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World Institute for Development Economics Research

Research Paper No. 2006/72

The Role of Federalism in Developing the US during Nineteenth-century Globalization

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July 2006

Abstract

During its development into a continental empire, the US, like other countries relied on the investment of capital and labour from abroad; unlike other countries, the US had a peculiar political institution, federalism, which channeled these resources and also determined the course of protest against these resources. The paper argues that federalism played a key role in determining the course of US economic development and reaction to this early instance of globalization, a role with possible lessons for other countries today.

Keywords: federalism, globalization, development, United States

JEL classification: N21, N41, N91

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This study has been prepared within the UNU-WIDER project on Institutions for Economic Development: Theory, History and Contemporary Experiences, directed by Ha-Joon Chang.

UNU-WIDER acknowledges the financial contributions to the research programme by the governments of Denmark (Royal Ministry of Foreign Affairs), Finland (Ministry for Foreign Affairs), Norway (Royal Ministry of Foreign Affairs), Sweden (Swedish International Development Cooperation Agency – Sida) and the United Kingdom (Department for International Development).

ISSN 1810-2611 ISBN 92-9190-850-9 (internet version)

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Camera-ready typescript prepared by Adam Swallow at UNU-WIDER

Despite disputes over the inputs to globalization in the long nineteenth century, the major outcome has been generally agreed since at least the publication of Sellar and Yeatman's pithy assessment of the world at 1918: 'America was thus clearly top nation, and History came to a .'[1] Later scholarly refinements in this view stress the United States of America's position as principal beneficiary of the free movement of both labour and capital in the 'first great globalization boom', but the essential point remains the same: the US received the lion's share of internationally mobile capital and labour[2] and the Americans made such profitable use of these additions to their already prodigious factor endowment that they transformed their nation within a scant few decades from the world's great debtor to its great creditor, and thus stood ready, at least in respect of their economic capacity, to assume the role of 'top nation', as recently vacated by Great Britain. We might therefore quite reasonably suppose that as an obvious outlier in the pool of developing nations the US might not provide usable lessons in the role of institutions on the course of development. But this is true only if we consider national economies as impervious black boxes – if we think, in short, in Sellar-and-Yeatmanesque terms of top *nations*. If we consider that regions within the US developed with marked unevenness, we should learn a set of lessons from the American pattern of development that might have a broader modern application.[3] The dispositive governmental institution in determining the unevenness of American development was federalism, by which we mean the relative autonomy of geographic regions within the nation, which were also represented, as regions, in the national legislature. This institution not only abetted the disparity of development among the Northern, Southern, and Western sections of the US, but also ensured that the emergent 'top nation' in 1918 had a state possessing few central powers, but considerable economic regulations nevertheless. The distinguishing characteristic of American federalism, as we shall consider it here, is its tendency to give representation and a measure of self-government (including the ability to borrow, develop infrastructure, and set social policy) to regions for essentially arbitrary reasons, irrespective either of their population or of their cultural integrity.

Scholars generally regard federalism as one of three central defining features of American constitutionalism, the others being presidentialism and judicialism. All three institutions provide that some parts of the political structure enjoy a significant degree of independence from the national legislature – presidentialism entails a strong executive independent of the legislature and judicialism a strong judiciary independent of the legislature; federalism entails strong semi-sovereign local entities, principally the states, largely independent of the national legislature. Federalism has traditionally attracted a great deal of international interest, at least since Tocqueville, for its ability to defuse political differences within a large polity. In turn American federalists had borrowed extensively from David Hume, and the political functions of federal union have a long transatlantic history. But federalism played an important and

[1] Which is to say, 'full stop.' W. C. Sellar and R. J. Yeatman, *1066 and All That* (1931; reprint, New York: Barnes & Noble, 1993), p. 115.

[2] Kevin H. O'Rourke and Jeffrey G. Williamson, *Globalization and History: The Evolution of a Nineteenth-Century Atlantic Economy* (Cambridge, MA: MIT Press, 1999), p. 4.

[3] See e.g. David F. Good, 'Uneven Development in the Nineteenth Century: A Comparison of the Habsburg Empire and the United States', *Journal of Economic History* 46, 1 (1986): 137-151.

underappreciated role in allowing Americans to adapt to the specific conditions of nineteenth-century globalization.[4]

Federalism had three principal consequences in the course of American development.

i) Local autonomy meant that different regions established institutions conducive to economic development at different rates; it also meant that the nation developed such institutions more swiftly than it would have under a national regime.

ii) Local autonomy under a national umbrella encouraged the establishment of the characteristically American layer of private investment-bank intermediaries that helped direct overseas investment in the developing US economy.

iii) Local autonomy combined with the foregoing factors channeled regional politics of protest against industrialization into the arena of national politics, shaping the modern American state.

If we wish to draw conclusions for the present day from this history, we should carefully consider the role played by federalism both in determining US success at attracting investment in the nineteenth-century era of globalization and also in distributing the benefits of that investment within the United States.

First we should consider the role of institutions in the phenomenon of American divergence. Kenneth L. Sokoloff and Stanley L. Engerman frame the debate over the role of institutions in development by noting that the divergence between the North American nations of the US and Canada and the rest of the Western hemisphere does not appear until the era of industrialization, in the early 1800s.[5] Prior to that the Caribbean islands were richer. Thus the literature on differential development within the New World normally emphasizes variation in habits and institutions associated with growth of industry – 'security of property rights, prevalence of corruption, structures of the financial sector, investment in public infrastructure and social capital, and the inclination to work hard or be entrepreneurial'.[6] But as Sokoloff and Engerman also remark it is difficult in turn to identify the encouraging factors in the establishment of such institutions. National heritage – thst is, the legacy of colonization by Britain as opposed to colonization by Spain – does not explain much of the international divergence in development. And initial factor endowments look similar across New World nations, all of which had relatively high availability of land and other natural resources and low supplies of labour. What differed was inequality, which was higher in

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4 On elements of American constitutionalism and their influence abroad, see George Athan Billias (ed.), *American Constitutionalism Abroad: Selected Essays in Comparative Constiutional History* (New York: Greenwood, 1990); Albert P. Blaustein, *The Influence of the United States Constitution Abroad* (Washington, DC: Washington Institute, 1986). On Hume and American federalism, see Douglass Adair, '"That Politics May Be Reduced to a Science": David Hume, James Madison, and the Tenth Federalist', in *Fame and the Founding Fathers: Essays by Douglass Adair*, Trevor Colbourn (ed.) (New York: W. W. Norton, 1974). See also Donald W. Livingston, *Philosophical Melancholy and Delirium: Hume's Pathology of Philosophy* (Chicago: University of Chicago Press, 1998), pp. 318-24.

