

SUBSIDIES, COMPETITION LAWS AND POLITICS: A COMPARISON OF THE E.U. AND THE U.S.A.

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Both the EU and the US have laws and rules intended to promote competition by discouraging monopolies and both sets of rules have similar "anti-trust" character. In the case of the EU, Community law contains general anti-trust provisions, provisions for the control of mergers and concentrations, provisions restricting state aids, and particular rules applying to public undertakings.¹ American anti-trust law covers similar ground with respect to competition, monopolies, mergers, collusive practices, price discrimination and exclusionary practices.

However, American anti-trust law says nothing about state aids or about pre-emptive control of subsidies by any level of government. The law's silence on this topic might seem paradoxical. Since the ideology behind anti-trust is so clearly an exaltation of free competition in a market economy, one would expect an explicit and stringent restriction of subsidies in American anti-trust law, alongside the suspicion of economic concentration that is so apparent. But the very strength of the ideology may it self explain the law's silence: the notion of government subsidy - at least so described - is sufficiently alien that law-makers have not even paused to consider its prohibition or restriction.

The historical background of anti-trust:

The scope of US anti-trust law derives historically from anxieties and ideals quite different from those that have shaped the European Union. Historically, anti-trust originated from the economic disorder that followed the Civil War. The misfortunes of farmers and small businesses were contrasted with the prosperity and growing market power of large industrial corporations, organized as trusts. It was this situation, and the fears and resentments it bred, that led to the adoption of anti-trust legislation, first by individual states and eventually, in 1890, by Congress in the Sherman Anti-Trust Act. This Act, and a number of amendments introduced over the years, constitutes the legislative framework of U.S. competition policy.

This ideological and historical background indicates that American anti-trust policy was not conceived as instrumental to the creation and maintenance of a market operated in common by various economic actors and public actors. A single market - at least as

concerns the free circulation of goods - had existed to a certain degree in the U.S. since the establishment of the Union itself. Legislators framed anti-trust legislation in order to protect this market from supposedly "unnatural" distortions caused by the strength of the most powerful actors.

The preoccupation with a free market also accounts for the occasional criticism that anti-trust regulations, like all government intervention, have attracted in the US as "counterproductive" and "overregulatory." Yet even those who criticize the costs, the efficacy and the consistency of anti-trust legislation do not call for the abolition of the federal machinery to deal with anti-trust issues.

The historical background of European integration:

In contrast to the American preoccupation with a free market, European integration has been driven by the ideal of creating a single market - an ideal that competition policy and merger control (among other legislation) is intended to advance.

The dismantling of customs barriers between the Member-States, as well as the abolition of a wide variety of regulatory and technical obstacles, has had a pivotal role in the progress of European integration. The free circulation of goods, services and capital, along with the free movement of workers, has made possible the creation of a common identity, if not yet a sense of common citizenship.

In this context, the protection of competition cannot be seen as an end in itself. Rather, it is one of the general and related objectives of the Treaties and is a prerequisite for the proper functioning of the common market.² The existence of separate national markets within the Community prior to integration, and the persistence of competition between them and between state-supported firms within national markets, necessarily led those pursuing integration to focus on state subsidies as a way of eliminating obstacles to fair and effective competition. Trade liberalization required an appropriate cross-border competition policy, which in turn called for control of subsidies.

While state aid is still a conspicuous feature of European economies - representing some ECU 90 billion (2% of Community GDP) between 1988 and 1990 - the EU Commission has become much more active in containing and regulating subsidies. Until the 1970s, the Commission was fairly inactive in this field, examining annually fewer than fifty cases. The number of cases reported has grown steadily since the second half of the 1980s, in connection with the strengthening of enforcement by the Commission and the pressures resulting from adoption of the program for completion of the single market by 1992.

Now some 600-700 cases are examined annually. Though relatively few lead to findings critical of the practices examined, increased monitoring on the part of the Commission has caused Member-State governments to restrict state aids to forms and levels more consistent with Community standards. Overall, the Commission's power to control subsidies by national governments is unique among the world's competition authorities.

Do subsidies exist in the US?

While the EU has taken broad powers to control subsidies, the US (as noted above) does not have anti-trust legislation restraining and restricting subsidies. It is clear that in the EU such controls respond to a reality of persistent and widespread government subsidization.

But does the lack of such controls in the US imply a corresponding lack of subsidies, in function if not in title? And does the lack of formal controls imply a lack of alternative public means of restraining types of government assistance that, in function if not in title, provide assistance to businesses?

