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Money for the Auto Industry: Consistent with WTO Rules?

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As the financial crisis threatens to lead to a depression, the woes of the automobile industry are second only to the distress of the financial sector. Employment in the US auto industry dropped 9 percent between 2007 and 2008, with much more to follow in 2009. Overall, US auto sales dropped 18 percent between 2007 and 2008, and sales of SUVs plunged 44 percent on a year-over-year basis.[1] Since some sort of financing is required for 90 percent of US car sales, the global credit freeze hit the auto industry with a second blow.

The "Big Three" Detroit automakers—General Motors (GM), Chrysler, and Ford—were particularly hard hit. Chrysler and GM are in dire shape. Ford may be able to make it through the storm without government aid, but large fourth-quarter losses ($5.9 billion) make for tough going. Forecasts for 2009 suggest that US auto-industry sales will drop an additional 24 percent year over year (Standard & Poor's 2009).

In November 2008, as the economy deteriorated, the Big Three appealed to the government for financial aid. Their argument was straightforward: They were "too big to fail." The Big Three accounted for close to 50 percent of total US auto sales in 2008 (Cooney 2009). If the Three file for bankruptcy proceedings, many auto-parts firms will collapse, with domino effects throughout the US economy and abroad. The Big Three account for nearly 240,000 jobs; double the figure of foreign automakers (around 115,000). Further, the auto industry is highly concentrated in a few states and represents almost 30 percent of all manufacturing employment in Michigan. The Center for Automobile Research estimates that a 50 percent reduction in the US operations of the Big Three would lead to a loss of 2.5 million jobs in direct, indirect, and spinoff employment in 2009 (Cole et al. 2008).

While the industry's troubles were exposed and worsened by the financial crisis, the problems have a long-term structural character. Among the Big Three, corporate debt reached unsustainable levels—$62 billion in the case of GM. Labor costs are extremely high. While the total labor cost of a Toyota worker in the United States is roughly $35 an hour, the figure is $59 an hour for the Big Three due to pension and health obligations and the jobs bank.[2] Finally, sales were artificially boosted in the past few years with zero–down payment, zero-interest financing schemes.[3] Many of the vehicles sold were SUVs, which have low fuel efficiency and high CO_2 emissions.

The Bush and Obama administrations and the US Congress have debated several measures for the auto industry: an outright bailout for GM and Chrysler, using the Troubled Assets Relief Program (TARP) to assist the financing arms of those two automakers; a "Cash for Clunkers" scheme to encourage the purchase of newer, more fuel-efficient vehicles; a tax credit for new purchases; and a bailout for auto-parts firms. As various plans take shape, they have provoked concerns both at home and abroad about their consistency with the rules of the World Trade Organization (WTO). Meanwhile, other countries are drafting

1. In the closing months of 2008, SUV sales picked up a bit, partly due to the sharp drop in gasoline prices from around $4 a gallon over the summer to under $2.

2. John D Stoll, "Ten Hard Questions Facing the 'Car Czar,'" *Wall Street Journal*, January 22, 2009. The jobs bank is a job-security program that continues to pay union workers 100 percent of their salaries even if they are out of work.

3. Despite this boost, the average fleet age for cars rose from 7.9 years in 1997 to 9.2 years in 2007.

their own assistance programs. This Policy Brief examines the measures being considered in the United States and abroad and considers whether they would violate WTO rules.

US AUTO MEASURES

Bailout for the Big Three

GM and Chrysler have received $6 billion and $1.5 billion, respectively, from the TARP. The TARP funds were directed toward the financing arms of each company, GMAC LLC and Chrysler Financial. GMAC is the primary source of loans for buyers of GM cars. GMAC's application to become a bank-holding company was approved by the Federal Reserve on December 25, 2008. How GMAC will raise the capital needed to maintain this status is uncertain.

[A] 50 percent reduction in the US operations of the Big Three would lead to a loss of 2.5 million jobs in direct, indirect, and spinoff employment in 2009

On December 10, 2008, the US House of Representatives passed the Auto Industry Financing and Restructuring Act. The bill, if passed by the Senate and signed by the president, would have approved $17.4 billion in loans for GM and Chrysler in two steps: $13.4 billion would be dispensed when enacted, with another $4 billion for GM (but not Chrysler) in February 2009.[4] The money comes from funds previously appropriated to Section 136 of the Energy Independence and Security Act.[5] The loans are bridge loans until March 31, 2009. If the loans become permanent, they will have to be paid back within seven years, with a 5 percent interest rate over the first five years, and a 9 percent rate over the last two years.

The bill would also create a "car czar," who would be appointed by the president to oversee restructuring in those companies that receive funds. However, the administration is now looking to create a Presidential Task Force on Autos, headed by "car czars" Treasury Secretary Timothy Geithner and Chief Economic Adviser Lawrence Summers.[6]

Finally, the bill would guarantee super seniority of the Section 136 loan above all other debt (see appendix for more detail) and limits executive compensation. Last but not least, restructuring plans will not be approved unless they comply with applicable requirements for fuel efficiency and CO_2 emissions.

Fuel Efficiency and Emissions Standards

On January 26, 2009, in a break from the Bush administration on environmental policies, President Obama announced that he would instruct the Environmental Protection Agency (EPA) to grant California a waiver from federal rules so that the state could implement its own tougher emissions standards for cars. Many other states will follow California's lead. Thus California's standards will set the bar for the entire country, since automakers will not want to make two models of each car, one model for California and its followers, and another for the rest of the states. The bailout requirements and California's emissions standards seek to move production toward smaller, more fuel-efficient cars. Current production emphasizes SUVs and pickup trucks, which are more profitable than small, fuel-efficient cars.[7] The goal of public policy is to shift the balance in the other direction.

