FINANCING THE CIVIL WAR:
THE CONFEDERACY'S FINANCIAL STRATEGY

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Abstract:

The onset of the American Civil War forced both the Confederate and Union governments to swiftly develop effective strategies to fund their military efforts. I focus on the following puzzle: Why did the Confederacy rely almost exclusively on inflation financing while the Union embarked on a successful financial strategy effectively combining loans, notes, and taxes? Why did the Confederacy fail to develop a sustainable financial strategy? This set of questions is not only of interest to scholars in American Politics, but also incorporates central concerns in Political Economy and International Relations. I pay particular attention to the Confederate government and Congress to illustrate the endogenous relationship between financial choices and the success or failure of military engagements. I argue that Southerners' preferences were shaped by their commitment to states' rights and slavery and that their financial strategies, motivated by these incentives, were conditional on the probability of defeating the Union. When the probability of victory was high, Southerners relied on financial policies that limited the aggrandizement of federal power (loans and notes), while eschewing financial policies that empowered the federal government (taxes). However, Confederate strategies did not remain static as the probability of victory plummeted during the Summer and Fall of 1863. Once Southerners updated their beliefs about the probability of success, they began to disregard their concern for states' rights and instead focused all resources to winning the war. Consequently, taxes were actively included in the Confederacy's financial portfolio beginning in the Winter of 1863. To evaluate the relationship between preferences and policy choice, I analyze roll call data by estimating various population average models using generalized estimating equations (GEE).

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> *"The political independence and power of a people depend upon that people's financial ability. It is a trite saying that (these) are as often determined by the length of the purse as by that of the sword."*
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> *The Charleston Mercury*, July 9, 1861.

1. Introduction

A government on the brink of war needs to mobilize its military forces, augment its administrative capabilities, and raise funds to support both of these activities. The success or failure of a military engagement is not only a function of military strategies and technology, but also depends on the state's ability to gather and secure resources for the war effort. While scholars have investigated a large number of questions about wars, there has been a dearth of studies that investigate the politics of war finance.

When political actors rely on one set of financial strategies rather than on another set, their choices can have repercussions on a number of dimensions. First, the turning points of a war, as well as its duration and outcome, are a function of the government's ability to provide resources to its military. Second, decision-makers' choices of financial strategies are as much a result of economic considerations as of political incentives. Third, the growth of the post-war economy may well be a consequence of the specific financial policies that were pursued during the war.

Understanding the political foundations of war financing unpacks a number of important questions: How do governments retain access to resources to fund their military efforts, especially when financial strategies that worked during peaceful periods are jeopardized? To what extent do political motivations and economic necessities affect the decision to pursue some financial strategies but not others? Finally, do financial strategies change over the course of the war? In other words, is there an endogenous relationship between financial policies and military success or failure?

I investigate these questions honing in on the financial strategies employed by the Confederacy during the American Civil War. The Confederacy's experience is an informative case for a number of reasons. First, the Civil War was similar to wars between states because the territorial boundaries were clearly delineated, rather than an independence movement that sprang up in different parts of the country.

This makes the experience of the South comparable not only to newly formed governments trying to gain their independence but also to developing countries engaged in inter-state military conflicts.[1]

Second, the Confederacy's financial choices are juxtaposed to the Union's financial strategy, albeit implicitly. Once the South seceded and the North began its military campaign, both governments had to mobilize their armies and navies, develop military strategies, and finance these efforts effectively. They both faced a formidable enemy; the key decision-makers on both sides knew each other well from previous experience in Washington; and the military and financial strategies that had been employed throughout the ante-bellum period were common knowledge.

Given that there was a sizeable overlap in knowledge, it would be plausible, if not expected, that both the Confederate and Union governments would pursue similar financial policies to set in motion and maintain their military forces. But this was not the case. In fact, the Union government was substantially more successful in financing the war than the Confederacy. The Union pursued a financial strategy that was sustainable over the long-term and successfully extracted resources from an economy that had previously been privy to an almost tax-free existence. The Confederacy, in contrast, adopted short-term financial strategies and only later in the war began to leverage its tax power, when it was probably too late to affect the outcome of the war.

The comparison between southern and northern revenue sources is summarized for the entire war in Table 1.[2] Each government, relative to the size of its economy, was able to contribute to the revenue side of the balance sheets, although they did so in decidedly different ways. The Union relied on taxes and customs for more than twenty percent of their revenue source, while long-term bond issues comprised thirty-one percent of the budget, and interest-bearing notes contributed almost twenty-seven percent. The Union's efforts to collect taxes, including taxes on goods, income, and licenses, improved the government's credibility in the bond market, providing a legitimate source of revenue to meet interest

[1] See also Patto, Carl Vernon. 1975. "Budgeting Under Crisis: The Confederacy as a Poor Country." *Administrative Science Quarterly*. 20(3): 355-370.
[2] See also Schwab, J. C. 1892. "The Finances of the Confederate States." *Political Science Quarterly*. 7(1): 38-56. Schwab, J. C. 1901. *The Confederate States of America 1861-1865: A Financial and Industrial History of the South During the Civil War*. New York: Charles Scribner's and Sons. Patterson, Robert T. 1952. "Government Finance on the Eve of the Civil War." *Journal of Economic History*. 12(1): 35-44. Burdekin, Richard C K., and Farokh K. Langdana. 1993. "War Finance in the Southern Confederacy." *Explorations in Economic History*. 30: 352-76.

payments.[3] In addition, the Union limited the issue of non-interest bearing notes stalling inflationary pressures.[4]

(Insert Table 1 about here)

In contrast, the Confederacy relied almost exclusively on loans and non-interest bearing notes, contributing twenty-one percent and fifty-four percent, respectively, while taxes only made up eight percent of the revenue. Depending almost exclusively on inflation financing, the South's attempts to fund the war were short-sighted and at best inadequate, potentially damaging the post-war economy for decades.[5] Given that the two governments had almost identical decision-making processes, political institutions, and knowledge of prior American financial policies, the difference in their strategies presents a puzzle. Were confederate decision-makers irrational? Did they expect that the war would end quickly? Were they fruitlessly anticipating England's interference? Was the Confederacy constrained in their financial choices because of a smaller resource base?

I argue that the key to understanding the Confederacy's financial policies is to take into account the political incentives underpinning their financial strategy as well as the endogenous relationship between financial choices and the success or failure of military engagements. Southerners' long-standing defense of states' rights and slavery motivated the initial set of financial policies. But their commitment was not unconditional adjusting to the necessities of war. When armies and navies were not adequately financed, the probability of executing a successful military strategy diminished. As the probability of

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[3] It is interesting to note that the concept of financial credibility was not lost on the North. In order to join the union, the readmitted states were required to default on their debt obligations. The fourth section of the fourteenth amendment states: "The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void." This shattered the Confederacy's credibility with lenders of any kind, making it futile to begin another insurrection, not for political but for financial reasons.

[4] For an excellent study of the Union's finances see Bensel, Richard. 1990. *Yankee Leviathan: The Origins of Central State Authority in America, 1859-1877*. Cambridge: Cambridge University Press. See also Roll, Richard. 1972. "Interest Rates and Price Expectations During the Civil War." *Journal of Economic History*. 32(2): 476-498. And Patterson, Robert T. 1952. "Government Finance on the Eve of the Civil War." *Journal of Economic History*. 12(1): 35-44.

[5] See Goldin, Claudia, and Frank D. Lewis. 1975. "The Economic Cost of the American Civil War: Estimates and Implications." *Journal of Economic History*. 35(2): 200-215. Persons, Warren M., Pierson M. Tuttle, and Edwin Frickey. 1920. "Business and Financial Conditions Following the Civil War in the United States." *The Review of Economic Statistics*. 2(2): 5-21. Temin, Peter. 1976. "The Post-Bellum Recovery of the South and the Cost of the Civil War." *Journal of Economic History*. 36(4): 898-907. For a discussion of Georgia's post-war economy see Wallenstein, Peter. 1984. "Rich Man's War, Rich Man's Fight: Civil War and the Transformation of Public Finance in Georgia." *The Journal of Southern History*. 50(1): 15-42. For a review of the North's economic development see Williamson, Jeffrey G. 1974. "Watersheds and Turning Points: Conjectures on the Long-Term Impact of Civil War Financing." *Journal of Economic History*. 34(3): 636-661.

winning the war plummeted, decision-makers began to consider a larger set of financial policies, regardless of the political costs, to counter their disadvantage and increase the probability of success. The pressure to reevaluate financial policies became relentless when the survival of the state itself hinged on a victory.

Employing the historical record and roll call votes on key financial legislation, I find that southern Congressmen's strategies were a function of their support for states' rights and slavery. Congressmen who were the most deeply committed to protecting states' rights and slavery were more likely to rely on financial policies that limited the aggrandizement of federal power, issuing loans and notes, and were more likely to oppose policies that empowered the federal government, in particular taxes. But strategies did not remain static. As the lack of funds and supplies unmistakably began to jeopardize the South's military efforts in the Summer and Fall of 1863, Congressmen who had previously opposed taxes, began to disregard their concern for states' rights and all efforts were focused on winning the war, including tax measures.