The truth is that in the US various forms of subsidy occur that in the EU would attract the attention of the Commission as representing forms of state aid. Typically, they are justified as supporting either "industrial policy" or "regional development" and they represent in aggregate substantial public expenditure. However, such subsidies do not qualify for consideration by the agencies with authority for implementing anti-trust law.

Though the use and extent of such subsidies may be surprising to Europeans - given the historical American attitude to the free market - both are familiar to politicians and students of economic policy in the US. Their existence and rationale have, indeed, recently come under attack following the establishment of a Republican majority in the US Congress in November 1994.

Comparison with subsidies in Europe should be made cautiously, since industrial and development plans in the US often combine aid (in the European sense) with broader fiscal and educational expenditure and spending on infrastructure.

This said, some examples of government actions intended to influence decision-making by business might include, in 1993 alone:

1. grants totaling more than \$360 million by the City of New York to keep enterprises from moving elsewhere;
2. the establishment by the state of New Jersey of a \$234 million economic development fund designed to stimulate new economic initiatives; and
3. an offering by the state of Kentucky (in competition with its rivals, Ohio and Pennsylvania) of a package of tax credits, low-interest loans and new roads that represented an investment of some \$350,000 for each of 400 jobs to be created by the establishment of a new steel plant by a Canadian corporation.

Comparable to the last example was the \$37 million package of incentives offered in 1994 by the State of Indiana to Steel Dynamics, Inc., to persuade the company to construct a 600-employee steel mill in the state (rather than in Illinois, Kentucky, Ohio or Michigan).

Packages of this type commonly offer tax credits to allow businesses to recoup the cost of new buildings, low-interest loans, and substantial tax deductions allowed on the costs of moving a firm's operations into a new area.

Criticism of incentive packages may simply assert that they are inappropriate in a free market economy. More recently, however, they tend to focus on the strategic wisdom of the approach, quite apart from its conformity with "American ideology"; For example, it is argued that bidding wars between states are self-defeating. They have not, in fact, reduced regional disparities since the wealthier states can always outbid their neighbors, but they certainly push up the costs for the public exchequer of job creation. Indeed, such packages may be not only costly but irrelevant, since the companies concerned may make their decisions on grounds other than the size of the incentive package offered by particular states.

Finally, incentive schemes tend to reward the most mobile firms without requiring or inducing them to become rooted in a locality. Firms that are mobile do not cease to be so just because they have taken advantage of incentive packages offered by states or lower-level governments. In several cases, firms have moved on, leaving relatively poor states or counties facing long-term indebtedness as a result of large incentive packages.

Striking figures for the magnitude of subsidies to particular sectors have come to light during the recent debate on cuts in the federal budget. The larger sectoral subsidies include:

1. \$45.3 billion for agricultural programs;
2. \$42.5 billion for the energy industry;
3. \$41.6 billion for transportation;
4. \$27.1 billion for aerospace and high-technology firms; and
5. \$24.7 billion for the construction industry.

In addition, a further \$140.7 billion has been provided for a variety of projects and industries through offshore tax exemptions and fiscal deductions.

In the following sections, we examine the incidence and impact of subsidies in particular areas of business development.

(a) Research and development:

Research and development provides a good example of the distortions created by government policy and illustrates the "hidden dimension" of competition policy in the US.

In 1993, projected expenditure from US government sources in support of R&D activities totaled \$76 billion. This public contribution to scientific research covers both basic and applied scientific research and amounts to 46% of total national expenditure on R&D in 1993. As the beneficiaries of the subsidies in question include federal agencies, national

laboratories, and non-profit universities, in addition to private sector research bodies, the rationale for government policy is that the taxpayers benefit twice from governmental support for R&D. First, taxpayers benefit from the achievements of government agencies. Secondly, taxpayers earn royalties or profits from the discoveries and their spin-offs when they enter the market as commercial goods.

This logic - resting upon the traditional right of government to the fruits of R&D it helps to fund - has been shaken by what can be described as the privatization of public technology.

Though no legal prohibition existed on exclusive marketing licenses for publicly funded technology prior to 1980, no such licenses were granted because the concession of exclusive use would raise clear anti-trust issues.