This shift, however, will be difficult, and US carmakers claim the automobile industry cannot handle such a drastic change in the current economic climate. These claims find some support in Congress. House Minority Leader John Boehner (R-OH) asserted that the waiver for California's standards will "destroy American jobs." Senator Carl Levin (D-MI) argued that California's standards would hurt the competitiveness of US automakers: "As the California standard is currently drafted, it is discriminatory against US-made vehicles of the same efficiency as the imports."[8] If the EPA does grant California the ability to set its own stricter emissions standards, the Big Three will likely contest the EPA's decision when it arrives.

Developing a new car, even without a special focus on the environmental angle, requires an investment of around $1 billion. Developing a fuel-efficient, low-emissions car will be even more expensive. But the Big Three will not be competi-

4. At the time of writing, GM and Chrysler are asking for an additional $20 billion combined, but the funds have not yet been agreed.

5. The program in question is known as the Advanced Technology Vehicles Manufacturing Incentive Program. Democratic leaders, including Speaker of the House Nancy Pelosi (D-CA) and Senate Majority Leader Harry Reid (D-NV), originally opposed using the Section 136 funds in this way, as those funds were intended for investments on research and development. The Democrats were forced to accept this source of support, however, due to the Bush administration's strict refusal to use TARP funds.

6. James R. Healey, "Does Auto Task Force Trump A Car Czar?" *USA Today*, February 17, 2009.

7. Mike Spector and Joseph B. White, "Auto Bailout Caps Flawed Relationship," *Wall Street Journal*, December 22, 2009. Profits amount to roughly $8,000 per truck.

8. Mike Lillis, "Study Contradicts Auto Makers' Emission Claims," *Washington Independent*, January 28, 2009.

tive until they achieve this goal. As President Obama put the matter, the "goal is not to further burden an already struggling industry. It is to help America's automakers prepare for the future."[9] Japanese competitors Nissan and Toyota have already developed electric cars; so has US newcomer Tesla Motors. European auto firms BMW of Germany and Fiat of Italy have invested significant amounts in the development of small cars, motivated by high fuel prices, which reflect a history of higher gas taxes throughout the European Union. These firms are now developing low-emission technologies fast, as they face strict European CO_2 standards starting in 2015.

In addition to the bailout aid, the US government unblocked further funds to help the auto industry meet environmental standards. The Energy Independence and Security Act of 2007, which launched the Advanced Technology Vehicles Manufacturing Incentive Program, provided a $25 billion loan program for the auto industry to support the development of fuel-efficient cars in the United States. GM applied for $8.3 billion; Ford is seeking $5 billion; and Tesla is asking for $450 million. On February 9, 2009, Nissan became the first foreign car company to ask for the funds.[10]

Restructuring Outlook

Under proposed legislation, GM has until February 17, 2009, to show progress on restructuring in order for the federal loans to be made permanent. Some, like United Auto Workers (UAW) President Ron Gettelfinger, worry that "this timeline is almost unattainable."[11] The terms of the restructuring involve cutting 31,000 jobs, restructuring GM debt, eliminating the jobs bank, and closing 1,750 dealerships and nine plants (though GM may close more due to the 49 percent decline in sales in January 2009).[12] GM and the UAW came to an agreement to close the jobs bank on February 2, 2009. Those leaving the program will receive state unemployment benefits and some compensation from GM. The amount, which is currently being negotiated with the UAW, should be around 72 percent of full pay, down from 100 percent in the jobs bank. Although GM has only 1,600 workers in the jobs bank, the program has become a symbol of restructuring.

Even with the loan, Chrysler's hopes of survival seem small. The firm's ranking in the collective view of auto buyers has sunk. The influential publication *Consumer Reports* does not recommend any Chrysler vehicles. The firm has no foreign subsidiaries and relies almost entirely on the North American market. Chrysler closed its jobs bank on January 26, 2009. Its surest bet right now is to have its best brands—Jeep, Chrysler, and Dodge minivans—acquired by another company.[13] Italian carmaker Fiat is in talks to acquire 35 percent of the company in exchange for access to Chrysler's small-car platforms and its global dealer network.[14] However, Fiat is not offering cash, which is what Chrysler desperately needs. Fiat has made the package conditional on Chrysler getting $3 billion in additional loans from the US Treasury.

Cash for Clunkers

Another measure being considered in Congress is the National Incentive Program for Voluntary Retirement of Fuel-Inefficient Vehicles, better known as Cash for Clunkers. The aim of the program is to accelerate fuel savings nationwide by providing an incentive to owners of older, gas-guzzling cars to trade them in for more fuel-efficient models. Conditions apply both on the cars that can be traded in and the standards for newly acquired cars (see appendix for details). Eligible drivers would receive a reimbursement voucher for the purchase of a new car or conforming used vehicle. If the vehicle traded in was made before 1998, the voucher would amount to $2,000, while the vouchers for vehicles made between 1998 and 2001 would be $3,000 and for any vehicle made after 2001, $4,500. The voucher could also be used for public transportation. The program would run from 2009 to 2012. The legislation attempts to set voucher amounts high enough to encourage consumers to trade in their inefficient cars at a faster pace than the normal renewal rate—that is, the rate at which people would trade in their old cars regardless of the program. Congress and the Big Three are currently discussing the measure, but the Big Three worry that the bill would not help them because auto buyers would replace their American cars with foreign-made ones.[15] *Freakonomics* author Steven Levitt has remarked that the scheme could raise the cost of used cars: "If the government gives you a $4,500 voucher for a 15-year-old car, that jacks up the future value of a 14-year-old car."[16] Moreover, the cost of repairing older cars might go up,

9. Ken Thomas, H. Josef Hebert, Dina Cappiello, and Erica Werner, "Obama orders push to cleaner, more efficient cars," *Associated Press*, January 26, 2009.

