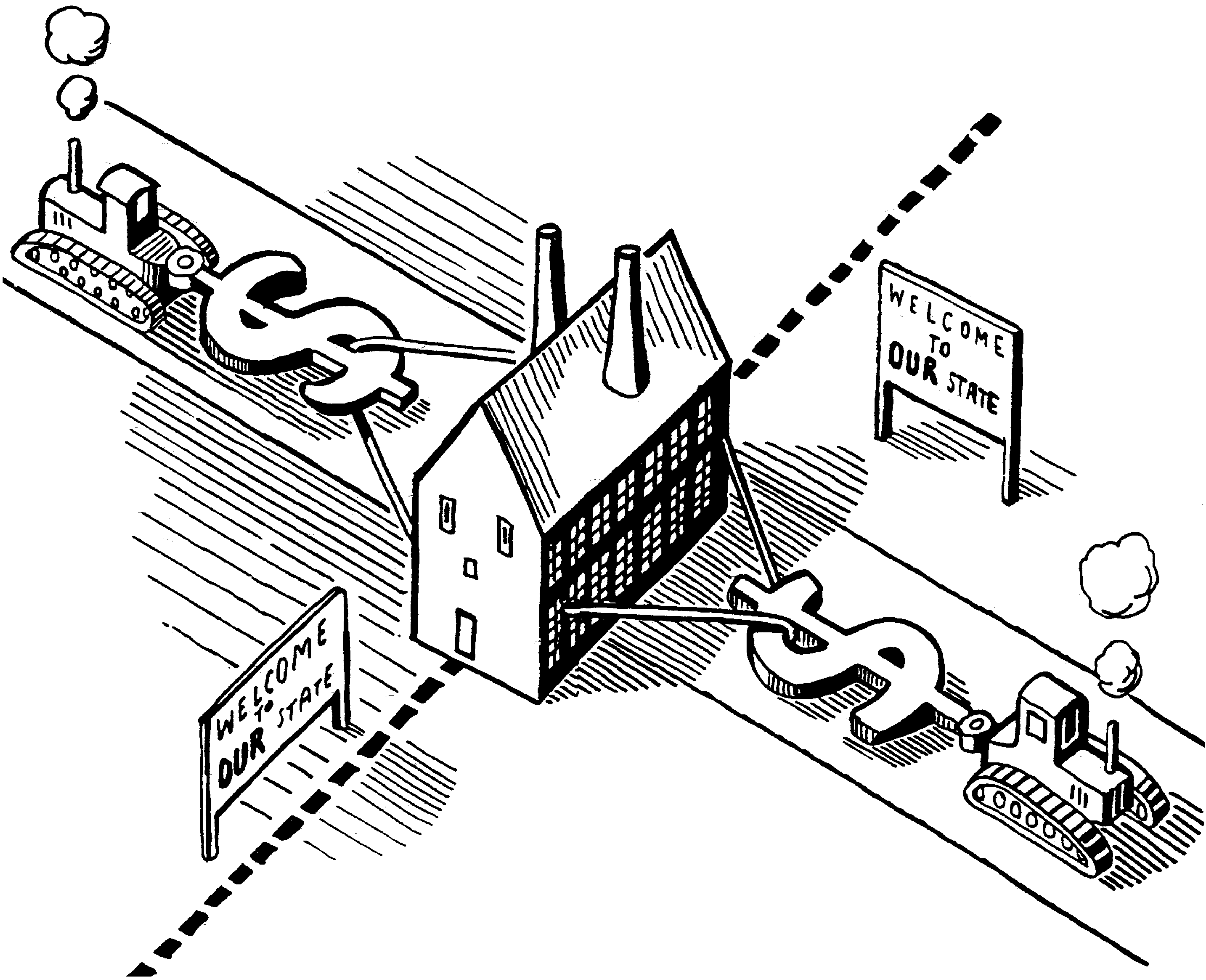
SPECIAL ISSUE

The Region

Federal Reserve Bank of Minneapolis 1994 Annual Report

Congress Should End the Economic War Among the States



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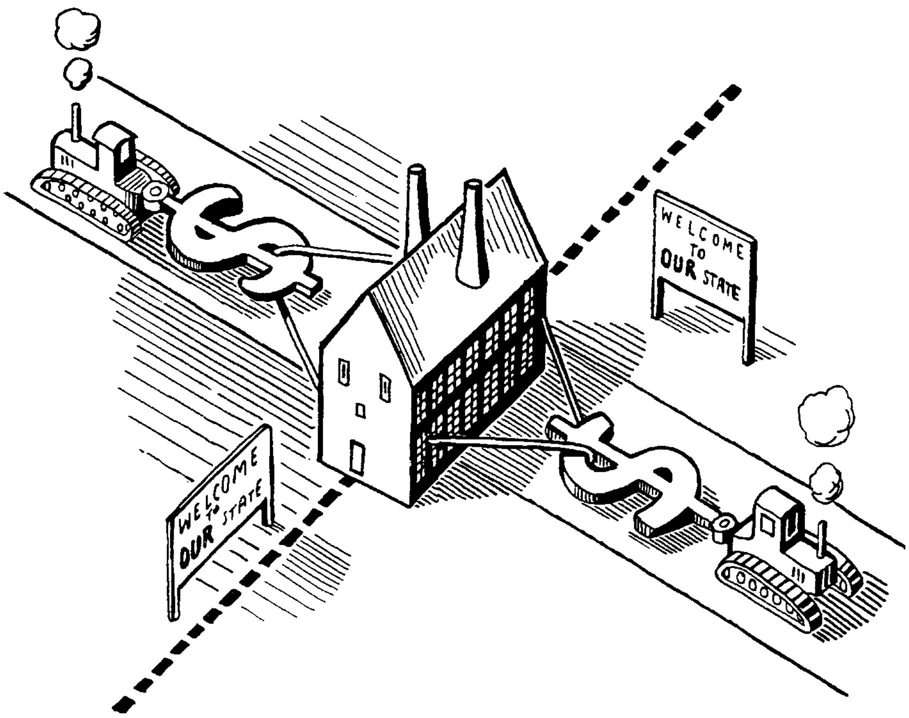
Congress Should End the Economic War Among the States

By Melvin L. Burstein and Arthur J. Rolnick
Federal Reserve Bank of Minneapolis



Burstein is executive vice president and general counsel of the Federal Reserve Bank of Minneapolis and Rolnick is senior vice president and director of Research. The authors wish to acknowledge the invaluable assistance of Thomas Holmes, economist, Federal Reserve Bank of Minneapolis, and Gary Spiegel, a senior at the University of Minnesota Law School.

The views expressed herein are those of the authors and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.

President's Message

Whenever I have the opportunity to meet with community leaders in the Ninth District, I've noticed that perhaps the most frequently asked questions relate to local economic development. They want to know, "Which state seems to have the most effective plan to lure business and workers?" or they might ask, "In your travels throughout the district, which cities would you say are the more clever in promoting themselves—and why?"

I fear my answers to them have not been very satisfying, in part because I claim no great knowledge of the subject, and also because my economic instincts tell me that it just doesn't make sense to have South Dakota and North Dakota place billboards in each other's states, each trying to entice business to cross the border. When you take the larger view of it, apart from the obvious neutralizing effect, it may even constitute a misuse of public funds.

