U.S. trade and commerce power shapes American federalism

State governments get few exemptions from a nearly universal principle

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Truckers battle deadlines to deliver their shipments. Thanks to the U.S. Commerce Clause, goods and investment capital circulate easily throughout the country where almost 90 per cent of the $13.8 trillion gross domestic product was consumed internally in 2007.

BY GREGORY GERMAIN

The Bill of Rights may well be a more glamorous law, but the commerce clause of the United States Constitution has probably had far greater overall impact on the wealth and dynamism of the U.S.

The commerce clause is a single line in the Constitution giving Congress – the U.S. House of Representatives and the Senate – the power "to regulate commerce with foreign nations, and among the several states, and with Indian tribes."

Virtually every major piece of domestic federal legislation, from the laws regulating securities, communications, energy, transportation, pharmaceuticals, food, employment rights, the environment, social security and civil rights, to most federal crimes, to name just a few, has been enacted by Congress under its commerce clause power.

As a result of the Supreme Court consistently interpreting the commerce clause very broadly, it has become the bulwark of federal authority for the last century.

The transformation of the U.S. from a loose confederation of powerful independent states to one composed of a massive centralized federal government began in earnest during the Great Depression of the 1930s with President Franklin D. Roosevelt's New Deal, which aimed to get Americans working by kick-starting the economy.

By 1942, the Supreme Court had eliminated virtually all constraints on federal power under the commerce clause by holding that Congress's federal wheat production limits could be applied to a dairy farmer who grew a small amount of wheat for his family's own consumption. The Court reasoned that the family's demand for wheat in the interstate market had been reduced by the farmer's production, causing a sufficient "effect" on interstate commerce to trigger the clause.

The modern Supreme Court has maintained that extremely broad construction of the commerce clause, making it almost impossible to challenge federal laws that have any conceivable effect on interstate commerce. When Congress speaks under the commerce clause, the Supreme Court listens.

States can't restrict free trade

While the Constitution explicitly gives Congress only the power to enact laws regulating interstate commerce, the Supreme Court has long recognized that the clause embodied a free trade principle even in its "dormant" state, that is, even when there was no specific law enacted by Congress.

Because the Commerce Clause gives

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A New York scrap yard posts its prices for disposing solid waste. Almost every major piece of domestic federal legislation has been enacted by Congress under the commerce clause, a bulwark of federal authority. In a rare exception, U.S. states can favour local scrap processors in subsidizing the disposal of scrap automobiles.

Congress – and not the states – the power to enact legislation affecting interstate commerce, the Supreme Court inferred that a state could not pass legislation that might interfere with Congress's unused power to regulate interstate commerce.

For more than 150 years, the Supreme Court has invalidated state protectionist laws under the so-called "dormant" commerce clause, even when Congress had chosen not to legislate on the issue.

Laws that discriminate on their face or in their practical effect in favor of local private actors and against out-of-state competitors are struck down by the Supreme Court according to what is called a "virtually per-se rule of invalidity."

Laws that have merely an unintended incidental effect on interstate commerce are to be judged by weighing the benefits of the legislation against the burdens on commerce.

This balancing test has been subject to substantial criticism because judges, while appearing scientific, can weigh and measure the various factors however they see fit.

The courts rarely engage in this balancing test because instead they generally strike down a legal provision that is manifestly discriminatory whenever the state laws appear to be protectionist.

While the benefits of free trade among the states have been considerable, the courts have been forced to create complex rules by which to judge the validity of state tax laws. The Supreme Court has developed a complex four-part test to assure that a tax fairly relates to the out-of-state taxpayer's in-state activity, and is no more burdensome than taxes on in-state competitors. The organization of tax lawyers has an entire section of tax law specialists devoted to analyzing state and local tax laws for compliance with the Court's complex commerce clause rules.

The commerce clause rules make it harder for states to enact laws favouring their own citizens at the expense of citizens from other states. The states must comply with the commerce clause rules when they enact such legislation.

Cash and tax subsidies

Direct cash subsidies are an important exception to the commerce clause's free trade principles. A state can provide cash subsidies to its own citizens without running afoul of the commerce clause rules because the cost of the subsidy is borne entirely by local taxpayers. In this way, a state can preclude citizens from other states from taking part and receiving such a subsidy.

A clever Massachusetts legislature combined a non-discriminatory tax on all milk sold by both local and out-of-state dairies to retailers in the state, with a program to pay the collected tax proceeds in a cash subsidy to local dairy farmers.

In this case the non-discriminatory tax and cash subsidy would have survived a challenge if viewed separately, but the Court recognized that the combined program had the effect of a discriminatory tax in restraint of free interstate trade and therefore struck it down.

Unlike cash subsidies, tax subsidies have not traditionally been exempted from commerce clause scrutiny. The Court has suggested that the use of the state's taxation machinery is inherently regulatory, although the conclusion makes little economic sense.

The Supreme Court was recently asked by local taxpayers to rule that property tax and franchise tax abatements offered to Daimler-Chrysler for expanding its manufacturing operations in Toledo, Ohio, violated the commerce clause.

The Court avoided addressing the difficult commerce clause questions by ruling that the taxpayers lacked standing, and thus did not have the right to raise a commerce clause challenge.

