

Economic Integration and Convergence: A Look at the U.S. States*

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Objective. Convergence among national economies in economic policy choices, structural features, and performance patterns is viewed by some observers as an inevitable result of increasing integration of product and financial markets. Yet several recent studies suggest that relatively little convergence has occurred thus far among the affluent industrialized countries. Is that because the extent of global economic integration is still limited, or because integration does not lead to convergence? This study attempts to sort out the relative importance of these two factors. *Methods.* I examine convergence among the fifty American states on a variety of indicators since 1970, focusing on changes (or lack thereof) in the coefficient of variation for these indicators over time. I also compare the current degree of homogeneity among the states to that among the twenty-four Organization for Economic Cooperation and Development (OECD) nations. *Results.* Despite having been relatively integrated for a considerable period of time, the U.S. states have exhibited little convergence over the past several decades. And on most measures for which comparison is possible, the states are only slightly more economically homogenous, or less so, than are the OECD countries. *Conclusions.* These findings suggest that the convergence-generating effects of economic integration are limited. I argue that this is because market competition permits considerable space for variation and because institutions mediate the impact of market forces.

Will globalization render economic differences across countries and regions a thing of the past? Recent empirical studies have found less convergence among national economies than some expect (Berger and Dore, 1996; Garrett, 1998a, 1998b; Kenworthy, 1997). There are two possible reasons why: (1) the extent of global economic integration is still limited; (2) globalization's convergence-generating impact is itself limited. This study attempts to sort out the relative importance of these two factors by examining the degree of convergence among the fifty American states.

The U.S. states have been subject to (relatively) free trade and extensive cross-border movement of production, capital, and labor for a consider-

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able period of time. Shifts of factories across state borders were already common by the late 1800s, when textile mills began moving from New England to the South. By the late 1950s, there was no correlation between state investment rates and state saving rates, indicating that financing could easily be obtained from outside state borders (Sinn, 1992). (By contrast, as of the mid-1990s, investment and saving rates among the twenty-four OECD countries correlated at .70.) Capital mobility has expanded even further since then, particularly in the 1980s as new unregulated financial actors emerged and many states reduced restrictions on interstate banking (Skalaban, 1992). By the 1960s, labor mobility across states was substantial enough for the country's labor market to be characterized as truly "national" in scope (Wright, 1987). If the states have converged in their economic policy choices, structural features, and performance patterns, we might reasonably expect national economies to do the same as global economic integration proceeds. If they have not exhibited much convergence, we should expect significant cross-country differences to persist as well.

Convergence is most usefully understood as *homogenization*, i.e., a reduction in dispersion (Baumol, Nelson, and Wolff, 1994). Proponents of the "convergence thesis" suggest that economic integration generates homogenization in economic policies and structures via three processes: (1) competitive selection, (2) exit by investors and producers, and (3) imitation (Alchian, 1950; Cohen, 1996; Gill and Law, 1989; Goodman and Pauly, 1993; Strange, 1996; see Kenworthy, 1997, 1999b, for elaboration and additional citations). Growing similarity in firm structures and strategies and in government policies is expected in turn to cause homogenization in economic performance patterns.

The pressures for convergence generated by product market and financial market integration are certainly real. Yet there is reason to be skeptical that they force the degree of homogeneity presumed by some observers. First, markets select on the basis of effectiveness, not optimality. Competition requires merely that firms do well, not that they be the best and certainly not that they be the same. Second, institutions mediate the impact of market forces. And institutions—interest group size and strength, government structures, policy arrangements, patterns of ideas, interfirm relationships, workforce skills, consumer tastes, and so on—differ across nations and states. Institutions tend to be sticky, or path dependent. They are resistant to change, even in the face of pressures such as those stemming from economic integration. Consequently, despite constraints of integrated capital and product markets and heightened exposure to "best practice," the goals, strategies, and resources of corporate managers, workers, and government policy makers vary between Japan and the United States, or between Massachusetts and Texas. These differing preferences and capacities are likely to result in nontrivial variation in economic

policies, structures, and performance patterns (Berger and Dore, 1996; Garrett, 1998a, 1998b; Hollingsworth and Streeck, 1994; Kenworthy, 1997).