More recently, however, the business community has managed to win exclusive marketing licenses for publicly financed technology. Apparently, this has happened because several large corporations campaigned for transferring the products of federally funded R&D to the private sector. Such corporations argued that valuable inventions were lying unused in public laboratories because the authorities were ineffective in cooperating with the private sector to develop commercial applications. Further, the corporations claimed that allowing the grantees exclusive licenses over federally-funded discoveries would make US companies more competitive and would provide an incentive for developing inventions into commercially viable products.

As a consequence, from 1980 onward a number of measures were passed in order to authorize the granting of exclusive marketing licenses to commercial manufacturers of government-owned intellectual property.³ The legislation was also intended to encourage the identification of technologies with possible commercial applications by public laboratories and to favor cooperation schemes (known as CRADAs - Cooperative Research and Development Agreements) between the public entities performing R&D and private sector partners. This policy progressively extended access to the benefits of these schemes from Small and Medium Enterprises (SMEs), universities and other non-profit organizations to all contractors, regardless of size.

As a result of the new legislative framework, contractors who have conducted research with public funds now own the rights to commercially exploit new research products and government retains little control over how these rights are exercised.

Regarding R&D carried out by public entities, various incentives are provided for the commercialization of innovations achieved in the course of their activity through exclusive marketing licenses. This goal is achieved through entitlement of federal researchers and laboratories to part of the royalties generated by the licensing process.

Critics focus on three possible dangers arising from this trend:

1. the diversion of scientific bodies, notably the universities, toward increased involvement in profit-making research programs, which de facto corrupts their traditional vocation of seeking knowledge independently and for purely scientific purposes;
2. the encouragement of anti-competitive practices: the contractor can legally withhold technical information - obtained with the use of public funds - from its competitors, thus preventing them from entering the market or increasing their own shares; and
3. the possibility of monopoly pricing: under the existing legislation, there is poor (if any) control over the way that products developed with public funding are marketed. This issue is particularly important in the area of life-saving drugs. For example, in the case of AZT (used to treat AIDS), the federal government apparently has no control over the pricing of the drug and receives no royalties from its sale, despite the fact that the drug was developed in government laboratories.

Although the above analysis is based on partial data, R&D policy exemplifies the one-dimensional character of US policy, which seeks to aid private industrial development, while relegating to second place public benefits (including those flowing from real competition in the marketplace).

EU policy in R&D shares some of the concern with "competitiveness" which justifies some subsidies and licensing by government in the US. Article 130 of the EC Treaty assigns responsibility to the Community for improving its competitiveness by strengthening the scientific and technological basis of European industry. The Commission has therefore looked favorably on aid for research and development.

The European Union has adopted a more discriminating approach than the US to the balancing of public and private interests in the exploitation of research. Article 92(1) of the EEC Treaty, which prohibits market-distorting state aids, does not apply to research funding, which is non-commercial in character. In practice, the Commission distinguishes between aid for basic research (which does not directly affect the productive process) and aid for applied research.

In the case of basic research, it allows aid for up to fifty per cent of R&D costs, as a general rule. In the case of applied research, the Commission's attitude depends on the probable effect on the relevant market. Normally, it allows state aid up to 25% of the cost of R&D, with larger amounts allowed for small and medium enterprises, companies operating in backward regions, and important projects of "common European interest."

Nevertheless, in order to level the playing field for European enterprises relative to businesses in other industrialized world regions, aid up to 75% of basic research R&D costs and 50% of other R&D may be authorized if such levels of subsidization are attained by programs located outside of the EU. This exception is in keeping with the World Trade Organization agreement on subsidies and compensatory measures.

(b) Industrial Development Bonds:

For the past fifty years, development in backward areas of the US has been encouraged by use of financial instruments called Industrial Development Bonds (IDBs).

IDBs are tax-exempt bonds issued by state and local governments to finance the purchase of land, structures, and equipment for private enterprises. Infrastructure and equipment for the beneficiaries under a rental plan is geared to the repayment of the investment, plus the administrative costs. At the end of the lease, the facilities are transferred to the recipient firm for a nominal amount. The public funding covers 10% of the investment and is frequently part of a plan including tax deductions and property tax abatement.

The advantages for the beneficiaries consist of:

1. reduced interest rates due to the tax-exempt status of IDBs;
2. deduction of the rent paid for the facilities from the taxable company's revenue;
3. exemption, in most cases, from local taxes.

The impact of advantages outlined above in terms of production costs vary according to the configuration of the incentive packages. Analysts estimate that the savings on capital costs range from 1.5% to 9.5%, while the labor cost differentials between 56%. The total volume of outstanding IDBs for manufacturing amounted in 1993 to approximately \$113 billion.

