

ON TARIFFS V. SUBSIDIES IN INTERSTATE TRADE: A LEGAL AND ECONOMIC ANALYSIS

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I. INTRODUCTION

The dormant Commerce Clause of the United States Constitution, as currently construed by the Supreme Court, permits states to “promote” in-state businesses but not to “protect” those businesses from out-of-state competition. Thus, states “may enact laws that have the purpose and effect of encouraging domestic industry”¹ and may “structur[e] their tax systems to encourage the growth and development of intrastate commerce and industry.”² States may not, however, engage in “economic protectionism”—enacting laws that “benefit in-state economic interests by burdening out-of-state competitors.”³

But the line between promotion and protection is a fine one indeed. Every law that protects local industry also promotes it. By reducing competition

1. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 271 (1984).

2. *Armco v. Hardesty*, 467 U.S. 638, 645-46 (1984) (quoting *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336-37 (1977)).

3. *New Energy Co. v. Limbach*, 486 U.S. 269, 273-74 (1988); see also *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 406 (1984) (indicating that states may not “‘foreclose[] tax-neutral decisions’ . . . in an attempt to induce ‘business operations to be performed in the home state that could more efficiently be performed elsewhere’”) (quoting *Boston Stock Exch.*, 429 U.S. at 331, 336 (quoting *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970) (internal quotation marks omitted))); *Guy v. Baltimore*, 100 U.S. 434, 443 (1879). The tension, if not inconsistency, between the statement from *Westinghouse* and the statement from *Armco* quoted in the text is highlighted by DANIEL SHAVIRO, *FEDERALISM IN TAXATION: THE CASE FOR GREATER UNIFORMITY* 54-55 (1993).

from out-of-state producers, a protectionist law “encourage[s] the growth and development of intrastate commerce and industry.”⁴ What is less obvious, but no less true, is that state laws that “promote” local industry can also “protect” it: they may “benefit in-state economic interests by burdening out-of-state competitors” through changes in the market price of the good being “promoted.”⁵

This Article examines the tenuous distinction between promoting and protecting local industry in the context of state tariffs and state subsidies.⁶ A state tariff—a tax imposed solely on goods imported from another state⁷—is the “paradigmatic example” of a protectionist state law that violates the dormant Commerce Clause.⁸ Meanwhile, a state subsidy to domestic producers of a good,⁹ when funded out of general revenues, is treated as

4. *Boston Stock Exch.*, 429 U.S. at 336-37.

5. *New Energy*, 486 U.S. at 273-74; *see infra* Part III.A.

6. In addition to its taxing and spending powers, a state also can use its regulatory powers to benefit in-state businesses. *See* Daniel A. Farber & Robert E. Hudec, *Free Trade and the Regulatory State: A GATT's-Eye View of the Dormant Commerce Clause*, 47 VAND. L. REV. 1401, 1402 (1994) (“Regulation often creates competitive disadvantages for foreign producers. Sometimes the disadvantage is intended . . .”). The history of dormant Commerce Clause jurisprudence is full of cases involving regulations with that effect. *E.g.*, *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333, 350-53 (1977). This Article does not deal with such regulations, although it might be possible to analogize them to tariffs or subsidies and incorporate them into the analysis. *See, e.g.*, *W.C.M. Window Co. v. Bernardi*, 730 F.2d 486, 494 (7th Cir. 1984) (Posner, J.) (“The Illinois preference law erects a nearly prohibitive tariff . . . against the use on any public project in Illinois of labor imported from another state or from a foreign country.”).

7. *E.g.*, *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 114 S. Ct. 2205, 2211 (1994); PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, *ECONOMICS* 688 (15th ed. 1995).

8. *West Lynn Creamery*, 114 S. Ct. at 2211; SHAVIRO, *supra* note 3, at 6.

9. Subsidies can come in any variety of forms. This Article focuses on a production subsidy—a cash payment to in-state producers of a good in an amount that varies according to their production. For a broader definition, see Final Act Embodying the Uruguay Round of Multilateral Trade Negotiations 229, art. 1.1 (Apr. 15, 1994), in OFFICE OF THE U.S. TRADE REPRESENTATIVE, EXECUTIVE OFFICE OF THE PRESIDENT, URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS GENERAL AGREEMENT ON TARIFFS AND TRADE (1994). Some variations on the basic form of subsidy and tariff are dealt with in Part III.

One form of subsidy that is beyond the scope of this Article is a “relocation” subsidy, by which a state seeks to induce a business to relocate to the state by giving the business tax exemptions or other incentives. Instead of discriminating against out-of-state producers and protecting local businesses, relocation subsidies discriminate against in-state producers and, thus, generally have avoided constitutional challenge under the dormant Commerce Clause. SHAVIRO, *supra* note 3, at 43 (noting that the antidiscrimination standard of the dormant Commerce Clause “does not bar discrimination against insiders, for example, to attract outside investment”); Saul Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 577 n.34 (1983); *see also* Metropolitan Life Ins. Co. v. Ward, 470 U.S. 869, 879-80 (1985); *Allied Stores, Inc. v. Bowers*, 358 U.S. 522, 528-29 (1959). States and local communities may compete fiercely in their attempts to attract businesses, and the desirability of such competition is debatable. *E.g.*, Melvin L. Burstein & Arthur J. Rolnick, *Congress Should End*

virtually per se constitutional because it “merely assists local business.”¹⁰ This Article looks to international economics and constitutional history in an attempt to justify the differing treatment of tariffs and subsidies. The analysis suggests that the differing treatment can be justified, although not because subsidies merely promote local business. The analysis also provides a framework for determining whether a state law is more like a valid subsidy or an invalid tariff, and thus aids in understanding a number of recent Supreme Court cases that address the validity of state taxing schemes that favor local businesses.¹¹

Part II of this Article sets out the Supreme Court’s current legal analysis of tariffs versus subsidies under the dormant Commerce Clause. According to the Court, state subsidies funded from general revenues are lawful because, unlike tariffs, they assist but do not burden interstate commerce. This reasoning ignores the practical economic effect of subsidies and is nothing less than a return to the sort of formalistic analysis which the Court has repudiated elsewhere under the dormant Commerce Clause.

Part III undertakes an economic analysis of tariffs versus subsidies, from both a traditional international economics perspective and from a rent-seeking perspective. It demonstrates that the Court’s distinction between tariffs and subsidies can be justified as an economic matter, but not because subsidies lack any effect on out-of-state competitors. Instead, the distinction is best justified on the grounds that (1) subsidies generally have lower efficiency costs than tariffs and (2) the institutional characteristics of subsidies make rent-seeking efforts less effective in obtaining protection by subsidy than by tariff. Part III concludes by addressing the hard cases, examining whether state tax expenditures (tax exemptions, deductions, and credits) and a subsidy funded by an earmarked tax on the good subsidized are properly

the Economic War Among the States, THE REGION, Mar. 1995, at 3, 4-10; Lawrence W. Reed, *Time to End the Economic War Between the States*, REGULATION, May 1996, at 35, 37-39; see also Ferdinand P. Schoettle, *Commerce Clause Challenges to State Taxes*, 75 MINN. L. REV. 907, 911 (1991) (“[T]ax that subsidizes interstate commerce . . . is as undesirable as a tax that does the opposite.”); Mark Taylor, Note, *A Proposal to Prohibit Industrial Relocation Subsidies*, 72 TEX. L. REV. 669, 678-92 (1994). See generally *The Economic War Between the States*, THE REGION, June 1996, at 4 (proceedings of a May 21-22, 1996 conference in Washington, D.C.). However, relocation subsidies present a different set of issues than those addressed by this Article.

10. *West Lynn Creamery*, 114 S. Ct. at 2214.

11. E.g., *General Motors Corp. v. Tracy*, 652 N.E.2d 188 (Ohio 1995) (per curiam), cert. granted, 116 S. Ct. 1349 (1996) (No. 95-1232); *West Lynn Creamery*, 114 S. Ct. at 2205; *New Energy Co. v. Limbach*, 486 U.S. 269 (1988); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); see *infra* text accompanying notes 173-200.

characterized as tariffs or subsidies.

Part IV suggests an alternative constitutional basis for the Court's distinction between tariffs and subsidies: the Import-Export Clause of the United States Constitution. As a matter of constitutional text, history, and policy, the Import-Export Clause should be construed as applying to interstate trade as well as foreign trade, expressly prohibiting state tariffs while permitting state subsidies. Part IV not only suggests a historical basis for the differing treatment of tariffs and subsidies, but also provides firm grounding in the constitutional text for a significant part of current dormant Commerce Clause doctrine, the legitimacy of which has been strongly challenged. Part V summarizes my conclusions.

II. A LEGAL ANALYSIS OF TARIFFS V. SUBSIDIES UNDER THE DORMANT COMMERCE CLAUSE

Currently, courts evaluate the constitutionality of state tariffs and subsidies under the negative, or dormant, Commerce Clause.¹² State tariffs certainly are unconstitutional under the dormant Commerce Clause; state subsidies, funded from the general revenues of the state, appear to be entirely constitutional. The Supreme Court has given no persuasive justification for this differing treatment. Indeed, the doctrinal grounds for invalidating tariffs would seem to require invalidating subsidies as well. But the Court to date has simply excluded subsidies from dormant Commerce Clause analysis altogether, reverting to formalism of the sort it otherwise has repudiated.

A. Overview of Dormant Commerce Clause Jurisprudence

The Commerce Clause of the United States Constitution expressly grants Congress the power to regulate interstate commerce. It provides that “[t]he Congress shall have Power . . . To regulate Commerce . . . among the several States.”¹³ The Supreme Court long has held the Commerce Clause to have a negative, or dormant, aspect as well, which limits states’ power to regulate

12. On occasion, other constitutional provisions have come into play. For example, in *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985), the Supreme Court invalidated discriminatory taxation of insurance companies under the Equal Protection Clause. *Id.* at 882. The dormant Commerce Clause did not apply in *Metropolitan Life* because of congressional action giving states broad powers to regulate insurance. *See id.* at 880 (citing the McCarran-Ferguson Act, codified at 15 U.S.C. §§ 1011-1015 (1994)).

13. U.S. CONST. art. I, § 8, cl. 3.

interstate commerce even when Congress has not acted.¹⁴ In other words, under current doctrine the grant of power to Congress to regulate interstate commerce is to some degree an exclusive one.

Defining the degree of exclusive federal power, however, has proven extremely difficult. David P. Currie has stated that “[i]n doctrinal terms the Court’s efforts in this field can be described only as a disaster.”¹⁵ The Supreme Court itself has called its dormant Commerce Clause jurisprudence a “quagmire.”¹⁶ In its early cases, the Court focused on identifying when a state “regulated” interstate commerce, because “when a State proceeds to regulate [interstate] commerce, it is exercising the very power that is granted to Congress, and is doing the very thing which Congress is authorized to do.”¹⁷ In attempting to distinguish permissible state actions from impermissible ones, the Court employed and subsequently rejected various formalistic and conclusory modes of analysis. It permitted states to adopt “police” regulations but not “regulations of interstate commerce,”¹⁸ to regulate “local matters” but not “national matters,”¹⁹ and to impose “indirect” burdens but not “direct” burdens on interstate commerce.²⁰

14. *E.g.*, *Case of the State Freight Tax*, 82 U.S. (15 Wall.) 232, 279-80 (1872); *Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 448-49 (1827); *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 208 (1824).

15. DAVID P. CURRIE, *THE CONSTITUTION IN THE SUPREME COURT: THE FIRST HUNDRED YEARS 1789-1888* at 342 (1985). *See generally id.* at 168-81, 222-36, 330-42, 403-16.

16. *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959).

17. *Gibbons*, 22 U.S. (9 Wheat.) at 199-200.

18. *E.g.*, *Mayor of New York v. Miln*, 36 U.S. (11 Pet.) 102, 132-33 (1837) (holding that a New York statute requiring the master of a vessel arriving in New York from out of state to report names of passengers was not regulation of interstate commerce but exercise of police power); *Willson v. Black-Bird Creek Marsh Co.*, 27 U.S. (2 Pet.) 245, 251-52 (1829) (holding that the state permissibly exercised police power to drain interstate waterway to protect the health of its citizens); *see* LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 6-3, at 406 (2d ed. 1988) (“To the modern observer, these labels appear to have been largely conclusory.”); *id.* § 6-13, at 437 (“[T]he distinction between ‘police regulation’ and ‘regulation of interstate commerce’ has long since been rejected as too wooden to be of much help in the actual decision of particular cases.”).

19. *E.g.*, *Wabash, St. L. & Pac. Ry. v. Illinois*, 118 U.S. 557, 577 (1886) (invalidating Illinois’ policy of regulating railway rates as national matter, best left to Congress); *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299, 319 (1851) (upholding Pennsylvania’s power to require foreign ships to use local pilots when entering or leaving the harbor because subject of regulation was local, not national); *see* TRIBE, *supra* note 18, § 6-4, at 407 (noting that “the attempt to test state regulation by classifying its subject matter as local or national has been largely abandoned”).

20. *See Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 522 (1935) (“Nice distinctions have been made at times between direct and indirect burdens. They are irrelevant when the avowed purpose of the obstruction, as well as its necessary tendency, is to suppress or mitigate the consequences of competition between the states.”); *see also* PAUL J. HARTMAN, *FEDERAL LIMITATIONS ON STATE & LOCAL TAXATION* § 2:13, at 63-64 (1981); TRIBE, *supra* note 18, § 6-4, at 408 (“Such analysis was at

The Supreme Court's recent dormant Commerce Clause decisions have, in the Court's words, "eschewed formalism for a sensitive, case-by-case analysis of purposes and effects."²¹ According to the Court, the purpose of the Commerce Clause, including its dormant aspect, is "to create an area of free trade among the several States."²² In accord with this objective, the focus of the Court's dormant Commerce Clause analysis today is on discrimination—whether the state action has the purpose or effect of disadvantaging out-of-state goods in favor of goods produced locally.²³

Discrimination is a central question regardless of whether a state regulation or a state tax is being challenged. State regulations that "clearly discriminate" against interstate commerce are "routinely struck down . . . unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism."²⁴ Attempts by a state to justify a discriminatory regulation rarely succeed.²⁵ If a regulation is not discriminatory on its face, the Court weighs the burden on interstate commerce against the nonprotectionist interests of the state, invalidating the regulation if the burden is too substantial.²⁶ Or, the Court may find that a facially neutral statute

first conducted (some would now say 'masked') by classifying the impact of state regulation on interstate commerce as either 'direct' or 'indirect.'"); *id.* § 6-5, at 408 ("The distinction between 'direct' and 'indirect' burdens has been rejected as overly conclusory and misleadingly precise."). Compare *Smith v. Alabama*, 124 U.S. 465, 482 (1888) (upholding a licensing requirement for railroad engineers because it imposed only an indirect burden) with *Seaboard Air Line Ry. v. Blackwell*, 244 U.S. 310, 316 (1917) (invalidating a state law requiring railroad trains to slow at public crossing invalid because the burden was direct).

21. *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 114 S. Ct. 2205, 2215 (1994); see also *Oklahoma Tax Comm'n v. Jefferson Lines*, 115 S. Ct. 1331, 1337 (1995); *Quill Corp. v. North Dakota*, 504 U.S. 298, 309 (1992); *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 405 (1984); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

22. *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 328 (1977) (quoting *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944)).

23. *E.g.*, *Oregon Waste Sys., Inc. v. Department of Env'tl. Quality*, 511 U.S. 93, 99 (1994) ("As we use the term here, 'discrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."); Walter Hellerstein, *State Taxation and the Supreme Court*, 1989 SUP. CT. REV. 223, 240.

24. *New Energy Co. v. Limbach*, 486 U.S. 269, 274 (1988); see *West Lynn Creamery*, 114 S. Ct. at 2211 (quoting with approval *New Energy*, 486 U.S. at 273-74); *City of Philadelphia v. New Jersey*, 437 U.S. 617, 628 (1978) (striking down New Jersey's ban on import of waste).

25. See, *e.g.*, *City of Philadelphia*, 437 U.S. at 626-27 (holding that New Jersey's goal of environmental protection cannot constitutionally be accomplished by a ban on solid and liquid wastes that violates the Commerce Clause); *Hughes v. Oklahoma*, 441 U.S. 322, 338 (1979) (holding that states can only promote the purpose of animal conservation in ways consistent with the Commerce Clause). But see *Maine v. Taylor*, 477 U.S. 131, 148-52 (1986) (finding that Maine's interest in protecting its aquatic ecosystems supported its total ban on importation of baitfish).

26. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970) ("Where the statute regulates

nonetheless discriminates in practical effect and is therefore unconstitutional.²⁷

In state tax cases, the Supreme Court applies a four-part test derived from *Complete Auto Transit, Inc. v. Brady*.²⁸ In *Complete Auto*, the Court unanimously overruled precedent outlawing state taxes on the “privilege of doing business” as applied to interstate businesses.²⁹ The Court refused to focus on “the formal language of the tax statute” and instead considered its “practical effect.”³⁰ After *Complete Auto*, a state tax is lawful only if (1) the activity taxed has sufficient nexus with the state to support imposition of the tax, (2) the tax is fairly apportioned, (3) the tax does not discriminate against interstate commerce, and (4) the tax is fairly related to the benefits provided by the state to the taxpayer.³¹ Of these four requirements, the nondiscrimination requirement has proved to be the most prominent and important.³²

A tax that is facially discriminatory is almost certain to be invalidated.³³ In addition, the Court will sometimes find unlawful discrimination other than on the face of the statute.³⁴ For example, the tax in *American Trucking Association v. Scheiner*³⁵ was a flat tax on trucks operating on Pennsylvania highways. The tax did not discriminate against interstate commerce on its face because all trucks paid the same flat twenty-five dollar fee regardless of their state of origin. But “in practical effect,” the Court concluded, because

evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”)

27. See, e.g., *Hunt v. Washington Apple Advertising Comm’n*, 432 U.S. 333, 350-54 (1977).

28. 430 U.S. 274, 287 (1977).

29. *Id.* at 288-89 (overruling *Spector Motor Serv., Inc. v. O’Conner*, 340 U.S. 602 (1951)).

30. *Id.* at 279.

31. *Id.* at 287; see also *Oklahoma Tax Comm’n v. Jefferson Lines*, 115 S. Ct. 1331, 1337 (1995) (noting the Court’s frequent use of the *Complete Auto* test); *Goldberg v. Sweet*, 488 U.S. 252, 259-60 (1989).

32. 1 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, *STATE TAXATION* ¶ 4.08, at 4-36 to 4-37 (2d ed. 1993); Levmore, *supra* note 9, at 592-93 n.91.

33. See, e.g., *Fulton Corp. v. Faulkner*, 116 S. Ct. 848, 860 (1996) (holding that a North Carolina intangibles tax discriminated against interstate commerce); *Associated Indus. of Mo. v. Lohman*, 511 U.S. 641, 647-54 (1994) (finding Missouri’s additional use tax unconstitutionally discriminatory).

34. See, e.g., *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 114 S. Ct. 2205, 2214-18 (1994) (holding unconstitutional a facially neutral tax on milk combined with a subsidy to in-state milk producers). *But see* *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617-19 (1981) (rejecting claim that a facially neutral tax was discriminatory because the burden of the tax was largely borne by out-of-state purchasers).

35. 483 U.S. 266 (1987).

the flat tax imposed “a cost per mile on [out-of-state] trucks that [was] approximately five times as heavy as the cost per mile borne by local trucks,”³⁶ the tax was “plainly discriminatory.”³⁷

B. Tariffs v. Subsidies Under the Dormant Commerce Clause

The Supreme Court has drawn a bright line between tariffs and subsidies under the dormant Commerce Clause—a line that is difficult to justify under the doctrine just described. Rather than looking beyond form to economic substance, the Court looks strictly to form to distinguish between tariffs and subsidies.

1. Tariffs

A tariff is the “paradigmatic example” of state action that is illegal under the dormant Commerce Clause.³⁸ According to the Supreme Court, “tariffs against the products of other States are so patently unconstitutional that our cases reveal not a single attempt by any State to enact one.”³⁹ However, the

36. *Id.* at 286. The Court explained that “Pennsylvania-based vehicles subject to the flat taxes travel about five times as many miles on Pennsylvania roads as do the out-of-state vehicles; correspondingly, the cost per mile of each of the flat taxes is approximately five times as high for out-of-state vehicles as for local vehicles.” *Id.* at 276.

37. *Id.* at 286. Justice Scalia dissented in *Scheiner*, arguing that only facially discriminatory taxes and regulations are invalid under the dormant Commerce Clause. Because the flat tax was neutral on its face, in his view, it should have been upheld. *Id.* at 304 (Scalia, J., dissenting). If the tax or regulation were not facially discriminatory, Justice Scalia would find it invalid only if it were indistinguishable from a tax or regulation previously struck down by the Court—i.e., as a matter of *stare decisis*. *West Lynn Creamery*, 114 S. Ct. at 2220 (Scalia, J., concurring). Justice Scalia’s view is based, at least in part, on his belief that the Court’s policing of state regulations and taxes under the dormant Commerce Clause is illegitimate. See *infra* note 204 and accompanying text. Justice Scalia’s position is very much a minority view on the Court, but Justice Thomas has joined on occasion. See, e.g., *West Lynn Creamery*, 104 S. Ct. at 2218 (Scalia, J., concurring, joined by Thomas, J.); *Oklahoma Tax Comm’n v. Jefferson Lines*, 115 S. Ct. 1331, 1346 (1995) (Scalia, J., concurring, joined by Thomas, J.).

38. *West Lynn Creamery*, 114 S. Ct. at 2211; SHAVIRO, *supra* note 3, at 6.

39. *West Lynn Creamery*, 114 S. Ct. at 2211. The Court’s assertion that its cases revealed no attempt by a state to enact a tariff on imports from another state appears to be an overstatement. For example, a Kentucky law, successfully challenged in *Department of Revenue v. James B. Beam Distilling Co.*, 377 U.S. 341 (1964), provided: “No person shall ship or transport or cause to be shipped or transported into the state any distilled spirits from points without the state without first obtaining a permit from the department and paying a tax of ten cents on each proof gallon contained in the shipment.” *Id.* at 342 (quoting KY. REV. STAT. ANN. § 243.680(2)(a) (repealed 1966)). The plaintiff challenged the application of the tax (or more accurately tariff) to whisky imported from Scotland and thus challenged the tax under the Import-Export Clause and not the dormant Commerce Clause. *Id.* at 341-42. However, by its terms the statute applied to imports from other states as well and

Supreme Court has invalidated state taxes and regulations less obviously offensive to the dormant Commerce Clause than tariffs by analogizing the tax or regulation to a tariff.

For example, in *Baldwin v. G.A.F. Seelig, Inc.*,⁴⁰ the Court struck down a New York statute that established minimum prices to be charged for milk. The price minimum applied to milk produced in other states as well as to milk produced in New York, effectively equalizing the prices of lower-cost out-of-state milk and higher-cost New York milk. The Court held that the milk pricing legislation was unlawful because it “set a barrier to traffic between one state and another as effective as if customs duties, equal to the price differential, had been laid upon the thing transported.”⁴¹ If such “imposts and duties upon interstate commerce” are unlawful under the dormant Commerce Clause,⁴² certainly a tariff would be also.