Method and Data

In assessing convergence among the U.S. states, I utilize a variety of indicators for state economic policy choices, structural features, and performance outcomes. For government policies, I examine tax revenues, welfare benefits, the adoption of "right-to-work" laws, and economic development programs. In assessing economic structural features, I analyze the sectoral composition of employment and unionization rates. (State-level data for other components of economic structure, such as relations between firms, between labor and management, and between firms and their investors, are insufficient to permit analysis here.) Indicators of economic performance include per capita personal income, median four-person family income, poverty, and unemployment.

Ideally, the effect of economic integration on convergence could be analyzed using regression, with the dependent variable being a measure of change in economic policy (or structure or performance) over time and the key independent variable being an interaction term for policy (or structure or performance) at a prior point in time multiplied by a measure of change in integration (see Garrett, 1998a). Unfortunately, data for the needed measures of integration—such as exports and imports or investment inflows and outflows—are not available for the U.S. states. Consequently, I use an indirect method of assessment. I examine changes over time in the coefficient of variation for various state economic policy, structure, and performance indicators. The coefficient of variation, which is the standard deviation for a group divided by the average for that group, is the best quantitative indicator of homogeneity. It allows us to assess the degree of dispersion where the average for a group differs over time, as is the case for the fifty states for virtually all economic indicators. If the convergence thesis is correct, the coefficient of variation for each measure of economic policy, structure, and performance should decrease over time.

I focus on the period from 1970 to the present. Data limitations prevent assessment of most of these indicators for earlier years (and, in a few instances, for recent years as well). The degree of integration among the American states need not have increased since 1970 for the convergence thesis to predict growing homogeneity during this period. Since convergence likely lags increases in integration by some time and also may be a relatively slow process, there is reason to expect convergence to still be occurring, even if the states were well integrated in all relevant respects prior to 1970.

There is no standard test of statistical significance for differences between coefficients of variation. I use a resampling with replacement technique to generate a sample distribution of coefficients of variation for each two-period comparison. This allows one to estimate the probability that an observed difference between the coefficients for two time periods could have occurred purely by chance. (For discussion of the general logic of this "bootstrapping" technique, see Mooney and Duval, 1993.) For each two-period comparison, one thousand resamples were drawn to generate the distribution. Statistically significant differences between time periods are noted in Table 1.

Assessing Convergence among the States

Table 1 shows the range, average, standard deviation, and coefficient of variation for ten indicators of economic policy, structure, and performance. In most instances I show the figures for the years 1970, 1980, 1990, and 1996, though for some of the indicators data limitations dictate use of a slightly different set of years. I focus on these years for ease of presentation; examining other years would not alter the conclusions.

Contrary to convergence-thesis expectations, on average the share of gross state product (GSP) going to state taxes increased during this twenty-six-year period. There also was not any noteworthy change in the coefficient of variation; it decreased slightly, but the decline is not statistically significant. Qualitative differences in state tax policy have remained marked as well. For instance, in 1970, eight states had no individual income tax and seven others had no property tax; as of 1996, seven did not levy an individual income tax and eleven had no tax on property.

Aid to Families with Dependent Children (AFDC) benefit levels (adjusted for inflation) declined in many states. In fact, the average benefit fell by more than one-third between 1970 and 1991. The coefficient of variation, however, suggests that there was no less variation in the early 1990s than for several decades ago because the trend toward benefit reduction was a general one, just as prevalent among low-benefit states as among high-benefit ones. The trend is similar for an alternative measure (not shown here): transfer payments as a share of GSP.

Right-to-work laws were passed by a number of states in the South, the West, and the central plains in the 1940s and 1950s. However, their spread came to an abrupt halt by the end of the 1950s. Since then only four states have passed such legislation, the most recent being Idaho in 1986. Currently twenty-two states have a right-to-work law. Instead of converging, then, the states seem to have settled into a condition of sharp variation on this crucial aspect of labor policy.

Trends in the presence/absence of thirty-seven types of state economic development programs for which data are available over time are shown in

TABLE 1

Have the States Converged?

