more easily satisfy their needs and produce more of their product. [LC 210] (Emphasis supplied.)

In the foregoing, apart from obviously dispelling the mercantilist notion of trade as a zero-sum game, it is notable how Azcárraga views the global benefits from trade as arising not from greater static efficiency but from dynamic gains associated with growth and development (i.e., “expanded production”; “produce more of their product”). His panegyric on the benefits of foreign trade—which, as will be discussed further below, went beyond even the views held by Smith—was a foundation of the argument for *laissez faire*:

Trade is the life of modern peoples and is the most powerful agent to spread civilization. This industry, which has the privilege of doing business by serving the interests of both producer and consumer, represents nothing less than the satisfaction of all aspirations, for which reason it is essential that the action of private interest [*interes particular*] should be left entirely free

¹⁰ In the US, Azcarraga [LC 202], saw as a hopeful sign the growing influence of the Democratic Party, which favored free trade and was associated with agricultural interests in the Southern (formerly slave-owning) states. In fact, however, the US would not conform to the European trend: the North’s victory in the civil war and the Republican control of congress meant the dominance of Northern manufacturing interests, which “set the stage for consistently high tariffs” until 1914 [Findlay and O’Rourke 2007:399].

¹¹ Legarda [2011:16] was among the first to call attention to this quote in his article for PRE’s issue commemorating Rizal’s birth bicentenary.

¹² Smith also refers to mercantilism as the “doctrine of the balance of trade” [WN IV.iii.c.2]. References to the *Wealth of Nations* follow the Glasgow edition [1976] citing the relevant book, chapter, and paragraph. The preceding thus refers to Book IV, Chapter iii.c., paragraph 2.

and untrammelled; that all the administration's attention and effort should be aimed at providing the greatest facilitation of trade; that not even the slightest obstacle should hinder its unifying movement; and that nothing should stand in the way of its march of expansion, for *it is humanity's march to progress*. [LC 200] (Emphasis supplied.)

4. The question posed

Azcárraga's treatise begins with a brief account [LC 12-21] of the Philippines' geographic and other natural advantages: the fecundity of its soil as seen in the various products it produces and currently exports; the existence of numerous natural harbors; its proximity to traditional markets such as China, India, and Japan, and to new markets, including then-French Indochina and the more distant British colonies in Australia; as well as its uninterrupted commercial relations with the US, England, and Spain, only certain to be enhanced with the recent inauguration of the Suez Canal. He notes with approval the rise since 1840 in exports of commercial crops such as tobacco, sugar, abaca, and (to a lesser extent) rice, the trade in which was liberalized in 1856, as well as the increase in internal trade.¹³

This favorable account of recent developments, however, is only a stepping stone to point to the country's commercial potential that was still far from being fully realized:

Notwithstanding the satisfactory picture we just painted, a mistaken and excessive love for all things ours should not blind us to the fact that the Philippine islands have not prospered as much as was to be expected from the very advantageous conditions with which Providence has favored them; their wealth has been paralysed for almost three centuries; and above all their trade has not taken off as it should, instead remaining enclosed in a small circle from which it is only now emerging. [LC 25]

Eerily reminiscent of how development economists of the 1990s would compare a laggard Philippines with the so-called "tiger economies", Azcárraga poses a similar development puzzle. He asks: considering its locational, climatic, and other natural similarities with (and indeed, advantages over) other colonies in the region, why is the Philippines less developed and less prosperous than the latter? Azcárraga notes, for example, the distinct absence in the country of large commercial plantations of sugar, coffee, cocoa, cinnamon, pepper, and tea, which are typical in British colonies such as Sri Lanka and Penang [LC 26, 30]. He senses this is a problem associated with the small number of private Spanish citizens (apart from friar corporations) who take a serious interest in plantation

¹³ In doing so he disputes the statistics provided by Sinibaldo de Mas, which tended to show a much smaller value of foreign trade.

agriculture. Land instead is in the hands of natives, highly subdivided, and without formally defined property rights, although he notes the increasing role of mestizo Chinese [LC 27-28]. With regard to trade, he marvels at the preeminent position and prosperity of global commercial centers (also British) such as Singapore and Hong Kong [LC 32, 33], with their volume of trade dwarfing that of Manila notwithstanding their more recent establishment and despite Manila's proximity to and long history of relations with China and other Asian countries.

In a precis of his subsequent argument, Azcárraga briefly enumerates—partly refuting and partly affirming—a number of hypotheses purporting to explain the superior performance of other (mainly British) colonies, on the one hand, and the Philippines' long-standing “paralysis” of riches and deficit in commercial activity, on the other. None of this, he argues, can be explained by any lack of enterprising or colonising spirit among the Spanish vis-à-vis the “Anglo-Saxon race”;¹⁴ or by the greater capital that London as a financial center might mobilize for overseas investment; or by the supposed pressure to find new markets for more productive British factories. Many of these supposed British advantages, after all, emerged only long after Spain had taken possession of the Philippines (i.e., in the late 18th and the 19th century).

Instead the primordial explanation for the archipelago's long-term underdevelopment, he argues, was Peninsular Spain's neglect of the islands, which for centuries were relegated to being an appendage of Mexico—“the colony of a colony”, as Chaunu [1960: 20] writes—and therefore dependent on the latter for personnel, military provisioning, and finance.

[N]o matter how great and active Spain would have been, *given America's proximity and the superior climate of its immense and fertile lands, the Spanish nation could not muster the fibre to attend to the remote provinces of Asia*; we see even today immigration from the Cantabrian coast to Buenos Aires and other places where conditions are more familiar to the European farmer, and *where no less wide a field is presented to enterprising spirits.* [LC 37] (Emphasis supplied.)

This initial explanation is not as facile as it seems. It anticipates the now-famous hypothesis of Acemoglu, Johnson, and Robinson [2001] that settler density may have played a vital role in creating a demand for inclusive institutions that ultimately favored development. (Azcárraga of course does not draw the latter implication.) An application of that hypothesis to the Philippines [Cruz 2013] suggests that the country's sheer distance from Peninsular Spain, the less familiar and less hospitable climate, and the paucity of especially mineral wealth—all in relation to the Americas, as Azcárraga maintains—may have served as a powerful

¹⁴ Azcárraga rejects this explanation, citing as counter-example the adventurous spirit of Spanish explorers and conquistadors, as well as the large migration flows of Spaniards to the Americas (particularly Basques to Buenos Aires).

disincentive to large-scale colonial settlement, leading to the negative institutional consequences Acemoglu, Johnson, and Robinson hypothesized. Spain's American possessions themselves were, of course, already a negative example supporting the settler density hypothesis, but the circumstances applied to the Philippines to a far greater degree.

Azcárraga's real point, however, is not to cite natural conditions and historical events as immutable fortune but rather to seek to ameliorate these through enlightened legislation, i.e., institutional changes.

These insuperable facts, which legislation cannot ignore, *needed to be modified by our economic legislation through provisions that would open the bosom of those islands to investors of all nations.*

But not only was this not done; on the contrary, *the concern for a need for Spanish trade has marked our legislation with such a stamp of exclusiveness that it has completely removed all foreign investors from that country*, and what is even more uncommon, even within the limits of national trade, such obstacles and so many limitations have existed for a long time that directly and powerfully impeded its development. [LC 37-38] (Emphasis supplied.)

Spain's failure to recognize initial conditions and its preferred policy of monopolizing trade for itself is what Azcárraga believed to be the "real reason" (*la verdadera causa*) [LC 39] for the lack of progress and relative commercial desolation of the Philippines. His essential assertion is that if Spain had instead adopted a regime of free trade and liberal, non-exclusive rules on foreign investment, then even the limits imposed by geography and history might have been overcome. This argument included the possibility that—failing sufficient Spanish or Mexican interest in the Philippines—other nations could have taken up the slack. Azcárraga's free trade advocacy is unique in that he proposed liberalizing not only Spain's trade policy in the Philippines but its investment and possibly immigration policy as well.

Despite significant progress in liberal thought and policy promoted by a more receptive Spanish government in his own time, however, Azcárraga thought the free-trade and mercantilist systems were "still in conflict" [LC 7] in his day, and that further liberalisation and economic progress were still possible for the Philippines. The rest of his work is an attempt to demonstrate this by tracing the thread of mercantilist ideas and policies in various forms that had time and again prevented Philippine trade from rising to its full potential and hindered the country's development.

5. Four epochs

Azcárraga divides Philippine commercial history into four “epochs” or periods, namely: (i) from Legazpi’s arrival to about 1593, a period of more or less unrestrained exchange between the Philippines and Spanish America; (ii) the longest period, beginning with the landmark royal decree of 1593 that laid down rules for the Manila-Acapulco trade and spanning the whole period to about 1750 when more or less similar restrictions remained in place; (iii) the period from about 1750 to when the galleon trade existed alongside direct trade between the Philippines and Peninsular Spain, initially carried through naval frigates and subsequently through ships of the Real Compañía de Filipinas or the Royal Philippine Company; and (iv) the final period, a distinctly liberal phase from about 1834, with the demise of the Royal Philippine Company and the opening of Manila and other ports to international shipping down to the time of Azcárraga’s writing.

Azcárraga praises the achievements of that first period, characterizing it as an almost ideal commercial situation approximating free trade between America and Asia with Manila serving as the intermediary, “opening a new outlet on the Asian continent for those manufactures whose trade with Europe through Mediterranean ports gave so much profit and fame to Genoa, Venice, and Barcelona at other times” [LC 41-42]. His account is short on data but focuses on the fact that Manila was in principle free to export goods to the Americas from various Asian sources without restrictions on value, kind, and quantity. To this he ascribes the anecdotal conspicuous wealth and cosmopolitan character quickly achieved by Manila in those early decades, citing as evidence the establishment of pious foundations through citizens’ donations, a university (Colegio de San Ignacio) whose inauguration was attended by Spanish “students wearing caps covered with pearls and fine gemstones”,¹⁵ the great variety of Asian goods available on the local market signifying purchasing power, the ability of provinces to pay their tribute in gold, and the colony’s ability to harness enough resources to conduct expeditions against the Moro tribes of Mindanao and defend itself against challenges from the Dutch and Chinese pirates [LC 42].

That the burgeoning wealth of Manila in the first decades attracted a growing Chinese and Japanese population that had taken over the retail trade was also something Azcárraga viewed with equanimity and indeed as a sign of easy and early success [LC 45]. He notes how various embassies and delegations from various Asian countries (China, Japan, Cambodia, and Siam) were sent to Manila to establish relations with the Spanish colony essentially treating the governor in Manila “as if he were the sovereign of an independent state” [LC 43].

¹⁵ De la Costa [1956:138] cites a similar anecdote from Murillo Velarde about the attire of Spanish students of the Colegio de San Jose but this was in relation to the feast of the Immaculate Conception in 1619.

One sees, therefore, that at the beginning of the 17th century, even without great efforts on our part, and *with no other attraction than trade—the true bond that must unite all peoples*—we managed to establish very good relations with all those nations of Asia which today require costly wars and expeditions on the part of some great powers to be persuaded to open their bosoms and accept the commerce that they then requested from us—nor is one even able to say whether the question has now been settled, or whether solid relations and peaceful dealings have been established with those peoples. And one also sees how the hospitality and franchises of the early days of our colony led to the quick setting-up of a great commercial establishment, as rich and as active as the best that we see being born and developed today in those seas—an establishment that, if it continued as it had begun, would today be the most powerful capital of the East Indies. [LC 45-46] (Emphasis supplied.)

He underscores the laissez-faire policy effectively underlying this success and the absence of any need to grant specific privileges to private interests to achieve it:

One surely cannot fail to view with pride and enthusiasm the high degree of prosperity reached by that capital of our nascent colony in so few years, simply by having its port open to all Asian nations and by knowing how to take advantage of its natural position in the globe, *without help from individual protections and privileges that always cause harm to the general public* [generalidad]. [LC 42]

(Azcárraga, of course, fails to mention that the galleon trade's largest subsidy and privilege throughout its existence was from the cost of galleon construction being borne by the crown.¹⁶) In any event, whether Azcárraga's assessment of Manila's early 17th century position and potential was naively optimistic should be a matter to be left to historians. Legarda [1999:34-37], for one, takes a less rose-colored view of these possibilities, noting that the early Spanish settlers were preeminently still concerned with their own security and fear of being attacked, e.g., by the Portuguese, the Chinese empire, or Chinese pirates. Even the quickly-expanded Chinese population of Manila—different from Azcárraga's benign view—was regarded by the authorities as a threat. Legarda also dampens enthusiasm over the prospects that the Manila Spanish might have traded directly with the Chinese mainland—an opportunity Azcárraga thought existed and should have been seized—given the prohibitions imposed on foreigners in the major Chinese ports and the opposition from the Portuguese who wanted to protect their

¹⁶ Schurz [1985(1939): 164-166] details the large sums needed to maintain the galleons and the burden this represented on the royal treasury. The decree of 1593 formally declared these to be “supported at royal expense”. Subsequent attempts by various Mexican viceroys to offload the costs to the Manila community as private individuals were resisted and failed.

privileged position in Macao.¹⁷ This left only the *sampan*¹⁸ trade from Fujian as the only possibility, with 30-50 sampans annually arriving in Manila bringing miscellaneous Chinese goods for re-export to the Spanish Americas.