The relationship between financial policies and war has been demonstrated in a number of seminal studies, which focus primarily on the government's ability to extract revenues from society. Tilly developed the succinct yet compelling argument that states make wars and wars make states.[6] The pressures of securing resources for war forced leaders to develop and improve their abilities to extract resources from the economy, in the process building a strong national state. Expanding on these questions, Levi has examined the constraints rulers face in their efforts to maximize revenue.[7] The predatory ruler's ability to extract from the economy was limited by his bargaining power, transaction costs, and discount rate. Rosenthal, focusing specifically on the bargaining game between the crown and the elite, argued that fiscal institutions were the key to understanding political and economic change in European countries.[8] Elite decision-makers who had power over the government's purse-strings could force the crown to seek their approval and support in his wars. In contrast to these studies, Brewer delved into the details of finance and administration in England.[9] He writes,

[6] Tilly, Charles. 1990. *Coercion, Capital, and European States, AD 990-1990*. Cambridge: Basil Blackwell.
[7] Levi, Margaret. 1988. *Of Rule and Revenue*. Berkeley: University of California Press.
[8] Rosenthal, Jean-Laurent. 1998. "The Political Economy of Absolutism Reconsidered." In *Analytic Narratives*. Robert H. Bates, Avner Greif, Margaret Levi, Jean-Laurent Rosenthal, and Barry R. Weingast, eds. Princeton: Princeton University Press. See also North, Douglass, and Barry R. Weingast. 1989. "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth Century England." *Journal of Economic History*. 49: 803-32.
[9] Brewer, John. 1988. *The Sinews of Power: War, Money and the English State, 1688-1783*. Cambridge: Harvard University Press. See also Stephen Skowronek's seminal study on American state-building. (1982. *Expansion of National Administrative Capacities, 1877-1920.* Cambridge: Cambridge University Press.)

> The struggle for power and control may not have been fought out in the bright, sanguinary colours of battle nor on the large canvas of several continents but, no matter how contained or muted it might appear, its effects were far-reaching. The ability of government administrators to establish the routine by which revenues were collected, money raised and supply requisitioned could make the difference between victory and humiliation.[10]

Shifting the spotlight from European state development, Bensel studied the extent to which the Confederacy built a strong central state based on roll call analysis of the Confederate Congresses.[11] He identified the types of policies that contributed the most to state-building efforts and found that "support for state expansion was broadly distributed among the most important groups and classes in the South."[12] Any differences along party affiliation, secessionist stand, and regional divisions dissolved when the Confederacy had to counter the North's military advances.

In addition to Bensel's work, economic historians have examined various aspects of the Confederacy's finances, including detailed studies of the Confederate Treasury, prices and interest rates, the South's ability to fund loans abroad, the impact of military events on gold prices and bond yields, and the effectiveness of the blockade.[13]

Analyzing the relationships between war, finance, and state-building in the Confederacy, I build on this literature in several ways. First, I investigate the extent to which financial policies were successfully executed. If decision-makers supported and implemented financial policies, increasing the state's autonomy and influence, then we should observe changes in the government's balance sheets.

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[10] Brewer. *The Sinews of Power: War, Money and the English State, 1688-1783*. p.xvi.

[11] Bensel, Richard. 1987. "Southern Leviathan: The Development of Central State Authority in the Confederate States of America." *Studies in American Political Development*. 2:68-136. See also McPherson, James M. 1992. "American Victory, American Defeat." In *Why the Confederacy Lost*. Edited by Gabor S. Boritt. New York: Oxford University Press.

[12] Bensel. "Southern Leviathan: The Development of Central State Authority in the Confederate States of America." p. 135.

[13] Ball, Douglas B. 1991. *Financial Failure and Confederate Defeat.* Urbana: University of Illinois Press. Burdekin, Richard C K., and Farokh K. Langdana. 1993. "War Finance in the Southern Confederacy." *Explorations in Economic History*. 30: 352-76. Lebergott, Stanley. 1981. "Through the Blockade: The Profitability and Extent of Cotton Smuggling." *Journal of Economic History*. 4:867-88. Patto, Carl Vernon. 1975. "Budgeting Under Crisis: The Confederacy as a Poor Country." *Administrative Science Quarterly*. 20(3): 355-370. Roll, Richard. 1972. "Interest Rates and Price Expectations During the Civil War." *Journal of Economic History*. 32(2): 476-498. Schwab, J. C. 1892. "The Finances of the Confederate States." *Political Science Quarterly*. 7(1): 38-56. Smith, Ernest Ashton. 1901. *The History of the Confederate Treasury*. Harrisburg, PA: Press of Harrisburg Publishing Co. Thornton, Mark, and Robert B. Ekelund, Jr. 2004. *Tariffs, Blockades, and Inflation: The Economics of the Civil War*. Wilmington, Delaware: A Scholarly Resources Inc. Imprint. Todd, Richard Cecil. 1954. *Confederate Finance*. Athens: University of Georgia Press. Weidenmier, Marc D. 2000. "The Market for Confederate Cotton Bonds." *Explorations in Economic History*. 37: 76-97. Weidenmier, Marc D. 2002. "Turning Points in the US Civil War: Views from the Grayback Market." *Southern Economic Journal*. 68(4): 875-90.

While intentions are important, a vote for or against a specific policy is only consequential if the policy was in fact implemented. Second, I examine in more detail the Confederacy's tax policies, one of the central pillars of any state-building effort. If Southerners were committed to building a strong state, then their failure to impose adequate taxation contradicts their broader state-building strategy.

Third, I broaden the literature in economic history by taking seriously the preferences of southern policy-makers in explaining their financial choices. Rather than focusing exclusively on outcomes, I attempt to understand which motivations led Confederate decision-makers to rely on some financial policies while ignoring others. Finally, I consider that strategies are not constant; decision-makers do not have static strategies over the course of the war. The development of the war can shape and change policies. By taking into account the endogeneity of this relationship, the progression of the military confrontation becomes a critical link between war and financial policies.

In the next section, I lay out a theory that explains legislators' preferences for different financial strategies as well as the key hypotheses. In section 3, I discuss the Confederacy's initial financial strategy driven by their commitment to states' rights and slavery, reinforced by their misplaced hopes for foreign intervention and northern apathy. In section 4, I review the significant changes that took place during the Summer and Fall of 1863, including the Confederacy's desperate attempts to mobilize resources as the failure of its financial policies became more and more apparent, the realization of the North's resolve and England's neutrality, and the North's progressive advancement into southern territory coupled with the emancipation of slaves. In Section 5, I examine the South's revised financial strategy and their attempts to reverse the advances of the Union. In Section 6, I briefly address alternative explanations. In Section 7, I identify and measure the incentives that motivated Confederate Congressmen's choices over financial policies focusing on key roll call votes on loan, impressment, and tax bills, estimating population average models with generalized estimating equations to account for multiple observations on the same individual. I conclude in Section 8 with a summary and conclusion.

2. <u>Theory and Hypotheses: Political Preferences and Financial Strategies</u>

When political decision-makers are confronted with the immediacy of financing a war, the choices they make can be critical, not only for the duration or development of the war, but also its final outcome. In this section, I develop a theory of how decision-makers choose financial policies in which their choices are a function of (1) political objectives in orthogonal policy dimensions, in the southern case slavery and the aggrandizement of federal power, and (2) their expected and updated probabilities of winning the war. While this theory is specific to the Confederacy's case, it can be generalized to any situation in which a second policy dimension exists that is inextricably linked to the selection of financial policies.

Decision-makers had two sets of conflicting preferences: the protection of slavery and victory against the North. First, southerners wanted to protect slavery from any legal infringements. The primary strategy to protect slavery, which developed over the ante-bellum period, had been to allocate political power at the state level rather than the federal level. The strategy was based on the logic that representatives in the federal government, who opposed slavery, could not outvote slave-state interests as long as important political power was placed at the state level. Furthermore, the strategy entailed not only that slave policies would be decided at the state level, but also that any type of aggrandizement of federal power was a threat to political power at the state level. Consequently, federal power had to be limited as much as possible to assure the supremacy of state-level politics and preferences. I argue that decision-makers who had the most to gain from the protection of slavery were also the ones who were the most protective of states' rights.

Second, southerners wanted to win their independence from the Union. Once the South seceded and the Union government was clearly intent on fighting to keep the country together, southerners' could no longer hope for a diplomatic resolution and had to win the war against the North. Southerners who had the most to loose from defeat, those who relied most extensively on the economy of slavery, would have the strongest incentives to defeat the Union. As a result, decision-makers who were the most committed to slavery had two sets of incentives, to protect states' rights and to win independence. These two preferences clashed when Congressmen had to choose among alternative financial policies.

Decision-makers could chose among four different financial policies to fund the war, long-term loans (bonds), notes (primarily non-interest bearing), taxes, and impressments. Each of these policies was consequential to the war effort but mapped onto Congressmen's competing incentive structures in different ways. Financial policies that empowered the federal government jeopardized the South's commitment to slavery and states' rights, while financial policies that did not strengthen the national government posed no threat to slavery.