Why are state tariffs unlawful under the dormant Commerce Clause? The Supreme Court in *West Lynn Creamery v. Healy*⁴³ suggested a variety of reasons. First, a tariff is a tax that on its face discriminates against interstate commerce: only goods imported into the state from another state are taxed.⁴⁴ As explained above, such discrimination is the central target of modern dormant Commerce Clause doctrine.⁴⁵ In addition, a tariff “neutralize[s] advantages belonging to the place of origin,”⁴⁶ “handicap[s] out-of-state competitors,”⁴⁷ “artificially encourag[es] in-state production even when the

thus would seem to have been a tariff on interstate trade. See Walter Hellerstein, *Michelin Tire Corp. v. Wages: Enhanced State Power to Tax Imports*, 1976 SUP. CT. REV. 99, 121 (asserting that “the statutory classification [at issue in *James Beam*] was broad enough to include out-of-state as well as foreign goods”).

40. 294 U.S. 511 (1935).

41. *Id.* at 521. In at least one respect, the regulation in *G.A.F. Seelig* is unlike a tariff. A tariff is a tax and, unless it is prohibitively high, raises revenue for the state imposing it. The price floor in *G.A.F. Seelig* did not raise revenue for the state of New York. See 2 RONALD D. ROTUNDA & JOHN E. NOWAK, *TREATISE ON CONSTITUTIONAL LAW* § 11.8, at 27-29 (2d ed. 1992). Instead, the increase in price paid by consumers went directly to milk producers, both in-state and out-of-state (if any). *Id.*

42. *G.A.F. Seelig*, 294 U.S. at 522; see also *West Lynn Creamery*, 114 S. Ct. at 2212-13 (holding that a tax on milk combined with a subsidy to in-state milk producers was invalid as a tariff); *Case of the State Freight Tax*, 82 U.S. (15 Wall.) 232, 276-77 (1872) (analogizing freight tax to state “establish[ing] custom-houses on her borders, wherever a railroad or canal comes to the State line, and demand[ing] at these houses a duty”); *Alliance for Clean Coal v. Miller*, 44 F.3d 591, 595-97 (7th Cir. 1995) (invalidating Illinois statute encouraging and requiring utilities to use Illinois coal as having the same effect as a tariff).

43. 512 U.S. 186, 114 S. Ct. 2205 (1994).

44. *Id.* at 2211.

45. See *supra* notes 24-37 and accompanying text.

46. *West Lynn Creamery*, 114 S. Ct. at 2213 (quoting *G.A.F. Seelig*, 294 U.S. at 527).

47. *Id.* at 2211.

same goods could be produced at lower cost in other States,”⁴⁸ “neutraliz[es] the advantage possessed by lower cost out-of-state producers,”⁴⁹ and “distort[s] . . . the geography of production.”⁵⁰ In short, a tariff enables local producers to increase their sales at the expense of out-of-state producers.

2. Subsidies

All of the above can be said about subsidies as well. Subsidies, like tariffs, discriminate against out-of-state producers. A subsidy is paid only to in-state producers of the good; out-of-state producers of identical goods receive no subsidy payments.⁵¹ Moreover, subsidies, like tariffs, neutralize the advantages of lower cost out-of-state producers, handicap out-of-state competitors, artificially encourage higher cost in-state production, and distort the geography of production.⁵² In short, subsidies, too, may enable local producers to increase their sales at the expense of out-of-state producers.⁵³

While state tariffs are the paradigm of illegality under the dormant Commerce Clause, the Supreme Court has treated state subsidies for all intents and purposes as per se lawful. The Court does not view subsidies as affecting interstate commerce differently than tariffs; to the contrary, the Court seems to believe that the effects of the two are similar, if not identical.⁵⁴ Nevertheless, the Supreme Court has concluded that the dormant Commerce

48. *Id.*

49. *Id.* at 2212.

50. *Id.* at 2211. Justice Scalia criticized the majority in *West Lynn Creamery* for this litany:

[The Court] seems to have canvassed the entire corpus of negative-Commerce-Clause opinions, culled out every free-market snippet of reasoning, and melded them into the sweeping principle that the Constitution is violated by any state law or regulation that “artificially encourag[es] in-state production even when the same goods could be produced at lower cost in other States.”

Id. at 2219 (Scalia, J., concurring) (second pair of brackets in original) (quoting *id.* at 2211).

51. See *New Energy Co. v. Limbach*, 486 U.S. 269, 278 (1988) (noting that a cash subsidy scheme “is no less discriminatory” than an unlawful state tax exemption); Karl Manheim, *New-Age Federalism and the Market Participant Doctrine*, 22 ARIZ. ST. L.J. 559, 592 (1990).

52. *New Energy*, 486 U.S. at 278 (finding a subsidy “no less effective in conferring a commercial advantage over out-of-state competitors” than an unlawful state tax exemption); see also *Fireside Nissan, Inc. v. Fanning*, 30 F.3d 206, 216 (1st Cir. 1994) (conceding that “we see no practical difference between the tax break offered to local liquor producers in *Bacchus*, for example, and a ‘direct’ cash subsidy to those same industries (thus blurring the imaginary line between discriminatory privileges that burden interstate commerce and those that do not)”; *The Supreme Court, 1975 Term*, 90 HARV. L. REV. 58, 60 (1976) (noting that subsidies “may provide local firms with a competitive edge by creating price differentials between local and in-state firms”).

53. See also *infra* notes 166-67 and accompanying text.

54. See *infra* text accompanying note 65.

Clause simply does not apply to subsidies, either because subsidies do not impose a burden on interstate commerce or because the state is acting as a participant rather than a regulator of, the market.⁵⁵

Thus, in dicta in *West Lynn Creamery*, the Court suggested that “[a] pure subsidy funded out of general revenue” would be lawful.⁵⁶ Such a subsidy “ordinarily imposes no burden on interstate commerce, but merely assists local business.”⁵⁷ *West Lynn Creamery* involved a subsidy to in-state milk producers funded not from state general revenues, but from a specific tax on milk.⁵⁸ The Court stated that the subsidy at issue, unlike a subsidy funded from general revenues, “not only assists local farmers, but burdens interstate commerce.”⁵⁹ Although the Court made clear that it was not deciding whether a subsidy funded from a state’s general revenues would be lawful,⁶⁰ such a conclusion seems to follow from its analysis.⁶¹

The Court’s discussion of subsidies in *New Energy Co. v. Limbach*⁶² is similar. Once again, a subsidy funded from the general revenues of the state was not directly at issue. Instead, *New Energy* involved a challenge by an out-of-state ethanol producer to an Ohio fuel tax credit available only for ethanol produced in Ohio.⁶³ In holding that the tax credit unconstitutionally discriminated against interstate commerce, the Court noted that the plaintiff, an Indiana ethanol producer, was eligible to receive a cash subsidy through an

55. See, e.g., Farber & Hudec, *supra* note 6, at 1412 n.32 (“Cases involving state proprietary functions and subsidies belong to yet another category, such laws being generally immune from [dormant Commerce Clause] scrutiny.”).

56. *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 114 S. Ct. 2205, 2214 (1994).

57. *Id.*

58. For further discussion of *West Lynn Creamery*, see *infra* notes 173-85 and accompanying text.

59. *West Lynn Creamery*, 114 S. Ct. at 2214.

60. *Id.* at 2214 n.15 (“We have never squarely confronted the constitutionality of subsidies, and we need not do so now.”). Justice Scalia, in his concurring opinion, asserted that the Court had approved a subsidy to in-state business funded from state general revenues in *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 809-10 (1976). *West Lynn Creamery*, 114 S. Ct. at 2220 (Scalia, J., concurring); see *infra* notes 68-72 and accompanying text.

61. Other recent cases likewise have indicated that subsidies would be permissible even if other forms of state action would not be. See *C & A Carbone, Inc. v. Town of Clarkstown*, 114 S. Ct. 1677, 1684 (1994) (“Clarkstown maintains that special financing is necessary to ensure the long-term survival of the designated facility. If so, the town may subsidize the facility through general taxes or municipal bonds.”); *Chemical Waste Mgmt., Inc. v. Hunt*, 504 U.S. 334, 351 (1992) (Rehnquist, C.J., dissenting) (“Other mechanisms also appear open to Alabama to achieve results similar to those that are foreclosed today. There seems to be nothing, for example, that would prevent Alabama from providing subsidies or other tax breaks to domestic industries that generate hazardous wastes.”).

62. 486 U.S. 269 (1988).

63. *Id.* at 271.

Indiana program limited to in-state ethanol producers.⁶⁴ Such a program, the Court stated, was “no less discriminatory . . . and no less effective in conferring a commercial advantage over out-of-state competitors” than the Ohio tax credit.⁶⁵ Nonetheless, the dormant Commerce Clause does not outlaw subsidies like that provided by Indiana:

The Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description *in connection with the State's regulation of interstate commerce*. Direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufacturers does.⁶⁶

Thus, at least in dicta, the Court concluded that subsidies are per se lawful, not because their effect is different from discriminatory tax exemptions or tariffs, but because the dormant Commerce Clause simply does not apply.⁶⁷

The Supreme Court has also approved state subsidies under the market participant exception to the dormant Commerce Clause, which excludes states that are acting as buyers or sellers in the market from standard dormant Commerce Clause analysis. In *Hughes v. Alexandria Scrap Corp.*,⁶⁸ the case

64. *Id.* at 278.

65. *Id.*

66. *Id.* The Court has offered no further explanation of its theory, but Mark Tushnet has suggested the following:

Although Justice Scalia does not spell out the argument, it must be that judicial authority to invalidate state legislation derives from Congress's power to regulate interstate commerce, which must to some degree, therefore, preempt state power to regulate interstate commerce. The courts' authority to invalidate state legislation is therefore limited to consideration of state laws that regulate interstate commerce, not those that discriminate against out-of-state commercial activity in some other way, for example, by a direct cash subsidy.

Mark V. Tushnet, *Scalia and the Dormant Commerce Clause: A Foolish Formalism?*, 12 CARDOZO L. REV. 1717, 1727 (1991). Tushnet finds such an explanation unpersuasive, however, arguing that “economic reality has nothing to do with the concept of discrimination” in *New Energy* and that the Court's analysis “can only be called formalist.” *Id.*

67. *New Energy*, 486 U.S. at 278.

68. 426 U.S. 794 (1976). *Alexandria Scrap* and its progeny have prompted extensive commentary. *E.g.*, Thomas K. Anson & P.M. Schenkkan, *Federalism, the Dormant Commerce Clause, and State-Owned Resources*, 59 TEX. L. REV. 71 (1980); Dan T. Coenen, *The Impact of the Garcia Decision on the Market-Participant Exception to the Dormant Commerce Clause*, 1995 U. ILL. L. REV. 727; Dan T. Coenen, *Untangling the Market-Participant Exemption to the Dormant Commerce Clause*, 88 MICH. L. REV. 395 (1989) [hereinafter Coenen, *Untangling*]; Earl M. Maltz, *How Much Regulation is Too Much—An Examination of Commerce Clause Jurisprudence*, 50 GEO. WASH. L. REV. 47, 67-72 (1981); Manheim, *supra* note 51, at 559; Michael J. Polelle, *A Critique of the Market Participation Exception*, 15 WHITTIER L. REV. 647 (1994); Michael Wells & Walter

in which the doctrine originated, a Virginia processor of scrap metal challenged a Maryland program that offered bounties—i.e., subsidies—for the processing of abandoned automobiles.⁶⁹ As implemented, the program made it easier for in-state processors to receive the bounty than out-of-state processors.⁷⁰ The Supreme Court upheld the bounty program against dormant Commerce Clause attack, reasoning that Maryland was not regulating the market, but rather was participating in it.⁷¹ Although the structure of the bounty program made automobile hulks more likely to be processed in Maryland, that was because of “market forces, including that exerted by money from the State,” and not trade barriers of the sort forbidden by the dormant Commerce Clause.⁷² Accordingly, even if it favored in-state processors, the bounty program did not violate the dormant Commerce Clause.

Hellerstein, *The Governmental-Proprietary Distinction in Constitutional Law*, 66 VA. L. REV. 1073 (1980).

69. *Alexandria Scrap*, 426 U.S. at 797. In his concurring opinion, Justice Stevens addressed the program expressly as a subsidy:

This is the first case in which any litigant has asked a federal court to address the question whether a state subsidy constitutes a “burden” on interstate commerce. That fact is significant because there must have been countless situations during the past two centuries in which the several States have experimented with different methods of encouraging local enterprise without providing like encouragement to out-of-state competitors. The absence of any previous challenge to such programs reflects, I believe, a common and correct interpretation of the Commerce Clause as primarily intended (at least when Congress has not spoken) to inhibit the several States’ power to create restrictions on the free flow of goods within the national market, rather than to provide the basis for questioning a State’s right to experiment with different incentives to business.

Id. at 816-17 (Stevens, J., concurring).

70. In particular, the documentation requirements were less stringent for automobile hulk processors located in Maryland than those located in other states. Maryland processors needed only to submit an indemnification agreement under which the person delivering the hulk asserted title and agreed to indemnify the processor in the event of any claims by third parties. Out-of-state processors were required to submit a certificate of title or some similar form of documentation in order to qualify for the bounty. *Id.* at 800-01.

71. *Id.* at 809-10. The Court held: “Nothing in the purposes animating the Commerce Clause prohibits a State, in the absence of congressional action, from participating in the market and exercising the right to favor its own citizens over others.” *Id.* at 810 (footnotes omitted).

72. *Id.* at 809-10. In subsequent cases the Court has extended the market participant exception to state programs that go beyond the scope of the direct subsidy in *Alexandria Scrap*. See *White v. Massachusetts Council of Constr. Employers, Inc.*, 460 U.S. 204, 214-15 (1983) (upholding city order that at least half of employees on city-funded construction projects must be city residents); *Reeves, Inc. v. Stake*, 447 U.S. 429, 436-37 (1980) (upholding policy of state-owned cement plant of limiting sales to in-state customers).

C. The Legal Treatment of Tariffs v. Subsidies: A Foolish Formalism?

The Supreme Court does not apply its usual dormant Commerce Clause doctrine to subsidies. If it did, at least in the Court's view, subsidies could well be invalid because they are discriminatory and because they increase the sale of goods produced in-state at the expense of goods produced out-of-state. Instead, the Court so far has exempted subsidies from dormant Commerce Clause analysis altogether on two grounds: either because a subsidy does not "burden" interstate commerce or because the state acts as a participant rather than a regulator of the market. Both of these exceptions, as applied to subsidies, elevate form over economic substance.

Indeed, the mere fact that the Court to date has applied special rules to subsidies when its general dormant Commerce Clause doctrine focuses on the practical effect of a state action suggests that it is disregarding economic substance. The burden of a subsidy on interstate commerce should depend on the economic effect of the subsidy, not on whether out-of-state producers are out-of-pocket any money. Whether there is such an economic effect is addressed in Part III. What is important here is that the answer is irrelevant to the Court.⁷³ The same is true under the market participant exception. The economic effect of the state bounty program in *Alexandria Scrap* was not material to the analysis; instead, all that mattered was the form of the state action: payments from the state treasury.⁷⁴

The inconsistency between the Court's special treatment of subsidies and its general move away from a focus on the form of a transaction is highlighted in *West Lynn Creamery*.⁷⁵ On the one hand, the Court rejected as unduly formalistic the state's argument that the pricing order was lawful because it consisted of two lawful parts (a nondiscriminatory tax on milk and a subsidy to in-state milk producers):

Our Commerce Clause jurisprudence is not so rigid as to be controlled by the form by which a State erects barriers to commerce. Rather our cases have eschewed formalism for a sensitive, case-by-case analysis of purposes and effects. As the Court declared over 50 years ago: "The commerce clause forbids discrimination, whether forthright or

73. See Tushnet, *supra* note 66, at 1727 (arguing that "economic reality has nothing to do with the concept of discrimination" in *New Energy*).

74. See Polelle, *supra* note 68, at 685 (asserting that the market participant exception of *Alexandria Scrap* is "arid formalism").

75. *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 114 S. Ct. 2205 (1994).

ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce."⁷⁶

On the other hand, the Court blithely asserted that "[a] pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business."⁷⁷ The basis for that assertion was not the practical effect of a subsidy from general revenues but rather its form: the funding for the subsidy does not come directly from a tax on goods produced out-of-state, although it may indirectly.⁷⁸

Indeed, the Court's treatment of subsidies looks a lot like a return to the discredited distinction between direct and indirect burdens on interstate commerce.⁷⁹ Under the Court's view, tariffs impose a direct burden on interstate commerce and therefore are invalid, while subsidies impose no burden, or at best only an indirect burden, and therefore are valid. The Court does not attempt to explain why prohibiting tariffs but not subsidies is consistent with the purposes of the dormant Commerce Clause. Rather, the Court reverts merely to identifying whether a state law in form regulates interstate commerce.⁸⁰

Whatever might be said for bright-line rules,⁸¹ the Supreme Court's adoption of a formalistic rule under the dormant Commerce Clause runs directly counter to the Court's own statements of how it is proceeding in this area. What is needed is a better justification for the formal line or an analysis that justifies the differing treatment of tariffs and subsidies on some basis other than a strictly formal one. The remainder of this Article seeks to offer both.

III. AN ECONOMIC ANALYSIS OF TARIFFS V. SUBSIDIES IN INTERSTATE TRADE

Although the Supreme Court has distinguished between (unlawful) tariffs

76. *Id.* at 2215-16 (quoting *Best & Co. v. Maxwell*, 311 U.S. 454, 455-56 (1940) (footnote omitted)).

77. *Id.* at 2214.

78. *See id.* at 2219 (Scalia, J., concurring) (reasoning that "subsidies funded from general state revenues . . . almost invariably include moneys from use taxes on out-of-state products").

79. *See supra* note 20 and accompanying text.

80. *See supra* note 17 and accompanying text.

81. *See, e.g., Antonin Scalia, The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175, 1182-83 (1989).

and (lawful) subsidies, its justification for doing so is unsatisfactory. This part of the Article draws from the economic theory of international trade to argue that the differing treatment of tariffs and subsidies *can* be justified. The analogy between international trade and interstate trade is a close and useful one; states and nations undertake similar sorts of actions that have comparable economic effects.⁸²

Trade theory suggests that although free trade is preferable to both subsidies and tariffs, subsidies generally are preferable to tariffs.⁸³ The basis for preferring subsidies is not, however, that they merely promote local business and have no effect on out-of-state producers. Instead, the lower efficiency costs of a subsidy to the nation as a whole, including the state adopting the subsidy, provide an economic justification for preferring subsidies over tariffs. Although both tariffs and subsidies inefficiently increase in-state production, tariffs, unlike subsidies, also inefficiently decrease consumption. Moreover, the costs of obtaining and maintaining the chosen form of protection through the political processes strengthen the economic preference for subsidies over tariffs.⁸⁴ Although subsidies are not efficient and may impose costs on out-of-state producers, they are nonetheless better than tariffs.

82. Several commentators have looked to the international economics literature in analyzing the dormant Commerce Clause, but not in any detail and certainly not with any consideration of rent-seeking. See, e.g., Richard B. Collins, *Economic Union as a Constitutional Value*, 63 N.Y.U. L. REV. 43, 98 & n.332 (1988); Mark P. Gergen, *The Selfish State and the Market*, 66 TEX. L. REV. 1097, 1135 (1988); Levmore, *supra* note 9, at 565 n.4. For a good analysis of dormant Commerce Clause challenges to state taxes from a public finance economics perspective, see Schoettle, *supra* note 9, at 910-15.

83. See *infra* notes 168-70 and accompanying text.

84. This economic analysis provides insights for both competing theoretical approaches to the dormant Commerce Clause. See Julian N. Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425, 437-43 (1982); Levmore, *supra* note 9, at 567-68; see also Farber & Hudec, *supra* note 6, at 1407 (offering a hybrid theory). The first approach (the "value" approach) argues that the constitution prohibits state protectionism for substantive reasons—because of the benefits of free trade to the nation as a whole. See, e.g., Collins, *supra* note 82, at 44, 62-64; Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1113-25 (1986). The other approach (the "process" approach) argues that the Constitution seeks to protect those who, because of the workings of the political process, are disadvantaged in protecting themselves from protectionist state laws. See, e.g., Eule, *supra*, at 455-74; Daniel A. Farber, *State Regulation and the Dormant Commerce Clause*, 3 CONST. COMMENTARY 395, 400-03 (1986); Jacques Le Boeuf, *The Economics of Federalism and the Proper Scope of the Federal Commerce Power*, 31 SAN DIEGO L. REV. 555, 609-15 (1994); Mark Tushnet, *Rethinking the Dormant Commerce Clause*, 1979 WIS. L. REV. 125, 130-41. But see Farber & Hudec, *supra* note 6 (Farber expressing somewhat different views than in his previous article). Traditional international trade theory is most directly relevant to the value approach. Rent-seeking analysis is helpful for both theoretical approaches.

In addition to helping understand the Supreme Court's distinction between tariffs and subsidies, the economic analysis that follows helps in applying the distinction. The Court seems likely to continue to approve of state subsidies and to invalidate state tariffs. The problem then becomes one of characterization: is a challenged state law more like a lawful subsidy or more like an unlawful tariff? The following analysis suggests a framework for making that determination that broadly applies and that makes sense of the reported cases.

A. *The International Economics of Tariffs v. Subsidies*

The international economics literature provides a rich source for comparing the effects of tariffs and subsidies on social welfare.⁸⁵ The following analysis draws from that literature, relying on a simple partial equilibrium model of trade between two states that together comprise a nation.⁸⁶ As will quickly become apparent, the analysis closely parallels the basic antitrust economics of competition versus monopoly (or more accurately, monopsony).⁸⁷

The precise welfare effects of tariffs versus subsidies depend on whether the importing state is a "small" state or a "large" state.⁸⁸ A small state is

85. For good expositions of the theory, see generally CHARLES P. KINDLEBERGER & PETER H. LINDERT, *INTERNATIONAL ECONOMICS* 107-47 (6th ed. 1978); BO SÖDERSTEN & GEOFFREY REED, *INTERNATIONAL ECONOMICS* 189-262 (3d ed. 1994). For a more rigorous analysis, see NEIL VOUSDEN, *THE ECONOMICS OF TRADE PROTECTION* 3-59 (1990).

86. Södersten and Reed explain the limitations of partial equilibrium analysis as follows:

We must make the usual *ceteris paribus* assumption, which implies that we should be wary of applying this methodology to situations where it is inappropriate. Strictly, we can only use partial equilibrium methods when the change in the policy instrument is small and/or when the market concerned is a small part of, or has very weak linkages with, other parts of the economy, and/or where the change in policy we are considering is not part of a larger package of measures.

SÖDERSTEN & REED, *supra* note 85, at 190-91; see also Alan O. Sykes, *Countervailing Duty Law: An Economic Perspective*, 89 COLUM. L. REV. 199, 215 n.76 (1989) (using partial equilibrium model to evaluate economics of countervailing duties). The two-state model is conceptually the same as a model in which one state trades with the rest of the country. SÖDERSTEN & REED, *supra* note 85, at 190.

87. For treatments of antitrust economics, see generally HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY* §§ 1.1-3 (1994); RICHARD A. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* (1976); E. THOMAS SULLIVAN & HERBERT HOVENKAMP, *ANTITRUST LAW, POLICY AND PROCEDURE* 49-69 (3d ed. 1994).