5 Kenneth L. Sokoloff and Stanley L. Engerman, 'History Lessons: Institutions, Factor Endowments, and Paths of Development in the New World', *Journal of Economic Perspectives* 14, 3 (2000): 217-32.

6 Ibid. 218.

the richer Southerly countries, which subsequently established institutions that encouraged the persistence of inequality and inhibited growth. The US and Canada did otherwise, instead promoting the rapid settlement of their profitable interiors, extending the suffrage, and promoting education. Sokoloff and Engerman hypothesize these institutions reinforced early patterns of lower inequality in the North American nations and encouraged sustained early economic growth through investment in increasing the productive capacity of larger numbers of people.[7]

To this point we are on relatively familiar ground. Even if we abandon the old theories of cultural heritage, which amount to little more than racial inheritance by another name, we face the same point – an institutional mix favouring economic development (Sokoloff and Engerman say, because it did not favour inequality) prevailed in the United States. We often find ourselves stuck at this point because we insist on thinking in terms of national economies – of the United States as a whole – rather than of constituent components. Yet we know full well both that economic development occurred unevenly within the United States and also that the institutions favouring it developed unevenly as well. This uneven development created pockets of economic backwardness within an otherwise forward country. But it also shaped the overall national process of development.

1 Regional representation and institutions favouring economic development

If it is true that the US established institutions, like widespread education, that promoted development of their interiors, it is also true that these institutions did not appear throughout the country but were concentrated in particular regions. Research on the determinants of international variation in developing these institutions indicates that regional representation and local autonomy played a key role not only allowing the creation of backward pockets within the United States but also in pushing the US to the forefront of nations encouraging economic development. Peter H. Lindert finds that the forward position of the US in developing primary schooling owed principally to the nation's decentralized character, which allowed the pro-schooling North to move ahead with establishing an extensive educational system in the early nineteenth century while the South, less enthusiastic about learning, remained behind.[8] Lindert shows that the decentralization of representation allowed the whole country to move ahead faster than it would have with a more central, national government that would have required a national majority to set pro-schooling policy. And it allowed the South to remain backward. Despite a momentary shift in Southern opinion in the era of Reconstruction that followed the Civil War – when Southern states had some degree of black voting and a viable Republican Party – the subsequent era of segregation in the 1880s and 1890s saw Southern retrenchment and a reaffirmation of its determination to underfund schools.[9]

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7 Ibid. 230.

8 Peter H. Lindert, *Growing Public: Social Spending and Economic Growth since the Eighteenth Century* (Cambridge: Cambridge University Press, 2004), pp. 104-127.

9 Ibid. 126-7.

Table 1 Lindert’s model showing how regional outonomy encourages the establishment of schools*

	Share of voters in favour of taxes and public schools			Whose children get public schools?	
Era	North	South	Both	With decentralization	With centralization
Backward era	30%	10%	20%	none	none
Early rise	55	25	40	North only	none
Middle era	70	40	55	North only	all
Advanced era	85	55	70	all	all

* The hypothesis is two regions, North and South, with differential desires for better schooling that advance as economic development in the region advances. From Lindert (2004: table 5.4).

The nineteenth century thus established the pattern of a Northern US willing to invest in institutions like widespread public education that encouraged economic development while the Southern US resisted this use of public funds. The same pattern applied to investment in infrastructure: Northern politicians tended to favour spending public monies on roads, canals, and railways while Southern politicians did not. This regional disparity had an expected outcome both in the proliferation of such transport links in the North and, if Lindert’s model of education funding applies here too, which seems reasonable, in the country overall to a greater degree than would have been the case had Americans relied solely on their national government to fund such improvements. It had an unexpected outcome in contributing to the growth of another institution critical to the pattern of American development.

As Joel Silbey notes, the strong partisan division within the US over the use of federal money for internal improvements in infrastructure complemented and cut across a sectional division over the same issue. Democrats, also known as Jacksonians, strongly opposed the use of federal dollars to pay for such improvements, leaving their opponents, the Whig party, to favour it. But even within the Whig party, Southerners remained ambivalent about the use of national power to promote such expansion. The Whigs, the national party nominally favouring central funding of infrastructure development, thus failed to present a unified front on this issue. The funding of infrastructure fell to local authorities including, principally, state governments who sold bonds to pay for them.[10]

This considerable borrowing, followed by the economic downturns of the late 1830s and early 1840s, led eight states and the territory of Florida to default on their debts, much of which had found its way into the hands of British investors. At the time the British writer Sydney Smith, who had invested in the bonds of Pennsylvania, railed against the Americans for refusing to raise their taxes sufficiently to honor their obligations, condemning them as ‘a nation with whom no contract can be made, because none will be kept; unstable in the very foundations of social life, deficient in the elements of good faith, men who prefer any load of infamy however great, to any

[10] Joel H. Silbey, *The American Political Nation, 1838-1893* (Stanford: Stanford University Press, 1991), pp. 85, 277 n39; and see also 160-2.

pressure of taxation, however light'.[11] John J. Wallis, Richard Sylla, and Arthur Grinath III find that at least in the case of Pennsylvania Smith was correct; the state should have been able to avoid default if it had 'imposed a realistic property tax'.[12]

The case of Mississippi – the defaulter that stayed in default – presented a different picture, inasmuch as bigotry, which would keep the South underdeveloped for generations, played some role in its default and also because the reasons for its default differed. Wallis et al. point out that Mississippi borrowed heavily to establish a state bank for development purposes. When this bank failed, Mississippi chose to default. The Magnolia State might have devoted its tax revenues, which were sufficient to the purpose, to covering its debts but chose instead to repudiate. Its Governor, Alexander McNutt, explained that this was in part because the debt would only enrich one of the Rothschilds:

> [Rothschild] has advanced money to the Sublime Porte [i.e. the Ottoman Empire, and Islamic kingdom; this was not true], and taken as security a mortgage upon the Holy City of Jerusalem, and the Sepulchre of our Saviour. [This was not true either, though it helped inflame anti-Semitic prejudice.] It is for the people to say whether he shall have a mortgage on our cotton fields, and make serfs of our children. Let the Baron [Rothschild] exact his pound of flesh of ... the Bank of the United States…[13]

Such generalized anti-foreign sentiment, coupled with other forms of racism or religious bigotry, helped keep the South isolated from internationally mobile capital and also from internationally mobile labour. Despite the hopes of New South boosters that immigration might reinvigorate the Southern economy after the end of slavery, few immigrants went to the South and those that did go soon left, unimpressed by the returns to plantation labourers and little interesting in being 'treated just as the black race used to be'.[14]

To this point we have seen that the institution of federalism, so central to the United States constitution, allowed Northerners to indulge their preferences for schooling and thus to lift the educational level of the nation as a whole, and also to allow the South to exercise its preference for slavery, plantation agriculture, and their cultural consequences over economic modernization. These developments both kept the United States *per se* an attractive investment and ensured that global investment – whether of

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11 Sydney Smith, *Letters on American Debts* (London: Longman, Brown, Green & Longmans, 1843), p. 9.

12 John Joseph Wallis, Richard E. Sylla, and Arthur Grinath, III, 'Sovereign Debt and Repudiation: The Emerging-Market Debt Crisis in the US States, 1839-1843', (National Bureau of Economic Research, 2004), NBER Working Paper 10753, 1-50, p. 23.

13 'Veto Message of Governor M'nutt, of Mississippi', *U.S. Commercial and Statistical Register*, 5 May 1841, p. 276. The Rothschilds did not establish a lending relationship with Turkey until 1854; the rumour that they had or wished to acquire Jerusalem was an anti-Semitic myth of long standing in the US press. See Niall Ferguson, *The World's Banker: The History of the House of Rothschild* (London: Weidenfeld & Nicolson, 1998), pp. 584, 419-20.

14 Rowland T. Berthoff, 'Southern Attitudes toward Immigration, 1865-1914', *Journal of Southern History* 17, 3 (1951): 328-60, p. 331.

capital or labour – went chiefly into the Northeast of the country and into those regions most tightly tied to it – the industrial Great Lakes region and, as rail lines extended under the pressure of investment capital, the further West.[15] The Northeast and the West became more developed sooner than the South, comprising a single, increasingly integrated market from which the South remained measurably excluded. And the institution of regional representation also encouraged the rise of another peculiarly American institution, the strong intermediary investment market of trans-atlantic banks.

2 Regional representation and private financial intermediaries

Within the world of nineteenth-century capital investment, the United States stands out as a peculiar case. This is not only because it received the largest single share of capital invested in developing countries – that is a question of quantity, and not necessarily an interestingly large quantity; relative to the size of its economy and to the capacity of American savers to invest, foreign investment in the United States did not amount to so very much. But in terms of the distribution of investment, foreign investment in the United States differed from foreign investment in other large borrowers. Particularly, while foreign investment in other developing countries went often into government securities, in the United States government borrowing accounted for a small share of foreign investment, the largest chunk of which went into private railway securities.

Capital called on British market by economic sector, 1865-1914 (%)

	US	Canada	Argentina	Australia	India
Government	6	34	22	66	46
Railways	62	40	58	1	40
Public utilities	9	6	9	4	3
Financial	6	6	5	12	2
Raw materials	5	4	0	13	6
Industrial	11	10	5	4	2
Shipping	1	0	1	1	1
Total private	94	66	78	34	54
Total (%)*	100	100	100	100	100

* Numbers rounded and so may not add exactly to 100.

15 On the isolation of the Southern market see Gavin Wright, *Old South, New South: Revolutions in the Southern Economy since the Civil War* (New York: Basic, 1986). More recently, Joshua L. Rosenbloom, ‘One Market or Many? Labour Market Integration in the Late Nineteenth-Century United States’, *Journal of Economic History* 50, 1 (1990): 85-107. Also, generally, Gavin Wright, ‘The Strange Career of the New Southern Economic History’, *Reviews in American History* 10, 4 (1982): 164-80.

Consider Table 2, derived from Irving Stone's figures.[16] Among the major recipients of British capital investment from 1865 to 1914, the United States stands out as having borrowed much less on public account – 6 per cent of the total sum of capital called, as opposed to between a fifth and two-thirds for others.

As the work of Mira Wilkins and of Lance Davis and Robert Gallman indicates, the reasons for this have to do at least in part with the American states' defaults, not only in the 1840s but again in the 1870s. As Davis and Gallman write,

> [g]overnments with good reputations, Australia and Canada for example, did not have to draw on the services of international financial syndicates to underwrite and market their bonds. In the case of the United States such syndicates were required. Although costly, they generated collateral economic benefits in terms of the evolution of the domestic financial structure. The American syndicates included not only well-established British and continental merchant banks, but also young US investment banks; and syndicate membership improved the reputations of those American bankers both at home and abroad.... The better the reputation of the government issues, the less need there was for specific private institutions designed to link foreign savers to domestic investors, institutions that could, at a later date, be modified to channel domestic savings into domestic investment.[17]

In countries like Argentina, with less capital of their own, where British investors could place their money directly, the import of poor reputation was less perverse than in the United States. But the US had not only a history of bad credit, but also a peculiar political structure within which to distribute responsibility for it.

In the wake of the defaults of the 1840s, 'United States' security' became a by-word for worthless paper in the world, as Charles Dickens had Ebenezer Scrooge exclaim in *A Christmas Carol*.[18] Sydney Smith claimed that the United States 'cannot draw the sword because they have not money to buy it', and so could not support 'a long, tedious ... war of four or five years duration'.[19] Smith proved wrong. Within a couple of decades, the United States was able to finance its Civil War, which was by any standard a major war of four years' duration. The US succeeded in this partly because banker Jay Cooke recruited thousands of salesmen to sell government debt.[20] Cooke wanted to finance the war without going to the global markets – '[w]e ... had better not put a whip into the hands of foreigners to punish us', he wrote. He succeeded, and his success on

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16 Irving Stone, *The Global Export of Capital from Great Britain, 1865-1914: A Statistical Survey* (New York: St. Martins, 1999).