	Range	Average	Standard Deviation	Coefficient of Variation
Government policies				
Tax revenue (% of GSP) ^a				
1970	3.1-7.4	5.0	1.0	.20
1980	2.8-7.4	5.1	0.9	.18
1990	2.5-8.0	5.5	1.0	.18
1996	2.5-8.5	5.7	1.1	.19
AFDC benefits (1991\$) ^b				
1970	193-1,132	634	230	.36
1980	156-802	481	174	.36
1991	120-891	392	158	.40
Right-to-work law (no or yes)				
1970	0-1	.38	.49	1.29
1980	0-1	.40	.49	1.23
1990	0-1	.44	.50	1.14
Economic development programs (#)				
1970	6-29	14.2	5.5	.39
1980	10-29	18.9	5.5	.29 ^c
1990	13-34	25.5	4.4	.17 ^{c,d}
Structural features				
Manufacturing employment (%)				
1970	4.2-40.4	24.4	10.0	.41
1980	4.6-34.5	20.6	8.2	.40
1990	4.0-27.6	16.6	6.2	.37
1995	3.2-25.0	15.2	5.7	.38
Unionization (%)				
1975	6.8-44.7	25.2	9.2	.37
1983	5.9-32.5	18.1	6.6	.36
1990	4.6-29.1	14.7	6.2	.42
1996	3.7-26.8	13.3	5.8	.44
Performance patterns				
Per capita personal income (1996\$) ^a				
1969	10,571-20,559	15,458	2,494	.16
1979	13,901-23,462	18,754	2,408	.13
1989	15,194-32,190	21,626	3,778	.17
1996	17,575-33,875	23,313	3,509	.15

Table 1. The figures suggest both greater activism and substantial convergence since 1970. Yet these data capture only the existence of particular programs; they tell us nothing about the *character and extensiveness* of such programs within particular states. The most careful quantitative study to date of trends in state economic development programs concludes that considerable dispersion remains: "Some regions show clear preferences for particular policies and the particular policy configuration in each region

TABLE 1—continued

	Range	Average	Standard Deviation	Coefficient of Variation
Median income for 4-person families (1996\$)				
1974	36,797-61,640	45,979	4,971	.11
1979	38,192-67,076	47,609	5,429	.11
1989	39,422-67,458	50,073	7,055	.14
1996	36,828-67,380	50,104	6,906	.14
Poverty (%)				
1969	7.2-35.4	14.8	6.1	.41
1979	7.9-23.9	12.5	3.5	.28 ^e
1989	6.4-25.2	13.1	4.1	.31 ^e
1996	6.4-25.5	12.8	4.0	.31 ^e
Unemployment (%) ^a				
1973	2.0-7.9	4.7	1.4	.30
1979	2.8-8.0	5.4	1.3	.24 ^f
1989	2.6-8.6	5.1	1.3	.25
1996	2.9-8.1	5.1	1.1	.22 ^f

SOURCES: Citro and Michael (1995); *Industrial Development and Site Selection Handbook* (various years); Troy and Sheflin (1985); U.S. Bureau of the Census (n.d., various years); U.S. Bureau of Economic Analysis (1997, n.d.); U.S. Bureau of Labor Statistics (unpublished data).

^aFigures exclude Alaska as an outlier.

^bMaximum monthly AFDC benefit for a family of three.

^cSignificantly different (at the .05 level) from the coefficient of variation for 1970.

^dSignificantly different (at the .05 level) from the coefficient of variation for 1980.

^eSignificantly different (at the .10 level) from the coefficient of variation for 1969.

^fSignificantly different (at the .10 level) from the coefficient of variation for 1973.

tends to be unique" (Grant, Wallace, and Pitney, 1995:142). Indeed, several case studies suggest that the degree of variation in economic development policy across states and regions may actually have widened during this period (Brace, 1993; Eisinger, 1988; Osborne, 1987). Some states, such as Massachusetts, Michigan, New York, and Pennsylvania, have become extremely active—offering a wide array of supports and committing extensive resources to them, with a focus on expansion of existing firms and creation of new ones. Others, such as Texas and Arizona, have been much more restrained in their efforts and have focused on attracting firms from other states, in large part by offering a low-tax, antiunion business climate.

Manufacturing's share of employment in the United States has been falling steadily since the 1950s, as it has in most industrialized nations. That trend continued—indeed, it accelerated—in the 1970s and 1980s. Yet

the coefficients of variation suggest little or no convergence. States that began at the low end of the distribution in 1970 experienced more or less the same rate of decrease as those at the high end.

The average unionization rate has also dropped considerably. But again the states on the low end of the spectrum have experienced declines that are just as substantial as those on the high end—in fact, more so. The unionization rate fell in “strong-union” states such as Michigan and West Virginia, from 42 to 24 percent in the former and from 37 to 16 percent in the latter. But it also declined in “weak-union” states, from 21 to 6 percent in Arizona, for instance, and from 20 to 8 percent in Louisiana. Consequently, there appears to be, if anything, *less* homogeneity as of the mid-1990s than several decades earlier.