88. This Article focuses on importing states: states that impose tariffs on imported goods or subsidize in-state producers that compete with imports. The theory, with appropriate modifications, also applies to exporting states.

defined as a price-taker in the good imported: a change in the quantity that the state demands does not affect the national price for the good.⁸⁹ A small state is thus like a purchaser in a perfectly competitive market—an individual whose decision to buy more or less milk at a grocery store does not affect the market price of milk.⁹⁰ A large state is a price-setter, and a change in its quantity demanded does affect the national price for a good.⁹¹ It acts like a monopolist—a buyer with monopoly power.⁹²

1. *Tariff in a Small State*

Begin with the case of a tariff on widgets enacted by a small state (“State *S*”). Without the tariff, the price State *S* pays for widgets will be the national price. Because State *S* can import any quantity at that price, no one in State *S* would buy widgets priced higher than the national price. Thus, the market price for widgets—both domestically produced and imported—will be the national price.⁹³

When State *S* enacts a tariff,⁹⁴ the domestic price increases by the amount of the tariff. This price increase affects both consumption and production of widgets in State *S*.⁹⁵ Because the price of widgets has gone up, the consumption of widgets falls.⁹⁶ Persons in State *S* who would have bought widgets at the national price do not buy them at the national price plus the tariff. These persons are worse off as a result of the tariff because they no longer buy widgets that they otherwise would have bought. This loss of

89. See SÖDERSTEN & REED, *supra* note 85, at 200; VOUSDEN, *supra* note 85, at 25.

90. See, e.g., HOVENKAMP, *supra* note 87, § 1.1a.

91. See SÖDERSTEN & REED, *supra* note 85, at 191; VOUSDEN, *supra* note 85, at 84.

92. See generally ROGER D. BLAIR & JEFFREY L. HARRISON, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* 36-61 (1993) (describing economic theory of monopsony).

93. Economists long have recognized that trade between two states can benefit both, even if one produces all goods more efficiently than the other. DAVID RICARDO, *PRINCIPLES OF POLITICAL ECONOMY AND TAXATION* 128-49 (Piero Sraffa ed., 1951) (positing the “theory of comparative advantage”); see also CHARLES K. ROWLEY ET AL., *TRADE PROTECTION IN THE UNITED STATES* 4-5 (1995); I ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 452-54 (R.H. Campbell & A.S. Skinner eds., 1976) (theory of absolute advantage).

94. A tariff can be imposed either in a flat amount per unit (a “specific” tariff) or as a percentage of the value of the good (an “ad valorem” tariff). For simplicity, here it is assumed that the tariff is an ad valorem one.

95. For a graphical analysis, see SÖDERSTEN & REED, *supra* note 85, at 200-01 & fig. 10.8.

96. This assumes of course that the demand for widgets is not perfectly price inelastic, i.e., wholly unaffected by price changes.

consumer surplus⁹⁷ is known as the “consumption loss” of a tariff.⁹⁸

In addition, because the price of imported widgets has gone up (by the amount of the tariff), domestic producers will increase their output of widgets.⁹⁹ But these new domestic widgets will be more costly to produce than the imported widgets that were displaced; otherwise, they would have been produced before the tariff was enacted. The price increase resulting from the tariff encourages these higher cost producers to make widgets using resources that could have been used more efficiently elsewhere. This loss is known as the “production loss” of a tariff.¹⁰⁰

The tariff in State *S* also has distributional consequences. The tariff transfers wealth from consumers, who purchase domestically produced widgets at the higher, tariff-enhanced price, to domestic producers.¹⁰¹ In addition, unless the tariff is so high as to exclude all imports—i.e., a prohibitive tariff—the tariff also raises revenue for the government at the expense of consumers buying imported goods.¹⁰² Thus, consumers are worse off, and domestic producers and the beneficiaries of government spending are better off, under a tariff.¹⁰³ Moreover, State *S* as a whole is worse off because of the dead-weight consumption and production losses.¹⁰⁴

But the tariff in State *S* does not harm the welfare of the rest of the country. Because by assumption a small state is a price-taker, a change in the

97. Consumer surplus is the difference between the market price of the good and what consumers would have been willing to pay for the good. JACK HIRSHLEIFER, *PRICE THEORY AND APPLICATIONS* 212-14 (2d ed. 1980). For the marginal consumer, consumer surplus is zero because the price that consumer paid was exactly equal to the value to him or her of the good. Other consumers, however, would have been willing to pay more for the good, and so the value of the good to them exceeds the market price.

98. W.M. CORDEN, *TRADE POLICY AND ECONOMIC WELFARE* 12-13 (1974); KINDLEBERGER & LINDERT, *supra* note 85, at 108-11; SÖDERSTEN & REED, *supra* note 85, at 195.

99. This assumes that the supply of widgets is not price inelastic.

100. CORDEN, *supra* note 98, at 12-13; KINDLEBERGER & LINDERT, *supra* note 85, at 111-12; SÖDERSTEN & REED, *supra* note 85, at 195.

101. *E.g.*, SÖDERSTEN & REED, *supra* note 85, at 201.

102. KINDLEBERGER & LINDERT, *supra* note 85, at 115-16; SÖDERSTEN & REED, *supra* note 85, at 201.

103. The traditional welfare economics assumption is that the utility of a dollar in the hands of a consumer is the same as the utility of a dollar in the hands of a producer. In other words, these wealth distribution effects are merely transfers and do not reduce overall societal welfare. *See, e.g.*, Oliver E. Williamson, *Economies as an Antitrust Defense Revisited*, 125 U. PA. L. REV. 699, 711 (1977). If that assumption is rejected, however, the total welfare costs of tariffs will either increase (if consumers are favored) or decrease (if producers are favored). KINDLEBERGER & LINDERT, *supra* note 85, at 116-19.

104. In addition, society will be worse off by the amount of any rent-seeking costs—costs incurred by the affected groups in seeking or fending off protection. Those costs are discussed in Part III.B.

amount that it imports does not affect the national price.¹⁰⁵ State *S* will import fewer widgets, but by assumption the market will accommodate the decrease in demand without affecting the price for the rest of the nation. A tariff is less efficient than free trade, but all of the efficiency costs are borne within the state enacting the tariff.

2. *Subsidy in a Small State*

The effect of a subsidy to widget producers in State *S* differs from the effect of a comparable tariff.¹⁰⁶ Like the tariff, the subsidy will not hurt out-of-state producers or consumers, again because of the assumption that the small state is a price-taker.¹⁰⁷ Within State *S*, a subsidy of comparable magnitude to the tariff will have an identical production loss. The subsidy will enable higher cost domestic producers of widgets to increase production at the expense of lower cost, out-of-state producers, with a similar waste of resources as the tariff.¹⁰⁸ Unlike the tariff, however, a subsidy has no consumption loss.¹⁰⁹ Goods continue to be imported at the national price, consumers continue to pay that price, and consumption is unchanged.¹¹⁰ The effect of the subsidy is to enable domestic producers to increase production at that price. A subsidy is still inefficient, but it is less inefficient than a tariff.

The reason a subsidy is less inefficient than a tariff is because of a key assumption about how the subsidy is financed. The above conclusion holds true only if the subsidy's funding source does not itself distort the economy.¹¹¹ Thus, if State *S* funds the subsidy by a lump-sum head tax, the

105. Alternatively, the issue might be viewed as one of the incidence of the tax: whether out-of-state producers in fact bear the burden of the tax. See Charles E. McLure, Jr., *Incidence Analysis and the Supreme Court: An Examination of Four Cases from the 1980 Term*, 1 SUP. CT. ECON. REV. 69, 94-97 (1982). Market dominance again is a central consideration. *Id.* at 77.

106. By comparable, I mean one that results in a similar increase in domestic production. SÖDERSTEN & REED, *supra* note 85, at 210.

107. See *supra* text accompanying notes 89-90.

108. KINDLEBERGER & LINDERT, *supra* note 85, at 138-40; SÖDERSTEN & REED, *supra* note 85, at 210-11.

109. This assumes that the subsidy is financed by a tax that does not itself distort the economy. See *infra* notes 111-16 and accompanying text.

110. Some legal commentators have recognized this difference (in non-economic terms) between tariffs and subsidies. See, e.g., Jonathan D. Varat, *State "Citizenship" and Interstate Equality*, 48 U. CHI. L. REV. 487, 544 (1981); *The Supreme Court, 1975 Term, supra* note 52, at 61.

111. E.g., W. MAX CORDEN, PROTECTION, GROWTH AND TRADE 37 (1985); CORDEN, *supra* note 98, at 25 (assuming subsidy "financed by a non-distorting tax"); KINDLEBERGER & LINDERT, *supra* note 85, at 140 n.1; see Edgar K. Browning, *Subsidies Financed with Distorting Taxes*, 46 NAT'L TAX J. 121, 122-27 (1993).

only efficiency cost of the subsidy is the production loss.¹¹² But if State *S* funds the subsidy through some tax source that itself causes inefficiencies, the efficiency advantage of a subsidy over a tariff decreases, although in most cases the advantage will still exist.

For example, if the subsidy is financed by an increase in the income tax, persons subject to the tax increase will change their behavior in ways that are inefficient.¹¹³ The efficiency costs of this distortion, which may be small relative to the consumption loss of a tariff, nonetheless need to be added to the production loss of the subsidy.¹¹⁴ In the extreme case of State *S* funding the subsidy by a tax on widgets, the good being subsidized, the welfare consequences of the subsidy will be indistinguishable from those of a tariff.¹¹⁵ Because the tax necessary to finance the subsidy will increase the price of widgets and reduce widget consumption, the subsidy will now have the same consumption loss—as well as the same production loss—as a tariff.¹¹⁶

The distributional consequences of a subsidy also differ from those of a tariff. Because the price of widgets does not go up, consumers in State *S* are unaffected. Instead, the subsidy transfers wealth from taxpayers (or beneficiaries of government spending) to widget producers.¹¹⁷

3. *Tariff in a Large State*

Now take the case of a tariff in a large state (“State *L*”). A large state by definition is a price-setter, not a price-taker. The quantity demanded by State *L* does affect the national price of widgets.¹¹⁸ If State *L* increases its demand for widgets, the national price of widgets will increase. If State *L* reduces its demand for widgets, the national price of widgets will decrease. Thus, when State *L* enacts a tariff on widgets, it is able to shift some of the costs of that tariff to the rest of the nation by changing the terms on which the state trades.

A tariff in State *L* increases the price of widgets in the state, reduces the

112. See KINDLEBERGER & LINDERT, *supra* note 85, at 140 n.1.

113. See CORDEN, *supra* note 111, at 35-36.

114. Kindleberger and Lindert conclude that “[t]hese possible source-of-subsidy distortions would have to be considered in policymaking. Yet it seems reasonable to presume that they are less important than the distorting of consumption” caused by a tariff. KINDLEBERGER & LINDERT, *supra* note 85, at 140 n.1.

115. CORDEN, *supra* note 98, at 44-45.

116. This was what happened in *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 114 S. Ct. 2205 (1994). See *infra* notes 173-82 and accompanying text.

117. SÖDERSTEN & REED, *supra* note 85, at 211.

118. See *supra* text accompanying notes 91-92.

demand for widgets, and increases in-state production. Thus, the tariff causes both a consumption loss and a production loss.¹¹⁹ In addition, the decline in demand in State *L* by assumption reduces the national price for widgets. State *L* thus pays out-of-state producers less for imported widgets than it did before the tariff, although the in-state price including the tariff is still higher than the national price. This is known as the “terms-of-trade gain” from a tariff: State *L* is able to get imported widgets more cheaply than without the tariff.¹²⁰

As a result, the efficiency consequences of a tariff in a large state differ from those of a tariff in a small state. State *L* suffers a production loss and a consumption loss, but achieves a terms-of-trade gain. At certain tariff levels, the gain may exceed the losses, and State *L* may, in fact, be better off as a result of the tariff.¹²¹ However, the net gain to State *L* from the tariff is exceeded by the losses to the rest of the nation. Even if State *L* is better off, the nation as a whole is worse off from the tariff.¹²²

The distributional consequences also differ somewhat from the case of a tariff in a small state. Once again, domestic producers benefit from the price increase, and domestic consumers suffer. Also, beneficiaries of government spending benefit from the tariff revenue. Unlike the case of the small state tariff, however, out-of-state producers lose while out-of-state consumers gain, because the large state tariff depresses the national price.¹²³

4. *Subsidy in a Large State*

The effects of a production subsidy in a large state are likewise more complicated than in a small state, although a subsidy is still more efficient than a tariff for the nation as a whole. The in-state price and the national price of widgets will fall as a result of the subsidy, and output in State *L* will expand. Producers and consumers in State *L* thus are better off. As in a small state, taxpayers and those who benefit from government spending are worse off because of the revenue required to fund the subsidy. However, because of the depressed national price, out-of-state producers suffer, while out-of-state

119. See, e.g., SÖDERSTEN & REED, *supra* note 85, at 195.

120. KINDLEBERGER & LINDERT, *supra* note 85, at 130-34; ROWLEY ET AL., *supra* note 93, at 32-33; SÖDERSTEN & REED, *supra* note 85, at 195.

121. The tariff that makes State *L* best off is the so-called “optimal tariff.” E.g., VOUSDEN, *supra* note 85, at 84-89.

122. KINDLEBERGER & LINDERT, *supra* note 85, at 134; SÖDERSTEN & REED, *supra* note 85, at 195.

123. SÖDERSTEN & REED, *supra* note 85, at 195.

consumers benefit.¹²⁴ State *L* gives up some of the terms-of-trade gain with a subsidy, however, because the national price does not fall as far as with a tariff. To that extent, whether State *L* is better off with the subsidy than with a tariff is less certain. Nonetheless, as with the small state, the rest of the nation and the nation as a whole are better off with a subsidy than with a tariff.¹²⁵

5. Other Costs

Tariffs and subsidies have other costs as well. For example, tariffs must be collected and subsidies must be disbursed. These administrative costs are probably lower for a tariff because tariffs have no disbursement costs and may be cheaper to collect (at the time of import) than the taxes used to finance the subsidy.¹²⁶ In addition, a tariff poses a more serious risk of prompting other states to retaliate by enacting their own tariffs.¹²⁷ Such retaliation would multiply the losses from the tariff to the nation as a whole,¹²⁸ strengthening the preference for a subsidy.

B. Tariffs v. Subsidies in the Rent-Seeking Society

The above-described analysis of tariffs versus subsidies is incomplete. It assumes that a "benevolent dictator" decides which form of protection to adopt.¹²⁹ As is now almost a cliché to point out, the political processes do not work that way.¹³⁰ Instead, interested parties expend substantial resources in seeking the rents available from government protection, diverting resources

124. *Id.* at 211.

125. *Id.* at 212.

126. *See, e.g.*, CORDEN, *supra* note 98, at 45-46, 48-50; KINDLEBERGER & LINDERT, *supra* note 85, at 122.

127. *See* 2 ROTUNDA & NOWAK, *supra* note 41, § 11.8, at 28-29.

128. KINDLEBERGER & LINDERT, *supra* note 85, at 134.

129. Arye L. Hillman, *International Trade Policy: Benevolent Dictators and Optimizing Politicians*, 74 PUB. CHOICE 1, 10 (1992).

130. For positive analyses of choice of the form of trade protection in the international trade literature, see ARYE L. HILLMAN, *THE POLITICAL ECONOMY OF PROTECTION* (1989); STEPHEN P. MAGEE ET AL., *BLACK HOLE TARIFFS AND ENDOGENOUS POLICY THEORY: POLITICAL ECONOMY IN GENERAL EQUILIBRIUM* (1989); Stephen P. Magee, *Endogenous Tariff Theory: A Survey*, in *NEOCLASSICAL POLITICAL ECONOMY: THE ANALYSIS OF RENT-SEEKING AND DUP ACTIVITIES* 41 (David C. Colander ed., 1984); and Douglas Nelson, *Endogenous Tariff Theory: A Critical Survey*, 32 AM. J. POL. SCI. 796 (1988). For a recent collection of studies of protection in individual industries, see *THE POLITICAL ECONOMY OF AMERICAN TRADE POLICY* (Anne O. Krueger ed., 1996) (analyzing protection of American automobile, steel, semiconductor, lumber, wheat, and textile and apparel industries).

away from more productive uses.¹³¹ Some groups are more effective than others at obtaining (or fending off) protection, and some forms of protection are more easily and cheaply obtained than others. When such public choice considerations are examined, however, the conclusion remains the same as under the international economic model: there is an economic basis for preferring subsidies to tariffs.

Rent (or economic rent) is the economic term for the extent to which a payment to a resource owner exceeds the resource's opportunity cost.¹³² The pursuit of rents is what makes the free market system work. An innovator earns rents for a period of time before competitors catch up. Those rents provide an incentive to innovate. But, innovation is not the only source of rents. Government regulation also creates rents, such as by restricting entry of competitors and enabling existing businesses to earn monopoly profits.

Firms will seek economic rents and will incur costs in doing so. The costs incurred in seeking and responding to innovation benefit society because innovations create new value.¹³³ But costs incurred in seeking rents through government protection are not so beneficial. Instead of creating new value, parties seeking rents through government intervention are seeking merely to redistribute existing value.¹³⁴ The resources wasted by this rent-seeking¹³⁵

131. On the role of interest groups in regulation, see Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 96 Q.J. ECON. 271 (1981); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (1974); and George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971). See generally William C. Mitchell & Michael C. Munger, *Economic Models of Interest Groups: An Introductory Survey*, 35 AM. J. POL. SCI. 512 (1991) (surveying economic approaches to interest groups in the political process).

132. E.g., James M. Buchanan, *Rent Seeking and Profit Seeking*, in TOWARD A THEORY OF THE RENT-SEEKING SOCIETY 3, 5 (James M. Buchanan et al. eds., 1980). The opportunity cost of a resource is the value of its next-best alternative use.

133. Buchanan refers to these costs as profit-seeking or rent-creation costs. *Id.* at 4, 7; see also Robert D. Tollison, *Rent-Seeking: A Survey*, 35 KYKLOS 575, 577-78 (1982).

134. Gordon Tullock, *The Cost of Transfers*, 24 KYKLOS 629, 642 (1971); see also Edgar K. Browning, *On the Welfare Cost of Transfers*, 27 KYKLOS 374 (1974); Gordon Tullock, *More on the Welfare Cost of Transfers*, 27 KYKLOS 378 (1974).

135. The term "rent-seeking" was first used by Anne O. Krueger in her study of import licenses in India. See Anne O. Krueger, *The Political Economy of the Rent-Seeking Society*, 64 AM. ECON. REV. 291, 291 (1974). Jagdish Bhagwati has referred to similar behavior as "DUP" activities: directly unproductive profit-seeking activities. Jagdish Bhagwati, *Directly Unproductive Profit-Seeking Activities*, 90 J. POL. ECON. 988, 989-90 (1982). Bhagwati's suggested change in terminology was "welcomed with about the same enthusiasm as the American switch to the metric system." Magee, *supra* note 130, at 51 n.2. A precise comparison of rent-seeking and DUP activities is contained in Charles K. Rowley, *Rent-Seeking Versus Directly Unproductive Profit-Seeking Activities*, in THE POLITICAL ECONOMY OF RENT-SEEKING 15 (Charles K. Rowley et al. eds., 1988). Literature surveys

behavior constitute real losses to society that must be considered in evaluating the costs of trade protection and other forms of government intervention.

Estimates of rent-seeking costs vary widely.¹³⁶ Risk-neutral, perfectly informed parties will incur rent-seeking costs equal to the expected value of the rents they are seeking. In such a case, the rents are fully dissipated, and the cost to society of the protection sought is any deadweight losses plus the amount of any transfers.¹³⁷ Identifying the amount of any transfers that result from government protection is an important first step in comparing various means of protection because "*ceteris paribus*, the greater the value of rents available in a particular situation, the higher the level of rent-seeking that would be observed."¹³⁸

Tariffs and subsidies both create opportunities for rent-seeking.¹³⁹ A tariff in a small state transfers wealth from consumers, who pay higher prices, to producers and to the government treasury. Thus, import-competing producers, their employees, and those who benefit from increased government spending all have incentives to lobby for tariffs.¹⁴⁰ A tariff in a

include Michael A. Brooks & Ben J. Heijdra, *An Exploration of Rent-Seeking*, 65 *ECON. REC.* 32 (1989) and Tollison, *supra* note 133, at 575.

136. Rigoberto A. Lopez & Emilio Pagoulatos, *Rent Seeking and the Welfare Cost of Trade Barriers*, 79 *PUB. CHOICE* 149, 158 (1994). See generally GORDON TULLOCK, *THE ECONOMICS OF SPECIAL PRIVILEGE AND RENT SEEKING* 3-45 (1989); William R. Dougan & James M. Snyder, *Are Rents Fully Dissipated?*, 77 *PUB. CHOICE* 793 (1993); William R. Dougan & James M. Snyder, *The Cost of Rent Seeking: Reply*, 82 *PUB. CHOICE* 185 (1995); Robert D. Tollison, *Is the Theory of Rent-Seeking Here to Stay?*, in *DEMOCRACY AND PUBLIC CHOICE: ESSAYS IN HONOR OF GORDON TULLOCK* 143, 148-49 (Charles K. Rowley ed., 1987); Gordon Tullock, *Are Rents Fully Dissipated? Comment*, 82 *PUB. CHOICE* 181 (1995). In this second-best world it should not be surprising that there are certain circumstances in which rent-seeking behavior may benefit society. Bhagwati, *supra* note 135, at 994; Jagdish N. Bhagwati, *Lobbying & Welfare*, 14 *J. PUB. ECON.* 355, 359 (1980). However, these circumstances are very much "an exception and not a rule." Magee, *supra* note 130, at 47.

137. The same insight is now commonplace in antitrust economics as well. *E.g.*, HOVENKAMP, *supra* note 87, § 1.3c; SULLIVAN & HOVENKAMP, *supra* note 87, at 69. The application to the costs of monopoly originated in Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 *W. ECON. J.* 224 (1967) and Richard A. Posner, *The Social Costs of Monopoly & Regulation*, 83 *J. POL. ECON.* 807 (1975).

138. Russell Pittman, *Rent-seeking and Market Structure: Comment*, 58 *PUB. CHOICE* 173, 173 (1988).

139. Gordon Tullock was the first to recognize this. Tullock, *supra* note 137, at 226-27. Tullock's article preceded Krueger's, *supra* note 135, by a number of years, although he did not refer to the costs he identified as "rent-seeking" costs.

140. ROWLEY ET AL., *supra* note 93, at 103; Anne O. Krueger, *Conclusions*, in *THE POLITICAL ECONOMY OF AMERICAN TRADE POLICY*, *supra* note 130, at 423, 434-35 (discussing appeals for protection based on plight of workers); Charles K. Rowley & Robert D. Tollison, *Rent-Seeking and Trade Protection*, 41 *AUSSENWIRTSCHAFT* 141, 154 (1986). The incentives of producers and beneficiaries of government spending differ because producers would benefit most from a prohibitive

large state has an additional transfer from out-of-state producers to in-state producers, in-state consumers, and out-of-state consumers because of the reduced national price for the good. A subsidy in a small state transfers wealth from the government treasury (either from taxpayers or competitors for government spending) to producers. A subsidy in a large state benefits in-state consumers, in-state producers, and out-of-state consumers at the expense of the government treasury and out-of-state producers.

In-state producers and their employees gain the same rents from a comparable tariff or subsidy. Thus, if all else were equal, they have no ground for preferring either tariffs or subsidies to the other. But all else is not equal.¹⁴¹

First, subsidies, at least in their pure form, are more “transparent” than tariffs—that is, their costs are more obvious to voters.¹⁴² With a subsidy, there is a state budget item that precisely quantifies the amount paid to domestic producers. That information is simply and cheaply available. The costs of tariffs are less readily observable and more difficult to measure. Because of the asymmetric availability of information, voters are more likely to remain rationally ignorant about the costs of tariffs, and political opposition to their enactment will be less.¹⁴³ Thus, the rent-seeking costs for obtaining a

tariff while the others would prefer a tariff that maximized tariff revenue. Rowley & Tollison, *supra*, at 154. The interests of employers and employees may diverge as to some issues, *cf.* Robert Howse & Michael J. Trebilcock, *Protecting the Employment Bargain*, 43 U. TORONTO L.J. 751, 787-88 (1993) (discussing employees’ interest in regulations of corporate takeovers), but would seem to coincide in preferring a tariff over a production subsidy. Smugglers would favor a tariff over a subsidy, although their interests obviously differ from those of the other groups favoring the tariff. ROWLEY ET AL., *supra* note 93, at 103-04; Rowley & Tollison, *supra*, at 154.