The public objectives pursued by IDBs are:

1. helping small and medium enterprises (SMEs);
2. directing investment to depressed regions; and
3. stimulating investment in general.

The effectiveness of IDBs has been criticized with particular regard to the last two criteria. It is admitted that IDBs can actually close the 'capital gap' of SMEs compared to the credit avenues generally open to large companies. Yet, cost-benefit studies indicate that the role of such incentives in directing capital to backward areas tends to be neutralized by the availability of IDBs in most states. Concerning the aim of stimulating new initiatives, various surveys indicate that only a minority of the IDB-financed investment would not have taken place without the subsidy.

It is significant that, from their inception in 1936 until 1968, no federal control on the use of IDBs existed. The tax exemption was allowed on the ground of the constitutional doctrine of reciprocal immunity from taxation among different levels of government. In 1968, 1982, and 1984, some limits were introduced on the value of IDBs entitled to tax-exempt status (a cap of \$10 million), on the projects eligible to tax-exempt financing (through exclusion of 'luxury' investments), on the aggregate amount allowed to a single beneficiary (\$40 million), and finally on the volume of bonds issued (\$150 per capita, per state).

These limitations have regulated, but not eliminated, IDBs, and the questions about public benefits achieved through these schemes persist. According to a report by the US General Accounting Office (GAO), the goals of job creation, development of economically-distressed areas, fostering of start-up companies, and keeping manufacturing firms in the country have been at best only partially attained, while the federal government currently forgoes over \$2 billion in tax revenue annually.

An in-depth GAO review of three states representing about 20% of all IDBs in the year of the survey - Ohio, Indiana and New Jersey - showed that:

1. about \$223 million of IDBs were issued in 1991;
2. for the 68 projects financed with IDBs in that year, only seven involved start-up companies and only sixteen were located in areas of high unemployment;
3. only one project would have been relocated elsewhere without IDB financing.

Though twelve states issued no IDBs at the time of the GAO's report, there is no indication that the states refused to do so because of lack of interest in regional development.

Applying EU criteria, most of the initiatives for which IDBs were used in the US would not have been eligible for regional aid in Europe because of the generality of their objectives, the loose rationale for the benefit to the interested business in terms of reduced interest rates (the tax exemption for the investors could be construed as a general measure), and the general lack of stringent criteria for ensuring that the projects were exclusively concerned with regional development.

In the European system, regions wishing to benefit from regional aid are the subject of precise criteria defined in the EC treaty (Article 92 (3), sub (a) and (c), plus the detailed method laid down in the implementing provisions of the Commission services). In the US, however, states and municipalities are not selected for regional development assistance by any central process, thereby becoming eligible for IDB financing. Further, no criteria are normally set within states to discriminate between advanced and disadvantaged areas with respect to schemes eligible for use of IDBs.

(c) Bailing out failing businesses

: Financial aid to failing businesses in the US is a topic of special interest to European observers. The federal government has come to the aid of relatively few companies, and in all such cases critics have been concerned about the use of taxpayers' money, the involvement of large corporate interests, and the consequences for free competition of government intervention.

The US does not have a formal policy justifying government intervention in the case of businesses facing impending insolvency and liquidation. But a series of crises in the seventies and eighties led to assistance programs for large companies such as Chrysler, Lockheed and some Northeastern railroads, as well as for the city of New York. The

GAO has developed specific guidelines based on previous experience. Congress would use these guidelines in exercising its exclusive decision-making power to grant federal aid to failing companies.

The railroads attracted the first extensive governmental aid program. Railroads in the US (though all private companies until recently) have been partially exempted from the normal consequences of filing for bankruptcy because, as utilities, it is assumed that they will have to continue to provide service, if necessary through reorganization. In 1974, prompted by the deep financial crisis facing eight bankrupt or nearly bankrupt railroad companies, Congress approved a package of loans, loan guarantees, and grants in order to protect the operations of these companies. Further, it established a publicly created quasi-private company - Conrail - to take charge of operating a consolidated freight rail system. Since 1974, the federal government has given substantial aid to Conrail, including some \$7 billion at the time of its creation, \$2.8 billion for settling the bankruptcies of the antecedent companies, and relief from public service operations. Nevertheless, Conrail has never been permanently profitable and has sold off some of its assets.