Specifically, the government's efforts to secure long-term loans, in bond markets both at home and abroad, would not lead to an increase in the federal government's capacity. Placing debt required a minimal state apparatus and could be administered by few bureaucrats with limited resources. Similarly, issuing notes was also a cheap method of financing the war. As long as the printing presses stood by, an increase in notes was simply a matter of enacting another round of prints. Neither bond nor note issues required a central government with strong organizational capabilities, an effective bureaucratic apparatus, or regular and direct interactions between the state and the polity.

Taxation, on the other hand, was the emblematic policy of state-building and federal expansion. The state's ability to extract resources from society was directly related to the expansion of its bureaucracy. Furthermore, taxation, depending on the target tax base, easily and frequently brought the government within striking distance of many of its citizens. The problem of taxation was the problem of empowering the federal government.

Policies implementing and regulating impressments do not easily translate into federal power. Impressments certainly strengthened the central government as it took upon itself the right to buy goods from private citizens. But impressments were clearly a wartime measure that was administered by the military. Once the war ended, impressments would cease.

Southern decision-makers were faced with two contradictory incentive structures. On the one hand, they wanted to protect states' rights at the expense of federal power ensuring the continuance of slavery and the supremacy of state politics. On the other hand, this strategy would limit their financial policies to loans, notes, and impressments and exclude aggressive tax policies, which in turn would make the war effort less successful.

But financial strategies were not static; they were adjusted to the expected outcome of the war. When Congressmen believed that the probability of winning was high, then they were willing to limit the power of the federal government at the cost of enacting a less effective financial strategy. But when the probability of winning declined, decision-makers were less willing to limit federal power and implemented a diverse financial strategy that included taxation, potentially a future threat to states' rights and slavery but increasing the South's chances of successfully defeating the Union.

Given these incentives, I argue that Congressmen's support of different financial strategies was a direct consequence of their varying opposition and commitment to slavery and the aggrandizement of state power conditional on the probability of winning. I derive several hypotheses from this theory. First, Congressmen regardless of how close they stood to states' rights would support financial policies that required a limited degree of state expansion and infiltration into the economy, bonds and notes. Furthermore, their choice was not conditional on the expected probability of winning the war since these were decentralized financial policies posing no threat to slavery or states' rights.

Second, Congressmen who had the strongest commitment to slavery and states' rights were opposed to financial policies that would empower the federal government, i.e. taxation, not only because of the immediate demands for a stronger national state, but also because it was doubtful that this type of expansion could be rolled back once the war ended. But this strategy was conditional on the expected probability of winning. When Congressmen updated their beliefs about the probability of victory, they adjusted their strategy accordingly. Specifically, Congressmen who were the most committed to winning the war would be more likely to support taxes as the probability of defeat grew.

Finally, it remains unclear whether states' rights advocates would be consistently for or against impressments, since it was strictly a wartime policy. While political considerations about slavery probably played a much smaller role in the support for impressment policies, Congressmen's personal stakes may have influenced their choice for or against impressments. In particular, Congressmen who had the most property to loose would more likely oppose impressments relative to less affected Congressmen.

To test these hypotheses, I first examine Congress' initial financial strategy during a period when the probability of defeating the Union was still relatively high. I then identify the months when the probability of winning declined precipitately and analyze the set of financial strategies that Congressmen chose once they updated their beliefs about a potential victory. I conclude by analyzing roll call data on key loan, note, tax, and impressment policies in order to test whether Congressmen's commitment to slavery and states' rights influenced their choice over financial policies conditional on the probability of winning.

3. Congress' Initial Financial Strategy

Confederate decision-makers, quickly assembling in the Provisional Congress and later in the Confederate Congress, had to formulate the first financial strategy to protect their newly claimed independence. Their choices were driven by a combination of incentives, paramount among them their objective to protect states' rights and slavery. Slavery, the linchpin of the southern economy, was protected and advocated under the broader auspices of a states' rights ideology. States' rights guiding principles included policy-making at the state level, a decentralized and small central government, and, most importantly, the protection of slavery across successive party regimes.

The South's secession from the United States was rooted in the fear that northeastern interests and the new Republican Party would continue threatening the southern "way of life" in particular slavery and the consequent social hierarchies that had been built around it. Gunderson argues that "because slavery was an attractive employment of capital and was expected to remain so, an enormous vested interest had been developed in its ownership by 1860."[14] He finds that the commercial benefits of slavery were not equally distributed among slave states. Gunderson calculates that in 1860 the average slave income per free citizen was about $50 for the states of the Deep South while the average income for the Upper South was only $20. After abolition, the free citizens of the Deep South had an average plunge of 31% in income, whereas the income in the Upper South only dropped by 17% (See Table 2). One study assessed that if slaves had not been emancipated, by 1890 their net marginal product would have been 52 percent greater than in 1860 and their investment value would have increased correspondingly.[15]

(Insert Table 2 about here)

Through most of the ante-bellum period, southern politicians worked to protect slavery and states' rights by opposing the aggrandizement of federal power. But as Northerners, both in political and social circles, became increasingly opposed to slavery, coupled with westward expansion and the ascent of the Republican Party, Southerners no longer believed that they could maintain their "peculiar institution." Southerners saw in secession a political strategy that would protect slavery and throw off the yoke of the increasingly powerful northeastern industrial interests.[16]

But once Southerners formed the Confederacy, their prior preference for a weak federal government and strong states' rights would not necessarily be transferred unconditionally into the new political arena. On the one hand, southern decision-makers completely controlled their new federal government with almost none, if any, opposition to slavery. Suddenly, the policies that had been advocated under the banner of states' rights were represented and protected by the federal government and the extension of federal power was no longer a threat to states' rights and slavery but rather a source of continued protection.

Southerners could now consider supporting a strong central state because it represented their interests.[17] Congressmen's emphasis on states' rights even became a source of frustration for some legislators. Senator Johnson "desired to know if the Confederate Government was regarded ... as a government at all.... He was a State rights man, but was tired of hearing the sovereignty of the States

[14] Gunderson, Gerald. 1974. "The Origins of the American Civil War." *Journal of Economic History*. 34:915-950. p. 917.
[15] Fogel, Robert W., and Stanley L. Engerman. 1974. *Time on the Cross*. Boston: Little, Brown. p. 96.
[16] Bensel. *Yankee Leviathan*.
[17] Bensel. "Southern Leviathan: The Development of Central State Authority in the Confederate States of America."

thrown every day, by senators, in the teeth of government. If the government possessed no power, senators had as well go home at once."[18] (April 7, 1862)

On the other hand, and this was the object of Senator Johnson's disdain, there was no guarantee that even if a governing party, or parties, was supportive of states' rights and slavery, that every future governing party would defend the same party platform. Maintaining and growing the power of state governments and limiting the expansion of the federal government comprised a different strategy of protecting states' rights and slavery. Senator Oldham of Texas described these concerns citing specific examples of federal infringement on state authority:

> The tendency to indoctrinate the people into the belief that there was no reliance in the State Government was the bane of the old republic, and would be, if not avoided, the bane of this. That government, from its commencement, gradually taught the people to centralize upon it, as the only reliance for their honour and welfare, and bought and bribed them not to rely upon the States themselves. The first measure was the establishment of a National Bank, the next the establishment of a Military Academy at West Point, and a Naval Academy at Annapolis, and so on.[19] (March 17, 1862)

But Southerners were not only concerned with the social and economic organization of their society, they had to defend themselves against the Union's unrelenting refusal to grant secession and against its military might. Faced with the immediate demands of a war time economy on goods, capital, and human labor, the choice to organize and build a strong central government would not only impact the future of the federal government but also the probability of mounting a successful military offensive. The central state's ability to engage in a victorious military confrontation increased as its power of extraction, control, and regulation over the population increased.[20] Financing the military was a paramount task of government.

Southern decision-makers were faced with two contradictory incentive structures: 1) protecting states' rights at the expense of federal power thereby ensuring the continuance of slavery and the supremacy of state politics but lowering the probability of winning the war, and 2) empowering the federal government, potentially a future threat to states' rights and slavery, but increasing the South's chances of successfully defeating the Union. As Congressmen coalesced around each incentive structure, their varying opposition and commitment to the aggrandizement of federal power played itself out in the

[18] *Southern Historical Society Papers*. 1925. New Number Series 7, Whole Number 45. p. 93.
[19] *Southern Historical Society Papers*. 1923. New Number Series 4, Whole Number 44. p. 171.
[20] See also Tilly. *Coercion, Capital, and European States, AD 990-1990*. Levi. *Of Rule and Revenue*. And Rosenthal, Jean-Laurent. "The Political Economy of Absolutism Reconsidered."

selection of financial policies. Congressmen's support or opposition for key financial policies was linked to their preference for a strong versus a weak federal government.

Southern Congressmen chose among four different financial policies to fund the war, long-term loans, notes, taxes, and impressments. The government was initially able to place a sizeable amount of bonds on the domestic and foreign bond market. The State Department "in charge of winning over friends abroad, extend credit abroad, (and) purchase southern cotton" was able to issue these bonds with a mere 29 civil servants. [21] A large number of notes were also issued to cover expenses of the war. (Figures 1 and 2 illustrate two samples of Confederate notes.)

