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COMPETITION, STATE AIDS AND SUBSIDIES

Contribution from the U.S. Federal Trade Commission

-- Session I --

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STATE AIDS AND SUBSIDIES

-- U.S. Federal Trade Commission --

1. Introduction

1. The United States does not have a system for the direct regulation of government financial aid to firms. In some extraordinary instances, the U.S. Government has provided assistance to industries and firms to address specific exigencies, for example, to protect critical infrastructure, employment, national defence, and the integrity of the banking and financial system.¹ In its recent rescue measures, the U.S. Government has taken steps to limit the possible negative effects of such interventions by restricting the duration and depth of its intervention. U.S. states may provide certain assistance to firms but, under the “dormant Commerce Clause” of the U.S. Constitution, their actions may not discriminate against other states or hinder interstate commerce.

2. State and Local Level Aids and Subsidies

2. The United States does not have a regulatory regime governing state and local aids and subsidies. However, courts have found certain state assistance to violate the Commerce Clause of the U.S. Constitution.² The Supreme Court has held that there is a “dormant” or “negative” aspect of the Commerce Clause that implicitly limits the states’ right to tax or otherwise regulate interstate commerce:

It has been long accepted that the Commerce Clause not only grants Congress the authority to regulate commerce among the States, but also directly limits the power of the States to discriminate against interstate commerce. ... This ‘negative’ aspect of the Commerce Clause prohibits economic protectionism – that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competition. ... Thus, State statutes that clearly discriminate against interstate commerce are routinely struck down, [...] unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism....³

3. Thus, measures that either discriminate against interstate commerce, because they favour in-state interests, or measures that burden interstate commerce, because (even if they are non-discriminatory) they

¹ This paper does not cover government measures that may indirectly benefit firms, such as those involving infrastructure, research and development, public services, and taxation.

² United States Constitution, Art. I, sec. 8, cl. 3. *See, e.g., Maryland v. Louisiana*, 451 U.S. 725 (1981). In *Maryland v. Louisiana*, the Supreme Court held that a Louisiana statute imposing a first-use tax on natural gas extracted from the continental shelf in an amount equivalent to the severance tax imposed on natural gas extracted in Louisiana unquestionably discriminated against interstate commerce in favour of a local interest and violated the Commerce Clause. *See also, West Lynn Creamery v. Healy*, 512 U.S. 186, 201 (1994), *Cuno*, 386 F.3rd 738, 743 (6th Cir. 2004), *rev’d in part on other grounds sub nom. DaimlerChrysler Corp. v. Cuno*, 126 S. Ct. 1854 (2006), and *Granholtz v. Heald*, 125 S. Ct. 1885, 1892 (2005), as discussed below.

³ *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 273-74 (1988).

make it cumbersome for a company to do business in the state, are equally offensive under the dormant Commerce Clause.⁴

4. States and local authorities regularly provide tax breaks and other incentives to attract new investors.⁵ Generally speaking, a challenged credit or exemption will not survive Commerce Clause scrutiny if it discriminates on its face or if, on the basis of a “sensitive, case-by-case analysis of purposes and effects,” the provision “will in its practical operation work discrimination against interstate commerce,”⁶ by “providing a direct commercial advantage to local business.”⁷ Discrimination means different treatment of in-state and out-of-state economic interest that benefits the former and burdens the latter.⁸ A state tax that discriminates against interstate commerce is invalid unless “it advances a legitimate local purpose that cannot be adequately served by reasonable non-discriminatory alternatives.”⁹

5. In *Cuno v. DaimlerChrysler, Inc.*,¹⁰ the U.S. Court of Appeals for the Sixth Circuit struck down Ohio’s income tax credit for new in-state investment on the grounds that it violated the Commerce Clause, stating that the income tax credit discriminated against interstate economic activity “by coercing businesses already subject to the Ohio franchise tax to expand locally rather than out-of-state.”¹¹

6. In *Granholm v. Heald*,¹² the U.S. Supreme Court invalidated laws in Michigan and New York that prevented or deterred out-of-state wineries from selling directly to in-state consumers yet allowed in-state wineries to do so. In finding that the regulations discriminated against interstate commerce in

⁴ See Diane P. Wood, “Cuno v. Daimler Chrysler, Inc.: State ‘Aids’ from an American Perspective,” *European State Aid Law*, 1/2007, at 7.