Needless to say, my thoughts on the subject have not been taken as enlightenment by those who are concocting the next promotion. They see the state and local units of government as appropriate players in the marketplace who should provide the necessary leverage to make the pitch to the XYZ Company. Besides, they say, if you don't involve the government, be certain that other cities/states will.

This topic has long interested Art Rolnick and Mel Burstein, both senior officials at the Federal Reserve Bank of Minneapolis, so I asked them to explore in depth the economics of government-sponsored development programs and to share their findings as the essay for the bank's 1994 annual report.

I will tell you in advance that their conclusions are controversial and, for most, at first blush, will seem antithetical to cherished ideas of liberty: big government telling us what we can't do. Rather, I take their conclusion as a support of the free market and a theoretical move that would take us one step closer to a world where the government is more referee than player.

Gary H. Stern
President

[The Constitution] was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division.

Justice Benjamin Cardozo, U.S. Supreme Court, 1934[1]

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Recently, St. Louis, Mo., pursued an aggressive economic development initiative to lure a professional football team, at a cost to state and local taxpayers estimated as high as $720 million.[2] Last year, Amarillo, Texas, decided to undertake an aggressive economic development initiative using a different strategy. Some 1,300 companies around the country were each sent a check for $8 million that the company could cash if it committed to creating 700 new jobs in Amarillo.[3]

What is so remarkable about these two initiatives is that they are not remarkable.

Competition among states for new and existing businesses has become the rule rather than the exception. A 1993 survey conducted by the Arizona Department of Revenue found that states' use of subsidies and preferential taxes to retain and attract specific businesses is widespread.[4] The survey found that half the states had recently enacted financial incentives to induce companies to locate, stay or expand in the state. Targeted businesses have ranged from airline maintenance facilities, automobile assembly plants and professional sports teams to chopstick factories and corn processing facilities.

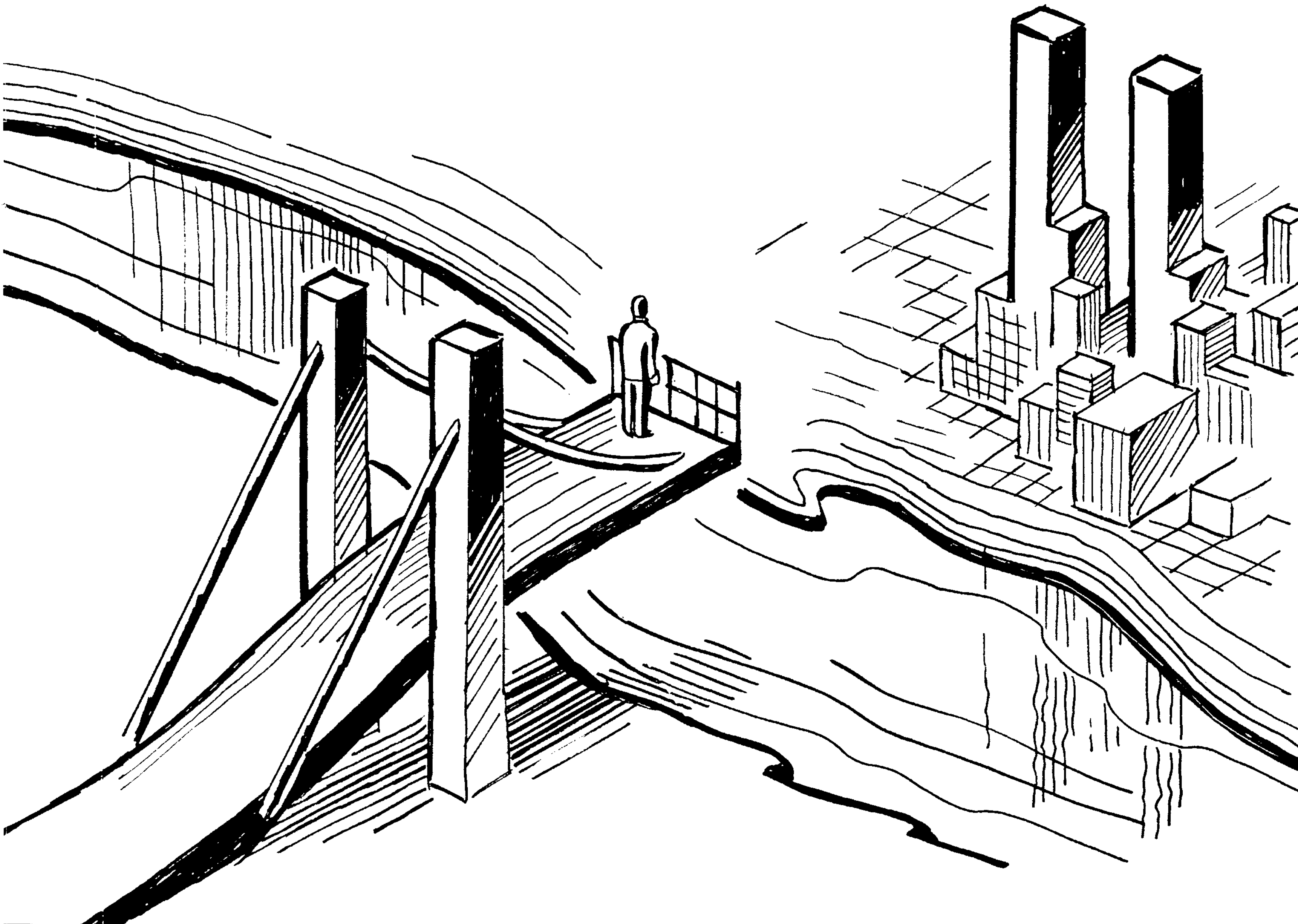
While states spend billions of dollars competing with one another to retain and attract businesses, they struggle to provide such public goods as schools and libraries, police and fire protection, and the roads, bridges and parks that are critical to the success of any community.[5] Surely, something is wrong with this picture! As Justice Cardozo suggested, the framers of the Constitution had something different in mind in granting Congress the power to regulate interstate commerce under the Commerce Clause. The objective was to create an economic union, particularly by ending the trade war among the states that prevailed under the Articles of Confederation. However, it was the Supreme Court, not Congress, that applied the Commerce Clause to end the trade war among the states.

In this essay we argue that it is now time for Congress to exercise its Commerce Clause power to end another economic war among the states. It is a war in which states are actively competing with one another for businesses by offering subsidies and preferential taxes. While the Court has not confronted the constitutionality of states engaging in these activities, it has expressed the view that these activities may be "admirable,"[6] and it would probably find that they fulfill a legitimate local public purpose. Economists reach a much different conclusion. They find that there is a role for competition among states when it takes the form of a general tax and spend policy. Such competition leads states to provide a more efficient allocation of public and private goods. But when that competition takes the form of preferential treatment for specific businesses, not only is it not "admirable," it interferes with interstate commerce and undermines the national economic union by misallocating resources and causing states to provide too few public goods. Moreover, the success of a state in attracting and retaining particular businesses is not a mitigating circumstance.