10. Alan Ohnsman and Tina Seeley, "Nissan Vies with GM for US Energy Department Loan," *Bloomberg.com*, February 9, 2009.

11. David Shepardson, "UAW: Auto plans need more time," *Detroit News*, January 20, 2009.

12. Sharon Terlep, Kate Linebaugh, and Jeff Bennett, "More Car Plants at Risk," *Wall Street Journal*, February 7, 2009.

13. "The Big Chill," *Economist*, January 17, 2009.

14. Sharon Silke Carty, "Chrysler Turns to Fiat for Strength," *USA Today*, January 28, 2009.

15. Brody Mullins and Elizabeth Williamson, "Cash for Clunkers Plan is Considered," *Wall Street Journal*, January 30, 2009.

16. "Editorial: cash for clunkers," *Richmond Times-Dispatch*, January 28, 2008.

since fewer parts will be available following the destruction of "clunkers." As a result, used cars could become more expensive and low-income families might bear part of the burden.

Tax Credits

Various bills have been presented in Congress that would provide tax credits toward the purchase of cars. The Commonsense Auto Recovery (CAR) Act offers a tax credit equal to the amount of state and local sales taxes on the purchase of any vehicle costing less than $50,000. The Consumer Auto Relief (also CAR) Act would allow anyone who purchases a new car in 2009 to claim the purchase price of the vehicle as a tax deduction, up to a limit of $7,500. The stimulus package (The American Recovery and Reinvestment Act) provides a tax deduction for the sales and excise taxes on the purchase of any new car or light truck, but the deduction will only apply on the first $49,500 of the price of the vehicle, and this benefit is subject to some income limitations on the buyer (see appendix for details). Since the stimulus package was signed into law on February 17, 2009, the other bills are unlikely to get much traction now. The stimulus provisions, however, do not tackle the problem of access to loans for auto buyers. The global credit freeze is plaguing the auto industry. One option for remedying this would be for the government to provide backup insurance on auto loans, thereby reducing the risk for auto lenders.[17] This would jump-start the auto-loan market, and in turn revive sales, perhaps more efficiently than a tax credit.

Help for Auto-Parts Firms

In late January 2009, the auto-parts makers asked for their own bailout package. Hurt by falling auto sales, parts makers are struggling to stay afloat and have laid off thousands of workers (77,000 between November 2007 and November 2008, or 13 percent of the total auto-parts manufacturing workforce). They are strapped for cash since banks have stopped accepting notes receivable as collateral. Auto-parts firms argue that their collapse would not only destroy jobs, but also jeopardize the viability of GM's restructuring plans. In 2008, forty auto-parts companies filed for Chapter 11 bankruptcy relief.[18]

Auto-parts suppliers have asked for $25.5 billion in aid. In addition, they want the government to guarantee the money owed them by the Big Three. By standard contract terms, the Big Three have 45 days to pay their suppliers for parts delivered. The amount owed is estimated at between $13 billion and $15 billion. Because of the difficulty in borrowing from banks using these receivables as collateral, the auto-parts makers want the payment period reduced to ten days.

AUTO MEASURES IN OTHER COUNTRIES

Troubles in the auto industry are not limited to the United States. With auto sales throughout the world in steep decline, other countries are considering their own aid programs. Proposed measures include several different programs of consumer and industry assistance, in widely varying amounts.

Canada and Mexico

The auto industries of both Canada and Mexico are highly dependent on the US market. Canada-US auto trade and Mexico-US auto trade represented 20 percent and 15 percent, respectively, of total bilateral trade in 2007. Around 70 percent of Mexican auto exports are destined for the US market. Canada and Mexico are particularly vulnerable to the failing US industry.

The auto industry in Canada represents 14 percent of the country's manufacturing output and employs 150,000 workers. Canadian auto sales fell 25 percent in the month of January 2009.[19] This decrease can be attributed in part to higher car prices expressed in Canadian dollars, since the Canadian dollar has dropped 14 percent against the US dollar since September 2008 and many vehicles sold in Canada are largely made in the United States.

In fact, the Canadian auto industry heavily relies on the Big Three. On December 20, 2008, Canada announced that it would provide loans to GM Canada and Chrysler Canada in the amounts of $3 billion and $1 billion, respectively. The two companies must deliver their restructuring plans by February 20, 2009. Other measures include plans by the Canadian Secured Credit Facility to boost lending by purchasing $9.9 billion (C$12 billion) of securities backed by loans and leases for autos and equipment.[20]

Estimates are circulating that Mexican auto production could drop 20 percent in 2009.[21] President Calderon has

17. Peter Valdes-Dapena, "Uncle Sam Wants You to Buy a Car," *CNN Money*, January 29, 2008.

18. John Reed, "Car Parts Sector Looks for $10bn Federal Bailout," *Financial Times*, January 26, 2009.

19. Keith Naughton, "Canadian Auto Sales Fall 25% on Declines for GM, Ford, Chrysler," *Bloomberg.com*, February 5, 2009.

20. Doug Alexander, "Chrysler, Ford Say Canada Leasing Program May Help Revive Sales," *Bloomberg.com*, January 28, 2009.

21. Alexandra Olson, "Mexican Auto Production Rises 4 Percent in 2008,"

pledged to spend $147 million (Mexican pesos 2 billion) on worker assistance and loans to automakers. Details are not yet known.