17 Lance Edwin Davis and Robert E. Gallman, *Evolving Financial Markets and International Capital Flows: Britain, the Americas, and Australia, 1870-1914* (Cambridge: Cambridge University Press, 2001), p. 763; Mira T. Wilkins, *The History of Foreign Investment in the United States to 1914* (Cambridge, MA: Harvard University Press, 1989), p. 111.

18 Charles Dickens, *Christmas Stories*, 2 vols. (Philadelphia: T. B. Peterson, 1857), vol. 1, p. 47.

19 Smith, *Letters on American Debts*, (1843) pp. 9, 14, 20.

20 Vincent P. Carosso, *Investment Banking in America* (Cambridge, MA: Harvard University Press, 1970), pp. 15-17.

the market and the US Army's success in the field re-established America's viability as an investment proposition and also established the role of private investment banks as central to that viability.

The panic of 1873 cemented the lesson that American states could not be relied upon. Ironically, Cooke's firm touched off the panic when the failure of the Northern Pacific railroad caused its own failure. Afterward eleven states, ten of them in the South, defaulted on debt amounting to perhaps $130 million (converted to today's dollars, as a relative share of US GDP, this would amount to about $159 thousand million).[21] In consequence, as Wilkins notes, the 1870s and 1880s saw relatively little foreign capital go into US government bonds.[22] Instead it went through private intermediaries, such as investment banks with offices on both sides of the Atlantic: J. S. Morgan & Co. and Drexel Morgan; Brown Shipley and Brown Brothers; Seligman Brothers and J. W. Seligman, and so forth.

As Davis and Gallman establish in their comparative study of developing nations, this history of public defaults and the rise of a private substitute for the unreliable public financial intermediary made the United States unusual among frontier nations of the late nineteenth century. Argentina, Australia, and Canada all used public debt to fund the development of their rich interiors. Even though Australia and Canada enjoyed political independence from Britain, the British saver tended to view their securities as backed by the British Treasury, and ultimately the law backed this view. US securities not only were not so soundly supported but bespoke a worryingly careless history, and so American government issues paid 1.8 per cent more than Canadian ones on average and 2.3 per cent more than Australian issues. Argentina did not enjoy such a favourable position, but lacking so much capital of its own quickly yielded its publicly owned railroads to direct private British control. Only the United States saw the development of significant private intermediaries, in the form of the transatlantic investment banks, to channel foreign investment.[23]

On this interpretation what makes the US experience distinctive is not, or not only, the canny behaviour of the early Federalists, but the careless behaviour of the subsequent Jacksonians, and the dispersal of financial responsibility among the various American states.[24] Despite the success of the 1790 reorganization of US debt under Alexander Hamilton and the subsequent good behaviour of the US federal government as debtor, the ability of Americans to borrow through their government suffered from the bad behaviour of the individual American states, whose defaults in the 1840s and 1870s damaged not only their ability to borrow, but that of the US government as well. US government debt remained relatively small, and domestic savers tended to buy it up for their own portfolios. The financing of major projects like the construction of Western

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21 Cleona Lewis and Karl T. Schlotterbeck, *America's Stake in International Investments* (Washington, DC: The Brookings Institution, 1938), p. 59.

22 Wilkins, *History of Foreign Investment to 1914* (1989), p. 111.

23 Davis and Gallman, *Evolving Financial Markets* (2001), pp. 759-63.

24 Cf. Michael D. Bordo and Carlos A. Vegh, 'What If Alexander Hamilton Had Been Argentinean? A Comparison of the Early Monetary Experiences of Argentina and the United States', (National Bureau of Economic Research, 1998), NBER Working Paper 6862, pp. 1-56. The argument presented here draws on Eric Rauchway, *Blessed among Nations* (New York: Hill & Wang, 2006).

railroads therefore encouraged the establishment of a relatively responsible private investment market devoted in part to channeling foreign capital into the United States.

To the extent that the United States' national government did finance and direct internal development it did so fitfully and with an eye often to partisan advantage rather than any particular economic theory. The first transcontinental railroad was indeed financed from public wealth, mainly by land-grants. Analysts have wrangled, at least since this effort imploded in scandal in the early 1870s, whether the decision to use public wealth to finance the railroad was wise. Few have disagreed that the distribution of resources benefited a few key figures with close ties to Republican politicians. Later historians have noted, though without quite reaching complete consensus, that the public subsidy of the railroads did not achieve significant developmental advantages. As Jeremy Atack and Peter Passell summarize the debate,

> Federal land grant subsidies, then, were a proposition of dubious value. They were unnecessary incentives for some of the railroads since claims of market failure were unfounded. They were an unnecessarily expensive incentive for others because the actual form of mitigating market failure was inefficient. They only possible saving grave of federal land grant subsidies was their value as a deterrent to inefficient monopoly pricing by the carriers. But the pratical impact of that deterrent has yet to be demonstrated empirically.[25]

And while it is true that beyond the railroad grants, the Republican Party established a national policy for economic development in the 1860s that had some important effects, it is also true that the party quickly departed from that policy when its political costs became too heavy. The railway subsidies went along with a protective tariff, an act to distribute homesteads, an act to encourage immigration, and the Morrill Land Grant Act, which created public institutions of higher education in American states, with the idea of promoting the development of scientific agriculture and mining. The encouragement and subsidy of immigration proved both unpopular and unnecessary. The tariff quickly lost whatever theoretical integrity it had in the chaos of intra-regional bargaining, and by the 1890s it had become an elabourate compromise brokered between Western and Eastern elements of the Republican coalition, tied intimately to the purchase of voter loyalty through the pension system. The Morrill Land Grant institutions, perhaps alone among the elements of the Republicans' national plan of the 1860s, lasted and made important and measurable contributions to American economic development. But the Republican Party had by the early 1870s backed off the commitment to a national developmental policy and did not, because it could not politically afford to, return to it.[26]

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25 Jeremy Atack and Peter Passell, *A New Economic View of American History*, 2nd edn. (New York: W.W. Norton, 1994), pp. 443-4.