⁵ E.g., in 1994, Indiana passed a law (“Economic Development for a Growing Economy” or “EDGE”) to provide income tax credits for companies that make major job-producing investments in the state. See Economic Development for a Growing Economy Tax Credit, Indiana Code 6-3.1-13, *available at* <http://www.ai.org/legislative/ic/code/title6/ar3.1/ch13.html>. South Carolina offered Haier, a Chinese appliance manufacturer, tax credits and other incentives for the construction of a new factory in the state. See “Against the Grain: A Chinese appliance maker has placed its bet on a counterintuitive strategy: It’s bringing jobs to the US,” *The Wall Street Journal*, Sept. 27, 2004, at R6. Georgia state and local authorities provided Kia, the South Korean automobile manufacturer, \$410 million in state and local tax credits and other assistance to build a plant employing 2,500 workers in Georgia. See “Kia joins Toyota in opening U.S. plants,” *The New York Times*, March 14, 2006, *available at* <http://www.nytimes.com/2006/03/14/business/worldbusiness/14iht-cars.html>. In January 2010, the Michigan Economic Development Corporation approved a \$22 million state tax credit to Tata Consultancy Services to establish a centre in Michigan that will involve an investment of \$125 million and create up to 750 jobs. See “Gov. Granholm Announces Over 5,200 New, Retained Jobs for Michigan,” U.S. FED. NEWS (Jan. 20, 2010).

⁶ *West Lynn Creamery v. Healy*, 512 U.S. 186, 201 (1994). In this case, a Massachusetts law imposed a tax on milk dealers for all in-state sales of milk, whether or not the milk had been produced in Massachusetts. The state then distributed the money from the tax only to operators of in-state daily farms. The Court found that it effectively gave Massachusetts producers a tax rebate that was indistinguishable from a discriminatory tax exemption.

⁷ *Bacchus Imports, LTD. v. Dias*, 460 U.S. 263, 272 (1984).

⁸ *Oregon Waste Sys., Inc. v. Dep’t of Env’tl. Quality*, 511 U.S. 93, 99 (1994).

⁹ *Id.*, at 101.

¹⁰ *Cuno*, 386 F.3rd 738, 743 (6th Cir. 2004), *rev’d in part on other grounds sub nom. DaimlerChrysler Corp. v. Cuno*, 126 S. Ct. 1854 (2006) (plaintiffs lacked standing to sue in federal court).

¹¹ *Id.*

¹² *Granholm v. Heald*, 125 S. Ct. 1885, 1892 (2005).

violation of the Commerce Clause, the Court heavily relied on the FTC's 2003 Wine Report.¹³ Citing the FTC report, the Court concluded that the regulations were not the least restrictive alternative for regulating interstate wine sales to minors and facilitating tax collection. The Court said the regulations were "the product of an ongoing, low-level trade war"¹⁴ among the states, and added that it was "evident that the object and design of the Michigan and New York statutes is to grant in-state wineries a competitive advantage over wineries located beyond the States' borders."¹⁵

3. Federal Government Assistance to Ailing Companies and Industries

3.1 History

7. The U.S. government's first extensive aid programmes occurred in the 1970s. Penn Central Railroad, on the verge of bankruptcy in 1970, appealed to the Federal Reserve for aid on the grounds that it provided critical infrastructure and transportation services that would otherwise be lost. In 1971, Congress provided Penn Central with \$673 million in loan guarantees. In 1974, Congress approved a package of loans, loan guarantees, and grants for Penn Central and five other railroad companies that were facing bankruptcy. In 1976, Congress established Conrail, a publicly created quasi-private company, to consolidate the freight rail system. The government spent approximately \$7 billion to keep Conrail operating. Conrail started to earn a profit in 1981¹⁶ and the federal government sold its ownership interest in 1987.¹⁷

8. Lockheed Aircraft Corporation received government aid in the early 1970s. In 1971, Lockheed experienced severe financial troubles. As a result of an appeal by the company's management to the federal authorities, Congress passed the Emergency Loan Guarantee Act in 1971, granting up to \$250 million in loan guarantees.¹⁸ The aid was motivated by the approximately 60,000 jobs at risk between Lockheed and its suppliers, the potential significant loss in GDP,¹⁹ and the implications for national defence given that Lockheed was a major defence contractor. The Treasury's aid enabled Lockheed to gradually recover from its financial crisis and win back its creditors' trust. Lockheed eventually paid off its loans and gave up the government's guarantee in 1977.