(Insert Figures 1 and 2 about here)

Over the first years of the war, both notes and bonds were issued in abundance. The first financial legislation of Congress was the $15 million loan authorized on February 28, 1861; its interest guaranteed by duty on raw cotton exported after August 1861. Subscriptions were invited on March 16 and within the first two days of the loan's opening $5 million had been subscribed. But as hostilities at Fort Sumter escalated, by mid May $5 million was still untaken and the loan was not completed until October of that year.[22] As the war continued, domestic investors hardly subscribed to bonds and only foreign investors lured with the promise of cotton bought Confederate bonds. In 1861, bonds comprised about $14 million out of a total $41 million revenue sources; in 1862, it was only $15 million of $153 million in revenue; although by 1863, the revenue from bonds was almost $15 million out of $59 million in revenue (all receipts in real values, see Table 3).

(Insert Table 3 about here)

Notes, on the other hand, were issued in abundance. At first the issues were small, with the original issue of $1 million authorized on March 9, 1861; the issue was doubled on August 3, 1861. By August 19, 1861, the Treasury Secretary was authorized to issue notes as the public required up to $100 million. On December 24, 1861, the cap was increased to $150 million in notes; on April 12, 1862 the cap was $215 million; six months later the cap was once more raised to $218 million. On March 23, 1863, Congress authorized the Treasury Secretary to issue up to $50 million in notes per month. In real terms, the amount of notes issued dominated the Confederacy's Treasury with larger and larger issues as the war continued.

[21] Van Riper, Paul P., and Harry N. Scheiber. 1959. "The Confederate Civil Service." *The Journal of Southern History*. 25(4):448-470.
[22] Smith. *The History of the Confederate Treasury*.

In addition to bonds and notes, taxation provided an additional alternative to financing the war. The issue of taxation was not lost on the polity and was discussed repeatedly in newspapers, even before the entire South had seceded. For example, on February 26, 1861, a commentator writes that "a mere government organization, without money, is a lifeless corpse. Money itself is lifeblood. ... The raising of the taxes and the expenditure of the taxes – these constitute the grand difficulty in all free governments."[23] Public sentiments were echoed, albeit in more subtle ways, by public officials. For example, in a private report the Secretary of Treasury informed Howell Cobb, a member of the Provisional Congress, that "'the most certain and most enduring resources must be sought out by the Government and taxes are the only sure reliance under all circumstances. Loans come from only a portion; duties reach farther, yet not all; bur direct taxes pervade the whole body politic and bring forth the contributions of the willing and unwilling.'"[24]

Despite these public and official concerns, Congressmen refrained from enacting a comprehensive set of tax laws. Tax policies during the early Confederacy reflect the lack of coordination among Congressmen and almost no taxes were enacted during the first years of the Confederacy. The first major tax law was passed on August 19, 1861 instituting a 0.05% tax on $100 worth in property. Making this stingy tax rate even easier to digest, the tax was only to be collected one year later, in May 1862. The next tax law was passed about two years later on April 24, 1863. It included an 8% tax on various goods[25], a 2% income tax on income above $1,500[26], an annual business registration tax that ranged from $500 for bankers to $50 for jugglers, and a tax on gross sales, with distillers taxed the highest rate at 20% and butchers and bakers taxed at 1%. Given the first law's low tax rate and late collection and the delay in enacting the second major tax law, real income from taxes was minimal. In 1862, it was about $5 million out of a revenue base of about $55 million, and in the first half of 1863, the Confederacy collected $421,000 in taxes out of $31 million in total revenue.

In addition, the government also enacted impressment laws. Impressments were used by the military to requisition goods and supplies by paying for them with bonds and notes.[27] Because of the

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[23] *Charleston Mercury* (Item #603). See also Feb. 5, 1861, *The Charleston Mercury* (Item #354), February 25, 1861, *The Charleston Mercury* (Item #595). See also May 16, 1861, *The Charleston Mercury* (Item #1305), which advocated that the fairest method of raising funds was by direct taxation.
[24] Smith. *The History of the Confederate Treasury*. p. 9.
[25] Goods included salt, wine, liquors, tobacco, cotton, wool, flour, sugar, molasses, syrup, rice, and other agricultural products.
[26] Income below $1,000 was exempt; and income between $1,000 and $1,500 was taxed at 1%.
[27] There were many debates and discussions about the adequate compensation to property owners. Some congressmen argued that property owners should be compensated at the market price, resulting in debates about how such a market price could be determined. Senator Henry of Tennessee humorously points out the problem of relying on market prices: "As an instance, Richard III when down in the dust and blood of Bosworth field, offered his

difficulty in tracking all goods impressed and confiscated, there is ambiguity about the total contributions that impressments made to the budget.

Finally, Congress imposed tariff duties although this policy became almost immediately ineffectual due to the Union's successful blockade. The first tariff law was passed on March 15, 1861, with a 15% import duty on various goods; a second law was passed on May 21, 1861, with import duties ranging from 5% to 25% depending on the good. Congress' attempt to fund the war with tariffs was by far the least successful strategy. For example, the tariff law of May 21, 1861, was expected to bring in $12 million, but receipts from July until December, 1861, were only $63,138 while expenses at the customs houses for the same period were $63,774. On July 9, 1861, collectors at all small ports were dismissed[28] and the receipts from imports from February 1861 to February 1862 were less than 1% of the total revenue.[29]

4. <u>The Confederacy Under Siege</u>

The initial financial strategy pursued by the Confederacy was optimistic. But once the South's military and financial prospects began to sink into distress, southern Congressmen began to revamp their initial choices. A number of factors, the South's inadequate finances, England's neutrality, the Union's military advances, and the Emancipation Proclamation that freed more and more slaves as the war progressed clearly shifted the advantage to the Union in the Summer and Fall of 1863.

First, any prudent observer could have predicted that the continuous issuance of Treasury notes would eventually lead to hyperinflation. Illustrative of these inflation rates, between 1863 and early 1865, the price of wheat increased by almost 1,700%, bacon by 2,500%, and flour by almost 2,800%. By the end of the war, prices for shoes rose to $600 per pair in some counties and a simple wool overcoat could cost as much as $1,500.[30] In fact, the volume of currency was so large that some printers had to use old

'kingdom for a horse.' … that was the market value of a horse at that juncture." (Confederate Congress Debates. *Southern Historical Society Papers*. 1941. New Number Series 10, Whole Number 48. March 5, 1863, p. 255.) Other debates centered on which military officers would have the authority to impress property. Senator Wigfall of Texas argues that "it might occur that the commander would be miles distant from the camp. Should the army which had been marching without food and was still on the march, be allowed to starve because the Colonel could not find the commander?" (Confederate Congress Debates. March 4, 1863, pp. 245-246.) Eventually, a board was set up to decide on fair prices.

[28] See Smith. *The History of the Treasury*.

[29] See Schwab. "The Finances of the Confederate States." *Political Science Quarterly*.

[30] Neil Fulghum. "Moneys for the Southern Cause." University of North Carolina at Chapel Hill Libraries. *Documenting the American South*. http://docsouth.unc.edu/imls/currency/index.html. In Salisbury, North Carolina, an angry throng of soldiers' wives hacked down a store owner's door showing their outrage at the "unreasonable" prices they were expected to pay for basic goods. Once the mob gained access to the store, the owner sensibly sold

and used paper to satisfy the demands of the Treasury. Some printers even supplemented their paper supply with lining papers and wallpapers to continue printing notes.[31]

In Figure 3, the monthly price index, wage index, and money supply index are plotted over the course of the war. Several aspects of the graph are noteworthy. Wages did not keep up with the price index as early as January 1863, and strongly diverged after September 1863. Furthermore, the price index far outstripped the money supply index after September 1863 indicating that people's confidence in the government currency was declining faster than the money was pumped into the economy.

(Insert Figure 3 about here)

The South's inflation rate was not due to the expected depreciation that accompanies most wars. Compared to the Union, the South's inflation rate was significantly higher. In Table 4, the value of one gold dollar is compared with both US and Confederate notes. While the North did suffer from inflation, with the price of gold more than doubling, the South's currency declined to $18 for one gold dollar in December 1863 and $34 for one gold dollar in December 1864. The first significant decline in the Confederacy's currency seems to have taken place in the Summer of 1863, with a threefold depreciation from $5 in March to $14 in October for one gold dollar; at no other point did the value of the currency decline at this rate in the span of seven months.

(Insert Table 4 about here)

As the money supply flooded the economy, capital markets dried up. In addition, military setbacks, especially the news of Gettysburg and Vicksburg in early July 1863, led to a sharp decline in Erlanger bonds.[32] "By the fall of 1863 McRae (the Confederate agent abroad) had decided that it would be impossible to raise a large amount of money on good terms unless the Confederates began to have better success in war."[33] Doubts began to overshadow the potential for military success and members of Congress realized that loans would no longer be forthcoming. In the words of Congressman Conrad, a member of the Ways and Means Committee, "to nations embarrassed in finances, and carrying on a great

10 barrels of flour at reduced prices. Neil Fulghum. "Money Troubles on North Carolina's Homefront." *Documenting the American South*.