The Lockheed aircraft corporation was a second major recipient of government aid to industry. In 1971, Lockheed was suffering severe financial problems, having lost some \$86.3 million in 1970 alone. Lockheed's difficulties were tied to those of Rolls Royce in the United Kingdom, since the latter was to supply jet engines for Lockheed's new airliner, the L1011. As a result of an appeal by the management of Lockheed (supported by the British government) to the federal authorities, Congress passed the Emergency Loan Guarantee Act, allowing for up to \$250 million in loan guarantees to Lockheed.

The Treasury's intervention enabled Lockheed to gradually recover from its crisis, winning back the creditors' trust, finalizing some major production programs, and eventually giving up the government's guarantee in 1977. The public aid was motivated by the high number of jobs at risk (about 60,000 between Lockheed itself and its suppliers), the potential GDP loss (estimated at \$120 to \$475 million), the implications for national defense (Lockheed was a major defense contractor) and, significantly, the consequences for competition in the aerospace industry (the disappearance of Lockheed would have left only two competitors in the commercial aerospace industry).

New York City was also a recipient of substantial amounts of aid. Financial interventions by the state and the federal government were motivated by the foreseeable consequences of a default of a municipality as large as New York City on the banking system (that is, on the hundreds of banks to which NYC was in debt and the municipal bond markets managed through banks or other financial institutions all over the US), on US financial stability, and on world monetary stability. The approach taken to such a critical situation does not differ - in terms of ways and means - from the treatment of major crises that occur in the private sector.

The federal aid to New York included short-term loans of up to \$2.3 billion and federally guaranteed city bonds of up to \$1.54 billion, plus substantial additional funds from private sources. The aid package provided for appropriate monitoring, reform of the

municipal accounting system, and balancing of the city's budget in accordance with generally accepted accounting principles. By 1993, the budget was balanced and the city was able to reenter the credit markets.

The Chrysler automobile company provides the last important example of state intervention. As the aid took the form of loan guarantees for a major industrial company, this case can be likened to the Lockheed rescue. The main differences lie in the larger amount mobilized for Chrysler (\$1.5 billion) and the concessions given by creditors and other interested parties to match federal assistance.

In the late seventies, Chrysler reported heavy losses (\$1,126 million in 1979) and was approaching bankruptcy. Federal assistance was authorized on the following grounds:

1. the number of jobs at stake and the likely regional effects of the corporation's default (134,000 workers concentrated in an area, Detroit, with a high rate of unemployment);
2. The consequences for competition in the car industry, as the loss of Chrysler would have left the US market with only two major producers;
3. the role of Chrysler as a defense contractor; and
4. possible increased market penetration by foreign competitors, with consequent implications for the US balance of payments.

In further contrast to the Lockheed case (where the main issue was overcoming a cash flow crisis), the viability of Chrysler was carefully considered as a condition of the aid. As a result, the Chrysler assistance program approved by Congress required all direct and indirect beneficiaries (US and foreign banks, other creditors, stockholders, suppliers, dealers, and employees) to make some concessions. In addition, restrictions on dividends, inspections of books, audits, and previous approval by the governmental authorities of major asset sales, contracts, as well as operating and financial plans were imposed. The operation involved the temporary sale of some of Chrysler's shares using government warrants. These warrants were later bought by Chrysler itself in a public distribution where the company was the highest bidder. Only \$1.2 billion of the \$1.5 billion guarantee package was actually used. Chrysler was again profitable by 1982, thanks especially to the downsizing of its operations and the lowering of its break-even point.

The GAO considers the Chrysler program successful, despite the lay-offs resulting from the restructuring measures. In particular, it credits the guarantees granted to Chrysler with having allowed restructuring to take place with less interruption of the firm's operations than would have been the case in a bankruptcy.

Comparing American and European practice:

The review of public subsidies in the previous section is no more than cursory. Its purpose is simply to cover some areas that provide a basis for comparison with the regulatory framework and practice of EU state aid policy as part of competition policy.

Though limited in scope, this exercise provides sufficient material for some tentative conclusions on the US situation.

From the point of view of a practitioner of European law, subsidies in the US offer a varied picture that can be summarized as follows:

(a) Subsidies have not been uniformly successful: for example, while the industrial rescue plans have worked, support for R&D and reduced interest loans for local developers through the IDBs have been questionable in their intent and their outcomes;

(b) Subsidies have no clear relationship to preservation of the free competitive market so central to American economic philosophy.