The economic merits of ending the war among the states

To understand why economists conclude that the use of public funds to attract and retain specific businesses does not serve a legitimate local public purpose, we need to understand what they mean by public purpose. Economists' view of public purpose relies critically on a distinction between public and private goods. A *public good,* unlike a private good, is one in which a single person's consumption of that good does not subtract from another person's consumption. A lighthouse is an often cited example of a pure public good: The light from a lighthouse used by one ship on a foggy night does not prevent its use by another ship. Providing for the national defense, clean air and a legal system are other examples of goods that any citizen can consume without subtracting from what can be consumed by any other citizen in the community.

Besides pure public goods there are some goods that lack the explicit quality of a public good but give off external effects that qualify them as such. Health care provided to an individual is a private good because it subtracts from the consumption of other individuals; nevertheless, it may have external effects that are public. For example, having one person innoculated for some communicable disease makes for a healthier environment, and a healthier environment is a good that any person can consume



While states spend billions of dollars competing with one another to retain and attract businesses, they struggle to provide such public goods as schools and libraries, police and fire protection, and the roads, bridges and parks that are critical to the success of any community. Surely, something is wrong with this picture!

without subtracting from the consumption of any other person. Similarly, educational services consumed by one individual subtract from the consumption of other individuals, but education increases a community's stock of knowledge and is critical to a well-functioning democracy, two highly regarded public goods.

Economists have found that while the production of private goods is best left to market forces, the production of public goods should be the principal role of government because the market fails to produce enough public goods. The reason the market fails is that since people cannot be excluded from consuming public goods, charging people for what they consume is difficult. It is often impossible to say if and how much of a public good a person consumes. How much does one consume of a healthy environment, or national defense or a lighthouse beam? A private firm producing a public good might try to survey the citizens of its community to uncover how much each consumes of a public good and charge accordingly. However, knowing they will be charged based on how much they say they benefit from the public good, and knowing they will get to consume as much as they want, regardless of the charge, people will tend to understate the benefits. Moreover, private firms could not enforce payment for such goods even if they knew how much to provide. Consequently, left to the market, too few public goods, if any, will be produced.

We turn to the government, then, to finance and provide for the use of public goods. Government, by its very nature, can solve the financing problem for it has the power to appropriate funds from its citizens (the power to tax) for the provision of public goods. Solving the provision problem of public goods is more difficult.

Competition among states through general tax and spend policies leads to the right amount of public goods

For state and local governments there is a form of intergovernment competition that guides them to provide the right amount of public goods. This type of competition among government entities has been compared to the invisible hand that guides private business to produce the right amount of private goods.

Charles M. Tiebout argued in 1956 that as state and local governments compete through general tax and spending programs to attract people and businesses, these government entities are led to produce the desired level of public goods. Tiebout notes that people can vote with their feet and choose to live in the community that provides them with the public services for which they are willing to pay. As a result, people in effect reveal their true preferences, and state and local governments provide more public goods than if these governments were not competing. The problem of providing the right level of public goods is alleviated by competition among state and local government entities.

But competition among states for specific businesses is harmful

When states compete through subsidies and preferential taxes for specific businesses, the overall economy suffers. From the states' point of view each may appear better off competing for particular businesses, but the overall economy ends up with less of both private and public goods than if such competition was prohibited.

State and local officials often boast about the new businesses they have attracted, the old ones they have retained and the number of jobs they have created. And in many instances these officials should boast. They have either managed to maintain their tax base by enticing a local business to stay or they have added to their tax base by enticing an out-of-state business to relocate. As long as the subsidies and preferential taxes given to a business are worth less than the revenue the business will contribute to the state over its operating years, the citizens of the state are better off than if their state officials had not played this competitive game. The state has more jobs and hence more tax revenue to pay for public goods than if it had not competed.

But even though it is rational for individual states to compete for specific businesses, the overall economy is worse off for their efforts. Economists have found that if states are prohibited from competing for specific businesses there will be more public and private goods for all citizens to consume.[7] To illustrate this point, we will consider several possible outcomes of this competition.

In the first outcome, no business actually moves to a new location. In other words, suppose that each state goes on the offensive to lure businesses away from other states, but defensive strategies prevail; local subsidies and preferential taxes to businesses that might consider moving, keep them from leaving. While each state could claim a victory of sorts (for no state loses a business), clearly all states are worse off than if they had not competed. Competition has simply led states to give away a portion of their tax revenue to local businesses; consequently, they have fewer resources to spend on public goods, and the country as a whole has too few public goods.

It is unlikely, of course, that businesses will not be enticed to relocate. In this second outcome, the damage to the overall economy can be even greater. At first glance, when businesses relocate there appears to be no net loss to the overall economy; jobs that one state loses another gains. Yet on closer examination we can see that this is not just a zero-sum game. As in the case with no relocations, there will be fewer public goods produced in the overall economy because, in the aggregate, states will have less revenue. This follows because the revenue decline in the losing states must be greater than the revenue increase in the winning states. (If this was not true, businesses would not have relocated.) In addition to this loss, the overall economy becomes less efficient because output will be lost as businesses are enticed to move from their optimal locations.

Each business that is enticed to relocate represents a potential loss of efficiency for the overall economy and hence less output, less tax revenue and fewer public and private goods. To be more concrete, let us suppose a company chooses to relocate its manufacturing plant from a warm climate state, like Louisiana, to Alaska, even though its operating costs are substantially higher in a cold weather climate. We will assume that the company is more than fully compensated by Alaska for the move and for the additional operating costs. However, it now takes more resources for this company to produce the same quantity of output in Alaska than it did in Louisiana.