26 On the national plan of the 1860s, Heather Cox Richardson, *The Greatest Nation of the Earth: Republican Economic Policies During the Civil War* (Cambridge, MA: Harvard University Press, 1997). On the demise of that plan, Heather Cox Richardson, *The Death of Reconstruction: Race, Labour, and Politics in the Post-Civil War North, 1865-1901* (Cambridge, MA: Harvard University Press, 2001). On the tariff as part of a bargaining chip in the Republicans' sectional coalition, Richard Franklin Bensel, *The Political Economy of American Industrialization, 1877-1900* (Cambridge: Cambridge University Press, 2000). On the Land Grant College Act, see Louis Ferleger and William

We can then say that the institution of regional representation and the American federal structure entailed at least two major consequences for the pattern of US development in the nineteenth-century era of globalization. First, regional representation allowed the expression, protection, and implementation of local preferences for the establishment of institutions conducive to economic development. This meant not only that certain sections of the US became more developed earlier than others, but also that the whole nation became more developed than it otherwise would. Thus the US became an attractive investment for overseas capital, but some parts of it became more attractive than others. Second, regional representation allowed the expression, protection, and implementation of local preferences for financial responsibility. This meant not only that certain sections of the US were better able to borrow than others, but also that Americans had to develop a national institution devoted to serving the role of information aggregator and arbiter, a role otherwise and elsewhere served by governments. Thus the US remained an attractive investment for overseas capital, but that capital tended to come through private investment banks rather than through public coffers. Taking these developments together we can move to a consideration of the third, and perhaps most important, consequence of federalism for the US as a developing nation.

3 Regional representation and the reaction to globalization

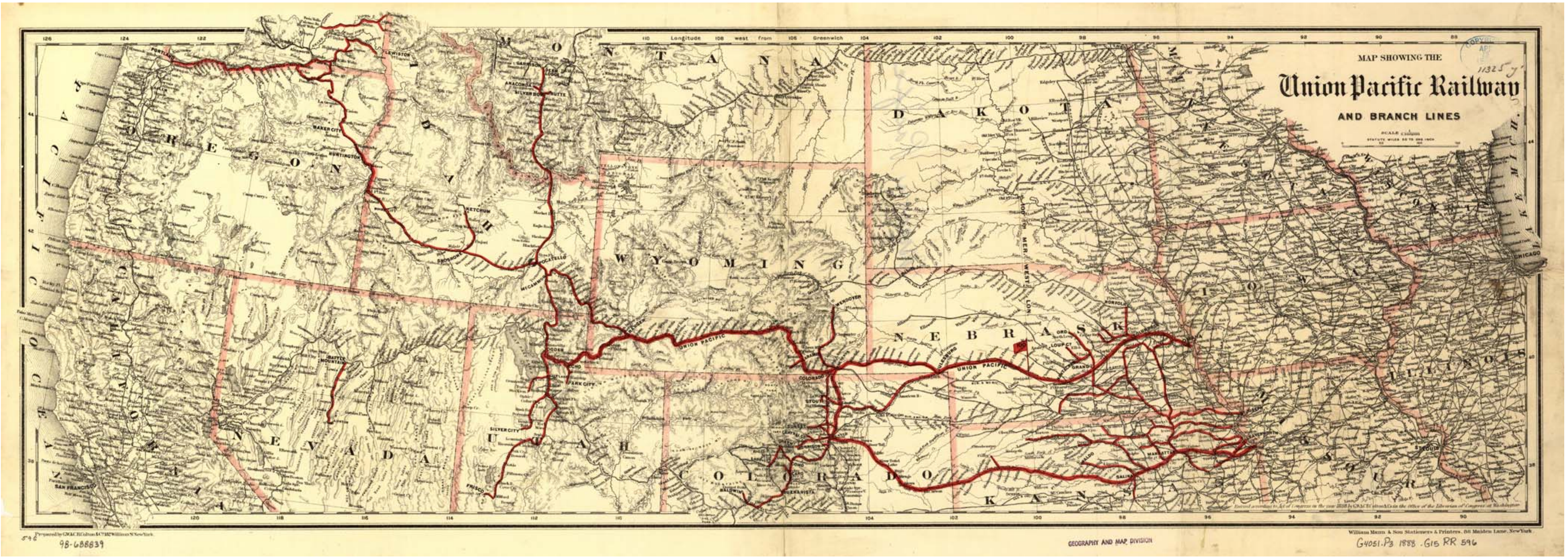
As we have seen so far one of the major effects of federalism was to allow the US South to effectively exempt itself from the process of globalization, opting out of the international movement of capital and labour. Southern states resisted investment in institutions that increased the value of their workforce, resisted immigration, and accounted for the majority of defaults. This led to the isolation of the South economically, and contributed to its historic sense of alienation from nationalizing projects of all kinds.

Another major effect of federalism in the era of nineteenth-century globalization was to allow the influential political expression of regional dissatisfaction with the movement of foreign capital and labour into and through the country. More concretely, the importance of regional representation in the US constitution meant that the relatively underpopulated Western part of the country, especially when allied with the perennially discontented South, could determine national policy with respect to the movement of global capital and labour.[27] And although the term ‘globalization’ belongs to our era, we can surely recognize that a nineteenth-century protest against the impact of foreign capital and the impact of foreign labour has a great deal in common with the protests against globalization in our own time.

Lazonick, ‘Higher Education for an Innovative Economy: Land-Grant Colleges and the Managerial Revolution in America’, *Business and Economic History* 23, 1 (1994): 116-128. Again, because of federalism, this act had highly varying sectional impact, and in the South often supported the developmentally counter-indicated tradition of segregation; see Gordon C. Lee, ‘The Morrill Act and Education’, *British Journal of Educational Studies* 12, 1 (1963): 19-40.

[27] On Western and Southern roles in resisting globalization and establishing legislation in Congress, see Eric Rauchway, ‘The Transformation of the Congressional Experience’, in Julian E. Zelizer (ed.) *The American Congress: The Building of Democracy* (Boston: Houghton Mifflin, 2004).