141. Legal commentators have touched on various differences between tariffs and subsidies but have not fully spelled out why the differences matter. *E.g.*, Coenen, *Untangling*, *supra* note 68, at 479 (reasoning that “even low-cost subsidies present visible preferences of one in-state constituency over another; thus, they are more likely than tariffs to engender resistance in the local legislative process”); Collins, *supra* note 82, at 102 (noting that the “immediate expense [of subsidies] is borne by the state treasury or other state property”); Regan, *supra* note 84, at 1194 (arguing that subsidies “involve spending and are therefore relatively expensive as a way of securing local benefit”); Varat, *supra* note 110, at 541 (noting that “monetary resources are finite; making funds available for one purpose, or for one group, makes them unavailable for use by another”).

142. Subsidies can be made less transparent without too much difficulty. This likely explains why subsidies usually are not lump-sum payments to producers but instead are based on the level of production or some similar factor. *Cf.* ROBERT E. BALDWIN, *NONTARIFF DISTORTIONS OF INTERNATIONAL TRADE* 111 n.1 (1970). It also helps explain the prevalence of government loan programs.

143. Perhaps the best statement of the transparency justification for preferring subsidies over tariffs is by W. Max Corden.

A subsidy financed by tax revenue and hence going through the budget makes it obvious that an industry is protected. A clear sum of money stands witness to the cost, even though it is not, strictly, a measure of welfare cost. By contrast, a tariff or quota hides the reality. Quite elaborate

particular level of protection will be greater for subsidies than for tariffs, with the result that fewer subsidies will be enacted.¹⁴⁴

Second, groups other than in-state producers are affected differently by tariffs and subsidies. Tariffs raise revenue, thus benefiting taxpayers and the beneficiaries of government spending, while subsidies, which require the outlay of government funds, disadvantage those same groups.¹⁴⁵ Additionally, tariffs burden consumers, who pay higher prices, while subsidies (at least in a small state) do not affect consumers. Of the affected groups, consumers are likely to have the highest costs of organizing and the least at stake.¹⁴⁶ Taxpayers,¹⁴⁷ and certainly the beneficiaries of government spending,¹⁴⁸ are

research may be needed to calculate the subsidy-equivalent of the tariff or quota. . . . Protection unnoticed is protection more secure. . . . For this very reason—the obscurantist aspect of tariffs and quotas—free-trade-minded economists preferred subsidies to tariffs long before the theory of domestic distortions was developed. The chances of sustained protection are certainly less with subsidies than with tariffs, so that it is in the interests of exporters and relevant consumers that explicit subsidies rather than tariffs are used as protection devices.

CORDEN, *supra* note 98, at 56; *see also* CORDEN, *supra* note 111, at 43-44; HILLMAN, *supra* note 130, at 73-74; MAGEE ET AL., *supra* note 130, at 257-63 (positing the “principle of *optimal obfuscation*” by which transparency benefits of particular means of protection are balanced against the efficiency costs of that means to obtain the “optimal level of obfuscation”); ROWLEY ET AL., *supra* note 93, at 103; Stephen Coate & Stephen Morris, *On the Form of Transfers to Special Interests*, 103 J. POL. ECON. 1210, 1230 (1995); *cf.* Pennell v. City of San Jose, 485 U.S. 1, 22-23 (1988) (Scalia, J., concurring in part and dissenting in part) (transparency as grounds for preferring subsidy to regulation).

144. *See* Michael A. Crew & Charles K. Rowley, *Toward a Public Choice Theory of Monopoly Regulation*, 57 PUB. CHOICE 49, 57 (1988). Crew and Rowley argue:

Rent-seeking into the property rights of others stimulates a rent-protection reaction from those whose wealth is placed at risk. The more transparent the rent-seeking, the more vigorous, predictably, will be the response. Tax/subsidy redistribution, therefore, is highly wasteful of resources (as a consequence of rent dissipation rather than deadweight loss) to the extent that it occurs. The heavy losses involved, and the limited redistribution that results, limit the extent of this political market equilibrium.

Id. at 57.

145. Rent-seeking also can alter the welfare preferences for the forms of taxation used to finance the subsidy. *See* Dwight R. Lee & Robert D. Tollison, *Optimal Taxation in a Rent-Seeking Environment*, in THE POLITICAL ECONOMY OF RENT-SEEKING, *supra* note 135, at 339, 348-49; Posner, *supra* note 137, at 825-26.

146. *E.g.*, MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION 29, 48 (1965); ROWLEY ET AL., *supra* note 93, at 19, 92-93; SHAVIRO, *supra* note 3, at 44; VOUSDEN, *supra* note 85, at 181-82; *see also* Fred S. McChesney, *Rent Extraction and Interest-Group Organization in a Coasean Model of Regulation*, 20 J. LEGAL STUD. 73, 85 (1991). However, this general result may not hold for consumers of certain products, who may have substantial stakes and be well organized.

147. CORDEN, *supra* note 111, at 43-44 (“Since the raising of explicit taxes—as distinct from taxing consumers indirectly through tariffs or import quotas—is politically difficult, pressure groups demanding subsidies are more likely to be resisted than those demanding tariffs or quotas.”); Collins, *supra* note 82, at 102-03. Alternatively, this may be a manifestation of the greater transparency of subsidies. *See supra* notes 144-45 and accompanying text.

likely to be better organized than consumers.¹⁴⁹ This difference in ability to organize suggests that efforts to obtain subsidies will provoke a more potent response than efforts to obtain tariffs. Again, the rent-seeking costs for a given subsidy are likely to be greater than for a comparable tariff, making it likely that in equilibrium there will be fewer subsidies than tariffs.

For both of the above reasons, obtaining rents via a subsidy is more costly to a party than obtaining equal rents via a tariff. Rent-seeking costs per dollar of rent obtained via subsidy are greater than the costs for a comparable tariff. Because the total rents available to producers are the same for both,¹⁵⁰ the total rent-seeking costs are likely to be comparable. The higher effective cost of obtaining a subsidy means that there will be fewer subsidies than tariffs. Therefore, the overall deadweight losses from subsidies (which were lower than tariffs to begin with) will be even lower.¹⁵¹

A final difference between tariffs and subsidies is that a subsidy is a less durable form of protection than a tariff.¹⁵² Subsidies must be appropriated by

148. If nothing else, the beneficiaries of government spending were sufficiently well organized to obtain those benefits in the first place.

149. In addition, when the state enacting the tariff or subsidy is a large state, disadvantaged out-of-state producers will be less able to participate in the political processes of the state than domestic beneficiaries of the protection. This, of course, is the rationale of the political process theories of the dormant Commerce Clause. *See supra* note 84.

150. *See supra* note 106 and accompanying text

151. Dani Rodrik argues that tariffs are preferable to subsidies because of greater free riding on lobbying for tariffs than for subsidies. Dani Rodrik, *Tariffs, Subsidies, and Welfare with Endogenous Policy*, 21 J. INT'L ECON. 284, 285-87 (1986). Tariffs benefit all producers in an industry, whether the producer lobbies for tariff protection or not. A producer thus has an incentive to free ride on the lobbying efforts of others: it will receive the benefits of any tariff without incurring any of the costs. As a result, there will be fewer lobbying expenditures and less protection than optimal for the industry. Because subsidies can be firm-specific, they are less subject to this sort of free riding. *Id.*; *see* Edna Loehman et al., *Free-Rider Effects in Rent-Seeking Groups Competing for Public Goods*, 86 PUB. CHOICE 35, 51 (1996) (experimental model finding free riding in rent-seeking setting). Such firm-specific subsidies are uncommon in litigation under the dormant Commerce Clause, *see supra* note 9; therefore, Rodrik's argument, while valid, is not decisive in this analysis. The argument suggests, however, that relocation subsidies, which are likely to be firm-specific, may have greater rent-seeking costs than production subsidies of the kind addressed in this Article.

Jean-Luc Migué contends that only producers in supply-inelastic industries will support subsidies because otherwise new entry will tend to dissipate the rents available through subsidies. Jean-Luc Migué, *Controls Versus Subsidies in the Economic Theory of Regulation*, 20 J.L. & ECON. 213, 214-16 (1977); *see also* Stigler, *supra* note 131, at 4-5. But the same is true for tariffs because tariffs do not restrict entry of new producers any more than subsidies. ROWLEY ET AL., *supra* note 93, at 104; Rowley & Tollison, *supra* note 140, at 155. *But see* Migué, *supra*, at 220.

152. For the role of an independent judiciary in enhancing the durability of legislation, *see* William M. Landes & Richard A. Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 J.L. & ECON. 875 (1975) and Gary M. Anderson et al., *On the Incentives of Judges to Enforce Legislative Wealth Transfers*, 32 J.L. & ECON. 215 (1989).

the state legislature on an annual basis. Thus, subsidies require ongoing lobbying by protected industries in order to assure that protection continues. Conversely, tariffs are not automatically revisited on a year-to-year basis. Once a tariff is enacted, it continues to protect the industry until affirmatively repealed by the legislature.¹⁵³ Durability affects principally the timing of rent-seeking costs. More durable forms of protection have greater sunk rent-seeking costs, meaning that the costs cannot be recouped. Because the costs are sunk, there is less benefit to later removing the protection. Less durable forms of protection, on the other hand, will have greater ongoing rent-seeking expenditures and less up-front expenditure.¹⁵⁴

Because subsidies are less durable than tariffs, there should be a greater future savings of rent-seeking costs from eliminating a subsidy than a tariff. Further, the potential benefit from eliminating the subsidy also provides political incentives to do just that—again reducing the aggregate deadweight losses from subsidies.¹⁵⁵ However, the constitutional prohibition on state tariffs makes tariffs less durable than they otherwise would be, reduces the sunk expenditures in obtaining tariff protection, and makes tariff protection far less likely.

C. Implications of the Economic Model

This economic analysis has a number of implications for the legal analysis of tariffs versus subsidies under the dormant Commerce Clause.

1. Neither Small State Tariffs Nor Subsidies Cause Welfare Losses in Other States

A tariff enacted by a state that lacks the ability to affect the national price of a good by its trading activities—in other words, by a small state—will not

153. Interestingly, this seems not to have been the case in colonial days. Willard Clark Fisher comments on the “short duration of colonial acts”:

Following a precedent set by the Parliament in many customs acts, the colonial tariffs were not enacted to stand for a long term of years or until repealed, but for one, two, three, or at most four years, and, in the formula of the times, “thereafter until the end of the next session of the Assembly.” There were, however, occasionally, permanent acts, and on the other hand many for even briefer terms.

Willard C. Fisher, *American Trade Regulations Before 1789*, in 3 PAPERS OF THE AMERICAN HISTORICAL ASSOCIATION 223, 246-47 (New York, Knickerbocker Press 1889).

154. Rowley & Tollison, *supra* note 140, at 146-49.

155. *Id.*

reduce welfare in other states. A tariff will cause efficiency losses, but those losses will be borne by the residents of the state.

That the costs of a tariff are borne solely by a small state does not mean that such states will never enact a tariff. Tariffs and subsidies still redistribute wealth.¹⁵⁶ These distributional consequences provide a strong incentive for organized groups of affected parties to lobby for tariffs and subsidies even if the costs of the favored form of protection are borne solely by state residents.¹⁵⁷

Even though small state tariffs do not have welfare consequences in other states, they are nonetheless unconstitutional. Dormant Commerce Clause doctrine does not require an actual effect on national markets before the tariff is proscribed.¹⁵⁸ One way of rationalizing the doctrine with economic theory might be to say that the reduction in imports by a small state that has enacted a tariff is a sufficient effect on interstate commerce to justify the bar, even if there is no efficiency harm in those states.

Alternatively, the bar on tariffs might be viewed as a rule of per se unconstitutionality, like the per se rule of antitrust liability for price-fixing.¹⁵⁹ Under the antitrust laws, certain agreements among businesses "are so plainly anticompetitive, and so often lack . . . any redeeming virtue, that they are conclusively presumed illegal without further examination."¹⁶⁰ Thus, an agreement to fix prices between two of thirty competing gas stations violates

156. See *supra* notes 101-03, 117 and accompanying text.

157. One international trade commentator goes so far as to argue that although "redistributive rent seeking [by means of trade protection] creates spillover effects on foreigners, . . . [those effects are] mainly as an unintended consequence of the domestic struggle." Peter Moser, *Toward an Open World Order: A Constitutional Economics Approach*, 9 CATO J. 133, 140 (1989).

158. *But see* Treaty Establishing the European Economic Community, Mar. 25, 1957, art. 92, 298 U.N.T.S. 11, 51-52 (providing "any aid, granted by a Member State or granted by means of State resources, in any manner whatsoever, which distorts or threatens to distort competition by favouring certain enterprises or certain productions goods shall, to the extent to which it adversely affects trade between Member States, be deemed incompatible with the Common Market") (emphasis added). See generally GARY C. HUFBAUER & JOANNA SHELTON ERB, *SUBSIDIES IN INTERNATIONAL TRADE* 19-44 (1984) (discussing competing trade impact standards).

159. Comparisons between the antitrust laws and the dormant Commerce Clause are not uncommon. *E.g.*, Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 J.L. & ECON. 23, 46 (1983) (comparing state action doctrine under antitrust laws with dormant Commerce Clause); Daniel J. Gifford, *Federalism, Efficiency, the Commerce Clause, and the Sherman Act: Why We Should Follow a Consistent Free-Market Policy*, 44 EMORY L.J. 1227 (1995) (arguing that dormant Commerce Clause and antitrust laws should be construed "in tandem").

160. *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 8 (1979) (citations and internal quotation marks omitted); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940).

the antitrust laws even though the agreeing parties could not effectively have raised the price above the market price. Similarly, it may be that a state tariff is so plainly anticompetitive and of such little redeeming value that it should be per se unconstitutional.

Whether that is so depends, at least in part, on the empirical question of how frequently states have monopsony power over their imports.¹⁶¹ Most examples of state market power involve exports, not imports.¹⁶² Charles McLure argues that “[d]ominance on the demand side is rare; even states as large as California and New York do not loom large enough in national (and especially world) markets to have an appreciable effect on the net prices of most products that their residents buy.”¹⁶³ That differs from the international arena, in which nations such as the United States may well have monopsony power in certain markets.¹⁶⁴ If McLure is right, then efficiency benefits of free trade for the nation as a whole are less than might be believed.¹⁶⁵

2. *Both Large State Tariffs and Subsidies Cause Welfare Losses in Other States*

In large states, both subsidies and tariffs impose burdens on out-of-state producers. A state with monopsony power can obtain a terms-of-trade gain at the expense of the rest of the nation from either a tariff or a subsidy.¹⁶⁶ Even

161. If small states colluded in adopting tariffs or subsidies, they would more likely be able to exercise monopsony power. *See, e.g.*, McLure, *supra* note 105, at 88 (discussing possibility of collusion by coal-producing states that adopted severance taxes on coal).

162. *E.g.*, Levmore, *supra* note 9, at 571-72.

163. McLure, *supra* note 105, at 77. Judge Easterbrook seems to overlook this point in his analysis of *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984):

[T]he tax exemption, which reduced the price of the Hawaiian products relative to other products, harmed the out-of-state products. The national demand for these products would fall, and with it their price. Part of the 20% tax would be paid by the producers and importers, rather than consumers in Hawaii, through this reduction in the price producers would realize. The harm may not have been large; it takes a big price difference to induce fanciers of fine wines to drink swill instead. But the direction of the effect can be known with certainty.

Frank H. Easterbrook, *The Supreme Court, 1983 Term—Foreword: The Court and the Economic System*, 98 HARV. L. REV. 4, 34 (1984) (footnote omitted). It seems unlikely that Hawaii has sufficient dominance in the national market for alcoholic beverages to be able to affect the market price through a tax exemption that amounted to a tariff. *See infra* notes 195-97 and accompanying text.

164. Commonly given examples are the markets for automobiles and various consumer goods. KINDLEBERGER & LINDERT, *supra* note 85, at 131.

165. However, a prohibition on state tariffs still may be beneficial by reducing the risk of retaliation by other states. *See supra* note 127 and accompanying text.

166. *See supra* notes 118-25 and accompanying text. Levmore argues that subsidies are preferable to tariffs because a state cannot exploit other states by using a subsidy:

though a subsidy in a large state does not in form “burden” interstate commerce, it nonetheless has a very real effect on out-of-state producers. A subsidy drives down the national price of the good and enables the large state to pay less for the goods it imports in the same way as a tariff. Thus, the Supreme Court’s current doctrinal approach to subsidies ignores economic reality in favor of a focus on the form of the state action. Subsidies in large states do not merely assist local business; they benefit it by burdening out-of-state competitors. In the Supreme Court’s parlance,¹⁶⁷ subsidies, like tariffs, also can be protectionist.

3. *Subsidies Are More Efficient Than Tariffs*

Generally, subsidies are a more efficient (or perhaps more accurately, less inefficient) means of state intervention than tariffs. While both tariffs and subsidies cause production losses, subsidies do not have (or at least have smaller) consumption losses.¹⁶⁸ Indeed, when the state is seeking to achieve non-protectionist goals, a subsidy will almost always be preferable on efficiency grounds to the less direct approach of a tariff.¹⁶⁹ When other costs

In all such [subsidy] cases, the statutes are likely to yield increased production levels. Although these statutes might well cause overproduction as inefficient as a monopoly’s underproduction, the legislating state itself pays for its action rather than profits from it, so that the legislature’s judgment may be thought more reliable than parochial.

Levmore, *supra* note 9, at 584; *see id.* (arguing that “the subsidization of both cement production and in-state automobile hulk disposal . . . hardly can promote monopolistic exploitation of other states” (footnotes omitted)); *id.* at 570-72; *see also* 2 ROTUNDA & NOWAK, *supra* note 41, § 11.8, at 28-29 (arguing that subsidies are subject to an “inner political check” that insures state residents pay costs, unlike trade barriers by which “a state tries to shift that cost to out-of-state residents”). Levmore ignores the dangers of monopolistic buyers (monopsonies) that can be just as exploitive. *See supra* notes 87-125 and accompanying text; *see also* Michael T. Maloney et al., *Economic Regulation, Competitive Governments, and Specialized Resources*, 27 J.L. & ECON. 329, 337-38 & n.16 (1984). Indeed, Levmore himself recognizes the effects of monopsony in other contexts, but he disregards those effects of subsidies. *See* Levmore, *supra* note 9, at 591 & n.87 (discussing quarantine that “poses monopoly or monopsony dangers”).

167. *See supra* notes 3-4 and accompanying text. A possible implication of this conclusion is that state subsidies, like tariffs, should be unlawful under the dormant Commerce Clause. Because the Supreme Court seems unlikely to take that path however, this Article instead offers an economic explanation for the Court’s distinction.

168. *See supra* notes 109-14 and accompanying text.

169. CORDEN, *supra* note 98, at 28-33 (positing a “hierarchy of policies” and concluding that a narrowly directed subsidy is preferable to a tariff so long as the end sought to be achieved by the state is not trade-related); KINDLEBERGER & LINDERT, *supra* note 85, at 136-41; SÖDERSTEN & REED, *supra* note 85, at 211 (“The general principle is that when the intention of the government of a small country is to achieve some domestic production or consumption target then a policy directed specifically at that target is preferable on welfare grounds to a trade policy.”); Jagdish Bhagwati &

of tariffs—such as rent-seeking costs and the heightened risk of retaliation—are considered, the preference for subsidies is even stronger.¹⁷⁰

Thus, there is an economic basis for the Supreme Court's distinction between tariffs and subsidies. Subsidies are less costly to the nation as a whole than tariffs. The benefit attends solely to the enacting state when it is a small state, but the rest of the nation benefits when the enacting state is a large state. In addition, transparency and other public choice considerations will result in states enacting fewer subsidies than tariffs, further enhancing the preference for subsidies.

4. Financing Source and Rent-Seeking Characteristics Differentiate Tariffs from Subsidies

Finally, this economic analysis is useful in identifying when a state action should be characterized as a tariff or a subsidy. Two sets of considerations are paramount.

The first is the financing source of the subsidy. The economic effect of a subsidy differs from the effect of a tariff when the subsidy is assumed to be financed by a non-distorting tax. Presumably, the distortion caused by financing a subsidy by a pool of taxes is relatively small, at least as compared to financing the subsidy by a tax on the particular good being subsidized. The greater the distortion caused by the financing source, the more like a tariff a subsidy becomes. The Court considers this factor to some extent now (without explaining why it matters) in indicating that a subsidy funded from the general revenues of the state is constitutional.

The second consideration in differentiating tariffs from subsidies is the various factors identified in the rent-seeking and trade protection analysis. The amount of rents available from the form of protection is important. If the rewards from rent-seeking are greater, all else being equal, rent-seeking costs will be greater. In addition, institutional characteristics are important. A subsidy is more transparent than a tariff, less durable than a tariff, and more

V.K. Ramaswami, *Domestic Distortions, Tariffs and the Theory of the Optimum Subsidy*, 71 J. POL. ECON. 44, 50 (1963); Robert M. Stern, *Conflict and Cooperation in International Economic Policy and Law*, 17 U. PA. J. INT'L ECON. L. 539, 542-43 (1996) (asserting that "trade policy is like 'doing acupuncture with a fork: no matter how carefully you insert one prong, the other is likely to do damage'") (quoting Alan V. Deardorff & Robert M. Stern, *Current Issues in Trade Policy: An Overview*, in U.S. TRADE POLICIES IN A CHANGING WORLD ECONOMY 15, 39 (Robert M. Stern ed. 1987)).

170. See *supra* notes 126-28 and accompanying text.

likely to prompt domestic political opposition. Forms of protection that share these characteristics with subsidies will be less common and thus less costly than tariffs.

D. Characterization Problems

So far, this discussion has focused on distinguishing a tariff from a subsidy funded from state general revenues. Not surprisingly, the reported cases rarely involve such basic forms. Instead, as the Supreme Court pointed out in *West Lynn Creamery*, states “aspire to reap some of the benefits of tariffs by other means.”¹⁷¹ It is these other means that are usually at issue in the cases.

Nevertheless, in characterizing these more difficult cases analogizing to a tariff or a subsidy is useful. Indeed, courts sometimes do so.¹⁷² The above economic discussion suggests the sorts of considerations that will be useful in deciding whether a protective state action is more like an unlawful tariff or a lawful subsidy.

1. Combined Tax and Subsidy

The first characterization problem is a subsidy funded by a tax on the good being subsidized. Such a subsidy was at issue in *West Lynn Creamery v. Healy*.¹⁷³ In *West Lynn Creamery*, the Massachusetts Department of Food and Agriculture issued a pricing order in response to a “state of emergency” facing the Massachusetts dairy industry.¹⁷⁴ The pricing order required all milk dealers in Massachusetts to make a “premium payment” every month into the Massachusetts Dairy Equalization Fund. The premium was calculated by subtracting the federal minimum milk price¹⁷⁵ from \$15.00, dividing the

171. *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 114 S. Ct. 2205, 2211 (1994).