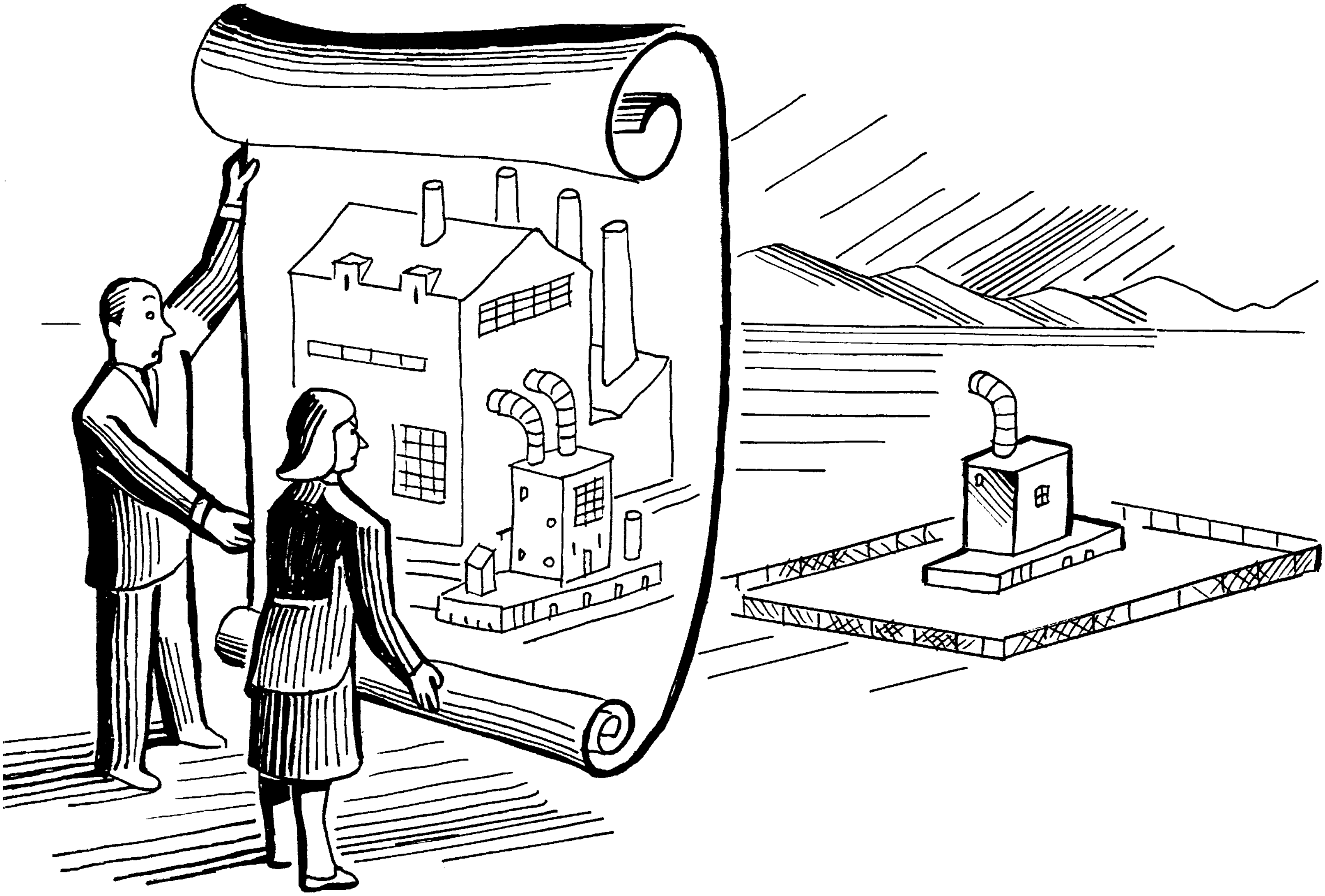
There is another reason businesses will be less productive when states are allowed to compete for individual businesses. States may increase taxes on those firms that are less likely to move to offset the lost revenue from firms that have moved (or have threatened to move). It is a well-known proposition in economics that taxes generally distort economic decisions and at an increasing rate. Business taxes, in particular, induce firms to produce less efficiently. Again to make the argument concrete, consider the hypothetical example of a tax on machines like those used in car washes. Without a tax or with a very small tax, the most efficient and profitable way to operate a car wash is to invest in high quality machines that require only few workers. As the tax increases, the most profitable way to operate the car wash will be to invest in less sophisticated machines that require more labor; although fewer cars will be washed per day, having less expensive machines reduces the tax payment, more than compensating for the lower productivity. And since tax distortions generally grow at an increasing rate, at higher tax rates relatively fewer cars are washed.

In general, it can be shown that the optimal tax (the tax that distorts the least) is one that is uniformly applied to all businesses. Allowing states to have a discriminatory tax policy, one that is based on location preferences or degree of mobility, therefore, will result in the overall economy yielding fewer private and public goods.[8]

State competition for specific businesses involves one additional loss that could make those already mentioned pale by comparison. We have assumed that states have the information to understand the businesses they are courting; that is, their willingness to move, how long they will stay in existence and how much tax revenue they will generate. In practice, states have much less than perfect information. Assuming all states are so handicapped, they will on average end up with fewer jobs and tax revenues than they had anticipated, and at times the competition may not even be worth winning.

For example, Pennsylvania, bidding for a Volkswagen factory in 1978, gave a $71 million incentive package for a factory that was projected to eventually employ 20,000 workers. The factory never employed more than 6,000 and was closed within a decade.

Minnesota's 1991 deal with Northwest Airlines is



The company has yet to fulfill its part of the bargain. Moreover, the commitment to build the two repair facilities that would employ 2,000 workers has been reduced to a commitment to build one very modest facility and an airline reservation center, which together would employ fewer than 1,000 workers.

another example of a Pyrrhic victory. A state agency agreed to provide the company with a $270 million operating loan at a very favorable rate of interest. In return, Northwest agreed to build (with an additional $400 million of state and local government funding) two airplane repair facilities that would eventually employ up to 2,000 highly skilled workers in an economically depressed region of the state. While the operating loan was made in the spring of 1992, the company has yet to fulfill its part of the bargain. Moreover, the commitment to build the two repair facilities that would employ 2,000 workers has been reduced to a commitment to build one very modest facility and an airline reservation center, which together would employ fewer than 1,000 workers.

Despite the fact that state deals have gone sour, some may still be tempted to argue that competition among states for specific businesses will lead to a good outcome for the overall economy. Some may be tempted to make this argument because it seems, as we argued earlier in this essay, people can vote with their feet (or vote policymakers out of office). Hence, if people are unhappy with their state's economic development strategy, there is an internal political check. People, however, may not be unhappy with these strategies—the state is acting in their best interest. Not to compete, while other states are, may be detrimental to a state's economy. Moreover, there may not be a place to go because all states may be competing. For this type of competition there is no invisible hand (or more accurately, no invisible foot) to lead states to do what is best for the country.

Only Congress can end the war among the states

How can this war among the states be brought to an end? The states won't end this war, and the courts are not equipped to do so. Only federal legislation can prevent states from using subsidies and preferential taxes to attract and retain businesses.

The powers granted to Congress under the Constitution enable it to fashion the legislative tools necessary to prevent the states from using subsidies and preferential taxes to attract and retain businesses. For example, Congress could tax the receiving business on the direct and imputed value of these benefits, it could deny tax-exempt status on debt of states that offer such subsidies, or it could deny federal funding that would otherwise be payable to such states, much as it denies highway funds to states that fail to meet federal pollution standards.

The states

The states won't, on their own, stop using subsidies and preferential taxes to attract and retain businesses. There is anecdotal evidence that some state and local governments recognize they are all losing in this economic war. Nevertheless, as long as a single state engages in this practice, others will feel compelled to compete. New York, New Jersey and Connecticut all recognized that they were losing from this competition, and in 1991 they informally agreed to stop competing with each other. It was not long, however, before New Jersey broke the deal.

Even if a number of states were interested in formally agreeing to stop the practice of competing to attract and retain businesses, it would be a practical impossibility to devise an arrangement that would both cover all the forms of subsidies and preferential taxes the states might devise and provide an effective method of enforcement. Also, such a multistate treaty might run afoul of the Compact Clause of the Constitution, which prohibits a state from entering into a compact with another state, in the absence of the consent of Congress.

The courts

To understand why this problem cannot be left to the courts, it is important to know something of the history and purpose of the Commerce Clause and the role that the courts[9] played in its evolution and application.