What is not in doubt is that even the “sampan trade” alone made possible a rapid expansion of the value of trade between Manila and the Americas, with galleons being dispatched (in the early decades, at times more than two annually) not only to Acapulco but also to Peru and the Isthmus of Panama (i.e., Tierra Firme). A check on Chauu’s figures [1960: 136; Table 1 Column I] indeed shows a rapid expansion in the value of trade to a record level from 1586 to 1620 that would be surpassed only in 1776.¹⁹

6. Critique of restrictions on the galleon trade

Azcárraga uses the first epoch mainly as a counterfactual or a natural experiment to illustrate what might have been if the restrictive system imposed in the second period had not materialized. The shift towards protectionism began in the well-known January 11, 1593 decree of Philip II that would lay down the basic rules for the Asia-Americas trade with effective implementation beginning from 1605.²⁰ The most significant restrictions were that the Philippines should trade only with Mexico; that only citizens of Manila could engage in the trade but that no Philippine residents (or indeed any Spanish subjects) could directly sail to China for the purposes of trade; and most importantly that the Manila-Acapulco trade should be limited annually to two outgoing ships from Manila with a cargo limit of 300 tons each and a combined value not exceeding 250,000 pesos and with a returning value of 500,000 pesos (i.e., a rate of return of 100 percent). These rules were modified in 1724 without a change in principle to allow a single outbound ship annually with bigger capacity of 1,200 tons; a higher limit of 300,000 pesos in cargo; and the same maximum of 100 percent rate of return in silver on the return trip. The restriction of the annual voyage to one ship annually did not itself seem to represent a particular constraint—it was proposed by the Manila business community itself [LC 55-56]—and seemed to be associated with the high fixed costs of constructing and outfitting two ships [Giraldez 2015: 150-151], suggesting scale economies.

¹⁷ In the trade coming through Macao in the 16th century, the Portuguese used Japanese silver to procure Chinese silk and other goods to serve the Japanese as well as European markets, reaching the latter via the westward route of Malacca, Goa, and Lisbon.

¹⁸ Azcárraga and Legarda, respectively, use the terms *champan* or *sampan* to denote the Chinese vessels calling on Manila. Sampans however refer to smaller boats driven by oars. As one referee has pointed out, a better term for the Chinese ocean-going vessels would be *junk*. I retain the former term against better advice for correspondence with the translations.

¹⁹ Trade restrictions would not take effect until 1605 (see below), and even after that, these would be enforced only unevenly; 1635 appears to be a watermark when Quiroga was sent to finally enforce those restrictions strictly.

²⁰ Legarda [1999: 37] notes that the restrictive trend began earlier, with legislation prohibiting direct trade between the Philippines and Peru (1582) and a series of laws passed from 1591 to 1604 limiting trade between China and the Americas only to Mexico. Later legislation also prohibited trade between Mexico and Peru to prevent transshipments of Asian goods from the former.

Rather, the binding constraints seemed to be the limits on value and volume. As Azcárraga notes wryly however:

Fortunately, this tyrannical stipulation floundered on the powerful obstacle of the private interests that it would have so badly harmed, among which were those of the same authorities and officials mandated with its compliance and observance; this prevented the royal decree from being considered at that time, and thus the commerce with Acapulco in reality continued without a limit on volume until the year 1604. [LC 49]

It was clear to Azcárraga—and well-accepted in histories of this period—that the shift to restricting the Nao de Acapulco was the result of lobbying efforts of Andalusian (and to a lesser extent also Mexican) silk cloth producers,²¹ who wished to protect their markets in the Americas and Europe against imports of Chinese silk arriving via the galleon trade that were frequently of superior quality. This led to ever-tighter restrictions: first on destination, i.e., preventing sales to Peru; second, on those limiting its volume, the equivalent of a modern-day quota or voluntary export-restraint; and, third, for a brief period (1720-1723), even an explicit prohibition on the carrying of Chinese silk itself.²²

Azcárraga devotes a great deal of ink to demonstrating the lack of basis—in either fact or reason—of Cadiz and Seville's remonstrations regarding the alleged harm brought to them by the galleon trade (especially *LC* Chapter VII), and on the other hand the deleterious effects of that trade restriction on the well-being of the Philippines as a Spanish colony. His detailed account of the exchange of petitions and counter-petitions between the Manila and Cadiz lobbies is a valuable summary record. As a factual observation, he notes that even when the strictest measures were placed on the galleon trade (e.g., as when the very export of Chinese silk from Manila was completely prohibited in 1720), Cadiz could not fill the bottoms of America-bound vessels with Spanish-made textiles and had to load these with foreign-made textiles, since Spanish textiles had become demonstrably uncompetitive and moribund even in their home market:

[E]ven absent the prohibition, it would have been very hard indeed for our American colonies to buy Spanish manufactures which nobody wanted in Spain itself, since not even these existed in sufficient quantities to sustain a trade whose protection was used as a pretext to occlude or extinguish that coming from Manila. [LC 87]

²¹ The secret of silk-production had filtered from China through Byzantium to Europe as early as the 6th century, and led to a well-entrenched home-grown silk-making industry in Spain and Italy, and subsequently, Mexico [Bernstein 2008: 200].

²² A description is found in Legarda [1999:32-50].

This implied, of course, that what was really involved was not even a protection of Spanish industrial production but a mere redistribution of trading profits as between Manila (which re-exported Chinese silks) and Cadiz (which was effectively re-exporting English and French textiles). He uses this fact to argue that the decline in Spanish manufacture was not due to competition from the Manila galleon but to causes internal to industry.

In a telling chronological point, he notes that the decline of the Andalusian textile industry began well before the galleon trade was even established, and he supports the opinion of other writers who point to the real reasons for that decline, namely: a labor drain to the Americas with the resulting inflow of precious metals causing a further internal diversion of talent, an extreme case of what could later be called booming sector or “Dutch Disease”.

This spirit of adventure gave rise to a continuous migration to the newly discovered lands, an idea of which is provided by those provisional kingdoms in South and North Americas and those selfsame expeditions to Oceania. That emigration caused the depopulation of the Peninsula’s fields, leading to a lack of hands for the aforementioned (i.e., textile) factories but also for agriculture, where our true wealth lies.

The torrent of precious metals that poured into Spain from the mines of Mexico and Peru created a delusion among Spaniards; it created habits of laxity and sloth; it took them away from the mechanical arts, previously called servile; everyone wanted to gird their sword and enjoy the spoils of conquest. Meanwhile the habits of other nations were changing, as were their tastes in fashion and in fabrics; their merchants and manufacturers knew how to follow and get on the right side of these changes, which Spain in the midst of its apparent greatness hardly noticed; and when industrialists and our own rulers came to their senses, they found that manufactures from France, England, and the Netherlands had invaded our markets; they had seized our consumer centers in the Peninsula and through smuggling did the same even in the newly-conquered countries.

These were the true causes of the decline and disappearance of our looms and manufactures; these were also the causes of the decline of the nation itself, which lacked hands not only for the arts and agriculture, but also for the other services needed to establish a powerful state. *This was the sad picture presented by our country at the end of the 16th century at the time of the discovery of the Philippines:* hence the idea was neither new nor unfounded when the immortal Cervantes created the inspired type of hero who had a mind full of fancy but an emaciated body;²³ he wanted to represent his impoverished and poorly governed homeland without agriculture,

²³ *Don Quijote* was first published in 1605.

without arts, and without commerce, consuming all its energies in foolhardy enterprises that were momentarily brilliant but ultimately very expensive and of no real benefit to the nation. [LC 84-85] (Emphasis supplied.)

From the Philippine side, the most visible source of the distortion caused by the protectionist policy was the restriction on allowable value, volume, and profits on cargo, even if these were often easily evaded through benign neglect or corruption. The relaxation of these limits was the subject of the Manila business community's numerous petitions to the court. Azcárraga condemns these restrictions as "irksome" [LC 49], "absurd" [LC 49, 60], and even "tyrannical" [LC 49].

Also coming in for criticism was the additional transaction cost imposed to enforce the monopoly of Philippine [Spanish] residents over the trade [LC 72]. This prevented the consignment of cargo to non-Filipino residents. Shippers from Manila could neither consign their cargo directly to Mexicans at the other end, nor to the galleon's captain or crew. Instead, shippers had to hire pursers or agents to accompany the cargo, as well as to compensate the real Mexican consignees who would facilitate the offloading of the cargo so that "each expedition of the Nao had two consignees, one on board and the other at Acapulco" [LC 72]. Far from benefiting the shippers, this "nationality restriction" represented an additional burden on trade.

A final and crucial point of Azcárraga's criticism of the 1593 regulations was the prohibition on Spanish subjects, particularly those of the Philippines, from directly acquiring merchandise from China, India, and other Asian ports. This effectively relegated Manila to the sampan trade, where the colony had to await the arrival of merchandise conveyed by Chinese and other vessels calling on Manila instead of actively seeking out products by dispatching vessels of their own. This issue touches on Azcárraga's vision of development for the country and will be discussed further below.

The static welfare analysis of an export quota or export restraint such as that regulating the galleon trade is fairly standard from a contemporary viewpoint.²⁴ Aside from protecting the "home" (i.e., Peninsular and Mexican) industries, its effects include the creation of rents accruing to the export source-country (the Philippines), a definite loss to the consumers of the importing country (Spanish America) owing to higher prices, and an upgrade of the types of goods sold.²⁵ The net welfare effect on the source-country, on the other hand, depends on whether the rents due to a higher export price—caused by the restriction of supply to the importing country—are greater than the producer's surplus under an unrestricted regime.²⁶ Since American

²⁴ For a textbook explanation, see, e.g. Saylor Academy [2012: Sec. 7.21].

²⁵ On the upgrading effect, see, e.g., Hamilton [1986].

²⁶ The higher export price is a terms-of-trade effect. The same terms-of-trade effect may yield a benefit to consumers of the exporting country, who might enjoy a lower price of the exported goods as a result. This effect is negligible in this context, however, given the small size of the domestic Philippine market relative to export demand.

demand for the type of goods in question was likely elastic, it seems intuitive that revenues and profits under restricted trade were greater than under the earlier regime of unrestricted trade; hence a net loss to the source-country can be presumed. In the case of the galleon trade, the restrictions preserved the rents to Cadiz and Seville but, notwithstanding the rents accruing to the Manila business community, which was given exclusive trade privileges, the latter's complaints against the restrictions and its unremitting lobbying for a more relaxed quota would appear well-founded.

Azcárraga seemed well aware of the comparative statics of the situation. In principle, a first-best and truly free-trade solution might have involved direct trade between Asia and the Americas without Philippine intermediation, but his viewpoint focused on the fact that the Philippines was already *de facto* a trading center in the making based on revealed private initiative:

Would it have been better if the Chinese, Japanese and Armenians²⁷ took their manufactures directly to Acapulco? Better for the Americans, undoubtedly, since they would have acquired the textiles more cheaply; *but then the trading center of Manila would have lost its advantages from transporting these commodities*. Would it have been better if American vessels had come in search of Asiatic products? We believe this would also have been better for the Americans and our navigation in general, *although this would inevitably have deprived Manila of the benefits indicated*. *But since no such direct commerce was established, it was undoubtedly of utmost advantage for both sides that we established our colony in Manila*; that they knew how to take advantage of this business opportunity indicates to us that those adventurers, the first settlers in this country [*sic*], aside from being fearless warriors and skillful politicians, were no mean businessmen. [LC 91] (Emphasis supplied.)

