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Financing a new nation: a comparative study of the financial roots of the USA and Gran Colombia*

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Abstract

The structure of the USA and the countries that emerged from the remains of Gran Colombia ultimately took different shapes from those suggested in the era immediately after independence, particularly in regard to the extent of each state's fiscal and monetary capacities. This article applies Oszlak's model of 'stateness' to the early financial and monetary histories of the USA (roughly 1776–93) and Gran Colombia (roughly 1819–35) to assess and compare the role of financial and monetary capacities in long-run state consolidation and economic development. The US was ultimately more successful than Gran Colombia at adapting its financial and monetary capacities and institutions, creating better conditions for the attainment of 'stateness', stronger economic growth, and greater endurance as a national entity. The comparison ultimately suggests a reciprocal relationship between the legitimization of a state's authority (that is, state consolidation) and the development and solidification of fiscal and monetary capacities.

Keywords American Independence, economic development, financial development, foreign debt, Gran Colombia

America is ungovernable; those who served the Revolution have plowed the sea.
(Simón Bolívar, December 1830)

We have probably had too good an opinion of human nature in forming our confederation ... What a triumph for the advocates of despotism to find that we are incapable of governing ourselves, and that systems founded on the basis of equal liberty are merely ideal & fallacious!
(George Washington, Letter to John Jay, 15 August 1786)

As a very important source of strength and security, cherish public credit.
(George Washington, Farewell Address, 17 September 1796)

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Rhetoric relating to the American revolutions has reappeared often since independence from Britain and Spain was first sought and achieved. Most recently, manifestations of revolutionary rhetoric can be observed in the 'Tea Party' movement in the United States and the appeals for a 'Bolivarian Revolution' in Venezuela and elsewhere. Hugo Chavez's recent exhumation of Simón Bolívar aptly illustrates that revolutionary symbolism is alive and well, even if the symbols themselves are long dead.[1] An essential element of the arguments underscored by the use of such historical rhetoric and symbolism is the desired size of government and the scope of its fiscal and monetary authority. Tea Party supporters desire smaller government and lower taxes, while Bolivarians promote, among other things, Pan-Americanism and social reform, necessarily suggesting bigger government.

Debate over the size and scope of governments' fiscal and monetary authority has been commonplace in both North and South America since before their wars for independence. The abuse of the authority of imperial governments to levy taxes was one of the mobilizing forces for revolution in both continents. The original Boston Tea Party was a reaction against British policies deemed economically stifling and unjust. Similarly, tax reforms in Spanish America in the 1770s were a leading motivator of the Comunero Rebellion of 1781 in the Viceroyalty of New Granada, nearly three decades before all-out revolution.[2] The scope of imperial financial and monetary authority was thus an early and persistent point of tension. While a focus on strictly economic issues as *casus belli* may be myopic, it cannot be denied that financial and monetary factors and the scope of governmental authority over these issues were important considerations in the decision to revolt. Furthermore, financial and monetary considerations were paramount to the ability to wage war and, more importantly, the ability to form a new government in the wars' aftermaths.

The first attempts in each region to impose a system of government consistent with the fiscal rhetoric of their revolutions ultimately failed and were replaced by political and economic systems at odds with many of the revolutionary ideals lauded in modern discourse, such as a fiscally limited central government in the USA and a government with continental reach in Latin America. In the USA, the Articles of Confederation established a very limited central government that proved too weak and too confining for the commercial and financial needs of the new nation. By 1789 it had been replaced by a much more powerful, though still limited, national government under the Constitution of 1787, with much broader financial and monetary authority. Conversely, in the former Viceroyalty of New Granada, the Congress of Cúcuta established the Republic of Colombia (commonly referred to as 'Gran Colombia'), comprising present-day Ecuador, Colombia, Panama, and Venezuela. This union dissolved by 1830 into its three main constituent parts amid monetary fragmentation, political rivalries, and substantial public indebtedness. The eventual economic and political formation of the USA and the countries that emerged from Gran Colombia ultimately looked different from the designs suggested during and

1 Simon Romero, 'Building a new history by exhuming Bolívar', *The New York Times*, 3 August 2010, http://www.nytimes.com/2010/08/04/world/americas/04venez.html?_r=1&ref=americas (consulted 20 August 2010).

2 Maurice P. Brungardt, 'The economy of Colombia in the late colonial and early national periods', in John R. Fisher, Allan J. Kuethe, and Anthony McFarlane, eds., *Reform and insurrection in Bourbon New Granada and Peru*, Baton Rouge, LA: Louisiana State University Press, 1990, p. 164.

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immediately after the revolutions, particularly in regard to the size and financial scope of government.

The fiscal and monetary structure of both regions in the era immediately following independence had a profound impact on their future paths of economic growth and quality of state consolidation. The United States under the Constitution ultimately proved stronger as an enduring national entity than the states that emerged from the remains of Gran Colombia.

This article uses Oscar Oszlak's framework of 'stateness' to analyse the different paths taken by the USA and Gran Colombia in terms of each country's early financial and monetary structures, and the associated differences in economic growth and degrees of state consolidation. Oszlak describes state consolidation, or 'stateness', as the attainment of specific properties that 'define the existence of a state'.[3] Specifically, these properties include the ability of a state to '(1) externalize its power; (2) institutionalize its authority; (3) differentiate its control; and (4) internalize a collective identity'.[4] Oszlak takes social, political, and economic considerations into account in successful state formation, and alludes to the role of 'an apparatus of collection and financial administration' as an important element in that process.[5] His methodological and theoretical guidelines for the formation of the 'state' were specifically developed to evaluate Latin American state formation, but I believe that the similar circumstances of state formation – that is, having thrown off an imperial power before the first age of globalization – warrants applying this framework to the USA. Using Oszlak's model of 'stateness' as a starting point, this article seeks to assess the effects of fiscal and monetary management by infant states on their ability to obtain 'stateness' and to endure generally. Specifically, the article asks: to what extent can the early financial systems of the newly independent republics of the USA and Gran Colombia explain their respective political and economic success and failure? Or, reframed: to what extent can the relative degrees of 'stateness' obtained by the USA and Gran Colombia be understood in terms of the adaptation of their early financial systems? Thus, the article seeks to apply the framework of 'stateness' to the financial and monetary capacities of the USA and Gran Colombia during their formative periods in order to identify major differences and similarities. Such comparisons may prove useful in the enduring debate on the role of the state in the economy and the relationship between the legitimacy of a state and its financial and monetary capacities.

The comparison ultimately suggests that, in terms of the importance of the four elements of 'stateness' as applied to financial and monetary capacities, 'institutionalization of authority' is a necessary precondition for the successful 'externalization of power'. Essentially, this conclusion conforms to the analysis of Benjamin Franklin. In 1784, Franklin wrote to John Adams, who was soliciting loans in Holland while efforts to reform the dysfunctional internal financial system were failing. Franklin stated: 'I hope these mischievous events will at length convince our people of the truth of what I long since wrote to them, that

3 Oscar Oszlak, 'The historical formation of the state in Latin America: some theoretical and methodological guidelines for its study', *Latin American Research Review*, 16, 2, 1981, p. 7.

4 *Ibid*.

5 *Ibid*., p. 23.

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the foundation of credit abroad must be laid at home'.[6] While both countries were diplomatically recognized abroad, Gran Colombia's failure to get its own financial affairs in order and gain domestic legitimacy ultimately contributed, among other factors, to its financial de-legitimization abroad and to the eventual dissolution of the republic. In contrast, the USA, under the tutelage of Alexander Hamilton, was eventually able to institutionalize its authority under the new Constitution and reform its internal financial structure, enabling the country to achieve the legitimacy necessary to secure foreign loans and maintain international recognition.

This article first examines existing analyses of economic growth and explores the concept of 'stateness' in more detail. It then compares the financial histories of the USA and Gran Colombia in terms of the four components of Oszlak's model of 'stateness', and ends with some conclusions about the role of financial and monetary capacities in the legitimization of state authority.

Divergent paths of economic growth

There is substantial literature comparing the divergent paths of economic growth of North and South America.[7] John Coatsworth notes that GDP growth in each region has been virtually equal since the end of the nineteenth century, and that divergence must therefore be traced back to the colonial and immediate postcolonial periods.[8] With the colonial period as the starting point, several lines of argument have emerged, which often compete with one another. These include the role of institutions and the impact of situational and international factors.