The coefficients of variation for two measures of income, per capita personal income and median four-person family income, suggest that no homogenization has occurred in the period since 1970. (The trend is virtually identical for a third measure: per capita GSP.) Rates of income growth in wealthy states have been similar to those in poorer ones. A few poorer states have grown rapidly enough to move to the top portion of the list, but they have been replaced by formerly better-off states that dropped back in the pack. Hence, the degree of diversity across states remains substantial. The wealthiest state as of 1996 had a level of per capita income and a median four-person family income nearly twice that of the poorest.

A recent study (Barro and Sala-i-Martin, 1992) found evidence of *catch-up* in per capita personal income over the 1970s and 1980s. That is, poorer states tended to experience more rapid income growth than did richer states. Yet catch-up and homogenization are distinct phenomena (see Baumol, Nelson, and Wolff, 1994; Quah, 1993). Catch-up involves a narrowing of the gap between the leader and the followers within a group, while homogenization consists of a reduction in the overall dispersion within a group. Catch-up can occur without homogenization if the gap between leader and followers decreases while dispersion among followers increases. That seems to have been the case for per capita income levels across the U.S. states in recent decades. A catch-up process may have occurred, but homogenization has not.

There is evidence of homogenization in poverty rates during the 1970s. The average poverty rate dropped, but it fell more quickly in high-poverty states than in low-poverty states. In the 1980s, however, the reverse occurred. The average for the fifty states increased between 1979 and 1989, and it rose more in high-poverty states than in low-poverty ones. No noteworthy change occurred in the early to mid-1990s. The coefficient of variation for 1996 was still well below that for 1969, indicating that over this nearly three-decade period as a whole, there has been some convergence. But no convergence has occurred since the late 1970s, and sizable variation across the states remains. As of 1996, eleven states had poverty

rates of less than 10 percent, with the low being 6 percent in New Hampshire, while eight states had rates higher than 17 percent, including a high of 25 percent in New Mexico.

Finally, as for poverty, the coefficients of variation for unemployment suggest a narrowing of diversity across states during the 1970s but then no further change. Here too the degree of heterogeneity remains substantial.

Comparing the States with the OECD Nations

The available data suggest, then, that very little convergence has occurred among the U.S. states since 1970. It could be, however, that extensive convergence occurred prior to 1970 and that little or no further homogenization can reasonably be expected. It is difficult to assess this possibility, because reliable state-level data are lacking for most key economic indicators for earlier years. One indicator for which data are available is per capita personal income, and several studies suggest that there was indeed convergence in that area among the states prior to the 1970s (Barro and Sala-i-Martin, 1992; Brace, 1993). Perhaps the same is true in other areas.

If the U.S. states have become as homogenous as they ever will, then the convergence thesis would expect the states to be more homogenous than nations. The states, after all, are integrated to a much greater extent than are nations (see, e.g., *The Economist*, 1997; Helliwell, 1998). The most suitable comparison group for the fifty American states is the set of twenty-four OECD nations. Table 2 shows the range, average, standard deviation, and coefficient of variation for these countries on seven economic indicators for which data are available for both groups—the American states and the OECD countries. In each case the figures are shown for the same year (or as close a year as possible) as the most recent year examined for the U.S. states in Table 1. The ranges and averages differ from those for the states, of course, since these are measures for nations and are slightly different, in several instances, from those used for the states. Of primary interest are the coefficients of variation.

On five of the seven indicators—tax revenues, unionization, per capita income, poverty, and unemployment—the coefficient of variation is smaller for the U.S. states than for the OECD countries. But only for unemployment is it substantially smaller. And for government transfers and manufacturing employment, the coefficients indicate greater diversity among the states than among nations. With the exception of unemployment rates, then, the states appear to be little or no more homogenous in some of their chief economic policies, structural features, and performance outcomes than are the OECD nations. This suggests further grounds for skepticism regarding the veracity of the convergence thesis.