The above shows that Azcárraga knew that from a static-welfare perspective the galleon trade even at its least restrictive was inferior to a direct Asian-American trans-Pacific exchange. His pragmatic assessment, however, was that since no move emerged from either Spanish American or Asian interests to venture into or even lobby for direct exchange, the best that could be expected was an approach to a situation consistent with what private business interest (from the Philippines) actively exhibited, namely, a system of transshipment of Asian goods to the Americas with Manila as entrepôt. That this coincided with the interests of Manila and the Philippines was a bias Azcárraga was not embarrassed to display. More importantly, however, this advocacy was based not solely on partisanship (e.g., possibly stemming from his affinity for his native land). Azcárraga criticized the restrictions not because they did not deliver large enough rents to Manila or

²⁷ Armenian merchants also sold silk in Manila, and there was a quarter especially reserved for them. Giraldez [2015: 114-115] traces their influence to their monopoly of the trade in raw silk and to their alliance with the British under an Anglo-Armenian agreement in 1688, which allowed Armenians to cooperate with the British East India Company.

low enough prices to America. His real advocacy was not to maximise global static welfare gains from trade but to realize the dynamic gains from developing Manila as a full-blown trading center and with that, achieving the development of the Philippines as a Spanish colony.

For all Azcárraga's praise of private initiative, of course, the galleon trade was still a venture heavily subsidized by the crown—on whose account fell the costly construction and manning of the galleons.²⁸ Hence there is no question that private Spanish capital alone would not have sufficed to sustain the effort given the ceilings on cargo and returns. One might surmise however that it was Azcárraga's view that less of a subsidy might have been needed and more private capital (not exclusively Spanish) would have participated if the trade had been unrestricted. At any rate any subsidy would have been a better investment if accompanied by rules that allowed full play for the Philippines to trade with its neighboring countries as well as with all of Spanish America.

7. Manila as center for the carrying trade

Azcárraga's alternative vision for the port of Manila was its development as a hub for the "carrying trade" (*comercio de escala*) and its rise as an entrepôt in the mold of Singapore and Hong Kong. He believed this could have been accomplished from the earliest days. The "carrying trade" in the words of Adam Smith, involves merchants "purchasing foreign goods in one foreign country in order to supply the consumption of another" [WN II.ii.32]. Azcárraga accorded this particular species of trade a special significance.

The carrying trade is one of the forms taken by merchant enterprise [*especulaciones*] in its fervid search for profit; it is perhaps also the form that requires the most ingenuity and energy from the entrepreneurs engaged in it. To seek goods that are abundant in foreign markets in order to deliver these to those parts of the world that need them and fancy their consumption is to render a service to both sides; and since this service is not free but rather takes advantage of the difference in prices between that in the producing and consuming countries, the result is clearly a great advantage to the merchants and the center that pursues that trade. [LC 90]

Azcárraga extols the virtues of the carrying trade by citing the affluence and progress it brought to trading centers engaged in it. His examples range from ancient Palmyra, to Hormuz under the Portuguese, and to the more recent and relevant examples of the British colonies of Singapore and Hong Kong:

²⁸ Early attempts to outfit galleons at private expense were abandoned since "private enterprise could not compete with the subsidized state galleons" (Schurz [1985(1939)]: 164-166).

It is no other than the carrying trade that has given life and growing prosperity to the trading center of Singapore... This is trade that consists in storing all manner of products from China and goods from England, where the former are imported, not to be consumed in their entirety, but for a part to be exported to other nations, while the latter are to be exported to the Celestial Empire and even to Japan. The same is true of the new, more proximate entrepôt that is Hong Kong, formed and created in our times and before our eyes, without English traders viewing themselves as being disadvantaged by this commerce, but rather regarding it as an auxiliary; this though the balance of trade mostly turns against England, with the difference often having to be paid with a respectable sum in silver. Without this carrying and entrepôt trade, what would Singapore and Hong Kong be today? [LC 92]

The galleon trade itself was, of course, already one leg of such a carrying trade—albeit a deliberately crippled one. Through the Philippines, Spain was already intermediating between Asia and Mexico by supplying the latter with Asian (especially Chinese) goods in exchange for Mexican silver, of which the Chinese were in perennial want.²⁹ In Azcarraga's alternative vision of how Spain should have organized its commerce, however, it would have dispatched its ships to procure high-value goods directly from the major ports of Asia, especially China, India, and Japan, the source of production of such goods. The merchandise would then have been deposited in Manila, from which they would have been re-exported to the Americas and to Europe on Spanish and other foreign vessels.

Such a vision differed from the actually existing system of the *Nao de Acapulco*. Aside from limits on the frequency, cargo, and destinations of the galleons, already noted, Spain could not itself actively seek out Asian goods at the source. The 1593 decree prohibited any person from the Philippines from doing direct business with China, that is, from merchants sending their own ships to purchase Chinese merchandise at the source. Instead, a cumbersome system was imposed that entailed waiting for Chinese and other traders to descend upon Manila bringing such goods. These goods were then sold in the annual fair (the *pancada*³⁰), where the governor unilaterally set the value on distinct lots or piles of heterogeneous goods, the lots being determined by the Chinese traders who owned them and put them on offer.

²⁹ The reasons for China's perennially high demand for silver lie in the idiosyncratic currency system it implemented. Precious metals like silver were never minted into currency; the government instead minted bronze and iron coins and encouraged the use of paper notes. The failure of the paper money system, however, led the Ming dynasty to require tax obligations to be discharged in unprocessed silver ingots, thus effectively monetizing the commodity. Silver proved to be a desirable asset both in periods of economic growth (as an increase in demand for a money-like asset) and in recessions (as an asset protected from inflation). The reader may wish to consult von Glahn [1996] for a more detailed narrative.

³⁰ Azcárraga explains [LC 103] how the *pancada* (meaning "pile" or "heap") did not entail sales of distinct classes of goods but rather of lots each consisting of miscellaneous merchandise.

Azcárraga criticizes this system as having ceded unnecessary benefits to the Chinese merchants, compared to a system where Spanish ships sought out these same goods from the producer-countries, as the British and Dutch had successfully done.

The mere fact that the Chinese themselves transported their merchandise to our port would produce, as a precise consequence, a reduction in imports and an increase in their prices. They sailed, as they still do today, using those heavy vessels called *sampans*, which are quite suited to staying afloat but not to deftly plying the seas; therefore no more than one annual expedition to Manila was possible, owing to the need to await the favorable northern monsoon in order for them to reach this port and the southwest monsoon for their return. Another irritant in this prohibition, however, was that it placed the Chinese in a position to lay down the law on Philippine trade and to exercise an intolerable monopoly, removing the competition that our ships would have undoubtedly posed to them in this commerce. For although their goods were subject to appraisal, [the Chinese merchants] could very well withdraw them from sale or not return to that trading center if they found the price unsuitable. [LC 75].

Azcárraga does not record—although he would have certainly regarded it as a missed opportunity—that the Manila Spaniards had in 1598 managed to negotiate the establishment of a trading outpost on the Chinese mainland near Canton called *El Pinal* [Giraldez 2015: 148]. This failed to prosper however, owing to the objections from the Portuguese, who were jealous of the privileges of the trading privileges of their outpost in Macao.

Azcárraga [LC 76] argues it was Spain's failure to fully exploit its first-mover advantages in the carrying trade between Asia and America that created a vacuum ("making our flag disappear from the Indian seas and China") later to be filled by the English, Dutch, and Portuguese, who had no qualms about directly dealing with the producing countries. To rub salt in Spanish wounds, French and English merchants were effectively able to game the galleon trade itself by supplying goods to Manila by flying false flags ("Armenian or Moorish")—effectively mimicking the role of the Chinese—and collecting rents from the large Asian-American price differentials without themselves having to undertake the perilous trans-Pacific crossing [LC 76-77].³¹

The gains forgone by not directly dealing on an unrestricted scale with Asian countries were not limited to the rents from trade, however, but extended to the stimulus this could have given to manufacturing, with increased consumption of novel products stimulating imitation and domestic production of the same:

³¹ This was especially true for the exchange between Madras and Manila. On this, see Legarda [1999: 84-85] and Giraldez [2015: 114]; the latter discusses the special role of Armenians at some length.

It should be noted, then, that the nations that strove the hardest to capture that Asian trade are those that today have the highest level of development in their manufactures; *through the imitation of porcelain and Chinese fabrics with their vivid colors, they have created new industries and therefore increased their wealth and commercial activity.* And if we also observe that this great movement in all Europe occurred in the very epoch when Spain opposed our trade in Asia, which had been reduced to a small scale between Manila and Acapulco, it will be well understood that the suppression of the same was what hurt the commerce and wealth of the Peninsula. *For if in Spain the taste or caprice for the fabrics and manufactures of China and India had also spread, there was no other conduit for these but those foreign nations that went to the East and imported them in great quantity and without competition, to the great advantage of their trade and well-known damage to our navigation.* [LC 89] (Emphasis supplied.)

Apart from the adverse impact on the Andalusian silk and textile industry, the other mercantilist argument against the galleons was that they drained precious metals from the Spain and funnelled these into “heathen hands”. This was the advocacy of, for example Uztárriz,³² (see Castillo [1930: 97]) an earlier writer who in 1724 supported the restriction of trade between the Philippines and New Spain, since it benefited the Chinese and Muslims and drained America of the precious metals that such writers thought should have benefited Spain. Against this hoary mercantilist idea, Azcárraga notes:

[I]t is of no importance to us that the other million pesos a year went to China and Japan and India; because that hefty sum was not a gift from the Americans, nor a violent exaction by the Asians; it was merchandise given in exchange for the very desirable goods that our Naos brought over from these nations. What purpose would it have served Mexico and Peru to have rich mines of gold and silver if these could not be exchanged for fabrics to dress in or for other objects of need or whim? What would these coveted treasures be if they were denied conditions of exchange and circulation? Of what significance is money destined to stay quietly in treasure chests? [LC 91-92]

Azcárraga here was of course already well within Smithian orthodoxy in dispelling the idea that “wealth consists in in money, or in gold or silver” [WN IV.i.1], rather than in the consumable commodities and the productive capacity needed to acquire them.

³² Gerónimo Uztárriz (1689-1751) was a prominent Spanish mercantilist writer. Castillo’s [1930] work on this author is incidentally significant as the first doctoral dissertation in economics written by a Filipino in the modern era. Submitted to Columbia University in 1930, it is noted in Schumpeter’s [1954] famous *History of economic analysis*. Again, I am indebted to Dr. Legarda for having pointed this out long ago in a conversation.

8. Critique of Basco's mercantilism

By the late 18th century, the balance-of-trade version of mercantilism that had dominated the second period had morphed into a more Colbertist version, which went beyond restrictions on imports and outflows of metal specie and began to emphasise domestic production for possible export to address the fiscal drain represented by the colony. José Basco y Vargas (governor-general from 1778 to 1787), ushered in a series of economic reforms in the Philippines by promoting the establishment of the Royal Economic Society³³ (1781) and the Royal Philippine Company (1785).

The Royal Philippine Company aimed to provide an impulse to Philippine development by connecting its commerce directly with Spain and for this reason was exempted from some of the restrictions that had hitherto bound the galleon trade. Azcárraga was aware that the Royal Philippine Company created another monopoly,³⁴ but he still regarded it as a signal improvement in that its charter allowed it to dispatch its own ships to fully engage in the carrying trade, i.e., to procure products directly from China and the rest of Asia and deliver these directly to Spain and the rest of Europe. Outbound company ships would sail from Cadiz to Manila, by either passing through Cape Horn and stopping over at a South American port (e.g., Callao in Peru) before proceeding to Manila, or sailing east and rounding the Cape of Good Hope. In Manila they would offload European goods and take on Asian and Philippine goods. The return voyage from Manila to Cadiz would then always take the route passing the Cape of Good Hope, possibly trading at other Asian ports along the way. As this delineation makes clear, however, the Manila community was allowed to maintain its own monopoly of the trade with Mexico: no Company ships were allowed to supply America with Asian or European goods. The Spanish court viewed this clumsy mercantilist compromise as a means of opening up a new trading channel without disturbing already-established vested interests. To have hewed in principle to Azcárraga's ideal vision, however, the Company should have been allowed not only to source its products directly from Asian countries but also to freely transport and sell these to the American colonies, thus providing direct competition to the galleon trade.

The troubles that beset the Company's foreign trade ventures and the reasons leading to its ultimate failure are well known and are enumerated by Legarda [1999: 78-80]. These included the deep mistrust and lack of cooperation shown by the established Manila traders' community, particularly their refusal

³³ *Sociedad Economica de Amigos del Pais*.