European Union

Auto sales in European countries fell sharply in the second half of 2008 and the first month of 2009. In December 2008, the registration of new cars—a number that mirrors sales—fell 19 percent in the European Union as a whole, year over year. This number masks more dramatic plunges in individual member countries: 62 percent in Ireland, 50 percent in Spain, 46 percent in Denmark, and 45 percent in Sweden. The United Kingdom and France fared slightly better, with registration drops of 21 percent and 16 percent, respectively, in December 2008, year over year. Germany witnessed a registration slump of around 7 percent.[22]

The French auto-bailout plans will dedicate up to $7.7 billion (€6 billion) to the failing auto industry in the form of credit lines. President Sarkozy insists on making aid conditional on automakers' maintaining their production on French soil and purchasing a certain volume of parts from French suppliers, to forestall the export of jobs to other countries, a controversial measure.

A French Cash for Clunkers scheme was implemented in December 2008 and will run through the end of 2009.[23] Cars more than 10 years old can be traded in for a voucher worth $1,300 (€1,000) to purchase a new car with CO_2 emissions below 3.5 ounces per mile (oz/mile), expressed as 160 grams per kilometer (g/km). Renault and Peugeot are extending this scheme to cars more than 8 years old, and Citroen is doubling the value of the voucher. Some analysts have claimed that the measures increased sales by around 13,000 cars, compared to expected sales in December 2008.[24]

In Germany, the government is allowing automakers to put their workers on reduced hours or temporary lay-off. Laid-off workers will receive around 60 percent of their wage from the Federal Labor Agency. Benefits will be paid for 18 months; after that workers will be let go if their company has not recovered. The German government also pledged to provide $2.3 billion (€1.8 billion) in loans to Opel, a European branch of GM.

Germany has put in place its own Cash for Clunkers program in the amount of $3,300 (€2,500) for cars at least 10 years old when replaced by a new car that meets Euro-4 emissions standards. Although local hotlines for this scheme were submerged with potential applicants in the first few days, the real effect is unclear: German car sales for January 2009 tumbled 14 percent compared to the previous month.

In the United Kingdom, automakers have received $3.2 billion (£2.3 billion) in loan guarantees, including $1.4 billion (£1 billion) from the European Investment Bank (EIB). However, complaints have emerged that most of the funds will go to Jaguar Land Rover and Vauxhall, with little for auto-parts companies.[25] This deal will also have an environmental spin to it by supporting the production of more fuel-efficient cars.

With auto sales throughout the world in steep decline, other countries are considering their own aid programs

On February 4, 2009, Italian Prime Minister Silvio Berlusconi announced the imminent release of a "sizeable" aid package to the ailing Italian auto industry, including parts makers, though details have not been disclosed.[26] Sweden's stimulus plan includes a $3.4 billion (Swedish krone 28 billion) rescue package for the auto industry.[27]

European countries asked the European Commission to further relax the rules on aid to industries, but the Commission refused. The Commission is considering the possible harmonization of Cash for Clunkers programs. Since the value of vouchers can vary significantly, from $1,300 (€1,000) in France to $3,300 (€2,500) in Germany, there is a risk that competition will be distorted within the single market. However, previous programs of a similar nature have existed in Europe, albeit for safety and environmental purposes, so the additional impact of expanded schemes to encourage the purchase of new cars may not be large.

The European Investment Bank (EIB) may increase its lending to the automobile sector. The EIB plans to lend $5.2

Associated Press, January 12, 2009.

22. Figures from the Association Auxiliaire de l'Automobile.

23. "Nicolas Sarkozy Envisage une Prime de 1000 Euros Pour les Vehicules Mis a la Casse" ("Nicolas Sarkozy Plans a 1,000 Euro Cash for Clunkers Scheme"), *Le Monde*, December 3, 2008. Previous programs in France granted a $390 (€300) voucher for vehicles over 15 years old if the replacement car's CO_2 emissions were below 2.8 oz/mile (130 g/km).

24. David Pearson, "French Car Registrations Fall Despite Aid by Paris," *Wall Street Journal*, January 6, 2009.

25. Robert Hutton and Mark Deen, "UK Automakers Get $3.2 Billion in Loan Guarantees (Update 3)," *Bloomberg.com*, January 27, 2009.

26. "Update 1 – Italy Eyes 'Sizeable' Aide for Auto, Appliance Sector," *Reuters UK*, February 4, 2009.

27. Niklas Magnusson and Johan Carlstrom, "Sweden to Inject $6 Billion in Banks to Ease Lending (Update 3)," *Bloomberg.com*, February 3, 2009.

billion (€4 billion) a year in 2009 and 2010, with $1.3 billion (€1 billion) more coming from the member states and other European funds. European auto companies have asked for an additional $6.5 billion (€5 billion).[28] Adding everything up, the companies are asking for $52 billion (€40 billion) in loans at reduced interest rates to finance research and development and comply with the new CO_2-emission standards by 2015.

Other Countries

On November 10, 2008, Australia became one of the first governments to announce a bailout for automakers and auto-parts suppliers, in the amount of $2.3 billion (Australian dollars 3.4 billion) through 2020.[29] The bailout plan will include a "Green Car" fund to create more fuel-efficient cars within the next 18 months.[30] The Australian auto industry not only has to cope with the global economic slowdown, but also with a halving of tariffs on imported cars to 5 percent by 2010.