Douglass North describes institutions as 'the humanly devised constraints that shape human interaction', and highlights their importance for understanding change in history.[9] He argues that colonial institutional legacies set the path for the divergent economic development of North and South America.[10] He explains that, although Latin American revolutions were informed by the ideologies of the French and US revolutions, and the newly formed Latin American states adopted 'US-inspired constitutions', the outcomes in Latin

6 Benjamin Franklin, quoted in Albert S. Bolles, *The financial history of the United States from 1774–1789: embracing the period of the American Revolution*, New York, NY: D. Appleton and Co., 1884, p. 257 (emphasis added).

7 I have discarded a discussion of the 'endowment approach', which argues in part that natural endowments are paramount to understanding institutional development and long-term economic growth. See, for example, Stanley Engerman and Kenneth L. Sokoloff, *Factor endowments, inequality, and paths of development among new world economies*, Cambridge, MA: National Bureau of Economic Research, 2002; Daron Acemoglu, Simon Johnson, and James A. Robinson, 'The colonial origins of comparative development: an empirical investigation', *American Economic Review*, December 2001; Daron Acemoglu, Simon Johnson, and James A. Robinson, 'Reversal of fortune: geography and institutions in the making of the modern world income distribution', *Quarterly Journal of Economics*, 107, 4, 2002, pp. 1231–94.

8 John Coatsworth, 'Notes on the comparative economic history of Latin America and the United States', in Walther L. Bernecker and Hans Werner Tobler, eds., *Development and underdevelopment in America*, Berlin: Walter De Gruyter, 1993, pp. 10, 17. Coatsworth reassembled data collected from Angus Maddison, *The world economy in the twentieth century*, Paris: OECD, 1989, pp. 15, 19.

9 Douglass C. North, *Institutions, institutional change and economic performance*, Cambridge: Cambridge University Press, 1990, p. 3.

10 *Ibid.*, p. 102.

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America were dramatically different from that in the USA, largely because of the divergent institutional legacy of Spain.[11] North, William Summerhill, and Barry Weingast elaborate on this by incorporating the idea of inherited structures of order.[12] They explain that political order was present in British North America, where institutions were established that protected property rights, promoted civic participation, and limited the gains from achieving political power.[13] The Spanish and Portuguese, meanwhile, left a legacy of minimal civic participation and a resilient tradition of corporate paternalism.[14] Thus the resultant institutions inherited in North America promoted economic development while those in South America hindered it.

Arguing that the degree of financial development was determined by which system of law a colonized territory adopted, Rafael La Porta et al compare the level of financial development in countries with a common-law tradition, such as Britain and the USA, and those in which French, German, and Scandinavian civil law was adopted. They show that countries that inherited common-law systems provide better protection for the rights of investors than countries based on civil-law systems.[15] As a result, common-law countries ultimately developed stronger financial systems and experienced stronger economic growth.

Stephen Haber, Douglass North and Barry Weingast argue that this emphasis on legal origins does not properly consider politics or political institutions.[16] They assert that 'legal origin has little effect on financial development' and that, rather, 'financial development is an outcome of specific laws and regulations, which are the product of politics and political institutions'.[17] For them, financial systems 'are composed of private banks, securities markets, a money supply, a central bank, and a system of public finance', with governments exerting direct or indirect influence over all of these.[18] The financial system is thus the intersection of the state and the economy: the strength and legitimacy of both the state and the economy may be largely dictated by the strength of the financial system, and vice versa. Following the lead of Haber, an emphasis on institutions will be a significant part of the analysis in this article. The fact that the states that ultimately formed the USA had a long tradition of financial innovation will underscore the importance of the different institutional starting points of financial development of the USA and Gran Colombia.

In contrast to an emphasis on institutions, several scholars explain the divergent economic growth of North and South America by examining the conditions surrounding the attainment

11 *Ibid.*, p. 103.

12 Douglass C. North, William Summerhill, and Barry R. Weingast, 'Order, disorder and economic change: Latin America vs. North America', in Bruce Bueno de Mesquita and Hilton L. Root, eds., *Governing for prosperity*, New Haven, CT: Yale University Press, 2000, p. 20.

13 *Ibid.*, p. 25.

14 *Ibid.*, p. 47.

15 Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny, 'Law and finance', *Journal of Political Economy*, 106, 6, 1998, p. 1151.

16 Stephen Haber, Douglass C. North, and Barry R. Weingast, 'Political institutions and financial development', in Stephen Haber, Douglass C. North, and Barry R. Weingast, eds., *Political institutions and financial development*, Stanford, CA: Stanford University Press, 2008, p. 2.

17 *Ibid.*

18 *Ibid.*, pp. 2–3.

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of independence and the contemporaneous international economic and political environment. For example, Leandro Prados de la Escosura states that 'Independence ... and the resulting insertion into the international economy ... appear as the two most important events in assessments of economic performance in nineteenth-century Latin America'.[19] He argues that the rupture of colonial commercial links resulting from independence led to the duplication of costs of defence and made it more difficult to provide public goods.[20] That is, Spanish rule was actually beneficial for market integration and economic growth.

Similarly, Regina Grafe and Maria Alejandra Irigoin take issue with the institutionalist approach. They argue that, rather than creating a tradition of absolutist, top-down rule, Spanish control of South America was 'negotiated'. The colonial tax system was not uniform but a 'patchwork reality of fiscality', demonstrating that colonial economic interests played a negotiated role in the determination of colonial finances.[21] The evidence presented by Grafe and Irigoin competes with the overarching influence of an absolutist Spanish rule posited by the institutionalists.

Another historical factor that potentially contributes to the different rates of growth is the nature of the independence movements themselves. In the USA, the independence movement relied on a relatively coherent ideology and stemmed from the agency and collective action of the colonists. Conversely, according to David Landes, 'in Latin America, independence came not of colonial ideology and political initiative but of the weakness and misfortunes of Spain (and Portugal) at home, in the context of European rivalries and wars'.[22] That is, the weakness of Spain and the opportunism of some influential colonists paved the way for independence without necessitating a coherence that might have been beneficial to the process of state consolidation in the aftermaths of the wars. Miguel Centeno points out that 'wars can only make states if they are preceded by at least a modicum of political organization', which was lacking in much of Latin America.[23] Irigoin and Grafe make a similar point, arguing that the break with Spain resulted from an almost accidental confluence of events that left Spain financially weak and the local oligarchies 'stronger than ever'.[24] This culminated in the invasion of Spain by Napoleon and the abduction of the king, creating a power vacuum and the opportunity for Latin American independence. There was no overwhelming need for political organization.

Irigoin and Grafe go on to say that, in the aftermath of war, 'the massive redistribution of revenues that underpinned the imperial system ceased almost immediately to exist,

19 Leandro Prados de la Escosura, 'The economic consequences of independence in Latin America', in Victor Bulmer-Thomas, John H. Coatsworth, and Roberto Cortés-Conde, eds., *The Cambridge economic history of Latin America, Vol. I: the colonial era and the short nineteenth century*, Cambridge: Cambridge University Press, 2006, p. 463.

20 *Ibid.*, p. 481. See also Miguel Angel Centeno, *Blood and debt: war and the nation-state in Latin America*, University Park, PA: Pennsylvania State University Press, 2002, p. 131.

21 Regina Grafe and Maria Alejandra Irigoin, 'The Spanish empire and its legacy: fiscal redistribution and political conflict in colonial and post-colonial Spanish America', *Journal of Global History*, 1, 2, 2006, p. 14.

22 David S. Landes, *The wealth and poverty of nations: why some are so rich and some so poor*, New York, NY: Norton & Company, 1998, p. 313.