The subsidy allocation and review processes in the two systems have both similarities and significant differences. In both, one finds:

1. enterprises seeking reduced costs or other benefits;
2. regions or territories interested in economic development;
3. individual investors looking for tax-exempt or tax-reduced income;
4. creditors or shareholders of firms in financial difficulty;
5. public authorities entrusted with the right to grant subsidies and concessions; and sometimes
6. a watchdog body (in the EU case, the Commission);
7. taxpayers, usually in a passive role.

In the American case, a pluralistic process occurs by which each player attempts individually or in alliance with others to affect the initial decision. While the players converge around an authority that has the power to decide on specific cases, that authority may not have a watchdog role and it may have no explicit concern with preserving the level playing field so central to European notions of competition policy and subsidy control.

The working of this process virtually requires, for fairness' sake, the insertion of a third party - other than the would-be recipient and the government body solicited for aid - whose task is to ensure that decisions on particular cases take account of the interests of consumers and competitors. The EU provides this third party in the agency of the Commission, which is the independent body charged with assessing and deciding upon almost all measures of state aid proposed or adopted by state, regional and local authorities. The only exceptions are minor subsidies, dealt with under a *de minimis* rule, that are presumed to be so small as to be unlikely to distort competition.

The American process, in contrast, seems likely to produce outcomes that are both economically irrational and distorting to competition. Since subsidies are granted on an ad hoc, individual basis and by a process of bilateral negotiation between the applicant and the grantor, neither consistency nor protection of broader interests is assured. The cases of the IDB bonds, the commercialization of publicly funded R&D, and the bidding

wars between states for inward investment certainly offer no reassurance. However, when both the Federal government and Congress have been involved - as in the Chrysler, Lockheed and New York City cases - the outcome has generally been better. The involvement of Congress and the Executive branch has practically made up for the absence of anti-trust rules applicable to subsidies. These bodies - and especially Congress - constitute the needed "third party."

The results in the bailout cases - and the subsequent judgments of the GAO, which acts as an evaluator of government operations - sustain this impression of success. The rescue plans have produced a better outcome than the eventual bankruptcy of the companies would have entailed, not only with respect to the preservation of jobs but also measured against the companies' ability to return to normal operation in the market within a reasonable deadline. The 1979 Chrysler program has been characterized as the most sophisticated of recent cases in terms of its embodiment of commercial lending principles in the program's structure, with precautions built in against default and with concessions from all associated with the firm, including the creditors and the shareholders, and restrictions on the decision-making powers of the company's management.

Such results were possible in the Lockheed, Chrysler and New York cases because of the involvement of both the Administration and the Congress. Congress has played an instrumental, arbitrating role, setting out detailed and strict conditions in ad hoc legislation, which favored successful implementation of the bailout programs. The use of parliamentary procedure ensured full representation and expression of all relevant interests and gave all players a say. Further, the Administration was closely and actively associated in the management of the rescue packages.

None of this applied in the cases of the R&D investments, the IDBs, and the states' bidding wars over investment incentives. The R&D case needs most explanation, since in this instance both Congress and the Administration were involved. The virtually unconditional funding of R&D and transfer of resultant discoveries to the private companies clearly calls out for a more sophisticated approach to subsidies than is usually adopted in bilateral negotiation. Apparently, the process failed in this case because of a distorted perception by Congress of the interests at stake. Public funding of private research and/or private use of publicly-funded technology have been inaccurately identified with the public interest, probably because of the influence of the dominant political ideology of the Reagan/Bush period and because of relentless lobbying by the eventual beneficiaries.

As for the reduced interest loans made possible through the IDB schemes, they had limited impact on regional development. It was difficult to secure investment and new jobs without offering prospective investors incentives equivalent to those available in neighboring states. Quite simply, the competition between states had the effect of neutralizing the advantages offered by incentives and substantially raising the costs (and reducing the benefits) for the eventual winner.

At the local level, IDBs offered clear advantages to individual municipalities. Attracting income-generating businesses improves the tax base of municipalities, adds to the incomes of other businesses and citizens, and improves the municipalities' standing with creditors and bond-rating bodies.

The current political climate, emphasizing large-scale cutbacks in public spending, does not improve the prospects either for regional development subsidies or for a more rational approach to those now available.

Inner-city initiatives:

Any survey of local development subsidies in the US would be incomplete without discussion of (Federal) Empowerment Zones (FEZs) and (State) Enterprise Zones (EZs).