In Japan, auto sales dropped 28 percent in January 2008, a 35-year low. In December 2008, the ruling Liberal Democratic Party proposed an "incentive tax scheme to promote fuel-efficient vehicles in Japan." The program, which would start in April 2009 and last three years, would provide an individual tax deduction of between 50 and 100 percent on the purchase of eligible cars.

Nissan is expected to cut some 10,000 jobs in Japan and move production to lower-cost plants in foreign countries. The Japanese auto industry is characterized by large exports to foreign markets, especially the United States. Nissan and other Japanese car makers are suffering from a strong yen, which increases the price of their cars for foreign buyers. As a result Nissan might apply to the Development Bank of Japan for a low-interest loan.[31]

In late December 2008, the South Korean government pledged to supply liquidity to auto-parts makers and to revive the loan market for auto purchases. Indirect methods to boost sales include a cut of auto excise taxes of up to 30 percent. However, the government vowed it would not inject capital into specific companies, so as to not violate WTO law.[32] Ssangyong Motor is currently in talks with the Seoul Central District Court about a bailout program.[33]

While auto sales in China grew by almost 9 percent in January 2009 on a year over year basis, this still represents a sharp decline compared to a 24 percent increase in January 2008, year over year. As a result, the Chinese government announced it may cut in half the tax on second-hand car sales, to just 1 percent. Effective January 20, 2009, through the end of the year, the tax on small cars (engines smaller than 1.6 liters) will be halved from 10 percent to 5 percent.[34]

Russia raised its import duties on foreign cars starting January 1, 2009. The increase will remain in place for nine months. Given the low quality ratings of Russian cars, and thus a strong consumer preference for foreign cars, this has caused civil discontent throughout the country.[35]

WTO COMPLIANCE OF US AND FOREIGN MEASURES

At the first hint of measures to assist the failing auto industry, European Commission President Jose Manuel Barroso said the Europeans would watch the US plan very closely and that "if it amounts to illegal state aid, [the European Union] will act at the WTO."[36] Throughout the world, concerns have been heard about rising protection in the United States and abroad, and auto measures are often cited.[37]

In June 2007, in the context of negotiations for the Doha Development Round, US Trade Representative (USTR) Susan Schwab proposed new language to prohibit five additional subsidies under WTO rules. She explained that:

> It is time to take the next step in the development of stronger WTO rules that will rein in the use of industrial subsidies. In an increasingly global economy, foreign government subsidies provide an unfair competitive advantage. The subsidies we want to prohibit maintain inefficient production capacity in industries ranging from steel to semiconductors. Stronger rules for these

28. "Bruxelles Refuse d'Assouplir ses Regles sur les Aides d'Etat au Secteur Automobile" ("Brussels Refuses to Relax its Rules on State Aid to the Automobile Sector"), *Le Monde*, January 18, 2009.

29. The only automakers in Australia are subsidiaries of GM, Ford, and Toyota.

30. "Australia Car Industry gets $2.3bn Aid Package," *Reuters*, November 10, 2008.

31. John Murphy, "Nissan to Slash Payroll, Pare Japanese Output," *Wall Street Journal*, February 9, 2009.

32. "South Korea: Government Promises Automaker Aid," *Just-Auto.com*, December 25, 2008.

33. Kim Hyun-cheol, "No Shanghai Aid in Ssangyong's Bailout Plan," *Korea Times*, January 18, 2009.

34. George Gao, "China May Cut Second-Hand Car Sales Tax to 1%," *Huliq News*, February 4, 2009.

35. "Russia's New Car Import Duties Cause Billion-Dollar Damage to Nation's Budget," *Pravda*, January 13, 2009.

36. "Barroso Threatens to Take US to WTO over Car Rescue Plan," *Europolitics*, November 17, 2008.

37. "The Return of Economic Nationalism," *Economist*, February 5, 2009.

> types of subsidies would address significant trade-distorting practices of many of our trading partners that often lead to unfair trade (USTR 2008).

Her quote clearly shows that, at the time, the United States realized the risks to the global trading system that are associated with aid to domestic industries.

The subsidies proposed for listing under the prohibited schedule were the following: coverage of operating losses; forgiveness of government-held debt; lending to "uncreditworthy" companies; equity investments in "unequityworthy" companies; and other financing, such as "royalty-based" financing, not on commercial terms. Had that language been accepted and the Doha negotiations concluded, nearly all the auto-bailout schemes would have clearly violated WTO rules. However, under current rules, the grounds for mounting a complaint are weaker.

WTO Agreement on Subsidies and Countervailing Measures

Under the WTO Agreement on Subsidies and Countervailing Measures (ASCM), in order to sustain a legitimate trade complaint, an objectionable subsidy must meet multiple tests. First, it must be a "financial contribution," made "by or at the direction of a government or any public body within the territory of a Member" (WTO 1994, Article 1). Loans and guarantees for the auto industry easily pass this test.

Second, the financial contribution must confer a benefit to the receiving parties. In other words, the loans and guarantees must convey to the companies an advantage that they would not enjoy under normal market conditions. Government loans to GM and Chrysler are not provided on commercial terms, since the interest rate on the loans is 5 percent, just 3 percent above the London Interbank Loan Offered Rate (LIBOR). If GM were to seek a loan on the commercial market today, the interest rate would be based on the yield on GM bonds. On December 19, 2008, the yield on bonds due May 2009 was 143 percent, indicating that the market expected GM to default on its debt, through a restructuring program or bankruptcy. While GM is an extreme case, government loans and guarantees to auto companies around the world invariably entail below-market interest or credit-guarantee rates. In short, GM, Chrysler, and other auto firms are benefitting from financial contributions made by governments, according to the language of the ASCM.