23 Centeno, *Blood and debt*, p. 106.

24 Grafe and Irigoin, 'The Spanish empire', p. 36.

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opening a process of increasing fiscal and political fragmentation', ultimately contributing to the creation of regional economies without the benefit of regional integration present under Spanish rule.[25] They explain that 'In Spanish America an operational unified political and economic empire collapsed into a large number of poorly defined and legitimated nation states', while in the USA 'a new nation state emerged out of the aggregation of quasi autonomous, self-governed, fiscally independent colonies'.[26] The ultimate conclusion is that 'the Spanish path to the formation of an empire turned out to be a poor basis for state formation and institution building in the post-independence period'.[27]

Moreover, historical and international factors directly affected the types of loans available to each country during and after their revolutions. The USA had the advantage of receiving loans, and often gifts, from Spain and France. France especially recognized its geopolitical interest in weakening Britain, and subsidized the independence effort with gifts of supplies and finance, and ultimately direct military involvement.[28] As a by-product of France's role in the US revolution, France experienced its own revolution, which ultimately brought Napoleon to power. After the Napoleonic wars, the market for sovereign debt developed dramatically, and the centre of private finance moved from Amsterdam to London.[29] Flush with cash, private British financiers looked to the emerging governments of Latin America.[30] While the USA could rely in part on loans, subsidies, and military aid from other sovereigns, Gran Colombia relied almost entirely on private loans in a changing, and arguably immature, market for sovereign debt.[31] Such historical and international circumstances will also play a role in the analysis in this article.

A third area of concern for scholars tracing the divergent paths of economic growth is state consolidation and fiscal capacity. This literature primarily focuses on European state formation, but certain elements of this scholarship may prove useful to the study of American state formation. The fiscal militarism model developed for Europe, for example, may be relevant to the case of the Americas.[32] In this line of thought, an efficient tax system, usually established in response to geopolitical rivalry, was an essential element of state consolidation and an important contributing factor to the course of long-run economic growth.[33] As applied to North and South America, the argument can be made that a centralized fiscal authority was necessary both to wage the wars for independence and to establish

25 *Ibid*., p. 40.

26 *Ibid*., p. 41.

27 *Ibid*.

28 Edwin J. Perkins, *American public finance and financial services 1700–1815*, Columbus, OH: Ohio State University Press, 1994 p. 104.

29 Frank Griffith Dawson, *The first Latin American debt crisis: the City of London and the 1822–25 loan bubble*, New Haven, CT: Yale University Press, 1990, p. 14.

30 *Ibid*., p. 22.

31 Centeno, *Blood and debt*, p. 134.

32 Fernando Lopez-Alves considers this relevance in 'The transatlantic bridge: mirrors, Charles Tilly, and state formation in the River Plate', in Miguel Centeno and Fernando Lopez-Alves, eds., *The other mirror: grand theory through the lens of Latin America*, Princeton, NJ: Princeton University Press, pp. 153–76.

33 For example, see Charles Tilly, *Coercion, capital and European states, AD 990–1990*, Cambridge, MA: Blackwell, 1990; Patrick K. O'Brien, 'Fiscal and financial preconditions for the rise of British naval hegemony, 1485–1815', LSE Working Papers in Economic History, 2005, http://eprints.lse.ac.uk/22326/1/WP91.pdf

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new governments capable of providing for the common defence. Gran Colombia and the USA both had difficulty financing their wars, but in both cases the wartime fiscal structure provided a foundation for the process of post-war state formation.

Arguing against the state-competition perspective, Peer Vries suggests that the relationship between fiscal capacity and state consolidation was, among other things, a factor of the homogeneity and size of a population and the geographical extent of a territory.[34] In this vein, some authors have argued that the 'rugged topography' of Colombia contributed to its 'limited economic interactions' and probably made it more difficult to collect taxes efficiently.[35] Thus some ideas about the development of state fiscal capacity are unrelated to state competition.

Finally, Linda Weiss and John Hobson present the 'neo-statist' position. They agree with the notion that the development of a weak or strong state was largely a consequence of 'interstate military competition'.[36] However, they extend the statist position by highlighting the importance of the legitimization of state extractive powers through 'cooperative relations with civil society'.[37] This view assigns importance to political and economic institutions as potentially legitimizing or de-legitimizing forces.

These ideas are applicable to American state formation. For example, Weiss and Hobson's notion of neo-statism and its relation to fiscal capacity and state formation is directly applicable to Oszlak's Latin American-specific idea of 'stateness', which addresses the relationship between the institutionalization of a state's authority and the state's ability to endure intact. The notion of 'stateness', as it will be used in this analysis, will attempt to harmonize the literature relating to state formation and fiscalism with the literature relating to political institutions and fiscalism.

Oszlak on 'stateness'

Oszlak defines 'stateness' as 'the degree in which a system of social domination has acquired' a particular set of properties through an enduring 'formative process'.[38] As noted above, he draws upon the work of Schmitter, Coatsworth, and Fox Przeworski to identify four specific properties: the ability of a state to externalize its power, institutionalize its authority, differentiate its control, and internalize a collective identity. The externalization of power relates to the recognition and guarantee of sovereignty by other sovereign powers 'within a system of interstate relations'. Institutionalization of authority deals broadly with

(consulted 30 May 2010); Linda Weiss and John M. Hobson, *States and economic development: a comparative historical analysis*, Cambridge, MA: Polity Press, 1995.

34 P.H.H. Vries, 'Governing growth: a comparative analysis of the role of the state in the rise of the West', *Journal of World History*, 13, 1, 2002, pp. 67–138.

35 Jaime Jaramillo, Adolfo Meisel, and Miguel Urrutia, 'Continuities and discontinuities in the fiscal and monetary institutions of New Granada, 1783–1850', in Michael D. Bordo and Roberto Cortés-Conde, eds., *Transferring wealth and power from the old to the new world: monetary and fiscal institutions in the 17th through the 19th century*, Cambridge: Cambridge University Press, 2001, p. 415.

36 Weiss and Hobson, *States and economic development*, p. 9.

37 *Ibid*., p. 4.

38 Oszlak, 'Historical formation', p. 7.

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the 'imposition of a power structure capable of exercising a monopoly over the organized means of coercion'. Differentiation of control relates to the exercise of unique powers, including 'a recognized capacity to extract, on a regular basis, resources from society'. Finally, the internalization of a collective identity refers to the capacity of a state 'to generate symbols that reinforce feelings of belonging and social cohesiveness' in order to 'assure ideological support for the system of domination'.[39]

The importance and applicability of Oszlak's model emerges from its recognition of the reciprocal relationship between the development of the state and the market economy. Oszlak argues that 'the formation of a capitalist economy and of a national state are aspects of a single process – albeit chronologically and spatially distinct'.[40] He further explains that 'the appearance of material conditions that make the formation of a national market possible are a necessary condition for the formation of a national state'.[41] By applying financial and monetary histories to Oszlak's model, we can focus on the meeting point of the state and the economy in an effort to understand the nature of the reciprocal relationship between state consolidation and economic development.

The remainder of this article will analyse the historical development of the fiscal and monetary capacities of the USA and Gran Colombia with respect to each of the four properties of 'stateness'. For example, the externalization of power will be discussed in terms of diplomatic recognition by foreign powers and the ability to secure sovereign loans from abroad. Institutionalization of authority is related to the ability of the central government to levy taxes effectively, as it relates to the legitimacy of the state. Differentiation of control will be considered in terms of the central governments' abilities to establish financial capacities distinct from municipalities and state governments and their ability to limit or supersede the financial capacities of local governing institutions. Finally, the internalization of a collective identity will be associated with the institutionalization of authority and differentiation of control, as well as with the development of national financial and monetary capacities.

Oszlak explains that the model 'postulates a relationship of reciprocal determination between the acquisition of certain attributes of "stateness" and the resolution of certain social issues'.[42] The evidence in this article focuses on the resolution of financial and monetary issues, postulating a 'relationship of reciprocal determination between the acquisitions of certain attributes of "stateness"' and the resolution of those financial and monetary issues. The histories and the theory combine to present an apparent Catch-22: the state must have legitimacy in order to exercise its coercive powers to extract resources from within the nation, but also needs extractive capacity in order to build the institutions that grant it legitimacy. In the USA, legitimacy was first achieved at home and then abroad, whereas in Gran Colombia the reverse occurred. This difference ultimately provides clues to understanding their divergent paths of growth and differing degrees of state consolidation.

39 *Ibid*., pp. 7–8.

40 *Ibid*., p. 6.

41 Ibid.

42 *Ibid*., p. 14.