The FEZs and EZs are specially designated areas entitled to tax breaks, grants, wage credits and a wide range of general interest programs (such as social services, crime prevention, and job training). They are intended to attract new investment and to concentrate the efforts of different public agencies in order to revive socially and economically blighted communities.

Currently, there are nine FEZs (chosen nationally) and over three thousand EZs designated by state legislation in thirty-seven states.

Because these schemes offer resources to all enterprises, sectors and residents, they resemble what the EU would define as general measures rather than the kind of state aid covered by Article 92 (1) of the EC Treaty. They would therefore be subject to much less strict control, as provided for in Articles 101 and 102 of the Treaty, though there is a gray area between the topics covered under these articles and those covered by Article 92.

The important point is that the FEZs and EZs differ significantly from the IDB-funded initiatives. They represent an attempt to focus and concentrate public resources on particular areas, though this is more the case with the FEZs (of which there are only nine) than with the several thousand EZs, which tend to disperse resources.

It is too early to evaluate the FEZs (which were only created in 1994, with funding of \$3.5 billion). Nevertheless, the empowerment and enterprise zones are distinctive (when compared to the IDBs) in that they focus on the objective of regional development; are structured according to priorities set by a public authority; and they break out of the bilateral framework between prospective investors and local authorities by using a framework that allows consideration of the various interests involved in the use of public resources.

Implications for the EU:

What lessons does an examination of American treatment to subsidies suggest for the EU?

The EU Commission is currently devoting greater attention to state aid. The number of cases examined has increased, the accounts of public and state-controlled companies are scrutinized more closely, and proposals for aid to troubled firms are considered more critically.

The cases involving rescuing and restructuring firms are among the most controversial that the Commission has to examine. All such cases tend to stir up public debate and to call into question the way in which the Commission uses its discretionary power. Since 1994, *The Financial Times* has been running a series of articles that are highly critical of the Commission's implementation of the rules on state aid.⁴ These articles do not ordinarily address the bulk of undisputed decisions approving aid for small firms or aid with regional or sectoral objectives. Rather, they focus on cases of rescuing and/or restructuring in highly competitive sectors (such as Bull in the computer industry and Air France or Iberia in the airline industry). In such cases, they commonly hint at political manipulation by the Commission.

The Financial Times traditionally echoes the views of business, legal and administrative elites in Europe, and the criticism comes at a time when a growing number of Commission decisions are being challenged not only by Member-States but by parties with direct stakes in the decisions.

Since the critics aim particularly at the discretionary powers of the Commission - implying that such discretion is used for political purposes - the idea of transferring this discretion to an independent competition office acquired currency in the discussions leading up to this year's Intergovernmental Conference (IGC).

It is always tempting to believe that setting up a new specialized agency would lead to more rational decisions. But in this case (as in many others) the proposal does not tackle the underlying causes of the problems afflicting the Commission. Setting up a new body would work only if the new agency truly had greater independence than Directorate General IV (the Commission's body now responsible for competition policy) and had independent powers of enforcement. To establish such a body would require great boldness as well as unanimity on the part of Member-States.

The chances are that, instead, the Commission will have to live with and adopt its decisions under the present legal rules and with the administrative structures now in place, albeit with some modifications. One probable change, flowing from the Commission's own initiative, will involve implementation of Article 94 of the EC Treaty to exempt from scrutiny types of aid that do not affect intra-European competition. Such aid can best be dealt with by national governments, and this approach would be consistent with the present emphasis on subsidiarity⁵ (Article 3b of the EC Treaty). Such a change would allow the Commission to concentrate its attention on cases having a European dimension.

Some improvements in present practice are, however, possible, especially in cases involving aid to failing businesses and cities. The present European approach to such

issues is embodied in guidelines issued by the Commission in July 1994, which update the policy outlines in the Eighth Report on Competition Policy, published in 1979.⁶ Compared with the American initiatives in the 1970s, this approach is well conceived, but lacks adequate enforcement powers. The procedure requires (in the case of companies) submission of a credible restructuring plan aimed at restoring the financial health and viability of the company in question within a reasonable time. Once a plan is approved, its implementation depends on an annual report submitted by the appropriate national authority, which offers relevant information to enable the Commission to ensure that the provisions of the plan are being enforced.

This reporting requirement reflects the overall weakness of the Commission and its dependence on Member-State governments for cooperation in enforcement.⁷ It is clearly inadequate as a procedure for direct and close enforcement. It may be noted that the main criticism leveled by observers of EC policy on state aid is that somehow subsidies are approved periodically and repeatedly to the same recipients, departing from the principle of "one-time" aid that should be a feature of all rescue schemes. This suggests that the Commission lacks enforcement powers and that the involvement of Member-States undermines the "one-time" principle.