³⁴ Regarding the premature withdrawal of the privileges of the Company in view of its shortcomings, Azcárraga concedes: "On sound economic principle, it is not possible to successfully oppose that measure, whose direction was to destroy a *monopoly that harmed the consumer and the freedom of other merchants*" (Emphasis supplied.) [LC 144]. He nonetheless criticises the curtailment of the company's charter on grounds that contracts needed to be respected. The latter is an echo of Smith's [WN IV. ii.44] gradualist warning against sudden withdrawal of monopoly privileges, once they have been granted.

to purchase the shares of the initial offering reserved for them; the inherently inferior profitability of the trade routes allowed the Company, which excluded the lucrative Manila-Acapulco trade; the government's failure to fill up the promised capital for the Company; and policy changes from the Madrid court that eroded some of its important privileges.

Azcárraga nonetheless lauds the establishment of the Company and the changes in policy this entailed. With the Company's establishment, he writes, "most if not all of the many obstacles that prevented our colony from developing disappeared" [LC 124]. Among others, the Company diluted the monopoly of the Nao (albeit by creating another monopoly) and, at least in principle, was a step towards what Azcárraga regarded as the judicious Spanish commercial policy for the Philippines, namely the active pursuit of a carrying trade that dealt directly with China, India, and Japan. He regarded his opinion as vindicated by the resulting increased activity at the port of Manila. The reality, of course, was a mixed picture and due in no small part to the Company's failures rather than its successes. Rather than call directly at other Asian ports, for example, the Company's agents largely emulated the galleon trade in simply awaiting the arrival of Asian goods at Manila—transhipped by both Asian and other European carriers—so that these could be loaded onto the Company's ships bound for Europe [LC 141]. The Company also fell short of its envisioned role as the exclusive supplier of European goods to the Philippines; that monopoly function was gradually ceded to foreign ships as the Company's voyages became less frequent [Legarda 1999: 85]. The greater presence of foreign ships in Manila that Azcárraga observed, therefore, was more a sign of the Company's failure in and abdication of its function. From the viewpoint of his free trade advocacy, however, even the failure of this mercantilist enterprise was a step forward and achieved what Azcárraga ultimately envisioned—a port of Manila open to all flags.

A second mandate of the Royal Philippine Company was to invest part of its capital in the development of manufacturing and agricultural products. This initiative was a departure from the earlier type of mercantilism centered on protecting Spanish industry (particularly the Andalusian textile industry) that had motivated the restrictive policies on the galleon trade. Instead, it affirmed the importance of trade for the Philippines (Manila, in particular) in seeking to make the colony financially self-sustaining by augmenting the profits from the Asian trade with a direct export of Philippine agricultural and manufactured products to Spain and other Asian destinations. Towards this end, the Company promoted the cultivation of various crops such as mulberry trees as an attempt at a silk industry, cotton, indigo, black pepper, and sugar. Azcárraga notes with some approval the initial successes in this agricultural diversification [LC 134-135]. Even so, however, he qualifies this assessment by noting that "to judge by the present-day results, the directors of that society do not seem to have been very successful; for what today forms the great wealth of the Philippine Islands—tobacco, abaca, and sugar—were

not the products that merited their greatest attention and outlays" [LC 197]. Black pepper cultivation was an especially large source of losses, with large advances being made and left unpaid.

With respect to the Company's ventures into supporting crafts manufacturing, however, Azcárraga is unequivocally critical. While conceding the Company's benevolent intent, Azcárraga criticized its plans to export not only Philippine "colonial products" but also manufactures based on existing craft production. Implicitly he derided the Company's idea of "turn[ing] a colony so rich in natural products into a manufacturing nation" based on "the proposition that it is possible for a country producing primary goods and supplying foodstuffs abundantly and at a low cost, and in which wages are low, to have factories that would lack only special tools" [LC 135]:

[The Company] believed that the looms for blankets, rayadillos, *nipis*, *guinaras*, *tapis*, terlingas, burnished canvases, *cambayas*,³⁵ and other fabrics that existed on the islands could serve as the basis for a great manufacturing industry and a new staple for their trade and their ships; and it proposed that these fabrics, even if they could not replace the blankets and other fabrics obtained from Bengal and Coromandel, could at least compete with the latter both in Manila and in the other neighboring markets. This was a struggle in which it incurred a good deal of expense, much of which has borne no fruit.

The directors in this respect were unaware that as a general rule, *what the European nations in their distant expeditions were looking for, apart from the treasures of China and Japan, were those natural products—so-called colonial products—which, though provided by nature only in warmer climes, are highly desired by the inhabitants of cold and temperate regions, and which have become part of the needs of modern life; that as compensation and in exchange for that imported production, these nations needed to establish consumer markets as an outlet for their increasingly abundant and improved manufactures.* [LC 136] (Emphasis supplied.)

9. An implicit theory of trade and development

Azcárraga regarded these state-directed export-cum-production plans in crafts and manufacturing—and to a lesser degree even in agricultural products—as an unnecessary and misguided intervention leading to waste, since they ran counter to natural (i.e., absolute) advantage. He essentially envisioned a pattern of trade where the Philippines would concentrate on the export on resource-based products such as sugar, tobacco, and abaca, cotton, using the earnings it made

³⁵ *Nipis* was fine cloth made from piña, sinamay, jusi, or similar fibres; *guinara* was coarse cloth from abaca; *cambaya* and *rayadillo* were textiles made from cotton.

from these to support its import of manufactures. The Company's disregard for natural advantage was the point of his critique:

Although the directors set in motion their good plans to create a great mass of natural products for export, *they apparently did not take over the limitless field that was open to the ventures of the Company*; for no matter how much advantage they would derive from the labour of the indigenous people, and *no matter how great the production of the protected articles would become, the demand would always be greater in view of the constant increase in the population consuming them*, and in view of the prodigious spread of their consumption: they did not seem to want to focus their attention on the fact that *it is the same to produce a given value, part in sugar, for example, and part in fabrics, which is to produce the same given value, everything in sugar, since with the product for sale of the largest amount of sugar the necessary fabrics could be acquired*: the disregard of these maxims and other wrong calculations induced the Company to make large unproductive disbursements, which contributed in no small manner to its ruin, or at least to the non-attainment of the beneficial results that were reasonably promised. [LC 138] (Emphasis supplied.)

In the above excerpt, Azcárraga attributes at least part of the Company's financial undoing to its failure to focus its promotion activities on those products in which the country had a natural advantage (i.e., agricultural or "colonial" products). Its efforts instead were diluted by simultaneously trying to promote a manufacturing industry based on local craft production, most of which turned out to be bad investments.

We are left to infer the trade-theoretic argument behind Azcárraga's criticism. A straightforward modern interpretation of his point is that a country like the Philippines initially operates *below* its production-possibilities curve, so that current consumption is below potential output for many or even all commodities. Holding consumption constant for the moment, a production stimulus could push the economy towards the frontier and result in more of some—or indeed even *all*—products being produced and potentially exported, i.e., since these would be in excess of current consumption.³⁶ This is certainly possible in a colonial economy resembling a command economy, with authorities able to push production in certain directions without immediately affecting consumption. Azcárraga argues however that, given the choice, any push for higher output should be in the direction of those products in which the country has an absolute advantage (again, agricultural or "colonial" products), and where the increased output is less likely to be preempted by rising domestic demand as incomes rose and population grew.

³⁶ In the familiar two-product production possibilities diagram of most textbooks, with the consumption-production point strictly below the frontier, the stimulus pushes the production point outward in a quadrant strictly northeast of the consumption point.

While it might be possible for a time to export income-elastic products such as native crafts, this would not be sustained in the long run, since the eventual rise in income and consumption would erode the tradable surplus in those goods.

This reconstruction is bolstered by his remarks in later sections, which envision an improvement in welfare caused by trade based on absolute advantage:

It is already an incontrovertible truth that no people can produce all the necessary articles for its well-being; for there are certain productions that can occur only in certain climes; cotton, for example, which is so widely used everywhere, is produced only in warm or temperate zones, and yet the inhabitants of cold regions also like to dress in cotton cloth. The same can be said about tobacco, sugar, coffee, and other colonial products that require certain climatic conditions but are generally consumed worldwide; we may also mention that in the Philippines themselves, ice is highly desired for drinks, especially in the hottest season. Thus all nations are interested in importing foreign goods.

It is another truth that the wealth and well-being of a country are indicated first of all by its greater production of goods suited to its climate and adequate to its terrain, to the point where it generally exceeds domestic consumption and requires export to other countries, without whose stimulus production would neither increase nor achieve abundance and cheapness. [LC 207-208]. (Emphasis supplied.)

The first paragraph supports the idea that Azcárraga held an absolute advantage theory of trade, recalling Smith's famous words on the matter³⁷ and in line with much of continental thought in the 19th century.³⁸ The second paragraph supports the interpretation that Azcárraga envisioned a pre-trade situation where a country initially operates below its production possibilities, but where trade possibilities push it closer to the frontier. In the latter he is aligned with Myint's [1958] later interpretation of Smith as positing gains from trade being a "vent for surplus".³⁹ This, too, is unsurprising since the idea of exports resulting from an excess in the

³⁷ That is, "If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage" [WN IV.ii.12]. In WN IV.ii.15, Smith also speaks of a country's natural advantages in producing some commodities being so great "it is acknowledged by all the world to be in vain to struggle with them". The famous example he provides is the great expense involved in producing good grapes and wine in Scotland.

³⁸ Bloomfield [1989: 621] writes how "French writers in the first half of the 19th century and even to some extent thereafter generally regarded trade as based on absolute differences in costs or on what has been called absolute advantage". He dates the earliest statement of comparative costs by a French author to a book by Antoine Cherbulliez published in 1862, well after Azcárraga had completed his studies [Bloomfield 1989: 626].

³⁹ Schumacher [2015: 583-590] disputes the interpretation that Smith assumed the existence of unemployed resources in autarky. While conceding the theoretical validity of the idea, he prefers to ascribe its real source to later writers including JS Mill, who expressed openness to such an idea more explicitly [Schumacher 2015].

production of certain goods over their consumption can also be found in the works of many contemporary authors in Azcárraga's time. Bloomfield [1989: 624], for example, cites a number of French authors who express themselves the same way—again remembering the relevant fact that a much of economics in 19th century Spain was filtered through French treatises and translations.

Azcárraga however is not vulnerable to the charge of presuming that a prior surplus or overproduction exists in autarky—a charge Schumacher [2015: 597-598] levels against Myint and one that JB Say also made against some of his contemporaries.⁴⁰ Azcárraga after all clearly states that the excess of production over consumption would not exist absent the demand coming from exports, “without whose stimulus production would neither increase nor achieve abundance and cheapness”.

We might call this the first sense in which Azcárraga depicts trade as an engine of growth, i.e., mainly its *allocative effect*. It should be clear however that this goes beyond just the neoclassical idea of efficient allocation, where a country already at full employment merely reallocates its resources towards goods more valuable in trade. Rather it implies trade serving as a stimulus that overcomes certain distortions that have hitherto prevented a country from reaching its (given) full potential. In the case of the Philippines these distortions are to be understood as arising from the mercantilist regulations that stifled trade.

There is a broader sense, however, in which Azcárraga saw trade as an engine of growth, and this was his view of trade as a means of *capital accumulation*. While showing some sympathy for the Company's efforts to promote agricultural exports as compared to manufacturing, he was critical of the whole idea of a forced attempt to promote exports of whatever kind—even agricultural. He regarded the latter as a lesser error but an error nonetheless:

As a tribute to the energetic governor (i.e., Basco) mentioned earlier, however, we prefer to interpret his words as being guided by the best intentions of wanting to expand the trade of Manila and to draw its attention to the advantages of exporting its own products, channeling them directly to the centers of European consumption; for in this sense there is no doubt that the routine and non-expanding trade of Manila left much to be desired.

It might also be presumed that if commerce had found the expeditions to New Spain profitable—and, accustomed to acting freely and driven only by the powerful motive of private interest either to continue an activity or abandon it when circumstances changed—then it would have pursued other ventures in different destinations, such as say, direct trade with Europe even before this had been promoted by the government; it would have frequented the ports of China and India, and could be in those waters today, if not at the level of English trade, then at least in a position less disadvantageous than the one it now occupies. [LC 95]

⁴⁰ See Bloomfield [1989: 624], who quotes Say's 1848 *Oeuvres diverses*.

But let us consider some points. *To begin with, did such natural products exist in the Islands at the time in sufficient quantities as to sustain a trade of any significance? Was there available capital to invest in promoting their production?* Was communication with Spain via the Cape of Good Hope possible at the time? And even if such natural products had existed, why should the Acapulco trade be abandoned? What incompatibility was there between the one and the other? [LC 94]

...[I]f the natural trend of commerce that arose in Manila from earliest times had been left to expand, it would have taken off incredibly; the returns from the Nao would have grown fabulously each year; *the wealth of the city would in no time have grown annually in proportion, and there would have been abundant capitals that, dedicated to agriculture, would have yielded the natural products to sustain that an export trade and in consequence, also the import trade* [LC 95]. (Emphasis supplied.)