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State finances and the externalization of power

A state can be said to have externalized its power when it has been diplomatically recognized by other sovereign powers. Diplomatic recognition by foreign powers generally occurs when, in the eyes of other states, the recognized state has adequately consolidated power and achieved legitimacy within its boundaries so that no other entity can legitimately claim sovereignty. Importantly, diplomatic recognition can serve as a credit rating for private and public issuers of debt: it can symbolize the faith of a foreign government in a state's capacity to use its resources and extractive capacity to make productive use of a loan and eventually repay it. Diplomatic recognition could therefore symbolize the attainment of financial capacity and state legitimacy in the eyes of the world. Because the USA and Gran Colombia experienced quite different paths to the externalization of power, they therefore also experienced very different routes to the concomitant accessibility of foreign loans.

In terms of the four components of 'stateness', logic would suggest that the institutionalization of authority, differentiation of control, and the internalization of a national identity would largely precede diplomatic recognition. That is because the first three are seemingly necessary preconditions for the attainment of domestic legitimacy, and thereby foreign recognition. However, in much of Latin America generally, and in Gran Colombia specifically, the externalization of power preceded the attainment of the other elements of 'stateness'.[43] While a flood of foreign finance was soon followed by diplomatic recognition, it may have come too soon. Conversely, in the USA, external recognition was attained, then waned, and was ultimately reaffirmed as the other elements of 'stateness' were reinforced under the new constitution.

The union that formed the Republic of Colombia first took shape in 1819 and was formalized as a centralized government under a constitution at the Congress of Cúcuta in 1821.[44] The US government granted diplomatic recognition to the new republic in 1822 and Great Britain granted official recognition in 1825.[45] Even before Britain officially recognized Gran Colombia, however, the new government was attempting to raise loans in London.

As mentioned above, the market for sovereign debt grew dramatically in the years after the Napoleonic wars. London financiers were eager to lend money to the emerging countries in Latin America and elsewhere, and the public was eager to subscribe.[46] Eager financiers and investors often did not perform due diligence, however.[47] As a result, a wave of defaults ultimately followed the issuance of bonds, as new countries were unable to keep up their payments. The value of the debt decreased dramatically, and both holders of sovereign debt and floundering Latin American republics experienced what has been coined the 'first Latin American debt crisis'.[48]

43 *Ibid.*, p. 8.

44 David Bushnell, *The Santander regime in Gran Colombia*, Westport, CT: Greenwood, 1954, pp. 12, 22, 24.

45 *Ibid.*, p. 24.

46 Dawson, *First Latin American debt crisis*, p. 40.

47 A famous example of the dangerous eagerness of London financiers to create new bonds in the 1820s is the case of the loan to Poyais, a fictional country led by Gregor MacGregor. See, for example, *ibid.*, p. 41.

48 See generally, *ibid.*

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The first major loan to Gran Colombia was raised in 1822 from the London financial firm Herring, Graham, and Powles.[49] Mounting war debts, the costs of establishing a new government, and the inefficiency of adapting an inherited colonial tax system soon expanded the internal debt. As a result, the government sought another loan in 1824 in order to finance the quickly growing public deficit and to help prevent the burgeoning financial crisis.[50] Bushnell calls this a 'cure worse than the disease', highlighting the imprudence of seeking another loan in order to finance a growing deficit under conditions of tenuous domestic political legitimacy and uncertainty about being able to finance the loan.[51] Making matters worse, an average of just 60% of the bargained-for amounts ever reached the country, after costs of underwriting and various fees were deducted.[52] The money was used rapidly and the government faced substantial domestic criticism for its handling of the loan.[53]

Bernecker describes the general trend for Latin American loans raised in London between 1822 and 1825: 'For the most part, these government loans were used – unproductively – to pay off old debts from the wars of independence and to buy arms. However, since the national economies … grew more slowly than had been hoped for, most Latin American countries suspended their foreign debts payments very soon.'[54] In 1826, amid a British monetary crisis, the lending house responsible for the 1824 loan, Goldschmidt and Co., fell into bankruptcy. Soon thereafter Gran Colombia defaulted on its 1824 loan, permanently debasing its foreign credit.[55] This occurred in the political context of a recent revolt in Venezuela, further undermining the legitimacy and stability of the young central government.[56]

It is worth noting that Gran Colombia received loans from private British firms *before* receiving official recognition from the British government, but forever tarnished its credit in 1826, *after* being diplomatically recognized. Britain had hesitated to recognize Gran Colombia for fear of offending Spain and because of aristocratic fears of emerging republicanism.[57] However, the government ultimately recognized the new country in early 1825 in order to begin negotiating commercial treaties with it.[58] This instigated a brief period of even greater (unwarranted) optimism in the creditworthiness of Gran Colombia.[59] It appears that the British government followed private investors in believing in the legitimacy of the government of Gran Colombia, and its role as a symbolic credit rating agency made matters worse.

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49 Bushnell, *Santander regime*, p. 113.

50 *Ibid*., p. 96.

51 *Ibid*., p. 96.

52 Dawson, *First Latin American debt crisis*, p. 225.

53 Bushnell, *Santander regime*, pp. 117–18.

54 Walther L. Bernecker, 'Latin America and Europe in the nineteenth century: the impact of an unequal relationship', in Bernecker and Tobler, *Development and underdevelopment*, p. 151.

55 Bushnell, *Santander regime*, p. 124.

56 *Ibid*.

57 Dawson, *First Latin American debt crisis*, p. 24.

58 *Ibid*., p. 92.

59 *Ibid*., pp. 92–93.

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Conversely, in the USA, the attainment of diplomatic recognition was, on at least one occasion, a necessary precondition for obtaining private foreign loans. Another striking difference is the amount of money – both loans and gifts – successfully solicited from foreign governments, particularly the French and Spanish, as opposed to strictly private financiers. While the Articles of Confederation were not officially ratified until 1781, in 1775 the Continental Congress began issuing monetized bonds, known as the 'Continental', in order to finance the War of Independence.[60] These were issued in excess and their value depreciated substantially, severely undermining both domestic and foreign credit.[61] It was then the responsibility of American agents abroad to improve American credit in the eyes of European financiers.

As early as 1777, Benjamin Franklin and others were soliciting and receiving funds (both loans and gifts) clandestinely from the French government, with whom the infant country had signed a treaty of support for their war against the British.[62] By 1779 the Congress decided to solicit the Amsterdam financial market as well.[63] Private Dutch financiers wavered at the solicitations until France successfully convinced the States General of the Netherlands to recognize the USA diplomatically. Recognition by the Dutch was officially granted on 19 April 1782, following the appointment of John Adams as 'minister plenipotentiary of Congress' a year earlier.[64] Later in 1782 Adams secured a loan at 5% interest from private Dutch financiers, the 'favorable rate of interest' reflecting 'the growing credit of the new republic'.[65] However, following the apparent crumbling of the young financial system, highlighted by the inability of the now formalized government to secure the needed unanimity to pass a national tariff, Dutch financiers began to waver once more. By 1786, according to Davis Dewey, the national financial system was again in distress and ultimately 'broke down completely'.[66]

In like manner to Gran Colombia, the USA faced periods of insolvency. In 1782 the government defaulted on both its debt to France and its domestic debt, and even the recent creation of the Bank of North America to 'provide temporary bridge loans . . . was of limited

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60 For more information about the 'Continental', see for example Farley Grubb, 'Creating the U.S. dollar currency union, 1748–1811: a quest for monetary stability or a usurpation of state sovereignty for personal gain?', *American Economic Review*, 93, 5, 2003, pp. 1778–98; idem, 'The US Constitution and monetary powers: an analysis of the 1787 Constitutional Convention and how the constitutional transformation of the nation's monetary system emerged', NBER Working Paper 11783, 2005; idem, 'Benjamin Franklin and the birth of a paper money economy', University of Delaware Working Paper 2007-01, 2007, http://www.lerner.udel.edu/economics/WorkingPapers/2007/UDWP2007-01.pdf (consulted 6 December 2011); Perkins, *American public finance*; E. James Ferguson, *The power of the purse: a history of American public finance, 1776–1790*, Chapel Hill, NC: University of North Carolina Press, 1961; Bolles, *Financial history*.

61 Bolles, *Financial history,* p. 230.

62 James C. Riley and Peter J. Van Winter, *American finance and Dutch investment 1780–1805*, New York, NY: Arno, 1977, p. 26. See also Davis Rich Dewey, *Financial history of the United States*, New York, NY: Longmans Green, 1920, pp. 47–8.