Those two tests define the loans and guarantees to the auto industry as subsidies. But to be actionable under the WTO, a subsidy must also be "specific," as defined in ASCM Article 2. The basic idea is that the public financial contribution should confer a benefit on an enterprise or industry, or on a group of enterprises and industries. Since auto loans and guarantees are not available to a wide spectrum of industrial enterprises, they clearly provide a specific subsidy.

Finally, there is the question of trade effects. First, we discuss the trade effects in a hypothetical WTO case. Then we discuss trade effects under the US countervailing duty law.

It would be controversial to bring a WTO case if the US bailout is tied to environmental and fuel-efficiency conditions, since everyone agrees that greener cars are desirable

In a WTO case, one possibility is to show that the subsidies cause "serious prejudice" to imports from foreign firms. This is a major hurdle, since several years of data would normally be required to establish that imports declined on account of the domestic subsidies. However, an earlier case can be brought by showing that the subsidies cause "a threat of serious prejudice."[38] A subsidy that is designed to allow domestic firms to charge lower prices yet remain afloat will likely present a threat of serious prejudice.

Complicating factors, however, are fuel-efficiency and environmental mandates. New GM and Chrysler cars will have to comply with higher fuel-efficiency and CO_2 standards. Higher standards, however, are not unique to GM and Chrysler. They will also apply, with some variants, to foreign firms that export their cars on the US market. Since those firms will not benefit from the new subsidies, they will arguably be put at a disadvantage. Therefore, it could be claimed a threat of serious prejudice will be created by the terms of the US bailout package.

If a WTO member that exports cars to the United States brings a case, it will be no defense, in legal terms, for the United States to assert that the member state in question also subsidizes its auto industry. In the court of public opinion, however, it looks bad for the pot to call the kettle black. Moreover, the United States could always bring a national countervailing duty case against subsidized auto imports, setting the

38. In the US-Brazil cotton case, Brazil argued that US cotton subsidies had caused "serious prejudice" and also posed a "threat of serious prejudice" in the future. Since the Appellate Body ruling found actual "serious prejudice" and demanded the removal of the subsidies, it was not necessary to rule on the presence of the threat.

stage for tit-for-tat retaliation. We discuss the countervailing duty scenario later in this Policy Brief.

Another consideration: It would be controversial to bring a WTO case if the US bailout is tied to environmental and fuel-efficiency conditions, since everyone agrees that greener cars are desirable. In fact, when criticizing the first draft of the US auto bailout in November 2008, the European Union hinted that EU schemes were safe from WTO dispute because they fall under exemptions from WTO subsidy disciplines for environmental reasons, though the European Union did not explain further.[39] In the original ASCM, a provision stated that certain subsidies to promote the adaptation of existing facilities to new environmental requirements would be nonactionable. However, that provision expired at the end of 1999, and without it, environmental subsidies would likely be considered on equal footing with other subsidies (Hufbauer, Charnovitz, and Kim forthcoming).

Political realism suggests that a WTO auto case against the United States, or any other country, is unlikely, since most countries with large auto industries have anticipated or echoed US auto measures

The installation of car czars might undermine US defenses in a hypothetical WTO case. There are two angles to the trade-system dimensions of car czars. First, appointing someone to this office indirectly strengthens the ties between auto companies and the government, thereby improving the credit of auto companies relative to their foreign competitors. Second, the car czars might use their power to target sales competition not between the Big Three rivals, but rather against foreign brands.

Broadly speaking, government control means a weaker orientation toward decision making based on market precepts. WTO disciplines are built on the ideal of a clear separation between government and private firms. When the separation disappears, the WTO system has a harder time carrying out its functions both as a surveillance body and as a forum for ensuring compliance.

For the most part, the WTO legality of foreign bailout schemes would follow much the same track as the discussion of US bailout plans, with the exception that proposals for a car czar or car czars do not appear in other assistance schemes. The French plan, however, is unique in certain respects. As currently envisaged, French measures would violate both WTO and EU rules. Policies that favor both home-grown producers and purchases from French suppliers represent a clear challenge to these rules. EU Commissioner for Competition Nelly Kroes warned French President Sarkozy that auto bailouts must comply with EU competition policies and with EU laws on the freedom of movement and capital.[40] French proposals are creating strong discontent, especially in the Czech Republic, as French car companies are being asked to shut down their factories in Eastern Europe.[41] Moreover, by forcing French companies to produce in France, President Sarkozy could potentially impose higher costs on auto manufacturers when domestic components are more expensive than foreign ones—a result that would clearly not improve the competitive position of the French auto industry.

US Countervailing Duty Law

Some foreign measures could be actionable under US countervailing duty (CVD) law. There would be many similarities between a WTO ASCM case and a US CVD case, reflecting the fact that the United States played a large role in shaping the ASCM. The tests of financial contribution, benefit, and specificity all apply, but the trade-effects tests are different. Moreover, in a US CVD case, it is an industry that brings the case, rather than a government as under the WTO ASCM.

A countervailable subsidy occurs when a public authority from a foreign country provides a financial contribution, defined as "the direct transfer of funds, such as grants, loans, and equity infusions, or the potential direct transfer of funds or liabilities, such as loan guarantees."[42] Foreign auto-assistance measures that provide loans or loan guarantees clearly fall within this definition.

The next step is to establish that there has been a benefit conferred to the industry receiving the loans or the loan guarantees. Since all foreign schemes that involve loans and loan guarantees provide reduced interest rates, they are not given on commercial terms, and thus they provide a clear benefit.

Finally, foreign loans and guarantees easily pass the specificity test of the US CVD law: "Where the authority providing the subsidy…expressly limits access to the subsidy to an enterprise or industry, the subsidy is specific as a matter of law."