The foregoing implicitly outlines the counterfactual sequence of economic development Azcárraga envisioned that the Philippines might have followed. It was one where, first of all, the carrying trade should have been encouraged—untrammelled as to origin, nature, and quantity of products, as well as point of final sale. Based on the country's geographical location and following its "natural trend", such a liberalized carrying trade would have directly sourced products from China, India, and other Asian ports. With Manila serving as port of call and entrepôt, such products would eventually have been exported to the Americas (and not just Mexico) as well as to the Peninsula and ultimately the rest of Europe. Foreign ships would also have been allowed to call in Manila as an entrepôt. (Azcárraga was mindful of the examples of Singapore and Hong Kong.) Presuming the returns from such a trade to be highly lucrative—which seemed reasonable considering the large profits being obtained even from a repressed galleon trade—wealth and capital would have been accumulated in the Philippines, which Azcárraga asserted would have subsequently found their way into financing investments in agriculture. The resulting development of domestic production would have led in time to an export of Philippine agricultural products along the lines of absolute advantage. In accord with free trade, the natural sequence leading to development and an expansion of Philippine trade was not through state subsidies from mercantile companies that selected projects and products in a *dirigiste* manner, but through a removal of restraints on the carrying trade that already existed, leading to capital accumulation, leading to private investment in internal projects in line with natural advantage, and ultimately to exports of locally produced commodities. It is in this connection Azcárraga extols private initiative over the mercantilist approach of Basco and the Company:

In either case, and in principle, the administration should have limited itself to facilitating activity, removing all obstacles to its citizens, even attracting foreigners, and establishing for each, all the security necessary for transactions. For the system of protections and privileges, no matter how much it would wish to meet the aspirations of private interest, is always slower to move than the latter, which presents itself in many different forms and moves at a speed that is incompatible with the formalities required by the repeal or reform of some legislative provision. [LC 95]

This is a virtual recounting of some passages of the *Wealth of Nations*, particularly *WN* IV.ix.50-51, where Smith speaks of the “delusions” among governments that they could ever properly perform a task for which “no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society”. Instead Smith enumerates the three minimal roles of the sovereign, as providing defence, administering justice, and establishing certain public works or institutions—the first two of these, of course, correspond to the “security necessary for transactions” that Azcárraga mentions.

Once more, the parallels between the lines of this implicit debate and those between liberal and heterodox economists in the second half of the 20th century are striking. The arguments anticipate aspects of the “Great Debate” in the Philippines in the post-World War II years [Takagi 2008] between those who favored domestic industrialisation and a strong currency versus those who advocated a weaker currency to benefit exporters (then also consisting primarily of agricultural and natural resource-based products). They also anticipate the more erudite debate over industrial policy in promoting development in underdeveloped regions during the 1990s: the Company’s Colbertism finds an echo in Ha-Joon Chang’s [Chang and Gershman 2003] advocacy of industrial policy for developing countries, just as Azcárraga’s viewpoint is represented in the World Bank’s [1991] mantra of labor-intensive export-oriented industrialization with minimal state intervention and based on comparative advantage—both being competing explanations of the “East Asian miracle”.⁴¹

10. The role of foreign capital

The parallel between Azcárraga’s advocacy and late 20th century liberal prescriptions approaching the “Washington Consensus” is almost complete if one considers his favorable disposition towards foreign direct investment and towards foreigners freely engaging in trade. This is already evident in his benign regard for the Chinese in the sampan trade during the period of the galleons—an attitude that contrasts with the negative and hostile opinion of contemporary writers and colonial administrators, who viewed them as security risks. He enumerates the

⁴¹ A brief but nuanced contrast between these positions can be found in Lin and Chang [1999].

various abuses committed against Chinese immigrants and traders [LC 101-102], and marvels at how, despite such impositions and vexations, the Chinese persisted in the trade.

But the crucial economic role he ascribed to foreign capital is clearest in his discussion of the fourth epoch, the liberal phase of his periodization. With the independence of the American colonies, the end of the galleon trade, and the lapse of the charter of the Royal Philippine Company, this period begins in 1834 with what he regarded as the most significant reform—the unrestricted opening of the port of Manila to international trade and shipping, which simultaneously meant permission given for English and American foreign trading houses to operate in the capital.⁴² Azcárraga notes this is when “the true prosperity of the Philippines begins” [LC 157]. The great change, in the words of Legarda [1999: 334], was the Philippines’ transformation from a subsistence economy to “an agricultural export economy”. Azcárraga notes how “so many successes have been achieved by the commerce of those Islands in an arena of free trade” [LC 197-198]. In terms of tariffs and duties themselves, piecemeal policy changes were made, but a generally low level of average tariffs prevailed from the 1840s to the 1880s.⁴³ Legarda [1999: 197] notes that the resource-allocation effects of tariff legislation, particularly the 1832 legislation, which endured until 1869, may have been “at best only auxiliary” in achieving the country’s transformation into an export economy by the 1870s.

These favorable developments notwithstanding, Azcárraga saw a further obstacle that prevented development from coming sooner and being more widespread. A major one was the delayed opening of other provincial ports to international shipping. Between 1834 and 1855, Manila remained the only port of call open to international traffic and the only place where foreign merchant houses were franchised to purchase and sell Philippine goods.

[E]ven this very triumph of free trade we have just laid out suffered from a major flaw in its implementation: that is, with Manila being the only port open to foreign trade and having the only customs house through which all import and export items had to pass, all the country's products had to come to this port, even those from the most distant provinces; and from there the manufactured goods that were imported had to be distributed over the last mile for their intended consumption. [LC 161-162].

He points out how during those decades, sugar, rice, abaca, and other products not only from Luzon but from Visayas and Mindanao had to be transported to Manila in order to be exported. Similarly, imports having to pass through Manila would become more costly owing to the costs of cabotage.⁴⁴

⁴² The reader is referred to the exhaustive treatment by Legarda [1999: 234-289].

⁴³ See Legarda's Table 14 [1999: 205].

⁴⁴ Again, interestingly, the issue of cabotage would continue to rankle until 2015, when the Cabotage Act (RA 10668) was passed, allowing foreign carriers to move cargo freely between and among domestic and foreign ports.

This trading point (i.e., Manila), so distant from most of the production and consumption centers, necessarily makes exported products and manufactured goods more expensive in the country owing to the repeated freight, loading, and unloading forced upon them; the unnecessary risks they must run; and the losses frequently suffered by the small and poorly prepared ships that make these crossings; thus all the islands were constituted as tributaries of the city of Manila by effect of this tax system, which had no other purpose than to collect an indirect tax to sustain the expenses of the State and to provide undue protection to certain industries both in the country and in the Peninsula. [LC 162-163].

In the delayed opening of regional ports and in the failure to encourage the operation of foreign trading houses in the provincial centers, Azcárraga saw a persistence of mercantilist and protectionist practice in a different guise. If the Manila business community had previously represented the more liberal lobby against mercantilist policy in the Peninsula, by the fourth epoch it was the government in Spain itself that had begun to envision a more liberal trade policy for the Philippines—and it was the Manileños that foot-dragged and fought to delay the policy. Presaging complaints of a later age against “imperial Manila”, the pro-Manila lobby argued against new international ports, using various arguments such as the advantages of promoting the cabotage industry, noting the capital already invested in domestic shipping and employment it provided, the added expense of setting up regional customs houses, and so on—“without accounting for the fact that those expenses incurred in export and import always ended up costing the producer and the consumer”:

[H]ere again we see private interests wanting to assume the guise of the general good: the city of Manila, which seemed to have forgotten the damages and hardships that the selfishness of Cádiz and Seville had made it suffer for two centuries, the city of Manila, which energetically resisted even the creation of the Philippine Company because it believed that institution deprived it of its right to negotiate freely with the Metropolis, proposed on this occasion to take advantage of its supremacy and exercise over all the islands the monopoly that in other times had been imposed on it: a sad human condition that requires so much time and effort to understand and to unite the general interest. [LC 163-164]

In the event, over the objections of the Manila lobby, the regional ports of Zamboanga, Iloilo, and Sual (all in 1855) and later Cebu (1860), were ultimately opened to international shipping. Nonetheless it took a few more years before these regional ports became viable, and the reason Azcárraga cites is the delay or discouragement of the activity of foreign trading houses that would use them as bases of operations:

As we have already said, *the lack of development of these new foreign commercial centers comes from the fact that foreign houses have not established themselves in them*; because it must be borne in mind that almost all the exported articles from the country and imports of manufactured goods are carried by those English, North American, German, and French foreign houses in Manila, all of which buy the indigenous products that arrive in the center or that are brought to them by Spanish purchasers to whom they have advanced money, which has in turn been obtained as loans from the Bank⁴⁵ or from private persons. It is also they who then sell to retail merchants the manufactured goods from those tireless European factories (i.e., imports) which the country needs for its consumption. [LC 29] (Emphasis supplied.)

Azcárraga is not explicit about the conditions he thought were necessary for the establishment of foreign trade houses in the newly opened ports. Causation could have run either way: low production volumes may cause low trade levels that fail to justify international ships calling on regional ports; alternatively, the lack of trade outlets may prevent production itself from being stimulated. In keeping with the vent-for-surplus interpretation of his views, however, the latter would be his more plausible reconstruction, i.e., allowing for elements of inertia, easier access to trade outlets would result in lower transactions costs and larger margins for both foreign trading houses and domestic producers and therefore simultaneously expand both trade and production volumes. More significantly there is a dynamic effect if trading possibilities stimulate an infusion of capital in the production of goods where the country had a natural advantage. In the event, Azcárraga cites data to show how after four years, international trade had picked up in the regional ports, as seen in the rise of exports originating from them [LC 165-166].

The fact that the new investments in agricultural production would come mostly from foreigners was something Azcárraga viewed pragmatically as something to be encouraged, owing to the dearth or sluggishness of Spanish capital.

Foreign commerce is, without a doubt, that which has most taken advantage of the franchises we are dealing with; it is also consequently that which has promoted the wealth of the islands of Panay and Negros, sending them capital in cash and in credit, ingenuity, and in lieu of labour, something that replaces and surpasses it, namely machinery. We have already said that the apparent wealth from exports has been produced with steam or animal-powered iron mills run by foreigners. [LC 170]

He argues that Spanish capital already enjoyed initial advantages, especially in the form of the flag discrimination baked into the tariff system and the close contact of Spaniards with the native population. These should have given Spanish capital a

⁴⁵ Apparently the Banco Español Filipino, in which American firms owned shares.

headstart in promoting domestic agricultural production and international exports from the regions. Yet Spanish capital was slow to respond to such inherent advantages:

...[I]f with these advantages Spanish commerce has been unable to act, the government should not do more, because any other measure would be to the detriment of the wealth of the Islands, which can be promoted by no more effective means than exportation. If, in order to superimpose Spanish over foreign commerce, a monopoly is established, then production is harmed, and hatred is aroused against the monopolists, lowering their prestige and giving the measure a result contrary to the objective the monopoly envisioned. [LC 170]

The tepid response of Spanish capital, he thought, could no longer be used as an excuse for policy to prevent the major entry of foreign shipping and capital:

...[T]he government does not have to create what should be left for private interest to do. The government must not deviate from the good principles established by science and experience, and cannot, therefore, drive away a powerful element of wealth such as foreign commerce, only so that Spanish commerce grows and prospers. [LC 170]

In the event, by the time Azcárraga was writing, with regional ports open to international shipping, the involvement of foreign trading firms in the Philippine economy was in full swing. A notable part of their business was merchant-financing, which involved making advances or loans, often through several layers, to agricultural producers to supply the world demand for exports. Legarda [1999: 284] retrospectively affirms that the merchant-financier stands “at the centre of economic change, growth, and progress in the nineteenth-century Philippines”. All this, of course, appeared to support Azcárraga’s hopeful thesis that all that was needed for growth was an opening of trade outlets that in turn would induce an inflow of capital, both being provided by the foreign trading houses. This is the third sense—as *an impetus to foreign investment*—that one might further consider trade an engine of growth.

In summary, Azcárraga viewed free trade as an engine of growth⁴⁶ in three distinct ways: (a) as a vent for surplus for the export of goods in accordance with absolute advantage; (b) as a vehicle for domestic capital accumulation, and (c) as a means to attract foreign capital and new technology. Of the three, historical events would put a premium on the last.