172. *E.g., id.* at 2212; *id.* at 2220 (Scalia, J., concurring); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 514-15 (1935); *Case of the State Freight Tax*, 82 U.S. (15 Wall.) 232, 276-77 (1872); *Alliance for Clean Coal v. Miller*, 44 F.3d 591, 595 (7th Cir. 1995); *New York v. Brown*, 721 F. Supp. 629, 639 (D.N.J. 1989) (“The best method of determining whether a state law regulates interstate commerce—assuming the case is not an obvious one where a State forbids the entry of or imposes a tariff on goods produced in other States—is to inquire whether the statute or regulation has the same effect as a tariff . . .”).

173. 512 U.S. 186, 114 S. Ct. 2205 (1994).

174. The “emergency” was that low dairy prices had forced many Massachusetts dairy farmers to sell their farms. *Id.* at 2209-10.

175. For an economic analysis of the system of federal milk price regulation underlying the events in *West Lynn Creamery*, see Richard D. Ippolito & Robert T. Masson, *The Social Cost of Government*

difference by three, and multiplying that result by the dealer's monthly sales.¹⁷⁶ In the example used by the Court, if the federal price was \$12/cwt. (i.e., per hundred pounds), the premium payment would be \$15 minus \$12 divided by three, or \$1 per cwt. of sales.¹⁷⁷ The premium was set at one-third of the price difference because Massachusetts dairy farmers produced about one-third of the milk sold in the state.¹⁷⁸ The total premiums contributed to the fund were then distributed monthly as a subsidy to Massachusetts milk producers based on their share of total milk production in the state.¹⁷⁹

Under traditional international economic analysis, the milk pricing order is virtually identical to a tariff, even though in form it is a nondiscriminatory tax and subsidy.¹⁸⁰ The combined tax-subsidy in *West Lynn Creamery* caused both a production loss and a consumption loss because the tax increased the price of milk to consumers, even though it was imposed on milk dealers.¹⁸¹ In this respect, the pricing order is more like a tariff and less like a subsidy.¹⁸² The only difference between the Massachusetts milk pricing order and a traditional tariff is that the milk pricing order did not raise any revenue for the government. All of the tax proceeds were distributed to milk producers. Effectively, the pricing order was a tariff in which the tariff revenue was paid to in-state producers—hardly a saving feature.

An examination of the rent-seeking characteristics of the milk pricing order confirms its unconstitutionality. First, the milk pricing order was an

Regulation of Milk, 21 J.L. & ECON. 33 (1978).

176. *West Lynn Creamery*, 114 S. Ct. at 2210.

177. *Id.*

178. *Id.* at 2210 n.5.

179. *Id.* at 2210 & n.8.

180. CORDEN, *supra* note 98, at 44 (positing that a tariff is "the equivalent of a tax on consumers of the product concerned, the revenue from which finances a subsidy to the domestic producers of this product, the rates of consumption tax and production subsidy being the same" (emphasis omitted)); *id.* at 45 (arguing that a tariff is a subsidy "financed in a very particular way—solely by a tax on consumers of that particular product"); CORDEN, *supra* note 111, at 38; *see* Varat, *supra* note 110, at 542 (arguing that "the same impermissible result would be produced if resident and nonresident businesses were equally taxed but only resident businesses received cash subsidy rebates").

181. The State of Massachusetts argued that the likely price increase from the tax was small—only about two cents per gallon of milk. *West Lynn Creamery*, 114 S. Ct. at 2215 n.18. If true, however, that just means that the amount of the tariff was small, which has never been a defense under the dormant Commerce Clause. *Wyoming v. Oklahoma*, 502 U.S. 437, 455 (1992).

182. *See supra* notes 94-98, 109-10, 119, 125 and accompanying text; *cf.* George P. Patterson, Note, *Does the Commerce Clause Value Public Goods?: West Lynn Creamery v. Healy*, 44 CATH. U. L. REV. 977, 1018-19 (1995).

administrative order, not a statute, and therefore easier to enact but also less durable than a statute.¹⁸³ Second, like a tariff and unlike a subsidy, the pricing order benefited producers at the expense of consumers, not taxpayers. The money raised by the milk tax never made it to the general revenues of the state, but was distributed directly to milk producers. Thus, the pricing order increased the rewards for rent-seeking by allowing beneficiaries to avoid the political restraints posed by well-organized competitors for government funds.¹⁸⁴ Third, the milk pricing order was more transparent than a tariff but less transparent than a pure subsidy. The budgetary cost of the pricing order was the total amount paid into the equalization fund, which, like a subsidy, could readily be quantified. But the true economic effect of the pricing order was hidden because the order appeared to be something (a subsidy) that it really was not.

Overall, the similarities to a tariff predominate. Indeed, a tariff probably is preferable to the pricing order: it would provide lower returns for rent-seeking producers because the tariff revenue would go to the state's general revenues and not directly to milk producers.¹⁸⁵ In short, the Supreme Court's decision in *West Lynn Creamery* was correct. The Massachusetts milk pricing order caused the same deadweight losses as a tariff, and from a rent-seeking perspective, the pricing order was more like a tariff than a subsidy from general revenues. The Supreme Court properly struck it down.

183. A similar milk tax/subsidy proposal had previously failed in the Massachusetts state senate by a single vote. Mary Sit, *Massachusetts Dairy Farms in Crisis*, BOSTON GLOBE, Jan. 14, 1992, at B33, available in 1992 WL 4160072.

184. See Arye L. Hillman, *Tariff Revenue Transfers to Protectionist Interests: Compensation for Reduced Protection or Supplementary Reward for Successful Lobbying?*, 58 PUB. CHOICE 169, 171-72 (1988); William H. Kaempfer & Thomas D. Willett, *Combining Rent-Seeking and Public Choice Theory in the Analysis of Tariffs Versus Quotas*, 63 PUB. CHOICE 79, 84 n.8 (1989); Richard B. McKenzie, *Tax/Compensation Schemes: Misleading Advice in a Rent-Seeking Society*, 48 PUB. CHOICE 189, 190 (1986). See generally CHARGING FOR GOVERNMENT: USER CHARGES AND EARMARKED TAXES IN PRINCIPLE AND PRACTICE (Richard E. Wagner ed., 1991).

185. The majority in *West Lynn Creamery* argued that "because the tax was coupled with a subsidy, one of the most powerful of these groups [that would otherwise lobby against the tax], Massachusetts dairy farmers, instead of exerting their influence against the tax, were in fact its primary supporters." *West Lynn Creamery*, 114 S. Ct. at 2215. The majority's analysis has the tail wagging the cow. The pricing order was not structured as it was to buy off opponents of a general milk tax. It was structured as it was to transfer wealth to milk producers with the least political opposition by others. Note that four of the justices flatly rejected the relevance of any such political process reasoning as a component of dormant Commerce Clause analysis. *Id.* at 2221 (Scalia, J., concurring, joined by Thomas, J.); *id.* at 2222 (Rehnquist, C.J., dissenting, joined by Blackmun, J.).

2. Tax Exemptions, Deductions, and Credits

The most common characterization problem involves state tax exemptions, deductions, and credits that are limited to in-state producers. The Supreme Court has described such "tax expenditures"¹⁸⁶ as "a form of subsidy that is administered through the tax system."¹⁸⁷ Yet in recent years, the Court has consistently held state tax exemptions unconstitutional when limited to in-state producers or goods.¹⁸⁸ Are state tax expenditures properly characterized as lawful subsidies or unlawful tariffs? The answer is that it depends on the type of tax from which the exemption, deduction, or credit is given.

In a series of cases beginning in 1977, the Supreme Court has consistently invalidated state tax exemptions and credits that favor local industries.¹⁸⁹ The

186. See STANLEY S. SURREY, *PATHWAYS TO TAX REFORM* 6 (1973); STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* 2-4 (1985); Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1157-62.

187. *Regan v. Taxation With Representation*, 461 U.S. 540, 544 (1983).

188. See *infra* notes 189-94 and accompanying text.

189. Walter Hellerstein discusses five tax exemption cases in his recent "preliminary analysis" of state tax incentives. Walter Hellerstein, *West Lynn Creamery Inc. v. Healy and the Constitutionality of State Tax Incentives: A Preliminary Analysis*, 7 ST. TAX NOTES 1182, 1186-87 (1994) [hereinafter Hellerstein, *Incentives*]; see also Walter Hellerstein, *Commerce Clause Restraints on State Tax Incentives*, THE REGION, June 1996, at 60, 61 (adapted from Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789 (1996)) [hereinafter Hellerstein, *Restraints*]. The two cases involving tax exemptions that operate most clearly like tariffs are discussed in the text of this Article. The other three cases involve tax exemptions adopted by exporting states rather than importing states. Of those three, two involve tax exemptions with tariff-like characteristics designed to protect local industry from the effects of a tax that was paid largely by residents of other states (the problem of tax exporting). See *Maryland v. Louisiana*, 451 U.S. 725, 756-60 (1981) (holding unconstitutional Louisiana tax on "first use" of natural gas in the state that largely exempted gas produced in Louisiana); *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 328-37 (1977) (holding unconstitutional New York's transfer tax on securities transactions that, because of various discounts and caps, taxed out-of-state sales more heavily than in-state sales). See generally WALTER HELLERSTEIN, *STATE AND LOCAL TAXATION OF NATURAL RESOURCES IN THE FEDERAL SYSTEM* 121-29 (1986) (describing economics of tax exportation); Walter Hellerstein, *State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication*, 41 TAX LAW. 37 (1987) (analyzing constitutional limitations on state tax exporting) [hereinafter Hellerstein, *Perspectives*]; McLure, *supra* note 105, at 89-92 (discussing *Maryland v. Louisiana*). The final case is *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984), in which the Court invalidated a New York tax credit from its franchise tax for the export sales of "Domestic International Sales Corporations" originating in New York. The tax credit in *Westinghouse* can be characterized as an export subsidy, *id.* at 406 n.12, which is imposed by an exporting state rather than an importing state but, like a tariff, has both a production loss and a consumption loss. See SÖDERSTEN & REED, *supra* note 85, at 203.

two cases most directly on point are *Bacchus Imports, Ltd. v. Dias*¹⁹⁰ and *New Energy Co. v. Limbach*.¹⁹¹ In *Bacchus*, the Supreme Court struck down a Hawaiian excise tax on the sale of alcoholic beverages because the tax exempted certain locally produced alcoholic beverages. The Court concluded that because there was “some competition between the locally produced exempt products and nonexempt products from outside the State,” the tax had an unconstitutional discriminatory effect.¹⁹² In *New Energy*, the Court invalidated a credit against Ohio’s fuel tax for locally produced ethanol. The credit “explicitly deprive[d] certain products of generally available beneficial tax treatment because they [were] made in certain other states” and was thus facially discriminatory in violation of the dormant Commerce Clause.¹⁹³ These cases, together with broad language in the Supreme Court’s opinion in *West Lynn Creamery*, have prompted several commentators to contend that many, if not all, tax exemptions that favor in-state producers are, or should be, unconstitutional.¹⁹⁴

These cases need not be interpreted so broadly, however. The taxes at issue in *Bacchus* and *New Energy* have essentially the same economic effect

190. 468 U.S. 263, 268-76 (1984).

191. 486 U.S. 269, 273-80 (1988).

192. *Bacchus*, 468 U.S. at 271.

193. *New Energy*, 486 U.S. at 274.

194. For example, Walter Hellerstein concludes that “*West Lynn Creamery* and the decisions on which it rests reaffirm the Court’s strong stance against state taxes that favor local over out-of-state activities and cast a constitutional pall over state tax incentives embodied in many state taxing statutes.” Hellerstein, *Incentives*, *supra* note 189, at 1187. Hellerstein states, however, that

[a]t least one significant category of tax incentives . . . should escape invalidation: those tax incentives which are framed not as exemptions from or reductions of *existing* State tax liability but rather as exemptions from or reductions of *additional* state tax liability to which the taxpayer would be subjected only if the taxpayer were to engage in the targeted activity in the state.

Hellerstein, *Restraints*, *supra* note 189, at 63; see also Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Restraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377 (1996); Hellerstein & Coenen, *supra* note 189. Both the Enrich and Hellerstein & Coenen articles are excellent treatments of the issues addressed here that were published after this Article was completed.

Some commentators argue that *West Lynn Creamery* casts doubt on the constitutionality of all state subsidies. William L. Oemichen, *Milk, State Taxes, State Subsidies, and the Commerce Clause: When States Cannot Tax an Agricultural Commodity to Fund a Subsidy for Its Struggling Industries*, *West Lynn Creamery, Inc. v. Healy*, 114 S. Ct. 2205 (1994), 18 HAMLINE L. REV. 415, 428-29 (1995) (“decision places in constitutional jeopardy the ability of states to subsidize domestic industries”); Christopher P. LaPuma, Note, *Massachusetts Tax and Subsidy Scheme Violates Commerce Clause: West Lynn Creamery, Inc. v. Healy*, 48 TAX LAW. 641, 653 (1995) (noting that the Court in *West Lynn Creamery* “has inadvertently cast doubt on the validity of subsidies themselves”). That fear should be unwarranted. See *supra* notes 173-85 and accompanying text.

as a tariff: because of the exemption or credit, the tax falls largely, if not exclusively, on goods or services imported from out-of-state. Each tax will have both a production loss and a consumption loss, very much as a tariff does. In each case, the tax applies only to the particular good or service at issue—alcoholic beverages and motor vehicle fuel—thus distorting consumption of those goods and services relative to the rest of the economy, just as a tariff would.¹⁹⁵

The rent-seeking characteristics of the tax exemptions and credits invalidated by the Supreme Court also are similar to those of a tariff. The distributional consequences are the same: in-state producers and the beneficiaries of government spending benefit, and consumers lose. The same interest groups would support and oppose the exemptions as would support and oppose a comparable tariff. The exemptions and credits make the tax less transparent than a tariff because the combined working of the tax and of any exemptions is less visible. Tax exemptions and credits are as durable as a tariff because the legislature does not automatically revisit the tax code every year.¹⁹⁶ Thus, the Supreme Court properly treated the tax exemptions at issue in *Bacchus* and *New Energy* as tariffs and held them invalid.¹⁹⁷

The same result does not automatically follow, however, for tax exemptions from broad-based state taxes such as sales and use taxes, property taxes, or income taxes. An exemption from a broad-based state tax operates much less like a tariff than the exemptions and credits at issue in *Bacchus* and *New Energy*. The consumption loss will be less than that of a tariff because presumably the distortion from any increase in the generally applicable tax to “fund” the tax expenditure will be less than the distortion from a tax solely on a single good or service. Moreover, although such a tax exemption avoids the state budgeting process (making it more durable and less subject to

195. The taxes at issue in *Boston Stock Exchange* and *Maryland v. Louisiana* also share that characteristic: they were limited to the good (natural gas) or service (stock transactions) for which the domestic exemption was provided. See *supra* note 189.

196. Coenen, *Untangling*, *supra* note 68, at 480-81. Edward A. Zelinsky argues that, at least on the federal level, tax committees and tax agencies are less likely to be influenced by special interest groups seeking special treatment. Edward A. Zelinsky, *James Madison & Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L.J. 1165 (1993). The complexity of the Internal Revenue Code would seem to belie his argument, however, and he does not suggest that the argument extends to the state level.

197. *But see* Polelle, *supra* note 68, at 686-87 (reporting that in a survey of thirty randomly selected economists, “twenty-two of the thirty found economically unjustified the Supreme Court’s refusal in *Limbach* to treat tax credits and other forms of tax regulation as the legal equivalent of indirect subsidy participation”).

competition for government spending), the tax itself is broadly applicable.¹⁹⁸ Consequently, interest groups in the state that pay the tax or that are seeking their own exemptions have an incentive to oppose an exemption for a specific domestic industry.¹⁹⁹

The tax exemption from a broad-based state tax, therefore, is more like a subsidy funded from general revenues than any of the tax exemptions in the above described cases. It is not identical, to be sure, because a state's general revenues are a combination of revenues from various types of taxes, not just the generally applicable tax, and because the tax exemption, unlike the state budget, is not revisited annually. Nevertheless, it simply is not the case that *West Lynn Creamery*, *Bacchus*, and *New Energy* require the invalidation of all state tax incentive programs that favor in-state producers. In my view, the Supreme Court should uphold those state tax incentives that involve industry-specific exemptions, deductions, or credits from broad-based state taxes. They operate more like a subsidy than a tariff. Only if the tax expenditure operates as a tariff—either because the tax is limited to the good or service at issue or because the exemptions are overly broad—should it be struck down.²⁰⁰

198. Of course, if the exemptions from a broad-based tax were extensive enough—such as an exemption for all domestically produced goods—even such a tax could operate as a tariff (on all imports into the state). *I.M. Darnell & Son v. City of Memphis* may be an example of this type of case. 208 U.S. 113, 115 (1908) (invalidating exemption from Tennessee's sales tax for "direct product of the soil of this state in the hands of the producer and his immediate vendee, and manufactured articles from the produce of the state in the hands of the manufacturer").

199. See, e.g., *Minneapolis Star & Trib. Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575, 585 (1983) ("When the State imposes a generally applicable tax, there is little cause for concern. We need not fear that a government will destroy a selected group of taxpayers by burdensome taxation if it must impose the same burden on the rest of its constituency.").

200. The Supreme Court may shed some light on this question in the pending case of *General Motors Corp. v. Tracy*, 652 N.E.2d 188 (Ohio 1995) (per curiam), cert. granted, 116 S. Ct. 1349 (1996) (No. 95-1232). In *Tracy*, the state of Ohio exempted from its sales and use tax on tangible personal property sales of natural gas by local distribution companies ("LDCs") in Ohio. With the substantial deregulation of the natural gas market, some customers (including plaintiff General Motors) purchase natural gas from interstate brokers instead of the LDC. Those purchases are subject to Ohio's use tax. See *Chrysler Corp. v. Tracy*, 652 N.E.2d 185 (Ohio 1995) (per curiam), cited in *Tracy*, 652 N.E.2d at 189. General Motors is challenging the exemption for LDC sales as unconstitutionally discriminatory under the dormant Commerce Clause. Ohio's main argument is that the tax exemption is not discriminatory because local distribution companies and interstate natural gas brokers are not "similarly situated" industries that must be taxed identically. Brief for Respondent at 23-29, *Tracy*, 116 S. Ct. 1349 (1996) (No. 95-1232). The exemption at issue in the case is an industry-specific exemption from the broad-based sales and use tax, and my analysis would indicate that it should be upheld.

Another pending case, *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 655 A.2d 876, 877 (Me. 1995), cert. granted, 116 S. Ct. 1040 (1996) (No. 94-1988), involves a challenge to a Maine property tax exemption that in essence is available only to nonprofit institutions operated principally for the benefit of Maine residents. Again, the exemption is an industry-specific exemption from a

IV. IMPOSTS, BOUNTIES, AND INTERSTATE TRADE: THE IMPORT-EXPORT CLAUSE AS AN ALTERNATIVE TO DORMANT COMMERCE CLAUSE ANALYSIS

Although the Supreme Court's differing treatment of tariffs and subsidies can be justified as a matter of economics, the doctrinal difficulties remain. Those difficulties would disappear, however, if tariffs and subsidies were analyzed under the Import-Export Clause of the Constitution instead of the dormant Commerce Clause. The Import-Export Clause provides: "No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports."²⁰¹ If applied to interstate trade, the Import-Export Clause would plainly outlaw state tariffs, but leave state subsidies unaffected.

Since the 1868 case of *Woodruff v. Parham*,²⁰² the Supreme Court has interpreted the Import-Export Clause as applying only to imports and exports from foreign nations and not applying to imports and exports from other states. That interpretation is unwarranted.²⁰³ The Framers' plain meaning and

broad-based state tax. The tax exemption in *Camps Newfound/Owatonna*, however, does not appear to protect Maine nonprofit institutions from out-of-state competition. Instead, it seems to be either an attempt to export some of the tax burden to out-of-state residents or else simply an in-state redistributive measure. Thus, the case is distinguishable on its facts from the problem addressed in this Article. The respondent, however, has argued that the tax exemption is a lawful subsidy and that it is valid under the market participant exception to the dormant Commerce Clause. Brief for Respondent at 30-40, *Camps Newfound/Owatonna*, 116 S. Ct. 1040 (1996) (No. 94-1988). As a result, the Supreme Court has the opportunity in the case to clarify some of the doctrinal uncertainty discussed in this Article, *see supra* Part II.C, although whether it will do so remains to be seen.

201. U.S. CONST. art. I, § 10, cl. 2.

202. 75 U.S. (8 Wall.) 123 (1868).

203. I am not the first to contend that the Import-Export Clause applies to interstate trade as well as foreign trade. William Crosskey laid out the argument in most detail. *See* 1 WILLIAM W. CROSSKEY, POLITICS AND THE CONSTITUTION IN THE HISTORY OF THE UNITED STATES 295-323 (1953); 3 WILLIAM W. CROSSKEY & WILLIAM JEFFREY, JR., POLITICS AND THE CONSTITUTION IN THE HISTORY OF THE UNITED STATES 11-13 (1980). However, others made the same argument earlier. *See, e.g.,* American Fertilizing Co. v. Board of Agric., 43 F. 609, 612 (C.C.E.D.N.C. 1890) ("Were it not for the decision in *Woodruff v. Parham* we would not hesitate to say that [the term *import*] included, as Chief Justice Marshall evidently supposed that it did, goods brought from one state into another."); E. PARMALLEE PRENTICE & JOHN G. EGAN, THE COMMERCE CLAUSE OF THE FEDERAL CONSTITUTION 152 n.5 (1898) ("At the same time, Mr. Justice Miller's statement, that at the time of the formation of the Constitution and its preceding discussion the words 'exports' and 'imports' were confined to foreign trade, is perhaps not altogether accurate."). With some exceptions, the argument has received little attention since made by Crosskey. *See, e.g.,* THOMAS R. POWELL, VAGARIES AND VARIETIES IN CONSTITUTIONAL INTERPRETATION 182 (1956) ("I certainly would have agreed that goods from sister states are imports."); SHAVIRO, *supra* note 3, at 66 (positing that "the [dormant Commerce] [C]lause, even if a judicially created fiction, may perform the originally intended function of the import-export clause, . . . if, as some have asserted, that clause meant to apply to the interstate, not just international, movement of goods") (footnote omitted); Hellerstein, *Perspectives, supra* note 189, at 39 ("This clause

the events giving rise to the Constitution strongly support applying the Clause to interstate trade as well as to foreign trade. Moreover, the policy grounds that once supported the *Woodruff* Court's decision have diminished in recent years, as the Supreme Court has narrowed the prohibition of the Import-Export Clause.

If the Import-Export Clause were to apply to interstate trade, the dormant Commerce Clause would not necessarily cease to determine the constitutionality of state tariffs and subsidies (although perhaps by negative implication it might). It is beyond the scope of this Article to examine in detail the arguments that judicial review under the dormant Commerce Clause is illegitimate.²⁰⁴ Regardless of how one views those arguments, however, recognizing that the Import-Export Clause applies to interstate trade is nonetheless important. If one believes that dormant Commerce Clause review is illegitimate, the Import-Export Clause provides a textual basis for a significant part of existing dormant Commerce Clause doctrine—the prohibition on state tariffs²⁰⁵—and for the Supreme Court's distinction between unlawful tariffs and lawful subsidies. By its terms, the Import-Export Clause outlaws duties and excises (i.e., tariffs) on imports.²⁰⁶ It does not,

might have served as a critical restraint on the state taxation of interstate commerce.”); see also FELIX FRANKFURTER, *THE COMMERCE CLAUSE UNDER MARSHALL, TANEY AND WAITE* 37 (1978) (Marshall's extension of the Import-Export Clause to interstate trade “would have unduly contracted the available resources of the states' taxing power”); Collins, *supra* note 82, at 51 n.61. Crosskey's controversial character may be part of the reason the argument has received so little attention, see, e.g., Henry M. Hart, Jr., *Professor Crosskey & Judicial Review*, 67 HARV. L. REV. 1456, 1475, 1486 (1954) (reviewing 2 CROSSKEY, *supra*); Abe Krash, *The Legacy of William Crosskey*, 93 YALE L.J. 959, 959 (1984) (reviewing 3 CROSSKEY & JEFFREY, *supra*), as well as the fact that as interpreted, the dormant Commerce Clause has been serving much the same function, see *supra* notes 21-37 and accompanying text.