The trade effects are where US CVD laws differ from a

39. "Possible US Auto Industry Bailout Could Face WTO Challenge by EU," *Inside US Trade*, November 21, 2008.

40. David Gow, "EU Threatens Legal Action over American Car Industry Bailout," *Guardian*, February 3, 2009.

41. Ben Hall, George Parker, and Norma Cohen, "Brown Furious over Sarkozy VAT Attack," *Financial Times*, February 7, 2009.

42. See US Code Title 19, Chapter 4, Subtitle IV, Section 1677 (5).

WTO ASCM case. The CVD impact tests are "material injury" or "threat of material injury." The terms are loosely defined in the statute, and past cases do not draw a bright line to define "material injury." However, the decided cases do show that "threat" is fairly easy to demonstrate.

Therefore, if the US auto industry brought a countervailing duty case to the US Department of Commerce and the International Trade Commission, it would likely pass all the tests needed to be considered a countervailable subsidy. An affirmative finding by both agencies would lead to the imposition of a CVD duty on imported auto merchandise. Thereafter, the targeted country could chose to mount a challenge in the US courts and the WTO. However, the case could take two or three years to resolve, and duties would be imposed in the meantime.

Cash for Clunkers and Tax Credits

Cash for Clunkers programs and tax credits do not qualify as actionable subsidies under either the WTO ASCM or US CVD laws because they do not confer an advantage on domestic firms. The Cash for Clunkers plans do not mandate that the voucher be spent on domestically produced cars. Similarly, tax credits are not limited to the purchase of national brands. Therefore, they do not benefit domestic auto manufacturers over imported brands.

INTERNATIONAL REGULATION OF THE AUTO INDUSTRY

Political realism suggests that a WTO auto case against the United States, or any other country, is unlikely, since most countries with large auto industries have anticipated or echoed US auto measures. The threat of a WTO case would be most plausible if brought by a country that has not followed the lead of the United States in aiding its auto industry. For example, Spain and Brazil, which both ranked among the top ten motor vehicle producers in the world in 2008, have not yet implemented measures to help their auto industries (International Organization of Motor Vehicle Manufacturers 2007).[43] However, for assorted geopolitical reasons, the chances of a WTO case being brought by one of those "innocent" countries seem remote.

A CVD case seems more likely, but the nature of the industry will limit the number of occurrences. The industry is characterized by a large amount of cross ownership among companies, so it is improbable that there will be many CVD cases brought to US courts or other national courts. If a case were brought to a national court, the remedy would not force the accused country to change its laws; it would simply impose a countervailing duty on exports to the affected market.

The greater risk is that the auto industry will become an industry that removes itself from WTO discipline. Governments of all major auto producers may resort to public loans, guarantees, vouchers, and tax credits to support and nourish their industries. Countries would then essentially set their own benchmarks for permissible subsidies, determined by the push and pull of domestic political considerations and with little regard for the global marketplace.

If an important industry, like autos, can take itself out of WTO disciplines, the world trading system will be seriously weakened

This would not be a novel phenomenon. For decades, the shipbuilding industry has been characterized by high government intervention, owing both to strong cyclicality—the boom of 2007 quickly became the bust of 2008—and the political imperative of supporting national shipyards. Since most shipbuilding countries play the subsidy game, discipline is very weak.[44] Yet attempts have been made: In December 1994, the main shipbuilding nations signed the "Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry" under the auspices of the Organization for Economic Cooperation and Development (OECD).[45] But the agreement never entered into force because the United States refused to ratify it. The European Union launched other attempts, again in the context of the OECD, to reach an agreement between 26 countries, representing 95 percent of world shipping capacity, but negotiations stalled in 2005. To this day, the shipbuilding sector remains virtually outside multilateral regulation.

Steel is another industry with traditionally high levels of subsidies, protection, and buy-national rules. This shows up in public support for steel mills in China, higher tariffs in India, and recently introduced Buy American provisions in the stimulus bill passed by the US House of Representatives on January 28, 2009 (Hufbauer and Schott 2009). Similar measures on steel and other industries either have been already

43. It is worth noting that neither Spain nor Brazil is a large exporter of motor vehicles.

44. For a discussion of the difficulties of applying the WTO ASCM and Anti-Dumping Agreement to the shipbuilding industry, see European Commission (2009).

45. Signatory countries were the European Communities, Finland, Japan, Korea, Norway, Sweden, and the United States.

adopted or are being considered in Argentina, China, Ecuador, India, Indonesia, and Russia.[46]

Subsidies have also been the rule of the game in the aircraft industry. The civil aircraft sector is concentrated in the United States and Europe, with activity in Canada, Brazil, and a few other countries. In 1992, the United States and Europe took regulation into their own hands and signed the Agreement on Large Civil Aircraft. The agreement placed limits on certain government support, including limiting subsidies to one third of the costs of developing a new aircraft. But the agreement was terminated in 2004. Since then the United States and the European Union have each launched cases against the other using the WTO dispute system.

Protection through subsidies is perhaps most egregious in agriculture. Developing countries, where agriculture still represents a large share of GDP, are trying to obtain market access to rich-country markets for their commodities. But rich countries are prey to strong farm lobbies, and despite round after round of multilateral negotiations, agriculture remains highly subsidized and protected.

CONCLUSION

Auto bailouts in the United States and elsewhere largely fall within the purview of the WTO definition of actionable subsidies. But fuel-efficiency and environmental standards complicate the issue, and bringing a case to the WTO based on environmental mandates would be hard to justify politically. Moreover, since virtually all major auto exporters have implemented some auto industry aid, any country that brings the first case to the WTO can expect to be challenged with a case against their own auto measures. Therefore, it is unlikely that WTO cases will arise on auto-assistance measures.