TABLE 2

Homogeneity among the 24 OECD Nations on Comparable Economic Indicators

	Range	Average	Standard Deviation	Coefficient of Variation
Tax revenues, 1995 (% of GDP) ^a	32.0-58.1	43.8	7.8	.18
Government transfers, 1991 (% of GDP) ^a	6.2-26.0	16.4	4.8	.29
Manufacturing employment, 1995 (%)	13.5-28.9	19.5	3.9	.20
Unionization, 1995 (%)	9.1-91.1	40.8	22.5	.55
GDP per capita, 1996 (US\$) ^b	12,743-27,821	20,376	3,654	.18
Poverty, 1991 (%) ^c	9.2-39.2	23.2	8.7	.37
Unemployment, 1996 (%) ^d	3.0-15.3	7.9	3.4	.43

Sources: Kenworthy (1999a); OECD (1997, n.d.); Visser and Ebbinghaus (1999).

^aData are not available for Luxembourg, New Zealand, and Turkey.

^bCalculated using purchasing power parities. Figures exclude Luxembourg and Turkey as outliers.

^cPoverty rate before taxes and transfers, using 40% of the U.S. median household income as the poverty line. This measure is the closest available counterpart to the official U.S. poverty measure. Data are not available for Austria, Greece, Iceland, Japan, Luxembourg, New Zealand, Portugal, Spain, and Turkey.

^dData are not available for Greece, Iceland, and Turkey. Figures exclude Spain as an outlier.

Why Aren't the States More Homogenous?

How can we account for these findings? There are four possible explanations.

One is that the American states are not integrated enough for the convergence effect to have taken hold. That, however, seems implausible. Although there do continue to be some limits on movement of finance, production, and persons across state lines, those limits are very minor and have been so for a considerable period of time.

A second possibility is that convergence among the states occurred and reached its final equilibrium point, as it were, prior to 1970. The convergence induced by economic integration thus would not be observable during the time period analyzed here. Lack of reliable data for earlier years prevents direct assessment of this possibility. If it is correct, however, we must conclude that economic integration produces only limited convergence, for (1) there is a rather substantial degree of diversity among the states as of the mid-1990s and (2) despite their greater degree of economic integration, the states are only somewhat, if at all, more homogenous than are the twenty-four OECD nations.

Third, at least since 1980 a possible reason for the apparent lack of convergence among the states is the reduced role of the federal government,

which has opened up greater space for state-level policy activism. Research by Brace (1993) suggests that the influence of the national economy on state economic performance declined in the 1980s when compared to the 1970s. It could be argued that this development—heightened federalism—biases my examination of over-time trends against the convergence thesis. Yet the devolution of policy activism from the federal government to the states during the 1980s did not reduce the degree of economic integration among the states. On the contrary, as noted earlier, the degree of integration increased during the 1980s, particularly in finance (Skalaban, 1992). Given such heightened integration, the very fact of greater state-level policy activism since 1980—which may have generated greater diversity in state policy approaches, structural features, and performance outcomes—indicates that integration does not automatically produce homogeneity.

A fourth explanation, which seems the most compelling, is that continued diversity among the states owes to the space for variation permitted by market competition and to the importance of economic institutions in mediating the impact of market forces. Economic integration imposes constraints; but those constraints allow significant leeway for choice, and they can be blunted or even circumvented by interest groups, government policies, patterns of ideas, and other institutional factors.

That does not mean that the convergence thesis is entirely mistaken. On some of the indicators examined here, the states have moved in the general direction expected by the thesis. That is particularly the case for social-welfare spending and unionization rates, both of which are predicted to decline. Among nations, the same is true for inflation rates (Kenworthy, 1997). Heightened mobility of capital is expected to increase the pressure on national monetary authorities to maintain low rates of inflation, and many have done exactly that in recent years. Arguments that focus on ways in which economic integration generates *trends* may therefore find more empirical support than those which predict convergence in *levels*.

On the other hand, some trends have not moved in the direction expected by those making convergence predictions. For the U.S. states, the most notable example is taxes. The pressures stemming from economic integration are expected to induce lower tax rates, and thus lower levels of tax revenues as a share of GSP. Between 1970 and 1996, however, the opposite occurred. A number of exceptions to expected trend directions can be found among the most affluent OECD countries as well—including taxes, overall government expenditures, and expenditures on social-welfare programs (Kenworthy, 1997).

All told, the findings here offer little support for the view that economic integration necessarily results in convergence. The American states have converged very little over the past several decades, and on a number of key indicators they are only slightly more homogenous, or even less so, than the OECD nations. Given that there has been much freer movement of

capital, firms, goods, and labor across state borders than across national borders for a considerable period of time, these findings for the U.S. states suggest that it may be only in the distant future, if ever, that we witness much in the way of homogenization among national economies.

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