63 Riley and Van Winter, *American finance*, p. 36.

64 *Ibid*., pp. 52, 61, 63.

65 Dewey, *Financial history*, p. 48.

66 *Ibid*., p. 58.

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value'.[67] In 1787 the country was again in default on a loan from France, though the French government, more conciliatory than private British financiers would be to Gran Colombia, took control of the payments.[68] These financial difficulties cast doubt on the legitimacy of the government and were a catalyst for the reorganization of the country under a new Constitution and a new centralized financial system, the latter under the leadership of Alexander Hamilton. Similarly, the financial difficulties of Gran Colombia undermined the legitimacy of the country both domestically and abroad and ultimately resulted in a political restructuring. However, the ultimate financial and political restructurings of each country in response to their financial crises were dramatically different.

In 1830 Gran Colombia broke apart into three distinct sovereignties: Ecuador, Venezuela, and New Granada (present-day Colombia and Panama). In 1839 the substantial outstanding foreign debt was divided and assumed by each new government: New Granada assumed 50%, Venezuela 28.5%, and Ecuador 21.5%.[69] The dissolution of Gran Colombia meant that each new country would have to externalize its power anew. The persistent debt made that a difficult task. Jaramillo, Meisel, and Urrutia note that in New Granada foreign loans were absent between 1831 and 1850.[70] Moreover, Fred Rippy notes that, as late as 1870, investors still had no desire to finance Ecuador or Colombia.[71] Such poor international credit standings, in the eyes of both private and public sources of foreign finance, might signify an inability to sustain the externalization of power. It shows, among other things, that foreign investors lacked faith in the ability of a sovereign state to collect taxes and maintain a solvent fiscal system. In short, it is a reflection of the belief that, when a government lacks political legitimacy at home, it therefore lacks financial legitimacy abroad.

In the face of financial fatigue, the USA, under the Articles of Confederation, initially spread its internal debt to the states and expropriated goods and services from its own citizens in order to finance its foreign debts. For example, as early as 1776 Congress authorized the expropriation of goods and services for the army through impressments.[72] Federal officers issued certificates, or drafts, for goods and services 'in lieu of money'.[73] By 1781 and 1782 the states had assumed payments to the country's soldiers and gradually assumed the debt of the army, by 'taking up the certificates from their citizens in payment of taxes'.[74] The primary reason for reverting financial authority to the states was the inability of the

67 Michael D. Bordo and Carlos A. Végh, 'What if Alexander Hamilton had been Argentinean? A comparison of the early monetary experiences of Argentina and the United States', *Journal of Monetary Economics*, 49, 3, 2002, p. 473.

68 Donald R. Stabile, *The origins of American public finances: debates over money, debt, and taxes in the Constitutional Era, 1776–1836*, Westport, CT: Greenwood, 1998, p. 46.

69 Jaramillo, Meisel, and Urrutia, 'Continuities and discontinuities', p. 439.

70 *Ibid*., p. 439.

71 Fred J. Rippy, *British investments in Latin America, 1822–1949: a study in the operation of private enterprise in retarded regions*, Minneapolis, MN: University of Minnesota, 1959, p. 28.

72 Ferguson, *Power of the purse*, p. 58.

73 *Ibid*., p. 57.

74 *Ibid*., p. 144.

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government to levy tax under the Articles of Confederation, creating an inability to 'credibly commit to redeeming its bills of credit'.[75]

The power of the central government was ultimately consolidated under the Constitution of 1787, which granted the central government important powers such as the power to tax and the sole right to coin money.[76] Moreover, in a reversal, the new government ultimately assumed the public debt of the states.[77] The decision to assume the debts of the states was hotly contested, largely by the South, and actually failed initially.[78] However, assumption was eventually agreed upon in a deal to move the capital to the Potomac, a measure long desired by the influential Virginia delegates.[79] Ultimately, Hamilton's argument that a national debt could act as a 'cement' to help keep the nation together prevailed, and the federal government assumed the debts of the states.[80]

Furthermore, in his role as first Secretary of the Treasury, Hamilton successfully pushed for financial reforms that dramatically improved the USA's financial capacity. Among these reforms was the creation of a sinking fund to pay down the foreign debt, financed largely from the sale of western lands.[81] These reforms greatly improved the country's credit abroad. Ferguson doubts whether the USA could have maintained its foreign credit had it not reorganized its governing system,[82] which underscores the importance of institutional innovation in the young country's response to financial difficulties.

While Gran Colombia responded to its financial and political crises by dissolving into smaller spheres of legitimate political power and dividing its debt, the USA responded by strengthening its central administrative and financial apparatuses and ultimately assuming the debt of its parts. The former severely damaged its reputation abroad and found it nearly impossible to raise foreign loans for many years. The latter developed a vibrant financial system and maintained diplomatic recognition and access to foreign credit. A primary point of divergence is related to Gran Colombia's inability to innovate institutionally and, in so doing, institutionalize its authority by developing an efficient and legitimate tax system. The ability to externalize power successfully and permanently, as demonstrated by diplomatic recognition and the ability to borrow from abroad, is related to the attainment of a domestic source of finance, the ability to collect taxes efficiently, and hence the institutionalization of a state's authority.

State finances and the institutionalization of authority

Oszlak explains that the institutionalization of a state's authority 'implies the imposition of a power structure capable of exercising a monopoly over the organized means of

75 Grubb, 'US Constitution', p. 8.

76 Stabile, *Origins*, pp. 54, 59.

77 *Ibid*., p. 64.

78 Ferguson, *Power of the purse*, p. 318.

79 *Ibid*., p. 319.

80 Alexander Hamilton, quoted in Richard Sylla, 'The United States: financial innovation and adaptation', in Bordo and Cortés-Conde, *Transferring wealth and power*, p. 244.

81 Stabile, *Origins*, p. 12; Bordo and Végh, 'What if Alexander Hamilton', p. 474.

82 Ferguson, *Power of the purse*, p. 238.

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coercion'.[83] A state can be said to have institutionalized its authority in terms of its financial capacity when it has successfully established and monopolized a system of internal revenue and maintained a distinct monetary authority. Typically, the success of an internal revenue system depends upon either the coercion-cum-military powers of the collecting state or the faith of the taxed parties in the legitimacy of the state. Legitimacy is often derived from representation and the protection against excessive or arbitrary powers. Bordo and Cortés-Conde explain: 'As tax levies impinge on tax payers' property rights, the perception of the legitimacy of the tax regime becomes a key factor for the efficiency of the system.'[84] In this vein, institutionalization of authority can be measured by the ability of a state to levy and collect taxes efficiently without excessive recourse to coercive powers, thereby signifying a popular 'perception of legitimacy'. It can also be measured in terms of a state's ability to monopolize the coining of money and to maintain its value, further solidifying the perception of legitimacy.

The USA and Gran Colombia developed these capacities to different degrees. While both countries were initially plagued with financial and monetary difficulties, the USA ultimately proved more successful at institutionalizing its authority in terms of its financial and monetary capacities. The financial and monetary factors that marred the legitimacy of the two fledgling republics included a period of difficult financial adaptation, an inability to collect taxes efficiently, and monetary debasement, all of which had political repercussions. However, each country dealt with these issues differently. While Gran Colombia reverted to colonial modes of raising revenue and broke into distinct sovereignties along the lines of the colonial financial structure, the USA, with a history of financial innovation, established new financial structures that would ultimately prove robust.

In 1821 Gran Colombia took the early step of radically altering the colonial tax system, abolishing or changing many important sources of royal revenue.[85] These included abolishing the Indian tribute, the *alcabalas* (a sales tax on many consumer goods), and the liquor monopoly, as well as temporarily exempting or reducing taxes on several important exports.[86] However, the dire fiscal straits of the mid 1820s described in the previous section led many of these royal taxes to be re-established in the republic's final years.[87] In contrast, the USA maintained some semblance of the colonial tax system under the Articles of Confederation in the early 1780s before pursuing more innovative financial mechanisms under the Constitution of 1787. For instance, without the power to levy tax, under the Articles of Confederation the national government relied on requisitions from the several states, resembling the system used by the British.[88] However, the weak national government found collecting from the states to be difficult. The states often reneged on their payments, ultimately undermining the credit of the young government. In response, by the mid 1780s, many national leaders

83 Oszlak, 'Historical formation', p. 7.

84 Michael Bordo and Roberto Cortés-Conde, 'Introduction', in Bordo and Cortés-Conde, *Transferring wealth and power*, p. 8.