National CVDs are more likely. However, any country that became the target of a US CVD case would probably not abandon the subsidy in response to the duties imposed against its exports. The target country would simply limit its exports to the United States. This would probably be followed by measures targeting US auto firms. Therefore, even a successful US CVD case would likely serve to fragment global auto markets even further, not a desirable outcome.

As auto bailouts and aid continue and intensify without WTO challenges, the world auto industry could gradually leave the realm of WTO discipline. This would set a dangerous precedent. If an important industry, like autos, can take itself out of WTO disciplines, the world trading system will be seriously weakened. Instead, G-20 leaders should proclaim a vision of restoring "normal market conditions" to both the auto industries and others that are now heavily subsidized.[47]

APPENDIX: US AUTO ASSISTANCE MEASURES UNDER CONSIDERATION

The Auto Industry Financing and Restructuring Act (H.R. 7321)

The bill, introduced December 10, 2008, unblocked $17.4 billion total in aid to automakers: $13.4 billion for GM and Chrysler now, and another $4 billion for GM when the second half of the TARP funds are released. The money comes from funds previously appropriated for Section 136 of the Energy Independence and Security Act. The funds are in the form of a bridge loan to the companies in question until March 31, 2009, and must be paid back within 7 years, with 5 percent interest over the first 5 years and 9 percent interest over the last 2 years if they become permanent.

The bill creates a position for someone within the Executive Branch to be designated by the president (the president's designee, or car czar) who will oversee and negotiate the restructuring of the companies that receive the funds.

Each auto company must provide its restructuring plan by March 31, 2009. If the designee does not agree with the plan, he or she can put forward his or her own and present it to Congress. If no plan is put forward by the auto company by March 31, 2009, and the designee's plan is not approved within 30 days of that date, the loan will be recalled.

The restructuring plan will not be approved unless it complies with applicable fuel-efficiency and emissions requirements. In addition, the designee may accelerate repayment of a loan or cancel other financial assistance if the auto firm fails to comply with applicable fuel-efficiency and emissions requirements after March 31, 2009.

The bill includes the following protections for taxpayers:

- The bill mandates super seniority of this loan above all others. Companies must pledge all available security and collateral against the loans.
- The bill requires a warranty of 20 percent of the value of the loan in the form of nonvoting common stock or preferred stock.
- The bill places limits on executive compensation: all the

46. David Gow, "EU Threatens Legal Action over American Car Industry Bailout," *Guardian*, February 3, 2009.

47. The Group of 20 includes: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States, and the European Union.

restrictions of the TARP, plus no bonuses or incentives to the 25 most highly paid employees, stringent prohibitions on golden parachutes, and no compensation that could encourage manipulation of reported earnings.

- The bill prohibits the payment of dividends.
- In the event of bankruptcy, the debts to the government from the financial assistance will not be dischargeable.
- Auto firms must divest and may not own or lease any private passenger aircrafts.

National Incentive Program for Voluntary Retirement of Fuel-Inefficient Vehicles, Cash for Clunkers (S. 247)

The bill, introduced January 14, 2009, aims to accelerate fuel savings nationwide by providing incentives to registered owners of high fuel-consumption automobiles to replace such automobiles with more fuel-efficient automobiles or public transportation. The program would last four years, from 2009 to 2012. Eligible drivers would receive a reimbursement voucher for the purchase of a new or used vehicle. If the retired vehicle was made before 1998, the voucher would amount to $2,000, while vehicles from 1999–2001 would get $3,000 and any vehicles made after 2002 would get $4,500.

The program is subject to the following conditions:

- The car traded in must be drivable, have a fuel-economy rating of less than 18 miles per gallon, and have been registered for at least the past 120 days. Once traded in, the old vehicles would be taken apart for scrap.
- The new or used vehicle purchased with the voucher must have a fuel-economy rating that exceeds the CAFE target for that class of vehicle by at least 25 percent, an MSRP of less than $45,000, a model year 2004 or later, and meet or exceed federal emissions standards. A person can also claim the equivalent dollar amount in public-transit fares.

The American Recovery and Reinvestment Act (H.R. 1)

The stimulus bill, signed into law on February 17, 2009, provides a tax benefit for new cars and light trucks (no more than 8,500 pounds) purchased between the day the bill becomes law and December 31, 2009. The bill allows individuals purchasing an eligible vehicle to deduct the amount of the sales and excise taxes applicable on the first $49,500 of the purchase price of the vehicle. Any amount that exceeds this limit will be taxed. To be eligible, the taxpayer's adjusted gross income must not exceed $125,000, or $250,000 in the case of a joint return.

The Commonsense Auto Recovery (CAR) Act (H.R. 100)

The bill, introduced January 6, 2009, would amend the Internal Revenue Code of 1986 to create a tax credit equal to the amount of state and local sales taxes on the purchase of a new or used passenger vehicle. Any individual or small-business owner is eligible for the credit, which applies to all cars with an MSRP of less than $50,000.

Consumer Auto Relief Act (H.R. 385)

The bill, also introduced January 9, 2009, would amend the Internal Revenue Code of 1986 to provide tax incentives to consumers and lenders for the purchase of a new passenger vehicle during 2009. Anyone who purchases a car in 2009 can claim the purchase price of the vehicle as a tax deduction in the amount of $7,500 if the vehicle is placed in service during the 90 day period beginning on the day of the enactment, $5,000 if placed in service within another 90 days, and $2,500 otherwise.

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