[31] Neil Fulghum. "Money Troubles on North Carolina's Homefront." *Documenting the American South*.

[32] Grossman, Herschel I., Taejoon Han. 1996. "War Debt, Moral Hazard, and the Financing of the Confederacy." *Journal of Money, Credit, and Banking*. 28(2): 200-215.

[33] Gentry, quoted in Grossman and Han. "War Debt, Moral Hazard, and the Financing of the Confederacy."

internal war, loans and taxes were the only two ready remedies that present themselves. Everybody knows we cannot borrow nor negotiate a foreign loan."[34] (June 9, 1864)

As funding for the war became increasingly scarce, the government's lack of tax revenues was scrutinized and reevaluated. One commentator argued on August 15, 1863, that the cause for the currency's rapid depreciation was that no taxes had been enacted and if taxes had been raised earlier, the large volume of Treasury notes would not have been necessary.[35] Another commentator blamed the lack of taxes for the government's increasingly dismal creditworthiness. He wrote on June 12, 1863 that "the sponge of credit has been exhausted, by being squeezed always, without the slightest replenishment. The legitimate income of a Government is derived from taxation.... But the Confederate Government has not yet seen the first cent from that source – that is to say, it has never had a cent which it might consider its own. It has been spending promises to pay."[36]

Public sentiments were reflected in Congress. For example, Representative Kenner from Louisiana argued that "the true basis of credit, public or private, was revenue or property.... He knew that many were disposed to 'Go ahead, Mr. Memminger, keep your printing press going and 'twill carry us safely to the end of the war'; but in reality our condition was similar to that of our forefathers ... in revolutionary times."[37] (September 23, 1862) And when inflation financing seemed to have reached its absolute limit, the Treasury Secretary on April 14, 1863 communicated to Congress that the expected government expenditures for the next six months would exceed the legal limit of $50 million in notes advising "that the expedient of laying taxes in kind be resorted to."[38]

Impressment policies were also unsuccessful, especially in the latter years of the war. While the military relied frequently on impressments to keep their troops fed and clothed, people began hiding their property or selling their goods before they could be confiscated. Farmers also stopped growing crops that could be used by the military to avoid impressment resulting in food shortages for the military.[39]

And as revenue sources became tighter, expenditures bulged. From July to November 1861, real total spending topped $18 million, in the next four months, real spending increased to $51 million; from August to December 1862, real expenditures were $43 million, and from October 1863 to April 1864, real

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[34] *Southern Historical Society Papers*. 1958. New Number Series 13, Whole Number 51. p. 223.
[35] *The Charleston Mercury* (Item #8089). See also Oct 6, 1863, *The Charleston Mercury* (Item #8319); Oct. 7, 1863, *The Charleston Mercury* (Item #8327 and #8324), Dec. 24, 1863, *The Charleston Mercury* (Item #8739).
[36] *The Charleston Mercury* (Item #7545).
[37] *Southern Historical Society Papers*. 1925. New Number Series 7, Whole Number 45. pp. 221-222.
[38] *Southern Historical Society Papers*. 1943. New Number Series 11, Whole Number 49. p. 137.
[39] Lebergott, Stanley. 1983. "Why the South Lost: Commercial Purpose in the Confederacy, 1861-1865." *The Journal of American History*. 70(1): 58-74.

spending dropped to $13 million; a plunge ominous of events to come.[40] The Confederacy could no longer ignore the demands on its economy and expenditures had to be financed.

The impact of these financial policies was not constrained to civilians but directly felt by the troops. As early as April 1862, the army's meat ration was reduced from twelve to eight ounces and again reduced by half in January 1863.[41] In addition to meager supplies, soldiers were often not paid. "One of the primary causes of demoralization among Confederate fighting men was their government's failure to provide adequate pay – or, indeed, in many cases, to provide any pay whatever."[42] The unfortunate soldiers stationed beyond the Mississippi were never paid after September 1863 because of the difficulty of transporting funds. And when General Lee examined the causes for the high desertion rates, he found that the lack of food and pay were at the root of the problem.[43]

As early as August 1862, Congress tried to address the problem of soldiers' pay and a bill was proposed to create an independent bureau in charge of administering pay. But the bill was tabled when it became clear that troop pay had less to do with administration than with the lack of funds.[44] In March 1863, Congress recommended planting food instead of cotton and tobacco, but they did not enact this policy. "Speaking almost as a bystander, Pres. Jefferson Davis 'noted with interest [Georgia's] prohibiting the cultivation of cotton in the state during the war.' He hoped 'for concurrent action of the other States and observed that 'the possibility of a short supply of provisions presents the greatest danger to successful prosecution of the war.''"[45]

To make matters worse, the Confederacy's hope that England's reliance on cotton would guarantee their financial and military support in the war were crushed. Commentators were suspicious of European interference early in the war, and if any had been hopeful their viewpoints were not published in the press. As one writer put it on August 27, 1862, "Is it not high time for our Commissioners to be recalled from their humiliating position at the Courts of Europe?" [46]

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[40] Burdekin and Langdana. "War Finance in the Southern Confederacy." p. 355.
[41] Lebergott. "Why the South Lost: Commercial Purpose in the Confederacy, 1861-1865." p. 66.
[42] Scheiber, Harry N. 1969. "The Pay of Confederate Troops and Problems of Demoralization: A Case of Administrative Failure." *Civil War History*. 15:226-236. p. 226.
[43] Scheiber. "The Pay of Confederate Troops and Problems of Demoralization: A Case of Administrative Failure." p. 227, 234..
[44] *Southern Historical Society Papers*. 1925. New Number Series 7, Whole Number 45. p. 255, 270. *Southern Historical Society Papers*. 1928. New Number Series 8, Whole Number 46. pp. 3-4.
[45] Lebergott. "Why the South Lost: Commercial Purpose in the Confederacy, 1861-1865." p. 62.
[46] *The Charleston Mercury* (Item #5489). See also July 9, 1861, *The Charleston Mercury* (Item #1707); March 4, 1862, *The Charleston Mercury* (Item #3756); January 15, 1863, *The Charleston Mercury* (Item #6726).

Even those Congressmen who had been expectant about England's engagement, voiced their doubts about this strategy albeit later than the popular press. On March 12, 1862, Senator Semmes "had long since abandoned the idea that 'cotton is king.' He had thought that nations would violate the laws of nations upon the basis of necessity. This belief had proven invalid.... We must abandon the idea of all foreign legislation in regard to our affairs."[47] About a year later, on March 9, 1863, Senator Maxwell, joined by Senator Yancey, "was not of the number who believed that there were hopes of peace by the intervention of foreign powers. Everywhere on the horizon, he could see nothing but war and preparations for war."[48]

The advances of Union troops into southern territory, especially during the summer and fall of 1863, increased the Confederacy's stake in the war from a defensive engagement to a war of survival. By the end of the Provisional Congress on February 17, 1862, most of Missouri, Kentucky, as well as the northwestern portion of Virginia, was under the control of the Union army. During the first Session of the first Congress, the remaining districts of Missouri and Kentucky were occupied and Nashville fell to the Union on February 25. After the first Session, federal troops captured New Orleans gaining control over the strategically important mouth of the Mississippi River. The second and third Sessions of Congress were relatively uneventful and there were few changes in areas under Union control.

But after the end of the third Session, on May 1, 1863, the Union successfully gained control of the Mississippi River while the Confederacy surrendered at Vicksburg in July 1863. Federal forces also captured Knoxville, Tennessee, and won the battle of Chattanooga in November 1863 before the fourth Session of Congress began on December 7, 1863. By the second Session of the second Congress, the confederacy was clearly going to be defeated. "A final Union campaign around Richmond and a siege of the city began in the late fall of 1864, and the last session of the Confederate Congress was literally spent within sight and sound of the front lines."[49] (See Table 5 for the number of districts occupied throughout the war by state, and Table 6 for the dates of the Confederate Congress.)

(Insert Tables 5 and 6 about here)

The Union's occupation of southern territory was not only critical from a military perspective but also brought to reality Lincoln's Emancipation Proclamation. Lincoln announced on September 22, 1862 that beginning on January 1, 1863 all slaves would be freed in states that had seceded from the Union.

[47] *Southern Historical Society Papers*. 1923. New Number Series 4, Whole Number 44. p. 149.
[48] *Southern Historical Society Papers*. 1941. New Number Series 10, Whole Number 48. p. 270.
[49] Martis, Kenneth C. 1994. *The Historical Atlas of the Congresses of the Confederate States of America 1861-1865*. New York: Simon and Schuster. p. 28.

The proclamation raised the stakes of the war because the South could no longer rejoin the Union with slavery intact; "reunification now meant the destruction of their way of life."[50]

Initially the proclamation had a more symbolic rather than real impact since those parts of the Confederacy that were already under northern control were exempt and the Union had no means to enforce the proclamation in the unoccupied territories. The impact, therefore, was not immediately felt and depended on Union military victories. But as the North occupied more and more of the Confederacy, thousands of slaves were set free by the advancing federal troops and the decree became a reality. The Proclamation most likely decreased the South's chances of winning since it gave the North the moral upper hand and support among the African-American population both in occupied and unoccupied territories. In addition, the Proclamation placed the ultimate importance on the Confederacy's survival, the only outcome that would ensure the preservation of slavery.