⁴⁶The phrase “engine of growth” was ironically first used by 20th century writers—notably DH Robertson, R Prebisch, and WA Lewis—who observed that its effects were no longer as potent as they were in the 19th century and who for that reason advocated less, not more, reliance on trade (see, e.g., Riedel [1988]).

11. Relation to Smith's ideas of trade and development

Continuing scholarship⁴⁷ into Adam Smith's ideas on international trade fortuitously provides a deeper insight into Azcárraga's free trade advocacy and how this squares with ideas of Smith who was his source of inspiration. It was Myint [1958, 1977] who first pointed to the need to embed Smith's views on trade in his broader views of development, and we have already discussed the vent-for-surplus idea that is implicit in Azcárraga's own trade theory. More recently, Schumacher [2015, 2018] has argued that Smith's theory of trade should be regarded as part of his more general theory of capital accumulation, i.e., the "natural progress of opulence", treated in the Book III of *WN*. Schumacher disagrees with Myint's reading on the point that Smith assumed unemployed resources (hence trade as a "vent for surplus"); instead he interprets Smith as viewing capital accumulation and growth occurring at full employment in every period. Both agree however that Smith's trade theory should be understood from a dynamic growth, if not a development perspective. Smith thought the progress of trade followed the natural course of capital accumulation, proceeding as capital first began to be invested in agriculture, then domestic industry (manufacturing), then the internal (home) trade, and finally foreign trade. Investment in foreign trade itself is divided into direct bilateral trade ("purchasing foreign goods for home consumption") and the carrying trade ("transacting the commerce of foreign countries", i.e. "carrying the surplus produce of one to the another" [*WN* II.v.24]).

This sequence, it will be recalled, was Smith's original illustration of the "invisible hand" [*WN* IV.ii.9], on the principle that capital flowed from the least risky to the riskiest, and from the most to the least profitable branches of activity without need for special encouragement. In particular, the tendency of capital to flow into the home industry and manufacturing in this progression owing to naturally favorable risk-reward factors was Smith's argument to show that mercantile protectionism was superfluous. In this view, the mercantilist emphasis on foreign trade and a favorable trade balance, too, was misplaced, since the burgeoning of a country's foreign trade was not the cause of its prosperity but its consequence. Foreign trade, for Smith, far from being an engine of growth, was rather the offshoot of successful capital accumulation: countries that had become capital-rich from the development of home industry and internal trade were those that could afford to venture into foreign trade.

All this, of course, will appear contrary to Azcárraga's propositions. In particular, Azcárraga's enthusiasm for the fullest development of the carrying trade as a first

⁴⁷ Among other things, Schumacher [2015] seeks to corrects Myint's [1958] influential reading of Smith as holding a "vent for surplus" theory of trade. Beyond this, however, at least three or four interpretations of Smith's ideas on trade have been distinguished, each of which finds greater or lesser support in some passages in *WN*. Briefly, these are: the long-standing (neo)classical interpretation of Smith as holding a view of trade based on absolute costs and natural endowments; an increasing-returns interpretation; a theory of uneven development; and more recently his anticipation of the gravity theory [Elmslie 2018].

and key strategy for Philippine development is a complete inversion of Smith's presumed "natural progress of opulence". Smith's sceptical view of the carrying trade follows directly from his idea that foreign trade was a consequence rather than a cause of prosperity. He viewed the carrying trade in particular as a rarefied channel of investment compared even to, say, domestic trade or bilateral export or imports, gaining in importance only because capital had become too abundant:

When the capital stock of any country is increased to such a degree, that it cannot be all employed in supplying the consumption, and supporting the productive labour of that particular country, the surplus part of it naturally disgorge itself into the carrying trade, and is employed in performing the same offices to other countries. *The carrying trade is the natural effect and symptom of great national wealth: but it does not seem to be the natural cause of it. Those statesmen who have been disposed to favor it with particular encouragements, seem to have mistaken the effect and symptom for the cause.* [WN II.v.34-35] (Emphasis supplied.)

It may take us a bit far afield, but it is important to note that this judgement ultimately flows from Smith's peculiar theory of value—a theory of natural price with little room for profits arising from differences in international values. Short of direct exchange between producers, Smith argues that any wholesale trade (including the carrying trade) requires a trading merchant to completely reimburse or replace the capital previously expended by producers in order to sustain employment (roughly in the form of a wages fund), even as the past period's output waits to be sold or exchanged. This means the merchant must be extended or exposed by an amount between the time he purchases the produce and the time he is able to sell or exchange it [WN II.v.25]. Smith's skepticism regarding all forms of wholesale trade (whether domestic or foreign) then boils down to his notion that capital suspended between purchase and sale is idle; the more circuitous and mediated the exchange, the longer the turnaround time for capital to return to production. On this basis, Smith favored capital to be invested directly in production over its being devoted to any form of wholesale trade, which he almost views as a necessary evil. Of the various species of wholesale trade, moreover, the "home trade" (i.e., domestic wholesale trade) is preferable to foreign trade owing to the more rapid turnover of the former and hence its greater ability to "return" to support production:

[T]he returns of the foreign trade of consumption are very seldom so quick as those of the home-trade. The returns of the home-trade generally come in before the end of the year, and sometimes three or four times in the year. The returns of the foreign trade of consumption seldom come in before the end of the year, and sometimes not till after two or three years. [WN II.v.26].

Though the returns, therefore, of the foreign trade of consumption should be as quick as those of the home-trade, the capital employed in it will give but one-half the encouragement to the industry or productive labour of the country [WN II.v.26].

A capital, therefore, employed in the home-trade will sometimes make twelve operations, or be sent out and returned twelve times, before a capital employed in the foreign trade of consumption has made one. If the capitals are equal, therefore, the one will give four and twenty times more encouragement and support to the industry of the country than the other [WN II.v.27].

This implicitly contrasts with a situation where capital is directly and immediately invested in production or in facilitating domestic trade. It is on this same principle that Smith forms an even more negative judgement of investment in the carrying trade, citing it as the least desirable and least important use of capital:

That part of the capital of any country which is employed in the carrying trade, is altogether withdrawn from supporting the productive labour of that particular country, to support that of some foreign countries. [WN II.v.30]

The capital, therefore, employed in the home-trade of any country will generally give encouragement and support to a greater quantity of productive labour in that country, and increase the value of its annual produce more than an equal capital employed in the foreign trade of consumption: and the capital employed in this latter trade has in both these respects a still greater advantage over an equal capital employed in the carrying trade. [WN II.v.31]

To recapitulate: in Smith's view of the sequence of growth, the best and most natural channel for capital is its investment in home production (first agriculture, then manufacturing), followed by domestic trade, followed by bilateral foreign trade. Last in this sequence is the carrying trade, which is that much worse because it deals entirely in foreign goods, meaning that a home (say, British) merchant's capital is to be advanced in the interim to foreign producers rather than invested in home production. For this reason, foreign trade—and especially the carrying trade—cannot be the engine of growth.

It is important to note however that Smith's view in this case was peculiar and deficient: the profitability of any investment does not after all simply turn on the number of steps or degree of roundaboutness of the transaction without reference to the rate of return of each individual transaction. Smith's contemporary commentator Pownall [1778: 24] noted as much when he distinguished between a "circuitous trade", which involved trading at different points with a profit on exploiting divergent international values, versus a "roundabout trade", which unnecessarily diverts the course of commodities. Smith however worked with categories where commodities always and everywhere exchanged at their values,

so that no special advantages could be had in shuttling commodities between different ports.

Nonetheless, despite this apparent difference, the more important common ground between Azcárraga and Smith is their stress on capital accumulation as the source of development. Smith writes: “The industry of the society can augment only in proportion as its capital augments, and its capital can augment only in proportion to what can be gradually saved out of its revenue” [WN IV.ii.13]. Azcárraga differs from this only in the *means* by which he thinks capital accumulation can be best achieved. Smith’s judgement was based on the presumed higher returns to be had by first investing in internal economic activity. Azcárraga thought on the contrary that the carrying trade provided the highest returns to capital, which when exploited would have been the source of capital for domestic investment. As previously quoted, he predicted that based on an unrestricted carrying trade, “the wealth of the city would in no time have grown annually in proportion, and there would have been abundant capitals that, dedicated to agriculture, would have yielded the natural products to sustain that an export trade and in consequence, also the import trade” [LC 95]. Alternatively, if not from domestic capital, the higher profits from free trade would attract foreign capital, which would then ultimately be invested in agriculture and (perhaps) manufacturing. It is in these more important senses that he thought trade would serve as the engine of growth. Their differing conclusions notwithstanding, the same principle underlay Smith’s and Azcárraga’s arguments, namely, the reliance of industrial progress upon capital accumulation. As to why Smith’s order of industrial progress differed from his, Azcárraga would probably have used Smith’s own argument, i.e., that *laissez faire* should be left to determine the “natural” course of capital; and in the Philippines this was at least initially not in agriculture and certainly not in crafts manufacturing but in the carrying trade, where mercantilist restrictions had artificially suppressed the inflow of capital.

12. Welfare effects

More generally, Azcárraga’s advocacy derives from a utilitarian, essentially Benthamite, vision of maximising the “common good” (*utilidad comun*), which he believed could be achieved mainly through the lower prices and abundance afforded by free trade:

If we study the objective idea of the system of free trade, we shall see that setting down its principles does not entail rising to some lofty sphere, but rather descending to something as mundane as commerce; *the objective of this doctrine is to provide all peoples with abundant, good, and cheap goods, that is, to make foodstuffs and other objects necessary or useful in life available to the greatest possible number of human beings*, which is, without a doubt,

to provide the *highest degree of well-being to all classes of society and thus to contribute to the general good, the benefit of all, or what we have above called the common good* [utilidad comun]. [LC 202] (Emphasis supplied.)

To his credit, Azcárraga's welfare criterion for trade policy reform extended beyond the fiscal and political benefits to Peninsular Spain, or to the profits accruing to Manila's trading community. Rather it consisted primarily in uplifting the material well-being of the native population—a remarkable fact considering that his advocacy was not meant to assuage or curry favor among Filipinos but to persuade Spanish colonial policy makers:

... [T]here is no doubt that it would be a great benefit for the Islands if, instead of the *indio* living in a poor shack, without a chair, without a bed, without a table, without any dishes to partake of his meager ration of rice and salt, we should rather see him at least living in a wooden house, with a roof that protects his modest fortune and gives him relief from the frequent scourge of fires; that we should see him eat a frugal but abundant meal at a rustic table; and that instead of covering his nakedness with rags, he should be dressed properly as the requirements of decency and hygiene demand.

These improvements, which are far from the attainment of a perfect state, would mean, however, a great improvement in the welfare of the people and would give a highly favorable idea of the ruling nation, of the nation entrusted with propagating in those countries, along with the light of Christianity, the benefits of European civilization, its inseparable companion. [LC 204-205]

Moreover, unlike mercantilists who tended to exclusively cite the benefits coming from the export trade and a positive trade balance, Azcárraga stresses the more immediate welfare benefits that imports bring to consumption, i.e., affording consumption goods that are cheaper to import than to produce domestically ("cheapness"). He also notes the further positive effect of imports on productivity since—relative to autarky or a regulated trade regime—imports allow a country to acquire intermediate inputs and producer goods. Finally, he cites the incentive effect of newly created wants owing to exposure to new goods:

...[W]e shall say with respect to the Philippines that free trade is cheap rice, an idea which does not arise from the delirium of a feverish imagination but, on the contrary, a practical truth that cannot be more philosophical or humanitarian.

Whoever talks of cheap rice also talks of abundance and cheapness of the people's clothing, household furniture, instruments of the sciences and arts, farming tools, the means of transportation and communication—everything necessary for the development of human knowledge and the prosperity of industries, everything that leads to the provision of society's welfare. The desire

for what is cheap is a universal fact in history; at all times and in all countries, man is always in search for what is cheapest, even if he already has something else in hand, for it is in this manner that he gains more of means, more money to meet other needs, to satisfy other pleasures. [LC 218]

When rice and other foodstuffs, household essentials, tools and instruments for farming and for other industries shall have attained the greatest cheapness in their prices, then shall we see abundance on the native's table, comfort in his homes and improvement in his industries; for the amount that it costs for him to live badly today would be the same as what it would cost him to live well; and those newly created needs will be a new stimulus for work, to produce more in order to satisfy more enjoyments, and will launch the native into the great reciprocal and continuous movement of today's civilization to produce and to consume. [LC 206-207]

The reference to rice is portentous but the theory behind the proposal was straightforward, i.e., allowing free import and export of the good in order to moderate price fluctuations:

[S]o that when there is a large harvest it will be easy and expeditious to bring the cereal for sale to neighboring markets to the great benefit of the producer, and when there are shortages in the islands, it is equally easy to bring it from other countries, so that this much-needed food may always retain a moderate price. [LC 19-20]

At the time Azcárraga wrote, the Philippines was a marginal rice exporter [LC 19; 221-222]. He anticipated only a minor disruption to the country's rice-surplus status resulting from a further expansion of the other major export commodities, since he believed farmers would always put a high priority on cultivating the all-important food staple for their needs. Indeed, he looked forward to expanding exports to rice-deficit countries such as China and Vietnam [LC 16]—an ironic conjecture in light of current circumstances. In any event, even the Philippines' relegation to a net rice importer would not have concerned Azcárraga, since it would still have achieved the goal of "cheapness".