204. See *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232, 265 (1987) (Scalia, J., concurring in part and dissenting in part); Steven Breker-Cooper, *The Commerce Clause: The Case for Judicial Non-Intervention*, 69 OR. L. REV. 895, 934-42 (1990); Eule, *supra* note 84, at 429-35; Richard D. Friedman, *Putting the Dormancy Doctrine Out of Its Misery*, 12 CARDOZO L. REV. 1745 (1991); Edmund W. Kitch, *Regulation, the American Common Market and Public Choice*, 6 HARV. J.L. & PUB. POL'Y 119, 123 (1982) (arguing that judicial protection of free trade is “an idea of absolutely no merit”); Patrick C. McGinley, *Trashing the Constitution: Judicial Activism, the Dormant Commerce Clause, and the Federalism Mantra*, 71 OR. L. REV. 409, 455-56 (1992); Martin H. Redish & Shane V. Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 1987 DUKE L.J. 569, 581-90.

205. Other commentators have looked to the Privileges and Immunities Clause, U.S. CONST. art. IV, § 2, cl. 1, for this purpose. E.g., George F. Carpinello, *State Protective Legislation and Nonresident Corporations: The Privileges and Immunities Clause as a Treaty of Nondiscrimination*, 73 IOWA L. REV. 351 (1988); Eule, *supra* note 84, at 446-55; Gergen, *supra* note 82, at 1116-32 (1988); Redish & Nugent, *supra* note 204, at 605-12.

206. U.S. CONST. art. I, § 10, cl. 2.

however, outlaw bounties (i.e., subsidies) limited solely to in-state producers. If one believes that judicial review under the dormant Commerce Clause is proper, the Import-Export Clause provides at the very least historical evidence that supports the Court's distinction between tariffs and subsidies.

A. *Early Interpretations of the Import-Export Clause*

In two early cases, the Supreme Court indicated that the Import-Export Clause applied to interstate trade. The first of these cases was *Brown v. Maryland*.²⁰⁷ In *Brown*, the Court held that a Maryland statute requiring importers of "foreign articles or commodities" to pay \$50 for a license was unconstitutional under the Import-Export Clause.²⁰⁸ Chief Justice Marshall, writing for the Court, concluded that so long as goods "remain[ed] the property of the importer, in his warehouse, in the original form or package in which [they were] imported, a tax upon [the goods was] too plainly a duty on imports to escape the prohibition" of the Import-Export Clause.²⁰⁹

The license fee, as considered by the Court in *Brown*, applied only to importers of "foreign articles"—goods produced in other countries.²¹⁰ In the

207. 25 U.S. (12 Wheat.) 419 (1827).

208. *Id.* at 459-60.

209. *Id.* at 442. Once the goods were sold by the importer, or their original package was broken, the goods would "become incorporated with the general mass of property" of the state and were subject to tax. *Id.* at 443. In addition, Chief Justice Marshall would have permitted states to tax sales by auction: "Auctioneers are persons licensed by the State, and if the importer chooses to employ them, he can as little object to paying for this service, as for any other for which he may apply to an officer of the State." *Id.*

210. *Id.* at 437-38. Professor Crosskey points out that the Maryland statute might be interpreted as applying to interstate imports as well as foreign imports. 1 CROSSKEY, *supra* note 203, at 311 & n.*. The statute required a license for importers "of foreign articles or commodities, of dry goods, wares, or merchandise, . . . or of wine, rum, brandy, whiskey and other distilled spiritous liquors." See *Brown*, 25 U.S. (12 Wheat.) at 436. Dry goods and alcoholic beverages seemingly need not have been of foreign origin to come within the statute. Based on this interpretation, Crosskey argues that the *Brown* Court must have held that the Import-Export Clause invalidated the tax as to state imports as well as foreign imports. 1 CROSSKEY, *supra* note 203, at 311 & n.*.

There is no indication that *Brown* sought to import goods from other states, however, and the Court limits its consideration to the question of "whether the legislature of a State can constitutionally require the importer of *foreign articles* to take out a license from the State, before he shall be permitted to sell a bale or package so imported." *Brown*, 25 U.S. (8 Wheat.) at 436 (emphasis added). Although the Court certainly was concerned with how its holding would be applied to imports from other states, the issue was not before it. That would explain why Chief Justice Marshall defined "[a]n impost, or duty on imports, [as] a custom or a tax levied on articles brought into a country." *Id.* at 437. He focused on imports from other countries rather than on imports from other states because that was the issue the Court faced. However, Chief Justice Marshall's dictum that the principles of the case also applied to interstate trade strongly indicated that his definition of *impost* was not meant to be

second-to-last paragraph of its opinion, however, the Court stated: "It may be proper to add, that we suppose the principles laid down in this case, to apply equally to importations from a sister State."²¹¹ Because no imports from other states were at issue in the case, this statement is dictum.²¹² Moreover, because it immediately followed an analysis by the Court of the legality of the license tax under the Commerce Clause, it might be construed only as referring to that discussion and not to the Import-Export Clause discussion.²¹³ Nonetheless, the dictum in *Brown* is at least suggestive that Chief Justice Marshall would have construed the Import-Export Clause to apply to interstate imports and exports.²¹⁴

Chief Justice Marshall's dictum seemed to come to fruition in *Almy v. California*.²¹⁵ *Almy* was convicted of failing to pay a stamp tax on a bill of lading for gold dust to be shipped from California to New York.²¹⁶ The Supreme Court, in an opinion by Chief Justice Taney, reversed the conviction on the authority of *Brown v. Maryland*.²¹⁷ The opinion frequently referred to trade with foreign countries,²¹⁸ but unlike *Brown* the transaction at issue was purely an interstate one. The Court did not expressly address the question whether the Import-Export Clause applies to interstate trade, but in invalidating the tax on that basis the Court necessarily assumed that it does.

The license fee in *Brown* and the stamp duty in *Almy* both were

exclusive. *See id.* at 449.

211. *Brown*, 25 U.S. (12 Wheat.) at 449.

212. CURRIE, *supra* note 15, at 336 n.46.

213. *Brown*, 25 U.S. (12 Wheat.) at 446-49.

214. *E.g.*, CURRIE, *supra* note 15, at 181 n.162; Hellerstein, *Perspectives*, *supra* note 189, at 39.

215. 65 U.S. (24 How.) 169 (1860). Prior to *Almy*, the Supreme Court in the *License Cases* had cast doubt on Chief Justice Marshall's dictum by upholding a license fee on liquor sales even when applied to gin imported from another state. 46 U.S. (5 How.) 504, 554 (1847); *see id.* at 595 (McLean, J.) (asserting that "neither the facts nor the reasons of [*Brown*] apply to a person who transports an article from one State to another"). Also before *Almy*, a number of state courts had decided that the Import-Export Clause did not apply to interstate trade. *See* *Beall v. State*, 4 Blackf. 107, 109 (Ind. 1835); *Harrison v. Mayor of Vicksburg*, 6 Miss. (3 S. & M.) 581, 586-87 (1844); *State ex rel. Rhett v. Pinckney*, 44 S.C.L. (10 Rich.) 474, 484-86 (1857); *see also* *Padelford, Fay & Co. v. Mayor of Savannah*, 14 Ga. 438, 446 (1854) (concluding that Georgia courts not bound to follow U.S. Supreme Court decisions, including *Brown v. Maryland*).

216. *Almy*, 65 U.S. (24 How.) at 172.

217. *Id.* at 173.

218. *Id.* at 174 ("A bill of lading, therefore, or some equivalent instrument of writing, is invariably associated with every cargo of merchandise exported to a foreign country . . .") (emphasis added); *id.* ("every cargo of every description exported from the United States"); *id.* (bill of lading "always associated with every shipment of articles of commerce from the ports of one country to those of another"); *id.* ("[w]hen such articles are exported to a foreign country").

discriminatory: they were imposed only on imports or exports.²¹⁹ But the Supreme Court rested neither decision on that fact, and subsequent cases failed to recognize its importance. Until recent years, most litigation focused on whether goods remained “imports” and paid little regard to whether the tax at issue was an “impost” or “duty.”²²⁰ As a result, courts broadly applied the “original package” doctrine of *Brown*²²¹ to protect imports even from nondiscriminatory taxation, thereby providing a broad tax exemption for imported goods.²²² So long as the goods remained in their original packages, they were exempt from tax under the Import-Export Clause.

B. *Woodruff v. Parham*

Based on *Almy* and the dictum in *Brown*, the broad prohibition on taxing imports and exports seemed to extend to interstate trade as well as foreign trade. Consequently, states faced the prospect of a severe limitation on their ability to raise revenues. The Supreme Court responded to that fear in *Woodruff v. Parham*,²²³ decided only nine years after *Almy*, and held that the Import-Export Clause did not apply to interstate trade.

The tax at issue in *Woodruff* was a Mobile, Alabama sales tax of 0.5% (50 cents per \$100) on all goods sold in the city.²²⁴ The tax was not discriminatory; to the contrary, by its terms the tax applied equally to the sale of goods produced within and without Alabama, so long as the goods were sold in Mobile.²²⁵ Parham, the tax collector, assessed plaintiffs Woodruff and Parker with a tax of \$1500 on goods produced in other states and sold in Mobile.²²⁶ When the plaintiffs refused to pay, Parham seized “fifty barrels of

219. See 2 ROTUNDA & NOWAK, *supra* note 41, § 13.2, at 132-33.

220. 1 HELLERSTEIN & HELLERSTEIN, *supra* note 32, ¶ 5.02[1], at 5-4 to 5-6; JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, *STATE & LOCAL TAXATION* 346-47 (5th ed. 1988); Walter Hellerstein, *Constitutional Limitations on State Tax Exporting*, 1982 AM. B. FOUND. RES. J. 1, 5.

221. Although *Brown* first introduced the original package doctrine, it was merely dictum in that case because the Court struck down the tax. Subsequent cases firmly adopted the doctrine. See HARTMAN, *supra* note 20, § 5:2, at 193; 2 ROTUNDA & NOWAK, *supra* note 41, § 13.2, at 133-35.

222. See, e.g., *Low v. Austin*, 80 U.S. (13 Wall.) 29, 34 (1871) (nondiscriminatory ad valorem property tax), *overruled*, *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 301 (1976).

223. 75 U.S. (8 Wall.) 123 (1868); see also *Coe v. Errol*, 116 U.S. 517, 527-29 (1886) (extending the holding of *Woodruff* to exports).

224. The facts that follow are taken from the parties' agreed statement of facts, which is reprinted in the opinion of the Alabama Supreme Court. *Woodruff v. Parham*, 41 Ala. 334, 335-36 (1867), *aff'd*, 75 U.S. (8 Wall.) 123 (1868).

225. *Id.* at 335-36.

226. The goods, which the plaintiffs sold for \$300,000, were liquor, tobacco, and various dry

whiskey, and twenty cases of dry goods" in payment of the tax.²²⁷

The plaintiffs filed suit challenging the seizure as a violation of the Import-Export Clause. They argued that the goods had been imported from other states and were still in their original packaging and that under *Brown* and *Almy*, the Import-Export Clause precluded imposition of the tax.²²⁸ The Alabama Supreme Court rejected their argument, concluding that the Import-Export Clause did not apply to interstate trade.²²⁹ The United States Supreme Court, in an opinion written by Justice Miller, affirmed,²³⁰ with Justice Nelson stridently dissenting.²³¹

Although the Court acknowledged that the words *import* and *export* were "susceptible of being applied to" interstate trade,²³² it rejected that interpretation for textual and historical reasons. First, the Court asserted, such an interpretation would make Article I, Section 9 of the Constitution nonsensical. That provision forbids Congress to tax exports from a state, but in interstate trade all exports from one state are imports into another. Thus, the Court concluded, interpreting the word *export* to include interstate exports

goods from New York, Massachusetts, Pennsylvania, Ohio, Missouri, Georgia, and Louisiana. *Id.* at 335-36. At least some of the goods were sold at auction, because either *Woodruff* or *Parker* (or both) was an auctioneer. *Id.* at 335.

227. *Id.*

228. *Id.* at 336.

229. *Id.* at 337. The Alabama Supreme Court relied on its decision in *Hinson v. Lott*, 40 Ala. 123 (1866). At issue in *Hinson* was an Alabama tax on "spiritous liquors" imported into the state from other states and abroad. *Id.* at 123-24. The Alabama Supreme Court held that the tax was invalid as applied to imports from foreign countries, but valid as applied to imports from other states. *Id.* at 131-33. The court reasoned that the Import-Export Clause did not apply to the latter. *Id.* at 137-41. The United States Supreme Court affirmed the decision the same day it decided *Woodruff*, relying on *Woodruff* as the basis for rejecting the Import-Export Clause claim. *Hinson v. Lott*, 75 U.S. (8 Wall.) 148, 150-51 (1868). The Court also rejected a Commerce Clause challenge to the tax in *Hinson*, reasoning that the tax on imported liquor was "complementary" to an identical tax, contained elsewhere in the same statute, on liquor produced in Alabama. *Id.* at 152-53. Taken together, the two provisions taxed all liquor equally.

David Currie has criticized the Supreme Court's decision in *Hinson*, arguing that "the Court seems to have overlooked an allegation that some of the goods had come from foreign countries." CURRIE, *supra* note 15, at 336 n.46; see *Hinson*, 75 U.S. (8 Wall.) at 149. However, the Alabama Supreme Court had invalidated the tax as applied to foreign goods, *Hinson*, 40 Ala. at 131, and there is no indication that the state challenged that holding before the United States Supreme Court.

230. *Woodruff v. Parham*, 75 U.S. (8 Wall.) 123 (1868). Thomas Reed Powell has suggested that the case might have been decided on a narrower ground—the "auction" exception of Chief Justice Marshall in *Brown*, see *supra* note 209. POWELL, *supra* note 203, at 184; Thomas R. Powell, *State Taxation of Imports—When Does an Import Cease to Be an Import?*, 58 HARV. L. REV. 858, 869 (1945).

231. *Woodruff*, 75 U.S. (8 Wall.) at 140-47 (Nelson, J., dissenting).

232. *Id.* at 132.

would prohibit Congress from taxing interstate imports as well, contrary to the plain meaning of Article I, Section 9, and effectively exempting interstate commerce from federal taxes.²³³ Second, the Court argued, as used in the Articles of Confederation, the words *import*, *export*, and *impost* referred exclusively to trade with foreign countries, not between states.²³⁴ Third, the Court reasoned that the debates at the Constitutional Convention on the Import-Export Clause “are full of the subject of the injustice done by the States who had good seaports, by duties levied in those ports on foreign goods designed for States who had no such ports.”²³⁵ The Court inferred that the evil the Clause was intended to cure was state tariffs on foreign trade, not on interstate trade.

The *Woodruff* Court also justified its decision on policy grounds.²³⁶ To illustrate, the Court gave the following examples:

The merchant of Chicago who buys his goods in New York and sells at wholesale in the original packages, may have his millions employed in trade for half a lifetime and escape all State, county, and city taxes; for all that he is worth is invested in goods which he claims to be protected as imports from New York. Neither the State nor the city which protects his life and property can make him contribute a dollar to support its government, improve its thoroughfares or educate its children. The merchant in a town in Massachusetts, who deals only in wholesale, if he purchases his goods in New York, is exempt from taxation. If his neighbor purchase in Boston, he must pay all the taxes which Massachusetts levies with equal justice on the property of all its citizens.²³⁷

233. *Id.* at 132.

234. *Id.* at 133; see ARTICLES OF CONFEDERATION art. 6, § 3, 1 Stat. 4, 5 (1778) (“No State shall lay any imposts or duties which may interfere with any stipulations in treaties, entered into by the United States, in Congress assembled, with any king, prince or State, in pursuance of any treaties already proposed by Congress to the courts of France and Spain.”); *id.* art. 9, § 1, 1 Stat. at 6 (“[N]o treaty of commerce shall be made whereby the legislative power of the respective States shall be restrained from imposing such imposts and duties on foreigners, as their own people are subject to . . .”).

235. *Woodruff*, 75 U.S. (8 Wall.) at 134-36; see *infra* notes 273-77 and accompanying text.

236. Justice Miller wrote that “[i]f we examine for a moment the results of an opposite doctrine, we shall be well satisfied with the wisdom of the Constitution as thus construed.” *Id.* at 136-37. To Professor Powell, this phrasing “call[ed] to mind that of young Master Horner who put in his thumb and pulled out a plum and said: ‘What a good boy am I!’” Powell, *supra* note 230, at 870 n.45; see also POWELL, *supra* note 203, at 183.

237. *Woodruff*, 75 U.S. (8 Wall.) at 137.

Thus, if the Import-Export Clause applied to interstate trade, the Court concluded, “the grossest injustice must prevail, and equality of public burdens in all our large cities is impossible.”²³⁸ This argument, while a valid one, is largely a criticism of the broad protections granted imports under the original package doctrine; it does not justify limiting the Import-Export Clause to foreign trade.²³⁹

Neither *Brown* nor *Almy* required a different result. According to the Court, Chief Justice Marshall’s “casual remark” in *Brown* was merely dictum, and the remark probably was directed only to his own immediately preceding discussion of the Commerce Clause, not to the Import-Export Clause.²⁴⁰ The Court viewed *Almy* as a mistake. Justice Miller wrote that “[i]t seems to have escaped the attention of counsel on both sides, and of the Chief Justice who delivered the opinion, that the case was one of inter-state commerce.”²⁴¹

Justice Miller concluded by sharing his own dictum about the constitutional limits on state taxing power. In a passage that foreshadows modern dormant Commerce Clause doctrine, the Court stressed that the tax being challenged was nondiscriminatory:

There is no attempt to discriminate injuriously against the products of other States or the rights of their citizens, and the case is not, therefore, an attempt to fetter commerce among the States, or to deprive the citizens of other States of any privilege or immunity possessed by citizens of Alabama.²⁴²

The implication is that if the tax were discriminatory, it would be unconstitutional.²⁴³

238. *Id.*

239. If the Import-Export Clause were interpreted as precluding only discriminatory taxes, at least as to goods no longer in transit, none of the Court’s criticisms would persist.

240. *Woodruff*, 75 U.S. (8 Wall.) at 138-39.

241. *Id.* at 137; see FREDERICK H. COOKE, THE COMMERCE CLAUSE OF THE FEDERAL CONSTITUTION 256 n.13 (1908) (concluding that reliance on Import-Export clause in *Almy* “seems to have been an oversight”); CURRIE, *supra* note 15, at 336 n.46.

242. *Woodruff*, 75 (8 Wall.) at 140.

243. In dissent, Justice Nelson argued that (1) nothing in the language of the Import-Export Clause limits its application to foreign commerce, and the Framers very easily could have added such a limitation; and (2) the protection of the Clause would largely be lost if it were limited to foreign trade. *Id.* at 140-42 (Nelson, J., dissenting). Justice Nelson also found support in *Brown*, *Almy*, and Joseph Story’s constitutional law treatise: “We have, therefore, the deliberate opinions of Marshall, and Taney, and Story concurring in this construction—great names in this and in every country where jurisprudence is cultivated as a science, and especially eminent at home as expounders of our constitutional law.” *Id.* at 147 (Nelson, J., dissenting).

The Supreme Court has consistently adhered to its decision in *Woodruff*.²⁴⁴ However, an array of commentators has criticized the opinion.²⁴⁵ One of the most astute critics was Thomas Reed Powell, who chastised the Court for its “dubious literary exegesis and dubious historical inference” and concluded that “[s]o far from compelling is Mr. Justice Miller’s interpretation of the words of Marshall and of the Fathers that it is hard to escape the conclusion that his impelling motive was economic rather than literary.”²⁴⁶ As the following section explains, the *Woodruff* Court’s textual and historical analysis is indeed dubious, and Powell was absolutely correct that the decisive factor in *Woodruff* was economic: the Court’s fear that a contrary decision would too greatly restrict the states’ ability to raise revenues.

C. “*The True Meaning of the Imports and Exports Clause*”²⁴⁷

In my view, the decision in *Woodruff* is incorrect. The Import-Export Clause was intended to outlaw, and should be construed as outlawing, state taxes that act as tariffs on goods imported from other states.²⁴⁸ Imports, within the meaning of the Import-Export Clause, should include all goods brought into a state from without. The term certainly includes goods brought from foreign countries into the United States, but its meaning should not be so limited, as the historical record makes clear.²⁴⁹ The arguments made by the Court in *Woodruff* are not without some force, particularly given the

244. *E.g.*, *Richfield Oil Corp. v. State Bd. of Equalization*, 329 U.S. 69, 78 (1946); *Hooven & Allison Co. v. Evatt*, 324 U.S. 652, 658 (1945), *overruled on other grounds*, *Limbach v. Hooven & Allison Co.*, 466 U.S. 353 (1984); *Sonneborn Bros. v. Cureton*, 262 U.S. 506, 510-12 (1923); *American Steel & Wire Co. v. Speed*, 192 U.S. 500, 519-22 (1904); *Pittsburgh & S. Coal Co. v. Louisiana*, 156 U.S. 590, 600 (1895); *Brown v. Houston*, 114 U.S. 622, 628-30 (1885).

245. *E.g.*, 1 CROSSKEY, *supra* note 203, at 315; CURRIE, *supra* note 15, at 336 (referring to Justice Miller’s “well-written though disputable refutation” of *Brown v. Maryland*); PRENTICE & EGAN, *supra* note 203, at 152 n.5 (stating that Court’s plain meaning analysis was “perhaps not altogether accurate”). *But see* CURRIE, *supra* note 15, at 336 n.46 (arguing that Justice Miller in *Woodruff v. Parham* “correctly dismissed Marshall’s statement as unexplained dictum.”); Collins, *supra* note 82, at 51 n.61 (“Justice Miller’s argument that a basic purpose of the import-export clause, and a benchmark for review of state laws alleged to infringe the clause, was to secure federal revenues against erosion by state laws has not been successfully refuted.”).

246. Powell, *supra* note 230, at 869; *see also* POWELL, *supra* note 203, at 182-84.

247. The quoted language is the title of the chapter of William Crosskey’s book in which he argues for a broader interpretation of the Import-Export Clause. 1 CROSSKEY, *supra* note 203, at 295. As will soon be seen, I agree with some, but not all, of Crosskey’s argument. *See infra* note 313.

248. The Clause extends beyond interstate tariffs on imports, of course. For example, it forbids a state to impose imposts or duties on exports as well. U.S. CONST. art. I, § 10, cl. 2.

249. *See infra* text accompanying notes 253-311.

expansive reach of the Import-Export Clause at the time. However, that reach has been curbed,²⁵⁰ and there is no longer any reason to exclude imports from other states from the protection they should be afforded by the Import-Export Clause.

1. Constitutional Text

The starting place is the language of the Import-Export Clause. The Clause reads in full as follows:

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 its 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.²⁵¹

The Clause contains four main provisions. First, it prohibits states from imposing “Imposts or Duties on Imports or Exports” unless Congress consents. The express provision for a congressional override would provide a textual basis for one of the more unusual features of current dormant Commerce Clause doctrine.²⁵² Second, it excepts from the above prohibition imposts or duties “absolutely necessary” for the execution of state inspection laws. Third, it directs that all revenue from state imposts and duties “be for the Use of the Treasury of the United States.” And fourth, it provides that all such laws are subject to congressional control.