Hyperinflation, lack of credit, absence of tax revenues, resistance to impressment, and the ever increasing demands of the war, coupled with England's neutrality, the North's military successes and resolve, and the threat of emancipation, set the stage in the late fall of 1863 for a reevaluation of financial policies.

5. Updating Financial Strategies to New Conditions

The winner and loser in a war is seldom known with certainty, and, while in hindsight the outcome may seem obvious, as the war progresses the military advantage shifts from side to side before finally swinging to the victor. We should not expect, therefore, that strategies, in particular financial strategies, would remain constant and unresponsive to changes on the battlefield. Instead, we would expect a dynamic relationship between military engagements and financial policies. As the demands of the war increase, as financial policies become inadequate, and as the military advantage shifts over the course of the war, decision-makers adjust their financial strategies to accommodate the new demands.[51]

After the progressively worsening prospects for the Confederacy, Congress, after ending the prior session on May 1, 1863, began the Fourth Session of the First Congress on December 7, 1863 with the objective to turn the war in their favor. The connection between military success and finances was summarized in the Report of the Committee on Finance printed on January 25, 1864: "No scheme of

[50] Pecquet, Gary, George Davis, and Bryce Kanago. 2004. "The Emancipation Proclamation, Confederate Expectations, and the Price of Southern Bank Notes." *Southern Economic Journal*. 70(3):616-630. p. 617.

[51] For an application of war financing and borrowing see Grossman, Herschel I., Taejoon Han. 1991. "A Theory of War Finance." *NBER Working Papers Series*. Paper 3799. 1-18. And Grossman, Herschel I., Taejoon Han. 1996. "War Debt, Moral Hazard, and the Financing of the Confederacy." *Journal of Money, Credit, and Banking*. 28(2): 200-215.

finance can be maintained in the face of serious military reverses. For, after all, public credit depends as much upon the sword of the soldier who defends the country as upon the pen of the law-giver who regulates its form and character."[52]

The financial policy that showed the most promise was taxation since both the value of Treasury notes and access to capital markets hinged on the government's extractive capabilities. Increasing the money supply would only have forced the inflation rate higher, and issuing bonds would have been futile given that domestic subscriptions had never fully materialized and foreign subscriptions had quickly dried up in light of the North's military progress. Although there had been resistance to taxes before the Summer of 1863, all reservations about the expansion of the federal government or the potential threat to slavery were dropped once the survival of the state itself was at risk.[53]

The tax law enacted on April 24, 1863, during the third Session of Congress, taxed goods, income, and licenses. Specific taxes included an 8% tax on naval stores, salt, wines, liquors, tobacco, cotton, wool, flour, sugar, rice; a 1% tax on all money, notes or currency; a 1% tax on salaries above $1500; as well as a 10% tax in kind on many foods. Once the fourth Session began, a new tax bill was proposed that increased taxes considerably.

In addition to the April 24, 1863 taxes, on February 17, 1864, Congress taxed all property at 5%; all gold, silver, and jewels were taxed at 10%; all shares or interest in banks, companies or businesses were taxed at 5%; monies in any form were taxed at 5%; and profits from the April 24 law were taxed an additional 10%, with companies that made more than a 25% profit taxed at 25%. One commentator, discussing the February 17 tax law, wrote: "For it is easier for a camel to go through the eye of a needle than for a rich man to escape this tax law."[54] This law was followed by the June 10, 1864, law raising rates again by increasing all existing tax rates by 20% of the previous rate.[55] And on June 14, 1864, profits were taxed an additional 30%.

But these were not simply valiant enactments that rang hollow in the vaults of the Treasury. The War Tax of August 19, 1861, brought $17 million into the coffers of the Confederacy by the end of July 1863. (See Table 7) While taxes collected under the Acts of April 24, 1863, February 17, 1864, and June

[52] The Report was on H.R. 92, a bill to tax, fund and limit the currency.
[53] In other policy areas Southerners were also willing to abandon the even the most basic motivations for secession. The most striking example was President Davis' unsuccessful proposal on November 7, 1864, to enroll slaves in the Confederate military in exchange for their freedom. When Congress authorized the recruitment of slaves into the military but without offering them freedom on March 13, 1865, their concession was a symbolic gesture at best.
[54] February 19, 1864, *The Richmond Enquirer* (Item #9017).
[55] For example, a 10% tax on bank shares increased to 12%.

14, 1864, totaled $118 million, more than ten times as much. (See Table 8) Even though the average rate of state contributions declined from 87% to 62%, the absolute amount of taxes paid was still considerable given that the war was in full swing.

(Insert Tables 7 and 8 about here)

In aggregate terms, the proportion of the revenue that came from taxes increased over this period. From February to August 1862, the Treasury collected $3,741 thousand in real terms; during the following five months, it was $1,206 thousand; and from January to September 1863, the same months that the South faced serious financial, political, and military setbacks, was only $421 thousand. But from October 1863 to April 1864, tax revenues improved considerably jumping up to $2,204 thousand with an additional collection of $1,347 thousand from April to October 1864. (See Table 3) In aggregate, revenue from taxation increased from $1.6 million, collected during September 1862 to September 1863, to $3.5 million collected in the following year, from October 1863 to October 1864.

Although Congressmen realized that new taxes had to be raised to finance the war, they also recognized that their efforts were most probably too late. House member Gilmer stated on December 12, 1864, that "in the progress of the war we have been compelled to issue a large quantity of Treasury notes, when, perhaps, it would have been more to the true interest of the country to have resorted at first to high taxation."[56] The Finance Committee reiterated Gilmer's sentiments writing in their report that "the Government should have resorted to taxation and the sale of bonds for the means of executing its expenditures.... It would have been far better (than) ... to threaten with ruin both public and private credit."[57] In Figure 4, I summarize the Confederacy's major financial laws, and also include the Union's key financial laws, crucial battles, and political events.

(Insert Figure 4 about here)

The Confederate government adjusted to new circumstances improving their ill-conceived financial policies, even though these efforts were too late to have changed the outcome of the war. It is important to note that the tipping point at which Confederate Congressmen decided to change their financial strategy is not ex ante specified. Over the course of the war the South's prospects for winning clearly declined, but it is difficult to pin down the months when the Confederacy's chances of winning shifted from a possibility to a near improbability. Instead, the evidence gathered here is used to illustrate

[56] *Southern Historical Society Papers*. 1958. New Number Series 13, Whole Number 51. pp. 458-459.
[57] See also commentary published on March 21, 1864, *The Charleston Mercury* (Item #9144), criticizing Congress' delay in raising taxes.

that the Confederacy was damaged on a number of fronts, financial, international, and military, over a few months and that a shift in financial strategies would likely have occurred to meet the changing demands of a war economy.

6. Alternative Explanations

Before examining Congressmen's incentive structure that led to the initial financial policy and its subsequent adjustment, I briefly address some alternative explanations that could account for the South's financial strategies. First, Southerners did not want to impose taxes during the early years of the war because they did not want to make the necessary sacrifices and were committed foremost to their commercial interests. But this explanation stands in stark contrast to their willingness to sacrifice human life.

Second, they were unaware of the policy alternatives and the importance of raising taxes. But the Union's financial laws were often reviewed in southern newspapers and in a number of debates southern Congressmen refer to the Union's financial policies.[58] Furthermore, the Confederate Treasury had been organized on the same model as Hamilton's; several high ranking Treasury officials joined the Confederacy, including Philip Clayton an Assistant Secretary in Buchanan's administration who took the same position in Montgomery; C.T. Jones who came to the Register's Office "as chief clerk, well equipped, bringing from Washington copies of all the forms in use in the several bureaus;" and W. H. S. Taylor who had worked for the US government for twenty-five years as second auditor.[59] In addition, many members of the Confederate Congresses had previously held office in the US government; thirty-two percent had been in Congress; and, three percent had held cabinet or diplomatic posts.[60]

Third, Confederate Congressmen were unable to overcome the collective action dilemma inherent in tax policies because they lacked the leadership and coordination of strong parties.[61] But if that had been the case, they would not have been able to coordinate on many other policies such as note issues, loans, impressments, confiscation, and conscription.

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[58] See also McCandless, George T. Jr. 1996. "Money, Expectations, and the US Civil War." *The American Economic Review*. 86(3): 661-671.
[59] Smith, Ernest Ashton. 1901. *The History of the Confederate Treasury*. Harrisburg, PA: Press of Harrisburg Publishing Co. (p. 3)
[60] Alexander, Thomas B. and Richard E. Beringer. 1972. *The Anatomy of the Confederate Congress*. Nashville: Vanderbilt University Press. (p. 24)
[61] Jenkins, Jeffrey A. 1999. "Examining the Bonding Effects of Party: A Comparative Analysis of Roll-Call Voting in the US and Confederate Houses." *American Journal of Political Science*. 43(4): 1144-1165. Jenkins, Jeffrey A. 2000. "Examining the Robustness of Ideological Voting: Evidence from the Confederate House of Representatives." *American Journal of Political Science*. 44(4): 811-822.