The path of the Union Pacific railway, one of the great successes and scandals of post-Civil War railway construction, showing the railroad passing through seven of the twelve post-Civil War states



Library of Congress Railroad Map no. 596; call number G4051.P3 1888 .G15 RR 596

The principal effect of foreign investment in the United States, going as it did first into railways and secondarily into mining and other frontier activities, was to speed the development and to a degree the settlement of the West. Between the US Civil War and the Great War, twelve new states entered the American union, carved out of the nation's rich interior and following a path roughly consonant with that of the new railroads. Even though these states often had notably few people living in them, owing to the unalterable provisions of the US Constitution they enjoyed the usual representation in the United States Senate.[28] The new states thus contributed one-quarter of the nation's Senators by 1913.

An economically colonial connection bound the new states to the Northeastern portion of the country, such that Westerners and subsequent historians alike identified the relationship between the sections as imperial. The process of developing the American West, much like the process of colonizing Africa or Southeast Asia, was undertaken by 'an expanding metropolitan economy creating ever more elabourate and intimate linkages' to a hinterland rich in animal, mineral, or vegetable resources and inhabited by people unable to fight off the armies of the metropolis.[29] The people of the West nursed resentment at their 'essentially 'colonial' relationship' to the capital-rich East.[30]

Westerners inclined to protest this relationship were well aware – economic historians often suggest they were overly aware – of the peculiar sources of their discontent.[31] They clearly identified private investment houses, such as J.P. Morgan & Co., as playing a semi-sovereign role in American economic development, a role that in other countries was played by government, and complained about the authority thus given to unelected men responsive only to their clientele and to no political constituency.[32] They objected to immigration, which powerfully affected the wages of less-skilled workers and which, Timothy Hatton and Jeffrey Williamson confirm, pushed native-born workers out of their home cities and into the West.[33] They blamed foreign investors for laws protecting high interest rates and monopoly prices: 'Englishmen now own a

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[28] On the order of admission of new states see also Charles Stewart, III and Barry R. Weingast, 'Stacking the Senate, Changing the Nation: Republican Rotten Boroughs, Statehood Politics, and American Political Development', *Studies in American Political Development* 6 (1992): 223-71.

[29] William Cronon, *Nature's Metropolis: Chicago and the Great West* (New York: W. W. Norton & Co., 1991), p. xv.

[30] Donald Meinig, 'American Wests: Preface to a Geographical Interpretation', *Annals of the Association of American Geographers* 62, 2 (1972): 159-184, p. 181.

[31] For a discussion of the real or illusory origins of farm protest, see Anne Mayhew, 'A Reappraisal of the Causes of Farm Protest in the United States, 1870-1900', *Journal of Economic History* 32, 2 (1972): 464-75.

[32] See e.g. W. H. Harvey, *Coin on Money, Trusts, and Imperialism* (1899; reprint, Westport, CT: Hyperion Press, 1975); W. H. Harvey, *Coin's Financial School* (Cambridge, MA: Belknap Press of Harvard University Press, 1963); H. L. Loucks, *The Great Conspiracy of the House of Morgan, and How to Defeat It* (New York: Arno, 1975).

[33] Timothy J. Hatton and Jeffrey G. Williamson, *The Age of Mass Migration: Causes and Economic Impact* (New York: Oxford University Press, 1998), pp. 164-9. See also Hope T. Eldridge and Dorothy Swaine Thomas, *Demographic Analyses and Interrelations*, in Simon Kuznets (ed.), vol. 3, *Population Redistribution and Economic Growth* (Philadelphia: American Philosophical Society, 1964); Carter Goodrich et al., *Migration and Economic Opportunity: The Report of the Study of Population Redistribution* (Philadelphia: University of Pennsylvania Press, 1936).

majority of the stock of our railroads [not true of the industry overall though true of some major lines]... [O]ur fields and factories are being stripped to pay interest to the money lenders of England... In Egypt and India she has placed her soldiers to protect her bondholders... The money lenders of America, who are advocating our present financial laws, are the soldiers of England on the soil of the United States'.[34]

As Wallis et al. suggest, we might thus view the United States as 'less a nation or country in the usual sense, and more akin to an empire of different geographic and economic regions at different stages of development. Like the British Empire of that era, the United States had its commercial-industrial center (similar to Great Britain) in the northeast, its semi-tropical cash-crop exporting area (its India) in the South, and its temperate region of recent settlement (its Canada, Australia, and New Zealand) in the old northwest'.[35] Unlike the British empire, the United States gave its colonial regions full representation in its metropolitan parliament. India had no MPs at Westminster, but Wyoming had two Senators and a Congressman at Washington.

In consequence, protest against the colonial relationship found an outlet in the national politics of the United States. During the period from the 1880s through the First World War, when other rich industrial countries were busily establishing welfare-state policies, the national politics of the United States focused instead, almost entirely to the exclusion of social spending, on the problems of regulating commerce and banking within the internal empire of continental America. And although support for such measures was not confined to peripheral regions, it was characteristic of the American federal institution that, as Elizabeth Sanders argues, in the US Congress the farmers of the South and West together 'had the incentive and provided the muscle' to create such a regulatory state.[36]

By the time the United States entered the First World War, its politics of sectional protest, funneled through its institutions of regional representation, provided it with a regime of economic regulation. Its Interstate Commerce Commission, established in 1887 and strengthened by subsequent legislation, regulated railway and other shipping within the continental empire. Its Federal Trade Commission, established in 1914, investigated, weighed, and judged accusations of unfair trade practices. Its Employee's Compensation and Eight-hour Commissions, established in 1916, enforced labour law. Its Bureaus of Immigration and Naturalization, established in 1891 and 1906, enforced increasingly restrictive immigration legislation that, as of 1917, included a literacy test in the migrant's native language. All these measures enjoyed their strongest support from the regions within the United States that were peripheral to its economy – which is to say, from the South and the West.