The economic union—from the Articles of Confederation to the Constitution

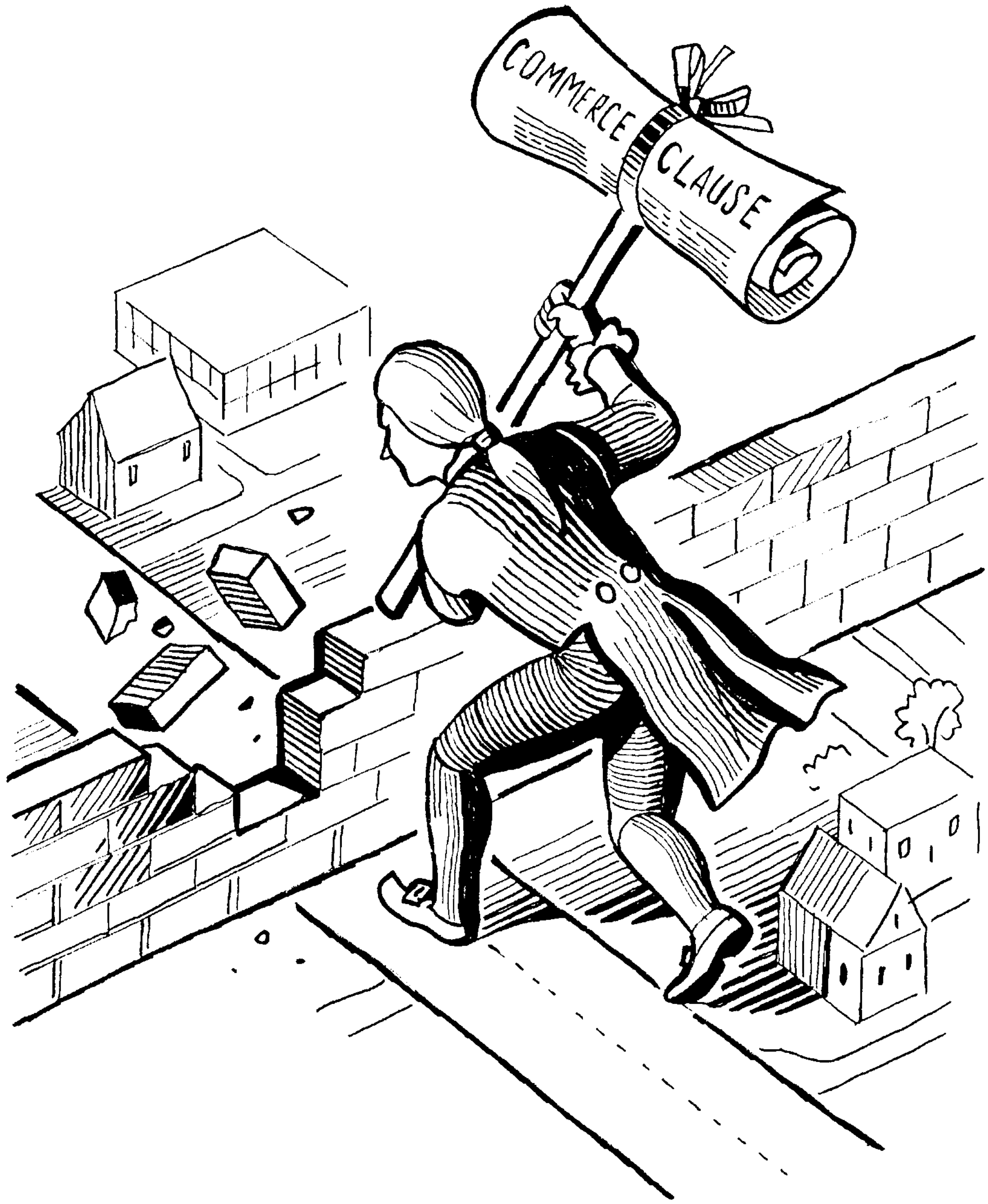
A driving force in the nation's movement from the Articles of Confederation to the Constitution was that the Articles did not provide a national economic union. The Annapolis Convention of 1786 was convened to discuss the removal of the impediments to commercial activity, both among the states and between the United States and foreign nations, under the Articles. It ended with a call for a meeting the following year to discuss changes to the Articles to correct the defects that adversely affected commerce. The 1787 meeting evolved into the Constitutional Convention as it became apparent that the commercial problems could not be remedied by simply amending the Articles.

Under the Articles, the states had freely engaged in destructive economic warfare by imposing all types of trade barriers against one another. To address this, James Madison, the recognized father of the Constitution, added the Commerce Clause to the Constitution, to help promote an economic union of the states. The Commerce Clause grants Congress the power to regulate "Commerce ... among the several States. ..."[10]

Madison expected that Congress would do little to regulate interstate commerce. It was his concept that the Commerce Clause would, in effect, preempt the states from interfering with interstate commerce. In practice, the Commerce Clause did not discourage the states from interfering with interstate commerce and Congress did little, if anything, to constrain them. As a consequence, while Madison intended that the Commerce Clause would almost be self operating in fostering economic union, in the absence of congressional action the courts were left to implement the economic union through *ad hoc* interpretation of the Commerce Clause.

The courts and the Commerce Clause

The Commerce Clause contains an ambiguity: It gives Congress the power to regulate interstate commerce but does not expressly prohibit the states from interfering with interstate commerce. To address this



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ambiguity, the Court developed a doctrine known as the "dormant" or "negative" Commerce Clause, which it applies, in the absence of congressional action, to strike down state laws that it has determined excessively burden interstate commerce.

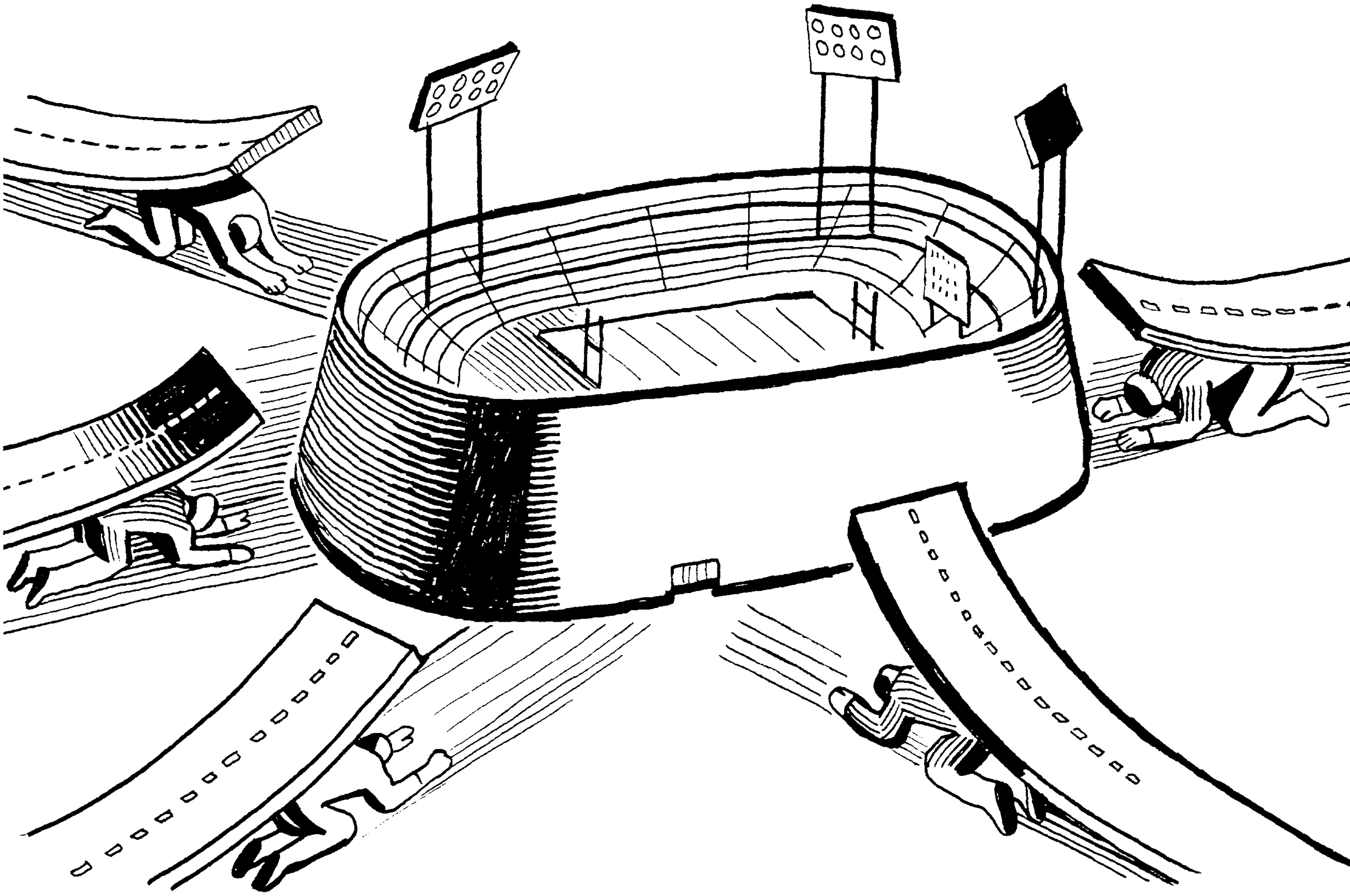
The Court has supported the ideal of an economic union through its application of the dormant Commerce Clause. However, contrary to Madison's vision of the Commerce Clause, the Court will tolerate some state action that imposes a burden on interstate commerce if the burden is not excessive in relation to the benefit accruing to the state from a legitimate local public purpose. A legitimate local public purpose is one for health, safety or welfare, including the economic welfare of the state. The Court recently has said that "a pure subsidy funded out of general revenues ordinarily *imposes no burden on interstate commerce, but merely assists local business.*"[11] (Emphasis added.) In an earlier decision, and more directly to the point of this essay, the Court said that "a State's goal of bringing in new business is legitimate *and often admirable.*"[12] (Emphasis added.)

