Mitchell's Musings 8-18-14: Commerce Among the Several States

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You could grow bananas at the North Pole. How? With enough subsidy for insulation, heating, solar lamps, etc., it would be possible. Since there would be a need to construct the facilities and then maintenance, there would be jobs created at the North Pole. But would such a project be worthwhile? Surely not. The North Pole is clearly not the best place for growing bananas.

It is also true in less extreme circumstances that you can artificially create jobs. Providing a subsidy can induce economic activity in the location offering the subsidy. But you can always ask whether it is worthwhile.

The question of "worthwhile-ness," if there is such a word, can be explored further. Let's assume that without a subsidy, a particular activity (with its jobs) would gravitate to a particular location. For example, steel mills might want to locate close to coal mines to reduce the transportation costs of coal. Nonetheless, if a locality far from coal mines offered to offset the transportation disadvantage with a sufficient subsidy, steel mills might relocate to the subsidized region, creating jobs there (at the expense of the region where steel might "naturally" be produced).

The original location, which had the natural advantage of coal, might – of course – offer a sufficient counteracting subsidy to offset the subsidy of the distant location (thus retaining jobs). Indeed, we can imagine both regions competing with each other to offer more and more subsidies, each with the argument that jobs are at stake. The ultimate beneficiary of such competition is the ownership of the steel industry. The losers are taxpayers who pay for the competing subsidies.

The flip side of subsidies is taxes. Suppose the location that was distant from coal imposed a tariff (a type of tax) on steel shipped from the area close to coal. With a high enough tariff, it could induce internal steel production to meet its domestic demand because the tariff would make steel imports uncompetitive. In response to the loss of steel demand (and related jobs) due to the tariff, however, the area with coal might impose a retaliatory tariff on some other product that would otherwise have gravitated to the far-from-coal region. In the end, the prices of the products on which tariffs were imposed would be increased, thus harming consumers.

Of course, there is more to this story than can be discussed here and some qualifications to it. Nonetheless, it is noteworthy that the U.S. constitution – which in part defines the relations of the states within the U.S. with each other as well as Congress' authority over them – has provisions designed to limit artificial competition between the states or artificial advantages given to them:

In Article 1, Section 8, Congress is given the authority "*to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.*"

In Article I, Section 10, we find:

No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing it's inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Controul of the Congress.

To “create a more perfect union,” Congress is supposed to be the primary regulatory body when it comes to external commerce and commerce between the states. California, for example, cannot impose tariffs on goods coming from Nevada. The objective of the founding fathers was to create a federated system in which goods and people flowed freely within and whatever limits were placed on external commerce were to be centrally determined.

From an economic perspective, the U.S. can be seen as an early version of the E.U. Within the E.U. there are supposed to be no artificial barriers to trade among the various member nations. Germany cannot impose tariffs on French goods. Rules limit the ability of member states to subsidize their internal economic activities at the expense of one another.

These observations are a preamble to the observation that within the U.S., while we clearly don’t allow tariffs between the states, we do seem to allow all manner of subsidy. At this writing, in the California legislature, there is a bill pending to quadruple the tax credits for movie making within the state. The justification is that other states are giving bigger tax subsidies and California has to compete (for jobs) by spending (or forgoing revenue) at a higher level. Proponents can point to the fact that in the film “Battle: Los Angeles,” the LA that aliens from some other world actually invaded was Louisiana, due to that state’s tax credits for movie making.

Welcome to Louisiana

And it's not just the film industry that is receiving taxpayer largess. California has been handing out tax credits to what remains of its old aerospace industry. Meanwhile, new industries in California – which have a certain cachet among state legislators – (Tesla is a recent example), have learned to play one state against the other. Isn't it time for Congress to take seriously its authority over commerce among the states and legislate against state-provided corporate welfare?