The adoption of such a regulatory regime increased the power of the national government in the United States, and so at first glance it may appear paradoxical that

34 Harvey, *Coin on Money, Trusts, and Imperialism* ([1899] 1975), pp. 80-2.

35 Wallis, Sylla, and Grinath, 'Sovereign Debt' (2004), p. 26.

36 Elizabeth Sanders, *Roots of Reform: Farmers, Workers, and the American State, 1877-1917* (Chicago: University of Chicago Press, 1999), p. 164. On other sources of protest see Ha-Joon Chang, 'Regulation of Foreign Investment in Historical Perspective', *European Journal of Development Research* 16, 3 (2004): 687-715.

the South, which had only recently fought a Civil War over its asserted right to keep the federal government out of its affairs, should have supported such an agenda. But as Sanders points out, the South and West supported a particular kind of increase in state power: 'guarantees, benefits, or prohibitions [that] might require judicial suits and, ultimately, the exercise of federal police power', but 'little, if any, bureaucratic discretion'. The eight-hour day or the bar on monopolies had, Sanders writes, 'an automatic, relatively self-enforcing quality' and so Southerners or other libertarians might back them in the comfortable hope they would not lead to a significant increase in the arbitrary power or permanent bureaucratic structures of the state.[37] Even the most bluntly redistributive policies supported by this coalition – the taxes on income, inheritance, and excess profits – partook of this generally rule-based, ostensibly self-enforcing character.[38]

Indeed even in policy areas that would normally favour centralization and expertise as a matter of course, the politics of reaction against globalization funneled through the institutions of regional representation created decentralized, purportedly rule-based systems. The major example of such an institution is the US Federal Reserve, created in 1913. After early experiments of the late eighteenth and early nineteenth century, the United States abandoned its central banks and did not seriously begin to consider establishing one again until after the panic of 1907. The US thus adopted central banking late and indeed at an awkward time both for itself and for the world; the first Federal Reserve Board took office in the week after the First World War began. And even so its makers did not intend the Federal Reserve System to operate as a central bank – after all it was not central, but with its twelve districts explicitly and obviously decentralized; nor was it a bank, but a banking system supervised by a politically appointed board.[39] Whatever it was, there is general agreement that it was ill-suited in its infancy to guide the US through the challenges of the World War and the crises that followed.[40] But perhaps this failure is a matter of timing rather than of the Federal Reserve System's intrinsic nature; had not the mantle of 'top nation' fallen on American shoulders so soon after the Fed's creation, it might not have made such a mess of its work – or it might not have mattered much to the rest of the world. Following the logic of historians of the US West and South who see the US as a federated empire, we might consider it a rather well-integrated and -regulated empire, successful at managing the openness of internal and external markets, because its central legislature allowed representation of its colonized regions, and thus of economic interests within the empire, irrespective of their population or their colonial status.

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37 Sanders, *Roots of Reform* (1999), p. 388.

38 Steven R. Weisman, *The Great Tax Wars: Lincoln to Wilson* (New York: Simon & Schuster, 2002).

39 See Allan H. Meltzer, *A History of the Federal Reserve, 1913-1951* (Chicago: University of Chicago Press, 2003); Richard H. Timberlake, *Monetary Policy in the United States: An Intellectual and Institutional History* (Chicago: University of Chicago Press, 1993). Also the account in Sanders, *Roots of Reform* (1999), pp. 236-59.

40 See Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression, 1919-1939* (New York: Oxford University Press, 1992); Barry Eichengreen, 'The Origins and Nature of the Great Slump Revisited', *Economic History Review* 45, 2 (1992): 213-39; Peter Temin, *Lessons from the Great Depression* (Cambridge, MA: MIT Press, 1989).

4 Lessons for today

In 1948 the political scientist and historian Charles Austin Beard argued that 'with the world just emerging from one global war and trembling on the verge of another, federalism is now offered as the best pledge that mankind, tormented by wars for countless generations, may at last establish tranquillity throughout the earth'.[41] As borrowed from Hume and refined by James Madison, the institution of federalism offered a solution to the creation of a large and indefinitely extensive republic: divide it into constituent and semi-autonomous parts.[42] In the late 1940s, the institution of federalism appeared to offer a mechanism whereby nation-states could shed a little of their Westphalian autonomy in exchange for a seat on a managing council – perhaps the United Nations – and thus defuse interstate conflict.

As we have seen there is some reason to argue that the institution of federalism also helped the United States adapt to the influence of overseas capital and labour coming into the country. Federalism encouraged the regional establishment of widespread public education and other institutions, including flexible labour markets, that underwrote economic growth. It allowed those regions who wished to go ahead with the establishment of such institutions do so without waiting to secure the assent of those who did not – particularly, the US South. The ability of the South to opt out of such processes while the rest of the country went ahead also contributed, albeit by indirect methods, to the establishment of the generally successful private investment intermediaries that distinguished foreign investment in the US from that in otherwise comparable developing countries of the era. The default of states kept the public borrowing and the government of the United States relatively small, and ensured that its private banking sector played a semi-sovereign role in its economic development. Finally, federalism defused the backlash of America's internal colonies – the South and the West – channeling it into regulatory policies. Because these regions enjoyed representation at Washington disproportionate to their population, they played an outsized role in shaping the regulatory state the US created for itself in the late nineteenth and early twentieth centuries.

Yet, with a few exceptions, the American variety of federalism does not much appeal to other countries in writing their constitutions. The exceptions – Belgium, Germany, and Switzerland – comprised a set of long-established, culturally distinct and semi-autonomous principalities for whom the appeal of federation was obvious.[43] Otherwise federalism, if adopted at all, usually subsumed itself to a parliamentary supremacy. And indeed in such cases it sometimes failed (as in Yugoslavia) or led to limping and never completely comfortable success (as in Canada).[44] The problems in such cases appear to

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41 Charles Austin Beard, *The Enduring Federalist* (Garden City, NY: Doubleday, 1948), p. 4.