85 Jaramillo, Meisel, and Urrutia, 'Continuities and discontinuities', pp. 425–6.

86 *Ibid.*, p. 425.

87 *Ibid.*, p. 426.

88 Stabile, *Origins*, p. 23.

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sought to expand the power of the central government by, among other things, giving it the authority to levy tax.[89] This consolidation of central power stands in contrast to the eventual diffusion of financial authority to the three distinct parts of Gran Colombia.

Before the ratification of the Constitution in 1789, the US government lacked the coercive powers to demand payments from the states. Furthermore, the unanimity required under the Articles of Confederation made attempts to secure a national tariff nearly futile: on two occasions a much needed tariff fell short by just one vote (by Rhode Island in 1781 and by New York in 1786).[90] Similarly, the government of Gran Colombia was ineffective at collecting taxes. Smuggling, tax evasion, laxity on the part of customs officials, and the 'popular habit of cheating the government' were prevalent.[91] As early as 1819 the government resorted to imprisoning tax evaders, including members of the aristocracy, and threatening the death penalty for financial employees found guilty of fraud.[92] These measures had negative political consequences and undermined Gran Colombia's legitimacy by galvanizing important members of society against the new tax regime.[93]

From the beginning of the American War of Independence, the Continental Congress had to be careful to avoid de-legitimizing its cause and its authority. Having initiated the war largely under the rallying cry of 'no taxation without representation', the Continental Congress was hesitant to levy taxes.[94] Instead, by excessively issuing the 'Continental', the Congress levied an almost imperceptible tax through depreciation. That is, Congress printed more and more currency until it became nearly valueless.[95] This ultimately proved unsustainable, largely because Congress did not control any certain revenues, which could have been used to support the value of the Continental.[96] The waning value of the Continental eventually led merchants and others to reject it as a form of payment, suggesting an underlying belief in the illegitimacy of the national government.[97] In response, General Washington was granted the power to imprison those who refused to accept the paper currency.[98] Washington was also authorized to solicit goods and services through impressments.[99] Yet, the use of such coercive powers was not sufficient to legitimate

89 *Ibid.*, pp. 54, 59.

90 Dewey, *Financial History*, pp. 50–1.

91 Bushnell, *Santander regime*, pp. 84, 85. Bolívar noted that, even though the taxes were no more oppressive than under the colonial regime, 'the old taxes had the advantage of being habitual and therefore were considered mild'. This underscores the way in which familiarity can create legitimacy in the collection of taxes. Bolívar from *La Gaceta de Colombia*, 17 December 1826, as quoted in Bushnell, *Santander Regime*, p. 107.

92 *Ibid.*, pp. 86, 99.

93 Bushnell, *Santander regime*, p. 99.

94 Gouverneur Morris, a founding father, once wrote: 'America having never been much taxed . . . and the contest in question being on the very Question of Taxation the laying of Imposts unless from the Last necessity would have been Madness' (as quoted in Stabile, *Origins*, p. 23).

95 Ferguson, *Power of the purse*, p. 27.

96 *Ibid.*, p. 51.

97 Bolles, *Financial history,* p. 121.

98 *Ibid.*,.

99 Ferguson, *Power of the purse*, p. 58.

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the government's authority to levy a hidden tax through depreciation. Furthermore, counterfeiting was rampant and the Congress lacked the resources to stop it.[100] As a result, by 1780 'faith in paper money was gone' and the credit of the country had been 'completely paralyzed and destroyed' by its use.[101]

Just as the USA could not maintain the value of its paper currency in the early years of its existence, the government of Gran Colombia was complicit in the debasement of the coins that dominated its economy. Gran Colombia did not experiment significantly with paper currency and relied instead on officially minted precious metals as a medium of exchange.[102] However, the purity, and hence the value, of the coins was not well regulated. Irigoin notes that, beginning in the colonial period, the mints in New Granada did not maintain the Spanish standards.[103] Moreover, coins from other parts of the Spanish empire circulated widely in Gran Colombia as a result of the colonial subsidies received by New Granada, adding to the monetary chaos.[104] Finally, during the revolution, debasement of the coins was a part of the strategy of the Patriots.[105] Even before independence was achieved, Gran Colombia suffered from a debased monetary regime.

Once independence was all but achieved, the new government desired to restore the quality of coins to the previous standards. But, despite this desire, Irigion notes that 'until 1828 the government continued minting much lower quality pieces stamped with the year of the constitution 1821 as a (false) guarantee of the silver content'.[106] As a result, Gresham's Law took effect and the bad currency drove out the good.[107] The quality of the currency was severely degraded. As in the USA, the inability of the Gran Colombian government to maintain the value of its currency probably served to undermine the legitimacy of the government and to impede the institutionalization of its authority.

Important political repercussions stemmed from each country's difficulties with taxation, monetary instability, undeveloped financial capacities, and tenuous or negligible institutionalization of authority. For example, Bushnell explains that in Gran Colombia financial difficulties 'caused the army to feel neglected by the civil authorities … and thus helped it to acquire the dangerous habit of looking out for its own interests'.[108] The

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100 Bolles, *Financial history*, p. 129.

101 *Ibid*., pp. 135, 141, 142.

102 Maria Alejandra Irigion, 'Gresham on horseback: the monetary roots of Spanish American political fragmentation in the nineteenth century', LSE Economic History Working Paper 96/06, December 2006, http://eprints.lse.ac.uk/22321/1/wp96.pdf (consulted 6 December 2011), p. 15.

103 *Ibid*., p. 13.

104 *Ibid*. As New Granada was less productive than Peru or Mexico, it received *situados* (subsidies) from other parts of the empire to help cover the costs of colonial administration. Once independence was achieved, Gran Colombia relied on foreign loans to bridge the gap between its expenses and its domestic revenues. See Irigion, 'Gresham on horseback'. See also John R. Fisher, Allan J. Kuethe, and Anthony McFarlane, eds., *Reform and insurrection in New Granada and Peru*, Baton Rouge, LA: Louisiana State University Press, 1990, p. 2.

105 Irigion, 'Gresham on horseback', p. 13.

106 *Ibid*., p. 14.

107 Gresham's Law essentially states that bad money will drive out good money if both are required to be accepted as legal tender. When the quality of money varies, the incentive becomes to hoard higher quality currency, leading the lower quality money to be circulated more predominantly.

108 Bushnell, *Santander regime*, p. 107.

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inability to maintain the allegiance of the military would ultimately contribute to the dissolution of the union.[109] Moreover, as Bushnell explains, 'financial difficulties are one reason why the ideal judiciary and bureaucracy could never be fully established'.[110] This inability to build high-quality institutions served to undermine the legitimacy of the government further and to undercut the institutionalization of its authority. When bankruptcy and political fragmentation finally brought an end to the union, which had existed at least on paper,[111] the country essentially separated 'along the lines of territories where the [colonial] regional treasuries were located', namely the Presidency of Quito (Ecuador), the Captaincy-General of Venezuela, and New Granada (Colombia).[112]

There are several further explanations for Gran Columbia's financial and monetary difficulties. Jaramillo, Meisel, and Urrutia base the failure of the Colombian state to manage the economy effectively on the 'absence of pre-Columbian structures of long standing ... plus a very rugged topography'.[113] In other words, both inherited institutions and endowments were to blame. In contrast, Bushnell considers the lack of experienced public officials as an important source of trouble for the country's financial management, and explains bluntly that the Finance Minister, Jose Maria de Castillo y Rada, was 'not an outstanding administrator'.[114] Furthermore, in contrast to the USA, Gran Colombia did not have a history of financial experimentation. During colonial times, the region could rely instead on the presence of a Spanish mint in the territory to handle its monetary needs. This suggests more proximate and historical causes for the difficulty of achieving institutional adaptation and of legitimizing the state's authority.