Finally, the Confederacy did not pursue tax policies as a viable strategy because they knew they could never raise sufficient funds to counter the North. If this were accurate, then we would not have observed the increase in tax receipts in the period from October 1863 to April 1864. Furthermore, if Southerners had had that much foresight, they should also have realized that they could not have won a war against their northern counterpart and abandoned their dreams of independence as soon as the first soldier was down.

7. Roll Call Analysis: Congressmen's Preferences and Financial Policies

In this section, I test the relationship between Congressmen's commitment to states' rights and slavery and their support of various financial policies by examining roll call data during the first and second Congresses. I focus on the House because it is a larger sample of decision-makers and because more of the debates in the House were recorded, in contrast to the Senate which held almost all debates in secret session.

The roll call votes confirm the analysis above. When Congressmen believed that the probability of winning was relatively high, financial policies empowering the federal government, specifically taxes, were opposed by staunch slavery and states' rights supporters. Once the war turned in the North's favor, Congressmen updated their beliefs about the probability of victory and adjusted their strategy accordingly. Specifically, Congressmen most committed to slavery were the most supportive of tax policies to finance the war effort. In contrast, alternative financial policies, in particular loans, were indiscriminately supported in Congress regardless of the preferences for slavery or the probability of winning. Finally, I find some support that impressment policies, which have an ambiguous impact on slavery and states' rights, were driven by Congressmen's personal economic interests.

Before I discuss the selection of roll calls, the model for Congressmen's vote choices, and the measures I use to operationalize preferences, I briefly review the appropriate statistical model for this type of data. For many of the bills the same Congressmen voted on each proposal violating the assumption of a single dichotomous response for a sample of statistically independent subjects. As a result, each Congressman represents a cluster of correlated observations of the outcome where the interdependence is not temporal. Furthermore, all of the cluster-specific covariates do not vary over the observations but are time invariant (except for one control variable). The most appropriate model in this case is a population average model.[62]

[62] For a detailed review and empirical applications of this model see Zorn, Christopher J. W. 2001. "Generalized Estimating Equation Models for Correlated Data: A Review with Applications." *American Journal of Political*

Suppose we have m subjects or clusters, in this case Congressmen, and n observations per subject, in this case roll calls. The dichotomous outcome variable is Y_{ij} and the vector of covariates is $x'_{ij} = (1, x_{1ij}, x_{2ij}, \ldots, x_{pij})$ for the *j*th observation in the *i*th cluster. In the population average model we average "over the statistical distribution of the random effect and assume that this process yields the logit"[63]

$$g(x_{ij}, \beta_{PA}) = x'_{ij}\, \beta_{PA}$$

In this model we model the average response over the sub-population that shares a common value of X; no cluster-specific or subject-specific effects are included. The estimated coefficient, β, corresponds to the average effect, across the entire population, of a one-unit change in X_{ij} on $Pr(Y_{ij})$. The statistical distribution of the random effects has not been determined yet, only the marginal or population proportions have the logit function given above. Because the population average model does not take advantage of independent variables whose values vary within clusters, this model is best suited for covariates that are constant for each subject.

To estimate this model the method of generalized estimating equations (GEE) is used. The GEE approach uses a set of equations that resemble weighted likelihood equations. The weights are based on an approximation of the underlying covariance matrix of the correlated within-cluster observations. In order to estimate the model, we need to make assumptions about the nature of the correlation, i.e. the working correlation. While there are a number of working correlations to choose from, two correlation structures are used in this estimation, the exchangeable and the independent correlation structures.[64]

The exchangeable correlation assumes that the correlation between pairs of responses is constant, that is the values of the dependent variable "are assumed to covary equally across all observations within a cluster"[65], $Cor(Y_{ij}, Y_{il})=\rho$ for $j \neq l$. The independent correlation structure assumes that the correlation between pairs is zero, $Cor(Y_{ij}, Y_{il})=0$ for $j \neq l$, in which case the GEE equations simplify to the likelihood

Science. 45(2): 470-490; and Hosmer, David W. and Stanley Lemeshow. 2000. 2nd Edition. *Applied Logistic Regression*. New York: John Wiley & Sons, Inc. For models with temporally dependent observations see Beck, Nathaniel, Jonathan N. Katz, and Richard Tucker. 1998. "Taking Time Seriously: Time- Series-Cross-Section Analysis with a Binary Dependent Variable." *American Journal of Political Science*. 42:1260-1288. For models with time-varying variables see Wawro, Gregory. 2001. "A Panel Probit Analysis of Campaign Contributions and Roll-Call Votes." *American Journal of Political Science*. 45(3): 563-579.

63 Hosmer and Lemeshow. *Applied Logistic Regression*. p. 311.

64 There is also an auto-regressive and unstructured correlation structure.

65 Zorn. "Generalized Estimating Equation Models for Correlated Data: A Review with Applications." p. 473.

equations obtained from the binomial likelihood for the multiple logistic regression model. "It turns out that, in a wide variety of settings, assuming exchangeable correlation gives good results."[66]

Although the GEE estimator produces consistent estimates of β even if the working correlation structure is not specified correctly, the variances will not be consistent when the working correlation is misspecified. As a result, the "robust" estimate of the variance-covariance matrix is used in this estimation providing consistent estimates even when the working correlation is misspecified. The estimated coefficients and standard errors can then be used to estimate odds-ratios and to test the significance of the coefficients.[67]

To analyze voting patterns, I focus on key House votes. I adhered to the following selection criteria: The bill had to address one of the four financial policies, long-term loans, note issues, impressments, and taxes. The direction of the vote relative to the policy had to be clear, whether based on the wording of the bill, a final passage vote, or debates in Congress that provided enough detail to identify the vote. In other words, it had to be clear what they were voting on and whether a yes vote was for or against the policy.[68] I was able to identify six votes on long-term debt, two votes on impressments, and eight votes on taxes.

Of the six votes on long-term debt, five of them showed the same pattern; each bill passed increased the government's capacity to borrow (See Table 9). The first two loan bills were passed to prop up the Confederacy's credit, providing for an interest rate of eight percent and requiring the Committee on Ways and Means to report a bill for paying interest on the debt. Two bills were passed authorizing foreign loans. And one bill was not passed, which would have postponed the consideration of a bill to issue another round of bonds. The one exception was the bill to authorize the President to negotiate a foreign loan (vote number 342-129) which did not pass.

(Insert Table 9 about here)

The two votes on impressments were final passage votes on the authorization and regulation of impressments of private property (See Table 10). The first passed on February 13, 1863 and the second passed on March 28, 1863.

(Insert Table 10 about here)

[66] Hosmer and Lemeshow. *Applied Logistic Regression*. p. 313.
[67] Since GEE is not based on likelihood, log-likelihood tests cannot be used.
[68] I thank Jeffrey Jenkins for making several key datasets available to me.

Finally, there were eight votes on taxes, three before the end of Congress' third Session, May 1, 1863, and five votes after the start of the fourth Session on December 7, 1863 (See Table 11). During the third Session, two of the three measures to increase taxes were rejected. First, an amendment on March 20, 1863 to end all taxes under the bill after a period of three years passed. Second, a vote on March 21, 1863 to apportion $28 million annually among the states did not pass. The third vote on final passage of a bill to assess and collect direct taxes and internal duties passed on March 23, 1863.[69]

After the end of the third Session, the Confederacy's probability of winning declined significantly as financial pressures were mounting and the North's military advances became increasingly more successful. Responding to the new demands and pressures of the war five tax bills were proposed, each increasing taxes, and each was passed. These included a bill to tax, fund, and limit the currency, a bill to levy additional taxes for the common defense, a resolution to instruct the Committee on Ways and Means to report on providing revenue by taxation, a bill to amend the tax law by increasing real estate and securities taxes, and a bill to provide means to support the government by an additional increase in the tax rate.

(Insert Table 11 about here)

This data set has two weaknesses. First, I was unable to identify any votes on note issues and could not test the argument that all House members regardless of their incentive structure would have favored issuing notes. Although based on all of the recorded debates, I found no evidence that any legislators opposed note issues until inflation rates skyrocketed. Second, while I was able to collect votes on tax bills both during the Third Session and after the start of the Fourth Session, I did not find votes on debt and impressments after Congress' Third Session. This was most likely the result of legislators' focus on tax legislation after debt issues, note issues, and impressments had failed to finance the war effort. Nonetheless, I can only test the hypotheses for debt and impressment policies during the early phases of the war.

I model Congressmen's vote choice as a function of their commitment to slavery and states' rights, the distribution of slaves at the district and state level, their personal economic stakes, as well as a control variable for districts that are under Union occupation.[70] I measure support of slavery and states'

[69] This law established a federal administrative agency for tax collection, the Office of the Commissioner of Taxes. Appointments included a Commissioner, state collectors, and district collectors.
[70] The biographical information for each congressman is based on Alexander and Beringer *The Anatomy of the Confederate Congress*, available in electronic format from ICPSR.

rights as membership in the Deep South.[71] Legislators from states that were the first to secede, the seven Deep South states, had the most at stake, politically, socially, and economically, in both secession and slavery. As noted earlier, legislators who had the most to gain from the protection of slavery were the most supportive of states' rights but were also the most committed to winning the war. The tradeoff between these two preferences adjusted as the probability of victory changed. The protection of states' rights was only vital when the chances of winning were high. Once the probability of success dropped, the most important objective was to win the war regardless of the long-term consequences for states' rights and slavery.