The key question in this analysis is what are “Imports or Exports”? Because the Clause contains no express limitation to foreign trade, any such limitation would have to come from the words *imports* and *exports*

250. See *infra* text accompanying notes 312-27.

251. U.S. CONST. art. I, § 10, cl. 2.

252. Unlike other constitutional prohibitions, the dormant Commerce Clause limitations on state protectionism can be overridden by federal statute. See, e.g., *Western & S. Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 652-53 (1981); *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 421-27 (1946); see also *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232, 263 n.4 (1987) (Scalia, J., concurring in part and dissenting in part) (objecting to this feature of the current doctrine). The Import-Export Clause expressly authorizes Congress to consent to state tariffs, but it requires that the proceeds of any tariff be for the use of the federal treasury. Whether Congress may immediately return the revenue for use by the state imposing the tariff is uncertain. See *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 301 n.13 (1976); Powell, *supra* note 230, at 876 n.64.

themselves.²⁵³ As currently used, the words are so limited and refer only to international trade. Goods brought into one country from another are imports, and goods sent out of one country to another are exports.²⁵⁴ That was not, however, how the words were used at the time of the Framers.

During the confederation era, each state viewed itself as a sovereign entity.²⁵⁵ Because the states were seen as independent sovereigns and thus “foreign to each other in commercial matters,”²⁵⁶ it should not be surprising that the word *imports*, which might otherwise refer only to international trade, was used at the time to include interstate trade as well. That is precisely what the documentary record shows. For example, Professor Crosskey canvassed advertisements, news items, and letters in colonial newspapers and identified repeated instances of *import* being used to mean goods brought into one state from another state.²⁵⁷

The usage was common in correspondence among the Framers as well. For example, in a 1786 letter to Thomas Jefferson, James Madison wrote of states “laying duties on imports *from other States*.”²⁵⁸ Later that year Pennsylvanian Tench Coxe complained of goods that were manufactured in one state being “charged with high Duties upon importation into the enacting

253. In other words, the Clause could have prohibited states from imposing imposts or duties on imports or exports from *foreign* countries, or the like, but it did not.

254. *E.g.*, BLACK’S LAW DICTIONARY 755 (6th ed. 1990); WEBSTER’S NINTH NEW COLLEGIATE DICTIONARY 605 (1985). Crosskey indicates that this was the 18th-Century English usage as well. 1 CROSSKEY, *supra* note 203, at 295.

255. ARTICLES OF CONFEDERATION, art. 2, 1 Stat. 4 (1778) (“Each state retains its sovereignty, freedom, and independence”); THE FEDERALIST NO. 39, at 283 (James Madison) (Benjamin F. Wright ed., 1961) (“Each State, in ratifying the Constitution, is considered as a sovereign body, independent of all others”); THE FEDERALIST NO. 15, at 161 (Alexander Hamilton) (Benjamin F. Wright ed., 1961); THE FEDERALIST NO. 40, at 288-89 (James Madison) (Benjamin F. Wright ed. 1961); *see* RAOUL BERGER, FEDERALISM: THE FOUNDERS’ DESIGN 21-47 (1987) (reviewing evidence and concluding that “the colonies, having severed their common allegiance to Great Britain, were sovereign and independent of each other”); POWELL, *supra* note 203, at 182. *But see* Richard B. Morris, “*We the People of the United States*”: *The Bicentennial of a People’s Revolution*, 82 AM. HIST. REV. 1, 14 (1977). *See generally* Claude H. Van Tyne, *Sovereignty in the American Revolution: An Historical Study*, 12 AM. HIST. REV. 529 (1907).

256. Powell, *supra* note 230, at 869 n.43.

257. 1 CROSSKEY, *supra* note 203, at 297-301.

258. Letter with Enclosure from James Madison to Thomas Jefferson (Jan. 22, 1786) (emphasis added), in 9 THE PAPERS OF THOMAS JEFFERSON, 1785-1786, at 194, 198 (Julian P. Boyd ed., 1954) (setting letter in its full historical context) [hereinafter Madison Letter with Enclosure]; *see also* Letter from James Madison to Thomas Jefferson (Feb. 7, 1796), in 16 THE PAPERS OF JAMES MADISON, 1795-1797, at 214, 215 (J.C.A. Stagg et al. eds., 1989) (“The Eastern States always require large importations [of wheat] from the others.”).

State.”²⁵⁹ At the Constitutional Convention, Madison explained that using duties to encourage local production “requires duties not only on imports directly from foreign Countries, but from the other States in the Union.”²⁶⁰

State tariff laws of the time, as Professor Crosskey points out,²⁶¹ had the same usage: *import* commonly encompassed interstate trade. The tariff laws of the original thirteen states clearly and repeatedly distinguished between imports from foreign countries and imports from other states, using the word *imports* to include both. For example, a 1784 tariff law of Connecticut imposed a tariff of four pence per pound on sugar, “whether the Produce or Manufacture of the United States, or not, imported into this State.”²⁶² More commonly, tariff statutes such as the 1784 New York act broadly taxed a long list of goods “which shall be imported and brought into this State by land or water,” but expressly excepted “goods wares and merchandize of the growth product or manufacture of the United States of America or any of them.”²⁶³ Such an exception would be unnecessary if *imports* did not include such goods in the first place.²⁶⁴

The Court’s arguments in *Woodruff* do not weaken the force of this historical evidence. References in the Articles of Confederation and the

259. Letter from Tench Coxe to Edmund Randolph et al. (Sept. 13, 1786), in 4 CALENDAR OF VIRGINIA STATE PAPERS 168, 169 (1884) [hereinafter Coxe Letter].

260. 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 441 (Max Farrand ed., 1966) [hereinafter RECORDS]. Madison made this statement during discussion on his motion to have the prohibition on state imposts and duties made absolute, rather than permitting congressional consent to override the prohibition. The motion ultimately was defeated. *Id.*

261. 1 CROSSKEY, *supra* note 203, at 300-03.

262. An Act for Levying and Collecting Duties on the Importation of Certain Articles, and for Appropriating the Same, 1784 Conn. Pub. Acts 309.

263. An Act Imposing Duties on the Importation of Certain Goods Wares and Merchandize, ch. 10, 1784 N.Y. Laws 599, 599; *see also* An Act to Revise and Amend an Act for Regulating the Trade. Laying Duties upon all Wares, Goods, Liquors Merchandizes and Negroes Imported into this State also. An Impost on the Tonnage of Shipping and for Other Purposes Therein Mentioned (Feb. 13, 1786), in 19 THE COLONIAL RECORDS OF THE STATE OF GEORGIA, pt. 2, at 498, 501 (Allen D. Candler ed., 1911) (“On all other goods, Wares and Merchandize not before enumerated (*except the produce and Manufacture of the United States of America*) imported into any part of this State . . .”) (emphasis added); An Act for Levying and Collecting Certain Duties and Imposts Therein Mentioned, in Aid of the Public Revenue; and for Repealing an Act, Entitled “An Act for Levying and Collecting Certain Duties and Imposts Therein Mentioned in Aid of the Public Revenue,” § 24 (Mar. 26, 1784) (by 1790 the section was no longer in force, *see* THE PUBLIC LAWS OF THE STATE OF SOUTH-CAROLINA, No. 1332, at 340, 341 (John F. Grimké ed., Philadelphia, R. Aitken & Son 1790)), in THE STATUTES AT LARGE OF SOUTH CAROLINA, No. 1218, at 607, 613 (Thomas Cooper ed., Columbia, S.C., A.S. Johnston 1836).

264. 1 CROSSKEY, *supra* note 203, at 300.

debates on the Constitutional Convention to foreign imports,²⁶⁵ while certainly demonstrating that imports included foreign trade, do not show that the meaning was limited to foreign trade. Nothing in the Articles or the Framers' debates excludes construing the word *imports* as meaning imports from other states. Further, construing a limitation on congressional power to tax exports as applying only to foreign trade is not inconsistent with construing the Import-Export Clause as applying to interstate trade as well.²⁶⁶ It is simply a matter of perspective. Article I, Section 9 deals with the powers of the national government. From the national perspective, *exports* would refer exclusively to foreign trade. But the Import-Export Clause deals with the powers of the states. From the state perspective, *imports* and *exports* mean goods in interstate trade as well as foreign trade.

In sum, the plain meaning of the words *imports* and *exports* when the Constitution was ratified was not limited to foreign trade. The words meant any goods carried into or out of the state, including both trade with foreign countries and trade with other states.

2. History: State Tariffs Under the Articles of Confederation

The historical record confirms the textual evidence. Even if, as some historians have claimed, interstate trade barriers during the confederation era were not as widespread as once believed,²⁶⁷ state tariffs on imports from other

265. See *supra* notes 234-35 and accompanying text.

266. See *supra* text accompanying note 233.

267. A leading historian of the period, Merrill Jensen, concludes that

the picture by the end of 1787 is not the conventional one of interstate trade barriers, but a novel one of reciprocity between state and state. American goods were free of duties, and foreign goods arriving in American ships were charged lower duties in most of the states than when brought in in foreign ships, and particularly, in the ships of non-treaty countries.

MERRILL JENSEN, *THE NEW NATION: A HISTORY OF THE UNITED STATES DURING THE CONFEDERATION 1781-1789*, at 342 (1950); see also ALBERT A. GIESECKE, *AMERICAN COMMERCIAL LEGISLATION BEFORE 1789*, at 135 (1910); William F. Zornow, *Georgia Tariff Policies, 1775 to 1789*, 38 GA. HIST. Q. 1 (1954); William F. Zornow, *Massachusetts Tariff Policies, 1775-1789*, 90 ESSEX INST. HIST. COLLECTIONS 194 (1954); William F. Zornow, *New York Tariff Policies, 1775-1789*, 37 PROC. N.Y. ST. HIST. ASS'N 40 (1956) [hereinafter Zornow, *New York*]; William F. Zornow, *Tariff Policies in South Carolina 1775-1789*, 56 S.C. HIST. MAG. 31 (1955); William F. Zornow, *The Tariff Policies of Virginia, 1775-1789*, 62 VA. MAG. HIST. & BIOGRAPHY 306 (1954) [hereinafter Zornow, *Virginia*].

These historians may well be correct that there were in reality far fewer interstate trade barriers than once believed. Without a doubt, however, there were significant disputes between the states during the confederation era concerning tariffs on goods imported from other states. See *infra* text accompanying notes 282-96. Even if those disputes were relatively rare, they did happen and could

states were sufficiently widespread and unpopular that one may be “virtually certain” that they were among the practices the Import-Export Clause was intended to end.²⁶⁸

There were a number of reasons for the inclusion of the Import-Export Clause in the Constitution.²⁶⁹ First, the Import-Export Clause was necessary to keep the states from undercutting the national tariff, which was to be a major source of funds for the new federal government.²⁷⁰ Second, the Clause, together with other constitutional provisions,²⁷¹ was needed so that the national government could deal effectively with other nations in commercial matters.²⁷² These first two reasons obviously focus on foreign trade, not on

have happened again if not guarded against in the Constitution. Moreover, what matters most for interpretative purposes is not what actually happened, but what the founders believed had happened or could happen. Regan, *supra* note 84, at 1114 n.55 (“For my purposes, however, it is more important what the framers feared (or what they thought they saw) than what they actually experienced.”). Even Professor Zornow admits that many contemporaries with the Constitution were “convinced that each state, motivated by self-interest solely, was trying to hamper its neighbors’ trade” and that “[t]hese men pointed to this situation as one of their chief justifications for demanding a stronger central government.” Zornow, *Virginia, supra*, at 306.

268. 1 CROSSKEY, *supra* note 203, at 304.

269. The Supreme Court in *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), identified “three main concerns” prompting the Import-Export Clause:

[T]he Federal Government must speak with one voice when regulating commercial relations with foreign governments, and tariffs, which might affect foreign relations, could not be implemented by the States consistently with that exclusive power; import revenues were to be the major source of revenue of the Federal Government and should not be diverted to the States; and harmony among the States might be disturbed unless seaboard States, with their crucial ports of entry, were prohibited from levying taxes on citizens of other States by taxing goods merely flowing through their ports to the other States not situated as favorably geographically.

Id. at 285-86 (footnotes omitted); see also *Youngstown Sheet & Tube Co. v. Bowers*, 358 U.S. 534, 555-57 (1959) (Frankfurter, J., dissenting). That the Court did not include interstate tariffs as a concern is not surprising given *Woodruff v. Parham*. Cf. Edmund W. Kitch, *Regulation and the American Common Market*, in *REGULATION, FEDERALISM, AND INTERSTATE COMMERCE* 9, 16, 18-19 (A. Dan Tarlock ed., 1981) (including interstate trade barriers in list of problems “concerning commerce” that arose under the Articles of Confederation).

270. Letter from James Madison to Thomas Jefferson (Mar. 18, 1786), in 8 *THE PAPERS OF JAMES MADISON, 1784-1786*, at 500, 502 (Robert A. Rutland et al. eds., 1973) [hereinafter *Madison Letter of Mar. 18, 1786*] (arguing that the failure of a plan to unite the states “will dissipate every prospect of drawing a steady revenue from our imposts either directly into the federal treasury, or indirectly thro’ the treasuries of the Commercial States”); see also *Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 437 (1827).

271. *E.g.*, U.S. CONST. art. I, § 8, cl. 3 (Foreign Commerce Clause); *id.* art. I, § 10, cl. 1 (“No State shall enter into any Treaty, Alliance, or Confederation . . .”).

272. The states were sorely ineffective in matters of foreign policy under the Articles of Confederation. *THE FEDERALIST* NO. 22, at 191-92 (Alexander Hamilton) (Benjamin Wright ed., 1961) (“Several States have endeavored, by separate prohibitions, restrictions, and exclusions, to influence the conduct of that kingdom [Great Britain] in this particular, but the want of concert, arising from the

interstate trade. However, the fact that foreign trade was addressed does not mean that interstate trade was not.

The third reason, as the Court in *Woodruff* noted,²⁷³ was that states with well-developed port facilities used tariffs to raise revenues at the expense of neighboring states that lacked adequate port facilities.²⁷⁴ New Jersey, for example, relied heavily on New York as a port for its foreign imports. When New York imposed a tariff on foreign goods, much of the burden of the tariff fell on New Jersey residents, while the tariff revenue went to New York.²⁷⁵

Contrary to the Court's argument in *Woodruff*, however, this basis for the Import-Export Clause does not support limiting the Clause to foreign trade. In the case of New York, the problem involved foreign imports only because New York did not impose a tariff on goods manufactured within the United

want of a general authority and from clashing and dissimilar views in the State, has hitherto frustrated every experiment of the kind, and will continue to do so as long as the same obstacles to a uniformity of measures continue to exist.”); Madison Letter of Mar. 18, 1786, *supra* note 270, at 502 (“When Masss. set on foot a retaliation of the policy of G. B. Connecticut declared her ports free. N. Jersey served N. York in the same way. And Delaware I am told has lately followed the example in opposition to the commercial plans of Penna.”); Letter from James Madison to Professor Davis (1832), in 3 RECORDS, *supra* note 260, at 518, 520-21 [hereinafter Madison Letter to Davis]; James Madison, *Preface to the Debates in the Convention of 1787*, in 3 RECORDS, *supra* note 260, at 539, 547-48 [hereinafter Madison, *Preface*]; see also *Brown*, 25 U.S. (12 Wheat.) at 439.

273. *Woodruff v. Parham*, 75 U.S. (8 Wall.) 123, 134-36 (1868).

274. THE FEDERALIST NO. 7, at 116-17 (Alexander Hamilton) (Benjamin F. Wright ed., 1961) (“The opportunities which some States would have of rendering others tributary to them by commercial regulations would be impatiently submitted to by the tributary States.”); THE FEDERALIST NO. 42, at 305 (James Madison) (Benjamin F. Wright ed., 1961); 2 RECORDS, *supra* note 260, at 441 (remarks of James Madison); Madison, *Preface*, *supra* note 272, at 539, 546-47; 4 THE DEBATES IN THE SEVERAL STATE CONVENTIONS ON THE ADOPTION OF THE FEDERAL CONSTITUTION 79-80 (Jonathan Elliot ed., 2d ed. 1836) (comments by Gov. Johnston that North Carolina pays imposts on goods imported for it by other states) [hereinafter DEBATES]; see also *Youngstown Sheet & Tube Co. v. Bowers*, 358 U.S. 534, 556-57 (1958) (Frankfurter, J., dissenting); 3 CROSSKEY & JEFFREY, *supra* note 203, at 195-98; Albert S. Abel, *The Commerce Clause in the Constitutional Convention and in Contemporary Comment*, 25 MINN. L. REV. 432, 448-49 (1941).

275. See 2 DEBATES, *supra* note 274, at 189 (remarks of Oliver Ellsworth of Connecticut) (“The state of New York raises 60 or £80,000 a year by impost. Connecticut consumes about one third of the goods upon which this impost is laid, and consequently pays one third of this sum to New York.”); Madison, *Preface*, *supra* note 272, at 539, 542 (“New Jersey, placed between Phila. & N. York, was likened to a Cask tapped at both ends . . .”); Letter from William Grayson to James Monroe (May 29, 1787), in 3 RECORDS, *supra* note 260, at 30 (“In N. York they pay well because they can do it by plundering N. Jersey & Connecticut . . .”); THE FEDERALIST NO. 7, *supra* note 274, at 116-17. Compare JENSEN, *supra* note 267, at 339 (“The arguments of their politicians that [New Jersey and Connecticut] had to pay tribute to [New York] had only a partial foundation. In 1784 and again in 1787 the New York legislature provided that goods brought in for re-export, if kept in original packages, should be free of duties.”) with Carpinello, *supra* note 205, at 368 n.121 (finding “sufficient evidence from other sources, however, to indicate the exemption either was not honored or that it was impractical to receive”).

States.²⁷⁶ But not every trading state exempted domestic goods from its tariff statute.²⁷⁷ Thus, the *Woodruff* Court was wrong when it used the existence of this practice as a grounds for excluding domestic imports from the reach of the Import-Export Clause.

Fourth, the Import-Export Clause was necessary because states had been imposing tariffs on goods imported from other states.²⁷⁸ Sometimes states enacted the tariffs to raise revenues or to protect their own industry and imposed the tariffs on goods wherever manufactured, including those manufactured in the United States.²⁷⁹ At other times, states enacted the tariffs to reduce their dependence on the ports of neighboring states and imposed the tariffs on goods produced abroad but imported from other states.²⁸⁰ Such tariffs were common enough to be the subject of discussion by the Framers and to prompt efforts to restrict such practices. These efforts ultimately culminated in the Import-Export Clause.²⁸¹

Although tariffs on interstate trade declined over time, a number of states²⁸² (and prior to that a number of colonies)²⁸³ imposed tariffs on goods manufactured in other states of the United States. A leading example was Virginia, which in its 1781 tariff statute imposed duties on alcoholic beverages, sugar, and coffee, plus a one percent ad valorem tariff on all other imported goods, when imported “from any port or place whatsoever.”²⁸⁴ The

276. Zornow, *New York*, *supra* note 267, at 44, 50-51.

277. *See infra* notes 284-89 and accompanying text (discussing Virginia).

278. Professor Kitch argues that “[t]here is only one recorded instance of one state imposing a restriction on commerce coming from other states,” referring to a New Jersey retaliatory tax on a lighthouse owned by New York. Kitch, *supra* note 269, at 18-19. For descriptions of the incident, see JENSEN, *supra* note 267, at 338-39; and Zornow, *New York*, *supra* note 267, at 54-55. Kitch simply ignores the state tariffs discussed in the text. He acknowledges the existence of some state tariffs during the Confederation era, so perhaps he attaches a narrow meaning to what constitutes a “restriction on commerce.” Kitch, *supra* note 269, at 18 n.29.

279. *See infra* notes 282-87 and accompanying text.

280. *See infra* notes 290-93 and accompanying text.

281. Indeed, there is some slight indication that the Clause was understood at the time to apply to interstate trade. *See* Letter from Samuel McDowell to William Fleming (Dec. 20, 1787), in 8 THE DOCUMENTARY HISTORY OF THE RATIFICATION OF THE CONSTITUTION 254, 255 (John P. Kaminski & Gaspare J. Saladino eds., 1988) (“If I recollect, it is not in the Power of any State to lay a Duty or Impost on goods &c brought into it from any other of these States.”).

282. GIESECKE, *supra* note 267, at 134-35; I EMORY R. JOHNSON ET AL., HISTORY OF DOMESTIC AND FOREIGN COMMERCE OF THE UNITED STATES 138 (1915); *see also infra* notes 284-87, 290-93 and accompanying text.

283. GIESECKE, *supra* note 267, at 40-41; JENSEN, *supra* note 267, at 337-38; I JOHNSON ET AL., *supra* note 282, at 58; Fisher, *supra* note 153, at 237-40.

284. An Act for Ascertaining Certain Taxes and Duties, and for Establishing a Permanent Revenue, § 6, 1781 Va. Acts ch. 40 (Nov. sess.), *reprinted in* THE FIRST LAWS OF THE STATE OF

list of commodities changed somewhat over time,²⁸⁵ and the one percent ad valorem tariff was increased to one-and-one-half percent in 1784.²⁸⁶ However, throughout the period leading up to the Constitutional Convention, Virginia continued to impose its tariff on imports from other states as well as from other countries.²⁸⁷

In 1786, the Virginia tariff statute prompted an objection from Tench Coxe at the Annapolis Convention, the precursor to the Constitutional Convention in Philadelphia the next year. Coxe, the delegate from Pennsylvania, wrote to the three commissioners for the State of Virginia,²⁸⁸ objecting to various provisions of the “commercial laws of the states,”

VIRGINIA 151, 154 (John D. Cushing ed., 1982). The Virginia legislature the next year removed any doubt and made it clear that the tariff did apply to imports from other states. An Act to Amend the Act for Ascertaining Certain Taxes and Duties, and for Establishing a Permanent Revenue, § 14, 1782 Va. Acts Ch. 39 (May sess.) (An editor’s note in 11 HENING’S STATUTES AT LARGE 66 (facsimile reprint 1969) (William W. Hening ed., Richmond, Va., George Cochran, 1823) notes that the chapter for this statute was originally 79.). A 1780 tariff law had imposed a similar one percent ad valorem duty on all imported goods, without specifying that the place of origin was irrelevant. An Act for the Defence of the Eastern Frontier of this Commonwealth, § 4, 1780 Va. Acts ch. 31 (Oct. sess.). The tariff excepted iron from Maryland, however, suggesting that other goods produced in the United States were subject to the tariff. *See id.*

Virginia was not the only state to enact such laws. *See, e.g.*, An Act for Levying and Collecting Certain Duties and Imposts Therein Mentioned, in Aid of the Public Revenue, § 20 (Aug. 13, 1783) (imposing duty of 2.5% on value of all goods not previously enumerated), in THE STATUTES AT LARGE OF SOUTH CAROLINA, *supra* note 263, No. 1196, at 576, 581, *repealed by* An Act for Levying and Collecting Certain Duties and Imposts Therein Mentioned, in Aid of The Public Revenue, in THE STATUTES AT LARGE OF SOUTH CAROLINA, *supra* note 263, No. 1218, at 607, 610 (Section 8 of the repealing act added a provision that “nothing herein contained shall be construed to impose any duty whatever upon any goods, wares or merchandises of the growth, produce or manufacture of any of the United States.”); An Act Imposing Duties on Certain Goods Wares and Merchandize Imported into this State, ch. 7, 1784 N.Y. Laws 11, 12 (imposing tariff of four shillings per hundred weight on “cordage either from Europe or any of the United States or elsewhere”).