Therefore, if the Court were to consider the constitutionality of a state subsidy or preferential tax to attract or retain businesses, one would expect it to hold[13] that subsidies or preferential taxes impose no burden on interstate commerce. Even if the Court were to decide that such a state subsidy or tax preference burdens interstate commerce, it would weigh that burden against what it would undoubtedly regard to be a legitimate local public purpose, attracting and retaining businesses.

In any case, the Court may not wish to act because Congress has remained silent.[14] The failure of Congress to speak to an issue can have a profound effect on the Court. When Congress remains silent after the Court has clearly expressed a position in the area of interstate commerce, the Court is likely to regard that silence as tacit approval. Therefore, the Court, having clearly expressed the view that state subsidies to attract and retain businesses do not interfere with interstate commerce, including twice during its 1993-94 term, may take the silence of Congress to be tacit approval.

Finally, the courts are not a practical vehicle for preventing the states from using subsidies and preferential taxes to attract and retain particular businesses. The courts, including the Supreme Court, do not have the power to prevent the states from interfering with interstate commerce. A court can only consider the constitutionality of a state law in the context of a particular case that is before it. As a consequence:

> *Spasmodic and unrelated instances of litigation cannot afford an adequate basis for the creation of integrated national rules which alone can afford that full protection for interstate commerce intended by the Constitution. We would, therefore, leave the questions raised ... for consideration of Congress. ...*[15]



Consider the variety of subsidies and preferential taxes a city and state might use to attract a sports franchise: tax-exempt debt, bargain rent, rebuilt streets and highways, tax increment financing and real estate tax abatements.

Congress can and should prohibit state business subsidies and preferential taxes

The Supreme Court must be credited with implementing the Commerce Clause and preserving Madison's objective of an economic union. Congress has done little to foster the intended purpose of the Commerce Clause. However, the Court can only decide the cases and controversies that come before it. It can't create laws to implement the Commerce Clause.

Only Congress has the power to enact legislation to prohibit and prevent the states from using subsidies and preferential taxes to compete with one another for businesses. In addition to its power under the Commerce Clause, Congress has the ancillary power it derives from its power to tax and appropriate money, and the power to make all laws that are needed to carry out its enumerated constitutional powers. Moreover, under the Supremacy Clause the Constitution and the laws of the United States are the supreme law of the land.

The power of Congress under the Commerce Clause is so sweeping that to enact legislation to prohibit the states from using subsidies and preferential taxes to compete with one another, it need only make a finding, formal or informal, that such subsidies and taxes substantially affect interstate commerce. The Supreme Court will defer to such a congressional finding if there is any rational basis for the finding. No Supreme Court decision in at least the past 50 years has set aside federal legislation on the ground that Congress did not have a rational basis for such a finding.[16] The Court has recognized that the power of Congress under the Commerce Clause even extends to intrastate activities that have a substantial effect on interstate commerce. Moreover, Congress can legislatively supplement, revise or overturn any of the Court's decisions under the dormant Commerce Clause doctrine.

To illustrate how Congress might discourage states from using subsidies and preferential taxes to compete with one another for businesses, consider the variety of subsidies and preferential taxes a city and state might use to attract a sports franchise away from another city. It would not be unusual for them to offer some or all of the following: 1) build a stadium funded by public, tax-exempt debt, 2) lease the stadium to team owners at bargain rent, 3) rebuild streets and highways to provide stadium access, 4) loan or grant the team owners relocation funds, 5) pay for land with tax increment financing on which team owners can build an office building, and 6) grant the team owners a real estate tax abatement on the building. To implement a legislative prohibition, Congress could impose sanctions such as taxing imputed income, denying tax-exempt status to public debt used to compete for businesses and impounding federal funds payable to states engaging in such competition.