The seven state Deep South, except for Texas, had the highest percent of slaves in the population and also the largest number of slaves per owner (See Table 12). In addition, as noted above, the average income per free citizen from slavery was about $50 for the Deep South states but only $20 for the Upper South. The plunge in income after abolition was also more deeply felt in the Deep South, with an average decline of 31% in income for free citizens, compared to a drop of only 17% in the Upper South (See Table 2). Representatives from the Deep South, deeply committed to the survival of slavery and its social hierarchies, would have been more supportive of states' rights than representatives from the Upper South.

(Insert Table 12 about here)

A binary variable is by no means the best measure of Congressmen's states' rights preferences. Some Congressmen would certainly have had extreme preferences for or against states' rights, but many Congressmen would be forced into one of the two polarized preference measures, even though their preferences would be better gauged along a spectrum. Unfortunately, the measures we can utilize for Confederate Congressmen are limited and while a binary variable is not an ideal measure, it is exogenous to the roll call data and captures to a certain extent a Congressman's defense of slavery as well as the South's long-standing political tradition of discontent with an expanding federal government.

In order to capture the regional effect, I control for the distribution of slaves in legislators' districts and states. I use two measures for slave populations, the percentage of slaves in the district and in the state, and the number of slaves per owner in the district and in the state.[72] Since the percentage of slaves and slaves per owner are highly correlated, 0.933 in the district and 0.959 in the state, I use the two measures interchangeably. These variables also control for constituency pressures which legislators may be responsive to. By including this measure, I can estimate the impact of slavery and states' rights,

[71] The Deep South includes Alabama, Florida, Georgia, Louisiana, Mississippi, South Carolina, and Texas. The other four states that joined the Confederacy were Virginia, Arkansas, North Carolina, and Tennessee.
[72] In the analysis, I use the ln of the number of slaves per owner.

measured as a Congressman's regional affiliation, separately from local commercial and social preferences for slavery.

Third, each Congressman may have been influenced by his material wellbeing, measured as the number of slaves he owned and the value of his estate.[73] I include these variables primarily as controls, except for the impressment votes when personal gains and losses may have motivated legislators' vote choice. Finally, I include a control variable that indicates whether a Congressman's district was occupied by Union forces. One could argue that when legislators' districts are occupied, they have every incentive to pass impressment and tax policies since their constituencies would not be affected and would also be the most urgently pressed to reverse the Union's progression into the South. This is the only variable that varies for legislators, but turns out to be insignificant and does not change the substantive results.

For each set of roll calls, bonds, impressments, and taxes, I estimated four population average models to test the key hypotheses. First, I argue that Congressmen should not have differed in their support of bonds and loans despite differences in regional affiliation, slave populations, personal characteristics, or occupied districts. In Table 13 the results for the four models are summarized. The findings support the hypothesis. None of the variables are significant across all of the models. Even though the binary variable for Deep South is negative and significant (at the 2.3% and 8.0% levels), the result only holds when the percentage of slaves per district and state are used. When slaves per owner in the district and state are included instead, the result disappears. In addition, the percentage of slaves per district is significant in only the first model and only when an exchangeable correlation structure is assumed. With an independent correlation structure the coefficient is no longer significant at the 10% level. All other results remain substantively the same between the GEE model with exchangeable and independent correlation structures.

(Insert Table 13 about here)

Second, legislators could have had a personal stake in impressments; those who had the most to loose financially from any type of impressment should have been more likely to oppose both bills. The best measure of a Congressman's material interests is the number of slaves he owned since slaves could be impressed by the army to provide basic labor. In contrast, the value of his estate is a less appropriate measure as it is primarily based on his real estate holdings which could not easily be impressed. The results in Table 14-a support the hypothesis. The only estimated coefficient significant at the 10% level or higher is for the number of slaves a legislator owned and is negative in each case.

[73] In the analysis, I use the ln of the number of slaves owned and ln of the value of the estate.

(Insert Table 14-a about here)

In Table 14-b the odds ratio of voting for impressments are calculated. For model 1, the odds of voting for impressment policies computed from the proportion of legislators who had 10 more slaves than some reference level of slave ownership is 0.369 times that based on the proportion of legislators who were at the reference level of slave ownership, holding all else constant. For the proportion of legislators who had 20 more slaves than some reference level of slaves the odds dropped to 0.262. Similar odds ratios are computed based on the estimates of models 2, 3, and 4. Again, all results are substantively the same with an independent correlation structure.

(Insert Table 14-b about here)

Third, I argue that legislators most committed to slavery and states' rights, measured as their regional affiliation, should have been more likely to oppose tax legislation when the prospects for victory were good but should have been more likely to support tax bills once the probability of winning declined. To test this hypothesis, I included an interaction effect between Deep South and Regime (=1 for low probability of victory) in each model. Regime is a dummy variable that captures legislators' updated beliefs; in the first period, before the 1863 recess, the probability of winning was higher, than in the second period, after the 1863 recess, when the probability of victory dropped.

The results are summarized in Table 15-a and support the hypothesis. While Regime is significant and positive, that is to be expected since every tax bill in the second period was passed. Every legislator had a higher average probability of voting for tax legislation once the probability of defeat rose. The interaction effect between Deep South and Regime, in all four models, was positive and significant at the 10% level (7.8%, 7.5%, 7.6%, and 9.5%).

(Insert Table 15-a about here)

The odds ratios are listed in Table 15-b. In the first model, the odds of voting for tax legislation when the probability of victory was high, i.e. before the 1863 recess, computed from the proportion of legislators who were from the Deep South is estimated to be 0.722 times that based on the proportion of legislators not from the Deep South, holding all else constant. While the odds of voting for tax legislation when the probability of victory was low, i.e. after the 1863 recess, based on the proportion of Deep South Congressmen is 1.283 times that based on the proportion of non-Deep South Congressmen. This is the most conservative estimate. In models 2 and 4, when the probability of victory was low, the odds jumped to 1.997, i.e. legislators from the Deep South were almost twice as likely to vote for tax legislation once the chance of defeat increased. These results remain substantively the same with an independent correlation structure.

(Insert Table 15-b about here)

Summarizing the key results, I found that loans were supported by all Congressmen, as predicted, regardless of incentive structures. Decisions about impressments were most influenced by legislators' personal economic interests. For tax policies, I found that Congressmen who wanted to protect states' rights and slavery were more likely to oppose taxes that increased federal authority before the 1863 recess when the chances of victory were still good. As the war continued without signs of a speedy resolution and Congress met again after the 1863 recess, legislators who had the most to loose from defeat reevaluated their strategy and began to direct the resources of the economy, without any constraints, toward a full-fledged support of the war effort.

8. Summary and Conclusion

In this paper, I provide an explanation of the Confederacy's choice of financial policies during the Civil War. I focused on the apparently irrational and short-sighted financial strategies pursued by southern decision-makers, finding that confederate Congressmen made rational choices once we take into account their preferences for a weak central state and strong states' rights. Specifically, Congressmen representing the Deep South, who were committed to states' rights and the protection of slavery, were significantly more likely to oppose financial policies that empowered the federal government, federal taxes. But as hostilities stretched out into a protracted war, strategies adjusted accordingly. By the Winter of 1863, Congressmen from the Deep South were more likely to support taxes in the Confederacy's financial portfolio than other legislators.

I do not argue that the Confederacy could have defeated the Union if they had grasped the financial demands of war sooner and mobilized all resources immediately, but they could have increased the probability of winning independence. Small powers have won big wars, such as the Revolutionary War and the War of 1812; in both instances the government had to address a grave financial situation. In addition, the impact of financial policies is often cumulative. If the Confederacy had raised taxes during the first stages of the war, they may have also been able to borrow more easily both at home and abroad and could have limited their currency issues. While the South could not compete with the North's resources, a sustainable financial strategy could have prolonged the war and weakened the Union's resolve.

Whether these prospects would have been realized is difficult to prove. Nevertheless, we need to take political incentives seriously in order to understand financial strategies which shape the progression and potentially outcomes of war in important ways. If we focus only on the outcome variable, the realized revenues for example, we can describe the Confederacy's finances, but we would not be able to understand why they chose one financial strategy in place of another. In this paper, I tried to tie together decision-makers' political motivations and intentions with their financial choices. I found that, despite the crisis, financial policies were handicapped by political incentives rather than motivated by purely economic calculations. We should expect, therefore, that politics, influential during war times, would have an even larger impact on financial choices during peaceful times.[74] In addition, I did not assume that a financial strategy, once selected, would continue indefinitely, but took into account the interaction effect between finance and war. The government's ability to fund the war influenced its military successes; in turn, the tides of war pressured decision-makers to reevaluate financial policies. Taking this dynamic into account illuminates not only the policies that were enacted but also the war's duration and outcome.

[74] See also Bensel, Richard F. 2000. *The Political Economy of American Industrialization, 1877-1900*. Cambridge: Cambridge University Press.