42 Adair, 'David Hume, James Madison, and the Tenth Federalist ' (1974), p. 103.

43 See e.g. Blaustein, *Influence* (1986), p.18.

44 The convention of referring to the discomforts of Canadian federalism owes to the occasional recurrence of Quebecois separatism, but unless it should someday succeed in the global scheme of things Canadian federalism looks a considerable success. See essays in Stephen Randall and Roger Gibbins (eds), *Federalism and the New World Order* (Calgary: University of Calgary Press, 1994).

be that, as James C. MacPherson writes, in these cases ‘ethnic configurations did not follow clear territorial boundaries’.[45]

But this is not quite what we have found in our examination of the role American federalism played in the US response to globalization. Rather, the story we know seems to suggest, however perversely, that the arbitrary drawing of regional lines irrespective of population or ethnicity can as succeed as well, provided the lines correspond to more or less clear catchments of economic interest. The key to Wyoming’s role in the development of the American state lay not in the mystical tie of Wyomingers to their land, nor to their ethnic homogeneity, but to their shared experience of annoyance at railroads, to their common interest in the prosperity of commodity producers, and to their absolute entitlement, however apparently ungrounded in any serious theory of representation, to two Senators and a minimum of one Congressman at Washington.[46]

It also appears that semi-sovereign localities may be allowed to fail in their fiscal responsibility, that democracy may be allowed to exert its peculiar prejudices, provided that some umbrella protections, if not inducements, remain for private-sector institutions to take their place. The defaults of American states contributed to what appears in the long run to have been a relatively successful emergence of private investment institutions to serve the role that governments would not. This would not have been possible had not national law generally protected the interests of such interstate businesses, but in the US it did.[47]

We cannot allow either these qualified comments about the unintended successes of US federalism or the more exuberant comments of scholars like Beard to blind us to the bleaker failures of the system that permitted relative regional autonomy. One of its great successes, as we have seen, was its ability to let some sections of the country forge ahead while others remained behind. The concrete consequence of this regional flexibility was that while the Northern states abandoned slavery in the late eighteenth and early nineteenth century, the Southern states kept and strengthened it. And so under the system of federalism the Civil War came. Moreover, even afterward, the South retained institutions that deprived the freedmen of their civil rights and also kept the region economically backward for generations.[48] Only the benevolent internal colonialism of the New Deal, followed by the more forcible internal colonialism of the

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[45] James C. MacPherson, ‘The Future of Federalism’, in Stephen Randall and Roger Gibbins (eds) *Federalism and the New World Order*, (Calgary: University of Calgary Press, 1994), p. 11.

[46] On the political role of the new states see Nolan McCarty, Keith T. Poole and Howard Rosenthal, ‘Congress and the Territorial Expansion of the United States’, in David W. Brady and Mathew D. McCubbins (eds), *Party, Process, and Political Change in Congress: New Perspectives on the History of Congress* (Stanford: Stanford University Press, 2002); Stewart and Weingast, ‘Stacking the Senate’ *Studies in American Political Development* 6 (1992).

[47] See Herbert Hovenkamp, *Enterprise and American Law, 1836-1937* (Cambridge, MA: Harvard University Press, 1991); Paul Kens, ‘The Source of a Myth: Police Powers of the States and Laissez Faire Constitutionalism, 1900-1937’, *American Journal of Legal History* 35, 1 (1991): 70-98; William J. Novak, ‘Public Economy and the Well-Ordered Market: Law and Economic Regulation in 19th-Century America’, *Law & Social Inquiry* 18, 1 (1993): 1-32.

[48] Roger L. Ransom and Richard Sutch, *One Kind of Freedom: The Economic Consequences of Emancipation*, 2nd edn (Cambridge: Cambridge University Press, 2001).

Warren Court era, came anywhere near to ending this Southern backwardness.[49] This is not even to mention the military campaigns against and resettlement of aboriginal populations that attended the establishment of states in the US West, a process that, were it to occur today, a majority in the world would certainly identify as an unlawful ethnic cleansing or genocide.[50]

The general lessons we see are three. First, the institution of regional representation, which is to say a system preserving some local autonomy under a covering umbrella government, appears to have allowed the US successfully to adapt to the influence of globalization. Second, this institution did not protect minority rights in its semi-autonomous regions. Third, its failures often required a more vigorous form of colonial intervention, as occurred in the era of the 1860s and again in the 1960s.

Although more specific lessons require detailed examination of cases we can hazard here some speculation informed by the foregoing analysis. Beard and other proselytizers for the US Constitution have at one time or another expected a world federation and perhaps such may someday come. But at present it seems unlikely. Even the development of Europe into a proper confederation seems a long way off. And in any case, a world federation or a European federation would not really match the conditions in which federalism appears to have served the US comparatively well. Rather, the place to try implementation of the model might be within developing countries or developing regions. It is possible to imagine a confederation of Asian, Latin American, or African nations whose federal government enjoyed regulatory authority over the movement of capital and labour while its constituent polities retained jurisdiction over schooling and infrastructural improvements. It is even possible to imagine existing regional trade federations evolving in this direction. It is also possible to imagine a newly established, or re-established, developing country adopting a federal structure specifically to encourage the flexibility that the late nineteenth-century US showed. But here the problem lies with the circumstances of newly established nations. Their leaders often appeal to the unity of the Westphalian nation-state to pull the country out of crisis, as for example Ayad Allawi did after the Iraqi elections of 2005: 'If the objective of national unity is missed, if the objective of national reconciliation is overlooked, then this will definitely spell out disaster'.[51] It is hard to imagine such a leader appealing instead to the idea of consciously, even arbitrarily, dividing such a nation into bits, especially when the history of federalism in the United States suggests that even under such a system, bad social features will survive and tensions persist such that intervention from outside – whether from the IMF or some military coalition – might prove necessary anyway.

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49 See L. A. Scot Powe, *The Warren Court and American Politics* (Cambridge, MA: Belknap Press of Harvard University Press, 2000); Bruce J. Schulman, *From Cotton Belt to Sunbelt: Federal Policy, Economic Development, and the Transformation of the South, 1938-1980* (Durham: Duke University Press, 1994).

50 On the military campaigns, see Robert M. Utley, *Frontier Regulars: The United States Army and the Indian, 1866-1891*, Bison Books edn (Lincoln: University of Nebraska Press, 1984). On resettlement and expropriation, see Frederick E. Hoxie, *A Final Promise: The Campaign to Assimilate the Indians, 1880-1920*, Bison Books edn (Lincoln: University of Nebraska Press, 2001).

51 Anthony Shadid, 'Iraq Must Unify or Face "Disaster", Premier Warns', *Washington Post*, 18 February 2005, A16.

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