Conclusion

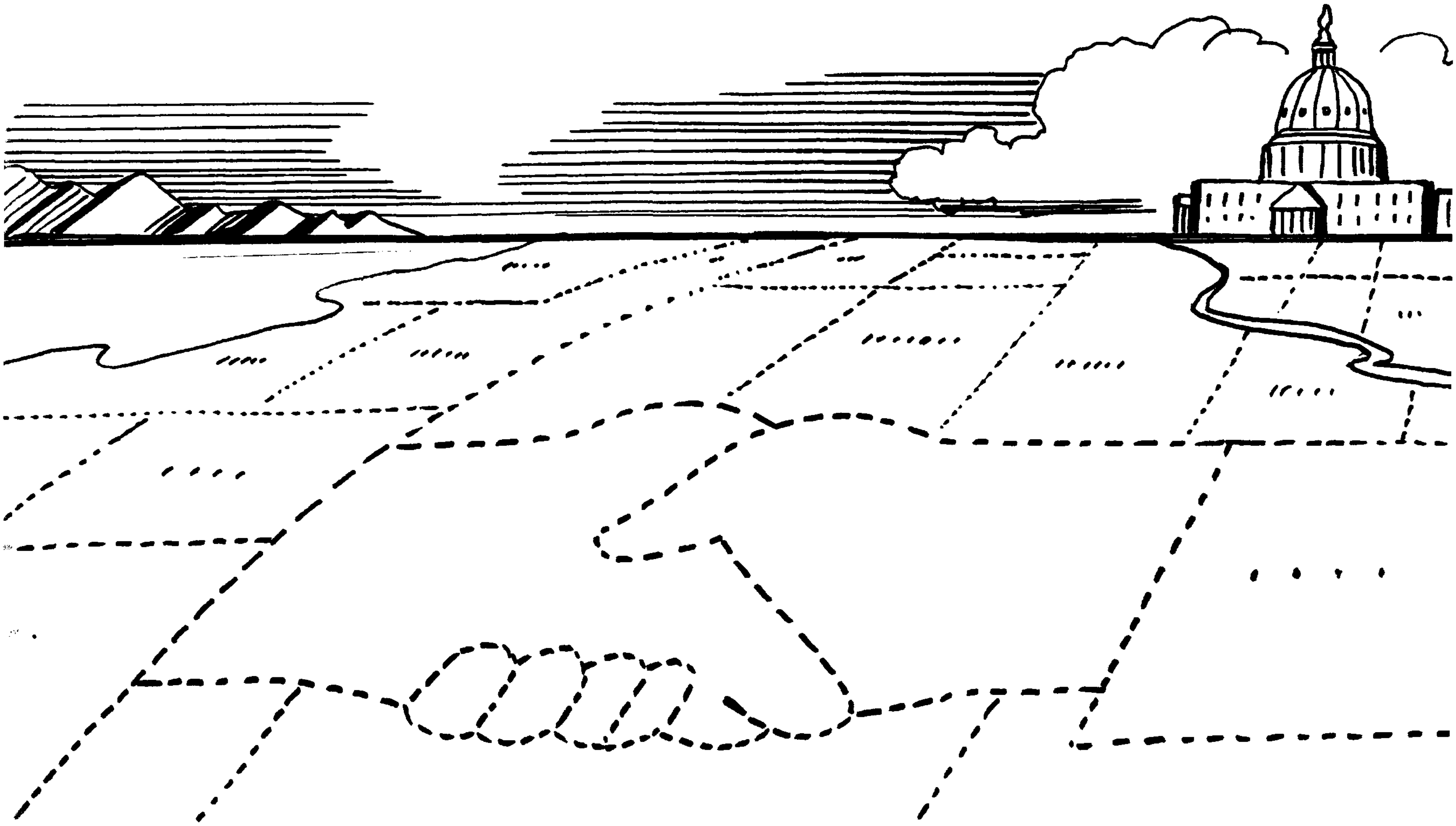
Unfettered competition among private businesses has generally proven to be a very successful economic system. As Adam Smith predicted over 200 years ago, individuals acting in their own best interest are led, as if by an invisible hand, to produce what is best for the overall economy. And experience has shown that Smith was right. Those countries that have relied on a market-oriented economy have outperformed (based on virtually all measures of success) those countries that have relied on a central planning strategy.

But what is true of individuals acting in their own interest is not necessarily true of state governments acting on behalf of their local citizens. Competition among governments based on their general tax and spend policies leads to a better outcome for the overall economy. However, when that competition takes the form of preferential financial treatment for specific companies, the overall economy is made worse off. Such competition results in a misallocation of resources and, in particular, too few public goods.

Competition among states for specific businesses is commonplace and growing more costly. Most states today have put in place some type of economic development program to attract and retain businesses. While some state officials have questioned the economic wisdom of this type of competition, there is little likelihood that the states will successfully establish either formal or informal non-compete agreements, because it appears that the incentive to cheat is too great.

The Supreme Court, which has, for the most part, been the surrogate for Congress in preventing activities that interfere with interstate commerce, is not equipped to end this economic war among the states. To the extent that it has power to do so, there is little, if anything, in its decisions to date that suggest that it would.

Only Congress, with its sweeping constitutional powers, particularly under the Commerce Clause, has the ability to end this economic war among the states. And it is time for Congress to act.



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Endnotes

[1] Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 523 (1934).

[2] John Helyar, "Beat Me in St. Louis," *Wall Street Journal,* January 27, 1995, at 1A.

[3] Jane Seaberry, "Amarillo Lures Business With $8 million Checks," *Dallas Morning News,* September 13, 1994, at 1D. Until this economic development initiative, Amarillo was best known for its farming, ranching and flat terrain.

[4] William Schweke et al., "Bidding for Business: Are Cities and States Selling Themselves Short?," 18 (Corporation for Enterprise Development, Washington, D.C. 1994).

[5] Unless the context clearly indicates otherwise, all references to "state" or "states" are intended to include local government units as well. For purposes of the Commerce Clause it should not make any difference whether subsidies and preferential taxes are offered by states or local governmental units. Most, if not all, subsidies and preferential taxes are offered by the local government under state enabling legislation, and part of the cost of the benefit is, directly or indirectly, borne by the state.

[6] Metropolitan Life Insurance Company v. Ward, 470 U.S. 869, 879 (1985).

[7] For a formal analysis of this proposition, see Thomas Holmes, "The Effects of Tax Discrimination When Local Governments Compete for a Tax Base," Research Department Working Paper 544, Federal Reserve Bank of Minneapolis, 1995.

[8] Holmes (1995) finds that, in general, the overall economy is worse off when states use preferential tax treatment to attract or retain businesses. In those cases where the overall economy might be better off, the net gain is very small and turns negative if the tax on immobile firms becomes too high.

[9] Most of our discussion about the judiciary's role in effectuating the Commerce Clause concerns the U. S. Supreme Court, which we will sometimes refer to as "the Court." Although the Court reviews only a very small number of all the cases involving the Commerce Clause, its holdings are controlling in the absence of federal legislation on the subject. Occasionally, however, we will make more general references to "the courts," which apply decisions of the Court on the Commerce Clause to the cases before them. The term "the courts" will usually include both federal and state courts. Our use of the terms "the Court" and "the courts" is deliberate and the difference in meaning should be clear from the context within which the term is used.

[10] U.S. Const. art. I, sec. 8, cl. 3.

[11] West Lynn Creamery, Inc. v. Healy, 114 S. Ct. 2205, 2214 (1994).

[12] *Metropolitan,* 470 U.S. at 879.

[13]The term "hold" or "holding" refers to the specific issue being decided by the Court. For example, in the West Lynn Creamery case the Court *held* that the Massachusetts tax on fluid milk unconstitutionally discriminated against interstate commerce. The *holding* of the Court should be distinguished from observations the Court makes in its opinions. Although such observations may be persuasive evidence of how the Court or a particular justice might rule in a future case before the Court, the observation cannot be cited as authority for a legal proposition.

[14] See, e.g., Federal Baseball Club of Baltimore, Inc. v. National League of Professional Baseball Clubs, 259 U.S. 200 (1922). In this case, the Court held that professional

baseball was exempt from antitrust legislation because it was not engaged in commerce among the states. No one today would seriously argue that professional baseball is not engaged in commerce among the states; nevertheless, the Court has never overturned that decision, in part because Congress has been silent on the issue.

[15] McCarroll v. Dixie Lines, Inc., 309 U.S. 176, 189 (1940), (Justices Black, Frankfurter and Douglas dissenting).