By contrast, the virtue of the American approach has been that Congress and the Executive Branch have been directly and closely involved in management of plans approved by Congress. Congress and the administration have not only been arbitrators between those seeking assistance and their creditors but have taken direct responsibility for negotiations with creditors and trade unions.

This procedure cannot simply be copied in the EU. Whatever the media suggests, in all comparable cases the Commission only acts when it receives a plan drafted at the national level that has already been accepted and funded. Indeed, such plans often take no account of Community law. Admittedly, the Commission may (pursuant to Article 93 (2) of the EC Treaty) conduct an investigation into the case and may make its approval conditional upon acceptance of certain requirements (compliance with which must be covered by the annual reporting mentioned above). But in reality this procedure gives little leeway for negotiation with Member-State governments, who have already reached a complex settlement under the internal political and legal constraints to which they are subject.

The idea of a direct involvement of the Commission in enforcement of restructuring plans, analogous to American practice, thus runs up against constitutional objections arising from subsidiarity and the lack of positive legal powers. In practice, it would also require staffing and expertise greater than the Commission now has.

Yet the Commission could handle rescue packages better if the following principles were applied:

1. The principle of "one-time" aid should be applied stringently, accompanied by an understanding that rescue aid can be allowed only once in a decade. Aid granted

- more often almost certainly has a distorting effect on competition and on trade between Member-States;
2. The Commission should insist that concessions be made by parties interested in the future of a company before formal approval of a rescue package is granted. Such concessions might involve temporary suspension of dividend payments and partial waiving of credit. Employee's interests would not have to be sacrificed. In this respect the Commission can use its discretion to assert social interests over purely economic considerations;
 3. All financial and other assistance provided to the beneficiary should be paid in installments, payment of each portion to depend on evidence of compliance with precise conditions designed to monitor the firm's performance;
 4. The rescue and restructuring plan should be endorsed by an appropriate national auditing and financial body, which should also be directly involved in monitoring the plan's progress and which should formally assent before the release of further installments of aid;
 5. In the interests of transparency, information about a proposal should be published before the Commission makes a decision. Such publication would make clear how much discretion the Commission actually enjoys in such cases;
 6. Consistent with the "private investor" principle commonly applied by the Commission, the beneficiary of a proposed aid package should be expected to obtain adequate financial guarantees and some risk compensation should be included in the aid package. Merchant banks normally require such steps when negotiating rescue plans, and this requirement would put pressure on the beneficiary to comply with the plan's provisions and deadlines and would assure observers that the program incorporated commercial lending principles.

These recommendations do not require amendments to the Treaties or to its implementing legislation. Their adoption would only involve publication of a Commission notice so as to ensure transparency of the criteria being applied.

Whatever the value of these recommendations, we may conclude, perhaps as a paradox, that the experience of the US - a country that has no state aid policy and does not refer to public subsidies in its anti-trust laws - may be useful for the improvement of European law in its treatment of state aid to companies threatened with bankruptcy and collapse.

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Notes

1 Anti-trust rules derive from Articles 85-86 of the EC Treaty and Articles 65-66 of the ECSC Treaty; control of mergers and concentrations from Regulation (EEC) 4064/89 and Article 66 of the ECSC Treaty; control of state aids from Articles 92-93 of the ECSC Treaty and Article 4(c) of the ECSC Treaty; and rules applying to public undertakings appear in Articles 90 (1), (2) and (3) of the EC Treaty.

2 Specifically, Article 3(g) of the EC treaty and Article 4(d) of the ECSC Treaty.

3 The main pieces of legislation were the Government Patent Policy Act, the Technology Innovation Act, the Federal Technology Transfer Act, and the National Competitive Technology Transfer Act.

4 See, for example, "In a flap at feeding time," Financial Times, 11 March 1994, p. 17 and "Controlling state aids," Financial Times, 19 October 1994, p. 23. See also "A case for stricter discipline," Financial Times, 17 February 1995, p. 16 and "More folly in banking," Financial Times, 22 February 1995, p. 21.

5 Subsidiarity is the legal principle within the European Union that policy decisions should be taken at the lowest appropriate governmental level (editor).

6 See especially Paras. 177 and 227-8.

7 Based on Articles 5, 93(2), 155, and 169 of the EC Treaty.