285. For a detailed overview of the evolution of the Virginia tariff scheme, see Zornow, *Virginia*, *supra* note 267, at 308-13.

286. An Act for Imposing an Additional Duty of One and an Half Per Centum on Certain Goods, Wares, and Merchandizes, § 2, 1784 Va. Acts ch. 13.

287. Virginia repealed its tariff on goods imported from other states in 1788. An Act to Amend the Laws of Revenue, to Provide for the Support of Civil Government, and the Gradual Redemption of All the Debts Due by this Commonwealth, § 5, 1787 Va. Acts ch. 1 (enacted Jan. 1788). The Virginia legislature clearly was aware of the new Constitution when it did so. *See* Memorial of Winchester [Virginia] Merchants and Traders (Nov. 6, 1787), in 10 THE DOCUMENTARY HISTORY OF THE RATIFICATION OF THE CONSTITUTION, *supra* note 281 (microfiche supp. doc. 17, at 14) (urging Virginia legislature to repeal tariff on goods imported from other states, although erroneously relying on clause prohibiting *Congress* from imposing duties of tonnage on vessels passing from one state to another, *see* U.S. CONST. art. I, § 9, cl. 6).

288. The Virginia Commissioners addressed in Coxe’s letter were Edmund Randolph, James Madison, and St. George Tucker. Coxe Letter, *supra* note 259.

including the following:

3d. That Goods of the growth, product, and manufacture of the other States in the Union, were charged with high Duties upon importation into the enacting State, as great, in many instances, as those imposed on foreign Articles of the same kinds.²⁸⁹

Coxe urged the commissioners, upon their return to Virginia, to have the state legislature bring the Virginia tariff law in line with that of Pennsylvania, which exempted domestically produced goods from its tariff.

Connecticut is another example. In 1784, Connecticut enacted a tariff statute imposing duties on two classes of goods. First, the statute imposed tariffs on a variety of specified goods when “imported or brought into this State, by Land or Water, from any of the United States of America,” even when produced in the United States.²⁹⁰ Indeed, at the time, several of the goods subject to the tariff, including rum and loaf sugar, were produced in neighboring Massachusetts.²⁹¹ Second, the statute imposed an ad valorem tariff of five percent on all other goods not produced in the United States that were “brought or imported into this State, by Land or Water, from any of the United States.”²⁹² Foreign goods imported directly into Connecticut from abroad were not subject to duty.²⁹³

289. *Id.* The other provisions objected to were the following:

1st. That the duty of Tonnage on Vessels, built in or belonging to the citizens of the other States, was greater than that imposed on Vessels belonging to the Citizens of the States enacting the Law, and equal in some instances to the Tonnage laid upon most of the foreign nations that have a Commercial intercourse with America.

2dly. That the duties imposed upon Goods imported in Vessels built in or belonging to other parts of the Union, were greater than those laid on Goods imported in Vessels belonging to the enacting State.

Id.

290. An Act for Levying and Collecting a Duty on Certain Articles of Goods, Wares and Merchandize Imported into this State, by Land or Water, 1784 Conn. Pub. Acts 271, 271, *reprinted in THE FIRST LAWS OF THE STATE OF CONNECTICUT* 271, 271 (John D. Cushing ed., 1982) [hereinafter *FIRST LAWS OF CONNECTICUT*]. The tariff was imposed on various alcoholic beverages, snuff, tea, coffee, chocolate, sugar, and paper. *Id.* A subsequent law, enacted later in 1784, imposed a tariff of “Four-pence per Pound; on each Pound of Sugar, other than brown Sugar, whether the Produce or Manufacture of the United States, or not, imported into this State.” An Act for Levying and Collecting Duties on the Importation of Certain Articles, and for Appropriating the Same, 1784 Conn. Pub. Acts 309, 309.

291. *See* Letter from James Bowdoin to Patrick Henry (Oct. 18, 1785), in 6 *COLLECTIONS OF THE MASSACHUSETTS HISTORICAL SOCIETY* 76, 76 (7th series 1907) [hereinafter *Bowdoin Letter to Henry*]. The letter also is reprinted in 4 *CALENDAR OF VIRGINIA STATE PAPERS* 60 (1884).

292. 1784 Conn. Pub. Acts 271, 271.

293. The obvious purpose of the tariff was to encourage the development of Connecticut ports, but

The Connecticut tariff prompted a letter of protest from James Bowdoin, the governor of Massachusetts, to the governor of Connecticut objecting both to the favorable treatment given to imports directly from abroad and to the imposition of a tariff on goods produced in Massachusetts.²⁹⁴ Bowdoin wrote that the latter provision of the Connecticut law “must be considered as the more exceptionable” given that Massachusetts, “for the sake of cementing the Union,” exempted from its tariff all goods manufactured in other states of the United States.²⁹⁵ Bowdoin forwarded a copy of the Massachusetts protest to several other states, including Virginia, so that “if any of them should think proper to revise their commercial laws, and should thereupon observe an instance of such a nature & tendency, it would be altered or repealed.”²⁹⁶

The appeal to Virginia was unsuccessful. The state maintained its tariff on goods imported from other states until 1788.²⁹⁷ However, a more sweeping attempt to restrict state tariffs originated in Virginia shortly after the Massachusetts protest. In November 1785, James Madison introduced a proposal in the Virginia House of Delegates seeking to expand the power of Congress to regulate commerce.²⁹⁸ The proposal as originally drafted would have permitted Congress to prohibit certain foreign vessels from entering United States ports, to impose a uniform tariff on goods in foreign vessels with the proceeds to go to state treasuries, and to impose an additional uniform tariff of up to five percent on goods imported into the United States from any foreign ports, with proceeds to go to the federal treasury.²⁹⁹

Most significant for present purposes is the third provision in the proposal:

3d, That no state be at liberty to impose duties on any goods, wares, or merchandizes, imported by land or by water from any other State; but

Jensen argues that the law was not successful in this regard. JENSEN, *supra* note 267, at 339.

294. Letter from James Bowdoin to the Governor of Connecticut (July 27, 1785), in 6 COLLECTIONS OF THE MASSACHUSETTS HISTORICAL SOCIETY, *supra* note 291, at 62.

295. *Id.* at 63.

296. Bowdoin Letter to Henry, *supra* note 291, at 77.

297. See *supra* note 287. Connecticut, however, repealed its tariff in large part in 1785. An Act in Further Addition to and Alteration of an Act for Levying and Collecting a Duty on Certain Articles of Goods, Wares and Merchandize, Imported into this State by Land or Water, 1785 Conn. Pub. Acts 322, 322.

298. Madison Letter with Enclosure, *supra* note 258, at 203 encl. The proposal instructed the Virginia delegates in Congress to propose in Congress a recommendation that the states authorize Congress to regulate commerce in accordance with specified principles. *Id.*

299. *Id.* The actual enclosure to Madison's letter, which contained handwritten modifications to an original proposal made in the committee of the whole, appears to be lost, but it has been reconstructed. 9 THE PAPERS OF THOMAS JEFFERSON, *supra* note 258, at 204 ed. note.

may altogether prohibit the importation from any other state of any particular species or description of goods, wares, or merchandize, [of] which the importation is at the same time prohibited from all other places whatsoever.³⁰⁰

As stated, the proposal would have outlawed all state tariffs on imports *from other states*. In his notes for debate on the proposal,³⁰¹ and in a subsequent letter to Thomas Jefferson,³⁰² Madison explained that the prohibition on state tariffs was intended to address precisely the sort of problems caused by actions such as the 1784 Connecticut tariff.

The committee of the whole modified the resolution in various ways, but left the prohibition on state tariffs on imports from other states largely unchanged.³⁰³ The most important change was to limit the congressional power authorized by the resolution to only thirteen years.³⁰⁴ As a result, the proponents of the resolution decided not to push it, and the resolution ultimately died.³⁰⁵ In its place, the House of Delegates passed a resolution appointing commissioners to attend a meeting with the other states to discuss Congress' regulation of commerce.³⁰⁶ This meeting was the Annapolis

300. Madison Letter with Enclosure, *supra* note 258, at 204 (alteration in original). An earlier draft of the proposal contained the following language instead:

4.Resd. that no State ought to be at liberty to impose duties on any goods ware or merchandizes imported by land or water from any other State; but each State ought to be free to prohibit altogether the importation from any other State, of any particular species or description of goods wares or merchandizes, which are at the same time prohibited to be imported from all other places whatsoever.

Draft Resolutions on Foreign Trade (Nov. 12, 1785), *reprinted in* 8 THE PAPERS OF JAMES MADISON, *supra* note 270, at 409-10.

301. James Madison, *Notes for Debate on Commercial Regulations by Congress* (Nov. 30-Dec. 1, 1785), *in* 8 THE PAPERS OF JAMES MADISON, *supra* note 270, at 431 (arguing that resolution was "necessary to prevent animosity" such as that between Massachusetts and Connecticut).

302. Madison Letter with Enclosure, *supra* note 258, at 198; *see also* Madison, *Preface*, *supra* note 272, at 539, 548.

303. *See* 1 DEBATES, *supra* note 274, at 114 (reprinting the resolution as approved by the committee of the whole).

304. *Id.* at 115.

305. Madison Letter of Mar. 18, 1786, *supra* note 270, at 476-77; Letter from James Madison to George Washington (Dec. 9, 1785), *in* 3 THE PAPERS OF GEORGE WASHINGTON 439, 439 (W.W. Abbot & Dorothy Twohig eds., Confederation Series 1994); *see also* 1 GEORGE TICKNOR CURTIS, CONSTITUTIONAL HISTORY OF THE UNITED STATES: FROM THE DECLARATION OF INDEPENDENCE TO THE CLOSE OF THEIR CIVIL WAR 229 (1889).

306. Proposition of the General Assembly of Virginia (Jan. 21, 1786), *reprinted in* 1 DEBATES, *supra* note 274, at 115 (calling for a meeting of the commissioners "to take into consideration the trade of the United States; to examine the relative situation and trade of the said states; to consider how far a uniform system in their commercial regulations may be necessary to their common interest and their

Convention of 1786, which led to the Constitutional Convention of 1787.³⁰⁷ In the end, out of the failure of the Virginia resolution rose the success of the Constitutional Convention.³⁰⁸

Thus, the evidence is strong that the failed resolution of 1786 is a direct ancestor of the Import-Export Clause.³⁰⁹ The Virginia resolution was more limited in scope: it would have outlawed only state imposts on imports from other states. The resolution did not expressly prohibit the imposition of state imposts on foreign trade, although the drafters may have contemplated that the resolution would have that effect,³¹⁰ nor did it apply to exports. The Import-Export Clause in the Constitution is broader and more general than the Virginia resolution. It outlaws all state duties and imposts on imports and exports,³¹¹ including state imposts and duties on foreign trade. The Import-Export Clause added this latter prohibition to what otherwise would have been prohibited under the draft resolution: state tariffs on imports from other states.

permanent harmony; and to report to the several States such an act relative to this great object”).

307. See 1 ALFRED H. KELLY ET AL., *THE AMERICAN CONSTITUTION: ITS ORIGINS AND DEVELOPMENT* 91 (6th ed. 1983); 1 JOSEPH STORY, *COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES* §§ 274-275, at 187-88 (Boston, Charles C. Little & James Brown 2d ed. 1851); CHARLES WARREN, *THE MAKING OF THE CONSTITUTION* 23 (1929).

308. *Knowlton v. Moore*, 178 U.S. 41, 100-01 (1900) (“Though the resolution of Mr. Madison was not adopted, it led to the sending by Virginia of commissioners to Annapolis to meet commissioners from the other States, the result of which meeting was the Federal convention of 1787.”); 9 *THE PAPERS OF THOMAS JEFFERSON*, *supra* note 258, at 208 (editor’s note) (“[B]y a happy irony the triumph of Tyler’s resolution and the defeat of Madison’s set the country on the route toward an early and effective re-modeling of the national constitution.”).

309. Professors Kurkland and Lerner do not include the draft resolution in their key documents on the Import-Export Clause, see 3 *THE FOUNDER’S CONSTITUTION* 473-79 (Philip Kurkland & Ralph Lerner eds., 1987), but they do reprint it in the section on the Commerce Clause, see 2 *id.* at 477, 482-83.

310. See 2 IRVING BRANT, *JAMES MADISON: THE NATIONALIST 1780-1787*, at 380 (1948) (discussing this “shrewdly worded paragraph”).

On the surface, that was a retention of the right to tax foreign goods, and to shut out foreign goods or all goods. In reality, it allowed only a total embargo of specific items. Short of that, American goods could not be banned, and how could foreign goods be taxed or banned when they could be brought in duty-free from other states? . . . The purpose here was to grant more power than met the eye. As Madison put it, the bill was written to give Congress “such direct power only as would not alarm” and “indirectly require a conformity” of the states to federal regulations. So thoroughly was this purpose concealed that the issue never arose during a struggle in which other features of the bill were torn to pieces.

Id. But see 3 CROSSKEY & JEFFREY, *supra* note 203, at 225-27 (referring to the “extreme meagreness of the national powers under this Virginia resolution”).

311. The addition of exports to the Import-Export Clause was approved by only one vote at the Constitutional Convention. 2 *RECORDS*, *supra* note 260, at 442.

3. Policy: Impact on State Revenues

The *Woodruff* Court's textual and historical analysis was weak. Construed properly, both the text of the Constitution and the historical setting strongly support interpreting the Import-Export Clause as applying to imports from other states. It is clear, however, that the Court's policy concerns ultimately dictated its decision. The Court feared that extending *Brown's* "original package" doctrine to interstate trade would have invalidated even nondiscriminatory taxes and severely hampered the states in raising revenue.³¹² As a result, the Court in *Woodruff* sought to avoid limiting the states' fiscal powers in this way.³¹³

Today, however, that fear is unfounded. The modern scope of the Import-Export Clause is far less expansive than at the time *Woodruff* was decided. Beginning in *Michelin Tire Corp. v. Wages*,³¹⁴ and continuing with *Department of Revenue v. Association of Washington Stevedoring Cos.*³¹⁵ and subsequent cases,³¹⁶ the Court has pared down and refocused its Import-Export Clause, analysis. Today the Import-Export Clause differs little in reach from the dormant Commerce Clause except that it is limited to foreign trade.

312. See CURRIE, *supra* note 15, at 336 n.46 ("The arguably erroneous view that the imports clause barred even nondiscriminatory taxes weighed heavily in Miller's refusal to hold that it applied to imports from other states."); POWELL, *supra* note 203, at 182-84; COLLINS, *supra* note 82, at 51 n.61; POWELL, *supra* note 230, at 869.

313. William Crosskey's reinterpretation of the Import-Export Clause would do little to assuage such fears. Crosskey argued not only that *imports* and *exports* included interstate trade, but also that *duties* had a far broader meaning than it was ordinarily given. In Crosskey's view, "'duties' was a comprehensive term covering all kinds of 'taxes' applicable to such 'things,' except 'property taxes.'" 1 CROSSKEY, *supra* note 203, at 304. As a result, Crosskey argued that "*all taxes upon both interstate and foreign 'imports' and 'exports' were covered by the Imports and Exports Clause,*" with the lone exception of property taxes. *Id.* If Crosskey's view were to be adopted, the state taxing power would be substantially limited.

The Supreme Court correctly rejected Crosskey's argument in *Department of Revenue v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734 (1978). In *Washington Stevedoring*, the Court concluded that Crosskey's broad reading would render Congress' Article I, Section 8 power to tax "excises" redundant because *duties*, in Crosskey's reading, included *excises*. 435 U.S. at 760 & n.26. Instead, it seems likely that the word *duties* was meant to extend the prohibition of the Clause to stamp duties like the kind at issue in *Almy v. California*, 65 U.S. (24 How.) 169, 172 (1860). See 2 RECORDS, *supra* note 260, at 305; see also Luther Martin, *Genuine Information*, reprinted in 3 RECORDS, *supra* note 260, at 172, 203.

314. 423 U.S. 276 (1976) (overruling *Low v. Austin*, 80 U.S. (13 Wall.) 29 (1872)).

315. 435 U.S. 734 (1978).

316. *Itel Containers Int'l Corp. v. Huddleston*, 507 U.S. 60, 76-78 (1993); *R.J. Reynolds Tobacco Co. v. Durham County*, 479 U.S. 130, 152-55 (1986); *Limbach v. Hooven & Allison Co.*, 466 U.S. 353, 357-61 (1984) (overruling *Hooven & Allison Co. v. Evatt*, 324 U.S. 652 (1945)).

In *Michelin*, the Supreme Court upheld a nondiscriminatory ad valorem property tax assessed on imported tires against a challenge under the Import-Export Clause.³¹⁷ Although the lower court had held that the goods were no longer imports and so subject to tax,³¹⁸ the Supreme Court did not even address that question.³¹⁹ Instead, the Court held that a nondiscriminatory property tax was not an “impost” or “duty” within the meaning of the Import-Export Clause.³²⁰ It concluded that “[n]othing in the history of the Import-Export Clause even remotely suggests that a nondiscriminatory ad valorem property tax which is also imposed on imported goods that are no longer in import transit was the type of exaction that was regarded as objectionable by the Framers of the Constitution.”³²¹

In *Washington Stevedoring*, the Supreme Court upheld application of Washington’s business and occupation tax to stevedoring activities provided for goods in foreign commerce.³²² Although, unlike in *Michelin*, the goods were still in transit, the tax was imposed only on the business of loading and unloading the ships, not on the goods themselves. Therefore, the Court held that the tax did not violate the Import-Export Clause.³²³ The Court made clear that not all varieties of taxes are included in the terms *imposts* and *duties* and expressly rejected Professor Crosskey’s argument that “the concept of ‘Duties’ encompassed excises.”³²⁴

Thus, today the fears in *Woodruff* are groundless. Rather than construing the Import-Export Clause narrowly to exclude interstate trade, the Court in *Woodruff* should have construed its prohibition narrowly to limit it principally to tariffs or tariff-like taxes, whether on foreign or interstate trade.³²⁵ Now, the Import-Export Clause does little more for foreign commerce than the dormant Commerce Clause does for interstate commerce.³²⁶ Accordingly, it is time for

317. *Michelin*, 423 U.S. at 302.

318. *Id.* at 279.

319. *Id.*

320. *Id.* at 290-91.

321. *Id.* at 286.

322. *Washington Stevedoring*, 435 U.S. at 751-61.

323. *Id.* at 755.

324. *Id.* at 759-60; *see supra* note 313.

325. In addition, both the Import-Export Clause and the dormant Commerce Clause may preclude the imposition of nondiscriminatory taxes on goods in transit. *Compare* *United States v. IBM*, 116 S. Ct. 1793, 1803-04 (1996) (Import-Export Clause) (dicta) with 1 HELLERSTEIN & HELLERSTEIN, *supra* note 32, ¶ 4.11 (dormant Commerce Clause).

326. 1 HELLERSTEIN & HELLERSTEIN, *supra* note 32, ¶ 5.06; Hellerstein, *supra* note 39, at 130-31; Hellerstein, *Perspectives*, *supra* note 189, at 39 n.12 (concluding that the Import-Export Clause, “once invoked to invalidate even nondiscriminatory taxes on imports and exports, has been read to bar, in

the Court to recognize the original and proper meaning of the Import-Export Clause as applying to imports and exports from other states.³²⁷

D. Tariffs v. Subsidies Under the Import-Export Clause

As the preceding discussion demonstrates, there is a strong basis for construing the Import-Export Clause as applicable to interstate trade. If the Supreme Court were to do so, the constitutional basis for distinguishing between unlawful tariffs and lawful subsidies would be far stronger.

Under the Import-Export Clause as applied to interstate trade, tariffs plainly would be unlawful. The plain meaning of the prohibition on “imposts and duties on imports” outlaws tariffs. Thus, under the Import-Export Clause, tariffs would (not surprisingly) be treated exactly the same as they are under the dormant Commerce Clause.

Subsidies, meanwhile, would be per se lawful, just as they apparently are under the dormant Commerce Clause. A subsidy is neither an impost nor a duty. In the usage of the Framers, a subsidy is a “bounty,”³²⁸ which the Import-Export Clause does not prohibit. Moreover, the historical record supports the view that bounties should be constitutional. Bounties were plentiful during the colonial period. Although the use of bounties declined during the confederation era (mainly for budgetary reasons),³²⁹ they continued to be used with little or no complaint.³³⁰ Moreover, states continued to enact bounties after the ratification of the Constitution, suggesting that bounties had

general, only those taxes discriminating against goods on the basis of their foreign origin or destination”).

327. Even if in some particulars Import-Export Clause doctrine would extend too far in protecting interstate imports, the Court could construe the Clause more narrowly in these respects. The Court in *Woodruff* had precisely that option, but chose not to follow it. Powell, *supra* note 230, at 870. The importance for present purposes of the Import-Export Clause is not every detail of its doctrine, but the grounding it gives the Court’s dormant Commerce Clause jurisprudence—particularly as to the distinction between tariffs and subsidies.

328. *E.g.*, An Act Granting a Bounty on Hemp to be Raised Within this State, and Imposing an Additional Duty on Sundry Article of Merchandise, and for Other Purposes Therein Mentioned, ch. 68, 1785 N.Y. Laws 120, 120; *see* 1 JOHNSON ET AL., *supra* note 282, at 141.

329. 1 JOHNSON ET AL., *supra* note 282, at 141.

330. *Id.*; Jensen, *supra* note 267, at 286-87; *see, e.g.*, An Act to Promote the Making of Raw-Silk Within this State, 1784 Conn. Pub. Acts 232, 232, *reprinted in* FIRST LAWS OF CONNECTICUT, *supra* note 290, at 232; An Act Granting a Bounty on Hemp to be Raised Within this State, and Imposing an Additional Duty on Sundry Article of Merchandise, and for Other Purposes Therein Mentioned, ch. 68, 1785 N.Y. Laws 120, 120; An Act Granting A Bounty on Hemp, to be Raised Within this State, ch. 54, 1788 N.Y. Laws 718, 719.

not become unlawful.³³¹

In short, the Import-Export Clause provides clear support for the constitutional line drawn by the Supreme Court between unlawful tariffs and lawful subsidies.³³²

V. CONCLUSION

The Supreme Court's present analysis of tariffs versus subsidies under the dormant Commerce Clause is inconsistent and contradictory. At the same time the Court is proclaiming its rejection of formalism, it is excluding state subsidies from dormant Commerce Clause analysis altogether by devices that can only be described as formalistic. The line the Court has drawn, however, between lawful subsidies and unlawful tariffs is a sound one. It is a line that makes sense as a matter of economics not because subsidies merely promote local industry, but because, even considering their protectionist effects, subsidies are nonetheless more efficient than tariffs. And it is a line that makes sense as a matter of history, when the Import-Export Clause is construed properly as extending to interstate trade and not just foreign trade.

331. See, e.g., An Act to Encourage the Raising of Hemp and Flax, ¶ 1, 1803 Conn. Pub. Acts 629; An Act for the Encouragement of the Glass Manufactory Within this Commonwealth, ch. 3, 1793 Mass. Acts 346; An Act to Encourage the Manufacture of Pot-Ash, 1789 N.C. Sess. Laws 482, reprinted in 2 THE FIRST LAWS OF THE STATE OF NORTH CAROLINA 690 (John D. Cushing ed., 1984).

332. Thus, those commentators who rely on history or tradition in support of the distinction between tariffs and subsidies are correct. E.g., Coenen, *Untangling*, *supra* note 68, at 481; Gergen, *supra* note 82, at 1137.