[16] *See* United States v. Lopez, 2 F. 3d 1342, 1363 (5th Cir. 1993), cert. granted 114 S. Ct. 1536 (1994).

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Federal Reserve Bank of Minneapolis

Statement of Condition (in thousands)

	December 31, 1994	December 31, 1993
Assets		
Gold Certificate Account	$ 230,000	$ 243,000
Special Drawing Rights	186,000	186,000
Coin	20,777	15,365
Loans to Depository Institutions	10,922	4,300
Securities:		
Federal Agency Obligations	80,090	106,173
U.S. Government Securities	8,027,738	7,599,809
Cash Items in Process of Collection	380,107	465,435
Bank Premises and Equipment –		
Less Accumulated Depreciation of $39,393 and $42,172	54,224	43,626
Foreign Currencies	588,722	585,294
Other Assets	187,716	172,676
Interdistrict Settlement Fund	(1,896,665)	(1,003,850)
Total Assets	$7,869,631	$8,417,828
Liabilities		
Federal Reserve Notes[1]	$6,552,810	$7,048,384
Deposits:		
Depository Institutions	611,857	676,876
Foreign, Official Accounts	3,766	3,642
Other Deposits	15,235	5,327
Total Deposits	630,858	685,845
Deferred Credit Items	379,599	435,376
Other Liabilities	109,840	66,535
Total Liabilities	7,673,107	8,236,140
Capital Accounts		
Capital Paid In	98,262	90,844
Surplus	98,262	90,844
Total Capital Accounts	196,524	181,688
Total Liabilities and Capital Accounts	$7,869,631	$8,417,828

1 Amount is net of notes held by the Bank of $1,491 million in 1994 and $1,171 million in 1993.

Earnings and Expenses (in thousands)

For the Year Ended December 31,	1994	1993
Current Earnings		
Interest on U.S. Government Securities and Federal Agency Obligations	$425,703	$347,125
Interest on Foreign Currency Investments	23,864	32,740
Interest on Loans to Depository Institutions	4,162	1,749
Revenue from Priced Services	42,443	41,659
All Other Earnings	313	129
Total Current Earnings	496,485	423,402
Current Expenses		
Salaries and Other Personnel Expenses	45,521	43,306
Retirement and Other Benefits	11,224	10,513
Travel	2,784	2,728
Postage and Shipping	5,830	5,814
Communications	573	500
Software	1,465	2,143
Materials and Supplies	2,226	2,431
Building Expenses:		
Real Estate Taxes	1,143	866
Depreciation – Bank Premises	868	1,149
Utilities	965	1,046
Rent and Other Building Expenses	1,523	1,440
Furniture and Operating Equipment:		
Rentals	1,003	970
Depreciation and Miscellaneous Purchases	4,194	5,130
Repairs and Maintenance	2,873	3,029
Cost of Earnings Credits	5,389	3,945
Net Costs Distributed/Received from Other FR Banks	4,840	(870)
Other Operating Expenses	1,888	2,048
Total Current Expenses	94,309	86,188
Reimbursed Expenses[1]	(10,886)	(6,894)
Net Expenses	83,423	79,294
Current Net Earnings	413,062	344,108
Net (Deductions) or Additions[2]	64,171	(13,149)
Less:		
Assessment by Board of Governors:		
Board Expenditures	3,925	3,739
Federal Reserve Currency Costs	7,545	8,021
Dividends Paid	5,684	5,321
Payments to U.S. Treasury	452,661	303,003
Transferred to Surplus	$ 7,418	$ 10,875
Surplus Account		
Surplus, January 1	$ 90,844	$ 79,969
Transferred to Surplus – as above	7,418	10,875
Surplus, December 31	$ 98,262	$ 90,844

1 Reimbursements due from the U.S. Treasury and other Federal agencies; $2,327 was unreimbursed in 1994 and $1,890 in 1993.

2 This item consists mainly of unrealized net gains or (losses) related to revaluation of assets denominated in foreign currencies to market rates.

Directors Federal Reserve Bank of Minneapolis

December 31, 1994

Gerald A. Rauenhorst
Chairman and Federal Reserve Agent

Jean D. Kinsey
Deputy Chair

Class A Elected by Member Banks

Susanne V. Boxer
President
MFC First National Bank
Houghton, Michigan

Jerry B. Melby
President
First National Bank
Bowbells, North Dakota

William W. Strausburg
Chairman and Chief Executive Officer
First Bank Montana, N.A.
Billings, Montana

Class B Elected by Member Banks

Duane E. Dingmann
President
Trubilt Auto Body, Inc.
Eau Claire, Wisconsin

Dennis W. Johnson
President
TMI Systems Design Corp.
Dickinson, North Dakota

Clarence D. Mortenson
President
M/C Professional Associates, Inc.
Pierre, South Dakota

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Chairman and Chief Executive Officer
Graco, Inc.
Golden Valley, Minnesota

Jean D. Kinsey
Professor of Consumption and Consumer Economics
University of Minnesota
St. Paul, Minnesota

Gerald A. Rauenhorst
Chairman and Chief Executive Officer
Opus Corporation
Minneapolis, Minnesota

Federal Advisory Council Member

John F. Grundhofer
Chairman, President and Chief Executive Officer
First Bank System, Inc.
Minneapolis, Minnesota

Helena Branch

Lane W. Basso
Chairman

Matthew J. Quinn
Vice Chairman

Appointed by the Board of Governors

Lane W. Basso
President
Deaconess Medical Center
Billings, Montana

Matthew J. Quinn
President
Carroll College
Helena, Montana

Appointed by the Board of Directors
Federal Reserve Bank of Minneapolis

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President
First State Bank of Malta
Malta, Montana

Donald E. Olsson, Jr.
President
Ronan State Bank
Ronan, Montana

Nancy McLeod Stephenson
Executive Director
Neighborhood Housing Services
Great Falls, Montana

Officers Federal Reserve Bank of Minneapolis

December 31, 1994

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President

Colleen K. Strand
First Vice President
and Electronic Payments Product Director

Melvin L. Burstein
Executive Vice President, Senior Advisor
and General Counsel

Sheldon A. Azine
Senior Vice President

James M. Lyon
Senior Vice President

Arthur J. Rolnick
Senior Vice President and
Director of Research

Theodore E. Umhoefer, Jr.
Senior Vice President

John. H. Boyd
Senior Research Officer

Scott H. Dake
Vice President

Kathleen J. Erickson
Vice President

Creighton R. Fricek
Vice President and Corporate Secretary

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Vice President

Caryl W. Hayward
Vice President and
Electronic Payments Product Manager

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Vice President

Ronald O. Hostad
Vice President

Bruce H. Johnson
Vice President

Thomas E. Kleinschmit
Vice President

Richard L. Kuxhausen
Vice President

David Levy
Vice President and
Director of Public Affairs

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Vice President

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Vice President and Monetary Advisor

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Vice President and
Deputy General Counsel

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General Auditor

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Senior Research Officer

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Niel D. Willardson
Assistant Vice President

Mildred F. Williams
Assistant Vice President

Marvin L. Knoff
Supervision Officer

Robert E. Teetshorn
Supervision Officer

Helena Branch

John D. Johnson
Vice President and Branch Manager

Samuel H. Gane
Assistant Vice President
and Assistant Branch Manager