Azcárraga did not perceive the costs of adjusting to free trade to be substantial, and his views on the production effects occasioned by trade specialisation were quite sanguine. With regard to the effects of free trade on native crafts production, he first of all argues that a minimum level of craft industry serving the domestic market would nonetheless survive trade liberalisation, since foreign products—in his example, imported versus native textiles—would be unable to compete with domestically oriented craft products in terms of price and quality (i.e., essentially product differentiation). This natural protection would be further enhanced if free trade made available intermediate inputs and machinery needed by crafts.

The Philippine islands are not strictly speaking a sphere of manufacturing; their great wealth lies in agriculture and consists in the production of items desired in all parts of the globe: it is true a good part of the fabrics consumed in the country are the product of domestic industry, such as gingones, rayadillos, *nipis*, *piña* and *sinamay*; but we doubt that similar foreign fabrics can compete advantageously with those in terms of price; it is necessary to take into account two very important points with respect to these industries: one is that almost all of them need cotton and silk, whose raw materials will abound in the market owing to the free entry that our system would give to everything that comes from abroad; and the same would happen in regard to all the machinery that these industries need to perfect and to be able to reach all the cheapness that we seek for the life of the natives. [LC 218-219]

The second reason he cites for low transition costs is the low level of fixed capital involved in any crafts production that might possibly be displaced. A reallocation of resources would therefore not result in large capital losses:

The other point is a special characteristic of that country; all this non-negligible volume of manufacturing that is produced in it comes from industries that can be called domestic, comes from looms in which a small number of male and female workers work, which most often are the family itself and some close friends of the modest businessman: there are therefore no large factories and no capital employed in these industries; thus, *if with the approach of our system it was necessary to abandon these manufactures, which we doubt, there would be no lost capitals, there would be no ruined industries; with the same ease with which they set up their looms, they will adopt another way of living and if they dedicate themselves to agriculture, exploiting those immense valuable lands, they will improve their situation and the country will win, greatly*; To verify this assertion, one need only compare the wealth and well-being of the provinces that produce only rice and those textiles with that of others that produce sugar and abaca. [LC 219] (Emphasis supplied)

13. The customs house—the last obstacle

Any consistent advocacy of free trade must ultimately deal with the issue of the imposition of any form of trade taxes—both tariffs and export duties. This final issue preoccupied Azcárraga when he discussed the final epoch of development of Philippine commercial policy.

Even as he extolled the virtues of free trade and advocated the complete abolition of trade taxes as a matter of principle—calling customs duties “the biggest hindrance the progress of humanity has encountered” [LC 215] and an “anachronism” in the century of steam and electricity [LC 216]—Azcárraga

nonetheless wrote pragmatically when it came to the sequence of reforms needed for progress on the issue of complete trade liberalization. He recognized first of all that tariffs constituted a significant source of government revenue. To replace the customs revenue to be potentially foregone, he proposed to gradually replace them with various internal taxes, applied sequentially in a well-defined manner.

As a first step, he proposed levying location-specific taxes on provinces associated with specific exporting industries such as abaca, sugar, and coffee, which he argued would benefit with certainty and immediately from the reduction in transactions costs from the opening of regional ports to international shipping. It is important to note that he did not appear to have in mind trade taxes on the exports *per se*, but on economic activities within the exporting provinces, including agricultural production and processing as well as the wholesale and retail trade, the professions, and activities entailing significant capital investments [LC 227]. It is less clear how he proposed to determine the exact bases of taxation for such different activities. At any rate, he saw such domestic taxes as effectively skimming off some of the windfall gains from the expansion of trade and the economic activity it would stimulate, not only among the direct exporters but among the broader provincial population of exporting provinces.

More interestingly, he saw this as an important step in demonstrating to the native population that justice and equity could be embodied in the tax system, since it would not exempt people on the basis of race or privilege:

...[T]he natives would be shown a healthy example of justice where *he who has more, pays more*; and one would thereby combat the preconception—widespread in the country and founded in the current tax system—that paying a tax is a diminution, while not paying denotes, if not nobility then least a kind of superiority that is hard to reconcile with a prudent policy of assimilation that accords with the spirit of our laws of the Indies and modern provisions. [LC 227-228] (Emphasis supplied.)

This proposal must be viewed in the context of the then-existing system where Spanish citizens were exempt from paying the head-tax or tribute. Azcárraga was effectively proposing a gradual application of a personal tax regardless of race.

Azcárraga then turns his attention to the abolition of the long-standing tobacco monopoly,⁴⁸ up to that time a major source of revenue. As replacement, he proposed a system of taxes on the harvesting, manufacture, and sale of tobacco products. Mindful once more of the possible loss in revenue in the transition, however, he proposed to abolish the monopoly only *after* taxes on the other exporting provinces had been levied. Here, a practical inkling of the theory of second-best can be detected, since Azcárraga proposed to remove a major distortion (the replacement

⁴⁸The monopoly was finally abolished in 1881, an event Azcárraga hailed in his intervention at the Luna-Hidalgo dinner.

of the monopoly with taxes) only after other branches had also been “distorted” with the application of taxes. Ultimately, he argues that abolishing the internal monopoly might even take priority over the adoption of free trade itself.

...[T]he principle of freedom of trade and industry requires that all branches enter into free exchange so that they may grow and improve. It therefore requires the suppression of another source of revenue which is the tobacco monopoly: the huge production of this commodity, the full benefit from which has not yet been realized, has for a century suffered the burdensome and most absurd of all contributions, and thus *efforts towards the abolition of this monopoly should almost be preferred over the abolition of customs duties; for in the end customs duties weigh equally upon all productive activities of the country, while the monopoly weighs down on only one branch of wealth, making its producers shoulder over half of the Islands' budget of expenditures.* [LC 225-226] (Emphasis supplied.)

In the above, Azcárraga argues that the adoption of free trade, a first-best measure, may not be optimal in the presence of domestic distortions. In his view of a reform sequence, once other export-benefiting areas have been properly assessed and taxed, the tobacco-producing areas may be liberated from the tobacco monopoly and placed on a similar footing without occasioning envy or distortion. This in turn would pave the way to the extension of internal taxation to the other areas of the country, including the larger non-exporting areas such as the great rice-growing provinces:

When these taxes are raised on commerce and industries and on the main branches of agricultural wealth, the injustice that other minor industries, trades, and other wealth do not also pay their corresponding share will jump out at you, and it will then be easy to make the rice-harvesting towns and all the natives understand that everyone, in proportion to their income or earnings, must contribute to the support of the different expenses of the State which benefit everyone; *thus we shall have established direct taxation, which is the fairest of all, and we shall be able to present in the Philippines a practical model of a perfect economic system.* [LC 230-231] (Emphasis supplied.)

There is every likelihood that Azcárraga's ideas directly influenced subsequent legislation enacted of his time. Aguilar [2019: 397-398] enumerates a series of proposals and actual measures of internal taxation beginning from 1874 to 1884 that seem to align both in rationale and form with Azcárraga's ideas. This is unsurprising since, it will be recalled, Azcárraga was appointed to the *Consejo de Filipinas*⁴⁹ in 1871 until he left for Spain to pursue a parliamentary career in 1876.

⁴⁹The council was created by a royal decree of December 4, 1870 as a consultative body for Philippine affairs under the Overseas Ministry.

Especially striking is the language of the reform proposal from that same council in 1874 that envisioned a replacement of the racially biased tribute with a “direct contribution based on wealth with no racial distinction”. This was to “demonstrate to the indio’s eyes that not to pay is not a sign of superiority. On the contrary, he who earns more and has more possessions pays more” (*el que más vale y posee, mas paga*) (as quoted in Aguilar [2019: 399]). This is a virtual paraphrase of Azcárraga’s words already cited [LC 227-228] about showing the natives a “healthy example of justice where he who has more, pays more (*mas pague el que mas tiene*)” and “combat[ing] the “preconception...that paying a tax is a diminution, while not paying denotes, if not nobility then least a kind of superiority”. Ultimately, of course this merely repeats the well-known Smithian maxim [WN V.ii.b.3] of payment based on ability to pay.

Equally striking however is the gradualism and sequence in which internal taxes were actually introduced, i.e., almost entirely in accordance with the reform sequence Azcárraga outlined in *Libertad*. Aguilar [2019: 399] notes that the council shied away from immediately replacing the tribute with a personal tax based on ability to pay—which would be the *cedula* introduced only in 1884. Instead, two taxes were introduced in 1878: a tax on urban property (*Urbana*) and one—more akin to licenses than a proportional tax—on business, trade, and the professions (*Industria*). These two, but especially the last, closely resembles the amorphous tax Azcárraga contemplated for the provinces that benefited from the opening of regional ports. They fall short of, but are nonetheless a step towards, that system of direct and proportional taxation he aspired to, which is “fairest of all” in a “perfect economic system” [LC 230-231]. It was subsequent to the introduction of these internal taxes that the tobacco monopoly was abolished (1882) whereupon the tribute was also finally replaced by the personal tax (*cedula personal*) (1884) which was imperfectly proportional to means. All in all, therefore, the sequence of legislated tax reforms conformed closely with what Azcárraga had outlined in *Libertad* more than a decade earlier.⁵⁰

14. Sequel and significance

At around the time he wrote, Azcárraga had all the reason to hope that the Philippines would prosper under Spanish rule by pursuing to the utmost the liberal trade policies he advocated. Spain’s own “Glorious Revolution” (1868),

⁵⁰ Aguilar [2019: 397] reports on Dela Costa’s speculation that a connection existed between Gregorio Sancianco’s [1975(1881)] treatise and the pace of reforms proposals by the Consejo, specifically the abolition of the tribute. The more reasonable direction of influence based on chronology, however, would be that Sancianco’s ideas built upon and reinforced those of Azcárraga, with which he will have been familiar. Sancianco’s proposals for presumptive taxation (see, e.g., de Dios [2013]), for example, were step closer to a system of proportional taxation than the *Urbana* and *Industria* taxes. Also significant is that Sancianco, like Azcárraga, clearly favored free trade as soon as internal sources could replace lost revenues from trade taxes [Sancianco [1975(1881):95].

despite its tumultuous aftermath, had created a succession of governments that invariably brought to power liberals and republicans receptive to economic and social, if not always political, reforms in the Philippines. Segismundo Moret, in particular, whom Azcárraga mentions in several places, was a free trade advocate who briefly became overseas minister under Prim.

Nonetheless the republicans who governed Spain at the time always sought a delicate balance between the liberal programme they wished to implement in the metropolis—which their Enlightenment ideology, by rights, required them to extend to the archipelago as well—versus supporting the conservative frailocracy whose cooperation was deemed essential for controlling the colony [Sarkisyanz 1995].⁵¹ It is perhaps for this reason Azcárraga chose to focus on economic reforms more than political ones, stressing instead the material benefits of trade and making clear his moderate to conservative political leanings:

We who have always shown ourselves more inclined to material reforms than to contests over political rights—because we see the latter only as means and the former as ends—have already stated on another occasion that the first among all rights is the freedom to sell goods wherever and in whatever form it best suits the owner, and the first of all freedoms is that of freely acquiring all objects, regardless of origin, that may suit the individual without the fiscus being allowed under any circumstances to impose limitations to the exercise of these important rights; for we believe that abundance and cheapness constitute the well-being of a people, and these can result only from the genuine and rigorous application of free trade to its fullest extent and with all its consequences. [LC 199-200]

Writing of that period, Legarda [1999:181] documents how the Philippines finally became transformed “from a subsistence economy to an export economy”, with developments to a great extent vindicating the mechanism Azcárraga’s envisioned. In particular, as trade was increasingly liberalized—with first Manila, then regional ports being opened to international shipping, with low tariffs enacted, and with the differential flag rights removed—foreign capital did indeed come to take a much larger interest in the Philippines, to the point that the country could almost be called an “Anglo-Chinese commercial colony flying a Spanish flag” [Legarda 2012]. Foreign merchant houses advanced capital to farmers for crops and introduced machinery that facilitated the cultivation of export crops, particularly sugar and abaca, causing an unprecedented regional specialization. The weakness of Spain’s ability for commerce and capital created a unique phenomenon where the colonial power could not exercise monopoly control, so that foreigners had to deal directly (and more favorably) with local entrepreneurs

⁵¹ This difficulty is exemplified by the fate of Moret’s radical act as overseas minister (1870) to secularize the University of Santo Tomas and convert it into the State University of the Philippines, a move that was suspended upon facing opposition by the Dominicans [Sarkisyanz 1995:103].

and producers. Legarda [2012: 46] shares Chaunu's [1960: 21] assessment of "the great period 1820-1898 which, all things considered, constitutes in the history of the Philippines the only moment of real near-independence". In particular, Legarda [2011:14] calls the second half of the 19th century "a period of growth and diversification" and details the advances in communications, finance, and infrastructure that occurred during the period.