¹³ Staff of the U.S. Federal Trade Commission, "Possible Anticompetitive Barriers to E-Commerce: Wine" (July 2003), available at <http://www.ftc.gov/os/2003/07/winereport2.pdf>. The Report explores the ways in which various state governments restrict competition in U.S. wine markets by making it difficult or impossible for out-of-state wine producers to sell wine directly to consumers in other states. After analysing these laws and the justifications given for them, comparing conditions among states with different laws, and conducting an empirical study, the FTC Staff concluded that state bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce in wine and recommended that states allow direct shipping from out-of-state wineries and retailers, as well as from in-state suppliers. *Id.*, at 3 and 40.

¹⁴ *Supra* note 11, at 1896.

¹⁵ *Id.*, at 1892.

¹⁶ An important step towards Conrail's financial turnaround was the passage in 1980 of the Staggers Act, which allowed railroads to set their own rates according to market conditions.

¹⁷ "85% U.S. Stake in Conrail Sold for 1.6 Billion," *The New York Times*, March 27, 1987, available at <http://www.nytimes.com/1987/03/27/business/85-us-stake-in-conrail-sold-for-1.6-billion.html?pagewanted=1>.

¹⁸ "The Lockheed Bailout Battle," *Time Magazine* (Aug. 9, 1971).

¹⁹ The potential loss in GNP from a Lockheed bankruptcy was estimated between \$120 and \$475 million.

9. The U.S. government's assistance to Chrysler Corporation in 1980 was probably the best-known example of government aid to a troubled company in U.S. economic history. Under the 1980 Chrysler Loan Guarantee Act, Chrysler, which was on the brink of bankruptcy, received \$1.2 billion in federal loan guarantees. Treasury Secretary G. William Miller stated, "There is a public interest in sustaining [its] jobs and maintaining a strong and competitive national automotive industry."²⁰ Chrysler paid back the loan in 1983.

10. The last federal assistance programme prior to the recent rescue measures in response to the 2008 financial crisis took place in the airline industry in 2001. Following the September 11, 2001, attacks, the grounding of airplanes hit an already financially troubled industry very hard. To assure the functioning of airlines and air transportation facilities during the crisis, Congress enacted a \$15 billion financial aid package.²¹

3.2 Rescue Measures for Banks and Car Makers in the Recent Financial Crisis

11. As a result of the international financial crisis that erupted in late 2008, the U.S. Government established the "Troubled Assets Relief Programme" ("TARP") pursuant to the Emergency Economic Stabilisation Act ("EESA"). TARP's goal is to maintain the functioning and integrity of the banking and financial markets and thereby, the broader economy.

12. EESA authorised \$700 billion of Treasury investments under TARP. Pursuant to TARP's Capital Purchase Programme, the U.S. Treasury Department and the Federal Reserve Board have invested in 707 U.S. banks.²² TARP's Targeted Investment Programme invested \$20 billion each in Citigroup Inc. and Bank of America Corp.²³ As of January 2010, approximately \$545 billion has been programmed, although not necessarily disbursed, under various TARP initiatives. The U.S. Government is unlikely to utilise the full \$700 billion in budgetary authority allowed for TARP pursuant to the EESA. TARP has helped U.S. banks to stabilise and several banks that received TARP assistance have started to pay back these loans. As of January 2010, total TARP repayments were over \$165 billion, or two-thirds of total TARP investments in U.S. banks.²⁴

13. The federal government also provided TARP aid for the automobile industry to "facilitate the restructuring of our domestic auto industry, prevent disorderly bankruptcies during a time of economic

²⁰ "Chrysler's Crisis Bailout," *Time Magazine* (Aug. 20, 1979).