Meanwhile, scholars have contended that the USA was not afflicted with such disadvantages. It had a long history of financial experimentation. Unlike the Spanish, the British denied the colonists a local mint 'to produce English coins for the local population'.[115] As a result, colonial legislatures experimented with fiat currencies early and often. By 1755 every colony had some experience issuing fiat currencies.[116] Furthermore, Bordo and Cortés-Conde explain that the innovative financial capacity of the USA was made possible by inherited British institutions. For example, they show that the system of representation within local governments, inherited from the British, 'not only legitimated taxes but also made their collection more effective and easy', at the local level before the Constitution and at the national level after its enactment.[117] It is important to keep in mind that the

109 The military of Gran Colombia was dominated by Venezuelans whereas the government was more strongly influenced by Colombians. This was a persistent source of tension in the Republic. See, for instance, *ibid*., pp. 60–1.

110 *Ibid*., p. 107.

111 Dawson, *First Latin American debt crisis*, p. 22.

112 Grafe and Irigoin, 'The Spanish empire', p. 40.

113 Jaramillo, Meisel, and Urrutia, 'Continuities and discontinuities', p. 417.

114 Bushnell, *Santander regime*, p. 84.

115 Perkins, *American public finance*, p. 358.

116 *Ibid*., p. 349.

117 Bordo and Cortés-Conde, 'Introduction', p. 10.

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institutional starting points for each country and historical experience with financial innovation were significantly different.

Finally, the differing abilities of individual actors may have played a role. For example, Alexander Hamilton is repeatedly lauded in the history texts as the crucial architect of the financial system of the USA.[118] This stands in sharp contrast to the poor impression left by Colombian administrators.

The primary difference between the two cases is that the USA appears to have been more capable of institutional innovation. Early on, Gran Colombia attempted financial institutional innovation by abandoning the colonial tax system, but failed to obtain the credit of the population, gain domestic legitimacy, or institutionalize its authority. The USA initially had difficultly institutionalizing its authority, largely as the result of the constraining character of the Articles of Confederation and the destabilizing effects of over-issuing the Continental. However, the Constitution initiated a transformation of the country's fiscal and institutional capacities, so that, as Richard Sylla notes, 'By 1795, the United States had all the key institutional components of a modern financial system'.[119] It is worth noting that these changes did not occur without dissent,[120] and that there were setbacks, including the failure to renew the charter of the First Bank of the United States in 1811.[121] This aside, Sylla continues, 'political and financial reforms were intimately bound up with one another'.[122] The conclusion is that financial and monetary capacities can potentially serve as proxies to assess the institutionalization of a state's political authority, and also serve as sources of legitimacy for the state.

We might conclude that those countries that can adapt and innovate to improve their political and financial structures simultaneously are more likely to institutionalize their authority successfully and perhaps more likely to endure. But we must also consider the institutional and historical starting point of each country and their relative experience with financial experimentation. The analysis in this section is in line with a conclusion by Hansjjorg Sigenthaler: 'Institutional learning is at the center of the process of modern economic growth. Successful learning took place somehow within the United States. Learning was less successful in South America.'[123] While Jaramillo, Meisel, and Uruttia explain that New Granada, once separate from Venezuela and Ecuador, successfully improved its financial structure and moved decidedly away from the colonial tax structures, this process took substantially longer than in the USA and came at the cost of the union of Gran Colombia.

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118 See, for instance, Bordo and Végh, 'What if Alexander Hamilton'; Richard Sylla, 'The political economy of early U.S. financial development', in Haber, North, and Weingast, *Political institutions*, pp. 60–91.

119 Sylla, 'Political economy', p. 61.

120 See for example Grubb 'Creating the U.S. dollar'; idem, 'US Constitution and monetary powers'; Perkins, *American public finance*; Ferguson, *Power of the purse*.

121 Sylla, 'Political economy', p. 85.

122 *Ibid*., p. 63.

123 Hansjjorg Siegenthaler, 'Hazards of growth and conditions of long run success: the case of the United States', in Bernecker and Tobler, *Development and underdevelopment*, p. 34.

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State finances and differentiation of control

The differentiation of a state's control is related to its ability to institutionalize its authority and to meet challenges by innovating institutionally. Control is differentiated in that it is distinct from the direction of local or colonial authorities. It signifies the solidification of 'relatively autonomous' and 'functionally differentiated public institutions' under a national government.[124] Oszlak describes three elements of differentiation: first, the 'recognized capacity to extract, on a regular basis, resources from society' (related to the institutionalization of authority discussed above); second, a 'degree of professionalization' of the institutions and their public functionaries; and third, the centralization of control over the activities of the public institutions.[125] As it relates to financial and monetary capacities, the first element of the differentiation of control deals with a state's capacity to tax. The second element relates more to political differentiation than financial or monetary differentiation, and so will generally be not taken up in this discussion. Finally, the third element relates to the centralization of fiscal and monetary authority, including the centralized control over monetary standards, the assumption of a national debt under a central authority, and the legitimate collection of internal revenues by the central government.

In the USA, federal control was eventually and concretely differentiated from that of the states under the Constitution of 1787. In Gran Colombia, by contrast, control was not adequately differentiated and each department of the country ultimately claimed sovereignty and sole control over its financial and monetary capacities and its institutions in general. Initially, Gran Colombia was successful at differentiating its control from Spain, whereas the US central government under the Articles of Confederation was unable to differentiate its control adequately from the states. As with the institutionalization of authority, however, the USA ultimately proved more capable of the institutional innovation necessary to solidify its differentiation of control and its degree of 'stateness' more generally.

The ability of the government of Gran Colombia to 'extract, on a regular basis, resources from society' was only realized to a limited extent. Under the Constitution of 1821, the government was granted the authority to extract resources from society, and the initial acts of Congress solidified that capacity by removing several sources of colonial taxation and implementing, for the first time, a direct tax (*contribución directa*).[126] However, while the government had the authority to identify and levy taxes, it lacked the capacity to do so effectively. Fraud and evasion were rampant and government revenues remained below the amount needed to implement desired social programmes, such as 'measures for popular education' and 'the manumission of slaves', or to pay down the national debt.[127] Finally, despite efforts to solidify its extractive capacity, the legitimacy of the young republic remained in question and regional rivalries soon brought an end to

124 Oszlak, 'Historical formation', p. 7.

125 *Ibid.*

126 Bushnell, *Santander regime*, pp. 78, 81.

127 *Ibid.*, pp. 81, 107.

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the union. As a result, the capacity to extract resources from society was reassigned to the newly independent departments under three new constitutions.[128]

The central government of the USA had similar difficulty solidifying its extractive capacity and, like the Gran Colombian government, it 'replaced colonial and revolutionary-period financial and monetary institutions with new ones'.[129] However, this adaptation occurred in the context of a weak extractive capacity. Under the Articles of Confederation, the government lacked the means to demand taxes; states and local governments maintained the only significant capacity to levy taxes.[130] This effective inability to demand funds encouraged national leaders to scrap the severely limiting Articles of Confederation in exchange for the Constitution, with its less confining limits on the power to extract resources from society.[131] The new government made use of its expanded powers by levying customs duties and some excise taxes, as well as by assuming the revenues from the sale of western land.[132] Furthermore, the financial system developed under Alexander Hamilton in the early 1790s provided the government with the capacity to borrow money from domestic sources, an extension of its extractive capacity. Sylla calls this capacity a 'key difference between the United States and most other countries of the New World'.[133]

The centralization of power over financial and monetary institutions is another important condition for the differentiation of control; monopolization of a monetary regime forms a key component of the centralization of control. As discussed in the previous section, the USA partially centralized control over its monetary regime under the Constitution, after a period of competing state-based monetary regimes, permissible under the Articles of Confederation and before.[134] Meanwhile, Gran Colombia failed to maintain the quality of its monetary regime, thereby increasing transaction costs by undermining the value of the currency in circulation.[135] This reflects a failure to centralize control adequately.

Again, the important difference is the capacity of the USA for institutional innovation. The USA endured under a centralized monetary authority while Gran Colombia fragmented along the fault lines of a colonial financial system. Bushnell describes this failure to improve upon the colonial institutions, despite the desire of the government to do so: 'the net progress made toward revising colonial institutions was limited, either because of the power of vested interests or because of the continuing strength of traditional beliefs and attitudes … among the general population'.[136] The failure of the Gran Colombian state to differentiate its control and institutionalize its authority effectively in terms of its financial and monetary

128 Ximena Orjuela, *El congreso hace historia: Colombia 1819–1929*, Bogotá, Colombia: Villegas Editores, 2004, p. 69.

129 Sylla, 'United States', p. 232.

130 *Ibid*., p. 236.