However, Azcárraga's prognosis underestimated the adjustment costs arising from trade liberalization (perhaps a cautionary tale in a modern setting). He had argued that labor mobility, combined with low fixed-capital in the activities to be displaced, would mean only minimal welfare losses as the working population shifted from activities oriented to the domestic market to those meant for exports. Any losses or reduction in food crop production might easily be replaced by imports financed by the more valuable export crops. The actual results were less than ideal, however, since the areas and populations that gained from the new export economy were different from those that lost from because of it and compensation of the losers from trade was far from assured. Legarda [1999: 173-180] cites Panay and Ilocos as examples. Panay's economy previously involved rice production alongside a native weaving industry run mostly by women who provided supplementary incomes for their families. The weaving industry however was ruined by imports of manufactured textiles, which displaced a good deal of labour, particularly among women. The diversion of labour to the emerging sugar sector (in neighboring Negros) affected food production in Panay, which together with the loss of supplementary incomes from weaving created serious regional food shortages and famines in the 1870s. Legarda hypothesizes that the resulting poverty and emigration out of the Ilocos region in the 1870s may have been the result of similar forces, namely the decline of cotton cultivation and weaving as sources of side-incomes as manufactured textile imports came to rule the field. The country in the meantime turned from a marginal rice exporter to a permanent rice importer. Changing world prices for export crops caught in the rapid technological changes of the Industrial Revolution (e.g., indigo being replaced by chemical dyes) also required a nimbleness in shifting production that for many peasant smallholders was simply absent.

Still, there was no doubt that the country prospered in aggregate terms during this period, and the efficiency and productivity Azcárraga predicted would arise from freer trade did indeed bring about the economic improvement he desired. This was most visible in the rise of a nascent native middle class that profited from the economic opening, from whose ranks would later rise the *ilustrados*. The absence of an adequate transport infrastructure and a competent national administration, however, meant that the gains from trade would always be unevenly distributed across regions and across classes.

Azcárraga had originally expected the new prosperity to demonstrate Spain's benevolence towards its colony and therefore serve to bind the Philippines

closer to the metropolis. Material improvement would, he thought, preserve the Philippines for Spain. Pardo de Tavera saw the same forces at work which Azcárraga predicted but also the radical social and cultural changes this new affluence brought:

Freedom of trade was bound to bring capital and active people from outside the archipelago. Capital would be of use to develop production and, naturally, consumption and exportation. Persons who came freely brought new ideas, new methods, new moral and intellectual needs, without the support of privileges which served for exploitation, so that such men had to influence favorably the progress of the Filipinos...Freedom of trade brought about the development of agriculture which had already been initiated by the Real Compañía...Wealthy citizens would come to Manila, make purchases, become acquainted with the great merchants who entertained them in their quality as customers, whose trade they needed; they visited the Governor-General, who would receive them according to the position their money gave; they came to know the justices of the Supreme Court, the provincials of the religious orders; they brushed up as a result of their contact, with people of the capital and on returning to the pueblo, they took in their hearts and minds with them the germ of what was subsequently called subversive ideas and later *filibusterismo*. (Quoted in Legarda [1999: 215].)

It was not only travel to the capital, of course, that provided the source of these dangerous ideas. More potently, the newfound prosperity would allow many native families to send their scions abroad, particularly to Spain for studies, where Filipinos would find a fountainhead of republican, liberal, even revolutionary thought that could feed the dry wells at home. It might therefore be said, if crudely, that free trade made possible the likes of a del Pilar, a Lopez-Jaena, a Rizal—and ultimately even a Bonifacio.⁵² But even as they were its creations, such men would demand more than the freedom of commerce and material progress Azcárraga advocated. They would push further and demand that the political rights and freedoms they knew existed in Spain—which Azcárraga regarded only as “means” rather than “ends”—should also be extended to the Philippines.

The final outcome of the struggle for those demands was one Azcárraga was unlikely to have foreseen.

⁵² Although Bonifacio did not travel abroad or have a family background in commercial crop agriculture, he was employed by foreign merchant firms that were a crucial element of the export economy.

Acknowledgement: This essay is dedicated to the memory of Dr. Benito F. Legarda, Jr., who many years ago first called the author's attention to Azcárraga's work. Quoted passages from *Libertad* are my translations from the original Spanish; page numbers refer to locations of the quoted material in the original publication. I am grateful to an anonymous referee for suggested improvements. Remaining errors and omissions are my own. A grant to professors emeriti from the University of the Philippines is gratefully acknowledged.

References

- Acemoglu, D., S. Johnson, and J. Robinson [2001] "The colonial origins of comparative development: an empirical investigation", *American Economic Review* 91(5):1369-1401.
- Aguilar, F. [2019] "Gregorio Sancianco, colonial tribute, and social identities: on the cusp of Filipino nationalist consciousness", *Philippine Studies* 67(3-4): 375-410.
- Arteaga, F., D. Desierto, and M. Koyama [2020] "Shipwrecked by rents", (September 15). Available at SSRN: <https://ssrn.com/abstract=3693463> or <http://dx.doi.org/10.2139/ssrn.3693463>. Accessed 30 April 2022.
- Azcárraga y Palmero, M. [1872] *La libertad de comercio en las Islas Filipinas*. Madrid: Jose Noguera. Available from: <https://www.cervantesvirtual.com/downloadPdf/la-libertad-de-comercio-en-las-islas-filipinas-878094/>. Accessed 20 September 2019.
- Bernstein, W. [2008] *A splendid exchange: how trade shaped the world*. New York: Grove Press.
- Bloomfield, A. [1989] "Aspects of the theory of international trade in France: 1800-1914", *Oxford Economic Papers*, New Series, 41(3):619-639.
- Blair, E. and J. Robertson [1903] *The Philippine islands, 1493-1898* (55 vols.). Cleveland, Ohio: Arthur H. Clark Co. Available from: <https://quod.lib.umich.edu/p/philamer/afk2830.0001.001/15?page=root;size=100;view=image;q1=blair>. Accessed 26 November 2021.
- Castillo, A. [1980(1930)] *Spanish mercantilism: Gerónimo de Uztáriz—economist*. Philadelphia: Porcupine Press.
- Chang, H. and J. Gershaman [2003] "Kicking away the ladder: the (real) history of free trade", *Foreign Policy* (December). Available from https://fpif.org/kicking_away_the_ladder_the_real_history_of_free_trade/. Accessed 15 January 2022.
- Chaunu, P. [1960] *Les Philippines et le Pacifique des Iberiques (XVIc, XVIIc, XVIIIc siècles). Introduction méthodologique et indices d'activité*. Paris: S.E.V.P.E.N..
- de Dios, E. [2013] "Gregorio Sancianco: an early advocate of presumptive taxation", *History of Economic Ideas* 21(3):69-90.
- Elmslie, B. [2018] "Adam Smith's discovery of trade gravity", *Journal of Economic Literature* 32(2):209-222.

- Findlay, R. and K. O'Rourke [2007] *Power and plenty*. Princeton and Oxford: Princeton University Press.
- Fish, S. [2011] *The Manila-Acapulco galleons: treasure ships of the Pacific*. Central Milton Keynes: Authorhouse.
- Giraldez, A. [2015] *The age of trade: the Manila galleons and the dawn of the world economy*. London: Rowman and Littlefield.
- Glahn, R. von [1996] "Myth and reality of China's seventeenth-century monetary crisis", *Journal of Economic History* 56(2):429-454.
- Hamilton, C. [1986] "The upgrading effect of voluntary export restraints", *Review of World Economics* 122(2):358-364.
- Legarda, B. [1999] *After the galleons: foreign trade, economic change, and entrepreneurship in the nineteenth century Philippines*. Quezon City: Ateneo de Manila University Press.
- Legarda, B. [2011] "The economic background of Rizal's time", *Philippine Review of Economics* 68(2):1-22.
- Legarda, B. [2012] "The Spanish flag over an Anglo-Chinese commercial colony: the Philippines in the 19th century", *Philippine Review of Economics* 59(2):41-50.
- Lin, J. and H. Chang [2009] "Should industrial policy in developing countries conform to comparative advantage of defy it? A debate between Justin Lin and Ha-Joon Chang", *Development Policy Review* 27(5):483-502.
- Myint, H. [1958] "The 'classical theory' of international trade and the underdeveloped countries", *Economic Journal* 68(270):317-337.
- Myint, H. [1977] "Adam Smith's theory of international trade in the perspective of economic development", *Economica* 44(175):231-48.
- Pownall, T. [1778] *A letter from Governor Pownall to Adam Smith, etc.* London: J. Almon. Available from: <https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/smith/letterpownall.pdf>. Accessed 20 October 2021.
- Riedel, J. [1988] "Trade as an engine of growth: theory and evidence", in: D. Greenaway (ed.) *International trade and economic development*. London: Macmillan Education. 25-54.
- Rizal, J. [2004(1890)] *The indolence of the Filipino* (C. Derbyshire, trans.) e-book version. Available from: <http://www.gutenberg.org/cache/epub/6885/pg6885.html>. Accessed 20 December 2020.
- Rodriguez Martin, M. [1989] "La institucionalizacion de los estudios de economia politica en la universidad Española (1776-1857)", *Revista de Historia Económica* 7(2) Supplement:89-91.
- Sancianco, G. [1975(1881)] *The progress of the Philippines: economic, administrative, and political studies*, transl. by E. Alzona, Manila, National Historical Institute.
- Sarkisyanz, M. [1995] *Rizal and Republican Spain and other Rizalist essays*. Manila: National Historical Institute.

- Saylor Academy [2012] *International trade: theory and policy*. Available from: https://saylordotorg.github.io/text_international-trade-theory-and-policy/index.html Accessed 22 September 2021.
- Schumacher, J. [1973] *The Propaganda Movement: 1880-1895*. Manila: Solidaridad Publishing.
- Schumacher, R. [2020] "Altering the pattern of trade in the Wealth of nations: Adam Smith and the historiography of international trade theory", *Journal of the History of Economic Thought* 42(1):19-42.
- Schumacher, R. [2018] "Adam Smith, the patterns of foreign trade and the division of labour: a country as a jack-of-all-trades rather than a specialist", *The Adam Smith Review* 10:4-21.
- Schumacher, R. [2015] "Adam Smith's 'two distinct benefits' from trade: the dead end of 'vent-for-surplus'", *History of Political Economy* 47(4):577-603.
- Schumpeter, J. [1954] *History of economic analysis*. New York: Allen and Unwin.
- Schurz, W. [1985(1939)] *The Manila galleon*. Manila: Manila Historical Conservation Society. (Originally published in 1939 by E.P. Dutton, New York).
- Smith, A. [1976(1776)] *An inquiry into the nature and causes of the wealth of nations*. 2 vols. R. Campbell and A. Skinner, eds. Oxford: Clarendon Press.
- Takagi, Y. [2008] "Politics of the Great Debate in the 1950s: revisiting economic decolonization in the Philippines", *Kasarinlan: Philippine Journal of Third World Studies* 23(1):91-114.
- Toribio, J.M.C. [n.d.] "Marcelo de Azcarraga y Palmero", *Diccionario Biografico, Real Academia de la Historia*, <https://dbe.rah.es/biografias/7296/marcelo-de-azcarraga-y-palmero>.
- Williamson, J. [2020] "Economist, historian, and patriot: Benito J. Legarda 1926-2020", *Philippine Review of Economics* 57(2):46-47.