²¹ Air Transportation Safety and System Stabilisation Act of 2001, 49 USC 4010 note.

²² TARP's Capital Purchase Programme invested \$205 billion in U.S. banks. See Report of the Special Inspector General for TARP, available at http://www.sig tarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf, and Office of Financial Stability, Dep't of Treasury, Troubled Asset Relief Programme Transactions Report (January 13, 2010). See also figure 4 in dep't of treasury, troubled asset relief programme monthly 105(a) report – December 2009 6 (January 11, 2010) and Office of Financial Stability, Dep't of Treasury, warrant disposition report 1 (2010).

²³ Office of Financial Stability, Dep't of Treasury, Troubled Asset Relief Programme Transactions Report 17 (January 13, 2010).

²⁴ *Id.* See also Figure 4 in Dep't of Treasury, Troubled Asset Relief Programme Monthly 105(a) Report – December 2009 6 (January 11, 2010). This consists mainly of over \$122 billion repaid under the Capital Purchase Programme and \$40 billion repaid under the Targeted Investment Programme. See Office of Financial Stability, Dep't of Treasury, Warrant Disposition Report 1 (2010) and Dep't of Treasury "Treasury Receives \$45 Billion in Repayments from Wells Fargo and Citigroup – TARP Repayments Now Total \$164 Billion," Press Release (December 22, 2009), available at http://www.financialstability.gov/latest/pr_12232009b.html.

difficulty, and protect the taxpayer by ensuring that only financially viable firms receive assistance.”²⁵ The companies were required to make fundamental changes in their management and products as conditions for assistance.

14. In December 2008, Congress enacted the Automotive Industry Financing and Restructuring Act, which provided \$14 billion in short-term bridge loans to GM and Chrysler.²⁶ Because the recipients did not present viable restructuring measures, the government announced new initiatives to provide assistance to the industry in the framework of the Auto Industry Financing Programme (2009). The initiatives included programmes that ensured payments to the car makers’ largest suppliers, established a warranty commitment programme to cover the possible deterrent effect of bankruptcy, and initiated programmes to respond to job losses and community effects to ease a possible transition process for workers in areas dependent on the automobile industry. The cost of government assistance, including loans, assistance to finance companies, the supplier support programme, and the warranty commitment initiative, totalled \$36.4 billion.

15. The government’s intervention in Chrysler resulted in another auto company’s taking substantial ownership of Chrysler and managing its remaining assets. Fiat obtained a 35 percent stake in the new Chrysler, while the U.S. government retained 8 percent following the company’s reorganisation. The government pursued a different strategy regarding GM. GM was required to cut about one-third of its work-force, sell half of its brands, make substantial wage concessions, revise health and insurance benefits, and replace its senior management and board of directors. The plan transformed GM into a majority publicly-owned company, with the U.S. government owning 60 percent of the company.

16. To limit potentially negative ramifications of these rescue measures, the U.S. government has taken steps to ensure that the assistance is transitory and limited to taking ownership stakes that do not compromise the independent direction and management of the company. President Obama recently described this policy in the context of General Motors, but the principles are applicable to other situations as well: “[W]e are acting as reluctant shareholders . . . The federal government will refrain from exercising its rights as a shareholder in all but the most fundamental corporate decisions. . . . In short, our goal is to get GM back on its feet, take a hands-off approach, and get out quickly.”²⁷

²⁵ The White House, “Fact Sheet: Financing Assistance to Facilitate the Restructuring of Auto Manufacturers to Attain Financial Viability,” Dec. 19, 2008, *available at* <http://www.whitehouse.gov/news/releases/2008/12/20081219-6.html>.

²⁶ As Ford made a series of significant financial targets in 2006, it allowed the company to cover its own losses and remain independent.

²⁷ Remarks by President Obama on General Motors Restructuring (June 1, 2009), *available at* http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-General-Motors-Restructuring/. The policy of limited assertion of ownership has been similar in the banking industry. *See* Remarks of President Obama on the Economy (Georgetown University, Apr. 14, 2009) (“we believe that pre-emptive government takeovers are likely to end up costing taxpayers even more in the end, and because it’s more likely to undermine than create confidence”), *available at* http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-the-Economy/.