The dormant commerce clause protects competitors, not taxpayers. The important legal issue raised by the Daimler-Chrysler case will probably rise anew when an out-of-state competitor cries foul over tax incentives granted to a local manufacturer.

Applying the commerce clause to a state's own activities generated a huge controversy. In 1976, a divided Supreme Court ruled that Congress could not impose its uniform national minimum wage and maximum hour standards on state workers engaged in traditional governmental functions.

In 1985, in another divided opinion, the Supreme Court reversed course and held that Congress could impose minimum wage and maximum hour standards on such state workers. Nevertheless, the Court stated that there are limits to Congress's power to tax or regulate traditional governmental func-

tions. The precise contours of those limits remain undefined.

Exception for state government activities

In 1976, the Court also for the first time recognized an exception to the so-called dormant commerce clause. The Court ruled that when a state "enter[s] the market as a purchaser [or seller]" it can, like any private purchaser or seller, choose with whom it wishes to deal.

The state can favour local scrap processors in subsidizing the disposal of "hulk" (i.e., scrap) automobiles that it has purchased, can favour in-state residents when hiring workers for state-funded construction projects and can favour local residents in the sale of cement produced by a municipally-owned cement plant.

In January 2007, the Supreme Court substantially expanded this exception. Municipalities in upstate New York opened a waste processing facility and enacted a "flow control" ordinance requiring all local garbage to be processed at the municipal facility.

The ordinance forced garbage collectors to pay the facility's high "tipping fees" for the waste disposal. A private hauler challenged the ordinance under the commerce clause, arguing that the ordinance, with its local processing requirement, went far beyond the previous exception.

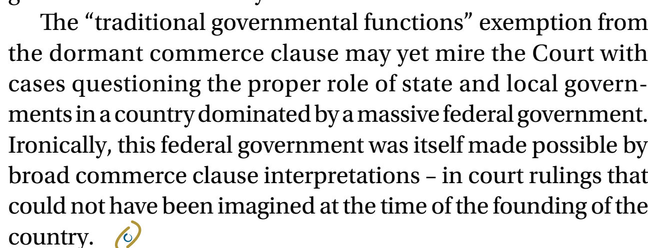
After all, private parties could not compel others to do business with them, while the ordinance required garbage collectors to do business with the municipality. The Court upheld the ordinance using broad language harkening back to its 1976 direct commerce clause ruling, which exempted "traditional governmental functions" from the reach of the commerce clause.

In May 2008, the Court reiterated the "traditional governmental functions" exemption by allowing the State of Kentucky to tax its own citizens on interest earned from municipal bonds issued by other states while exempting interest on Kentucky municipal bonds. The same discriminatory bond taxing system exists in 38 other states.

Amazingly, all 50 states, even those who would benefit from free trade in municipal bonds, joined together to ask the Court to stay out of the business of regulating state proprietary activities under the dormant commerce clause. Apparently, the states did not want the federal courts scrutinizing their proprietary activities.

The courts' broad interpretation of the dormant commerce clause has paved the way for a vigorous free market within the United States, yet that same interpretation has helped contribute to the growth of an enormously powerful federal government bureaucracy.

The "traditional governmental functions" exemption from the dormant commerce clause may yet mire the Court with cases questioning the proper role of state and local governments in a country dominated by a massive federal government. Ironically, this federal government was itself made possible by broad commerce clause interpretations – in court rulings that could not have been imagined at the time of the founding of the country.



The U.S. is still one of the world's largest free trade zones

BY CARL STIEREN

Until the end of the 20th Century, the United States had a higher Gross Domestic Product (GDP) than any free trade zone in the world.

It has since fallen to third place, behind the GDP of the North American Free Trade Agreement (of which it is a member) and that of the European Union.

The benefits of free trade were hailed by the New York Times on August 10, 1894: "Free trade within our borders, steadily extending to meet the vast and varied progress of a population that has spread over a continent and has created every ten years a dominion as large in area as many a European country and of greater resources of any but the largest, has absorbed the thought and energy of the American people."

This too was due in large part to the Supreme Court's unusual interpretation of the commerce clause.

By opening the gates for interstate commerce – helped by the canals, rivers, railroads and Interstate highways built and regulated by Congress under the commerce clause – enabled goods and investment capital to circulate easily throughout the country.

When advertising on radio and television appeared, many local products became national. Coast-to-coast retail chains, from Sears to Target and Wal-Mart, and national brands, from Coca-Cola to Budweiser, replaced many a local store and local brewery.

By the end of the 20th century, even local convenience stores and neighbourhood bookstores had to make way for national chains. Without the judicially-created free trade principle, local political majorities would have used their political power to prevent the development of national commerce.

Most of U.S. trade today is still among the states. The U.S. GDP for 2007 was $13.8 trillion. GDP is a measure of the total value of all services and goods produced in a country in a one-year time span.

The same year, $1.6 trillion worth of goods and services were exported from the United States. These figures show that 88 per cent of the GDP was consumed domestically. Only 12 per cent of U.S. production was exported.

In 1997, the United States' GDP was $8.24 trillion, of which $964 billion was exported, accounting for 11.6 per cent of the U.S. GDP. In other words, between 80 and 90 per cent of what the U.S. produces stays within the country.

These figures explain the periodic insular impulses of the U.S. and demonstrate that the country's economy figuratively makes of the U.S., a near island unto itself.

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