131 Bordo and Végh, 'What if Alexander Hamilton', p. 473.

132 Sylla, 'United States', p. 237.

133 *Ibid*., p. 246.

134 Sylla, 'Political economy', p. 74.

135 Jaramillo, Meisel, and Urrutia, 'Continuities and discontinuities', p. 441.

136 David Bushnell, *The making of modern Colombia: a nation in spite of itself*, Berkeley, CA: University Press, 1993, p. 54.

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capacities, as compared to the relative success of the USA after 1787, illustrates an important link between a state's ability to endure and its ability to adapt its financial capacity to facilitate the demands of both domestic and international economies.

State finances and the internalization of a collective identity

Oszlak explains that the internalization of a collective identity 'consists of the ability of the state to generate symbols that reinforce feelings of belonging' in order to 'assure ideological support for the system of domination'.[137] In terms of financial and monetary capacities, the internalization of a collective identity can be facilitated by the maintenance of a national currency, adorned with national symbols and deriving its value from the authority of the state. Furthermore, the state can facilitate the emergence of a collective identity by appropriating funds for that specific purpose. Finally, a collective identity can be facilitated or debilitated depending on the specific nature of the tax regime in place, the extent to which the state assumes authority over a national debt, and the success of such national financial institutions as a national bank.

Gran Columbia was not successful at promoting a collective identity, despite explicit provisions for the diffusion of national symbols in the Fundamental Law establishing Gran Colombia. Articles 13 and 14 of the Fundamental Law (written in 1819, before the formalization of the country at the Congress of Cúcuta in 1821) contain provisions for the ceremonial proclamation of the Republic of Colombia 'in towns and in the armies, with festivals and public rejoicings' and for annual celebrations thereafter.[138] However, from the beginning the sense of a complete national identity was tenuous. Neither Panama nor Ecuador was represented at the Congress of Cúcuta during the formalization of the country, thereby limiting any sense of unity from the outset.[139] Orjuela explains that Ecuador maintained a sense of *su propia autonomía* ('its own autonomy'), which eventually contributed to its decision to abandon the union.[140] Another factor in Ecuador's discontent was the national reduction of tariffs. As the only major textile-manufacturing region of the country, Ecuador was the most severely hurt by cheaper imports of foreign manufactures, which favoured the predominately agricultural Venezuela.[141] Finally, as mentioned above, the government of Gran Colombia never successfully controlled the mint. Coins continued to circulate from other parts of the former Spanish empire and many coins were illegitimately stamped with years prior to the formalization of the republic.[142] This potentially served to undermine the widespread diffusion of an essential and widely used national symbol – currency. A coherent national currency is not only

137 Oszlak, 'Historical formation', p. 7.

138 *Constitution of the Republic of Colombia*, trans. Bernard Moses, Philadelphia, PA: American Academy of Political and Social Science, 1893, Articles 13 and 14, p. 63.

139 Bushnell, *Santander regime*, p. 24.

140 Orjuela, *El congreso hace historia*, p. 70.

141 Bushnell, *Making of modern Colombia*, p. 62.

142 Irigoin, 'Gresham on horseback', pp. 13–14.

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an important store of value and medium of exchange but is also a key tool for the subtle internalization of a collective identity.

Thus Gran Colombia, born without the consent of all of its parts, was comparatively unsuccessful at internalizing a collective identity. Its monetary regime was poorly regulated and did not facilitate the diffusion of a key national symbol. Furthermore, elements of its financial structure undermined the economic strength of some of its parts, serving as a wedge between parts.

The USA ultimately proved more capable than Gran Columbia of adapting its institutions to facilitate the internalization of a collective identity and a more concrete sense of nationhood. Initially, it faced similar difficulties establishing a currency that could serve as a national symbol. Each state printed its own money adorned with state symbols, so that the internalization of a collective identity on a national scale was undermined by identification with the individual states. But the Constitution of 1787 put an end to that by prohibiting the states from printing their own currency. The Constitution also technically prohibited the federal government from printing money.[143] As a result, banks were the primary issuers of paper currency, and it was initially unclear whether the federal government had the power to charter banks.[144] However, in 1791, under the direction of Hamilton, Congress and the President approved the charter for the First Bank of the US (BUS), a privately operated bank, to act as the 'federal government's bank'.[145] With a 20% share in the bank, the national government was able to assist the BUS in diffusing banknotes widely throughout the young country.[146] Bearing the words 'Bank of the United States', these banknotes could potentially be understood as a national symbol. However, for a long period state-charted private banks were still the primary issuers of paper currency.[147] While US currency did not take its modern form, complete with depictions of national symbols, until well after the formation of the country, the First BUS issued bills of credit featuring the name of the 'Bank of the United States'. BUS banknotes were issued alongside banknotes of state-charted banks and foreign currencies, including the Spanish dollar, but the presence of the BUS banknotes could arguably have helped internalize a national identity.[148] The intent of prohibiting the states from printing money was primarily to lessen the effects of inflation and competing monetary regimes, but this move and the subsequent charter of the BUS and its wide issuance of banknote currency also served as a means of internalizing a collective identity.

The internalization of a collective identity has a symbiotic relationship with the differentiation of control and the institutionalization of authority, because it reinforces a belief in the legitimacy of the state. The institutionalization of authority, in turn, promotes the internalization of a collective identity by providing the institutional framework to support a national identity. The USA was able to institutionalize its authority under the Constitution

143 Grubb, 'US Constitution', p. 59.

144 *Ibid*., p. 52.

145 *Ibid*.

146 Sylla, 'Political economy', p. 734.

147 *Ibid*.

148 Grubb, 'US Constitution', pp. 1, 59. See also Peter L. Rousseau, 'A common currency: early U.S. monetary policy and the transition to the dollar', NBER Working Paper 10702, 2004, pp. 3–4.

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of 1787 and simultaneously facilitate the internalization of a collective identity through its prohibition of monetary powers previously possessed by the states, control over the mint, and charter of the First BUS.

Conclusion

This article has used Oszlak's model of 'stateness' as a framework for comparing the financial and monetary histories of the USA and Gran Colombia. The comparison demonstrates the important role played by the state in the development of financial and monetary capacities and the simultaneous role played by those capacities in the consolidation of the state. The analysis has shown how financial and monetary capacities can be used to evaluate the relative success of a state's ability to externalize power, institutionalize authority, differentiate control, and internalize a collective identity. Together, these factors can contribute to the consolidation and legitimization of a state, or to what Oszlak describes as the attainment of 'stateness'. It has been shown that a state can derive legitimacy and stability from the strength of its fiscal and monetary capacities, but that it simultaneously requires legitimacy and stability to establish those capacities adequately.

From this analysis, it appears that successful state consolidation and the development of fiscal and monetary capacities through institutional innovation are aspects of the same process. The success and adaptability of a state's financial system, as the intersection of the state and the economy, is of seemingly paramount importance to the ultimate success and endurance of both the state and the economy. This comparison is hardly exhaustive. But it may prove useful as a framework for future work seeking to express the inherent connections between state development, development of fiscal capacity, and economic development.

The role of the state in the economy remains an important source of tension in markets and polities worldwide. Contemporary appeals to revolutionary ideals often play a central role in these debates. The rhetoric used is not always consistent with the historical reality. For example, tensions between the US-backed Colombia and the more left-leaning Venezuela and Ecuador are currently high, despite a shared history and a formerly shared flag. Venezuela's recent exhumation of Bolívar's body carries divisive political undertones directed at Colombia, despite the Pan-Americanism and cooperation at the heart of the Bolivarian ideal.[149] Similarly, in the USA the various founding fathers have been co-opted by groups with widely varying political ideologies, which make competing claims to an understanding of the intent of the founders without regard for historical actualities. Rather than calling upon past ideals and idealizations, however, the debate over the relationship between the state and the economy ought instead to consider actual historical developments that would assist individuals and governments in making informed decisions.

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149 Romero, 'Building a new history'.

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